Reforming the IMF: Back to the Drawing Board

YILMAZ AKYÜZ

TWN
Third World Network

Reforming the IMF: Back to the Drawing Board

Yilmaz Akyüz

TWN
Third World Network

Reforming the IMF: Back to the Drawing Board
Published in 2006 by
Third World Network
131 Jalan Macalister
10400 Penang, Malaysia
Website: www.twnside.org.sg
Email: twnet@po.jaring.my

Printed by Jutaprint
2 Solok Sungei Pinang 3, Sg. Pinang
11600 Penang, Malaysia.

ISBN: 983-2729-53-X

CONTENTS

Chapter 1

INTRODUCTION

The best reformers the world has ever seen are those who commence on themselves.

George Bernard Shaw

THERE have been widespread misgivings about international economic cooperation in recent years even as the need for global collective action has grown because of recurrent financial crises in emerging markets, the increased gap between the rich and the poor, and the persistence of extreme poverty in many countries in the developing world. Perhaps more than any other international organisation the International Monetary Fund (IMF) has been the focus of these misgivings.

Several observers including former Treasury Secretaries of the United States, a Nobel Prize economist, and many NGOs have called for its abolition on the ground that it is no longer needed, or that its interventions in emerging market crises are not only wasteful but also harmful for international economic stability, or that its programmes in the

This paper was prepared under the UNCTAD Project of Technical Assistance to the Intergovernmental Group of Twenty-Four on International Monetary Affairs, supported by the International Development Research Centre of Canada. An earlier version was presented at a technical group meeting of G-24 in IMF on 16 September 2005. Comments and suggestions by Ariel Buira, Andrew Cornford, Richard Kozul-Wright and the participants of the G-24 Technical Group Meeting are greatly appreciated. The usual caveat applies.

Third World serve to aggravate rather than alleviate poverty.[1] Others want the IMF to be merged into the World Bank because they see them as doing pretty much the same thing with the same clientele.[2]

Many who still wish to keep the Fund as an independent institution with a distinct mission, call for reform of both what it has been doing and how it has been doing it.[3] All these groups include individuals across a wide spectrum of political opinion, ranging from conservative free marketers to anti-globalisers.

The principal rationale for global collective action in financial matters and for institutions needed to facilitate such action is market failure. More specifically, international financial markets fail to provide adequate liquidity and development financing for a large number of countries, and they are the main source of global economic instability. These have repercussions not only for the countries directly concerned but also for the international community as a whole because of the existence of international externalities. Furthermore, due to cross-border interdependence, pursuit of national interests by individual countries in macroeconomic and financial policies can result in negative global externalities, and preventing conflicts and collective damage calls for a certain degree of multilateral discipline over national policy making as well as economic cooperation.[4]

---

1 The abolitionists include Walters (1994); Schultz, Simon and Wriston (1998); and Schwartz (1998). Friedman (2004) argues for closing down both the World Bank and the IMF on grounds that "they have done more harm than good, and have the capacity for continuing to do more harm than good."

2 See e.g., Clark (1990), Crook (1991), Schultz (1998), Burnham (1999) and Fischer (2004).

3 The list of reformists is much longer. The better known include the report by the Meltzer Commission (2000) and suggestions made by the former Chief Economist of the World Bank, a stern critique of the Fund, Joseph Stiglitz (2002, particularly Chap. 9; and 2003). See also Boughton (2004) and a number of other articles in the same issue of Finance & Development prepared on the occasion of the 60th anniversary of the Bretton Woods Conference. For a review of several reports on the role and reform of the IMF see Williamson (2001). The Group of 24 research programme has produced several papers on the reform of the IMF now jointly published by UNCTAD and G24 and placed on their respective websites. There are also many NGOs in the group of reformists demanding profound transformation of both the IMF and the World Bank.

4 For a discussion of the rationale for multilateral financial cooperation and the Bretton Woods institutions see Akyüz (2005a, section I).

Such concerns in fact provided the original rationale for the creation of the IMF and the World Bank with a clear division of labour between the two. However, these institutions have gone through considerable transformation in response to changes that have taken place in the world economic and political landscape in the past 60 years. In particular, the Fund is no longer performing the functions it was originally designed for, namely, securing multilateral discipline in exchange rate policies and providing liquidity for current account financing. Rather, it has been focussing on development finance and policy and poverty alleviation in poor countries, and the management and resolution of capital account crises in emerging markets.

This paper argues that there is no sound rationale for the Fund to be involved in development matters, including long-term lending. This is also true for several areas of policy closely connected to development, most notably trade policy which is a matter for multilateral negotiations elsewhere in the global system. On the other hand, while the management and resolution of financial crises in emerging markets constitute a key area of interest to the Fund in the context of its broader objective of securing international monetary and financial stability, there is little rationale for financial bail-out operations that have so far been the main instrument of the Fund's interventions in such crises. The original considerations that precluded IMF lending to finance capital outflows continue to be equally valid today since such operations do not correct but aggravate market failures. There are other institutions and mechanisms that can serve better the objectives that may be sought by such lending.

By contrast the Fund should pay much greater attention to two areas in which its existence carries a stronger rationale, namely, short-term, counter-cyclical current account financing, and effective surveillance over national macroeconomic and financial policies, particularly of countries which have a disproportionately large impact on international monetary and financial stability. In other words, a genuine reform of the Fund would require as much a redirection of its activities as improvements in its policies and operational modalities. However, none of these would be possible without addressing shortcomings in its governance structure.

The purpose of this paper is not to provide a blueprint for the reform of the Fund, but to discuss and elaborate a number of broad issues that would need to be taken into account in any serious attempt to make the Fund a genuinely multilateral institution with equal rights and obligations for all its members, in practice as well as in theory. The next Chapter will give a brief description of the original rationale for the Fund, its evolution in the past sixty years and current focus. This is followed by a discussion of what the Fund is but should not be doing; that is, development policy and financing, and trade policy. Chapter 5 makes a critical assessment of the Fund's role in crisis management and resolution while Chapter 6 turns to issues related to the reform of its lending policy and resources. This is followed by a section on the Fund's surveillance function. Chapter 8 focuses on governance issues, notably the prerequisites for a genuinely symmetrical and multilateral financial institution. The paper ends with a summary of the main proposals.

Chapter 2

THE ORIGINAL RATIONALE AND THE POSTWAR EVOLUTION OF THE IMF

THE main objective pursued by the architects of the postwar economic system with the creation of the IMF was to avoid the recurrence of a number of difficulties that had led to the breakdown of international trade and payments in the interwar period. These difficulties arose in large part because of lack of multilateral arrangements to facilitate an orderly payments adjustment in countries facing large external debt and deficits. Under conditions of excessively volatile short-term capital flows and in the absence of any obligation on the side of the surplus countries to share the burden of adjustment, deficit countries had been forced to undertake deflationary measures, or resort to trade and exchange restrictions and competitive devaluations in order to protect economic activity and employment, thereby generating negative externalities and frictions in international economic relations.

Arrangements for multilateral discipline over exchange rate policies, provision of adequate international liquidity, and restrictions over destabilising capital flows were thus seen as essential for international monetary stability and prevention of tensions and disruptions in international trade and payments. The IMF was designed to ensure an orderly system of international payments at stable but multilaterally negotiated, adjustable exchange rates under conditions of strictly limited international capital flows.

A key task of the Fund was to provide international liquidity in order to avoid deflationary and destabilising adjustments and trade and exchange restrictions in countries facing temporary balance of payments deficits. Although the responsibility for addressing the problems associated with fluctuations in export earnings of developing countries effectively fell under the IMF's role for the provision of liquidity, the Fund was created primarily for securing the stability of external payments and exchange rates of the major industrial countries, rather than for the stabilisation of balance of payments of developing countries.

There was a certain degree of creative ambiguity in the way the Fund's Articles were drafted in order to reach consensus. This was the case for exchange rate arrangements which sought to reconcile multilateral discipline with national autonomy. Countries undertook obligations to maintain their exchange rates within a narrow range of their par values and were allowed to change their par values under fundamental disequilibrium, but the latter was never defined in the Articles of Agreement. An unauthorised change in par value was not a violation of the Articles, but would enable the Fund to withhold the member's access to its resources and even to force the member to withdraw (Dam 1982, pp. 90-93).

This was also the case with arrangements regarding the modalities for the provision of liquidity, one of the most controversial issues during the negotiations. Keynes strongly argued that members should have unconditional access to the Fund within the limits of their quotas and that "it would be very unwise to try to make an untried institution too grandmotherly" (IMF 1969, Vol. 1, p. 72). However, the United States resisted unconditional drawings on grounds that it would be the only source of net credit in the immediate postwar era since the dollar was then the only convertible currency. The compromise agreed to in Article V entitling members "to purchase the currencies of other members from the Fund", together with the absence of the language of credit from the Articles, had the connotation that members would have the right to determine how much they would draw within the limits of their quotas, treating their subscriptions as their own reserves (Dam 1982, p. 106; and Dell 1981, pp. 4-5). Most countries believed that this formulation gave members unconditional drawing rights, though there was considerable room for other interpretation.

Access to the Fund was restricted to current account financing. The Fund was prohibited to lend to meet sustained outflow of capital and empowered to compel a member to exercise capital controls as a condition for access to its resources. In effect, these arrangements discouraged reliance on private flows for balance of payment financing. During the negotiations for the Bank there was considerable debate on whether the task could be effectively performed by private lenders, but this was not the case for IMF financing. Although there were some instances of currency stabilisation in interwar years supported by officially arranged private lending (Oliver 1975, pp. 12-15), it was almost taken for granted that commercial banks could not be relied on for such a task, particularly given the high degree of volatility of short-term capital flows during interwar years and pro-cyclical behaviour of private lending.

The members' contributions to the Fund, their drawing rights and voting rights were all linked to a single concept of quotas, determined through a highly politicised exercise so as to give an effective veto power to the United States over key decisions.[5] This has been an important factor in the evolution of the Fund over subsequent years, particularly with respect to conditions governing the members' drawings and the operational procedures followed.[6]

The process of legitimising and ratcheting conditionality started soon after the Bretton Woods Conference. A key decision in 1952 formally adopted conditionality and introduced standby arrangements as the central operational modality (IMF 1969, Vol. 3. pp. 228-230). This was followed by a 1956 decision on the phased drawings in order to better enforce conditionality with loans disbursed in tranches, contin-

5 According to Raymond Mikesell, who was actually given the task of calculating the quotas: "Assigning quotas in the Fund was the most difficult and divisive task of the conference... The quota formula was not distributed, and White asked me not to reveal it.... I tried to make the process appear as scientific as possible, but the delegates were intelligent enough to know that the process was more political than scientific". Mikesell (1994, pp. 35-36).

6 For an excellent account of the rationale and evolution of IMF conditionality, see Dell (1981). For more recent trends see Jungito (1994), Kapur and Webb (2000), and Buira (2003a).

gent on satisfactory achievement of agreed targets, and proliferation of performance criteria.[7] Although the Board decided in 1968 to limit the number of performance criteria after developing countries argued that the minimum conditionality applied to the drawing by the United Kingdom in 1967 should become the norm, in practice there was no easing of conditionality, particularly after it was given legal sanction in 1969 through an amendment of the Articles.[8]

As a result of these changes, automatic drawing has been confined to the reserve tranche with higher tranches bringing tighter conditionality. Thus, the Fund has moved away from provision of liquidity, that is, finance available on short notice and virtually unconditionally, towards finance supplied on the basis of negotiated conditions and made available through successive tranches.[9] And since the IMF quotas have considerably lagged behind the growth of world trade, countries' access to balance of payments financing has come increasingly under IMF policy oversight.

But perhaps one of the biggest divergences from the Bretton Woods objectives has been in the content of conditionality rather than the principle. Through conditionality the Fund has effectively sought to impose exactly the kind of policies that the postwar planners wanted to avoid in countries facing payments difficulties – austerity and destabilising currency adjustments. Austerity has been promoted not only when balance of payments difficulties were due to excessive domestic spending or distortions in the price structure, but also when they resulted from

---

[7] Performance criteria are specific preconditions for disbursement of IMF credit. Quantitative performance criteria include macroeconomic policy variables such as international reserves, monetary and credit aggregates, and fiscal balances. Structural performance criteria vary widely, but could include specific measures to restructure key sectors such as energy, reform social security systems, or improve financial sector operations (IMF 2002).

[8] After the 1969 amendment Article V, Sec. 3(c) stated that the "Fund shall examine a request for a purchase to determine whether the proposed purchase would be consistent with the provisions of this Agreement and the policies adopted under them, provided that requests for reserve tranche purchases shall not be subject to challenge".

[9] This distinction is made by Helleiner (1999, p. 7) in the context of crisis lending. See also Mohammed (1999) who distinguishes between conditional and unconditional liquidity in the same context.

external disturbances such as adverse terms of trade movements, hikes in international interest rates or trade measures introduced by another country. Furthermore, the distinction between temporary and structural disequilibria has become blurred, often implying that a developing country should interpret every positive shock as temporary and thus refrain from using it as an opportunity for expansion, and every negative shock as permanent, thus adjusting to it by cutting growth and/or altering the domestic price structure.

