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" The Future Role of the IMF "

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The Future Role of the IMF

by

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Abstract

A great deal of literature has been produced in the past few years by both official and non-official sources on crisis prevention and crisis resolution issues in emerging market countries in the wake of the succession of crises that have afflicted Mexico, the East Asian countries, Korea and Brazil in the 1995-99 period. A certain degree of consensus has been reached on the etiology and the prescriptions for prevention of financial crises but there is much less agreement on what needs to be done for the resolution of crisis, once it breaks out. Large differences of view persist on the roles to be assigned to the international institutions, especially the IMF, between those preoccupied with moral hazard questions and others willing to consider a more ambitious agenda of intervention. There remain complex issues concerning the participation of the private sector in financial crisis management and measures for improving the working of financial markets. In all these areas, a variety of proposals have emanated from governments, inter-governmental groups and non-governmental expert bodies, culminating in the G-7/G-8 communiques from the Economic Summit meetings held in Japan last June and several reports submitted to the Summit leaders by the G-7 Ministers of Finance.

This paper looks at the IMF in the light of the recent debates on its role in the evolving global financial system. It finds that on certain issues, such as the scope and purposes of its lending operations, there is an approaching consensus that it should serve all its members, including the poorest, and that its resources should be available for supporting macro-relevant structural reforms as well as for dealing with financial crises. On a number of issues, however, there remain differences between industrial and developing country views, including on the extension of IMF surveillance to cover the observance of international standards and codes and the degree of disclosure of surveillance documents. Largely unsettled are the modalities of the involvement of the private sector in crisis resolution, with special reference to the development of arrangements in the international sphere that would be analogous to domestic bankruptcy procedures, including the declaration of standstills and principles for orderly and equitable debt workouts. Recent proposals for hardening the terms for IMF non-concessional financing remain in contention. The liberalization of the capital account and the choice of exchange regimes are two inter-connected areas in which international prescriptions conflict with developing country insistence on the preservation of national autonomy. The scope and content of IMF conditionality raises the issue of how to reconcile it with the importance of assuring country ownership. Finally, the governance of the IMF poses questions about the exercise of decision-making powers in the institution. Developing country positions have not been firmed up in all these areas, especially on the subject of private sector involvement in financial crisis prevention and resolution. However, a preference is suggested for a predictable rules-based framework rather than one derived on a "case-by-case basis. The next section enumerates four areas where debate has been muted or absent: these relate to the surveillance over, and coordination of, the macroeconomic policies of the three principal international currency issuers; the relationship of international and regional arrangements; the distribution of voting power in the IMF and in the international system generally and the future evolution of the international reserve system. It is concluded that while these issues are not currently on the table for discussions on the international financial architecture, yet they are important for the evolution of a sustainable international monetary and financial system that demands both efficiency and equity in international relations.

I Introduction:

A world-wide debate on the operations of the IMF and its future role has been underway in the wake of the financial crisis in Mexico in 1994-95, followed in 1997-98 by a succession of crises affecting countries in South-East Asia, Korea, Russia and Brazil. Most of the countries involved were in the developing or transition worlds – an exception being the collapse of an important hedge fund in the United States in the second half of 1998 which directly threatened international financial markets and forced the Federal Reserve to intervene to prevent a global meltdown. It might therefore appear natural for much of the subsequent discussion to focus on the prevention and resolution of financial crises in affected countries, and especially on a sub-set of those with closer connections with international capital markets, namely the emerging market economies. Much less attention has been directed to the reform of policies and arrangements in the major industrial countries, where changes in interest rates and exchange rates generate powerful effects on the rest of the world. Nor has much emphasis been placed on structural deficiencies in the working of financial markets and the transmission mechanism between them, on herd behavior, asymmetric information and over-shooting proclivities that have produced such a devastating impact on previously fast growing, dynamic economies.

