

A suitable case for treatment? Understanding the ongoing debate about the IMF

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ABSTRACT *The International Monetary Fund has been in the spotlight over recent years, particularly in the context of its involvement in the East Asian economies following the 1997–98 crisis. Various reports on aspects of the international financial system have made recommendations for reforming the IMF. Having provided a brief historical and empirical background, this paper identifies the underlying issues in the ongoing debate: does the world still need the IMF, should the Fund be an adjustment or lending institution, what should be its relationship with private capital markets, should it be a crisis averter, crisis lender or crisis manager, does it have a long term lending role in developing countries and is there too much overlap with the World Bank, do Fund programmes work and what is the future for conditionality, should the Fund's organisational structure be reformed, and how should the Fund be financed? The paper distinguishes between areas of consensus and dissent and briefly assesses the chances of reform.*

Although the International Monetary Fund (IMF) has been a much-studied institution since its inception at the Bretton Woods conference in 1944, it is probably fair to say that it has never received such close examination and critical analysis as it has since the mid-1990s. This rush of interest started somewhat artificially with the 50th anniversary of Bretton Woods and the deliberations of the Bretton Woods Commission, but became more compelling as the wider debate about a new international financial architecture gained momentum in response to various economic and financial crises. Accusations that the Fund mishandled the crises in East Asia in 1997, and in Russia in 1998, combined with broader criticism of its systemic role in a world economy dominated by large and volatile private capital flows gave the debate a sharper and more immediate focus.

Even large industrial economies now feared that they might not be exempt from the spillover effects of crises in emerging market economies and, in some quarters, the crises were seen as the 'Achilles heel' of global capitalism. In this context, attention has been paid to the part that the IMF might play in helping to avert such crises or to minimise their adverse global effects, should they occur.

Moreover, the large loans that were associated with its involvement in crisis

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countries meant that the Fund itself became short of liquidity. The decision as to whether or not to increase its capital base provided both a further opportunity, as well as the motivation, to reassess its role. Clearly the world economy at the end of the twentieth century was very different from the one that had existed in the middle of the century, when the Bretton Woods institutions were set up; it was natural therefore to consider whether these institutions had adapted appropriately to meet the contemporary challenges the world economy now appeared to face. Ultimately, did the world still need the IMF? If so, did it need it in its current or some modified form?

Against this background there has been a spate of reports published seeking to assess the pros and cons of the Fund's operations and to plot out the direction that reform should take. Indeed, when combined with the academic and popular literature on the subject there has been a veritable avalanche of material produced about the Fund. It is easy to get swept away in this, but in so doing to fail to isolate the principal issues that lie at the heart of this debate and also to fail to distinguish areas where there is consensus from those where there is dissent. The purpose of this paper is to provide a guide to help understand the ongoing debate about the future of the IMF. It aims to provide a brief historical background to explain how the Fund's activities have evolved over time, and to isolate the central questions to which this story of evolution gives rise, putting the current debate in context. The next section identifies the principal historical landmarks and traces out the evolution of the debate about the Fund. The following section summarises the Fund's contemporary sphere of operations. The next section extracts the key issues that emerge from the foregoing discussion and that dominate the current debate. The final section offers a few concluding remarks about the political economy of reforming the IMF.

A brief historical background'

The Bretton Woods conference in 1944 represented a response to the international financial 'anarchy' that had existed in the 1930s as countries pursued beggar-my-neighbour policies in the form of competitive devaluations and protectionist commercial policy. Against a backdrop of global recession and shrinking world trade there was a belief that an international monetary order could be established that would facilitate global expansion and 'full' employment without having to revert to the rigidities imposed by the gold standard.

Of the two principal plans discussed at Bretton Woods, the US plan presented by Harry Dexter White was generally favoured over the more ambitious Keynes Plan put forward by the UK, which involved a new international currency, *bancor*, and an International Clearing Union in which countries would hold *bancor* accounts which would then be used to settle international debts. The White Plan maintained that all that was needed was some form of relatively modest stabilisation fund that would provide countries with short-to-medium term financial assistance to tide them over during periods of balance of payments deficit while they corrected their underlying domestic macroeconomic disequilibria. Although some acknowledgement was made of Keynes' concerns about the potentially asymmetrical distribution of the adjustment burden between

deficit and surplus countries by including a ‘scarce currency clause’, which in principle enabled pressure to be exerted on countries which persistently ran surpluses, the Articles of Agreement emerging from Bretton Woods essentially created White’s stabilisation fund.

Borrowing from the IMF did not initially involve ‘conditionality’—this was introduced in the 1950s as the USA continued to fear that it might in effect be required to underwrite the Fund’s lending operations. By the time the Bretton Woods system was up and running at the end of the 1950s, when the free convertibility of European currencies was introduced, the IMF had assumed the general role of overseeing, or even managing, the Bretton Woods system.

This system involved countries pegging the par values of their currencies, and only altering them in the event of a ‘fundamental disequilibrium’, where domestic and external policy targets became incompatible at the pegged exchange rate. However, not all currencies were treated equally. The US dollar was made the pivot of the system, with its price being tied to gold. Although in principle involving an adjustable peg system for exchange rates, the reality was that pegs were not adjusted very frequently so that balance of payments correction in fact relied heavily on managing domestic aggregate demand.

Within the context of the Bretton Woods system the IMF fulfilled four key functions. First, it was an adjustment institution offering advice and some degree of compulsion in terms of appropriate domestic macroeconomic policy. Second, it was a financing institution providing short-to-medium term financial assistance in support of approved policy, designed to eliminate balance of payments deficits. Third, it helped to co-ordinate macroeconomic policy internationally by encouraging countries to design policies in ways that supported pegged exchange rates, in effect supervising a rule-based system of macroeconomic co-ordination. Finally, it acted as a forum for the debate of international monetary reform.

Although never completely free from contemporary criticism, during the golden age of the 1950s and 1960s criticisms of the Fund were muted. The Fund had been set up to run a system designed to encourage global economic growth, full employment and expanding world trade and on all counts the world economy seemed to be performing quite satisfactorily.² During the 1960s debates involving the Fund focused instead on, first, its potential contribution to creating additional global liquidity and, second, whether it needed to modify its lending operations to accommodate what developing countries presented as their particular and unique problems.³

In terms of global liquidity the fear was that, within a system involving infrequent exchange rate changes and a relatively inefficient adjustment mechanism, inadequate liquidity would threaten future global economic growth, and that, with the rapidly growing Eurodollar market, a shortage of official reserves would expose the system to the threat of exchange rate crises associated with speculative attacks on currencies. This debate culminated at the end of the 1960s with the introduction of Special Drawing Rights (SDRs)—an international reserve asset that the IMF could itself create as it deemed necessary.⁴

In terms of the special interests of developing countries, the Fund relaxed its initial approach, which was that its standby agreements adequately met the needs of all its member countries, and during the 1960s introduced first the Com-

pensatory Financing Facility and then the Buffer Stock Financing Facility, each of which was, in its own way, designed to deal with the problems of export instability and adverse terms of trade movements. Unlike standby arrangements, drawings under these facilities involved only modest or 'low' conditionality, reflecting the view that export instability was largely exogenous and required liquidity rather than adjustment.

However, these reforms failed to prevent the collapse of the Bretton Woods system during 1971–73. To what extent was the IMF to blame for the collapse? In a sense it cannot be exonerated from blame. After all, the Fund had been designed to operate the Bretton Woods system, and yet it clearly failed to prevent developments that led to the system's eventual breakdown.⁵ In essence, it had not prevented currencies from becoming seriously misaligned. Whatever its share of responsibility, the legacy of the collapse of the Bretton Woods system was to call into question the future of the Fund. If it was there to supervise the Bretton Woods system, why was it needed once that system had collapsed? While this question was asked by several commentators, a more measured analysis of the need for international financial reform and of the IMF was proffered, at the time, by the so-called Committee of Twenty (C-20). While still emphasising the importance of stable exchange rates, the C-20 recognised that greater exchange rate flexibility could be appropriate. It also envisaged a larger role for the SDR as a reserve asset and an extension of IMF lending into the medium to longer term in association with structural change.

