The International Monetary Fund: Retrospect and Prospect in a Time of Reform

W. Max Corden, Brett House and David Vines

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W. Max Corden

Professor W. (Warner) Max Corden is Emeritus Professor of International Economics of John Hopkins University, and has been a Professorial Fellow in the Department of Economics of the University of Melbourne since July 2002. Professor Corden is a graduate of the University of Melbourne and the London School of Economics. His degrees are B.Com. (Melbourne), M.Com. (Melbourne), Ph.D. (London), D.Com. *honoris causa* (Melbourne), and MA (Oxford). In Australia he has held positions at the University of Melbourne (1958-61) and the Australian National University (1962-67 and 1977-88). From 1967 to 1976 he was Nuffield Reader in International Economics and Fellow of Nuffield College, Oxford, and from 1989 to 2002 he was Professor of International Economics (holding the Chung Ju Yung Chair in the latter part of the period) at the Paul H. Nitze School of Advanced International Studies (SAIS) of the Johns Hopkins University in Washington DC. He has also taught at Berkeley, Minnesota, Princeton and Harvard. In addition, he was Senior Advisor in the Research Department of the International Monetary Fund for two years from October 1986.

Brett House

Brett House is a Senior Macroeconomist at Columbia University and a Policy Advisor and Senior Macroeconomist at the UNDP. He is also an Economist at the IMF where he does applied research on debt sustainability, emerging market vulnerabilities, and global economic governance. In the past, he has also worked on the Dominican Republic, DR Congo and other central African country teams. He was previously Director of Studies in Economics and Stipendiary Lecturer at Keble College, University of Oxford, where he was a Rhodes Scholar, and Lecturer in Economics at the University of Cape Town, where he was a Rotary Scholar. He is a Term Member of the Council on Foreign Relations.

David Vines

Dr. Vines is Professor of Economics in the Economics Department, Oxford University and a Fellow of Balliol College, Oxford. Professor Vines is Director of the Centre for International Macroeconomics based at Oxford University's Economics Department. Formerly a Houblon-Norman Senior Fellow at the Bank of England, he has advised a number of international organisations and governmental bodies. Professor Vines was awarded a PhD in Economics by Cambridge University.

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The International Monetary Fund (henceforth 'the IMF' or 'the Fund') was conceived at a conference at the Mount Washington Hotel in Bretton Woods, New Hampshire, in July 1944 and its Articles of Agreement entered into force in December 1945. The World Bank (henceforth 'the Bank') was set up at the same time. The IMF was established to promote international monetary cooperation and the elimination of exchange restrictions on current account transactions; to facilitate trade, economic growth and high levels of employment; to foster exchange rate stability, and to provide temporary financial assistance to countries so as to ease balance of payments adjustment. More specifically, it was given the role of supervising a system of pegged but adjustable exchange rates, which became known as the Bretton Woods System. In the first two sections of this paper we explain how the Bretton Woods system worked, and why it broke down in 1971. In the following sections we consider the roles which the Fund now plays, which differ from its original activities. They are: surveillance, ensuring stability for the international financial system and for individual economies within this system, and assisting the world's poorest economies. As part of each of these three activities, the Fund also provides policy advice and technical assistance. This is a much less clear collection of responsibilities, and, as a result, the future direction of the Fund is somewhat uncertain. The aim of this paper is to review the achievements of the Fund, and also the challenges that lie ahead. A related overview of some of the issues discussed here can be found in Gilbert and Vines (2004)

I. The Bretton Woods system

(I) Intentions

As the Second World War drew to a close, the United Kingdom, the United States and their allies, inspired in part by the *General Theory* of John Maynard Keynes (Keynes, 1936), established a policy framework in which countries would be able to promote high levels of employment and output, by means of demand management policies, focused mainly on fiscal measures. This would—it was hoped—avert slumps in growth and would thereby prevent the re-emergence of the kind of global depression that had occurred in the 1930s. (See Williamson, 1983a; Moggridge, 1986.)

From early on, Keynes had seen that such policies would need global support. This is because they would have to be reconciled with the need for each country to be sufficiently competitive; that is, each country would need to be able to export enough to pay for the imports that would be purchased at full employment. In 1942, Keynes put forward plans for a new post-war international monetary system designed to make this possible, which he called a 'Clearing Union'. (See Keynes, 1971–88, 25: 41–67; van Dormael, 1978; Gardner, 1956.) His plan drew on the theoretical arguments in his *General Theory*, and also on the harsh practical example provided by the United Kingdom's return to the gold standard in 1925 (Eichengreen, 1992). He argued that, for many countries, sufficient competitiveness would not be assured if the world returned to a gold standard after the War. Such a standard would require that any country with balance of payments difficulties, of the kind which Britain was likely to have, would need to rely on downward adjustment of its wages and prices, in order to make its goods sufficiently attractive in world markets. Keynes judged

that, in the political climate of the post-war world, such wage-and-price adjustments might not be possible. Nevertheless, because of the exchange rate instability of the early 1920s and the 1930s, he also showed no enthusiasm for floating exchange rates. The need for something different was discussed in much detail over the next two years with Harry Dexter White and others from the United States (Keynes, 1971–88, 25: 338 ff.), including during a visit that Keynes made to Washington in 1943.

The analytical content of these immensely difficult negotiations is discussed in more detail in Vines (2003), which draws on the wonderful historical account by Skidelsky (2000). Skidelsky makes clear that Keynes was propelled in these discussions by the knowledge that the generous provision by the United States of war-time funding to the United Kingdom ('Lend Lease') had put the United States in a position in which it would be able to dismember the British Empire after the war. Keynes, who had been accustomed to Britain managing the global economy, wanted to create a new global order in which prospects for Britain remained acceptable, even although global economic hegemony would pass to the United States. He feared that difficulties in the balance-of-payments adjustment process might impose, on deficit countries like Britain, an obligation to deflate demand below full employment, something which might not be matched by symmetrical over-expansion by surplus countries, and might thereby create pressures towards global deflation. This is why he wanted his Clearing Union to be able to create global liquidity. (Like a bank, it would 'clear' the overdrafts which countries could obtain from it.) He differed in this view from Harry Dexter White, who feared an outcome in which liquidity would be so freely available that there would be a great post-war worldwide inflation.

What emerged at Bretton Woods was a global system of pegged but adjustable exchange rates, to be overseen by an International Monetary Fund. The currency system was to have three major features. First, each country would establish a *par value* for its currency in terms of gold or dollars. Second, all exchange controls would be removed for current-account transactions and all currencies would be freely convertible into dollars. But controls on international capital flows would remain in place. Third, dollars would be freely convertible into gold. Thus, the system was to be a 'gold exchange standard'; it would differ from a gold standard in being a club, rather than a unilateral pegging arrangement, and in allowing for occasional exchange rate changes.

The IMF would do two things in this system. First, exchange-rate pegs would only be adjusted if the approval of the IMF's Executive Board had been obtained. That approval would not be given unless there were deemed to be a 'fundamental disequilibrium'. This term was imprecisely defined, but it meant a situation in which an exchange rate was not at a level that would ensure that exports could equal imports at full employment. This kind of test was designed, with memory of the 1930s in mind, to prevent countries pursuing a 'beggar-thy-neighbour' devaluation of their currencies so as to steer towards full employment by 'stealing' jobs from other countries rather than by expanding expenditure at home. A country with longer-term difficulties would be declared to be in 'fundamental disequilibrium' and would be expected to devalue its currency by an appropriate amount after consulting with the Fund and getting the required approval. Similarly, a country with

an excessively large and sustained balance of payments surplus would be expected to revalue its currency.

Second, the Fund would be set up like a credit union, into which members would place deposits; a country in temporary balance of payments difficulty rather than 'fundamental disequilibrium' would be able to draw on a short-term basis from the Fund to help it address the problem. It was thought that these loans would be repaid quite rapidly (that is, within three to five years), since more fundamental difficulties would be addressed by exchange rate adjustments. Each country in this credit union was to be given a 'quota', based on a nonlinear equation that took account of a country's national income, its international trade, and its official reserves; services, other external current account transactions, and a measure of volatility were further added to the quota formula in the 1960s. The quotas would define each country's capital contribution, its borrowing entitlement, and in aggregate, the Fund's lending capacity. The US quota was initially about 20 percent of the total (less than would have been implied by a strict calculation based on the variables noted above), and originally the United Kingdom had, by design, the second largest quota. This was *not* like Keynes' Clearing Union, and Keynes was dismayed at how little the Fund would be able to lend (see Vines, 2003). There have been a number of substantial increases in total quotas under regular quinquennial reviews, but they have not grown in such a way as to keep pace with the expansion of the world economy and international financial flows. In addition, as the relative size and importance of countries have changed, there has been a need to adjust both quota shares and the factors used in the calculation of these quotas. Both of these types of adjustment have been politically difficult; the most recent (small and interim) adjustment for four emerging-market countries (China, Korea, Mexico, and Turkey) happened as recently as September 2006.

The quota system partly determined the relative voting entitlements of countries on the Executive Board of the Fund. It seemed obvious, for a credit union to which money had been contributed, to make voting power depend partly on the amount contributed, and on the amount which could be borrowed at a time of difficulty, rather than using a one-member one-vote system of governance like that adopted at the United Nations. However, there were also a number of 'basic votes' allotted equally to all members, whose effect was to mitigate a little the voting power of large countries.

The Fund's Articles and their subsequent amendments established that a member is allowed to borrow up to a certain proportion of its quota as of right, without policy conditions. This amount was referred to as the 'reserve tranche'; it was equal to 25 percent of quota and corresponded to the amount that a member had paid into the Fund in hard foreign currencies. Beyond the reserve tranche, a country had an option to borrow up to four 'credit tranches', each of which represented 25 percent of quota. Access to the first credit tranche was relatively easy; borrowing under the subsequent or 'upper' credit tranches was normally made available through what were (and still are) described rather quaintly as 'stand-by arrangements'.