The evolution of IMF conditionality has been shaped by shifts in economic and political conditions and interests of its major shareholders. Initially the United States had insisted on some form of conditionality to stem excessive reliance on dollar credits. Subsequently, it used conditionality to pursue its national interests. Europe, notably the United Kingdom, initially resisted conditionality because of its need to draw on the Fund's resources. Subsequently, when they no longer relied on the Fund, conditionality ceased to be a problem for the European countries, including for the smaller ones which took refuge in the European Monetary System, losing monetary autonomy ***vis-à-vis*** Germany but gaining considerable protection from Fund conditionality.[10]

A major transformation of the Fund took place with the breakdown of the Bretton Woods exchange rate system brought about in large part by inconsistencies of policies among major industrial countries and rapid growth of international financial markets and capital movements. While floating was adopted with the understanding that its stability depended upon orderly underlying conditions, the obligations undertaken by countries were, as pointed out by Triffin (1976, pp. 47-48), "so general and obvious as to appear rather superfluous" and the system "essentially proposed to legalise … the widespread and illegal repudiation of Bretton Woods commitments, without putting any other binding commitments in their place." This in effect meant that currency stability ceased to be

[10] See Akyüz and Flassbeck (2002, p. 98). The last standby agreements with industrial countries were with Italy and the United Kingdom in 1977 and Spain in 1978; see Finance and Development. September 2004, p. 15.

a key objective of international economic cooperation. It also meant that there would no longer be any mechanism to ensure effective multilateral discipline over the policies of non-borrowing members of the IMF.

In its operations in developing countries the focus of the Fund was initially on short-term current account financing. The Compensatory Financing Facility (CFF) introduced in the early 1960s as a result of a UN initiative enabled countries facing temporary shortfalls in primary export earnings to draw on the Fund beyond their normal drawing rights without the performance criteria normally required for upper credit tranches (Dam 1982, pp. 127-128). However, automaticity was effectively removed by a subsequent decision of the Fund (Dell 1985, p. 245), and the "reforms" introduced in 2000 tightened further the circumstances for unconditional access to CFF (IMF 2004b, p. 10).

A number of other similar ad hoc facilities have also been discontinued, including the buffer stock financing facility introduced in the late 1960s. This is also true for the two oil facilities of the 1970s which constituted exceptional steps in IMF lending practices as they had been introduced as deliberate countercyclical devices to prevent oil price hikes from triggering a global recession.[11] They also allowed the kind of automaticity of drawings advocated by Keynes during the Bretton Woods negotiations (Dell 1986, p. 1207).

The breakdown of the Bretton Woods exchange rate system together with the graduation of the European countries from the Fund pushed it closer to development issues. In this respect the creation of the Extended Fund Facility (EFF) in 1974 marks a turning point. It was established as a non-concessional lending facility to address persistent and structural balance of payments problems.[12] This was followed by the Structural Adjustment Facility and the Enhanced Structural Adjustment Facility,

---

[11] In effect from 1974 to 1976, the oil facilities allowed the IMF to borrow from oil exporters and other countries in a strong external position and lend to oil importers; see Mohammed (1999, p. 53).

[12] See Dam (1982, p.284). For the implications of this mission creep for Bank-Fund relations see Ahluwalia (1999).

which provided concessional lending to low-income countries for structural change. As a result of increased emphasis on poverty reduction, the latter was replaced in 1999 by a Poverty Reduction and Growth Facility (PRGF), a concessional window for low-income countries.

In perhaps an even more important shift, the Fund has become a crisis lender and manager for emerging markets. This role effectively started with the outbreak of the debt crisis in the 1980s when many developing countries borrowed heavily from multilateral sources to finance debt servicing to private creditors (Sachs 1998, p. 53). And with the recurrent financial crises in emerging markets in the 1990s, crisis lending has become the dominant financial activity of the Fund. The Supplemental Reserve Facility (SRF) was created in response to the deepening of the East Asian crisis in December 1997 in order to provide financing above normal access limits to countries experiencing exceptional payments difficulties, notably in servicing their external debt to private creditors and maintaining capital account convertibility, under a highly conditional standby or Extended Arrangement.

Thus sixty years after its inception, the IMF is now quite a different institution from the one created by the architects of the postwar international economic system. It "has adjusted to the changing economic conditions by sponsoring amendments to its Charter, by liberal interpretations of the Charter's provisions, and in some cases by ignoring limitations imposed by the Charter."[13] It is now deeply involved in development issues, providing long-term financing on concessional terms as well as assistance on HIPC: currently the number of low-income countries which are covered under financial arrangements for PRGF and HIPC assistance exceeds the number of countries with standby arrangements by a factor of four (IMF 2005a).

It started out as an institution designed to promote global growth and stability through multilateral discipline over exchange rate policies, control over capital flows and provision of liquidity for current account

[13] Mikesell (2001, p. 1). For a discussion of mission creep see Babb and Buira (2005).

financing. It has ended up focussing on the management and resolution of capital-account crises in emerging markets associated with excessive instability of capital flows and exchange rates, allocating a large proportion of its lending for financing capital outflows: during the financial year ended April 30, 2004, over 85 per cent of total purchases and loans were accounted for by crisis lending to Argentina, Brazil and Turkey (IMF 2004a, Table II.6).

More importantly, originally all members of the Fund had equal de jure and de facto obligations for maintaining stable exchange rates and orderly macroeconomic conditions. With the breakdown of the Bretton Woods exchange rate arrangements, the establishment of universal convertibility of the currencies of major industrial countries, and the emergence of international financial markets as a main source of liquidity for advanced economies, the Fund's policy oversight has been confined primarily to its poorest members who need to draw on its resources because of their lack of access to private sources of finance.

Chapter 3

MISSION CREEP INTO DEVELOPMENT FINANCE AND POLICY

Much of the recent debate on the role of the IMF in development has focussed on three issues. First, there has been widespread criticism of rapid deregulation and liberalisation promoted by the Fund in developing countries because of their adverse repercussions for economic growth and poverty. Second, the conditions attached to Fund lending have been under constant fire on grounds that, ***inter alia***, they interfere with the proper jurisdiction of a sovereign government and leave little room for manoeuvre to national policy makers. Finally, there is a broad consensus that financing provided in support of such programmes, including in the form of debt relief, is highly inadequate.

There has been less emphasis on whether the Fund should really be involved in development finance and policy, and poverty alleviation, particularly given that there are other multilateral institutions exclusively focussing on these issues, including multilateral development banks and various UN technical assistance agencies. Nevertheless, there are some notable exceptions. For instance the Meltzer Commission (2000) unanimously recommended that the IMF should restrict its financing to provision of liquidity, and stop lending to countries for long-term development assistance and structural transformation. Accordingly, the PRGF should be eliminated and long-term institutional assistance to foster development and encourage sound economic policies should be the exclusive responsibility of the World Bank and regional development banks. Similarly, according to the former World Bank chief economist Joseph Stiglitz (2002, p. 232) “a broad consensus – outside the IMF – has developed that the IMF should limit itself to its core area, managing crises; that it should no longer be involved (outside crises) in development or the economies of transition."

There are indeed no compelling reasons why the IMF should deal with structural problems in developing countries. As noted, the Fund moved towards developing countries in large part because it was no longer needed by industrial countries as a source of liquidity and it lost leverage over exchange rate and macroeconomic polices of these countries. Sticking to its original mandate for facilitating payments adjustment through provision of liquidity to meet temporary current account deficits would not have generated much business for the Fund in developing countries given that their balance of payments difficulties were structural and durable, rather than cyclical and temporary. This, together with the expansion of IMF membership in Africa, was the main reason why the Fund introduced long-term facilities and concessional lending. In doing so, however, it has gone right into the domain of development since overcoming structural payments deficits calls for reducing both savings and foreign exchange gaps, including chronic public sector deficits, which, in turn, depends on structural and institutional changes and economic growth, rather than demand management. But these are exactly the kind of issues dealt with by multilateral development banks, and involve action in wide areas of policy including agriculture, industry, trade, investment, technology, finance, the labour market and the public sector.[14]

That external disequilibrium in developing countries is structural does not justify the Fund going into long-term balance of payments support because this is exactly what the World Bank has been doing since the early 1980s when it shifted its lending from project financing to structural adjustment and development policy loans which now constitute about half of total Bank lending. Furthermore, the Bank is doing

---

[14] For a view that the Fund does not provide development finance but payments support see Boughton (2005, p. 10).

this for all developing countries while such long-term balance of payments support in the Fund is limited to low-income countries eligible to PRGF. This is an ad hoc arrangement without a sound rationale, since there are many middle-income countries with chronic payments deficits and excessive dependence on foreign capital, notably in Latin America, in need of long-term support to strengthen domestic savings and export capacity. This inconsistency should be addressed not by bringing them under the IMF, but taking the others out to the Bank.

As part of its work on development and poverty alleviation, the Fund's programmes and structural conditionality have addressed almost all areas of development policy. This is problematic for several reasons. First of all it is not clear that the Fund has the necessary competence and experience in such complex issues. Certainly, the kind of expertise in development policy resulting from research and practical experience, and access to a significant amount of information on institutions and policy environment expected from the Bank do not define the existing capabilities of the Fund.[15] Nor are they needed for the Fund to function effectively in its areas of core competence. Furthermore, there are serious risks in entrusting development matters to an organisation preoccupied with short-term financial outcomes and susceptible to strong influences from sudden shifts in market sentiments about the economies of its borrowers. Finally, there is no doubt that what the IMF does or should be doing for promoting monetary and financial stability has consequences for poverty and development, but this does not provide a rationale for the Fund to work in these areas. Such interdependencies exist in many areas of policy affecting poverty and development, including trade, labour, health, environment and security, both at the national and international level. What is needed is close cooperation and coordination with the institutions specialised in these matters with a view to attaining coherence and consistency, not duplication.

[15] See Rodrik (1995) and Gilbert, Powell and Vines (1999). However, it is not clear if the Bank really meets these expectations; see Akyüz (2005a).

The Bank and the Fund have taken great pains to show that they are closely coordinating in order to minimise overlap and duplication (IMF/WB 2004), but in reality much of what is being done in development by the Fund could easily be transferred to the Bank. This overlap has in fact given rise to calls to merge the Fund with the World Bank, including by George Shultz (1998), former Secretary of the Treasury and Secretary of State of the United States, arguing that their activities are becoming increasingly duplicative even though basically uncoordinated.[16] More recently a former German Executive Director for the World Bank Group and Executive Secretary of the Development Committee (Fischer 2004) argued that while complete fusion of the BWIs under a new charter would be the optimal solution, politically and practically a more feasible step would be to combine the administration and the boards of the two institutions, and to reshape the single board in such a way as to give greater voice to developing countries. This would reduce extensive duplication at the administrative level, bring greater consistency in policy advice and alleviate the pressure on poor countries with limited administrative capacities in coordinating measures promoted by the Fund and the Bank in overlapping areas of policy. According to one estimate a combined administration with a single board would reduce the personnel and other costs in the administrative budget by at least 25 per cent (Burnham 1999) – costs which are now effectively paid by debtor developing countries through charges and commission.

While it is often argued that the Fund and the Bank should be merged because they are effectively doing the same thing, what is argued here is that they should remain separate institutions doing different things. In fact there are many areas in which their activities do not and should not overlap. Crisis management and resolution, surveillance over macroeconomic and exchange rate policies, and provision of international liquidity are areas where the Fund should have a distinct role and competence. By contrast, the Fund should transfer development-

[16] For an earlier call for merger see Crook (1991).

related activities and facilities to the Bank. This would not lead to a significant retrenchment of Fund lending; at the end of 2004 outstanding PRGF credits were less than SDR 7,000 billion or 10 per cent of total outstanding credits (IMF 2004a, Table II.8). Nor would it entail a major expansion in outstanding IDA credits which currently are around $90 billion. The legal difficulties that might be involved in transferring the resources currently located in the Fund could be overcome once the principle is accepted (Ahluwalia 1999, p. 22).

In a recent statement the Managing Director has argued in favour of deepening the Fund's work on low-income countries and expressed his disagreement with the view that the "Fund ought to get out of the business of supporting low-income countries" on grounds that they "need macroeconomic policy advice from the Fund and they often need financial support from us" (De Rato 2005, p. 4). However, the issue is not about whether or not the Fund should be involved in policy design in and provision of finance to low-income countries, but the context in which such activities should be undertaken. As discussed in subsequent sections, a major task of the Fund should be to provide countercyclical current account financing to low-income countries facing excessive instability in export earnings. Again, macroeconomic conditions that may need to be attached to short-term lending and Article IV consultations would give the Fund ample opportunity to provide macroeconomic policy advice to low-income countries. None of these would require the Fund to be involved in development matters.

Chapter 4

TRESPASSING IN TRADE POLICY

THE Fund, as a monetary institution, was not to be involved in trade issues even though its Articles, in effect, authorised, through the scarce currency clause, trade measures against surplus countries unwilling to undertake expansionary measures by allowing discriminatory exchange restrictions (Dam 1982, p. 233). In the event, however, the Fund has gone in the opposite direction, putting pressure on deficit developing countries to undertake payments adjustment despite mounting protectionism in industrial countries against their exports, forcing them to resort to import compression and sacrifice growth (Akyüz and Dell 1987, p. 54).

More importantly, as the Fund became deeply involved in development issues, it increasingly saw trade liberalisation as an important component of structural adjustment to trade imbalances. As noted in a report by a group of independent experts, IMF surveillance has expanded into trade liberalisation, partly as a result of pressure from the United States as part of conditions for its agreement to quota increases (IMF/GIE 1999, p. 61). Trade liberalisation has also been promoted in certain emerging market economies in response to surges in capital inflows as a way of absorbing excess reserves and preventing currency appreciation (IMF/IEO 2005, pp. 8-9, and p. 59, Table 3.2).

Although greater openness to foreign competition has also been one of the pillars of the adjustment programmes supported by the Bank, the Fund is known to have played a more important role in this area. Low-income countries and LDCs working under Fund programmes have been encouraged and even compelled to undertake unilateral trade liberalisation, putting them at a disadvantage in multilateral trade negotiations. Indeed the consequences of unilateral trade liberalisation by developing countries outside the WTO framework are often discussed in relation to Fund programmes (see, e.g., WTO 2004a, Section II.A).

