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For some time now the Konrad-Adenauer-Stiftung in Washington has been engaged in a "Multinational Development Dialogue" between Europe, the United States and the developing countries. Important partners in this dialogue are the multilateral institutions as well as national governments and development organizations. In the context of the on-going debate about the need to reform some of these institutions, the Konrad-Adenauer-Stiftung Washington has commissioned a study on Reforming the International Monetary Fund. We are grateful that such a renowned economist as Professor Dr. Dr. h.c. Horst Siebert has graciously agreed to prepare this study. It was presented to the public in Berlin on November 8, 2006.

I am convinced that this study will be an important contribution to the discussions on reforming the IMF.

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Reforming the International Monetary Fund

by Prof. Dr. Dr. h.c. Horst Siebert*

The International Monetary Fund (IMF) has been suffering a crisis about the direction it is to pursue. Its mission appears to be frayed and not clearly defined. Its instruments are highly concentrated on *ex post* liquidity assistance without consideration being given to their incentive effects for new currency crises. The member nations' quotas no longer correspond to current weights in the global economy; and decision-making processes have come under criticism.

International Monetary Fund Mission

The IMF was founded in 1944 as multilateral institution for the purpose of fostering the stability of the international monetary system and, thus, enable good conditions for successful economic development after WWII. In the Bretton Woods exchange rate system the IMF was given the role to assist countries that had gotten into temporary balance of payments difficulties by providing bridging loans to them. In this manner the exchange rates could be kept more or less stable. When the system was changed to flexible exchange rates in 1973, it resulted in a fundamental change of the IMF's function: In a world where exchange rates for the short and medium term are determined not only by the trade in goods but also by volatile and rapidly reversing flows of capital, the IMF's purposes have primarily become those of preventing a national currency crisis from escalating into a systemic financial crisis of the global economy, of preventing a national currency crisis from developing and of supporting nations in a currency crisis so that they can overcome it. Additionally, the International Monetary Fund provides an institutional framework for discussions of international currency problems .[1]

In a system of flexible exchange rates a currency crisis that occurs in the presence of any kind of exchange rate linkages, that is with any "pegs", is characterized by the fact that the currency depreciates abruptly, unexpectedly and massively. During a major national currency crisis such depreciation, which often occurs within only a few weeks and is triggered by a reversal of capital flows, may amount to more than 50 percent of the foreign exchange value of the national currency, as was the case during the Mexican Peso crisis in 1994, the Asian currency crisis in 1997, the Brazilian crisis in 1999 and the Argentinean crisis in 2001/2002. A currency crisis destroys the savings of private households and of corporations. The balance sheets of banks, insurance companies, and corporations in the non-financial sector become disorderly.

* My thanks goes to Holger Wilms for collecting the empirical data and institutional aspects and for providing relevant suggestions, and to Szilard Erhart for his critical review of the manuscript. My discussions and correspondence with Barry Eichengreen, Gerd Haeusler, Adam Lerrick, Alan Meltzer, Herrmann Remsperger, and Andé Sapir provided valuable suggestions and ideas.

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Such a currency crisis results in a disastrous real distortion of the country's economy, during which the gross domestic product shrinks by about 20 percent during a brief period, such as one to two years.[2] Real losses in wages and other factor incomes are correspondingly high. A currency crisis with a massive impact on the real economy usually goes hand in hand with a political crisis. In contrast to any national currency crisis [3], a global systemic currency crisis impacts several or many currencies more or less simultaneously. Like during the Great Depression, the entire global financial system gets into disarray.

Other crises may also have an impact on currency stability, such as an emergency in a single financial institution like the near collapse of the "Long Term Capital Management (LTMC)" hedge fund in 1998; the bursting of a financial bubble like that in 1989 in Japan; and banking crises, although such events need not necessarily have an impact on currency stability.

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Top priority among the International Monetary Fund's missions is undoubtedly to prevent a systemic currency crisis. This includes preventing the spread of a national currency crisis to large parts of the international currency system or the entire currency architecture so that a national crisis does not spread to other economies. Fending off any contagion of other currencies [4] is of course inseparably linked to containing a national currency crisis. It is in this manner that the risk of a systemic contagion can be reduced instrumentally.

To control a national currency crisis two major approaches have to be differentiated: On the one hand, it is necessary to create conditions *ex ante* which preclude development of a currency crisis, and on the other hand there are *ex post* measures available, especially liquidity assistance, with which a currency crisis can be stopped or alleviated after it has started. The first category comprises financial monitoring by national oversight authorities and Central Banks; international coordination of financial oversight and its standards within the scope of activities of the Bank for International Settlements and the Financial Stability Forum (all of this not explicitly IMF missions); a national economic and financial policy designed for stability with an independent Central Bank; a prohibition to monetize public debt and institutional limits for public debt (again not explicitly IMF missions), and also an IMF early warning system. The IMF Facilities belong to the second category.

Both approaches are not independent of each other and influence each other mutually: Firstly, *ex post* assistance always has an incentive effect for the future behavior of borrowing countries and lenders. If generous assistance is granted *ex post*, governments are hardly going to make great efforts to avoid a currency crisis ("moral hazard"). Creditors will act with less prudence in granting loans. Thus, *ex post* assistance can increase the probability of currency crises. The *ex post* approach and the *ex ante* approach are therefore in conflict with each other. Secondly, although currency crises are a short-term phenomenon, they always have causes that have evolved over a long period. Thirdly, even though the International Monetary Fund can facilitate the burden of a country adapting to a currency crisis by *ex post* assistance, it is national economies themselves that have to bear a considerable portion of the losses,

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such as of savings and loss of total economic growth. Fourthly, in case of a currency crisis the IMF cannot simply give money to a country without the country changing its policies. Thus, the loans entail conditions for the borrowing countries ("conditionality"). Fifthly, although it is realistic to expect that currency crises will continue to occur so that *ex post* assistance will be required to prevent worse things from happening, it is advisable to give priority to *ex ante* instruments with which the probability of a crisis is reduced. Crisis prevention is better than acting as firefighters in a crisis.

Crisis prevention includes monitoring of economic development (monitoring) and advising national governments (Article IV consultations), usually called "surveillance". This includes analysis and assessment of currency risks and signaling an impending currency crisis under an early warning system. With its publications, World Economic Outlook, Global Financial Stability Report, and the Country Reports under Article IV, the IMF contributes to an analysis of the global economy and currency risks. The intention of the IMF leadership makes sense to include financial market data in the Article IV Reports and to pay attention to the possible effects of large national economies (IMF 2006a). The request to publish the results of country consultations has to be seen in this light. At this time, however, about one fifth of the member nations reject such publication in the form of a "Public Information Notice".

