The Role of the IMF: A Guide to the Reports

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Introduction

Many of the discussions on a new international financial architecture that were spawned by the East Asian crisis have dealt with the future role of the IMF. This paper starts by summarising the recommendations of five recent reports and one speech, and the reasoning that lies behind them. The recommendations are divided into four main areas: (i) the scope of Fund activities; (ii) surveillance; (iii) lending; and (iv) governance (on which topic a recent academic paper is also summarised). The last section of the paper offers a verdict on the first three of these topics.

The first of the five reports considered was published jointly by the International Centre for Monetary and Banking Studies in Geneva and the Centre for Economic Policy Research (CEPR) in London. The authors were Jose De Gregorio, Barry Eichengreen, Takatoshi Ito and Charles Wyplosz (1999). The report also contains brief accounts of alternative reform proposals made by Kiichi Miyazawa, Jeffrey Sachs, Sebastian Edwards, France, the UK and Italy, and of the idea of regional funds. It was discussed at a conference held in Geneva in May 1999, which is also reported in the document. This paper will be referred to as the Geneva Report.

The second report is that of an independent task force sponsored by the Council on Foreign Relations (CFR) and published in 1999. The task force was jointly chaired by Carla Hills and Peter Peterson, with Morris Goldstein as Project Director and 23 other luminaries of the American internationalist establishment, including C. Fred Bergsten, Director of the Institute for International Economics (IIE), as members. This will be referred to as the CFR Report. It contains eight statements of dissenting views, but all members signed the main report.

The third report was commissioned by the G-24 and written by Montek Ahluwalia in 1999. It was published by the United Nations Conference on Trade and Development (UNCTAD) in the latest volume of its series of publications of G-24 studies. It will be referred to as the Ahluwalia Report.

The fourth report is that of the International Financial Institution [*sic*]

Advisory Commission (IFIAC), established by the US Congress and chaired by Allan Meltzer, with an additional ten members including academics Charles Calomiris, Jerome Levinson and Jeffrey Sachs, businessmen, politicians, and think-tank directors C. Fred Bergsten of the IIE and Edwin Feulner of the Heritage Foundation. Despite the singular 'Institution' in its title, the report's terms of reference covered the World Bank, the three regional development banks, the WTO and the BIS, as well as the IMF. This was issued in March 2000 and will be referred to as the IFIAC report. It was accompanied by two 'supporting statements' arguing that it did not go far enough in gutting the IFIs, a joint minority statement by four members (including Bergsten and Levinson), three of whom did not sign the main report, and two additional dissents by two members of the minority (one of whom was Levinson) who did not sign the main report.

The fifth report is that of a task force established by the Overseas Development Council (ODC) in Washington, which reported in April 2000. This was co-chaired by John Sewell and Sylvia Saborio, directed by Kevin Morrison and comprised a further 11 members from academia, think-tanks, and non-governmental organisations 'who agreed with the overall direction and recommendations of the report, but not necessarily with all statements and emphases'. Task force members included Nancy Birdsall, Joe Stiglitz and John Williamson. This will be referred to as the ODC Report.

The speech included is that given by US Secretary of the Treasury Lawrence Summers at the London Business School in December 1999.

These six works include the views advanced by an international group of academics, by a collection of Americans who qualify as 'the great and the good', by a leading developing country official writing on behalf of the Group of 24 developing countries, by a mixed group of Americans writing a report for the US Congress, by another mixed group of predominantly American composition concerned with the problems of developing countries, and by the US Secretary of the Treasury. Although there is obviously some bias toward American sources, this provides a reasonable cross-section of informed thought on which to develop a set of proposals.

The Scope of the IMF

Not all the six documents being surveyed address all four of the topics discussed in this paper. The desirable scope of IMF activities, for example, is not touched on by the Geneva Report.

The CFR Report also treats the topic relatively cursorily, but it does urge the Fund (and, for that matter, the World Bank) to go 'back to basics'. It argues (p. 115) that the Fund is still needed to help countries resolve payments problems in an internationally responsible way, to address liquidity crises and to act as a crisis manager or convenor. Elsewhere it emphasises the Fund's role in crisis prevention. It also argues that 'the IMF is losing its focus and reducing its effectiveness by doing too much. Specifically, the IMF should limit the scope of its conditionality to monetary, fiscal, exchange rate and financial-sector policies' (p. 116). But it argues that the Fund's surveillance needs to be concerned with monitoring compliance with financial standards, as well as macro fundamentals.

The Ahluwalia Report (p. 22) dismisses the case for a merger between the Fund and the Bank on the grounds that there is an important and distinctive role for the Fund in dealing with crises, both in prevention (via surveillance) and in management (via financing). The report also argues that 'such financing does not have to be long-term and certainly not concessional'. It also states: 'The Fund should focus more sharply on sources of instability in the international financial system and on handling balance-of-payments problems which are either short-term or systemic in nature'. It goes on to suggest: 'It could even be argued that financing operations related to chronic balance-of-payments problems of low-income countries, e.g. the Enhanced Structural Adjustment Facilities (ESAF) and Heavily Indebted Poor Countries initiative should perhaps be shifted to the Bank, with co-operation from the Fund being available on technical matters'.

The Executive Summary of the IFIAC Report declares that 'the IMF should continue as crisis manager under new rules that give member countries incentives to increase the safety and soundness of their financial systems' (p. 6). The report identifies three roles implied by this: (i) serving as quasi-lender of last resort to emerging economies; (ii) collecting, publishing, and disseminating data on member countries; and (iii) providing advice (as opposed to imposing conditionality) relating to economic policy (pp. 42–43). It urges an end to long-term loans and specifically calls for the closing of what it calls the 'poverty and growth facility' (p. 43). It also calls for the replacement of conditionality by pre-qualification, according to principles outlined in the section on lending below.

The CFR Report argues that 'the IMF is losing its focus and reducing its effectiveness by doing too much . . .'

The ODC Report identifies the IMF's core competence as macroeconomic policy and hence sees its central role as crisis avoidance and, when that fails, promoting speedy recovery from crisis. It argues that this implies that its lending should be restricted to short-term liquidity lending in macro-economic crises, and calls for the Poverty Reduction and Growth Facility (PRGF) to be moved to the World Bank. It argues that the Fund should retain a role in the poorest countries, but only in the context of emergency lending, as in other member countries. The Fund should maintain its role in surveillance, geared toward providing advice that would minimise the probability of crises. But the report argues that statistics should be collected and disseminated by an independent statistical agency, rather than by the Fund (or Bank).

The Summers speech also urges a focus on core competence (p.5), but it interprets this rather more widely than the preceding reports. It suggests that the IMF should promote financial stability within countries, a stable flow of capital between them and rapid recovery following any financial disruption (p.3). Summers asserts that this points to six critical areas:

- promoting the flow of information from governments to markets and investors;
- giving attention to financial vulnerability as well as macro-economic fundamentals;
- developing a more selective financing role focused on emergency situations;
- catalysing market-based solutions;
- focusing on growth and poverty reduction in the poorest countries;
- modernising the IMF as an institution.

