Introductions:
Marcus Noland, Peterson Institute for International Economics (PIIE)
Charles Collyns, Institute of International Finance (IIF)
Domenico Lombardi, Centre for International Governance Innovation (CIGI)

Panel 1: IMF Surveillance and Crisis Prevention

Moderator: Hung Tran, IIF

Speakers:
James Boughton, CIGI
C. Fred Bergsten, PIIE
Adam Lerrick, American Enterprise Institute
Maziar Minovi, Goldman Sachs Investment Management

Marcus Noland:  
Good afternoon. Good afternoon. My name is Marcus Noland. I’m the executive vice-president and director of studies here at the Peterson Institute. It is an honor and pleasure to welcome you all to this conference co-hosted with the Center on International Governance Innovation and the Institute for International Finance on the IMF. Charles Collyns and Domenico Lombardi will each have their own introductions momentarily.

I don’t know who selected the title, “The IMF: What Is It Good For?” Those of us of a certain generation, it immediately conjures up the Vietnam War era hit War by Edwin Starr later covered by Bruce Springsteen. The song famously begins, “War, what is it good for?” Absolutely nothing.

So while our speakers this afternoon I’m sure we’ll offer up a variety of reforms for the fund, I am confident that none of them will conclude that it is good for absolutely nothing. Indeed, our three panels will address surveillance and crisis prevention, crisis resolution and debt restructuring, and institutional governance reforms.

Again, welcome to the Peterson Institute. With this, I would like to yield the podium to Charles Collyns, managing director and chief economist of the IIF. Thank you.

Charles Collyns:  
Thanks very much, Marcus, and thanks to Peterson for hosting this event and welcome to everybody here to what should be a pretty interesting half day of activities. I was also struck by the title, “IMF: What Is It Good For?” A particularly pertinent question right now after the US political system seems to have given a pretty negative answer to that question having refused to pass IMF reform legislation.

I confess that I’m a pretty partisan supporter of the IMF having worked with the IMF for over 25 years and spent the last 4 years before joining the IFF working pretty closely with
I think the IMF is good for a lot. It has been good for a lot. It’s a critical component of the international monetary system both in terms of its surveillance function providing relevant policy advice to countries in terms of cooperation of international policies at difficult times. And also more famously, for providing financing to countries at crisis repeatedly over the past 30 years stepping up to the plate when money is needed, most recently with bold progress towards the program with Ukraine.

Having said that, I think the US failure to pass quota legislation does raise a concern. The IMF needs to continue to evolve in order to be able to continue to be an effective institution in the future. I think all institutions face a problem of getting caught up with institutional inertia failing to change with the times and failing to adapt to a quickly changing world.

Now to be fair, the IMF has certainly changed pretty dramatically over the past 10 years or so in all areas. Certainly in the area of surveillance, I think it’s become more transparent. It’s more candid. It’s broadened its range of analytical issues, much more focused on financial and much more focused on spillovers. I think that’s all good. Similarly on the financing side, it’s broadened its toolkit. It’s capable of running very large amounts of money in pretty short notice. So it’s certainly retained its effectiveness up until now. But I think there are certainly questions going ahead about whether the IMF can keep up its game.

I think we’ll be addressing those questions this afternoon in the sessions. We have some excellent panelists. In the first panel on IMF surveillance, the key question there is going to be, can the IMF evolve beyond its reputation as representing first and foremost the interest of the advanced economies, the US and Europe? Can it broaden its voice? I think this is going to be absolutely essential for the IMF to maintain its capacity to be influential, to get traction for its advice.

Secondly, on the financing side, I think there are still substantial questions open about the capacity of the IMF to provide financing at a time when many emergent economies continue to see stigma in coming to the IMF given the unfortunate history in some cases. I think the IMF needs to sort through a number of difficult issues related to burden sharing. I’m sure that will be a difficult decision. How do you distribute the burden of meeting countries’ financing needs between the official sector, the private sector, and the country itself?

Then finally in the session at the end on governance reform, how can the IMF sustain its legitimacy in a rapidly changing world in which the emerging economies are playing an increasing role? If the IMF is unable to move ahead with crucial quota reform, then I think there’ll be increasing dissolution with the IMF as an institution.

Lots of difficult topics and a great set of speakers, I very much look forward to the afternoon. Now I’m going to pass the podium to Domenico Lombardi of CIGI. Thank you.

Domenico Lombardi: Thank you, Charles. First of all, I want to thank our partners, the Peterson Institute and the IIF. Clearly given our unique mandate at CIGI, we are very pleased to cover it with you in organizing this conference today.

As way of introduction, I would say that there are three broader issues that we’re going to consider today. First on surveillance, and here, I’m doing some research I did jointly with
my CIGI colleague [inaudible 07:10]. The available evidence also in terms of evaluations we have, some of them are provided by the IEO, suggested that IMF surveillance activities as historically structured have little scope to be effective beyond those countries that depend on the IMF for approval for resources.

In other words, IMF surveillance tends to work better when it acts as amplifier of conditionality. This in part reflects the way the IMF engages with the member countries in the way that is more staff-driven rather than member-driven as well as the limited degree of authority that has been delegated by members through time.

Occasionally and I would usually say at the outset of major financial crisis, members do ask the IMF to do more surveillance to improve, to strengthen surveillance activities. Yet, those same members have been quite reticent in delegating the institution enough power to conduct surveillance in ways that might be more effective.

The G20 was believed to be a valuable complement to IMF multilateral surveillance. Yet what we have seen is that the G20’s Mutual Assessment Process is still very much a work in progress. The recent failure to implement this whole package on IMF governance reform risks undermining the implicit contract that came with the elevation of the G20 at the leaders level, that is, advanced economies would provide more voice, stronger say to emerging economies, and the latter would take more responsibilities vis-à-vis the global economy.

Now, with this whole package on hold and other reform packages equally on hold, I think what we’re going to see is an increasing spreading debate on regional and plurilateral financial arrangements on the one hand. Then on the other, we might see and we’re already seeing increased central bank cooperation. Yet without a legitimate anchor as the IMF can be and should be, we’re bound to experience increased defragmentation in international financial architecture.

Finally, the third topic that we’re going to focus on today, debt restructuring, I would say that for the first time in several decades, we are witnessing escalating debt-to-GDP ratios in advanced economies. Many are localizing the euro area where we have, of course, low growth, very low inflation, and high debt stocks. As you know, there has been so far in almost dichotomic approach between statutory mechanisms and market-based approaches, here at CIGI we have been trying to provide some alternative views, some more eclectic views that leverage on market-based incentives while at the same time providing some structure albeit informal coordinating mechanisms. There is one paper that has been done by Richard Gitlin and Brett House that is available at the reception desk.

Anyway, at any rate, I don’t want to preempt the debate. I again want to thank our partners. Before I do so, I can’t help but notice that today as we celebrate the IMF at 70 and we have a hashtag for that for those who are going to tweet. Former Fund historian and now CIGI senior fellow, James Boughton, is turning 70. This must not be coincidence, of course. So, happy birthday, Jim, we’re honored to have you at CIGI and to have you speaking at this conference. I’m going to call on the first panel which Hung you’re going to chair. Thank you.

Hung Tran: Well thank you very much, Charles and Domenico. It is my honor and my pleasure to moderate the first session on the IMF and surveillance and contribution to crisis prevention.
We are very lucky to have a panel of very distinguished speakers with us today starting with Fred Bergsten. One of the jobs of a moderator is to introduce speakers, but with Fred since we are all sitting in the room named after him, there's no need for introduction. The other speakers, James Boughton, happy birthday, James, and Adam Lerrick and Maziar Minovi, they had detailed bios in the brochure outside for you. So to save time, you can refer to them for their particular.

The subject today is surveillance as one of the core activities and mission of the Fund. I proposed to the panel to look at, at least, four key areas, and of course their statement they can refer to any other observation if they want to, but at least four key areas: One, taking stock and looking at the track record of IMF surveillance over the past 70 years. The quality, the relevancy, the accuracy of the assessment; the diagnostic of the surveillance, and the forecast; also looking at the usefulness, efficacy of surveillance, particularly in contributing to encouraging countries to implement right policy, and major countries in coordinating policy so as to reduce macroeconomic imbalances.

Second area would be to look at the merit or dismerit of reasons Fund’s initiative to improve its own surveillance activities including several things that Charles and Domenico already mentioned, effort to do multilateral surveillance and how those that relate to the G20 MAP (Mutual Assessment Process) and financial surveillance where the FSAP program at the Fund is now trying to make FSAP mandatory and not voluntary. I understand that 29 countries now have agreed to have mandatory FSAP every two years.

Last but not least is the contribution of all of this to crisis prevention, how effective has it been, particularly how relevant and how effective Fund’s surveillance country report, communication about its assessment of debt sustainability analysis for country that have or not have market participant to avoid mispricing of sovereign credit risk, which we learned one of the contribution to many sovereign debt crisis.

Just to have the token by perspective voice in this debate, we would like to know also from private sector perspective how participant in the marketplace view the relevance, the usefulness of the Fund, its activities, its communications and so on, to what they do day in and day out. You already realized that we have four speakers and have four areas. My hope is that each of the speaker in their opening remarks would try to address the issue most relevant to their perspectives and experience. Of course, they can offer their views on anything else that they want to do.

Without further ado, I would like to start with James, the historian, to do the stock-picking. James, the floor is yours.

James Boughton: Okay. Thank you, Hung, and thank you, Domenico, for the birthday greetings and others. Five years ago at the time of the 65th anniversary of the Bretton Woods Conference, I was giving a talk at the Mount Washington Hotel where the conference took place. And somebody came up to me after my talk and said, “Where you there at the conference?” I thought, wow, I hope I don’t really look that old. Five years have gone by and I still don’t feel that old.

Just for the record, I was three months old when the conference took place and I was not there. I have had an opportunity to get some historical perspective on these issues I’d like to share with you in these few minutes this afternoon. In the first history of the Fund written
by Keith Horsefield in the late 1960s, he referred to consultations with member countries. They didn’t call it surveillance yet, but that’s what he was really talking about. He described those as the backbone of the work of the IMF.

I think it’s true that even now most people think of the backbone of the work of the IMF being lending to member countries. The IMF has about a trillion dollars’ worth of assets to help solve problems. At least the old-timers around the IMF still think of surveillance as the backbone of the work.

When I started writing history of the 1980s quite some time ago now, I wanted to put the story of the Latin American debt crisis first because I thought that was the most important part of what the IMF had done in the 1980s. I was told in very strong terms by the higher-ups that I had to put surveillance first, that that was the main story and that the Latin American debt crisis was just sort of cleaning up the mess once surveillance didn’t work.

What I’d like to emphasize at the beginning here is to think a little bit about why the IMF does surveillance and how it’s supposed to work. The original articles of agreement drafted at the Bretton Woods Conference almost 70 years ago specify that each member country was to set a par value for its exchange rate and was to force where the use of exchange restrictions on current account transactions.

The articles gave each country some time to adapt, to let their economies develop after the war to a point where they felt that they could … where the leaders would feel that they could do without imposing exchange restrictions. Those countries which were called Article XIV countries because that was the provision that let them have extra time, those countries agreed to consult regularly with the IMF on their plans to get rid of exchange restrictions. That became the backbone of the work of the IMF.

In 1961, the Fund started doing voluntary consultations with countries that had already agreed to the full set of articles and not to use exchange restrictions. I think it’s useful to think of that activity, these voluntary consultations, as kind of soft surveillance as opposed to the hard surveillance that certain countries were required to have with the IMF.

Those consultations, the soft consultations with Article VIII countries, evolved into something that became very useful for the IMF to use to try to convey to the whole membership, to the whole world community if you will, as to what was going on in the major countries because that was defining how well the system is going to work. The soft surveillance became a much more important part of what the IMF was doing.

Then in 1978 when the articles were rewritten, then every country became obligated to have annual consultations with the IMF. The hard surveillance was limited to obligations that countries had to meet certain obligations with regard to exchange rate policies. The consultations themselves dealt with a much wider range of issues. They dealt with monetary policies, fiscal policies, where countries didn’t have obligations to conduct those policies in a specific way, but they did have an obligation to discuss those with the IMF. That kind of surveillance sort of grew into something much more important.

The IMF also started doing what it came to call multilateral surveillance. This was mainly through the World Economic Outlook and then later on through other publications. That
evolved into meetings with originally with the G5 group of countries in the 1980s and much more recently with very regular work that the IMF does with the G20.

Surveillance started … now the point is surveillance has kind of grown over time from a very well-defined specific kind of activity with certain countries into a much broader range of activities—some of which is hard surveillance, meeting the obligations of the articles; some of which is soft surveillance, just trying to advise countries, inform countries, inform the general public now which was never part of surveillance in the early days. So it’s this whole range of activities that now that is the primary activity of the IMF.

Crisis prevention which is what we now want to focus on as a major goal of surveillance is in a way an afterthought. It’s not the main purpose of surveillance. It’s not hard surveillance. It is a very important part of what the IMF now does.

Overall I would summarize all these by saying that surveillance, modern surveillance, in today’s world has four purposes. First is the IMF was to advise countries on how to improve their policies. That activity is most useful to smaller countries that are willing to accept the kind of advice that they might get from the IMF. Secondly, a function of surveillance is to warn countries when the IMF concludes that their policies are off track. Third, to evaluate the consistency of policies across countries that’s mainly useful to groups like the G20 and to the general public. Then fourth, to convey key messages about what’s going on to the membership at large and to the general public.

It’s a strange kind of creature surveillances. It certainly has arms. It reaches out to the whole world in the way it acts. It certainly has legs. It’s lasted for a very long time and is expected to continue to do so. It may even have a heart and soul, although we can argue about that for a long time. What it does not have is teeth, that the … you know, it’s really not much more than what Teddy Roosevelt called in speaking about the US presidency. It’s not much more than a bully pulpit. The IMF can tell countries what it thinks are doing wrong. It doesn’t really, unless lending is involved, it doesn’t really have the power to tell countries how they have to act.

The messages that come out of surveillance are limited by the willingness of countries to hear those messages, and I think that’s a key point that we need to keep in mind as we discuss what the IMF might be able to do to make surveillance more effective. I mean I personally was involved in a number of cases in my 30-year career with the IMF in which countries were very clear that they didn’t want to hear those messages. Sometimes that led countries saying we don’t want to have a consultation and the IMF would wait, years sometimes, before they would be allowed to set foot in a country, other cases where the messages would be censored either directly by the country or by sort of self-censorship by the management of the IMF. There have been many, many examples of those.

I just like to sort of throw out the question about whether this is necessarily a bad thing. The IMF is a public institution. It’s not a private sector think tank. I’m sure that Fred would agree that if the Peterson Institute had a trillion dollars to use to try to get its messages across that people would probably pay even more attention to it than they do today.

Fred Bergsten: Well …
James Boughton: Think about that, Fred. So the IMF is limited but by the fact that it’s limited, it also has a lot more clout because governments have been willing to put a lot of resources into the IMF on condition that these limits exist. There’s a conflict between how much truth telling the IMF can do in private and how much truth telling the IMF can do in public.

Just to give you one very quick example. In 1997, the IMF perceived that Thailand was getting into a deep trouble with its policies that the exchange rate was becoming overvalued. The financial sector was getting into trouble. Camdessus went to Bangkok to convey this message. Stan Fischer went to Bangkok to convey this message. Missions went to Bangkok to convey this message. The finance minister simply did not want to listen to that message. That gave the IMF a choice. Do we go public with that message or do we simply say we’ve done all we can? They chose to stay quiet with that kind of message because they felt it would be counterproductive to sort of say publicly that they thought that Thailand was about to blow up. Thailand of course did blow up. We had the Asian crisis that followed. You can do a lot of soul searching. This gets into the soul of this strange creature. But that was the kind of trade-off that they were worried about.

The other thing to remember just to finish this up is that we have to remember that it is not always the case that the IMF is right and the country is wrong. That the IMF might go to a country and tell the finance minister that they think the policies were off track that a crisis is coming. They might be wrong. There was a time back in the simpler world of fixed exchange rates when you could kind of rely on adding up constraints and arithmetic and financing constraints and say this situation is unfinanceable. We don’t live in that world anymore. The IMF has to be cautious and make sure that when it conveys a message strongly and publicly that it’s going to be on the right side of history.

I would just conclude by saying that I think to strengthen surveillance today; there are two things that need to happen. Both of these things are happening but should probably happen even more. One is that we need more acceptance by countries of the idea that a candid and public assessment by the IMF is not something to be feared. That just because they disagree with the message, just because markets might react to the message doesn’t mean that it’s a message that should be suppressed. I think the IMF has done a lot to try to get that idea across, but there’s more that can be done.

Secondly, I think we need better analytical methods that the IMF has to recognize that it’s dealing in a complex world that it’s trying to give very complex messages. You can’t simply say these are our conclusions and these conclusions are right, and therefore, we can move on.

I tried to convince Tim Geithner of this one. I was working with him at the IMF years ago. And he looked at me and he said, “Do you mean to say that the IMF has existentially adrift?” And I said, “Gee, I think that’s exactly what I’m saying.” So that’s my final message that I think we’re all existentially adrift here and need to recognize that it’s a complex world and we don’t have all the answers.

Hung Tran: Well, James, thank you very much for a very concise 70-year history of Fund surveillance in 10 minutes. I would propose to ask Maziar who is managing director of Goldman Sachs Investment Management to speak next. Maziar.

Maziar Minovi: Sure. Thank you. Thank you, Hung, and thank you, James, for that great history that though there wasn’t a marked need to understand much more about. Hung was very kind to introduce me as the token private sector guy. I think Tim Adams was much more honest when we were talking about the role and he said sacrificial lamb from the private sector.
In that vein, I’d like to say that anything I say today are my own views, not the view of the institution I’m associated with.

In preparation for today, I thought I’d look around my colleagues in the market and ask them what thoughts and ideas they had about improving IMF surveillance and crisis prevention. About 70 percent of the reaction was just a blank stare back. “What do you mean? That’s not a concept anybody really focuses on.”