Recently the IMF's mission has noticeably expanded but the descriptions used for these new tasks have usually been very timid and cautious so that they may, if necessary, be later reinterpreted substantively. When evaluating these missions, the focus must be on the design expected in the future. In principle, any strengthening of surveillance is welcome (see early warning instruments below). But the expansive tendency expressed in items 7 and 8 of the Managing Director's Report (IMF 2006a) represents a considerable change of the IMF's mission. It includes monitoring exchange rates and multilateral cooperation.

Let me emphasize once more: The crucial aspect is how these items will be interpreted in the future. The IMF will inevitably fail if it promotes itself as the referee of exchange rates and desires to set „reference rates" for the most important currencies. This strategy, promoted primarily by the American economists Bergson and Williamson but now also taken up by the IMF, leads the IMF astray. The Fund does not have the necessary information for it; *ex ante* it cannot take on the role of market processes in determining exchange rates. Setting reference rates also presupposes that equally weighted exchange rates are determined and that the lines of monetary policy, fiscal policy, wage policy (in counties in which wages are set by labor and management), and the entire economic policy are specified in detail. (Siebert 2007, chap. 6). This would be the arrogance of knowledge addressed by Hayek. These approaches all too easily yield to the temptation of passing the buck to individual countries to bear the burden of adjustment. And often there is no agreement on the economic paradigm to be used as basis.[5] Finally, the experiences made with the Louvre Accord and Plaza Agreement in the 1980's and their impact on the development of the Japanese bubble in 1989 suggest that great caution is necessary.[6] The

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same applies to the establishment of optimum currency reserves.

The same reasons lead to the conclusion that the IMF cannot be an international coordination agency for national economic policies. The idea of having international macro-economic coordination is based on quite a bit of naiveté. What has been unachievable in a regional integration such as the European Union, i.e. harmonization of economic and financial policies within the euro zone, will work even less in a global organization. Moreover, this would move the IMF close to being an international economic government; these proposals are similar to ideas suggested for the European Monetary Union. But the IMF does not have any legitimate authority for this function; it would take the place of parliaments and democratically elected governments. The current Managing Director's idea to find new missions for the IMF in these fields therefore needs to be shot down.

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However, no objection exists to having a barometric coordination, in which governments exchange their views during multilateral consultations on the economic situation and technical policy actions planned by them. This includes the analysis of interdependencies of economic policy actions. Also, there is nothing wrong with having the IMF promote in the member countries suitable institutional conditions which prevent the development of a currency crisis. The IMF can also focus its instruments on promoting the establishment of such institutional measures. With respect to shaping national economic policy, the IMF has the role to explain the consequences of national decisions for currency crises to politicians, the public and the markets. This also applies to excessive current account deficits of individual countries (such as the U.S. in 2006) if they can lead to crisis-like adjustment processes. In such a case the IMF has the role of a trusted adviser.

Another expansion of its mission pursued by the IMF is playing a greater role in developing countries. While monitoring, advising and financial assistance during balance of payments problems are the traditional IMF missions in these countries, the approaches pursued in recent times have gone far beyond the IMF's missions (see instruments.)[7] This applies especially to debt relief for the poorest developing countries, which has been provided jointly with the World Bank. It is true that by using this instrument the IMF can silence criticism of some Non Governmental Organizations; and the argument is valid that the situation of developing countries and their balance of payments problems can be improved by loans. But the IMF mission does not include general lending in advance; this blurs the division of labor between IMF and World Bank. As welcome as such an initiative may be and as much as debt forgiveness improves the financial constraints of the poorest countries – this is no measure to prevent a currency crisis. Therefore it is not part of the IMF mission and should be left to the World Bank or a coalition of industrialized countries. Assuring currency stability is such a central mission for the world economy that the IMF as institution responsible for it should not be overburdened with other tasks, and its mission should not be diluted in this way. Otherwise the IMF loses its focus. Another important aspect is that these new peripheral tasks use a considerable number of staff and make expenditure containment

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more difficult.

One special point in the discussion has been for some time the role of the IMF as "lender of last resort". Here we need to differentiate between a systemic and a national currency crisis. Moreover, there is a relevant difference between a rescuer [lender] of "last liquidity" and a rescuer of "ultimate cost absorption" (who in effect bears the costs of the currency crisis by productivity losses and the use of tax funds). The IMF does not have sufficient financial funds to prevent a systemic crisis; its funds amount to about 170 billion US dollars. During a systemic currency crisis the three most important Central Banks, the Fed, the ECB and the Bank of Japan, must act in concert to provide liquidity (as they, e.g., did when the attack on the World Trade Center occurred on 11 September 2001). The rules for this function should preferably not be specified and published *ex ante*; it would permit speculators to gamble against the Central Banks. But during national currency crises the Monetary Fund may provide liquidity without assuming the costs of such a crisis. Thus, somewhat like a pawn in a game of royal chess, it acts in advance of the Central Banks as lender of last liquidity, thereby preventing a national crisis from escalating into a systemic crisis.

The IMF needs to be clearly differentiated from national or regional Central Banks, such as the Fed and the ECB, by the nature of its mission. The objective of Central Banks is to keep the value of money stable, i.e. a stable level of prices; that of the IMF is currency stability, i.e. controlling currency crises. The stability of the value of a currency and currency stability are closely linked. Because a loss in the value of a currency always goes hand in hand with a currency devaluation (if the rate of domestic inflation is higher than abroad), and analogously, a stable exchange rate requires a stable currency. If we understand currency neutrality to mean that a currency does not have a negative impact on the real economy, then the IMF is responsible only for one aspect of such currency neutrality, namely currency stability. The other aspect, the stability of the value of money is the responsibility of the Central Banks. The work of the IMF requires that Central Banks assure stable currency values.

The IMF should not become misguided in its mission if there are no currency crises for a lengthy period of time. It is the characteristic nature of currency crises that they occur unexpectedly. We realistically have to assume that in spite of all efforts made, there will be currency crises in the future. If this is the case, we need resilient institutional arrangements. If the IMF were overburdened with marginal missions which additionally would have to be handled during a crisis, it would not be able to do justice to its inherent original mission.

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Instrument Architecture

The interpretation of the IMF mission is reflected in the concrete form of its instruments. We need to differentiate between crisis prevention *ex ante*, instruments of *ex post* control of existing currency crises and *ex post* instruments which take into account any *ex ante* incentive effect for crisis prevention.

Ex ante Instruments for Crisis Prevention

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Crisis prevention measures include all information instruments available to the IMF, such as the World Economic Outlook, the Global Financial Stability Report, the Article IV Country Reports and the information exchange between members, such as during annual meetings. Essential elements of these information instruments are criteria which indicate an approaching currency thunderstorm. All of this information needs to be published and given to the markets. It is of little use if the IMF discusses the data behind closed doors with the governments of countries which have problems. It is necessary to sound the alarm before an incident has occurred. And it is preferable to accept a minor crisis if it can avoid a major crisis. In its operations, this early warning function certainly is not easy to perform since financial markets may overreact; and what must not happen is that trivial news items grow into a major crisis. It is necessary to have a vast number of unambiguous criteria and reliable reporting; in this role the IMF, similar to a Central Bank, has to establish its reputation and credibility. Under no circumstances may the IMF withhold information. It must resist the interests of national governments for whom the news may be inopportune. There is much to be said for regular publication of data, even of statistics (e.g. "country financial sector fact sheets"), without any consideration being given to national political calendars, such as election cycles.