(II) Consequences

The international monetary system followed only imperfectly the intentions underpinning the Bretton Woods system, and only until 1971. (See de Vries, 1976.) Current-account convertibility, for most European currencies, was not achieved until 1958 (the year after a large US current account deficit). There was a reluctance to alter exchange rates even in the presence of 'fundamental disequilibrium'. And the Fund was unable to stop France from implementing a multiple currency system in 1948. One major currency, the Canadian dollar, floated from 1950 to 1962 and the Fund acquiesced in this. The Fund ratified British devaluations in 1949 and 1967 at short notice (though it was closely involved in discussions in the second case). It had little influence on US policies—and has had little influence ever since. It played virtually no role in the later US decision to end gold convertibility in August 1971, a decision which brought the Bretton Woods system crashing down. And it had limited influence on the policies of the principal surplus countries in the 1960s. On the other hand, the Fund did have a role in the exchange rate realignments of other currencies that took place in 1949, 1967 and 1971 as a result of the sterling and dollar devaluations, when it sought to ensure 'orderly adjustment'. The most important point is that the IMF had an influence mainly through the conditions it could impose on those countries (such as the United Kingdom in 1976) which needed its funds.

When the Fund began providing stand-by arrangements in 1952 they were typically of short duration and did not feature any conditions. This may seem surprising now, given the close association in the popular imagination between conditional lending and the IMF. Policy conditions were first added to Fund-supported programs in 1954, partially in light of the increase in the size of borrowing under stand-by arrangements, as compared with first-credit tranche financing. Quantitative targets or 'performance criteria' followed in 1957, in order to provide a clear baseline for policymaking under IMF-supported programmes, and a clear yardstick by which the effects of these policies—and the possible need for further adjustments—might be assessed. They were calibrated using the Fund's financial programming framework, developed by Polak (1957), and came to be a nearly universal feature of Fund-supported programmes by the mid-1960s. (See IMF, 1987; 2004a; Mussa and Savastano, 1999.) This combination of policy or 'structural' commitments and quantitative performance criteria came to characterise the 'conditionality' attached to IMF lending from the 1960s to the present. This was justified—then as now—not so much as a way of collateralising IMF lending, and guaranteeing a turnover of the IMF's funds, but rather as a means of ensuring the viability of Fund-supported programs and the quick adjustment of countries in crisis back to a balanced growth path.

The period from 1945 to 1971 was one of extraordinary dynamism (a 'golden age'): it was a time in which Europe and Japan were first rebuilt after the war and then proceeded to catch up with the United States. The Bretton Woods system appears to have played a part in ensuring that this happened. In this system, the Fund was helped by the World Bank, whose role was to lend money for longer periods than the Fund, first for reconstruction after the war, and then, later on, to help finance development. (Keynes once helpfully remarked that in order to comprehend the Bretton Woods

system one has to understand that the Fund is a bank, and the Bank is a fund.) The purpose of this World Bank lending was to enable these countries to borrow abroad (in a world in which there was little international mobility of private capital), to run balance of trade deficits, to invest, and to grow—with the expectation that the borrowing would then be repaid out of the increased export proceeds that investment and growth made possible. In addition, a conference in Geneva in 1947 established the General Agreement on Tariffs and Trade (or GATT), to supplement the Bretton Woods system by encouraging the growth of international trade. The GATT's role in promoting the liberalisation of trade restrictions supplemented the Fund's role in promoting the liberalisation of exchange restrictions on current account transactions. In due course, a series of GATT 'rounds' brought about tariff reductions, which helped to create markets for exports as countries expanded. With high employment, with balance-of-payments deficits dealt with as described above, and with many countries growing by exporting, there were clear incentives for most countries to support trade liberalisation. That, in turn, made exports and imports more sensitive to exchange-rate levels and so made balance of payments adjustment easier to achieve by exchange-rate adjustments. Yet, these linkages between different aspects of the overall post-war policy framework are difficult to pin down empirically. This explains why economic historians still differ in their view as to how important the Bretton Woods system actually was in sustaining the golden age of growth observed in the 1950s and 1960s. (See Matthews, Feinstein and Odling-Smee, 1982; Matthews and Bowen, 1988; Temin, 2002; the papers in Eichengreen, 1995; and Eichengreen, 2007.)

II. Breakdown and reconfiguration

Up to the 1960s the growth of gold reserves had been slow, and the need for additional international liquidity was increasingly met by the use of the US dollar as a 'reserve currency'. This led to calls for the IMF to create a more multilateral way to augment official reserves. The IMF's Articles of Agreement were eventually amended in 1969 to allow the Fund to create 'special drawing rights' (SDRs) that would act as the Fund's unit of account and which could be used as a source of credit for member countries. (See Corden, 1983a; and Boughton, 2001.)

In the 1960s, imbalances also began to emerge: by the latter part of the decade, the United States had a large balance of payments deficit. A belief emerged that the dollar price of gold might rise as economic growth in Europe and Japan weakened the US dollar's role as anchor of the Bretton Woods system. In 1968, central banks ceased their efforts to control the dollar price of gold in private markets, which meant that the prevailing fixed price of gold applied only to central bank dealings. The market price of gold rose: in August 1971, following a massive speculative attack on the dollar, the United States ended the gold convertibility of dollars held by central banks and, as a result, the entire gold exchange standard broke down. A reluctant movement from a pegged exchange-rate system to a system with floating exchange rates followed. This outcome can best be explained by three sets of factors. (See Corden, 1993.)

First, many countries were unwilling to adjust the exchange rates for their currencies in the face of fundamental disequilibria. It was particularly problematic that the core country, the United States,

behaved in this way. Because US productivity growth lagged behind that of the countries which were catching up with it, the trade position of the United States was at risk by the late 1960s. In addition, the United States fought the Vietnam War and launched its 'Great Society' programmes at the same time, without adequately raising taxes. The result was a large balance of payments deficit for the United States, the correction of which required both real exchange rate depreciation and restraint of domestic expenditure. Neither of these actions was forthcoming.

Second, the growth of international capital flows—which was in part a result of the international stability associated with the golden age—helped to undermine the system. As first demonstrated by the 1967 sterling crisis, it was no longer possible for the IMF and national governments to set exchange rates without reference to the forward-looking perceptions of private markets about what sustainable exchange rates might be. With increasingly mobile capital, once a suspicion was generated that that there would be (or might need to be) a devaluation of a country's currency to preserve external balance, speculation could make it difficult or impossible for central banks to defend an existing rate. By 1971, the balance of payments deficit of the United States had caused a large build-up of mobile dollar holdings in off-shore or 'Euro-dollar' accounts. These funds were used to finance the speculative attack on the dollar in 1971.

Third, the Keynesian macroeconomic policy framework established after the Second World War contained no clear responsibility for preventing inflation. Although there were periods of (generally unsuccessful) price controls or 'incomes policy', the seeds of incipient inflation were sown by this omission. Eventually, tensions generated by the oil price shock of 1973, and by the period of undisciplined inflation which followed it, led to more than the collapse of the Bretton Woods system. The entire structure of Keynesian, interventionist, high-employment policies, which had been at the centre of the post-war policy architecture, came tumbling down, both in the United States and in Europe. For the ten years after 1971, macroeconomic policy was in a state of worldwide disarray.

The great inflation of the 1970s led to significant movements in the real exchange rates between countries, which killed nearly all of the (many) attempts made at the time to reconstruct an international monetary system with pegged exchange rates. (See Williamson, 1977.) There was only one lasting, partial, attempt to reconfigure such a system, in Europe, which led to the European Monetary Union.

For a period of time it appeared that the Keynesian approach to macroeconomic policy might be replaced by monetarist policies of a non-interventionist kind. But this alternative proved unsuccessful. Instead, with great difficulty, activist macroeconomic policies were reconstructed by the 1990s within inflation-targeting regimes, in which an inflation target was pursued through interest rate changes. This new system quickly came to be allied with a system of floating exchange rates in which there was a high degree of international capital mobility. In this new set-up, a floating exchange rate would help to stabilise demand, and movements in the exchange rate would become an important part of the process of inflation control. If a country suffered from a shock which raised prices, then its monetary policymakers would set higher interest rates, and the nominal exchange

rate of the country would appreciate. This would reduce net exports and import costs, and so inflation.

As a result of this reconfiguration of policy assignments, a second revision of the Fund's Articles of Agreement was made in 1976 and came into effect in 1978. At Bretton Woods, the Fund had been set up to manage a pegged exchange rate system. But it came to be realised that a country cannot have, at the same time, an independent monetary policy, capital markets which are open to the rest of the world, and a pegged exchange rate. (These three things, taken together, have become known as an 'impossible trinity'. The reason that these things cannot occur together is to be found in the Mundell-Fleming macroeconomic model, which was developed by Fleming and Mundell, at the IMF, in the early 1960s.) As a result, the Fund's revised Articles ratified a new form of international monetary system, in which a country did not have to establish a par value for its currency, but could instead have exchange rate arrangements of its own choice.

Since 1978, the Fund has gradually been drawn into new roles, in support of this revised, and more flexible, system. As described in the introduction, its work now has three aspects. First, the Fund's Articles, as revised in 1976, require it to exercise surveillance and influence over macroeconomic policies, and to monitor and guard against the development of unsustainable conditions that could lead to financial crisis. The Fund still lends to countries in balance of payments difficulty, and its second activity has been to do this for emerging-market economies and for 'transition economies' moving from central planning to market-based systems. More than this, the Fund helps such countries deal with, and prevent, the financial crises that have afflicted a number of them. Third, the Fund has lent money to the poorest developing countries, which generally do not have capital-market access. In these cases, Fund lending has often been indistinguishable from other long-term concessional development assistance because of the repeated rollover of its loans, and the Fund's main distinctive contribution has been to work with central banks and finance ministries in crafting credible macroeconomic frameworks that can elicit further support from aid donors. We consider each of these three activities in turn.

