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The Future Role of the International Monetary Fund

Aziz Ali Mohammed

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PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Macroeconomic and Development Policies Branch, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research carried out under the project is coordinated by Professor Dani Rodrik, John F. Kennedy School of Government, Harvard University. The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums. Previously, the research papers for the G-24 were published by UNCTAD in the collection *International Monetary and Financial Issues for the 1990s.* Between 1992 and 1999 more than 80 papers were published in 11 volumes of this collection, covering a wide range of monetary and financial issues of major interest to developing countries. Since the beginning of 2000 the studies are published jointly by UNCTAD and the Center for International Development at Harvard University in the *G-24 Discussion Paper Series.*

The Project of Technical Support to the G-24 receives generous financial support from the International Development Research Centre of Canada and the Governments of Denmark and the Netherlands, as well as contributions from the countries participating in the meetings of the G-24.

THE FUTURE ROLE OF THE INTERNATIONAL MONETARY FUND

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Abstract

This paper looks at the role of the International Monetary Fund (IMF) in the evolving global financial system from the perspective of developing country interests. It finds that on certain issues, such as the scope and purposes of its lending operations, a consensus has been reached that IMF should continue to serve all its members, including the poorest, and that its resources should be available for supporting macro-relevant structural reforms as well as for dealing with financial crises.

On a number of other issues, there remain differences between industrial and developing country views, including on the extension of IMF surveillance to cover the observance of international standards and codes. Largely unsettled are the modalities of the involvement of the private sector in crisis resolution, with special reference to the development of arrangements in the international sphere that would be analogous to domestic bankruptcy procedures, including the declaration of standstills and principles for orderly and equitable debt workouts. The liberalization of the capital account and the choice of exchange regimes are two interconnected areas in which international prescriptions conflict with developing country insistence on the preservation of national autonomy and in favour of intermediate regimes, as opposed to corner solutions. The scope and content of IMF conditionality raises the issue of how to reconcile it with the importance of assuring country ownership.

Finally, the governance of IMF poses questions about the exercise of decision-making powers in the institution. Developing country positions are evolving in all these areas, especially on the subject of private-sector involvement in financial crisis prevention and resolution. However, there appears to be a general preference for a more rules-based framework, rather than one derived on a "case-by-case" basis.

There are four areas of great interest to developing countries where the international debate has remained muted or has been largely absent in the recent literature: these relate to the surveillance over, and coordination of, the macroeconomic policies of the three principal international currency issuers; the relationship of international and regional arrangements; the distribution of voting power in both IMF and the international system generally, and the future evolution of the international reserve system.

Table of contents

THE FUTURE ROLE OF THE INTERNATIONAL MONETARY FUND

Aziz Ali Mohammed

I. Introduction

A worldwide debate on the operations of the International Monetary Fund (IMF) and its future role has been under way in the wake of the financial crisis in Mexico in 1994/95, followed in 1997/99 by a succession of crises affecting countries in South-East Asia, the Republic of Korea, the Russian Federation and Brazil. Most of the countries involved were in the developing or transition economies – an exception being the collapse of an important hedge fund in the United States in the second half of 1998, which directly threatened international financial markets and forced the Federal Reserve to intervene to prevent a global meltdown. It might therefore appear natural for much of the subsequent discussion to focus on the prevention and resolution of financial crises in affected countries, and especially on a subset of those with closer connections with international capital markets, namely the emerging market economies. Much less attention has been directed to the reform of policies and arrangements in the major industrial countries, where changes in interest rates and exchange rates generate powerful effects on the rest of the world. Nor has much emphasis been placed on structural deficiencies in the working of financial markets and the transmission mechanism between them, on herd behaviour, asymmetric information and overshooting proclivities that have produced such a devastating impact on previously fast growing, dynamic economies.

