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An Evaluation of Proposals to Reform the International Financial Architecture

Morris Goldstein

8.1 Introduction

The 1960s were the heyday of would-be reformers of the international monetary system, as widening cracks in the dollar exchange standard brought forth a host of reform proposals, eventually culminating in the early 1970s in the floating of major-currency exchange rates and in the first allocation of the new international reserve asset, the Special Drawing Rights (SDR). After a long lull, phase two of that reform effort has taken place over the past six or seven years under the banner of strengthening the international financial architecture (IFA).[1] In this latter case, the motivation for reform was supplied by the Mexican peso crisis of 1994–95 and, even more so, by the Asian financial crisis of 1997–98. As in the 1960s, the list of reform proposals has been long and varied.

In this paper, I provide a preliminary assessment of some of the leading reform proposals. Because the IFA covers such a wide subject area, it is necessary to be selective in a short paper.[2] Here, I have used the lending poli-

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1. By the IFA, I mean the institutions, policies, and practices associated with the prevention and resolution of banking, currency, and debt crises, primarily (but not exclusively) in emerging economies.

2. For a detailed list of ongoing reform activities in the IFA, see IMF (2000c). An integrated analysis of IFA reform issues can be found in Eichengreen (1999) and Council on Foreign Relations Task Force (1999). Williamson (2000) presents an analysis of reform proposals, including several made by groups not covered in this paper.

cies and practices of the International Monetary Fund (IMF) as a convenient organizing device to discuss selected key issues in the reform debate.[3] More specifically, section 8.2 looks at proposals to increase the interest rate or reduce the maturity of IMF loans. Section 8.3 focuses on proposals to restrict the size of IMF rescue packages. Section 8.4, which covers the most ground, examines various dimensions of IMF conditionality, including proposals to replace ex post macroeconomic policy conditionality with prequalification based on structural policies, proposals to reduce the scope and detail of IMF conditionality, proposals to narrow currency regime choices or increase private-creditor burden sharing, and proposals to condition IMF assistance on the implementation of international financial standards. Finally, in section 8.5, I offer some concluding remarks on priorities for IFA reform over the next year or two.

Instead of attempting to review comprehensively the burgeoning literature on the IFA, I have selected a subset of leading reform proposals by drawing on a group of recent appraisals of the IFA, including the "Report of an Independent Task Force Sponsored by the Council on Foreign Relations" (hereafter, the CFR Report [1999] and CFR Task Force); the "Report of the International Financial Institution Advisory Commission" (hereafter, the Meltzer Report 2000 and Meltzer Commission); the "U.S. [Clinton Administration] Treasury Department Response to the International Financial Institution Advisory Commission" (hereafter, U.S. Treasury 2000); the "Report from Group of Seven Finance Ministers to the Heads of State and Government" at Fukuoka, Japan on 8 July 2000 (hereafter, G7 Finance Ministers 2000); the "Statement of G7 Finance Ministers and Central Bank Governors" at Palermo, Italy on 17 February 2001 (hereafter, G7 Communiqué 2001); speeches on the IMF by former U.S. Treasury Secretary Lawrence Summers at the London Business School in December 1999 (Summers 1999) and before the Congress International Monetary and Finance Committee in April 2000 (Summers 2000); and speeches on the need for an international lender of last resort, on the IMF, and on the IMF's Contingency Credit Line (CCL) by IMF First Deputy Managing Director Stanley Fischer in New York in January 1999 (Fischer 1999); in Washington, D.C. in February 2000 (Fischer 2000a); and in Mexico City in November 2000 (Fischer 2000b), respectively.

8.2 Interest Rates and Maturity of International Monetary Fund Loans

The proposition that an official lender of last resort should lend at a penalty rate dates at least as far back as Bagehot (1873). If the interest rate is too low, borrowers that are in trouble may not face a sufficient incentive

3. I have also used this format in Goldstein (2000). The present paper updates and expands upon the analysis in the earlier one.

to be more careful next time; they will also see the official lender as their first, not last, resort. In addition, borrowers that are not currently in trouble may take excessive risks because they know that there is a cheap source of credit available if things turn out badly.

Taking heed of Bagehot's famous counsel, it has often been suggested that the IMF increase the interest rate it charges borrowers. Countries that enter into standby and Extended Financing Facility (EFF) arrangements with the IMF pay an interest rate (called the *rate of charge*) that is a weighted average of short-term interest rates in the Group of Five countries (the United States, France, Germany, Japan, and the United Kingdom) plus a small surcharge. The rate of charge averaged 4.7 percent in 1997, 4.4 percent in 1998, 3.9 percent in 1999, and 5.1 percent in 2000. Developing countries have to pay much more than that to access private international capital markets, especially when they are encountering crisis conditions. For example, emerging-market bond spreads (relative to U.S. Treasuries) have fluctuated from 375 to 1,700 basis points since the outbreak of the Thai crisis in mid-1997. This large difference between IMF and private borrowing costs is sometimes characterized as an unwarranted subsidy that promotes both excessive borrowing from the IMF and borrower "moral hazard."

In late 1997, the IMF seemingly took some account of this criticism by endowing its newly created Supplemental Reserve Facility (SRF) with an interest rate of 300–500 basis points above the rate of charge on regular IMF loans (with the rate higher for longer repayments than for shorter ones). This higher interest rate, however, need not apply to the whole loan. For example, in the recent (December 2000) program with Argentina, only one fifth of the IMF's $13.7 billion commitment was made available under the SRF; the other 80 percent was provided under normal standby terms.

Former U.S. Treasury Secretary Summers (2000) concluded in April 2000 that "a strong case could be made for an overall increase in the basic rate of charge" (p. 5). It has been reported that in late summer 2000 the Group of Seven (G7) countries pushed the IMF's executive board for a modest increase in the rate of charge but that opposition from developing countries and some others blocked that proposal; in the end, the compromise was to impose an interest rate premium only for "large" IMF loans; see section 8.3.

The Meltzer Commission (2000) concluded that IMF interest rates were much too low; specifically, they proposed that IMF borrowing cost be set at a premium over the sovereign yield paid by the borrowing country one week prior to applying for an IMF loan. The U.S. Treasury (2000) argued that such a penalty rate would be too high—so high as to worsen the underlying financial position of the borrowing country. Stanley Fischer (1999), the IMF's former first deputy managing director, has maintained that the penalty rate charged by the lender of last resort should be defined relative to the interest rate during normal times (not one week prior to the crisis), because

the objective of the rescue is to achieve the good, nonpanic, equilibrium. This would imply penalty rates closer to SRF terms than to "Meltzer" terms.

If SRF interest rate terms were extended to all nonconcessional IMF lending, I suspect that the impact would be greater on the speed with which countries repay their IMF borrowings than on the frequency of IMF borrowing.

When countries finally decide to ask the IMF for emergency financial assistance, it is usually in dire circumstances when financing from the private capital markets is unavailable in large amounts. Politicians who are fighting for survival are not likely to be deterred from going to the IMF by a higher interest rate (see Eichengreen 2000). In this connection, it is relevant to note that neither Turkey nor Argentina—both of which recently secured IMF financing packages in excess of 500 percent of their IMF quotas—were apparently dissuaded by either SRF interest rate terms or the new interest rate premium for large loans. All of this suggests that the decision to go to the IMF is apt to be less price elastic than the decision of how rapidly to repay the IMF loan—especially if the interest rate rises (as with the SRF) the longer the loan is outstanding. Crisis countries have more room for maneuvering at the time of repayment than they do at the outbreak of the crisis.

We should also not forget that a big difference between (upper credit tranche) IMF loans and loans from the private sector is that the former come with strong policy conditionality. When comparing IMF loans to private-sector loans, we have to look at the "conditionality-equivalent" interest rate, not just the nominal interest rate. A strong hint that conditionality matters is that, despite the large difference in nominal borrowing costs between the IMF and private markets, we do not observe emerging economies tripping over themselves in a rush to come to the IMF at the first sign of balance-of-payments trouble. Instead, countries come to the IMF late in the game. Conditionality (along with the IMF's senior creditor status) also gives IMF loans a higher probability of repayment than loans made by private creditors, implying that the market-clearing nominal interest rate for IMF loans is lower than that for private-sector ones. Again, the implication is that an increase in the rate of charge may not have a huge impact on the frequency of IMF borrowing (as long as IMF conditionality remains intrusive in both scope and detail).

What about the maturity of IMF loans? Standby arrangements cover a one- to three-year period, and drawings are phased on a quarterly basis. Repayments on standby arrangements used to be mandated within 3.25 to 5 years of each drawing; under the so-called facilities initiative agreed upon in September, 2000, repayment maturities were shortened to 2.25 to 4 years. Extended Financing Facility arrangements, which are meant to address adjustment problems that require bold structural transformation of the economy, normally run for three years (and can be extended for a fourth) and have phasing comparable to standby arrangements. The same facilities ini-

tiative also shorted repayment maturities for EFFs—from 4.5 to 10 years of the drawing to 4.5 to 7 years. Because the SRF was meant to deal with "exceptional balance of payments difficulties due to a large, short-term financing need resulting from the sudden disruptive loss of market confidence," it was created with shorter than normal repayment terms, namely 1 to 1.5 years after each disbursement.

The Meltzer Commission (2000) favored a more drastic cutback in the maturity of IMF loans—to a maximum of 120 days with only one allowable rollover (leading to a maximum maturity of 240 days). They argue that the IMF ought to be lending solely to counter liquidity crises (not insolvency crises) and that liquidity crises are typically very short-lived. The Meltzer Commission noted that prolonged use of IMF resources has been a serious shortcoming of IMF lending, with twenty four of the IMF's member countries in debt to the IMF in thirty or more of the past fifty years, and forty six more countries in debt for at least twenty of those years.

The U.S. Treasury (2000) called the Meltzer repayment period "unrealistically short." It noted that even in recent success cases, countries needed much longer than four months to be in a position to repay IMF loans. Fischer (1999) rejected the notion that it is straightforward to distinguish cases of illiquidity from insolvency. He argued that this distinction is often indeterminate in a crisis because it depends on how well the crisis is managed.

The G7 finance ministers (2000), along with former U.S. Treasury Secretary Summers (2000), have acknowledged that prolonged use of IMF resources needs to be more strongly discouraged, although they do not suggest a specific maturity cap. They would rely on an SRF-like price incentive to encourage prompt repayment. The G7 finance ministers' report (2000) argued that for all nonconcessional IMF facilities "the interest rate should increase on a graduated basis the longer countries have IMF resources outstanding." They appeared to be aiming for something closer to SRF maturities (one to two years) than to Meltzer maturities (four to eight months). In addition, there was a definite suggestion to make more selective and less frequent resort to the longer-maturity EFF window (in favor of shorter-maturity standby arrangements). Summers (2000) argued that the countries that are likely to fit the EFF's (new) requirements are lower-income transition countries that are undertaking far-reaching structural reforms to secure stabilization, and countries with incomes just above the threshold for concessional IMF financing under the Poverty Reduction and Growth Facility.

The IMF's Articles of Agreement (Article I) speak of making the IMF's general resources "temporarily available" to members dealing with balance-of-payments problems. This is in sharp contrast to the track record of frequent prolonged use of IMF resources. Consequently, moving to reduce the maturity and repayment periods for IMF loans makes sense. Charging higher interest rates for longer repayment periods ought to help promote that objective. Likewise, making resort to the EFF less frequent should keep

the IMF from getting too involved in those longer-term structural aspects of development that are best handled by the World Bank (see discussion in section 8.4 on the scope of IMF conditionality). It seems neither necessary nor desirable, however, to insist on repayment within a few months' time, as do the Meltzer Commission recommendations. Drawing on a sample of fifty industrial and developing countries over the 1975–97 period, an IMF (1998) study found that it typically takes over one and one-half years for GDP growth to return to trend after a currency crisis, and more than three years for output growth to recover from a banking crisis; the recovery times for severe currency crises and for twin crises (that is, for currency crises that were accompanied by banking crises) were even longer.[4] The (output) recoveries from both the Asian crisis and the Mexican crisis have been unusually rapid. Policy should not be set solely in terms of the best performers. Moreover, in many cases, the relatively rapid resumption of market access was accelerated by large-scale bailouts and "blanket guarantees" (including large, uninsured creditors of banks)—bailouts that we should seek to avoid or reduce in the future. Additionally, in cases in which the illiquidity/insolvency distinction is more blurred (e.g., a crisis in which the holes in the balance sheets of banks or corporations are hard to gauge quickly), it will be helpful to have longer than eight months for countries to repay.