A great deal of literature has been produced in the past few years from both official and non-official sources on crisis prevention and management problems in emerging market countries. A certain degree of consensus has been reached on the etiology and the prescriptions for prevention of financial crises and there is a better understanding of the principal issues that remain in contention as these apply to developing countries.[1] There is less agreement on what needs to be done for the resolution of crisis, once it breaks out. Large differences of view persist on the role to be assigned to the international institutions, especially the IMF, between those preoccupied with moral hazard questions and others willing to consider a more ambitious agenda of intervention. There remain complex issues concerning the participation of the private sector in financial crisis management; measures for improvements in the working of financial markets and the governance of the international financial institutions. In all these areas, a variety of proposals have emanated from individual governments, inter-governmental groups and non-governmental expert bodies, culminating in the G-7/G-8 communiques from the Economic Summit meetings held in Japan last June and several reports submitted to the Summit leaders by the G-7 Ministers of Finance.[2]

The rest of the paper is organized as follows: Section II identifies issues in the financial architecture area where there appears to be an emerging consensus in the international community. Section III reviews issues that remain in contention from the viewpoint of developing countries. Section IV enumerates some unresolved issues pertaining to the role of the major developed countries in the international financial system. A final section provides a summary and conclusions.

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[1] See a paper by this author on "The Future Role of the IMF – A developing Country Point of View", presented at a conference organized by the Forum on Debt and Development (FONDAD) in the Hague (26-27 June, 2000).

[2] There are four such reports titled (a) Strengthening the International Financial Architecture; (2) Poverty Reduction and Economic Development; (3) Actions against Abuse of the International Financial System and (4) Impact of the Information Technology Revolution on the Economy and Finance.

II. Issues Approaching Consensus:

The scope of IMF lending operations was one of the issues under debate where a consensus appears to have been attained, as indicated by the results of the G-7 Economic Summit. It will be recalled that the majority report of the Meltzer Commission [3] had proposed to restrict the IMF role to that of a "quasi-lender-of-last resort" providing very short-term, essentially unconditional, liquidity support for a limited number of relatively strong emerging market countries that would have pre-qualified for IMF assistance. The Commission also wanted to eliminate the Poverty Reduction and Growth Facility (PRGF). A number of academic and other non-governmental groups have similarly argued for taking the IMF out of the poverty alleviation business whereas developing countries wanted to maintain the IMF role in all member-countries, including in the poverty reduction area.. The G-7 Economic Summit leaders endorse the proposition that "as a universal institution, the IMF must work in partnership with all its members, including the poorest, based on shared interests".[4] The G-7 Finance Ministers take an even stronger line in their report by emphasizing that the "IMF has a critical role to play in supporting macroeconomic stability in the poorest countries, through the PRGF, integrating its efforts with those of the World Bank in working with countries on poverty reduction strategies"[5]. The World Bank is recognized as "the central institution for poverty reduction" but IMF "responsibility" for macroeconomic stability is stated to be a "key tool for the achievement of poverty reduction and growth" [6]. Whether this attempt to define the respective responsibilities and activities of the IMF and the World Bank Group in the poverty reduction area is clear enough remains to be seen. Much will depend on how rapidly the latter institution can fashion and implement a lending instrument that would complement the PRGF.

Another area where consensus is indicated relates to the purposes for which the IMF can lend. Here the discussion has been in terms of the reform of "IMF Facilities". The Extended Fund Facility that provides 10-year loans in support of structural adjustment measures was the main target of criticism. Conservative critics like the Meltzer majority wanted to restrict the IMF to short-term crisis lending. A number of academic and NGO groups have also argued that the IMF not engage in longer-term lending nor condition its lending to wide-ranging structural reforms that are said to lie beyond its macroeconomic stabilization and financial stability mandates and expertise. The G-7 Ministers do not accept this position. They expect that the EFF "should be used in well-defined cases where medium-term structural reform is important, and longer-term maturity is appropriate due to the country's structural balance of payments situation and its limited access to private capital". [7] How these circumstances are defined and implemented in the Fund's operations might carry potential for disagreement but at least the principle that developing countries have access to longer-term IMF funding in support of structural reforms has been conceded. There are, however, other types of limitations envisaged by the G-7 to discourage prolonged use of IMF resources that bear on this subject and these are discussed in the next section of the paper.

Also agreed in the area of IMF Facilities is the improvement of the Contingent Credit Line (CCL) through more automatic procedures for its activation so as to reassure the markets that resources under the facility would be available, at least for an initial drawing, without a review process or a streamlined one. There also appears to be broad agreement with G-7 proposals for reducing the rate of charge and the commitment fee and even the possibility of eliminating the fee altogether. There remain, however, unresolved questions about the strictness of the eligibility requirements and also the risks to a member of being asked to exit from the CCL if the IMF finds that the eligibility criteria are no longer being met.

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[3] *Vide* Report of the International Financial Institution Advisory Commission (IFIAC) (March 8, 2000). However, four members of the Commission had taken an opposing view on this, as on other, subjects.