I think the best answer I got was from a colleague who I said I knew I had the right guy. He had been at the Fund for years. He had been at the market for over a decade, very thoughtful. I told him about the session. He looked at me and he said, “Well, I disagree with the entire premise of the title. What do you mean crisis prevention? Why would you want to prevent crises? These are good things. If it wasn’t for crises, we wouldn’t be in business.” He went on to say that the trend growth … GDP growth of emerging market countries would be lower if crises were prevented. Not surprisingly, he studied in the University of Chicago.

Speaker: He’s not at the Fund anymore.

Maziar Minovi: Not at the Fund anymore, no. I realized that the market is not the direct audience for a lot of the efforts underway in improving market surveillance at the Fund. To the extent that we are involved in the capital of flows that both create crises and hopefully prevent them and reward countries for the right policies they do, hopefully we can add some value here.

I wanted to start with some perspective and say how much things have improved over the last 20 years, but that pales in comparison with what we’d just heard. Just in thinking about the session, I remember that back in the early to mid ’90s we were trying to understand more about Russia and how the economy was going to go with the debt situation. Believe it or not, we couldn’t find anyone at the IMF who had either had the experience on the ground there or was willing to talk. Of all places, we had to go to the World Bank to find someone. Things have changed quite a bit from back then.

How much does the Fund surveillance factor into our day-to-day decision-making and work, and how the changes there have impacted us? One caution I’d start out with is that the markets obviously are not a ubiquitous entity. Various different parts of it whether you’re a hedge fund whether you’re a real money fund or all of the alternative versions in between have a very different take on this question.

I’d say by and large, I wouldn’t be exaggerating if I’d say the vast majority of market interaction with the Fund and Fund surveillance comes in during our focus on program countries. That’s when the frequency of the output from the Fund is much more relevant from a market perspective, and frankly, that’s where the focus and attention of Fund resources seemed to be much more alive and useful in terms of directing capital flows.

I’d also add one other element which is the FCLs. I know there was a long history in convincing countries to be signing up for this sort of facility. When I had a short stint at the Fund, there was an ill-fated attempt to doing this. Actually FCLs are one element I think the market does has absorbed, does keep into account, and for us and many others when we for instance do our external vulnerability analysis, we put in the FCL as a reserve substitute. Whether or not that’s true when push comes to shove remains to be seen. There is an example of a crisis prevention tool that I think has been quite effective.

Aside from that, yes, there has been lots of improvement. We have the EBAs now, the DSAs, much more forward-leaning approach by the Fund, conference calls with mission
chiefs and key authors of certain reports. I’d say in terms of day in and day out interaction, that has certainly not added much beyond the program countries to a lot of what we do. Of course, the G20 related work also while very relevant and at least markets were focused on it in late ‘08–’09, maybe beginning of 2010, I don’t think that anybody is really paying attention to much of the work that’s coming out of there.

I realized that there is a tension between the dual roles of the Fund of a trusted advisor and also a credible surveillance mechanism. I think no words that better demonstrate it in the example James just gave in Thailand. In the crisis, we were investing at the time there. Certainly before the crisis hit, we and most others had no clue of the severity of the problem.

I find it actually frankly somewhat illuminating when in the same panel and conference we talk about dealing with situations where the poor short-sighted markets misprice credit. In reality, in a situation like Thailand, well, one of the factors that contributed to the mispricing of credit was the withholding of information like that from markets which certainly would have priced Thai credits and currency in a different way. Now, clearly, a transition from here to there can’t be instantaneous but I think that both sides here have to have to do a little bit more navel-gazing.

Another area where I think this dual role between trusted advisor and credible surveillance creates some tension and some … as the Fund is starting to think about further reforms, maybe we should think more about is in this whole debate about private sector involvement. I’m not going to go into the merits of this. I’m looking forward to hearing the views of the panel next.

I’m always struck by this initiative at least talk of now having a presumption of a bail-in possibly come into account when you have Fund programs and possibly unsustainable debt situations in countries. Because while from a trusted advisor point of view one can understand the desire to reduce the cost of restructuring and prevent a bailout of private investors in an indiscriminate way, let’s not kid ourselves. Even if a fully integrated private sector involvement process is in place, two things are going to happen.

One is that most of the debt of these countries is going to be issued by definition when things are going very well, therefore very little likelihood that the credit will be priced for that eventuality. When a whiff of a crisis comes given the impossibility of understanding ahead of time what’s a liquidity crisis and what’s a solvency crisis all that a possible solution like the PSI initiative is going to achieve is going to be hastened the point at which a private sector escapes.

Because if there’s one thing that private sector all agrees on, capital markets agree on, is that they hate uncertainty. If there is more and more likelihood that they’re going to be bailed in, they’re just going to leave earlier when you need them to stay in the most. That’s not to give a policy prescription but just a practical thought to have in mind as that debate goes on and as we think about what the Fund is trying to achieve going ahead for a crisis prevention.

Another example of this if we’re talking about it now is Ukraine. The Fund is obviously front and center in its role as a catalytic motivator of markets and trying to keep private capital in. There’s a strong tension between that and the possibility that when push comes to shove we may see some Fund-induced bail-in. Obviously, no one is talking about that now, but there needs to be some appreciation of that tension as we design the way ahead.
What are some other practical thoughts and suggestions that at least from a private sector point of view would make sense? I know this is politically difficult. As I said, I've been at the Fund for a while. If the idea of something like PSI is to insulate the discussions and better delineate what the staff sees on the ground, the market would very much appreciate actually more transparency in delineating not only the difference between the staff’s view and the authority’s views, but also frankly the difference between staff view and management and the board view. I think that would be quite a useful piece of information for the market. Clearly, again, this tension there with the trusted advisor role I think that may be something that … something to keep in mind in debate.

Another question is … another interesting possible addition for surveillance is on currency valuation. We constantly hear this refrain about how markets just pile into particular currencies when rates are high and things are good. Then they just as quickly escape when the situation reverses. True. Guilty as charged. What can the Fund do? For instance over the last few years, a lot of smart brains have been focusing on a currency valuation approach at the Fund. There are multiple ways that they do it and they internally discuss all of the results, but these results are not published.

Now, we all know that currency valuation metrics are not great determinants of future profits in trading currencies. If the Fund actually on a regular basis were to publish its results on the currency valuation … from its currency valuation metrics and update it with some frequency, let’s say, at the WEO publication, that actually may find its way into quantitative trading models and investor’s models who would then have those valuation numbers that are consistent with what the Fund sees lean against the enthusiasm during times of plenty and when capital is flowing and vice versa.

Now, I understand there are sensitivities there about calling out countries not being comfortable with calling out overvalued currencies. There are certainly obvious practical decision rules that can be applied. Let’s say we only will publish everything between plus or minus 10 percent and every year widen that band, or we would only publish it when it comes to down to 15 percent or something like that; decision rules that try to address those concerns. That’s a practical suggestion on surveillance that could help.

Data quality. Nothing could put market participants asleep faster than talking about data dissemination and data quality in emerging markets and developing countries. Certainly in particular areas where there’s particular cause for concern and the Fund has reason to think that that area could be a market moving or at least an event sort of data that whose release will help the markets put pressure on the governments to do the right policies may be more of a warning, more of a public warning, in publicizing of what the Fund sees as a useful tool.

For instance, is there huge amount of off-balance sheet open at currency positions in Indian corporates and banks right now? Maybe the data isn’t there, but the fact that it isn’t there and the IMF is worried about that if it was done in a systematic way across the range of countries and highlighted I think could be an improvement. Why don’t I stop there?

Hung Tran: Well, thank you very much, Maziar. I would like to invite Adam Lerrick, currently the visiting scholar at the American Enterprise Institute. Adam has been invited to provide highly critical but reasonable assessment of Fund surveillance. Adam.
Adam Lerrick: What Hung didn’t say is that he and I actually worked together more than 20 years ago at Salomon Brothers. As Hung said, Adam Posen sent me an email saying he wanted a highly critical—30-years ago, all right—highly critical but reasonable voice. I wrote back based on my view of the Peterson Institute and the others and the IIF and CIGI, I would have thought you would consider that a null set and that no one could meet that criteria. Adam replied back. “No, no, no. We want someone who has faith in markets,” as thought that was an endangered species. Let me say I have absolute faith in markets even though I started at MIT and maybe that’s just a reaction.

I’m going to talk a little bit in more general framework about the Fund’s crisis prevention activities. I think the Fund has done in my view one thing that is very valuable in preventing crises and that’s its contribution to setting information standards; that by forcing countries to collect information, publish information about their government finances about their financial systems, the Fund has improved the quality information and increased the speed of its flow.

As we all know, markets hate surprises. Surprises cause panics. Anything that provides markets with more information is going to prevent crises. They’ve set standards for disclosure. They disseminate the results. That has been extraordinarily helpful because it allows investors to take corrective action before large losses materialize.

After having said a positive thing about the Fund, I’m going to revert to form and say that I believe the Fund has been a source of great instability and source of crises. I think that by its intervention, meaning by its financing, it has increased the frequency and severity of financial crises. I want to talk a little bit about why I think that is and what we’ve learned over the last four years, which is a little different than in the emerging market crises.

In the last four years, we’ve gained a tremendous amount of technical knowledge. We know how CDS work. We know how leverage works. We know about settlement risks in clearinghouses and contracts between financial institutions. We even have figured out ways to value and restructure defaulted collateral at central banks.

In fact, I learned something very interesting technically in Cyprus which Athanasios is going to know but most people wouldn’t, which is that when you go to Cyprus and there is a crisis, you first go to the finance minister. If you convinced him, he sends you to the president. If you convinced the president, the president sends you to the archbishop. The archbishop is the one who has the final say.

What was interesting about the archbishop was he was clearly the smartest businessman of all of them because when I explained to him that this banking system needed to be restructured and large depositors need to become equity holders in the banks, he nodded. He said he understood. He said he agreed. Then as soon as I left, he called up the president and negotiated an exemption to the bail-in for the church. Therefore, he was very good about this.

We’ve gained all this technical knowledge, but we’ve gained very little knowledge about the core issues that prevent crises and I would put them in two forms. The first is that more … you need more information so markets can anticipate problems. The second is that you need incentives that reward stabilizing behavior and penalize excessive risk taking. On those two scores, I think the Fund and the official sector’s general rule has failed miserably.

If we look back at some of these issues in particular in Europe and I’ll now single out another institution so as not to be ganging up on the Fund, I want to talk about two aspects
of the ECB that are ongoing right now. The ECB is in the midst of conducting reviews of the solvency and stability of the banks. There's a huge debate how do they make their reviews credible, and really, that's a secondary issue. You could resolve that issue very easily. If the ECB simply published its reviews, published all the underlying data on each one of the banks, then the markets would decide which banks were solvent and which weren't, which ones needed capital and which didn't, and then how the ECB actually performed in view of secondary issue.

The second is something that is now in the press which is the ECB has proposed that there be, for banks that are undercapitalized but solvent, that there be temporary bail-outs that we don't want to fine the markets. If we have a bank that cannot meet its capital standards but is solvent, the official sector, the taxpayer, is going to step in and provide capital on a temporary basis until the bank can raise capital from the private sector.

I think that's the exact wrong response. I think if a bank is just in temporary need of capital, then there should be a temporary bail-in is the right response. The debt holder should be temporarily converted to equity until the necessary capital is raised. If the need is truly temporary, then the former debt holders will have the option of either keeping their shares or just reverting to their original claims at no loss.

The third example which I think is really quite telling is Greece. I view Greece as moral hazard turbocharged. Right now, you have a country where the debt is clearly unsustainable. The government is clearly insolvent. Yet at this moment, they're going to go to the markets and borrow new funds from investors who are going to fall over themselves to buy bonds at somewhere around at 5 percent interest rate which is only going to increase Greece's insolvency. Yet why is that?

Well because markets believe that in the case of Greece, the bondholders are now the senior creditors and the official sectors are the junior creditors. It's the reverse of what we were talking about, that the official sectors are supposed to be the preferred creditor. That all losses from here on end are going to be paid for by the taxpayers. Greece's return to the capital markets is a policy failure. It is not a success of the policy over the last four years.

I've asked myself. Why does the official sector shy away and the Fund in particular from the obvious responses, which are just giving markets more information and just letting markets take their lumps when they make bad decisions? I thought about this for a while. I remembered when I was five years old my father sent me into the barn to start taking care of the horses by myself. He said “always remember horses are very big, very strong, not very intelligent, and easily frightened. And that makes them a danger to themselves and to others.” That's the way the official sector views markets. They're big, strong, stupid, and easily frightened. Therefore, they are danger to everyone around them.

What they do is the official sectors constantly out of fear of causing a crisis, their policymakers are always hesitant to give markets too much information because that might tell them something and they'll start running, or to force markets to bear the full risk of their decisions, or to enforce clear rules and incentives. Making sure that markets are never frightened is not a policy that's going to prevent crises. It's only going to make them more severe and more frequent.

Until the official sector has a better understanding of markets and more confidence in markets that they can assimilate information correctly, they're only going to increase the … the official sector is only going to increase the uncertainty and endanger the stability they're trying to create. That's why policymakers … there's a phrase having been to many of these meetings, as Fred has and many of you have, a crisis is coming. A potential crisis is coming.
You look out and they run to the Secretary of the Treasury or the head of the IMF and everyone runs in with fear in their eyes and that causes a bail-out. What really happens is the policymakers confuse the end of their world with the end of the world. That’s the danger.

What I think we should do is that we need to make sure that markets are given more information and that the official sector moves out of what I call financial prehistory. Most of the official sectors still think that if a group of policymakers and the heads of few major banks get together, they can basically decide what’s going to happen. That was true in the 1980s. It was maybe true in the 1990s. It’s not true today. They cannot control the markets. They have to learn to use incentives to help the markets and to work with the markets. Otherwise, we’re just going to have more and more crises. Thank you.

Hung Tran: Thank you very much, Adam. I’m sure that we will come back and ask you some critical questions as well. As you realized by now, I have saved the best for last. Fred is going to tell us what he wants us to listen to him, so, Fred.

Fred Bergsten: Well thank you for that, I guess, compliment. Like Adam Lerrick methodologically but not substantively, I do want to address a little broader set of topics than just surveillance. I want to go back to the topic of this conference, what is the IMF good for. I want to suggest three things it is good for, three things it is not so good for. That would lead me back to surveillance and some fairly radical suggestions on how to improve the surveillance process.

I think there are three things that the Fund is very good for. One and it’s been mentioned is intellectual leadership. When policymakers and individual countries or thinking about the global economy what [inaudible 55:02] post. Where is the world economy going? What are the problems we face? What are options we’re dealing with it? They go to the IMF. The G20 does it. The G7 does it. Most national governments do it. The media do it. Almost everybody does it. So intellectual leadership is a clear public good provided by the Fund.

Secondly, technical assistance for many of its member countries. I’ve just been a few weeks in Barbados in the height of the winter snowstorms incidentally here. My timing at least was good. I was impressed by the extent at which that little country, 300,000 people, benefits from IMF technical cooperation. I didn’t know but there are 50 countries in the world with populations of a million or less. There are a lot of others who are not too much beyond that threshold. Those small countries in particular but lots of others and notably now like Greece, Ukraine; do rely on the IMF for technical help. That’s another clear public good we get from the IMF.

The third and then by far most publicly aware aspect of Fund contribution is, of course, crisis response. The Fund doesn’t always get the crisis response right. I think its ability to reduce the cost of crisis to crisis countries themselves, reduce spillover effects to the rest of the world, take the blame for the pain that’s inevitably required in the adjustment process, all those things make the IMF unique and in fact is one of the great successes of international economic cooperation in the last 50 years.

That I think is an unambiguously a huge benefit when the world as a group can collectively respond to national crises even in small countries but particularly when they affect the system as a whole. That I think is an unalloyed benefit. Even if the Fund doesn’t always get it exactly right, the function is clearly a huge benefit. I regard it as one of the great successes of international economic cooperation.

The other great success, I think, of international economic cooperation is the dispute settlement mechanism of the World Trade Organization, which is truly unique in the world. It
was agreed only 20 years ago. At that time, the world’s countries agreed to put teeth into their international trade institution. Though the WTO is now criticized widely for its failure to achieve global trade liberalization, it has a dispute settlement mechanism that is universally respected and praised. The WTO is clearly good for something resolving trade disputes among its members. Even our Congress—and I’m going to come back to that—even our Congress sometimes grudgingly but approves, applauds, supports the dispute settlement mechanism of the WTO.

I mean right now, they’re putting up a lot of money for the US to pay Brazil because the US violated its WTO obligations in the famous cotton case. As the Congress writes the Farm Bill, one of the most politically charged pieces of legislation in the United States, they’re going through every possible contortion to conform to the WTO dispute agreement on the fact that the US violated the rules and Brazil is owed US reforms.

The problem is there’s nothing like that in the IMF. Jim put it properly when he said except for cases where the Fund is lending to a program country and that was my crisis response to which I regard as very positive, except for that, the Fund has no teeth. That points, I think, to one of its key weaknesses and why it is so different, in a negative sense, from the World Trade Organization.

The IMF cannot enforce its own rules even when violations are clear. My favorite, of course, is currency manipulation when China or a whole number of countries blatantly violate the most fundamental IMF rule, namely, thou shall not competitively devalue. There’s nothing, nothing that the IMF can really do about it. That in turn I think relates directly to the IMF’s two other key problems, the first being the lack of enforcement tools. The other two are its failure at crisis prevention and its failure to be an effective system manager, a manager of the international financial system, which in broad terms it should be.

Now when I say it is weak at crisis prevention, I do not mean that it should be able to predict a subprime crisis here or the trigger that will lead to an outbreak of financial disruption in Thailand to anywhere else, though in that case they were ahead of the curve. Nobody can really predict in precise terms when a crisis is going to emerge. The IMF’s intellectual firepower, as Jim indicated in the Thailand case in 1997, can frequently see an imbalance emerging, describe it to the country involved or countries involved, maybe go public if that were the chosen course, but provide the foundation for effective crisis prevention.