An implication of unilateral liberalisation is that the industrial countries would not need to lower their tariffs in areas of export interest to developing countries in order to secure better access to the markets of these countries in the WTO where trade concessions are based on some form of reciprocity. Liberalisation without improved market access in the North creates the risk of deterioration in their trade balances, hence leading either to a tighter external constraint and income losses, or to increased external debt. Indeed there is an asymmetry in the multilateral consequences of trade policy actions taken by developing countries in the context of Fund-supported programmes. A country liberalising unilaterally acquires no automatic rights in the WTO ***vis-à-vis*** other countries, but it could become liable if it needs to take measures in breach of its obligations in the WTO.[17]

Although this is generally recognised to be a problem and discussed during the Uruguay Round, no mechanism has so far been introduced in the WTO for crediting developing countries for their unilateral liberalisation in the context of Fund-supported programmes. Furthermore, arguments are advanced that this should not affect the position of developing countries regarding their obligations in the WTO since what matters there is not applied but bound tariffs. However, for a number of reasons, including pressures from financial markets and major trading partners, developing countries find it difficult to raise their tariffs once they are lowered.

[17] The most interesting example is the case of Korea. In that country financial restructuring undertaken with the support of the Fund in response to the 1997 crisis naturally resulted in an increase in government equities in financial institutions. This became a basis for a legal challenge in the WTO on grounds that such measures constituted actionable subsidies: see WTO (2003, paras 8-10).

More importantly, applied tariffs are now providing a benchmark in binding and reducing tariffs in the current negotiations on industrial tariffs in the WTO. For instance, paragraph 5 of Annex B of the so-called July package which provides a framework for these negotiations based on proposals made by industrial countries takes the applied rates as the basis for commencing reductions for unbound tariffs in developing countries (WTO 2004b). It also proposes to give credit for autonomous liberalisation by developing countries provided that the tariff lines were bound on an MFN basis. However, it is not clear that a line-by-line commitment is necessarily in the best interest of these countries, or that the kind of unilateral liberalisation agreed under IMF pressure would be consistent with their bargaining positions in multilateral negotiations (Akyüz 2005b).

Despite the difficulties confronting developing countries in trade negotiations, the Fund staff have been advancing arguments in favour of unilateral liberalisation in these countries that go even beyond the positions advocated by major developed countries in the current negotiations on industrial tariffs. For instance a recent Fund paper argues that Africa's interest in the Doha Round would best be served by its own liberalisation, and that African countries, including the LDCs, should bind and reduce all tariffs, even though the July package exempts LDCs from tariff reductions and recognises the need for less-than-full reciprocity.[18] The First Deputy Managing Director of the IMF has encouraged developing countries to undertake unilateral liberalisation on several occasions, arguing that "countries that press ahead with unilateral liberalisation will enjoy enormous benefits and they will not be penalised by further multilateral liberalisation – quite the opposite. Countries that open up unilaterally help themselves" (Krueger 2005, p. 5).

[18] Yang (2005). See also Chauffour (2005). Interestingly the benefits claimed from liberalisation is very small, around $0.5 billion for entire sub-Saharan Africa excluding South Africa (Yang 2005, Table 7), or on average around $10 million per country per annum, certainly not worth giving up policy options regarding tariffs. For a critical assessment of the costs and benefits of trade liberalisation in the context of the current negotiations on industrial tariffs see Akyüz (2005b).

The Fund has recently introduced a Trade Integration Mechanism to mitigate concerns among some developing countries that their balance-of-payments position could suffer as a result of multilateral liberalisation in the current round of negotiations, insisting that such shortfalls would be small and temporary (IMF 2005b), despite mounting evidence that rapid liberalisation in poor countries can raise imports much faster than exports and that the external financing needed can add significantly to the debt burden.[19]

The Fund staff have been advocating binding tariffs closer to their applied levels on grounds that this would increase trade by reducing uncertainty of trade policy and hence transaction costs (see e.g., Yang 2005, p. 9). This may well be the case, but it is not a matter that should be of primary concern to the Fund. The international trading system no doubt needs greater predictability and stability, but discretion over tariffs by developing country governments is not the most serious source of disruption. As the recent experience regarding the movement of the dollar shows once again, exchange rate instability and misalignments are an equal and even more important source of uncertainty and friction in the international trading system.

This was recognised by the architects of the postwar international economic system, including Lord Keynes: "Tariffs and currency depreciations are in many alternatives. Without currency agreements you have no firm ground on which to discuss tariffs… It is very difficult while you have monetary chaos to have order of any kind in other directions."[20] It is thus advisable for the Fund to focus on its core responsibility of ensuring stability and better alignment of exchange rates, rather than narrowing the policy space for developing countries in matters related to trade and pushing trade liberalisation as if a consistent international monetary order existed.

---

19 See UNCTAD (1999, Chap. IV); Santos-Paulino and Thirlwall (2004); UNCTAD (2004, Part 2, Chap. 5); and Kraev (2005).

20 Keynes (1944, p. 5). The same point is made by Shultz (1998, p. 15) who suggested that the IMF should meet in WTO setting rather than with the World Bank since "exchange rates and trade rules are the two sides of the same coin."

As the Fund transfers its work on development to the Bank, it should also stop being involved in trade policy issues or undertake activities that interfere with multilateral trade negotiations. Its relation to the WTO should be confined to areas explicitly stated in the General Agreement on Tariffs and Trade (GATT), notably in Article XV on exchange arrangements. These include consultations and supplying information on monetary reserves, balance of payments and foreign exchange arrangements in order to help in matters such as the determination of whether balance of payments and reserve conditions of countries would entitle them to apply the provisions of Articles XII and XVIIIB of GATT and Article XII of GATS in order to avoid sacrificing growth and development as a result of temporary payments difficulties (see Das 1999, Chap. III.3; and Akyüz 2002, pp. 124-125).

Chapter 5

CRISIS MANAGEMENT AND RESOLUTION: BAILOUTS OR WORKOUTS?

THERE is a consensus that crises in emerging markets will continue to occur because of financial market failures as well as shortcomings in national policies and international surveillance mechanisms. There is also a wide agreement that the IMF should be involved in the management and resolution of such crises in order to limit the damage to the economies concerned, prevent contagion and reduce systemic risks. However, there is considerable controversy over how the Fund should intervene.

Until recently the Fund's intervention in financial crises in emerging markets involved ad hoc financial bailout operations designed to keep countries current on their debt payments to private creditors, to maintain capital account convertibility and to prevent default. IMF rescue packages amounted to several times the accepted quota limits (an annual limit of 100 per cent of a member's quota and a cumulative limit of 300 per cent), and were in certain instances combined with funds from development banks and bilateral contributions from major industrial countries.

IMF rescue packages for six emerging markets (Mexico, Thailand, Indonesia, Korea, Russia and Brazil) between 1995 and 1998 reached $231 billion, of which 44 per cent came from bilateral donors, 38 per cent from the IMF, and the rest from development banks (Ahluwalia 1999, p. 55, Table 1). From 1995 until the end of 2003 IMF exceptional financing for 9 emerging markets (the above six plus Argentina, Turkey and Uruguay) amounted to SDR 174 billion, with an average of 637 per cent of quota (IMF 2005c, Table 10). Such lending is the main source of income for the Fund to support its operational expenses, which stood at some SDR 1.5 billion at the end of FY2004. Thus, ironically, in the absence of financial crises and bailout operations in emerging markets, the Fund can cease to be a financially viable institution.

Crisis lending was combined with monetary and fiscal tightening in order to restore confidence, but this often failed to prevent sharp drops in the currency and hikes in interest rates, thereby deepening debt deflation, credit crunch and economic contraction. Such interventions took place not only when the country concerned was facing a liquidity problem, as in Korea, but also when there were signs of a problem of insolvency. Originally rescue packages involved short-term, temporary financing but more recently the Fund has provided medium-term financing, including to governments facing domestic debt problems such as in Turkey (Akyüz and Boratav 2003).

In addition to the SRF noted above, the Contingency Credit Line (CCL) was created in Spring 1999 in order to provide a precautionary line of defence in the form of short-term financing which would be available to meet future balance-of-payments problems arising from contagion.[21] Countries would pre-qualify for the CCL if they complied with conditions related to macroeconomic and external financial indicators and with international standards in areas such as transparency and banking supervision. However, this facility discontinued in November 2003 as countries avoided recourse to it owing to fears that it would give the wrong signal and impair their access to financial markets.[22]

There have also been suggestions to turn the Fund into an international lender of last resort with a view to helping prevent crises (Fischer 1999). It is argued that if the IMF stands ready to provide liquidity to countries with sound policies, they would be protected from contagion and financial panic so that a lender of last resort facility would have a

[21] IMF Press Release No. 99/14, 25 April 1999.

[22] For an earlier assessment along these lines see Akyüz and Cornford (2002, p. 135). See also Goldstein (2000, pp.12(13) and IMF (2003a).

preventive role. Clearly, such a step would involve a fundamental departure from the underlying premises of the Bretton Woods system. The report of the Meltzer Commission (2000) virtually proposes the elimination of all other forms of IMF lending, including those for current account financing which should, in their view, be provided by private markets.[23] Such a shift in IMF lending would imply that only a small number of more prosperous emerging economies would be eligible for IMF financing (Summers 2000, p.14). More importantly there are difficulties in transforming the IMF into a genuine international lender of last resort, and proposed arrangements could compound rather than resolve certain problems encountered in IMF bailouts.

The effective functioning of such a lender would require discretion to create its own liquidity in order to be able to provide an unlimited amount of financing. This problem could, in principle, be resolved by assigning a new role to the SDR, which could also help promote it as a true fiduciary asset.[24] Proposals have indeed been made to allow the Fund to issue reversible SDRs to itself for use in lender-of-last-resort operations, that is to say the allocated SDRs would be repurchased when the crisis was over.[25]

However, the real problem relates to the terms of access to such a facility. Genuine lender-of-last-resort financing (namely lending in unlimited amounts and without conditions except for penalty rates) would

[23] The dissenting members of the Meltzer Commission pointed out that the most damaging proposals relate to the IMF's role in financial crises (Fidler 2000); see also Eichengreen and Portes (2000) and Wolf (2000). In this respect the Commission Report is not consistent. As pointed out by DeLong (2000, p. 2) while it assigns a lender of last resort role to the Fund for solvent but illiquid governments, it condemns the Fund for its loans to Mexico in 1995 and recommends against any increase in the IMF's resources. See Meltzer (2001) for his comments on the critics.

[24] A suggestion along these lines was made by the Managing Director of the IMF to the Copenhagen Social Summit in March 1995, when he stated that an effective response to financial crises such as the Mexican one depended on "convincing our members to maintain, at the IMF level, the appropriate level of resources to be able to stem similar crises if they were to occur", adding that this should lead to a decision in favour of "further work on the role the SDR could play in putting in place a last resort financial safety net for the world" (IMF Survey, 20 March 1995). See also Mohammed (1999).

[25] See Ezekiel (1998); United Nations (1999); and Ahluwalia (1999).

need to be accompanied by tightened global supervision of debtor countries to ensure their solvency, and this would encounter not only technical but also political difficulties. Pre-qualification, that is allowing countries meeting certain ***ex ante*** conditions to be eligible to lender-of-last-resort financing, as in the case of ill-fated CCL, involves several problems. First, the IMF would have to act like a credit-rating agency. Second, it would be necessary to constantly monitor the fulfilment of the terms of the financing to ensure that the pressures on the capital account of a qualifying country have resulted from a sudden loss of confidence amongst investors triggered largely by external factors rather than macroeconomic and financial mismanagement. In these respects difficulties are likely to emerge in relations between the Fund and the member concerned.

Perhaps the most serious problem with rescue packages is that they tend to aggravate market failures and financial instability by creating moral hazard. This is more of a problem on the side of creditors than debtors since access to lender of last resort financing does not come free or prevent fully the adverse repercussions of financial panics and runs for debtor countries. The main difficulty is that bailouts undermine market discipline and encourage imprudent lending since private creditors are not made to bear the consequences of the risks they take.[26] A dose of constructive ambiguity by leaving lender discretion might help in reducing moral hazard, but at the expense of undermining the objective sought by establishing such a facility.

There has been growing agreement that orderly debt workout procedures drawing on certain principles of national bankruptcy laws, no-

[26] For a survey of empirical evidence on the effect of IMF intervention on debtor and creditor incentives see Haldane and Scheibe (2003) who "find concrete evidence of creditor-side moral hazard associated with IMF bail-outs" (p. 1). See also Mina and Martinez-Vazquez (2002) who conclude that IMF lending generates moral hazard in international financial markets from the perspective of the maturity composition of foreign debt.

tably Chapters 9 and 11 of the United States law provide a viable alternative to official bailout operations.[27] These should be designed to meet two interrelated objectives. On the one hand, they should help prevent financial meltdown and economic crises in developing countries facing difficulties in servicing their external obligations – a situation which often results in a loss of confidence of markets, collapse of currencies and hikes in interest rates, inflicting serious damage on both public and private balance sheets and leading to large losses in output and employment and sharp increases in poverty, all of these being part of actual experience in East Asia, Latin America and elsewhere during the past ten years. On the other hand, they should provide mechanisms to facilitate an equitable restructuring of debt which can no longer be serviced according to the original provisions of contracts. Attaining these two objectives does not require fully-fledged international bankruptcy procedures but the application of a few key principles:[28]

- A temporary debt standstill whether debt is owed by public or private sector, and whether debt servicing difficulties are due to solvency or liquidity problems – a distinction which is not always clear-cut. The decision for a standstill should be taken unilaterally by the debtor country and sanctioned by an independent panel rather than by the IMF because the countries affected are among the shareholders of the Fund

27 The list of institutions and experts who put forward various proposals for mechanisms to overcome moral hazard and involve the private sector in the resolution of financial crises includes the Group of 22 (1998), the Council of Foreign Relations Independent Task Force (CFRTF 1999); the Emerging Markets Eminent Persons Group (EMEPG 2001); and the High-Level Panel on Financing for Development (Zedillo 2001). For a discussion of issues in bailouts and reform see Goldstein (2000), Haldane (1999), Akyüz (2002) and Eichengreen (2002).

