much remains to be done on IFA reform and that priority should be now placed in the following six areas:

(i) controlling currency mismatches in emerging economies;

(ii) agreeing on and enforcing stronger injunctions against currency manipulation;

(iii) giving assessments of and policy prescriptions for debt sustainability a larger role in IMF surveillance, policy lending, and advice, and experimenting with the use of GDP-indexed bonds;

(iv) improving the quality of compliance evaluations for international standards and codes;

(v) shifting human resources within the IMF to give greater weight to the early warning of currency, banking, and debt crises in emerging economies; and

(vi) limiting the extension of very large IMF loans – known as exceptional access – to country cases that are truly exceptional.

In the remainder of this note, I lay out briefly the rationale for each of these six priorities by summarizing the nature of the problem and of the proposed solution.[1] A final section offers some brief concluding remarks.

II. Controlling Currency Mismatches in Emerging Economies

Problem: A currency mismatch exists when there is a difference in the currency composition of assets and liabilities such that an economy's (or sector's) net worth becomes sensitive to changes in the exchange rate. The control of currency mismatch merits high priority because serious currency mismatches have been a prominent feature

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currency mismatches engender a "fear of floating" in emerging economies that can deny these countries the benefits of greater exchange rate flexibility.

Proposed solution: Those emerging economies that are heavily involved with private capital markets should opt for a currency regime of (de facto) managed floating; this will produce an awareness of currency risk and an incentive to keep currency mismatches under control. A monetary policy framework of inflation targeting should be employed to provide a good nominal anchor against inflation; good inflation performance is crucial for developing a healthy, local-currency denominated bond market. Banks in emerging economies should apply tighter credit limits on foreign-currency-denominated loans to customers that do not generate enough foreign-currency revenues, and banking supervisors should strengthen regulations and capital requirements on banks' net open positions in foreign exchange. The IMF should regularly publish data on currency mismatches at the economy-wide and sectoral levels and should comment on those mismatches regarded as excessive.[2] Emerging economies that have a high share of public debt denominated in, or indexed to, foreign currency should adopt a medium-term objective of reducing that share, and countries with a poor track record on inflation would be better advised to use inflation-indexed bonds – rather than foreign-currency-indexed bonds – as a useful transition device to fixed rate, domestic-currency-denominated debt. Higher priority should be accorded to enlarging domestic bond markets, to encouraging the use of hedging instruments, and to reducing barriers to the entry of foreign-owned banks.[3] Cross-country experience indicates that currency mismatches can be reduced substantially over time periods shorter than a decade but only if the right set of policies is followed.

III. Stronger Injunctions against Currency Manipulation

Problem: A key reason for establishing the IMF was to put in place a set of international rules or guidelines that would discourage "beggar-thy-neighbor" exchange rate policies. The IMF's charter in fact stipulates that each member country shall "… avoid manipulating exchange rates or the international monetary system in order to prevent effective balance-of-payments adjustment or to gain unfair competitive advantage over other member countries." Unfortunately, very little has been done over the past 25 years either to identify serious episodes of exchange market manipulation or to enforce/ encourage remedial action when such episodes have occurred.

Over the past two years, the problem of exchange rate manipulation has become harder to deny. According to the IMF's surveillance guidelines on exchange rate policy, an important pointer of manipulation is large-scale, prolonged exchange market intervention in one direction. China has been engaging in just such behavior over the past two years:

[2] Goldstein and Turner (2004) have introduced (for 22 emerging economies) a new measure of aggregate effective currency mismatch (AECM) that should prove useful as a shorthand "stress test" of the output effects of a large depreciation of the exchange rate; those AECM data are now available for 9 Asian emerging economies on the website of the Asian Development Bank.

[3] The action program to reduce currency mismatches set out above can be classified as emphasizing actions at the "national" level; in contrast, Eichengreen and Hausmann (2003) opt for a more "international" approach to reducing currency mismatches.

China’s international reserves increased by roughly $160 billion in 2003 and by an

growth outcomes – not low ones, that are considered a success and that get politicians re-elected).

V. International Standards and Codes

Problem: Contrary to the projections of some pessimists, it has proven possible to secure within a relatively short time period international agreement on a set of international standards and codes of best practice. The Financial Stability Forum (FSF) has decided that 12 of these are crucial for sound financial systems and merit priority implementation. These 12 standards cover three broad areas: macroeconomic policy and data transparency, institutional market infrastructure, and financial regulation and supervision. The IMF and World Bank are actively involved in the key task of monitoring and evaluating countries compliance with many of the standards and an increasing share of these compliance evaluations (so-called Reports on the Observance of Standards and Codes, or ROSCs) are being published.[6]

All that is to the good. The rub is that we don't yet know very much about the impact of these standards;[7] in addition, some of the channels that were originally thought to increase the incentives for complying with the standards (such as offering complying countries more favorable risk weightings in the Basle II international capital standards and/or preferred access to IMF resources) have not been part of the official agenda. And there is a danger that the quality of the evaluation process will suffer if too many compliance reports are initiated.

Proposed solution: The way ahead on standards should be to concentrate on the core group of standards (rather than taking on new ones), to seek to raise the quality of ROSCs by limiting further the number

Problem: Investing in an early warning system for currency, banking, and debt crises should be attractive on at least two grounds.

Thailand (1997), Indonesia (1997), Indonesia (1997), Korea (1998), Brazil (1998-2001), Turkey (1999-2002), Uruguay (1999-2001), and Argentina (2000-2001). One result of this de facto access policy has been a high concentration of Fund credit among a small number of borrowing countries; e.g., in January 2004, credit outstanding to the Fund's three largest borrowers (Argentina, Brazil, and Turkey) hit an unprecedented 70 percent of total credit.

Deciding when access to IMF loans should be

VIII. Concluding Remarks

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