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Role in the International Monetary System

Mervyn King, in his remarks on the international monetary system at a conference, "Advancing Enterprise 2005," on February 4, 2005, summarized succinctly the view that the IMF should have a major role in addressing the proper functioning of the international monetary system:

> The international monetary system should be seen not as a series of bilateral relationships, but as a multilateral arrangement, albeit one where a small number [larger than the G-7] of key players can usefully communicate with each other. I think we need to rethink the role of the IMF in the international monetary system. . . . I am not convinced that the future of the Fund is primarily as an occasional international lender of last resort for middle-income countries suffering financial crises.

King's remarks suggest an IMF role that is broad and should contribute more than it does today to substantial cooperation, if not coordination, on national policies affecting the international economy and financial system. Others are highly skeptical about international macroeconomic policy coordination and by implication the role of any international organization in fostering such coordination. For example, Horst Siebert (2005) at a conference on the IMF stated, "The best that governments can do is to follow an atmospheric coordination, i.e., exchanging information on the situation and the paradigm to be used."

This chapter examines the IMF's role (1) in surveillance, (2) with regard to exchange rates and policies, (3) in capital account and financial-sector issues, and (4) with respect to regional arrangements. All four aspects are central to an effective role of the IMF in the international monetary system. In general, if the IMF is to play these roles effectively, it has to be more of an umpire and not just an adviser and sometime lender.

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Surveillance

It is widely agreed that surveillance and the associated process of policy coordination and cooperation are central roles of the IMF. Effective surveillance can help to solve the type of coordination problems that undermined the health of the global economy in the 1930s and led to the founding of the IMF at the end of World War II. Under the Bretton Woods system, coordination was forced through the fixed exchange rate system (gold exchange standard). With the forced abandonment of that system in the 1970s, surveillance remains an instrument to deal with imbalances in the global economic and financial system.

The disagreement today is how surveillance fits into the IMF's overall mission and whether surveillance has anything to do with the health of the international monetary system. Thus, the IMFC (2005) concluded:

> Surveillance is a central task of the IMF and determined efforts are required to enhance its effectiveness and impact, building on the conclusions of the Biennial Review of Surveillance. Surveillance should become more focused and selective in analyzing issues, in an evenhanded way across the membership. Regional and global surveillance should play an increasingly important role, and be better integrated with bilateral surveillance.

The IMFC's conclusions, although they mention the important role of regional and global surveillance that presumably has something to do with the functioning of the international monetary system, do not provide much guidance for what the IMF should be doing. The conclusions do point to the three levels of surveillance: national, regional, and multilateral. It is principally in its multilateral surveillance role that the IMF becomes concerned with the functioning of the international monetary system. To the extent that the policies and performances of individual countries or groups of countries affect the health and smooth functioning of the system, national and regional surveillance are also relevant.

The relevant questions with respect to the IMF and the international monetary system include: What is the scope of such surveillance and what variables and policies should it cover? Should the IMF more aggressively engage with countries on their exchange rate policies? How can the IMF be made more effective in altering exchange rate and other policies? Should the IMF have a larger role to play in policy coordination? How can the IMF perform its current role better? Or should it have a different role?

Currently many of the concerns and criticisms of the role of the IMF in the international monetary system are connected with the perception that global economic imbalances are a threat to international economic and financial stability and the IMF should be doing more about them. Of course, the IMF has hardly been silent on these issues, featuring them in successive reports on the *World Economic Outlook* and issuing special analyses of

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the general issue or on aspects of it, such as US fiscal policy. Managing Director de Rato devoted more than half of his remarks at the IESE Business School, University of Navarra, Madrid, on June 10, 2005, to the issue of global imbalances.

Global imbalances and the policies that support their continuation largely, but not entirely, involve the major economies: the United States, the euro area, and Japan. However, many informed and sympathetic observers despair about making any progress in this area. For example, Timothy Geithner commented before the Bretton Woods Committee on June 10, 2004, that the Fund "will never be decisive . . . in persuading the G-3 to avoid policies that create the risk of abrupt changes in financial market conditions or exchange rates."