The degree of consensus reflected in these five sources is rather remarkable. All reflect a concern with mission creep, and urge the Fund to focus on its core competence. All see the Fund as having a central role in aiming to prevent financial crises, and in managing them when they nevertheless occur. All wish the Fund to continue to lend in crisis situations. All concur in wishing to maintain surveillance, and none challenge the proposition that this should focus on financial standards and vulnerability as well as traditional macro-economic fundamentals.

Despite the apparent agreement, there is a profound gulf between the IFIAC majority, on the one hand, and the other five (together with the IFIAC minority), on the other, about the value of having an IMF at all. Everyone except the IFIAC majority emphasises the need for an international institution dedicated to building collaborative macro-economic policies among countries, to helping avoid crises and to aiding countries cope with crises that nonetheless occur. They all appear to agree that the world is a lot better off for having built that degree of international collaboration. The IFIAC majority starts instead from a concern that IMF lending may promote moral hazard (a phenomenon whose importance 'cannot be overstated'[1]), and concedes only reluctantly (and to the dismay of two of their number) that there may, after all, be a limited role for the Fund. On more concrete issues the disputed topics would seem to be:

- whether the Fund should maintain the PRGF (Summers considers that it should);
- whether the PRGF should be closed (IFIAC majority report) or moved to the Bank (Ahluwalia and ODC);
- whether the collection and dissemination of statistics should be moved to a separate agency, as urged by ODC.

Surveillance

Fund surveillance takes two forms: (i) general surveillance of the world economy, as reflected in the biennial publication *World Economic Outlook* and the annual *International Capital Markets Report*; and (ii) surveillance of individual countries, as undertaken primarily in Article IV consultations. No-one appears to challenge the usefulness of the former exercise or to offer significant suggestions for improving what the Fund does, except the Ahluwalia Report which urges that the Fund should draw on this information in introducing developing country interests into G-7 discussions. The debate focuses rather on surveillance of individual countries, and how this could be improved to diminish the probability of crises occurring.

The Geneva Report suggests that surveillance should seek to identify country vulnerabilities in areas like the banking system, exchange rate policy, reserve levels or accounting standards, and give countries confidential warnings of these vulnerabilities. It recognises that the Fund lacks expertise in many of the fields where standards are needed and being developed, and urges the Fund to accept that the standards will be designed by others, with its own role being confined to monitoring, with the use of experts from other institutions in its missions.

The CFR Report also suggests that the Fund should focus on each member country's compliance with international financial standards like the Fund's Special Data Dissemination Standard, the Basle Committee's Core Principles of Effective Banking Supervision and international accounting

[1]Prompting Paul Krugman (2000) to quip 'Oh, yes it can!'

standards, along with a 'viable' exchange rate regime, prudent debt management, etc. Rather than the results being communicated confidentially, however, the report proposes that the Fund should periodically publish a 'standards report' that details each country's performance, along with the Article IV reports assessing policies and prospects. It sees the incentive to comply with these standards as being provided by the likelihood of a lower cost of market borrowing, cheaper access to Fund credit when a country has to borrow and lower capital requirements for bank loans to those countries (pp.93–97). The Fund should encourage countries with fragile domestic financial sectors and weak prudential frameworks to adopt Chilean-style capital inflow taxes (p.98).

The Ahluwalia Report declares that surveillance is a core activity of the Fund and recommends that it be strengthened, primarily by increasing the disclosure of key information to financial markets.

The IFIAC Report has rather little to say about surveillance, except that the Fund should abandon Article IV consultations for the OECD countries (on the grounds of avoiding costly duplication of effort) and should publish promptly all Article IV consultation reports for other countries (pp.43–44). It also sees a major function of the Fund as being the collection and prompt publication of data, with a view to keeping market participants well informed (p.43). It proposes that the Fund should encourage countries either to hard fix their exchange rate or to float, since intermediate regimes are more subject to crises.

The ODC Report also approves of data collection (though arguing that this should be moved to a separate agency) and transparency, but argues that improvement in these directions is unlikely to end crises. It sees a unique role for the Fund in advising countries on macro policy aimed, *inter alia*, at avoiding macro-economic crises, and normally not based on financial arrangements. It too endorses Fund monitoring of a wide range of standards, while cautioning that the Fund does not have in-house expertise on all of them. It recommends that discussion of Article IV reports be moved from the full Executive Board to the sub-boards comprised of the executive directors (EDs) from particular geographical regions of the world, so as to diminish the workload on the full Board, but with regular reports from the sub-boards to the full Board. The report cautions against enthusiasm for the two-corners exchange rate fad (the notion that every country ought to have either a currency board or a floating exchange rate, but nothing in between).

Secretary Summers also favours a Fund role in collecting and disseminating information to investors and markets. Countries should be encouraged to adopt the SDDS and the various international codes that are being developed for sound policies, and the Fund's assessment of their compliance with those standards should be released into the public domain. Surveillance should cover financial vulnerability as well as macro fundamentals, and it should be recognised that this vulnerability is a function of the level of short-term foreign debt and of excessive government granting of guarantees. The Fund should focus on the strength of national balance sheets, for example by developing a more meaningful measure of reserve adequacy than the traditional reserves/imports ratio. It should draw attention to 'the dangers of opening up to short-term capital in the presence of too many domestic guarantees', and should highlight the risks posed by unsustainable exchange rate regimes.

Once again, the degree of consensus exhibited is quite significant. There is general enthusiasm for data collection (if not necessarily by the Fund), transparency, publication and continued surveillance. This is rather remarkable if one considers how secretive an institution the Fund has traditionally been. Several of the sources explicitly endorse focusing attention on vulnerabilities in the financial system, foreign debt, the various areas in which international standards are being promulgated and the exchange rate regime, and no-one opposes this approach. There was far greater recognition of a possible constructive role for capital inflow taxes than one would have expected to find in these places prior to the East Asian crisis. There remains a disagreement as to whether all intermediate exchange rate regimes are to be condemned as unsustainable, but everyone recognises that the issue of sustainability is an important one.

Lending

The Geneva Report expresses scepticism about the proposal to 'include some form of "pre-qualification" for financial support by the IMF' (p. 44).[1] It sees the appeal of pre-qualification as lying in a resolution of the problem of moral hazard, since a government could no longer be expected to be bailed out if it ignored warnings of imprudent behaviour. But it questions whether government moral hazard is a real problem (governments suffer enough when they engulf their countries in a crisis to eliminate any incentive to flirt with danger), and also argues that the criteria for pre-qualification would be arbitrary and the policy would be time-inconsistent (the threat to withhold help from countries that have no pre-qualified is not credible). The report also declares that the CCL created by the IMF in April 1999 suffered from the same drawbacks, as

[1]However, it did suggest lower interest rates on Fund lending to countries that include collective action clauses in their bond contracts, a related suggestion that is pursued later in this paper.

well as from the danger that disqualifying a country previously qualified could precipitate a crisis. It notes that no country has so far been induced to apply for a CCL.

