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LETTER OF TRANSMITTAL

November 6, 2000

To the Members of the Joint Economic Committee:

Transmitted hereby is a *Compendium of Staff Studies on International Economic Policy.* It is comprised of five Joint Economic Committee studies written by Christopher Frenze, Chief Economist to the Vice Chairman, and Robert E. Keleher, Chief Macroeconomist to the Vice Chairman.

The views expressed in this paper are those of the authors and do not necessarily represent the views of the individual Members of the Joint Economic Committee.

Sincerely,

Jim Saxton,
Vice Chairman.

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AN INTERNATIONAL LENDER OF LAST RESORT, THE IMF, AND THE FEDERAL RESERVE

I. INTRODUCTION

Recent international financial turbulence has stimulated discussion about reform of the "international financial architecture." Some of this discussion centers on the IMF and its potential role as an international lender of last resort (LOLR). Unfortunately, descriptions of the international LOLR function are particularly vague, with different premises, definitions, and understandings of that function creating semantic problems that often cloud the discussion.

This paper clarifies this discussion by briefly summarizing the functions of a domestic LOLR and describing two alternative ways such LOLR services can be supplied. The role of an international LOLR and the means by which its services can be supplied are then discussed. It is shown that international LOLR services cannot be provided by the IMF as it is presently constituted. Instead, under current circumstances, such services can be provided by the central banks of key reserve currency countries, and especially the Federal Reserve. Finally, recommendations as to how international LOLR services may best be provided are described.

II. A SUMMARY OF THE DOMESTIC LOLR FUNCTION

Relevant, key elements of the domestic LOLR function can be succinctly summarized in the form of the following propositions:[1]

- The need for a LOLR arises because of two important institutional characteristics of contemporary monetary systems, namely, fractional reserve banking and government monopoly of legal tender issuance. The first creates a need for a LOLR; the second, the means for satisfying that need. The LOLR is a money-creating backstop or liquidity guarantor which acts to prevent a panic-induced collapse of the fractional reserve banking system.

- The LOLR has a macroeconomic rather than a microeconomic responsibility. The monetary stabilization duty of the LOLR relates to market-wide (macroeconomic) effects and not to individual bank (microeconomic) effects. The LOLR function pertains to the responsibility of guaranteeing the liquidity of the entire economy but not necessarily the liquidity of particular institutions in the economy. Moreover, the LOLR role is not to prevent all

[1] For a thorough historical discussion of the lender of last resort, see Thomas M. Humphrey and Robert E. Keleher, "The Lender of Last Resort: A Historical Perspective," *Cato Journal*, vol. 4, no. 1 (spring/summer 1984). This section's summary of the domestic LOLR function draws from this earlier discussion.

disturbances to the financial system, but rather to minimize the secondary repercussions of such disturbances. Accordingly, the LOLR is charged with averting contagion, spillover, or domino effects which might threaten the stability of both the financial system as well as the value of money.

- In no case does the LOLR have a duty to sustain unsound banks. The LOLR should not intervene in the lending decisions of individual financial intermediaries. Poorly managed banks should be allowed to fail, with the LOLR only ensuring that such failures do not have important spillover effects. In short, the LOLR must distinguish clearly between promoting monetary stability and protecting the interests of bank owners and management. The former is a macro responsibility and the latter is not.

- The purpose of a LOLR is to prevent credit problems from becoming monetary crises. Although the operation of a LOLR should prevent system-wide runs on banks, large-scale loan call-ins, and collapses of asset prices, loans, and credit, its ultimate purpose is to prevent monetary collapses — to promote monetary stability.[2] To accomplish this goal, the LOLR must be able to respond both quickly and massively to a crisis.

- The LOLR function is a short-run stabilization role which does not conflict with longer-run central bank objectives. Prompt, vigorous LOLR action (activated only during temporary periods of emergency) will allay panic within a very short time and, consequently, well before longer-term goals such as price stability are threatened. As a result, any deviation of general prices from a longer-term target will be small in magnitude and duration. Price stability and LOLR goals, therefore, are complementary rather than conflicting central bank goals. Indeed, the pursuit of price stability normally results in the provision of last resort liquidity.

- The LOLR should be transparent. The LOLR's objectives and operations should be fully acknowledged and widely announced to the public before any crisis occurs. Credible assurance of this kind reduces uncertainty about the LOLR's willingness to act, in turn promoting confidence and thus generating stabilizing expectations that work to avert future panics and lessen the need for LOLR action. To minimize "moral hazard" problems, such advance announcement should indicate that assistance will not be provided to unsound banks but only "to the market" or to solvent, sound banks with good collateral, that are experiencing temporary liquidity problems. In short, advance widespread public notification should leave no doubt that insolvent banks will not be bailed out.

[2] The effective exercise of this emergency liquidity function will prevent a drastic, widespread call-in of loans as well as a dramatic fall (or collapse) of asset prices. Thus, in providing this function, the LOLR indirectly ensures that banks needing to sell liquid assets will not have to do so at large losses that might otherwise bring about insolvency and its adverse effects.

III. The Provision of LOLR Services

LOLR services can be provided via alternative mechanisms: namely, through the central banks' discount window using traditional Bagehot principles or via open market operations.[3]

Traditional Bagehot Principles

Traditionally, LOLR services are provided via the famous lending rule of Walter Bagehot: lend freely to the market at a penalty rate on good collateral. "Lending freely" on good collateral ensures that adequate last resort liquidity is available to sound banks, thereby providing enough liquidity to prevent any serious internal (reserve) drains.[4] Penalty rates ration scarce reserves among eager borrowers; encourage lending to remain short-term; ensure borrowers will exhaust private sources of funds, thereby making such lending genuinely "last resort;" and work to attract foreign capital, thereby minimizing external drains or depreciation of the exchange rate.

This traditional approach, therefore, has the distinct advantage of working to resolve banking crises (internal drains) and currency crises (external drains) at the same time. The disadvantage of such lending is that some time is normally required to properly evaluate the condition or collateral of borrowing banks, ensuring that last resort lending might not occur as quickly as possible in a sudden crisis.

Open Market Operations

A second method of providing LOLR liquidity is supplying such reserves directly to the market via open market operations. Open market purchases are a particularly efficient way of providing liquidity to the market, having the advantage of (almost instantaneous) speed as well as of regulating the total amount of market reserves, but not its allocation among particular users. In situations where external currency drains or rapid exchange rate depreciation accompany internal liquidity demands, however, large scale open market purchases to provide LOLR liquidity could serve to (at least temporarily) exacerbate these drains or depreciation. In this sense, open market purchases are a crude instrument relative to the discount-window-based Bagehot rule. Nevertheless, for accommodating emergency demands for high-powered money, open market operations are quick, convenient, efficient, and flexible.

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[3] Historically, LOLR principles were developed by Henry Thornton, the Banking School writers, and most completely by Walter Bagehot, the editor of the *Economist*. Bagehot's rule was to lend freely to the market on good collateral at a penalty rate. See Humphrey and Keleher, *op. cit.*, pp. 299-305.

[4] Under commodity (gold) standards, increased demands for liquidity could result in internal gold drains. In other regimes, internal currency drains could result from sharp increases in demand for liquidity.

IV. AN INTERNATIONAL LOLR

Most descriptions of the LOLR functions pertain to domestic LOLRs. While international LOLRs have been mentioned in the literature, descriptions remain particularly vague and ill-defined. Different underlying premises, definitions, or semantic problems often cloud the discussion. Analogous to domestic LOLRs, an international LOLR is relevant in circumstances of fractional reserve banking and an international medium of exchange serving as a world reserve currency. While no international legal tender monopoly exists, global reserve, key, and vehicle currencies persist under different exchange rate regimes.[5] History indicates that dominant international monies evolve very slowly in the market place and are not easily substitutable once well-established.[6] This suggests that in the very short-run — the time frame in which LOLR decisions often must necessarily be made — reserve currencies are for all practical purposes analogous to monopoly issuance. There are no ready alternative reserve currencies in such short-run time frames. This, in turn, suggests that in global financial crises (liquidity shortage) situations, managers of dominant international currencies should accept responsibility to supply needed world liquidity: to act as international LOLR.[7]

For an organization to function as an international LOLR, it must be able to create international reserves or money: i.e., to provide global liquidity quickly and in any amount on demand.[8] The world's central banks would turn to an international LOLR only if such an entity was the ultimate source of international reserves.

This is particularly relevant in circumstances of fixed exchange rates where national currencies are fully convertible into a common international reserve money.[9] In this case, for example, if the demand for an international medium of exchange increases and banks face runs from foreign depositors seeking to remove their money, it is possible that the respective central banks of these countries would face a run on their international reserves. If these central banks desire to maintain

[5] Reserve currencies serve as reserve assets and provide a store of value function. Key currencies serve the unit of account function and are often used as a peg in defining parities. Vehicle currencies provide the means of payment functions and are often used as intervention currencies in foreign exchange markets. See, for example, the discussion of reserve, key, and vehicle currencies in Benjamin J. Cohen, *The Future of Sterling as an International Currency*, MacMillan, St. Martin Press, London, 1971, pp 16-22.

[6] See, for example, Benjamin Klein and Michael Melvin, "Competing International Monies and International Monetary Arrangements," *The International Monetary System*, edited by Michael Connolly, Praeger, N.Y., 1982.

[7] Kindleberger, in effect, suggests that the responsibility of an international LOLR falls to reserve currency managers. See, for example, Charles Kindleberger, "Key Currencies and Financial Centers," *Reflections in a Troubled World Economy*, Essays in Honor of Herbert Giersch, St. Martin's Press, New York, 1983, p. 84, 87; Charles Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*, Basic Books, New York, 1978, p. 226.

[8] See R.G. Hawtrey, *The Art of Central Banking*, Frank Cass and Co., Ltd., London, 1962, p. 274.

[9] Even though many countries do not now operate under a fixed rate system, understanding its operation is important in order to grasp the international LOLR function under current exchange rate arrangements.

a fixed exchange rate, they may ultimately have to borrow from other central banks or from an international LOLR (the ultimate source of international money) which can supply such an international media of exchange rapidly on demand.

Although exact parallels cannot be easily drawn, the purpose of an international LOLR is to provide a backstop or mechanism to prevent a sharp collapse of international money or liquidity: i.e., to stabilize the value of such international money and to prevent various disturbances from developing into world money crises.

Under the post-Bretton Woods flexible exchange rate system, international (reserve, key, and vehicle) currencies have continued to exist. Many countries, for example, continue to use the dollar as a reserve asset, to peg their currencies to international reserve currencies like the dollar, and to denominate many of their transactions in terms of dollars. In short, there continues to be demand for such global reserve currencies even under current floating rate systems. Indeed, the magnitude of international reserve flows actually increased, rather than decreased, under existing floating exchange rate arrangements.[10] Under existing institutional arrangements, therefore, it should be recognized that the U.S. dollar has served as a most important international reserve or money.[11] Accordingly, it follows that Federal Reserve policy can importantly affect and create world reserves.

V. The IMF: A Potential International LOLR?

The IMF is often characterized as an actual or potential international LOLR. Some analysts contend that the IMF currently can serve as an international LOLR since it has substantial financial resources, the power to both raise additional funds and to issue Special Drawing Rights (SDRs), as well as a sizable gold stock.

The creators of the IMF, however, deliberately rejected the notion of an international LOLR or world central bank. Various proposals for a reserve-creating international bank were explicitly rejected by the U.S. and other countries at the time because of concern that such an institution would create excessive international money. The original IMF architects, therefore, made sure that the IMF did not have money-creating powers. Instead, the IMF was designed to assist member countries with short-term balance of payments problems through extensions of short-term loans.

As currently structured, the IMF cannot qualify as a genuine LOLR because it lacks several of the necessary characteristics of such an institution. The IMF lacks distinguishing features of an international LOLR, including the following:

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[10] See, for example, Robert Mundell, "The Future of the Exchange Rate System," Paper Prepared for the Rocca di Salimbeni Conference, Monte dei Paschi di Siena, Siena, Italy, November 24, 1994, p.12.

[11] To a lesser extent, Japanese yen and German marks have served these purposes.

- The IMF cannot create international money or reserves. The IMF cannot truly serve as an international LOLR since it cannot create high-powered money or international reserves. The funds it can make available are those resulting from borrowing: i.e., limited contributions made by member countries. Under current practices, once these quotas are consumed, available funding is limited and cannot readily be replenished.[12] Therefore, the IMF cannot "lend freely" without limit and therefore cannot prevent a sudden collapse of international money because, in accordance with its design, it simply does not have the necessary liquid resources to do so.

  While the IMF can issue SDRs, such issues are limited and not readily acceptable as international reserves. Furthermore, such issues are administratively clumsy since they cannot be made without prior authorization from membership. Similarly, the IMF gold stock is a (one-time) source of funds which, under current practice, in effect, is illiquid because of IMF fears that sizable gold sales will bring about sharp gold price declines in a thin gold market.

- The IMF cannot act quickly enough to serve as a LOLR. Genuine LOLR decisions often must be made very quickly, sometimes within hours (as in a banking liquidity crisis). Under current practices, however, IMF decision-making is ordinarily quite slow and cumbersome. For example, in providing money to a borrowing country, the IMF conducts lengthy negotiations involving reform programs and related conditionalities. Letters of intent and memoranda of understandings are drawn up. IMF executive board decisions are subject to the votes of executive directors who often consult their national authorities. All of this takes a good deal of time.