III. The IMF and policy surveillance

Countries that are creditworthy, and which have access to highly mobile international capital under floating exchange rate regimes, no longer need to borrow from the Fund in the way they did when the Fund was first established. Such countries can adjust to balance of payments disequilibria through exchange rate movements, supported by foreign borrowing from sources other than the Fund. (See Corden, 1983b; Dam, 1983.) At the time of writing, no advanced country had agreed on a borrowing arrangement with the Fund since the substantial stand-by arrangements with the United Kingdom and with Italy in 1976. Fund lending is only required at a time when a country ceases to be perceived as clearly creditworthy, something which, as of early-2008, had not happened in industrial countries since 1976. This was true even at the time of the crisis of the Exchange Rate Mechanism of the European Monetary System in 1992. At that time, the Fund did not provide financing to assist Sweden, Italy, the United Kingdom, or France in a defence of their

currencies. When crisis struck, these countries (eventually) allowed their currencies to float downwards, rather than using lending from the IMF to defend further their exchange rates.

Nevertheless, a world with a high degree of international capital mobility is not without difficulties. In such a system, the spending decisions of nations can move away from permanently sustainable positions for very long periods of time, an outcome in which an external current account deficit (or surplus) is persistently offset by an external capital account surplus (or deficit). The 'global imbalances' that can result have, as of early-2008, been substantial at three points of time since the 1960s. In the late 1960s, as we have seen, the United States ran a large current account deficit; current account surpluses of a number of European economies and of Japan, which, as noted above, were engaged in a process of export-led growth and 'catch-up', were the 'other side of the coin'. Nearly twenty years later, in the early-to-mid 1980s, President Reagan increased defence expenditures and cut taxes. Tight monetary policy was used to restrain demand at home, which caused the dollar to appreciate, and the result was a large current account deficit. Japanese current account surpluses were on the other side of this coin. Twenty years later, in 2008, the United States was again running a large fiscal deficit and an (unprecedentedly) large current account deficit; and again Japan was running the corresponding current account surpluses, this time along with China, other emerging-market economies in East Asia and elsewhere, and a number of oil-producing countries.

These global imbalances reflect decisions by countries to de-link income and spending over time. Of course, such 'intertemporal trade' can be welfare-improving. But such imbalances might instead reflect an urge by a deficit country to spend beyond its means. This was clearly the case for the United States in the late 1960s and the mid 1980s, and might also be the case from 2000 (and especially from 2005). Conversely, these imbalances might also partly reflect a desire by some countries to maintain their currencies at artificially devalued levels against the US dollar, in order to grow quickly through a process of export-led catch-up. This is something which, at one time, would have been called 'beggar-thy-neighbour' behaviour of the kind which the IMF was established to prevent. As noted above, one can argue that this may have been what was done by Western Europe and Japan in the late 1960s. Some commentators have argued that a number of emerging-market economies in East Asia, and elsewhere, are behaving the same way in the early 21st century (Dooley, Landau and Garber, 2003; Roubini and Setser, 2005). These commentators have, in recognition of the parallel, suggested that we were living under a 'Bretton Woods II' regime.

But global imbalances eventually unwind. They must do so if countries are eventually to repay what they owe. In 1971, global imbalances led to crisis, and to the collapse of the Bretton Woods financial system. By contrast, the imbalances of the mid-nineteen eighties were resolved in an orderly way. (See Eichengreen, 2004; Eichengreen and Park, 2006; Corden, 2007; Joshi, Lane, and Vines, 2006; and Williamson, 2006.) Such orderly adjustment requires the deficit country to cut expenditure and its currency to depreciate significantly (unless it grows its way out of difficulty). It also requires, in addition, that expenditure in surplus countries expands, so that global expenditure

is maintained, or, if this does not happen, that global interest rates fall so that global expenditure is stimulated by other means. If all of this happens, as it did in the late 1980s, then the benefits of intertemporal separation between spending and income may not be diminished by the costs of an adjustment crisis.

There are four main ways in which the existence of the Fund helps global imbalances to unwind in an orderly manner.

First, ever since the second amendment of the Fund's Articles described above, the Fund has been required to exercise 'firm surveillance' over the exchange rate and macroeconomic policies of its members. As a result, the Fund regularly sends to each country an 'Article IV Mission' whose purpose is to review the country's macroeconomic policies. This is done annually for most countries, and at interludes of up to 24 months in countries with active Fund-supported programmes. (For such countries the Article IV cycle is elongated since policies are reviewed frequently in the context of semi-annual or quarterly programme reviews.) All aspects of macroeconomic policy are considered on these occasions. Following the emerging-markets crises of the 1990s and early 2000s, the Article IV consultation process has been supplemented by detailed review of countries' financial sectors under the World Bank and IMF's joint Financial Sector Assessment Program (FSAP).

Second, the Fund provides a vast amount of published information and analysis, both about the world economy and financial system in general, and about particular countries. The Fund's biannual *World Economic Outlook* provides a forecast for the world economy, and analyses multilateral and regional issues; these reports are supplemented by *Regional Economic Outlooks*. These products are based in part on Article IV consultations and would not be possible without that process. The Fund also publishes a bi-annual *Global Financial Stability Report* which monitors markets, and several statistical publications that compile economic and financial data supplied by member countries, including *International Financial Statistics.*

Third, the Fund fills an important role in keeping the governments of all members in touch with developments in other countries and globally. The Article IV missions to the largest economies (and the related research, published in *Selected Economic Issues* papers that are companions to the Fund's Article IV staff reports) are particularly important in helping to keep governments informed of policies and developments that are likely to affect the world economy as a whole. Additionally, the Annual Meetings of the Boards of Governors of the IMF and the World Bank enable an informed exchange of ideas between countries, as do the Spring Meetings. The Fund thus provides a valuable global information network.

Finally, the Fund has also created a valuable global human network. Fund staff members are of high quality, something which is necessary since they have to deal with senior officials in many countries. The offices of Executive Directors of the Fund in Washington act as valuable means of communication between the member nations of the Fund. And in many national capitals, a large

number of public servants, and elected officials, have served on the Fund staff earlier in their careers, or have been located in Washington as Executive Directors at the Fund or as members of staff in Executive Directors' offices. This experience has made many decision-makers more internationally minded than they might otherwise have been.

Nevertheless, some have argued that the Fund's 'firm surveillance' is not firm enough. Arriazu, Crow and Thygesen (1999) discuss the impact of Fund surveillance, country-by-county, in the Article IV consultation process. They note that, although these consultations have been 'taken seriously', it does not appear that these reviews by the Fund have had more than an occasional impact on national policy decisions in some countries. A more recent assessment of Article IV consultations by Meyer *et al.* (2004) reaches similar conclusions. At present, when an Article IV mission goes to a country that does not borrow from the Fund (and which therefore does not require the Fund's *imprimatur* in order to obtain loans from other official creditors or from banks), the mission is usually relegated to a mainly advisory role, for which 'surveillance' may be too grand a label. But this *de facto* situation is not inevitable, since the *de jure* position of the Fund is that it should assess and appraise as well as advise. Goldstein (2006) asserts that there are gaps in the practice of bilateral surveillance and argues, in particular, that the Fund's dealings with China in the early 21st century have not been satisfactory in addressing and effecting remedies for exchange rate misalignments. He further observes that the Fund's Managing Director has only rarely used the power granted to him by the 1977 and 1979 Board decisions on *ad hoc* and 'supplemental' consultations with members to address cases where a country's exchange rate policies appear inconsistent with the exchange rate principles of the Fund's Articles. (See Boughton, 2001.)

It is important to note that these critics do *not* seek policy changes from countries, in the interests of the greater good that such countries would find unattractive if left to make policy choices on their own. That is, it is not suggested that the Fund could enforce a 'co-operative' outcome in macroeconomic policymaking when countries would prefer a different selfish, or 'Nash', outcome. (This difference between Nash and cooperative outcomes was much discussed in the 1980s literature on policy coordination, which is summarised by McKibbin, 1997). Instead, it is argued that the Fund could enable cooperative outcomes, so that any adjustments in countries' policies that need to happen in the face of global imbalances might happen in the right sequence, rather than in a disorganised manner. The capacity to enforce even this modest form of coordination might occasionally be important in the adjustment processes. (See Kumar, 2006; Wolf, 2005; 2006; Joshi, Lane and Vines, 2006.)

There was action of this kind under the Plaza Accord of September 1985, although it was not coordinated by the Fund. At this time, the finance ministers of the world's five largest national economies agreed that the value of the dollar needed to go down. They also arrived at some (rather general) agreements on the monetary and fiscal policies that would be needed in order for this fall in the dollar to be achievable, and announced coordinated intervention in foreign-exchange markets to help bring it about.

To act effectively in this way requires the Fund to come to terms with the difficult tension between its strengths as a universalist institution and the need, on occasion, to bring together a more limited group of players. But it is an objective of the Fund's 2005 Medium-Term Strategy that it should provide such a forum (IMF, 2005b). The Fund's Multilateral Consultation on global imbalances began by consulting with the United States, the European Union, Japan, China and Saudi Arabia, and it reported on its findings in April 2007. This work ran in parallel with similar discussions at summit meetings of Heads of Government of the Group of Eight Countries (or G8), and at meetings of the finance ministers and central bank governors of these countries. The G8 consists of the United States, Russia, Japan, Germany, Britain, France, Italy, and Canada. This is a powerful collection of countries, but it is not clear that these G8 meetings have had the right participants to deal with the global imbalances of the early 2000s. China and India have not been members of this group (though they have been observers), nor have many of the major oil-producing economies; by contrast, Canada and Italy, while committed to the G8 process, have been perhaps too small to contribute substantially to coordinated efforts to unwind global imbalances. The Fund may therefore have more to offer than such G8 gatherings, since the Fund can act as a locus of coordination amongst subsets of its membership, convening small groups of countries to deal with particular problems.

Nevertheless there are three reasons why further progress may be slow on this front.