A great deal of literature has been produced in the past few years by both official and non-official sources on crisis prevention and management problems in emerging market countries. A certain degree of consensus has been reached on etiology and the prescriptions for prevention of financial crises, and there is a better understanding of the principal issues that remain in contention as these apply to developing countries (Mohammed, 2000). There is less agreement on what needs to be done for the resolution of crisis, once it breaks out. Large differences of view persist on the role to be assigned to the international institutions, especially IMF, between those preoccupied with moral hazard concerns and others willing to consider a more ambitious agenda of intervention. There remain complex issues relating to the participation of the private sector in financial crisis management; measures for improvements in the working of financial markets and the governance of the international financial institutions. In all these areas, a variety of proposals have emanated from individual governments, intergovernmental groups and non-governmental expert bodies. The discussions reached a certain culmination in the proposals endorsed at the G-7 Economic Summit held in Japan, in July 2000, on the basis of several reports submitted to the Summit leaders by the G-7 Ministers of Finance.[1]

The rest of the paper is organized as follows: section II identifies issues in the area of financial architecture, where there appears to be an emerging consensus in the international community; section III reviews issues that remain in contention from the viewpoint of developing countries; section IV enumerates some unresolved issues pertaining to the role of the major developed countries in the international financial system; section V summarizes developments since the last G-7 Economic Summit.

II. Issues approaching consensus

The scope of IMF lending operations was one of the issues under debate where a consensus appears to have been attained. It will be recalled that the majority report of the Meltzer Commission (IFIAC, 2000)[2] had proposed to restrict the IMF role to that of a "quasi-lender-of-last resort" providing very short-term, essentially unconditional, liquidity support for a limited number of relatively strong emerging market countries that would have pre-qualified for IMF assistance. The Commission also wanted to eliminate the Poverty Reduction and Growth Facility (PRGF). A number of academic and other non-governmental groups have similarly argued for taking IMF out of the poverty alleviation business, whereas developing countries wanted to maintain IMF role in all member countries, including in the poverty reduction area. The G-7 Economic Summit leaders endorsed the proposition that "as a universal institution, IMF must work in partnership with all its members, including the poorest, based on shared interests".[3] The G-7 Finance Ministers took an even stronger line in their report to the Summit leaders by emphasizing that IMF had a critical role to play in supporting macroeconomic stability in the poorest countries, through the PRGF, integrating its efforts with those of the World Bank (Report of G-7 Finance Ministers, Fukuoka, 8 July 2000, para. 6g). The World Bank was recognized as "the central institution for poverty reduction", but IMF's "responsibility" for macroeconomic stability was stated to be a "key tool for the achievement of poverty reduction and growth" (ibid.). Whether this attempt to define the respective responsibilities and activities of IMF and the World Bank Group in the poverty reduction area is clear enough remains to be seen. Much will depend on how rapidly the latter institution can fashion and implement a lending instrument that would complement the PRGF.

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

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

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

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

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

An area where a consensus appeared to have been reached at one stage relates to the selection of the Managing Director of IMF. A press release authorized by the Executive Board, while it was still in the midst of the selection process declared that this was a "very important decision"; that the decision would have to be based on a discussion of "the exceptional qualities that the next MD will require", and that "the process of choosing the best person for the job from the possible candidates will, through the Board, involve all members of the Fund".[4] The Executive Boards of IMF and the World Bank Group subsequently established working groups to review the process for the selection of their respective chief executives; their reports were to be submitted to the next meeting of their respective Boards of Governors. However, no such reports were forthcoming at the Prague Annual Meetings, and there is some indication of a loss of interest in the subject on the part of the major shareholders.

III. Issues in contention

This section reviews issues that remain in contention from a developing country point of view. Among them, the following are examined:

- Extension of the surveillance exercise to cover the implementation of international standards and codes;
- Modalities for the involvement of the private sector in crisis resolution with special reference to "standstills" and debt workouts;
- Pricing of IMF non-concessional facilities;
- Liberalization of the capital account and choice of exchange regimes;
- The content of IMF conditionality and its bearing on country ownership; and
- Governance of IMF.

