
Does the IMF Need More Financial Resources?

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The IMF is best known as a financial institution that provides resources to member countries experiencing temporary balance of payments problems on condition that the borrowers undertake economic adjustment policies to address these difficulties.

Fund support covers a range of operations, which go from dealing with the more traditional type of balance of payments crises arising from fiscal imbalances and excessively expansionary monetary policies, to lending to emerging-market countries faced with speculative attacks that could potentially lead to financial crises if the countries were not faced with crises already, to promoting growth and poverty reduction through structural reforms in low-income countries.

The Fund is a cooperative international monetary organization, whose responsibilities derive from the purposes for which it was established. I shall base my argument on those purposes, stated mainly in Article I of the Articles of Agreement. The purposes include:

- facilitating the expansion and balanced growth of international trade, and contributing thereby to the *promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy; and*

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- giving confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to *correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity* (emphasis added).

Are Fund resources adequate for its task? In June 2005 the Fund's total resources stood at SDR 221 billion (\$322 billion). Its usable resources were SDR 126 billion (\$184 billion), of which uncommitted resources were SDR 112.4 billion (\$164 billion) and its one-year forward commitment capacity was SDR 91.3 billion (approximately \$143 billion).¹

One may think that because current Fund resources are not fully used, there is no need to increase them. This is a circular argument. Being prudent and acceding to the wishes of the major shareholders that do not favor quota increases, Fund management and staff have followed lending policies that maintain as liquid a part of Fund resources. Is this policy consistent with the purposes of the Fund? Or, in keeping with its purposes, should Fund resources increase in line with the members' needs, keeping pace with the growth of the world economy, the expansion of international trade, and the importance and volatility of capital movements in order to allow countries to correct payments imbalances without resort to a contraction in output? Are Fund resources sufficient for it to attain its purposes? How effectively does the Fund perform these functions?

At first sight, the Fund's liquidity position appears adequate. Note that as globalization proceeds and countries become more open to trade and capital movements, their vulnerability increases. For example, Paul Collier (2002) describes how a large negative commodity shock of approximately 7 percent of GDP to a primary exporter can trigger a cumulative contraction in the economy through a Keynesian-type multiplier and lead to an additional loss of output of approximately 14 percent of GDP over the following two or three years.

In addition, most countries, including emerging-market economies, when faced with payments difficulties, do not have significant access to financial markets or other sources of external finance. Moreover, the new type of financial crisis, associated with the capital account and the volatility of capital flows, calls for much larger amounts of support than the more traditional crisis resulting from trade or current account imbalances.

As Guillermo Calvo, Alejandro Izquierdo, and Luis-Fernando Mejía (2004) and Calvo and Carmen Reinhart (2000) have documented, the cost of a sudden reversal in capital and current account adjustment is much more sub-

1. This measures resources available for new commitments in the coming year. The Fund estimates this figure as equal to uncommitted usable resources plus expected repayments from member countries one year forward minus the prudential balance.

stantial in emerging markets than in developed countries. The average magnitude of a sudden reversal in capital flows is approximately 6.1 percent of GDP in emerging markets while it is only 1.1 in developed economies.

To assist countries in dealing with commodity shocks, the volatility of capital flows, and, in particular, sudden reversals in capital flows, one might expect Fund resources to increase considerably over time. However, as shown in table 22.1, the opposite has been the case, and Fund resources have declined sharply over time as measured by different indicators relative to quota resources. In particular, note the long-term decline in the resources of the Fund as a proportion of current payments.

Although Executive Board members agreed in recent quota review discussions that volatility of capital flows should be included in the quota formula, the current quota formula computes a country's vulnerability only through current account variables such as trade openness and export volatility, but it excludes volatility of capital movements.² In addition, the Fund has responded to the increase in risk caused by more financial integration and volatility by adding new financial facilities emphasizing crisis prevention. The main facility was the Contingent Credit Line (CCL). Unfortunately, design problems of the CCL made it unattractive to potential users and, after five years without any commitments, the Executive Board recently decided to cancel the CCL rather than correct its shortcomings.

Conditionality

The declining trend of Fund resources suggests that resources are probably insufficient to allow the Fund to provide support to member countries without a hardening of the conditionality under which it makes its resources available. Indeed, in view of the relative decline in Fund resources, the question is: Could a hardening of conditionality be avoided? This leads to the further question: Should adjustment programs be constructed around the level of Fund resources, however diminished? Should conditionality be determined by the availability of Fund resources even when these have diminished sharply over time?