28 A proposal to apply bankruptcy principles was made by UNCTAD (1986, annex to chap. VI) during the debt crisis of the 1980s. It was subsequently raised by Sachs (1995) and revisited by UNCTAD (1998, pp. 89-93) during the East Asian crisis. For a further discussion see Radelet (1999) and Akyüz (2002). The idea of establishing orderly workout procedures for international debt goes back even further. In 1942, in a report by the United States Council on Foreign Relations attention was drawn to interwar disputes between debtors and creditors and the need was recognised for exploration of the possibilities of establishing "a supranational judicial or arbitral institution for the settlements of disputes between debtors and creditors" (Oliver 1971, p. 20).

which is itself also a creditor. This sanction would provide an automatic stay on creditor litigation. Such a procedure would be similar to WTO safeguard provisions allowing countries to take emergency actions to suspend their obligations when faced with balance-of-payments difficulties (Akyüz 2002, pp. 124-25). Standstills would need to be accompanied by exchange controls, including suspension of convertibility for foreign currency deposits and other foreign exchange assets domestically held by residents.

- Provision of debtor-in-possession financing automatically granting seniority status to debt contracted after the imposition of the standstill. IMF should lend into arrears for financing imports and other vital current account transactions.

- Debt restructuring including rollovers and write-offs, based on negotiations between the debtor and creditors, and facilitated by the introduction of automatic rollover and collective action clauses (CACs) in debt contracts. The IMF should not be involved in the negotiations between sovereign debtors and private creditors.

These principles still leave open several issues of detail, but they nonetheless could serve as the basis for a coherent and comprehensive approach to crisis intervention and resolution. The Fund appeared to be moving in this direction at the end of the last decade with rising opposition to bailout operations from European and other governments and the increased frequency of crises in emerging markets. The IMF Board first recognised that "in extreme circumstances, if it is not possible to reach agreement on a voluntary standstill, members may find it necessary, as a last resort, to impose one unilaterally", and that since "there could be a risk that this action would trigger capital outflows ... a member would need to consider whether it might be necessary to resort to the introduction of more comprehensive exchange or capital controls."[29]

[29] See IMF (2000). For further discussion of the debate in the IMF see Akyüz (2002, pp. 123-128).

Although the Board was unwilling to provide statutory protection to debtors in the form of a stay on litigation, preferring instead "signalling the Fund(s acceptance of a standstill imposed by a member ... through a decision ... to lend into arrears to private creditors", the Fund secretariat moved towards establishing a formal mechanism for sovereign debt restructuring to "allow a country to come to the Fund and request a temporary standstill on the repayment of its debts, during which time it would negotiate a rescheduling with its creditors, given the Fund(s consent to that line of attack. During this limited period, probably some months in duration, the country would have to provide assurances to its creditors that money was not fleeing the country, which would presumably mean the imposition of exchange controls for a temporary period of time." (Krueger 2001, p. 7)

However, the provision for statutory protection to debtors in the form of a stay on litigation is not included in the proposal for Sovereign Debt Restructuring Mechanism (SDRM) prepared by the Fund management because of the opposition from financial markets and the United States government. The proposed mechanism also provides considerable leverage to creditors in seeking their permission in granting seniority to new debt needed to prevent disruption to economic activity. It gives considerable power to the Fund ***vis-à-vis*** the proposed Sovereign Debt Dispute Resolution Forum in determining debt sustainability.[30]

The SDRM proposal contains innovative mechanisms to facilitate sovereign bond restructuring for countries whose debt is deemed unsustainable in bringing debtors and bondholders together whether or not bond contracts contain CACs, in securing greater transparency, and in providing a mechanism for dispute resolution. It could thus constitute an important step in the move towards generalised CACs in international bonds. However, it only addresses part of the problem associated with financial crises. First, it would not apply to countries with sustainable debt but facing liquidity shortages. Secondly, it focuses

[30] See IMF (2003b) for a description of the SDRM and background information.

exclusively on international bonds as a source of financial fragility even though vulnerabilities associated with international bank debt, currency risks assumed by the domestic banking system, and public domestic debt played key roles in most recent crises in emerging markets. In the presence of such vulnerabilities bond clauses alone cannot stem currency attacks or prevent financial turmoil. While the SDRM includes a provision to discourage litigation by bondholders (through the application of the so-called hotchpot rule), such a rule cannot address the problem of how to stop financial meltdown, since in a country whose debt is judged unsustainable, currency runs could take place whether or not bondholders opt for litigation.

More importantly, the SDRM proposal does not fundamentally address the problems associated with IMF bailouts. It is based on the premise that countries facing liquidity problems would continue to receive IMF support and the SDRM will apply only to those with unsustainable debt. As part of its promotion of the SDRM the IMF has argued that unsustainable debt situations are rare. That means in most cases business as usual. In any case, it can reasonably be expected that countries with unsustainable debt would generally be unwilling to declare themselves insolvent and activate the SDRM. Instead, they would be inclined to ask the Fund to provide financing. But in most cases it would be difficult for the Fund to decline such requests on grounds that the country is facing a solvency problem. Here lies the rationale for limits on IMF crisis lending whether the problem is one of liquidity or insolvency: with strict access limits creditors cannot count on an IMF bailout, and debtors will be less averse to activating the SDRM and standstills when faced with serious difficulties in meeting their external obligations and maintaining convertibility. This means that to encourage countries to move quickly to debt restructuring, the SDRM should be combined with limits on crisis lending. But this could be problematic unless private sector involvement is secured through a statutory standstill and stay on litigation.

Even this watered down version of the SDRM proposal could not elicit adequate political support and has, at the time of writing, been put on the backburner. Indeed, the impetus for reform has generally been lost since the turn of the millennium because of widespread complacency associated with the recovery of capital flows to emerging markets. This recovery has been driven by a combination of highly favourable conditions including historically low interest rates, high levels of liquidity, strong commodity prices and buoyant international trade. Private capital flows to emerging markets appear to be in the boom phase of their third postwar cycle: the first began in the 1970s and ended with the debt crisis in the early 1980s, and the second began in the early 1990s and ended with the East Asian and Russian crises.[31] Total inflows in the current boom appear to have exceeded the peak observed in the previous boom, and almost all emerging markets have shared in this recovery. However, as noted by the Institute of International Finance, the system is becoming more fragile once again: "there is a risk that the pickup in flows into some emerging market assets has pushed valuations to levels that are not commensurate with underlying fundamentals." (IIF 2005a, p. 4). Thus, a combination of tightened liquidity, rising interest rates, slowing growth and global trade imbalances can reverse the boom, hitting particularly countries with weak fundamentals and incomplete self-insurance (IIF 2005b; Goldstein 2005b).[32] Under these conditions if the recent consensus against large-scale bail-out operations is adhered to, countries that may be facing rapid exit of capital and unsustainable debt burdens could be forced to undertake action for unilateral standstill, creating considerable uncertainties and confusion in the international financial system. If not, we will be back to square one.

---

[31] Boom-bust cycles characterise not only the postwar experience, but almost the entire history of private capital flows to developing countries. The boom in private flows to Latin American countries that started soon after their independence around 1820 was followed by widespread defaults and disappearance of international liquidity to the region until around 1850. Again the boom of the 1920s was followed by widespread defaults and cutbacks in private lending in the 1930s. For a more detailed account of these cycles see UNCTAD (2003, Chap. II, and pp. 129-132), UNCTAD (1998, Part One, Chap. III) and Kregel (2004).

[32] A "harsh economic scenario" recently simulated by the IMF (2005c, pp. 8-10) includes a 30 per cent contraction in private flows to emerging markets, increased spread, disorderly dollar depreciation, lower growth and weak commodity prices.

Chapter 6

RESTRUCTURING IMF LENDING AND SUPPLEMENTING RESOURCES

THE arguments developed above imply that the Fund should return to its original mandate for the provision of short-term current account financing and should no longer be engaged in development finance or financial bailout operations. This means abolishing the facilities designed for these purposes including the EFF, SRF and PRGF. Despite the rapid development and integration of international banking and credit markets, there is still a strong rationale for the Fund to have a role in providing liquidity because of pro-cyclical behaviour of financial markets and increased volatility of global economic environment. Such financing should be made available in order to support economic activity, employment and trade when countries face sharp declines or reversals of private capital flows, or temporary shortfalls in external payments as a result of trade shocks which cannot be met by private financing. In both cases access to credit tranches through stand-by agreements should be the main instrument for the provision of liquidity. Greater delineation of Bank-Fund activities requires that such financing should be the sole responsibility of the Fund, and the Bank should stay out of provision of short-term finance.[33]

---

[33] This view is also held by the majority in the Meltzer Commission (2000, p. 11). See also Gilbert, Powell and Vines (1999, p. 622) who note that during the 1998 crisis "the Bank provided around $8 billion in short-term liquidity in the packages of lending to Thailand, Indonesia and Korea. This 'defensive' lending had little to do with promoting development (in the normal sense of that expression). If it were to be repeated, such emergency lending could severely destabilise the Bank's normal development lending".

While it has to be recognised that money is fungible and in practice it is not always possible to identify the need catered for by a particular loan, it is important to ensure that IMF lending to counter volatility in private capital flows should aim at maintaining imports and the level of economic activity rather than debt repayment to private creditors and capital account convertibility. Such lending should be available to countries facing cutback in credit lines due to contagion as well as those facing currency and debt crises. To ensure that such lending does not amount to bailouts for private creditors, there should be strict limits to IMF crisis lending since otherwise it would be difficult to ensure private sector involvement.

This approach of constraining IMF lending to encourage private sector involvement in the resolution of international financial crises has been supported by some G-7 countries including Canada and England.[34] It has also been supported in a report to the Council on Foreign Relations which argued that the IMF should adhere consistently to normal access limits and that only "in the unusual case in which there appears to be a systemic crisis (that is a multicountry crisis where failure to intervene threatens the performance of the world economy and where there is widespread failure in the ability of private capital markets to distinguish creditworthy from less creditworthy borrowers), the IMF would return to its 'systemic' backup facilities" (CFRTF 1999, p. 63). However, exceptions to normal access limits could leave considerable room for large-scale bailout operations and excessive IMF discretion in assessing the conditions under which exceptional access in capital account crises are to be granted.[35] It would also allow room for considerable political leverage in IMF lending decisions by its major shareholders, as was seen in the differential treatment of Argentina and Turkey after the attacks of

---

[34] See the joint paper by two senior officials of Bank of Canada and Bank of England, Haldane and Kruger (2001).

[35] These include a high probability that debt will remain sustainable and good prospects for the member to regain access to private financial markets within the time Fund resources would be outstanding (IMF 2005c, p. 4) – conditions that failed to hold in the case of Argentina.

September 2001. Requiring supermajority for access to exceptional finance, as recommended by CFRTF (1999, p. 63) and Goldstein (2005a, pp. 299-300) would certainly be an important step, but it may not always prevent large scale bailouts driven by political motivations. In any case, the Fund should provide liquidity to countries facing cutback in private lending in order to support production, employment and trade, and should not be expected to help float imprudent international investors and lenders – a task that should fall on national authorities in creditor countries. On the other hand, the problem of inadequacy of normal lending limits for current account financing should be addressed by reforming quotas and access policy not by making exceptions to access limits.

Exceptional current account financing may be needed in times of a contraction in world trade and growth, and/or sharp declines in capital flows to developing countries, as was the case in the early 1980s and after the East Asian and Russian crises. The Fund's regular resources may not be adequate for dealing with such cases because they are not large or flexible enough. This can be handled by a global counter-cyclical facility based on reversible SDR allocations, which could be triggered by a decision of the Board on the basis of certain predetermined criteria regarding global trade and output and private capital flows to developing countries. Again countries could be permitted to have access to such a facility on a temporary basis within predetermined limits.

Fund lending in response to trade shocks is needed when financial markets are not willing to provide counter-cyclical finance. As noted the CFF was established in 1963 as an additional low-conditionality facility to help developing countries experiencing temporary shortfalls in export earnings due to external shocks in order to avoid undue retrenchment. Modifications made over the years have tightened conditions attached to the CFF, and the facility has not been used since the last review in 2000 despite two recognised temporary shocks including the attacks of September 2001 which affected earnings from tourism in the Caribbean region (IMF 2004b). A major problem is that in order to have low conditionality financing under CFF (the so-called stand alone CFF purchases) a country would need to have a viable payments position except for the effects of the shocks, but such a country would normally have access to alternative sources of finance. On the other hand, countries with structurally weak payments usually have other forms of high-conditionality Fund financing including the PRGF or emergency assistance (IMF 2004b). Under current arrangements the facility serves no useful purpose and many Executive Directors called for its discontinuation during the recent review, arguing that the CFF is not an attractive option for low-income countries given its non-concessional nature (IMF 2004c).

It is generally recognised that IMF quotas have considerably lagged behind the growth of global output and trade. According to one estimate, in 2000 they stood at 4 per cent of world imports compared to 58 per cent in 1944 (Buira 2003b, p. 9). It is, however, often argued that this does not imply that the size of the Fund would need to be raised considerably in order to keep up with growth in world trade because closely integrated and rapidly expanding financial markets now provide alternative sources of liquidity, and the move to floating together with the universal convertibility of several currencies have reduced the need for international reserves. While this may well be so for more advanced countries, many developing countries continue to depend on multilateral financing since market liquidity tends to disappear at the time when it is most needed. These countries are also more vulnerable to external shocks, be it in trade or finance.

