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International Monetary Fund (IMF) Reform: Past Solutions, Current Proposals

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ABSTRACT

This report examines past reforms of the International Monetary Fund (IMF) as expressed in amendments to the IMF's Articles of Agreement, or basic charter. It also summarizes the legislation passed by the 105th Congress with regard to the IMF. Finally, it briefly discusses current proposals to reform te IMF. This report will not be updated.

International Monetary Fund (IMF) Reform: Past Solutions, Current Proposals

Summary

Major changes in the International Monetary Fund (IMF) and the international monetary system have been reflected in amendments to the IMF's Articles of Agreement, its "constitution." Changes to the IMF's Articles require an 85% majority of the voting power, giving the United States, with 17.56% of the vote, a veto. Under the Bretton Woods Agreement Act (P. L. 79-171, 22 U.S.C. 286), any proposed changes to the IMF's Articles require congressional approval. Thus, by extension, the U.S. Congress has a veto power over changes to the IMF's Articles. Beyond the specific issues of amending the IMF's Articles, legislation enacted by the 105th Congress laid the groundwork for a much more active oversight of the IMF, its role, and any proposed changes in the "architecture" of the international monetary system. Finally, some proposals that do not involve amending the IMF's Articles might also be expressed in legislation.

The IMF's Articles have been amended three times and, appropriately, the changes have been designated the First, Second, and Third Amendments. The First Amendment created the "Special Drawing Right" (SDR), an international reserve asset issued by the IMF. The Second Amendment was the first and, so far, only comprehensive rewrite of the IMF's Articles of Agreement. It legitimized the floating exchange rate system that replaced the "fixed" exchange rate Bretton Woods system in the early 1970s. The Third Amendment, approved in 1992, addressed the problem of a build-up of arrears that were owed by the poorer countries and that threatened the IMF's own liquidity.

The period 1997-1999 has been one of enormous economic and financial turmoil. An examination of the history of amendments to the IMF's charter, however, shows much that is familiar, including: increased levels of cross-border capital flows, increased economic integration, increased market-pricing of exchange rates, the preeminence of the market over the regulator, and financial innovation.

The significant difference is the extent to which emerging market countries, transitional economies, and the poorer less developed countries have become a part of the global economy. This has been abetted by major advances in communications technology. These changes turned a financial crisis in Thailand into a global crisis.

A number of proposals are emerging that are intended to reform the IMF and the "architecture" of the international monetary system. A proposed Fourth Amendment, like the Third Amendment, reflects the number of transitional and poor countries that form the IMF's membership and loan base. The Fourth Amendment would provide additional liquidity to some 39 member countries by permitting a targeted allocation of SDRs. This would require congressional approval, but not U.S. budgetary funding. Finally, a controversial proposal to amend the IMF's Articles of Agreement to allow it to oversee the orderly liberalization of capital accounts has emerged. Agreement on the text, however, has not been reached.

This report will not be updated.

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The IMF was founded more than 50 years ago, in 1945, when 29 countries signed its original Articles of Agreement. Today the IMF, with a nearly universal membership of 182 countries, is still the centerpiece of the world financial system. That system, however, underpins a world economy that is vastly different from the war-torn and underdeveloped world of the immediate postwar era. Thus, as the world economy has changed, the IMF has also had to change.

Major changes in the IMF and the international monetary system have been reflected in amendments to the IMF's Articles of Agreement. These have been amended three times and, appropriately, the changes have been designated the First, Second, and Third Amendments. The first two amendments were driven by systemic changes, while the Third Amendment was driven by an institutional problem, a build-up of loan arrears to the IMF itself. Likewise, some of the proposals emerging out of the recent global financial crisis are likely to be expressed as and embodied in amendments to the IMF's Articles of Agreement.

Under the IMF's rules, amendments to the IMF's Articles require approval by an 85% majority of the IMF's total voting power. This requirement gives the United States, with 17.56% of the total voting power, veto authority over changes in the IMF's Articles. More importantly, under the Bretton Woods Agreement Act (P. L. 79-171, 22 U.S.C. 286), any proposed amendment to the IMF's Articles of Agreement requires congressional approval. Thus, by extension, the U.S. Congress has a veto power over any proposed changes in the IMF's Articles of Agreement.

