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The International Monetary Fund: Future Directions

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The International Monetary Fund: Future Prospects

Summary

The IMF was created in a world of fixed-parity exchange rates, where most currencies were defined in terms of the U.S. dollar and the dollar was defined in terms of gold. Countries could devalue their currencies only if they were faced with — in the original language of Article IV — "fundamental disequilibrium" in their economy and only if the IMF approved. International capital movements were restricted and cumbersome. That world has now largely disappeared. Since the 1970s, the relative value of most major currencies is determined by world currency markets, and the daily volume of international currency movements far surpasses the volume of currency circulating in most major countries. Article IV was amended in 1976 to replace the fixed-parity exchange rate system with new procedures for enhanced surveillance in the new world of flexible exchange rates.

This has led over time to the IMF having basically the same customer base as the multilateral development banks (MDBs). While the IMF's core concerns are macroeconomic and exchange rate stability, many of the factors the IMF now takes into account in its surveillance and loan programs are similar to those the MDBs consider in their development programs. The IMF is a monetary institution, not a development agency. Nevertheless, growth and development are among the purposes specified in its Articles of Agreement and its activities can have a significant impact on the economic prospects of its borrower countries.

Many ideas have been put forward in recent years suggesting ways the IMF, World Bank and other international financial institutions (IFIs) might be restructured or reformed. This report looks at proposals which have been made to alter the structure of the IMF — to change its format, add or eliminate programs, restrict the scope of its lending programs, and limit the scope of its loan conditionality.

This report discusses seven proposed ways that different authors believe the IMF should be changed: (1) Abolish the IMF, (2) Shrink the IMF, (3) Focus on Macroeconomics, (4) Streamline IMF Loan Operations, (5) Reassign Functions among the IFIs, (6) Better Coordination between the IMF and World Bank, and (7) Expand the IMF. Each is discussed and analyzed. In this way, the report hopes to give readers a better understanding of the basic issues and choices which affect the future direction of the IMF.

There are many avenues by which Congress can influence this debate. Congress must approve any increase in IMF or World Bank funding. It also frequently enacts legislation or includes directives in reports specifying goals the United States should pursue in the IFIs. The United States needs the support of other countries, however, if it wishes to effect change in the policies, procedures or structure of the IMF and the MDBs. Many of the alternatives listed above require changes in the international agencies' Articles of Agreement. This requires an 85% majority vote. Other changes may be effected by simple majority. However, this requires a broad consensus of support among the advanced industrial countries. Their views on these issues are often quite different from those expressed by policy makers from the United States. This report will be updated only if major developments require changes to be made.

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The International Monetary Fund: Future Prospects

What is the IMF's Mission?

The IMF was created in a world of fixed-parity exchange rates, where most currencies were defined in terms of the U.S. dollar and the dollar was defined in terms of gold. Countries could devalue their currencies only if they were faced with — in the original language of Article IV of its Articles of Agreement — "fundamental disequilibrium" in their economy and only if the IMF approved. International capital movements were restricted and cumbersome.

That world has now largely disappeared. Since the 1970s, the relative value of most major currencies is determined by world currency markets, the daily volume of international currency movements far surpasses the volume of currency circulating in most major countries, and no developed country — save perhaps South Korea in 1997 — has borrowed from the IMF since the United Kingdom's last standby expired in January 1979.[1] The IMF's Articles of Agreement were rewritten in 1976 to take account of the new realities caused by the system of flexible exchange rates.

The IMF now has basically the same developing country customer base as the multilateral development banks (MDBs). The balance of payments (BOP) problems of developing countries are often deeper and harder to resolve than those of the IMF's prior customer base. While the IMF's goals and core concerns (macroeconomic and exchange rate stability) differ from those of the MDBs, many of the factors the IMF now takes into account in its surveillance and loan programs are similar to those they consider in their development programs.[2] The IMF is a monetary institution, not a development agency. Nevertheless, growth and development are among the purposes specified in its Articles of Agreement and its activities can have a substantial impact on the economic prospects of its borrower countries.[3]

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[1] Some of the smaller developed countries have drawn since from their reserve tranche in the IMF. This is their own money, however. Access is automatic and borrowing it is akin to borrowing against the cash value of a life insurance policy. These were (country and IMF fiscal year): Australia (1983), Denmark (1987), Luxembourg (1984), Netherlands (1984 and 1987), and New Zealand (1982 and 1985). Australia borrowed from the IMF buffer stock facility in 1983, a specialized use of IMF resources. None have borrowed since 1987.

[2] For a further discussion, see CRS Report RL32364, *International Monetary Fund: Organization, Functions, and Role in the International Economy*, April 22, 2004.

[3] As set forth in its Articles of Agreement, the purposes of the IMF are (1) to promote international cooperation on international monetary problems, (2) to facilitate the expansion (continued...)

In many respects, the IMF's role in the world economy is much different than it was before. BOP lending continues to be a principal focus of IMF activity, to help countries correct maladjustments in their balance of payments without resorting to practices damaging to the world monetary system. However, with the end of the fixed-parity exchange rate system, the IMF's role in relation to exchange rates has changed substantially. In 1976, new language was added to Article IV requiring countries to pursue economic policies which generate orderly economic growth with reasonable price stability and a monetary system which does not produce erratic disruptions of the international monetary system.[4] The IMF was told "to exercise firm surveillance over the exchange rate policies of members" and to "adopt specific principles for the guidance of all members with respect to those policies."

The IMF was given no disciplinary tools, however, to exercise these functions. Currency values are determined in the marketplace, based partly on the strength of a country's foreign exchange reserves but mainly on the strength of its national economic policies and the market's confidence that sound policies will be maintained. The IMF has no role in exchange markets. Article IV now directs the IMF to consult annually with each IMF member country about its exchange rate and other economic policies. The staff submits an Article IV consultation report to the executive board annually summarizing these discussions and assessing economic conditions for each country. Article XII says that, without the permission of the country involved, the IMF may not publish information about these consultations. Since 1997, however, the IMF successfully persuaded an increasing number of countries to allow publication of their Article IV reports. The IMF has also expanded its technical assistance functions and broadened its role as a source of data about economic conditions and economic performance in its developing countries.

It is in this context that debate arises about the IMF's purpose, its policies, and it operating procedures. Some analysts argue that, with the end of the fixed-parity system, the IMF is no longer needed and it should be abolished. Others say the IMF

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[3] (...continued)
and balanced growth of international trade, promoting high levels of employment and real income and the development of productive resources in all member countries, (3) to promote exchange rate stability and to avoid competitive exchange rate depreciation, (4) to help establish a multilateral system of payments among countries for current transactions and to help eliminate foreign exchange restrictions which hamper world trade, (5) to make loans to member countries on a temporary basis with adequate safeguards for repayment, "thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity," and (6) to shorten with such loans the duration and to lessen the degree of disequilibrium in the international balances of payments of members.

[4] More specifically, Article IV requires that each country "(I) Endeavor to direct its economic and financial policies towards the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances, (ii) Seek to promote stability by fostering underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions, (iii) Avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain unfair advantage over other members, and (iv) Follow exchange rate policies compatible with the undertakings of this section."

is still vital but it needs to be restructured and its operations refocused. Still others suggest that new functions should be added to the IMF and its role in the international monetary system should be expanded.

Much of the discussion about the IMF's role centers on the issue of "mission creep," the idea that the IMF has broadened its agenda, taken on new functions, and expanded its mission into new areas not contemplated or perhaps not intended by its founders. Not everybody agrees that there has been mission creep. Many believe the IMF's basic mission has not changed, but — because of changes in the world financial system — it has had to evolve new procedures and new criteria in order to carry out its mission successfully.

Analysts, critics and non-critics alike, agree that a broad interpretation of the IMF's Articles of Agreement has been necessary to justify its new activities and its increased emphasis on poverty and economic development. This has raised, to a greater extent than before, questions (in Congress and elsewhere) about possible overlap between the activities of the IMF and those of the MDBs (particularly the World Bank) in developing countries.