  Admittedly, there are inherent, informational reasons for some sluggishness in lending decisions. An international lender seeking to follow Bagehot's rule simply does not have ready access to the information essential to making rapid lending decisions. As one analyst recently explained:

  > "...it is unlikely that (an) international lender of last resort would have the experience with countries, their financial systems, their assets and their collateral that national central banks have acquired by dealing with their banks every day."[13]

  Accordingly, an international LOLR often simply does not have sufficient information to be able to quickly distinguish between an illiquid and insolvent entity.[14]

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[12] The IMF can borrow from world capital markets, although it has never chosen to do so.

[13] Geoffrey Wood, "A Lender of Last Resort? It's a Foolish Proposition," *Wall Street Journal*, Thursday, October 29, 1998 (parenthesis added).

[14] See William A. Niskanen, "Reshaping the Global Financial Architecture: A Comment," Paper presented at Cato Institute's 16th Annual Monetary Conference cosponsored with the *Economist*, October 22, 1998, Washington, DC. See also Anna

- The IMF is not transparent. Successful LOLR practices also involve pre-announced objectives and procedures in order to both reduce uncertainties regarding the LOLR's willingness to act and to generate stabilizing expectations working to avert panics. Further, such advance announcements serve to notify prospective borrowers that last resort lending is exclusively short-term, for sound, illiquid entities and not for insolvent entities involving long-term structural problems. By so informing prospective borrowers, such advance announcements work to minimize moral hazard.

  These transparent procedures are clearly not followed by the IMF; its practices routinely violate these conditions. Accordingly, IMF lending in recent years has worked to prop up insolvent entities and create serious moral hazard problems.

  As presently constituted, therefore, the IMF cannot act as an international LOLR.[15] It cannot create reserves or international money, cannot act quickly enough to serve as an international LOLR, and does not operate in a transparent manner. Further, IMF lending currently (indirectly) serves to bailout insolvent institutions, something wholly inappropriate for an international LOLR.

VI. The Federal Reserve: An International LOLR

One of the undeniable characteristics of current international monetary arrangements is the existence of and demand for reserve currencies. Despite the fact that major currencies float against one another, important currencies continue to serve and be held as international monies or reserves. The U.S. dollar remains the dominant and most important of these international monies or reserve currencies and it serves several functions for the global system. In particular, the dollar serves as an international reserve, key, and vehicle currency.

Circumstances involving international liquidity shortages or sharp increased demands for international liquidity normally entail increased demand for the dollar as a reserve currency or international money. Such situations highlight the responsibilities of an international lender of last resort. In such cases, the international LOLR should prevent any sharp decline in international liquidity or a collapse of international money: i.e., it should provide conditions supporting a stable price anchor for the international monetary system.

Schwartz, "Time to Terminate the ESF and the IMF," Foreign Policy Briefing, Cato Institute, August 26, 1998, pp. 6-7.

[15] Substantial restructuring of the IMF, however, could change this situation. For a recent proposal to restructure the IMF, see Charles W. Calomiris, "Blueprints for a New Global Financial Architecture," Joint Economic Committee, October 7, 1998.

- The Federal Reserve can act as an international LOLR. When such global liquidity shortages arise, the Federal Reserve — unlike the IMF — has international reserve or money-creating powers and, accordingly, can act to satisfy increased demands for liquidity; it can act as an international LOLR. In addition to powers to create acceptable international money, the Fed can act to create liquidity quickly via open market operations rather than through the slower, more cumbersome discount window mechanism.[16] Providing such reserves via open market operations rather than through the discount window would also be much preferable on political grounds.[17]

In short, the responsibilities of an international LOLR currently fall on reserve currency central banks. Since the dollar is the dominant reserve currency and the Federal Reserve is the principal institution that can create world dollar reserves, this responsibility falls largely on the U.S. central bank. In serving as an international LOLR, the Federal Reserve can prevent a collapse in international money or liquidity, help stabilize or anchor the value of international money, and thereby prevent various (e.g., credit) disturbances from developing into world monetary crises.

Robert Mundell has long recognized this Federal Reserve responsibility:

> "The Federal Reserve... has the power to determine... the size of foreign exchange reserves abroad... In a practical sense, the Federal Reserve System is the lender of last resort to the international banking system, and the determinant of the dollar value of world reserves."[18]

- The Federal Reserve should explicitly recognize this function. While the Federal Reserve can quickly generate international reserves and thereby serve as an international LOLR, the Federal Reserve has not embraced this role in a transparent manner. The Federal Reserve should explicitly recognize this important role and openly clarify its international responsibilities before a crisis occurs. Credible assurance of this kind would not only reduce uncertainties about the provision of international LOLR services, but would also work to promote confidence and generate stabilizing expectations, thereby reducing the need for future LOLR action. By pre-announcing that LOLR assistance will be provided to the market, but not to insolvent, unsound entities, moral hazard problems would be minimized.

Notably, the provision of this short-term crisis function need not jeopardize longer-run objectives such as price stability. Prompt LOLR action activated only during temporary periods of emergency will allay panic within a short time, and, consequently, well before

[16] Since the global economy is closed, the international LOLR need not be concerned about external drains; attention can be focused on satisfying liquidity demands.

[17] International reserve-creating central banks should never lend to insolvent institutions via the discount window.

[18] Mundell, Robert A., *International Monetary Options*, Cato Journal, vol. 3, no. 1, Spring 1983, p.191.

longer-term goals such as price stability are threatened.[19] Consequently, any deviations of prices from a longer-term target will be small in magnitude and duration. International LOLR and price stability objectives, therefore, are complementary rather than conflicting goals for central banks with international reserve creating powers.

- This function can be readily implemented. The Federal Reserve can implement these responsibilities by using a number of indicators to supplement their domestic indicators. These indicators become relevant for policymaking during periods when international liquidity shortages emerge. Accordingly, these indicators should provide useful, timely information relating to the movement of global prices and world liquidity. Because LOLR decisions must often be made very quickly (sometimes in a matter of hours), data requirements also call for high frequency, readily available sources of data. Fortunately, there are a number of relevant indicators that meet these requirements. Several measures of global price movements, for example, are available. Such measures should be monitored in conjunction with a set of readily available market price indicators that provide up-to-date information highlighting actual and prospective global price movements and world liquidity. In particular, measures of world commodity prices, various bi-lateral and multi-lateral measures of the dollar exchange rate, and indices of global bond yields can be jointly assessed to gain information on prospective global price movements and world liquidity.[20]

  When international liquidity shortages (or sharp increases in the demand for international liquidity) occur, for example, these indicators often provide useful information when assessed together with global price movements. In this case, world inflation may be declining at the same time the dollar appreciates, world commodity prices soften, and global bond yields decline. Risk spreads may be widening at the same time. When all of these indicators signal a global liquidity shortage, the Federal Reserve should consider appropriate policy response: i.e., a more rapid supply of reserves or liquidity than would otherwise be the case. This easier policy stance is appropriate until the above-cited indicators suggest the liquidity shortage has abated.

VII. Summary and Conclusions

Recent discussions relating to reform of "the international financial architecture" have focused attention on the function of an international LOLR. There are, however, few, if any, clear delineations of this important function, partly because of differing premises, definitions, and understandings of an international LOLR role. After summarizing well-established domestic LOLR functions, this paper describes the international LOLR role. The question as to whether the IMF or Federal Reserve can provide such international services is then addressed.

[19] Responsible international LOLRs would absorb reserves later, after liquidity crises abate.

[20] These data can be supplemented with data measuring changes of liquidity preference, various risk spreads, bank stock movements, and other data pertaining to financial crises.

Under existing institutional arrangements, the IMF cannot serve as a genuine LOLR. Specifically, the IMF cannot create reserves, cannot make quick decisions, and does not act in a transparent manner in order to qualify as an authentic international LOLR. The Federal Reserve, however, does meet the essential requirements of an international LOLR. It can quickly create international reserves and money, although it has not openly embraced international LOLR responsibilities. The Federal Reserve can easily implement this function by employing several readily available market price indicators and global price measures.

Robert Keleher
Chief Macroeconomist

IMF Gold Sales in Perspective

IMF GOLD SALES IN PERSPECTIVE

There have been a number of recent calls for the International Monetary Fund (IMF) to sell part of its 103 million ounce gold holdings as part of a debt relief plan for the heavily indebted poor countries (HIPC). One such proposal has been advanced by the Administration, and officials of several other nations as well as the IMF have voiced support for similar plans. The proposed gold sales would require Congressional approval, and debate on this change in policy is already underway.

Although the exact form of the proposal is not yet clear, there are several reasons for Congress to closely examine this proposal and review the potential negative consequences:

- The proposal is not transparent in that its content and full ramifications are unclear, and it may ultimately facilitate financing for certain IMF operations without conventional authorization and oversight.
- The proposed gold sales would tap a hidden IMF gold reserve that can be viewed as belonging to member countries. The cost of the proposal to the U.S. would amount to half a billion dollars, relative to restitution to member countries.
- Continued gold sales may weaken the IMF's balance sheet. With one-third of its outstanding credit from its main account owed by Russia and Indonesia, it is reasonable to question whether potential weakening of the IMF's financial position is desirable at this time. The money contributed by the taxpayers of the U.S. and other nations is exposed in IMF lending, and IMF gold sales would increase this exposure further by reducing the capital cushion of the IMF.
- Gold sales may deepen already serious moral hazard problems by leading to expectations by other distressed borrowers of further gold sales for debt relief. The volume of proposed gold sales already has expanded significantly in recent months.
- The proposal could help perpetuate and reinforce the IMF's drift toward becoming another development bank similar in many respects to the World Bank.
- The proposal may encourage the IMF to continue its policy of deeply subsidized interest rates; this would include the IMF's reluctance to fully comply with the Congressional reforms mandated in 1998.
- The proposal has put downward pressure on gold prices and harmed poor nations that are also gold producers.

IMF Gold Holdings

The IMF holds 103 million ounces of gold originally acquired as quota contributions and through its transactions during the period when gold was a central element of the international monetary system. The collapse of the Bretton Woods system of fixed exchange rates in the early 1970's and subsequent policy decisions to demonetize gold were reflected in the second amendment to the IMF's Articles of Agreement in 1978. The second amendment officially demonetized gold and placed severe limitations on its use by the IMF or IMF member nations.

During the 1970s about one-third of the gold holdings of the IMF were disposed of in gold sales. The remaining gold was retained for a number of reasons, according to the IMF. These reasons include, "the potential unrealized gain on these assets may be considered a significant element adding to the overall strength of the IMF, that is, its basic—or ultimate—reserve;" in case of a "...need to meet creditors' claims on the institution in the event of liquidation..." and to provide resources if needed to "...encash members' reserve positions in the institution...;" and for "...unexpected systemic developments—that is, gold should be held as a reserve against future, unspecified contingencies...."[1]

Thus the gold reserve can be viewed as serving several purposes, including a provision for bad loans and a reserve against potential withdrawals of reserve positions by major donor nations. The potential use of gold as a reserve against donor withdrawals of reserves also reinforces the point made during Joint Economic Committee (JEC) hearings that padding or double counting of reserve accounts can be used as an accounting device to reduce the apparent level of usable resources available for IMF operations, thus justifying additional IMF appropriations. In any event, the IMF has identified a number of reasons to continue holding significant gold reserves.

On the other hand, the IMF identified several potential advantages to selling gold, including reduction of carrying and opportunity costs. In 1995 the IMF restated its policy on gold, recognizing that "any mobilization of gold should be carefully thought out to avoid any weakening in the IMF's overall financial position...."[2] and that "It must take great care to avoid causing disruption that would have an adverse impact on all gold holders and gold producers, as well as on the functioning of the gold market."[3] The IMF also maintained its position that "gold provides a fundamental strength to the IMF's balance sheet."[4]

In 1947 the IMF Executive Board asserted that the "gold and currency subscribed to the Fund are clearly within its unrestricted ownership. They do not belong in any way to the subscriber."[5] In the context of the Bretton Woods system and the official price of gold it established, this contention had an unambiguous meaning because the subscription price and the market value were essentially the same. However, the breakdown of the system in the early 1970s created for the first time the possibility of a large discrepancy between the official and the market price of gold. Only under these new circumstances could the value of the gold holdings increase significantly over their subscription value, and create the question of ownership of a surplus (capital gain). As we shall see, the IMF's restitution procedure renders this potentially troublesome legal issue largely irrelevant for the purposes of this analysis.

Perhaps in part due to the possibility of restitution to the member countries, the IMF values the gold on its financial statement at the old official price equivalent to about $48 per fine ounce, though its market value has been far higher since the mid-1970s. In light of potential restitution, this conservative accounting is quite defensible, but it does lead to potential issues in

[1] Treasurer's Department (IMF), *Financial Organization and Operations of the IMF*, Washington, D.C., 1998, p.117.
[2] *Ibid.*, p.117.
[3] *Ibid.*, p.118.
[4] *Ibid.*, p.117.
[5] Testimony of Harold J. Johnson, Jr., and Gary T. Engel, General Accounting Office, before the Joint Economic Committee, July 21, 1999, p.21.

a broader policy context. For example, the value of the gold held in excess of $48 per ounce then becomes, in effect, a hidden reserve, and attempts to use this reserve for various policy objectives may have the effect of obscuring their costs to affected parties.

As noted, one of these policy objectives is to sell IMF gold to finance debt relief under the HIPC initiative. A review of this proposal brings to light several important problems. These problems include a lack of transparency, costs to the taxpayer, excessive IMF loan exposure, potential effects on IMF reform, and counterproductive effects on vulnerable poor countries. The balance of this paper will examine these issues in more detail.

Problems Posed by IMF Gold Sales

Lack of Transparency

According to recent GAO testimony before the Joint Economic Committee,[6] many of the details of the gold sales proposal are "non-public." Furthermore, in addition to its direct cost, the effects of the gold sales on IMF finances are very difficult to evaluate because of the obscurity of IMF financial statements which have proven confusing even to IMF officials in the past.