Beyond the specific issue of amending the IMF's Articles, the U.S. Congress is certain to play an active oversight role in regard to any proposed changes in the structure of the IMF or in the "architecture" of the international monetary system. Finally, some proposals that do not involve an amendment to the IMF's Articles might also be expressed in legislation.

This report provides a brief history of past reforms to the IMF's Articles of Agreement. It also examines, briefly, actions taken by the 105th Congress and some of the new proposals for reforming the IMF and the "architecture" of the international monetary system. Two paired and related questions underlie the analysis: What aspects of the present debate represent a continuation of earlier trends? What is new about the present debate? Thus, the report is intended to provide to the Congress an understanding of the historical context and a partial framework for understanding the emerging reform debate.

This report will not be updated.

The First Three Amendments: A Brief History

The First Amendment to the IMF's Articles of Agreement, effective in 1969, resulted from a systemic problem with regards to liquidity. The exchange rate system established at Bretton Woods was a gold-dollar standard, that is, all major currencies were convertible at fixed rates into the U.S. dollar, which, in turn, was convertible into gold at the fixed price of $35 per fine ounce. An expansion in international trade and economic growth required an increase in international liquidity, that is, an increase in central bank holdings of the two major international reserve assets, gold and the U.S. dollar.

By the 1960s, with the economic recovery of Europe well advanced, the slow growth in gold supplies was hampering the growth of international reserve assets. As a result, the system became largely dependent on the other major international reserve asset, the U.S. dollar. The expansion of dollar reserves, in turn, was dependent on an outflow of dollars from the United States. An increase in dollar reserves, thus, depended on the continuation of a large U. S. balance-of-payments deficit.[1] The U.S. deficit was largely caused by huge long-term capital transfers from both the public and private sectors. Continued U.S. deficits, however, were turning the dollar "shortage" of the immediate postwar years into a dollar "glut."

The international monetary system had become dependent upon the continuation and expansion of the U.S. balance-of-payments deficit for the provision of adequate liquidity to support international trade and economic growth — a major systemic problem. This systemic reliance on the U.S. dollar as a reserve asset gave rise to the so-called Triffin dilemma, after economist Robert Triffin: If, on the one hand, the United States did not curb its deficit, there would eventually be a crisis of confidence in the U.S. dollar because the United States would eventually have insufficient gold reserves to convert outstanding foreign holdings of dollars into gold, as the Bretton Woods system required. If, on the other hand, the U.S. did curb its deficit, the creation of international reserves would be inadequate to support expanded world trade and economic growth. Stated another way, the choice was between instability and deflation.

The response to the Triffin dilemma was the First Amendment to the IMF's Articles of Agreement. The First Amendment created a new international reserve

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[1] The balance of payments is a statistical statement summarizing the economic transactions, during a given period, usually one year, between the residents of one country and the rest of the world. The balance of payments is based on double-entry book keeping. Thus, it must always balance, that is, statistically, its total is always "0." When analysts speak of a deficit (-) or a surplus (+), they are referring to specific components of the balance of payments. In the 1960s and 1970s, analysts of the U.S. balance of payments position tended to focus on the sum of two specific components of the balance of payments: the current account and the long-term capital account. The current account is the net balance of payments arising from the export and import of goods and services, together with "unilateral transfers," the latter including gifts, emigrants' transfers, and remittances. The capital account represents the net transfer of short- and long-term financial movements, including loans, credits, direct and portfolio investment. Long-term is defined as more than one year. A deficit (-) on current account must always be financed by a surplus (+) on capital account.

asset, the "Special Drawing Right" (SDR).[2] Then sometimes referred to as "paper gold," the SDR was to stand along with the U.S. dollar and gold as an international reserve asset. It was intended to sever the link between dollar surpluses and the creation of international liquidity.