Box: The International Financial Institutions

The International Monetary Fund (IMF) makes loans to help countries address financial or balance of payments crises. The IMF is a monetary institution, not a development bank. It does not finance projects or programs. Its principal responsibilities include stability of the world's monetary system and oversight of its member countries' exchange rate and economic systems.

The World Bank is a multilateral development bank (MDB) which makes loans (and some grants) to promote poverty-alleviation, economic development and growth, and economic policy reform in low- and middle-income countries. Two of its facilities, the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) lend directly to governments to finance projects and programs. The IBRD lends at market-based interest rates. IDA aid is highly concessional and is available only to low-income countries. They also make non-project loans to promote economic policy and institutional reform. Two other facilities, the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) also work with private firms to promote private sector growth.

The Regional Development Banks are MDBs which operate in specific areas of the world. They are independent bodies, not subsidiaries of the World Bank. The United States is a member of four regional banks: the African Development Bank (AFDB), Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), and Inter-American Development Bank (IDB). Except for the EBRD, the regional banks all have facilities — like the IBRD and IDA of the World Bank — which lend on market-based and concessional repayment terms.

Overlap With World Bank Activities

Whether one sees IMF and World Bank overlap as a problem or a necessity will depend on one's expectations about their roles in the world economy. Some believe they have distinct goals and unique functions. Any overlap in their activities is deemed unnecessary. Others believe the IMF and World Bank share a global agenda, yet retaining their own set of core activities. Though some have made proposals, others find it hard to separate the issues which should be the exclusive responsibility of the Fund from those which should be the exclusive jurisdiction of the Bank. As peoples' expectations differ, this debate will likely continue for some time. Congress will be an active participant through its oversight and appropriations role

"Mission Creep" or Effective Adaptation?

What some people call "mission creep" others call effective adaptation on the part of the IMF to new conditions and new requirements. The issue of mission creep has both functional and legal dimensions. The IMF's independent internal evaluation unit summarized the question in a 2002 report:

> The international community increasingly looks to the IMF to help developing countries — particularly the poorest — implement and maintain policies and institutions needed for the achievement of sustainable growth.... The fundamental objectives of the IMF, as set out in Article I of the Articles of Agreement, are sufficiently broad that they could encompass such an expanded role. However, this raises the basic question of where a legitimate adaptation of roles ends, and where inappropriate "mission creep" begins.[5]

Parkinson and McKissack, senior officials with the Australian Treasury, explained the issue in a 2003 report prepared for their government.[6] In part, they say, mission creep occurred at the behest of the IMF's shareholders, who asked the Fund to pay more attention to a range of areas only loosely related to its original purpose. They cite, for example, the IMF's increased attention to military expenditures, poverty reduction, and economic growth. In addition, they say, pressure for the IMF to expand the scope of its activity has also arisen as changes have taken place in its membership. With the end of the cold war, they note, countries with very different types of economic systems sought to make the transition to market economies. Likewise, the IMF found that many of the basic monetary and financial institutions in these countries and in developing countries were dysfunctional in ways that made more difficult the traditional application of macroeconomic conditionality. Consequently, they say, the IMF gave more consideration to institutional and structural issues because of their implications for macroeconomic stability and growth.

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[5] Independent Evaluation Office, *Evaluation of the Prolonged Use of Fund Resources*, International Monetary Fund. September 25, 2002. Pg. 110.

[6] Martin Parkinson and Adam McKissack. The IMF and the Challenge of Relevance in the International Financial Architecture. [Australian] Treasury Working Paper 2003-01, October 2003. Australian Government. The Treasury. Available at [http://www.treasury.gov.au]. Type authors' names in the keyword box.

Parkinson and McKissack report that there are some 40 separate issues covered in every IMF Article IV surveillance report.[7] Ultimately, they say, the key issue in mission creep is knowing where to stop. Almost any economic issue can be linked in some way to macroeconomic policy, they conclude, but lines should be drawn and not all of them need be considered. The temptation to expand might be diminished, they propose, if the Fund's technical assistance functions were shifted to other international agencies and it consulted with them instead.

Some critics argue that the IMF must reduce the scope of its operations because — they say — its new functions and activities violate the terms of its Articles of Agreement. Hockett says that, from a legal point of view, however, the question of mission creep is clear.[8] The IMF Board of Governors has final authority to interpret the IMF's Articles. If new measures are justified by its reading of the Articles and by reference to exigencies and changes in the world economy and the world financial system, he said, that is legally the end of the matter. Arguments that the IMF must drop these concerns because they are not included in its Articles are based, he said, on unsound legal premises. The question, he concluded, is not whether the IMF has the authority to deal with issues which go beyond the area of macroeconomic and exchange rate policy but whether its attention to these concerns is appropriate and whether other international agencies are better positioned to deal with them.

Early Beginnings

It was originally thought at Bretton Woods that the IMF would focus on the short-term and on monetary and balance of payments (BOP) issues while the Bank would look at the long-run and concern itself with economic development, production, growth and project support. This division of labor was spelled out in a 1966 internal memorandum. The IMF would have jurisdiction "for exchange rates and restrictive systems, for adjustment of temporary balance of payments disequilibria and for evaluating and assisting members to work out stabilization programs as a sound basis for economic advice." The Bank's responsibility would be "for the composition and appropriateness of development programs and project evaluation, including development priorities."[9]

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[7] Article IV of the IMF's Articles of Agreement specifies that the IMF "shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principals for the guidance of all members with respect to those policies." To carry out that duty, IMF staff meet annually with senior officials of each member country to assess its economic condition and its compliance with Fund-approved standards and guidelines. An annual Article IV consultation report is prepared for each country. If the country permits, each report is posted on IMF web page, at [http://www.imf.org]. Select "Country Information" at the top of page. Countries have a right to refuse publication of these reports, thought the identity of the countries blocking publication can be easily determined.

[8] Robert Hockett. "From Macro to Micro to 'Mission-Creep': Defending the IMF's Emerging Concern with the Infrastructure Prerequisites to Global Financial Stability." *Columbia Journal of Transnational Law* 41:153 (2002).

[9] Quoted in Graham Bird. "A suitable case for treatment? Understanding the ongoing debate about the IMF." *Third World Quarterly* 22:4 (2001), 823-48.

The IMF had concluded in the early 1970s, however, that payments deficits could be caused by structural problems in a country's economy and long-term assistance was needed to address them. In 1974, it created the Extended Fund Facility (EFF) to make long-term loans to promote BOP stability through basic change in institutions and the structure of the borrower's economy. Under the 1966 agreement, this task was entirely within the jurisdiction of the World Bank. In 1976, the IMF began making long-term low-interest stabilization loans to poor countries through the Enhanced Structural Adjustment Facility (ESAF) and its predecessors. In 1999, the ESAF was refocused and renamed the Poverty Reduction and Growth Facility (PRGF). Among other things, the PRGF plan required the IMF to work with the World Bank and developing countries to formulate Poverty Reduction Strategy Papers (PRSP) which would be supported by its loan program. In the late 1990s, in response to a series of international financial crises, the IMF began including institutional and structural change in its loan conditionality.

The overlap between the functions of the IMF and those of the MDBs was not necessarily the result of a one-sided IMF invasion of the other agencies' "turf." In the 1970s, when the IMF began making loans to promote structural change, the MDBs focused primarily on project finance. Since the early 1980s, however, the MDBs have expanded their emphasis in areas — such as macroeconomic stability and policy change — which were traditionally seen as the purview of the IMF.