This information includes data on the balance of payments situation, capital flows and their structure, foreign exchange reserves of a country and its special characteristics (are they committed elsewhere and/or "swapped"?, do they, like in China, serve to improve the capitalization of state banks), foreign debt and its type (direct investments, bonds, bank loans), national debt stock and indebtedness of the private sector, maturity structure of such debt, composition of debt with respect to currencies, explicit and implicit indebtedness including hidden future liabilities, the consolidated annual statements of the financial sector, its most important segments, and the largest enterprises, "off balance sheet liabilities", which i.a. is a measure for necessary reserves in the banking sector relative to liabilities, especially short-term ones. One crucial aspect of transparency is the information about the extent to which international banking rules and financial supervision rules are observed and whether there is a deposit insurance fund. As suggested by the Managing Director, country reports are to increasingly include the results of the "Financial Stability Report". The purpose of all this information must be to develop a robustness criterion.

Moreover, the IMF should use its influence to cause countries to be conscious of stability in their actions and to take appropriate institutional precautions. In addition to using persuasion, this can be achieved by linking *ex post* instruments to the implementation of institutional rules (see below).

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Ex post Instruments to Control Existing Currency Crises

So far the IMF has predominantly relied on *ex post* instruments, which are used after a currency crisis has erupted. Since capital markets provide no more liquidity to a country in crisis, that country is unable to meet its payment obligations (debt service, repayment of loans). There is a moratorium, and negotiations with creditors are started which result in the creditors losing part of their loans. To enable emergence from the crisis fresh capital is the priority need and is provided by the IMF in the form of liquidity assistance. This is the IMF's fire-fighting function. IMF loans bear interest [8], some with a surcharge, and are to be repaid. Since the IMF cannot just spend money it needs to establish conditions when providing funds that aim at improving the economic situation of the country in crisis.

The existing financing instruments limit the amount which can be drawn as loans to 100 percent of the quota on an annual basis and to a cumulative total of 300 percent, net, with consideration being given to negotiated repayments; in exceptional cases these limits may be exceeded. The needed refocusing of the IMF mission described here makes clear that the "Poverty Reduction and Growth Facility", introduced in 1999, should be abolished (see above). It is not unusual that facilities are terminated. For example the "Contingent Credit Line", which had also been introduced in 1999, ended in 2003. This facility had been designed to protect member nations from contagion. But it was not accepted by members because those countries that might have signed up for it were afraid to send a signal to the markets that a crisis was to be expected. The instrument acted as a stigmatization.

The other facilities, the "Stand-by Arrangements"[9], "Extended Fund Facility"[10] and "Supplemental Reserve Facility"[11], „Compensatory Financing Facility"[12], „Emergency Assistance"[13] und die „Exogenous Shocks Facility"[14] should be continued in principle except for the reorientation discussed in this study.[15]

A contagion fund has been suggested as a new instrument, which is to be used during a systemic crisis, that is when contagion needs to be prevented. To avoid repeating the negative experience made with the "Contingent Credit Line" this facility should be administered within the framework of the "New and General Agreements to Borrow"; it should provide for quick decisions and disbursements. The loans should not be tied to any conditionality and should not be more expensive than regular Fund loans. This facility should replace the "Supplemental Reserve Facility".

There have also been suggestions to reduce loan maturities, loan limits and interest levels. The Meltzer Commission, e.g., proposed a maximum term of 120 days with a one-time extension and a loan limit equal to a country's annual tax revenues. And the interest rate is to include a surcharge over previous market rates paid by the debtor ("penalty rate").

The IMF cannot grant loans without specifying conditions; otherwise, this would necessarily lead to wrong behavior. So far the IMF has demanded a change in economic policy ("conditionality") when granting loans. Hence, lending under the

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above described *ex post* instruments requires a discretionary decision and includes conditions. The criteria applied by the IMF in its lending have been the subject of a lively debate. In part this is because a consensus about the correct strategy is hard to achieve even among academic economists. One condition is especially useful, which provides that the debtor country starts serious and fair negotiations with its private creditors about debt rescheduling („good faith", serious and fair discussions). There is far-reaching agreement by now that in case of a currency crisis it is not advisable to defend at all costs a non-sustainable exchange rate that is not supported by economic fundamentals. Instead, devaluation is one of the instruments to exit from the crisis and to avoid distortions in exchange rates, the correction of which would ultimately be enforced by the markets through a currency crisis. Above all, an exchange rate should not be defended if a strong expansion in currency aggregates and credits and loans suggests a nominal devaluation and results in a real revaluation upward with a growing current account deficit. In a nominal devaluation care must be taken to avoid that the price increases resulting from devaluation do not lead to a second-round effect due to higher wage demands, and thus to an inflationary spiral. However, this is different from a situation where monetary policy tightens the interest rate screw in order to defend an exchange rate.

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There is controversy about conditionality in the area of fiscal policy. For example, even some IMF staff today think that the IMF conditions in the fiscal policy area were too harsh during the Korea crisis in 1997. But it probably will not be possible to control a currency crisis in a cisis country without those conditions which reverse absorption. Finally, there is a controversy about the conditions for structural reform, again in light of the experience made in Korea. The issue here is the legitimacy of the IMF, which arrives in a crisis country with a country team and demands conditions from a democratically elected legitimate government that has gotten into difficulties. The IMF cannot be the disciplinarian of national governments. The IMF's mission limits need to be defined so that the IMF does not assume the role of disciplinarian.[16]

A clear course to get out of this predicament would be to follow the Meltzer Commission's proposal, according to which the IMF may give loans only to those countries which have established adequate conditions for stability. No further conditions would have to be required; then the past practice of conditionality could be eliminated. The difficulty with this proposal is that the existence of conditions of stability cannot unambiguously be determined. When there is illiquidity, solvency alone is not a sufficient indicator for the presence of conditions of stability. Moreover, nations not accepting this condition would not receive any loans. This would be the case even when there is the risk of contagion for other economies. An alternative to this proposal would be to provide more favorable loan access to those countries which meet certain conditions of good fiscal management. (see below).