First, in the words of the IMF's Independent Evaluation Office (IEO) (2006a, p. 2), 'As a result of its … [country-by-country] orientation, multilateral surveillance has not sufficiently explored options to deal with policy spillovers in a global context'. Pursuing this theme, Mervyn King, Governor of the Bank of England made it clear (King, 2006b) that more effective multilateral surveillance would require: (i) that countries made clearer commitments about their objectives for macroeconomic policies (i.e., fiscal, monetary and financial); (ii) that the Fund's Article IV, and the *World Economic Outlook*, processes focussed more transparently on cases when these policy commitments, and the countries' policy actions, are not globally consistent; and (iii) that this process also transparently demonstrated the negative spill-over effects that come from such lack of consistency and proposed actions to reduce such negative spillovers. But, given the limits to the precision of what we know about the international economy at any given time, doing this will be difficult. And it should be noted that the Fund's management issued a rejoinder to the 2006 IEO report which explained this difficulty.

Second, there may well be governance limitations on such firm surveillance. As of 2008, Article IV consultations were not finalised by the Fund Staff sent on the Article IV mission, but by the Fund's Executive Board, whose views were conveyed to the authorities of the country concerned after discussion at the Board. It is possible that this has compromised the space for missions to assess and appraise frankly. If the process of IMF surveillance were made more independent of the IMF's Executive Board then this might allow clearer messages to be delivered to the Fund's member countries. As against this, the messages might then lose political weight because they would no longer

be seen as the views of the global community represented in the Executive Board.

Third, and fundamentally, the Fund is not an agent of a sovereign state in the way that central banks (except the ECB) are, however 'independent' these central banks may be. As a result, the Fund has no actual instruments of its own with which its recommendations on global cooperation can be implemented. It must always rely on being able to persuade its members to act.

IV. The IMF and crises in emerging markets since 1980

In the mid- to late 1970s, after the rise in the price of oil in 1973, funds flooded from oil producers on to the international capital market and flowed to middle-income countries. The early to mid-1990s saw a further massive surge of private capital flows into emerging market economies, and this was repeated in the mid-2000s. The economic benefits of such international capital mobility are obvious: if capital flows from relatively rich to relatively poor countries, and if the rate of return is high in poor countries, the potential gains can be substantial for both borrowers and lenders. But such funds are not always used well, the volatility of these flows can be very high, and they can create dangerous mismatches in the maturities and currencies of assets and liabilities. Indeed, these flows contributed to three major waves of financial crises, in Latin America, East Asia and Russia, something which has called into question the stability of the entire international financial system. Across these regions of the world, the IMF has been required to help prevent such crises through surveillance. It has also been required to assist in the orderly workout of crises, through lending and through ongoing engagement in the development of macroeconomic policies in the countries which it assists. We explain how the Fund's activities have evolved in these emerging-market economies, and how its role has broadened. We do this by examining the three generations of emerging-markets crises that occurred from the early 1980s onward.

(I) The Latin American debt crisis: a 'first generation' crisis

Oil money, facilitated by loans from international banks, financed a spending boom in Latin America and elsewhere during the 1970s. This led to a rapid increase in foreign debts (Little *et al.*, 1993) in countries which were not in a position subsequently to adjust and service these debts. In due course, significant balance of payments problems emerged when, in 1980–82, real interest rates rose, driven by tight monetary policy in the United States and by a world recession which worsened the terms of trade for many emerging-market economies. These countries rediscovered the truth of what Keynes had maintained forty years earlier: adjustment to external difficulties requires both good budgetary control and an appropriately competitive real exchange rate (Corden, 1990; Little, 1990). This turned out to be something which many policymakers in Latin America, and elsewhere, were unable to engineer, and monetised fiscal deficits led to reserve losses, uncontrolled devaluations of currencies and inflation, and difficulties in meeting foreign-currency-denominated debt obligations. Currency and debt crises were triggered more or less mechanically as macroeconomic fundamentals drove reserves down to critical levels, resulting in what has become known as a 'first-generation' crisis.

Although Latin America is most closely associated with the debt crisis of the early 1980s, other countries, including Morocco, were also involved. The crisis placed the IMF at the centre of the world stage in a way which made it more prominent than it had ever been under the Bretton Woods system. The Fund played four roles. First, it offered financial support with stand-by arrangements and other lending facilities. Second, the Fund came to define the broad envelope of resources that a country could be expected to devote to meeting its residual obligations under a debt rescheduling. In turn, the Fund, together with the United States and other bilateral creditors in the Paris Club, pressed creditor banks to reschedule debts and to engage in 'concerted lending' programmes, threatening to provide no support for indebted countries if banks did not cooperate, and hence, making defaults more likely. Third, the Fund's advice and conditionality, together with that of the World Bank, had significant effects on indebted governments' policies: they were encouraged to undertake growth-orientated structural reforms to escape from their debt problems. Fourth, the Fund's reports and conditionality provided the 'seal of good housekeeping' on the basis of which banks and bilateral creditors could justify rescheduling existing debt and providing new funds.

This use of the Fund, and the broader strategy surrounding it, is usually associated with James Baker, then Secretary of the US Treasury. It was a success only to the extent that it made the financial crisis manageable. The strategy avoided explicit debt reduction and insisted that indebted countries meet their obligations, although over an extended period of time. (This lengthening of the repayment profile did, of course, lead to some reduction in the net present value of debt.) Such an approach was advocated by the governments of major industrialised countries, especially the United States, that were concerned about systemic risks to their own banking systems arising from widespread write-downs of debt. The Fund was criticised in some quarters for acquiescing to this strategy and for acting as an 'enforcer' of debt service on behalf of private banks.

A policy shift took place in 1989. Under the Brady Plan, also initiated by the United States administration, the Fund and the World Bank provided encouragement and some financial support for debt reduction programmes for those countries (notably Mexico) where major policy reforms were being undertaken. The shift from the Baker Plan to the Brady Plan represented a tilt in favour of debtor countries relative to creditor banks. But this came only after a long period in which these banks were able to rebuild their balance sheets, thereby putting them in a position to weather debt restructuring. The US Treasury induced creditors to grant write-downs to debtor countries by collateralising the debt that emerged from these restructurings. The Fund backed up this carrot by concluding financing packages with debtor countries before the terms of debt reschedulings had been determined: a practice that came to be known as 'lending into arrears'. This acted as a stick to weaken creditor leverage in the negotiation process and it also greatly strengthened the role of the Fund in debt workouts since, during the negotiations, Fund staff came to play a major role in influencing debtor countries' macroeconomic policies.

(II) The Mexican 'Tequila' crisis: a 'second generation' crisis

The Latin American debt crisis of the early 1980s had been caused by *public*-sector overspending. But in 1994 something new happened. A major financial crisis, caused by the outflow of *private* capital, of the kind which had brought down the Bretton Woods system in 1971 and destabilised the European Monetary System in 1992, happened in Mexico. The Mexican crisis was different from the Latin American turmoil of the 1980s in that it was set off not just by fundamental weaknesses, such as unsustainable fiscal and current account deficits, but also by currency mismatches on the public-sector balance sheet. (See Calvo and Mendosa, 1996.) These caused a 'second generation' crisis in the form of a self-fulfilling currency run. This crisis presented new challenges for the IMF since it marked the first of a series of crises in emerging markets that originated in the capital account, rather than the current account, of the external balance of payments. The IMF was called on to assist Mexico despite the fact that its Articles of Agreement provided it with only limited jurisdiction over capital account issues.

Mexico had implemented a comprehensive reform programme in the early 1990s, which included financial liberalisation and the completion of the North American Free Trade Agreement (NAFTA) in 1993. This led to a surge in investment financed mainly by foreign capital flows. The result was a large (real) overvaluation of the peso and a very large current account deficit. Initially, the government maintained prudent fiscal policy. But during 1994, many began to question the sustainability of the exchange rate, the fiscal position and current account deficit. By December 1994 there was a massive reversal of capital flows, and the peso plummeted. The consequences for Mexico were severe: inflation increased from 7 per cent in 1994 to 35 per cent in 1995; and GDP fell by 6.2 per cent in 1995, compared with a growth rate of 4.4 per cent in the preceding year.

The pain inflicted on Mexico by private investors led to a view that pegged exchange-rate regimes are unviable everywhere, not just in advanced industrial countries. (Mexico had a 'crawling peg' at the time.) And in Mexico there was a new emerging-market feature. Much of the Mexican government's debt was denominated in US dollars (for example, the '*tesobonos*') because of the difficulty and high costs of borrowing in local currency; much of the government's revenue stream, by contrast, was peso-denominated (although oil revenue was denominated in dollars). This mismatch meant that the collapse of the peso led the government to the verge of default in early 1995.

The Fund played a critical role in stabilising the crisis. In particular, drawing on financing from bilateral creditors, it coordinated assistance, mainly from the United States, that totaled more than five times Mexico's quota entitlements at the IMF. After a significant real devaluation of the peso and fiscal correction, exports rebounded, the economy grew, although only slowly, and Mexico earned enough foreign exchange to repay the exceptional financing that had been provided to it during the crisis.

Some subsequent analyses (see, for example Calvo and Goldstein, 1996) were critical of the IMF's role in both surveillance and in crisis management for Mexico. But the arguments cut both ways.

On surveillance, it was claimed that IMF reports prior to the crisis placed insufficient emphasis on the vulnerabilities of public-sector and financial-sector balance sheets to the possibility of a run on the currency. Some authors argued that the Fund should have been more frank in conveying its views on macroeconomic and exchange-rate policy to its members, and that it should publish these appraisals. But there may well have been inadequate provision of information by Mexico to the Fund, as well as to the public. In particular, it appears that incomplete data may have been provided on official international reserves and liabilities (although the Mexican authorities disagreed with this claim when it was made). As a result, following the Mexican crisis, the Fund began a drive to get countries to sign on to transparency standards, such as the Fund's Special Data Dissemination Standards (which were established in 1996. See Fischer, 2004, 127). Additionally, the Fund began the practice of publishing Board documents, except when the authorities of a country objected. But this heightened focus on transparency left the Fund unclear on whether it should assist countries confidentially to prevent crises, or spur corrective action by bringing bad news to the market. Given the sometimes self-fulfilling mechanics of second generation currency crises, solving this dilemma is critical in defining the future role of the Fund in crisis prevention.