Adjustment loans are now a major component of the World Bank's annual loan program. From less than 4% of total lending in 1980, adjustment lending has grown substantially in recent years. By 1990 it comprised 27% of all World Bank lending. In 1999, during the world financial crises which followed Russia's default of its debt, adjustment loans accounted for 53% of the World Bank's annual aid. In the past three years, about one-third of the money lent by the World Bank has gone for adjustment loans.[10] The Bank is considering a plan to rename the program and to call these "development policy" loans in the future.[11] However, though the word "adjustment" will be eventually dropped and more emphasis will be put on growth and consultation with civil society, the basic requirements for macroeconomic and institutional change will be essentially the same in the newly re-named program as before. The regional MDBs have also expanded their levels of lending for adjustment-type programs. Only the European Bank for Reconstruction and Development (EBRD) — which has a more private sector focus — continues to allocate most all its aid for investment projects.

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[10] Three years ago, the World Bank undertook a major review and evaluation of its adjustment loan program in order to determine what had worked and what had not. See World Bank. *Adjustment Lending Retrospective: Final Report*, June 14, 2001. Prepared by the Operations Policy and Country Services Department. Available through the World Bank web page at [http://www.worldbank.org]. Type title in inquiry box.

[11] World Bank. *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy.* March 15, 2004. Operations Policy and Country Services Department. Available through the World Bank website at [http://www.worldbank.org]. Type title in inquiry box.

Adjustment loans are a specialized form of BOP support. In effect, in exchange for the loan, the country agrees to make specific policy or institutional changes. The MDB disburses its funds directly to the country's central bank. These are not used to fund inputs for development projects or development activities. In most cases, the Bank expects that countries will use the money for activities with positive development effects.[12] The developmental impact of an MDB adjustment loan comes, not from the activities funded, but from the increased productivity and the growth that occurs when the policy and institutional changes specified in the loan conditionality are put into effect.

Since 1995

In recent years, the IMF and the MDBs have sometimes used their stabilization and adjustment loan programs for common ends. In many cases, the IMF did not have enough money to fund a major stabilization program alone, or rather it did not want to leave its financial cupboard bare in case more crises occurred while other countries were still repaying their loans. To supplement the IMF's resources in times of crisis, the MDBs have sometimes lent substantial amounts for parallel adjustment operations and bilateral lending agencies have agreed to provide backup financing in case of additional need. Three instances might be cited — the Asian financial crisis and the recent crises in Brazil, and Argentina — which show the IMF and multilateral banks working jointly in their response to major financial crises.

Asian Financial Crisis. During the Asian financial crisis in 1997 and 1998, the World Bank and Asian Development Bank (ADB) lent major sums to help South Korea, Indonesia, Thailand and other countries.[13] This was, the IMF reported, "a new breed of economic crisis." In South Korea, the IMF announced a $58.2 billion program, including $21 billion of its own funds, an initial $14 billion pledge from the MDBs, and $23.3 in standby assurances from bilateral lenders. The IMF said that institutional and structural reform were the heart of its stabilization program. However, it disbursed all its money in the initial weeks of the crisis and the programs to restructure and strengthen Korea's financial institutions were managed by the MDBs. The World Bank lent $5 billion and the ADB lent $4 billion in fast-disbursing aid. Their loans were linked with programs to rebuild Korea's financial sector, improve corporate governance, and restructure its competition and labor market policies. They also provided technical aid to facilitate action in these areas.

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[12] Structural adjustment loans (SALs) promote broad changes in the structure and policy framework (not necessarily macroeconomic) of the borrower country. These are also now used sometimes to promote change at the sub-national level. Sector adjustment loans (SECALs) promote institutional and policy change in particular sectors of the economy.

[13] The IMF said later, in an assessment of the Asian crisis, that the sudden collapse of the three countries' currencies was due more to poor debt management policies, unsound banking institutions, and weak bank oversight procedures than to any specific problems with macroeconomic policy. See IMF. *Recovery from the Asian Crisis and the Role of the IMF*, prepared by IMF staff. IMF Issue Brief number 00/0-5, June 2002, available from the IMF website at [http://www.imf.org/external/np/exr/ib/2000/062300.htm#II].

Brazil. In November 1998, the IMF announced a $41.5 billion stabilization program for Brazil. Of this amount, $18.1 billion was from its own resources, $3.3 billion came from the World Bank and Inter-American Development Bank (IDB) and the rest was pledged by various countries. The MDB money was disbursed rapidly, to help Brazil cope with a very serious financial crisis. However, the MDBs targeted their money in ways which also served development objectives. To receive the banks' Social Protection and Social Sector Reform loans, the Brazilian government had to demonstrate that its domestic expenditures for health, education, and other key social services would be sustained as it strove to achieve the budget reduction goals mandated by it IMF-funded stabilization program.

Argentina. In 2000 and 2001, the IMF agreed to lend Argentina $14 billion to help it deal with a serious and growing balance of payments crisis. In January 2001 the Fund announced that the Argentines had assembled a $39.7 billion financial support package, including (besides the IMF money) $5 billion pledged by the World Bank and Inter-American Development Bank (IDB), $1 billion from Spain, and about $20 billion in voluntary refinancing by the private sector. In September 2003, the IMF agreed to lend an additional $12.6 billion.[14] That year, the IDB lent Argentina $1.9 billion and the World Bank lent $1.1 billion in fast disbursing emergency assistance to help it cope with the financial crisis. As in the Brazilian case, the Argentine government had to pledge that it would protect the budgets of priority social programs and maintain the social safety net which helped children, the poor, the unemployed and others vulnerable groups.

Two features of the MDBs' emergency aid programs for Argentina were particularly interesting. First, disbursements of the IDB funds were tied to the country's successful implementation of measures in the IMF-funded stabilization program aimed at strengthening the tax system and improving budgeting and financial management. Second, the World Bank funds were used in part for "deficit reduction efforts, elimination of quasi-monies, and regularization of salary payments" to civil servants. Clearing up the outstanding stock of national and provincial script was a central element of the IMF's program. Control of the monetary system was not possible so long as provinces could issue debt and circulate it as currency. In these two respects, the MDBs used their funds to encourage Argentine compliance with key aspects of the IMF's program for macroeconomic and structural reform. Unlike the Korean situation, though, they did not manage the reform programs themselves.

Coordinating Institutional Reform. These examples show the IMF and the MDBs working in a synchronized manner to address financial crises in developing countries. In all three instances, the MDBs provided fast disbursing money, to supplement the IMF's program, but their conditionality was targeted to bolster their prime development and anti-poverty concerns. The MDBs also addressed, either through activities they funded or through their conditionality, some of the key

[14] There was serious concern that Argentina might default (indeed it was twice overdue on payments) and many believed that the loan in 2003 was made to forestall that prospect. In March 2004, Argentina (SDR 10.7 billion) was the third largest borrower, after Brazil(SDR 10 billion) and Turkey (SDR 16 billion). For a further discussion of the Argentine situation, see CRS Report RS21072, *The Financial Crisis in Argentina*, June 5, 2003.

structural or institutional issues which the IMF said were at the heart of the problem. The IMF has expanded its program of technical assistance, to help countries design and implement improvements in their financial and monetary policies and institutions. For the most part, however, major projects for policy and institutional change are funded through projects funded and supervised by the MDBs.

Alternative Directions for the IMF

Many ideas have been put forward in recent years suggesting ways the IMF, World Bank and other international financial institutions might be restructured or reformulated.[15] On the whole, these can be separated into three categories. One is concerned about potential **changes in the policies of the institutions** — raising or lowering interest rates, including or excluding issues such as the environment, poverty alleviation, labor standards, or altering the policy conditions the international financial institutions (IFIs) attach to their loans. The second looks at possible **changes in the IFIs' procedures** — altering their systems of governance, giving developing countries or other donor countries (the Europeans' combined vote is double that of the United States) a larger say in the process or making the institutions' operational and decision making procedures more transparent and more open to outside influence. The third category involves possible **change in the architecture of the international agencies** — expanding or shrinking the IFIs' scope of operations, shifting functions or tasks from one institution to the other, or changing the way the IFIs coordinate their operations.

It is impossible to separate entirely the issues of policy and process from those of structure. Nevertheless, the present discussion focuses on architecture or structural issues, since this is the essential issue which underlies most discussion of mission creep. What should the IFIs be doing and which of them should perform what tasks? A variety of proposals might be considered.