The current mood on repayment maturities can be contrasted with that prevailing at the time the longer-maturity IMF lending windows (the EFF, the Structural Adjustment Facility, and the Enhanced Structural Adjustment Facility) were created. At that time, the maturity of IMF loans was also under attack, but from the opposite direction (see, e.g., Helleiner 1987; Camdessus 1987; and Conable 1987). Then, the criticism was that IMF lending programs were too short-sighted, too focused on correcting balance-of-payments disequilibria, and not focused enough on promoting sustainable economic growth. Demand management alone could not do the job; supply measures were needed, and these would take time. The recommended prescription was greater financial support for structural reforms, along with longer program periods and repayment maturities to allow those structural reforms to take root and bear fruit. Now that many more developing countries have access to private capital markets, that private capital flows have become extremely large relative to official finance, and that prolonged use of IMF resources has become a widespread problem, the pendulum is swinging back the other way.

8.3 Size of International Monetary Fund Loans

Size is another important dimension of IMF lending. The IMF's normal access limits for its loans are expressed in terms of a country's quota in the

4. Goldstein, Kaminsky, and Reinhart (2000) also find longer recovery periods after crises (particularly after banking and twin crises) than implied by "Meltzer" repayment maturities.

IMF. The normal access limits are 100 percent of quota annually and 300 percent on a cumulative basis. By this metric, the amounts committed under rescue packages for Mexico (1995), Thailand (1997), Indonesia (1997), Brazil (1998), Argentina (2000), and Turkey (2000) were exceptionally large, because they were in the range of 500–830 percent of quota. The rescue package for South Korea (1997) was much larger still—1,900 percent of quota.[5]

Amounts actually disbursed under the Asian rescue packages were, however, considerably smaller than amounts committed. More fundamentally, the IMF has maintained that metrics other than quotas (or absolute dollar figures) should be used to evaluate the size of packages. Fischer (1999) and Mussa (1999) have noted that IMF quotas have not kept pace with the growth of GDP, trade, or capital mobility, and therefore that quotas constitute a poor benchmark for evaluating the size of IMF loans. Fischer noted that if the IMF quotas were today the same size relative to output of IMF member countries as they were in 1945, quotas would be three times larger; adjusting quotas for the growth of world trade over the same period would leave them nine times larger. Mussa argued that official financing in the Asian crisis was not large relative to the decline in gross private capital flows during that period, or to the crisis countries' current-account adjustments, or to the huge output losses borne by the crisis countries.

Much of the recent concern has been that large rescue packages may contribute to moral hazard on the part of private creditors to emerging economies. If private creditors come to expect that IMF loans to emerging-economy governments will make these governments more capable and more likely to bail them out in cases of adverse circumstances, then private creditors will act less prudently in monitoring the performance of borrowers. Put in other words, if private creditors are shielded unduly from the consequences of poor lending and investment decisions, market discipline will suffer and future crises will become more likely.

It is widely acknowledged that moral hazard is a problem with all insurance arrangements. The solution is not to have no insurance but rather to limit the amount of payment (e.g., coinsurance or deductibles) or to price the insurance appropriately (i.e., with higher insurance rates for more risky policy holders). Critics of large rescue packages also concede that a lender of last resort, by providing emergency assistance to an illiquid (but not insolvent) borrower and thereby preventing a costly default and its spillover to other borrowers, serves a useful function for the economy as a whole. Moreover, it is recognized that equity holders and bond holders suffered large losses in the Asian crisis and that banks took a sizable hit during the Russian crisis. Still, most of the critics conclude that smaller IMF rescue packages would reduce lender moral hazard, improve market discipline and

5. One of the reasons the rescue package for Korea was so large relative to its quota is that Korea's quota is so small for its economic size.

crisis prevention, and prevent IMF money from financing sustained capital flight. In addition, smaller packages would provide a practical mechanism for introducing private-sector involvement (because any shortfall between debt payments and liquid assets inclusive of IMF loans would need to be covered, one way or another, by the private sector).

At the same time, even those who regard the (lender) moral hazard criticism as greatly exaggerated acknowledge that IMF rescue packages in the run-up to the Russian crisis of 1998 were too large and were a key reason that investors continued to pour money into Russian government securities (GKOs) despite weak economic fundamentals. They argue, however, that there is no empirical evidence suggesting that moral hazard was driving private capital flows to Mexico or to Asia in the run-up to their crises, or that the composition of capital flows has since then switched in favor of the lenders (banks) usually singled out as the main beneficiaries of lender moral hazard (see Zhang 1999; Eichengreen and Hausman 2000). They also emphasize that IMF rescue packages are loans, not grants, with reasonable interest rates and a history of very low default; because there are no losses on these loans, IMF lending cannot be considered a "direct" source of moral hazard.[6] Moreover, they maintain that moral hazard is small relative to the real hazards facing developing countries in today's capital markets.

Even though the Meltzer Report (2000) concluded that IMF loans generated serious moral hazard problems ("the importance of the moral hazard problem cannot be overstated," 33), the Commission did not recommend smaller IMF rescue packages as an antidote for that problem. Echoing the Bagehot (1873) guideline that a lender of last resort should "lend freely" (albeit at a penalty rate and on good collateral), they proposed that the IMF lend on a substantial scale—indeed, up to one year's tax revenue—to countries that have met certain prequalification criteria. This could produce massive rescue packages, far larger than any loans the IMF has extended heretofore. As noted by the U.S. Treasury (2000), such a lending guideline applied to, say, Brazil in 1997 would have resulted in a $139 billion rescue package—3,088 percent of Brazil's quota in the IMF and almost ten times as large as the IMF rescue package extended to Brazil in early 1999. The Meltzer Commission proposed instead that moral hazard problems be tackled by encouraging financial institutions in the borrowing countries to adopt higher standards of safety and soundness and by discouraging reliance on short-term borrowing.

The CFR Task Force issued the strongest call for a return to smaller IMF

6. See Mussa (1999). He refers to "indirect" moral hazard as a situation in which international financial support facilitates moral hazard by national governments. The Meltzer Report (2000) has this in mind when it charges that the IMF "did little [in Asia] to end the use of the banking and financial systems to finance government-favored projects, eliminate so-called 'crony capitalism' and corruption, or promote safer and sounder banking and financial systems" (33).

loans. The CFR Report (1999) argued that the IMF should distinguish "country crises" (crises that do not threaten the functioning of the international financial system) from "systemic crises" and should treat the two differently. For country crises, the IMF should return to normal access limits (100–300 percent of quota). For systemic crises, the IMF should turn to systemic lending windows—the existing New Arrangement to Borrow (NAB) if the crisis is mainly the result of the borrowing country's policy inadequacies and an IMF program is needed to correct those policy shortcomings, and a newly created "contagion facility" if the country is mainly a victim of contagion. To activate either the NAB or the contagion facility, a supermajority of creditor countries would have to reach the judgment that the crisis was systemic. Once activated, however, the systemic facilities could provide large access, and the contagion facility would be funded by a special allocation of IMF Special Drawing Rights (SDRs).

According to the CFR Report (1999), smaller IMF loans for country crises would still permit some cushioning of the recession, some smoothing operations in foreign exchange markets, and a modest contribution toward the cost of bank restructuring and recapitalization. These loans would not, however, be large enough to support the defense of overvalued fixed exchange rates or to bail out large uninsured private creditors. It is often suggested that there is a certain unique size of an IMF rescue package that is needed to restore confidence in the crisis country. The CFR Report rejected that view. It notes that some empirical studies have found that asset prices typically fail to stabilize right after the signing of an IMF program (see Brealey and Kaplanis 1999); instead, stability comes later, when there is stronger evidence of political leadership and when there are concrete policy actions to deal with policy shortcomings. Yes, the CFR Task Force acknowledged that smaller IMF rescue packages would probably increase the cost of market borrowing for developing countries and perhaps reduce somewhat the flow of private capital to them. However, it argues that because net private capital flows to emerging economies in the 1990–96 period were too large and the interest rate spread on that borrowing too low, some moderate move in the opposite direction would be no bad thing.

By going to smaller IMF loans for country crises, by making IMF loans to countries with unsustainable debt profiles conditional on greater private-creditor burden sharing, by encouraging all countries to include "collective action clauses" in their sovereign bond contracts, and by allowing the IMF to approve standstills declared by the debtors with unsustainable debt profiles, it would be possible, the CFR Report (1999) believes, to reduce significantly indirect (lender) moral hazard stemming from IMF rescue packages.[7]

7. On the importance of collection action clauses and creditor steering committees, see Eichengreen (1999).

The U.S. Treasury (2000) has rejected the very large IMF loans implicit in the Meltzer Commission recommendations as "unrealistic and undesirable" and as surpassing the financial capacity of the IMF and increasing moral hazard.

It was only relatively recently that the U.S. Treasury and G7 finance ministers came out in favor of an incentive to reduce the scale of IMF loans. In September 2000, as part of the facilities initiative, the IMF executive board agreed to impose an interest rate surcharge for large IMF loans: 100 basis points for IMF loans equal to 200 percent of quota, rising to 300 basis points for loans above 300 percent of quota.

The CFR view and the U.S. Treasury view on the scale of IMF financing differ on at least three grounds.

First, as regards constraints or disincentives on large rescue packages, the Clinton Treasury preferred a price (interest rate) mechanism, whereas the CFR Task Force preferred a quantity-cum-governance constraint (i.e., loans above 300 percent of quota would have to be deemed systemic by a super-majority of creditors, and those official creditors—not the IMF—would bear the credit risk). A disadvantage of the interest rate approach (and of leaving the decision to be made by the borrower) is that countries in crisis may be willing to pay a large premium to get enough IMF resources to defend overvalued exchange rates or to bail out uninsured private creditors, even if there is no systemic risk involved. If such a demand for large rescue packages is relatively price-inelastic—as I believe it is—then lender moral hazard will not be much deterred by such a (moderate) size-related premium.

One aim of requiring super-majorities for large packages is to counteract the bias for creditor countries to regard crises in their own neighborhood as systemic (even if they are not). Another aim is to counteract the bias toward discounting unduly the effect of a bail-out today on the probability of future crises. The disadvantage of the quantity-cum-governance approach is the risk of ineffectiveness or inaction in the face of a genuine systemic threat: that is, a super-majority of official creditors may allow the crisis to spread by refusing to extend the larger loan.

Difference number two is that the Treasury's approach gives more discretion to IMF management and to U.S. authorities in deciding when to activate very large rescue packages. The definition of *exceptional circumstances*, which activates abnormally large access under standby and EFF arrangements, and the definition of *systemic*, which activates very large access under the SRF and CCL, are in the eye of the beholder and do not require super-majority consent. In contrast, the CFR approach makes the decision to activate very large access one is that is shared more equally among a wider group of creditor countries.

The financing of very large rescue packages constitutes yet a third difference. Under existing IMF policy, the large access afforded under the SRF

and CCL are financed out of the IMF's existing quota pool of resources. This runs the risk that if there are many serious financial crises occurring simultaneously and if it has been some time since the IMF has had a quota increase (as in 1998), then the IMF may not have enough resources to put out such a large and contagious fire. In contrast, the CFR approach provides new money for systemic contagion cases by financing large access with a special SDR allocation.

Those favoring large IMF rescue packages sometimes argue that they are the financial analogue to the "[Colin] Powell doctrine" on military intervention: be selective in choosing where to intervene, but once the decision is made to go in, employ "overwhelming force" to guarantee a successful outcome. In my view, that analogy is flawed in at least three respects.

To begin with, the IMF's de facto capacity to mobilize overwhelming financial force (along the lines recommended in the Meltzer Report) is limited. Unlike national central banks, the IMF cannot create money. Even in periods when the IMF's liquidity situation is relatively comfortable, I doubt that the IMF's main shareholders would be comfortable approving loans that run potentially to thousands of percent of the borrowing country's quota (in the absence of an extraordinary systemic threat). Where sovereign entities are involved, willingness to pay needs to be assessed along with ability to repay, and actual and perceived inequities in burden sharing linked to the repayment of IMF loans—both across groups within the borrowing country (e.g., taxpayers versus large domestic creditors of banks) and across countries (e.g., workers in the borrowing country versus private creditors in the lending countries)—means that willingness to pay is not a sure thing. Unlike national central banks, the IMF does ask for collateral on its loans. Although arrears to the IMF have been relatively infrequent in the past, they are hardly unknown. In fact, the way the IMF currently calculates its rate of charge has been influenced by a brief but unhappy upsurge in arrears in the 1980s. This does not deny that the essence of a good official crisis lender is that it is willing to supply loans in a crisis to solvent borrowers in amounts not available from private lenders. However, it does underline that there are nontrivial repayment risks associated with very large IMF loans. My reading is that large IMF rescue packages are already unpopular in the legislatures of some large creditor countries. They would surely be much more so if there were a large default to the IMF and to creditor governments. The reality is that the IMF will not be given the same lender-of-last-resort capability as a national central bank even if the penalties for defaulting on an IMF loan were much larger than they are today.