For example, as a lending institution, the IMF does not refer to its loans from its main lending account as "loans," but as "currency purchases." The central IMF budget is treated as a classified document, and separates usable from nonusable resources in IMF operations, a distinction that is not typically made in the public presentation of IMF financial accounts.

As noted, the details of the gold sales proposal, including even the amounts available for debt relief, are confidential. A complete and transparent analysis of the gold sales proposal on IMF finances is impossible because this would require comparison of the confidential information of the gold sales proposal to data in a classified budget. This lack of transparency means that Congress is unable to make a fully informed decision on the gold sales proposal in consultation with independent experts and academics.

Although the available public information about the proposal is very inadequate, enough information can be assembled to show that the proposed gold sales raise funds by absorbing part of the hidden gold reserve not shown on the IMF's balance sheet.[7] These gold "profits" could then be invested in securities, and the interest generated used for debt relief. By tapping this hidden reserve, the proposal can be presented as a "free lunch" in that assets worth billions of dollars could be made available for IMF use without an apparent cost to anyone. However, at least from one point of view reflected in the IMF's own charter, most of the proceeds raised through the gold sales can be viewed as disguised contributions from major donor countries, though this fact is veiled in obscure IMF accounting and procedures.

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[6] *Transparency and the Financial Structure of the IMF*, hearing of the Joint Economic Committee, July 21, 1999.

[7] A footnote to the IMF balance sheet does note the market value of gold holdings.

These concerns about IMF gold sales were recognized in 1975 in a joint bipartisan statement by Senator Ribicoff (D-Conn.) and Senator Taft (R-Ohio):

> Either the gold belongs to the IMF, or it belongs to the member states, which contributed the gold in proportion to their quotas. **In either case, the profits should be distributed to the member nations in proportion to their quotas.**
>
> The IMF is not designed to be a relief agency, nor an investment agency. If the nations owning stock in the International Bank for Reconstruction and Development [World Bank] wish to increase their subscriptions, or to increase their bilateral aid, out of IMF gold sale profits or with any other funds, then well and good. However, such a decision should be taken openly, by each nation, unencumbered by an artificial link between the question of aid and the role of gold in international payments.[8]

Taxpayer Expense

As noted, IMF gold holdings reflect member contributions to, and transactions with, the IMF at a time when gold had a central role in the monetary system. After the collapse of the Bretton Woods system, gold was demonetized, but disagreements about the role of gold were reflected in a compromise amendment to the IMF charter in 1978 that severely limited the IMF's use of gold but permitted certain gold sales,[9] including what IMF documents refer to as "restitution." Dictionaries define restitution as "restoring to the rightful owner of something that has been taken away, lost, or surrendered." While significant restitution of IMF gold to members in the near term has not been proposed, restitution does provide a useful benchmark of the opportunity costs imposed by alternative proposals.

Under IMF rules, the IMF could restitute gold to member countries at a price currently equivalent to $48, according to a formula based on member contributions in 1975. Under this formula the U.S. would receive 23 percent of the amount of any gold restitution. For example, if 10 million ounces were restituted, the U.S. would receive 2.3 million ounces. Under current market conditions, the U.S. would pay $110 million for this gold (2.3 million ounces multiplied by $48 per ounce), but then receive an asset worth $592 million, leading to a total net gain of $482 million.[10] Restitution is a useful benchmark to use in evaluating other forms of gold sales in terms of potential costs to the taxpayers of the U.S. and other affected nations.

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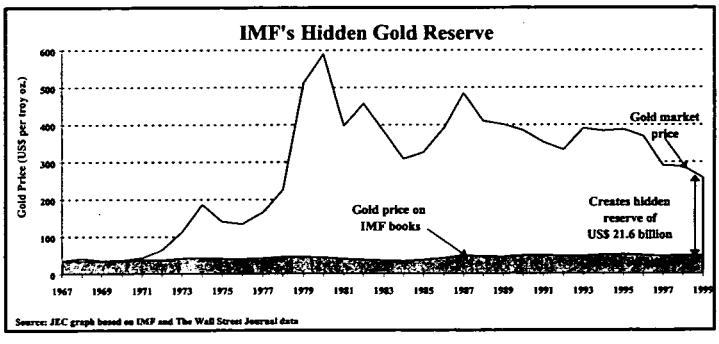
[8] Comments of Senators Ribicoff and Taft, *The Proposed IMF Agreement on Gold*, Report of the Subcommittee on International Economics, Joint Economic Committee, December 17, 1975, p.11 (emphasis added).

[9] Treasurer's Department, *op. cit.*, pp.109-110.

[10] Assuming a price of $48 per fine ounce for 2.3 million ounces would generate $110.4 million in revenue to the IMF. The 2.3 million ounces of gold held by the U.S. would be worth $592 million, resulting in a net profit of $482 million. This is based on a market price of $257.30 per fine ounce as of August 4, 1999.

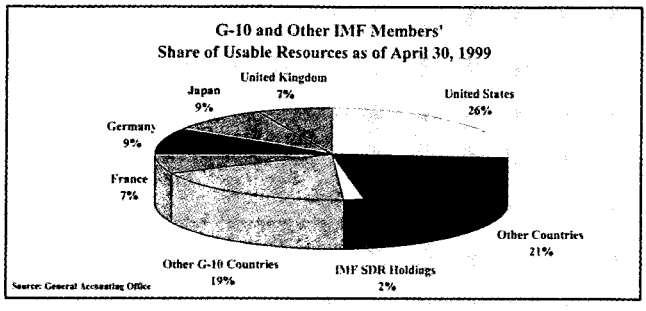
As noted, the gold held by the IMF is valued on the IMF balance sheet at equivalent to $48 per fine ounce, relative to a current market price of about $257. The undervalued IMF book value of gold creates a hidden IMF gold reserve of over $21 billion (see graph below). The recent IMF gold sales proposal would tap part of this hidden reserve to finance the debt restructuring plan. If 10 million ounces of gold were sold for about $2.6 billion at current market prices, about $2.1 billion of the total would be generated by the value of gold not shown on the balance sheet. This is the hidden cost to donor countries in terms of foregone profits. The effect would be the same if some other mechanism were used to tap into the gold reserve to finance debt relief.



Though the proposal has been presented as something of a "free lunch" by its sponsors, the hidden or obscured nature of its costs do not make them nonexistent. By tapping the value of gold not appearing on the IMF's balance sheet, these costs can be obscured, but once identified, these costs are quite significant. Relative to the restitution benchmark, the proposed gold sales will cost the U.S. and its taxpayers $482 million. For every billion dollars of IMF gold sales not in the form of restitution, the U.S. cost is $187 million.[11] Furthermore, in addition to the proceeds from the gold value not on the balance sheet, the capital value of the gold, or $48 per ounce, goes directly to the main IMF account, the General Resources Account (GRA).

Potential taxpayer expense is an important issue especially in light of the highly concentrated financing of the IMF as a whole. The U.S. already provides 26 percent of the IMF's $195 billion of usable contributions; the G-10 countries as a whole provide 77 percent of the usable resources for IMF operations (see graph below). Many of these same nations will again make another disproportionate contribution if the proposed IMF gold sales were approved.

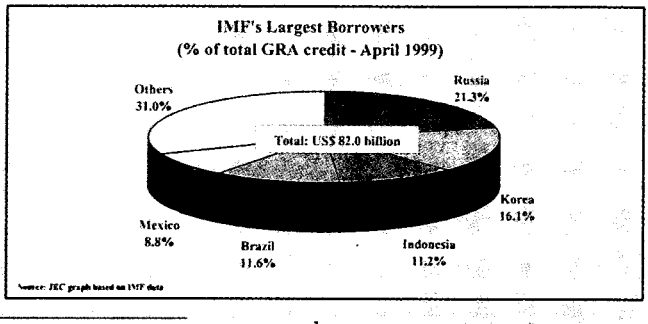
[11] This figure is derived from the United States' share of $230 million (or 894,000 ounces) out of total restitution amounting to $1 billion. This $230 million of gold minus $43 million in payments to the IMF leaves a net value of $187 million.



It is interesting to note that the remaining 171 members of the IMF contribute only 21% of its usable resources. Nearly half of IMF member nations maintain little or no reserve positions at the IMF. Many of these nations make required hard currency contributions to satisfy IMF membership requirements, and then immediately withdraw these contributions without affecting their voting rights. In short, the voting shares of countries has little relation to their financial participation.

IMF Loan Exposure

As an "ultimate reserve," IMF gold sales must be viewed in the context of the IMF's finances and lending policies. The lack of diversification in IMF lending, including a heavy concentration in certain countries that are questionable credit risks, is not very well known. As of April 30, 1999, about 70 percent of IMF outstanding loans from the IMF main account were owed by the IMF's five largest borrowers.[12] Russia and Indonesia together account for one-third of all outstanding credits. Neither Russia nor Indonesia is regarded as a very good credit risk by international credit rating agencies. The pie chart below shows major IMF borrowers:

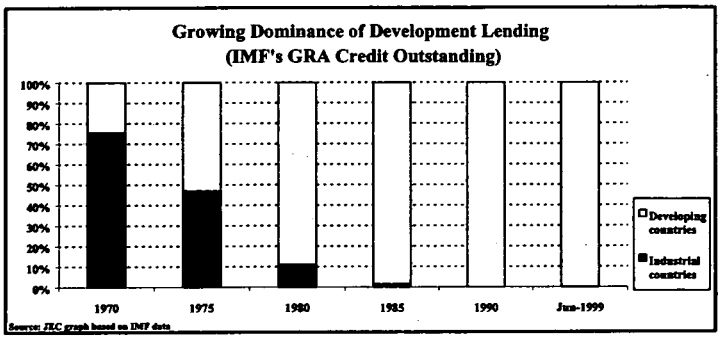


[12] International Monetary Fund *Financial Statements*, Quarter Ending April 30, 1999, p.10.

It may be argued that any concerns about IMF loan exposure are overstated and that historically the IMF has not experienced significant defaults. However, the lack of IMF transparency and *de facto* debt rescheduling make it difficult to empirically evaluate the past or present problems. Furthermore, the changes in the nature of IMF lending and the relaxation of loan limits have led to a very different current situation that is unprecedented.

Past guidelines used by the IMF had restricted the level of borrowing to a nation's quota level (100 percent of quota). This policy was presumably intended to promote loan diversification and limit IMF donor exposure. However, since these guidelines were relaxed, IMF loans may rise as high as several hundred percent of a borrower's quota contribution (around 500 percent in the case of Korea). Over its entire history, it is doubtful that the IMF has ever had such a sizeable proportion of its outstanding credit owed by such large and dubious credit risks, at least one of which has had to borrow from the IMF for the purpose of servicing its IMF loan. Thus, it is reasonable to question whether further erosion in the financial position of the IMF is desirable at this time by liquidation of reserves that could help cover potential loan losses and help create the confidence of its ability to do so.

Underlying the concentration of IMF lending to dubious credit risks is a major change in the nature of IMF lending. Over the last few decades, the IMF has transformed itself from a lender for balance of payments purposes to a longer-term lender for development and economic restructuring. This transformation reflects the collapse of the Bretton Woods system and the search for a new mission to justify IMF activities, but it also entails potentially greater risks. Recent IMF borrowers have broader and deeper systematic problems than the kind of balance of payments pressures financed by the IMF in the previous era. This evolution entails the potential for higher risk from longer loan maturity, type and use of loans, and the credit risk of borrowers. The graph below documents the trend in IMF lending since the collapse of the Bretton Woods arrangement.



The drift of the IMF towards becoming another development lender similar to the World Bank raises a number of important policy issues regarding the IMF's finances. The fact that IMF gold holdings could act as a loan loss reserve suggests that the greater risks of recent IMF lending should be balanced by retention of the gold reserve, at least for the foreseeable future.

Furthermore, given the changing view of gold by official institutions, the current proposal can be seen as a precedent for similar IMF gold sales in the future. This could lead to further pressures to erode more of the gold reserve in a way that is not in the interest of the taxpayers of donor countries.

The proposed gold sales would also enhance moral hazard in several ways. The perception that gold sales are something of a "free lunch" may ultimately encourage other IMF borrowers to favor or expect gold sales to relieve their debt burdens. IMF borrowers from the main General Resources Account (GRA) who are experiencing severe economic setbacks or difficulties may also come to expect some measure of debt relief financed by further gold sales.

Gold Sales and Debt Relief

Part of the proceeds from the IMF gold sales of the 1970's financed the Structural Adjustment Facility, later to become the Enhanced Structural Adjustment Facility (ESAF), a development lending program charging interest rates typically as low as 0.5 to 1 percent. The creation of this loan program marked the beginning of an important transition in the evolution of the IMF from its previous monetary role at the center of a fixed exchange rate system into a major lender for development and structural adjustment projects. By the 1990s, a large portion of IMF lending was devoted to various large-scale economic restructuring purposes, which were very different in nature from lending to bridge temporary balance of payments problems.

Unfortunately, the official development lending of which ESAF was a part seems to have become more of a hindrance than a help to many of the poor borrowing countries. The IMF recognizes that the total debt burden of many countries is larger than many of these borrowers are willing or able to service, and so the IMF has agreed to assist in financing the HIPC initiative. To help do so, the IMF would seek contributions from members and if these did not suffice, the IMF would attempt to win approval for gold sales. However, this juncture also provides an opportunity to reevaluate this IMF-sponsored activity and whether it should be continued.