Some people believe the IMF should be abolished, substantially reduced in size, or limited to its original focus on macroeconomic concerns. Others want a clearer line of differentiation between the IMF and the MDBs. Activities and functions should be shifted or transferred between the IMF and World Bank, they say, in order to reduce overlap and to give each a specific area of responsibility. Finally, some believe that the idea of separating the functions of the IFIs into separate boxes is an exercise in artificial clarity. The work of the IMF and the multilateral banks is inextricably linked at the functional level, they argue. Better to put more effort into policy and program coordination, they say, rather than stopping the World Bank from promoting policy changes or prohibiting IMF from looking at institutional factors that might precipitate or exacerbate a future financial crisis.

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[15] Not everyone agrees that these proposed changes are "reforms," in the sense that they will make things better. Many believe that some of the "reforms" proposed in each of the three categories would be damaging to the IFIs, hurtful to people living in borrower countries, and injurious to the world financial system. Others argue that their proposed "reforms" will be beneficial. For a comprehensive bibliography on this subject, see Nouriel Roubini's global macroeconomic and financial site at [http://www.stern.nyu.edu/globalmacro/].

Abolish the IMF

Proposal. Shultz, Simon and Wriston wrote, in an opinion piece first published in the *Wall Street Journal,* that "The IMF is ineffective, unnecessary, and obsolete." Once the Asian crisis was over, they said, it should be abolished.[16] When the IMF intervenes in a crisis, they said, governments and their foreign creditors are rescued but not the people, who generally suffer massive declines in their standards of living. Moreover, they argued, the IMF promotes moral hazard because it insulates politicians and foreign creditors from the consequences of bad economic and financial decisions. Because the IMF stands ready to protect them in times of crisis, Shultz, Simon and Wriston write, lenders make risky loans and countries pursue unsound policies and avoid real reform of their monetary and financial policies. Moreover, they say, the IMF's policy prescriptions make crises worse. From their perspective, abolishing the IMF would force countries to change their policies and to operate sound financial institutions. The private sector is better able than governments or official institutions, they say, to monitor and discipline country behavior.

Assessment. This proposal assumes that governments will undertake real reform only when they see that — absent the IMF — they will be punished, perhaps severely, rather than rewarded if they continue to pursue unsound economic policies. Some question whether governments — particularly those in developing countries — are quite so pragmatic and whether policy reform in those countries is as easy to adopt as Shultz, Simon, and Wriston seem to suggest. Without an international agency to help encourage and facilitate the process, the dissenters say, countries may be unable to muster the will and skills necessary to implement reform. Their record before 1945 was not encouraging in that respect. Moreover, many analysts will argue that Shultz, Simon and Wriston underestimate the temptation governments may feel to pursue beggar-thy-neighbor policies or to adopt macro policies which preserve monetary stability at the price of growth or opportunity for non-privileged groups.

It might be said, however, that the Shultz, Simon and Wriston proposal points to concerns that many find valid. Questions remain how the IMF should relate to the private sector, how it can promote open systems and sound financial institutions while still remaining bound by the requirements of confidentiality and consensus and where the world's major governments have the final say (through the executive board) about its policy and loan decisions.

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[16] George P. Shultz, William E. Simon and Walter B. Wriston. *Who Needs the IMF?* The Wall Street Journal, February 3, 1998. Shultz is, among other things, former U.S. Secretary of State, of the Treasury, and of Labor. Simon is a former U.S. Secretary of the Treasury. Wriston is a former chairman and CEO of Citicorp/Citibank. Their article was republished and is available through the Hoover Institution's website at [http://www.imfsite.org/abolish/needsshultz.html]. Rebuttal articles by Lawrence Summers, former U.S. Secretary of the Treasury and President of Harvard University, Robert Solomon, economics journalist, and others are also available on the same page.

Shrink the IMF

Proposal. In March 2002, the International Financial Institutions Advisory Commission (IFIAC) published a report which sought to more clearly delineate the functions of the IMF and the MDBs and to give market forces the principal role in international and development finance.[17] Its members agreed unanimously that the IMF should restrict its lending to the provision of short-term liquidity and it should cease making long-term loans for poverty reduction and other purposes.[18] A majority of the Commission, including Allan Meltzer, its chairman, also recommended that the IMF's role in the world financial system should be shrunk considerably.

The IMF would be a kind of "lender of last resort," the Commission said. It would also continue to be a source of data and provide advice to countries through its Article IV consultation process. The Commission said that all IMF Article IV consultation reports should be published.[19] The Commission recommended, however, that the IMF's lending authority should be strictly limited. It should only be able to make short-term loans — with little or no conditionality but at penalty rates of interest — and its prospective borrowers would have to qualify in advance (before any crisis occurred) by meeting "prudential" eligibility requirements. Eligible countries would need to allow full freedom of entry and operation in their domestic economy for foreign financial institutions; financial institutions would need to be well regulated in order to assure adequate capitalization and prudent behavior; and governments would need to publish regular data on their foreign debt and other off-balance sheet liabilities. Countries would also need to meet IMF fiscal requirements to assure that IMF loans do not support irresponsible budgetary policies.

The Commission said that long-term development aid, policy reform, and assistance to countries that do not qualify for IMF assistance should be the responsibility of the World Bank, though it also proposed that the Bank's scope of action and its resources should be reduced. It said that the newly renamed World Development Agency should replace its loan program with a program of grants — funded by donor contributions — emphasizing poverty alleviation, education, health, and the construction of physical infrastructure. It could also make subsidized loans to promote policy and institutional change but crisis lending would not be allowed. Borrowers would lose the interest subsidy and they would have to begin repayments immediately if, during any one year, they failed to achieve the performance standards specified in their loan.

Assessment. The arguments in support of the IFIAC plan are similar to those for the proposal by Schultz, Simon and Wriston. The frequency and severity

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[17] *Report of the International Financial Institution Advisory Commission*, Allan H. Meltzer, Chairman. March 2000. Commonly called the Meltzer Commission. Available at [http://www.house.gov/jec/imf/ifiac.htm].

[18] They also agreed unanimously that the IMF, World Bank, and regional development banks should write-off in entirety their claims against all heavily-indebted poor countries (HIPCs.)

[19] As noted, Article XII says such information can be released only if the country assents.

of the recent financial crises raise doubts, the Commission said, about the system of crisis management now in place and the incentives for private action that it encourages and sustains. They maintain that IMF lending encourages moral hazard and sends the wrong message to international lenders and borrowers. By providing countries with funds they can use to pay off foreign creditors in times of crisis, the Commission argued, the IMF implicitly assures international lenders and borrowers that they can take inappropriate risks and pursue unsound policies and the IMF will bail them out if they get into trouble. If the IMF did not exist, the Commission asserted, the market would force countries and lenders to be more prudent in their decisions and it would require that countries adjust more rapidly to changes in their economic situation.

IMF loans let countries stretch out or delay the adjustment process, the Commission said, thus prolonging the crisis and delaying the recovery which will take place only after the needed policy changes have been put into effect. Furthermore, the Commission argued, the IMF is deficient in its current form as an instrument for providing liquidity during crises. Conditioned lending, it said, with each stage disbursed over time as specified requirements are met, is not a very effective way to respond to a liquidity crisis.

Despite its criticisms, the Commission did not recommend that the IMF should be abolished. A more limited version of the IMF should be maintained, it said, in case concerted action by major central banks and — to a lesser extent action by the IMF — might be needed to address major financial crises with broad possible effects.

Many have questioned the feasibility and utility of the IFIAC plan. Some members of the panel argued, for example, that, if the IMF lent without conditionality, as the IFIAC majority proposed, "this would virtually eliminate any prospect of overcoming the crisis" since countries would not be required to abandon the policies which brought on the crisis when they resort to the revised IMF for crisis finance. On the other hand, they said, the stipulation that countries must meet an undefined IMF "proper fiscal requirement" in order to prequalify for loans would seem to require the kind of perpetual IMF oversight and discipline of country budgetary policies that the majority otherwise rejects.