The basic problem, as described by David Peretz (2005) and many others, is that the IMF lacks leverage over the policies of countries that do not need, and especially those that never anticipate having a need, to borrow from the Fund. In addition, these countries either do not agree that their policies risk adverse global effects or, if they agree, they are unable for domestic political reasons to do anything to affect their policies.

Even for those observers who agree there is a need, effective remedies are not easy to design. Some candidates for remedies include the following:

- ***Increase transparency.*** This is a general prescription for many of the problems of the international financial system, but it applies with some vigor to global surveillance. José De Gregorio et al. (1999) advocate increased transparency with regard to the IMF's internal operations along with increased independence for the Executive Board and the staff.[1] Their focus is principally with regard to IMF relations with emerging-market countries, but one could argue those recommendations also should be relevant to the larger economies that potentially affect the health of the international monetary system. Barry Eichengreen (2004) repeats his recommendation that all IMF surveillance documents should be released to the public, rather than leaving discretion with each country.
- ***Increase candor.*** The IMF (management and staff) has become more candid in recent years in its pronouncements on risks to the international financial system and the links between those risks and the policies of the major economies. However, both Michel Camdessus and Jacques de Larosière (Camdessus, de Larosière, and Köhler 2004) point to the need for G-7 countries to listen more carefully to what the IMF is saying and for greater focus on systemic interactions in the process of multilateral surveillance. Increased candor probably should be

1. Prompt publication of detailed minutes of Executive Board meetings, decisions through voting, and voting records is one example.

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coupled with increased IMF humility. When the IMF staff or management predicts a disaster and the disaster does not occur, there should be an explanation of why—changes in circumstances or wrong policy prescriptions.

- ***Specify remedies.*** IMF reports on countries that are systemically significant often suggest appropriate changes in policies. IMF reports on the risks facing the global economy do the same. However, those suggestions are general in nature—tighten fiscal policy, avoid financial bubbles, intensify structural adjustment. The IMF might go several steps further and specify as precisely as possible the size if not the content of the policy adjustments it would require if the policy excesses of the countries involved were to lead to a need to borrow from the IMF. This approach could be applied even in cases where such an eventuality was highly unlikely. The more specific the IMF was in its advice, the more specific the country would have to be in rejecting that advice.
- ***Issue ratings.*** It has been proposed, and to date rejected, that the IMF issue ratings of countries. Again, this proposal normally is advanced in the context of IMF surveillance of countries that might reasonably be expected to borrow from the IMF, but why should there not be a rating system that applies to countries whose policies have systemic significance?
- ***Develop scorecards.*** Timothy Geithner, in his remarks before the Bretton Woods Committee, endorsed for emerging-market countries "a process with more frequent, publicized [IMF] staff assessments of performance against a medium-term framework designed by a member country." That approach could be extended to all systemically important countries, including important industrial countries.
- ***Change the paradigm.*** Multilateral surveillance and the associated surveillance of the systemically important members of the IMF are process driven. Even when multilateral surveillance is subjected to independent evaluation, that evaluation is likely to be process oriented. The IMF's Independent Evaluation Office is currently evaluating IMF multilateral surveillance. The draft issues paper (IMF-IEO 2005d, 11) identifies two objectives: "(i) contributing to transparency by showing how multilateral surveillance works in practice and (ii) identifying areas, *if any,* where improvement can be made to make multilateral surveillance more effective" (emphasis added). This is not a very ambitious work program.

  What may be needed is to change the paradigm of IMF surveillance. The Fund might start from the needs and objectives of the international monetary system, work back from that assessment to what the assessment implies about the policies of the systemically important countries,

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and use the framework to evaluate actual policies. A reasonable, but not the only, place to start this evaluation might be exchange rates. A widespread view is that (1) excessive exchange rate stability or (2) excessive swings (or excessive instability) in exchange rates among the major currencies contribute to imbalances that threaten global prosperity. A framework of this type is John Williamson's (1985) target zone proposal that he has articulated and advocated for many years in a number of different forms and formats; see also Williamson (2000) and Williamson's chapter 6 in the forthcoming conference volume. An alternative framework might start from an evaluation of global saving and investment. This starting point would be likely to produce norms similar to those associated with Williamson's target zones or reference rates.