[4] G-7 Statement: Okinawa, 21 July, 2000 (paragraph 8).

[5] Report from G-7 Finance Ministers, Fukuoka, 8 July, 2000 (paragraph 6g).

[6] *Ibid*

[7] *Ibid*

Turning to the scope and content of IMF surveillance, while there are several issues to be placed in the contentious category, the G-7 statement that "strong surveillance must be at the center of the IMF's efforts to strengthen the world economy and the international financial architecture"[8] leaves little room for doubt that this central activity applies to all members of the IMF. This language should put at rest the misgivings associated with the Meltzer Commission's recommendation that OECD countries be exempted from the obligations of surveillance. How effectively surveillance works in practice to influence exchange rate, interest rate and related policies in the major industrial countries remains one of the most important issues to be considered in Section IV.

On the issue of transparency as it applies to the IMF, the project currently under way indicates that most members are prepared to have public information notices (PINS) released on the Executive Board discussion of their countries following Article IV consultations. Similarly, there is broad acceptance to the release of IMF policy documents, and in several recent instances (e.g., the draft on the establishment of an Independent Evaluation Office), public comment has been sought prior to the taking of final decisions in the Executive Board. The G-7 clearly wish to press the transparency initiative further by supporting "the principle" of the release of IMF Article IV staff reports as well as the Reports on the Observance of Standards and Codes (ROSCS) but consensus has not been reached in the Executive Board on the results of the "pilot" projects still in train.

On the complex issues surrounding the involvement of the private sector in the prevention and resolution of financial crises, there is broad agreement that its participation is essential. And that, in the interest of minimizing moral hazard, the official community should not provide such large "packages" of funding as would enable the private sector to exit during a crisis. The major question still to be answered is how that participation is to be ensured.

The final issue on which there is a consensus is in the governance area and relates to the narrow question of the selection of the Managing Director of the IMF. A high degree of agreement on this subject was foreshadowed by a press release authorized by the Executive Board while it was still in the midst of the selection process declaring that this was a "very important decision"; that the decision would be based on a discussion of "the exceptional qualities that the next MD will require" and that "the process of choosing the best person for the job from the possible candidates will, through the Board, involve all members of the Fund".[9] The Executive Boards of the IMF and the World Bank Group have subsequently established working groups to review the process for the selection of their respective chief executives and their reports will be submitted to their respective Boards of Governors at the next Annual Meetings in September 2000. However, since both incumbents have been appointed recently to five-year terms, any decisions on the selection process carry no immediate relevance. Other issues on the governance agenda have far greater significance and are treated in the following two sections.

II. Issues in Contention:

This section reviews issues that remain in contention from a developing country point of view. Among them, the following are of special importance and are examined in six sub-sections:

- the extension of the surveillance exercise to cover the implementation of international standards and codes;
- the modalities for the involvement of the private sector in crisis resolution with special reference to "standstills" and debt workouts;
- the pricing of IMF non-concessional facilities;

[8] *Ibid*

[9] IMF Press Release No. 99/56 dated 11/23/99

- the liberalization of the capital account and the choice of exchange regimes;
- the content of IMF conditionality and its bearing on country ownership and
- the governance of the IMF.

a. Fund surveillance: There has been a steady extension of the ambit of Fund surveillance beyond its traditional concern with macroeconomic conditions and monetary, fiscal and exchange rate policies in individual member-countries and with the functioning of the international monetary system. The rapid growth of private capital flows and the series of financial crises associated with massive reversals of such flows has focused attention on financial sector issues, with special emphasis on the need for better identification of sources of vulnerability and measures to prevent the emergence of crises. The G-7 Finance Ministers expect the IMF "in conducting its surveillance work, (to) continue to sharpen its focus on macroeconomic policy, capital flows and structural issues which have an impact on macroeconomic stability, in particular in the financial sector, and on exchange rates with a view toward encouraging countries to avoid unsustainable regimes". The Economic Summit leaders seek a qualitative shift in the nature and scope of IMF surveillance to prevent crises and expresses determination to strengthen efforts to implement international codes and standards, "including through their incorporation in IMF surveillance".[10] While welcoming the development of "codes, standards and best practices", developing countries are equally emphatic that "the scope of surveillance should not be extended to cover the observance of such codes and standards, which should remain a voluntary choice by each member"[11] Earlier, G-24 Ministers had explained their reservations by noting that assessments of practices in these areas "should take fully into account their institutional capacities and stage of development, so as not to place developing countries at a comparative disadvantage"." They also warned that increased attention given to these matters is "acceptable as part of Fund surveillance as long as it remains within the core competencies of the Fund and subscription to international standards remains voluntary".[12] These cautions suggest that while developing countries are prepared for the IMF to develop internationally agreed standards in the areas of data dissemination, fiscal transparency and transparency in monetary and financial policies, they are less prepared to have IMF surveillance extend to monitoring their observance of standards or to be measured against them. This reluctance applies especially strongly to areas beyond the IMF's traditional expertise, such as securities, investment funds, insurance, accounting, auditing and corporate governance. While IMF Management has offered assurances that it would work closely with the World Bank Group and other institutions, including standard-setting bodies, and that the preparation of assessments would be carried out in a phased manner, the insistent tone of industrial country pronouncements [13] leaves much uncertainty about how these assurances will apply in practice.