As the debate about international financial reform was going on, the world was in effect forced by expediency to adopt generalised flexible exchange rates in 1973 to try and correct persistent currency misalignment, and encountered an enhanced need for international financial intermediation in the context of the quadrupling in the price of oil in 1974, which created large surpluses in the oil exporting countries and large deficits among oil importers.⁶ While the Fund responded by creating a temporary Oil Facility designed to recycle oil revenues from oil producers to countries with oil-related balance of payments deficits, the task of recycling petrodollars was largely performed by private international banks.

In broader terms, during the 1970s the IMF became marginalised as an institution. Its adjustment role was reduced by the introduction of exchange rate flexibility. Its lending role was overshadowed by international financial intermediation by the private banks. Its macroeconomic co-ordination role seemed less relevant where it was believed that flexible exchange rates would insulate countries from external shocks. Even its role as a forum for international monetary reform was reduced by the trend towards regionalisation in Europe and the existence of other fora with overlapping spheres of responsibility.⁷ Moreover, with flexible exchange rates and large private capital flows, the issue of the global adequacy of official international reserves became, in many ways, irrelevant. Although the Fund continued to set itself an (over)ambitious systemic target in terms of establishing the SDR as the principal international reserve asset, the reality was that the system evolved more in the direction of multiple reserve currencies; even the Fund's own asset faded into obscurity.

There were also changes in the global economic paradigm that had a bearing

on the Fund. The Bretton Woods system had been devised by reasonably like-minded Keynesians and the IMF was designed to provide countries with financial assistance in order to help them avoid deflationary policies that would have adverse implications for economic growth and employment. During the 1970s the Keynesian consensus evaporated and by the beginning of the 1980s political leaders in a number of the Fund's major shareholders, who were anxious to reduce the role of government nationally, were at least ambivalent about the role of an intergovernmental organisation such as the IMF. If the Fund had been established at a time of Keynesian consensus it became marginalised over a period of time when Keynesianism was under attack.

Attempts continued to address the special interests of developing countries which, during the 1970s, became the Fund's only clients, with the opening of a new medium-term lending window—the Extended Fund Facility (EFF)—the establishment of a Trust Fund, financed by IMF gold sales, to help provide concessionary assistance to poor countries through interest rate subsidies, and the liberalisation of conditionality. In practice, the EFF was initially relatively little used and seemed to be unpopular both among borrowing countries and the IMF. Certainly it did not seem to meet the needs of the world's poorest countries. Even so, by the beginning of the 1980s the IMF was lending exclusively to low-income countries. The better-off developing countries seemed able to meet their need for external financing by borrowing from the private international banks. An apparently natural division of labour had emerged between the IMF and private capital markets as the Fund dealt with those countries bypassed by the private banks. Critical analysis of the IMF focused on its involvement in developing countries rather than its eroded systemic role and concentrated on the design and effectiveness of conditionality.⁸ Here critics of the Fund argued that, in design, conditionality reflected monetarist modes of thought, focused excessively on the demand side of economies to the exclusion of the supply side, and was insufficiently flexible to respond to country-specific needs. Others complained that conditionality was based on old-fashioned macroeconomics, that it misinterpreted the appropriate role of the state in many developing countries by emphasising its 'crowding out' effects rather than its 'crowding in' effects, and that it was subject to a fallacy of composition in as much as policies that might be effective when pursued in isolation by one country would be ineffective when pursued simultaneously by a group of countries. New structuralists argued that IMF conditionality based on exchange rate devaluation and monetary contraction was stagflationary. More generally, critics claimed that the empirical evidence suggested that conditionality had little if any significant impact on key macroeconomic variables. The debate over conditionality—for there were counterclaims to each of these accusations—became and remains an enduring feature of most discussions of the IMF.

However, the 1980s saw a number of important changes for the IMF. In terms of both its clientele and its role there was a radical change in 1982. Faced with a deteriorating global economic environment, which involved sharply higher world interest rates and faltering export performance alongside aspects of domestic economic mismanagement, many highly indebted developing countries—largely in Latin America—that had formerly relied on private capital began to encounter

severe debt problems and started to turn to the Fund. To the extent that these threatened the solvency of US and other banks that had made loans to these countries, the debt crisis was perceived by some—although by no means all—observers as threatening to destabilise the international financial system. The Fund's involvement took on a quasi-systemic dimension. While it was applauded in some quarters, others criticised the Fund for what they saw as its mishandling of the Third World debt crisis.

The criticisms comprised a number of elements. First, critics argued that the Fund had become more overtly political. According to this view, lending decisions were forced through by creditor countries, in particular the USA, with the clear objective of preventing specific debtor countries from defaulting and thereby damaging the interests of the large commercial banks that still had significant loans outstanding to them. The claim that this was justified in order to ensure systemic stability became increasingly illegitimate as the banks themselves adjusted to the crisis by provisioning, by reducing their developing country exposures through the secondary market, and by expanding other lines of business. Even the Fund's own staff began to complain that it was being politically manoeuvred.⁹ Without having to subscribe to this view, aggregate evidence drawn from the mid-1980s suggests that positive net transfers from the Fund to indebted developing countries financed negative transfers with the banks. It requires only a short step to claim that the Fund was bailing out the banks.

A second criticism was that the Fund treated the debt problem as if it was one of illiquidity and inadequate cash flow rather than a more deep-rooted and longer-term one of structural adjustment. The Fund opted to support new financing which assisted countries in meeting their outstanding debt servicing obligations, but did less to restore medium-term viability to their balance of payments. The adjustment programmes favoured by the Fund called for conventional demand-side contraction.

Third, critics complained that the Fund failed to devise incentives that positively encouraged adjustment. The additional foreign exchange that adjustment created was largely used to repay commercial creditors abroad. The domestic rate of return was in many cases low. Critics argued that it was this low domestic return which led to problems of non-compliance. Governments found it difficult to muster domestic political support for programmes which seemed to imply heavy domestic costs but no readily discernible benefits. Such critics went on to argue that what was needed was debt relief in order to reduce the domestic adjustment burden and raise the incentive to adjust. Instead, through its policy of 'assured financing', the Fund discouraged banks from granting relief and in this way postponed appropriate systemic reform.¹⁰

It was only following the introduction of the Brady Plan, towards the end of the 1980s, that the Latin American debt crisis appeared to ease. Before that the Fund had largely failed to achieve its target of normalising creditor-debtor relations and restoring country access to sustainable and spontaneous lending.

While highly indebted developing countries borrowed heavily from the IMF in the 1980s, most Fund programmes continued to be with the low-income countries of Africa and Asia. Here, more than elsewhere, some critics of the IMF argued

that conventional demand-side conditionality was particularly inappropriate. They argued that low foreign trade elasticities limited the effectiveness of devaluation, and that ill-developed financial markets constrained the impact of rising interest rates. Moreover, since fiscal deficits were frequently monetised, the strengthening of the tax base was often presented by critics as a higher priority than curbs on government expenditure.¹¹ Some NGOs went as far as suggesting that the Fund was doing more harm than good in low income countries because its programmes had a negative effect on economic growth, income distribution and poverty. Capturing the essence of this critique, UNICEF claimed that what was needed was ‘adjustment with a human face’.

Early in the 1980s, and partially in response to a second big increase in oil prices at the end of the 1970s and a change in the dominant economic paradigm, the Fund had retreated from the EFF and had, in effect, phased out low conditionality lending through reforms to the CFF. The emphasis had returned to conventional macroeconomic stabilisation based on controlling aggregate demand through fiscal and monetary policy. Now alongside the appointment of a new Managing Director—Michel Camdessus—in the late 1980s, the Fund offered an institutional response to concerns that it was under-emphasising the supply side and the social consequences of adjustment. Its rhetoric began to refer more to encouraging economic growth as a ‘primary’ objective of adjustment programmes and protecting ‘vulnerable groups’ from the costs of adjustment. Perhaps most notably, the Fund introduced in 1987 the Enhanced Structural Adjustment Facility (ESAF). This was targeted at low income countries and emphasised a broader range of conditionality which, while still including conventional demand-side measures, also included specific supply-side and micro-economic measures.¹³

The move into structural adjustment that the ESAF signalled began both to increase the diversity and sharpen the intensity of the debate surrounding the Fund. It now became more difficult to sustain the demarcation between the Fund and its sister institution the World Bank; a demarcation further eroded by the Bank’s move into policy-based structural adjustment starting at the beginning of the 1980s.¹⁴

As originally envisaged, the division of labour between the Fund and the Bank had been relatively straightforward. The Fund’s orientation was towards the short run, the balance of payments, the demand side, the monetary sector and programme support. The Bank’s was towards the long run, economic development, the supply side, the real sector and project support. The differences between the two institutions were nicely encapsulated in Keynes’ observation that the Board of the Fund should comprise ‘cautious bankers’ whereas that of the Bank should comprise ‘imaginative expansionists’.