Again, they may get it wrong sometimes. They may be false positives. They’re always nervous about going ahead because of that. Many times they will see a crisis coming. They have no mechanism through which to get the countries who need to change policies to do so. The lack of enforcement tools where in this case countries may be violating their obligations to maintain stable financial policies, policies that are consistent with the rest of the world, et cetera et cetera, the Fund has no mechanism to do that.

Again, the currency manipulation case is a very clear example. It led or at least contributed importantly to huge international imbalances. Those international imbalances in turn played an important role, some would say a decisive role, in the onset of the great risk of the financial breakdown in ’07–’08 and the global crisis. Yet, nothing was done or was able to be done to head that off despite much discussion on it within the Fund.
It was not for lack of effort. CIGI, our colleague in this conference today, has published a superb book that I refer you to. Paul Blustein did it. It’s called Off Balance. Among other things, it has a detailed play by play of the IMF’s effort to deal with the currency imbalance problem, the currency manipulation problem, the huge global imbalances in the run-up to the crisis in ’07–’08. They actually got closer than many of us realized at the time. They failed and they were unable to head off a systemic breakdown. They were unable to provide effective crisis prevention because in part they did not have a dispute settlement mechanism and tools to get their views adequately acted upon in their member countries.

Now that’s where surveillance comes in, because absent an effective dispute settlement mechanism or enforcement tools, or lack of teeth in Jim’s terms, the IMF is constrained to pursue sweet reason. You try to persuade people to do what you, the Fund, and many of the members think is correct. That is the surveillance process. It is a weak sister, a poor substitute for being able to act more forcefully and effectively to get good policy advice accepted, head off crises, strengthen the world economy.

I think the Fund management, the staff, many of the member countries had been extremely creative in figuring out ways to run the surveillance process, to change it, to strengthen it, move from bilateral to multilateral—all sorts of different devices had been tried. At the end of the day, it’s a poor substitute for something more forceful because it leaves governments free to do what they want to do as Jim has said.

Now, some people would say, “Well but that’s inherent in the business. Governments are sovereign. They’re going to do what they want to do. How can you get them to do anything different no matter how smart you may be, no matter how persuasive, no matter how many countries you may have on your side telling them—particularly if they’re a big country—to do something different?” That leads me back to the WTO.

The member countries of the WTO did agree to exactly that. They agreed in the Uruguay Round to have their domestic decisions overridden by an international institution. Moreover, by panels of experts, not high politicians, panels of experts coming to judgment as to whether they violated the rules. There are appellate bodies and there’s this whole legal process. When it is appealed to, when it is acted upon because the country complains, it plays its way through and its dictates, its decisions are almost always honored by countries ranging from the United States to India to China. Virtually everybody agrees to play by those rules.

How can it be that countries will agree to have their solemn sovereign domestic trade policy decisions overridden by an international compact, a charter, in the case of WTO charter, and an international quasi-judicial process? How can it be they do that but not in the IMF? Why not try it in the IMF? Why not try to put a somewhat similar set of devices into the IMF?

What that would mean is really just two things. It would mean putting some mechanism for dispute resolution into the IMF system so that if country A complains about country B’s currency manipulation, they can raise the issue, have a panel judge it, and decide whether there is in fact a violation.

Then secondly, of course, you need sanctions. You need effective mechanisms to enforce those judgments so that the violating country has some penalty to pay. You can’t even in a WTO case force a country to change its policy. If it refuses to change its policy you autho-
rize retaliation against it, compensation for the cause that levies on others, and you make it pay a price. My radical thought is why not do something like that in the IMF?

My final point is that it may turn out to be necessary to do something like that in the IMF. I say that because of what I regard as an existential crisis that the IMF now faces because of what happened in the US Congress over the last few months.

I regard the Congress' rejection of the IMF legislation and the failure of the administration to bring that administration forward for over three years and then not push it adequately except at the very last moment, building on the fact that the US tried to block the 2012 Lagarde initiative to raise money to support the Fund's resources as it looked at that time might be necessary. As I looked at the political outlook here in the United States for upcoming congressional elections, maybe the next presidential election, this may not be a short-term problem.

This may be a time in which the United States effectively leaves active participation at least at the margin in the IMF. It will then pose what I would call an existential issue for the IMF: should it proceed without the United States? Now, my colleague, Ted Truman, has some ideas on that. He's going to talk about it in the governance panel later. Ted and I jointly authored a piece that's out there on the table for you to pick up and look at. It's got several ideas in it for how that might proceed.

I think if those questions that I raised about the Fund's effectiveness are not answered, that existential problem may continue. Remember that the failure of the Fund to deal with the problems that I mentioned today has led to not one but two huge Congressional reactions. Congress seeing the IMF unable to deal with the currency issue—just to stick with that one—has now insisted majorities; bipartisan majorities of both houses of Congress have insisted that all of future US trade agreements include enforceable currency manipulation disciplines.

Many people think that would kill the whole trade agreements program. It would certainly change it in a big way. That is an act of frustration that the institution that ought to deal with the problem, the IMF, has not done so, and now comes this rejection of the IMF as a whole by the Congress not pushed very hard by the administration. That more broadly reflects an existential threat in my view.

These are not theoretical problems that we talk about today. They're real world problems in terms of economic impact, but their political spillover that now in the largest country in the IMF, its traditional leader, without which it is hard to see how the kind of positives in the Fund that I talked about continue will continue. That, I think, is a problem that we ought to discuss as much as we can, including in this conference today.

Hung Tran: Well thank you very much, Fred, as I said, saving the best for last. I would just sum up three main takeaways that I have containing some questions for the panelists to come back to and then open up for at least the first round of questions I will collect several and then ask the panelists to address them, yes. People in the front will have traveling mics and people in the back will go to the standing microphone to ask your questions. Please state your name and affiliation.

My three takeaways is, number one, it looks like there are several areas of agreement that sharing information, sharing staff, or Fund's assessment of the economic prospect potential
risk including to some extent the debt sustainability analysis of country preferably program
countries. All of that will be useful. Then, my question is to what extent sharing informa-
tion will not inadvertently trigger the precise collapse of confidence that that Fund and
countries try to avoid, so number one.

Number two also from the discussion particularly from my vantage point, it seems to me
clear that Fund’s surveillance and advice and warning, particularly early warnings to au-
thorities, can really benefit and make use of market signals including CDS preps, including
ratings by the agency, including discussion with their investor base and so on and not resist
or not fight market signals the way we have seen particularly from many countries. I think
the Fund can have a useful role here to somehow make full use of market signals to help
country authorities take actions early on a timely basis to ward off crisis.

Last but least, everyone agreed that the Fund should be given more teeth and one clear pre-
cise proposal from Fred is to make it more like WTO with dispute settlement mechanism
and sanctions. We would like to hear your view on that as well. My own prediction which
I feel very safe to make is that the US Congress will love it when you put sanctions into
Fund’s ways and of the US economy.

At this point, I invite colleagues in the audience to ask questions, Wilhelm first and Nancy
and Jessica … oh, wait until …

**Wilhelm:** Speaking in an exceedingly personal capacity, I don’t think I want the Fund necessarily to
have more teeth. Just in its sort of individual country crisis prevention or crisis resolution
programs, I’d like it to be less pressurized by politics. I mean as on the scandal of Greece,
right, where blatantly insolvent sovereign in 2010 I’m talking about now, was given cookies
by the European and by the Fund under very strong political pressure and against staff ad-
vice I think is a sorry example. Until that changes and we get the WTO-type technocratic
independence, I wouldn’t want to give them any more teeth on the individual country.

As regards surveillance, I really think the analogy between the mechanisms for dispute reso-
lution for the Fund and WTO is completely false because we don’t know what the rules of
the game should be in international macroeconomics. We don’t understand really much
of anything about the nature of macroeconomic interdependence and spillovers. What are
the positive and negative externalities? Is monetary policy, expansive monetary policy with
floating exchange rate always back at your neighbor? You know this kind of thing. Thus
QE, currency manipulation by the US is tapering financial vandalism unless the Fed offers
pipelines to the fragile five or ten? I mean we can have a very nice discussion about it. It is
not something that a bunch of technocrats can decide on because nobody agrees on it. We
do not know. As regards currency manipulation, it’s not a terribly useful term and if there is
any it doesn’t matter. Thank you.

**Hung Tran:** Thank you very much. Nancy and Jessica. Nancy.

**Nancy Jacklin:** Nancy Jacklin, I’m now with SAIS. I agree with Wilhelm and the premise I guess of all of
these is that a central role for the IMF and what it is there for is to establish some rules of
the game in the international monetary and financial system. Surveillance is kind of one of
the major tools to try to do that. I don’t understand how you can get as Wilhelm does to a
WTO type enforcement mechanism when you’re not just asking for some trade concessions
or on cotton or on oranges or on sugar. You’re talking about fundamental principles of what
kind of monetary policy and fiscal policy a country follows. It’s very hard to try to get the
same kind of enforcement system there.

What surprises me in surveillance is that lesser mechanisms to try to impose peer pressure
and influence on countries which we think are not following at least the understood rules of
the games such on currency, right, and buildup of excessive reserves. You don’t have either
the private sector reinforcement of the messages and it may be we need more transparency to
get the markets to help deliver messages to countries when their policies are out of line.

You also don’t have countries willing to do anything in their overall bilateral relationships
to in a sense punish bad behavior and reward good behavior. My favorite example is when
people started to get very upset about the Chinese exchange rate. China was very smart.
They would go on a shopping trip and visit the countries that were making noise and give
them more trade access, right, whether it was for our Boeing planes or it was a shopping
trip in Europe to get more European exports to China.

If countries aren’t bilaterally willing to use their full toolset to enforce the rules of the game,
how in the world are you going to get it done through some kind of WTO-type mecha-
nism in the IMF?

Jessica Einhorn: Hi, it’s Jessica Einhorn at the Rock Creek Group. I’m going to be brief because I think
we’re all piling on on the same question. My question was also following up on Fred with
the metaphor with WTO and the IMF.

Two quick points. First, you well know that the IMF actually calls for a referral by the IMF
executive board of a dispute to the WTO in just the kinds of areas you were talking about.
The question is whether if you have something so straightforward that hits the trade ac-
count where you already have consensus whether a better mechanism is to have a dispute
move on to the WTO courtesy of the IMF rather than stay there.

Secondly and picking up on what the other said, I think yet another way of viewing this is
the sanctions approach is a metaphor … that’s where the metaphor works. For surveillance,
what you’re looking for is improvements in what suboptimal to getting to closer to optimal
in terms of global growth policies and that’s quite a different challenge requiring different
instruments.

Hung Tran: I have time only for three questions so Domenico, Susan Schadler, and the gentleman there
so three. Then we should give time for the panel to respond to the questions.

Domenico Lombard: Thank you. Just one question on IMF surveillance, I think that one issue that re-
ally comes out for many evaluation or from the literature is that bilateral surveillance with
whatever limitation that you might think of, bilateral surveillance does work better than
multilateral surveillance. This is the first source of asymmetry.

The second source of asymmetry is and you know I would be interested in getting the pan-
el’s reaction on that, within bilateral surveillance there is further asymmetry between small
countries versus larger countries. In other words, the IMF surveillance tends to be more
effective in smaller medium-sized countries rather than big countries like the United States
and China and some big European countries. Thank you.

Hung Tran: Susan and then Ernest.

Susan Schadler: Susan Schadler of CIGI. I would comment on what Adam said that that’s most of the com-
ments that I’m going to make in my session so they’ll come later.

What Wilhelm said to Fred, I just don’t agree with that. I mean there are a lot of things that
we don’t know about and we can’t be sure about. If this kind of dispute settlement mecha-
nism were in place, you can establish a pretty clear threshold of reserve accumulation that
would start to tell you that an exchange rate is wrongly valued. It's pretty close to unam-
biguous. I don't understand why that the members of the IMF can't commit to certain rules
on the speed and size of reserve accumulation and that triggers some sort of requirement
for the country to respond.

Hung Tran: Then the last questions, Ernest, please.

Ernest Preeg: Ernie Preeg of Manufacturers Alliance. Thank you for the honor of being the last ques-
tioner, which is to Fred again a little more specific. You say, Fred, why not create within the
IMF a dispute resolution mechanism including possible sanctions. I would say to a sense
that is politically impossible is an understatement.

There is an alternative which is to link, as was raised, the IMF and WTO. IMF Article IV
says members should not manipulate their currency to gain an unfair competitive advan-
tage in trade. WTO GATT Article XV says members should not use exchange rate policy
that would have adverse impact on reciprocal access to markets for trade.

The US response should be two things simultaneous. In the IMF, the Secretary of the Tre-
sury every six months has to report to Senate Banking Committee. Is anybody in violation?
He should say I mean the facts are there. Yes, China and perhaps a few others, we want a
serious discussion. In parallel, we should request a dispute panel on GATT Article XV say-
ing this is having adverse impact on reciprocity to markets. By the way, we think that our
trade balance and price exchange rate sensitive manufacturers, deficit has gone up $300 bil-
lion in the last five years. That's a couple million jobs. I think we got a very good case and
we should pursue the two things in parallel without having to change any IMF or GATT
rules.

Hung Tran: We just have enough time for the panel to respond to the questions that have been raised.
I'll start with Fred.

Fred Bergsten: Let me first point out the internal inconsistency between Wilhelm's two points. He first
said this politicization of all this stuff is terrible. What we need is something more technoc-
ocratic and less political. Then when I proposed something less technocratic … for individu-
al countries that's fine. Country X is violating its IMF obligation that's what I wanted to do
but you dumped on that.

Wilhelm: Yes.

Fred Bergsten: Well you said we don't know enough. Susan gave you an answer. Gagnon and others here
and I have laid out a very clear methodology for defining violations in that area.

Wilhelm: It makes no sense.

Fred Bergsten: Why not?

Wilhelm: Because it confuses normal and real exchange rates. I think it's a very simple point.

Fred Bergsten: No, it's a very simple point …

Hung Tran: Let the panelist answer the questions, please.

Fred Bergsten: So that was point one, Wilhelm was internally inconsistent and I think actually winds up
supporting my basic point of view and I thank Susan and Ernie for supporting me as well.
Nancy makes a very important point. If individual countries don’t step up, then how can the Fund step up? Of course that’s a little confusion that ends in me the Fund is the countries. The countries have to step up.

Be careful what you ask for because remember that the alternative to multilateral action on issues like this which I suspect most of us in this room advocate is unilateral action. The United States did in 1971 and broke up the Bretton Woods system of adjustable pegs because the multilateral process didn’t deliver. In 1985, Jim Baker Plaza Agreement, fortunately that was more cooperative, but the system, the institutions, the rules were not delivering, there was a huge problem. The Congress was about to take the US out of the trading system. Something initially unilateral and then subsequently luckily G5 put the thing together.

I pointed out and that’s why I stressed that the vacuum that we’re now seeing from the failure of the multilateral process is leading to threats of serious unilateral action. The Congress is saying currency issues have got to be at all future trade agreements. Well, you may like that or not. You may think it busted up the trading system or at least obviate the chance for future trade agreements or not, but that would be a rather significant unilateral alternative to multilateral reform.

I agree with what Nancy said. The US in particular would have to lead hard within the multilaterals. If you read the Blustein book, you’ll see a lot of evidence of that, but the US was feckless. It was unwilling to designate any country as currency manipulators. How could it then go to the world and say the world will designate the countries as currency manipulators? US was internally inconsistent. I’ve been very critical of that as well.

Again, be careful what you ask for if you say this should not be done multilaterally. What you’re at least opening the door for is it being done unilaterally.

Hung Tran: Thank you, Fred. Any of my colleagues on the panel, any response? Adam.

Adam Lerrick: First let me say the last thing in the world I want to see the Fund get more teeth of any sort, okay? I want to be on the record in that respect. I don’t think the Fund needs more teeth. I think the Fund needs to enforce the teeth it has.

Wilhelm talks about Greece in 2010. One of my days when my self-confidence was gravely shaken was I gave a speech in New York where I talked about how Greece was insolvent that what the Europeans were going to do was simply transfer the debt. The debt was simply going to migrate from the private sector to the official sector. Greece will become a ward of the European Union for the next century with an unsustainable debt.

My self-confidence was shaken when Felix Salmon wrote in Reuters the next day that the most surprising thing of the conference was how reasonable Adam Lerrick sounded. He actually was making good points. And I thought that showed that I was getting old and weak. In 2010, I was in Berlin at one point and I explained that Greece’s debt had to be restructured. It had to be written down. It had to be restructured. The response I’ve got was what do we have to do to make that happen. I said you have to do something very simple but very difficult. You have to say no and make everyone believe you.
The senior members of the Treasury started laughing and said, “You’re right. That’s very hard.” Because the whole problem in Greece and when Fred talks about having a multilateral system of enforcement of reviews about macroeconomic policy, the Europeans are much smaller group, much more uniform economies in the world system. They have not succeeded to any extent at enforcing a system of penalizing the people that misbehave. That’s a real problem.

I don’t think a WTO system, resolution system, or dispute system is viable first for the reasons I think it’s politically impossible, and second, for the reasons some that Wilhelm raised that it is not as easy to quantify and figure out and analyze as whether the price of cotton has been subsidized coming out of Louisiana or the price of oranges in Florida or orange juice or sugar. People want to have benchmarks reserve accumulation.

I don’t think that’s a good benchmark. It can be a benchmark but it’s not always going to be a benchmark, a valid benchmark. There could be other reasons that reserves are being accumulated, valid reasons that have to do with how the economy is adjusting. Eventually, the economy will be forced to adjust even without a dispute resolution. No country can accumulate reserves ad infinitum.

Fred Bergsten: China is trying.

Adam Lerrick: No. They’re three trillion now, a little over three trillion?

Fred Bergsten: Four. Half a trillion more last year annual record.

Adam Lerrick: Fine. At some point, they’re going to stop. They will stop.

Fred Bergsten: Well, hopefully.

Adam Lerrick: No, they will stop. I’ll leave that at that point. I don’t think the Fund needs more teeth. I think it needs to enforce the rules it has and that will solve a lot of the problems.