If the IMF were to adopt a new paradigm to use in conducting its multilateral surveillance, the first step would need to be the development of a consensus on that paradigm. The development of such a consensus need not initially involve the major countries. A substantial subset of other members of the IMF, if they were sufficiently like-minded, could initiate the debate. The IMF management and staff also could instigate it.

Given the central role of surveillance as one of the Fund's principal tools and how surveillance relates not only to global economic and financial stability but also to the design and desirability of individual lending arrangements, a number of officials and observers (Brown 2005 and Ubide 2005, to name two) have suggested that the surveillance function become fully independent of the IMF's lending programs and other programs, including for the large countries and presumably with respect to regional and global surveillance.[2] The IMF as an institution might consist of two subsidiaries, the surveillance subsidiary and the program subsidiary, both reporting to the management (managing director and deputy managing directors) and the Executive Board. Alternatively, the IMF could be split into two separate institutions. This would be an expensive solution in terms of staff resources and could sow confusion if the two bodies reached different conclusions, which would be reasonable because most important cases come down to a matter of judgment, not analysis.[3] Goldstein (2005a) would address the surveillance of emerging-market economies by more intense concentration on early-warning surveillance, compared with routine Article IV surveillance.

2. US Treasury Secretary Snow (2004) told the IMFC that the United States is open to the idea.

3. One argument that motivates advocates of separating the lending and surveillance functions of the IMF is the perception that Fund staff and management have a bias toward lending to help countries and that this bias clouds their perspective on the advisability of doing so. The counterargument is that, if this is a correct depiction, it reflects a management failure instead of a structural failure.

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An unfortunate side effect of the emphasis on the link between the quality of IMF surveillance and the quality of IMF lending programs that is made by some critics has been that the role of IMF surveillance with respect to global economic and financial stability is often viewed as a second-class activity. Moreover, many critics and observers fail to make the distinction between IMF surveillance before a country has a program—for example, with Thailand and Korea in 1996–97—and IMF surveillance after a country has some type of formal program—for example, with Argentina from the start of the 1990s through 2001.[4]

Exchange Rates and Policies

Exchange rates and exchange rate policies are an important subtopic in surveillance and the associated role of the IMF in the international monetary system. The vagaries of floating exchange rates have produced much handwringing from some prominent people, including, for example, Paul Volcker in his remarks before the Institute of International Finance in Washington on October 10, 1998:

> We still hear the siren song that somehow floating exchange rates will solve the problem. That seems to me a strange and sad refrain. The wide swings in the exchange rate of the world's two largest economies, Japan and the US, has been a critically important factor contributing to the instability of East Asia generally. How can there be a 'correct' rate, fixed or floating, for Thailand or Indonesia or the Philippines when the exchange rates of their major trading partners are diverging sharply? How can it be rational for some Asian countries to be advised to float their currencies while others are urged to stand firm in fixing their exchange rates, even while their competitive positions are deteriorating?

More recently, two former IMF managing directors have commented on the issue. In 2004, Michel Camdessus (Camdessus, de Larosière, and Köhler 2004) wrote:

> I still cannot reconcile myself to a degree of instability of exchange rates—every 10 years or so we observe swings of up to 50 percent in the exchange rates of the major reserve currencies—that is so costly for the entire system, so disruptive for vulnerable countries, and acceptable only to (if not welcomed by) those whose job it is to provide profitable cover against those fluctuations.

Jacques de Larosière (also in Camdessus, de Larosière, and Köhler 2004) came from a somewhat different perspective:

> I also believe the international monetary system is slipping into a semifixed à la carte system where some countries choose their exchange rate peg (often undervalued) to take the best advantage of their export capacities. The question is what should the IMF do about this situation?

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4. Chapter 5 on IMF lending facilities touches upon the related issue of the link between IMF surveillance and a possible insurance facility in the IMF.