Second, the effectiveness of large financial force in restoring stability to countries is less assured than in the military example. With country rescues, winning the confidence game requires good crisis management and, in particular, good macroeconomic and supporting policies. If crisis management is poor, then the financing gap will get much larger (via capital flight) than

originally assumed and even a very large IMF loan is likely to be inadequate to the task at hand. The spat between Prime Minister Ecevit and President Sezer (just before two important Turkish Treasury Bill auctions) is illustrative of how quickly a large IMF program can lose market confidence when prospects for policy implementation deteriorate unexpectedly. In contrast, if the accompanying policies are good, it may be possible to restore stability and confidence with IMF loans within normal access limits. The fact that asset prices do not seem to stabilize immediately after the announcement of an IMF program supports the view that the amount of IMF money is not all that matters, and maybe not even the main thing that matters (see, e.g., Haldane 1999).

Third, even large IMF loans that are repaid on time and that are effective in restoring stability carry a moral hazard risk that private lenders will be even less careful in the future in assessing the creditworthiness of borrowers. Such moral hazard seems more important in the financial sphere than in the military one. Some observers have dismissed the practical significance of lender moral hazard by noting that several empirical studies have failed to find a link between earlier large rescue packages (e.g., Mexico in 1994–95 or Asian crisis countries in 1997) and the postcrisis behavior of interest rate spreads for emerging-market borrowers.

A new study by Dell'Ariccia, Gödde, and Zettelmeyer (2000) suggests that most of the previous work on the empirical significance of lender moral hazard–cum–IMF rescue packages is methodologically flawed.[8] They argue persuasively that a good event study has to satisfy three conditions: (a) it has to change the public perception of the extent or the character of future international crisis lending; (b) it has to be unexpected (otherwise the reaction to the event could show up before the event rather than after it); and (c) it must not lead to a reassessment of risks other than through the expectations of future international rescues.[9] The events following the Russian default in August 1998 come closest to meeting these requirements for a valid experiment. They also show that it is inappropriate to look only at impact of the event on the average level of spreads for a single country; instead, the test should look to changes in the level of spreads in a wide range of countries, to changes in the sensitivity with which spreads react to fundamentals, and to changes in the cross-country variance of spreads (also controlling for fundamentals). In the end, their results find strong evidence consistent with the existence of (lender) moral hazard. At the very least, the findings of Dell'Ariccia, Godde, and Zettelmeyer should give pause to those who dismiss lender moral hazard in the 1990s as peanuts.

If large IMF rescue packages are to be discouraged, there remains the

8. This criticism would apply, for example, to Zhang (1999) and Lane and Phillips (2000).

9. Because rescue funds are fungible, there is also the complication that the indirect, moral-hazard impact of international rescues may extend to a variety of domestic institutions and domestic creditors, and some of these may not issue publicly traded debt.

question of how best to do so. Not surprisingly (given my role as project director and author of the CFR Report), I regard the CFR approach to discouraging large rescues as preferable to the interest rate–premium approach recently adopted by the IMF's Executive Board.

8.4 International Monetary Fund Policy Conditionality

Yet another element of Bagehot's (1873) guideline for a (national) lender of last resort is that lending should be done on "good collateral." Good collateral serves several purposes. It provides a test of whether the borrower is just illiquid rather than insolvent (i.e., a solvent borrower has good collateral to pledge; an insolvent one does not). Because the good collateral has market value, it safeguards the solvency of the lender. It also avoids the potentially time-consuming process of negotiating and monitoring conditions on the borrower that would maximize the likelihood of repayment. Additionally, it reduces (borrower) moral hazard by discouraging the borrower from holding risky assets that would not be accepted as good collateral.

The IMF does not lend to countries against collateral. Instead, it lends to countries that have a balance-of-payment need under "adequate safeguards." What are these safeguards? The main one is the policy action(s)—so-called conditionality—that the borrowing country agrees to undertake to qualify for the loans. These policy conditions are meant to correct the underlying balance-of-payments problem and to restore the borrower's ability to repay the IMF. Policy conditions are negotiated and agreed between the borrowing country and the IMF. These conditions typically cover macroeconomic policies (i.e., monetary and fiscal policies), exchange rate policy, and a range of structural policies (e.g., financial-sector policies, trade policy, reform of public enterprises, etc). As a further safeguard, IMF disbursements are made in phases or "tranches" (rather than all at once), with the ability to draw that tranche dependent on the borrower's meeting certain predetermined performance criteria.[10] Because some other lenders (both official and private) condition their lending to the borrowing country on either the existence or the successful implementation of an IMF program, the amount of funding that the borrowing country can lose by not meeting the performance criteria is usually larger than the loss of IMF support. If the borrower does not repay the IMF on time, it faces loss of access to future IMF lending and ultimately even expulsion. Moreover, because member countries regard their creditor position in the IMF as part of their international reserves, the IMF has consistently maintained the view that it cannot reschedule its loans to countries with debt-servicing difficulties.

10. These performance criteria are meant to be within the control of the borrower. If unexpected developments intrude that prevent the borrower from meeting the performance criteria, the borrower may be granted a waiver to draw anyway.

Some observers submit that the explicit and implicit costs that would be associated with not repaying IMF loans give the IMF a de facto if not de jure status as a preferred (senior) creditor.

Supporters of the IMF would concede that the above description of IMF conditionality does not do justice to the problems often encountered in its implementation. In some cases, negotiations over policy conditions can be long and contentious, and the borrowing country may never take "ownership" of the program. Nonobservance of performance criteria can lead to interruptions in IMF drawings. Sometimes funding may continue despite nonobservance of performance criteria because of political pressures from a variety of sources (including the IMF's major shareholder countries). In still other cases, the economic analysis and advice embodied in the policy conditions may be inappropriate for the unfolding economic conditions on the ground (e.g., the recession may be deeper than anticipated when the program was formulated) and revisions to program design may be too slow in coming. Borrowing countries that do not repay on time may either get de facto rescheduling (extension of new IMF loans to repay earlier ones) or may get many chances to repay before their eligibility for new loans is cut off or before they get expelled. Still, supporters argue that the existing system of conditionality works reasonably well most of the time and that, just as importantly, it works better than the alternatives.

Here, I take up four dimensions of policy conditionality that have been much debated in the discussion of the need for IMF reform, namely, (a) ex post policy conditionality versus ex ante conditionality (i.e., prequalification based on structural-policy preconditions); (b) the scope of conditionality; (c) currency regime and private-sector burden-sharing aspects of conditionality; and (d) implementation of international financial standards.[11]

8.4.1 Ex Post Policy Conditionality versus Preconditions (Ex Ante Conditionality)

The Meltzer Report (2000) was extremely critical of the existing (ex post) approach to IMF conditionality. The majority in the Meltzer Commission (2000) concluded that detailed IMF policy conditionality has "burdened IMF programs in recent years and made such programs unwieldy, highly conflictive, time consuming to negotiate, and often ineffectual" (7). They went on to argue that there was no evidence of systematic, predictable effects from most of the IMF's policy conditionality. Later on, they maintained (not entirely consistently) both that if the IMF did not exist, the market would force a country in crisis to follow similar policies and that IMF policy conditionality in the Asian crisis actually made the crisis coun-

11. There is also an issue of whether IMF conditionality should supercede any conditionality that would be linked to crisis lending from "regional" official crisis lenders (such as an Asian Monetary Fund).

tries worse off than they would have been without IMF assistance. Put in other words, when the bottom-line results in IMF program countries look good, the outcome would have happened anyway (without the IMF); and when the results look bad, they reflect the negative influence of IMF policy conditionality and advice.

The Meltzer Report (2000) did not recommend that the IMF insist on "good collateral" as a substitute for its policy conditionality (despite the fact that the Commission's chairman favored this prescription in his recent writings on how to redesign the Fund; see, e.g., Meltzer 1999). Some have argued that if countries in crises were able to satisfy a stringent collateral requirement, then they wouldn't need the IMF (i.e., they would be able to use this collateral to borrow from private creditors); hence, little "additional" financial stability would be obtained by such a reform. Although one can point to episodes in which even borrowers with good collateral could not get credit in a panic, perhaps the Commission gave this "additionality" argument some weight. Or perhaps the Commission became convinced that giving the IMF a more established de jure status as a preferred creditor—lending only to countries that met certain prequalification requirements (see discussion below)—would provide sufficient protection for the IMF against credit risk. Or perhaps the collateral idea simply was not deemed attractive enough to elicit majority support either within the Commission or outside more generally.

The Meltzer Report (2000) did recommend that the IMF eliminate most of the macroeconomic and structural policy conditions that have characterized (upper credit tranche) IMF programs in the past. It proposed instead that countries qualifying for short-term IMF liquidity assistance would need to meet the following preconditions: (a) freedom of entry and operation for foreign financial institutions; (b) regular and timely publication of the maturity structure of outstanding sovereign and guaranteed debt and off–balance sheet liabilities; (c) adequate capitalization of commercial banks, either by a significant equity position à la international standards or by subordinated debt held by nongovernmental and unaffiliated entities; and (d) a proper fiscal requirement. These new rules would be phased in over a period of five years.

Those developing countries that met these preconditions would be eligible immediately for short-term liquidity assistance; those that did not meet these preconditions would not be eligible (unless there is an unusual situation in which the "crisis poses a threat the global economy"). Larger industrial countries would not be eligible for IMF liquidity assistance; their central banks would assume this task.

In order to establish the seniority of IMF claims on borrowing countries, members would exempt the IMF from negative pledge clauses and would give the IMF specific legal priority with respect to all other creditors (secured and unsecured). Countries that defaulted on IMF debts would not be

eligible for loans or grants from other multilateral agencies or other member countries.

The Meltzer Commission plan would not prohibit the IMF from continuing to offer advice on a wider range of economic policies (including the currency regime) in its Article IV consultations with developing countries; moreover, these reports would be published promptly. Industrial countries could opt out of these IMF consultations if they wished. However, the IMF could NOT make its advice on economic policy a condition for its loans. Nor could the IMF make other types of loans for whatever purpose. Longer-term institutional assistance to foster economic development would be the responsibility of a reconstructed World Bank or regional development banks. The IMF's Poverty Reduction and Growth Facility (PRGF) would be closed.

The structural policy preconditions in the Meltzer Report have been criticized on four counts.

First, there is the charge that the (majority in the) Meltzer Commission misread history. This criticism is evident within the Meltzer Commission itself from the dissent penned by four commission members appointed by the Congressional Democrats (namely, C. Fred Bergsten, Richard Huber, Jerome Levinson, and Esteban Torres).[12] In looking at the fifty-year tenure of the IMF and the World Bank (hereafter, the IFIs), the dissenters concluded that "the bottom line of the 'era of the IFIs,' despite obvious shortcomings, has been an unambiguous success of historic proportions in both economic and social terms" (119). They note, in addition, that almost all the crisis countries of the past few years, ranging from Mexico to the countries of East Asia to Brazil, have experienced rapid "V-shaped" recoveries; that never in human history have so many people advanced so rapidly out of abject poverty; and that more than half of the world's population now lives under democratic governments. In short, "the allegations of the report simply fail to square with history" (121).

The CFR Report (1999), while stressing the need for IMF reform, painted a more favorable picture of IMF involvement. For example, in evaluating the IMF's role during the Asian crisis, the report concluded: "As costly as the Asian crisis has been, no doubt we would have seen even deeper recessions, more competitive devaluations, more defaults, and more resort to trade restrictions if no financial support had been provided by the IMF to the crisis countries. . . . [T]here can be legitimate differences of view

12. The Meltzer Commission had eleven members. Six of those (Allan Meltzer, chairman; Charles Calomiris, Tom Campbell, Edwin Feulner, Lee Hoskins, and Manuel Johnson) were appointed by the Congressional Republicans; the other five members (Fred Bergsten, Richard Huber, Jerome Levinson, Jeffrey Sachs, and Esteban Torres) were appointed by the Congressional Democrats. In the end, eight members (all six Republican appointees, Jeff Sachs, and Richard Huber) voted for the report, and four members were opposed (including Richard Huber, who supported both the majority and minority reports).

about IMF advice on fiscal and monetary policy in the crisis countries. . . . But we had a look in the 1930s at how serious global instability is handled without an IMF, and few would want to return to that world" (88).

The IMF interprets the existing empirical studies on the effects of IMF programs differently than did the Meltzer Commission. Fischer (2000a), for example, summed up the recent studies as follows: "The consensus view now seems to be that in a typical [IMF] program, economic activity will be depressed in the short term as macroeconomic policies are tightened, but that growth subsequently revives as structural reforms take root. Meanwhile, the balance of payments improves, removing the need for further Fund financing. The impact on inflation is usually favorable . . . although in general not large enough to be statistically significant" (8).

A second line of criticism is that the Meltzer preconditions would suffice neither to prevent financial crises nor to achieve the balance-of-payments adjustment necessary to restore countries' ability to repay the IMF; some critics would go farther and argue that reliance of these preconditions alone would promote financial instability.