An across the board increase in the size of the Fund may not address the problems faced by many developing countries because of the small size of their quotas. It is known that the current distribution of quotas does not reflect the relative size of the economies of the countries member to the IMF, and a redistribution of quotas based on actual shares of countries in aggregate world output would raise the proportion of IMF quotas allocated to developing countries, particularly if incomes are valued at purchasing power parities (PPP) rather than market exchange rates (Buira 2003b). However, this would only address a small part of the problem: according to the IMF World Economic Outlook, the share of advanced countries in aggregate GDP at PPP is close to 58 per cent while their share in IMF quotas is just over 60 per cent. For developing countries these numbers stand at around 38 and 30 per cent respectively. Moreover, a redistribution of quotas would not produce a tangible increase in the share of low-income developing countries which do not have adequate access to international financial markets.

One way to tackle the problem would be to adopt differential treatment of poorer countries in the determination of their drawing rights. Under existing arrangements quotas determine simultaneously countries' contributions to the Fund, voting rights and drawing rights. But this is not the best possible arrangement and the use of a single quota to serve three purposes was rightly criticised as "both illogical and unnecessary" (Mikesell 1994, p. 37). Putting a large wedge between countries' contributions and voting rights by subjecting them to totally different rules may be problematic, but there is no reason why drawing rights should not be based on different quotas from contributions.[36] After all non-reciprocity between rights and obligations for poorer countries has been an agreed principle in multilateral arrangements in other spheres of economic activity, notably trade, and such an approach would also be consistent with concessionality applied to lending to such countries by the Bretton Woods Institutions. This may be arranged by setting different access limits to different groups of countries according to their vulnerability to external shocks and access to financial markets, which in effect implies that, under current arrangements, countries would have different quotas for their contributions and drawing rights. Income shares can be taken as the basis for contributions while export earning volatility and access to private finance could be used as criteria for determining drawing limits. Such a need-based approach to access to IMF resources would make even greater sense if, as proposed in Chapter 9, the IMF ceases to be funded by its members, relying instead on SDRs for the resources needed.

[36] For a similar proposal see Kelkar, Yadav and Chaudhry (2004) who argue that contributions should be based on member's capacity to pay; access to resources should be based on need; and voting rights should balance the rights of creditors with the principle of sovereign equality.

An overall expansion of Fund quotas, together with its redistribution in favour of developing countries, would increase unconditional access through reserve tranche purchases. However, automatic access would also be expanded beyond the reserve tranche for the poorer countries if quotas for drawings are differentiated from those for contributions. On the other hand, once the Fund stops dealing with development and poverty, structural conditionality should no longer be applied for access to upper credit tranches. Conditionality would then be restricted to fiscal, monetary and exchange rate policies – the Fund's core areas of competence.

Increased resources at the IMF should be expected to help strike a better balance between financing and macroeconomic adjustment. In any case, the kind of conditions to be attached to lending should depend on the nature of payment imbalances. If the shortfall is due to temporary trade and financial shocks, then it is important to ensure that the Fund do not act pro-cyclically and impose policy tightening. In such cases the balance between policy adjustment and financing should be tilted towards the latter. If expansionary macroeconomic policies and excessive domestic absorption are at the root of the problem, then financing would need to be accompanied by realignment of monetary, fiscal and exchange rate policies. However, if it turns out that payments equilibrium can only be sustained at permanently depressed rates of economic growth, this is a matter that should be addressed by multilateral development banks through provision of development finance and promotion of structural policies, including in areas affecting government revenues and spending, rather than by IMF lending or macroeconomic policy prescriptions for demand management.

An issue here is whether it would be possible to distinguish between temporary and permanent shocks or between structural and cyclical deficits (see e.g., IMF 2004b, p. 10). There are no doubt difficulties in making judgment in these areas, which call for prudence. However, such judgments are also necessary under current arrangements in order to strike a balance between adjustment and financing, and between structural and macroeconomic conditionality. Moreover, the Fund is engaged in making judgments in areas that involve even higher degrees of uncertainty such as debt sustainability and prospects of the country regaining access to private finance as part of the criteria to be met for exceptional access in capital account crises (IMF 2005c, p. 4). Placing macroeconomic and structural aspects of payments adjustment in different institutions is no more problematic than combining them under the same roof. It would also have the additional advantage of reducing the imbalance between adjustment and financing since structural adjustment needs to be supported by a lot more financing than macroeconomic adjustment, and the IMF programmes tend to rely heavily on macroeconomic tightening to reduce payments imbalances even when they are structural in nature.

Chapter 7

INEFFECTIVENESS AND ASYMMETRY OF FUND SURVEILLANCE

THE architects of the Bretton Woods system recognised the role of surveillance over national policies for international economic stability. But it was only after the collapse of the fixed exchange rate system and the expansion of capital markets that IMF surveillance gained critical importance. With the second amendment of the Articles of Agreement the Fund was charged with exercising firm surveillance over members' policies at the same time as members were allowed the right to choose their own exchange rate arrangements. Its objective, as formally adopted, was limited to surveillance over exchange rate policies, focussing primarily on the sustainability of exchange rates and external payments positions, and on the appropriateness of the associated economic policies, particularly monetary and fiscal policies, of individual countries. However, its scope and coverage have expanded over time into structural policies, the financial sector and a number of other areas (IMF/GIE 1999, p. 21; Mohammed 2000). The guidelines established in 1977 made an explicit reference to the obligations of members to avoid manipulating exchange rates or the international monetary system to gain an unfair competitive advantage over other members.[37] In the 1980s the major members of the Fund came to favour a broader interpretation and recognised that "to be effective surveillance over exchange rates must concern itself with the assessment of all the policies that affect trade, capital movements,

[37] See Executive Board Decision no. 5392-(77/63) adopted on 29 April 1977.

external adjustment, and the effective functioning of the international monetary system."[38] After a series of emerging market crises the Interim Committee agreed in April 1998 that the Fund should intensify its surveillance of financial sector issues and capital flows, giving particular attention to policy interdependence and risks of contagion, and ensure that it is fully aware of market views and perspectives.[39] Various codes and standards established on the basis of benchmarks appropriate to major industrial countries for macroeconomic policy, institutional and market structure, and financial regulation and supervision have become important components of the surveillance process (Cornford 2002, pp. 31-33).

However, the Fund's intensive bilateral surveillance of developing countries' policies has not been effective in crisis prevention in large part because it has failed to diagnose and act on the root causes of the problem. Indeed, according to an independent assessment of Fund surveillance, policy makers interviewed had important reservations regarding the quality of the Fund's analysis of capital account issues (IMF/GIE 1999, p. 13). Experience since the early 1990s shows that preventing unsustainable surges in private capital inflows, currency appreciations and trade deficits holds the key to preventing financial crises in emerging markets. However, as recognised by the IMF's Independent Evaluation Office (IEO), there is a consensus that none of the standard policy measures recommended by the Fund for this purpose, including countercyclical monetary and fiscal policy and exchange rate flexibility, is a panacea, and each involves significant costs or otherwise brings about other policy dilemmas (IMF/IEO 2005, p. 60). Sterilisation through issuing government paper, raising reserve requirements or generating fiscal surpluses runs up against a host of problems. While fixed or adjustable peg regimes tend to encourage short-term inflows by reducing perceived currency risks, the floating regime, which has come to be favoured

38 Group of Ten (1985, para 40). For further discussion see Akyüz and Dell (1987).
39 IMF Interim Committee Communiqué of 16 April 1998; Washington, D.C.

by the Fund after recurrent crises in emerging markets, does not provide a viable alternative. As shown by the post-Bretton Woods experience of advanced industrial countries and the more recent experience of several emerging market economies floating does not prevent excessive inflows of capital, misalignments in exchange rates and unsustainable trade deficits; nor does it always secure an orderly currency and payments adjustment.[40] Similarly, prudential regulations can help contain the damage caused by rapid exit of capital, but they are not always effective in checking the build-up of external fragility even when counter-cyclical adjustments are made to rules governing loan-loss provisions, capital requirements, collateral valuation and other measures affecting conditions in credit and asset markets in order to limit the cyclicality of the financial system.

All these imply that direct measures of control over capital inflows that go beyond prudential regulations may become necessary to prevent build up of financial fragility and vulnerability to external shocks.[41] Developing country governments have generally been unwilling to slow down excessive capital inflows using, instead, the opportunity to pursue pro-cyclical fiscal policies. Taiwan is a notable exception with effective restrictions over arbitrage flows which protected the economy from the East Asian crisis in 1997-1998.[42] Again Chile and Colombia employed un-remunerated reserve requirements in a counter-cyclical manner, imposed at times of strong inflows in the 1990s and phased out when capital dried up at the end of the decade. This was a price-based, non-discriminative measure which effectively taxed arbitrage inflows with the implicit tax rate varying inversely with maturity. These measures were effective in improving the maturity profile of external borrowing but not in checking aggregate capital inflows. The Fund has been am-

40 For the recent experience see Goldstein (2005b).

41 For a discussion of policy issues in securing greater financial stability see Kindleberger (1995), McCauley (2001), BIS (2001, Chap. VII); and Akyüz (2004).

42 Because of such regulations Taiwan has so far been denied the developed market status by FTSE, the global index provider jointly owned by the Financial Times and the London stock Exchange; see Hille and Jung-a (2005, p. 3).

bivalent even towards these market-based measures, questioning their rationale and effectiveness (IMF/IEO 2005, p. 46, Box 2.3). This is largely because, as noted in an independent report on surveillance, the Fund has generally been optimistic regarding the sustainability of capital inflows to emerging markets (IMF/GIE 1999, p. 44, Box 3.2). It has been averse to temporary control measures even when there were clear signs that surges in short-term capital inflows were leading to persistent currency appreciations and growing trade deficits, advocating, instead, fiscal tightening and greater exchange rate flexibility (IMF/IEO 2005, pp. 8-9, and p. 59, Table 3.2).

The Fund has little leverage over policies in emerging market economies enjoying surges in capital flows, since they rarely need the Fund at such times of bliss. It cannot act as a rating agency and issue strong public warnings about sustainability of economic conditions in its member countries because of their possible adverse financial consequences. But it is also notable that the Fund refrains from requesting policy changes and effective capital account measures to slow down speculative capital inflows, check sharp currency appreciations and growing current account deficits even in countries with standby agreements. This was certainly the case in the 1990s when it supported exchange-based stabilisation programmes relying on short-term capital inflows. More recently Turkey has also been going through a similar process of continued appreciation and growing current account deficits under a floating regime, brought about, in large part, by a surge in arbitrage flows encouraged by high interest rates. Although its external conditions appear to be highly fragile and unsustainable, the Fund has done little to check this process; it has actually given a further momentum by constantly praising the policies pursued under its supervision.[43] Ironically, the Fund also seems to be aware of the risks and vulnerabilities created

[43] In a recent study of vulnerability of emerging markets to adverse global financial conditions, potential exchange rate problems and fiscal and monetary policy challenges, Turkey heads the list; see Goldstein (2005b, particularly Table 11). On external financial fragility of the Turkish economy see also UNECE (2005, Chap. 4).

by the current boom in capital inflows to emerging markets; as noted, it has been simulating scenarios for a group of "21 vulnerable emerging market countries" to predict the financial gap that could emerge in the event of "financial drought and poor economic conditions" (IMF 2005c, p. 8).

According to the recent report by the IEO "the IMF has learned over time on capital account issues" and "the new paradigm ... acknowledges the usefulness of capital controls under certain conditions, particularly controls over inflows", but this not yet reflected in policy advice because of "the lack of a clear position by the institution" (IMF/IEO 2005, p. 11). The report goes on to make recommendations to bring about greater clarity in policy advice and the role of capital account issues in IMF surveillance, but it is not clear if these would lead to the kind of fundamental changes needed in the Fund's approach to capital account regimes.

The Articles allow the Fund to request members to exercise control on capital outflows and recognise the right of members to regulate international capital flows. The 1977 surveillance decision mentions, among the developments that might indicate the need for discussion with a member, the behaviour of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements while the 1995 amendment explicitly refers to "unsustainable flows of private capital" as an event triggering such discussion. In other words surveillance should include sustainability of a country's external balance sheet and hence effective management of external liabilities.[44]

However, none of these give the Fund clear and effective jurisdiction over capital account issues or allow it to include capital account measures as conditionality in its financial arrangements with a member (IMF/IEO 2005, p. 50). Despite that the Fund has played an important

44 Indeed management of external liabilities was a key part of the report of the Financial Stability Forum on capital flows. For a discussion see Cornford (2000).

role in promoting capital account liberalisation in developing countries. After many years of turmoil in emerging markets, the issue now faced is how to include capital account measures to the arsenal of policy tools for effective management of international capital flows. As already argued, restrictions over capital outflows should become legitimate tools of policy in the context of orderly debt workout procedures at times of rapid exit of capital. In the same vein, guidelines for IMF surveillance should specify circumstances in which the Fund should actually recommend the imposition or strengthening of capital controls over inflows, and the Fund should be able to request exercise of control over inflows as well as outflows. It should also develop new techniques and mechanisms designed to separate, to the extent possible, capital account from current account transactions, to distinguish among different types of capital flows from the point of view of their sustainability and economic impact, and to provide policy advice and technical assistance to countries at times when such measures are needed.

How far should IMF surveillance cover subjects such as financial regulation and standards for financial reporting and accounting? This is clearly a delicate question involving not only technical competence but also powers and responsibilities in areas where there already exist other multilateral bodies. It is much more important for the Fund to focus on the analysis of capital flows including their nature and sustainability with a view to reducing the likelihood of crises than on the observance of international standards in developing countries in order to limit the damage that may be caused by their reversals, leaving these matters to institutions with the necessary expertise. This was indeed one of the recommendations of the report by independent experts on surveillance (IMF/IGE 1999, p. 15).