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Morris Goldstein (2005a) has an answer to de Larosière's question. The IMF can and should pursue much more aggressively countries that engage in "currency manipulation" by pegging their exchange rates for extended periods of time at undervalued levels while piling up foreign exchange reserves and frustrating the international adjustment process. C. Fred Bergsten (testimony before the Subcommittee on International Trade and Finance of the US Senate Committee on Banking, Housing and Urban Affairs on June 7, 2005) echoes his colleague.

Managing Director de Rato in his report to the IMFC (IMF 2005f) called for a "deeper treatment of exchange rate issues" and noted that the Executive Board had held a seminar on operational aspects of moving toward greater exchange rate flexibility. However, the staff paper prepared for that discussion (IMF 2004a) was decidedly cool to regimes of floating exchange rates. It stressed that four ingredients are needed successfully to make the transition: (1) deep and liquid foreign exchange markets, (2) a coherent intervention policy, (3) an appropriate alternative nominal anchor such as inflation targeting, and (4) adequate systems to review and manage public- and private-sector exchange risks. If those are the tests for success with a flexible exchange rate regime, few countries with floating exchange rates are successful practitioners because most of them would fail one or more of those tests. This is not helpful IMF staff guidance.

It is not surprising that the IMF staff was so timid in its paper because the Executive Board for which it works and many national authorities for whom the executive directors work are deeply divided on these issues. The report of the executive directors' discussion (IMF 2004d) as well as ample other evidence imply that many policymakers are far from convinced that exchange rate flexibility is ever desirable. Adding more cautions to those advanced by the staff, for example, the executive directors

- voiced the familiar refrain that no single exchange rate regime is appropriate for all countries in all circumstances, without adding the qualification that it can be very costly to change regimes;
- called for more work on moving toward greater exchange rate stability, for example by joining regional exchange rate arrangements; and
- stressed the need to develop a global monitoring system for hedge funds if floating is to be successful, implying incorrectly that hedge funds are the most important source of speculation and exchange rate volatility in the international financial system.[5]

5. The Independent Evaluation Office of the IMF will be conducting a review of the IMF's advice on exchange rate policy (IMF-IEO 2005c). The review of IMF surveillance over exchange rate policies will touch on two sets of issues: (1) members' choices of exchange rate regimes and (2) the level of exchange rates in terms of competitiveness, exchange rate sustainability, and exchange rate manipulation. The focus will be the post-1998 period. From the perspective of the international monetary system, the second set of issues, in particular exchange rate manipulation, is most relevant.

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If further evidence is needed to buttress the view that the IMF institutionally does not think consistently and coherently about exchange rates and exchange rate policies, consider two IMF reports on East Asian exchange rate arrangements that were completed in the fourth quarter of 2004. In the concluding statement of the Article IV mission to Korea (IMF 2004f) the staff "strongly supports the official policy of allowing the won's external value to be determined in the market, with intervention limited to smoothing operations." However, it was only shortly after this statement was released on October 28 that the Korean authorities scaled back their massive intervention operations and allowed the won to appreciate sharply over the balance of the year. The IMF staff praised a nonpolicy!

In contrast, in the documents associated with the Article IV consultation with Hong Kong conducted at essentially the same time (IMF 2005e), the staff assessment was that the authorities' "response to appreciation pressures over the past year has enhanced the resilience of the LERS [linked exchange rate system, i.e., peg to the US dollar]. The LERS remains robust and the staff continues to support the authorities' commitment to it."[6] In February 2005, the Executive Board (IMF 2005e) echoed the staff view: "They reiterated their support for the authorities' commitment to the LERS." One might reasonably ask how and why a hard peg between the Hong Kong dollar and the US dollar makes any economic sense; the two countries certainly are not an optimum currency area. Wouldn't a peg to the Chinese yuan make more sense over the long term? Doesn't the Hong Kong dollar's peg to the US dollar militate against an early, substantial adjustment of the Chinese yuan against the US dollar? One would hope that the IMF staff and Executive Board discussed the issue of the long-term viability of the Hong Kong dollar's peg and also the short-term what-if issue for Hong Kong of a substantial revaluation of the Chinese yuan. However, such discussions are not hinted at in the public documents. Their absence illustrates the tension between candor and transparency in IMF surveillance.[7]

Capital Accounts and Financial Sectors

IMF surveillance in practice also extends to members' capital accounts, including the size and composition of their external debts and the potential

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6. The LERS at the time was asymmetric in the sense that it was softer on the upside. Subsequently, the regime has been hardened and has become symmetric.