A. Fund surveillance

There has been a steady extension of the ambit of Fund surveillance beyond its traditional concern with macroeconomic conditions and monetary, fiscal and exchange rate policies in individual member countries and with the functioning of the international monetary system. The rapid growth of private capital flows and the series of financial crises associated with massive reversals of such flows has focused attention on financial sector issues, with special emphasis on the need for better identification of sources of vulnerability and measures to prevent the emergence of crises. The G-7 Finance Ministers expect IMF "in conducting its surveillance work, [to] continue to sharpen its focus on macroeconomic policy, capital flows and structural issues which have an impact on macroeconomic stability, in particular in the financial sector, and on exchange rates with a view toward encouraging countries to avoid unsustainable regimes". The Economic Summit leaders asked for a qualitative shift in the nature and scope of IMF surveillance to prevent crises and expressed determination to strengthen efforts to implement international codes and standards, "including through their incorporation in IMF surveillance".[5] While welcoming the development of "codes, standards and best practices", developing countries have been equally emphatic that "the scope of surveillance should not be extended to cover the observance of such codes and standards, which should remain a voluntary choice by each member".[6] In an earlier communique, the G-24 Ministers had explained their reservations by noting that assessment of practices in these areas "should take fully into account their institutional capacities and stage of development, so as not to place developing countries at a comparative disadvantage". They also warned that increased attention given to these matters would be "acceptable as part of Fund surveillance as long as it remains within the core competencies of the Fund and subscription to international standards remains voluntary".[7] These cautions indicate that while developing countries are prepared for IMF and the World Bank to help them prepare Financial Sector Assessments under the FSAP project and for IMF to develop internationally agreed standards in areas of core competence (such as data dissemination, fiscal transparency and transparency in monetary and financial policies), they are less prepared to have IMF surveillance extended to monitoring their observance of standards or to be measured against them. This reluctance applies especially strongly to areas beyond IMF's traditional expertise, such as securities, investment funds, insurance, accounting, auditing and corporate governance. While IMF management has offered assurances that it would work closely with the World Bank Group and other institutions, including standard-setting bodies, and that the preparation of financial sector assessments would be carried out in a phased manner, the insistent tone of industrial country pronouncements[8] leaves much uncertainty as to how these assurances will apply in practice.

Another set of apprehensions relates to how much disclosure of surveillance judgements is to be required. The United States Secretary of the Treasury has argued that the focus of surveillance "should shift from collecting and sharing information within the club of nations to promoting the collection and dissemination of information for markets and investors".[9] Developing countries argue that as a cooperative of governments, IMF cannot be expected to serve as a super-rating agency for the benefit of private markets, nor should it issue public warnings that are likely to become self-fulfilling prophecies.

B. Private-sector involvement

As noted earlier, the official community is agreed that the private sector should participate in the prevention as well as the resolution of financial crises. On the prevention side, the major question raised by developing countries relates to the disclosure practices of financial institutions, especially in relation to their funding of the activities of highly leveraged institutions (HLI), such as hedge funds and their operations in offshore financial centres, where a significant proportion of unregulated hedge funds are located. The recommendations in these interrelated areas have been the subject of studies by the Financial Stability Forum (FSF) Working Groups and are largely of a self-regulating character. The G-7 Ministers were not prepared to recommend "at this stage, direct regulation of the currently unregulated HLIs", indicating their desire to propitiate private financial interests in their own markets. The transparency obligations and regulatory restraints being applied to developing countries are not balanced by a commensurate application to institutions whose operations have generated such disruptive market dynamics in other countries' markets. Indeed, the need for transparency extends beyond these marked institutions to the actions of those who regulate them and to the decision makers who frame the environment within which both operate.