Again, the dissenting group within the Meltzer Commission reached conclusions at odds with those of the majority group. Specifically, the former argued that the majority would have the IMF totally ignore the macroeconomic policy stance of the crisis country, thereby sanctioning IMF support for countries with runaway budget deficits and profligate monetary policies. They go on to conclude that "this would virtually eliminate any prospect of overcoming the crisis; it would instead enable the country to perpetuate the very policies that triggered the crisis in the first place and thus greatly increase the risk of global instability" (121). They also note that the "proper fiscal requirement" included in the preconditions is left undefined in the report and, if left open to content, would require IMF conditionality of the same type that the majority rejects.[13]

The U.S. Treasury (2000) agreed with the Meltzer Commission dissenters on the effectiveness of the proposed Meltzer preconditions: "the proposed eligibility criteria are too narrow. Even where they are met, they would be unlikely to protect economies from the broad range of potential causes of crises. The criteria focus on the financial sector, and yet even problems that surface in the financial sector often have their roots in deeper economic and structural weaknesses" (17). The treasury worries further that combining large IMF disbursements with ineffective eligibility requirements could actually increase the amount of moral hazard in the system.

Criticism number three is that it would prove neither feasible nor desir-

13. My IIE colleague, C. Fred Bergsten, who was a member of both the Meltzer Commission and the CFR Task Force, maintains that both the undefined "proper fiscal requirement" and the systemic override (that allows assistance to countries that do not meet the prequalification criteria if there is a threat to the global economy) were added to the Meltzer Report at the last minute in an attempt to reduce the impact of the joint dissent.

able to exclude completely from IMF financing countries that did not meet the structural preconditions. Fischer (1999) offers the following assessment on that point: "It is doubtful that the international community would be indifferent to the fate of countries that do not meet the pre-qualification requirements, or to the instability that might be generated when they get into trouble and are denied help. In practice, in such circumstances the large industrial countries would probably find another, less transparent, way to help the country in crisis" (10). I suppose the retort of the Meltzer Commission would be that other ways of assisting countries that don't meet the prequalification requirement are to be preferred to IMF assistance because they would be more (not less) transparent and would not risk turning the IMF into a political slush fund.

The all-or-nothing approach to eligibility for IMF assistance was rejected by the CFR Task Force. In its recommendations, countries that follow a set of "good housekeeping" crisis prevention policies qualify for a lower interest rate from the IMF than do countries that do not follow these policies. However, the latter group is not excluded from IMF assistance.

In its evaluation of the Meltzer Commission's prequalification criteria, the U.S. Treasury (2000) argued: "this recommendation would preclude the IMF from being able to respond to financial emergencies and support recovery in the vast majority of its members, possibly including all of the emerging market countries affected by the financial crises of 1997 and 1998.[14] The exclusive focus on relatively strong emerging economies would leave out most of the Fund's membership, notably all low income countries and many transition economics" (17).

Yet a fourth set of criticisms of the Meltzer preconditions is that their implementation would involve more serious operational problems and raise more questions than the authors imply. For one thing, as argued in the CFR Report (1999), it is far from clear that prequalification would deter speculative attacks. Hong Kong, for example, had $60–100 billion of reserves in 1997–98 and pledges of financial support from Beijing; yet it faced strong attacks on its currency during that period. For another, it is probably naive to assume that the decision to declare countries that originally met the preconditions as ineligible (because of subsequent backtracking on compliance) would not be subject to strong political pressures. Also, the report does not discuss who would monitor compliance with the preconditions; if the answer is that national regulatory authorities would do it (see the later discussion on international financial standards), then there is a serious question of whether those judgments would be objective. Last but not least, there are questions about whether some of the preconditions would have their intended effects. For example, Garber (2000) has argued that a subor-

14. Bergsten (2000) made essentially the same point in earlier testimony on the Meltzer Report before the Senate Committee on Banking, Housing, and Urban Affairs.

dinated debt requirement for banks (similar to the proposal advanced by the Meltzer Commission) could likely be manipulated and evaded, thereby weakening its attraction as a mechanism for stronger market discipline.

The notion of prequalifying for IMF liquidity assistance applies presently only to drawings under the IMF's recently established (April 1999) CCL. Countries can qualify for the CCL if they have good macro policies, are complying with international financial standards, and have constructive relations with their private creditors. So far, no country has applied for the CCL. According to the IMF (Fischer 2000b), the unpopularity of the CCL probably owed to its (earlier) pricing structure: because the interest rate on the CCL was the same as that on the SRF, there was no incentive to prequalify; in addition, access to the credit line was not seen as automatic enough (if a crisis broke out). An alternative hypothesis is that the unpopularity derives from the ambiguous signal that applying for the CCL sends (i.e., it could be interpreted as suggesting the country is expecting trouble); in addition, because the IMF has recently speeded up its decision-making for disbursement from other IMF facilities in a crisis, prequalification may not confer as much of an advantage as previously supposed.

In September 2000, as part of the "facilities initiative," the IMF's executive board agreed to make the CCL more attractive by reducing the interest rate surcharge (from the previous 300 basis points to 150 basis points), by reducing slightly the commitment fee, and by making monitoring arrangements less intensive and the activation review less demanding. We will see if those sweeteners attract any more bees.

I do not find the Meltzer structural-policy preconditions attractive as an alternative way of qualifying countries for IMF financial assistance. Although meeting those criteria would, ceteris paribus, reduce the risk of getting into a crisis, they are not sufficient by themselves to deter a crisis; just as important, they are not very useful for getting out of a crisis once it hits.

Recent cross-country empirical research on financial development and on vulnerability to a banking crisis does indeed suggest that easing restrictions on foreign bank entry positively affects the efficiency of the domestic banking system and reduces banking fragility, particularly in emerging economies with small financial systems (see Barth, Caprio, and Levine 2000; Caprio and Honohan 2000). Also, many of the concerns about foreign-bank entry—for example, that foreign banks will destabilize the flow of credit during a crisis, or that foreign banks will drive domestic banks out of business, or that foreign banks will lower the effectiveness of banking supervision—have not found empirical support (see Goldberg, Dages, and Kinney 2000; Claessens and Jansen 2000). Likewise, I believe that better public disclosure and more timely publication of data on the currency and maturity composition of debt would be helpful in discouraging the buildup of large currency and maturity mismatches (see section 8.5).

However, helpful is not the same thing as adequate to the task at hand. The same empirical research that shows that vulnerability to emerging-market banking crises is reduced by easier entry of foreign banks also shows that it would be reduced by lower state ownership of banking systems, by less generous deposit insurance and official safety nets, and by other factors (including wider banking powers)—and the Meltzer preconditions say nothing about those determinants of fragility. More generally, freedom of entry in banking plus a subordinated debt requirement are not likely to be adequate substitutes for the wider range of factors outlined (e.g., "fit and proper" requirements for getting a banking license) in the Basel Core Principles of Banking Supervision and in the recent empirical literature. In addition, although empirical research suggests that many currency crises are preceded by banking crises, many others are not (see Goldstein, Kaminsky, and Reinhart 2000). Giving huge credit lines to countries without any monetary policy conditionality seems counter-intuitive. The fiscal policy precondition is not discussed in a serious way in the Meltzer Report; it reads like an afterthought.

Freedom of entry for foreign banks and timely reporting of debt maturities will not get a country out of a balance-of-payments crisis. Without measures to reduce absorption and to switch expenditure from foreign to domestic goods, the crisis country's ability to repay is not likely to improve. Although I share the Meltzer Commission's desire to reduce the scope and intrusiveness of present IMF structural policy conditionality, this does not look like the best way to do it.

I am not a big fan of the CCL. I believe the design flaws there extend beyond pricing and that it is possible to create a superior lending window to deal with the systemic cases of cross-country contagion along the lines outlined in the CFR Report (1999).

8.4.2 Scope and Detail of Conditionality

None of the charges leveled at the IMF during the Asian crisis was probably more widespread than the criticism that the IMF has allowed the scope and detail of its conditionality to become overextended, particularly in the area of structural policies (see Feldstein 1998). The most visible manifestation of the reach of IMF programs was the vast array of structural conditions (more than 100) in the IMF's 1997 program with Indonesia (see Goldstein 2003). These included, inter alia, measures dealing with reforestation programs; phasing-out of local content programs for motor vehicles; discontinuation of support for a particular aircraft project and for special privileges granted to the National Car; abolition of the compulsory 2 percent after-tax contribution to charity foundations; development of rules for the Jakarta Clearinghouse; the end of restrictive marketing agreements for cement, paper, and plywood; the elimination of the Clove Marketing Board; the termination of requirements on farmers for the forced planting of sugar

cane; the introduction of a micro credit scheme to assist small businesses; and eighteen specific follow-up actions to the findings of the audit of Bank Indonesia.

A recent comprehensive review of IMF structural policy conditionality is contained in Goldstein (2003). Among the main findings were the following: (a) structural policy conditionality is a now a common and important element of IMF conditionality; (b) combining prior actions, performance criteria, structural benchmarks, and program reviews, it has been typical over the past three or four years for a one-year standby arrangement to have about a dozen structural conditions and for a three-year EFF program to have on the order of fifty such conditions; (c) about two-thirds of those conditions fell in the areas of fiscal policy, financial-sector reform, and privatization, with the rest scattered across a fairly wide field; (d) structural conditions in the IMF's recent programs with Indonesia, South Korea, and Thailand were more numerous and detailed than is usually the case; (e) there has been a pronounced upward trend in structural policy conditionality over the past fifteen years, and this trend has become steeper in the 1990s; (f) there has been a shift over time in the instruments used by the IMF to monitor structural conditionality, with resort to structural benchmarks, conditions for program reviews, and prior actions having risen faster than formal performance criteria; (g) obtaining compliance with IMF conditionality has been a serious problem (including the IMF's structural policy conditionality), with the compliance rate hovering at about 50 percent and falling over time; (h) for the most part, the IMF's structural policy recommendations reflect the economics profession's consensus of what constitutes sensible policy reform, although some serious mistakes on sequencing have sometimes taken place; and (i) the IMF's recent experience with structural conditionality as a whole indicates that the IMF has bitten off more—in both scope and detail—than either it or its member countries can chew. There are limits, no matter how numerous and detailed the IMF's monitoring techniques, to how far the IMF can push a country to undertake structural reforms that it is not committed to.

This upward trend in IMF structural policy conditionality reflects many influences. The following seven factors (discussed more fully in Goldstein 2003) merit mention.

1. In the 1970s and early 1980s, IMF programs came under sharp criticism from many developing countries as being too demand-oriented and too short-run, and as not paying enough attention to economic growth, to supply-side reforms, and to income distribution. Because it was developing countries that increasingly constituted the demand for IMF resources, neither the IMF nor creditor governments could easily dismiss that criticism. New lending windows with higher structural policy content and with lending terms more favorable to low-income countries were created, and moni-

toring techniques for gauging compliance with structural policy conditions evolved.

2. The huge transformation task faced by the transition economies—especially in the first half of the 1990s—made structural policies and the building of a market infrastructure the name of the game in that region. The IMF (along with the European Bank for Reconstruction and Development) was at the center of the technical assistance and policy lending to those transition economies. Again, structural benchmarks came to be relied upon as a way of monitoring structural policy conditionality across a wide front. When structural problems arose in later crises (Asia), the same monitoring techniques were applied.

3. All the while, the IMF was more and more interpreting its mandate as being broader than just promoting macroeconomic and financial stability and helping countries to manage financial crises. From the mid-1980s on, economic growth and, later, high-quality growth were given increased prominence. Additionally, after the Mexican peso crisis of 1994–95, crisis prevention—with particular attention to strengthening financial systems at the national level and developing international standards and codes of good practice—moved up on the agenda as well.

4. Crises that involve severe balance sheet problems of banks and private corporations lead to more structural policy–intensive IMF programs than do those that stem from traditional monetary and fiscal policy excesses, and the Asian crises of 1997–98 had those balance sheet problems in spades.

5. The long-standing and growing problem of obtaining good compliance with IMF programs led over time to greater reliance on prior actions and to more wide-ranging and detailed structural policy conditions, presumably in an effort to penalize poor earlier track records, to thwart evasion, and to detect slippage at an earlier stage. The IMF's 1979 Guidelines for Conditionality in standby arrangements—which might have reined in excessive structural policy conditionality—came to be viewed by the IMF's executive board as broad principles of intention, not as something to be monitored carefully and enforced.[15]

6. In the meantime, a wide array of legislative groups, nongovernmental organizations, and even other international financial organizations came to the see an IMF letter of intent as the preferred instrument of leverage for their own agendas in emerging economies. Yes, the International Labor Organization might be the logical place to push core labor standards, but it does not have the teeth of an IMF program. Simultaneously, various G7

15. Guideline 9 of the 1979 Guidelines states: "Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives. Performance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the Articles. . . . Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact."

governments—and particularly the IMF's largest shareholder—were finding it increasingly difficult to get congressional support for "clean" IMF funding bills. Reflecting this congressional pressure from both major parties, the U.S. executive director at the IMF has been obliged to support with voice and vote a long list of structural policies (ranging from protection of the environment to promotion of economic deregulation and privatization of industry), and the U.S. Treasury is required to report annually to the Congress on its compliance with relevant sections of the Foreign Operations, Export Financing, and Related Programs Appropriation Act of 1999. Likewise, in countries where there was prolonged use of IMF resources, IMF letters of intent sometimes became an instrument of leverage that the finance ministry could use to push structural reforms on other departments in the government that were opposed. In short, everybody has gotten in on the act.