7. A third example is Malaysia (IMF 2005a). The IMF staff concluded that in September 2004 the ringgit was undervalued by 3 to 5 percent in real effective terms, clearly an underestimate in the context of the prevailing global imbalances. In contrast, in the case of China the IMF staff has not even gone so far as to say that the yuan is undervalued. However, it was only the executive directors (most of them), not the staff, that called for IMF engagement with the Malaysian authorities about their policy alternatives with a view toward moving toward greater (than zero, bilateral) exchange rate flexibility.

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for capital account crises. These crises, in turn, are often closely linked to financial-sector development and stability, an area in which the IMF has been assigned a major surveillance role along with the World Bank. In addition, capital controls are a major ingredient supporting exchange rate policies and the manipulation of exchange rates to present effective balance of payments adjustment. From a global perspective, all aspects are integral to the IMF's role in the international monetary and financial system.

As noted in chapter 2, IMF work on the financial-sector and capital account issues is not fully grounded in the Articles of Agreement. Possibly for that reason as well as others, the IMF's analysis of these issues is widely regarded as not satisfactory. Although the IMF Executive Board (IMF 2005c) commended the IMF staff on the "continuing success" of the FSAP, it is well known that many observers think the program has serious shortcomings. One point of controversy is that publication of the resulting ROSC modules is voluntary.[8] A second is that a major, systemically important country—the United States—has not had an FSAP.[9] Moreover, until 2002 Japan successfully resisted an FSAP review of its ailing financial system. For more than a decade previously, the Japanese financial system was widely seen as a threat to Japanese economic and financial stability as well as to global economic prosperity if not financial stability. Many would argue that this episode clearly indicates a weakness of the IMF in dealing with threats to the stability of the international monetary and financial system that originated in the malfunctioning financial sector of a major economy.

The IMF Independent Evaluation Office in 2005 conducted a review of the FSAP, including its links with Article IV surveillance as well as the design and implementation of the FSAP. As noted in chapter 2, the managing director assembled the McDonough Working Group to provide an assessment of the IMF's work on the financial system and capital markets.

Aside from the issue of authority, three basic issues are involved in the dissatisfaction with the IMF's work on capital account and financial-sector issues. First, the culture and work of the IMF is dominated by macroeconomists with little training or interest in financial-sector issues, and that emphasis carries over into the work of the area departments, which are ill equipped to analyze, or are uninterested in, financial-sector and capital market issues, reflecting either understaffing or staff with the wrong skills. Second, substantial IMF staff resources are devoted to the treatment of these issues, but the institutional payoffs are not associated with good analyses of particular problems. Instead, the major rewards are

8. The 68 percent of the member countries with completed ROSC modules have allowed a total of 74 percent of the results to be published (IMF 2005g, table 1).

9. The only other G-7 country that had not had an FSAP is Italy, which is currently undergoing a review. The only other non-G-7 G-10 country that had not had an FSAP is Belgium, which is also currently undergoing a review.

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forthcoming for provocative overall assessments that are provided to the Executive Board and the general public. Third, when it comes to country surveillance in these areas, not only is it not well integrated with other aspects of surveillance but also it is, if anything, too comprehensive and lacking in prioritization.

On the broader but related issue of capital account policies, it is well known that the membership of the IMF debated during 1996–97 whether the IMF Articles of Agreement should be amended to (1) update and clarify the role of the IMF with respect to capital account transactions, (2) establish capital account liberalization as an objective for IMF members, and (3) establish the IMF's jurisdiction with respect to capital account matters.[10]

This initiative foundered on the fallout from the East Asian financial crises. Many commentators who should know better, including in the financial press, demonized the G-7 and the management of the IMF for this initiative. The facts are quite different. Stanley Fischer (1998) summarizes the case quite well:

> The increasing importance of international capital flows is a fact that needs to be better recognized in the laws and agreements that help bring order to the international economy and to the process by which individual countries liberalize their capital accounts. The proposed amendment to the IMF's Articles of Agreement will serve this purpose and the international community as well.