Many doubt that shrinking the IMF is the right answer to the problem of moral hazard. They dispute the assertion that the prospect of future IMF lending encourages moral hazard. It is unlikely, they argue, that governments or lenders will intentionally risk a financial crisis simply on the expectation that they will be "bailed out" if things go wrong. As the *Economist* noted, "Few of those involved when a country finds itself in financial crisis escape without penalty."[20] Most foreign

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[20] "Tricky moves for the Bank and the Fund; What now for the Bank and the Fund?" *The Economist*, February 17, 2001, p. 1. Then Treasury Secretary Lawrence Summers wrote, in May 2000, that concern about moral hazard is exaggerated and "it is hard to make the case that investments in emerging markets have been heavily influenced by the expectation of the availability of official resources for bailouts." See his 2000 Richard T. Ely lecture, printed as "International Financial Crises: Causes, Prevention, and Cures." The American Economic Review: *Papers and Proceedings of the 112th Annual Meeting of the American*

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creditors and investors have lost substantially when crises occur, even though the debtor or host country borrows from the IMF. Getting the large lenders of short-term money to participate in these losses is an important issue, they agree. However, they argue, new policy arrangements are likely to be a more effective approach. The process of settling financial crises in developing countries will be more disorderly, they say, if those countries are not eligible for IMF loans and it is more likely in such situation that some creditors will be treated more favorably than others.

The Meltzer Commission says that the IMF should continue to be a source of data and provide advice to countries through its Article IV consultation process even though many of its member countries would not qualify for loans. Many doubt that this would be feasible. The statistical data and the country reports which the IMF and World Bank publish on a regular basis, are important sources of information for government, academia, and business. Krueger noted in 1999 that other international agencies, or perhaps even private firms, could provide this service instead.[21] However, she said, the fact that the IMF and World Bank are undertaking other activities probably gives them an edge in obtaining information from member country governments. "It is at least as likely that, in the absence of the other relationships between the multilateral institutions and individual governments," she said, "the data would be forthcoming later, in less reliable form, and be less accessible for researchers and other users." The same might be said — for countries ineligible to borrow from the IMF — about their openness to IMF advice, during Article IV consultations, or their willingness to discuss in detail their internal economic situation or the underlying dynamics of their exchange rate regimes.

Many also question whether developing countries will be able to reform if they are not eligible to borrow from the IMF. Presumably most countries will aspire to the status of IMF eligibility. However, without international assistance to help them cope with crises along the way, critics of the IFIAC plan argue, their path to that goal may be hard. They note that the World Bank, under the IFIAC plan, would have neither the mandate nor the resources to play the role of balance of payments lender to the countries excluded from access to the IMF. It would be able to make loans, under the IFIAC plan, to promote policy and institutional reform but monetary and exchange rate policy would be outside its terms of reference and crisis lending would be prohibited. The stiff penalty for failure (immediate repayment and termination of the interest subsidy) might discourage countries from pursuing hard but important changes in their policies and institutions and — unless they provide rapid infusions of money — these loans would be of limited use to countries suffering a BOP crisis.

Even if the Bank had the funds and the mandate, some question whether it can be simultaneously a monetary and a development institution. Monetary stability and growth often have conflicting requirements. In a sense, the first requires a quick readiness to put a foot on the brake when growth gets too fast while the second requires continuous pressure on the economic accelerator. There is a tension between

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[20] (...continued)
Economic Association 90:2 (May 2000), p. 13.

[21] Anne O. Krueger. "Whither the World Bank and the IMF?" *Journal of Economic Literature* 36:4 (December 1998), p. 1997. She was then teaching at Stanford University.

the IMF and the World Bank because they have sometimes contradictory goals. If the World Bank tries to play both roles in developing countries, it will take this source of tension into itself and its operations.

Focus on Macroeconomics

Proposal. Many commentators have argued that the IMF should reduce the scope of its activities and focus on its core responsibilities. The Meltzer Commission found, for example, that the IMF has strayed from its core areas of competence and it provides too many long-term loans with too much microeconomic conditionality. Treasury Under Secretary John Taylor reiterated this view in 2002 when he told a conference of bankers that "We need to narrow the focus of the IMF."[22]

Others have expressed similar concerns.[23] The Council on Foreign Relations (CFR) said, in a 1999 task force report, for example, that "the IMF is losing its focus and reducing its effectiveness by doing too much.[24]" The Fund needed to go "back to basics," the CFR report concluded. It should limit the scope of its conditionality to monetary, fiscal, exchange rate and financial sector policies. The Overseas Development Council (ODC) concluded, in a 2000 task force report, that the IMF should scale back its activities and focus on its core competency, which it said was macroeconomic policy.[25] The IMF should continue being a source of data and of policy advice (through Article IV consultations) for member countries. However, the ODC report said that (1) it should limit itself to providing short-term liquidity to countries hit by macroeconomic crises, (2) it should stop providing long-term development finance, and (3) it should cease its involvement with structural and institutional issues and exclude them from its loan conditionality. The latter discourages countries from coming to the IMF until they have no other choice, the task force said. It also scares away foreign investors by giving them the impression that the problems that caused the crisis in a country might be not be easy to fix.

The CFR and ODC reports recommended that the IMF should leave long-term structural change and development finance to the World Bank and the other development banks. The ODC says that structural and institutional problems take a long time to fix and they are not easily addressed during the midst of a financial crisis

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[22] Under Secretary of Treasury for International Affairs John B. Taylor, "Improving the Bretton Woods Financial Institutions" Remarks at the Annual Midwinter Strategic Issues Conference, Bankers Association for Finance and Trade, Washington, DC. February 7, 2002.

[23] For a summary of five reports on the IMF and the international financial architecture, including the IFIAC report, see John Williamson, The Role of the IMF: A Guide to the Reports, *International Economics Policy Brief Number 00-5*, Washington: Institute for International Economics, May 2000. Available at [http://www.iie.com/publications/pb/pb00-5.htm]. Also a available at [http://www.google.com]. Type title in search box.

[24] Council on Foreign Relations Independent Task Force. *Safeguarding Prosperity in a Global Financial System: The Future International Financial Architecture*. Washington: Institute for International Economics, 1999.

[25] ODC Task Force Report. *The Future Role of the IMF in Development.* Washington: Overseas Development Council, April 2000.

The CFR and ODC reports also recommend, for many of these same reasons, that the IMF's concessional loan program for low-income countries, the Poverty Reduction and Growth Facility (PRGF), should be transferred to the World Bank.

Assessment. The IMF's operations would be clearer and easier to implement if it only dealt with macroeconomic issues. It would only need to talk with the officials from borrower countries who deal with those issues and it would not need to negotiate with others about institutional and structural reforms. It could disburse money more rapidly, since changes in fiscal, exchange rate, and monetary policy can be accomplished much more quickly than can institutional change. If the MDBs also went "back to basics" — if they stopped providing BOP aid to countries in the form of structural adjustment or sectoral adjustment loans — the overlap between Bank and Fund operations would be substantially reduced. Among other things, the IMF would not need to be concerned that the macroeconomic conditionality of MDB loans might conflict with its own conditionality.

This concept might be appropriate if balance of payments crises were caused only by poor or poorly executed macroeconomic policy. However, many economists believe that structural and institutional problems can also precipitate or intensify the effects of financial crises. The IMF found in its study of the Asian financial crisis (cited above)that the crisis of 1997-8 was due more to poor debt management policies, unsound banking institutions and weak bank oversight procedures than to any specific problems with macroeconomic policy. From this perspective, even the best-laid macroeconomic policies will be ineffective in their execution if the institutions which apply it are defective.[26]

The IMF's Articles of Agreement do not specify, in Article I, what means the IMF should use to "promote exchange rate stability" or how its loans will help borrowers "correct maladjustments in their balance of payments." Article IV does not say how the IMF shall "exercise firm surveillance over the exchange rate policies of members." Macroeconomic criteria have been the means traditionally used to carry out these tasks but there is nothing in the Articles prohibiting the IMF from considering institutional and microeconomic issues as well if it finds these help it accomplish its primary mission.