Hung Tran: I can safely make another prediction that all of us on this table will have been retired by that point when China stops, but, James.

James Boughton: Yeah, I’d like to just very briefly turn the conversation away from teeth a little bit. I’d like to respond to a point that Adam made in his initial presentation almost as a throwaway line although it’s been a major theme of his over the years.

When he said that he thought that the availability of IMF financing in the case of a crisis actually was making this crisis much more likely is a classic moral hazard argument. I think in this context, it doesn’t really hold up to scrutiny very well. If the IMF makes serious mistakes or if the people overseeing the IMF make serious mistakes you can get bad outcomes, but I don’t think that’s an existential problem for the way the IMF does business.

Adam talked about Greece. Now I don’t think anybody thinks that the Greek program was either well designed or well administered. We could argue about that all day. I think a clearer example of what we’re talking about was the onset of the Asian crisis in 1997. The Mexican crisis that preceded it at the end of 1994 was reasonably well handled but it had a fatal flaw, which was that the tesobono holders, the holders of the short-term dollar-denominated bonds issued by the Mexican government were made whole. They got paid back 100 percent on the dollar in dollars despite the fact that these were not supposed to be handled that way.
The fact that bondholders were made whole in the Mexican crisis probably made financial markets more willing to lend and to Asian countries and ignore the storm clouds that were approaching in 1996 and 1997. Again, I don't think that's an existential crisis and I don't think there is anything that the IMF could have done given the political constraints to avoid that bad outcome on the Mexican crisis. They were being sat upon very heavily by the US Treasury at the time which was being closely watched by the US banking system and other bondholders of tesobonos.

I think we could argue a lot about specific cases on how they've been mishandled. I think it would be a disservice to go away with the impression that the whole model of the way the IMF is doing this kind of business was wrong.

Hung Tran: Since we are pushing into coffee time, Maziar, you have the last brief words.

Maziar Minovi: Thank you and I'd like to take issue with Fred's view as well. Now that we're safely off of IMF reform and back onto surveillance, I just wanted to make the point and address the question you had which is how could we resolve the conflict between the IMF sharing more information and precipitating the very crises that we're trying to avoid. I would say that let's not make the perfect be the enemy of the good here. There are certainly circumstances that that's the case. Maybe Ukraine now is a good example.

There are plenty of other places where IMF views and information and analysis would be very welcome. Right now, the market is hyperfocused on what's dubbed the “fragile five” countries. Many of them are not in danger of immediate balance of payment crisis; Brazil being a perfect example, lots of reserves and a lot of structural problems. In a situation like that, it would be fantastic for the Fund to opine on a real-time basis the $100 billion swap program that the Brazilians are using to deal with a crisis. What are the downsides? What are the externalities? What are the implications?

We've been trying for five years to find out, find a good study on the impact, the spillover of Chinese slowdown and commodity price decreases on Brazilian growth. And anywhere in the Fund we've looked at, nobody has done it. We go to Brazil. No economists have done it. The Fund is a perfect place to extend the good work that's being done on spillovers to something more specific like that that actually can help in forming direct capital flows.

Or kind of further away from an immediate crisis, country like Hungary, they certainly have a lot of strengths and a current account surplus. But there's a lot of vulnerabilities in that country. From what we likely surmised, there are a lot of disagreement about the direction of structural policy there. The Fund just went on a mission there. They've come back and there's actually no concluding statement, presumably because the government didn't want one before the election.

How can you say the same sentence that the markets are mispricing Hungarian credit, Hungarian currency, and yet some relatively useful information is being withheld and releasing them certainly won't precipitate a crisis. I'll stop there.

Hung Tran: I think with that, please join me in thanking the panel for a job well done.
Panel 2: IMF Role in Crisis Resolution Including Debt Restructuring

Moderator: Domenico Lombardi, CIGI

Speakers:
Anna Gelpern, PIIE and Georgetown Law
Susan Schadler, CIGI
Hung Tran, IIF

Domenico Lombardi: Okay. We’re running a little bit late. Let’s start this second session on the IMF’s role in crisis resolution. As we’ve seen in the previous session, surveillance may have a heart, may have a soul, may lack teeth however, but there is a framework. In the context of crisis resolution, in particular debt restructuring, I’m not sure that we can really say that we have a framework. We know the IMF is working on some proposals that the Executive Board might be considering over the next few months. The US Treasury is also working on a report. We at CIGI have also been working on some research, some proposals; likewise our partners at Peterson and IIF.

Without further ado, let me call on first speaker Anna, a Senior fellow here at Peterson and, as many of you know, a Professor at Georgetown Law. Anna, the floor is yours.

Anna Gelpern: Thank you, Domenico and it’s an honor to be here. This is, as you’ve heard many times, a very important time for thinking about the IMF and its role in crises. I will probably channel some of the existential tension themes that you heard in the preceding panel. I will focus the bulk of my remarks on the broader issue of the IMF role in the financial crisis and I will come back to debt restructuring in particular, if time permits. If not, we can talk about it in the Q&A.

Now, when I looked at the title of this panel, I thought, “My goodness, how can an institution be at once completely indispensable and equally indefensible?” It was a really stark thing to think about because in the one hand, as a matter of fact, the IMF is the indispensable anchor for crisis containment and resolution, whether you like it or not.

It is charged with systemic stability and balanced growth globally. The IMF was macro-prudential before there was macro-prudential. That’s something to think about. It has a mandate to correct maladjustments in individual members’ balance of payments, a role analogous to the lender of last resort addressing liquidity problems.

At the same time, it is also the preeminent restructuring lender addressing solvency problems when a country’s debt is unsustainable, to use the jargon. In return, it gets informal repayment, preference, and adequate safeguards, credible reform for IMF resource to safeguard IMF resources.

Finally, it is de facto, the arbiter or reorganization plans, like a bankruptcy judge. If we’re honest, also the principal designer of these plans determining the role for all the other players.

Having described it that way, and by the way, that’s all out of Article 1 of the Articles of Agreement. I didn't make it up. It is not hard to see why so many people think that the
Funds roll on this basis is completely indefensible. Criticizing the IMF for crisis response must be the lowest hanging fruit on the planet. Its policy diagnosis is wrong. Its policy design is wrong. It lends too little. It lends too much. It is hopelessly conflicted and therefore, illegitimate.

Now, it is not just that some of these statements are true some of the time. All of these statements have got to be true at any given time depending on your view of the IMF mandate and mission. If you think of it as a lender of last resort, it’s always lending too little. If you think of it as a restructuring lender, well, then it’s always bailing somebody out and it shouldn’t do it. That’s just inherent to what the Fund is.

Now, one response to this realization is to just dismantle the IMF and have standalone functional alternatives-- macroeconomic financial surveillance body, a lender of last resort, a restructuring debtor in possession type lender, an expert consultant and an impartial tribunal.

Each of these would make for a terrific policy proposal with the inestimable virtue of being not the IMF. You could literally just have a policy paper proposing an institution doing all of these, but each of these would have to be designed to have global financing capacity, expertise and political legitimacy.

You would have to have these pieces. Not each of them would have to have the financing capacity but at least one would have to have global financing capacity. All of them would have to have legitimacy. All of them would have to have expertise.

The genius in the sheer chutzpah of the Breton Woods designers, if I may use that term—(you have to have chutzpah to be a founding father of anything, I suppose)—is to design an institution capable of combining these functions that has a decent but not perfect claim on both technocratic and political legitimacy?

Now, the Fund at its best, I would argue, emerges precisely from this tension among these different aspects of the mandate. It cannot lend freely like a traditional lender of last resort because it has the express mandate not to add to the unsustainable debt burden. It has a responsibility for the adjustment policy mix.

The IMF actually, when I started thinking about this, it is unique of all institutions anywhere for having the capacity to recognize and act on the fact that the line between illiquidity and insolvency is a total fudge. There is no other institution like that. There are institutions that have to hold their nose and pretend it’s all a liquidity. There are others that can go ahead and say its solvency.

As a universal institution with both the surveillance mandate and the financing mandate, the IMF can and must address both individual cases of distress and systemic spillovers.
Finally, it cannot ignore political capacity for adjustment or the political will of its members
to finance adjustment. Yet, by definition, it is an international institution that has got to be
apolitical. This is really hard. You have multiple mandates; policy tools and accountability
demands that by definition have got to create uncertainty which then sows doubt about
efficacy and accountability and that can turn into a self-fulfilling prophecy.

In the remaining couple of minutes, I want to talk a little more about the IMF and debt
restructuring and then bring it back to the fruits of existential tension.

The IMF’s role in debt restructuring is residual. It follows from other aspects of its man-
date. It doesn’t have a mandate to have countries go restructure their debts. In addressing
the members’ balance of payments problems, with adequate safeguards on its own resour-
ces, the Fund has got to recognize both the limits on adjustment and the limits on available
resources. The gap between those two gives you debt restructuring. That requires difficult
judgments and political adjustment capacity. The availability of market financing and non-
market, also known as political, resource availability.

It also implicates the Fund in the restructuring process, so the timing, the method, and
how does that happen? Three steps. First, debt sustainability analysis, the diagnostic starting
point for burden sharing. There we have seen a lot of improvements since 2002 in rigor and
transparency and most recently with public availability of tools.

Second, lending policies, which is really de facto restructuring conditionality. This is where
the restructuring conditionality, such as it is, comes from, policies in normal and excep-
tional access, which I’m sure Susan will talk about, lending into arrears, securing financing
commitments.

Then the third piece of it is policy advice, and that is where you get contract reform and
debt management policy.

Now, some say that you could have some of these tools but not all of them. If you’ve got
the DSA right, (the debt sustainability analysis), and if you had just the right contracts,
restructuring will happen organically. I strongly disagree with that. I think that the power
and the burden for the Fund is precisely in the combination. The ability to change con-
tracts does not translate into willingness to change contracts just as ability to pay is not the
same as willingness to pay.

Now, note also that this is a whole lot of tools. The IMF today can insist on restructuring
and establish financial parameters for restructuring and influence the method of restructur-
ing with no new tools whatsoever. With that we have to think about what has the track
record been? Have we seen with all these tools a bias in favor of restructuring or perhaps
against it. That’s where the debate is, which in conclusion brings me back to politics.

The judgment when to restructure and how much to restructure is an irreducibly political
judgment that implicates the debtor’s capacity to adjust (economic and political), and the
Fund members’ willingness to put resources on the line as well as suffer contagion. In that
context, knowing that the politics is irreducible here, the Fund is going to be implicated in a
political judgment and it’s going to come under political pressure, political accountability is
crucial and that’s what’s at the heart of preserving the IMF as a legitimate global institution.
This in turn has three dimensions. One is financing and governance, which we’re going to hear a lot about in the next session. Second, something I want to highlight, and that is tool clarity. Third is public engagement. By tool clarity, I mean aligning tools to the various mandates and making the methodology and the choices transparent. Having a lender of last resort facility (so this is the FCL analog), as distinct from a standby, as distinct from an extended facility, is important. Transparency in debt sustainability analysis and the methodology is similarly important for these legitimate, political legitimacy reasons.

Finally, public engagement and information disclosure as well as pushing member governments for transparency is also critical, not just for the markets; smart, dumb, big, small, but also for the broader political legitimacy that unfortunately we’re seeing the fruits of in the recent Congressional debates.

Considering the unavoidable centrality of the IMF, the crisis architecture, its multiple mandates and tools and the lack of plausible alternatives for now, I think the most important thing to do is to really focus along these three dimensions and it’s also the least we can do. Thank you.

Domenico Lombardi: Thank you very much, Anna. Let me call on Susan Schadler, CIGI senior fellow.

Susan Schadler: Thanks, Domenico. First of all, I like the question posed by this conference. It’s a good wakeup question and I can’t resist the opportunity to go on record to give my answer. I see the IMF as a gift from a previous generation, the immediate post-war generation specifically. It’s common to hear the thought that if the IMF didn’t exist, it would have to be invented, but I’m not so sure. I imagine that the hurdles that would have to be overcome and the debate that would have to be held in today’s fractious global debating society would be a real difficult hurdle to overcome. I’m not so sure that leaders would give birth to... you can’t hear?

It’s off. Maybe it’s that I’m too close. Is there still an echo? A little bit.

I don’t think that the IMF would be reinvented. It is indeed a gift from a previous generation and it seems to me the task of our generation is to preserve it. That’s why I like this conference and I think the main thing one has to think is continuously, what is going to preserve the IMF.

Now, obviously stripped to its core the IMF has two functions, surveillance, information exchange, data collection, all of that in one bucket. Just discussed in the second is crisis mediation. That’s what this session is about.

Now, the big event in the past few years, the event which is going to stand out in ten years when history of the Fund is updated, was the way the Fund behaved itself in the EC crisis. The Fund was faced with the most severe and the most globally important crisis since the mid-1990s. First, with Greece and then with a number of other European countries. I’m going to focus on Greece, because in many respects, what was done in Greece set the path for the future.

Now, to understand what the IMF did in Greece and how important it was, you have to really go back to the legacy of the crises from 1990s. There was some appreciation at the end of that. It was arduously debated during the 1990s and the early 2000s that the IMF
needed to distinguish clearly between crises where a country with a stabilizing package or policies was going to be able to service its debt, and crises where a country even with the strongest policies you can imagine—the country implementing was not going to be able to stabilize its debt—to be able to service its debt in the future. It’s going to need a restructuring. This was the lesson that came out in the 1990s. There needed to be a clear distinction between these two.

Now, in the former set of countries, ones that could be conceived as having debt sustain-ability with the right policies, a conventional IMF loan was going to be of significant ben-efit. In the latter set of countries, the politically dreaded necessity of restructuring before the IMF committed resources was essential.

The stark reality that was absolutely core to the IMF’s credibility and effectiveness in crisis management was then encoded in 2003 in what rather archaically are called the Four Cri-eria for Exceptional Access. It’s got a really archaic name that nobody in the outside world can understand except only people who work in the Fund really understand it.

These are not criteria in the performance criteria sense of the word which most people are conversant with, what the country has to do to get a Funding from the IMF. They’re really criteria that the Fund itself has to meet in order to go ahead with a loan to a country that’s in distress. The cracks of these criteria is that the IMF must assess that the country can and will be able to repay its debts without a restructuring of privately held debt and that it will regain market access during the life of the Fund resources being outstanding.

It needs to say we don’t envisage that the restructuring is going to be needed and if the Fund can’t reach that assessment, it needs to say, “We need to restructure and then we’ll go ahead with the loan and with the package of policies.”

Now, of course, the story of Greece is that the Fund rather willfully walked into a train wreck. The IMF changed the rules, changed the four criteria that it set for itself in the after- math of the Asia crisis. It introduced formally during the very session of the Executive Board that approved the loan to Greece, an option, a permanent option, for the Fund to waive the requirement that the country will be sustainable without a restructuring.

Effectively, the lessons of the 1990s were thrown out in an afternoon session of the Executive Board meeting. Most Executive Directors didn’t even know that this was going to come. They were surprised at the Board meeting. If you work in the Fund, this is sort of unimaginable because things in the Fund, first, they get proposed, the staff debates them, then capitals debate them, then the Board debates them and after many many rounds of debate, a policy change might be made. This was done in a stroke like that; permanent.

This change allowed the Fund to lend to Greece without debt sustainability. We now actu-ally have a record, thanks to the Wall Street Journal, of what happened in that Board meet-ing where several Executive Directors, including the Executive Director from the United States, asked for a reaffirmation of the Funds preferred creditor status implicitly because, or explicitly—if you work in the Fund, then they’re were Fundees, that there was going to be a restructuring needed in Greece and it was being pushed down the line.

This was bad for Greece. It contributed to the prolongation of the Euro Crisis, and was particularly bad as precedent for the future in the IMF. It leaves open the question now of
what is going to prevent this kind of political manipulation of the Fund which undermines its effectiveness and its credibility in the future?

Well, there are pretty much two-and-a-half options here. First the half; some form of debt restructuring mechanism. Now, I don’t say this to trivialize the importance of a debt restructuring mechanism. I actually wholeheartedly support some sort of mechanism being put in place. Even if such a mechanism existed, even if we overcame all these hurdles and something was put in place, it has to be used. The only reason it’ll ever be used is because the Fund, or to really put it more bluntly, the members of the Fund, are going to have to be able to constrain the political influences that drive decisions like that made in Greece.

This is half an option only because it would help if it were there, but it’s not going to overcome the politicization problem of these lending decisions in unsustainable circumstances.

So what are the other two options? First, obviously, one could reinstate the Four Criteria. Once could say, “We made a big mistake. We now see from the Euro Crisis that this was a really silly and costly thing to have lent to Greece and not to have insisted on an upfront restructuring. We’re going to go back to the old criteria and perhaps a little impulsively, we’re really going to stick to them this time.” It’s got some credibility problems but still, I’d say overall that would be the desirable way to proceed going forward.

Now, another option is, and what I would consider to be a far inferior option, is to chart a different path to disciplining the Fund and that concerns the Fund’s preferred creditor status.

Now, just an aside here, I did a project last year for CIGI in which I looked at the reasons why the four criteria were changed. I actually went out as objectively as it was possible to be, interviewed about 30 to 35 key figures in this decision to lend to Greece and change the four criteria and asked them were there good reasons to do this. Is there’s something that we and the public aren’t really appreciating? I wrote a paper on it and I think fundamentally came to the conclusion that changing the four criteria had not been a good idea.

When I presented this paper and I see many faces that were there when I was presenting this in various fora, the question that always came up was, “Well, what about the Fund’s preferred creditor status? What is all of this changing the criteria say about giving the Fund this very privileged position of preferred creditor status?”

Now, my nearest at the Fund rival, I think anyone else is in this room and I drank the Kool Aid. The Kool Aid in the Fund is preferred creditor status is absolutely essential to the Fund doing its job. The Fund lends in the various risky circumstances in the world. It lends at below market interest rates. Preferred creditor status both allows the Fund to lend in these circumstances. It provides the security to its members who are committing their own resources and it’s compensation for the fact that we’re lending at a very low interest rate.