The statement attached to the September 21 communiqué of the Interim Committee (1997) issued in Hong Kong is quite balanced and circumscribed. It speaks of the growing importance of private capital movements and the necessity of ensuring the orderly liberalization of capital flows. It states that the IMF is uniquely placed to assist this process and asserts the committee's view that the Fund's new mandate in this area should be "bold in its vision, but cautious in its implementation." The Executive Board in its work on the proposed amendment was called on to make liberalization of capital movements one of the purposes of the Fund and to extend the Fund's jurisdiction over the liberalization process, but to do so with safeguards, transitional arrangements, flexible approval processes, and in recognition that in the new world of liberalized capital movements "there could be a large need for financing from the Fund and other sources." As noted, the Executive Board did not complete its work.

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10. Capital account liberalization covers two broad areas: (1) cross-border access via direct investment and the ability to provide services by institutions that operate in the financial sector and (2) capital account flows or financial transactions. The first area is within the jurisdiction of the World Trade Organization (WTO). In the 1990s, the concern of some was that in the absence of a clear definition of the jurisdiction of the IMF over the second area, the WTO would further expand its mandate to cover this area as well. On the other hand, the Fund's authority over current account transactions pertains to payments (exchange restrictions), not the substance of those transactions—tariffs and quotas. The analogous distinction with respect to the capital account is more difficult to make.

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Part of the controversy that emerged in the wake of the East Asian financial crises, the Brazilian crises, the Russian crisis, Turkey's crisis, and the Argentina debacle concerned not the aborted effort to amend the IMF Articles of Agreement with respect to capital account liberalization but the extent to which the Fund had been pushing capital account liberalization willy-nilly. The report of the IMF-IEO (2005a) did not confirm this accusation. It finds no evidence that the IMF as an institution used its leverage to push countries to move faster than they were willing to go in liberalizing their capital account transactions. Individual Fund staff, however, did in general encourage those countries that wanted to do so to move ahead without paying sufficient attention to the risks involved, the proper sequencing of the liberalization, and the interaction with domestic financial-sector development.

This lack of attention to sequencing and financial-sector development was caused in part by the absence of an official IMF position on capital account liberalization that allowed individual staff members the latitude to espouse their own disparate views when it came to advising members on these issues. The IMF-IEO report (2005a) recommends increased clarity on these matters and greater attention to supply-side aspects of international capital flows involving principally the industrial countries and efforts, for example, to limit herd behavior on the part of investors.[11]

Where is the IMF likely to go with the issue of the IMF's role in capital account liberalization? Peretz (2005) advocates revisiting the consensus of 1996–97 and reviving the idea of an amendment to the IMF Articles of Agreement on this topic.[12]

Jack Boorman, in remarks to an Institute of International Finance Seminar in London on November 17, 2004, also advocated revisiting this issue on jurisdiction grounds vis-à-vis the WTO. He also sees continuing potential for pressure on IMF resources from poorly designed and implemented liberalization programs. However, he cautions that first the IMF and its membership would need to clear the air on several issues:

- What was the IMF advising member countries with regard to capital account liberalization in the early and mid-1990s? The IMF-IEO appears to have dealt with this issue, although critics, being critics, no doubt will not be satisfied.
- The IMF needs to integrate into its regular operations the past decade's lessons with respect to capital account liberalization. This process seems to be under way but far from complete to the general satisfaction of most members.

11. Williamson (2005) addresses many of these issues in more detail than does the IMF-IEO report, and various IMF *Global Financial Stability Reports* have emphasized these issues.

12. Peretz's position is not altogether surprising, as he was a British official at the IMF in the 1990s and the UK government was a principal advocate for change at that time.