In 1966 an internal memorandum had clarified the division of labour by assigning ‘primary responsibilities’ to each agency. The Fund had jurisdiction ‘for exchange rates and restrictive systems, for adjustment of temporary balance of payments disequilibria and for evaluating and assisting members to work out stabilization programs as a sound basis for economic advice’. The Bank’s primary responsibility, in contrast, was ‘for the composition and appropriateness of development programs and project evaluation, including development

priorities’.

Less than a decade later the Fund had begun to accept that payments deficits could be of a structural nature, for which correction required longer-term financial support. The Extended Fund Facility (EFF) had been introduced to fill what was perceived as a gap in the range of the Fund’s lending facilities and clouded the distinction between the Fund and the Bank. But it was in the 1980s and in the context of structural adjustment that the overlap became most pronounced.

With the introduction of the ESAF (and the SAF shortly before it), the argument that the IMF was moving too far in the direction of becoming a development agency rather than being solely an international financial agency became more frequently heard. While those from the right of the political spectrum claimed that the Fund was evolving in an inappropriate way by offering too much aid to countries that were pursuing ill-designed policies, often under unacceptable political regimes and with little chance of success, those from the left—including, as noted earlier, the NGOs—maintained that, to the extent that the Fund had taken on a development role, it performed this role badly by hurting economic growth and failing to alleviate poverty. Even those who had criticised IMF conditionality for being too narrow and for being overly reliant on seeking to control monetary aggregates, now began to draw attention to the dangers of excessive conditionality. Certainly, in spite of its highly concessionary rate of interest, many developing countries remained reluctant to use the ESAF and the track record of those that did was not such as to convince its critics that the facility represented a worthwhile extension of the Fund’s operations.

During the 1990s a series of reviews of ESAF—including an external assessment—struggled to strengthen it.¹⁵ Its metamorphosis into a lending window which more directly focused on economic growth and poverty reduction culminated with its renaming as the Poverty Reduction and Growth Facility in 1999. To some critics this was a step in the right direction, but to many others it was simply not a legitimate part of the Fund’s mandate to become directly involved in issues of poverty and economic growth—areas in which in any case the Fund was supposedly at a comparative disadvantage. But there were other developments during the 1990s that further and perhaps more particularly enlivened the debate about the Fund.

Just as the Third World debt crisis during the 1980s had thrust many Latin American economies into the Fund, the fall of Communism at the beginning of the 1990s and the embarkation of formerly socialist economies into a process of transition towards more market-based systems meant that the Fund was confronted with the challenge of assisting many of them. Challenge it was, since the institutional structures necessary to support a market economy were absent. Yet again the debate raged over how well or badly the Fund responded to the challenge. Some commentators suggested that it responded completely inadequately by providing insufficient financial support and offering inappropriate policy advice. Others argued that the Fund simply poured good money after bad without exerting enough pressure on countries—most strategically Russia—to carry out the necessary policy changes. Stories that Fund resources were simply passing through Russia briefly on their way to Swiss bank accounts fanned the

increasingly popular view that the IMF was beginning to make too many mistakes, often allowing political objectives of its major shareholders to interfere with its economic judgment.¹⁶ This perception was hardly helped by the Mexican peso-crisis in 1994, nor, more significantly perhaps, by the East Asian financial crisis in 1997–98 and the additional crises that occurred in Russia in 1998 and Brazil in 1999.

While in the mid-1990s the Volcker Commission had been—perhaps to a fault—measured and temperate in its analysis and the advice it gave, towards the end of the 1990s commentary on the Fund became much more outspoken and direct.¹⁷ Illustrative of this was a lively—if not downright heated—interchange between Joseph Stiglitz and Rudiger Dornbusch in the pages of the *New Republic*. Stiglitz accused the Fund of seriously misdiagnosing the nature of the East Asian crisis and of continuing to design conditionality as if one size fitted all. He argued that Fund conditionality had a perverse effect and came close to suggesting that the Fund was incompetent and closed to criticism, even when it came from the World Bank. Dornbusch strongly defended the Fund, arguing that the sharp recovery in Korea following the crisis vindicated its advice. But in terms of the published contributions—as is usually the case with contentious issues—criticisms tended to outweigh defences. Among the issues raised were the following. Why had the Fund not seen the East Asian crisis coming? Was it monitoring the wrong variables? What was it missing? Had it pushed financial liberalisation too hard? Had it failed to recognise the deficiencies of domestic financial supervision and regulation? Was it a mistake to advocate capital account liberalisation alongside domestic financial liberalisation? Was the sequencing of liberalisation wrong? Had its willingness to provide large amounts of finance to Mexico in 1994 led private capital markets to over-lend elsewhere, believing that they would be effectively bailed out by the Fund should things go wrong; did IMF lending therefore involve a moral hazard problem? Why had the Fund recommended fiscal retrenchment in East Asian economies when fiscal deficits were not large, and when private sector saving was high? Had the devaluations favoured by the Fund as well as the breadth and depth of its conditionality triggered further panic and capital outflows, consequently leading to exchange rate overshooting and further economic recession? Was the Fund sending out the wrong signals to private capital markets? Had sharp rises in interest rates exacerbated problems for the financial and corporate sectors? Had the Fund done enough to try and bail in private capital? In designing conditionality, had the Fund stipulated policies beyond those necessary to stabilise the affected economies and well beyond those that it had a ‘moral right’ to require? Was it encroaching too far into micro-economic issues, into economic structure, into the reform of the financial institutions as well as into aspects of political behaviour? Was this motivated by a desire to serve the interests of richer industrialised economies and in particular the USA? Was it acting more as an agent for private capital markets than its client countries? Was the desire to avoid conditionality forcing countries to build up excessive holdings of international reserves? The list of questions goes on. But fundamentally the Fund’s role as both an adjustment and a financing institution came under sharp attack.¹⁸

Critics suggested that in spite of its surveillance of economies the Fund had not

done enough to avert crises, that its role as a crisis lender had been in some ways counter-productive, and that it had met with only mixed success as a crisis manager. In these circumstances, and against a backdrop that called for a new international financial architecture, it is easy to see why a full reassessment of the Fund's role in the global economy seemed relevant.

The Fund's response to the crises of the 1990s, as it had often been beforehand, was to erect new lending windows. As noted above with transition economies in mind, it had established the Systemic Transformation Facility. Now with quota-constrained demands on its resources, it introduced the Supplemental Reserve Facility, which allowed its lending to individual countries to exceed quota limits, and introduced New Arrangements to Borrow to augment its own resources. In an attempt to provide countries with precautionary finance to help in the contingency of a contagion effect from a crisis, it established the Contingent Credit Line. But were these adequate or even appropriate responses? An important question became whether the Fund's operations had evolved in an incremental and piecemeal way that had resulted in it trying to play a role that was either inappropriate or beyond its means? Had there been excessive 'mission creep'? In the context of this surge of criticism and with the Fund looking for additional resources, a clustering of reports coming from the Council on Foreign Relations, the International Financial Institution Advisory Commission, the Group of 24 and UNCTAD, the Overseas Development Council and the Centre for Economic Policy Research were published in 1999 and 2000.

A brief statistical background

The purpose of this section is to provide an indication of the Fund's operations during the 1990s. It therefore sets out the empirical context in which the current debate about reforming the Fund is being conducted. Table 1 shows how Fund lending changed throughout the 1990s. Both in terms of net credit—allowing for repayments—and gross disbursements, it is apparent that there are peaks and troughs in Fund lending. These depend essentially on whether large economies such as Mexico or Korea or Russia are drawing resources from the Fund. Thus the sharp rise in IMF lending in 1995 was associated with the Mexican crisis and its spillover effects, while the subsequent rise in 1997, and more so in 1998, reflected the East Asian financial crisis.