Now, there’s also no denying that preferred creditor status carries moral hazard, obviously. Think about it. If you’re a bank you’re told you can lend to this country and you have preferred creditor status, you’re probably not going to take that decision to lend this seriously as if someone said, “Yeah and your resources are on the line.”
In fact, as I said earlier, the minutes of the Executive Board meeting in which the loan to Greece was approved, make it clear that the US, among other countries, was asking for a reaffirmation in the Fund’s preferred creditor status because they expected that there was going to be a restructuring. They didn’t want to have to go to Capitol Hill and explain to Congress people why we needed to recapitalize the Fund, because the loan to Greece had not been repaid.

Now, obviously eliminating preferred creditor status would be a step toward disciplining the Fund. It would be one way to discipline the Fund. You can take a rules-based approach, the four criteria. You can take a market-based approach denying preferred creditor status. That’s pretty much exhausting the possibilities, but that’s a pretty extreme way to go. It’s a very different view of what the Fund does for the last 60, 70 years it’s been doing. It would be a big step and I think it’s a step that only should be taken if a rules-based approach can’t be resuscitated.

So rule out changing the preferred creditor status. I don’t think so. I think that needs to be an option that’s on the table. If for no other reason, then eventually, should the Fund get involved in more of these loans where restructuring is seen as very likely, eventually, the Fund’s preferred creditor status is going to be questioned. Let’s remember, the Fund’s preferred creditor status is not de jure. It’s de facto. It’s something everyone has accepted.

When I was doing this paper, I did call my friend Lee [inaudible 0:25:01] and I said, “Doesn’t anyone ever challenge this?” She says, “Oh they always challenge it. It’s just in debt restructuring arrangements. It’s just that the Fund is usually sort of small peanuts so when some resistance is put up, they just sort of drop it and figure, take on bigger fish. Someday if Greece were to be a precedent followed in the future, the Fund’s preferred creditor status will be questioned and this whole issue is going to be opened with all its ugliness.

Domenico Lombardi: Thank you, Susan. Let me call on Hung Tran, Executive Managing Director of IIF.

Hung Tran: Thank you very much, Domenico. To complement what Anna and Susan just said, I just want to make four points.

Number (1). It is useful in my view in this discussion to keep distinction between what the Fund does and what the market does. The Fund is completely within its mandate. Its right to define its lending policy and conditionality for lending including requiring debt restructuring PSI when it deems necessary. My only observation is that such authority and mandate is already there particularly in Article 6 of the Fund’s Articles of Agreement. To spell it out and to categorize such requirement in any written document is really unnecessary restrict room for maneuver for the Fund to deal with crisis.

However, there is mentally at least distinct from a contractual matter between the sovereign debtor and its international creditors. By entering into contract for commercial transaction, contract should be honored when for unavoidable reasons contracts have to be changed. There should be a process whereby the change in contract would be agreed to by both sides of the contracting parties. Point number one.

Point number (2). It is only reason to support that approach because history sinks deep first. Sovereign bond restructuring in the modern times back with Mongolia in 1997, 34 sovereign bond restructuring, all of them worked except one and I don’t need to spell out
what that one case is. Except one, every bond restructuring worked pretty well within ten months of announcement of restructuring, within seven months on average of starting negotiations consummated. High participation rate, 95%. [inaudible 0:27:40] litigation absolutely not a problem. Coordination problem among diverse set of creditors, absolutely not a problem; 30% of sovereign bond restructuring, critics claim resulted in redefault by the sovereign debtor, but it is not different from the 41% re-default rate in the global corporate bond restructuring episodes.

The NBV loss in sovereign bond restructuring averaged 47% but with very wide high standard deviation of 26%. That means ranging from 5% to 95%. Last but not least, a lot of the bond restructuring usually have majority extension, some interest rate reduction and less than half of the time nominal haircuts. That's second point.

Third point. Has such a market approach with such a superior record of 30 to 1 cases being successfully completed perfect? No, it's not perfect nor should it be, because breaking contracts is a bad thing, not a good thing, and it should not be made easy or perfect and then more it has it and everything acting basically is not right thing to make breaking contracts an easy thing to do.

When we talk about breaking contracts, we are talking basically about fair burden-sharing of the different stakeholders in the process and we, in the earlier session, talk about the country on the one hand, the international financial institution, international financial community on the other hand and private sector crave those. Each has to play a role in a fair way and most importantly, transparent and good faith process to achieve an agreement to share the burden equally.

In these contracts, the debate that we have seen in recent months and weeks basically making use of the ruling by the US New York District Court about interpretation of the [inaudible 00:29:49] clause in the ratable payment for Argentinean bonds. In my view is very problematic because it leads to misguided effort to really weaken creditor rights unnecessarily.

We should realize that in sovereign bonds. International private sector creditors already start out with the weak hand dealing with sovereign. Over the years there has been a steady erosion of investor rights. In Mexico, bonds in 2003 first introducing modern cuts in modern context, 85% is the threshold for voting to agree to a restructuring. That has been diluted, weakened, now to 66-2/3% of meeting with a very low quorum. In other words, as little as one quarter of the bond holders of outstanding bond can impose, by agreeing to a restructuring proposal, can impose its decision on the vast majority of bond holders. It is really not that fair when one comes to think of it.

Therefore, to learn from experience and to promote kind of a robust framework to deal with the minority cases when contracts cannot be honored, one really should stress this point of fairness and good faith negotiation between the stakeholders in this process to arrive at a mutually agreed solution.

Last point, we ourselves at the IIF together with colleagues and other organizations--ICMA, International Capital Markets Association in particular--have been working and promoting further enhancement and development of collective action clauses particularly aggregation clause where we try to make it even more difficult for a minority of investor to accumulate sufficient position in one bond series with which to obstruct or to hold up a restructuring of the bond.
That is another step in term of weakening creditor rise, but we think that that is worth-
while to make sure that overall the marketplace is robust. Perry Paso clause, we think that it
should be clarified to the extent that if the contracting parties really do not want to see the
ratable payment ruling by the New York District Judge, they should say so clearly in their
contract. They say [inaudible 0:32:16] doesn't mean at all ratable payment. However, if the
contracting parties being consenting adults really want to have ratable payments or pro rata
payment in their contracts, so be it. You should be interested to know that in the past five
years, the volume of international emerging markets, sovereign bonds more and more con-
tain such explicit pro rata payment obligation by the debtor to investors.

Creditor engagement clause is also important to really make clear that the sovereign debtor,
when they get into trouble, should engage with creditors to solve their problem. Last but
not least, waiver of sovereign immunity rights in the commercial transaction is a very good
thing to do. Thank you very much.

Domenico Lombardi: Thank you, Hung, for resting within your allotted time. I think there are three
broader issues. One is how specified the IMF’s mandate and crisis management and resolu-
tion, how predictable should that crisis framework be, what to do with the Fund’s preferred
creditor status. Finally how to allow for a distinction of rules between the IMF and markets
and safeguarding the investor rights. I think we have time for a few questions. Maybe I will
suggest that you raise your hands and identify yourself and then we’ll collect questions in
group of two or three.

Bill Cline: Bill Cline from the Institute. I think a particularly crucial point of the IMF decision in
Greece was the calculation at that particular time. A forced haircut would have massive
ramifications for the much more important economies of Italy, Spain. I think it’s a little bit
misleading to impose today’s tranquility on that moment. This is of course one of the re-
sponses that the Europeans themselves come back to the critique of the Fund.

I think more importantly going forward, what do you want the Fund to do? I think those
who suggest the Fund should reinvent the sovereign debt restructuring mechanism implicitly
think there’s going to be a lot of important insolvencies right around the corner. They
implicitly think that Italy is next and you better setup a more methodical process. I don’t
think that’s the case. It’s not clear to me that you want to send the wrong signal by setting
up a mechanism for the odd case of the small country where it would be a problem.

At the end of 2011, I wrote a paper projecting that they could in fact service the entire
debt. It was not insolvency as long as they could stretch it out. That in the first PSI would
be sufficient. It could be sufficient. Well, of course, we know that all of the projections went
straight downhill, the growth projections, et cetera. If you lay them out, you see successive
downgrading and of course a lot of that had to do with political unraveling.

The point is, suppose that you are making the decision at that point and you knew there’s a
lot of very negative spillover effects. You realize there is some possibility that you can in fact
validate insolvency through the stretch out since the first PSI, not at all obvious to me that we should complacently--with the benefit of hindsight--conclude that the fun was hijacked by special interests and everybody knew there was going to be a huge haircut. The only solution going forward is to have a sovereign debt restructuring mechanism.

Domenico Lombardi: Thank you, Bill Wynbiter.

Wynbiter: Just a minor factual correction. Greece was not the first industrial country to default since 1930. Germany, or rather West Germany defaulted on internal debt in 1948 and external debt in 1953. It did them a lot of good, I would say much more even than the martial plan. I don't understand the argument that this is creating an institution like an SDRM that can supplement market-based voluntary mechanisms, like CAKS which are useful. To restructure sovereigns in a way that does the least unnecessary damage. That it should not be done because it might scare the children. I find it an extraordinary argument. You want to do it precisely now that things are quiet. You want to create it so it's ready. The belief that after Greece there are going to be other takers--from your mouth to god say Bill--I think that unless we have a minor miracle in the brief of the Euro area and the sovereigns there, and the countries manage to grow at a nominal GDP growth rate of about 4% from now on average till kingdom come, none of these sovereigns are going to make it.

The ECB who's producing negative inflation for the periphery and half a percent for the Euro average, is not helping here. It effectively requires the periphery goes 4% real to keep the sovereign solvent. I think there are serious question marks around the solvency of all the periphery sovereigns from the biggest Italy to the one most likely to escape untouched, which is Ireland despite its very high debt burden.

It goes beyond that. I think, the way in which I think the IMF and the Europeans fail to address sovereign's sovereign later debt issues. [inaudible 0:39:11] of Ireland, where the sovereign was effectively bullied by the Troika and indeed by the American Executive Treasury into stopping... not implementing their plan for bailing in senior unsecured bank creditors. Basically the Irish got three phone calls; one from Trisha, one from Shoible, and one from the American. There's an executive saying, “Don't do this,” touché because loss unthinkable. Shoible, because there's German banks are too exposed and the American Executive Treasury because of what did you do to the US Money Market Funds who heavily invested not in Irish debt per se, but in European bank debt.

So and again this systemical [inaudible 0:40:04] useful. I think about catastrophic error, this time, the debt wasn't moved wholesale onto the backs of the international taxpayer, but private debt again, was moved on to the books or the Irish sovereign and to highly subsidized funding from Europe into the sovereigns there. I think there's a double argument, a double error there that the IMF contributed to, not solely responsible but it didn't stop it. It went along with this sad charade.

Domenico Lombardi: Thank you. So we have one question over there and then one more in the back.

Sarah Julinas: My name is Sarah Julinas. I worked at Eton Mans, which is an investment managing company, based in Boston. I really enjoyed the discussion and the topic of SDRM, but I wonder how you ever insulate these decisions from politics. Susan, you were speaking about how they waived the Four Criteria when it came to Greece. We're looking at Ukraine right
now and obviously geopolitical concerns seem to outweigh any economic ones. How do you ever create a system that can't be waived or that won't have to be deferred to the needs of politics. Thanks.

Domenico Lombardi:  Thank you. One more question and then we'll give it a chance to the panelists to react.

Landon Thomas:  Thank you. Landon Thomas, New York Times. I guess I was just on the question of surveillance, I was going to ask you guys about the Article 4 and why they aren't used more effectively as a warning signal and as a way to, I guess, get people's attention. From my experience, the most I've ever learned about countries' debt and other problems are from this Article 4s.

Now, in fact, the Article 4 in Greece in 2009, if you go back and read it, is very critical. I later learned that it had been massaged a bit by the Greek representative on the Executive Board. I guess, it seems to me the crucial question is that why can't these extremely well-done rigorous assessments of a country's economic well-being be more forceful and I guess resist the tampering because in every case, the actual draft has to be approved by the country that is being monitored which in fact you lose the whole purpose. The criticism really doesn't go far enough.

Domenico Lombardi:  Thank you. I would now call the panelist in reverse order. Hung, you first.

Hung Trang:  Thank you. Only two responses and I leave time for my colleagues to respond as well. Number (1) SDRM, so the SDRM Light Treaty approach, strategic approach, they are either unnecessary or unworkable because completely contrary to domestic US corporate municipality restructuring process, Chapter 9 or Chapter 11 where both the debtor and the bond holders subject to the ruling of the bankruptcy judge of core subject to appeal to the appeal court. Basically, they are bound by the judge.

A servant is not bound by anybody except its parliament because it is sovereign and therefore no treaty, no SDRM, no whatever will work if the sovereign debtor chooses to behave in a unilateral way, like the single case that I highlighted before, 1 out of 34. Nothing will work. No treaty, no SDRM will work. If the sovereign debtor, however, like in the 33 other cases, chooses to behave in the collaborative way, no treaty is necessary.

Point number (2) to Landon's. That's why I asked a question in the first session about the tension between sharing information and assessment by Fund staff and the fear and the sensitivity that that could inadvertently particularly the precise crisis that the whole exercise is designed to avoid. Two possible remedy. One is more transparency, disclosure of quality data, timely data, so everyone will know there's no hidden surprise in term of exposure of the country to unsustainable level of debt or off balance sheet obligations.

So more transparency and disclosure. Secondly, my pet suggestion is making the publication of Article 4 country report mandatory and not up to countries to decide. It has to be published. Country can have a few place to rebut the view of staff but every Article 4 assessment country has to be published.

Domenico Lombardi:  Thank you. Anna?

Anna Gelpern:  Thank you for the questions and I also want to quickly react to a couple of things that we talked about on the panel. First on access criteria and possible fixes. I think this is a case of tool confusion. You have a situation where the fear is contagion or at least the stated fear is
contagion. You can believe it or not believe it, but you’re worried about Italy and Spain and your solution is to lend to Greece. That to me is the problem. It sounds to me like what you need is tools to make Funding available to Italy and Spain to--and this is the liquidity solvency issue. You need more imaginative tools to deal with contagion and true liquidity concerns rather than pile it on onto the one insolvent country.

On weakening creditor rights, I think that the trajectory is not entirely clear because collective action clauses you could just as easily argue was the strengthening of creditor rights. Mexico starts with 75% of outstanding. No, Mexico’s 75, Brazil is 85. At that time, in the UK, you could amend with 66% of a core amount at a delayed meeting dot, dot, dot with 20%. The evolution of CAK since 2003 has almost obliterated that option and has made exit consents more difficult. In fact, the whole point of contractual renovation is that it actually proceeds in a much more balanced way, that is you can call it weakening, but actually if you look at what changed in the contracts, you can easily argue that on balance, it has become harder for debtors to restructure. That may be actually a terrific thing depending on where you sit.

SDRM is just simply not on the table. An SDRM is a very particular institutional construct from 2003 that some people may like, some people may not like. It is nowhere on the agenda. I think, there is a separate and interesting question about what institutional innovations we need in the sovereign debt restructuring space, but this is not an SDRM discussion. That is a red herring.

I think that you do not ever insulate this process from politics. That’s the point. It is irreducibly political at the core and then the design focus has to be on improving accountability mechanisms. There, I think I agree with my colleagues very much that transparency is certainly a good thing, but also transparency involves tradeoffs and if you publish more Article 4s, it’s done quicker. The argument is they’re not going to say as much as you’d like them to say. I happen to think that in most cases, it’s a worthwhile tradeoff, but I think we need to recognize it as such. Thank you for that.

Domenico Lombardi: Thank you, Anna. Susan?

Susan Schadler: Okay. Thanks. On the question that… I think it went off. As I said, I did this project last year on examining, interviewing 30 to 40 people who were key figures in the decision to change the criteria within the Fund permanently and to lend to Greece, even though it was not expected that the debt was to be sustainable. These were people in Greece, officials in other European countries, in European institutions, in the IMF, in the United States government. A lot of different people. Most of them spoke on the condition of anonymity. I would say and I really want to emphasize it, I didn’t go with an agenda except to ask a few questions, equally of everyone in as objective a way as it was possible. Obviously, contagion was the big issue. Was the decision to lend to Greece necessary because the contagion threat was as serious.

Actually, surprisingly in the end, with the exception of one very important person, the view was, yeah, a contagion was the concern, but probably it was overblown. Not just with the benefit of hindsight, but probably even at the time, people work themselves into a frenzy of concern about contagion. The second response was typically contagion happened. I mean, in the end, the decisions to lend to Greece did not stop Spain and Italy from falling to pretty serious trades. It’s not clear. It would have been worse. It probably definitely would have been a shorter crisis had the path taken in Greece not been started.
On the SDRM and whether this is- I mean there isn’t going to be a SDRM. I agree with Anna completely, but to sort of clearly the Fund is in the process of trying to revitalize the debate about an SDRM like instrument. Even within the European Union, you see, well in Brueghel, for example, you see questions being asked whether a European SDRM is needed.

Okay, first of all, I think a lot of people talking about this are rather imprecise in making it clear that restructuring should not happen. I mean, in general, countries should honor their debt commitments. There are some cases where it’s impossible without massive political risks. In those cases, you got to face facts and do it. Would that be a bad signal now? I tend to agree with Philemon on this. I think it’s precisely the signal that is needed right now to get people to focus on what’s going to happen if things don’t work out. We are after all poised right now on the cutting edge of weak growth and the potential rise in interest rates. I mean, what combination of those is going to happen is not clear but there are many adverse scenarios that are very plausible.

It’s quite possible that it all works out fine. That we got a slow, but steady recovery. Interest rates rise gradually. The world adjusts. We have got a lot of countries with very high debt ratios and to the extent that this balance doesn’t work out right, we’re going to be in trouble and we’re going to have a lot of debt crises. It seems to me if there is anything that the Fund can do that’s useful, it’s anticipate what institutions and procedures are going to be necessary to deal with the problems if they arise.