The CFR and ODC reports agree that the IMF should pay attention to structural and institutional issues during its surveillance process. It is not clear from the two reports, however, what the IMF should do if it finds that institutional or structural problems in a country are threatening to undercut its monetary stability or precipitate a crisis. Should the IMF simply mention its concerns in its Article IV surveillance report or should it require countries to approach the World Bank or the regional MDBs for loans to rectify the situation? If institutional and structural issues are outside its core competence, how does it justify that requirement? What should the IMF do if the development agencies proceed in ways other than those it prefers? If the IMF has standards and guidelines to assure that the programs to revise a countries economic institutions meet its concerns, then it will have to involve itself in the

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[26] For an introduction to the institutions and economic growth literature, see "Growth and Institutions, in *World Economic Outlook, April 2003*, IMF, pp. 95-128.

details even if it does not fund the reform project. If it pays no attention, on grounds that structural reform is outside its core competence, it might find that the final results are unsatisfactory.

The CFR and ODC reports say that the World Bank and the regional banks should bear the responsibility for promoting long-term policy reform and institutional and structural change. However, if the MDBs stop making adjustment loans, in order to leave the area of BOP lending entirely to the IMF, they may have difficulty promoting the kinds of reforms the CFR and ODC envision. On the other hand, if the MDBs continue making adjustment loans in order to promote policy reform, the IMF may need some way of keeping the conditionality and timing of these loans congruent with its own operations.

Streamline Loan Operations

There seems to be general agreement that the IMF's surveillance function should be retained. There is less agreement about the policies and tools the IMF needs in order to carry out its duty to promote exchange rate stability in a world where exchange rates are largely determined by market forces. Arguably, the IMF's resources are now too small, compared to the volume of international financial flows and world trade, to undertake the stabilization role it played in the old fixed-parity exchange rate system. Likewise, the IMF cannot stop countries from pursuing policies that increase or diminish the value of their currencies even though this may have serious destabilizing effects on other countries. If countries do not need to borrow money from it, the IMF can do little more than give them advice and publicize its concern in documents such as its *World Economic Outlook* and Article IV consultation reports (if a country allows publication).

Proposals. Some experts believe the IMF's loan operations could be streamlined and its procedures simplified. Williamson[27] and Bird[28] contend, for example, that the IMF needs only two loan facilities. One would lend, with little or no conditionality, to help countries maintain liquidity when they are hit by exogenous shocks.[29] The other would lend, with conditionality, to help countries surmount balance of payments crises caused by their own policies or performance. Williamson says the IMF should address only monetary, fiscal and exchange rate issues in its loan programs, though countries should also be required to stop servicing their foreign debts when they apply for IMF aid. Bird says that structural and institutional matters should also be within the IMF's ambit of concern.

Williamson says that IMF rates should vary and countries should get better terms from the crisis facility if they prequalified in advance by adopting improvements in their domestic banking procedures, by maintaining transparency in

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[27] Williamson, "The Role of the IMF: A Guide to the Reports," *op. cit*.

[28] Graham Bird. "Restructuring the IMF's Lending Facilities," *The World Economy* 26:2 (2003), 229-245.

[29] These are events beyond a country's control, Williamson said, such as sudden changes in key import or export prices, contagion effects from crises elsewhere or natural disasters.

economic data, and by achieving good marks in their most recent Article IV report. Bird says the interest rate charged to borrowers from the crisis facility should vary depending on the country's condition and its relative compliance with specified financial norms. He also says that conditionality for the crisis facility should be relatively light by comparison with current standards but the IMF might restrict its lending in the future if borrowers fail to adequately address their problems.

Caballero argues, by contrast, that the IMF needs only one loan facility to address crises caused by exogenous events and poor policy.[30] Instead of lending in response to crises, however, he believes the IMF's main function should be one of preventing crises and stabilizing exchange rates through market arrangements. Renamed by Caballero the International Market Facilitator, the IMF would create hedge arrangements in private markets in order to insure countries against volatile capital flows. It would also help countries design macroeconomic policy frameworks consistent with those insurance mechanisms and, through its surveillance function, it would assure that countries comply with their terms.

Buira also believes the IMF only needs one loan window and he says its requirements can be very simple.[31] As chief of secretariat for the Intergovernmental Group of 24 (G-24), an association of developing countries, Buira believes the Fund should lend with virtually no conditionality, just a pledge by the borrower — as is currently the practice with IMF first credit tranche loans — that it will "make reasonable efforts to solve its problems." Under this proposal, more money should be available to borrowers and it should be repayable over longer periods of time. IMF staff should operate like outside advisors or consultants, Buira argues, helping countries choose policies and programs consistent with their goals and consistent with the Fund's mandate. The IMF should limit itself to monetary and exchange rate issues, Buira says, and should not use monetary crises as an opportunity to force basic changes in the borrower's domestic institutions or to open its economy to foreign penetration.

Assessment. A two-tiered loan program would let the IMF differentiate between countries whose crises were attributable to their own actions and those whose crises were less of their making. Macroeconomic and structural conditionality would not be necessary for countries buffeted by contagion effects, as is often the current IMF practice. This assumes, however, that the IMF will be able to discern accurately which exogenous shocks are only temporary and which herald permanent changes in the world economy. In the latter case, countries may be lulled deeper into debt through unconditioned liquidity loans and the eventual burden of adjustment may be heavier than if they had begun the adjustment process earlier.

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[30] Ricardo J. Caballero. "The Future of the IMF." *The American Economic Review*. Papers and Proceedings of the 185th Annual Meeting of the American Economic Association. Washington, D.C. June 3-5, 2003, pp. 31-8.

[31] Ariel Buira. "An Analysis of IMF Conditionality," in Buira (ed.) *Challenges to the World Bank and IMF: Developing Country Perspectives.* G-24 Research Program. London: Anthem Press, 2003, pp. 55-81.

The plan for an IMF market hedging facility would require considerable amounts of operating capital — money which the IMF does not currently have — and it presumes that the separate parts of the house built through hedging can stand even though others may fall. It also assumes that IMF's market traders can build a financial network strong enough to withstand a crisis where everyone else is betting against it. Many will dispute these assumptions. Some will also wonder why this task should be done by an international agency rather than by private firms or governments themselves. Long-term loans with little conditionality might be very desirable, from the point of view of developing countries. However, with no specific requirements, progress towards adjustment and policy change may be slow or negligible. The rich countries may be unwilling to let the IMF lend large amounts of their quota money for long periods without some assurance that conditions in the borrower will improve and the money will be repaid.

Reassign Functions And Authority

Proposal. Gilbert, Powell, and Vines say there needs to be a new agreement on the division of labor between the World Bank and the IMF.[32] Overlap in their functions is inevitable, they say, and there needs to be clear agreement about the terms on which the two agencies share the common ground. Each should focus on its own core mission — the IMF on macroeconomic and crisis resolution and macro-policy advice and the Bank on long-term development, including microeconomics and trade and industry issues. The authors say there should be an agreed list of competencies and a division of lead responsibilities, though in all areas there should be an obligation to consult. In each area, one agency would have the final authority and the other would have a right to be consulted and to give its views. In some instances, for example, the IMF might have the final say regarding certain macroeconomic aspects of World Bank and the Bank would have similar authority regarding certain social or developmental aspects of IMF stabilization programs.

Assessment. A formal division of labor and authority may be useful, particularly in areas where the Bank and Fund agree. It may be less workable, though, when they disagree. Even if the IMF had final authority regarding balance of payments aid, for example, the Bank might not be willing to let the Fund veto its development policy loan or adjustment loan operations. Even if the Bank were the final authority for growth and development policy, the Fund might not be willing to let the Bank decide how rigorous the terms of its stabilization programs should be. By itself, authority on paper may not be very durable. Agencies will likely define problems or issues in such a way as to ensure that they fall within their area of jurisdiction. Furthermore, if an agency has overall responsibility for a program, it will probably follow its own judgment rather than acquiescing to decisions by others. Likewise, if an agency sees a problem which impacts its core mission, it is more likely to deal with the issue itself rather than ask someone else to do the job. The IMF's establishment of the EFF and the ESAF in the 1970s is a case in point.