Although the IMF is heavily involved in sub-Saharan Africa, drawings from these economies generally represent a very modest fraction of total Fund lending. Indeed as far as low income countries in general are concerned, in 1998 drawings under the ESAF accounted for only about 10% of total disbursements and just under 2% of net credit provided by the Fund.

From the figures provided in Table 1 it is easy to see why the current debate about the Fund has concentrated so heavily on its role in emerging economies in crisis. Quantitatively it is these countries that have dominated Fund lending. However, just to focus on its total amount of lending is to misrepresent the Fund's operations. The data in Table 2 provide a slightly different perspective. This table focuses on the number of programmes as well as the amount of lending. The data in it provide a snapshot of the Fund's operations towards the

TABLE 1
Net credit and loans from IMF (US \$ billions)¹

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Advanced economies	-	0.3	-	-	-0.1	-0.1	11.3	5.2	-10.3
Newly industrialised Asian economies	-	-	-	-	-	-	11.3	5.2	-10.3
Developing countries	1.1	-0.4	-0.1	-0.8	12.6	-2.9	0.8	8.5	1.3
Regional groups									
Africa	0.2	-0.2	0.2	0.9	0.8	0.6	-0.5	-0.4	-0.2
Sub-Sahara	-	-	0.7	0.5	0.6	0.1	-0.5	-0.3	-0.1
Asia	1.9	1.3	0.6	-0.8	-1.5	-1.7	5.0	6.6	1.7
Excluding China and India	0.2	0.1	0.1	0.4	-0.3	-0.4	5.7	7.0	2.1
Middle East and Europe	-	0.1	-	0.4	0.4	0.1	0.2	-0.1	0.6
Western hemisphere	-1.0	-1.6	-0.9	-1.3	12.9	-2.0	-4.0	2.5	-0.9
Countries in transition	2.4	1.6	3.7	2.4	4.7	3.7	2.5	5.5	-3.6
Central and Eastern Europe	2.4	0.5	2.0	0.5	-1.3	-	0.7	-0.1	-
Excluding Belarus and Ukraine	2.4	0.5	2.0	0.2	-2.7	-0.8	0.4	-0.4	-
Russia	-	1.0	1.5	1.5	5.5	3.2	1.5	5.3	-3.6
Transcaucasus and central Asia	-	-	0.2	0.3	0.6	0.5	0.2	0.3	-
<i>Memorandum</i>									
Total									
Net credit provided under:									
General Resources									
Account	2.520	0.644	3.374	0.594	15.633	0.291	14.355	18.811	-12.856
Trust Fund	-0.069	-	-0.060	-0.014	-0.015	-	-0.007	-0.001	-0.001
PRGF	1.070	0.733	0.253	0.998	1.619	0.325	0.179	0.374	0.193
Disbursements at year-end under: ²									
General Resources									
Account	31.821	31.217	34.503	37.276	53.275	51.824	62.703	84.961	69.913
Trust Fund	0.226	0.217	0.157	0.153	0.141	0.137	0.121	0.126	0.122
PRGF	4.499	5.041	5.285	6.634	8.342	8.392	8.049	8.788	8.760

Notes: ¹ Includes net disbursements from programmes under the General Resources Account, Trust Fund and Poverty Reduction and Growth Facility (formerly ESAF). The data are on a transactions basis, with conversion to US dollar values at annual average exchange rates. ² Converted to US dollar values at end-of-period exchange rates.

end of 1998, which we have already identified as a year when the Fund was lending relatively heavily. It was against this background that the reports mentioned in the previous section were published.

A number of features of Table 2 are notable. First, there were outstanding arrangements with 62 countries, representing about one-third of the Fund's membership. Second, the arrangements covered both developing countries and countries in transition, ranging from the better-off among them to the very poorest countries in the world. Taking the UNDP's Human Development Index

TABLE 2
Standby, EFF and ESAF arrangements (as of 30 November 1998)

<i>Member</i>	<i>Date of arrangement</i>	<i>Expiration date</i>	<i>Amount approved</i>	<i>Undrawn balance</i>	<i>Real GDP per capita (ppp \$) 1994</i>	<i>Human Development Index rank</i>
<i>Standby arrangements</i>			19834.17	4042.06		
Bosnia and Herzegovina	29 May 1998	28 May 1998	60.60	36.36		
Cape Verde	20 February 1998	19 April 1999	2.10	2.10	1,862	123
Djibouti	15 April 1996	31 March 1999	8.25	1.95	1,270	162
El Salvador	23 September 1998	22 February 2000	37.68	37.68	2,417	112
Estonia	17 December 1997	16 March 1999	16.10	16.10	4,294	71
Korea ¹	4 December 1997	3 December 2000	15500.00	2175.00	10,656	32
Latvia	10 October 1997	9 April 1999	33.00	33.00	3,332	92
Philippines	1 April 1998	31 March 2000	1020.79	823.42	2,681	98
Thailand	20 August 1997	19 June 2000	2900.00	700.00	7,104	59
Uruguay	20 June 1997	19 March 1999	125.00	125.00	6,752	37
Zimbabwe	1 June 1998	30 June 1999	130.65	91.45	2,196	129
<i>EFF arrangements</i>			24414.26	15536.23		
Argentina	4 February 1998	3 February 2001	2080.00	2080.00	8,937	36
Azerbaijan	20 December 1996	19 December 1999	58.50	17.56	1,670	106
Bulgaria	25 September 1998	24 September 2001	627.62	523.02	4,533	69
Croatia, Republic of	12 March 1997	11 March 2000	353.16	324.38	3,960	77
Gabon	8 November 1995	7 March 1999	110.30	49.63	3,641	120
Indonesia	25 August 1998	5 November 2000	4669.10	2566.70	3,740	99
Jordan	9 February 1996	8 February 1999	238.04	35.52	4,187	84
Kazakhstan	17 July 1996	16 July 1999	309.40	309.40	3,284	93
Moldova	20 May 1996	19 May 1999	135.00	97.50	1,576	110
Pakistan	20 October 1997	19 October 2000	454.92	398.06	2,154	139
Panama	10 December 1997	9 December 2000	120.00	80.00	6,104	45
Peru	1 July 1996	31 March 1999	300.20	139.70	3,645	89
Russian Federation ¹	26 March 1996	25 March 2000	13206.57	7426.86	4,828	67
Ukraine	4 September 1998	3 September 2001	1645.55	1400.00	2,718	95
Yemen	29 October 1997	28 October 2000	105.00	87.90	805	148
<i>ESAF arrangements</i>			4580.98	2301.00		
Albania	13 May 1998	12 May 2001	35.30	29.42	2,788	102
Armenia	14 February 1996	13 February 1999	101.25	33.75	1,737	103
Azerbaijan	20 December 1996	19 December 1999	93.60	23.40	1,670	106
Benin	28 August 1996	27 August 1999	27.10	18.12	1,696	146
Bolivia	18 September 1998	17 September 2002	100.96	34.13	2,598	113
Burkina Faso	14 June 1996	13 June 1999	39.78	6.63	796	172
Cameroon	20 August 1997	19 August 2000	162.12	81.06	2,120	133
Central African Republic	20 July 1998	19 July 2001	49.44	41.20	1,130	151
Chad	1 September 1995	28 April 1999	49.56	8.26	700	164
Congo, Republic of	28 June 1996	27 June 1999	69.48	55.58	2,410	130
Cote d'Ivoire	17 March 1998	16 March 2001	285.84	202.47	1,668	145
Ethiopia	11 October 1996	10 October 1999	88.47	58.98	427	170
The Gambia	29 June 1998	28 June 2001	20.61	17.18	939	165
Georgia	28 February 1996	27 February 1999	166.50	27.75	1,585	105
Ghana	30 June 1995	29 June 1999	164.40	68.50	1,960	132
Guinea	13 January 1997	12 January 2000	70.80	23.60	1,103	167