It seems to me all the arguments point toward getting this question on the table as quickly as possible. Now, Villam also raises this issue about distribution, that by taking this course in Greece, basically what you were doing is setting yourself up to socialize Greece’s debt to take that from the private sector, put it on to the shoulders of taxpayers. Of course, that’s right. I mean, of course, we’re saying that. That goes without saying, but I have to say, I do ask whether it’s the Fund’s role to prevent that. After all, if the Europeans decide the way out of their mess is for Greece to repay its private creditors and shift the debt to European taxpayers, why is the IMF to say, “You shouldn’t be doing that?”

Then you have to ask yourself the next question. What is the value added of an international organization like the IMF? Well, it seems to me, if you say it’s just a reserve pooling operation, well then, why do you need to have that big building and those thousands of economists employed? I mean, there’s no point. It’s a big waste. When you really think about it, you got to say the value added of the IMF, is to be able to offer as objective advice as is possible on crises or surveillance or whatever other issue you wanted to take up. Politics will always be involved, but if you can’t put in place some firewalls between what the IMF says and does and what the political influences within the IMF are, then I think basically, you have a big waste of money on your hands within the IMF.
Finally, on the question from Landon about the surveillance in Greece in 2009. Yeah, I mean, most of these things were written down and it was kind of anticipated that… well, certainly, it was stated that Greece was very vulnerable, but there are lot of countries that get tagged as very vulnerable. The one that we always point to is Lebanon, which had the debt ratio of well over 200% of GDP. For literally years, a decade, the IMF said Lebanon is a crisis waiting to happen. Lebanon is just fine. It is always going to be true, as was said in the first session, that the IMF doesn't have the sure fire answers to every economic problem. It can raise questions about vulnerability. You can put the countries in different classes of vulnerability, but that's pretty much the end of surveillance.

Domenico Lombardi: Okay. On this very reassuring note, let me end the panel here. We are going to adjourn for a coffee break. Thank you.

Panel 3: IMF Reforms Including Governance, Resources and Relationship with Regional Financial Institutions

Moderator: Adam Posen, PIIE
Speakers: Thomas Bernes, CIGI
Charles Collyns, IIF
Athanasios Orphanides, former Governor, Central Bank of Cyprus
Edwin Truman, PIIE

Adam Posen: Finally, the aforementioned Ted Truman, Senior Fellow here at the Peterson Institute, a predecessor of Charles’ as Assistant Secretary for International Monetary Affairs of the Treasury, the of course, Institutional Baron of the Division of International Finance of the Federal Reserve for many years and a good colleague.

So, all that out of the way, let me turn to Thomas and ask you to give us a non-American, non-narrow perspective on governance in the IMF.

Vinod Thomas: Thanks Adam. I’m delighted to be back here and see some familiar faces in the room. The topic of governance is one that’s being kicked around a lot over the last number of years and it’s hard to think of something new to say on it, but let me share a few thoughts.

First, when I was meeting this morning with some folks at Treasury and I mentioned I was going to be here this afternoon. They said, “Well, no doubt you’re going to, while the rest of them bash the United States, the Congress rightly so,” they said, “For this failure.” So let me start by bashing the United States for the failure to pass the legislation.

I mean, it’s ironic in some ways because the implementation of the 2010 Agreement, which was obviously brokered by the United States with the—with the leading role played by intellectually otherwise, by one of the people on this panel. We’re now finding United States isolated and the IMF frozen in its Governance Reform project. And it’s ironic, as I say, because it’s crippled US leadership and credibility within the Fund on these issues. And I think, as I’ll try to explain it imperils the IMF capacity to play a leading role in addressing a number of policy issues.

Susan Schadler said she had to answer the question, “What is it good for?” I mean that—the title of the conference struck me, too; What Is It Good For? And I think Susan had a
couple of roles. I mean, I think actually four roles. I mean surveillance, research, technical assistance, capacity building and crisis management and financing. I mean global public goods. They are important.

And on average, the Fund staff did a good job. I was Director of the Independent Evaluation Office for years and we looked at a number of issues and at times we were critical. Obviously, any organization can do things better, it can improve, but basically my conclusion was the Fund did good job. They weren't always as omnipotent the staff sometimes thought. They weren't as bad as some of the critics would have it. They did a good job.

They're really struck now with a challenge. I mean, one of the issues is and you ask yourself, how does the IMF exercise leverage? And I guess as I see it, there are three ways. I mean, one is overwhelming intellectual leadership. Well, I think the IMF has been—can be a leader, whether it, in today's world, can exercise overwhelming intellectual leadership, I would argue not. I think the areas of expertise have grown, whether it be in academia, whether it's in the Fed, whether it's elsewhere. So, leverage its limited there.

Secondly, money, it brings money in the table it can exercise leverage and it will continue to do that in certain circumstances. Thirdly, is through engaging with groupings such as the G-20 today. Earlier it was the G7 and it maximizes the Fund's leverage. It was also a vehicle for these groupings to exercise their leverage on the system. It raises questions of legitimacy and so on. It is a means to do so.

What we've seen though is that with the establishment of the G-20, the role of the IMF, in fact, I would argue has been eroding over the last few years, in part because the criticism of emerging markets that the Fund lacks even-handedness. It's not a level playing field and therefore, the processes that have started within the G-20 have said, “This is a country-driven exercise. We drive it. The IMF will do as we ask them to do, nothing more.”

Now, and as the agenda has broadened, they're getting now into structural adjustment, the first meetings if you look, G-20 task the IMF and the World Bank. I mean, today they task the IMF working with the World Bank, OECD, UNCTAD, ILO, to produce a report. I just saw one last week that said, “It prepared for the last G-20 finance ministers meeting in Sydney on structural reform issues prepared by IMF staff with input from the OECD and the World Bank.” And I said, “I mean, one, it was a bit of a vacuous document.” Apart from that, I said, “I mean, who is accountable for this?” And I think that's part of the challenge that we're bringing more and more players in, but where is the accountability? I mean, who is providing the advice? Who's to be held accountable at the end of the day?

I talked about this emerging market view that the IMF lacks even had in this. I mean, let me just give a couple of examples as to why that's the case and why that's important. I mean, Fred mentioned Paul Bluestein's book, Off Balance, which is a terrific to read. I mean, what Fred didn't mention is that IMF staff had gone to the Senior Deputy Managing Director at the time, John Lipsky, and said, “The United States should be one of the first cases brought to the board for fundamental misalignment.” And, John Lipsky said, “No, we're not going to do that.”

Now, that's what's stated in the book. I've heard for myself, some others that is true. So, not to deny anything that Fred was saying earlier, but there is another side to that debate, in which is why they're getting this reaction from the emerging markets that this is not a level playing field and we want—which is why the quota issue and the ownership issue, the Fund becomes so important. Because until that's solved you are going to continue to have this sense that that is an institution controlled, partly by the Americans who serve their own interest.
Or let me give another example, which was referred to in the last panel. I mean, that’s the case of Greece and the Troika that was set-up. Now, the Troika was established to manage the Euro-zone crisis with the European Commission with the ECB and with the Fund. I mean, never before to my knowledge and history of the Fund, Jim, correct me if I’m wrong, has one of the authorities sat on the same side of the table as IMF staff in negotiating the program. Certainly, in the Caribbean which had the Eastern Caribbean Central Bank and a number of governments that negotiated programs—that certainly wasn’t how the Fund staff organized itself at that time to deal with those countries.

Having said that, you can make an argument, well, it makes sense, in fact, the European Commission lacked experience in putting programs together. I mean, the Fund did have unique experience. The European Commission was very politicized; it was useful to have more honest broker at the table. There’s another dimension to this and this is when you look at the board. I mean, there are two things. One is letting the point that Susan made. Is staff management introduced the board aqueous in allowing a major change in the rules, allowing systemic importance to creep into allowing the rules to be broken.

More than that, you had a board where a quarter of the members happened to be representing two of the players on the Troika. Somebody called that a conflict of interest. I would. So, I mean, there are huge governance issues that arise there, but again, it comes back to why is there attitude on the part of a number of emerging markets that the Fund is not providing a level playing field and why that then plays back into the G-20 and why the Fund is being held at a certain limited capacity.

So, solving the quota issue is I think—-I mean, so, the 2010 decision, DSK described it as historic, I described it as a small step forward. I think it was a small step in terms of what needs to be done. It did break a log jam, but it’s not frozen and until we get off of that I think we’re in trouble and sitting here, I mean, I just don’t see a way where the- I mean, Ted, I’m sure will have some ideas on how we can break this deadlock. I don’t see how one gets the stalemate in the US Congress Administration on this issue off center. And as long as that’s stuck there, I mean, I think we’re all stuck.

Okay. Resources, I mean, this is also linked to the first, but just very quickly, a part of the debate, including the debate in Congress, I mean, the Fund is not getting new resources. In a sense, we’re shuffling money from one window to another. The Fund might get more resources under quotas, the NAB commitments would go down. You can have an argument as to whether it’s better put into permanent quotas versus a facility like the NAB. The overall point, I think, is that there’s not new money going into the system as part of this.

Now, one can sit down and do spreadsheets and say how much resources should the Fund have, what scenarios we’re going to have in terms of what crisis. As a matter of a judgment, you can come up with any figure you probably want. I suspect the money is going to be there. On the resource side, I’m not personally, overly concerned. I think the resources, if you look at the Fund’s resources right now, they’re huge. And relative to most reasonable scenarios and if we go elsewhere, I think as we saw on this last crisis, the resources will be available or we’ll all be in trouble.

I think the more difficult question is the relationship with regional financial institutions who give—I think the world is changing. I mean, the Troika, how does the IMF work with the commission with the ECB is one element? Chiang Mai, Asia, I mean, these are all evolving. I think the rules aren’t clear. The Fund is no longer going to be the head, the master, the control point. I think it’s going to be a much more a primus inter pares and it’s going to have to learn to work with these other organizations. I think the Fund has been changing and doing
that, but it’s going to require a change in attitude on the part of the Fund. It’s going to in-
volve looking at different governance arrangements. How do we organize? How are decisions
reached? And they’re going to be very difficult and they’re not obvious.

It all goes back to, I think, to the first point, until we get a breakthrough on the quality
issue, I think the whole thing is frozen and I suspect that means at least until the next ad-
ministration of the US.

Adam Posen: Lovely, thank you. Charles.

Charles Calomiris: Thanks Adam. I’m also going to talk mainly about Quota Reform. In the past, ev-
everyone’s saying they’re going to talk about Quota Reform and I think it puts most people to
sleep. It’s a very dry and Archean topic. In fact, I have been myself put to sleep many times
sitting around G-20 meetings discussing the intricacies of the Quota Formula and trying to
negotiate minor adjustments to the formula very rapidly gets into a very tricky and not very
exciting detail.

I agree that the failure of the US Congress to pass the Quota Legislation is a big deal. I
wouldn’t go as far as to say it’s an existential threat to the IMF. The IMF will continue, but
I think its effectiveness is seriously damaged and undermined. I think that the potential for
moving ahead in other areas is clearly going to be curtailed.

And I would also emphasize that it’s not just damaging the US, I mean, it’s not just damag-
ing the IMF, it’s also seriously damaging the US’ interests and the US’ capacity to influence
the Fund and to move the Fund to taking steps that are important in the interest of the
United States, as well as the global economy.

I think throughout the day, we’ve had a pretty good discussion of what is it that the IMF
does that is so important. I think pretty much everyone has agreed that there are things that
are important, perhaps a little disagreement on some of the details. Clearly in the area of
intellectual leadership, through its surveillance and it’s in the area of crisis resolution, crisis
response, the IMF plays a critical role, but its capacity to play the critical role in both of
these areas depends on the adequacy of its resources and on the legitimacy of its analysis.
And I think failing to move ahead in the end with Quota Reform has a particularly effect
on the latter.

I agree with Tom, that on the resources front, there isn’t an immediate short-term prob-
lem. The Fund has, according to the estimates, the Fund published at the end of February,
something like $839 billion financial resources based on a quota base of $370 billion and
the NAB credit lines of $570 billion; that provides usable lending capacity of $625 billion
against outstanding credits of $127 billion and commitments of $160 billion. So there’s a
forward lending capacity of over $400 billion waiting to be used. Moreover, should there
be a turn for the worse, then the Fund could activate bilateral credit lines of up to over an-
other $400 billion as a second line of defense.

So there’s no immediate need for additional Fund financing.

The one concern I would have though, is that if you can’t pass the 2010 Quota Reform,
you can’t begin the next Quota Reform. The 15th Quota Review was supposed to have
started last year. There were supposed to be in progress on revising the Quota Formula.
That was a subject of all this rather dull meetings in the G-20 last year that I had to sit
through. That is one process that’s completely frozen by the inability to complete the 2010
Quota Reform.
I think the much bigger problem for the Fund is the implications for the legitimacy of the Fund. The Fund has long been viewed, as Tom and others have said, as being overly influenced, overly dominated by the advanced economies, particularly the United States and Europe. Over 60% of the quotas are held by the advanced economies. And I’d also mentioned that the key top two management positions in the IMF are held by a European and by an American.

And, not surprisingly, this dominance has indeed created exception of bias in the IMF surveillance policy advice, a lack of even-handedness, a greater willingness to reflect the points of view of the US and the Europeans and a lack of understanding of the points of view of others, particularly, for example, in Asia where they often have a very different approach to economic issues.

And I think this weakens the impact of Fund surveillance, it also weakens the impact of the Fund as a crisis responder. On those surveillance front, it’s harder for the Fund to come through with tough judgments if the basis for those judgments is not trusted if there is a suspicion that the Fund is not reflecting its deeply filled analysis, but rather points of view of its larger shareholders.

The Fund has been, I think trying quite hard to demonstrate its willingness to listen to a broader range of opinion. I think you could see this for example, in the new guidelines on the use of capital controls in the face of a volatile capital movements. Now, if you read the decision you might think that it’s rather a pig’s breakfast. It’s hard to see much coherence, but it clearly reflects an attempt to take a much more eclectic approach than it has been the case in the past. I think despite these efforts, I think the Fund is still tarred with this perception that its intellectual engine is still dominated by its major shareholders.

And on the programs side too, I think there is a serious problem, maybe even a bigger problem, which is summed up in the word stigma. I think there is still a massive reluctance in countries to come to the Fund for support at an early stage. Countries will come at the last minute when they’re forced to come, but they won’t come earlier when the problems are easier to deal with and it’s particularly meant that countries have not come to use the various forms of precaution and facilities that the Fund has developed in recent years. Three countries have used the FCL. All these three countries are countries that are, I think, particularly close to the US or to Western Europe: Mexico, Colombia and Poland. We haven’t seen a broader range of countries; we haven’t seen countries in Asia, for example, coming to the Fund.

We saw none of these major countries coming to the Fund, for example, in the context of the global financial crisis. And I think this is going to continue to be the case as long as the Fund has seen it’s lacking legitimacy and its following is being more strongly influenced by the advanced economies.

Now the Quota Reform wouldn’t have solved this problem, but at least it would have made progress in the direction of addressing the problem. The 2010 Quota Reform would raise the quotas of the emerging markets in developing countries from 39.5% of the total to 42.3%, which would be more or less in line with the share of these countries in global GDP when measured as a blended average of market exchange rates and PPP.

So it would have been progress in the right direction, however, it would have still have left quite considerable imbalances, particularly with the BRICs. The BRICs substantially underrepresented in the Fund, even after the 2010 Quota Reform is approved, they were still only have 15% of quotas compared to 22% of their share of global GDP. And on the other side of that is the European countries, which would have 30% of quota compared to
24% of their share of global GDP. And this really reflects the design of the Quota Formula, which gives a heavy weight to trade openness as one of the factors determining the allocation of quotas. And one of the big debates we've been having is trying figure out a simpler, more transparent formula that gives a heavier weight to GDP, less weight to openness that would have helped increase the share of the BRICs.

The other issue, which, and Tom mentioned, that I think is important to emphasize, is the issue of leadership. I think there has been some progress towards developing a more transparent selection process based more on merit than on nationality, but the reality is that it hasn't actually delivered the results that are intended. And so, we've maintained this pattern of choosing the European for the IMF and an American for the World Bank.

I think part of the issue is that the Europeans are actually much more effective, much more united in coming up quickly with the candidates and that the emerging markets tend to not want to support each other candidate's and even a very strong candidate like Agustin Carstens failed to receive much support in the last leadership round, but I think it just reinforces the perception that countries have the emerging market voices is not really recognized.

Let me say a few words on the US and the damage done to the US influence and the Fund. I think the US clearly relies very heavily on the IMF as a major partner for ensuring a stable international monetary system. I think the key area where the Fund is able to act in areas with the US is really not able to act, is in the area of crisis support; and this is true also of the European countries. The Fund is able to move very quickly with large amounts. It's able to take risks. It can be pretty bold. And I think the recent announcement of its willingness to support the Ukraine is a good example of this. So the Fund came forward and said we're required to put $14 to $18 billion on the table for a two years program for Ukraine.

At the same time, the US put forward a $1 billion loan guarantee and frankly, that's pretty paltry. The budgetary implications of a one billion loan guarantee is only a few hundred million. The process is cumbersome, the money won't come quickly. It's not really commensurate with the geopolitical importance of supporting the Ukraine. And frankly, the Europeans didn't go very much further. Similarly in the the Arab spring, the US bilateral contribution that was on the table for countries like Egypt was really very limited compared to what countries could get from partners in the Gulf. So, the US cannot exert influence directly very effectively through balance support, but it relies instead on the role of the IMF.

There is this Exchange Stabilization Fund that the US has. It's worth $100 billion. It provided $20 billion in the case of the Tequila crisis, that was 20 years ago and the very strong push-back from Congress after that has meant that ever since then, the US Treasury has not proposed use of the ESF for balance or payment support, not even in this recent case with the Ukraine.

I think clearly, if the US is not able to push forward this Quota Legislation, it will substantially lose influence at the IMF. We're already seeing this like with very strong reaction, particularly among the emerging market countries, among the larger emerging markets, the BRICs. I'm sure we'll hear of that this week during the spring meetings.