7. Unlike other IFIs, the IMF and the World Bank have sufficient "ground troops" to perform on-site visits to all countries. In addition, at least in official circles, the IMF has developed a reputation for being able to act quickly and efficiently. When new structural challenges have arisen, there has therefore been a tendency to say, "give it to the IMF; they go there anyway; just have them add a few specialists on problem X to the mission." The management of the IMF has apparently not said "no" very often to those demands.

In Feldstein's (1998) view, when the IMF contemplates including a particular policy reform in its programs with emerging economies, it should ask itself two questions: is this reform necessary to restore the country's access to international capital markets, and would the IMF ask the same measures of a major industrial country if it were the subject of a IMF program? If the answer to either question is "no," then that policy should not be part of the IMF program.

According to the CFR Report (1999), the traditional separation of responsibilities between the IMF and the World Bank had become blurred in recent years, to the disadvantage of both institutions and their clients. It recommended that the IMF confine the scope of its conditionality to monetary, fiscal, exchange rate, and financial-sector policies. A recent external review of IMF surveillance by a group of outside experts led by former Bank of Canada Governor John Crow (see Crow, Arriazu, and Thygesen 1999) outlined the same boundaries for the IMF's core competence. Financial-sector policies (and surveillance) were included in the IMF's mandate under the rationale that banking and financial-sector problems were much more connected than other structural policy areas to the prevention, management, and resolution of financial crises. The CFR Task Force also recommended that the World Bank should concentrate on the longer-term structural and social aspects of economic development and should expand

its work on social safety nets. The World Bank should not be involved in crisis management, emergency lending, or macroeconomic policy advice.

The Meltzer Report (2000) recommended that the IMF cease lending to countries for long-term structural transformation (as in the transition economies) and for long-term development assistance (as in sub-Saharian Africa). It would eliminate the IMF's concessional lending window for poor countries, the PRGF. Long-term structural assistance to support institutional reform and sound economic policies would be the responsibility of the World Bank and the regional development banks (i.e., the Asian Development Bank, the African Development Bank, and the Inter-American Development Bank).

The U.S. Treasury (2000) opposed the Meltzer Commission's recommendations that the PRGF be closed and that long-term assistance to foster development and sound economic policies be handled exclusively by the World Bank and the regional development banks. It emphasized that poverty reduction in poor developing countries will not occur without economic growth and that good growth performance in these countries will not take place without sound macroeconomic policies. Because the treasury saw the IMF's particular expertise in helping countries to set up appropriate macroeconomic frameworks as not being shared by the multilateral development banks (MDBs), it was opposed to transferring this responsibility from the IMF to the MDBs. Moreover, it did not feel that the IMF's advice on macroeconomic policy would be influential in poor countries unless it was supported by some IMF lending arrangement. It also hinted that bilateral contributions funding the IMF's concessional lending activities might be cut back to some extent if the IMF were no longer involved in lending to poor countries. All this having been said, the U.S. Treasury (2000) did acknowledge that the IMF's role in concessional lending "needs to change significantly" (22). Specifically, it called within the PRGF for a clearer division of labor between the IMF and the World Bank, with the IMF focusing on macroeconomic policy and structural reform in related areas (tax policy and fiscal management) and with the World Bank taking the lead on national poverty-reduction strategies and other structural reforms.

The IMF has defended strenuously its lending activities to poor countries. Fischer (2000a) argued that poor countries also have macroeconomic problems and that they have a right like every other member to access the facilities of the IMF. He also maintained that the new PRGF will improve lending to the poor countries because it forces the IMF, in cooperation with the World Bank, "to make sure that the macroeconomic framework is fully consistent with what needs to be done for social reasons" (4).

In their report of July 2000, G7 finance ministers (2000) expressed support for the IMF's role in the PRGF. The report also noted that the issues dealt with by the IMF and the World Bank are increasingly interrelated. It acknowledged that a "clearer definition of their respective responsibilities

and activities" would be desirable but did not provide any specific suggestions on what this definition should be. Indeed, it pretty much ducked the issue. At their meeting in February 2001 (the first one to include new U.S. Treasury Secretary O'Neill), G7 finance ministers and central bank governors issued a short communiqué (G7 2001); under the heading of strengthening the international financial architecture, they looked forward to "further progress on prioritization of IMF conditionality" (2).

Given the long-standing pressures emanating from both industrial and developing economies to use the IMF to pursue wide-ranging goals, the practical difficulties of getting the IMF to focus on a leaner agenda should not be underestimated. Still, there are signs from both new IMF Managing Director Horst Kohler (2000) and from new U.S. Treasury Secretary Paul O'Neill that they want to get the IMF "back to basics" and to streamline IMF conditionality. If they can sustain that shift in direction, they will deserve our applause.[16] For reasons laid out in both the CFR Report (1999) and the Crow Report (1999), I think the most sensible definition of IMF core competence is monetary, fiscal, exchange rate, and financial-sector policies; the rest should be the comparative advantage and primary responsibility of other IFIs.

I question the argument that if the PRGF were transferred to the World Bank, the IMF would be unable to have a significant influence on the macroeconomic framework in its poorer member countries. If the focus of the PRGF is really on long-term poverty reduction strategies, the World Bank should take the lead role (which would include supplying the financing). To ensure that the IMF's voice on macroeconomic policies is heard loud and clear, the IMF should have a strong "sign off" mechanism. Giving the World Bank its own PRGF-type lending window hardly seems a good solution; why does the world need two windows to do nearly the same thing? The institutional specifics of IFI lending facilities need to give way to a sensible and consistent division of labor—not the other way around.

8.4.3 Currency-Regime and Burden-Sharing Aspects of IMF Conditionality

No discussion of IMF conditionality would be complete without addressing currency regime and private-creditor burden-sharing issues.

The list of larger emerging economies with relatively open capital markets that have been able to maintain a fixed exchange rate for five years or longer is now very short: Argentina and Hong Kong. During the past six years, Mexico, most of the Asian crisis countries, Russia, Brazil, and Turkey (among others) have all been forced to abandon publicly declared exchange

16. Also commendable was the decision of the IMF last year to eliminate several lending facilities that were no longer needed (namely, the Buffer Stock Financing Facility, the Currency Stabilization Fund, and the Debt and Debt Service Reduction Facility).

rate targets of one kind or another. The main lesson of this experience is that emerging economies should choose either a regime of managed floating or a hard peg (i.e., a currency board or dollarization). Adjustable peg regimes (so-called soft pegs) are too fragile for a world of high capital mobility—both because they offer no workable exit mechanism once the fixed rate becomes overvalued, and because there are strict limits to how long emerging economies can keep interest sky-high in a currency defense (especially when the country has a weak banking system or the corporate sector has a high debt-equity ratio, or the economy is in recession, or the government has a large fiscal deficit with a great deal of floating rate debt). Despite these vulnerabilities, history suggests that some emerging economies will be tempted to try to maintain overvalued soft pegs if they think they can get large-scale IMF or G7 financial support in a crisis; the Brazilian crisis in early 1999 was a leading case in point.

The Meltzer Commission (2000) argued that countries should avoid pegged or adjustable exchange rates and suggested that the IMF use its Article IV consultations to make countries aware of the costs and risks associated with pegged or adjustable rates. The report states that fluctuating exchange rates or hard pegs would be a better regime choice. However, the Meltzer Report did *not* recommend that the IMF include the currency regime as one of the structural preconditions for IMF liquidity assistance, arguing that stabilizing budget and credit policies is far more important than the choice of exchange rate regime.

The CFR Report (1999) went further than the Meltzer Commission on the choice of currency regime. The report concluded that managed floating should be the IMF's main-line currency regime recommendation for emerging economies, with hard pegs also advocated in particular circumstances.[17] More noteworthy, the CFR Task Force recommended that the IMF NOT provide large-scale financial assistance to countries that are intent on defending arguably overvalued fixed exchange rates.[18] In this sense, the CFR Task Force would make exchange rate policy an integral part of IMF conditionality.

This consensus on currency regime choices for emerging economies also seems to be shared by the IMF. Fischer (2000a) noted that all the countries that recently had major international crises had relied on a pegged or fixed exchange rate system before the crisis. He also projected that "we are likely

17. Under the IMF's existing Articles of Agreement, countries can choose any currency regime (with the exception of linking the currency to gold). However, this does not mean that the IMF cannot ask countries to follow a particular exchange rate policy as a condition for IMF financial assistance.

18. A sizeable minority (eleven of twenty-nine members) of the CFR Task Force also took the view that there could no stability for emerging-economy currency regimes and no international financial stability more broadly until there was greater stability in G3 currency relationships. Toward that end, they proposed a "target zone" plan for the G3 currencies. The majority of the task force, however, rejected this approach.

to see emerging market countries moving towards the two extremes, of either a flexible rate or a very hard peg—and in the long run, the trend is most likely to be towards fewer currencies" (10).

The "corners" view of currency regimes for emerging economies was likewise endorsed by the Clinton Treasury. Summers (1999) has stated that countries maintaining a fixed rate should be expected to make explicit the extent to which monetary policy is being subordinated to the exchange rate objective, and (if using fixed rates as a tool of disinflation) to disclose the nature of their exit strategy. He concluded that "countries that are involved with the world capital market should increasingly avoid the 'middle ground' of pegged rates with discretionary monetary policies, in favor of either more firmly institutionalized fixed rate regimes or floating" (4).

In my view, the "corners school" consensus on currency regimes for emerging economies is soundly based on the lessons of experience. The key question is whether the G7 and the IMF are prepared to act on that recommendation when push comes to shove by not providing large-scale support for defense of overvalued fixed rates. I don't think merely advising emerging economies on choice of regime in Article IV consultations (as recommended by the Meltzer Commission) will get the job done.

We also need to understand better why so many emerging economies exhibit a serious "fear of floating," as documented in several recent empirical papers (see, e.g., Calvo and Reinhart 2000). One explanation is history, that is, a long memory by domestic and foreign creditors of earlier periods of high inflation (and also, sometimes, negative or very low real interest rates). This memory can lead private creditors to think that any temporary easing of monetary policy means the authorities are again "off to the races." Brazil's recent postcrisis experience, however, with managed floating–cum–inflation targeting and an independent central bank, suggests that history need not be insurmountable. A second and more weighty explanation is that many of these economies have large, unhedged, foreign currency–denominated liability positions on the part of banks or corporations; given that mismatch, a large depreciation would make many banks and firms insolvent, with large adverse effects on the real economy à la the Asian crisis.[19] Here, dollarization is seen as a sensible second best policy choice, given the difficulty of reaching the first best policy, namely, reducing or eliminating the mismatch itself. To me, however, the usual arguments put forward as to why the first best policy option is not available (e.g., private capital markets will not lend to emerging economies in their own currency) are not convincing. Thus, I still regard managed floating—probably with inflation targeting as a nominal anchor—as the preferred choice in most circumstances.

I suspect that the choice between the two corners over the next few years

19. Turkey's banks are also reported having suffered large losses in the recent (February 2001) depreciation of the lira due to unhedged currency positions.

will depend heavily on the real-life experiment now going on in Latin America. If Argentina's currency board eventually disappears because the cost of not having (domestic) monetary policy available to help emerge from anemic economic growth proves too great to bear, then the momentum for currency boards and dollarization will fade in favor of managed floating. On the other hand, if Brazil is unable to sustain its recent progress on inflation or the exchange rate runs out of control, then managed floating could well become a relic for most emerging economies. We will see who wins the race; right now, I would bet on the managed-floating horse.

Turning to private-sector involvement (PSI), the aim is to see that private creditors do not escape from paying their fair share of the burden of crisis resolution. As outlined earlier, the worry is that if private creditors do not "take a hit" when they make poor lending and investment decisions, there will not be sufficient incentive to undertake more careful risk assessment in the future.