UNDERSTANDING THE ONGOING DEBATE ABOUT THE IMF

Guyana	15 July 1998	14 July 2001	53.76	44.80	2,729	104
Haiti	18 October 1996	17 October 1999	91.05	75.88	896	156
Kenya	26 April 1996	25 April 1999	149.55	124.63	1,404	134
Kyrgyz Republic	26 June 1998	25 June 2001	64.50	53.75	1,930	107
Macedonia, FYR	11 April 1997	10 April 2000	54.56	27.28	3,965	80
Madagascar	27 November 1996	26 November 1999	81.36	54.24	694	152
Malawi	18 October 1995	31 December 1998	45.81	15.27	694	161
Mali	10 April 1996	5 August 1999	62.01	10.34	543	171
Mongolia	30 July 1997	29 July 2000	33.39	27.83	3,766	101
Mozambique	21 June 1996	24 August 1999	75.60	12.60	986	166
Nicaragua	18 March 1998	17 March 2001	100.91	84.09	1,580	127
Niger	12 June 1996	1 September 1999	57.96	9.66	787	173
Pakistan	20 October 1997	19 October 2000	682.83	454.92	2,154	139
Rwanda	24 June 1998	23 June 2001	71.40	59.50	352	174
Senegal	20 April 1998	19 April 2001	107.01	89.18	1,596	160
Tajikistan	24 June 1998	23 June 2001	96.00	78.00	1,117	115
Tanzania	8 November 1996	7 November 1999	161.59	38.76	656	149
Uganda	10 November 1997	9 November 2000	100.43	43.52	1,370	159
Yemen	29 October 1997	28 October 2000	264.75	176.75	805	148
Zambia	6 December 1995	5 December 1998	701.68	40.00	962	143
Total			48829.40	21879.29		

Notes: ¹ Includes amounts under Supplemental Reserve Facility. EFF = Extended Fund Facility. ESAF = Enhanced Structural Adjustment Facility. Figures may not add up to totals because of rounding.

Source: IMF Treasurer's Department, UNDP, *Human Development Report*.

(HDI), the highest ranked recipient of IMF finance was Korea (32), with the lowest ranked being Rwanda (174). Standby and extended arrangements were more common among the better-off developing countries and CITS, while ESAF loans were focused on the poorer countries. Of the 62 arrangements recorded in Table 2, 17 were with countries ranked in the top 100, according to the HDI, while the remaining 45 were with countries in the bottom 75.

Third, arrangements existed across most regions of the world including Africa, Asia, Latin America and Central and Eastern Europe. Fourth, as suggested by Table 1, in quantitative terms, total Fund lending commitments (at nearly SDR49 billion) were concentrated in a relatively small number of countries; arrangements in Korea (SDR15.5 billion), Russia (SDR13.2 billion) and Indonesia (SDR4.7 billion), for example, accounted for about 68% of the total amount of lending approved; on the other hand, lending to 36 low-income countries under the ESAF amounted to only about the same as the single loan to Indonesia.

The debate about the Fund: the underlying issues

The foregoing discussion covering both its historical evolution and the nature of its current operations allows us to place in context the current debate about the IMF. The debate touches on a range of issues and in this section we identify the most important of them and discuss each briefly.

Does the world still need the IMF?

With flexible exchange rates and large private capital markets from which countries can borrow to finance balance of payments deficits, why is the Fund needed? Would it not be simpler to scrap it altogether? The counter-argument is that for various, but essentially conventional reasons, private capital markets may 'fail'. There may, for example, be shortcomings in dealing with systemic risk, externalities associated with international lending, problems associated with asymmetrical information and co-ordination and collective action problems. Should the Fund not be playing a role in offsetting these failures and in supplying what are in effect international public goods such as information, conditionality and crisis lending and management? Would private markets left to themselves allocate financing in an efficient and equitable way? Moreover, exclusive reliance on private capital markets would lead to many countries being unable to raise balance of payments financing. Would this be acceptable to the international community? If the Fund did not exist, would we need to establish it? But then again, just as markets may involve elements of market failure, so too the Fund may be subject to bureaucratic failures; what of the public choice approach to the Fund's operations? Fund lending might enable countries to avoid making the policy changes that would in the long run assist their market access. While the currency crises of the 1990s have been taken by some as a clear indicator of the need for the IMF in order to help the world contend with such crises, others suggest that it has been the very presence of the Fund that has contributed to causing the crises in the first place.

Just as markets may fail, domestic governments may also fail in the sense of pursuing inappropriate policies that may in turn impose external costs on other countries. It was the pursuit of beggar-thy-neighbour policies in the 1930s that in part justified setting up the Fund. In principle therefore the involvement of the IMF may lead to superior policies. Moreover, signing an agreement with the Fund may be seen as locking governments into these policies in a way that deals with the time consistency problem—the incentive for governments to renege on policy promises if their announcement has positive effects while their implementation carries a political cost. However, critics argue that there is little reason to believe that the IMF is in a better position to design appropriate adjustment policy and that the poor completion record of IMF programmes shows that governments are not in practice locked in. Although those who advocate closure are in the minority, the majority view is that, while the world continues to need the IMF, it needs it in a modified form.¹⁹

Should the Fund be an adjustment or a lending institution?

Balance of payments deficits can be handled using different intensities of adjustment and financing. What is the optimum mix, and does the Fund facilitate it? If not, does it provide too much or too little financing? A public choice approach might suggest that the Fund should not be lending at all, since this creates perverse incentives. This approach views IMF lending as encouraging countries to pursue policies which increase their access to concessionary financing from the

Fund. On the other hand, would the Fund's adjustment programmes be credible with private capital markets if the Fund did not itself provide financial support? Does it have to put its money where its mouth is? The grounds for believing that Fund conditionality alone will catalyse others to lend is weak. But while Fund lending may, for these reasons, need to be positive, how large should it be? If this was an easy question to answer there would be less disagreement each time a quota increase is discussed.²⁰

What should be the Fund's relationship with private capital markets: how important is moral hazard?

As noted earlier, one view is that Fund lending encourages private lenders to take excessive risks by providing what is perceived as a safety net. In the midst of a crisis the Fund bails out private lenders, which then does nothing to alter this perception. To the extent that currency crises reflect excessive capital inflows before crises as much as they do excessive contemporary outflows during them, there is a potential moral hazard problem. However, it is difficult to quantify the importance of this problem and consequently views differ sharply. A counter-view is that the prospect of Fund involvement in no way creates a risk-free environment for all private lenders and that, as part of a broad explanation of private capital flows, the relevance of the Fund is, at most, modest.²¹

While the moral hazard argument suggests that the Fund will be lending at precisely the times that private capital is moving out, a related issue is whether the Fund can manage other capital flows more effectively and make them a complement to its own lending. In the aftermath of the Third World debt crisis the Fund certainly exerted significant pressure on commercial banks to continue lending at the same time as it was involved. While circumstances have moved on since then, not least because creditors are more diverse, the question remains of whether the Fund can still beneficially influence private capital flows. Part of the answer could involve easing up on the pursuit of capital account liberalisation and supporting countries which wish to tax excessive capital inflows and thereby seek to discourage excessive capital inflows. Other ideas hinge on improving the effectiveness of conditionality, improving surveillance and providing and interpreting additional information—either implicitly or more explicitly by giving countries a credit rating—and by permitting the suspension of debt repayments and supporting the reform of loan contracts to allow for 'collective action clauses' which might then both discourage excessive lending before crises and facilitate crisis management by 'bailing in' private capital as opposed to bailing it out.

At a general level many of these ideas seem uncontroversial. The devil tends to be in the detail. How can conditionality be made more effective? What extra information should the Fund collect and publish? Given that the Fund's predictions have not always been accurate in the past, would there not be a danger that by publishing more outspoken judgements on countries the Fund would spook capital markets and create the crises that it is seeking to avoid? Certainly we have no idea of the response elasticities and may even be unsure as to their sign.

Should the Fund be a crisis-avertor, crisis-lender or crisis-manager? The Fund versus other financial agencies

Given the incidence of financial crises in the 1990s, much of the current debate surrounding the IMF has focused on its role in the context of crises. Systemically the issue breaks down into how best the Fund can try to prevent crises and deal with those that it fails to prevent. Of course behind this apparently straightforward distinction lies the whole question of what causes crises in the first place. Since there is theoretical and empirical disagreement on this question, it is unsurprising to find disagreement also about how best the Fund should seek to avert crises. Will greater surveillance of economic policy and performance do the trick? But what elements of policy and performance are important? Do countries perhaps need to be encouraged to turn to the Fund at an earlier stage before their problems reach crisis proportions? But then how can they be encouraged to do this, and will the Fund's principal shareholders be happy to see the Fund lending to countries that may still have access to private capital? Will a pre-commitment to provide financial support in the event of a crisis create greater confidence in private markets and make crises less likely or will the negotiations undermine and provoke crises?