And I think it's ironic too, that the—one of the consequences of not pushing forward the Quota Reform and relying—continuing to rely heavily on the NAB, is actually increases the capacity of the emerging markets and the BRICs to control the Funds activities. For example, the continuation of the activation of the NAB depends on achieving an 85% support from the contributors of the NAB and that gives the emerging markets an effective veto on the use of the NAB.
So, I think it’s a serious problem and I end with a point I made in my introductory remarks this morning. The Fund has been very effective agents in the past, but the Fund to continue to be effective in the future, it needs to continue to update itself. If it’s caught with institutional inertia, then I think the Fund will lose influence and it will be superseded by other approaches. Thanks.

Adam Posen: Charles, just a quick question with your new IIF hat on and this is intentionally meant to be challenging, but I’m sure you’ll have a right answer ready. What about those who say that the Fund is not only unfairly governed in the sense of weighting the views of the West too heavily? What about those who say that the Fund is unfairly governed, that the weights the views of the creditors of the markets too heavily? Is that a governance issue? Is that a myth?

Charles Calomiris: I think that’s a myth. I mean, if the IIF were concerned that the Fund is now proposing shifts in the framework for sovereign debt structure, and we had a bit of discussion of that this morning that shifts the balance too much towards the debtor countries. It’s always a difficult balance to strike, because on the one hand, you want to protect the rights of creditors. On the other hand, you want to make sure that there is an efficient mechanism to deal with bankruptcy problems as they arise. And, the IIF’s view is that you need to do that in a market-based contractual framework, rather than putting too much rigidity into rules that would make the Fund override the interest of creditors in an excessive way.

Adam Posen: Very good. Nicely done. Thank you. Now, turning to Athanasios, who I’m sure will be able to tell us just how wonderful it is to be a European getting huge amounts of money from the Fund in the Troika’s tender embrace, right?

Athanasios Orphanides: A pleasure to be here and I didn’t give you any glimpse of that. And just hearing about the European view and whatever that means. So, it’s one of the issues on the table.

And indeed, the IMF has been criticized for dealing with a crisis in Europe differently from earlier crisis. For example, in Asia and Latin America, we just had comments about the level playing field issue or the lack of even-handedness and this raised a number of questions about the governance of the IMF. And indeed, on my perspective, having seen the first half of the Euro-area crisis from the inside in Europe, in the last two years from this side of the Atlantic, I want to focus on the role of the IMF in Europe and the governance issues that it raises.

You may ask why this is important now. Isn’t the Euro-area crisis over? Well, it’s great, but the market-

Adam Posen: That’s the subject of tomorrow’s breakfast in this room, by the way.

Athanasios Orphanides: So I’ll just say that it’s great, that markets are so incredibly and nicely complacent right now. Let me just say that the Euro-area means fragile in my view.

The second element is that we need to remember that during the crisis we had European politicians serving at the helm of the IMF and that happens to still be the case. So, whatever problems we’ve experienced in the last few years and whatever governance problems have been created, unfortunately, whatever conflicts of interest that were just pointed out, are still with us. So, we need to worry, particularly about the Euro-area and the continuing crisis, even though I hope that nobody will notice that it’s still in a crisis.

So, I’m going to organize my points around two sets of questions. First, about how the governance has hampered the contribution of the IMF to the Euro-area crisis. And, to this one, other questions that can be asked this, well, is the Euro-area a single economy? Should we
be thinking about it as a Europe or a Euro-area question or governance or position? Or is this just a collection of separate economies that share the same currency?

And, one thing I want to start with is by noticing that the IMF has been doing very nice spiel of their reports during the crisis. And in those reports, the Euro-area is treated this as single economy. Let’s examine this very nice, the impact of the Euro-area crisis for example, or an additional worsening in the euro-area on China or the US, as examples.

From my perspective it’s been very strange that the impact of Euro-area decisions inside the Euro-area and the distributional impact inside the Euro-area, hasn’t been mentioned. That’s one of the issues. The other issue has been mentioned just a few minutes ago, which side of the table does the central bank of a Euro-area member state to sit when an IMF program is discussed; next to the IMF or opposite to the IMF? It has been quite unique in this situation that the ECB, as the central bank of the Euro-area member state, should have been sitting on the other side of the IMF, I believe, next to the government of the member state, but this is not what has been happening.

And, there has been a number of decisions so that are influencing differently different member states in the Euro-area, where I think that the IMF could have helped the Europeans. Here, I can actually use them as a collective to see clearer about the damage that was being done, the contagion that has been harming some member states in the Euro-area.

The benefits that were happening in other members of the Euro-area, that set us up to these decisions. I can list a couple. One is the appealed signed decision, October 2010, that reversed the IMF ordering on you first examine sustainability. If a country is sustainable, you give a loan. No. That decision was saying, “No, no, if it’s about a Euro-area country, first you involve the private sector and then you consider making a loan,” which of course created the contagion in Europe.

Or another one that is very close to my mind because of what’s maybe happening, what is happening whereas this year. If you go back to 2011 we have the July and October stress test exercises with [inaudible 00:34:54]. And again, that’s a sort decision that can create systemic issues and differential impact; some countries beneficially some countries adversely.

I think the IMF could have guided Europe better in those instances by offering analysis on how these decisions damaged economies inside the Euro-area, instead of looking at the Euro-area as a whole, which was much of the emphasis.

The second set of questions I have is actually, in my mind, more challenging, which is whose interest does the IMF serve when participating in a Troika program in the Euro-area? What are the additional constraints that appear and have appeared and continued to appear in the Euro-area, because of the construction of the Euro-area and the interaction of the Euro-area and the IMF? And a couple of these issues have already come up. There is one peculiarity of programs the IMF got involved into the IMF that is really unique that I want to highlight, that has not been highlighted before.

Take Ireland as an example and think about Ireland before getting into the Euro-area and after getting to the Euro-area. Let’s say Ireland needed consultation in the program with the IMF in the 90s. It was not the case, but let’s supposed that it did. It had its own currency. It had its own central bank. If you are to do that and they needed some assistance, then government, a central bank would come here, would negotiate with the IMF, a program would have been designed in a few weeks. The IMF board of directors would consider it. It would be done. Note, that in this process, no other European government could veto details of the program, add elements to it or otherwise obstruct what the IMF could recommend for Ireland in that case.

And then consider this with Ireland in the Euro-area, what do we see in 2010? In that case,
for the Euro-area member states right now, the IMF de facto allows every other government to have veto power on details of a program. As a result, what is observed, in my view, is the programs are not designed to serve necessarily the interests of either the global economy or the country involved, because other interests actually interfere with that.

Let me remind you in 2010 and 2011, in the case of Ireland, we had serious discussions of hearing about the tax regime in Ireland, not because the IMF will bring it up, not because the Irish government was bring it up, but because some other member states of the Euro-area that are large and have a lot of influence at the IMF were bringing these things up.

These conflicts create severe problems that are detrimental for the programs and have added fuel to a crisis in the last four years. And what's even worse is that as a result of these governance problems and the effective veto that some members states, that all members states in the Euro-area have, whenever the IMF gets involved in a Troika program, the IMF got involved, it didn't want to, but it got involved in the process of shifting losses from the crisis from stakeholders in one country to stakeholders in other countries.

And we have the situation that too often in this crisis, the IMF deviated from technocratic prescriptions and fell prey to political interests in some Euro-area, influential member states, and whatever special interests those governments represent.

A couple of examples have been mentioned already, but I'm going to give them to you at a different light. Take the decision in 2010 involving the Irish debt on bankrupt banks that was held by other banks including, as I understand largely, by other Euro-area member state banks. As I understand, it has become public since then. The IMF technocratic position was that the Irish governments thought that losses should be imposed, was supported by the IMF. However, the IMF agreed to a program that imposed all of those losses to the Irish taxpayer; not quite the technocratic idea that you would want to have.

We've also heard earlier today about the 2010 decision in Greece. Again, I want you to do the analysis in terms of just pure, pure economic costs and shifting losses around. You have to go into your mind and maybe using the BIS exposure state I think, who exactly were the holders of Greek debt in 2010? Which members states benefited from delaying the restructuring of Greek debt and coming up in the meantime with a very nice scheme of unloading holdings of selected banks onto the ECB and then on decision much later in the process to protect the ECB holdings from a [inaudible 00:40:53]. This sequence of decisions had very real consequences in terms of shifting losses around.

Equally, they're worse. It's when I consider what happened in Cyprus last year, I see an IMF that implicitly, unfortunately, got very deeply involved in member state politics. In the case of last year in Cyprus, we had a solution that was not the solution the Cypriot Government wanted, not the solution that the European Commission wanted or the majority of the Euro-area member states.

Unfortunately, there was a very large Euro-area member state whose government was facing an election last September and that government formulated a plan that best suited it for that election. And the IMF was in this very weird position that it ended up actually aligning itself with that particular government because it failed; it had to support a very influential Euro-area member state and the electoral consideration so that government laid there in the year. That's not how you would want IMF programs to work really.

It got even be worse than that after the events of March 2013, it also became known that several billion Euro assets, about 20% of Cypriot GDP were shifted from Cyprus to recapitalize a specific bank in Greece that was apparently bankrupt before this amazing trick.
Raising additional questions about what is the role of the IMF in shifting losses in this case, from one state under a program to another state under a program? Really strange stuff.

So, I’d agree that there is no question that the IMF has been dealing with the Euro-area crisis differently than other crisis in a less technocratic fashion, in a more political fashion, being unduly guided by politics in some large member Euro-area states, not a European voice as a whole at all.

And this is unfortunate for many reasons. The worst of all because it damages the reputation of the IMF and limits the good that it can do to help maintain global stability. Because I also thought about the topic of today’s meeting, the IMF: What Is It Good For? When I think about this question, I think about all of the untapped potential that can we had by having an institution like the IMF protect global financial stability and improve growth, which was one of the articles of—upon which it was founded.

So, I’m going to just end with one very obvious policy recommendation to improve the governance problem that could be done immediately. There could be immediate agreement with politicians from large Euro-area member states ruled as candidates for the leadership of the institution. Let me just stop here.

Adam Posen: Why stop? That sounds good. Very quick question of Athanasios. I mean, that was fascinating. For the problem you confronted, in your view, would Quota Reform has made any difference or is it just Germany is too big and like Mexico to the US, you’re just too close?

Athanasios Orphanides: I think the Quota Reform would have many absolutely no difference because it was just discussed for all of the programs. All of the variations of the formulas discussed still allowed a select number of European countries to maintain a lot of influence in the process. I think what would have made a big difference would have been if we had leadership at the IMF that was based on technocratic criteria instead of being driven by European politics.

And there, we’ve heard variations of this already. I think in that case, the IMF would not have been playing with politics of the large member states in the Euro-area and things could have been different. I think we would have been out of this crisis in that alternative counter factor.

Adam Posen: Very good. Thank you Athanasios. Ted, maybe it’s not all Europe’s fault, right?

Ted Truman: Is that like a cue that I will start talking? Okay. So, thank you. I, maybe like [inaudible 00:45:42], I can issue a disclaimer that the views I’m expressing and not necessarily the views of the Peterson Institute for International Economics. Its president—past—president, somewhat associated with the past president, but certainly not anybody else. Indeed, they’re not widely shared within the institution.

Because I’m going to talk about whether it is time for the United States to risk, and want the waiting risk, it’s the veto in the International Monetary Fund. In fact, my proposal is that it is. I am conscious of the fact that I’m the last speaker here, so you may see this as an issue of offering some comic relief.

And by the way, I’ve already been told by a close friend in the audience that a petition is being circulate to a seize my passport so I can’t get out of the country and can be prosecuted for disrespect for the United States government.

So with that beginning, I would submit that the support for the International Monetary Fund is a new—at a new law. I think we’ve heard quite a lot of that on this panel, as well
as the others. The reasons are many and variable—varied. The lack of that support is not limited to the United States. The United States is not—I mean, the IMF is not politically popular, not just among the men and women on the streets, most of whom have never heard of it, but also among political elite, including those represented in this room.

And the most recent indicator of US lack of support for the IMF is the failure of the Obama Administration and the Congress to incorporate the IMF Quota and Governance Reform Agreement into the—of November of 2010, into the legislation supporting Ukraine, even though that legislation in itself as we've just heard, said by the former US official, was on the puny side.

So, the IMF faces, as Fred said this morning, an existential crisis. And in my remarks I'm going to step back first to say a few words about the question we're all sort of required to answer, about why it's important and then propose a way out on the governance issue impasse by risking the US veto in the Fund.

What is the IMF good for? We've heard many answer. My answer is similar to those given by others. It delivers a wide range of public goods to global public goods. It does so, and I think this is important to remember, by a collective commitment by its members to exercise their rights and discharge their responsibilities to produce outcomes that no single country could produce.

For many, those public goods were associated with the economic and financial crisis. That was the focus of the previous panel. I think it was reassuring that that was not the focus of the whole conference. Since that's a great distortion, I will offer you a few facts. One is that about 15% of the US—of the IMF budget is devoted to lending activities in all forms. A bilateral surveillance covers about—remained at 60%, multilateral surveillance 22%. What they now called capacity building and we used to know as technical assistance, is 17%, and the governance and the support activities are the residual 29%.

Unfortunately, the ability of the Fund to deliver this wide range of public goods has been undermined by the stalemate on the IMF governance’s forum, stalemate caused by the United States. The IMF’s legitimacy has been undermined, reducing incentives for countries to cooperate with and through the Fund to address other international economic financial issues. And that in turn has been caused by the inability of the United States to—Administration to persuade the Congress to act on the Korean package; and this brings me to part two.

Delivered in this period long associated with Peterson Institute for International Economics of responsible excess. I have a proposal to break the stalemate, which involves thinking about the unthinkable. And in brief, the United States Congress should be put up to shut up or shut up. I propose to put at risk the US ability to block our veto certain decisions of the membership of the Fund, those are decisions that require an 85% majority of the total voting power. In brief, it’s time for the US to either embrace IMF Reform or get out of the way.

So let me explain a little bit. As you know, a member share in quotas is a principle determinant of its share of IMF votes. The US share is 17.7% of quotas and 16.7% of votes. So consequently, the United States has the capacity to block a small number of IMF decisions that require 85% majority. For example, those proposals involving proposals to change, I want to emphasize that, the quota of any, I want to emphasize that, any IMF member, and amendments to the IMF articles of agreement.

Moreover, resolutions by the governors approving proposed changes in quotas normally incorporate a provision that none of those changes can take effect until members with at least 85%
of the total voting power accept the changes in their quotas—technical or dis-consent. Alternati-
vively, as with the 2010 package, the effectiveness was linked to another provision, such as the
amendment of the articles agreement, which in turn requires an 85% majority vote.

I have to confess that I’ve long been uncomfortable with the US executive branches posture
emphasizing repeatedly the Congress over my 40 years in Washington, that the—42 I guess
it is, that the United States has and will retain this veto power. The status quo cannot go on
forever. The size of the US economy and financial system and the global role of the United
States has been steadily shrinking since the Bretton Woods Conference in July of 1914. I’m
older than Jim, so I was three years old and about 150 miles away.

That trend is a tribute to the success of the International Monetary Fund as an endeavor. In
the meantime, the rest of the world has been remarkably tolerant of the US political pro-
cesses that often delay implementation of important [inaudible 00:53:07] decisions, often
for a decade or more.

However, the world will not tolerate a continuation the of the US exercise of its rights in
this area unless it does so with reasonable responsibility. And that exercise of right should
not undercut the legitimacy of the Fund or its capacity to deliver global public goods. The
almost four-year delay in approving the IMF Reform Package has damaged the IMF’s legiti-
macy, a package as Charles emphasized and others had emphasized and Tom emphasized,
that we largely were responsible for creating and it damaged our influence of the organiza-
tion as well as other areas. And in brief, we have failed in our responsibilities.

So, of course, the first best solution is for the Congress to, and the Administration to reach
a deal soon, to implement the package and we can all go to the seashore. Absent quick ac-
tion by the US Congress to approve the package, what should be done? So I have a four-
part proposal.

First, the United States, the Administration should seek to set aside the 2010 package.

Secondly, the technical amendment of the articles agreement that provides for an all elective
executive board should be separated and resubmitted as a standalone element that requires
an 85% majority vote, including by the US Congress.

Third, the IMF Quota Reform component of US package should be amended and com-
bined with the 15th Quota Review that Tom mentioned. As part of that 2010 package,
most of you will know, that review was to be completed by January of next year, actually it
supposed to be completed by January this year, along with the revision of the Quota For-
mula. And, it was expected that that would deliver another shift in voting power possibly
from the Europeans, in their emerging market developing countries. So, everything is at an
impasse as Tom said.

And fourth, we have to break this impasse on quotas.

And that’s, I have a three-part initiative on this aspect. So first, let’s revise the quota formula
to increase the weight of GDP. Lend GDP, which is 60% at market rates and 40% at pur-
chase and [inaudible 00:56:01] from its current 50% to 90%.

Second, total of quotas should be doubled again, relative to the size anticipated in the 2010
package.

And third, and this is the key element, but the others are relevant, the IMF Governors reso-
lution on the revised changes in quotas should provide that they will take effect only when
consensus are received from the members with less than 85% of the voting power, say 80%. So let me expand on these three pieces.

With respect to the first part of the new package, the quota formula, if the rise formula were based only on blend GDP through 2011, that's measured through 2011, IMF quotas were again doubled. The increase in quote and the increasing quotas was distributed according to the new formula, the US quota would be-- would increase from 17.4% under the 2010 quota proposal, to 19.5%; though the United States might agree to contribute some of that to other countries.

However, the combined share of the European Union would shrink from 30.3% to 27.2%. This would imply a substantially larger decline in the combined EU share, quoted in the puny reduction of 1.6% each points involved in the 2010 package. And this aspect should be attractive to the emerging market developing countries, in particular, if the United States were to contribute some of its increase.

With respect to the second part of the new quota package, the further doubling of the IMF quota is the increase in usable IMF financial resources would be about $550 billion, raising the total to about 1.4 trillion. The increase in usable resources would be less than the headline figure, which would be $735 billion because quotas of about 25% of members are generally not usable in lending.