The record shows a sharp increase in the conditionality of Fund programs, particularly in the number of structural conditions per program year since the mid-1980s and during the 1990s, a trend that was initiated with the supply-side economics fashionable during the Reagan and Thatcher administrations in the United States and the United Kingdom (see figure 22.1).

2. In the five quota formulas, two include the sum of current receipts and payments and the other three include the current payments and openness ratio (current receipts divided by GDP); see IMF (2002a, 2002c).

Table 22.1 Actual and calculated size of the IMF, 1944–2003

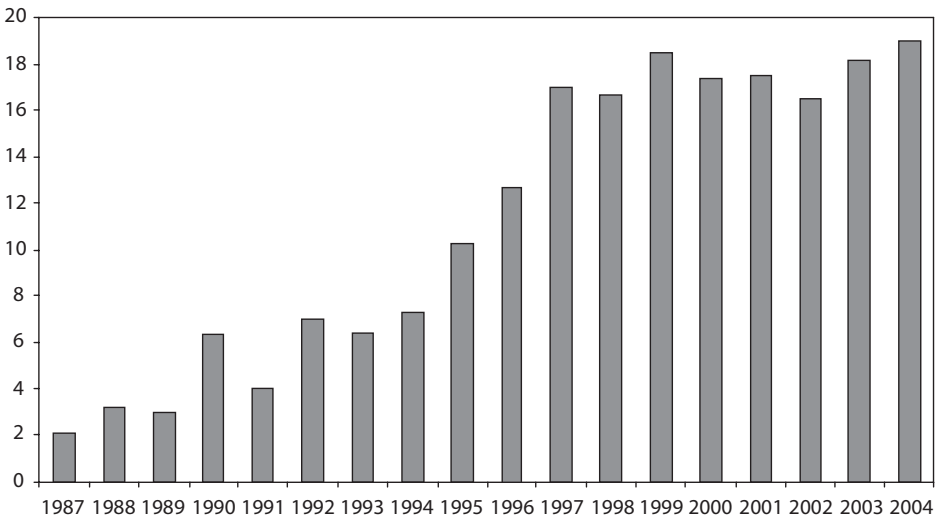
Indicator	1944 ^a	First Review, 1950 ^a	Fourth Review, 1965 ^a	Fifth Review, 1970 ^a	Seventh Review, 1978 ^a	Eighth Review, 1983 ^a	Ninth Review, 1990 ^a	Tenth Review, 1995 ^a	Eleventh Review, 1998 ^a	Twelfth Review, 2003 ^d
Agreed size of the Fund (in billions of SDR)	8.0	8.0	21.0	29.0	61.1 ^c	90.0	135.2	146.1	212.0	219.1
Quantitative economic indicators: ^e										
Fund size relative to each economic indicator, in shares (percent)										
Calculated quotas	100.0	44.4	110.5	93.5	59.9	43.1	41.0	33.1	38.9	22.4
Current payments	57.1	17.4	15.1	13.6	8.5	6.7	6.2	5.1	5.7	3.2
GDP	3.7	1.8	2.0	1.9	1.4	1.2	1.2	0.9	1.2	0.9
Reserves	29.6	22.2	36.8	44.6	33.0	27.0	34.6	24.6	27.6	13.9
Variability of current receipts	160.0	80.0	300.0	414.3	142.1	134.3	120.7	91.9	122.5	66.4

SDR = special drawing rights

- Year in which the quota review was completed, i.e., when the Board of Governors' resolution on quota increases was approved. Quota agreed in 1976 under the Sixth Review came into effect in 1978, following the coming into effect of the Second Amendment of the articles. The Tenth Review did not provide for an increase in quotas, and the increase in actual quotas relative to the Ninth Review is due to the increase in the number of members.
- This does not include China's ad hoc quota increase of 1.682 billion SDR quota in 2001.
- Including special quota increases for China and Saudi Arabia in 1980 and 1981.
- No quota increases approved during the Twelfth Review.
- Current payments five-year period averages, variability standard deviation of current receipts from five-year centered moving average, reserves, and GDP end of period.

Sources: IMF, Treasurer's Department and Quota Formula Review Group.