Given the current controversy over debt relief, it is reasonable to question whether it is necessary or desirable for the IMF to sponsor something like ESAF, a lending program more appropriately conducted by the World Bank. ESAF has become part of the official debt burdening underdeveloped countries, and it appears that the proceeds from gold sales could be used to help maintain its operations for the next several years. If ESAF were terminated, over $2 billion in ESAF reserves might be made available for other purposes, including debt relief. The termination of ESAF would be a desirable first step in refocusing the IMF on short-term crisis lending and away from a continued evolution into another development bank.

Alternatively, the implementation of the gold sales proposal would help gloss-over the failures of the development strategies fostered by the official institutions. This proposal would also continue, if not reinforce, the IMF's current drift into development and structural lending, not only in ESAF but in the lending from the General Resources Account (GRA) of the IMF as well. An alternative policy approach would be to terminate ESAF as an activity more appropriately conducted by the World Bank than by the IMF. ESAF reserves might be made available for debt restructuring and relief.

IMF Reform and Gold Sales

The IMF makes loans that are all heavily subsidized in varying degrees by the use of below market interest rates. For example, the standard IMF loan rate, currently about 3.8 percent, is considerably below the standard international reference rates such as LIBOR (London Interbank Offered Rate). The IMF's alternative premium rate for circumstances typical in bailout situations is currently about 6.8 percent.

The IMF's subsidized interest rates were one focus of the debate over the 1998 IMF appropriation in Congress. These interest rate subsidies became an issue because they distort price signals, are economically inefficient, and deepen already pervasive moral hazard problems. Much of the debate on these issues was stimulated by the *IMF Transparency and Efficiency Act*, a reform measure that provided for the use of market interest rates on all IMF loans. At the final stage of the legislative process, JEC staff was asked to assist in drafting reform language regarding IMF interest rates on loans used in typical crisis situations. This language, a version of which finally became law, stipulates that IMF interest rates under these crisis circumstances must be adjusted for risk. A formula for a minimum interest rate was provided for the sole purpose of preventing excessive discretion, and not for pegging the interest rate.

However, it remains unclear whether the IMF recognizes that the reform legislation requires an adjustment for risk, and does not replicate existing IMF interest rate formulae. In any event, as an alternative method of financing the IMF's HIPC contribution, the IMF could use a true adjustment for risk on affected loans, and thus generate higher interest earnings for debt relief. These premium interest rates would no longer be as deeply subsidized, and could provide the approximately $100 million annually for debt relief that is called for. Another option would be to slightly increase the deeply subsidized standard IMF loan interest rate.

It is to be expected that the IMF will resist such suggestions to reduce interest rate subsidies. Exorbitant interest subsidies are central to IMF's current operations. Additionally, the IMF would presumably argue that it is not desirable to use interest earnings from the main IMF account and channel part of it to ESAF for debt relief. However, the gold and certain interest, both already associated with the GRA, have been considered as sources of funding for debt relief, and an argument that only some proceeds arising from the GRA can be tapped but not others is not very persuasive. Furthermore, it appears likely that the funds raised by the gold sales would ultimately end up in the GRA.

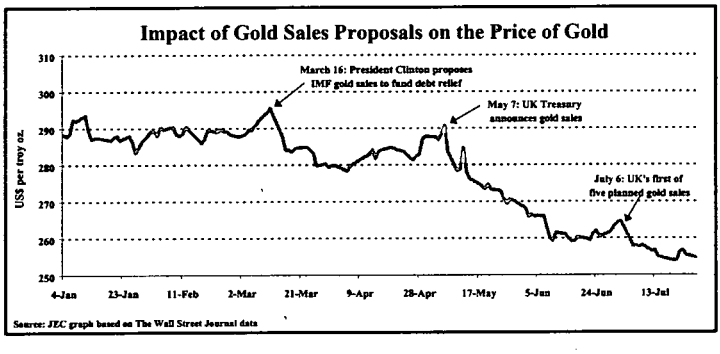
A very small rise in IMF interest rates could easily cover the costs of the debt relief initiative, as could the $2 billion in reserves already in the ESAF. However, these options would require the IMF to modestly reform its practices or use its own resources, but neither of these choices seems to have been seriously considered. Instead, a veiled way of tapping more resources by the IMF at taxpayer expense through gold sales has been the preferred course.

Market Disruptions

For an agency that presents itself as a stabilizing force in international markets, the effects of the IMF's proposed gold sales have been especially ironic. In the wake of clear signals from central banks, especially the Bank of England, that the status of gold was changing and that market sales were looming, the IMF and other proponents persisted in the proposal for additional market sales. While sorting out the precise impact of this proposal and its endorsement by the G-7 finance ministries is not possible, there is a widespread view that the IMF proposal has been a negative force in the gold markets (see graph below). After the IMF proposal was finalized, gold market prices drifted below the costs of production in at least one key producer country.

As the IMF Treasurer's Department itself pointed out only last year:

> An important element in considering potential gold sales by the IMF is that such sales -- or even the announcement of an intent to sell -- could, at least in the short run, cause the market price of gold to fall. Various official holders of gold that value their stock at or in relation to the market price may view with concern a sharp decline in the value of their holdings because of an announced program of gold sales by the IMF.[13]



[13] Treasurer's Department (IMF), *op. cit.*, p.117.

Conclusion

Proposals for use of taxpayer resources by the IMF should be fully explained in a transparent manner. The failure of the IMF and Administration to provide details on the proposed gold sales to Congress and the public does not permit fully informed consideration of this policy and possible alternatives. A complete explanation of this or any similar proposal should be provided to Congress and the public by the IMF or the Treasury. The costs of the proposal, and all costs associated with the IMF, should also routinely be delineated and provided to Congress, instead of the official pronouncements that there are no taxpayer costs associated with participation in the IMF.

Congressional concerns about lack of IMF transparency and IMF interest rate subsidies are reflected in enacted reforms that have become law. Approval of the proposed IMF gold sales could have the effect of delaying needed IMF reforms and be viewed as sanctioning IMF loan subsidies and current development policy under the IMF and ESAF. On the other hand, rejection of the proposed gold sales would send a strong message to the IMF that its current policies of loan subsidization and development lending lack support in Congress, and that genuine IMF reform is required.

Christopher Frenze
Chief Economist to the Vice Chairman

Alexandre Ferraz de Marinis provided research assistance for this study.

JEC Statements Before the
International Financial Institution Advisory Commission
September 9, 1999

STATEMENT OF CHRISTOPHER FRENZE

CHIEF ECONOMIST TO THE VICE CHAIRMAN
JOINT ECONOMIC COMMITTEE

Chairman Meltzer and Members of the Commission, thank you for the opportunity to appear before you today to discuss some of the financial issues related to the Joint Economic Committee's (JEC) review of the International Monetary Fund (IMF). I am accompanied today by Robert Keleher, Chief Macroeconomist to the Vice Chairman, who will make the second half of our presentation before the question period. As you know, the work of the JEC in this area was initiated two years ago by Congressman Jim Saxton, who was the JEC Chairman in the last Congress and continues as Vice Chairman in the current Congress.

We do not have all the answers to questions about the IMF and its financial operations, but we have asked some of the right questions and these have produced much useful information. The public record shows that two years ago there was relatively little clear and current data on total IMF usable contributions and resources, the division of usable and nonusable resources, the U.S. contribution as a share of total usable resources, certain IMF reserves, and other data needed to adequately understand the financial operations of the IMF.

The JEC tried to change this situation by gaining more public release of IMF financial information and thus reducing incentives for excessive secrecy. Over a year ago Mr. Saxton asked the General Accounting Office (GAO) to obtain much of this information from the IMF's operational budget and other sensitive documents, and the results were presented to the Joint Economic Committee in hearings in 1998 and 1999. Shortly after the first of these two hearings, the IMF began posting much more detailed financial information on its web site.

This JEC effort to obtain increased transparency was quite successful, but much more remains to be done. The GAO has been extremely helpful, and has folded some of our additional questions about IMF lending into a new report to be released in the near future that will provide yet more detailed information. However, this commission could also be extremely effective in fostering more IMF financial transparency and facilitating the publication of additional information. The commission could direct detailed questions on IMF finances directly to the IMF to provide needed historical and current information on many aspects of IMF activities including time series of annual quota levels, lending, usable contributions, loan rollovers, interest charges, loan conditions, and so forth.

The absence of much of this information in the public domain reflects a lack of IMF transparency that is not consistent with the IMF's own transparency standards it applies to member countries. Some of this information is publicly available, but only in a fragmentary or partial form that is not readily accessible given the confusing nature of IMF financial statements.

I would like to turn to a review of part of the IMF's public financial statements and explain their format. It is our view that the IMF's financial statements were designed for use in an institutional and economic environment that no longer exists. In the current context these financial statements can be confusing and they are not fully transparent, as conceded by a

member of the IMF Executive Board in congressional testimony last year. For example, the IMF does not consider its loans from its central account to be loans, so the term loan does not appear, but instead the IMF uses the term "currency purchases."

The widespread use of such obtuse concepts contributes significantly to a lack of transparency. Even so, the quarterly IMF financial statements and the IMF booklet called *Financial Organization and Operations of the IMF*, although very difficult and obtuse, are useful in reviewing IMF finances.

When new quota contributions are made 25 percent is typically paid in international reserve assets and the remaining 75 percent normally in promissory notes or letters of credit denominated in the members own currency. The reserve asset portion of the new quota subscription is added to what the fund calls the 'reserve tranche position" of the individual member. In addition, the IMF can encash the notes and letters of credit on demand to support its lending and other financial activities. These notes are reflected in a category called "IMF holdings of currencies." The quotas are part of the General Resources Account (GRA), the central account of the IMF.

The IMF is sometimes described as a cooperative or compared to a credit union, suggesting a broad-based support for lending. However, as a practical matter, the IMF is largely financed by a relatively small group of countries. In addition to their reserve positions, the IMF tends to encash the promissory notes of some countries much more heavily than others.

On the other hand, many other nations withdraw their reserve position, leaving all of their quota essentially in promissory notes. Nations can even borrow their reserve payments under quota increases, and then immediately withdraw these borrowed funds and repay borrowers. In this way they technically comply with IMF membership requirements but provide little or no usable resources to the IMF. Incidentally, the Exchange Stabilization Fund (ESF) has apparently been used to facilitate such borrowing.

The first entry in the briefing books we have provided is an overview of IMF finances from the quarter ending April 30, 1999. The last page of this overview contains a line item for the United States denominated in SDRs. As one can see, the quota of the U.S. is 37 billion SDRs, equal to about 50 billion dollars. The U.S. has 17 billion SDRs, or 46 percent, of its quota in its reserve position. The remaining 20 billion SDRs (54 percent) is in the column under IMF's holding of currencies. The amounts in this category are largely promissory notes and letters of credit.

Quotas, IMF's Holdings of Currencies, and Reserve Tranche Positions
As of April 30, 1999
(In Thousands of SDRs.)

	General Resources Account			
		IMF's Holdings of Currencies		
Member	Quota	Total	Percent of Quota	Reserve Tranche Position
United States	37,149,300	20,082,770	54.1	17,061,852
Ukraine	1,372,000	3,341,372	243.5	7
Turkemenistan	48,000	48,000	100	5

Source: International Monetary Fund

In other words, the sum of a *creditor* country's reserve position and IMF holdings of its currency is the amount of the quota. If the IMF were to encash more U.S. promissory notes this would raise the amount of the U.S. reserve tranche position and lower the amount of Fund holdings of currencies correspondingly.

The entry for Ukraine reflects the position of a net borrowing country. The Ukraine's quota is 1.4 billion SDRs, with virtually none of it in the reserve tranche position, but instead under IMF holdings of currencies. The Ukraine has provided what is essentially an IOU to the IMF equivalent to its borrowings of about 2 billion SDRs secured by its domestic currency provided to the Fund. This is reflected in the holdings of currencies; this amount is the sum of virtually all of the Ukraine's quota plus the value of its borrowing from the IMF. Borrowing countries typically have withdrawn most or all of their reserve positions so virtually all of their quota is in IMF holdings of currency. The amounts borrowed, reflected in domestic currency securing the loans, also are added in this category.

The case of Turkemenistan reflects the position of a member that is neither a creditor nor a borrower. This country has virtually no reserve tranche position and is not a borrower. Virtually all of its quota is in "holdings of currencies." This country currently is neither a creditor nor a borrower member.

This discussion may seem quite dry if not tedious, but provides a useful framework for review of the public IMF financial statements. As one scans through the statement of members' financial positions from the quarterly reports of the IMF, it is clear which countries maintain large reserve tranche positions providing support for IMF operations, and which on the other hand provide little or no support. The lower the percent of quota held in currencies, the higher the member's reserve position and relative degree of financial support for the IMF. On the other hand, it can be readily seen that many countries have all or nearly all of their quota in holdings of currency, meaning they have little or no reserve position to participate in the financing of IMF operations.

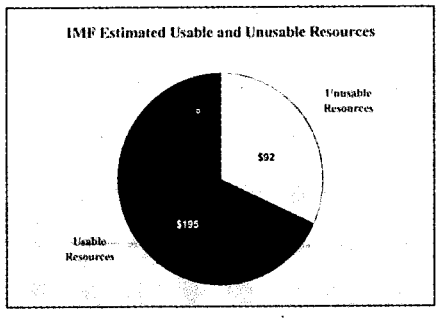
When the holding of currencies approaches or exceeds 100 percent, this typically means the member's reserve position is very low or zero. Nearly half of the IMF members currently maintain little or no reserve position, even after a recent quota increase. This suggests that the borrowing and immediate withdrawal of reserves required under a quota increase is quite widespread. The presence of these members does, however, provide a ready pool of current and potential future borrowers; about half the IMF's membership are current borrowers.