On the crisis resolution side, there is a whole skein of issues. The fundamental one, however, is whether private-sector involvement should be based on the use of concerted techniques applied under a rules-based framework or should be decided on a "case-by-case" basis. But the choice between the two approaches does not run along a North-South divide. A number of European countries and Canada favour clear rules determining when the private sector is to be "bailed in". Others (including the United States) argue for "constructive ambiguity".[10] The former group would establish a presumption that concerted private-sector involvement would be required if IMF resources needed for dealing with a financial crisis exceed some pre-specified limits on members' cumulative access to Fund credit. Use of IMF resources beyond such limits would be conditioned on the imposition of a standstill analogous to one that features in most domestic bankruptcy proceedings. The possibility of the debtor country being able to declare a standstill, together with some form of official acknowledgement, is seen as essential for bringing otherwise recalcitrant creditors to the table for negotiations. Those opposed to establishing a predictable framework are concerned that, apart from adversely affecting the efficient operation of international capital markets, it might accelerate a "rush for the exits" by creditors and impede a resumption of spontaneous market access by the country concerned, as well as producing adverse spill-over effects for other countries. While developing countries have not yet articulated a common position, the interests of smaller countries would indicate a preference for a rules-based framework. This would constitute an important step towards developing in the international sphere a bankruptcy regime similar to the one existing in the domestic arena. Another step would be to generalize the incorporation of collective action clauses in international sovereign bond contracts – a possibility now available for certain issuances on the London market.[11]

Beyond the issue of standstill lies the bigger one concerning the arrangements for orderly and equitable debt workouts. Where the problem is essentially one of liquidity (here defined to mean where a rapid return to market access on reasonable terms is deemed likely), it might be sufficient to arrange for debt rollovers with the help of an IMF-supported programme that serves a catalytic function. Where the prospects for a rapid return are poor (owing either to the country's own situation or because the markets are disturbed), it would be necessary to visualize debt restructuring and, in extreme cases, debt write-offs. IMF's role as a "gate-keeper" for Paris Club debt reorganizations is well established and has been strengthened in the context of the HIPC Initiative. This role, however, is concerned with sovereign debt and where the credits are officially granted or officially guaranteed. The IMF role is far more problematic when it is dealing with private-sector creditors and claims a "preferred creditor" status in relation to them. Developing countries have insisted on the principle that IMF should not become a party to the negotiations between the debtor country and its private creditors.[12]

Developing countries tend to be generally unconvinced that the official community will be able to overcome the powerful resistance of private-sector interests to concerted techniques for involving them. They would much rather that IMF were equipped with an emergency facility that could decisively underpin confidence in the international system when confronting speculative excesses in private capital markets. In a world where these markets can mobilize enormous sums in very short order to attack any country's currency, IMF could succeed in facing down market speculators only if it had the power to create international reserves freely through a prototype SDR mechanism.[13] While these arguments are made in the context of helping individual member countries subjected to speculative attack, a more nuanced position has been offered by the former IMF Managing Director, Michel Camdessus, who proposed that in the event of a "systemic credit crunch" IMF should be authorized "to inject additional liquidity – and to withdraw it when the need has passed – in a manner analogous to that of a national central bank, through the creation and selective allocation of SDRs" (Camdessus, 2000). The Independent Task Force of the Council on Foreign Relations proposed a Contagion Facility "that would be funded by pooling a one-off allocation of SDR" (CFR, 1999).[14]

C. IMF facilities

Several issues in this area were settled, as noted earlier. Some new ones arose, however, from G-7 demands for giving "priority to early progress in achieving a streamlined, incentive-based structure for IMF lending that encourages countries to develop stable access to private capital markets on a sustainable basis" (CFR, para. 9, fn. 5). To this end:

> … the new pricing structure should establish more consistent objectives across facilities … discourage prolonged use of, and deter inappropriate large-scale access to, IMF resources, thus contributing to their more efficient use. For all non-concessional facilities, the interest rate should increase on a graduated basis the longer countries have IMF resources outstanding. The possibility of adding a premium when the scale of financing goes beyond certain thresholds should be explored. In addition, for countries that continuously resort to IMF facilities, the IMF should make more intensive use of prior actions and limit access to its resources.

They also ask for "steps to encourage early repurchases once the IMF borrowers have returned to a sustainable economic and financial path" (CFR, paras. 11(a) and (b)). This set of proposals for tightening the terms of IMF credit are ostensibly directed to ensuring that Fund financing is not treated as a cheaper substitute for available market financing and in order to delay adjustment. Developing countries consider the rationale offered to be unconvincing and, since changes in the terms of IMF credit require a qualified majority of 70 per cent to be enacted, they would be able to block the G-7 proposals, provided they maintain solidarity (see the concluding section to this paper).