Figure 22.1 Average number of structural conditions imposed by the IMF per program year, 1987–2004



Note: Total number of structural performance criteria, benchmarks, prior actions, and conditions for completing reviews in Stand-By Arrangements, Extended Fund Facility, and Structural Adjustment Facility/Enhanced Structural Adjustment Facility/Poverty Reduction and Growth Facility programs. The data from 1995 onward are the average for IMF-supported programs with and without structural conditionality (data prior to 1995 are an average based only on programs with structural conditionality) and adjust for the actual duration of each of these programs, thus controlling for program stoppages (data prior to 1995 are based on program duration as envisaged at the time a new program was approved by the Executive Board). See IMF, SM/05/81 and SM/05/82 for a more detailed discussion of the 1995–2003 data.

Source: IMF staff estimates.

In response to concerns over the proliferation of conditionality and the high rate of program failure, the Fund adopted a new set of Guidelines on Conditionality in 2002 (IMF 2002b), which recommend the limited use of prior actions and program reviews and the scaling-down of performance criteria. The 1979 guidelines, which put considerably greater limits on conditionality than the current ones, have been unsuccessful in checking the explosive growth of conditions since the mid-1980s (Polak 1991). Indeed, there is no evidence that the new Guidelines on Conditionality, which were intended to reduce the number of conditions to those that were critical to the success of the program, have led to a significant reduction in the number of structural conditions. Possible exceptions are Poverty Reduction and Growth Facility programs, but conditionality in Stand-By Arrangement (SBA) and Extended Fund Facility programs has not diminished significantly, if at all.

Staff papers on conditionality argue that the fact that the number of conditions did not decline may be misleading. There has been a move from general review clauses to more specific and detailed conditions, which may at times mean an increase in their number. And the high number of conditions reflects a larger proportion of programs with weak track records. What I conclude is simply that there was a sharp increase in conditionality in the 1980s and that no decline in the number of conditions is apparent.³

Has conditionality really been streamlined? Are program-related conditions used parsimoniously and applied only to measures critical to the success of the program? In light of the above, I confess I am somewhat skeptical that, if the 30-plus targets of many programs are not met, the goals of the program can not be achieved.

A consequence of the rise in conditionality is that compliance with Fund programs has diminished as the higher number of conditions has made programs more difficult to manage. As structural conditionality increased, the rate of compliance with Fund programs declined, starting in the late 1980s and becoming more marked in the early 1990s. It is apparent from table 22.2, showing the distribution of disbursement ratios of disbursed resources by quartiles, that compliance has remained at low levels since then.

Low compliance with program conditionality has resulted in a low proportion of countries being able to fully disburse the resources allocated to them under Fund-supported programs. Even after waivers and reviews, only a small proportion of programs are successful, in the sense of fully complying with the conditionality envisaged. This suggests that Fund conditionality may be considered to be excessive and often too biased toward adjustment.

The argument behind conditionality in lending is that it is a way to protect the revolving character of the Fund's resources. However, the sharp fall in compliance raises questions as to the validity of this argument. How can programs that are not complied with ensure repayment? The fall in disbursement rates during the past 20 years following an increase in conditionality in the late 1980s seems striking given the sharp increase in the number of lending arrangements during the same period (figure 22.2).

3. The 2003 SBA with Turkey is associated with 38 prior actions and 42 structural benchmarks, most of them oriented toward an ambitious program of free-market reforms (IMF 2003). The Turkish SBA for the nine-month period of April to December 2004 looks a little better, but it has no less than 30 targets (including 1 prior action, 14 structural benchmarks, and 11 performance criteria, of which 6 are quantitative and 4 are indicative targets). This is for Turkey, a country that is often praised as a strong performer. In the Balkans, the SBAs with Albania and Bulgaria have 32 and 33 conditions, respectively. In contrast, the SBAs of the 1960s—United Kingdom (1963, 1964; without conditionality), Peru (1963, 1964), Jamaica (1963), Bolivia (1963), and Haiti (1963)—had only fiscal and monetary targets as well as prohibitions on exchange restrictions and multiple currency practices.