Another set of apprehensions relates to how much disclosure of surveillance judgements is to be required. U.S. Secretary of the Treasury has argued that the focus of surveillance "should shift from collecting and sharing information within the club of nations to promoting the collection and dissemination of information for markets and investors"[14]. Developing countries argue that as a cooperative of Governments, the IMF cannot be expected to serve as a super-rating agency for the

[10] *op.cit*, paragraph 8. The language in this context is quite pontifical: "We are determined to strengthen our efforts to this end…."

[11] G-24 Communique (April 15, 2000), paragraph 14

[12] G-24 Communique (September 22, 1999).

[13] Note, for instance, the statement of the U.K. Chancellor of the Exchequer and Chairman of the IMFC that internationally agreed codes of conduct "will only work if there is an effective and authoritative surveillance mechanism…The building block is already present in the IMF Article IV process to which all IMF member states are committed by their treaty obligations. It (surveillance) must become broader, encompassing not just macroeconomic policy but the implementation of the codes and standards on which stability depends".(*Vide* Speech delivered July 13, 2000 to the Royal Economic Society).

[14] Speech delivered at the London Business School on December 14, 1999

benefit of private markets nor should it issue public warnings that are likely to become self-fulfilling prophecies.

b. Private Sector Involvement: As noted earlier, the official community is agreed that the private sector should participate in the prevention as well as the resolution of financial crises. On the prevention side, the major question relates to the disclosure practices of financial institutions, especially in relation to their funding of the activities of highly leveraged institutions (HLI) such as hedge funds and their operations in offshore financial centers where a significant proportion of unregulated hedge funds are located. The recommendations in these inter-related areas that have been the subject of studies by the Financial Stability Forum (FSF) Working Groups are largely of a self-restraining character. The G-7 Ministers are not prepared to recommend "at this stage, direct regulation of the currently unregulated HLIs", indicating their desire to propitiate private financial interests in their own markets. The transparency obligations and regulatory restraints being applied to developing countries are not yet to be balanced by a commensurate application to entities whose operations have generated such disruptive market dynamics in those countries' markets.

On the crisis resolution side, there is a whole skein of issues. The fundamental one, however, is whether private sector involvement should be based on the use of concerted techniques applied under a rules-based framework or should it be decided on a "case-by-case" basis. The choice between the two approaches is not along a North-South divide. A number of European countries and Canada favor "clear rules determining when the private sector is to be "bailed-in". Others (including the United States) argue for constructive ambiguity". [15] The former group would establish a presumption that concerted private sector involvement would be required if IMF resources needed for dealing with a financial crisis exceed some prespecified limits on members' cumulative access to Fund credit. Use of IMF resources beyond such limits would be conditioned on the imposition of a standstill analogous to one that features in most domestic bankruptcy proceedings. The possibility of the debtor country being able to declare a standstill, together with some form of official acknowledgement, is seen as essential for bringing otherwise recalcitrant creditors to the table for negotiations. Those opposed to establishing a predictable framework are concerned that apart from adversely affecting the efficient operation of international capital markets, that it might accelerate a rush for the exits by creditors and impede a resumption of spontaneous market access by the country concerned as well as producing large spillover effects for other countries. While developing countries have not yet articulated a firm position, the interests of smaller countries would indicate a preference for a rules-based framework. This would constitute an important step to developing in the international sphere a bankruptcy regime analogous to the one existing in the domestic arena. Another step would be to generalize the incorporation of collective action clauses in international bond contracts, a possibility now available for those floated on the London market.[16]