Ex post Instruments Taking into Consideration the *ex ante* Incentive Effect for Crisis Avoidance

Ex post instruments raise the fundamental

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problem that these measures have *ex ante* effects. The literature speaks of the "moral hazard" problem, the problem of moral temptation or of wrong incentives. Governments, political parties, but also creditors such as banks and other lenders can rely on having a currency crisis become less serious because the IMF will be offering assistance. Accordingly, efforts to avoid a currency crisis will be less vigorous. The willingness to enforce institutional rules, for example, in the area of financial surveillance or limitation of public debt, is lessened. Thus, it becomes more probable that a currency crisis will occur. All *ex post* instruments used by the IMF are fraught with this problem. The current discussion therefore is exploring to what extent these instruments can be structured in such a way that they preclude undesired *ex ante* effects. In the existing *ex post* instruments these incentive effects have largely been neglected.

It is advisable to reward adherence to *ex ante* standards in determining access to loan facilities in case of a currency crisis by offering more favorable conditions, either with respect to loan amounts or interest rates. In this way, the IMF can cause nations to create preconditions for a stable currency system. In this way it gets a lever to influence national stabilization efforts and national regulatory policy. At the same time it offers a chance to reduce discretionary IMF decisions and make the allocation of liquidity assistance more automatic. Thus, the IMF appears less as the disciplinarian of sovereign nations which issues prohibitions and demands; instead, members voluntarily accept conditions *ex ante* without being subjected to the pressure of an existing currency crisis.

One idea is an *ex ante* published sliding interest scale dependent on loan amounts in relation to gross domestic product, and to have higher interest rates above a certain loan threshold. Much more promising than sanctions that have been announced *ex ante* are advantages offered to those member countries who abide by specified standards. The Meltzer Commission (IFIAC 2000, Meltzer Report) suggests as a positive incentive to have those member nations who meet a series of specified criteria gain access to loans without any additional consultations in case of a financial crisis. Among these criteria are free access for foreign banks, organized banking supervision and financial market regulation as well as the regular publication of the country's debt structure (see above). The Council on Foreign Relations (1999) speaks of a club of good economic governance ("good housekeeping club"), whose members get better conditions. For most of the IMF facilities a variable interest rate could be charged depending on whether or not the "best practice" rules established by the IMF are practiced. Countries could be divided into groups on the basis of this criterion; this would also act as a signal within the early warning system. By analogy, the Stiftung Wissenschaft und Politik (Zanker 2006) has suggested a differentiation between basic membership and privileged membership. Privileged membership which is tied to criteria of national indebtedness and financial market stability would enable qualified IMF members to obtain access to loans above and beyond the normal facilities in case of a liquidity crisis. The IMF has also proposed preferential access to loans in cases of good economic governance. (IMF 2006a).

Ex post instruments raise the fundamental problem that these measures have ex ante effects. The literature speaks of the "moral hazard" problem...

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The instruments discussed here do not signify any discrimination, they are appropriate to avoid a currency crisis. But all these instruments make sense only if they are credible, i.e. if they can be sustained in case of a currency crisis. This presupposes that the arrangements must be designed in such a way that currency crises can be controlled with them; under no circumstances should a national crisis be allowed to escalate into a systemic crisis.

The insurance facility proposed by IMF staff has some similarity to these proposals; it is to provide automatic access to IMF funds for emerging countries with a sound economic policy in case there is a financial crisis. But this instrument seems to be rather similar to the abolished "Contingent Credit Line". Negative signaling effects are probable in the markets. Moreover, IMF funds would have to be committed which then would not be available during a currency crisis. Thus, this instrument runs counter to a re-focusing of the IMF mission.

Insiders refer to the fact that IMF staff can prove themselves in the use of ex post instruments, especially if they have participated in ex post crisis control. This is how they advance their career. There is little glory to be gained with ex ante instruments.

Further Aspects Relating to *ex post* Instruments

Any re-orientation of the IMF has considerable impact on the staff. Insiders refer to the fact that IMF staff can prove themselves in the use of *ex post* instruments, especially if they have participated in *ex post* crisis control. This is how they advance their career. There is little glory to be gained with *ex ante* instruments. This creates a hard-to-control incentive problem and bias for *ex post* instruments in the entire organization.

In the area of risk allocation, that is the question who ultimately will bear the losses in case of a crisis, *ex ante* arrangements might be effective which determine risk allocation in advance. For example, it can be specified in advance for bank loans and bonds what creditor majorities will be required to change a loan agreement with a sovereign debtor in case of a crisis, and to approve any losses of lender capital (so called "sharing clauses", rules on collective representation, British-style trustee deed bonds instead of American style bonds). This raises the risks for lenders and therefore reduces their willingness to offer loans; hence, loan costs increase for borrowing countries. But at the same time risks are internalized in advance and the probability of currency crises is reduced. All of these rules are designed to replace discretionary decisions (preferred by the US) by automatic actions (preferred by the Europeans).

Farther-reaching proposals to create an insolvency law for sovereign debtors and to establish a type of global bankruptcy trustee have not gained acceptance so far. This applies to the concepts suggested by the IMF itself. The reason for rejection is that there is no bankruptcy law for sovereign debtor nations because sovereign nations are not willing to submit to arrangements that would provide that the IMF would play the role of bankruptcy trustee and could declare a nation illiquid. Lenders equally do not find it acceptable to have the IMF play a role in which it, analogous to a bankruptcy trustee, could decide the creditors' loss ratio during an illiquidity (or even an insolvency) of a sovereign debtor. There is resistance to such a concept even if the crisis country itself could declare a moratorium; by acting as loan monopolist, the IMF in the final analysis would gain considerable direct power over sovereign nations. In contrast, institutional

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arrangements of collective decision making offer the lenders the advantage that they correspond more to decentralized market-type processes.

Adapting the Bretton Woods Formula to the Changes in the Global Economy

The rights and obligations of the 184 IMF member countries are determined by the quotas of the individual countries, which specify the capital subscribed by a country, its voting power, its access limits to financing, with arrangements for exceptional situations, and its share of Special Drawing Rights. Special Drawing Rights are a reserve currency created in 1969 when the two other reserve currencies, gold and the US dollars, were in tight supply.

Decisions in the IMF are taken by the Board of Governors, which usually meets twice a year. Each member nation appoints a Governor and an Alternate (in most cases the Minister of Finance [Secretary of the Treasury] or the Head of the Central Bank), whose voting power is weighted according to his country's quota. Each country receives 250 basic votes plus one vote for every 100 000 Special Drawing Rights in its quota. The day-to-day business is managed by the Board of Executive Directors, which consists of 24 Directors. The US, Japan, Germany, Great Britain, and France appoint one Director each, the remaining 19 are nominated by groups of countries.