The Geneva Report also argues that the Fund's facilities have proliferated excessively and need to be streamlined with a view to making the Fund's emergency lending more transparent, simple and effective (p.48). It applauds the new SRF (which can lend exceptionally large sums at a penalty interest rate and was first deployed in South Korea) as a step in the right direction (p.53). It argues that the capital account crises that are now dominant are essentially caused by a lack of liquidity rather than bad fundamentals, and therefore require temporary financing with front-loaded disbursements (though it questions whether the support need always be large). Support from the Fund will need to be accompanied either by 'co-financing with the private-sector rollovers and rescheduling' or by a restructuring of external debt obligations in order to keep the size of financial packages within reason. The experience of South Korea in 1997 showed that a standstill could be a useful instrument in bailing in the private sector, but the experience of Mexico in 1982 should also stand as a warning that standstills are not a panacea.

The CFR Report proposes to draw a sharp distinction between 'country crises' and 'systemic crises'. Finance for the former would be limited to normal access limits (100 per cent of quota per year and 300 per cent cumulatively), and would be financed from the Fund's existing resources. Systemic crises might be financed from the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), or from a proposed new Contagion Facility that would replace both the CCL and the SRF. The Contagion Facility would be used for victims of contagion in which the payments deterioration reflected developments largely beyond their own control and would not require a Fund programme (p.110). It would be financed by a one-off SDR allocation in which all Fund members would donate their newly allocated SDRs to the Contagion Facility. The report also declares that in extreme cases, where the debt profile is clearly unsustainable, the Fund should require debtors to engage in 'good-faith' debt restructuring negotiations with their creditors as a condition of its support (p.102). Those discussions might be facilitated by declaration of a temporary standstill by the debtor. Interest rates on borrowings from the Fund would be lower for countries that made a series of efforts to forestall crises by complying with the international codes being developed, following sound macro policies, maintaining a viable currency regime and a prudent debt profile, and establishing contingent sources of liquidity support (p.94).

The Ahluwalia Report is sympathetic to the Fund acting as a lender of last resort in response to capital account crises, but worries about how such lending is to be financed. It also suggests resorting to a special SDR allocation (p. 14), as well as to bigger quotas. In terms of conditionality for such lending, it is sympathetic to pre-qualification but points to the problem that performance criteria judged adequate prior to a crisis may not appear to be so after the crisis has erupted (p. 16). It suggests a compromise solution in which pre-qualification would entitle a country to a first tranche almost automatically, but subsequent drawings would require conditionality. It notes the danger that withdrawal of cover before a crisis could precipitate a loss of confidence that would provoke the very crisis that the arrangement was designed to avoid.

The IFIAC Report identifies the first of the Fund's responsibilities as being 'to act as a quasi-lender of last resort to solvent emerging economies' (p. 42). The first point to note is that this is the only lending window that the report discusses; it appears to preclude not just lending to industrial countries, but also to the poorer developing countries that are not included in the term 'emerging economies'. Indeed, it specifically calls for closing the PRGF, currently the main instrument for lending to those countries (p. 43), and it rules out lending for non-financial emergencies, such as famines (p. 47). The report goes on to state that 'except in unusual circumstances, where the crises poses [*sic*] a threat to the global economy, loans would be only to countries in crises [*sic*] that have preconditions that establish financial soundness' (p. 43). Preconditions would replace conditionality. The preconditions proposed (pp. 44–45) are:

- freedom of entry and operation for foreign financial institutions;
- well-capitalised commercial banks, preferably with part of the capital in the form of uninsured subordinated debt;
- regular and timely publication of the maturity structure of outstanding sovereign and guaranteed debt and off-balance sheet liabilities;
- 'a proper fiscal requirement', the nature of which is not specified.

Countries that need to borrow before they have been able to fulfil these conditions should be entitled to do so at a 'super penalty rate' (all borrowing would be at a penalty rate), and countries that choose not to fulfil the conditions should be ineligible to borrow (p. 46). These loans would be of short maturity (for example a maximum of 120 days) with only one allowable rollover. The report also goes to considerable length to ensure the priority of IMF claims over all other claims, in analogy with the requirement of collateral in traditional last-resort lending.

Perhaps the most important criticism voiced by the minority who did not sign the IFIAC Report concerns the proposed limitations on borrowing from the Fund. They question whether it would be possible to fashion a fiscal pre-qualification requirement that would dispense with the need for conditionality, and are also concerned that the pre-qualification approach might preclude lending to countries of great systemic importance (pp. 121–22). They commend instead the CFR proposal to grant preferential lending terms to countries that have adopted the Basle Core Principles to strengthen their domestic banking systems (pp. 123–24).[1]

The ODC Report also sees the Fund's lending role as driven by crisis management, but it states explicitly that all countries should be eligible to borrow from the Fund in times of macro-economic crisis (p. 6). In furtherance of the objective of cutting back the IMF to its core competence, which excludes structural issues, it proposes to abolish the EFF and to transfer the PRGF (and hence also responsibility for the Heavily Indebted Poor Countries programme) from the Fund to the Bank. The Fund should advise the Bank on the macro conditions to be required for PRGF loans, though without a veto. The report argues that crisis lending should be done through the use of normal standby arrangements, which should be accessible by any member country, with a subsidised interest rate when one of the low-income members borrows. Conditionality should revert to focusing on the basics of macro policy, without the addition of numerous structural conditions such as adorned the East Asian programmes which, in the event, proved almost entirely irrelevant to nurturing the region's rapid recovery from crisis. The report calls for an effort to make *ex ante* assessments of the impact of IMF programmes on the poor, with a view to trying to reduce their adverse impact. It expresses scepticism about the CCL but calls for maintenance of the CFF.

Secretary Summers also calls for the Fund to focus its financing on emergency situations. It should be a last, not a first, resort; a backstop, not an alternative, to private finance. Longer-term lending would be phased out and the core instruments would become the CCL, short-term stand-by arrangements for countries with non-systemic problems and the SRF for systemic capital account crises. He argues that the penalty rate

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[1]At a meeting at the Brookings Institution on 11 April 2000, Alan Meltzer claimed that the majority report also contains just such a proposal for discriminating between lending at a penalty rate to countries that had pre-qualified ('List A') and lending at a super penalty rate to the rest ('List B'). There does not appear to be any passage in the majority report that bears that interpretation, beyond the transitional period, but his claim may be interpreted as indicating that at least the chairman of the Commission has been intellectually convinced of the desirability of this approach.

on SRF lending is a precedent on which to build, although the CCL might have a lower interest rate to encourage countries to qualify and apply. Conditionality will have to fit the specific country circumstances, but it should not intrude in areas irrelevant to the restoration of stability and growth. However, 'the stability of banking systems, issues of social cohesion and inclusion, and the capacity to enforce contractual arrangements' may all be relevant (p. 6). He also urges the official sector to help creditors to recognise their collective interest in maintaining exposure, even when their individual interest is in withdrawing funds. It will, however, occasionally be necessary to seek less voluntary debt restructuring and, in exceptional cases, the IMF should be prepared to lend into arrears.