Table 22.2 Disbursements of IMF-supported programs, 1973–2004, by quartiles (percent)

	DR < 0.25 (1)	0.25 ≤ DR < 0.5 (2)	0.5 ≤ DR < 0.75 (3)	0.75 ≤ DR < 1 (4)	Fully disbursed (DR = 1) (5)	Programs with high DR (4) + (5)	Number of arrangements
All arrangements							
1973–77	36.5	7.1	5.9	5.9	44.7	50.6	85
1978–82	19.4	16.1	10.5	12.9	41.1	54.0	124
1983–87	12.9	15.8	19.4	7.9	43.9	51.8	139
1988–92	17.5	15.1	20.6	14.3	32.5	46.8	126
1993–97	27.0	19.1	26.2	11.3	16.3	27.6	141
All arrangements, 1973–97	21.6	15.3	17.6	10.7	34.8	45.5	615
Of which:							
SBA	23.1	13.4	15.0	9.5	39.0	48.5	441
EFF	33.3	22.2	19.0	15.9	9.5	25.4	63
SAF/ESAF	9.0	18.9	27.0	12.6	32.4	45.0	111
All arrangements, 1998–2004 ^a	28.8	19.4	15.8	12.2	23.7	36.0	139
Of which:							
SBA	48.2	12.5	8.9	5.4	25.0	30.4	56
EFF	50.0	0.0	16.7	8.3	25.0	33.3	12
PRGF	9.9	28.2	21.1	18.3	22.5	40.8	71

DR = disbursement ratio

EFF = Extended Fund Facility

ESAF = Enhanced Structural Adjustment Facility

PRGF = Poverty Reduction and Growth Facility

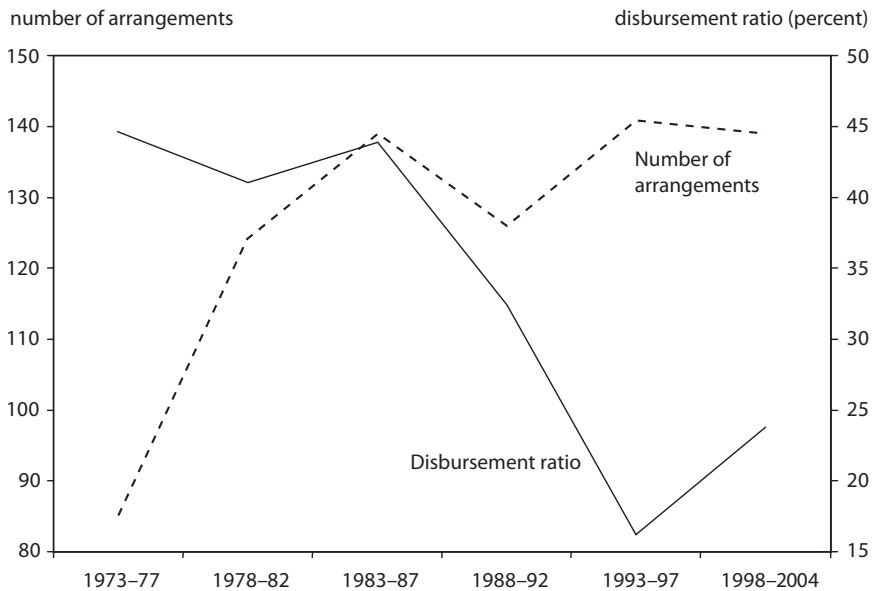
SAF = Structural Adjustment Facility

SBA = Stand-By Arrangements

a. Includes precautionary arrangements and ongoing programs; 1998–2004 data might not be strictly comparable with earlier years.

Sources: IMF Transactions of the Fund (FIN database); IMF staff estimates.

Figure 22.2 IMF lending arrangements and disbursement ratios, 1973–2004



Sources: IMF, FIN database; table 22.2 of this chapter.

The Hardening of Conditionality

The Articles of Agreement do not provide any indication about the appropriate speed of adjustment, but the statement of purpose—“providing members with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity” in Article I(v)—suggests that the priority of the founders, including John Maynard Keynes, was the protection of the levels of economic activity and that deflationary adjustment was to be avoided to the greatest possible extent.

Do Fund-supported programs currently give priority to avoiding measures destructive of national and international prosperity? The answer depends to a large extent on the amount of financing made available in each case.

The availability of resources is a major determinant of the nature and speed of the adjustment process undertaken by a country. At the extreme, a country with access to unlimited financing would not have to adjust, and, if it were to do so, it would be able to postpone adjustment for years. For example, the United States as a reserve-currency country has this advantage as long as holding dollars as reserve assets remains attractive.

Moreover, the United States may choose from among the different adjustment paths available the one that is more palatable and less costly in economic and political terms. On the other hand, a country with low reserves and very limited financing available to it as it undertakes adjustment may of necessity be compelled to cut investment, adopt severe, short-term programs that enter into conflict with the goal of maintaining high levels of activity, and sacrifice some of its longer-term development goals. Thus, there exists a trade-off between adjustment and financing of imbalances.