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[32] Christopher Gilbert, Andrew Powell and David Vines. "Positioning the World Bank." *The Economic Journal* 109 (November 1999), F598-F633.

Some of the overlap could be reduced if functions were shifted between the agencies. Transferring the PRGF to the Bank has already been discussed. This would not solve the tension, but it would put all the agencies which deal with poor countries under the World Bank President, who could settle disputes. Transferring the IMF's technical assistance functions elsewhere, as the Australian report suggested, would be another possibility. However, the Fund would still need to talk with them about common concerns. Alternatively, all the functions in the World Bank and the regional banks which deal with banking, finance, and corporate governance could be shifted to the IMF. It would then serve as advisor, regulator and source of funding for projects to strengthen and improve institutions and policy in these areas. However, this would make the IMF a development lending institution.

Better Bank/Fund Coordination

Proposal. Some would argue that dividing up the functions and putting the World Bank and IMF into separate boxes may not be a practical design. The Bank and Fund have different mandates but they have very many areas of common concern. Stiglitz says that it is inevitable that the two agencies will have major disagreements about economic policy.[33] Instead of papering over their differences by giving each agency total authority over certain areas of joint concern, he says, it is more important to find ways they can effectively discuss their differences.

Writing in 1999, Stiglitz reported that the Bank and Fund have tried on several occasions to reach an accord separating their areas of responsibility, but this has not been successful. It is natural for the Fund to take a large responsibility for macroeconomic issues and for the Bank to take lead responsibility for development. However, he notes, issues of macroeconomics and microeconomics are intertwined. Tight monetary policy, aimed at stabilizing a country's currency and balance of payments situation and strengthening the capital base of its banks, can lead to a credit crunch that hampers the Bank's efforts, undermines growth, and precipitates widespread bankruptcy. The Bank and Fund may have very different views about such situations. Likewise, the IMF found during the Asian financial crisis that structural and institutional change can be essential — to head off crises and to lessen their intensity — and it included them in its work program even though conceptually they lay entirely within the jurisdiction of the MDBs. The Fund may put higher priority on some of these concerns than does the Bank.

There are many areas where the Bank and Fund share responsibilities and have common concerns, Stiglitz says. Open disagreement can be healthy, he argues, particularly for situations where the competing policy choices have very different possible results. Instead of the Bank and Fund hammering out an agreement which they then impose on the borrower country, he proposes, the international agencies should advice governments about the alternatives available and the consequences of the choices and let them weigh the tradeoffs and risks and make the final choice.

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[33] Joseph E. Stiglitz. "The World Bank at the Millennium." *The Economic Journal* 109 (November 1999), pp F577-F597.

In the 1980s, many economists came to support the so-called "Washington Consensus," the view that sound macroeconomic policies and open domestic and international markets were crucial both for effective development and for sound monetary policy. In 1994, some economists began saying that the earlier consensus view embodied "first generation" reforms. They argued that another body of "second generation" reforms, involving institutional and structural changes in developing countries, was needed to consolidate and extend the development and monetary stabilization process begun by the earlier reforms.[34]

In 2000, the Managing Director of the IMF and the President of the World Bank issued a joint statement setting forth their shared vision for closer cooperation between the two agencies.[35] It stressed country ownership of programs to change policies and institutions, a more coherent approach to setting and upholding priorities for change, and better use of conditionality measures to improve program success. In 2001, the executive boards of the Bank and Fund approved a framework to promote consultation in the early stages of the policy process and greater information sharing between the two agencies' staff at both the country and functional ("thematic") levels of activity.

To prevent competing or duplicate conditionality between the two agencies, the guidelines employ a "lead agency" procedure to clarify responsibility. The new guidelines allow the IMF to draw on the advice of other international organizations in the design of conditionality. This is important since in the Bank and Fund often have their own separate assistance programs underway simultaneously in countries and there is no assurance that their conditions and guidelines are compatible.

Under the new procedures, IMF and Bank staff are expected to coordinate their policies for countries where they both have operations in effect. They are supposed to harmonize their country strategies, identify key areas where policy and institutional change will be sought, and implement a strict division of responsibilities in promoting them, with one of the agencies assuming a "lead" position for each of the goals. A series of interagency task forces were created to deal with issues such as improved financial sector policies and institutions, standards and codes, the suppression of illegal money laundering and terrorist finance, and various global development issues. The IMF adopted new conditionality guidelines in fall 2002 which, among other things, increased and strengthened collaboration between the IMF and the World Bank.[36]

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[34] For an introduction to the institutions and literature, see "Growth and Institutions," in *World Economic Outlook*, April 2003, International Monetary Fund, pp. 95-128. See also discussion of this issue in CRS Report RL32364, *International Monetary Fund: Organization, Functions, and Role in the International Economy*

[35] For a description of the consultation process and two progress reports on its implementation, see IMF. *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality -Progress Report.* Two different reports with the same title, one dated August 19, 2002 and the other February 24, 2004. Both are available from the IMF web page at [http://www.imf.org]. Type first 10 words of title in inquiry box.

[36] For more on the IMF's new conditionality guidelines, see CRS Report RS21357, *New*

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Assessment. Initial reports indicate that the coordination process is having some success, both in facilitating country ownership of the programs to promote institutional and policy change and in promoting interagency cooperation. The IMF's 2004 report (cited earlier) on consultation process suggests, however, that there continue to be problems stemming from differences in the two agencies mandates, cultures, and structures. It recommended, for example, that the Joint Implementation Committee (JIC) — a panel of senior staff created previously by the executive boards of the two institutions and then allowed to lapse — should be revived and revamped in order to monitor the consultation process more closely. Specifically, the report said that "when needed" the JIC should "help country teams in the two institutions to reach agreement on priorities so as to ensure coherence of policy advice and program design." It seems, from these remarks, that Bank and Fund staff continue to see things differently and there continues to be problems eliciting cooperation between them in the formulation of their country programs. This is the area where the difference in their mandates, priorities, and expectations is probably greatest. Perhaps top-down authority from the JIC (on a "when needed" basis) may be required to secure closer collaboration between the two agencies at the operating level.

Improvements in coordination may help the Bank and Fund pursue the mandates better with less friction and fewer occasions where they work at cross purposes. Nevertheless, while this arrangement changes their format to a degree, no fundamental changes in the scope of the Bank and Fund' operations or the terms and conditions of their assistance programs will likely result. Any possible gains in the efficiency and effectiveness of their programs will likely provide little satisfaction to those who want to reorganize the IMF in order to effect fundamental alterations in its policies, procedures, and mandate.

Expand the IMF

Proposals. There have been proposals, from time to time, that the functions and duties of the IMF should be expanded in various ways. In the late 1990s, before the Asian financial crisis, for example, IMF top management suggested that the core purposes of the IMF should be expanded to include the promotion and governance of international capital mobility. Little has been heard of this proposal since 1998.

Many have recommended that the IMF take the lead to stabilize international capital markets and to resolve international debt issues. Soros proposed in 1998, for example, that an International Credit Insurance Corporation (ICIC) should be formed, as an adjunct of the IMF, to provide countries with access to world capital markets (at prime rates) up to levels guaranteed by the ICIC.[37] In 1994, Sachs proposed that the IMF should act like an international bankruptcy court, bringing creditors and debtors together and implementing debt workout programs.[38] Kreuger, the First

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[36] (...continued)
IMF Conditionality Guidelines, by Martin A. Weiss.

[37] George Soros. "Capitalism's last chance?" *Foreign Policy*, Winter 1998.