As previously noted, the reserve positions supply the funds for IMF lending. At the bottom of this statement from the IMF quarterly report, one can see the total of 63 billion SDRs in the reserve position, and 61 billion SDRs loaned from these contributions.

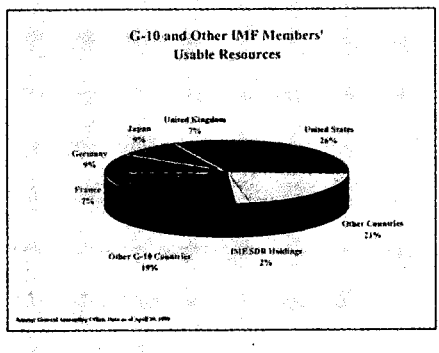
A separate issue regards the portion of quotas that can be used by the IMF for its lending. The public financial statements do not reflect the fact that many of the members have provided quota contributions, which are not regarded as usable by the IMF. In the IMF's confidential operational budget, the division is made between usable and nonusable resources. This is a critical distinction and has important implications for allocating the actual sources of funding for

IMF operations. This was one of the first pieces of information Mr. Saxton asked the GAO to obtain from the IMF through a review of the operational budget. The level of usable contributions is needed to know the amount of actual resources available to the IMF before lending, and also to gain a more accurate view of the financing burden borne by the donor nations.

This graph presented shows the usable and nonusable contributions. Of $287 billion of total contributions, $195 billion is usable and $92 billion is unusable. As noted previously, nearly half of the IMF members do not have significant reserve positions, and many of these also would not have currencies that would be deemed usable by the IMF in the operational budget.

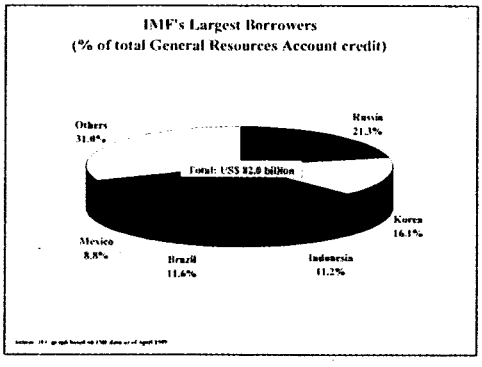


Once the level of usable resources is determined, an accurate picture of the IMF's sources of funds can be provided. The second graph displayed shows the portion of usable resources contributed by the major creditor nations. As shown, the G-10 nations supply 77 percent of the IMF's usable funds in its main account. The other 171 member nations supply about 21 percent of the usable funds. This graph shows the actual burden of financing once the nonusable quota subscriptions of many members are set aside.



The official line is that the U.S. provides 18 percent of the quotas, but the U.S. share of usable contributions is actually 26 percent. This relatively large U.S. position is reflected in the strong influence of the U.S. Treasury in IMF decision making. This graph illustrates the preeminent U.S. position, but also the high overall concentration in IMF financing, as opposed to the notion of broadly-shared financing often conveyed through the public quota statistics.

IMF lending is also highly concentrated. The next graph shows that the top 5 users of credit from the main IMF account for 70 percent of its outstanding credit. Russia and Indonesia together account for fully one third of these outstanding loans. The potential exposure of the IMF and its creditors from this high concentration of IMF lending is considerable. The relaxation of past IMF standards capping borrowing at 100 percent of member quota has led to the current situation. Borrowing can now be several hundred percent of quota contributions as more recent annual quota limits have also been further relaxed in recent years.



In summary, both IMF usable contributions and IMF lending are highly concentrated. A core group of advanced industrial nations is the primary source of funds. A distinct and much larger group of current and potential borrowers exist, most of who do not provide significant financial support for IMF activities. Even so, the IMF's lending is highly concentrated, with politically and socially unstable borrowers currently accounting for a large share of outstanding credit.

I would like to close on a related issue that may be of interest. Our review of IMF procedures found last year no evidence of credible IMF procedures to monitor or track the use of IMF loan proceeds. Mr. Saxton took note of the lack of accounting safeguards a year ago in connection with the loans to Russia, now the subject of several inquires. A letter from Majority Leader Armey and Mr. Saxton last March to then Secretary Rubin in connection with the new Russian loan asked for a public disclosure and explanation of any such accounting controls, but none was forthcoming.

Thus it appears that when the IMF disburses funds to a member's central bank, it does not really have an independent way of knowing exactly what happens to it after that point. Perhaps such accounting safeguards would be difficult or unfeasible to administer, but their absence would seem to require a much higher degree of vigilance and effort to protect taxpayer funds from potential misuse. Clearly the loaning of billions of dollars to countries with pervasive corruption problems would run the risk that at least some of it would be misused. In the absence of such accounting controls, it is not clear what procedures the IMF has available to ensure that significant misuse of loan proceeds does not occur aside from simply not making a loan in such cases.

The second part of our presentation by Robert Keleher will focus on the costs of U.S. participation in the IMF, along with several related issues.

STATEMENT OF DR. ROBERT KELEHER

CHIEF MACROECONOMIST TO THE VICE CHAIRMAN JOINT ECONOMIC COMMITTEE

INTRODUCTION

The Joint Economic Committee's (JEC) focus or interest in analyzing the International Monetary Fund (IMF) has *not* been to examine the specific details of loans or conditional loan programs in Russia, Indonesia, Thailand, Brazil, Korea or any other country. Rather, the JEC has focused on various aspects of the IMF *itself.*

In particular, we focused on the IMF's financial structure, the way the institution operates, and the costs of U.S. participation of the IMF. In our view, before Congressional policymakers can make sensible decisions about future IMF funding, IMF gold sales, or make constructive recommendations for reform, some essential, yet understandable information about how the IMF functions is required. In other words, information about, and some understanding of the institution is a prerequisite for sensible reform.

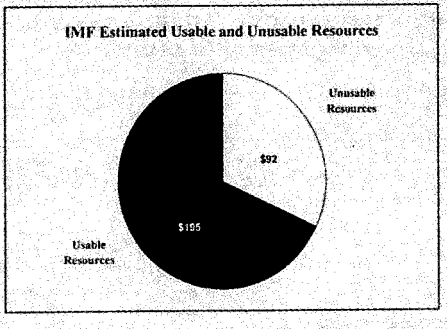
One of our goals was to highlight this relevant information; in a sense, to bring more transparency to the IMF. This has occurred in part through a series of JEC hearings, studies, and press releases. The JEC has used these vehicles of communication to highlight the resources available to the IMF, how the IMF's financial structure operates, and what is especially relevant to the Congress and the public, the costs of U.S. participation in the IMF.

On the other hand, we view our efforts as "work in progress" and as outsiders without access to confidential IMF information, do not pretend to have complete knowledge of the workings of the IMF.

With this in mind, I will quickly review IMF available resources (as requested by Chairman Meltzer); summarize some lessons we have learned about the costs of U.S. participation; and make some brief comments about the IMF's financial structure.

I. IMF AVAILABLE RESOURCES

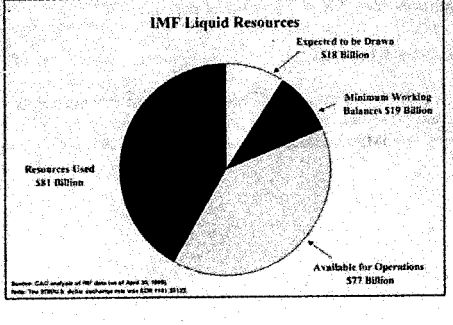
I have some charts I will be referring to in order to help illustrate my points. As my first chart demonstrates, the total resources available to the IMF are now about $287 billion. These are the total resources in the IMF's General Resources Account (GRA) obtained primarily from quotas.



The United States contributes 17.7% of the total, which is the largest share of all the IMF member countries. This percentage is the oft-cited contribution that importantly determines voting rights.

Of the total $287 billion, the IMF deems a sizable portion ($92 billion) to be unusable, leaving $195 billion as usable. This *unusable* portion is about 1/3 of the total and consists of the currencies of those contributions not sufficiently strong economically to permit their currencies to be used for IMF operations.

As the next chart illustrates, this leaves $195 billion as usable resources. Of the $195 billion, $81 billion is outstanding credit already extended (leaving $114 billion), $18 billion has been committed to countries needing assistance, and $19 billion is deemed necessary for minimum working balances. This leaves $77 billion available for additional credit to IMF members.



This $77 billion figure does *not* include three other possible funding sources. First, the IMF can borrow from members. The General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB) currently amount to $46 billion. Second, the IMF can borrow from credit markets which conservative estimates suggest could amount to $70 - $80 billion or more. Third, potential gold sales are an option which over the long term, could amount to about $26-$27 billion. Therefore, depending on how much of these additional resources are deemed (practically) obtainable, current usable IMF resources amount to anywhere from $77 billion to roughly in the neighborhood of $200 billion.

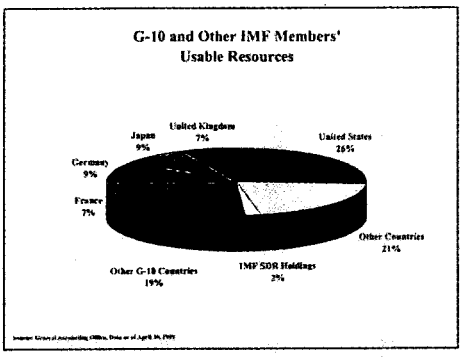
II. LESSONS ABOUT THE COSTS OF U.S. PARTICIPATION

As I mentioned earlier, another critical question for Congress and taxpayers relates to the cost of U.S. participation in the IMF. In examining this issue, we learned a number of lessons about these costs that I would like to briefly summarize for you this afternoon. As background, however, the U.S. contributes about 17.7 percent of total IMF quota subscriptions. It is this 17.7 percent figure that importantly determines the voting rights of IMF member countries and is often equated to, or identified as, the member country's official financial contribution.

However, the actual costs of U.S. participation in the IMF differ from this widely-cited 17.7 percent figure. In particular, evidence indicates that the U.S. is shouldering a larger burden than suggested by this figure. These additional costs are often inadvertently obscured by accounting practices and procedures as well as by difficulties in calculating various hidden costs, opportunity costs, subsidies, or risk factors.

Some of the lessons learned about the costs of U.S. participation in the IMF include the following: First, the U.S. contributes about 26 percent of *usable* financial resources to the IMF. As mentioned earlier, the IMF deems about 1/3 of member currency contributions to be "unusable" for IMF usage. Once you set aside these unusable currencies, the U.S. share of usable IMF quota contributions rises to about 26 percent, i.e., the U.S. contributes 26 percent of usable IMF quotas. Since this figure represents the proportion of those contributions that actually can be used for lending, it is economically more meaningful than the 17.7 percent figure. An implication is that the U.S. is contributing a higher percentage of usable resources than its voting shares would suggest.

The next chart shows the usable resource contributions of key IMF members. Of usable IMF resources, the U.S. contributes 26 percent, by far the largest contributed share. The next largest countries' contributed share are Germany's 9 percent and Japan's 9 percent. In other words, the United States' share is almost triple the size of the next largest member's share. It is also worthy to note that the G-10 countries' contributions to the IMF's usable resources clearly dominate all other sources. (The G-10 total is about 77 percent.) The implication is that IMF lending is largely being financed by a relatively small number of industrialized economies. As far as *usable* resources, then, the IMF does *not* have the broad-based support that is often suggested in the literature.



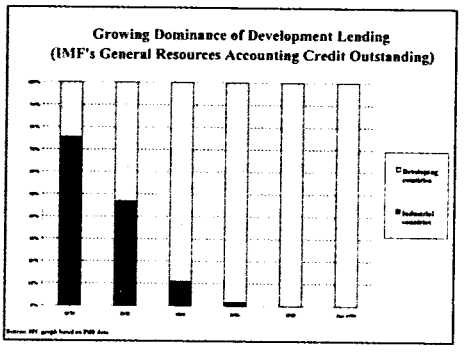
Second, the U.S. share of contributions to the GAB credit line is also significantly higher than its share of quota contributions: the U.S. share of this credit line commitment is about 25 percent. This commitment's share also *exceeds* the oft-cited quota-based, voting rights share (of 17.7 percent).

Third, the U.S. is remunerated for (part of) its reserve tranche position. This rate of remuneration, however, is at a rate of interest *below* that of comparable U.S. Treasury rates and therefore involves a subsidy. The current rate of interest remunerated on U.S. funds is about 3.4 percent. In other words, the U.S. government is lending at more favorable rates than the cost of money to the government. This subsidy should be recognized as a cost. In fact, the *President's Commission on Budget Concepts* defines the budget cost of an "exchange of assets" program as the difference between the Treasury's cost of funds for the term of the provision of resources and its rate of remuneration. (The Treasury rate minus the remuneration rate equals the cost.) Conservative estimates of this cost suggest it is not trivial; it could be as high as hundreds of millions of dollars per year.

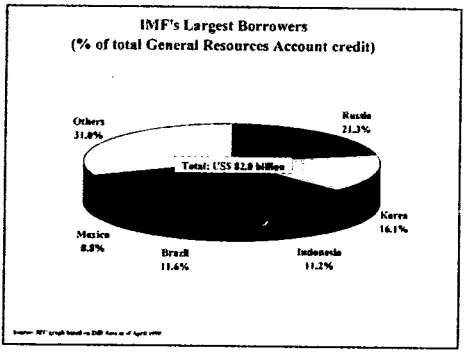
The United States also has a non-remunerated portion of its reserve position that (percentage-wise) involves an even larger subsidy. This unremunerated portion of the U.S. reserve position amounts to about $2.3 billion. The cumulative value of lost interest payments (from 1975-1999) may amount to several billion dollars. (A GAO witness estimated it to be $3.5 billion, but some private sources think it is even larger.) In any case, these costs are non-trivial and are not generally recognized by policymakers, the public, or taxpayers.