Judging from a recent report of G7 Finance Ministers (2000), congressional testimony by former U.S. Treasury Secretary Summers, and a recent progress report on IFA reform by the IMF (2000a), the official sector (at least in the major industrial countries) felt it had made real progress on PSI. In this connection, the G7 finance ministers (2000) have noted that "private sector investors and lenders have been more involved in the financing of recent IMF-led programs" (2). Similarly, in listing recent important achievements on the reform of the IFA (in testimony before the House Banking Committee in March of this year), Secretary Summers stated that "we have found new ways to involve the private sector in the resolution of crises—most notably in the cases of Korea and Brazil" (2–3). Additionally, an IMF (2000c) progress report observed that "two recent cases of efforts to secure private sector involvement with members that had lost spontaneous access to capital markets through the restructuring of international bonds had been encouraging" (14); later on, however, that IMF report also acknowledged that "only limited progress has been made in lifting institutional constraints to debt restructuring" (17). The references above are to the less-than-voluntary rollover (albeit with a government guarantee and interest rates 150–200 basis points higher than precrisis rates) of interbank credits by G7 commercial banks in South Korea in early 1998, to the voluntary rollover of interbank and trade lines in Brazil in March 1999, to a tougher initial negotiating stance by the IMF or the Paris Club in several recent (1999 and 2000) emerging-market bond restructurings (Ecuador, Nigeria, Pakistan, Romania, and the Ukraine), and to rather limited success in encouraging creditor committees and inclusion of "collective-action clauses" (CACs) in sovereign bond contracts (at least among the G7 countries).

Some private analysts do not share this (rosy) assessment. Eichengreen (2000), for example, in a recent comprehensive review of PSI over the past few years, concluded that efforts to enhance significantly the participation

of the private sector in crisis management and resolution have so far been a "failure" (1). Moreover, a recent IMF *International Capital Markets Report* (2000b) acknowledged that all the recent successful bond exchanges have involved some form of "substantial sweetener" for existing bond holders.

The Meltzer Report (2000) basically ducked on the PSI issue, notwithstanding its concern about lender moral hazard. It concluded that "the development of new ways of resolving sovereign borrower and lender conflicts in default situations should be encouraged but left to participants until there is better understanding by debtors, creditors, and outside observers of how, if at all, public-sector intervention can improve negotiations" (50).

In contrast, the CFR Report (1999) took a more activist position on PSI. More specifically, the report recommended (a) that all countries, including the G7 countries, commit to including CACs in their sovereign bond contracts and require that such clauses be present in all new sovereign bonds issued and traded in their markets; (b) that the IMF advise all emerging economies to adopt a "structured early intervention and resolution" approach to deposit insurance reform in their banking systems and reward countries that do so; (c) that the IMF make it known that it will provide emergency financial assistance only when there is a good prospect of the recipient country's achieving balance-of-payments (BOP) "viability" in the medium term (including a sustainable debt and debt-servicing profile); (d) that, in extreme cases of unsustainable debt profiles, the IMF expect as a condition for its support that debtors engage in good-faith discussions with their private creditors with the aim of reaching a more sustainable debt profile; and (e) that the IMF recognize that orderly debt rescheduling may be facilitated by having the debtor declare a temporary payments standstill (with the final decision to impose the standstill resting with the debtor country, not the IMF).[20] The aim of the CFR approach was to reduce lender moral hazard at the national and international level and to promote timeliness and orderliness in private debt rescheduling, but without going so far as to promote borrower moral hazard.

The IMF, U.S. Treasury, and G7 finance ministers all seem to have favored a differentiated case-by-case approach to PSI, guided by a few principles. They also favor some institutional changes but are not very specific about what they are willing to do to make these changes come about. A recent G7 finance ministers report (2000) illustrates the point. They say that the IMF should "encourage" use of CACs to facilitate more orderly crisis resolution, but they do not indicate what form this encouragement should take. Similarly, they say that use of CACs in international bonds issued by emerging economies in G7 financial markets should be "facilitated" but do not say how. They recommend different approaches to PSI depending on

20. Only one of the twenty-nine members of the CFR Task Force (namely, William Rhodes of Citigroup) dissented from the private-sector burden-sharing and CAC recommendations.

the borrowing country's medium-term debt and balance-of-payments profile. Where that profile is sustainable, they prescribe catalytic official financing and policy adjustment or voluntary approaches to overcome creditor coordination problems. Where the debt and BOP profiles are not sustainable, a broader spectrum of actions by private creditors—including comprehensive debt restructuring—is regarded as appropriate.

Contrary to the authors of the Meltzer Report, I do not believe that the PSI problem will solve itself in the marketplace. What the official sector does on PSI inevitably influences the balance of power between official debtors and private creditors in debt negotiations (as the IMF implicitly acknowledged in the late 1980s when it finally endorsed selective use of IMF "lending into arrears" to private creditors).

Like the authors of the CFR Report, I think the G7 countries will need to be more activist in facilitating wider use of CACs in sovereign bond contracts, as well as in endorsing selective use of temporary standstills. Eichengreen (2000) estimates that at present slightly more than half of all international bonds and about two thirds of all emerging-market issues do not contain CACs. In recent empirical work (Eichengreen and Mody 2000 and Eichengreen 2000), Eichengreen also demonstrates that (counter to the claims made by some private-creditor groups, like the Institute for International Finance) neither CACS nor internationally sanctioned standstills are likely to raise borrowing costs for emerging economies: CACs seem to lower borrowing costs for more creditworthy emerging economies and raise them for less creditworthy ones, and results for cross-country differences in creditor rights suggest that a well-designed IMF-sanctioned standstill would reduce borrowing costs (that is, the prevention of a creditor grab race has a more powerful effect on borrowing cost than the weakening of creditor rights). The decisions by the United Kingdom and Canada to include CACs in some of their sovereign bond contracts is welcome; other G7 countries should now follow their lead. Standstills could be given some legal force by following the recent proposal of Canadian Finance Minister Paul Martin (Martin 1999) to require all cross-border financial contracts to include (ex ante) a provision recognizing the IMF's authority to declare a standstill. Although it is true (as emphasized by Frankel and Roubini 2000) that some recent international bond exchanges for small emerging economies have permitted de facto rescheduling without recourse to CACs (or even in their absence), those exchanges were accompanied by substantial sweeteners to creditors; in addition, in those cases in which CACS were present, the implicit threat of invoking them may have facilitated the (voluntary) exchange.

I also continue to believe that PSI will not be successful until there is an agreement to limit the size of IMF rescue packages (for nonsystemic cases), until the official sector insists (in cases of unsustainable debt profiles) on appropriate debt restructuring with private creditors as a condition for IMF financial support, and until most emerging economies have in place good

deposit insurance systems. Although it is true that small(er) rescue packages may not quell an investor panic, neither is it assured that large rescue packages (in the politically feasible range) will do so, and smaller packages at least introduce PSI in a direct way. Although initial IMF efforts in Romania and the Ukraine to condition its support on PSI were unsuccessful, this tells us relatively little about prospects for success in larger emerging-market economies where the stakes for private creditors would be bigger. Finally, most lender moral hazard occurs at the national level, not at the international level, and this will continue until good deposit insurance systems and other elements of an incentive-compatible financial safety net are in place.[21]

8.4.4 Implementation of International Financial Standards

The elements of IFA reform discussed thus far in this paper are not likely to have much of an impact on crisis prevention in emerging economies unless those economies also undertake a broad and determined effort to strengthen their domestic banking and financial systems. After all, over the past fifteen years, there have been more than sixty five episodes in which banking problems in emerging economies got so bad that the entire banking system was rendered insolvent. In the Asian crisis countries, we are now looking at fiscal costs of bank recapitalization that range from 10 to 60 percent of GDP (see World Bank 2000).

One of the key mechanisms being used to guide this upgrading of financial systems in emerging economies is international financial standards. Each of these standards is drawn by an international group of experts and represents agreement on minimum requirements for good practice. The Financial Stability Forum (FSF) has now decided that twelve of these standards are crucial for sound financial systems and deserve priority implementation. The twelve key standards (known as the "compendium of standards") cover data dissemination, banking supervision, insurance supervision, securities regulation, insolvency regimes, corporate governance, accounting, auditing, payment and settlement, market integrity, fiscal policy transparency, and monetary and financial policy transparency.

Establishing standards is one thing. Getting countries to implement and enforce these "voluntary" standards is another. In seeking to identify incentives that would speed the implementation of international financial standards, the official sector has relied on two channels.[22]

21. By a "good" deposit insurance system, I mean one that puts large uninsured creditors of banks at the back of the queue when failed banks are resolved, that places stringent accountability conditions on senior economic officials when they invoke "too large to fail," and that gives banking supervisors better protection against strong political pressures for regulatory forbearance.

22. Originally, there was also to be a third incentive channel, which would link implementation of international financial standards to preferred risk weights in the revised Basel Capital Accord. I understand, however, that this idea has recently been shelved.

First, there is the expected market payoff. If market participants can tell who is and who is not implementing the standards and if complying countries are regarded as more creditworthy, then the latter should be the beneficiaries of a lower market cost of borrowing. Early on, there was some hope that the private credit rating agencies might take up the task of evaluating compliance with standards and publish the results. That has not happened. Instead, it is the official sector—and, primarily, the IMF—that has taken the lead in this process. A few examples illustrate the process. The IMF now posts on the internet the list of countries that have signed on to the data dissemination standard. Similarly, for the banking supervision standard, the IMF prepares Reports on the Observance of Standards and Codes (ROSCs); so far, ROSCs for about fifteen countries have been completed and another twenty or so are under preparation. The decisions to have a ROSC and to have the report published are at the discretion of countries; the majority of completed ROSCs have been published. The IMF and the World Bank jointly produce Financial Sector Assessment Programs (FSAPs) that evaluate financial-sector vulnerabilities as well as assessing compliance with those financial-sector standards that affect stability. World Bank staff expect to have about six corporate governance and six accounting reports available soon (see IMF 2000c).

Two factors have constrained the market payoff channel. One is the concern that naming publicly the noncomplying countries could precipitate runs or crises. Recently, however, that concern appears to be waning. Within the past few months, the FSF published the list of offshore financial centers whose regulatory and supervisory practices are regarded as lax; the Organization for Economic Cooperation and Development named jurisdictions that promote harmful tax competition; and the Financial Action Task Force identified fifteen jurisdictions that were judged to be uncooperative in the fight against money laundering. This recent public naming of names could be ushering in a more aggressive stance by the official sector. The other constraint is that evaluation of compliance in areas outside the competence of the IMF and the World Bank presupposes a good deal of interagency cooperation and coordination. This still remains a bottleneck.

The second incentive channel for implementation of financial standards is the Bretton Woods channel. More specifically, the IMF and the World Bank could give those countries implementing the standards a better insurance deal (larger access or lower interest rates) when they needed financial assistance. This still appears to be on the drawing board. Implementation of financial standards is supposed to be one of the eligibility factors for accessing the CCL, but, as mentioned earlier, no country has yet applied for CCL assistance.

The U.S. Treasury and the G7 finance ministers appeared be on the same page as far as where they wanted to go with the standards. In brief, they were encouraging countries to sign up for assessments of compliance with

the standards and to allow the results to be published; in addition, they were encouraging the IMF to identify which standards should have the highest priority for which countries. They were also asking the FSF to see if there are farther supervisory and regulatory incentives that would promote observance of the standards.

The Meltzer Report (2000) took a different tack. It recommended that financial standards should be set by the Bank for International Settlements (BIS) and that implementation of standards, and decisions to adopt them, should be left to domestic regulators and legislators. Perhaps they were relying on regulatory competition to eventually induce reform.

In contrast, the CFR Report (1999) called on the IMF to monitor countries' compliance with standards (at least the ones that fall into its core competence) and to charge lower interest rates to countries that make better crisis prevention efforts, where implementation of standards would be one of the key elements in "crisis prevention efforts." Furthermore, the report urged that this risk-based insurance premium apply to all the IMF's nonconcessional lending, not just to the CCL. In addition, the CFR Task Force recommended that the IMF publish its evaluations of compliance with standards so that the markets could take note.

Implementation of international financial standards is one of the areas in IFA reform that has shown the most progress over the past few years.

Any recommendation to have domestic regulators act as the sole evaluator of compliance with standards is a bad idea. It is very unlikely that such self-evaluations will be objective rather than self-serving. In this connection, a survey sent to 129 countries in 1996 by the Basel Committee on Banking Supervision is instructive; on element after element of banking supervision (from government-directed lending to loan classification procedures to independence of the supervisory agency . . . on and on), a very high proportion of respondents ranked themselves as doing a very good job—and this despite the sorry record of banking crises over the preceding twenty years, to say nothing of the banking crises to come (just a year or so after the survey) in Asia;[23] I understand that a more recent Basel Committee survey again demonstrated the strong bias in self-evaluation. Assessment of compliance with international financial standards should continue to be done by (more objective) international agencies with the relevant expertise, at least until the private sector is prepared to take up that task in a serious way. The recent decisions by the FSF and other official agencies to publicly name names of non-complying economies suggests that they have crossed the Rubicon on this issue. This should increase the market payoff to implementing the standards.

The next bottlenecks that need to be tackled are better coordination among the evaluating agencies, and making the private sector—and partic-

23. See Goldstein (1997) for a discussion of the survey results.

ularly the major rating agencies—more familiar with the official evaluations. It would be very helpful to have assessments on key standards collected and published in one place—say, in the IMF's Article IV consultation report. In addition, the IMF, the World Bank, and the FSF should increase efforts to publicize their evaluations; until the rating agencies and other market participants become convinced that such (official) evaluations of compliance are useful in evaluating creditworthiness, their impact on market borrowing costs will be minimal.