Country quotas are determined in accordance with the Bretton Woods Formula and its variations, five formulas in total, comprising five factors, i.e. gross domestic product, currency reserves, current account balance transactions, one factor measuring the variability of current revenues, and the ratio of current revenues to gross domestic product. Although this formula has repeatedly been adjusted it is not transparent and is too closely tied to the Bretton Woods System. An external commission, appointed by the IMF for the first time, the Quota Formula Review Group (IMF 2000), of which I was a member, therefore proposed a single simple linear formula to determine the quota, namely

$$\text{Quota} = a\,Y + bV,$$

where Y is the gross domestic product, V is a measure for the external variability of current revenue and a and b are relative weights. Gross domestic product is an expression of the efficiency of an economy in the financing area and is to have twice the weight of variability (2/3 and 1/3). The variability of current revenue, which characterizes the vulnerability of an economy, is to include the variability of long-term net capital flows. Both criteria also express the substantive interest of nations in having an effective institution. Productive economies might lose much in currency crises but the vulnerability factor is also an indicator for the interest of nations in having an effective IMF.

If gross domestic product were measured in purchasing power parities the non-tradable goods sector would be overvalued, because purchasing power parities give this sector a greater weight. It should therefore be computed in market prices by calculating three-year averages in constant prices. In principle, a country's global

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Adapting the Bretton Woods Formula...

market share might be used as a possible criterion in the Bretton Woods Formula. [18] However, market share values fluctuate strongly with the exchange rates even if averages over several years are used; an upward revaluation of the US dollar leads to a mathematical increase of US market share and reduces market shares of other countries before the higher US dollar reduces US exports over the longer term in a second-round effect. Moreover, if the focus was only on global market share, no consideration would be given to the total productive capacity of a country's economy; the entire area of non-tradable goods would not be covered by the formula. It also should be noted that gross domestic product or global market share cannot represent the sole criteria and that other aspects are relevant, such as vulnerability. Currency reserves are not a useful criterion for calculating quotas. The experience with currency crises has shown that reserves melt like snow in the spring sun during a reversal of capital flows and that any decline in reserves that becomes public knowledge worsens the situation like in a vicious circle. In addition, large currency reserves are of little use if they represent the surety for a fragile banking system (like in China); reserves therefore would have to be corrected for the stability of the banking system and other factors. Using population figures as an alternative criterion for gross domestic product would express neither the financial effectiveness nor the vulnerability of an economy. Moreover, the principle of "one country - one vote", as applied in the WTO, e.g., would not meet the material interests of member countries and would so jeopardize the financing of the IMF.

A quota is not perfectly identical to the weighted voting power. For example, Germany's quota is 6.09, its share of votes is 5.99. For the US the comparable figures are 17.40 and 17.08. These differences are caused, among other things, by the fact that basic shares are independent of quota. Moreover, other factors impact the actual influence of a member, such as who selects the Managing Director and his Deputy and where the organization is headquartered.

Irrespective of the criteria used to determine quotas, the current quota allocation no longer corresponds to the actual conditions in the world economy.

Irrespective of the criteria used to determine quotas, the current quota allocation no longer corresponds to the actual conditions in the world economy. It does not reflect the growth of important emerging countries and their welcome integration into the world economy. On the basis of the most recent data China, e.g., has become the fourth largest economy in the world as measured by its gross domestic product at market prices (in 2004 its share in global economic output amounted to 4.68 percent); but it has an IMF quota of only 2.98 percent (Table 1). In Asia China, Japan, and Korea are underrepresented in their quotas if the 2004 gross domestic product in current prices is used as a basis. On the basis of the gross domestic product criterion, it is especially the smaller countries of the European Union that are overrepresented, such as Belgium, the Netherlands, Sweden and Switzerland; Spain is underrepresented. The European Union, with a quota of 32.22 for a production share of 31 percent, is only slightly overrepresented. This also applies to the European Monetary Union (quota 24.01; production share 23.63 percent). Europe provides the Managing Director. The United States have a quota of 17.40 percent with a

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share of 30.73 percent of global economic output; but they have the advantage that the IMF is headquartered in Washington, that the US appoints the Deputy Director, and that the “peer group“ of American economists (it is often desirable for staff to have a Ph.D. from an American university) exerts a not- inconsiderable influence on the IMF’s direction. In Latin America, when measuring shares of global gross domestic product, Brazil and Mexico have a slightly low quota while Venezuela has a quota that is too high. The quota of Africa is markedly higher than its share in production output.

If gross domestic product is used as criterion, North America, and in particular the United States, are underrepresented; however, no change in US quota is currently planned. The quotas of Asia and the European Union correspond approximately to their production figures. Central and Latin America as well as Africa have higher quotas than would correspond to their gross domestic product. The quotas of some countries do not correspond to their production output; China, Japan, and Korea as important Asian countries are under-represented (even with regard to quotas calculated according to the current formula, see 3rd column in Table 1). In Europe some of the smaller countries are overrepresented. Other countries, such as Saudi Arabia, Venezuela, and Russia also have relatively large quotas.

Especially for China and Korea the current quota allocation no longer reflects economic realities. The current quota allocation prevents underrepresented members from developing an interest in the IMF as institution, especially when they expect to have strong growth. Over the long term this weakens the IMF’s raison d’être. It should be noted that gross domestic product represents only one possible criterion. Quota allocation is always a zero sum game: An increase for some countries necessarily results in a decrease for others.

A two step process is used as a pragmatic solution. During the Singapore meeting of the IMF in September [2006] , the quotas of China, Korea, Mexico and Turkey were adjusted in a first step, with Mexico’s and Turkey’s quotas having deviated only negligibly from their production shares (and calculated quotas). The quotas of the four countries were increased by 1.8 percent; the quotas of the other countries were proportionally reduced. China’ s quota was increased by less than one percent to 3.719 [19] (IMF 2006d). A second step aims at reaching a political solution in which basic votes are to be increased (see below). To this end, the US might relinquish one percent of its voting share without giving up its blocking minority shareholding of a little over 15 percent if Europe in parallel relinquishes some of its voting power and, like the US, does not insist that its economic production share be used as guideline.

The current quota allocation prevents underrepresented members from developing an interest in the IMF as institution, especially when they expect to have strong growth.