On crisis management, no clear conclusions emerged, either. *Ex post* it appeared that the private sector should have been prepared to lend short term to the Mexican government in the way that the IMF and the United States did. Overcoming such a market failure is surely a role of the IMF and national governments, and giving the IMF the capacity to provide such big loans seemed important to many observers. From this experience, Sachs (1995) concluded that the Fund should be given an explicit international lender-of-last resort capacity, well beyond that formally possible under its 'credit-union' status, so as to enable it to be ready to respond forcefully and quickly to emerging crises, as it had done in the Mexican crisis. (See also Fischer, 1999.) With such firm IMF action, currency crises could be contained as liquidity crises rather than becoming solvency crises. Indeed, it appears that the combination of large-scale IMF financing, combined with significant adjustment by the authorities, prevented the development of a solvency crisis in Mexico. However, some authors began to warn that if the IMF always acted as a lender of last resort in the face of crisis, then this might create moral hazard on the part of lenders to emerging markets, who might expect to be able to lend virtually risk-free with any possibility of default prevented by IMF action. (The Fund-led bailout of *tesobonos* holders strengthened these fears.) These critics suggested that efforts be made to make sovereign debt rescheduling easier and more orderly (Eichengreen and Portes, 1995), thereby containing the threat of creditor moral hazard.

(III) The Asian financial crisis of 1997–98: the 'third generation' of crises

Two and a half years later these issues re-emerged in Asia, in a crisis which interrupted a long period of sustained economic growth financed by exports and foreign capital inflows. Unlike the earlier Latin American debt crisis, or even the crisis in Mexico, fiscal profligacy played no *explicit*

part in the East Asian crisis. But there were two other main policy failings. (See Blustein, 2001; Corbett and Vines, 1999a; 1999b; Corbett, Irwin and Vines, 1999.)

First, much more than in Mexico, an under-developed financial system and over-protected financial sector in some Asian economies meant that the private sector had to rely on borrowing, rather than equity issuance, to raise investment funds. As a result, firms became highly leveraged, but banks continued to lend because they were underpinned by *implicit* government guarantees. When growth slowed, as it first did in Thailand in 1996, these banks were exposed to the inability of borrowers to repay loans.

Second, a further difficulty came, as so many times before, from the existence of fixed exchange-rate systems, but with a new twist. Banks financed much of their domestic corporate lending by borrowing in foreign exchange from abroad, often at shorter maturities than those employed when they lent onwards in domestic currency. Very little of this borrowing was hedged as a result of the implicit guarantee on the exchange rate. As noted in the previous paragraph, the financial sector was already in difficulty after the initial slow down in growth in 1996. Currencies fell in mid- to late 1997 because of foreign investors' concerns about these difficulties; as a consequence, widespread bankruptcies and potential bank failures loomed because of the unhedged foreign-currency obligations. Fear grew that fiscal systems would be unable to bear the cost of large-scale bank rescues (Irwin and Vines, 2003).

The East Asian debacle marked the advent of 'third generation' crises in which currency crises and banking crises are intimately intertwined—situations in which vulnerabilities in the private balance sheet can quickly translate into a public debt crisis.

As in Mexico, the Fund played a large part in resolving the crises. The IMF moved quickly to lend very large sums to Thailand, Korea and Indonesia. Nevertheless there has been widespread criticism of the Fund's behaviour before and after the crisis. (See, for example, Stiglitz, 2002.)

Two difficulties must be acknowledged in the Fund's *crisis prevention* work in East Asia. First, the Fund may have underestimated the risks associated with capital account liberalisation. Second, the Fund may not have been firm enough in warning of the difficulties inherent in maintaining a fixed exchange-rate peg. Nevertheless, Thailand, for instance, was warned privately by the Fund several times in the year leading up to the 1997 currency crisis. The Fund, like some private-sector analysts, saw problems looming in Thailand, but its advice was not heeded.

Concerning the Fund's work on *crisis management*, there are three points to consider.

First, as the Fund has acknowledged in both its own reviews of the East Asian crisis and in the evaluations performed by its IEO (IMF, 2003), its programmes may have placed too much emphasis on tightening budgets in countries that were already running prudent fiscal policies. Stanley Fischer, then the Fund's First Deputy Managing Director (FDMD), argues, however, that

this approach was driven by a need to boost government savings to support the current account and provision for the impending cost of bank restructurings. (See Fischer, 2004.) Furthermore, the credibility of an adjustment programme at a time of crisis may hinge on policy erring towards being too tight, in order to send a clear signal to markets. Once the scale of the economic downturn became apparent in East Asia and current account balances improved, Fischer argues that Fund programmes shifted to addressing structural problems. (See also Corden, 1999; Boorman *et al.,* 2000.)

Second, monetary policy was also tightened in an attempt to defend currencies. There is an inevitable trade-off between raising interest rates in order to moderate exchange rate depreciations and lowering interest rates so as to ease the stress on both the banking system and on corporations that depended on domestic credit. Stiglitz (2002) argues that the tightening was too forceful. However, it does appear that this tightening was essential in order to stem capital flight. Nevertheless, this tightening was not followed by a concerted move to an inflation-targeting regime of a kind that might have allayed concerns of further depreciation. Hence, pressure on the region's currencies continued. And rather than stimulating recovery, these depreciations proved contractionary, at least initially, owing to their effects on external debt burdens. (See Krugman, 1999.)

Third, the Fund did not have a mandate to declare 'standstills' on external debt payments during the crisis. In corporate bankruptcies, standstills force creditors to share in the burden of crisis and to agree to reasonable debt reschedulings. In the context of a currency crisis, a standstill mechanism would similarly 'bail-in' foreign private-sector creditors and then make reschedulings possible to reduce debt to sustainable levels. The fact that a standstill was not imposed in Thailand, Korea or Indonesia enabled creditors to race to get their assets out of these countries. Negotiations with foreign creditors to Korea and Indonesia did ensure some rollover of existing short-term lending, with effects similar to those that might have resulted from standstills. In both cases, however, negotiations were pursued too late and without sufficient coordination to maximise their impact (though they did stave off collapse in Korea). The only comprehensive brake on external payments was that imposed in Malaysia through the implementation of capital controls rather than a standstill by the government of Prime Minister Mahathir bin Mohamad in late 1998, a move that contravened the Fund's advice. But this was done only after substantial capital outflows from Malaysia had already taken place.

Because the Fund lacked a mandate to impose standstills, it lent countries money in an attempt to allay the concerns of foreign creditors and to stem capital flight. Given the scale of the external capital-account movements in these countries, the size of IMF financing packages soared, especially after it became clear that smaller lending programmes would be unlikely to produce adequate results. In the case of Korea, the authorities of the IMF's large shareholder governments, notably the United States and Japan, also made a key decision to pursue a debt-rollover plan and to exert moral suasion on creditor banks. These banks presumably realised that the alternative would have been partial default. The IMF played a useful role in facilitating communication among the

different actors, in providing information, and in certifying that the policies to be pursued by the Korean authorities were appropriate. The IMF's IEO writes, 'No single national government, nor any private sector institution, could have played this role as effectively' (IMF, 2003, 115).

Although the Fund's work in Korea showed that the IMF could effectively manage a debt workout, its conduct elsewhere in the East Asia crisis had the effect of shifting the balance of power in debt workouts back toward creditors. IMF programmes did *not* reduce the debt overhang in Indonesia, and Thailand. Instead, governments rescued banks and corporations by shifting their debt to the public balance sheet. Taxpayers in these countries still bear the burden of this debt. Rather than 'bailing in' private creditors, the Fund's handling of the crises in these countries may have provided creditors with an even bigger bailout than they might have expected under the terms established in the 1990s' Brady Plan.

Partially out of dissatisfaction with this result, Anne Krueger, who followed Fischer as the Fund's FDMD in 2001, proposed a bankruptcy or standstill procedure for countries, the 'Sovereign Debt Restructuring Mechanism' or SDRM (Krueger, 2002). The US Treasury and financial markets both opposed this proposal out of a concern it would create unrestrained debtor moral hazard. Under what came to be known as the 'Taylor Doctrine' (after John Taylor, then US Treasury Under Secretary for International Affairs), the US government argued that countries should be left on their own to negotiate with their creditors. But this is only feasible when the number of external creditors is small, which for most countries has not been the case since the 1980s when external borrowing was provided mainly under loans from banks. To help remedy this problem, the United States supported the introduction of 'collective action clauses' (CACs) in bond contracts with commercial creditors. These clauses prevent rogue creditors from holding out in restructuring negotiations in order to extract a premium from the bond issuer; they work by enforcing a restructuring if a pre-specified minimum proportion of creditors have agreed to its terms. CACs do not, however, provide a framework to guide the allocation of losses between borrowers and lenders, which is necessary in any restructuring. In the absence of a clear means of sharing these losses, it may prove impossible to renegotiate debt owed to commercial creditors. When faced with debt-servicing problems, debtor countries may then decide to borrow from official sources (including the IMF, whose debt is senior to other external liabilities and not reschedulable) in order to repay private sector creditors, as happened in Korea, Thailand and Indonesia. Since private sector creditors are likely to believe that this will happen, the Taylor doctrine's approach, even when coupled with CACs, might promote creditor moral hazard, something which has been feared ever since the Mexican crisis. Thus, although the Taylor doctrine's approach has the virtue of minimising debtor moral hazard, it appears to go in the opposite direction by promoting creditor moral hazard.

(IV) Default: the Russian and Argentine crises

Russia. The fall of the Berlin wall in 1989 and the dissolution of the Soviet Union in 1991 enabled the IMF at last to become a (nearly) universal institution. In three years, membership increased

from 152 countries to 172, the most rapid increase since the influx of African members in the 1960s. The IMF supported programs in most former Eastern Bloc countries and newly independent ex-Soviet Republics to help ease the transition to a market economy. The contribution the IMF made to the speed and relative smoothness of this transition is, perhaps, one of its most singular and least heralded achievements.