Some commentators believe that the Fund should evolve into a more fully fledged international lender of last resort (ILLR) providing the kind of confidence to international financial markets that national central banks provide for domestic financial markets. Others argue that this analogy is misplaced since the Fund cannot create money in the same way as central banks can. Without the necessary resources, the Fund's commitment to such a role would not carry credibility, and it may be unrealistic to assume that the Fund will be given them even if we knew what resources would be necessary.

To the extent that the world economy requires some type of ILLR facility to provide countries with short-term emergency lending on a sufficient scale to calm markets in the event of a crisis, the question then becomes whether there are other institutions that already exist, or may still need to be created, that could undertake the task better than the Fund. Some commentators favour the BIS in the role. Others argue that, since the contagion effects of crises have tended to be regional, there may be a role for regional financial institutions to play. Perhaps the Fund should instead focus on co-ordinating other creditors, attempting to exert an influence on others to lend rather than lending itself. But again how can it exercise this influence?²²

*Should the Fund be involved in long-term lending to developing countries?
Is there too much overlap with the World Bank?*

When critics talk about 'mission creep', it is frequently the Fund's operations in low-income countries to which they are referring. In short, has the Fund moved too far in the direction of becoming a development agency? Again, in order to constitute a part of the ongoing 'debate' about the Fund there must be arguments on both sides. One point is that it has become much more difficult, in the context of structural adjustment, to draw a clear distinction between economic develop-

ment and the balance of payments. Institutional ambiguities may simply reflect this. But even so, much concern has been expressed about the Fund becoming directly involved with issues of poverty, economic growth and debt relief. This concern has found expression in proposals that the Fund should either discontinue the Poverty Reduction and Growth Facility (PRGF) altogether or that the facility should be moved to the World Bank where, it is suggested, the comparative advantage in issues surrounding poverty and economic growth lies. Two fundamental issues are therefore at the heart of the debate about this question. The first is how best to assist low-income countries. What policies do they need, how much economic and structural adjustment should they undertake and how much external financial support is required to support these policies? The second is what are the best institutional arrangements for providing this assistance? While there is some appeal in the argument that issues of poverty and growth are development issues and responsibility for them should therefore be lodged with the World Bank, rather than the IMF, there are complicating factors. How would macroeconomic stabilisation be integrated into programmes led by the Bank? The Fund would still need to make an input. Would a shift in the responsibility for the PRGF have an effect on the willingness of private capital markets, or, more significantly, bilateral aid donors to lend? What would be the effects on the HIPC initiative? Moreover, the World Bank's record on structural adjustment has not been clearly superior to that of the Fund and there must therefore be some doubts about whether shifting the PRGF to the Bank would in itself make a significant difference for low-income countries, which might, in any case, not be completely enthusiastic about allocating a monopoly role in structural adjustment to the Bank any more than they would to the Fund.²³

Do Fund-supported programmes work? What future is there for IMF conditionality?

There would be less debate about the future of the Fund and its role in developing countries and emerging economies if its programmes had been perceived as successful in the past. This is not the general perception, hence the debate. The difficulty is that there is enough ambiguity in the empirical evidence to allow the Fund to claim that 'on balance' its programmes 'work' and for others to claim that they do not. Evaluating the effects of Fund programmes is an ongoing and complex exercise and there still remain fundamental questions to answer. For example, to what extent does success depend on the extent to which agreed programmes are completed? At present, the empirical answer to this question is unclear, as therefore is also the extent to which the effects of Fund programmes depend on the degree to which they are implemented.

However, to criticise IMF conditionality is not necessarily to advocate that it should be abandoned. A more nuanced response is to seek to reform it in order to make it more effective. But how can this be achieved? Should conditionality be narrow or wide-ranging? How much emphasis should be placed on conventional demand-side policies as opposed to structural adjustment? Has conditionality become excessive, with counter-productive implications? Should more emphasis be placed on preconditions rather than conditions that have to be met during the

course of a programme, and, if so, what should these preconditions be? Should the Fund seek to restore the distinction between low and high conditionality lending, allowing countries to gain access to financial assistance with few conditions in circumstances where it can be established that balance of payments problems have been caused by external shocks, where there is a reasonable presumption that the shock will be self-correcting or where appropriate policies will be pursued without direct Fund involvement, and where the need is for additional liquidity from the IMF rather than adjustment advice?

Even when high conditionality is appropriate, there is a strong and growing consensus that programmes work best when the underlying policies are 'owned' by the relevant government. How can the Fund go about establishing a stronger sense of ownership? It is interesting that most moves in this direction have occurred in the context of the ESAF, and now the PRGF, which is the facility that many critics of the Fund are most anxious to see discontinued. Are they objecting to the trend in conditionality towards greater ownership or to the inappropriateness of the client base of the PRGF in terms of the Fund's underlying rationale?²⁴

Should the Fund's organisational structure be reformed? Transparency and governance

As noted earlier, the IMF has typically responded to the deficiencies in its provision by introducing new lending windows, of which there has been a rapid proliferation. A first step in structurally adjusting the Fund's operations might be to rationalise these. One possibility would be to retain a low conditionality facility and a high conditionality facility, with the degree of concessionality depending on the per capita GDP of the borrowing country. But other types of rationalisation could be feasible building on the notion that if the Fund is to be remodelled it should have fewer lending windows. Other possibilities would be to give countries some choice about the combination of conditionality and concessionality, allowing them to opt for cheaper/more conditional support or more expensive/less conditional support. Current conditionality could also perhaps be modified to reflect past performance in order to provide a stronger incentive to avoid economic mismanagement and to comply with conditionality. The ease with which new programmes can apparently be arranged may create another moral hazard.

Other organisational issues relate to the transparency of the Fund's operations, its governance and exposure to political manipulation. An opaque organisational and decision-making structure may make it unclear as to where the responsibility for mistakes lies. This may also make it more likely that mistakes will be made and less likely that they will be corrected in the future. Greater transparency and exposure to outside judgement could offset any tendency towards inefficiency. Commentators have certainly argued that the Fund has been insufficiently willing to evaluate its decisions and operations and has been resistant to criticism.

For the Fund to be an effective financial organisation it needs to be flexible and responsive. It is therefore important to avoid an unwieldy organisational structure where decisions are slow to be made; this implies a significant degree of delegation of decision making. On the other hand, it is also important that all members

of the IMF feel a degree of institutional ownership, otherwise the Fund's decisions will carry less credibility and its policies will be less effective because they lack the support of those who believe that their views have been under-represented.

There is also the question of the extent to which the Fund's staff or management should be allowed to make decisions independent of political interference. If there are strong arguments for granting central banks independence at least in terms of deciding how to achieve inflationary goals, are there equally strong argument for granting the Fund greater autonomy? Or is the analogy between national central banks and the IMF far from perfect? For starters the Fund faces a less well defined set of objectives and does not exert direct control over many crucial aspects of policy.²⁵

How should the Fund be financed?

The Fund currently relies on periodic increases in quotas alongside *ad hoc* arrangements such as the GAB and NAB in order to increase its lending capacity. Discrete quota increases are, in many ways, unsatisfactory. Although, from a political point of view, they may keep the Fund on a short leash, they do little to ensure that the Fund's lending capacity adjusts smoothly to the claims put upon it. The quota system, according to some observers, encourages the Fund to engage in 'hurry-up lending' shortly before a quota review, designed to justify an increase, and certainly it seems to generate significant political controversy. Would it be better to have quotas linked automatically to some set of indicators of the need for Fund resources? But then what should these indicators be? The need for Fund resources will, of course, depend on the role that the Fund is seeking to perform. If it became an adjustment-only institution, debates about the adequacy of its lending resources would become irrelevant.

Other ideas are that the Fund should move away from relying on quota-based subscriptions to provide its resources and instead put greater emphasis on SDR allocations, gold sales and even the revenue from a Tobin tax on international currency transactions. More realistic might be to examine the scope for the Fund to borrow directly from private international capital markets. Up until now this option has been rejected as being inconsistent with the Fund's essential character. But if this is changing in a global environment where capital market volatility has become an increasingly important problem, the idea may be worthy of re-examination.²⁶

Concluding remarks

Has the debate about the Fund led to any consensus about reform? The Reports mentioned earlier in this paper do share some common ground. They agree first that the Fund should be retained but reformed; second, that its operations should be more transparent and that it should be more accountable; third, that there should be a clearer delineation between the Fund and the World Bank and that the Fund should withdraw from long-term lending to developing countries. Finally, they agree that it should strongly encourage countries to avoid pegged exchange rates.