Beyond the standstill issue lie larger questions of the arrangements for orderly and equitable debt workouts. Where the problem is essentially one of liquidity (here defined to mean where a rapid return to market access on reasonable terms is deemed likely), it might be sufficient to arrange for debt rollovers with the help of an IMF-supported program that serves a catalytic function. Where the prospects for a rapid return are poor (due either to the country's own situation or because the markets are in a disturbed condition) it would become necessary to visualize debt restructuring, and in extreme cases, debt write-offs. The IMF role as a "gate-keeper" for Paris Club debt re-organizations is well established and has been strengthened in the context of the HIPC Initiative. This role, however, is concerned with debts of sovereigns and where the credits are officially granted or officially guaranteed. The IMF role is far more problematic where it is dealing with private sector creditors and

[15] Speech delivered at the International Law Association Biennial Conference in London (July 26, 2000).

[16] The G-7 Finance Ministers recommend that the use of collective action clauses should be facilitated in bonds issued in their own financial markets. They also ask the World Bank and other Multilateral Development Banks to have such clauses used in international sovereign bonds or loans for which provide a guarantee.

claims a "preferred creditor" status in relation to them. Developing countries have insisted on the principle that the IMF not be a party to the negotiations between the debtor country and its private creditors.[17]

Developing countries tend to be generally unconvinced that the official community will be able to overcome the powerful resistance of private sector to concerted techniques for their involvement. They would much rather that the IMF were equipped with an emergency facility that could decisively underpin confidence in the international system when confronting speculative excesses in private capital markets. In a world where these markets can mobilize enormous sums in very short order to attack any country's currency, the IMF could succeed in facing down market speculators only if it has the power to create international reserves freely through a prototype SDR mechanism.[18] While their arguments are made in the context of helping individual member-countries subjected to speculative attack, a more nuanced position has been offered by the former IMF Managing Director, Michel Camdessus, who proposes that "in the event of a "systemic credit crunch" the IMF should be authorized "to inject additional liquidity – and to withdraw it when the need has passed – in a manner analogous to that of a national central bank, through the creation and selective allocation of SDRs"[19] The Independent Task Force of the Council on Foreign Relations proposes a "Contagion Facility "that would be funded by pooling a one-off allocation of SDR".[20]

c. IMF Facilities: Several issues in this area were settled, as noted earlier, in light of the G-7 Summit decisions. However, some new ones arose from the same sources. One relates to the "priority to early progress in achieving a streamlined, incentive-based structure for IMF lending that encourages countries to develop stable access to private capital markets on a sustainable basis".[21] To this end, "the new pricing structure should establish more consistent objectives across facilities…discourage prolonged use of, and deter inappropriate large-scale access to IMF resources, thus contributing to their more efficient use. For all non-concessional facilities, the interest rate should increase on a graduated basis the longer countries have IMF resources outstanding. The possibility of adding a premium when the scale of financing goes beyond certain thresholds should be explored. In addition, for countries that continuously resort to IMF facilities, the IMF should make more intensive use of prior actions and limit access to its resources". They also ask for "steps to encourage early repurchases once the IMF borrowers have returned to a sustainable economic and financial path".[22] This set of proposals for tightening the terms of IMF credit are ostensibly directed to ensuring that Funb financing is not treated as a cheaper substitute for available market financing and to delay adjustment. Developing countries consider the rationale offered to be unconvincing and since changes in the terms of IMF credit require a qualified majority of 70 percent to be enacted, they would be able to block the G-7 proposals, provided they maintain solidarity.

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[17] See speech by Dr. German Suarez, President of the Central Reserve Bank of Peru and current Chairman of the G-24 at the inauguration of the Twelfth Technical Group Meeting of the G-24 (Lima, March 1, 2000). He would expect the IMF "to play the role of a facilitator – and not an arbiter – for an agreement between debtor countries and (their) private commercial creditors."

[18] The case for such a mechanism has been made in papers prepared for the G-24 Research Program. See Montek S. Ahluwalia: "The IMF and the World Bank in the New Financial Architecture" and Aziz Ali Mohammed: "Adequacy of International Liquidity in the Current Financial Environment" (published in Vol. XI of International Monetary and Financial Issues for the 1990s (United Nations, 1999). Both papers envisage that SDR allocations created for emergency lending would be cancelled once the emergency ends.

[19] Remarks at the Institute for the Study of Diplomacy, School of Foreign Service, Georgetown University titiled "The IMF We Need" (February 4, 2000)

[20] Council on Foreign Relations Independent Task Force Report on The Future of the International Financial Architecture (New York, September, 1999)

[21] *op.cit.*, fn.5, paragraph 9.