8.5 Concluding Remarks

More has been happening on reform of the IFA over the past five years than many people think. However, progress has been quite uneven. Progress has been considerable in the setting and implementation of international financial standards. Currency regimes for emerging economies have likewise improved, although that has been forced by the market, not by the official sector. The redesign of IMF lending facilities is also moving in the right direction. Much less progress has been made, however, on discouraging currency mismatching, on PSI, and on refocusing the mandates of the IMF and the World Bank. That is where the priority needs to be over the next year or two.

One of the key lessons that we should take away from the emerging-market financial crises of the past seven or eight years is that a 30 percent-plus devaluation is a very different animal when banks and corporations have large currency mismatches than when they do not. One only has to compare the widespread insolvencies and deep output losses in the Asian and Mexican crises on the one side (in which currency mismatches were large prior to devaluation) with the more moderate effects during the Brazilian crisis on the other side (in which mismatches were much smaller) to see what difference it makes to the bottom line. Moreover, wherever large currency mismatches exist, there will be understandably be great reluctance to accept a large devaluation even when the real exchange rate is significantly overvalued, thereby often making the final exchange rate adjustment even larger.

Discouraging currency mismatching is particularly challenging for private-sector borrowing. Whereas an enlightened government debt manager may be able to internalize the externalities associated with unhedged foreign currency borrowing, private-sector actors often see it differently. If others are availing themselves of lower interest rates on foreign currency–denominated debt, competitive pressures may tempt them to do so as well; in addition, there is always the possibility that losses on foreign currency borrowing induced by a devaluation may be bailed out by the authorities (especially if the borrower is a bank).

Most of the antidotes for the currency mismatching problem proposed so

far (that is, dollarization, prohibiting foreign currency–denominated loans, and making such obligations unenforceable in domestic courts of developing countries) seem to me to be either too costly or too drastic.[24] I would rather see more emerging economies follow Mexico's recent lead by combining a managed floating rate with active development of hedging mechanisms. In addition, every request for an IMF program should contain data on existing currency mismatching by the banking and corporate sectors, analysis of the sustainability of these mismatches (including scenarios of what the consequences of a devaluation would be), and explicit conditions for reducing the mismatch (if the existing or prospective mismatch is judged to be too large). Furthermore, in either its *International Capital Markets Report* or its *World Economic Outlook*, the IMF should be drawing attention (on a regular basis) to currency mismatch figures for all countries that have significant involvement with private international capital markets; some of that kind of analysis has appeared in recent issues of the Bank of England's *Financial Stability Review,* and it could be extended by the IMF. The more that private market participants are aware of the magnitude of currency mismatching, the better the chances that market pressures would be brought to bear to reduce it before a crisis takes place.

Turning to PSI, the analysis in section 8.4 suggests that there could be large dividends to putting in place an incentive-compatible system of deposit insurance for banks in emerging economies, to cutting back on the size of IMF rescue packages for non-systemic crises, and to encouraging greater use of CACs and (in extreme cases) internationally sanctioned standstills as well.

The former managing director of the IMF, Michel Camdessus, was fond of saying, "The fund should do more and do it better." I would argue that the fund should do less so that it can do it better. Comparative advantage should apply to the IFIs as well as to their member countries.

A way needs to be found to resist the constant calls on the IMF to become a "general-purpose organization." Its core competence in monetary, fiscal, exchange rate, and financial-sector policies should be protected; this will require the cooperation of the membership, and particularly of the largest shareholders. It will also require firmness from the IMF's new managing director. If IMF structural conditionality is to be streamlined, IMF management will have to say "no" more than in the past—to requests for IMF assistance when the expectation is low that the country will implement IMF policy conditions, to G7 governments when they propose new tasks for the IMF that go beyond the IMF's core competence, to nongovernmental organizations that seek to use a country's letter of intent with the IMF to advance agendas that (even if desirable) lie outside the IMF's mandate, and to

24. For analysis of the currency mismatching problem and what to do about it, see Dooley (1999) and Krueger (2000).

developing-country finance ministers who want to use micro conditions in IMF programs to impose spending discipline on other government ministries that could not be agreed upon in their national legislatures. None of this means that the IMF should not take account of social needs in its programs or that it cannot provide good service to its poorer member countries (any more than making price stability the key objective of central banks means that they should ignore the real economy or financial stability). However, it does mean that both the IMF and the World Bank have to allow their 19th Street partner to lead in the areas of its comparative advantage, as well as rationalizing their lending windows.

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Comment Andrew Berg

Morris Goldstein's paper is a comprehensive, authoritative, sensible, and well-written insider's guide to the architecture debate as it stood at the end of the Summers-Rubin-Camdessus administration. It is organized around a daunting array of proposed reforms, from exchange rate policy to package size to deposit insurance and the relative role of the World Bank and the International Monetary Fund (IMF). For purposes of discussion, I want to divide them into three categories:

1. Those whose advisability is controversial and depends on the diagnosis of the problem. Here I would place the question of the size of IMF packages and the appropriate role of private-sector burden sharing.
2. Those that are controversial because of feasibility concerns. Here, the most important proposal is a greater reliance on ex ante conditionality, as many of the radical proposals for reform hinge on this. Ex ante conditionality that worked—for example, conditioning support on prior measures to maintain a strong banking system—would hold the promise of avoiding moral hazard while allowing large bailouts that can solve at least the liquidity-related market failures. The doubts are about whether it can work in practice, for example whether appropriate ex ante conditions can be defined and whether the IMF can behave in a time-consistent manner.
3. Those that have been more or less agreed upon and whose implementation has begun. Here the main question is how much they will help. Examples include changing the interest rates and tenor of IMF lending and developing international codes and standards in a variety of areas.

Rather than organizing my comments around various proposals, I want to organize thinking around a few key analytic questions. I will focus on category-1 issues, which implies trying to link proposed solutions to diagnoses of the problems to be solved.

An analysis of the international architecture problem depends on two main considerations. The first is the importance of market failure in international capital markets. For liquidity crises, this failure may be associated with multiple equilibria in exchange rates and capital markets or "irrational" contagion. For solvency or debt crises, the problem may be the absence of sovereign bankruptcy procedures. This, in turn, may imply an inability to efficiently resolve debt overhang, a rush for the exit by creditors, an inefficient lack of new money in the absence of mechanisms for collective action, and so on.

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The second key consideration is the significance of the moral hazard associated with bailouts by official creditors.

I will now try to place views on a key category-1 issue, the appropriate size of rescue packages, in this framework. The Meltzer Commission (MC) report places substantial emphasis on potential market failures in terms of liquidity crises resulting from the lack of an international lender of last resort. They (more or less implicitly) give little weight to problems associated with the absence of an international bankruptcy procedure, in that there seems to be little concern about developing mechanisms to resolve bankruptcies beyond letting the market take care of them. The MC report also clearly considers that moral hazard associated with the action of the IMF is substantial.

Figure 8C.1 illustrates the MC views in moral hazard–market failure space. Recommended rescue package size rises as opinions move toward the northeast in this figure. As befits the complexity of their analysis, the MC gets three areas. The spot on the upper right reflects the MC view of liquidity crises, which is that there is great risk of moral hazard associated with bailouts but that market failures are potentially large. Recommended package is modest (or zero). The dark spot in the upper left represents the MC belief that ex ante conditionality solves the moral hazard problems, so that recommended package size is enormous (much greater than has been observed) as long as ex ante conditionality is enforced. The larger area in the lower right represents the MC views on solvency crises, as much as they can

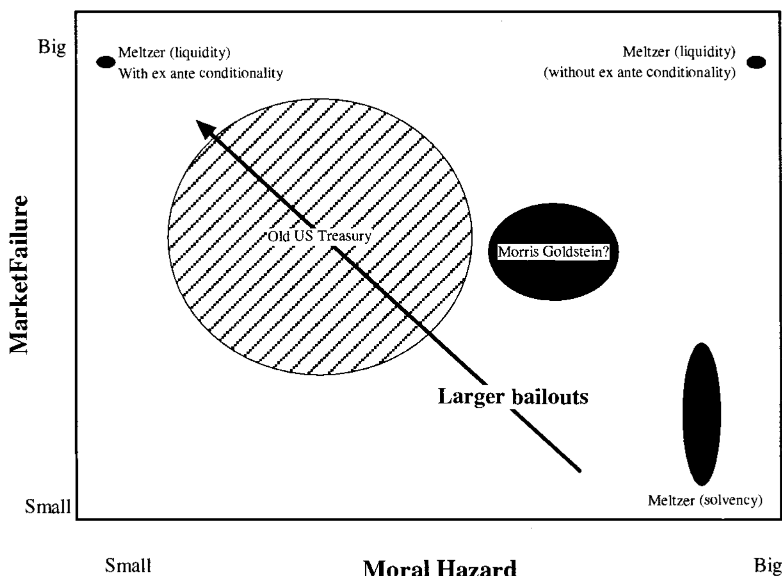

Fig. 8C.1 Market failure and moral hazard

be ascertained. Moral hazard is key, whereas it is unclear that market failure is significant.

The Rubin-Summers Treasury and the Camdessus-Fischer IMF (USTIMF) believed that market failures were potentially large, large enough to justify rescue packages of unprecedented size. The failures include contagion as well as liquidity crises, as in Korea in 1997, when creditors could be coordinated to stay in, but only with substantial official support. There was also recognition of market failure in the context of debt workouts, although less was done about it. As befits the case-by-case approach, views are relatively indistinct, resulting in the large oval in the figure. Preferred package sizes are similarly varied, depending on the degree of moral hazard in the particular case (which depends in part on how far the country is toward the insolvency end of the spectrum) and how unnecessarily bad the situation would be absent support.

Goldstein argues for somewhat smaller rescue packages than under the USTIMF regime. I confess I do not find his arguments convincing here. He argues that the IMF (and others) should not try to back the defense of overvalued pegs, although they can still help in the aftermath. Most of the large IMF-led packages we have in mind, though, did not involve the defense of pegs (the Mexico, Thailand, Korea, and Indonesia programs, for example, all *followed* devaluations). He also argues that packages alone are never enough and that they can never be large enough. None of this speaks to the (admittedly quite difficult) question of how large they should be.

As I noted above, the importance of moral hazard plays a determinative role in recommendations for the size and nature of rescue packages. Goldstein clearly thinks it is very important but does not explain why or how much. The logic for the potential of moral hazard is clear; the harder question is how much there is in practice. For some, fear of moral hazard should deter large rescue packages no more than it argues for banning fire departments. For others, it is the dominant feature of international capital markets.

My own view is that cases vary but that it is rarely a major factor. As pointed out by Jeanne and Zettelmeyer (2001), the size of the direct subsidy associated with the rescue packages would seem too small for them to generate major moral hazard. Evidence presented by Dell'Ariccia, Gödde, and Zettelmeyer (2000) suggests strongly that there is some moral hazard, as suggested by the increase in spreads and their tighter relationship to fundamentals after the Russian default of 1998. As those authors argue, the Mexico bailout of 1994–95 was not a good "natural experiment" to test the implications of the bailout itself as distinct from other things that went on at the same time. Nonetheless, the evidence about the Mexican bailout of 1994–95 argues strongly that the combined effects of the Mexican crisis itself and the associated bailout were negative for emerging-market spreads, even in Asia. At a minimum, the insurance was not perceived to be com-

plete. My impression, based on more anecdotal evidence, is also that there was very little thought that the IMF might actually have to bail out the Asian tigers prior to the crisis of 1997. Financial booms can precede financial busts without moral hazard.[1]

I do not want to give the impression that the USTIMF had a fully articulated rationale for package sizes. On the contrary, the process has been entirely ad hoc. Politics have played an important role, of course, but there have also been efforts to conduct gap-filling exercises to determine how much is needed. The traditional IMF financing gap analysis assumes some feasible but broadly "good" scenario with an amount of adjustment deemed appropriate. The resulting balance-of-payments financing gap must be closed with IMF (or other "exceptional") official lending. An alternative approach that has emerged in the major crises of the 1990s has been to examine the vulnerability of the country to a shortage of liquidity. In practice, specific categories of liabilities have been the focus of the liquidity crisis, and calculations of required package size have typically involved assuming that these categories will flee the country, whereas others may be rolled over. The at-risk categories have varied across episodes. It is not clear, in general, what claims should be the focus of the liquidity crisis; presumably expectations may coordinate around many equilibria.