In his remarks on the poorest countries (p. 8), Summers lauds the progress made in developing the HIPC as 'a fundamentally new framework for the international community's efforts to combat poverty, one that gives the World Bank the lead and the IMF a more tightly focused role'. He does not hint at the desirability of moving the PRGF.

The common theme of these six sources is the central role of IMF financing in managing crises. There are clearly a number of other ideas that have appealed quite widely without achieving unanimous support: some form of pre-qualification (though with a strategic difference as to whether failure to pre-qualify would disqualify a country from borrowing or simply stiffen the terms); shifting the PRGF from the Fund to the Bank; and accompanying IMF crisis lending by some form of payments standstill, at least in certain circumstances.

Governance

The Geneva Report argues that the IMF needs greater transparency and more accountability. More decisions should be taken by vote rather than consensus, and the minutes and the votes should be published. Programmes should be evaluated both by staff and by outside panels, and the findings should be published. Above all, the Executive Board should become independent in the same sense that the boards of many central banks are now independent; they should be appointed for multi-year terms and should not receive instructions from the governments that appointed them, the Board should be given an explicit mandate such as promoting economic and financial stability, and the Board should periodically report to what is now the International Monetary and Financial Committee (the IMFC, formerly known as the Interim Committee). A country under discussion should send a representative to sit with the Board. In order to increase its independence from governments, the Fund should borrow in the market rather than acquire its resources from member governments.

The CFR Report also urges more transparency, but Fund governance is not prominent among its concerns. Likewise the Ahluwalia Report says little on this topic, except for arguing against a merger of the Fund and the Bank, and suggesting the establishment of an overarching ministerial committee to supervise them both. The IFIAC Report calls for the Fund to be restructured as a smaller institution (p.42), and for more transparency in its accounting (pp.50–51).

The ODC Report calls for a realignment of the voting power in the Fund to reflect the current weight of economic power; this would involve Asian representation growing and that of Europe diminishing. The report recommends reducing the super-majority needed for certain key decisions so as to eliminate the US veto. It also calls for a more neutral and transparent process for the selection of the managing director. It recommends that the links between member countries and the Fund should be broadened, so that the Fund could interact with a prime minister's office or a planning ministry (or, in developed countries, an overseas aid ministry), rather than just with the finance ministry and central bank. It urges the establishment of a small external evaluation unit to report to the IMFC. (The Fund announced the establishment of such a permanent evaluation office just days before the report was published, but reporting to the Executive Board rather than to the IMFC.) The report also urges that data collection and dissemination should be relocated to a separate statistical agency.

It is difficult to detect much common ground between these proposals, beyond the general desire to continue to advance in the direction of greater transparency and openness, although it might be possible to find a widespread desire to reform the process of selecting the Managing Director after the recent fiasco. Perhaps it is premature to try to reform the Fund's governance before it has been decided what the Fund should do.[1]

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[1]Nevertheless, there may be some interest in a set of proposals in a recent article that focused exclusively on the question of Fund governance (Askari and Chebil, 1999). They express concern about the distribution of quotas, and the ad hoc procedures for adjusting quotas, which have led to current anomalies like the large over-representation of Euroland and Saudi Arabia and the under-representation of South Korea, and arguably China, and a number of other Asian countries. They recommend reducing the super-majority needed to approve certain decisions so as to deprive the USA of its veto, citing the conditionality that Congress has unilaterally imposed on the Fund for its approval of quota increases as intolerable for a multilateral institution.

An Agenda for Reform of the IMF

At this stage this paper will discuss what an agenda for the reform of the IMF might look like. It will not address the issues of governance, since one first needs to decide what the Fund should do. The paper is in full agreement with the consensus views on the scope of the Fund that were noted earlier. In particular, it endorses the view that the failure to resist the mission creep imposed on it by the G-7, and most specifically the conditionality that the US Congress attached to the most recent increase in Fund quotas, threatens to undermine the effectiveness of the IMF. The Fund should indeed return to concentrate on its core competence. There seems to be unanimous agreement about what that is (at least among those who do not dismiss the IMF as irreparably incompetent). For example, the G-7 communiqué of 15 April 2000 stated: 'Crisis prevention and response should be at the core of the IMF's work'. Everyone seems to agree that that involves both maintaining surveillance, with a view to avoiding crises, and helping to manage those crises which nevertheless occur.

It is extraordinary that the official world, including Secretary Summers and those who endorsed the decisions of the spring meetings of the IMFC, regard these principles as consistent with the maintenance of the PRGF (and therefore with the HIPC, whose conditionality is tied to the PRGF) in the Fund. It is one thing to oppose the recommendation of the

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(This included in 1989 a requirement that the Fund recruit development economists trained in analysing the linkages between macro-economic conditions and short- and long-term impacts on sustainable management of natural resources, and in 1998 a requirement that no IMF money be used to subsidise South Korean industries that compete with US industries (see Askari and Chebil, 1999, p.351)). They advance a number of proposals for improving the operation of the Executive Board: seeking a greater diversity of backgrounds of Executive Directors, and even appointing a couple of non-voting Directors with no country affiliation from the private sector; making all the constituencies multi-country; and encouraging the Board to initiate proposals rather than simply rubber-stamp staff initiatives. They argue that the positions of the Managing Director and First Deputy Managing Director should be opened up to the best person available, irrespective of nationality and professional background, and again betray a sympathy for candidates from the private financial sector. They urge that the staff should also have more diverse professional backgrounds than economists with PhDs from American universities, and that there should be higher rewards for good performers and a greater willingness to fire poor performers. They criticise the use of the IMF as a political slush fund (a theme that can also be found in several of the five reports that have been reviewed, although not in the speech of Secretary Summers). They argue for transparency and point to deficiencies in the Fund's historical record on corruption. They conclude that the time has come for a comprehensive review of the IMF's governance in parallel with its policies, and urge the Fund's management to reach out to international civil society in initiating a review which might strengthen the Fund and enhance its performance.