Russia, however, got off to an inauspicious start under the first stand-by arrangement with the Fund in 1992. The IMF encountered intense difficulties in influencing the Russian leadership (Odling-Smee, 2004). GDP fell for several years under the IMF-supported combination of macroeconomic stabilisation and industrial restructuring. Although the IMF can claim credit for helping to instill some monetary discipline by the mid-1990s, the process took time, foreign direct investment remained low, tax collection was poor, and the fiscal deficit remained large. Growth in real GDP did re-emerge by 1997. But, following the onset of the East Asian crisis, the ruble came under speculative attack in November 1997. Pressure on the ruble was compounded by foreign investors' attempts to hedge their ruble holdings, as well as by a drop in the price of oil, which accounted for about one-third of Russia's foreign-exchange inflows.

Russia sought additional IMF financing in early 1998, but agreement on the terms of a new program could not be reached owing, in part, to a failure by the Russian authorities to secure an increase in fiscal revenue. As a result, foreign investors began to unload Russian assets and about US$4 billion fled the country in the summer of 1998. By the time additional IMF financing was agreed in July 1998, fears of a devaluation led to such a pronounced sell-off of Russian securities that the authorities were forced to devalue the ruble and halt payments on both domestic and foreign debt.

Although the Fund is routinely criticised for providing cover for private capital flight from Russia in the first half of 1998, private investors who maintained faith that the Fund would rescue Russia sustained even greater losses when the ruble was devalued. This was perhaps the largest case to that point where the Fund stepped away from a floundering member, declared a solvency crisis, and let private creditors sustain substantial losses. It marked a different approach to the challenge of balancing creditor and debtor interests from that which the Fund had adopted in East Asia. And in some ways, it set a precedent for the Fund's handling of the Argentine crisis in 2001.

Argentina. After a sustained period of hyperinflation in the 1980s, Argentina decided in 1991 to peg its currency, the peso, to the US dollar under a quasi currency-board regime at a one-to-one parity. Although the Fund cautioned that Argentina had neither the fiscal discipline nor the robust export sector needed to sustain such a system, it acquiesced to the authorities' plans and supported their macroeconomic program under a series of lending arrangements. By the late 1990s, Argentina was widely hailed as a model of successful economic reform as the rate of inflation fell to single digits and growth increased. In addition, the economy had successfully weathered the global turbulence caused by the East Asian crisis of 1997–8, and the Russian crisis of 1998.

But the seeds of the problems identified by the Fund back in the early 1990s were beginning to bear fruit by the end of the decade. Fiscal policy remained insufficiently tight owing to the lack of effective central government control on provincial borrowing, and this stimulated domestic demand for imports. Argentina's export sector remained too small to finance these imports, and its real exchange rate made its goods uncompetitive on regional and international markets. As a result, Argentina chose to borrow substantial amounts in US dollars to finance its imports. Brazil's decision to float the real in 1999 in response to pressure from the Russian crisis made it even harder for Argentina to compete under its quasi currency-board regime. The Argentine authorities allowed the peso to float in January 2002 and it quickly collapsed from parity with the US dollar to an exchange rate of nearly 3.9 to the dollar in June 2002. Output fell sharply, inflation reignited, the government defaulted on its debt, and the banking system was largely paralysed.

The Argentine debacle rightly cast several doubts on the Fund's conduct of both crisis prevention and crisis management in emerging markets. At the outset of the 1990s, the Fund proved incapable of resisting Argentina's arguably doomed effort to impose its quasi currency board. Subsequently, the Fund endorsed Argentina's exchange rate peg in a series of programs through the 1990s that coincided with an accumulation of macroeconomic vulnerabilities. When the regime became unsustainable in 2001 (or earlier), the Fund maintained lending until the end of that year in an attempt to save the peg. After the crisis, the Fund resumed lending to an insolvent Argentina in 2003 at the behest of the Executive Board, even although misgivings were expressed by the Fund staff. IMF lending ceased again later in 2003 and Argentina pursued an aggressive 'take it or leave it' strategy with private creditors. The Argentine authorities achieved a roughly 75 percent write-down on the country's defaulted foreign bonds, while leaving nearly US$20 billion in unexchanged bonds in default (IMF, 2005a).

The Fund's experience with Argentina demonstrates at least four things. First, it can be very difficult for Fund staff to resist Executive Board pressure to support a country with IMF lending, either when inappropriate policies are being pursued (e.g., the creation of the quasi currency board) or when a country is insolvent (as Argentina was in 2003). Second, the Fund has sometimes found it just as hard as its members to take a stand against an inappropriate fixed-exchange-rate regime. Third, the absence of any international standstill process or debt restructuring mechanism makes it difficult and time consuming to reconstruct a financial system and to reach a balanced solution with creditors once a crisis has occurred. The Taylor Doctrine has not worked out wholly as planned. Fourth, once damaged, the quality of the policy dialogue between the Fund and its members is difficult to restore. Since the crisis, Argentina's policies have appeared unsustainable: Argentina has contrived to keep its exchange rate at a level at which its exports seem to be excessively competitive, while relying heavily on high international primary commodity prices to sustain its balance of payments. These policies do not seem consistent with the world envisaged in the second amendment of the Fund's Articles, a world in which the Fund exercises firm surveillance over member countries' policies in its role as steward of the international financial system.

(V) Conclusions

The capital account crises of the 1990s and 2000s represent a new chapter in the Fund's history: they mark a shift from the Fund's previous bread-and-butter work of dealing with current account crises. These capital account crises created new challenges and strains on the Fund—some of which it responded to well, some less so.

On *crisis prevention* the Fund has learned much. Since the Mexican crisis it has promoted regulatory reform, increased transparency, and better monitoring in emerging market economies. The Fund's Articles prevent it from pronouncing on countries' particular choice of exchange-rate regimes. But in its policy advice, the Fund now makes clear that the trilogy of floating exchange rates, carefully sequenced liberalisation of capital accounts and financial systems, and inflation targeting can work well (Blejer *et al.*, 2001; Corden, 2002; Batini, Kuttner and Laxton, 2005), and, by contrast, the Fund has given clear advice about the difficulties faced by fixed exchange-rate regimes. The Fund has also attempted to reinvent itself as a lender of 'first resort' through the creation of contingent or 'pre-approved' lending facilities aimed at crisis prevention. These lending windows would provide members with an added incentive to pursue sound policies and a signalling framework under which they could commit to these policies. But the Fund's first effort in this direction—1999's Contingent Credit Lines (CCL)—expired in 2003 after four years without use, owing to somewhat stringent qualification criteria, less than full automaticity in disbursements, and concerns amongst members that a request for a CCL might send a negative signal to capital markets. New effort was invested in the design of such an instrument, initially called the Reserve Augmentation Line (RAL), during 2006–07.

On *crisis management*, much work has been done to better understand how to construct, balance and sequence macroeconomic policy restraint at a time of crisis. The Fund has developed a detailed debt sustainability framework and complemented its traditional analysis of financial flows with a 'balance sheet approach' to analysing stock imbalances, so as to enable it to understand the financial vulnerabilities of countries. This tool was designed to help Fund staff draw a clearer distinction between liquidity crises and solvency cases. (On this see Irwin and Vines, 2005; Cohen and Portes, 2004; Portes, 2004.) But from the early 1980s onward, the three generations of crises outlined above also threw into sharp relief the problem of moral hazard arising from IMF lending. The need to better balance debtor moral hazard and creditor moral hazard became one of the key challenges facing the Fund in the design of its lending facilities and its accompanying policy responses to crises. This paper has highlighted the manner in which the Fund has occasionally oscillated between favouring creditor interests and favouring debtor interests, in an attempt to balance these competing interests in an acceptable way.

The Fund's experience with crisis management in the 1990s revealed difficulties with Fund conditionality. By then the conditions attached to Fund loans had grown far beyond what had earlier been thought necessary to ensure adequate macroeconomic adjustment, and came to include substantial 'structural conditionalities'. Some of these concerned macroeconomic issues of proper concern to the Fund. But there was also an explicit concern with a range of microeconomic reform

issues, and, even more broadly, with poverty-reduction questions. Many observers, including Arriazu, Crow and Thygesen (1999), IFIAC (2000) and Williamson (2000), have questioned the wisdom of this policy creep, although it should be said that, in some cases (for example, poverty reduction), the spread of IMF conditionality reflected the concerns of member countries rather than an attempt by the Fund to expand its mandate. Following member country dissatisfaction with the comprehensive conditionalities included in their programmes (Indonesia's programmes in the late 1990s are particularly relevant cases), there has been much work at the IMF since 2000 on streamlining conditionality, and on pulling back from a range of concerns about structural issues that are not deemed 'macro critical'. This led to a careful restatement during 2002 of the principles governing the IMF's design and implementation of conditionality, with a view to ensuring that the conditions attached to IMF lending focus only on policies essential to the macroeconomic viability of Fund-supported programs. (See IMF, 2002a; Boughton and Mourmouras, 2004).)

At the time of the preparation of this paper (2008) there has been a lull in the frequency of crises, and a significant decline in the volume of Fund lending. The Asian, Russian and Argentine borrowings which originated in the crises described above have all been repaid. There is a striking parallel here with the end of the 1980s, when the Fund's stock of outstanding loans to emerging markets was also quite modest. At that time, the Latin American arrangements that had originated in the crisis years 1980–83 had been repaid. But, just as then, risks remain; the international community must stay engaged in the task of ensuring that the Fund is prepared to respond to and manage crises when they occur.

Dissatisfaction with the Fund's recent practice in crisis management continues to cast a long shadow over the Fund's relations with many emerging-market economies, which may have some consequences. A number of East Asian countries, over the ten years since the East Asian crisis, accumulated in excess of a trillion US dollars of reserves. This massive reserve accumulation reflects a persistent excess of saving over investment across these economies, which may, at least in part, represent a conscious choice to amass reserves as a form of self-insurance against future crises. These countries went about a pooling of some of these reserves into a common fund, a process which began in 2000 when ASEAN, Japan, China and Korea agreed to set up a bilateral currency swap scheme known as the Chiang Mai Initiative. There are some suggestions that this might one day form the basis of an Asian regional alternative to the IMF that would be designed to help these countries to co-insure and spread risks. But taking this step would require difficult decisions by these countries in order to make surveillance between the pool's members effective and enforceable. And such a common pool of reserves might also create its own form of moral hazard if it were to encourage countries to take excessive risks with foreign borrowing.