Fourth, IMF remunerations do not adequately reflect the increased riskiness of IMF lending. IMF lending however, has become riskier over time. Earlier, the IMF made relatively safe, short-term (low-risk) loans to high-grade industrial countries (such as the UK, France, or Italy). Recently, it increasingly has made significantly higher-risk, longer-term loans to lower-rated countries such as Russia, Indonesia, Brazil, Mexico, or Korea.

The next chart shows how IMF lending has changed over time from industrialized to developing country lending. As you can see, in earlier periods, more loans were made to industrial countries than is now the case. Currently, almost all loans are made to developing countries.



The next chart shows the IMF's largest borrowers. At times, the IMF loan portfolio has become highly concentrated with loans to riskier developing countries like Russia, Indonesia, Brazil, Mexico, and Korea. This has occurred as lending limits have been raised substantially. Note that almost 70 percent of current IMF lending goes to only five countries and 1/3 of these loans go to Russia and Indonesia alone.



Note that these loans are not only riskier, lower-rated borrowers and highly concentrated, but also longer-term in nature. Since these higher risks expose the lender, lenders should be compensated for these higher risks. But this risk factor is generally not reflected in interest rates received by lenders to the IMF. This uncompensated risk factor is (in effect) another form of subsidy and cost borne by lenders such as the U.S. (and its taxpayers). This cost is yet another cost that is not generally recognized by Congress, the public, or taxpayers.

Fifth, I will simply mention that unrestituted gold sales can entail substantial costs to U.S. taxpayers.

In short, the sum of these costs can be substantial. There are several dimensions to the costs of U.S. participation in the IMF that policymakers, taxpayers, and the public should understand. These include a substantial shouldering of usable financial contributions and commitments to the IMF that exceed the oft-cited voting rights share, the costs of subsidized interest rates, the cost of the absorption of risk, and aspects of gold sales. Conservative estimates suggest that the costs of U.S. participation in the IMF are substantial, in the neighborhood of half a billion dollar per year. (Notably, the best quantitative estimates can be found in Adam Lerrick's study for the Bretton Woods Committee.)

All of this suggests that the United States is shouldering a significantly higher proportion of the IMF's financial resources than the oft-cited 17.7 percent quota share would suggest. Furthermore, these facts have not been transparent to policymakers, the public, or the taxpayer. These costs to the U.S. taxpayer too often have been understated, or obscured (perhaps inadvertently) by IMF accounting practices and procedures.

III. SOME BRIEF COMMENTS ON THE IMF'S FINANCIAL STRUCTURE

Finally, in addition to these costs, it is important to highlight the changing nature of the IMF financial structure. I have mentioned earlier about IMF lending and borrowing. IMF lending has become increasingly concentrated with longer-term, riskier borrowing from developing countries than was earlier the case. At the same time, usable resources of the IMF are largely provided by a relatively small group of industrialized countries. In fact, the IMF does not have broad-based financial support as is often reported. As much as 77 percent of IMF usable resources are supplied by the G-10 countries. In short, the IMF is a much different institution than was earlier the case: the IMF is using resources from a small number of industrialized countries and lending this money to a small number of risky developing countries at subsidized interest rates.

CONCLUSION

In conclusion, there are many dimensions to the costs of U.S. participation in the IMF that policymakers and the taxpaying public should understand. I have tried to summarize several important aspects of these costs this afternoon.

Research Findings Regarding The Costs of U.S. Participation In the IMF

RESEARCH FINDINGS REGARDING THE COSTS OF U.S. PARTICIPATION IN THE IMF

Introduction

The finances of the IMF are relevant to U.S. taxpayers because of the prominent role of the U.S. in funding the IMF and guiding its decisions. Consequently, IMF quota increases and most significant IMF gold sales are considered as important policy issues before the Congress. However, informed policy decisions by Congress require adequate IMF transparency to ensure the availability of necessary information. Only with adequate transparency can Congress, in consultation with academic and other experts, develop a thorough understanding of the IMF's financial structure and the costs of U.S. participation in the IMF.

Over the last two years, the Joint Economic Committee (JEC) has promoted essential transparency through hearings, research papers and press statements. This paper reviews some of the key conclusions of JEC research concerning IMF financial structure and costs of U.S. IMF participation.[1]

This paper reviews several findings derived from an examination of the IMF financial structure and costs of U.S. IMF participation. While there are obviously many other important policy issues involved in examining IMF policy (e.g. moral hazard, conditionality), this paper focuses on summarizing the costs of U.S. participation in the IMF. The paper also discusses the changed IMF's financial structure and comments on IMF transparency.

Costs of U.S. Participation in the IMF

The U.S. contributes about 17.7 percent of total IMF quota subscriptions. It is this percentage of quota resources that determines the voting rights of IMF member countries and is often equated to the member country's official financial contribution.

However, the actual economic costs of U.S. participation in the IMF differ significantly from this widely cited 17.7 percent figure. In particular, the evidence demonstrates that in a number of ways the U.S. is shouldering a significantly larger burden than is suggested by the Treasury or official IMF statements. These additional

[1] The General Accounting Office has provided helpful assistance to the JEC in this effort in response to a request by then-Chairman Saxton in 1998. See, the GAO reports "The Transparency and Financial Structure of the IMF," hearing before the Joint Economic Committee, One Hundred Fifth Congress, Second Session, July 23, 1998; and "Transparency and the Financial Structure of the IMF," hearing before the Joint Economic Committee, One Hundred Sixth Congress, First Session, July 21, 1999. JEC research papers related to the IMF include: Christopher Frenze, *IMF Gold Sales in Perspective*, August 1999; Robert Keleher, *An International Lender of Last Resort, the IMF, and the Federal Reserve*, February 1999; Christopher Frenze and Robert Keleher, *IMF Financing: A Review of the Issues*, March 1998; and Robert Keleher, *Financial Crises in Emerging Markets: Incentives and the IMF*, August 1998. For this and more information on the IMF, please visit our website at www.house.gov/jec.

costs are often obscured by accounting practices and procedures as well as by related difficulties in calculating various hidden costs, opportunity costs, subsidies, risk factors, or their accruals over time. Some observations relating to this issue include the following:

- **The U.S. contributes about 26 percent of usable financial resources to the IMF.**

In its quarterly operating budget, the IMF separates usable contributions from the unusable contributions from countries in weak economic condition. (There is little, if any, demand for the currencies of these later countries for international transactions.) With these unusable quota contributions set aside, the U.S. share of usable IMF quota contributions rises to about 26 percent. Since this figure represents the proportion of those contributions that actually can be used for lending, it is an economically more meaningful figure than the overall quota percentage. It demonstrates that the U.S. is contributing a significantly larger share of financial resources than suggested by the quota percentage often cited by the Treasury and the IMF.

- **The U.S. contributes a higher proportion of its quota in international reserve assets than the initially required 25 percent of quota.**

Under IMF procedures, 25 percent of quotas are initially paid in international reserve assets, primarily foreign exchange. The other 75 percent ordinarily takes the form of local currency or promissory notes. But some countries, such as the U.S., persistently contribute more than initial 25 percent of quota in reserve assets, including hard currency. In fact, the U.S. reserve tranche position as a percentage of quota currently is about 42.3 percent. The reasons for this are that (1) the U.S. -- unlike many other countries -- does not normally run down its reserve tranche position and (2) the IMF "encashes" U.S. promissory notes to raise additional funds for IMF lending. In so doing, the IMF enlarges the U.S. reserve tranche position. Accordingly, countries like the U.S. provide the extra marginal resources used for additional IMF lending programs. At the same time, many other countries -- nearly one half of IMF membership -- maintain virtually no reserve positions.[2] Furthermore, under the recent quota increase, over half of the IMF members immediately withdrew the economically meaningful portion of their contribution. According to the GAO:

> Between January 1999, when the Eleventh General Review quota became effective, and April 30, 1999, ... 92 members withdrew the entire $3.6 billion of usable currencies or SDR, replacing them with their national currencies.[3]

In sum, the additional reserve positions financing the IMF are largely from the U.S. and a relatively small group of other advanced countries, whereas a large share of

[2] See "Transparency and the Financial Structure of the IMF," hearing before the Joint Economic Committee, One Hundred Sixth Congress, First Session, July 21, 1999.
[3] GAO, "Observations on the IMF's Financial Operations," September 1999, p.36.

IMF members contribute little or no usable monies. Indeed, of the total amount contributed in excess of 25 percent of member quota in hard currency, about 30.8 percent is contributed by the United States.

In short, the U.S. is contributing significantly more than 17.7 percent of both usable and hard currency contributions to the IMF. Thus, U.S. taxpayers are contributing proportionately more meaningful financial resources than the 17.7 percent implied by their oft-cited quota-determined voting rights percentage.

- **The U.S. share of contributions to the General Arrangements to Borrow (GAB) credit line is also significantly higher than its share of quota contributions.**

The U.S. share of total credit arrangements of the GAB amounts to 25%. Again, this amounts to a commitment whose share exceeds that of the oft-cited quota-based voting rights share. Accordingly, it indicates the U.S. is shouldering a larger share of the credit line commitment than suggested by its quota contribution share. This is case even when the New Arrangements to Borrow (NAB) are considered, although the combined share does decline to 19.7 percent.

- **The U.S. is remunerated for (part of) its reserve tranche position used by the IMF. This rate of remuneration, however, is at a rate of interest below that of comparable U.S. Treasury rates, and, therefore, involves a subsidy.**

The current rate of interest that is remunerated on U.S. funds is about 3.4 percent, a rate below that on U.S. Treasury securities. In other words, the U.S. government is lending at more favorable interest rates than the cost of money to the government. The government, therefore, is lending at "below-cost" rates involving a subsidy that should be recognized.[4]

From another perspective, the U.S. is essentially financing and providing the IMF with predominately long-term money (its reserve position at the IMF) while receiving a short-term rate of remuneration. This involves a subsidy to the IMF and a corresponding cost to U.S. taxpayers.[5]

- **The U.S also has an unremunerated portion of its reserve position that constitutes a significant subsidy.**

[4] As Lerrick has argued, the *1967 President's Commission on Budget Concepts* "defines the budget cost of an 'exchange of assets' program as the difference between the Treasury's cost of funds for the term of the provision of resources and its rate of remuneration." See Adam Lerrick, *Private Sector Financing for the IMF: Now Part of an Optimal Funding Mix*, The Bretton Woods Committee, Washington D.C., April 1999, p.11.

[5] See Lerrick, *op. cit.*, pp.11-13.

In addition to the portion of the U.S. reserve position that receives interest payments (or remuneration), there is an unremunerated portion as well that does not generate interest payments.[6] Accordingly, this portion involves an even larger (percentage wise) subsidy than the remunerated portion. In other words, there is a portion of our reserve position that is, in effect, providing "free money" to the IMF. According to the new report by the General Accounting Office, the cumulative value of lost interest payments amounts to $2.7 billion dollars.[7] This unremunerated portion of the U.S. reserve position constitutes another sizable subsidy to the IMF and a significant cost to the U.S. taxpayer.

- **IMF interest payments do not adequately reflect the increased riskiness of IMF lending.**

Another issue relating to IMF operations is the increased riskiness of IMF lending. In particular, over the years IMF lending has changed from making a large share of relatively safe, short-term (low risk) loans to high-grade industrial countries such as the U.S., U.K., France, and Italy to making significantly higher risk, longer-term loans to lower-rated countries such as Russia, Indonesia, Brazil, Mexico, and Korea. At times, the IMF loan portfolio has been highly concentrated with the latter type of loans since IMF lending limits have been raised substantially. In short, the IMF loan portfolio has become considerably riskier over time.

Since these higher risks expose the lender, the IMF's donor countries should be compensated for these higher risks via higher interest rates; the interest rate charged the borrower and compensating the lender should reflect this higher risk. Yet this additional risk factor is generally not recognized or reflected in the interest rates paid by borrowers from the IMF and received by lenders to the IMF. This uncompensated risk factor is another subsidy and cost borne by lenders such as the U.S. and its taxpayers. But this risk factor is exceedingly difficult to accurately calculate or quantify for a number of reasons. One recent study recognizes and discusses the problems of calculating such risk factors. In particular, Lerrick recommends that "a risk premium or allowance for credit losses should be included in the cost of providing resources" to the IMF.[8]

- **Gold sales can entail substantial costs to U.S. taxpayers.**

IMF proposals to sell gold from its sizable reserves and use the proceeds for various IMF purposes, instead of restituting the gold to the original contributors, also entail significant costs to U.S. taxpayers. Costs associated with U.S. gold contributions are often hidden or obscure and usually not adequately taken into account in most

[6] This portion originated in the mid-1970s with the demonetization of gold. When the second amendment to the articles of agreement was passed in 1978, the gold stayed with the Fund. The U.S. reserve account was credited with an equivalent amount of reserve assets. This portion was deemed non-interest paying.
[7] GAO, "Observations on the IMF's Financial Operations," September 1999, p.56.
[8] See Lerrick, *op. cit.*, p.15.

discussions of IMF gold sales. Such hidden costs are another non-transparent element of the costs of U.S. participation in the IMF.[9]

Gold is carried on the IMF books at about $48 per ounce, well below current market prices. Accordingly, this below-market value hides the (higher) economic value of these reserves. Consequently, any gold sale which occurs at market prices will entail sizable gains to the seller. Relative to the restitution provisions under the IMF charter, such gains would come at the expense of the original contributors of the IMF gold. In any event, the potential profits from gold sales were nonexistant when the gold was initially contributed and should not be usurped by the IMF, but returned to the member nations.