Areas of dissent across the reports relate to the circumstances in which countries should be able to borrow from the Fund and the role of preconditions and conditionality, although the dissent widens when the views of other commentators are taken into account.

What is the likelihood of reform? There has been some movement by the Fund over recent years. The image of the Fund as an institution impervious to criticism and incapable of change is misplaced. It has become increasingly open, has shown a willingness to introduce new lending facilities and modify existing ones and is in the process of reviewing both conditionality and quotas. Having said this, it seems unlikely that there will be fundamental reforms. Changes are likely to be marginal, incremental and piecemeal. Fundamental reform is only likely to be seen as appropriate in the midst of a global crisis. But in such circumstances time will not allow reform to be fundamental. Once the crisis passes the perceived need for fundamental reform diminishes. Thus it seems improbable that conditionality will be abandoned but likely that its focus on monetary policy, fiscal policy and exchange rate policy will be reaffirmed. It seems improbable that the Fund will cease to lend to developing countries altogether and pass this role over completely to the World Bank, but likely that the pursuit of closer institutional co-operation and co-ordination will continue. It seems improbable that the Fund will withdraw from lending in crisis situations but likely that it will reform the Contingent Credit Line (CCL) and encourage the growth of regional arrangements to augment international liquidity in the event of crises. Moreover, while industrial countries may be persuaded to grant a bigger say to developing and emerging economies it is unlikely that they will relinquish their dominant position in the Fund's decision making.

Just as it was the East Asian crisis that heightened interest in a new international financial architecture and a reformed role for the IMF, in the post-crisis recovery the momentum for reform will slacken, at least until the next crisis comes along.²⁷

Notes

- ¹ This section aims to provide only a brief historical account. The Fund itself has produced a series of volumes which discuss the origins and evolution of the IMF in considerable detail. For example Horsefield (1969) describes the establishment of the IMF and its early years. A useful retrospective view on the Bretton Woods system is to be found in Bordo and Eichengreen (1993), with James (1996) providing a thorough discussion of events since the collapse of that system up until the early 1990s. Bordo and James (2000) focus on the role of the IMF taking an historical perspective and discuss, in slightly more detail, and sometimes with different emphasis, many of the issues that we cover here. They also provide a useful summary of institutional details that we omit.
- ² There is, of course, an underlying issue of causation. Was it the Bretton Woods system that facilitated or even created economic success, or was it economic stability and prosperity that enabled the Bretton Woods system to survive?
- ³ At the time these problems were expressed largely in terms of export instability and adverse long-run terms of trade movements.
- ⁴ For a brief discussion of the origins and evolution of the SDR see Bird (1998).
- ⁵ Bordo and James (2000) claim that 'the best way of thinking of the IMF and its functions during the period of the so-called Bretton Woods regime (1945–1973) is not so much as an institution, but as the institutional embodiment of a system of rules (the IMF's Articles of Agreement)' (p 13). Given this interpretation, the collapse of the Bretton Woods system amounted to almost the same thing as the collapse of the 'institutional embodiment'.

- ⁶ An international monetary conference held at the Smithsonian Institute in Washington DC in December 1971 had, in effect, tried to salvage the Bretton Woods system by increasing the dollar price of gold, realigning exchange rates and introducing slightly wider bands around the new central values. In effect it was the failure of the Smithsonian Agreement that drove the global economy towards flexible exchange rates.
- ⁷ In particular, the Bank for International Settlements (BIS) had a mandate to promote international co-operation on monetary and financial issues with the objective of contributing to international financial stability. Over time a range of other institutional changes, including global economic summits involving G-7 countries, began to erode somewhat the position of the IMF. But in this context it is interesting that during the 1960s the Fund had had to fight hard to ensure that the SDR was incorporated within the IMF and that SDRs should be allocated universally rather than just to industrial economies. Even at that time swap agreements designed to provide additional liquidity to support pegged exchange rates were orchestrated largely outside the Fund.
- ⁸ Two volumes on the IMF produced at the beginning of the 1980s (Williamson, 1983; Killick *et al.*, 1984) took conditionality as their principal theme. Defenders of the Fund also based their arguments on a similar agenda (Nowzad, 1981). The question of reforming the IMF, in large measure, came down to the issue of reforming conditionality (Spraos, 1986). Discussion of other aspects of the Fund's operations did take place and was covered in the literature (see, for example, Bird, 1987a) but these other issues—such as the Fund's lending role, whether there was a moral hazard problem, and alternative ways of financing the Fund, did not excite commentators on the IMF as much as conditionality. Bird (1996a) provides a brief survey of the issues raised by the debate over conditionality and cites many of the most important studies. These include Edwards (1989), Goldstein and Montiel (1986), Gylfason (1987), Khan and Knight (1982), Pastor (1987) and Khan (1990). Edwards criticised the Fund's lethargy in keeping up with advances in macroeconomic theory, while Killick (1989) argued that the Fund had gone too far in its attack on the state.
- ⁹ Perhaps the most powerful critique came from Finch (1989). However, others argued that the Fund modified conditionality according to the strategic importance and bargaining position of borrowing countries (Stiles, 1990). Claims that Fund involvement not only reflected political imperatives but also resulted in political instability in borrowing countries were also made, although systematic evidence for this appeared to be lacking (Siddell, 1988).
- ¹⁰ Sachs (1989a, 1989b) was among the strongest critics of the IMF in the context of its involvement in the Third World debt crisis of the 1980s, and linked much of his criticism to the related concept of 'debt overhang'. Although not necessarily seeing this as part of the Fund's responsibilities, it was also in the context of the 1980s debt crisis that the idea of international bankruptcy arrangements or similar began to be widely discussed (for example, Cohen, 1989; Corden, 1988; Sachs, 1989a).
- ¹¹ Among others, arguments such as these were put forward by Helleiner (1983), anxious to ensure that a preoccupation with Latin American debt did not crowd out consideration of the Fund's role in the poorest countries of the world.
- ¹² In anticipation of its 50th anniversary 'celebrations' Oxfam took the lead in criticising the effects of the Fund's involvement in Africa (Oxfam, 1993). This, in spite of the fact that research demonstrated the complex way in which adjustment was interrelated with poverty (Demery & Addison, 1987). However, UNICEF's attack on Fund and Bank conditionality (Cornia *et al.*, 1987) was illustrative of mounting concerns that conventional IMF conditionality had a negative effect on economic growth, the implications of which for poverty could be accentuated by income distributive effects.
- ¹³ This coincided with a Washington consensus across both the Fund and the Bank about the appropriate direction of economic policy in developing countries covering macroeconomic stability, micro-economic liberalisation and openness. At about the same time, some critics of the Fund claim that it also extended its conditionality on another front by beginning to use 'political conditionality' to cover governance-related issues (Kapur & Webb, 2000).
- ¹⁴ The erosion was observed and well described early on by Feinberg (1988), with Bird (1993) summarising the institutional implications to which this gave rise. The overlap in the responsibilities of the IMF and the World Bank initially led to institutional frictions and 'turf wars'. However, under pressure from their principal shareholders, the institutions devised procedures for minimising conflict and maximising co-ordination and co-operation. One initiative was the introduction of Policy Framework Papers that were associated with ESAF lending. These have now been replaced by Poverty Reduction Strategy Papers which are designed to bring together the Fund and the Bank with the government and civil society. While borrowing countries clearly do not want to be confronted with conflicting conditionality, a more open question relates to the extent to which it is desirable to have both of the Bretton Woods institutions singing from exactly the same song sheet; some degree of differentiation may be desirable. Although some commentators have suggested that agreement around Washington consensus policies served to reduce institutional conflict (Junguito, 1996), it is also clear—according to Stiglitz (2000a)—that there was significant disagreement between the Fund and the Bank about the

appropriate policy response to the East Asian crisis.