By the time of the ratification of the First Amendment, events in the world economy were already moving beyond the liquidity issues of the 1960s. Instead, the focus was now on the adjustment process, both with regard to balance-of-payments adjustment in general and exchange rate adjustment in particular. A large and prolonged U.S. balance of payments deficit was mirrored by its counterpart, large surpluses in the balance of payments of other major industrial countries. As a result, much of the 1960s was characterized by substantial currency instability as liberalized capital flows brought about repeated exchange rate crises in the, supposedly, "fixed" exchange rate Bretton Woods system.

In 1970, a resumption in capital outflows from the United States, which had briefly been reversed in 1968 and 1969, reflected a continuation of inflation within the U.S. domestic economy and declining confidence in the U.S. dollar. Foreign central banks increasingly became reluctant holders of U.S. dollars and began exchanging their dollar reserves for U.S. gold holdings. This led to U.S. suspension of gold convertibility on August 15, 1971. At the so-called Smithsonian meeting in December 1971, the finance ministers of the major industrial countries realigned their exchange rates and the United States devalued the dollar by raising the official price of gold from $35 to $38 per fine ounce. With continued currency instability, however, the Bretton Woods system of fixed exchange rates finally collapsed amidst a generalized "floating" of the major currencies in March 1973. The major purpose of the IMF as originally conceived at Bretton Woods — to maintain fixed exchange rates — was, thus, at an end.

The Second Amendment to the IMF's Articles of Agreement was the upshot of the collapse of the Bretton Woods system of fixed exchange rates and the generalized floating of the world's major currencies in March 1973. The Second Amendment was ratified on April 1, 1978. It was the first and, so far, the only comprehensive rewrite of the IMF's Articles. It enshrined the floating-rate exchange rate system that was already in place; officially ended the international monetary role of gold (although gold remains an international monetary asset); and, nominally, but unsuccessfully, made the SDR the world's "principal reserve asset."

From the vantage point of today's international financial turmoil, it is important to note that the crisis of the early 1970s:

- was underpinned by increased **capital account liberalization**, that is, by the liberalization of financial flows between countries, in this case between the major industrial countries, beginning in the late 1950s;

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[2] For more information on the SDR, see CRS Report 97-738 E, *The IMF's Proposed Special Drawing Rights' (SDRs) Allocation: A Background Paper*, by (name redacted).

- reflected increasing levels of world trade and economic growth and, therefore, greater **economic integration**;

- terminated a fixed exchange rate regime for the major currencies and replaced it with **floating exchange rates**;

- was **market-driven** and, thus, to some extent placed regulators and financial officials in the position of playing "catch up" to systemic change; and

- involved an early postwar example of **financial innovation**, that is, the emergence of the Eurodollar and other offshore currency markets.

Thus, in some sense, the recent global financial crisis looks not like something wholly new, but, rather, like a continuation and expansion of existing trends.

A major effect of the demise of the system of fixed exchange rates among the major industrial countries was that the IMF virtually ceased lending to the major industrial countries after 1978,[3] when the United States drew its reserve tranche. Decolonization, however, meant that many newly emerged developing countries had become IMF members, substantially altering the IMF's membership base. Other developments also helped to change the character and direction of the IMF. The 1973-1974 run up in international oil prices as a result of concerted action by the Organization of Petroleum Exporting Countries (OPEC) created large international payments imbalances. While the major industrial countries were able to finance their balance-of-payments deficits in private financial markets, the oil-importing developing countries turned to the IMF and to the major private commercial banks, which needed to "recycle" these so-called petrodollars, that is, to put to work the financial surpluses that they were receiving as deposits from the oil-exporting nations.

By fostering the build-up of external debt among the developing countries, the 1970s' petrodollar crisis, in turn, set the stage for the Third World debt crisis that began in August 1982 with a default by Mexico. With U.S. support, perhaps insistence, the IMF was placed at the center of the strategy to solve the 1980s' debt crisis. Similarly, in the 1990s, it was placed at the center of Western efforts to assist the formerly Communist nations that are now making the difficult transition to market economies. Thus, by February 28, 1999, the IMF's total loan portfolio — an amount totaling about \$88.4 billion (SDR 64.7 billion) — was comprised solely of loans to developing countries and transitional economies.