V The IMF and Low-Income Countries

Until the mid-1970s, the Fund's work in its role as coordinator and monitor of the international monetary system was concerned mainly with monetary, exchange-rate and trade issues. To the extent that the IMF also functioned as a credit union for countries in balance of payments

difficulties, its lending focused on the provision of short-term, self-liquidating loans to buttress central banks through temporary balance of payments difficulties. The Fund's cornerstone principle of equal treatment of member countries dictated that financing to low-income countries was provided largely under stand-by arrangements on the same terms as those approved for emerging markets and industrialised countries. The oil crises of the 1970s, however, made it increasingly clear that intractable structural issues in many low-income countries needed to be tackled if balance of payments difficulties were to be addressed. As a result, the 1970s saw a lengthening of the average maturity of stand-by arrangements in both emerging markets and low-income countries, accompanied by the advent of lending on concessional terms, with lower interest rates, to low-income countries. This created some tension between the Fund's essentially monetary character, and its deepening role in the provision of longer-term resources in support of broad macroeconomic adjustment in developing countries.

In order to provide member countries with more breathing room to enact structural economic reforms, the Fund created a series of new lending instruments from the mid-1970s onward. The first amongst these, the Extended Financing Facility (EFF), provided greater financing and longer maturities than traditional stand-by arrangements, but its terms were not concessional. The Fund's Articles of Agreement did not provide for the use of IMF resources for concessional lending to a subset of the Fund's membership and the EFF's market-linked interest rates were identical to those of other Fund arrangements. An EFF did, however, typically carry more stringent conditionality than a stand-by arrangement in response to concerns that greater financing implied a need for greater adjustment.

The obstacle to financing concessional lending posed by the Fund's Articles was overcome in the 1970s by the solicitation of donor funds and the sale of a portion of the IMF's gold. Concessional IMF lending began under the 1975 Oil Facility Subsidy Account, in which contributions from 25 countries were used to reduce the interest cost of borrowing from a Fund facility set up to assist countries deemed to have been most severely affected by the sudden rise in oil prices. In the following year, the IMF created a Trust Fund for all low-income countries out of profits from the sale of a portion of the Fund's stock of gold. The Trust Fund offered long-term low-interest loans to low-income countries from 1976 until its resources were fully committed in 1981. Borrowing under the Trust Fund was similar to financing under the first credit tranche: in order to obtain financing, low-income countries had only to demonstrate a balance-of-payments need and explain the efforts they were taking to reduce it.

These new financing windows provided concessional loans to developing countries, but it was feared that the weak conditionality attached to these loans did not induce sufficient adjustment (Boughton, 2001). In the early to mid-1980s, prices for many primary commodities collapsed, and many developing countries faced new external balance of payments challenges. The Fund moved to reinvigorate its concessional lending by using the repayments of Trust Fund loans to finance a new round of concessional credit under what, in 1986, came to be known as the Structural Adjustment Facility (SAF). The SAF marked a determined attempt by the Fund to integrate concessionality

with conditionality. In part, this twinning of concessionality with conditionality allowed the Fund to lobby for new donor loans and grants, which expanded the SAF some threefold into the Enhanced SAF (ESAF) in 1987.

Boughton (2001) contends that the ESAF became one of the IMF's great success stories, as it allowed the Fund to send billions of dollars to the world's poorest counties on concessional terms with longer maturities than was possible under previous IMF facilities. (See also Tarp, 1993.) The ESAF also had a catalytic effect on lending from other official creditors, and IMF collaboration with the World Bank and the regional development banks, as well as with, *inter alia*, the UN, UNICEF, UNDP and bilateral donors, all appeared to improve under the ESAF process (Boughton, 2001). In addition, IMF technical assistance to many developing countries on monetary, fiscal, and trade policy, as well as debt management, also expanded substantially in order to help countries achieve their programme commitments. This increase in technical assistance has been very valuable.

Despite these gains, and even though the ESAF was technically distinct from the Fund's general resources, some critics have charged that the ESAF marked an unfortunate departure from the Fund's monetary focus. Others have questioned the strict conditionality on adjustment agreed under ESAF-supported programmes, especially because some of the structural conditions have appeared to intrude on the traditional territory of the World Bank. In reply it might be said that this has happened partly because the Bank has not proved capable of devising appropriate conditions for its own loans. (See Gilbert and Vines, 2000.)

Despite the Fund's efforts—both to revive its concessional lending in 1986 and 1987, and to increase its accompanying technical assistance—it was clear by 1988 that many low-income countries would find it impossible to grow without debt relief. Under the auspices of the Paris Club of bilateral creditors, a series of progressively more concessional refinancing terms for bilateral debts were agreed from 1988 onward, for both emerging market, and relatively poor, indebted countries. Nevertheless, even with this bilateral debt relief, many low-income countries had trouble meeting the payment obligations on their stand-by arrangements and EFFs. But the absence of a serious lobby of private creditors (most low-income countries' external debt was owed to the Paris Club and other public creditors) may have delayed efforts to find a comprehensive solution to the debt problems of developing countries until the late-1990s.

By the 1990s, the Fund's engagement in low-income countries had become the target of a rising chorus of concern. Some civil society organisations and academics, as well as some low-income governments themselves, contended that IMF conditionality and programme design in low-income countries tended to prioritise adjustment over poverty reduction, growth, and income distribution concerns. This criticism is summarised by Easterly (2005). It arose despite the fact that the Fund has been helping to produce, in many low-income countries, a marked stabilisation in macroeconomic indicators, and in some cases, the beginning of sustained periods of growth. In response to critics' concerns, and in a further step in the evolution of Fund lending, IMF Managing

Director Michel Camdessus advocated in the mid-1990s a fresh model of engagement with low-income countries in which there would be a renewed role for the Fund in reducing global poverty and in promoting high-quality growth in developing countries.

This new strategy featured three main elements. First, along with bilateral donors and other international financial institutions, the Fund recognised that catalysing growth in low-income countries would require more profound debt relief, including treatment of previously unrescheduled multilateral concessional debt. The 1996 Heavily Indebted Poor Countries' (HIPC) Initiative represented the concerted efforts of the international community to address the external debt overhang in poor countries; the Initiative was later enhanced in 1999 to provide deeper and faster debt reduction. The HIPC Initiative was novel, particularly in that debt relief was explicitly tied to plans to spend debt-service savings on poverty-alleviating social expenditure. From 1999, these plans were articulated in a country-based Poverty Reduction Strategy Paper (PRSP). This approach, initiated by the Fund in conjunction with the World Bank, formed the second prong of the Fund's renewed engagement with low-income countries. The PRSP approach aimed to provide a clear country-owned link between national policy frameworks, donor support, and development outcomes. The PRSP approach also dovetailed neatly with the United Nations' Millennium Development Goals (MDGs). These goals were articulated at the UN Millennium Summit in 2000 and were centred on halving global poverty by 2015. The PRSPs were also intended to form the basis of the targets and policy conditions in programmes supported by the IMF's Poverty Reduction and Growth Facility (PRGF). This was the successor in 1999 to the ESAF and formed the third element of the Fund's new approach to low-income countries.

The results of these initiatives by the early 21st century were mixed. Reviews of the PRGF by IMF staff in 2002 (IMF, 2002b) and by the IMF's IEO in 2004 (IMF, 2004b) found that PRGF-supported programs had become more accommodating to higher public expenditure, in particular pro-poor spending. Nevertheless, a review of PRGF program design by the IMF Executive Board in September 2005 (IMF, 2005c) found that per capita income and growth rates remained low despite some improvements in a range of macroeconomic indicators. More recently, the IEO found in its evaluation of Fund engagement in sub-Saharan Africa (IMF, 2007b) that the PRGF and PRSP approaches have not had a significant positive effect on catalysing new aid flows. This is despite the fact that commitments to increase such flows were made in 2002 under the 'Monterrey Consensus' and at the Gleneagles G8 summit in 2005. The IMF's Spring 2007 *Regional Economic Outlook* notes, however, that Sub-Saharan Africa's growth performance during the past three years has been the best in more than three decades (IMF, 2007d). In sum, the impact of the PRGF and PRSP on aid and spending in low-income countries remains inconclusive, but their growth effects appeared increasingly positive by 2008.

The rise of the HIPC Initiative, the PRSP and the PRGF together intertwined the work of the IMF and World Bank in developing countries to an unprecedented extent. The Multilateral Debt Relief Initiative (MDRI) agreed at the Gleneagles G8 Summit in 2005, and which provided a framework for the write-off of nearly all remaining HIPC-country debts to the IMF, World Bank and African

Development Bank, represented a major step forward in this collaboration. While the MDRI drew a welcome line under the multilateral debt relief process, it left several questions about the next phase of IMF and World Bank support for low-income countries unanswered. Having written off so much concessional debt, the MDRI may imply that future multilateral support for low-income countries should be provided only as grants, not loans. The source of financing for such grants remained unclear. And in some cases, financing, whether by grants or loans, may not be the most crucial contribution that the international financial institutions can make to development. The Fund's 2005 Policy Support Instrument (PSI), essentially a 'no money' program, acknowledged that Fund macroeconomic advice, rather than short-term balance of payments financing, might be a valuable channel of support for developing countries. These matters have been complicated by the growth of 'South-South' flows in development assistance from new donors such as China and Brazil. These flows have raised doubts about the future necessity of concessional financing from the Bretton Woods institutions. But they have also called into question the future of the conditionality that comes attached to IMF and World Bank money. Such financing from nontraditional donors may also complicate future debt restructurings, should they prove necessary, since most new donors are not members of the Paris Club.