- ¹⁵ The Fund's own internal reviews had generally been quite positive (Schadler *et al.*, 1993), although outside academics heavily criticised the evidence upon which this judgement was reached (Killick, 1995). In response the Fund established a panel of independent assessors—a rare departure—to examine the ESAF in detail. More critical of it than the internal evaluations had been, this created some momentum for reform, although the Fund appeared somewhat reluctant to fully endorse the findings of the outside assessors (Batchwey *et al.*, 1998).
- ¹⁶ Again Sachs became a 'thorn in the side' of the Fund by writing a series of articles which were highly critical of the IMF's handling of transition (for example Sachs, 1995). Claims that the USA and France had pressured the Fund to make loans to favoured clients were now matched by the claim that European economies had pushed the Fund into making loans to Russia in circumstances where there was no evidence to suggest that the 'agreed' programmes would be implemented. Institutionally the Fund responded to the needs of CRTs by temporarily introducing the Systemic Transformation Facility. To many observers this involved relatively light conditionality, a point not missed by the Fund's developing country members.
- ¹⁷ While mentioning many of the issues that were to come to dominate discussion of the Fund, the Bretton Woods Commission (1995) tended to concentrate most on the question of international macroeconomic co-ordination. Many industrial economies were, at the time, running large fiscal deficits which were perceived to have an internationally destabilising effect. Although the Mexican crisis had happened and was seen by some as a sign of things to come, there was insufficient consensus around this view to make capital volatility the dominant theme of the Commission's report. While expressing some dissatisfaction with flexible exchange rates, the Bretton Woods Commission remained studiously non-committal about exchange rate policy, choosing instead to focus on fiscal imbalances as a root cause of exchange rate instability.
- ¹⁸ Apart from Stiglitz (2000a) and Dornbusch (2000) many other well known and well respected economists contributed to the debate, offering severe criticism of the Fund. In a sense this reflected the importance attached to the issues discussed but also raised the profile of the debate. Thus Feldstein (1998), Rodrik (1999) and Radelet and Sachs (1998) were all critical of the design of IMF programmes arguing that conventional fiscal contraction had been used in circumstances where it was inappropriate. Via various papers posted on his website Bird made a similar argument. They were also generally critical of the premature move towards capital account liberalisation. Radelet and Sachs argued that overly contractionary programmes supported by the Fund had encouraged further capital outflows, making the situation worse. Feldstein argued that conditionality, whatever the merits or demerits of its contents, went far beyond what was legitimate for the Fund to require in order to stabilise economies and restore market access, and certainly far beyond what would have been required of industrial economies in similar circumstances—hence the issue of 'moral right'. Bhagwati (1998) as well as Feldstein suggested the crisis and IMF conditionality were being used to further the interests of largely US-based private capital and transnational companies. Feldstein (1998), Sachs (1997) and Stiglitz (2000b) also argued that the IMF was bypassing and overriding domestic political processes and interfering with the jurisdiction of sovereign governments.
- ¹⁹ For illustration of claims that the Fund should be scrapped, see, for example, Schultz *et al.* (1998). For an attempt to provide an analytical justification for the Fund's existence based on market failure and collective action see Bird (1995), Stiglitz (2000b), and Bird and Joyce (2001). While these sources discuss market failure relative to the possibility of bureaucratic failure, Vaubel (1991, 1994 and 1996) provides a more forthright critique of the Fund on public choice grounds. Willett (1999) offers a 'softer' public choice critique of the Fund, which emphasises appropriate reform rather than closure. Frey (1997) also uses a public choice approach to help analyse the Fund. Some commentators suggest that there is an important distinction between 'global' and 'local' public goods. The logical conclusion based on subsidiarity is that regional agencies may be better able than the IMF to deal with some dimensions of market failure. It is in this context that there have been proposals for an Asian Monetary Fund. Bird and Rajan (2000) discuss the arguments for and against such an idea.
- ²⁰ The optimum mix will differ according to circumstances. There is a compelling argument that temporary and self-reversing disequilibria should be handled via additional liquidity rather than adjustment, something that has implications for IMF conditionality. Rodrik (1996) and Bird and Rowlands (1997) discuss and attempt to estimate the statistical importance of the catalytic effect of IMF lending. The question of the optimal amount of Fund lending depends, to a degree, on the strength of the catalytic effect, but akin to the debate surrounding the global adequacy of international reserves in the context of proposed additional allocations of SDRs, it is impossible to be precise about the optimal amount of IMF lending.
- ²¹ While some commentators have suggested that it is impossible to overstate the importance of the moral hazard problem, others claim that there is no evidence to support it. Disagreement over the moral hazard of IMF lending was one issue upon which the minority report of the International

- Financial Institution Advisory Commission (IFIAC) strongly distanced itself from the main report.
- ²² One approach is to ask what functions need to be performed in order to achieve a given set of objectives and then contemplate the best institutional arrangements for realising these. For some commentators this involves reforming the IMF. For others it involves setting up new institutions (Eichengreen, 1999, provides a succinct review). Thus Eatwell and Taylor (2000) propose a World Financial Authority that, *inter alia*, would assume the responsibility of setting prudential and supervisory standards. Others see the Fund tapping into national expertise and selecting and advocating best practice. For some, the Fund's role would be that of standing at the apex of a pyramid of other agencies, some of which might have issue-specific expertise and others of which would be region-specific. Having the Fund exist alongside other agencies with related functions could also weaken its monopoly power (Stiglitz, 2000b).
- ²³ Mosley *et al* (1991) offer a comprehensive assessment of World Bank structural adjustment lending and point to a number of deficiencies. Moreover, there is evidence to suggest that, even where structural adjustment has contributed to an improvement in economic performance, this has had little to do with the World Bank (Dollar & Svensson, 1998). Reforms have served to strengthen the ESAF and there is some evidence to suggest that it may have become a more effective tool of IMF lending (Bird & Mosley, 2000, Dicks-Mireaux *et al*, 2000).
- ²⁴ As noted earlier, in a large literature dealing with various aspects of the IMF's operations, most attention has been paid to conditionality and the effects of IMF-supported programmes. However, there is probably as much that we do not know as we do. A recent attempt to survey this area drawing on all the research available at the time is provided by Killick (1995a). However, it is not enough to know whether IMF conditionality is effective or not. We also need to know what factors influence effectiveness. Why might it be effective in some cases but not in others? Collier (1997) provides a strong critique of conditionality as it has been exercised by the IMF and the World Bank.
- ²⁵ Some critics argue that the fact that the IMF is accountable to finance ministries rather than (say) labour ministries also shapes its policy advice in a globally inappropriate way, providing a deflationary bias to an institution which was originally established precisely to avoid deflation and recession. On governance, a worry may be that giving the Fund staff greater autonomy could further expose it to the public choice critique. Again, for this reason, some reformers advocate greater accountability rather than autonomy (Stiglitz, 2000b), although the two are not necessarily mutually exclusive. Helleiner (2000) and others have stressed how developing countries, and in particular the poorest countries of the world, are largely excluded from the decision-making processes of global institutions, including the IMF, where the USA frequently carries an effective veto and the Managing Director is by convention a European. The worry is that an institution which advocates good governance and democracy may itself fail to adhere to the basic principles which it expects of others. What can small developing economies do when they disagree with policies adopted by the Fund? Given their relatively poor representation in the Fund's decision-making processes the 'voice' mechanism is not available to them. However, neither is the 'exit' mechanism, since countries generally only turn to the Fund when nobody else is prepared to lend to them. Woods (1998) provides a review of governance issues associated with the Bretton Woods institutions.
- ²⁶ Vaubel (1996) provides a critique of the quota system based on the idea of 'hurry up' lending. A more rounded analysis of the quota system is provided by Bird (1987b). Bird and Rowlands (2001) discuss the idea of direct borrowing from private capital markets, while Polak (1996, 1999) advocates a more full-blown 'streamlining' of the Fund's financial structure based on the SDR.
- ²⁷ Although international organisations have a perhaps surprisingly high mortality rate overall, it is quite low for large organisations. Moreover, the longer an organisation survives, the longer it is likely to survive. The IMF is large and has been around a long time. It is most unlikely to be scrapped. But what factors affect the susceptibility of organisations to reform (Kapur & Webb, 2000)? Is international monetary reform involving significant changes to the IMF likely to occur (Bird, 1996b)? Policy makers seem to be myopic.

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