IFIAC majority to close the PRGF,[1] which would imply reducing the resource transfer to the poorest countries. But both the Ahluwalia and ODC reports suggested an alternative – not closing it but, rather, transferring it to the Bank. The argument for this is that the PRGF is not concerned with crisis lending, the area of the Fund's core competence, but with poverty reduction and growth. No-one doubts that growth, and the poverty reduction that flows from it, is critically dependent upon disciplined macro policies, and that these lie within the core competence of the Fund. But macro policy is, as emphasised in the Bank's Comprehensive Development Framework, merely one of a number of areas that it is essential to get roughly right if an economy is to grow at anything close to its potential rate. Since the Bank has the core competence in most of these fields, it seems quixotic to place the PRGF in the Fund rather than the Bank. This is an anomaly that can be explained only by history.[2]

Quixotic it may seem, but the location of the PRGF in the Fund has been vigorously defended by Stanley Fischer in his capacity as the IMF's Acting Managing Director. As quoted in the *Financial Times* on 14 April 2000, he said, in response to a question about the recommendation to move the PRGF in the ODC report:

> *there is no reason poor countries should not be able to benefit from the IMF's expertise in macro-economic policy. The argument strikes me as one which imagines there is a different macro-economics for poor countries and rich countries. Inflation and economic* [in]*stability is bad for all people.*

This misinterprets the ODC report, which explicitly argues (p. 5) that the Fund has 'a unique role in the international system, including in poor countries: to advise countries on how to avoid macro-economic crisis and to restore stability in the midst of such crises'. The ODC report also says baldly: 'Stability is an essential condition for growth'. In fact, the argument is one for eliminating the differential treatment of poor and rich countries in all respects except one: the interest rate at which they are entitled to borrow should they need to borrow in the event of a macro

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[1]However, members of the IFIAC majority have in private conversation urged that one should not take the text of the report too literally, and stated they would not oppose transferring the PRGF to the Bank.

[2]Specifically, the IMF was allowed to sell a small part of its gold holdings in the 1970s, after the monetary use of gold was first suppressed, in order to create a trust fund to make low-interest loans to poor countries. In the late 1970s, the Fund also made extensive standby loans to poor countries, which they were unable to service in the adverse conditions of the 1980s. Both were therefore refinanced by low-interest loans from a newly-created Structural Adjustment Facility in the 1980s, which was further expanded to the Enhanced Structural Adjustment Facility in the 1990s. This was renamed the PRGF in 1999 to reflect the increased concern with poverty.

crisis. The Fund would retain the same role in both types of countries, namely surveillance directed to crisis avoidance and short-term lending when avoidance fails. Perhaps there is a good argument for retaining the PRGF in the Fund but, if so, Fischer did not articulate it.[1] Of course, he would have jeopardised his reputation as an outstanding bureaucrat had he acknowledged the logic of transferring a substantial part of his organisation's responsibilities to its sibling institution. One can hardly expect him to spearhead this particular reform, but that does not make it an undesirable change.

The danger of locating the facility in the Fund is that its traditions will prevent it from treating macro policy as merely one among a number of critical areas. On past experience one has to expect that the Fund will always make macro stability *primus inter pares*, whether it deserves to be or not. However, when countries are not in crisis, macro stability ought not to be accorded primacy. If the Fund is in charge, there will be no-one to countermand an excessive emphasis on macro perfection at the expense of getting public expenditure priorities right and reforming corporate governance and building up the education system. If the Bank is in charge, the Fund will still have the duty to examine macro policy and will be able to make a case if it sees problems; if the Bank agrees that macro stability is in jeopardy then it will have the duty to hold up disbursement until policy has been adjusted appropriately. This will ensure both that the Fund cannot be ignored and that countries cannot be deprived of its advice. But since another agency will have to agree that macro stability is indeed at risk, the country will be safeguarded against an excessive emphasis on macro stability at the expense of other priorities.

The other argument for relocating the PRGF concerns the time horizon of Fund programmes. We know that poverty reduction requires decades, rather than the three years allotted to a PRGF programme, implying that one must look forward to a succession of such programmes and a long-term IMF involvement in development finance under present arrangements. In the past it has always been assumed that Fund involvement should be occasional and episodic rather than continuing, and one may wonder whether confusion between these two roles may not prejudice the Fund's ability to act effectively in the event of a crisis.

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[1]Some people seem to argue that the IMF should help all its members, on equity grounds. But poor countries would still get benefits in terms of policy advice, hopefully crisis avoidance and crisis resolution under the ODC proposals, as well as access under the CFF. The Fund might usefully consider the case for improving access to the CFF.

Supporters of the status quo are likely to argue that the Fund is a more effective vehicle for dispensing conditionality than is the Bank. The author has served in both organisations and can confirm that they have a valid point. There is no question but that the Fund's hierarchical organisation is more effective in producing timely and coherent action than the loose organisation and pluralism in ideas that characterise the Bank.

However, two counter-arguments deserve attention. One is that the way a bureaucracy develops is in part a consequence of what it is asked to do. Since the Bank has not in the past had any responsibility for organising a PRGF-type programme, it is not surprising that it does not have up and running the capacity to do so. The question is whether there are convincing reasons for supposing that the Bank would be incapable of developing such capacity should it be given the responsibility for the PRGF.

The other counter-argument is that the PRGF is not intended to replicate the pattern of past conditionality. On the contrary, lending under this programme is to be guided by a Poverty Reduction Strategy Paper (PRSP), which is to be prepared by the borrowing government in consultation with its civil society and private sector (as well as with the Fund and Bank). The intention is to ensure that the programme has local ownership, something that recent research has demonstrated conclusively to be of key importance if reforms are to deliver. The danger is that the PRSP will prove to be a mere fig leaf which the Fund dictates, as it has so often dictated conditionality in the past (which is also supposed to be the borrowing government's own programme). Some Fund staff members regard ownership and conditionality as antithetical – conditionality ought to require, in their view, a country to do things that it does not want to do. The logic is that conditionality is used as a device to ration access to cheap IMF credit; make the conditions the perpetuation of sensible past policies, and the IMF would soon be flooded by requests to borrow. One may have serious doubts about the ability of an organisation in which such attitudes exist to make the intellectual leap to lending on the basis of programmes that enjoy ownership. The Bank, in contrast, has worked quite hard in recent years to foster local ownership, and would therefore be much better placed to initiate a programme in which ownership is key.

Another change suggested by the ODC report concerns the collection and dissemination of statistics (p. 12). It urges that both the IMF and the World Bank should hive off their statistics operations and that these should be placed in a separate and independent agency devoted exclusively to collecting and publishing economic data. This would be a useful change, which would preclude the potential danger that a conflict of interest could corrode data, as well as centralise statistical expertise.

The discussion of surveillance above also noted the substantial measure of consensus on the Fund's role in surveillance, particularly concerning the desirability of increasing transparency. In fact the Fund has already come a long way in this direction. The author of this paper recalls his pride in being so subversive as to publish the text of a Letter of Intent in Williamson (1983). The IMF now routinely publishes the text of Letters of Intent, and much more, on its website. There is widespread consensus that the Fund could usefully focus attention on vulnerabilities stemming from weaknesses in the financial system, the level and maturity structure of foreign debt, and progress in implementing the sundry international standards currently being developed. This paper also endorses the CFR view that the Fund should actively encourage potentially vulnerable countries to impose appropriate capital inflow taxes.