Throughout this section we have noted the latent tension between the Fund's monetary character and its tendency to provide long-term support for low-income countries. This tension is heightened by the intertwining of the work of the Fund and the World Bank, which we have just reviewed. The report of the external review committee on Bank-Fund collaboration (IMF, 2007c) provided some suggestions on strengthening Bank-Fund collaboration, while reducing overlap between the two institutions.

VI. The future of the IMF: next steps

In mid-2004 the Fund's then Managing Director, Rodrigo de Rato, launched a review of the role of IMF in light of the challenges posed by a changing and increasingly complex global economic system. Stemming from this review, De Rato presented the aforementioned Medium-Term Strategy for the Fund (IMF, 2005b) to the World Bank-IMF Annual Meetings in September 2005, and shortly thereafter followed up with a plan for the Strategy's implementation (IMF, 2006b). The plan focuses on specific proposals to ensure that the Fund:

- provides more effective surveillance and better monitoring of policies in advanced economies;
- provides better monitoring of emerging markets economies, re-explores financing mechanisms to help prevent crises, and reconsiders issues regarding capital account liberalisation;
- enhances the role of IMF in low-income countries, and sharpens its focus;
- reforms IMF governance, particularly country representation; and,
- restructures the IMF's own budget, including by broadening the Fund's income base, and its management practices.

The plan also expressed an intention to expand the role of the IMF as provider of technical assistance and training, while improving Fund communications and transparency to ensure that the Fund plays a more central role in global policy debates.

The Fund's Medium-Term Strategy is a clear response to the three dominant tasks it has assumed following the collapse of the Bretton Woods system of fixed exchange rates in 1971, tasks which we have reviewed in sections 3 to 5 of this paper. But if the Fund is to be able to act effectively in relation to these tasks it will need to have: (i) a better system of governance; (ii) a more secure and robust source of income so that it can cover its operating expenses; and (iii) a larger stock of resources to lend for crisis prevention and resolution. We conclude this paper by briefly discussing these three issues. (See also Lane, 2006.)

(I) Governance

The first subsection of the Fund's Articles of Agreement made clear that its founding purpose was 'to promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems'. At the time of the Fund's creation, most countries stood a reasonable chance of alternating between being a creditor to and borrower from the Fund over time. Since then, the ranks of creditors and borrowers have diverged as industrial countries have stopped using IMF financing, a role which has instead been filled by emerging market economies and low-income countries. A number of reformers such as Woods (2006) argue that the Fund's capacity to facilitate solutions to international monetary problems depends on the Fund's decision-making structure being made more reflective of the interests and voices of the emerging markets and developing countries which borrow from it, and which see their public policy frameworks at least partly determined by Fund conditionality. The demand for such reform is bolstered by the fact that the relative distribution of quotas, which determine the voting power in the Fund, has become separated from the relative economic (and political) weights of many emerging markets in the global economy. In addition, the relative power of basic votes, which were intended to provide some measure of fairness to poorer countries, has been substantially eroded relative to the contribution of quotas to voting weights at the Executive Board. The *ad hoc* provision of increased quota shares to China, Korea, Mexico, and Turkey in 2006 under the Fund's Medium-Term Strategy was a first step toward realigning voting power in the Fund with emerging markets' growing share of the world economy; further steps will be more difficult since increased voting shares for some countries will inevitably mean painful decisions to reduce the shares of others. It may, however, be possible for countries to change the way in which the 24 chairs on the IMF's Executive Board are allocated in order to partly compensate for changes in relative voting shares.

Changing the Fund's voting structure will not in and of itself alter the way in which the Fund operates, suddenly making it better able to deliver on the objectives set out in its 2005 Medium-Term Strategy. De Gregorio *et al*. (1999); King (2006a, 12); Dodge (2006a;2006b) and Kenen

(2006) have all argued that parallel changes in the Fund's governance arrangements might help the Fund in its push towards these objectives.

One proposal would put the responsibility for the delivery of improved policies more firmly in the hands of the management of the IMF. Up to 2008, the Executive Board of the Fund involved itself in day-to-day reviews of Article IV reports, approved all lending decisions, and reviewed the design of the Funds's lending programmes. Stepping back from this activity would enable Directors to pay proportionately more attention to strategic issues. That would move the governance structure of the Fund closer to the relationship between management and advisory boards that ones sees in the private sector, where non-executive directors bring dispassionate external views to broad questions of corporate operations and strategy, and clearly delegate day-to-day operations to management.

Evolution in this direction could strengthen the accountability of the Managing Director and his Deputies. In one version of this type of arrangement, all of the Managing Director, the Deputy Managing Directors, and Department Directors, would report on a regular basis to the Board, but Executive Directors would be more removed from many of the day-to-day decisions of the institution. Doing this could have an effect—even if only implicit or indirect—on the Fund's ability to function better in its pursuit of more dispassionate surveillance. It might also lead to more effective crisis prevention and resolution through a careful balancing of debtor moral hazard and creditor moral hazard in Fund lending; and also to a clearer focus in the Fund's work with low-income countries.

A move to a non-resident Executive Board would draw a clearer line between the work of Directors and management. Such a move would leave the Managing Director in control of the execution of the Fund's work since the Executive Directors would give only part-time oversight and direction. Making this change would take the governance of the Fund closer to Keynes' original vision. (See King, 2006a.) Directors would be the senior public servants that steer policy in their national capitals, and not, as in 2008, their proxies resident in Washington. In contrast with 1946, the ease of modern travel makes a non-resident Board, with meetings some six to eight times a year, entirely feasible. Any move in this direction would, however, need to ensure that the nexus of communication between capitals, which the Board currently provides, is preserved in some other way.

(II) Income

In May 2006, the Managing Director established a committee (the 'Crockett Committee'), chaired by a former General Manager of the Bank for International Settlements, Andrew Crockett, to study options for sustainable long-term financing of the IMF. The Committee's report, released on 31 January 2007 (IMF, 2007a), argued that the IMF's current funding model was unsustainable and that a more diversified income stream needed to be developed in order to guarantee the institution's financial future.

The IMF's revenue stream had been primarily based on income derived from its lending for crisis resolution (IMF, 2007a, Annex 2, 2). This financing mechanism was not entirely appropriate, because, as Crockett said during the press briefing to launch the Committee's report, 'it's a concentrated income source…It's volatile, because when the Fund is lending a lot…it generates large resources. When the Fund is not lending, it doesn't generate resources.' In a low-lending environment, as existed in the early 21st century, the Fund's income model appeared untenable over the longer term; in the shorter term, it could also be inconsistent with sound incentives to minimise moral hazard in Fund lending.

The Committee considered some alternative sources of income for the Fund. In assessing these possibilities, the committee observed that the Fund's activities can be broken down into three types of functions that cut across the full membership of industrialised countries, emerging markets, and low-income economies: financial intermediation, the provision of global public goods (for example, data, standards and codes, combating terrorist financing), and the provision of bilateral services, in the form of capacity building and technical assistance.

The Committee concluded that revenue from Fund lending should be sufficient to cover its ongoing costs arising from financial intermediation. The Committee also noted that this income should not be used to cross-subsidise the provision of global public goods because (i) this income was too volatile for this purpose and (ii) cross-subsidisation could cause IMF lending to become too expensive compared with private financing

In order to ensure that the Fund could continue to provide its key global public goods, the Committee noted that the Fund could, like the United Nations, assess a periodic levy on member countries. The Committee did not, however, favour this source of income, as it 'would risk politicising the activities of the Fund' by making its work subject to regular financing calls. Nevertheless, the Committee did note that charging fees for some services might generate a small amount of additional revenue.

The Committee's core proposal concerned the creation of an endowment for the IMF that would provide a reliable income stream without relying on annual requests to member countries. The Committee suggested a further sale of IMF gold as a possible source of endowment funds. Such sales had been mooted at various points in the past for a variety of purposes; most recently this was done to finance the establishment of the trust funds that underwrote the 1996 HIPC Initiative. But other plans for such sales have usually failed to gain enough support in the face of opposition from the United States and from gold-producing countries. To allay these fears, the Committee report suggested a 'balanced' approach, in which the Fund would also invest some of its quota resources in highly rated securities so that the burden of creating an investment endowment would not fall exclusively on the sale of gold.

As this paper was being drafted, discussion continued on the exact form an endowment for the Fund could take. In meantime, the Fund had begun to invest some of its retained earnings from lending in investment grade securities in an effort to supplement its income.

(III) Resources

The relative size of the Fund shrank markedly from the 1970s in comparison with, inter alia, global reserves, international trade, financial flows, stocks of financial assets and world output. This decline in pecuniary stature has distorted some of the debates about the Fund's work, most notably on creditor and debtor moral hazard. Much of the debate over the implications of jumbo or 'exceptional access' arrangements in the 1990s (arrangements in which lending was equivalent to 300 percent of quota or more) would be moot if regular quota increases had maintained the Fund's relative size in the global economy. Indeed, had the Fund grown through regularly scheduled quota increases, very few of the arrangements of the 1990s and 2000s would have been deemed at all exceptional. This suggests a simple yardstick for an appropriately-sized IMF: at any given time, the sum of the Fund's quotas should enable a risk-adjusted subset of its membership to borrow from the Fund on non-exceptional terms to finance their adjustment needs.

Accepting the validity of such a yardstick depends critically, however, on one's ultimate view of the role the IMF should play in the international system: trusted macroeconomic advisor, catalyst for private capital inflows and foreign assistance, or potential lender of last resort at time of crisis? To some extent the Fund played all of these roles at the turn of the 21st century, though its reduced relative size meant the lender-of-last-resort function was credible for only its smaller members. The Fund staff, its shareholders, and those who care about the future of the multilateral system will need to decide which of these roles the IMF should continue to play.

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The Global Economic Governance Programme
University College, Oxford OX1 4BH

Tel. +44 (0) 1865 276 639 or 279 630
Fax. +44 (0) 1865 276 659
Email: geg@univ.ox.ac.uk
www.globaleconomicgovernance.org