The failure of IMF surveillance in preventing international financial crises also reflects the unbalanced nature of the procedures which give too little recognition to shortcomings in the institutions and policies in major industrial countries with large impact on global economic conditions. For its borrowers the policy advice given by the IMF in Article IV consultations often provide the framework for the conditionality to be attached to any future Fund programme (IMF/GIE 1999, p. 20), while its surveillance of the policies of the most important players in the global system has lost any real meaning with the graduation of the industrial countries from the Fund and the breakdown of the Bretton Woods arrangements for exchange rates. This asymmetry in surveillance between the creditors and debtors of the Fund has increased further after recurrent emerging market crises throughout the 1990s. Standards and codes have been designed primarily to discipline debtor developing countries on the presumption that the cause of crises rests primarily with policy and institutional weaknesses in these countries. By contrast very little attention has been given to the role played by policies and institutions in major industrial countries in triggering international financial crises. For instance while it is widely recognised that non-compliance with standards and codes is a global problem, the incentive structure for compliance is highly ineffectual for the developed country members of the Fund (Schneider and Silva 2002, p. 4). Again, the Fund has paid very little attention to how instability of capital flows on the supply side could be reduced through regulatory measures targeted at institutional investors in major industrial countries (IMF/IEO 2005, p. 7), or how transparency could be increased for institutions engaged in destabilising financial transactions such as the hedge funds.

IMF multilateral surveillance has not paid adequate attention to systemic interrelation among countries – an area of improvement identified by a former Managing Director.[45] More importantly, the modalities of IMF surveillance do not include ways of responding to and dealing with unidirectional impulses emanating from changes in the monetary and exchange-rate policies of the United States and a few other G-7 countries. Indeed, boom-bust cycles in capital flows to developing countries and major international financial crises are typically connected to large shifts in macroeconomic and financial conditions in the major industrial countries. The sharp rise in the United States interest rates and

[45] See remarks by Camdessus on "How Should the IMF be Reshaped?" *Finance and Development.* September 2004, p. 27.

the appreciation of the dollar was a main factor in the debt crisis of the 1980s. Likewise, the boom-bust cycle of capital flows in the 1990s which devastated many countries in Latin America and East Asia were strongly influenced by shifts in monetary conditions in the United States and the exchange rates among the major reserve currencies (UNCTAD 1998, Part II, Chap. IV; and 2003, Chap. II). Again much of the current surge in capital flows to emerging markets is driven by financial market conditions in industrial countries, including historically low interest rates and ample liquidity, rather than by fundamentals in recipient countries, and a reversal of these conditions could trigger serious instability in several emerging markets.

It has often been argued that the problems regarding the quality, effectiveness and evenhandedness of surveillance could be addressed by overhauling and downsizing the Board to make it more representative and effective, and giving greater independence to Executive Directors ***vis-à-vis*** their capitals and to the IMF secretariat ***vis-à-vis*** its governing bodies.[46] This view has been taken further by a senior British Treasury official who argued in favour of a formal separation of surveillance from decisions about programme lending and the use of IMF resources so as to establish the Fund as independent from political influence in its surveillance of economies as an independent central bank is in the operation of monetary policy (Balls 2003). It is argued that the current structure of the IMF treats programme design as an extension of surveillance, but the lack of a clear distinction between lending and surveillance activities creates the wrong incentives and diminishes the effectiveness of surveillance. Moreover, there is currently no formal regular mechanism for assessing whether the Fund is providing objective, rigorous, and consistent standards of surveillance across all member

[46] For a discussion of these issues see Cottarelli (2005); van Houtven (2004); Kelkar, Chaudhry and Vanduzer-Snow (2005); and Kelkar, Chaudhry, Vanduzer-Snow and Bhaskar (2005) Some of these elements of governance reform have also been emphasized, to varying degrees, by the three former Managing Directors of the Fund, De Larosière, Camdessus and Köhler; see "How Should the IMF be Reshaped?" *Finance and Development*. September 2004, pp. 27-29.

countries – programme and non-programme countries. While responsible for ensuring the effectiveness of the Fund's activities, Executive Directors also have responsibilities to their authorities. This creates a conflict of interest where Executive Directors tend to collude in surveillance in defence of the countries they represent, turning peer pressure into peer protection. Surveillance should thus rest with authorities who are independent of their governments and who are not involved in lending decisions, making it impartial, legitimate, authoritative, transparent and accountable. This would also have the advantage of protecting the Board and IMF management from being dragged into decisions, which – on the basis of objective evidence – they would not want to take or publicly justify.

Such a step could indeed help improve the quality of surveillance for both programme and non-programme countries in identifying risks and fragilities and the policy measures needed. However, it is not clear if it could really secure evenhandedness between programme and non-programme countries. For programme countries, it would not be possible to delink lending decisions from surveillance. Indeed, if the proposed arrangements are to improve the quality, authority and credibility, results of surveillance should provide a sound and legitimate basis for lending decisions by the Board. But for non-programme countries there would be no such mechanism to encourage governments to heed the policy advice emerging from the surveillance process. Publication of surveillance reports and a wider debate over policy could help prevent build up of fragilities and vulnerabilities by providing signals to market participants and creating public pressure on governments in need of corrective action, but even an independent body responsible for surveillance cannot be expected to issue public warnings since they can become self-fulfilling prophecies. For G-1 or G-3 countries whose policies set the terms and conditions in global financial markets, even such warnings may be of little use in encouraging policy reorientation or coordination.

Therefore, while independent surveillance may improve its quality, credibility and impact for non-programme countries, it cannot be relied on for bringing greater symmetry between creditor and debtor countries. Such a step may need to be supplemented by reforms in many areas of governance to be taken up in the following section. However, given the limits to improving significantly the leverage of the Fund over non-borrowing countries, evenhandedness may only be possible by minimising conditionality for programme countries and increasing the degree of automaticity of their access to the Fund in the ways discussed above.

Chapter 8

GOVERNANCE: MAKING THE FUND A GENUINELY MULTILATERAL INSTITUTION

THE debate over governance of the IMF has focussed mainly on issues raised by exercise of power by its major shareholders, particularly the United States. The most frequently debated areas of reform include the procedures for the choice of the Managing Director and, more importantly, the distribution of voting rights. Shortcomings in transparency and accountability are also closely related to "democratic deficit" within the governance structure of the Fund resulting from the quota regime.

The postwar bargain struck between the United States and Western Europe for the distribution of the heads of the Bretton Woods institutions between the two shores of the Atlantic has survived widespread public criticism and initiatives taken by developing countries. The latest selection of the Managing Director was again business as usual despite the apparent consensus reached during the previous round by the Board that the decision for selection would be based on a wide and open discussion involving all members of the Fund.[47]

There is a consensus among independent observers that the present distribution of voting rights lacks legitimacy not only because it does not meet the minimum standards for equity due to erosion of "basic votes", but also because it no longer reflects the relative economic importance of the members of the Fund.[48] The existing distribution of voting rights, together with the special majority requirements for key decisions, effec-

47 See IMF Press Release 99/56, 23 November 1999.

48 See e.g. Woods (1998, 2001), Mohammed (2000), Buira (2003b, and 2005), Kelkar, Yadav and Chaudhry (2004), and Kelkar, Chaudhry, Vanduzer-Snow, and Bhaskar (2005).

tively gives a veto power to the United States in matters such as adjustment of quotas, the sale of IMF gold reserves, balance of payments assistance to developing countries, and allocation of SDRs. Such a degree of control by the United States may have had some rationale during the immediate postwar years when it was the single most important creditor to the rest of the world and effectively the only creditor of the Fund. However, now not only is the United States the single largest debtor country in the world, but it is only one of the 45 creditor countries at the IMF.[49]

In theory the Fund appears to be a consensus builder since decisions by the Board are taken without formal voting.[50] But there has been hardly any consensus on proposals for change favoured by developing countries in areas such as quotas, voting rights or SDR allocation. In reality the consensual process of decision-making on the Executive Board does not constitute a democratising feature of Fund governance, but a way of exerting pressure on dissenting countries to go along with its major shareholders. The influence of developing countries is further weakened by the practice of arriving at decisions through consensus among Executive Directors, rather than direct exercise of voting rights by each and every member, since many developing countries are represented by Executive Directors from industrial countries.[51]

The procedures followed for the preparation and approval of country programmes also diminish the impact of developing countries. Typically agreement is reached between the country concerned and the Fund staff before a programme is presented to the Board, and it is not always

[49] IMF (2004a, p. 72). For the definition of net financial position in the IMF see Boughton (2005, pp. 4-5)

[50] The former Managing Director Köhler argues that "it's critical for the IMF to maintain the spirit of consensus ... [and] this is more important than numerical representation", while another former Managing Director De Larosière confirms that this is indeed the case: "During my years as a Managing Director, I do not remember that we ever counted votes." *Finance and Development*. September 2004, p. 29.

[51] See Buira (2003b, p. 4). Currently there are 30 developing countries represented by EDs from industrial countries (12 by Australia, 10 by Canada, 6 by Spain, and one by Italy and Belgium each).

clear to what extent the agreement reached reflects what the country really wants to do as opposed to what it has been compelled to accept. This tends to discourage developing country Executive Directors to oppose potentially damaging stabilisation and adjustment programmes even though in theory they have collectively the required number of votes to block them. Clearly an alternative procedure allowing the country concerned to make a presentation to the Board about its policy intentions and to back it up, when needed, with expert witnesses before entering into any discussion with the management could provide for a broader debate over country programmes and greater say for developing countries in the Board.

The current distribution of voting rights and the manner in which they are exercised effectively enable the major industrial countries to use the Fund as a multilateral seal of approval to legitimise decisions already taken elsewhere by this small number of countries. Lack of broad participation in the decision-making process is also a main reason why the Fund does not meet the minimum standards of transparency or accountability. There is an increased agreement that despite certain measures recently taken, lack of transparency goes well beyond that justified by the confidential nature of the issues dealt with by the Fund. The record on accountability is even less encouraging: the Fund is protected against bearing the consequences of the decisions taken, and the burden of inappropriate policy choices invariably falls on countries following its advice.

The proposals for reform for reducing the democratic deficit fall into two categories. First, changes could be made to special majority requirements in order to remove the veto power of the Fund's major shareholders over key decisions. Second, and more importantly, voting rights could be reallocated so as to increase the voice of developing countries. This could be done by increasing the share of the basic votes in total voting rights and/or by reallocating quotas on the basis of PPP. The main loser would be the European Union, which collectively holds almost twice as many votes as the United States, far above the level justified by the share of the region in the world economy. According to a proposal for restoring basic votes to its original share of around 11 per cent of total votes and allocating quota-based votes on the basis of PPP, the share of industrial countries would fall from over 62 per cent to 51 per cent while that of developing countries would rise from around 30 per cent to 42 per cent (Kelkar, Yadav and Chaudhry 2004, Appendix 1).

There can be little doubt that a reform along these lines would constitute an important step in improving the Fund's governance. It would rectify anomalies such as Canada holding the same number of votes as China or smaller European countries including Belgium and the Netherlands holding more votes than India, Brazil or Mexico, making the Fund look a more participatory and democratic institution. Nevertheless, it is unlikely to make a significant impact on the political leverage of its major shareholders or reduce the imbalance between its creditor and debtors.

The problems of governance and lack of uniformity of treatment across members cannot be resolved as long as Fund resources depend on the discretion of a small number of its shareholders. Reserve currency countries are the principal creditors to the Fund and their quota subscription payments provide the only usable international assets since there is no demand for national currencies paid in by developing countries. Moreover, the Fund borrows not from international financial markets, but from a minority of its members under two standing arrangements, GAB and NAB. It is true that the distinction between creditor and debtor countries is not the same as that between industrial and developing countries, and at the end of 2004 of the 45 creditor countries to the Fund nine were developing countries. However, unlike industrial countries, developing countries' net financial position in the Fund has been highly volatile. Almost all of the 44 countries which have switched, at least once, over 1980-2004 between being net financial contributors to the Fund and being debtors, and back, are developing countries (Boughton 2005, p. 4). With increased frequency of financial crises in emerging markets, this classification, like international credit ratings, has become highly unstable. For instance Korea, Malaysia, Mexico and

Thailand now are among the creditors of the IMF while they were heavily indebted a few years ago. Again there is no guarantee that countries such as Chile and China which have been IMF creditors for some time will remain so in the years ahead.[52]

In trade, bilateralism is often seen as a threat to multilateralism because of the preferential treatment it accords to some countries at the expense of the others in violation of the MFN principle, and the role played by political considerations in bilateral and regional trade arrangements. In the sphere of finance, by contrast, bilateral and multilateral arrangements are often seen as complementary. As already noted, in several instances the Fund's interventions in emerging market crises were combined with bilateral contributions from major industrial countries, notably but not solely the United States, particularly where political, economic and military interests were involved. Again, official debt reduction initiatives combine bilateral and multilateral debt, as in HIPC, and bilateral lenders often insist that any talks in the Paris club should be preceded by a formal IMF programme. Since bilateral lending is driven largely by political considerations (Gilbert, Powell, and Vines 1999; Kapur and Webb 1994; and Rodrik 1995) and bilateral debt negotiations rarely satisfy uniformity of treatment of debtors, such arrangements serve to subvert the governance of the Fund further, thereby enhancing the scope to make it an instrument for major industrial countries to pursue their national interests.

A reform that would translate the Fund into a truly multilateral institution responsible for international monetary and financial stability with equal rights and obligations of all its members, ***de facto*** as well as ***de jure***, would call for, ***inter alia***, an international agreement on sources of finance that do not depend on the discretion of a handful of countries as well as a clear separation of multilateral financial arrangements from bilateral creditor-debtor relations. The potential sources of genuinely

[52] Mohammed (2000, p. 208) uses "structural debtors" and "structural creditors" to make the distinction between industrial and developing countries.

multilateral finance are twofold. First, an agreement could be reached on international taxes, including the currency transaction tax (the so-called Tobin tax), environmental taxes and various other taxes such as those on arms trade, to be applied by all parties to the agreement on the transactions and activities concerned (Atkinson 2003; Wahl 2005). A common feature of these is that they are all sin taxes which would provide revenues while discouraging certain global public bads such as currency speculation, environmental damage or armed conflict and violence. However, these sources of revenue are more appropriate for development grants to poorest countries or for the provision of global public goods rather than provision of liquidity for temporary payments imbalances.