There remains one major area where this paper (like the ODC report) is out of sympathy with the current conventional wisdom. This concerns the question as to whether all intermediate exchange rate regimes should be discouraged by IMF surveillance (for emerging markets and industrial countries, if not necessarily for low-income countries where capital mobility is still low) in favour of one or other of the two 'corner solutions', either a currency board or a floating rate. The author of this paper has discussed this extensively elsewhere (Williamson, 2000), but would not deny that intermediate regimes are probably more prone to crisis than the corners. The point is that they also offer benefits that the corners do not, namely the possibility of resisting the misalignments that are so often generated by both fixed and floating exchange rate regimes. If one judges that a seriously misaligned exchange rate jeopardises the possibility of rapid and sustained growth, this is serious and suggests that one should resist the temptation to focus surveillance exclusively on crisis avoidance. Important as that is, countries should also be encouraged to make the most of their growth potential.

Nevertheless, the major differences about the future of the Fund are concerned with its role as a lender rather than with surveillance. Everyone agrees that the Fund should have a central role in any financing that may occur in the context of a macro crisis, but that is about the extent of agreement. The disputed issues are:

- the range of facilities under which the Fund should lend;
- the role, if any, of pre-qualification in the Fund's lending operations;
- the role, if any, of a payments standstill in accompanying Fund crisis lending;
- the terms on which the Fund lends.

The Range of the Fund's Facilities. At present the Fund is able to lend under six different facilities: traditional standbys; the high-interest Supplementary Reserve Facility (SRF) introduced in 1998; the Contingency Credit Line (CCL) announced in 1998 but so far unutilised; the Extended Fund Facility (EFF) introduced in 1975 with the objective of allowing the Fund to make longer-term loans to developing countries experiencing a payments problem with a structural origin; the PRGF, through which the Fund makes low-interest loans to low-income members; and the Compensatory Financing Facility (CFF) which dates from the 1960s and makes low-conditionality loans to countries experiencing an exogenous and temporary shortfall in export proceeds, a surge in the cost of cereal imports or an increase in interest costs. This already represents a significant rationalisation compared with the situation prevailing before the spring 2000 meetings of the IMFC, which eliminated the Currency Stabilisation Fund, the Buffer Stock Financing Facility and support for commercial bank debt reduction (i.e. the Brady Plan). This paper has already argued that the PRGF should be transferred to the World Bank. One needs also to ask whether further streamlining would be appropriate.

To start at the end, there is a strong logical case for retaining the CFF. This is a mechanism whereby the international community helps primary-producing countries to cope with shocks that are truly exogenous with respect to their own behaviour, without requiring them to devote their own real resources to building up reserves ahead of time. It economises on the need to build up reserves.

An equally persuasive case cannot be made for retaining the EFF. When this was introduced, in the 1970s, many middle-income countries were only just establishing access to the international capital market. The World Bank did not have a capacity to lend for adjustment; its lending was all project-directed. Hence such countries could not rely on being able to borrow in order to adjust to a payments shock with a structural origin, so it seemed reasonable for the Fund to provide a facility to respond to this need. But times have changed – in three ways. One is that most middle-income countries can now borrow on the international capital market. Another is that the World Bank has since moved into structural adjustment lending, which is able to cope with very much the same type of situation. The third is that the low-income countries that are excluded from the international capital market are now accommodated by the Fund through the PRGF, which will still be available to them even if it is relocated to the World Bank. Bulgaria perhaps provides the strongest recent case for arguing that the EFF still has a role, but it is not obvious that Bulgaria could not have been accommodated through a

World Bank structural adjustment loan.

That brings us to the CCL. This was introduced with the hope that countries that felt themselves liable to be exposed to contagion would be able to fortify their liquidity to a point that would deter any speculative attack. But, as noted, no country has so far applied for a CCL, and one needs to ask why. It is not difficult to find a plausible explanation. Application is in itself liable to be interpreted by the market as an admission that the country fears a speculative attack, an interpretation that is liable to provoke the very attack that it is hoped to deter. Even if that danger is circumvented, there is a similar danger that an attack could be induced if the Fund ever found it necessary to withdraw a country's eligibility to borrow. Then there is the fact that the Fund has judged it necessary to avoid a completely automatic right-to-draw even after a country has been declared eligible, and envisages an attenuated, but nonetheless substantive, process of review that could end with the imposition of additional conditionality. Thus it is not difficult to see why the CCL has so far failed to appeal to potential candidates. It is difficult to see this lack of interest ever changing by fiddling about with interest incentives. The obvious conclusion is that it would be sensible to abolish the CCL, while absorbing some of the features of its design into the other facilities designed to allow the Fund to respond to crises.

Those other facilities are standbys and the SRF. Everyone, even the IFIAC majority, agrees that the Fund needs to be able to lend in a crisis situation. The questions are: under what conditions, on what terms, and in what quantities? While it seems quite sensible to envisage larger lending (relative to quota) carrying a higher interest rate, it is difficult to see what advantage is gained by having a separate window for the higher-interest lending. Accordingly, this paper recommends consolidating both facilities into a single window, which one might call the Crisis Facility, since its purpose is precisely to allow the Fund to help countries deal with crisis situations.[1]

Thus the Fund would be streamlined so that it offered two facilities. The CFF would provide low-conditionality loans in response to shocks that were clearly outside a country's own control, such as shortfalls in the value of primary commodity exports. It would seem logical to include also other exogenous shocks, including natural disasters (such as the 1998

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[1]This bears some similarity to the CFR proposal to consolidate the SRF and the CCL into a new contagion facility, although the lack of conditionality envisaged for the contagion facility strikes me as unrealistic and differs significantly from my subsequent proposals.

floods in Bangladesh). The Crisis Facility would make loans in situations of macro-economic crisis.

Pre-qualification. While this paper has argued that the CCL is unattractive to potential borrowers for very basic reasons, it would be a mistake to dismiss the line of analysis that motivated its creation. The wisdom of the IFIAC majority recommendation that (after a transitional period) the Fund should lend only to countries that had pre-qualified is questionable. Nevertheless, the idea that countries should be able to borrow more, and/or more easily, and/or more cheaply is one with considerable merit if the countries have pre-satisfied certain conditions.

The attractions are most obvious with respect to the Crisis Facility. One wants to encourage countries to take actions that will minimise their vulnerability to crisis, and it seems natural to reward those that do by giving them assured access (or at least semi-assured access) to a lender of last resort (or at least to a quasi-lender of last resort). The key question is, then, what actions should be required to pre-qualify? The majority IFIAC report suggests four:

- freedom of entry and operation for foreign financial institutions;
- well-capitalised commercial banks, preferably with part of the capital in the form of uninsured subordinated debt;
- regular and timely publication of the maturity structure of outstanding sovereign and guaranteed debt and off-balance sheet liabilities;
- 'a proper fiscal requirement.'

The first of these is problematic. Traditionally countries have been allowed to decide for themselves whether or not they wish to allow entry of foreign banks. There is a legitimate economic reason why countries may, under some circumstances, hesitate to allow foreign banks to enter, namely that this can erode the franchise value of existing banks, and therefore precipitate 'gambling for redemption'. Nor does there appear to be any empirical evidence that foreign banks can be relied on to stand by a country in times of crisis by increasing their exposure; indeed, the foreign banks in Argentina froze their exposure during the 'tequila' crisis in 1995. Thus this proposal would seem at best premature.