[22] *Ibid* paragraph 11 (a) and (b).

Developing countries are even less persuaded by another proposal of the G-7 Finance Ministers, *viz*., the call "to explore….appropriate use of any resulting increase in IMF income within the existing framework of the Articles with the objective of targeting support to poorest countries".[23] The effect of this recommendation would be to shift the burden of helping the poorest from the developed member-countries to those somewhat less poor. It would be tantamount to repealing an implicit contract that underpins the weighted voting power that the rich countries exercise in the IMF, namely, that this "democracy-deficit" is justified by the contribution that the richer countries are expected to make for providing resources to the IMF, particularly concessional resources.[24]

d. Capital Account Liberalization and the Choice of Exchange Regime: The major issue in contention is the degree of national autonomy that countries exercise in regard to the management of their capital accounts. A powerful campaign launched in the mid-1990s, with strong ideological overtones, for an IMF supervised regime reached its peak in 1997 when the Interim Committee resolved to invest the institution with statutory authority to promote capital liberalization. This push has tended to lose momentum in light of the subsequent experience with the massive volatility of private capital movements, that created enormous havoc in a succession of emerging market countries. While the IMF has continued to argue for liberalization, it has qualified its advocacy with cautions about the process being gradual, orderly and properly sequenced. There is particular emphasis on having in place a strong regime of prudential regulation and supervision of domestic financial systems and equally strong liability management policies aimed at producing sustainable debt ratios and debt profiles covering external and domestic currency debt, of both private and public sector. As regards capital inflows, there is acceptance of the need to deter large-scale short-term capital with the help of indirect price-based policy tools such as the reserve requirements used by Chile and Colombia in recent years. There is less agreement on whether direct administrative controls are desirable, although these might be preferable in the case of underdeveloped regulatory systems. In the case of capital outflows, there is a tendency to consider them as unworkable, especially if they are introduced during a crisis. Ocampo has argued that "a permanent system of capital account regulation which can be strengthened or loosened throughout the business cycle is preferable to the alternation of free capital movements during booms and quantitative controls during crisis"[25]. Moreover, any use of concerted techniques for involving the private sector in crisis resolution would have to provide for the suspension of debt service payments, including through the application of exchange controls on private sector payments.

The importance of maintaining national autonomy in the choice of exchange regime also bears on the management of the capital account. Developing countries are being pushed, on the basis of the "impossible trinity" argument to choose between "corner" solutions: either free floats or currency board arrangements. Yet most developing countries continue to operate intermediate regimes and there are grounds on which such choices can be justified.[26] In any event, such intermediate regimes would have a better chance of operating successfully in tandem with capital account regimes that allow for capital controls, whether of a price-based or administrative character. Developing countries would favor an acceptance by the IMF of the possibility of using capital controls as a regular instrument of national policy instead of treating them as temporary devices to deal with emergency situations in countries with poor prudential regulations.

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[23] *Ibid,* paragraph 11 (c).

[24] In a moment of candor, the IMF Managing Director notes that the prospects of implementing the proposed changes are not promising "because a big group of countries within the Fund feel lectured (to) by the presentation of these ideas". (He was answering questions at the National Press Club in Washington, D.C. *Vide* IMF Survey, Vol. 29, No 16, August 14, 2000).

[25] Jose Antonio Ocampos, Executive Secretary, ECLAC titled "Recasting the International Financial Agenda" (memeo).

[26] See IMF Survey (August 28, 2000) reporting on Jeffrey Frankel's search for the "missing middle". Also John Williamson: Exchange Rate Regimes for Emerging Markets: Reviving the Intermediate Option (Institute for International Economics, Washington, D.C.)

e. Conditionality and Country Ownership: This has been a traditional area of contention and the controversies have intensified in the wake of IMF interventions in the East Asian countries, Brazil and transition countries. In addition to questions about the correctness of technical conditions (e.g., over-emphasis on fiscal retrenchment, balance of payments adjustment biases at the expense of growth and social spending, insistence on structural measures beyond those required for macroeconomic stabilization), developing countries have argued that new conditions of a political economy character relating to governance (rule of law, judiciary reforms, civil society participation etc.) have represented an unwarranted invasion of national sovereignty.[27] The number and variety of conditions applied had made for great difficulty in meeting them and has tended to delay disbursements. There has been a greater willingness on the part of IMF Management to streamline conditions and to restrict structural conditions to those essential measures that are "macro-relevant" and in the Fund's core area of responsibility.