Developing countries are even less persuaded by another proposal of the G-7 Finance Ministers, viz. the call "to explore appropriate use of any resulting increase in IMF income within the existing framework of the Articles with the objective of targeting support to poorest countries" (ibid., para. 11(c)). The effect of this recommendation would be to shift the burden of helping the poorest of the developed member countries to those somewhat less poor. It would be tantamount to repealing an implicit contract that underpins the weighted voting power that the rich countries exercise in IMF, namely that this "democracy deficit" is justified by the contribution that the richer countries are expected to make for providing resources to IMF, particularly concessionary resources.[15]

D. *Capital-account liberalization and the choice of exchange regime*

The major issue in contention is the degree of national autonomy that countries exercise in regard to the management of their capital accounts. A powerful campaign launched in the mid-1990s, with strong ideological overtones, for an IMF-supervised regime reached its peak in 1997 when the Interim Committee resolved to invest the institution with statutory authority to promote capital liberalization. This push lost momentum following the experience with the massive volatility of private capital movements in the 1997/99 period that created enormous havoc in a succession of emerging market countries. The IMF has subsequently qualified its advocacy with cautions about the process being gradual, orderly and properly sequenced. There is particular emphasis on having in place a strong regime of prudential regulation and supervision of domestic financial systems, as well as equally strong liability management policies aimed at producing sustainable debt ratios and debt profiles covering external and domestic currency debt of both the private and public sectors. As regards capital inflows, there is greater acceptance of the need to deter large-scale, short-term capital inflows with the help of indirect, price-based, policy tools, such as the reserve requirements used by Chile and Colombia in recent years. There is less agreement on whether direct administrative controls are desirable, although these might be acceptable in the case of underdeveloped regulatory systems. In the case of capital outflows, there is a tendency to consider them as unworkable, especially if they are introduced during a crisis. Ocampo has argued that "a permanent system of capital-account regulation which can be strengthened or loosened throughout the business cycle is preferable to the alternation of free capital movements during booms and quantitative controls during crisis".[16] Moreover, any use of concerted techniques for involving the private sector in crisis resolution would have to provide for the suspension of debt-service payments, including through the application of exchange controls on private-sector payments.

The importance of maintaining national autonomy in the choice of exchange regime also bears on the management of the capital account. Developing countries are being pushed, on the basis of the "impossible trinity" argument to choose between "corner" solutions: either free floats or currency board arrangements. Yet most developing countries continue to operate intermediate regimes, and there are grounds on which such choices can be justified.[17] In any event, such intermediate regimes would have a better chance of operating successfully in tandem with capital-account regimes that allow for capital controls, whether of a price-based or administrative character. Developing countries would favour an acceptance by IMF of the possibility of using capital controls as a regular instrument of national policy, instead of treating them as temporary devices to deal with emergency situations in countries with poor prudential regulations.

E. *Conditionality and country ownership*

This has been a traditional area of contention, and the controversies have intensified in the wake of IMF interventions in the East Asian countries, Brazil and transition countries. In addition to questions about the correctness of technical conditions (e.g. overemphasis on fiscal retrenchment, balance-of-payments adjustment biases at the expense of growth and social spending, and insistence on structural measures beyond those required for macroeconomic stabilization), developing countries have argued that new conditions of a political economy character relating to governance (rule of law, judiciary reforms, civil society participation, etc.) have represented an unwarranted invasion of national sovereignty (Kapur and Webb, 2000). The number and variety of conditions applied have created great difficulty in meeting them and tended to delay disbursements. There has been a greater willingness on the part of IMF management to streamline conditions and to restrict structural conditions to those essential measures that are "macro-relevant" and within the Fund's core area of responsibility.