[38] Jeffrey Sachs. "IMF, Reform Thyself." First published in the *Wall Street Journal*, July 21
(continued...)

Deputy Managing Director of the IMF, later proposed a plan in which the IMF would play a major role helping ensure the orderly and timely restructuring of unsustainable sovereign debts.[39]

On a different plane, Camdessus, a former Managing Director of the Fund (1987 to 2000), said after his retirement that he believed the IMF Interim Committee (International Monetary and Financial Committee) should become a decision-making council for the major strategic orientations of the world economy.[40] The responsibility for international economic policy coordination should be placed squarely, he said, where most people believe it already rests.

In 2002, Soros proposed that the IMF should become a major new source of funding for global public goods (such as education and health) and for development.[41] It should make a large ($27 billion) issuance of SDRs, he said, and the proceeds should be used for these purposes. Stiglitz said, in a book review, that Soros' plan for a one-time issuance would not be enough.[42] Much larger amounts would be needed every year, he said, in order to achieve what he called modest development goals such as the $50 billion annual effort to achieve the Millennium Development Goals by 2015.

Assessment. These proposals, either to expand the IMF's functions — establishing it as a kind of international bankruptcy mediator or making it a new source of development aid — might have useful effects. To date, however, there appears to be no international consensus on their behalf and little support among the major creditor countries. In terms of Camdessus's recommendation, it seems very unlikely that governments will be willing to surrender to an IMF inter-governmental committee their power to determine their own economic policy.

In any case, it is unclear how these new functions would be integrated with the IMF's existing responsibilities. The internal strain within the organization would be great, for example, if the IMF is making loans to help countries deal with BOP crises at the same time that it is working to settle or write down sovereign debt. Securing private sector cooperation with its stabilization programs for countries with substantial debt might be problematical. Likewise, the IMF's role as a monetary

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[38] (...continued)
1994. Available through the Hoover Institution's international finance website at [http://www.imfsite.org/reform/sachs2.html].

[39] Anne Krueger. "New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking." Speech delivered at the *Conference on "Sovereign Debt Workouts: Hopes and Hazards."* Institute for International Economics. Washington DC, April 1, 2002. Available through the IMF website at [http://www.imf.org]. Type title in inquiry box and find on list. See also "Krueger Updates Two Track Approach." *IMF Survey*. June 24, 2002, p. 196.

[40] Michel Camdessus. "The IMF at the Beginning of the Twenty-First Century: Can We Establish a Humanized Globalization?" *Global Governance* 7 (2001), 363-370.

[41] George Soros. *On Globalization*. New York and London: Public Affairs, 2002.

[42] Joseph E. Stiglitz. "A Fair Deal for the World," reviewing Soros' new book *On Globalization*, in *The New York Review of Books*, May 23, 2002.

authority might be compromised if it issued large stocks of SDRs each year for development purposes, assuming that sufficient majority support (85%) could be garnered among its membership annually for that initiative. In any case, the IMF lacks any special aptitude for selecting and administering the kinds of development programs the SDRs would supposedly finance. This is far outside its core competencies, no matter how they are defined. Transferring the funds and responsibility to one of the development agencies would seem more appropriate.

The Role of Congress in Shaping the IMF's Agenda

The role of the IMF is discussed periodically, often during major changes or turning points in the institution. The 60th anniversary of the Bretton Woods Agreements in 2004, the May 2004 election of Rodrigo Rato, as the first Spanish Managing Director of the IMF and the pending conclusion of James Wolfensohn's second five-term in 2005 as the World Bank's president present opportunities for Congress to address these institutions and "take stock" of their effectiveness and role in the international economy. This report has presented a sample of the wide spectrum of options that experts have presented on what a "proper" role of the IMF should be in the 21st century.

There are many avenues by which Congress can influence this debate. For example, Congress has enacted legislation specifying what U.S. policy shall be in the international financial institutions (IFIs) and how the U.S. executive directors at these institutions shall vote and the objectives they shall pursue. The number of policy goals or requirements enacted by Congress is large.[43] For example, the Anti-Terrorism and Effective Death Penalty Act of 1996 (P.L. 104-132) instructs the Treasury Department to oppose any loan or other use of IFI funds to or for any country for which the Secretary of State has determined is a state-sponsor of terrorism. Congress also must authorize and appropriate any increase in IMF or World Bank funding.

Congress has frequently made specific suggestions to the Administration through Sense of Congress resolutions or language in committee reports accompanying legislation suggesting specific goals and priorities the United States ought to emphasize in the IFIs. Since the World Bank and the other multilateral institutions are not agencies of the U.S. government, but rather international institutions, their activities and policies are not subject to U.S. law.[44]

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[43] For a discussion of legislative requirements and efforts by the U.S. executive branch to comply with them, see U.S. General Accounting Office. *International Monetary Fund: Efforts to Advance U.S. Policies at the Fund.* GAO-01-214, January 23, 2001. See also three reports to Congress from the Treasury Department discussing actions taken to meet legislative requirements. *Implementation of Legislative Provisions Relating to the International Monetary Fund*, October 2001, October 2002 and October 2003. Available from the U.S. Treasury website at [http://www.treas.gov]. Type title in Search box.

[44] See CRS Report RL32364, *International Monetary Fund: Organization, Functions, and Role in the International Economy*, for further discussion of the role of Congress.

Changing the IMF

Any future changes in the structure of the IMF will be the result of a new consensus among its stockholders. Authority among the IMF's member countries is widely distributed and an 85% majority is required to alter the Articles of Agreement. Consequently, there is a strong built-in bias in favor of continuity and against fundamental change. Most of the changes in the IMF discussed in this report would require broad membership support. The Articles would need to be amended, for instance, to expand the IMF's oversight authority, to add new functions such as a debt restructuring facility or a market hedging program or to change the IMF into a world central bank. Likewise, the Articles would need to be changed in order to rescind the language barring the IMF from releasing information about economic conditions in a member country without its consent, to extend the loan repayment period, or to alter the requirement that the interest rates and repayment periods must be uniform for all borrowers. A 70% vote is needed to raise or lower the interest rate charged for IMF loans. It may be difficult to get an 85% majority to effect these proposals. Given its voting structure, all major groups of countries in the IMF have veto power over changes in the Articles of Agreement, issuances of new SDRs, approval of new quota increases, the sale of IMF gold, and other major actions.

Super-majorities would not be needed to effect some of the other changes proposed by the various authors. Nevertheless, broad support among the IMF's major stockholders will still be required. Together, the United States, the other G-7 countries, and other advanced countries in Europe have nearly 56% of the vote. A broad consensus among these countries might be sufficient to change IMF loan policy, IMF procedures, or the structure of the organization. However, broad unity among the major countries would be needed. Initiatives for change will likely fail if the major countries split their votes. It seems doubtful that many potential borrower countries would vote for initiatives that would restrict their future access to IMF credit or disadvantage them in other ways.

Traditionally, the United States has exercised leadership in the IFIs. However, other major governments often have views which differ substantially from those advocated by the United States. They are not likely to support initiatives for change unless they agree on the merits that they are desirable. Several of these countries have expressed reservations about some of the alternatives discussed earlier in this report. In the past, the United States often resolved disagreements of this sort through a series of one-on-one bilateral talks with other countries. More recently, though, as seen in some recent negotiations about World Bank issues, many countries have preferred to discuss their differences with the United States in block (all at the same time). The more advanced members of the European Union have about 31% of the vote and there has been discussion among them in recent years about ways they could pool their vote and exercise a larger leadership role in the international financial institutions.

Proposals to change or restructure the IMF can be offered at any time. However, the most likely occasion for consideration will occur during future negotiations about possible new IMF quota increases or other similar events. The IMF is required by its Articles to consider every five years whether its resources are

adequate and whether a new quota increase is needed. In 2002, the United States and other major countries decided that no increase was necessary. The next occasion for formal consideration of this issue will likely occur in 2007. Those seeking to effect change in the IMF may keep this timetable in mind as they formulate their proposals.