The debate has moved further, with a good deal of new thinking on whether conditionality undermines "ownership" of programs by the borrowing country and thereby contributes to program failure. While the fiduciary responsibility of the IMF to safeguard the use of its resources leaves the institution little choice in the matter, there is scope for putting greater effort into fostering country ownership by assuring a more active involvement of the authorities in the diagnosis and prescription of measures to resolve the problem that led to their approaching the IMF in the first place. Such an approach would be precluded in the presence of crisis situations but provided the country makes a timely approach, a negotiating process that allows for serious consideration of alternative designs and time-paths for the implementation of an adjustment program would appear to be essential reform of IMF practice.

f. Governance of the IMF: There are several issues in contention, of which perhaps the single-most significant is the influence of developing countries in the decision-making process of the institution. The original concept of the IMF as a cooperative institution has eroded as industrial countries have not needed to borrow from the IMF – a consequence of the growth of global capital markets. With the membership split between "structural" creditors and "structural" debtors, the former group has felt no constraints about elaborating conditions to be applied to the latter group, since they were most unlikely to apply to themselves. A manifestation of this tendency has been the growing arrogation of decision-making by smaller groups of the industrial countries, notably the G-7 which are then pushed through the IMF on the basis of weighted voting power.[28] This has been noted, for example, in the 1999 Economic Summit decisions relating to the enhancement of the HIPC Initiative which were then adopted by the Executive Boards of the Bretton Woods institutions, despite the fact that the enhancement added to the costs of the Initiative for these (and other multilateral) institutions (as well as other creditor governments) and the G-7 made no commitments of their own on how these costs would be met.. Even more striking is the use of unusually strident language in G-7 Finance Ministers report at their Fukuoka Meeting last July. In a preamble to their Report, the Ministers state that they "are determined to implement *all the measures in this report, as well as the broad range of measures endorsed at the Cologne Summit*" (italics supplied). While this sentence is followed by a reference to working together with other members of the international community, the context suggests that this is for the purpose of making "steady progress" towards implementing their decisions.

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[27] Seee a paper by Davesh Kapur and Richard Webb titled "Governance-Related Conditionalities of the IFIs" presented at the XII Technical Group Meeting of the G-24 Research Program in Lima, Peru. (March, 2000) memeo.

[28] The group can be even smaller as when the U.S. Congress legislates on the governance of the IMF and the other members of the G-7 are required to fall in line in order to obtain Congressional consent; an IMF quota increase requires a qualified majority of 85 percent of total votes and the USA enjoying a veto with its 17.5 percent share in total votes; a similar veto applies to other major decisions i.e. the sale of IMF gold, SDR allocations and amendment of the Articles of Agreement

Substantial changes in IMF governance would probably require an amendment of the Articles and there is little possibility of such an amendment passing the U.S. Congress that would result in a surrender of its voting power. There might be other changes, as for instance, in constituency representation on the Executive Board that might be contemplated through a voluntary act of international solidarity on the part of (say) the European countries agreeing to cede some of their Chairs to (say) the sub-Saharan African countries who must now make do with only two Chairs to represent some 40-plus member-countries. A more significant change could come about from a re-allocation of quota shares on the basis of radical changes in the formulae for the calculation of quotas e.g., by moving to purchasing-power-parity exchange rates instead of market exchange rates for converting the chosen variables to a common denominator.[29] Another possibility would be to formulate group (rather than country) focused criteria for quotas, such as was done at the time it was decided to raise the quotas of OPEC members in the 1970s'. A group criterion could, for example, take into account the agree of volatility in private capital movements and/or the extent of integration into global capital markets as variables in order to give greater weight to the emerging market economies whose problems constitute such an important part of the IMF's work in a world that will continue to be dominated by global capital markets.