This was forcefully recognized in a bipartisan manner in 1975, when earlier discussions about the proceeds of gold sales occurred. According to the view of Senator Ribicoff (D-Conn.) and Senator Taft (R-Ohio), expressed in a joint statement from a Joint Economic Committee subcommittee document:

> Either the gold belongs to the IMF, or it belongs to the members states, which contributed the gold in proportion to their quotas. <u>In either case, the profits (of sales) should be distributed to the member nations in proportion to their quotas.</u>[10]

The IMF currently owns 103 million ounces of gold. Since the IMF's restitution formula provides for an U.S. share of about 23 percent of this gold, any restitution to the U.S. would entail a sizable sum. For purposes of illustration, for example, at a market price of $260/ounce, the U.S. taxpayer share of potential restitution of the entire IMF gold stock would be approximately 23 percent of the gain, or about $5.02 billion.[11] The U.S. gain amounts to about $190 million for each billion dollars of gold sales.

On the other hand, U.S. taxpayers would forgo this amount in the case of non-restituted sales. For example, a 10 million ounce sale without restitution, as recently proposed, would cost the U.S. taxpayer about $488 million.[12] These are not trivial sums. But these costs are seldom recognized in discussions of alternative gold sale proposals.

- **<u>The sum of these costs is substantial.</u>**

There are many dimensions to the costs of U.S. participation in the IMF that policymakers, taxpayers, and the public should understand. These include a

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[9] These costs are examined and detailed in a recent JEC study. See Christopher Frenze, *IMF Gold Sales in Perspective*, Joint Economic Committee, August 1999.

[10] Comments of Senators Ribicoff and Taft, *The Proposed IMF Agreement on Gold, Report of the Subcommittee on International Economics*, Joint Economic Committee, December 17, 1975, p.11 (emphasis and parenthesis added).

[11] The U.S. share of a total 103 million ounce sale would be 23 percent of the $260-$48 gain, or about $5.02 billion.

[12] The U.S. share of the 10 million ounce sale would be 23 percent of the $260-$48 gain, or about $488 million.

disproportionate shouldering of financial contributions and commitments to the IMF, subsidized interest rates, absorption of risk, and aspects of gold sales. Conservative estimates of the costs of U.S. participation in the IMF (following the *President's Commission on Budget Concepts*) suggest that these costs are substantial.[13] In summarizing these costs, it is reasonable to conclude the following:

- The U.S. is contributing a disproportionate share of usable funds to the IMF.
- The U.S. is contributing a disproportionate share of reserves to the IMF.
- The U.S. commits a disproportionate share of credit line support to the IMF.
- The U.S. is providing subsidized remunerated funds to the IMF.
- The U.S. is providing subsidized unremunerated resources to the IMF.
- The costs of riskier lending are being borne by creditor countries including the U.S.
- Gold sales without restitution to original gold donors would constitute a significant cost to U.S. taxpayers.

All of this indicates that the U.S. is shouldering a significantly greater proportion of the IMF's financial resources than the oft-cited 17.7 percent quota share would suggest. Furthermore, these facts have not been transparent to policymakers, the public, or the taxpayer. These costs to the U.S. taxpayer too often have been understated, hidden, or obscured by IMF accounting practices and procedures. Indeed, a number of these costs are not adequately accounted for in U.S. budgetary documents as recommended, for example, in the *1967 President's Commission on Budget Concepts*.[14] In this context, it will be recalled that a year or so ago, IMF and Treasury sources were claiming that U.S. participation in the IMF was costless! Efforts to make IMF finances more transparent would help to put an end to such misrepresentations.

The changing IMF financial structure.

Identifying the many dimensions to the costs of U.S. participation in the IMF is one aspect of our examination of IMF financial practices. Another key point relates to the IMF's changing financial structure.

The IMF's original procedures, practices, and structure were designed in an era of fixed exchange rates, with gold and the U.S. dollar at the center of the Bretton Woods System. For the most part, IMF lending largely pertained to (short-term) loans to highly-rated, creditworthy, industrialized countries experiencing temporary balance of payments disturbances. Being temporary, such lending was seen as an approximation to short-term asset exchanges. Since interest rates were relatively low, interest charges and related subsidies were deemphasized and viewed as of secondary importance.

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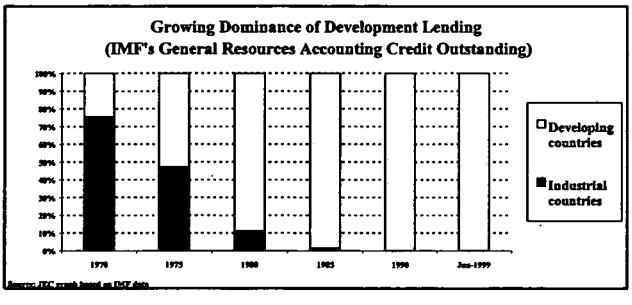
[13] See Lerrick, *op. cit.*

[14] Under the *1967 President's Commission of Budget Concepts*, approaches were recommended to costing various programs, including loan programs or asset exchanges. Subsidization of the cost of funds as well as default risk were to be considered in making cost calculations. See Lerrick, *op. cit.*

In the years since the demise of the Bretton Woods System, however, IMF practices and its clientele have changed significantly in a number of important ways. The IMF's portfolio, for example, has become riskier with a longer-term maturity structure. The IMF has evolved into an organization that is redistributive in nature in that the flow of subsidies is from one group of donors to a different and much larger group of borrowers.

The IMF's portfolio has become riskier in a number of ways. For the most part, IMF lending to lower-rated, higher-risk developing economies has replaced the lending to higher-grade, lower-risk industrial countries.

Further, loans are significantly longer-term and often more structural or developmental in nature than was earlier the case. Indeed, developing country lending now constitutes virtually all of IMF lending as compared to a significantly lesser share, for example, in 1970 (see graph).



An additional element of risk has been added by the liberalization of IMF loan limits that formerly capped borrowing to 100 percent of a member's quota. Not only have these limits been relaxed, but even the new rules have been grossly exceeded in recent years. As the JEC has pointed out, this relaxation of IMF lending limits has led to an unhealthy concentration of IMF lending to a small number of high-risk borrowers, thereby subjecting the IMF's lenders to considerable risk exposure. These JEC findings have also been noted by the GAO:

> In the past 4 years, the IMF has provided financing to five large developing countries that have experienced financial crises. This financing was in amounts that were all well in excess of the IMF's limit on cumulative borrowing.[15]

[15] GAO, "Observations on the IMF's Financial Operations," September 1999, p.28.

In addition to having a riskier, longer-maturity portfolio, the IMF has evolved into an organization that is redistributive in nature. As mentioned, loans and associated subsidies are increasingly concentrated among lower-rated, lower-income developing countries in contrast to the industrialized country lending of earlier periods. At the same time, financial support is narrowly-based among the G-10 countries. In fact, the IMF does not have broad-based financial support. This is illustrated by the fact that as much as 77 percent of the IMF's usable resources are supplied by the G-10 countries, and nearly half of IMF members maintain little or no reserve positions. In short, financial support is increasingly supplied by a small number of industrialized countries while borrowers are typically developing economies facing long-term structural problems. In sum, the IMF portfolio has become more redistributionist over time.

Transparency and the IMF.

The above-cited costs as well as the IMF's changing financial structure have been obscured from Congressional policymakers, the public, and U.S. taxpayers. Yet in order for well-informed Congressional decisions pertaining to the IMF to be made, such information is essential. Part of the reason policymakers have been uninformed on some of these matters is due to a lack of transparency on the part of the IMF.

Transparency, of course, has many different dimensions, and it means different things to different people. In brief, however, transparent policy is characterized by a lack of secrecy, obfuscation, or ambiguity and should be clear, simple, and understandable to policymakers as well as to the taxpaying public. It involves goal clarification as well as clear reporting on a real time, "ex-ante," and "ex-post" basis.[16] Unfortunately, while the IMF has made some limited improvements in the dissemination of data and information, the IMF has a long way to go before it can be viewed as a truly transparent institution.

Numerous examples support this finding of non-transparency. The language used by the IMF, for example, illustrates this contention. The IMF refers to its lending from its principle account not as "loans," but rather as "currency purchases." Furthermore, changed IMF objectives -- as reflected in its dramatically altered financial structure -- have never been spelled out in a meaningful way. IMF financial documents as well as its accounting practices and procedures are neither clear nor understandable even to some senior IMF officials themselves.

Many of the costs of participation in the IMF (cited earlier) are difficult to calculate because much of the information needed to make such calculations is unavailable, obscure, hidden, or difficult to understand or to collect. Accurate information related to usable versus unusable resources, for example, are in operational budgets which are not available to the public. Similarly, the calculation of remunerated interest subsidies can be difficult. The costs of non-remuneration of interest are even less well-known since the concept has been hidden and calculation of the unremunerated reserve tranche position is not straightforward. Similarly, calculation of risk premium

[16] See, for example, Robert Keleher, *Transparency and U.S. Dollar Policy*, Joint Economic Committee, July 1999, p.2.

and associated costs of risk is a complicated and difficult task that is not undertaken by the IMF. The cost related to non-restituted gold sales is hidden and obscure as well-documented in a recent JEC study.[17] Much of the essential information pertaining to the recent IMF gold sales proposal, for example, was not available to the public. Accordingly, no rational and informed discussion was able to occur among policymakers in consultation with academic experts and academics.[18]

In sum, despite recent improvements in disseminating some data and information, a good deal more reform should be undertaken in order to make the IMF a truly transparent organization.

Summary and Conclusions:

The U.S. Congress is responsible for decisions related to IMF quota increases as well as to IMF gold sales. To make informed decisions, policymakers must have a certain amount of essential, yet understandable information. An understanding of the IMF's financial structure and the costs of U.S. participation in the IMF is especially pertinent. The JEC has worked to provide and highlight some of this essential information in the form of hearings, research papers, and press releases.

This paper has reviewed some of the key findings identified in examining IMF financial structure and costs of U.S. IMF participation. Further areas of investigation remain (e.g., the workings of the SDR department, accurate quantification of risk, etc.). Nonetheless, it is important that the information conveyed in these lessons be made available and accessible to policymakers and the taxpaying public.

There are many dimensions to the costs of U.S. participation in the IMF that policymakers and the taxpaying public need to understand. These include the disproportionate U.S. burden of financial contributions and commitments to the IMF, subsidized interest rates, absorption of risk, and aspects of non-restituted gold sales. Conservative estimates of the costs of U.S. participation in the IMF suggest that these costs are substantial. All of this suggests that the U.S. is shouldering a significantly greater proportion of the IMF's financial resources than the oft-cited 17.7 percent quota share would indicate.

In addition to these U.S. costs, it is important to highlight the changing nature of the IMF financial structure. The IMF's portfolio has become riskier in a number of ways. Longer-term loans are increasingly made to lower-grade, higher-risk developing countries. The IMF's portfolio has become concentrated with a small number of large loans of this type. Further, the IMF has evolved into an organization that is increasingly redistributionist in nature. Financial support is increasingly supplied by a small number of industrialized countries while borrowers are for the most part developing countries facing long-term structural problems.

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[17] See Frenze, *op. cit.*
[18] See Frenze, *op. cit.*, p.3.

All of this information, while essential for Congressional decisionmaking, has generally not readily been available to Congressional policymakers or the taxpaying public. A major reason policymakers and the public are not well informed on these matters is a lack of transparency on the part of the IMF.

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Can IMF Lending Promote Corruption?

CAN IMF LENDING PROMOTE CORRUPTION?

Introduction

Emerging evidence of widespread corruption in several countries receiving substantial IMF assistance has raised questions related to a number of issues. For example, do corrupt governments tend to receive government-to-government assistance? What is the relationship between such assistance and corruption? Does financial assistance reduce such corruption? Or, could government assistance actually foster corruption?

The emerging evidence about corruption also raises questions about the policies underlying IMF procedures surrounding such assistance. Analysts, for example, have questioned how borrowed monies are monitored or tracked to ensure they are used for the purposes intended by the donors. Others question the anti-corruption conditionalities attached to lending agreements.

While most analysts agree some corruption is present in all countries and is often "home-grown," there are a number of reasons to believe that under certain conditions, government-to-government assistance and lending can actually promote corruption. This paper explores these corruption-promoting circumstances. The relevant foreign aid literature is reviewed and then related to IMF lending before remedies are prescribed.

Can Foreign Assistance Promote Corruption?

Recent research tentatively identifies certain conditions that tend to promote corruption. Leite and Weidmann (1999), for example, argue that among other things, corruption depends on governmental policies and the concentration of bureaucratic power.[1] Tanzi (1998) suggests that factors tending to promote corruption over time include government regulations and authorizations, certain characteristics of tax and government spending systems, government provision of goods and services at below market prices, and bureaucratic traditions.[2] In an earlier paper, Tanzi (1994) argued that opportunities for corruption increase with a larger role of the state in the economy. In his own words, "The more pervasive is the role of the public sector (through regulations, taxes, etc.)... the greater will be the scope for corruption."[3] Lane and Tornell (1996) suggest that corrupt activity can operate in economies with powerful interest groups and weak institutions.[4] Further, it is now widely recognized that centrally planned economies were closely associated both with many of these characteristics and a significant degree of corruption.