Arguably, the changed composition of the IMF's loan portfolio led to the Third Amendment of the IMF's Articles of Agreement. Beginning in the early 1980s, the IMF began to experience difficulties with the overdue repayment of its loans. Since the IMF is a revolving fund, arrears impair its ability to continue making loans, raise

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[3] The United Kingdom was the last of the G-10 industrial countries (the G-7 countries, which include the United States, Germany, Japan, France, United Kingdom, Italy, and Canada, plus Belgium, Netherlands, and Sweden) to borrow from the IMF. Its last use of Fund credit occurred in 1982.

the cost of its loans to borrowers, and potentially constitute a threat to the IMF's own financial viability.

The IMF undertook several steps both to resolve and prevent problems with arrears. The Third Amendment, which entered into effect on November 11, 1992, was the most important of the steps the IMF took to resolve its problem with arrears. It applies only to IMF members that have already been declared ineligible to use the IMF's general resources because of arrears in their payments to the IMF. The Third Amendment allows the IMF's Executive Board to decide, by a 70% majority of the total voting power, to suspend the voting and certain related rights of any ineligible member persisting in arrears. Suspension is an intermediate step between a declaration of ineligibility and compulsory withdrawal. As of April 1998, the Executive Board had suspended the voting and related rights of two IMF members, the Democratic Republic of the Congo and Sudan. The arrears problem peaked in 1992 and has since been substantially reduced. It is important to note that some of these arrears arise from political causes, for example, the breakup of Yugoslavia.

Finally, the changed character of loan recipients meant that, beginning, at least, with the "Baker Plan" in 1985 (as a somewhat arbitrary marker),[4] IMF loans increasingly involved structural or microeconomic conditionality along with the more traditional macroeconomic conditionality. In the view of some, particularly loan recipients, IMF conditionality has, thus, become more extensive and intrusive. This has also certainly made IMF conditionality more controversial.

The 105th Congress and the IMF: Laying the Groundwork

Congress is responsible for authorizing and appropriating all U.S. financial commitments to the IMF. With the passage and signing of the "Omnibus Consolidated and Emergency Supplemental Appropriations Act for FY 1999" (H.R. 4328, P. L. 105-277), Congress appropriated the full funding requested for the IMF. The dollar equivalent of SDR 10,622.5 million for U.S. participation in the IMF quota increase is scored in the FY 1999 budget as $14.5 billion; the SDR 2,462 million funding required for U.S. participation in the "New Arrangements to Borrow" (NAB), as $3.4 billion.[5]

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[4]On October 8, 1985, U.S. Secretary of the Treasury James A. Baker, III, speaking at the joint annual meeting of the IMF and the World Bank in Seoul, Korea, made a proposal for solving the international debt problem. A key aspect of the proposal was its recognition of and emphasis on the structural aspects of the debt problem. It was this microeconomic emphasis that represented a major policy shift from earlier approaches to the problem. For additional information see CRS Report 97-661 E, *U.S. International Debt Strategy: The "Brady Plan" Revisited*, by (name redacted).

[5]For more information on the quota increase and the NAB, see CRS Report 98-56 E, *The International Monetary Fund's (IMF) Proposed Quota Increase: Issues for Congress*, and CRS Report 97-468 E, *The IMF's Proposed New Arrangements to Borrow (NAB): An Overview*, both by (name redacted).