III. Issues Relating to Industrial Countries: This paper has focused on IMF issues that have direct impact on developing countries. There are, however, another set of issues that cover the relations of the IMF with its major shareholders and that are notable for their absence from the current discussions but which an indirect impact on the developing world– issues such as

--the global implications of exchange rate movements of the principal international currencies, namely the dollar, the euro and the Japanese yen, and the fact that their fluctuations are major contributors to financial disturbance in other countries. It has been noted that every emerging market crisis in the past two decades has been associated with major swings of exchange rates and liquidity conditions in the major industrial countries.[30] Gyrations of up to 20 percent between bilateral exchange rates of the three currencies have taken place within the span of a few months or even a few weeks. Other countries are simply expected to accommodate themselves to such large movements. The lack of stable arrangements to assure the coherence of the macroeconomic policies of the major countries remains a major lacuna in the international monetary and financial system;

--the relationship of international and regional institutions for surveillance, mutual financial support and decision-making, especially in crisis situations, is another area that calls for discussion in light of changing political realities, such as the evolution of U.S. Congressional attitudes towards the IMF and other international institutions and the example set by the formation of a single currency area on the European Continent. The Japanese proposal in 1997 for the creation of an Asian Monetary Fund was too hastily withdrawn and while there has been some revival of the concept in the ASEAN+3 framework in recent days, it needs to be developed to be meaningful.

[29] A Committee headed by Professor Richard Cooper of Harvard University has reviewed quota formulas but its conclusions are not in the public domain. Actual quotas in the IMF, however, bear little resemblance to the results of the existing formulas and any new formulas would suffer from the same deficiency. Past quota revisions (with the exception of the 1976 revision of OPEC members' quotas) have placed disproportionate weight on "equiproportional" increases, thereby perpetuating the status quo. This is largely because the use of calculated quotas as the key for quota changes would have intensified the inequity of the initial distribution.

[30] See Remarks by Yilmaz Akyuz, Officer-in-Charge, UNCTAD Division on Globalization and Development Strategies at Regional Preparatory Meeting on Financing for Development held in Jakarta (August 2-5, 2000). memeo

Similar arrangements might be worthy of consideration in Latin America, the Middle East (e.g., in the Gulf Cooperation Council countries) and in North Africa;

--the exercise of voting power within the IMF, as determined by the distribution of quotas that derives historically from an arbitrary quota allocation formula designed to perpetuate the dominance of a few industrial countries[31] has important implications for the internal governance of that institution, and through that on the governance of the international monetary system. The issue is broader, however, when one considers the power alignments across international institutions with overlapping mandates and operations, including the World Bank Group, the World Trade Organization, the Bank for International Settlements, the Basel Committees and the more recently established Financial Stability Forum. The relationship of the treaty-based institutions with defined rights and obligation of members versus ad-hoc groupings, such as the Canadian-chaired Group of Twenty raise important questions on the influence exerted by a small sub-set of the membership;

--the international reserve mechanism and its current heavy reliance on a very few national currencies. While the debates of earlier decades on the supposed "benefits" obtained by the currency issuers may no longer be relevant, there remains an outstanding question about the role of the SDR mechanism in an evolving global system in need of a genuine lender-of-last-resort;

Section V. Summary and Conclusions: This paper has looked at the IMF in the light of recent debates on its role in the evolving global financial system. It has found that on certain issues, such as the scope and purposes of its lending operations, there is an approaching concensus that it should serve all its members, including the poorest and that its resources should be available for supporting structural reforms as well as for dealing with financial crises. On a number of issues, however, there remain large differences of view, including on the extension of IMF surveillance to cover the implementation of international standards and codes and the degree of permissible disclosure of surveillance documents; the modalities of the involvement of the private sector in crisis resolution with special reference to the development of arrangements in the international sphere that would be analogous to domestic bankruptcy procedures, including the declaration of standstills and principles for orderly and equitable debt workouts; recent proposals for hardening the terms for IMF non-concessional financing, including the introduction of premium pricing for longer-term and/or larger use of Fund resources; the liberalization of the capital account and the choice of exchange regimes in which national autonomy is to be preserved; the content of IMF conditionality and its bearing of country Ownership and finally, the governance of the IMF. Developing country positions have not been firmed up in all these areas, especially on the subject of private sector involvement in financial crisis prevention and resolution. However, a preference is suggested for a predictable rules-based framework rather than one derived on a "case-by-case basis. The next section enumerates four areas where debate has been muted or absent: these relate to the surveillance over the macroeconomic policies of the three principal international currency issuers; the relationship of international and regional arrangements; the distribution of power in the IMF and in the international system generally and the future evolution of the international reserve system. It is concluded that while these issues are not currently on the table for discussions on the international financial architecture. Yet they are important for the evolution of a sustainable international monetary and financial system that demands both efficiency and equity in international relations.

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[31] Buira, Ariel: An Alternative Approach to Financial Crises (Essays in International Finance, No 212, February 1999).