Table 1: Current IMF Quotas, Quotas According to the Shares in Global Economic Output, in World Trade and in a Combined Indicator

	Current Quota 2006[a]	Calculated Quota[b]	Share of Global Economic Output 2004[c]	Share of Global Trade 2004[c]	Combined Indicator 2004[d]
G7	46,08	47,32	65,07	40,22	54,75
USA	17,40	16,80	30,7	10,7	22,0
Japan	6,24	7,52	11,20	4,44	8,94
Germany	6,09	6,95	6,64	9,10	7,46
France	5,03	4,33	4,96	4,64	4,85
Great Britain	5,03	5,18	5,14	4,58	4,96
Italy	3,31	3,44	4,06	3,90	4,01
Canada	2,98	3,10	2,37	2,86	2,53
Europ. Union (EU 25)	32,22	37,61	31,01	39,95	33,99
Euro Zone	24,01	27,61	23,63	31,23	26,15
North America	20,34	19,90	32,9	13,9	24,5
Emerging Countries in	27,09	15,28	26,04	24,44	25,52
China	2,98 bzw. [3,719][e]	5,20	4,68	5,73	5,03
Korea	0,76 bzw. [1,346][e]	2,51	1,65	2,62	1,97
Transf. Countries					
Russian Federation	2,79	1,52	1,41	1,78	1,53
Near East					
Saudi Arabia	3,27	1,06	0,61	1,15	0,79
Turkey	0,45 bzw. [0,548][e]	0,74	0,73	0,76	0,74
Central - and Latin America	7,32	5,18	4,85	4,63	4,77
Brazil	1,42	1,00	1,46	0,95	1,29
Mexico	1,21 bzw. [1,449][e]	1,93	1,64	1,78	1,68
Venezuela	1,25	0,42	0,27	0,35	0,29
Africa	5,91	2,43	1,39	2,08	1,84

[a] September 1, 2006. [b] Data of the German Central Bank [Deutsche Bundesbank] as of 9. 14.2006. [c] Trade in goods or including services in current prices; Source: World Bank, World Development Indicators. 2004 . [d] Weighted Indicator: 2/3rds share of global economic output and 1/3rd share of global trade . [e] Quota after adjustments of Singapore. Quotas of the other members change negligibly.

Representation of the European Monetary Union

There is no agreement on whether the European Monetary Union should have a common representative. This would ultimately mean that Germany and France would not be represented by their own directors and that the other ten of the twelve Euro Member Countries would not be represented in their respective constituencies. The arguments in favor of a joint representative are the common monetary policy, increasing harmonization in banking supervision and the essentially coherent economic area. A currency crisis of the euro would affect their common currency. Arguments against such a move are: Balance of payments as macroeconomic budgetary and financial restrictions have remained a national function; balance of payments problems have to be solved on the national level. Even a currency crisis of the euro could ultimately not be controlled by the European Central Bank; it does not have instruments for it, for example in the financial policy area. Instead, the member countries of the European Monetary Union would have to use these instruments and bear the costs of such a crisis by using tax revenues to control the crisis. In case of liquidity assistance by the IMF, any potential conditionality would have to be directed at national governments. This applies in particular to the tax and budget policies of member countries. Large areas of economic policy have remained national responsibilities in the European Monetary Union. These are the reasons why, unlike in the World Trade Organization, where regional integrations such as the European Union have harmonized important instruments of trade policy, such as customs duties, and thus are represented as one unit, it is provided in the IMF By-Laws that only nations can become members of the IMF (IMF 2000).[20]

A common representative may undoubtedly be seen as one piece in a puzzle which would add pressure toward further currency integration, including toward a unified economic government in the European Monetary Union. But it is doubtful whether this argument, which has been raised by French economists, would represent a desirable development within the European Monetary Union. Mention should also be made that there may be a future trend to demand that Europe eliminate its intra-EU trade from its calculation of global trade. In this case EU quotas would be considerably lower. Based on the Foreign Trade Statistics for 2004, this would mean a decline for the EU 25 by 66 percent in the world trade indicator. And global trade as indicator for quota calculation would still have to be reduced by 50 percent for the Euro Zone. If quota calculation is based on a weight of one third for global trade (Table 1) this would mean a reduction in the current voting shares by 22 percent and 16 percent.

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IMF Financing Problems

During recent years there have been problems with financing the IMF's work. The Fund primarily finances its operations from the difference between interest paid and interest received. According to IMF information, the 2005 income amounted to 3.6 billion US dollars. This compared to interest payments of 2.6 billion US dollars to member countries whose quota shares were used for international loans. The difference is used primarily to fund IMF operating costs. The IMF official expenditure projection („Medium Term Expenditure Framework") estimated administrative Fund costs at 880 million US dollars for 2006 and about 914 million US dollars for 2007. The largest portion of Fund expenditures are personnel costs, which with about 600 million US dollars amount to almost three fourths of the Fund's administrative expenses. Administrative costs also include about 44 million US dollars for capital investments in buildings and information technology. Costs have been rising on the expenditure side while income has steadily declined since 2002. The practice until now to set the basic IMF interest rate level in such a way that interest profit at least covers IMF expenditures will not be sustainable over the medium term since the lending volume has been declining drastically while expenditures have remained unchanged. The lowest lending volume in 25 years has resulted in one of the lowest incomes in the Fund's history. In 2006 only Turkey still pays de facto loan interest. For its budget, the IMF has reserves in the amount of about six billion US dollars. But the current financing situation can hardly be called sustainable if the current trend of declining lending volumes were to continue.

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In addition to the Secretariat's reform proposals and independent of pending Crocket Commission proposals, it is necessary to drastically reduce expenditures, to end non-core missions (see above under Mission), and to reduce staff accordingly, in order to assure the IMF's financing for the long term. Insiders talk about a bloated bureaucracy. The mission and expenditure structures have to take into account that the IMF as an institution is moving away from crisis management toward crisis prevention, and that this results in a decline in lending volume. Although a partial sale of gold reserves would provide relief on the income side, it would only be temporary. The need for reform would lose its urgency. Reinvestment of profits, a "better" lending strategy, the expansion of third party financing, and the introduction of an investment fund for existing Fund reserves would increase the Institution's financial vulnerability and, thus, would limit its possibilities to act during monetary crises. It does not seem advisable to pursue the idea that the IMF should charge service fees for economic policy analysis in member countries (Country Reports). The IMF would find little favor among its members because its advice is often not welcome. Thus the IMF would quickly face a catch-22 situation of buying acceptance by giving positive assessments. Moreover, the IMF does not have a monopoly on these analyses; it competes, i.a. with the International Bank for Settlements, the World Bank, the OECD and the Rating Agencies. Other than by reducing expenditures, the IMF's financing problem could be solved for the long term only by an increase in capital. It is doubtful, however, whether the shareholders are willing to do so because this would take the

Changing the Decision-Making Processes

In addition to an adjustment of quotas, there is also a debate about changes in the institutional rules for decision-making processes.

After the IMF meeting in Singapore there are plans with respect to voting rights to increase the basic shares of currently 250 basic votes, which apply to all member countries, and to correspondingly reduce all shares above the basic votes that depend on the quota. The Board of Executive Directors has, for example, proposed (IMF 2006b, 2006c) to raise the basic voting rights to a minimum of 500 in order to give low-income countries a bigger share. In total, the basic votes of the 184 members would then rise from 2.1 percent of total votes (amounting to 2 178 037 million) to 4.2 percent. Taken to the extreme, this way to proceed would result in nothing but basic voting shares and all members would have the same voice ("one country - one vote"). But in contrast to other international institutions, the IMF is an institution whose special nature requires it to have sufficient capital at its disposal to prevent monetary crises. Moreover, it is an institution that must take rapid decisions when a monetary crisis is developing. The IMF mission and its capacity to react quickly and appropriately would be restricted if basic voting shares were greatly expanded. Countries would have little interest to contribute to its financing. The institution would become less attractive; its ability to perform would suffer. So there are some good arguments for keeping the current approach for determining quotas. Hence, an increase in basic voting shares is possible to a limited extent only.