In an unprecedented move, the 105th Congress stipulated that the newly appropriated funds could not be made available until 15 days after the Secretary of the Treasury and the Chairman of the Federal Reserve Board provided written notification that the major shareholders had publicly agreed to act to implement specific policies within the IMF. Specifically, conditionality on IMF loans is to promote policies that liberalize restrictions on trade in goods and services, that eliminate the practice of government-directed lending on noncommercial terms, and that establish a legal basis for nondiscriminatory treatment in insolvency proceedings. In addition, the IMF is to begin making its Executive Board minutes and loan documents (Letters of Intent, Memoranda of Understanding, and Policy Framework Papers) publicly available. Finally, when a country is experiencing a short-term loss of confidence, IMF loans are to carry shorter maturities and bear higher interest rates, a requirement that is now embodied in the IMF's new Supplemental Reserve Facility (SRF).

A number of statements issued on October 30, 1998 by the IMF's major shareholders (the G-7 countries) are taken as fulfilling this requirement for a public declaration of support for the specified policies. Certification was sent to Congress on November 2, 1998. The NAB entered into effect on November 17, 1998. The quota increase became effective on January 22, 1999.

Historically, requests for funding the IMF have been the occasion for vigorous congressional oversight of the IMF's policies, programs, and performance. At the same time, congressional oversight also has been limited largely to those occasions when funding has been requested. Thus, the last previous instance of intensive oversight occurred in 1992, when the quota increase that immediately preceded this one was approved. In P. L. 105-277, however, the 105th Congress laid the groundwork for a much more active and continuous oversight of the IMF, particularly with regard to the emerging issue of international financial reform. This was achieved in a number of ways, notably including:

- establishing, for a duration of six months, an International Financial Institution Advisory Commission with a broad mandate to advise and report to Congress on international financial issues, especially system reform;

- requiring an annual report and testimony by the Secretary of the Treasury on the state of the international financial system, IMF reform, and compliance with IMF agreements;

- providing for annual audits of the IMF by the General Accounting Office (GAO); and

- instructing the Secretary of the Treasury to seek to establish a permanent advisory committee to the Interim Committee of the IMF that would consist of elected members of the national legislatures of the five countries that appoint members to the IMF's Executive Board, including the United States, which is the IMF's largest shareholder.

These provisions are amplified by additional reporting requirements,[6] notably by two reports on the "architecture" of the international monetary system, due on July 15 of 1999 and 2000, and by requirements for greater IMF transparency. Taken as a whole, the newly enacted legislation opens up the IMF for congressional examination to an unprecedented degree.

P.L 105-277 mandates that the International Financial Institution Advisory Commission include eleven members. The House and Senate majority and minority leadership appoint the commission members, originally to have been not later than 45 days after enactment of the law, that is, by October 21, 1998.[7] Four of the 11 appointees must have been officers or employees of the Executive Branch prior to January 20, 1992, but no more than two of these are to have served under Presidents from the same political party. The Commission could contribute to a broader and fuller discussion of international financial issues at this critical time.

Finally, P .L. 105-277 also included a significant number of policy prescriptions or "admonitions" regarding the IMF and its programs. Although it remains to be seen exactly what the impact of these provisions will be, it would appear that, given their broad-ranging nature, they are likely to strengthen the IMF and expand its activities. This is, perhaps, ironic given the extreme controversy that surrounded the IMF's performance in the on-going global financial crisis during the last Congress.

P. L. 105-277 instructed the U.S. Executive Director to the IMF to use the "voice and vote" of the United States to advocate policies within the IMF that would, among other things, promote exchange rate stability and avoid competitive devaluations; promote market-oriented reform and trade liberalization; open domestic markets to competition and deregulation; strengthen social safety nets; encourage the opening of markets to agricultural commodities; strengthen the financial systems of developing countries and promote sound banking practices; facilitate the development of domestic bankruptcy laws and burden-sharing by private creditors; strengthen the IMF's crisis-prevention mechanisms and surveillance; promote good governance, including reductions in excessive military spending; improve core labor standards; promote environmental protection; and promote credit to small business. Much of this suggests a much more intrusive IMF.

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[6] A list of the reporting requirements is contained in **table 1** at the end of this report.

[7] On February 12, 1999, the Democratic Leader of the Senate and the Minority Leader of the House announced the appointment of Richard L. Huber, Jerome L. Levinson, Jeffrey D. Sachs, Esteban Torres, and Paul A. Volcker to the International Financial Institution Advisory Commission. Members proposed by the Majority apparently include Charles W. Calormiris, Alan Meltzer, Lawrence Lindsay, Edward Fuelner, and Manley Johnson.