A more appropriate source of funding for the provision of international liquidity is the SDR. Under present arrangements the IMF may allocate SDRs to members in proportion to their quotas, but not to itself. Members obtain or use SDRs through voluntary exchanges or by the Fund designating members with strong external positions to purchase SDRs from members with weak external position. When members' holdings rise above or fall below their allocation they earn or pay interest respectively. These arrangements would need to be changed to allow the SDR to replace quotas and GAB and NAB as the source of funding for the IMF. The Fund should be allowed to issue SDR to itself up to a certain limit which should increase over time with growth in world trade. The SDR could become a universally accepted means of payments, held privately as well as by public institutions. Countries' access would be subject to predetermined limits which should also grow over time with world trade. The demand for SDRs can be expected to be inversely related to buoyancy in global trade and production and the availability of private financing for external payments. Thus, it would help counter deflationary forces in the world economy and provide an offset to fluctuations in private balance of payments financing.

Several issues of detail would still need to be worked out, but once an agreement is reached to replace traditional sources of funding with the SDR, the IMF could in fact be translated into a technocratic institution of the kind advocated by Keynes during the Bretton Woods negotiations.[53] Its funding would no longer be subjected to arduous and politically charged negotiations dominated by major industrial countries. The case for creating SDRs to provide funding for the IMF for current account financing is much stronger than the case for using them to back up financial bail-outs associated with a potential lender of last resort function advocated by some observers (e.g. Fischer 1999) in so far as it could help improve the governance of the Fund and reduce the imbalance between its creditors and debtors. Such a step, if supplemented by the kind of reforms regarding its mandate, operational modalities and governance structure discussed earlier, would give the Fund a chance to operate as an institution for all countries, rather than as an instrument of some.

[53] For a brief history of the debate over IMF governance see Cottarelli (2005, pp. 6-9).

Chapter 9

SUMMARY AND CONCLUSIONS

A GENUINE reform of the international financial system generally and the Fund particularly depends on developing countries forming a coherent view on a broad range of issues which, in turn, calls for greater understanding of various options as well as extensive deliberations and consultations. This paper aims at contributing to this process.

A main conclusion that emerges from the discussions above is that the original rationale of the Fund, namely to safeguard international monetary and financial stability, is now even stronger than in the immediate postwar era given the size and speed of international capital flows and their capacity to inflict damage on the real economy. Thus the Fund needs to go back to its core objectives and focus on preventing market and policy failures in order to attain greater international economic stability and facilitate expansion of employment, trade and income. Realisation of this objective calls for reforms on several fronts:

- The Fund needs a greater focus. It should stay out of development finance and policy and poverty alleviation. This is an unjustified diversion and an area that belongs to multilateral development banks. All facilities created for this purpose should be transferred to the World Bank as the Fund terminates its activities in development and long-term lending.
- A major task of the Fund is to promote a stable system of exchange rates and payments to ensure a predictable trading environment. In this task the Fund should focus on macroeconomic and exchange rate policies and stay away from trade policies. The attempts by

the Fund to promote unilateral liberalisation in developing countries drawing on its resources undermine the bargaining power of these countries in multilateral trade negotiations.

- Crisis management and resolution is an increasingly important area of responsibility of the Fund. However, the Fund should not be allowed to bail out lenders and investors since such operations prevent market discipline and create lenders' moral hazard. Accordingly, there should be strict limits to the Fund's crisis lending. Instead, the Fund should help develop orderly workout mechanisms for sovereign debt both to prevent financial meltdown and to restructure debt which cannot be serviced according to its original terms and conditions. Temporary debt standstills and exchange restrictions should thus become legitimate ingredients of multilateral financial arrangements.
- The Fund should focus on lending to finance temporary current account imbalances resulting from external trade and financial shocks as well as from domestic policy imbalances. There should be greater automaticity in meeting payments imbalances resulting from external shocks and less emphasis on policy adjustment. Conditionality should not be extended to structural issues but confined to macroeconomic and exchange rate policies.
- The Fund's resources need to be increased to keep up with growth in international trade. Access of countries to Fund resources should be based on the principle of need, not on countries' contribution to the Fund or their relative importance in the world economy.
- Fund surveillance has been ineffective in preventing emerging market crises. While the primary responsibility for avoiding crises lies with individual countries' own policy choices, the Fund has contributed to increased vulnerability and fragility of emerging markets by promoting premature capital account liberalisation and failing to alert countries against unsustainable surges in capital inflows, currency appreciations and current account imbalances. Progress on this front depends on a fundamental change in the approach of the Fund to capital market issues. The Fund should

improve its ability to identify risks and fragilities, and develop policy tools to prevent unsustainable capital flows to emerging markets, including direct and indirect control mechanisms, and provide policy advice.

- The Fund surveillance has also been unable to prevent destabilising impulses originating from persistent trade imbalances and exchange rate misalignments in major industrial countries. This too is partly due to the poor quality of policy analysis and assessment of market conditions. Separating surveillance from lending decisions and assigning it to an authority independent of the Board could improve its quality, legitimacy and impact. However, such a reform alone is unlikely to increase significantly the leverage of the Fund over non-programme countries and eliminate the imbalance between the Fund's debtors and creditors.
- Any reform designed to bring greater authority and legitimacy would need to address shortcomings in the Fund's governance in several areas including the selection of its head, the distribution of voting rights, transparency and accountability. However the Fund is unlikely to become a genuinely multilateral institution with equal rights and obligations for all its members, in practice as well as in theory, as long as it depends for resources on a handful of industrial countries and its financial activities are intimately linked to bilateral debtor-creditor relations between donor and recipients. These problems could be overcome if the IMF ceases to be an institution funded by its members, and relies on SDRs for the resources needed.

REFERENCES

Ahluwalia, Montek S. (1999). "The IMF and the World Bank in the New Financial Architecture." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. XI. Geneva.

Akyüz, Yilmaz. (2002). "Crisis Management and Burden Sharing." In Yilmaz Akyüz, ed., Reforming the Global Financial Architecture. Issues and Proposals. London: Zed Books.

Akyüz, Yilmaz. (2004). "Managing Financial Instability and Shocks in a Globalizing World." Paper presented at a public lecture sponsored by Bank Negara and the University of Malaya, February 6, Kuala Lumpur.

Akyüz, Yilmaz. (2005a). "Rectifying Capital Market Imperfections. The Continuing Rationales for Multilateral Lending." In Inge Kaul and Ronald Mendoza, eds. The New Public Finance: Responding to Global Challenges. Oxford University Press.

Akyüz, Yilmaz. (2005b). "WTO Negotiations on Industrial Tariffs: What is at Stake for Developing Countries?" TWN Trade & Development Series 24. Penang: Third World Network.

Akyüz, Yilmaz, and Sidney Dell. (1987). "Issues in International Monetary Reform." In UNCTAD, International Monetary and Financial Issues for the Developing Countries. Geneva.

Akyüz, Yilmaz, and Heiner Flassbeck. (2002). "Exchange Rate Regimes and the Scope for Regional Cooperation." In Yilmaz Akyüz, ed., Reforming the Global Financial Architecture. Issues and Proposals. London: Zed Books.

Akyüz, Yilmaz, and Andrew Cornford. (2002). "Capital Flows to Developing Countries and the Reform of the International Financial System." In Deepak Nayyar, ed., Governing Globalization. New York: Oxford University Press.

Akyüz, Yilmaz, and Korkut Boratav. (2003). "The Making of the Turkish Financial Crisis", World Development. 31(9). September.

Atkinson, Anthony B. ed. (2003). "New Sources of Development Finance." UNU-WIDER Studies in Development Economics. New York: Oxford University Press.

Babb, Sarah and Ariel Buira. (2005). "Mission Creep, Mission Push and Discretion: The Case of IMF Conditionality." In Ariel Buira, ed., The IMF and the World Bank at Sixty. London: Anthem Press.

Balls, Edward. (2003). "Preventing Financial Crises: The Case for Independent IMF Surveillance." Remarks made at the Institute for International Economics. Washington, D.C. March 6. BIS. (Bank for International Settlements) (2001). 71st Annual Report. Basel.

Boughton, James M. (2004). "IMF at 60. Reflections on the Reform at the IMF and the Demands of a Changing World Economy." Finance & Development, September.

Boughton, James M. (2005). "Does the World Need a Universal Financial Institution?" Working Paper 116. IMF: Washington, D.C.

Buira, Ariel. (2003a). "An Analysis of IMF Conditionality." G-24 Discussion Paper 22. UNCTAD, Geneva.

Buira, Ariel. (2003b). "The Governance of the IMF in a Global Economy." G-24. Washington, D.C.

Buira, Ariel. (2005). "The Bretton Woods Institutions: Governance Without Legitimacy?" In Ariel Buira, ed., Reforming the Governance of the IMF and the World Bank. London: Anthem Press.

Burnham, James B. (1999). "The IMF and World Bank: Time to Merge." The Washington Quarterly. 22:2. Spring.

Chauffour, Jean-Pierre. (2005). "Ensuring Coherence between Africa's Trade Agenda and Long-Term Development Objectives." Introductory remarks made at the Workshop on Ensuring Coherence between Africa's Trade Agenda and Long-Term Development Objectives. Lausanne. May 13-14.

Clark Jr. Lindley H. (1990). "Let's Merge the World Bank and the IMF." Wall Street Journal, January 4.

CFRTF (Council on Foreign Relations Independent Task Force). (1999). "Safeguarding Prosperity in a Global Financial System. The Future International Financial Architecture." Washington, DC.: Council on Foreign Relations.

Cornford, Andrew. (2000). "Commentary on the Financial Stability Forum's Report of the Working Group on Capital Flows." G-24 Discussion Paper 7. UNCTAD, Geneva.

Cornford, Andrew. (2002)."Standards and Regulations." In Yilmaz Akyüz, ed., Reforming the Global Financial Architecture. Issues and Proposals. London: Zed Books.

Cottarelli, Carlo. (2005). "Efficiency and Legitimacy: Trade-Offs in IMF Governance." Working Paper WP/05/107. Washington, D.C.: IMF.

Crook, Clive. (1991). "Sisters in the Wood – A Survey of the IMF and the World Bank." The Economist. October 12.

Dam, Kenneth W. (1982). "The Rules of the Game. Reform and Evolution in the International Monetary System." Chicago: University of Chicago Press.

Das, Bhagirath Lal. (1999). "The World Trade Organisation. A Guide to the Framework for International Trade." Penang: Third World Network.

Dell, Sidney. (1981). "On Being Grandmotherly: The Evolution of Fund Conditionality." Essays in International Finance 144. Princeton, N.J.: Princeton University Press.

Dell, Sidney. (1985). "The Fifth Credit Tranche." World Development 13 (2): 245-9.
Dell, Sidney. (1986). "The History of the IMF." World Development 14 (9): 1203-12.
DeLong, J. Bradford. (2000). Comment on "The Meltzer Report." [www.j-bradford-delong.net].
De Rato, Rodrigo. (2005). "Remarks at the Institute for International economics Conference on IMF Reform." IMF Website. Speeches. September 23.
Eichengreen, Barry. (2002). "Financial Crises and What To Do About Them." New York: Oxford University Press.
Eichengreen, Barry, and Richard Portes. (2000). "A Shortsighted Vision for IMF Reform". Financial Times, March 9.
EMEPG (Emerging Markets Eminent Persons Group). (2001). "Building the International Financial Architecture." Korea Institute for International Economics, Seoul.
Ezekiel, Hannan. (1998). "The Role of Special Drawing Rights in the International Monetary System." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. IX. Geneva.
Fidler, Stephen. (2000). "Report Urges Slimming Down of IMF and World Bank". Financial Times, March 8.
Fischer, Fritz. (2004). "Thinking the Unthinkable: Combining the IMF and World Bank." The International Economy. Fall.
Fischer, Stanley. (1999). "On the need for an International Lender of Last Resort." Journal of Economic Perspectives 13 (4): 85-104.
Friedman, Milton. (2004). "60 at 60: Is There a Need to Change the Structure of the IMF and World Bank?" Emerging Markets 60th Anniversary Special.
Gilbert, Christopher, Andrew Powell, and David Vines. (1999). "Positioning the World Bank." Economic Journal 109 (459): 598-633.
Goldstein, Morris. (2000). "Strengthening the International Financial Architecture. Where Do We Stand?" Working Paper 00-8. Institute of International Economics, Washington, D.C.
Goldstein, Morris. (2005a). "The International Financial Architecture." In C. Fred Bergsten, ed., The United States and the World Economy: Foreign Policy for the Next Decade. Institute for International Economics, Washington, D.C.
Goldstein, Morris. (2005b). "What Might the Next Emerging-Market Financial Crisis Look Like?" Working Paper 05-7. Institute for International Economics, Washington, D.C.
Group of Ten. (1985). "The Functioning of the International Monetary System." A Report to the Ministers and Governors by the Group of Deputies. Washington, D.C.