The situation is different in respect to the procedure for appointing the 24 Executive Directors. In principle, the entitlement of some countries to appoint a director (currently the US, Japan, Germany, France, Great Britain) and the possibility to establish groups of countries (constituencies) changes when quotas are adjusted to the new weightings in the global economy. Members with a voting share of more than 4.17 percent would have the right to appoint a director to one of the 24 Director positions. A comparison with the current Board seat distribution confirms that the US, Japan, Germany, France and Great Britain could continue to appoint one executive director, each, in accordance with Table 1. In addition, China, which already has an executive director, would have that right. But in a strict interpretation Russia and Saudi Arabia could no longer form a constituency by themselves.

In the remaining 16 constituencies with more than one IMF member country, these countries may appoint an executive director from within their country group if they are able to organize an appropriate voting share by forming coalitions. In principle, the procedure of forming coalitions seems to make sense. Various groups use different methods for it, rotation procedures are used and also regular elections. There evidently is one difficulty that some countries are not willing to form coalitions for political reasons and insist on their own seat in spite of having a low share of votes. Moreover, it is noticeable in the current allocation of Board seats that the country with the largest voting share among its constituency provides the Executive Director or his Alternate in 11 of the 16 constituencies. Since these are often the smaller

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European countries, such as Belgium, the Netherlands or Switzerland, these nations have an above average influence on appointing that Executive Director. The voting power of an Executive Director on the Executive Board is weighted according to the voting power of the country or constituency he represents. Hence, the U.S. Executive Director has 17.08 percent of the votes on the Executive Board, whereas the smallest African constituency has an Executive Director on the Board with a voting share of only 1.41 percent.

Even after a change in quotas, a continuing characteristic of the IMF is that IMF management and the interests of member countries are closely intertwined. This can be interpreted in a positive way insofar as the nations must ultimately provide a guarantee with their capital shares and that they gain benefits from the IMF's successful crisis management in other countries for their own foreign trade and capital transactions and, thus, for important export areas, for importers, the banking sector, and other parts of their economies, and even for growth and employment. To this extent, the interest of member countries in the IMF's work is legitimate; it is also consistent with the basic principle of quota determination. It would be unrealistic to demand that countries all of which have a strong interest in a positive development of the global economy could not combine to form coalitions; even if this results in a situation where the G-7 hold almost half the votes. [21] It is a completely different matter if the IMF is used for foreign policy purposes of a single member country, such as the U.S.. In the framework of the existing quota system this can be thwarted only by an appropriate resistance by the other member countries, such as the European Union. On balance, these arguments lead to the conclusion to stay with the number of 24 Executive Directors.[22]

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It is still unclear whether regional IMFs might form in parallel to the disintegration of institutional arrangements within the WTO due to bilateralism and regionalism, as the efforts in Asia seem to suggest. As far as security networks against financial crises are concerned, there are no objections in principle to have a hierarchy of such security networks (for national banks e.g.); but it would be difficult to design such a network in a way that is consistent with the IMF's structure. Furthermore, monetary crises by their nature are not limited to a region but are interdependent through multiple mechanisms (Siebert 2007). Unfortunately, the exchange rate, which is at the core of the IMF's activity, has been considered a political tool. Any regionalization of institutions must necessarily result in a further fragmentation of the world economy.

The proposals to fundamentally change the decision-making process and to make IMF management more independent are more far-reaching. The proposal made by the Governor of the Bank of England, Mervyn King, (2006) returns to some Keynesian ideas: Accordingly, the IMF is to be managed by a Managing Director with a markedly strengthened role who would be responsible for the IMF's proper functioning. The Executive Board would be eliminated or it would lose substantially in importance; this would solve or defuse the problem of how the 24 Executive Directors are appointed. The Managing Director would be supervised by the Board of Governors

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whose national members would meet in Washington more frequently than now, e.g. six to eight times a year. The Board of Governors would be composed of representatives of the national Ministries of Finance or Central Banks and, thus, would not reside at headquarters. King pointed out that the lines of authority in the Fund are not clearly discernible in the current structure. Moreover, Executive Board members are confronted with a wealth of material during their meetings of 500 hours per year (300 pages of documents per working day); this work load makes it harder to manage the IMF and makes each Director dependent on his national experts.

One criticism raised against this proposal is that the individual countries would have to cede important decision-making authority to the Managing Director. For example, they would have to be willing to support his decisions on loans even if this might mean a financial liability for them. In case of a monetary crisis the Managing Director would probably have to be granted far-reaching authority to enable prompt decisions. With a non-resident Board of Governors it might be difficult to supervise the Managing Director. On the whole, supervision becomes more complicated if the current resident Executive Board is replaced by a non-resident Board of Governors. Furthermore, the United States would gain greater influence because of its presence at headquarters.

To avoid the problem of a non-resident Board of Governors Eichengreen (2006) suggests to appoint an independent committee, perhaps of five persons who would be the decision - makers. The Managing Director would be an equal among equals ("chairman of the board"). Similar to a Central Bank Board, the members would vote on important issues. They would be appointed for a six year term; the decisive criterion would be their qualification. The number "five" is derived from the five major regions of the world, Europe, North America, Latin America, Africa and Asia. However, members would not be selected by their regions of origin. Under this proposal Europe would lose the prerogative to appoint the Managing Director; the US would lose the prerogative to select the Deputy. The quota system would be suppressed in this IMF decision-making process.

This structure, based on the model of a Central Bank Board, such as the Central Banks with federal elements like the Federal Reserve Bank or the ECB, represents a marked shift of the decision-making authority from shareholders to the IMF. While the decisive argument for establishing an independent Central Bank, i.e. the depoliticizing of the money creation process, is that politicians may abuse the control over money for their own purposes (like Hitler in financing military expenditures during the re-armament for World War Two or like governments trying to maximize the votes they get) so that monetary stability suffers, there is no similarly strong argument for an IMF institution which is completely independent of its shareholders. The proposal implies a considerable relinquishment of sovereignty by major national economies which depend on global trade and global capital flows, but also by medium-sized and smaller open economies which derive their wealth from global trade and global capital flows. It is possible to imagine regulatory mecha-

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nisms, similar to those of the European Monetary Union, which would obligate countries to contribute capital while they would simultaneously be protected from excessive domination by IMF management. Such regulatory mechanisms would be similar in quality to the Growth and Stability Pact but they would be much more complex and would have to regulate both the relinquishment of sovereignty by member countries, for example during contributions of added capital, and also IMF oversight within an international treaty. It is hard to imagine a pragmatic solution here.