IMF Reform: Current Proposals for Amending the IMF's Articles

In September 1997, a proposal to again amend the IMF's Articles of Agreement — the Fourth Amendment — was adopted by the Board of Governors of the IMF. The proposed Fourth Amendment, like the Third Amendment, reflects the IMF's position as a lender to developing and transitional economies. It would permit a special, one-time targeted allocation of SDRs.[8] The last allocation of SDRs was approved in 1978 and allocated in 1979-1981. Since then 39 countries have joined the IMF. In addition, some countries that were IMF members at the time of the last allocation did not participate. Finally, as a result of past quota increases, some members that did participate in the last allocation now have very low ratios of cumulative SDR allocations to their total quotas. On the grounds of equity, therefore, the IMF's Executive Board recommended that a one-time "targeted" SDR allocation be undertaken. IMF Articles, however, require the nondiscriminatory treatment of all IMF members. Thus, to undertake a targeted and, therefore, discriminatory SDR allocation, the IMF's Articles must be amended. While the proposed amendment would provide additional international reserve assets to the recipients, it is largely peripheral to the immediate reformist debate that has arisen out of the recent global financial crisis.

The proposed Fourth Amendment has, however, important long-term implications for the stability of the international financial system. By easing the external financing constraint on the poorer countries, it will hasten the day when they can achieve healthy economic growth. In this respect, the proposal is a companion to the proposal to sell IMF gold in support of the HIPC ("Highly Indebted Poor Countries") debt relief initiative of the World Bank and the IMF, which also would ease the external financial constraint on a select group of poor countries.[9] Finally, the proposed Fourth Amendment might well be seen as part of the IMF's continuing effort to address the needs of and the problems arising from the poorer countries that are a part of its membership. In this strictly limited sense, the proposed Fourth Amendment is a linear descendent of the Third Amendment.

The Fourth Amendment would require congressional approval, but, to date, has not been brought before the U.S. Congress for consideration. As of February 9, 1999, 40 IMF members accounting for 25.27% of total voting power have approved

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[8] For more information on the SDR, see CRS Report 97-738 E, *The IMF's Proposed Special Drawing Rights' (SDRs) Allocation: A Background Paper*, by (name redacted). This report was written prior to its adoption by the IMF's Executive Board.

[9] For more information on IMF gold sales, see CRS Report 96-810 E, *International Monetary Fund (IMF) Gold Auctions: Current Proposal, History, and Congressional Role*, by (name redacted). The proposal was initially stalled by the objections of the German and Italian governments. These two governments have now dropped their opposition, and the proposal has been revitalized by renewed support from the U.S. government and its linkage to the HIPC initiative.

the amendment.[10] Because SDRs are created by the IMF, this proposal would not involve any budgetary funding by the United States.

A far more controversial proposal would amend the IMF's Articles to permit the IMF to play a central role in capital account liberalization issues. This proposal has been under study for some time. On September 21, 1997, the IMF's Interim Committee stated that the IMF's central role in the international monetary system and its near universal membership made it uniquely placed to help assure that the liberalization of capital flows occurred in an orderly manner, backed both by adequate national policies and a solid multilateral system for surveillance and financial support.[11] The Interim Committee recommended a phased, but comprehensive approach that would tailor capital account liberalization to the circumstances of individual countries. It recommended that the Executive Board complete its work on the proposed amendment, which would extend, as needed, the IMF's jurisdiction "through the establishment of carefully defined and uniformly applied obligations regarding the liberalization of [capital account] movements."[12]