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

F. Governance of IMF

There are several issues in contention, of which perhaps the single most significant one is the influence of developing countries in IMF's decision-making process. The original concept of IMF as a cooperative institution has eroded as industrial countries have not needed to borrow from it – a consequence of the growth of global capital markets. With the membership split between "structural" creditors and "structural" debtors, the former group has felt no compunctions about elaborating conditions to be applied to the latter group, since they were unlikely to apply them to themselves. A manifestation of this tendency has been the growing arrogation of decision-making by smaller groups of industrial countries (notably the G-7), which are then pushed through IMF on the basis of weighted voting power.[18] This has been seen, for example, in the 1999 Economic Summit decisions relating to the enhancement of the HIPC Initiative; these were pushed through the Executive Boards of the Bretton Woods institutions, despite the fact that the enhancement added to the costs of the Initiative for these (and other multilateral) institutions (as well as other creditor governments), and the G-7 made no commitments of their own on how these costs would be met. Even more striking was the use of unusually strident language in the Report of the G-7 Finance Ministers presented at their meeting at Fukuoka in July 2000. In a preamble to the Report, the Ministers state that they "*are determined to implement all the measures in this report, as well as the broad range of measures endorsed at the Cologne Summit*" (italics added).While this sentence was followed by a reference to working together with other members of the international community, the context suggested that this would be for the purpose of making "steady progress" towards implementing their decisions.

Substantial changes in IMF governance would probably require an amendment of the Articles, but there is little possibility of such an amendment passing the United States Congress that would result in a surrender of its veto power. There could be other changes, however, in constituency representation on the Executive Board that might be contemplated as an act of international solidarity through (say) the western European countries agreeing to cede one or more of their Chairs (they now occupy eight) to (say) the sub-Saharan African countries, which must now make do with only two Chairs to represent some 40-plus member countries. A more significant change could come about from a reallocation of quota shares on the basis of radical changes in the formulae for the calculation of quotas, e.g. by moving to purchasing-power-parity exchange rates instead of market exchange rates for converting the chosen variables to a common denominator.[19] Another possibility would be to formulate group-focused (rather than country-focused) criteria for quotas, such as was done at the time it was decided to raise the quotas of OPEC members in the 1970s. A group criterion could, for example, take into account the degree of volatility in private capital movements and/or the extent of integration into global capital markets as variables in order to give greater weight to the emerging-market economies, whose problems constitute such an important part of IMF work in a world that will continue to be dominated by global capital markets.

IV. Issues relating to industrial countries

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

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

- The relationship of international and regional institutions for surveillance, mutual financial support and decision-making – especially in crisis situations – is another area that calls for discussion in light of changing political realities, such as the hardening of attitudes in the United States Congress towards IMF and other international institutions and the example set by the formation of a single currency area on the European continent. The Japanese proposal in 1997 for the creation of an Asian monetary fund was too hastily withdrawn, and while there has been some evidence of a revival of the concept in recent days, it needs to be developed to be meaningful. Similar arrangements might be worthy of consideration in Latin America, the Middle East (e.g. in the Gulf Cooperation Council countries) and in North Africa;

- The exercise of voting power within IMF, as determined by the distribution of quotas that derives historically from an arbitrary quota allocation formula designed to perpetuate the dominance of a few industrial countries (Buira, 1999), has important implications for the internal governance of that institution and, through that, on the governance of the international monetary system. The issue is broader, however, when one considers the power alignments across international institutions with overlapping mandates and operations, including the World Bank Group, the World Trade Organization, the Bank for International Settlements, the Basel Committees and the more recently established Financial Stability Forum. The relationship of the treaty-based institutions with defined rights and obligations of members versus ad hoc groupings, such as the Canadian-chaired Group of Twenty, raises important questions on the influence exerted by a small subset of the membership. It also raises pertinent questions regarding the protection of minority rights in international institutions that are duly recognized when applied to the sphere of corporate governance;

- The international reserve mechanism and its current heavy reliance on a very few national currencies. While the debates of earlier decades on the supposed "benefits" obtained by the currency issuers may have lost some of its relevance, there remains an outstanding question about the role of the SDR mechanism in an evolving global system in need of a genuine international lender-of-last-resort.