The role of the Fund is to seek a “golden rule”—a suitable mix of adjustment and financing that fosters the necessary adjustment while it avoids the severe recessionary and destructive aspects of underfinanced programs.⁴ Because well-financed adjustment programs are much more attractive than underfinanced, severely recessionary ones that have a negative impact on development and social indicators, well-financed programs encourage the early correction of imbalances by member countries.

Because the harshness of a program and, consequently, its viability are largely dependent on the amount of financing available, a reduction in the resources of the Fund introduces a bias for the adoption of increased conditionality and more severe, shorter-term adjustments whose rates of success are bound to diminish. The decline observed in total Fund resources over time, measured as a proportion of international trade or of GDP, would appear to have required and have been associated with stiffer, more demanding conditionality.

Moreover, as countries become more open to trade and capital movements, their vulnerability increases. Most member countries, including emerging-market economies faced with difficulties, do not have significant access to other sources of external finance. In addition, the new type of financial crisis associated with the capital account and the volatility of capital flows calls for much larger amounts of support than the more traditional one resulting from trade or current account imbalances.

Why have Fund resources declined? Why have quota increases not kept pace with the expansion of world trade and capital flows? The majority of Fund member countries favor quota increases; however, these increases call for an 85 percent majority under the weighted voting system. Which countries limit the increase in Fund resources? Is the growing schism between creditors and prospective debtors relevant for the analysis of trends in the size of the Fund and the evolution of conditionality?

Finding conditionality unacceptable, no industrial country has resorted to Fund support since the late 1970s. Among the last such users were Italy and the United Kingdom; both requested Fund assistance under the lower-conditionality oil facility. In addition, the United Kingdom entered into an SBA with the Fund in 1976. Since then, industrial countries have

4. In some cases, Fund lending may be constrained by balances outstanding from previous borrowing.

developed a network of monetary cooperation arrangements and other sources of balance of payments support. As a result, during the past 25 years only developing countries and economies in transition have resorted to Fund support.

This is not to ignore that a number of large, systemically or strategically important countries—Mexico, Brazil, Russia, Korea, and Turkey among them—have received financial support well in excess of their access limits under Fund policies. Such exceptional support is neither transparent nor predictable, however, because it is not available to all Fund members and at times comes with questionable conditions imposed by countries that contribute to the financial rescue packages (Feldstein 1998). Moreover, during the financial crises of 1997–98, emerging-market countries in Asia considered Fund conditionality too restrictive and inappropriate. Consequently, to avoid having to rely on Fund support in the future, Asian countries decided to build up their reserves and develop regional monetary arrangements as a form of insurance.

The Chiang Mai Initiative was established to provide liquidity support to its members faced with contagion and speculative attacks against their currencies. Its expansion to allow multilateral currency swaps and the near doubling of the size of such swaps—from \$39.5 billion to more than \$70 billion—was agreed during the finance ministers’ meeting in Istanbul on May 5, 2005. Also reported was an additional agreement for a fourfold increase in the size of drawings that may be made without IMF conditionality.⁵ Masahiro Kawai, a former high official of the Japanese finance ministry who will head the new regional financial integration office at the Asian Development Bank, stated in the *Financial Times* on May 6, 2005, that “[t]he Chiang Mai initiative has the potential to become an Asian monetary fund.” A bond market in domestic currencies—the Asian bond fund—also aims at reducing the vulnerability of countries to risks of maturity and currency mismatches that could lead to financial crises. As a result of this rejection of IMF conditionality and of what Asian countries rightly perceive as the lack of adequate representation in decision making, these countries have decided to avoid coming to the Fund in the future.

Because they have access to financial markets only in good times and their access to market financing remains procyclical, Asian countries are not moving away from the Fund because they have “graduated” and no longer require international monetary cooperation. In fact, Asian countries are in the process of developing alternative regional monetary cooperation arrangements and are accumulating high levels of reserves as a form of self-insurance, the most primitive and costly form of insurance.

5. This results in a doubling of the total resources available and a doubling of the proportion that may be disbursed without a Fund program.

Why did the Fund lose influence over industrial countries and other major economies? The exponential growth of international financial markets has allowed industrial countries easy access to external financing. This access coupled with the growth of their own domestic financial markets and the development of regional monetary arrangements and, in a number of cases, reciprocal credit lines among them make it unnecessary for these countries to subject themselves to the conditionality associated with IMF support. This trend became apparent in the late 1970s as Europe developed its own monetary arrangements; Europe walked away from the Fund.