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- The motivation of the amendment to the Articles of Agreement needs to be made clear. In Boorman's view the motivation should be "to fill a regulatory gap in the international institutional structure and, by making liberalization a purpose of the Fund and giving the Fund authority, to coordinate this activity better within the Fund and, perhaps, even provide the resources needed to carry out the associated responsibilities."

The IMF's Executive Board has discussed more formally reopening the issue of an amendment to the IMF Articles of Agreement with respect to capital account liberalization in the context of the Fund's medium-term strategy. Managing Director de Rato reported to the IMFC (IMF 2005f, 7): "[M]ost Directors did not wish to explore further at present the possibility (raised in 1996–97) of giving the Fund authority over capital movements, although a number of them felt that the Fund should be prepared to return to this issue at an appropriate time."

At the IMFC meeting on April 16, 2005, finance ministers from two G-7 countries, Gordon Brown (2005) from the United Kingdom and Domenico Siniscalco (2005) from Italy, expressed support for greater IMF activity in this area. On the other hand, Burhanuddin Abdullah (2005), governor of the Central Bank of Indonesia (speaking for a number of ASEAN countries), was firmly negative:

> On the issue of capital account liberalization, we are of the view that the Fund should not play a "central" role in this area. Past and recent experiences have clearly demonstrated that capital account restrictions are justified in some cases. At the same time, countries are already proceeding along the liberalization path, as they see fit, and as warranted by their own set of economic and financial circumstances. Therefore, the role for the Fund should be to ensure effective surveillance and that the necessary supporting infrastructure, especially adequate financial resources and appropriate financing instruments, are in place to help countries faced with capital account vulnerabilities or difficulties.

The Fund's role with respect to capital account liberalization, including the potential transitional role of restrictions on capital flows in particular for prudential reasons, is an important issue that the IMF will have to address more effectively. It is central to the IMF mission in the 21st century. It is also closely linked to the IMF's involvement in financial-sector issues.

Regional Arrangements

A final important area of the IMF's interface with the international monetary and financial system involves the Fund's relations and interaction with other formal or informal international organizations.

On the more formal side, first, are the Fund's relations with its sister Bretton Woods institution, the World Bank, where, despite frequent pro-

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testations to the contrary from the leadership of the two organizations, it is widely believed that turf battles are frequent and cooperation and coordination fall short of what a rational person would view as desirable.[13]

Second, relations with the Bank for International Settlements (BIS) at present are generally considered better than in the past largely because the BIS is seen less and less as a rival to the IMF.[14]

Third, relations with the WTO are uneven, and, as noted, one motivation for amending the IMF Articles of Agreement with respect to capital account liberalization was to establish the capital account as the IMF's turf at least with respect to financial flows and to prevent the WTO from extending its authority.

Fourth, the IMF has generally cordial relations with the Organization for Economic Cooperation and Development (OECD), with its more limited membership; here the competition is largely in the area of research and ideas.

Finally, the IMF's involvement with the regional development banks has been limited except in crisis situations during which the Fund itself or its major shareholders have sought to bring those institutions, in particular the Inter-American Development Bank and the Asian Development Bank, into consortia helping to provide financing to ameliorate external financial crises and to deal with the underlying policy challenges in member countries. On the other hand, the regional development banks have been known to support countries whose macroeconomic policies the IMF has faulted. The Asian Development Bank is also perceived to be a strong supporter of the establishment of an Asian Monetary Fund (AMF) as an alternative to the International Monetary Fund.

With respect to less formal organizations and nascent efforts to promote regional cooperation, the Fund's involvement is decidedly more ambiguous. For example, it is asserted (Zeti 2004) that it was Michel Camdessus who initially suggested in November 1996 in Jakarta that the East Asian

13. Turf battles and coordination are problems within the institutions as well.

14. A resolution passed at the Bretton Woods conference in 1944 called for the dissolution of the BIS, as did the US legislation approving the Bretton Woods agreements. Partly reflecting these sentiments, the Federal Reserve did not take up its seat on the BIS board until September 1994 (Siegman 1994). Since then the BIS has considerably expanded its membership and the scope of its activities, and it celebrated its 75th anniversary in 2005. However, the BIS no longer is involved in financing or helping to finance international rescue operations as it was from its inception through the late 1980s; it played a limited, window-dressing role in contributing to the Mexican package in 1995. Thus, the BIS and its central bank members collectively are not in direct competition with the IMF except in the area of ideas, for example, assessments of the global economy and critiques of crisis management. The BIS does provide a home for, and some of the resources to support the secretariat of, the Financial Stability Forum (FSF), which some within and outside the IMF see as a rival to the IMF as an institution of global financial governance.