King's and Eichengreen's proposals, which aim at strengthening and depoliticizing the IMF, have little chance of being implemented. The IMF is, after all, the resultant force in a force field of member countries with extremely different fields of interest.

With respect to its instruments it should emphasize crisis prevention and set conditions for lending in advance to get away from the role of disciplinarian who sets conditions in the aftermath, and to avoid disincentives due to "moral hazard".

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The conclusion is: With respect to quotas the IMF should respond to the structural changes in the global economy and implement them so that it does not lose support from emerging economies in the global economy. It should replace the current non-transparent formula of quota calculation by a new Bretton-Woods-Formula reflecting these global economic changes. With respect to its instruments it should emphasize crisis prevention and set conditions for lending in advance to get away from the role of disciplinarian who sets conditions in the aftermath, and to avoid disincentives due to "moral hazard". These instruments include an efficient early warning system which shows international markets and governments of member countries what the consequences of their actions and their institutional arrangements are for economic development and for potential monetary crises. It is not advisable to establish equally weighted exchange rates or to engage in macro-economic coordination of economic policies in special technical policy areas. Above all, the IMF should remember its mission to control monetary crises. Because the damage caused by these crises is serious (in many cases a loss of gross domestic products by about 20 percent in two years). Therefore it remains true that: The world needs the IMF. Other functions which focus more on development policy should be left to the World Bank. Otherwise, the IMF loses its focus.

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[1] See Article I of the Articles of Agreement.
[2] Argentina, e.g. lost one fifth of its GDP during the three years of 2001-2002.
[3] A monetary crisis might be linked with a banking crisis and a financial crisis. But a banking crisis and a financial crisis does not necessarily lead to a monetary crisis. Even though the financial crisis in Japan in 1989, e.g., led to a massive GDP loss (20 percent cumulatively, over more than a decade, Siebert 2007) it was not linked to a monetary crisis.
[4] National economies are intertwined by flows of trade and capital transactions. A crisis in one country has an impact on an investor's investment behavior toward other countries in his entire portfolio. Also, there is psychological contagion.
[5] On this point compare the root cause analysis of the U.S. current account deficit: The high preference of Americans for current consumption and excessive energy consumption are among the reasons just as the lack of economic dynamism in Europe, and even Europeans' preference for leisure time and for its systems of social security are.
[6] Louvre Accord and Plaza Agreement of the 1980's are held responsible for the development of the Japanese bubble (see Siebert 2007).
[7] Comp. the Exogenous Shock Facility and the Poverty

References...

Reduction and Growth Facility.
[8] With the exception of the “Poverty Reduction and Growth Facility“ and “Exogenous Shock Facility”.
[9] Created as the first facility, the “Stand-by Arrangement” serves to bridge temporary balance of payments imbalances. Member countries may draw on up to 100 percent of their quota within a limited period of time (usually 12-18 months, up to three years). The loan must be repaid in 2¼ to 4 years.
[10] The “Extended Fund Facility”, established in 1974, is designed for structural balance of payments deficits that require a longer adjustment period. It contains greater liquidity assistance than the “Stand-by Arrangements“. Repayment must be made within 4½ to 7 years. Surcharges in case of high loan amounts.
[11] The “Supplemental Reserve Facility”, created in 1997, is designed for large short-term financing problems and exceptional balance of payments problems such as during the Mexican and Asian crises. Repayment is to occur within 2 to 2½ years. The interest rate starts at 3 percentage points above the IMF borrowing rate; interest rate rises over time. This facility was created in response to the new type of monetary crisis characterized by a reversal of capital flows.
[12] The “Compensatory Financing Facility”, introduced in 1963, provides liquidity to countries which experience a sudden collapse of their export prices or an increase in their import prices for grains due to fluctuations in global market prices. The conditions of the “Stand-by Agreement” are applicable.
[13] The “Emergency Assistance Facility“ provides funds to countries affected by natural disasters. The interest rate here is the IMF borrowing rate. Exceptions are made for countries that qualify for the “Poverty Reduction and Growth Facility”. Repayment is within 3½ to 5 years.
[14] The “Exogenous Shocks Facility” provides low income countries confronted with an exogenous shock with economic policy and financial support. It is available to countries who also qualify for the “Poverty and Shock Facility (PRGF)“. Financing Conditions correspond to those of the PRGF program.
[15] Below is an overview of the resulting instruments.

General Terms of IMF Financial Assistance				
		Repurchase Terms		
Facility or Policy	Charges	Obligation Schedule (Years)	Expectation[I] Schedule (Years)	Installments
Stand-by Arrangement	Basic rate plus surcharge	3¼–5	2¼–4	Quarterly
Extended Fund Facility	Basic rate plus surcharge	4½–10	4½–7	Semiannual
Compensatory Financing Facility	Basic rate	3¼–5	2¼–4	Quarterly
Emergency Assistance	Basic rate[IV]	3¼–5	N/A	Quarterly
Supplemental Reserve Facility	Basic rate plus surcharge[V]	2½–3	2–2½	Semiannual
Poverty Reduction and Growth Facility; and Exogenous Shocks Facility	0.5 percent per annum	5½–10	N/A	Semiannual
Memorandum Items:				
Service Charge	50 basis points			
Commitment Charge	25 basis points on committed amounts of up to 100 percent of quota, 10 basis points thereafter			

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[16] The efforts made by borrowers (Argentina, Russia) to repay their debts early might be due to the fact that these countries want to get the IMF off their backs.
[17] Compare here the discussion to establish an insolvency law for the federal states in Germany.
[18] The German Central Bank uses in its analyses the share of current account transactions of total global current account transactions averaged over a three year period. This approach might later result in a situation where the EU may be confronted with the demand to eliminate intra-European trade from its calculations.
[19] The new quota of Korea is 1.346; of Mexico 1.449; of Turkey 0.548. Germany's quota is reduced to 5.980.
[20] For the European Monetary Union having only a single vote on a Board of 24 would mean a loss of influence. Because then its position could be presented only once. Reducing the Executive Board seats to a smaller number would have other disadvantages (see below).
[21] While Ministers usually do not get involved, the State Secretaries [Deputy Ministers] of the Finance Ministries of the G7 indeed have the possibility to exert influence by way of interim meetings and telephone conferences.
[22] In principle, there are no systemic reasons why the Executive Board is to consist of exactly 24 directors. It is also possible to imagine an Executive Board composed of less than ten members. Then the position of the U.S. appointed director would approximate the U.S. capital shareholding. Such a proposal would again cause the question to be raised of limiting the representation of the European Monetary Union nations to one representative. But then the ties between individual member countries and the IMF would be weakened, and the interest of countries in the institution would be less strong.

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