In contrast, a requirement of a solvent, well-capitalised, and well-supervised banking system would appear entirely appropriate. The worst crises happen when a weak banking system deters a central bank from raising interest rates as needed, so that a currency crisis and a banking crisis occur simultaneously. And the suggestion that a part of bank capital should be required to take the form of uninsured subordinated debt held by third parties is also compelling; its attraction is that the holders of such debt have no possibility of upside gains from risky bank behaviour, so that they can be relied on to monitor and penalise any gambling behaviour by bank management. In asking how one might go about implementing this requirement, an attractive possibility would be to adopt the suggestion of the CFR report (and the IFIAC minority) that the test should be whether a country has adopted and implemented the Basle Core Principles. One might also ask whether it might not make sense to extend the principle to reward observance of some of the many other codes of standards currently being prepared, but, at least initially, it may be best not to overburden the system by making too many demands on surveillance.

The requirement for regular and timely publication of statistics regarding the maturity structure of sovereign debt (and off-balance sheet sovereign liabilities) is also sensible and unobjectionable. The obvious question it raises, however, is whether data on sovereign debt will suffice. None of the East Asian countries had a serious problem with sovereign debt: the problems arose with private sector debt, incurred either by banks (for example South Korea) or the corporate sector (for example Indonesia). Accumulating accurate and timely data on private sector debt raises altogether more formidable difficulties than are posed by sovereign debt. It so happens that the Fund has already established a standard on this topic, which embodies a judgment as to how much data it is reasonable to expect a country to collect. The criterion for a country to receive preferential treatment should be that it subscribes to the Fund's Special Data Dissemination Standard.

The IFIAC report does not attempt to spell out the nature of the 'proper fiscal requirement' that it suggests including as a pre-qualification requirement, presumably because this was added at the last moment in response to the objections of the minority that its absence would expose the Fund to supporting countries with runaway budget deficits. It is nonetheless not difficult to imagine the form that such a requirement might take. Perhaps it would be like the Maastricht fiscal requirement for joining the EMU: a budget deficit no greater than 3 per cent of GDP and a ratio of public sector debt to GDP of under 60 per cent (or trending down). Or perhaps it would be expressed in terms of the primary balance, to avoid the objection that a criterion expressed in terms of the total deficit could act as an inappropriate deterrent to tightening monetary policy (though this creates the problem that the necessary primary balance varies across countries depending on their level of public sector debt). Or perhaps it would be expressed in terms of the cyclically-adjusted balance, to avoid the objection that a criterion expressed in terms of the crude deficit could act as an inappropriate deterrent to an anti-cyclical fiscal policy. Or perhaps it should be expressed in terms of the operational deficit, to avoid making unreasonable demands on countries that have still not eliminated a high inertial inflation. Or perhaps it would be better not to try to lay down a universal requirement to be met by all countries, but instead to have the Fund make a regular judgment on a country's fiscal position.

That, then, raises the question as to why the Fund's judgment should be restricted to the fiscal dimension. Why not have the Fund's Article IV consultation end with the award of a rating of the country's overall macro-economic policy? One would surely want this rating to be more like those of the ratings agencies than the simple yes/no rating embodied in the CCL, so that countries can be downgraded when they deserve it without automatically provoking Armageddon in the markets. Having such a rating awarded regularly by an official institution would also resolve the problem of what to use to determine the risk ratings used in calculating bank capital adequacy requirements.

One other idea merits inclusion, in addition to the conditions suggested by the IFIAC report. This is the suggestion in the Geneva report (p.71) that the IMF should provide an incentive by lending on more attractive terms to countries that include appropriate provisions in bond covenants to make their bonds renegotiable under crisis conditions. These provisions 'would include majority representation, sharing, non-acceleration, minimum legal action threshold and collective representation clauses, where these last provisions allow an indenture trustee to represent and co-ordinate the bondholders'.

Hence the suggestions of a list of pre-qualification criteria that would entitle countries to draw from the Fund under the crisis facility on enhanced terms:

- adoption and implementation of the Basle Core Principles for the domestic banking system;
- subscription to the Special Data Dissemination Standard;
- a good rating for macro-economic policy in the most recent Article IV consultation, and inclusion of collective action and allied clauses in its foreign bonds, especially sovereign bonds.

How about drawings from the other facility that this paper has argued the Fund should retain – the CFF? Many of the countries that are most likely to suffer strong variations in commodity prices are unlikely to have banking systems that have advanced to the point of implementing all the Basle Core Principles. Similarly, they may not be able to afford a statistical service sufficiently sophisticated to be capable of subscribing to the SDDS. It would be unfair to penalise them for not meeting the full standards expected for crisis borrowers. They should, nonetheless, face the same requirement of good macro-economic policy as any other borrower, and they might also be rewarded for any of the other conditions that they meet.

Payments Standstills. Three of the six sources analysed in this paper – the Geneva report, the CFR report and Secretary Summers's speech – saw a role for standstills in dealing with at least some capital account crises. (The subject is not taken up in the other three reports.) All of them regard standstills as something to be deployed as a last resort rather than embodied as a regular element of crisis management.

This is a topic on which the conventional wisdom is deeply unrealistic. The world tried for many years after 1945 to deny that sovereign debts ever needed to be restructured, but the Brady Plan finally acknowledged that this is not tenable. Not all contingencies are foreseeable, and hence, no matter how conscientious the debtor, contingencies may arise in which it is something between unreasonably costly and totally impossible for the debtor to maintain debt service according to the original contractual terms. This is now widely acknowledged, but its corollary is not. That corollary is that any creditor that suspects restructuring to be a possibility has an incentive to liquidate its claim while that remains possible. Limited official loans will simply allow more creditors to get out, rather than encourage them to stay in. The choice is between unlimited official loans (a real lender of last resort rather than a quasi-lender of last resort) and restructuring the debt. In any single instance the provision of unlimited liquidity may well be the most attractive option, provided at least that the country really has got its fundamentals in order so that its problem is indeed one of illiquidity rather than insolvency. But, even if one is not sure that past IMF loans have been a major source of moral hazard in the way the IFIAC majority believe, it seems quite implausible that promulgation of such a policy would not create moral hazard in the future. If one worries about that, the logical conclusion is that the IMF should never undertake crisis lending except in the context of a standstill. An essential component of the policies needed to deal with a capital account crisis has to be reconstruction of debt on terms that the country can respect, and until that has been accomplished it is foolhardy to try to maintain debt service.

This means that a country that decided it needed to borrow from the Fund would be expected to declare a standstill while it negotiated with the Fund. It would start negotiating with at least some of its private creditors at the same time, with an overwhelming presumption that problems of illiquidity should be handled by extending maturities rather than reducing the present value of debt-service obligations. The IMF might provide bridging loans while the negotiations were in progress, provided it was convinced that the country was negotiating with its creditors in good faith. It would conclude the negotiations only when it was convinced that the restructured debt profile agreed between debtor and creditors was one that the country could be expected to service according to the new contractual terms. At that point the country would also lift its standstill and start servicing its debt on the revised terms. Note that these arrangements give an incentive to both parties to seek a prompt debt restructuring: the debtor will be denied bridge financing from the Fund if it does not negotiate in good faith, and the creditors will not see debt service resumed until the negotiations have been completed.