V. Conclusions

Decisions taken at the G-7 Economic Summits tend to set the agenda for subsequent work at IMF. The Ministerial meeting of the International Monetary and Financial Committee (IMFC), held in Prague after the Okinawa Summit, largely endorsed many of the proposals agreed there, leaving to the Executive Board the formulation of decisions and implementation guidelines with regard to Fund Facilities and related matters. In order to ensure that countries do not rely on Fund resources for excessively long periods, the Board decided to introduce time-based repurchase *expectations* ,while leaving unchanged the period when repurchase *obligations become due*. For purchases in the credit tranches, members would be expected to begin repurchase two and a quarter years after each purchase and to complete repurchases after four years. Under the EFF, members would be expected to meet repurchase expectations, starting from four and a half years and ending seven years after each purchase. While members would be expected to repurchase within a shorter period, a member could obtain an extension if the Board agreed that the member's external position was not sufficiently strong for it to repay early without undue hardship or risk.

The IMF Board also introduced surcharges that would apply to the amount outstanding above a threshold level, in order to discourage unduly large use of Fund resources. The use of credit above 200 per cent of a member's quota would carry a surcharge of 100 basis points above the regular rate of charge, and the surcharge would rise to 200 basis points for use of credit above 300 per cent of quota. The surcharges would not be changed for a period of at least four years; this was a major concession obtained by developing countries.

To encourage access to the CCL, the commitment fee was held to a uniform 25 basis points for amounts up to 100 per cent of quota that could be purchased over any 12-month period, and 10 basis points on amounts exceeding 100 per cent of quota. On actual use of credit under the CCL, the surcharge over the regular rate of charge would be 150 basis points initially, and would rise by 50 basis points one year from the date of the first purchase under the facility and every six months thereafter, until it reached a maximum of 350 basis points. Thus the surcharge on use of CCL would remain, at all times, 150 basis points lower than the surcharge that would be applicable under the Supplementary Reserve Facility (SRF). This is expected to give members an incentive to apply for the CCL instead of waiting until a crisis forced them to use the more expensive SRF. Other inducements included a presumption that a member should normally be able to draw one third of the total commitment of resources once activation was approved. No member has applied to date for the CCL.

The Fund clarified that the EFF would be granted only in cases where there is a reasonable expectation that the member's balance-of-payments difficulties would be relatively long-term, including because it had limited access to private capital, and where there was an appropriately strong structural reform programme to deal with embedded institutional or economic weaknesses. While the EFF was deemed to be especially appropriate for graduating PRGF and some transition countries that did not have enough access to capital markets, it was confirmed that the EFF remained available to all members.

Finally, on the use of Fund resources, it was agreed that when a member's credit outstanding in the General Resources Account (GRA) exceeded a threshold of 100 per cent of quota, there should be a presumption that the member would engage in Post-Programme Monitoring (PPM) by the Fund after the expiration of its arrangement. This would involve more frequent consultation with the Fund (than that which is normal under Article IV), with particular focus on macroeconomic and structural policies, and would include the submission of a quantified macroeconomic framework.

A major shift in the focus of IMF bilateral surveillance has been under way in the wake of the Financial Sector Assessment Programme (FSAP) that is jointly run by IMF and the World Bank Group. The prevention of financial crises is now placed at the heart of the surveillance exercise for emerging market countries, with increasing emphasis on identifying sources of vulnerability and on financial sector and financial market issues. In the joint FSAP undertaking, IMF is responsible for Financial System Stability Assessments (FSSA), and these are to be integrated with Article IV consultations. These assessments also cover the monitoring of observance of international standards, codes and best practices; they are designed to help countries to evaluate their own systems against international benchmarks, to identify vulnerabilities and gaps in regulatory structures and practices, and to indicate medium-term reform and development needs and priorities. A new item that has been added to the Fund's agenda is work on financial abuse, particularly money-laundering.

Much less progress has been made in developing the framework for the involvement of the private sector in the prevention and resolution of crises. The forum for broader discussion of financial architecture reform issues has apparently been moved from the Bretton Woods Institutions to the Group of Twenty.[21] However, preliminary work has continued at IMF on such operational issues as the merits of alternative "standstill" provisions, the restructuring of international sovereign bonds, out-of-court corporate workouts and the comparability of treatment between official bilateral and private creditors.