It is important to remember in all this, and this was the point of this whole package, that the principle way, voting shares in the IMF are reallocated is a lot increases in total quotas that are distributed differently than current quotas. Aside from the governance aspect, an increase in IMF quota resource of this size would merely make permanent $461 billion in additional ad hoc, bilateral borrowing at the IMF Managing Director, Christine Lagarde, lined up in 2012 that I think Charles referred to. This increase in IMF financial resources would be sufficient to carry the Fund through the middle of the next decade, which is the earliest date that the 16th general view of the IMF quotas is likely to take effect.

So, the third and final piece in my initiative here is to—is of course the most radical one. If the IMF Governors resolution on the increasing quotas sets as the trigger for its implementation at less than 85% of the total votes, and remember, that resolution itself has to pass by 85%, but its implementation does not have to require 85%. And to set that implementation at less than that, technically less than 83.3%, depriving the United States of the capacity to block the implementation via it's not approval of an increase in the US quota, the United States will be forced to in effect, put up or shut up.

The US Governor of the IMF, who in case you don't know it, is the Secretary of the Treasury, could vote for such a resolution by the IMF Governors without the approval of the US Congress. US law only requires that Congress approve any consent to an increase of the US quota. No doubt, Secretary Lew would be roundly criticized by many in Congress at US [inaudible 01:00:17] if you were to take the step, as I expect to be, for my advocating it. The United States would be seen too, by the rest of the world to be exercising its right in a manner consistent with its responsibilities.

Consequently, absent action by the US Congress, the US quota and voting share would be reduced to one quarter of its current size. US capacity alone to block other institution changes in the IMF would lapse. Before you start cheering, this situation likely would be temporary because normally countries that have not yet consented to increasing their quotas are granted a grace period to do so after the initial proposal has taken effect and I presume that would continue to be the practice.
So, under my proposal, the United States would set an example for other members of responsibility in exercising its rights. This would help to restore the legitimacy and authority of the Fund, as has been discussed extensively by this panel, among others. The Europeans, who have been recalcitrant in agreeing to a reduction in their combined quota share also would be put on the spot. At the same time, the major emerging market in developing countries, which would benefit from it, resulting reallocation of quota and voting power, would come under increasing pressure to act more responsibly in turn. For example, with respect to their exchange rate policies, reserved accumulation investment and transparency and accountability in these another areas.

Thank you very much.

Adam Posen: Wow! Applauding. Joking aside, I think it is-

Ted Truman: You pay my legal fees.

Adam Posen: Joking aside, I think it is an important moment and you'll see, you have the paper that Ted has prepared and again, Fred Bergsten is also on a similar path. While as with all things from the institute, our individual scholars are responsible for the reviews. There is no one institute position. I think it is an important moment to realize that people who've served at the highest levels in the US Treasury and advocated for the US Government's rule in the IMF and defended it through many years, are rethinking whether we've crossed a barrier, or as Ted put it, it's time to put up or shut up.

We certainly don't want you to shut up. So, in our remaining time, which is non-existent, I'd like to open the floor for questions and comments. We have a roving mic at the front. I see someone has loped to the back microphone. If you could identify yourself and state a question and if there's a particular person you want to ask.

Ola: Yes. I’m Ola [inaudible 01:03:13], IMF RETD and also a lot of other places RETD. I thought I was going to come up with a crazy idea, but I’m glad to hear that there are others that—well, if not crazy in Ted's case, at least radical.

I'd like to make a couple of comments about the political influence issue. I had a very quick one on the EU. We’ve heard lots today including Athanasios about how political influence affected the way in which the Greece situation was handled and Ireland and so forth.

I think I’m not going to say anything new, but I missed a little bit hearing about, not the contagion of financial concerns within the Euro-zone, contagion of Greece on Italy and Spain, but the contagion that the major political leaders in Europe worried about, the contagion of Euro-zone fragility on EU stability. I think that drove a lot of the thinking.

The second point that I want to make, and this has to do with my Ukrainian connections.

Adam Posen: Could you try to phrase it as a question just for fun?

Ola: Yes. I—the second point I want to make or a second question I will ask, is the Ukraine has been mentioned several times as if the decision to go ahead quickly were apolitical. I have no doubt that there were political influences, but I think one is overlooking to look closely enough at the nature of the economic program. This is a new day in Ukraine. I think you have to look closely. The IMF description of what the opportunities are, really, this is not 140% debt to GDP ratio, excuse me, it's 40% debt to GDP ratio. So, the situation is entirely different and the situation is different in terms of the economy opportunities. Is this really a political decision that's being made or is it a really economic crisis with the window of opportunity to do something about it?
And last, my radical crazy idea, it was fine throughout the day to hear about political influence and that we needed to do something to mitigate, but for the most part we heard very little. How about another small step, much smaller than Ted’s proposal on mitigating political influence? Wasn’t Jim, at the beginning of the discussion Bretton Woods, a proposal made that the board should not be sitting in place in Washington, but should be flying in, well at that time, voting in? Today, it takes a lot less time. Wouldn’t having the political influence, at least on a day-to-day basis out of the hair of management and staff, be helpful to do some mitigation? Of course, there are other mechanisms and political influence will continue. I have no doubts about it. Can’t a little bit be done of that sort?

Adam Posen: Right. Thank you [inaudible 01:06:17]. Before I let my colleagues here decide which parts of [inaudible 01:06:23] question fest they would like to respond to- Yeah, well, I’ll do that in a second, just because they did that doesn’t mean I will.

Secondly, I have to plug, we are going to be talking about Ukraine and Eastern Europe on Thursday afternoon at the semi-annual joint Moody’s Investor Services PIE Sovereign Debt Seminar and Ola was involved with a project that are Anders Aslund and Simeon Djankov, are leading on taking lessons from transition Europe and getting the real story from those who actually performed the transitions and coming up with an action plan for Ukraine, and that publication will be coming out shortly.

Unless, do any of my colleagues here want to respond directly or are we going to collect? You think we should collect? Yeah, I’m well aware of that. You, please. Ted, could we get the microphone to this gentleman?

Martin Weiss: Hi, Martin Weiss, from Congressional Research Service. Before we kind of cross the river-con with Ted’s suggestion, the IMF quota request is part of the FY 2015 budget request, which will—there will be hearing and they’ll be marked up, if you were back in Treasury, Charles as well, how would you advice Secretary Lew to prioritize this and what tradeoffs? There’s been some suggestions, some talk on the House side that they’d be willing to—may-be that the opposition is less ideological as rather political; what could be achieved as well? So, what would you be willing to—how would you—what would be a suggestion of legislative strategy and what would you be willing to trade to get the quota reform?

Jim: Thank you. I’m not—I’ll try to end up with a question.

Adam Posen: No. Actually, then please take the microphone away from him.

Jim: No, no, no, I know I will. I mean, Tom asked me to correct him if—on the point about whether what’s happened with Troika’s is unprecedented. And I think when in 1994, when the Fund was negotiating a devaluation of the CFA franc, it first negotiated with France and when in the final negotiations with the CFA countries; France was really on the same side of the table as the IMF. So that’s kind of partial precedent of what happened.

On Ted’s point, I think just to reinforce his point, the 85% participation requirement is not normal. There have been eight quota increases before the 2010 and the only one that had an 85% requirement was in 1998. On all the others the quota increases could have taken place without the participation of United States, and I think it was really a scandal that the US was enabled to force this 85% requirement in 1998 without a fight.

In response to Ola’s point, yes, it’s true that [inaudible 01:09:51] fought very hard to have a nonresident executive board. The problem with that proposal in trying to implement it today would be that if you had a nonresident on board, that would leave one executive director who was down the street from the building at all times and that would be the US executive director. So I’m not sure it would really solve that kind of problems.
So, my question is, is everybody agreed with that?

Adam Posen: Thank you for being brief. Why don’t you go to the back microphone if you could? And then Landon, you’ll be the last one if you follow him.

Russell Kincaid: Russell Kincaid from Oxford University and formerly the IMF. A question to Ted, why not just have an ad hoc quota increase, rather than your proposal and leaving the 2010 reform on the table? You wouldn’t have to have all the complications that you’ve presented.

Adam Posen: The last question at the back mic.

Landon Thomas: Thank you. Landon Thomas, New York Times. Just I guess, in response to this notion that perhaps more weight should be given to emerging markets, if you look back at the Euro crisis, a lot of the intellectual power within the Fund was Euro-centric and I think some have made the point that perhaps because Europe was so close to it they might have missed some of the warning signs, either purposely or perhaps just because they were too close to it and didn’t have the distance to see what was going on.

Is there a concern perhaps if we do get more weight to emerging markets, as we see some of the imbalances and uncertainties in the world shifting towards emerging markets, that we might run into the same problem where the emerging markets take on more weight and more power, but then perhaps, the next round of problems are going to come in emerging markets and will they have the ability to sort of see again, some of these problems even though they may even be part of the problem? Thank you.

Adam Posen: So we’re going to go in reverse order. Ted can answer what he wants and then we’ll end with Thomas and what he wants.

Ted Truman: So, first, is Ukraine political? Yes. And I think you’re going to see, but I’m not—my forecast you will see in the discussions of the Ukraine program and you’ve already seen it in the public pronouncements of a lot the countries, that in particular, the leading emerging market countries, are not particularly comfortable with this. They feel that it’s being jammed down their throat in an environment in which they aren’t given anything on governance, so it certainly is political. Whether or not it deserves to be on its merits is a different case, but it’s perceived to be political.

Priority to the IMF package, That’s above my pay grade. I mean, I do—with one, the qualification. I think the scope within the US political system to include the IMF legislation consideration of issues that have to do with the US involvement with the Fund. Right? So within the germane, if you want to put it that way to the legislation, that there’s—but trading off other across politically, other political issues, as I said, is above my pay grade, but I think it is important. And that’s where the administration has failed to make this—raise this to a—the level of an important and international issue. No speeches by the President on the subject. No letters to Congress. No involvement of the Federal Reserve as the alternate governor of the International Monetary Fund. Delaying and producing and putting it through. So there has not been the political push from the administration, but I’m not going to deal with that [inaudible 01:13:59].

On Jim’s point and which I think I knew, but didn’t know entirely, part of that was before we had—we could block it with a larger majority, so you were not—your numbers are not quite right. In 1998, we fixed things, but that actually goes to Russ’ point. Sure, you can have bunch of ad hoc quotas, but as I emphasized, you could increase everybody’s quotas but ours, but the Secretary of the Treasury have to vote for that, too. And you couldn’t [inaudible 01:14:30] the resolution of the governors requires an 85% majority vote.
So, there’s no way of increasing. Ad hoc increases in quotas, so John Snow voted for the 2016 ad hoc increases, it required a vote of the governors of the Fund, he had to vote for it. I was surprised, given that he was at war with China at that time that he voted for an ad hoc increase in the quota for China, but he did. So that is I think, not a—I mean, if United States want to do that, fine, but it’s certainly, they’re better off with my proposal than with yours. And at [inaudible 01:15:08] at this point, certainly that’s a risk. I mean, but that goes with the world and I think the point is, and that’s part of the issue here politically, the United States has been driving the Fund if you want to put it that way, for 70 years, right. It has taken largely responsibility for what it does for better or for worse, right? It’s time for other countries to take on responsibility.

The message that Fred Bergsten gave earlier at the beginning of this conference was, “Other countries have to step up and take on their responsibilities in terms of the management of their policies and their responsibilities for the International Monetary and Financial System,” and that’s where rights and responsibilities go together.

Athanasios Orphanides: Let me start with the same question as well. So in my view, if a voting power is diffused to—and the more diffused the better, that would give us a better chance of a more technocratic institution, less influenced by politics, because at the end of the day, we’re going to have a political influence there anyway. The issues how to reduce that and elevate, what would be the technocratic advice we would expect? That will be the ideal to get to in my view, so I wouldn’t worry about raising the weight of emerging markets to what it should be, based on GDP population trade and other formulas that are under consideration.

Let me also address the issue on the Euro-area crisis decisions was a concern that contagion in the Euro-area, in light of the fragility in the Euro-area, could actually impact on stability in the European Union more broadly. The answer is yes, absolutely. I could take each one of the decisions that have been taken sequential during the crisis and always come up with arguments pro against reducing contagion in May of 2010. I could have made the case for allowing just the IMF to solve the Greek problem and I think the crisis would have been other if Europe has done that. Or I could say, “Well, let’s find a European way; let’s neutralize the losses and end it here.”

There are different ways to ending the crisis. The point is that every crisis has some cost that needs to be dealt with and what we’ve seen the Euro-area crisis, in my reading, is that there was nobody in Europe who cared about minimizing the cost of handling the crisis and instead of handling the crisis we ended up having a sequence of decisions whose primary influence, however they were justified, some of them were justified on stability considerations, but their primary role seems to have been to shift losses around from country to country to country.

And look where we’ve ended up. Suppose that the original problem was a 50% of Greek GDP; let’s say that that was the original problem. This would have been 1% each point of Euro-area in GDP back in 2010. One percentage point of Euro-area in GDP. Because of the mess we’ve created in Europe with the help from the IMF, if you look at the statistics now you’re going to see that GDP in the Euro-area is about 5 percentage points below where it would have been without the Euro-area crisis. If you just have the same path here in the United States within global financial crisis, GDP would have 5 percentage points higher right now. So, because we couldn’t figure out how to handle a crisis worth 1 percentage point, we actually created this massive problem. That’s the issue.

Charles Calomiris: I will follow Ted’s excellent example and ducking the question on legislative tradecoffs. It’s certainly above my pay grade and expertise. I think the key point is to demonstrate the importance of passing the legislation by building a broad coalition of support in
the business community, the financial community, the foreign policy community, as well as
the IMF policy wants to convince both sides of Congress that this is really essential legisla-
tion and it's deeply damaging to US interests and not to move it forward.

On the Ukraine question in whether it's political or technocratic, I don't think it's a bad
thing for the IMF to be political. The IMF is a policy-making institution and to be effec-
tive, it has to have a good political sense. I think the managing directors of the IMF who
would be most effective are those ones who are the best politicians. My point is not the
IMF should become less political, but that the political forces should have a better balance,
that they should better reflect the global economic balance of power, rather than the bal-
ance of power within Europe and I think this is Athanasios point too, the IMF is too domi-
nated by local interests, rather than my global interests.

So, the IMF is not just something that looks at the European politics, but looks at the
global interest, and I think that is essential to maintain the effectiveness of the IMF going
forward.

Vinod Thomas: On this question Ola’s on having a nonresident board. I mean, in fact, I think you see to-
day with the G-20, what’s happening is surveillance of the G-20 countries has shifted to the
G-20, where countries fly in their representatives from capitals for the MAP process, the
Mutual Assessment Process and the board discussion is perfunctory. So in fact, and that’s
my concern, that that surveillance function, for the most important countries, is shifting
out of the Fund, which is why I think the government's reform is so important. So, we have
a nonresident board for surveillance for the G-20 and that’s where the action is increasingly
growing.

I think emerging markets, well they have access of influence. I think we're trying to rectify
their lack of reasonable representation and influence. And I think the staff level, it’s not
politicized. Most of the staff who were hired from emerging markets were trained and edu-
cated at Chicago, MIT, Harvard, I don't think there's much risk on that side. I think it re-
ally is at the senior management level and at the board level. The real issue is rectifying the
gross European over representation at this point.

Thirdly, on Ted's proposal, ingenious, if he thinks Congress can be scared enough to act,
that would be terrific. I guess I worry that I’d rather have a handicapped hedge-man there
at the Fund than no hedge-man. I mean, US leadership has been critical for the Fund
throughout its history. I mean, I’ve seen periods of benign neglect out of the Treasury and
those have not been good years in my experience. The Fund needs strong US participation
and leadership and I think the result we have to look for is something that can bring that
about.

And just the last comment. It’s actually all Canada’s fault. Jim Routon did an interesting
piece, with which I think was on the table out front on history of Canadian roles in the
IMF. One of the things, there’s this myth Jim says, that the agreement was Europe gets the
ND and Americans get the World Bank. Well, it turns out that apparently the Americans
wanted a Canadian as the first managing director and went after two distinguish Canadians
who both said, “No. No way.” And so, they turned to Europe as a fallback; so it’s really all
Canada's fault. Thank you Jim.

Adam Posen: It’s hard to follow that. I'm going to make an obligatory, but heartfelt thank you and then
I'm going to make one substantive point. The obligatory but heartfelt thank you is to all
of you who participated, but particularly my colleagues, Hung Tran from the IIF and Do-
menico Lombardi from CG, who worked together to put this great conference together,
but also people like [inaudible 01:24:30] and everyone who came together to speak and
I gave us so much to think about. I think it’s been constructive. I think it’s not been too depressing and I think it shows how much evenly fond friends of the IMF are trying to engage with its limitations and foibles.

My substantive point is to depress you a little, which is to say Charles and Ted are worried about being above their pay grade. My title is President so I can do whatever the hell I want, Fred taught me that. It is shameful that the US Treasury Secretary has been unwilling to cut deals or the President has been unwilling to cut deals and it’s not just the IMF. This is simultaneously at the time that the US Administration has been unwilling to cut deals or push hard enough or build the kind of coalition Charles talked about, for Trade Promotion Authority.

And the kinds of cost we’re talking about are, as Athanasios I think articulated very well, hijacking of situations by locally actors and problems that get worst rather than getting resolved quickly and that doesn’t even touch the opportunities that the US is foregoing. And so, when we came up with the provocative title, “IMF: What Is It Good For?” I think it was obvious to all that we wanted to make the sound intellectual case, but the honest case for why it’s good for the US and for the world and that there is a set of policies that can be in the US’ own interest sufficiently to carry the day without being seen as making the IMF a stalking horse for the US.

And, I would call upon everyone in this room whatever you think of Ted’s specific proposal or Athanasios’ vision of the Euro-area or whatever, to think in those terms and make that case, because the US government, both Congress and Executive Branch, are moving backwards now in a way that we’ve often worried about, but rarely seen. Thank you very much.