The proposed amendment would turn the IMF's *de facto* authority in this area into *de jure* authority and would represent a counterpart to the authority that it has had on current account issues since 1945. Some dispute whether this change is necessary. Others are more concerned about whether capital account liberalization *per se* is a desirable goal. Still others have been concerned about what constitutes an orderly process of liberalization: must a country, for example, wait until certain "preconditions" are met; how can standards for banking supervision and soundness be ensured at the international level; and what are the problems and consequences of uncontrolled short-term capital flows. The IMF held a seminar on March 9-10, 1998 to further study this issue. In April 1998, the Interim Committee reaffirmed its views. Provisional agreement on that part of the amendment dealing with the IMF's purposes has been reached.[13] Significantly, however, in its October 1998 communiqué, the Interim Committee "encouraged [the IMF] to continue its work, in the context of its surveillance activities and adjustment programs,"[14] but made no mention of the proposed amendment even while mentioning the proposed Fourth Amendment and other measures to strengthen the IMF. This very important issue, therefore, apparently remains unresolved.

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[10] Phone conversation with the IMF on February 9, 1999.

[11] Interim Committee Statement on Liberalization of Capital Movements Under an Amendment of the IMF's Articles, as adopted, Hong Kong SAR, September 21, 1997, published in IMF. *Annual Report*, 1998, p. 75.

[12] *Ibid*.

[13] *Ibid,* p. 77.

[14] IMF. Interim Committee. Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund, October 4, 1998. IMF Press Release No. 98/47.

Reforming the "Architecture" of the International Monetary System: Emerging Proposals

The Mexican financial crisis of 1994-1995 began a process of examining and rethinking the structure or "architecture" of the international monetary system. This process has been substantially accelerated by the current global financial crisis. An early product is the "New Arrangements to Borrow" (NAB), which went into effect on November 17, 1998. Nevertheless, the process appears to be in its early stages. In addition to capital account liberalization issues, several other areas in which work is under way include[15]:

- **Standards**: This denotes the development and dissemination of internationally accepted norms to raise the transparency of economic policy and to enable financial markets to better assess borrowers' creditworthiness. An IMF code on fiscal transparency has been completed; one on monetary and financial policies is under development. Other international areas where codes are sought include corporate governance, accountancy, and insolvency regimes.

- **Transparency**: This issue has become something of a "buzzword" that has achieved "motherhood-and-apple pie" status. Nobody is, in theory, against it, but agreement on specific proposals is certain to be substantially more difficult. Apropos of the importance of capital flows in the current crisis, agreement on the need for timely and detailed disclosure of international reserve positions; external debt positions; and short-term capital flows, including private flows, is a priority. Greater transparency regarding the position of private financial market participants, including hedge funds, is also being sought by regulatory and supervisory authorities. Finally, the IMF itself is becoming more transparent — an issue that was very much at the forefront of congressional oversight of the IMF last year.

- **Private Sector Contributions**: The Interim Committee has noted that greater participation of the private sector in preventing and resolving financial crises is important and has asked the IMF to study the use of market-based mechanisms to cope with sudden shifts in investor sentiment. This issue is central to dealing with the problem of "moral hazard," that is, perverse incentives that encourage precisely the kind of behavior that they are intended to prevent, in this case high-risk/high-return lending in the expectation that, if the loans went "bad," the lenders would be made whole by a rescue package backed by the IMF. The moral hazard issue has been important and controversial in connection both with the Mexican "bailout" of early 1995 and with the more recent financial rescue packages in Asia and in Russia.

- **Capital Account Liberalization**: Since international capital flows contribute to the efficient allocation of economic resources, capital account controls

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[15] This section is drawn, in part, from IMF. Interim Committee. Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund, October 4, 1998. IMF Press Release No. 98/47.

present difficulties. As noted in the previous section, however, the prudent and orderly liberalization of capital flows is one of the most important issues under study. Sound banking supervision and financial regulation, although nominally a "standards issue," is also deeply connected to the issue of capital account liberalization.

In all of these areas the IMF is certain to be working with other major international institutions, such as the World Bank and the Bank for International Settlements (BIS).