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economies get together and establish a process of regional surveillance along with a facility for mutual financial assistance.[15] When this proposal resurfaced less than a year later as a Japanese grandstand proposal for an AMF that would have been of no use in dealing with the East Asian financial crises because it would not come into existence for years, Camdessus was on the side of those who opposed the proposal. However, the proposal is not dead; it lives on in the form of the Chiang Mai Initiative and nascent Asian Bond Fund, and it has considerable support not only within the region but among certain people, including some within or close to the US government, who think that regional arrangements should shoulder a greater share of the general burden of emergency financing, in particular, and policy advice as well.

What should be the IMF's posture vis-à-vis such regional arrangements? Raghuram Rajan (2005a) has floated the idea that the IMF might seek the promotion of regional subsidiaries. If the regions with the mini-IMFs do not like being subsidiaries of a global institution in Washington dominated by the G-7 countries, how should the IMF seek to structure its relationship with independent organizations with essentially the same mandates to maintain economic and financial stability except in a regional context? Can one be confident that future external financial crises will have asymmetrical effects on countries in the region, facilitating mutual assistance, or will the crises continue to have symmetrical effects, rendering the possibility of such assistance nugatory? Can the global monetary system function effectively with more than one set of understandings, conventions, and rules, for example, about the trade-off between financing and adjustment or about the ultimate goal of capital account liberalization? In other words, is the global standard IMF conditionality or something weaker? These are big issues that the general membership of the IMF will not be able to continue to duck.

More prosaically, how should the IMF position itself vis-à-vis various efforts at regional integration? The European project has been ongoing for five decades. In East Asia, Africa, and Latin America integration efforts are more recent. The IMF now conducts formal regional surveillance exercises with respect to the euro area, the Central African Economic and Monetary Community, the West African Economic and Monetary Union, and the Eastern Caribbean Currency Union. In an era of scarce resources, the IMF might well want to scale back its surveillance activities with respect to the individual members of those regional arrangements while it concentrates on the larger units. At the same time, it might be expected to publish the documents that it produces in connection with its participation in peer-review processes such as the G-7 and various regional groups.

15. The official text ("Sustaining Macroeconomic Performance in the ASEAN Countries," an address to the Conference on Macroeconomic Issues Facing ASEAN Countries, Jakarta, Indonesia, November 7, 1996), published by the IMF, does not support this interpretation.

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One particular topic that should be on the IMF's agenda with respect to its role in the international monetary system is the prospect that the euro may emerge as a serious rival to the US dollar as the principal international currency and international reserve currency. In recent years, the amount of verbal and, perhaps, financial speculation about international reserve diversification has increased dramatically. I have written about this issue (Truman 2005b). I have proposed an international reserve diversification standard that builds on the disclosure requirements with respect to international reserves (the "reserve template") in the IMF's Special Data Dissemination Standard (SDDS). Under this proposal, all major reserve holders would be expected regularly to disclose the currency composition of their foreign exchange reserves. In addition, they would be required to declare a benchmark, or adhere to a general benchmark, for the currency composition of their reserves. If they changed their benchmarks, they would commit to doing so only gradually over a period of, say, five years.[16] This would be a market-oriented approach to reserve diversification in contrast with earlier proposals to create an IMF substitution account to facilitate the relocation of reserves from dollars into SDRs last considered in 1979–80 (Boughton 2001, 936–43).

16. It would follow that marginal increases or decreases in foreign exchange reserves, as the result of intervention, should be allocated immediately according to the benchmark.

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