These sorts of calculations, especially (but not only) the traditional analysis, would seem to assume some type of imperfect capital mobility. Put alternatively, the assumption is that sterilized intervention can work, in that it can keep incipient gaps from resulting in sharp interest rate increases or depreciations. My own view, although this is taking us far afield of Goldstein's paper, is that a complete view of appropriate package size will probably need to consider seriously imperfect capital mobility. Models of package size that assume perfect capital mobility have a hard time rationalizing the sort of interior solutions observed in practice (as shown by Jeanne and Wyplosz, chap. 4 in this volume). It may be that the practice is indefensible; alternatively, it may be that, especially in times of crisis, demands for the assets of a country are sloped, or certain types or categories of investments are more likely to flee.

The debate on private-sector involvement (PSI) or burden sharing is in many ways the dual of the discussion of package size. I would characterize the USTIMF view as having been one that found the liquidity/solvency distinction useful for describing the role of PSI. In cases that are toward the pure liquidity end of the spectrum, most notably Korea in 1997, PSI can be

1. DeRosa (2001) strongly asserts that moral hazard from the Mexico bailout led to the Asian crisis. He tells a number of stories about how market participants behaved in the run-up to the Asian crisis; however, that suggest a much different picture. They emphasize the role of shortsighted speculators' placing undue confidence in pegs, without a thought of the IMF. Indeed, he argues for a close analogy between the European exchange rate mechanism crisis in which surely confidence in IMF bailouts played no role) and the Asian crises.

helpful, although it may well be counterproductive to push for too much. Of course, the corollary is that a serious liquidity crisis might call for a large package. A demand for a standstill or other comprehensive PSI, as called for in recent years by some non-U.S. Group of Seven (G7) officials, requires an implausible leap of faith that such a standstill will coordinate expectations around a good equilibrium rather than leading to a rush for the exits.

For cases in which a major rescue package and policy adjustment are unlikely to solve the problem—that is, for crises that are closer to being solvency crises, the approach has been different. Indeed, since 1998 Pakistan, Ukraine, Ecuador, and Russia have defaulted on international debt. Although the IMF thus did not fully bail out creditors and avert default in these cases, it was often involved in the postdefault workouts. These sorts of cases have received much less attention in the public architecture debate, and in Goldstein's paper, than the Mexico-style bailouts without PSI. Recent events in Argentina have suggested that such solvency crises may return to a prominence they enjoyed in the 1980s, rather than the liquidity crises that have received so much attention of late.

More issues are raised by these sorts of cases than I can fully discuss here. It may be useful, though, to touch on the role of the IMF and other official creditors. In practice, the IMF has generally provided a seal of approval of the eventual workout, which was nonetheless negotiated between the countries and their creditors. The IMF was to some extent the agent of official bilateral creditors, who required, through the Paris Club process, that an in-force IMF program accompany their own rescheduling efforts. The IMF thus has found itself in the role of certifying that the debt write-down was sufficient to restore solvency and also that the country was making a reasonable effort to repay what it could.

Key unresolved questions are many:

- Have the potential coordination problems associated with the debt workouts been satisfactorily resolved? In some cases it may be that fears of legal action and insufficient debtor protection have led to minimal write-downs, such that debt overhang remains a serious problem.
- What is the potential role of collective action clauses in overcoming free-rider problems? In practice, debtors have not exploited these clauses even when available. In the case of Ecuador, they proved unnecessary. The debt contracts in Ecuador's external bond debt, as with most Eurobonds, permitted all but key financial terms of the arrangements to be modified with a 50 percent majority (through so-called exit amendments). Ecuador achieved its debt write-down by offering to exchange outstanding bonds for new ones of a smaller face value. Creditors accepting the exchange of their bonds had to first agree to exit amendments that substantially weakened the legal claims of holdouts. Thus, in the end, most bondholders tendered their bonds. Peru's recent

experience in which the sovereign settled with holdout claimants after the creditors had won some court cases, on the other hand, suggests that holdouts may remain an important obstacle to debt workouts. It is still unclear at this point whether Ecuador will provide a model for more complicated debt workout situations such as may occur in the future.

- The question of how the burden of write-downs is to be shared between private creditors and official bilateral creditors has been the source of great friction. In a typical Paris Club arrangement, amortizations over the IMF program period are rescheduled at low contractual interest rates. It can usually be safely assumed that subsequent amortizations will also be rescheduled on the same terms, although the Paris Club will make no commitment. Legal and political constraints also make it difficult for Paris Club to accept face-value reductions for all but the poorest debtors. Private-sector creditors, on the other hand, want a restructuring of the entire stock of debt, but they may willing to accept large face-value reductions, particularly in return for cash payments up front.
- Both private and public creditors are suspicious that the other set of creditors is getting a better deal, in part because they have sharply different views about how to compare these two types of reschedulings. The core of the difficulty lies in how to value the net present value (NPV) of future Paris Club amortizations (or, as it is sometimes said, whether to think about stocks or flows). The private sector tends to want to calculate the NPV of the stock of Paris Club debt, both rescheduled and not (yet) rescheduled. This may be substantial, because no face-value reductions take place and no further reschedulings can be assumed. Paris Club creditors, on the other hand, know they will likely never actually see a cent, due to future reschedulings, so they have a tendency to look at cash flows over the IMF program period. They thus look askance at large cash payments to the private-sector creditors, although these are often highly valued by these creditors and can be a condition for a successful exchange.

I have spent most of my time so far today on type-1 solutions as I categorized them above, that is, on those that are controversial mostly because of differing views of the nature of the problem. Let me touch a bit on some of the other parts of the paper. Section 8.2 discusses various changes in the terms of IMF lending. On the whole, the conclusion is that these may be useful changes but that they will not make much difference. I agree, largely for the reasons Goldstein lays out in the paper. Section 8.4 covers a wide variety of elements of IMF conditionality.

By far the most important question is whether the IMF can usefully condition assistance ex ante on structural policies or the implementation of international financial standards. This would hold the promise of allowing the easing of some of the market failures while mitigating the related costs

of moral hazard. As Goldstein outlines in the paper, the obstacles to movement in this direction are enormous, however, I see at least a couple of problem areas.

First, a switch to ex ante conditionality may not be time-consistent. We may not know what conditions to put down. In this case, many crises may happen anyway, and we will be faced with the possibility that a supplemental reserve facility (SRF)–type response would be, at that point, optimal. Similarly, authorities may not accept that they will only be helped if they satisfy ex ante conditions. That is, they may still count on the bailouts. The cost of the IMF's failing to satisfy these expectations could be high (under the assumption that SRF packages do in fact help, ignoring strategic considerations). One lesson is that merely adding ex ante conditionality to the current facilities (along the lines of the contingency credit line) is not likely to make much difference, because it will tend to be weak in terms of conditions and countries will not want it anyway, counting on the SRF if they really get in trouble. A more dramatic switch to purely ex ante conditionality would be risky: If no one noticed or believed the regime change, there would be no reason for crisis incidence to go down, and the worst of both worlds might prevail, at least for a time: high crisis incidence because of moral hazard but no mitigating support packages. (Jeanne and Zettelmeyer 2001 contains a useful discussion of this issue.)

Second, the resistance from developing country countries to any sort of dramatic move to ex ante conditionality would be extremely fierce. Moreover, such a move would, according to some, require amendments to the IMF articles. Of course, a unified and motivated G7 could presumably still make it happen.

In his discussion of the question of currency regimes, Goldstein suggests that the trend to the corners (i.e., to hard pegs or floats) is real and welcome. I would only add that the jury is still out on this question. Even though floating regimes do, I think, offer a real degree of freedom to many emerging markets, it is always possible that a sufficient degree of pressure on an exchange rate may lead the authorities to move from leaning against the wind to defending a parity, from which a crisis may ensure. In this case, managed floats are no panacea. Evidence in Berg, Borensztein, and Pattillo (2001) shows that currency crises have been no more likely to occur in fixed than flexible exchange rates over the 1973–99 period in a sample of twenty five emerging-market economies, consistent with a view that this sort of occurrence is common. As for the other corner, Argentina's recent experience may remind us that Panama has had more IMF programs than any other country over the last couple of decades.

I found it hard to see how to make operational the recommendation to streamline structural conditionality and the need to streamline. Almost everyone is in favor of simplified and focused conditionality in theory, but they typically disagree about what should be focused on. Goldstein wants

the IMF to go back to basics, but at various points he advocates the following: the publishing of detailed assessments of how countries are observing various codes and standards; publication of in-depth analyses of financial systems; the collection and reporting of data on maturity mismatches; a central role for the IMF in calling for payments standstills; and the enforcement by the IMF of good deposit insurance schemes. Collectively, this represents an extremely ambitious set of initiatives. The World Bank can perhaps carry some of the load, but it is worth emphasizing that for some time there has been widespread agreement that the division of labor between the World Bank and the IMF should move in this direction. The problem has been that the World Bank has not been able, in practice, to step up to the plate.

To conclude, the movement to reform the international architecture has been in some disarray for several years, because little progress was made on some key fronts after the Asia crisis. According to a common view, what began as architecture has ended up as interior decorating. Most disappointing to some observers has been the continuing practice in the later Clinton-Camdessus administration of providing large bailouts to emerging-market debtors such as Turkey and Argentina in 2000.

For a time, it seemed that the change of administration in 2001 could provide an opportunity to take a dramatically different tack. According to the view that market failures are fairly limited in importance and moral hazard a dominant problem in international capital markets, a reduction in the role of the IMF could be a useful tonic. Emerging markets would be encouraged to build institutions that would encourage stable capital flows. Moreover, ex ante conditionality seems to promise a way to buffer some of the most extreme vagaries of international capital markets while avoiding the alleged dangers of severe moral hazard created by the current system. Moreover, only in a context of a regime change might a credible switch to a new regime be achieved. If policy makers around the world could be convinced that bailouts were in fact no more, some of the potential costs of that switch might be mitigated.

However, as of this writing, the opportunity to make a clear and hence credible break with the past may have been lost. The response to crises in Argentina and Turkey has so far been broadly similar. Meanwhile, there is little to suggest that effective ex ante conditionality is in serious prospect of being in place in the foreseeable future.

Events may be moving much faster, though, than the architecture debate itself. Let me emphasize two dimensions. First, there would seem to be more differentiation among emerging-market countries than has been observed for much of the 1990s. Whereas countries such as Argentina and Turkey are mired in major crises, others, such as Mexico, Chile, and Poland, may have graduated. This latter group may be able to benefit from floating exchange rates to buffer shocks, have debt stocks that appear readily manageable, and

are gradually developing domestic capital markets in a way that may reduce dependence on volatile external capital flows over time.

The other major change that is occurring, and this one is more clear-cut, is that the crises that loom now are quite different from most of the major ones of the mid- to late 1990s, in that they seem to be mainly debt/solvency crises. Indeed, we see a disconcerting return to many of the problems associated with the debt crises of the 1980s. Much of the impetus for the first major bailout of the 1990s, the Mexico program in 1995, was a desire to avoid another "lost decade." By that measure, the Mexico rescue package must be judged a major success, at least for Mexico. I fear we will shortly see whether a (different) dramatic new policy response is needed to the new debt crises. Major debt workouts in international capital markets may turn out to be terribly painful, and it may become clear that more laissez-faire approaches to the role of the IMF will also turn out to be very costly. In any case, we can be fairly confident that the architectural debate will look very different in their wake.

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Discussion Summary

Jeffrey Shafer remarked that it makes little sense to adopt a smaller rescue package than what is needed for the crisis economy. He pointed to the distinction between liquidity and solvency issues and emphasized the importance of sustaining voluntary private-sector involvement. He noted that on the one hand it will be politically difficult for international financial institutions to be selective, whereas on the other hand these institutions will risk becoming increasingly discredited if they do not develop the capacity for being selective.

Richard Portes remarked that the paper would benefit from a more elaborate discussion of the controversy over whether rules or discretion should guide IMF policies. He observed that the extensive debate following the

Mexican and Asian crises on the international financial architecture seems to have had little effect on recent policies toward countries such as Turkey and Argentina.

Vincent Reinhart remarked that borrowing from the IMF is an adverse signal and noted that countries doing so still get subsidized.

Nouriel Roubini remarked that there is a trade-off between large-scale and small-scale private-sector involvement. He noted that the Meltzer proposal entails changing the current five-pillar structure of the IMF into a one-pillar system.

Peter B. Kenen wondered how the Meltzer proposal could be implemented and argued that it essentially implies closing down the IMF and reopening a new IMF consisting only of the qualifying countries. With respect to the size of packages, he noted that the pre-Mexico level of funds seems inadequate for the more recent crises. He added that the announced size of a package may be somewhat misleading because programs are tranched and parts are conditional on policies adopted.

Morris Goldstein remarked that more needs to be said with respect to the division between the IMF and the World Bank. In terms of the appropriate size of rescue packages, he favored conditioning package sizes on whether a crisis is systemic or non-systemic, although, admittedly, such a distinction is not clear-cut, because a crisis is always systemic for the neighbors and trading partners of the crisis country. He questioned whether it is possible to replicate the bailout of the Mexican crisis and argued that it seems impossible to achieve improved credit assessment unless investors perceive that there is a substantial amount of risk involved.