Group of 22. (1998). Report of the Working Group on International Financial Crises. Washington, D.C.
Haldane, Andrew G. (1999). “Private Sector Involvement in Financial Crisis: Analytics and Public Policy Approaches.” Financial Stability Review 9. Bank of England, London.
Haldane, Andrew, and Mark Kruger. (2001). “The Resolution of International Financial Crises: Private Finance and Public Funds”. Bank of Canada Working Paper 2001-20.
Haldane, Andrew G. and Jorg Scheibe. (2003). “IMF Lending and Creditor Moral Hazard”. Working Paper 216. Bank of England, London.
Helleiner, Gerry. (1999). “Small Countries and the New World Financial Architecture.” CIS Working Paper 2000-4. University of Toronto.
Hille, Kathryn, and Jung-a Song. (2005). “Reform Hurdles Still to be Jumped.” Financial Times.Fund Management. October 24.
IIF. (Institute of International Finance). (2005a). Update on Capital Flows to Emerging Market Economies. March 31. Washington, D.C.
IIF. (2005b). Press Release. Tightened Monetary Conditions, Slowing Growth, Global Economic Imbalances Pose Challenges for Emerging Markets. May 26. Washington, DC.
IMF. (International Monetary Fund). (1969). The International Monetary Fund 1945-1965. Vol. 1- 3. Washington, D.C.
IMF. (2000). “Executive Board Discusses Involving the Private Sector in the Resolution of Financial Crisis.” Public Information Notice 00/80. Washington, D.C.
IMF. (2002). IMF Conditionality: A Factsheet. Washington, D.C. [www.imf.org/external/np/exr/facts /conditio.htm].
IMF. (2003a). “IMF Concludes Discussion on the Review of Contingent Credit Lines.” Public Information Notice 03/146. Washington, D.C.
IMF. (2003b). Proposals for a Sovereign Debt Restructuring Mechanism (SDRM). A Factsheet. January.
IMF. (2004a). IMF Annual Report. Washington, D.C.
IMF. (2004b). “Review of the Compensatory Financing Facility.” Washington, D.C.
IMF. (2004c). “IMF Concludes Review of the Compensatory Financing Facility.” Public Information Notice 04/35. Washington, D.C.
IMF. (2005a). IMF Financial Activities- Update June 2. Washington, D.C.
IMF. (2005b). “The IMF’s Trade Integration Mechanism.” Washington, D.C.
IMF. (2005c). “Review of Access Policy in the Credit Tranches, the Extended Fund facility and the Poverty Reduction and Growth facility, and Exceptional Access Policy.” Washington, D.C.
IMF/GIE (IMF Group of Independent Experts). (1999). External Evaluation of IMF Surveillance. Report by a Group of Independent Experts. Washington, D.C.

IMF/IEO. (IMF Independent Evaluation Office) (2005). Report on the Evaluation of the IMF's Approach to Capital Account Liberalisation. Washington, D.C.

IMF/WB. (2004). "Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality- Progress Report." February 24: Washington, D.C.

Jungito, Roberto. (1994). "IMF-World Bank Policy Advice: The Coordination/ Cross-Conditionality Question." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. IV. Geneva.

Kapur, Davesh and Richard Webb. (1994). "The Evolution of Multilateral Development Banks." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. IV. Geneva.

Kapur, Davesh and Richard Webb. (2000). "Governance-related Conditionalities of the International Financial Institutions." G-24 Discussion Paper 6. UNCTAD, Geneva.

Kelkar, Vijay L., Vikash Yadav and Praveen K. Chaudhry. (2004). "Reforming the Governance of the International Monetary Fund." The World Economy, Vol. 27 (May): 727-43.

Kelkar, Vijay L., Praveen K. Chaudhry, and Martha Vanduzer-Snow. (2005). "Time for Change at the IMF." Finance and Development. March.

Kelkar, Vijay L., Praveen K. Chaudhry, Martha Vanduzer-Snow, and V. Bhaskar. (2005). "Reforming the International Monetary Fund: Towards Enhanced Accountability and Legitimacy." In Ariel Buira, ed., Reforming the Governance of the IMF and the World Bank. London: Anthem Press.

Keynes, J.M. (1944). John Maynard Keynes at the House of Lords, 23 May 1944. In Donald Moggridge, ed., The Collected Writings of John Maynard Keynes. Volume 26: Activities 1941-1946, Shaping the Post-War World, Bretton Woods and Reparations. Cambridge: Cambridge University Press. 1980.

Kindleberger, C. P. 1995. "Asset Inflation and Monetary Policy." Banco Nazionale del Lavaro Quarterly Review, (98) 192.

Kraev, Egor. (2005). "Estimating GDP Effects of Trade Liberalisation on Developing Countries." Christian Aid, London.

Kregel, Jan. (2004). "External Financing for Development and International Financial Stability." G-24 Discussion Paper 32, UNCTAD, Geneva.

Krueger, Anne O. (2001). "International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring." Address given at the National Economists' Club Annual Members' Dinner. Washington, DC. American Enterprise Institute. November 26.

Krueger, Anne O. (2005). "Trade Policy and the Strategy for Global Insertion." Speech at the Conference on Latin America in the Global Economy. Notre Dame, Indiana. April 19. IMF: Washington, D.C.

McCauley, R. N. 2001. "Setting Monetary Policy in East Asia: Goals, Developments and Institutions." Paper presented to the Conference on Financialization and the Global Economy", PERI, University of Massachusetts, Amherst,

Meltzer, Allan H. (2001). "The Report of the International Financial Institution Advisory Commission: Comments on the Critics." Carnegie Mellon Graduate School of Industrial Administration. [http://www.gsia.cmu.edu/afs/andrew/gsia/meltzer/Spanishedition3.doc].

Meltzer Commission. (2000). Final Report of the International Financial Institution Advisory Commission. Washington, D.C.: U.S. Government Printing Office.

Mikesell, Raymond F. (1994). "The Bretton Woods Debates: A Memoir." Essays in International Finance Series 192. Princeton University, Princeton, N.J.

Mikesell, Raymond F. (2001). "The Bretton Woods Vision: From the Past to the Present." Special Commentary. The Bretton Woods Committee Newsletter, Summer.

Mina, Wasseem, and Jorge Martinez-Vazquez. (2002). "IMF Lending, Maturity of International Debt and Moral Hazard." Working Paper 03-01. International Studies Program, Andrew Young School of Policy Studies. Georgia State University, Atlanta.

Mohammed, Aziz Ali. (1999). "Adequacy of International Liquidity in the Current Financial Environment." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. XI. Geneva.

Mohammed, Aziz Ali. (2000). "The Future Role of the IMF: A Developing Country Point of View." In Jan J. Teunissen, ed., Reforming the International Financial System. Crisis Prevention and Response. Fondad: The Hague.

Oliver, Robert W. (1971). "Early Plans for a World Bank." Princeton Studies in International Finance Series 29. Princeton University, Princeton, N.J.

Oliver, Robert W. (1975). "International Economic Cooperation and the World Bank." London: Macmillan.

Radelet, Steven. (1999). "Orderly Workouts for Cross-Border Private Debt." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. XI. Geneva.

Rodrik, Dani. (1995). Why is There Multilateral Lending? NBER Working Paper 5160. National Bureau of Economic Research, Cambridge, Mass.

Sachs, Jeffrey D. (1995). "Do We Need an International Lender of Last Resort?" Frank D. Graham Lecture. Princeton University, Vol. 8, April 20.

Sachs, Jeffrey D. (1998). "External Debt, Structural Adjustment and Economic Growth." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. IX. Geneva.

Santos-Paulino, Amelia, and A.P. Thirlwall. (2004). "The Impact of Trade Liberalisation on Exports, Imports and the Balance of Payments of Developing Countries." Economic Journal. 114: F50-F72.
Schneider, Benu, and Sacha Silva. (2002). "Conference Report on International Standards and Codes: The Developing Country Perspective." Conference held on 21 June 2002 at the Commonwealth Secretariat. Overseas Development Institute: London.
Schultz, George, P. (1998). "Merge the IMF and World Bank." The International Economy. January/February: 14-16.
Schultz, George P, William E. Simon, and Walter B. Wriston. (1998). "Who Needs the IMF?" Wall Street Journal, 3 February.
Schwartz, Anna J. (1998). "Time to Terminate the ESF and the IMF." Cato Foreign Policy Briefing 48.
Stiglitz, Joseph E. (2002). "Globalization and its Discontents." New York: W. W. Norton & Company.
Stiglitz, Joseph E. (2003). "Ethics, Market and Government failure, and Globalization." Paper presented to the Vatican Conference at the Ninth Plenary Session of the Pontifical Academy of Social Sciences, 2-6 May, Casina Pio IV.
Summers, Lawrence H. (2000). "Testimony Before the Banking Committee of the House of Representatives." Treasury News, March 23. Washington, D.C.
Triffin, Robert. (1976). "Jamaica: "Major Revision" or Fiasco". In E. M. Bernstein et al. eds., Reflections on Jamaica. Essays in International Finance Series 115. New York: Princeton University Press.
UNCTAD. (United Nations Conference on Trade and Development). (1986). Trade and Development Report. Geneva.
UNCTAD. (1998). Trade and Development Report. Geneva.
UNCTAD. (1999). Trade and Development Report. Geneva.
UNCTAD. (2003). Trade and Development Report. Geneva.
UNCTAD. (2004). The Least Developed Countries Report 2004. Linking Trade and Poverty Reduction. Geneva.
United Nations. (1999), Towards a New International Financial Architecture, Report of the Task Force of the United Nations Executive Committee of Economic and Social Affairs, January.
UNECE. (United Nations Economic Commission for Europe). (2005). Economic Survey of Europe No.1. Geneva.
Van Houtven, Leo. (2004). "Rethinking IMF Governance." Finance and Development. September.
Wahl, Peter. (2005). International Taxation: Regulating Globalization, Financing Development. World Economy, Ecology and Development (WEED), Berlin.
Walters, Alan. (1994). Do We Need the IMF and the World Bank? London: Institute of Economic Affairs.

Williamson, John. (2001). "The Role of the IMF: A Guide to the Reports." In S. Griffith-Jones and A. Bhattacharya eds., Developing Countries and the Global Financial System. London: The Commonwealth Secretariat.

Woods N (1998). "Governance in International Organizations: The Case for Reform in the Bretton Woods Institutions." In UNCTAD, International Monetary and Financial Issues for the 1990s. Vol. IX. Geneva.

Woods, Ngaire. (2001). Accountability, Governance, and Reform in the International Financial Institutions. Working Paper. Oxford University, University College.

Wolf, Martin. (2000). "Between Revolution and Reform – The Meltzer Commission's Vision". Financial Times, March 8.

WTO. (2003). "Report of the Meeting. Working Group on Trade, Debt and Finance." WT/WGTDF/M/4., Geneva.

WTO. (2004a). "Coherence in Global Economic Policymaking and Cooperation between the WTO, the IMF and the World Bank." WT/TF/COH/S/9. WTO: Geneva.

WTO. (2004b). "Doha Work Programme." Draft General Council Decision of 31 July 2004. WT/GC/W/535. WTO: Geneva.

Yang, Yongzheng. (2005). "Africa in the Doha Round: Dealing with Preference Erosion and Beyond." Paper presented at the Workshop on Ensuring Coherence between Africa's Trade Agenda and Long-Term Development Objectives, May 13-14, Lausanne.

Zedillo, Ernesto. (2001). Report of the High-level Panel on Financing for Development. United Nations, New York.

Titles in the TWN Global Economy Series

No. 1 Causes and Sources of the Asian Financial Crisis
by Yilmaz Akyüz
(24 pages US$6.00)

No. 2 The Debate on the International Financial Architecture: Reforming the Reformers *by Yilmaz Akyüz*
(28 pages US$6.00)

No. 3 An Introduction to Globalisation and its Impacts
by Bhagirath Lal Das
(44 pages US$6.00)

No. 4 A Critique of the IMF's Role and Policy Conditionality
by Martin Khor
(32 pages US$6.00)

No. 5 Bridging the Global Economic Divide: Proposals for Millennium Development Goal 8 on Global Partnership for Development *by Martin Khor*
(44 pages US$6.00)

No. 6 The Malaysian Experience in Financial-Economic Crisis Management: An Alternative to the IMF-Style Approach
by Martin Khor
(44 pages US$6.00)

No. 7 Reforming the IMF: Back to the Drawing Board
by Yilmaz Akyüz
(72 pages US$6.00)

REFORMING THE IMF: BACK TO THE DRAWING BOARD

A genuine reform of the International Monetary Fund (IMF) would require as much a redirection of its activities as improvements in its policies and operational modalities.

There is no sound rationale for the Fund to be involved in development and trade policy, or in bail-out operations in emerging market crises. It should focus on short-term counter-cyclical current account financing and policy surveillance.

To be effective in crisis prevention it should help emerging markets to manage unsustainable capital inflows by promoting appropriate measures, including direct and indirect controls. It should also pay greater attention to destabilising impulses originating from macroeconomic and financial policies in major industrial countries.

Any reform designed to bring greater legitimacy would need to address shortcomings in its governance structure, but the Fund is unlikely to become a genuinely multilateral institution with equal rights and obligations for all its members, ***de facto*** as well as de jure, unless it ceases to depend on a few countries for resources and there is a clear separation between multilateral and bilateral arrangements in debt and finance.

DR. YILMAZ AKYÜZ was the Director of the Division on Globalisation and Development Strategies and Chief Economist at UNCTAD until his retirement in August 2003. He was the principal author and head of the team preparing the UNCTAD Trade and Development Report, ***and UNCTAD coordinator of research support to developing countries (the Group of 24) in the IMF and the World Bank on international monetary and financial issues. Before joining UNCTAD in 1984 he taught at various universities in Turkey, England and elsewhere in Europe. He has published extensively in macroeconomics, finance, growth and development. Since retiring from UNCTAD, he has held the Tun Ismail Ali Chair in Monetary and Financial Economics, University of Malaya. His current activities include policy research for international organisations, and advising governments on development policy issues, and TWN on research in trade, finance and development.***

TWN GLOBAL ECONOMY SERIES

is a series of papers published by Third World Network on the global economy, particularly on current developments and trends in the global economy, such as those involving output, income, finance and investment. It complements the TWN Trade and Development Series which focuses on multilateral trade issues. It aims to generate discussion on and contribute to appropriate policies towards fulfilling human needs, social equity and environmental sustainability.