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[1] Leite, Carlos and Jens Weidmann, "Does Mother Nature Corrupt? Natural Resources, Corruption and Economic Growth." IMF Working Paper, WP/99/85, July 1999.
[2] Tanzi, Vito. "Corruption Around the World: Causes, Consequences, Scope, and Cures." IMF Working Paper WP/98/63, May 1998, pp.3, 6, 10-16.
[3] Tanzi, Vito, "Corruption, Government Activities, and Markets," IMF working paper No. 94/99, August 1994, p. iii.
[4] Lane, Philip R., and Aaron Tornell, "Power, Growth, and the Voracity Effect," Journal of Economic Growth, Volume 1: 213-241 (June, 1996).

Literature dealing with foreign economic aid recognizes that government-to-government foreign economic assistance often can (inadvertently) promote those conditions that foster corruption. This is especially the case when a significant degree of corruption is already present in recipient countries.

Foreign assistance and lending, for example, is sometimes conditioned on budget deficit reduction, i.e., on proposals that can effectively increase a country's tax burden. Such assistance has also been identified with strengthening the public-sector bureaucracy which directly receives the aid, thereby promoting this bureaucracy's concentration of power. It is also known that the availability of foreign assistance encourages rent-seeking behavior and that government-to-government transfers often result in increased government spending on the part of aid recipients.[5] While this literature pertains to the effects of foreign economic aid, it readily applies to the type of longer-term subsidized IMF lending that has occurred in recent years.

On the whole, this research suggests that while the objectives of foreign economic assistance are commendable, foreign aid and lending can have important (unintended) corruption-promoting effects on recipient economics for a number of reasons:

- **Foreign aid strengthens the government sector relative to the private sector.**

Foreign aid is usually provided from centralized government sources to centralized government recipients. More specifically, such aid is financed by taxing the private sector of donor countries and subsequently transferring the resulting resources, via centralized government-to-government means to recipient governments. This process works to subsidize and strengthen the public sector of the recipient country. Part of the explanation relates to the incentives of recipients.

As Bauer emphasized:

> Unlike manna from heaven, official aid does not descend indiscriminately on the population of the recipient country; it accrues to specific groups of people in positions of power and sets up repercussions often damaging to development, notably by contributing to the politicisation of economic life.[6]

Specific recipients of aid monies have economic incentives that may differ or conflict with the intentions of donors. They have incentives, for example, to reward their friends, supporters, and special interest constituents. Because of these realities, foreign aid can in practice work to strengthen the role of the recipient countries' public sector relative to its private sector.[7] Aid has tended to promote centralized economic control and fostered a concentration of bureaucratic power in recipient governments.[8] This is corroborated by the fact that government-to-

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[5] See, for example, World Bank, Assessing Aid: What Works, What Doesn't and Why, World Bank and Oxford University Press, 1998, pp.64-66.
[6] Bauer, P.T., Dissent on Development, Harvard University Press, Cambridge, Mass., 1976, p.21.
[7] See Milton Friedman, "Foreign Economic Aid: Means and Objectives," The Yale Review, vol. XLVII, June 1958 No. 4, p.503.
[8] See Bauer, *op. cit.*, p.128.

government transfers often lead to increases in government spending.[9] And, as one researcher concluded, "Aid... does increase the size of government."[10]

- **Foreign aid can perpetuate or strengthen existing corruption.**

Research relating to foreign aid shows that such aid is dispersed not on the basis of need, but on the basis of strategic and geo-political considerations.[11] That is, aid tends to support existing recipients who generally are supportive of existing donors. Donors, after all, have incentives to provide aid to those forces, supporters, and organizations that will help them remain in power. In practice, these characteristics are more important to donors than forces of change. A World Bank survey of research on foreign aid, for example, indicates that "there is little relationship between changes in aid and policy reform."[12] Foreign aid, then, often has not worked to promote reform. Consequently, aid tends to subsidize -- and thereby strengthen -- existing government connections and structures since aid recipients also will distribute this aid so as to preserve their political positions. In short, political elites can benefit from aid. In practice, aid subsidizes and strengthens existing regimes so they become solidified and entrenched. When existing regimes are corrupt, such regimes can be strengthened by foreign aid. It has been shown, for example, that foreign aid seldom includes meaningful incentives to alter governmental behavior with regard to corruption. In sum, when existing regimes are corrupt, the result is that these corrupt political regimes can benefit from foreign aid and become more firmly entrenched.[13]

Recent research by Alesina and Weder (1999) corroborates this view. They find that foreign economic aid actually is directly associated with corruption.[14] More specifically, Alesina and Weder contend that: "...our results ...suggest that foreign aid may increase, or at best, has no effect on corruption."[15] Their research shows that there is no evidence whatsoever that less corrupt governments receive more aid, or that aid donors discriminate against corruption.[16] Their research indicates that foreign aid appears to go to more corrupt governments.[17] According to the authors, "there is some evidence that more corrupt governments receive more" aid.[18] Alesina and Weder go on to say that multilateral aid seems to pay no attention to the level of corruption and there is some evidence that "multilateral aid is positively correlated to corruption."[19]

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[9] World Bank, *op. cit.*, p.64.
[10] Boone, Peter. "Politics and Effectiveness of Foreign Aid," NBER Working Paper #5308, October 1995 (Abstract).
[11] Alesina, Alberto and David Dollar (1998), "Who Gives Foreign Aid and Why?" NBER Working Paper, No. 6612. See also Alesina, Aleberto and Beatrice Weder, "Do Corrupt Governments Receive Less Foreign Aid?" NBER Working Paper No. 7108, May 1999, p.5.
[12] World Bank, *op. cit.*, p.49 (see also p.3).
[13] The World Bank survey finds that governments in power a long time are less likely to implement reforms. World Bank, *op. cit.*, p.52.
[14] Alesina and Weder, *op. cit.*, p.13.
[15] *Ibid.*, p.5.
[16] *Ibid.*, p. 13.
[17] *Ibid.*, p. 5.
[18] *Ibid.*, p. 13.
[19] *Ibid.*, p.16. (Note that the later evidence, however, is not statistically significant.) See also, p. 4.

Other researchers as well as Alesina and Weder also find support for what they call a "voracity effect" of foreign aid. This "voracity effect" indicates that when a recipient country obtains a foreign aid windfall, lobbying and redistribution efforts are heightened and corruption worsens. As a result, the windfall is turned into a social loss.[20] Because of this effect, more foreign aid tends to produce more corruption; that is, "countries that receive more (foreign) aid tend to have higher corruption."[21]

In sum, there appear to be logical reasons and empirical evidence that foreign aid can, and in fact does, foster corruption.

- **Foreign aid can delay pressures for reform and efforts to reduce corruption.**

Similarly, foreign aid can create incentives to maintain existing institutions and inhibit reform; foreign aid can work to further entrench the status quo. Foreign aid, for example, may inhibit efforts to reform for several reasons. As countries come to expect economic aid from external sources, the impetus to develop the necessary preconditions for advancement may dissipate. Necessary efforts to reform attitudes, institutions, and incentive structures, and to minimize corruption may become subordinate to efforts to obtain such aid. The availability of foreign aid therefore may spawn efforts to obtain this external aid instead of efforts to develop the necessary, essential ingredients for corruption-free internally driven growth. In short, foreign aid may redirect attention away from necessary governmental policy reforms that weed out corruption, and toward aid procurement.[22] In this way such aid may inhibit the commitment to reform and to reduce corruption.

In cases where significant corruption already exists, foreign aid typically has not worked to alleviate it. Recent research indicates that "there is little relationship between changes in aid and policy reform."[23]

Occasionally, conditionalities on aid are prescribed as methods to counter corruption. But, as recent research suggests, such conditionality is unlikely to work for a number of reasons. Conditionality, for example, is inherently difficult to monitor, is typically in force for limited time frames, and is administered under the strong pro-disbursing incentives of donor agencies. This research generally remains skeptical "about the ability of conditionality to promote reform in countries where there is no strong local movement in that direction."[24]

In sum; the foreign aid literature clearly makes the case that however commendable the objectives of foreign economic aid, such aid can promote (1) conditions fostering corruption, (2) the public sector relative to the private sector, (3) the status quo and existing corruption, and (4) delays in reform efforts to reduce corruption.

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[20] *Ibid.*, p. 12. See also Lane and Tornell, op. cit.
[21] Alesina and Weder, *op. cit.*, p.20 (parenthesis added).
[22] See Bauer, *op. cit.*, pp.100-3.
[23] See World Bank, *op. cit.*, p.49.
[24] World Bank, *Ibid.*, p.51.

Relevance to IMF Lending

Most of the above remarks pertaining to foreign aid are directly applicable to IMF lending. IMF assistance loans, after all, are heavily subsidized and increasingly longer-term in nature.[25] These loans are dispersed from a highly centralized (multilateral) government agency to centralized government recipients. The loans, therefore, go to those in power, supporting existing established elites. Furthermore, many of these loans recently have been made to lower-rated developing countries with especially high degrees of corruption as calibrated by various measures of corruption. In fact, many of these countries were identified as highly corrupt by the IMF's own research staff.[26] All of this suggests that IMF lending may subsidize and foster corruption.

Furthermore, the conditions placed on IMF loans to these countries often may (perhaps unwittingly) foster circumstances spawning further corruption. Conditions promoting increases in taxation, government spending, and subsidies to the bureaucracy, for example, may be counterproductive. IMF lending may also more directly promote corruption through the "voracity effect:" i.e., by increasing the conflict among powerful special interest groups and factions, their power and influence is strengthened and corruption thereby promoted. The fact that many countries receiving IMF loans have remained dependent on IMF assistance for extended time periods with little evidence of genuine reform suggests that the entrenchment of the (sometimes corrupt) status quo may be related to IMF lending.[27]

Despite widespread evidence of corruption in recipient countries, IMF lending has seldom, if ever, been associated with controls, safeguards, monitoring procedures, earmarking, or tracking systems to ensure such funds are used consistent with the wishes of donors.[28] Corruption-preventing conditionalities also have seldom been associated with IMF lending; such lending is not contingent on a lack of corruption. Further, there is little evidence that corrupt governments get less IMF support or that IMF lending reduces corruption.

In short, the evidence suggests the IMF knowingly makes loans to corrupt governments while recognizing that some of its loan conditions and procedures can create circumstances promoting additional corruption. Yet no important safeguards or preventive conditionalities have been attached to these loans. Thus, IMF lending operations may be consistent with subsidizing corruption.

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[25] See Robert Keleher and Christopher Frenze, "JEC Findings Regarding IMF Financial Structure and Cost of U.S. Participation in the IMF." Joint Economic Committee study, October 1999.

[26] See, for example, Tanzi (1998) *op. cit.*, Table 1 (pp.23-4) where Russia, Indonesia, Philippines, Brazil, Mexico, Thailand, and South Korea are all identified as being relatively corrupt. See also the data presented in Pranabe Bardhan, "Corruption and Development: A Review of Issues," Journal of Economic Literature, Sept. 1997, pp.1343-6.

[27] See, for example, Doug Bandow, "The IMF: A Record of Addiction and Failure," in Perpetuating Poverty, edited by Doug Bandow and Ian Vasquez, Cato Institute, Washington D.C., 1994, p.19.

[28] Since the IMF does not lend money for specific purposes and money is fungible, as long as macro conditions are satisfied, there is normally no strict monitoring of funds associated with IMF lending.

Remedies

Current forms of IMF assistance can foster or perpetuate corruption. To minimize the possibility of this occurring, several types of IMF reforms or procedural changes have been proposed. These proposals take the following forms:

- **Reduce and reform IMF lending:** Minimizing IMF lending is one obvious way to prevent IMF assistance from promoting corruption. But refocusing such lending away from longer-term structural lending and toward the type of temporary, shorter-term balance-of-payment lending that earlier characterized the IMF also would work in this way. Adopting prudent lending limits and thereby embracing smaller-scale lending is consistent with such an approach. Elimination of pervasive IMF interest subsidies would also work to reduce the potential for corruption.

- **Impose strong conditionalities:** Another proposal to minimize the corruption-promoting effects of IMF assistance is to impose strong conditionalities on such lending. Pre-screening countries by requiring certain legal standards, anti-corruption codes, and accounting practices be established prior to obtaining IMF funds could work to minimize corruption.

- **Establish monitoring procedures:** A third approach to minimize the possibility of enhanced corruption is to establish monitoring or earmarking systems to reliably track IMF funds. These procedures would presumably ensure these funds are utilized in ways consistent with the wishes of donors. This might involve the establishment of separate accounts or accounting practices used exclusively for IMF funds.

While these proposals seem reasonable, few, if any of such proposals have been taken seriously or successfully implemented. Nonetheless, such changes appear to offer viable options at this time.

Summary and Conclusions

Evidence of widespread corruption in several countries receiving IMF assistance has raised questions about the relationship between such assistance and corruption. Research pertaining to corruption indicates that the more pervasive the public sector's role in the economy, the more likely is corruption to flourish.[29]

However commendable the objectives of foreign aid, such assistance often can create the very conditions that foster corruption. Such aid can strengthen existing public sector bureaucracy, result in larger government spending and a larger public sector (relative to the private sector), promote more rent seeking activity, entrench a corrupt status quo elite, and foster delays in reforming existing corruption.

[29] See Tanzi, 1994, *op. cit.*, p.iii.

All of this is directly relevant to current IMF operations. IMF funds currently can be distributed to corrupt public bureaucracies and elites and are often (unwittingly) used to promote those conditions fostering additional corruption. Despite widespread evidence of corruption, IMF lending has been associated with neither safeguards or controls, nor contingencies related to the absence of corruption. This suggests IMF lending may work to foster corruption. Reducing or reforming IMF lending, imposing strict conditionalities, and/or establishing reliable monitoring methods appear to be alternative remedies available at this time.

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