This paper goes along with the bulk of the literature in assuming that it would be the country, rather than the IMF, that would declare a standstill. It would presumably do this at the same time that it announced that it was approaching the Fund. The difficulties in declaring a standstill are not as great as is frequently asserted. It is arguable that there is no need for a set of well-defined rules regarding coverage. The country would have a strong incentive to make coverage as broad as is necessary to re-establish its financial standing, since it would know that no IMF loan would be forthcoming unless enough of its debt was restructured to allow it to service its debt. If that could be achieved by restructuring only sovereign debt, and without an element of discrimination unacceptable to the Paris Club, then presumably the country would choose to limit the standstill to sovereign debt. But if it knew that the Paris Club would demand parallel treatment for London Club debt, it would be foolhardy not to extend the standstill immediately to bank debt as well, since every bank would have an overwhelming incentive to liquidate whatever loans it could before the standstill that, in that circumstance, it would have to expect would go into effect. The same applies to bonds if the Paris Club demanded similar treatment of bonds. And if it is unlikely that the country could get back on its feet without restructuring corporate debt, or while capital flight is in progress, then it would also be well-advised to impose exchange controls that would suspend the servicing of corporate debt and/or control capital flight. But there is no need for the IMF to lay down rules about the extent of the standstill that it would expect to accompany an approach for money. The country could be left to choose how extensive to make the standstill.

Critics of the standstill idea usually worry about the impact that legalisation of standstills might have on the flow of credit to borrowing countries. Would lenders not be so worried about the possibility of a standstill being imposed as to decline to lend significant sums? One could indeed imagine that reaction if a borrower had a unilateral right to impose a standstill without any international restraint. But the version outlined above requires the Fund to certify that the debtor is negotiating to restructure its debts in good faith as a condition for receiving interim finance, and that it gets a final agreement only after the debts have been successfully restructured. This should usually accelerate a country's return to health, including servicing debt on contractual terms. A creditor who knew that any currently unforeseeable debt problems would be handled in this expeditious way should be a more, not less, attractive client. It is only when a country had built up its debts to a point where a crisis began to be feared that its creditors would have a good reason for not lending; but it is in those circumstances that many of us feel it to be highly desirable for lenders to show more restraint. It is probably true that a standstill requirement would bring crises forward in time, and might even prevent the occasional case of a country with a potential crisis that manages to fight it off by prompt action, but even this would have a countervailing advantage in that it would be altogether more likely that countries would be brought to restructure their debts before a write-down was necessary. As creditors came to accept that the norm would be an extension of maturities, rather than a loss of present value, so any deterrent effect (other than in circumstances when debt was already excessive) would vanish.

Loan Terms. This concerns the questions of how large a loan countries should be entitled to, of the maturity of those loans, and of the interest rates they should be required to pay.

Some of the assertions that IMF loans could be reduced in size seem to be based more on faith than analysis. This paper has already argued that one would need indefinitely large loans in order to ensure the restoration of market confidence without an accompanying private sector debt restructuring. The addition of the requirement of a standstill and a private debt restructuring is essential if one wishes to limit the size of IMF loans and still be confident that they could restore a country's financial standing.

The IFIAC report suggests limiting IMF loans to 120 days, with the possibility of only one rollover. The reason it gives for this recommendation is that: '[h]istorical experience suggests that liquidity crises typically last for a matter of weeks or, in extreme cases, for several months' (p.46). This is naïve – the reason liquidity crises are short-lived is that private lenders are soon able to see where the country is going to be able to get the resources to service its debts. A sure-fire way of lengthening crises would be to make the Fund's credits sufficiently short term to keep private lenders guessing as to whether the country would be capable of honouring its debt-service obligations when the Fund has to be repaid. The maturity of the Fund's existing standby facility, namely 3–5 years, seems altogether more appropriate.

The IFIAC report suggested that Fund lending should be done at a penalty interest rate (defined as 'a premium over the sovereign yield paid by the member country one week prior to applying for an IMF loan', p. 46). This runs counter to the tradition by which the Fund lent on the finest terms that any sovereign could command, a tradition inspired by the idea of an international self-help co-operative. The disadvantage of this tradition is that it can tempt a rational government into regarding the Fund as a preferred source of credit, deterring prompt repayment of loans and conceivably even tempting it into qualifying for new loans (although this would normally require staging a crisis, which governments do not usually find attractive). A solution suggested in the ODC report is that the interest rate should be progressively increased as the duration of a Fund loan increases, thus providing an incentive for prompt repayment without threatening the effectiveness of a loan in the way that a short maturity would.

The ODC report argues that a concessional interest rate would be needed for low-income countries if their theoretical right to draw were to be a reality. This also seems a compelling argument, and not necessarily in conflict with the idea of a rate that becomes progressively more penal as time proceeds. The rate for these countries could start at a highly concessional level and then increase progressively over time.

The final idea that ought to be integrated into the interest rate structure is that countries should be given an incentive to take steps that would minimise the chance of their needing to borrow from the Fund. That is, countries would face a lower interest rate the more fully they satisfied the conditions listed above.

The result of taking all three of these factors into account in determining the interest rate to be charged for a loan from the Fund would be to produce a complex interest rate schedule rather than the simple pattern of either rate A or rate B. This is no great disaster. Computers are very good at doing the arithmetic that would be necessary to keep track of payments due. It would also have the great advantage of increasing the penalties paid by countries for policy slippage in marginal instalments, rather than confronting the Fund with the awful prospect of precipitating a certain crisis if it recognised worsening performance.

Concluding Remarks

There have been many calls in recent months for the Fund to get back to basics or to focus on its areas of core competence, which everyone agrees lie in macro policy, crisis avoidance and crisis management. The reform programme laid out in the preceding section of this paper is intended to do that, and to do it without emasculating the Fund in the way that the IFIAC majority would. It would not only return the Fund to the areas of its core competence, but it would strip the Fund down to two lending facilities, one designed to allow countries to replenish their liquidity when faced by exogenous shocks, and the other to help countries respond to crisis situations. It recognises that in a world of high capital mobility this is almost bound to involve debt restructuring, and therefore calls for countries applying for an IMF loan to impose a standstill on debt-service payments, an approach that would deal once and for all with the danger of creditor moral hazard. It suggests the use of variable interest rates on loans to build an appropriate pattern of incentives for member countries to choose policies that would minimise the danger of their encountering a crisis, and that would enable and encourage them to repay the Fund promptly when they found it necessary to borrow. While it returns the Fund to its areas of core competence, these are ones that are of major importance to even the poorest members of the Fund, ensuring that the IMF would continue to play a vital role in the world economy.

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