Finally, on quotas and the related issue of representation that are central to the internal governance of IMF, progress has been minimal. A notable development was the recommendation by the Executive Board to the Board of Governors for an ad hoc increase in the quota of China following the return of Hong Kong to Chinese sovereignty. The Chinese quota would increase to SDR 6369.2 billion (from SDR 4687.2 billion) – a figure identical to that of Canada, the member with the smallest quota in the G-7 Group.

Notes

1 There are four reports, entitled: (i) Strengthening the International Financial Architecture; (ii) Poverty Reduction and Economic Development; (iii) Actions Against Abuse of the International Financial System, and (iv) Impact of the Information Technology Revolution on the Economy and Finance.

2 However, four members of the Commission had taken an opposing view on this, as on other subjects.

3 See G-7 Statement, Okinawa, 21 July 2000 (para. 8).

4 IMF Press Release No. 99/56 of 23 November 1999.

5 *Op. cit.*, para. 8. The language in this context is quite pontifical: “We are determined to strengthen our efforts to this end….”.

6 G-24 Communique (April 15, 2000), para. 14.

7 G-24 Communique (22 September 1999).

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

9 Speech delivered by Lawrence Summers at the London Business School on 14 December 1999.

10 Speech delivered at the International Law Association Biennial Conference in London, 26 July 2000.

11 The G-7 Finance Ministers recommended the use of collective action clauses in bonds issued in their own financial markets. They also asked the World Bank and other multilateral development banks to have such clauses used in international sovereign bonds or loans for which they provide a guarantee.

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

13 The case for such a mechanism has been made in papers prepared for the G-24 Research Programme. See Ahluwalia (1999) and Mohammed (1999): both papers envisaged that SDR allocations created for emergency lending would be cancelled once the emergency ended.

14 Council on Foreign Relations Independent Task Force Report on *The Future of the International Financial Architecture*, New York, September, 1999.

15 In a moment of candor, the Managing Director of IMF, in answering questions at the National Press Club in Washington, stated that the prospects of implementing the proposed changes were not promising “because a big group of countries within the Fund feel lectured [to] by the presentation of these ideas” (IMF, 2000).

16 See paper (mimeo) by Jose Antonio Ocampo, Executive Secretary of ECLAC, entitled “Recasting the international financial agenda”.

17 See IMF *Survey* (28 August 2000) reporting on Jeffrey Frankel’s search for the “missing middle”. See also Williamson (2000).

18 The group may become even smaller when the United States Congress legislates on the governance of IMF, and the other members of the G-7 are required to fall in line in order to obtain Congressional consent to an IMF quota increase, which requires a qualified majority of 85 per cent of total votes, and the United States exercises a veto with its 17.29 per cent share in total votes. A similar veto applies to other major decisions, i.e. the sale of IMF gold, SDR allocations and amendment of the Articles of Agreement.

19 A Quota Formula Review Group (QFRG) of experts was commissioned by IMF under the chairmanship of Professor Richard Cooper of Harvard University and reported in April 2000. The QFRG proposed simplifying the current system of five variables into a formula consisting of only two variables: one indicating a country’s ability to contribute to the Fund’s resources, represented by the GDP variable; and the other a country’s external variability, represented by the variability of current receipts and of net long-term capital flows. The Group was unable to agree on the relative weights to be assigned to each, and some members wanted to add a third variable: openness, represented by average current payments and receipts, supplemented by direct investment flows (see QFRG Report, IMF, 19 September 2000).

20 See remarks (mimeo) by Yilmaz Akyüz, Officer-in-Charge, UNCTAD Division on Globalization and Development Strategies, at the Regional Preparatory Meeting on Financing for Development, Jakarta, 2–5 August 2000.

21 As reported in an Annex to the Press Release on a meeting of the G-20 Finance Ministers and Central Bank Governors, held in Montreal, Canada, 25 October 2000.

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