The rapid economic expansion of emerging-market countries, whose growing importance in the international economy and accumulation of international reserves has not been reflected by changes in the governance structure of the Bretton Woods institutions, has also eroded Fund influence. Inadequate representation of these countries made possible the policy prescriptions required by the Fund as a condition for support during the Asian financial crises of 1997–98, prescriptions that were perceived by many countries as inappropriate and contrary to their interests.

As a result of the hardening of conditionality and the nonrepresentative character of Fund governance, a growing chasm has emerged between shareholders and stakeholders, between those who determine IMF policies and decisions and those to whom those decisions and policies are applied. Thus, instead of a cooperative institution to which all members contribute and from which they may borrow from time to time, a distinction has emerged between creditor countries that have the power to make the rules⁶ and the debtor and prospective debtor countries that are subject to those rules.

Therefore, it is not surprising that, in addition to Europe, a growing number of countries in Asia and Latin America appear to be in the process of moving away from the IMF. To the extent that this process advances, the IMF would cease to be a truly multilateral institution of monetary cooperation. It would become instead an institution dealing mostly with the payments problems of very low income countries in Africa and elsewhere.

Thus, questions about the role and relevance of the Fund as a multilateral institution of monetary cooperation come to the fore and should be addressed. To my mind the preservation of the Fund's systemic role requires a review of both the governance structure and the level of resources the Fund can make available to member countries. In fact, both must go together because it is impossible to reduce countries' quotas in absolute terms without the countries' consent.

6. An agreement on policy issues reached among members of the Group of Seven turns the Executive Board discussion into a mere formality.

Conclusions

Whether the IMF has sufficient funds or needs additional resources depends on the role it is expected to play. The answer is usually colored by the views of the respondent on the role of the Fund, views that often reflect whether the respondent's country is a potential debtor or has no need to resort to the Fund because it has ready access to other sources of financing. The fact remains that (1) Fund resources have declined sharply in relation to all relevant variables—GDP, trade, capital movements, current payments, and reserves, (2) conditionality has increased, and (3) program compliance has fallen sharply. This has eroded the usefulness of the Fund to most member countries as an institution of international monetary cooperation, and many countries are distancing themselves from the Fund and setting up regional arrangements of monetary cooperation. I believe that at a time of increasing globalization, the fragmentation of the international monetary system is undesirable. Moreover, as the system breaks down, low-income countries cannot be expected to fend for themselves.

Restoring the role of the Fund to the center of the international monetary system requires, *inter alia*, a large increase in Fund resources and a reform of Fund governance structure to reflect changes that have taken place in the structure of the world economy, particularly the increased importance of a significant number of emerging-market countries that are substantially underrepresented. Because these countries' contributions would rise in a manner commensurate with the increase in their quotas, the contributions of most industrial countries should be less than proportional.

How large should the increase in Fund quotas be? It is difficult to give a precise answer, but after falling from 57 percent of current payments in 1944 and 13.6 percent in 1970 to 3.2 percent in 2003, it is clear that resources of the Fund have been allowed to decline beyond any reasonable level. The same argument may be made in terms of quotas, which on average represent nine-tenths of 1 percent of a country's GDP. Can normal access limits of 100 percent of quota, or even exceptional access of 300 percent of quota, during a period of one to three years provide members with the support required to adjust without resorting to measures destructive of national or international prosperity? If not, what is the level of resources, in keeping with the Fund's purposes, required to restore a certain balance between adjustment and financing and to attain a reasonable rate of program success?

Taken together, tables 22.1 and 22.2 and figure 22.1 suggest that (1) it is necessary for the resources of the Fund to increase to no less than their 1978 levels in relative terms or to roughly three times their current size and (2) conditionality should be further streamlined. Although arguments against such an increase can be made easily on the basis of the large expansion of capital markets, these markets are both volatile and markedly

procyclical, characteristics that make placing undue reliance on them questionable. Moreover, the fact remains that even in good times most Fund member countries have very limited access to these markets.

A second argument for increasing the resources of the Fund is that the reform of its governance structure, which is necessary for ensuring its future relevance and legitimacy, will be extremely difficult to achieve without a very substantial increase in quotas that takes fully into account the changes in the size and importance of emerging-market countries in the world economy (see Edwin M. Truman's comments in chapter 9 of this volume and Buira 2005).

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