The items that have been mentioned above are already under consideration, are often extremely technical, and are likely to take considerable time to achieve. Reform of the international monetary system is, however, also certain to receive broader discussion. Proposals may be expected to cover virtually the entire spectrum: On the one end of the spectrum, some suggest turning the IMF into a lender of last resort.[16] A lender of last resort, nearly always a country's central bank, provides liquidity, in the form of emergency credit, to the financial system to forestall a panic or the collapse of the banking or financial system. Adoption of such a proposal might well require providing additional funding for the IMF. On the other end of the spectrum, some would like to eliminate the IMF.[17]

Conclusion

The period 1997-1999 has been one of enormous economic and financial turmoil. The IMF has been at the center of efforts to deal with this global crisis, as it was in earlier periods of financial turmoil. An examination of the history of the amendments to the IMF's Articles of Agreement shows that much about today's crisis is familiar, including:

- increased levels of cross-border capital flows,
- increased economic integration,
- increased market-pricing of exchange rates,
- the preeminence of the market over the regulator, and
- financial innovation.

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[16] Stanley Fischer, Deputy Director of the IMF, published a paper on this topic on January 3, 1999. The paper, *On the Need for an International Lender of Last Resort*, is available on the IMF's web site (http://www.imf.org). In addition, see also, Soros, George. *To Avert the Next Crisis*. Financial Times, January 4, 1999, p. 18.

[17] See, for example, Schwartz, Anna J. *Time to Terminate the ESF and the IMF*. Cato Institute. Foreign Policy Briefing, No. 48, August 26, 1998, and Schultz, George P., William E. Simon, and Walter B. Wriston. *Who Needs the IMF?* Wall Street Journal, February 3, 1998, p. A22.

The significant difference between today and earlier periods is the extent to which emerging market countries, transitional economies, and the poorer less developed countries have become a part of the global economy. This has been abetted by major advances in communications technology. These differences turned a liquidity crisis in one of the world's smaller economies into a global financial crisis. The emerging debate over reforming the IMF and the international monetary system is certain to seek to address these systemic characteristics, both old and new.

Table 1. Reports on the IMF and Related Topics as Mandated by P. L. 105-277

Agency	Periodicity	Subject/Mandate in Brief Summary
U.S. Treasury	Contingent: Prior to Disbursement of IMF Loan Funds (No disbursements have occurred since enactment of P. L. 105-277)	Report on Certification as to whether IMF funds are supporting loans or guarantees to specified Korean industries: semiconductors, steel, automobiles, shipping, and textile and apparel industries
International Financial Institution Advisory Commission	One-time event, upon termination of its work (6 months after its first meeting, estimated to be not later than July 3, 1999)	Broad mandate to advise & report to Congress on future role and responsibilities of international financial institutions
U.S. Treasury	Within 3 months after end of International Financial Institution Advisory Commission's work (estimated to be not later than October 3, 1999) and then annually for 3 years	Report on desirability and feasibility of implementing the recommendations of the International Financial Institution Advisory Commission
U.S. Treasury	Within 6 months, (i.e., by April 20, 1999), with data to be provided upon request of appropriate congressional committees	Report on progress made toward strengthening IMF procedures for monitoring the use of its funds by borrowing countries
U.S. Treasury	Quarterly	Report on IMF standby or other loan programs, with specific identification of IMF loans to which the policies of Sec. 601(4) apply (i.e., effectively, countries receiving loans from the Supplementary Reserve Facility (SRF))
U.S. Treasury	July 15, 1999 and July 15, 2000	Report on the progress of efforts to reform the architecture of the international financial system
U.S. Treasury	March 15, 1999 and semiannually thereafter	Report on IMF stabilization programs that involve funds from the U.S. Exchange Stabilization Fund (ESF)
U.S. Treasury	Annually, not later than October 1 of each year	Report on the state of the international financial system, IMF reform, and compliance with IMF agreements (to be followed by testimony not later than March 1 of each year)
General Accounting Office (GAO)	Annually, beginning June 30, 1999	Report on financial condition of the IMF; status and any noncompliance, renegotiation, defaults, arrears, and yields on IMF loans; description of export policies of IMF borrowers

Source: Prepared by CRS.