



Strengthening IMF Surveillance: A Comprehensive Proposal

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The central challenge facing the global economy and financial system today is the failure of countries to limit the negative effects of their policies on other countries and on global economic and financial stability. The most prominent manifestations of this challenge are the balance-of-payments adjustment process and the notorious asymmetry therein, spillovers from other countries' financial-sector policies such as those involved in the crisis of 2007–10, and the prospect of sustained unbalanced growth in the global economy with some countries overheating and others facing substantial excess capacity. Against this background, I propose an approach to strengthened IMF surveillance over the economic and financial policies of its member countries.

These are not new challenges. They have been endemic to the world economy for the past 100 years at least. However,

the effects of deficiencies in national economic policies have been magnified in recent years, including before and during the crisis, by the increased globalization of the world economy and financial system.

The International Monetary Fund (IMF) was established to address the shortcomings in economic policy coordination during the interwar period, in particular following the onset of the Great Depression. However, the operation of the Bretton Woods system was suboptimal, leading to its collapse in the early 1970s. Since then, the operation of the system or nonsystem, according to one's perspective, has been little improved and some argue has been worse.

The approach proposed here is grounded on acceptance by all IMF members of an explicit obligation to promote global economic and financial stability. In effect, I am proposing a new overarching rule governing the policies of IMF members. However, rules alone are not sufficient to produce the desired result. The basic problem is that each country wants to maintain its sovereign scope for policy maneuver. Moreover, it is a challenge to write robust rules governing macroeconomic policies in all conceivable circumstances. More important, any agreed rules are not likely to be self-enforcing. Even in country groups like the European Union, whose economies are homogenous and whose leaders generally share a common vision of a shared destiny, the rules are incomplete and have proved to be less than totally effective in conditioning economic and financial policies and performance. However, rules do serve as useful precommitment devices. They provide a degree of constraint and symmetry by imposing presumptive obligations.

What is needed is an approach that builds on members' IMF obligations and also offers significant promise of affecting their policy choices. The approach advocated in this policy brief has five integrated components: (1) updated *obligations* of IMF membership, (2) development of a set of *norms* to guide members in meeting those obligations, (3) a process to apply *judgment* in monitoring compliance with those obligations, (4) *accountability* in the application of such judgment based on transparency, and (5) potential *consequences* for member countries that are judged not to have complied with their obligations.

Implementation of the proposed approach requires amendment of IMF Article IV regarding foreign exchange arrangements, Article VI regarding capital flows, and various articles

involving penalties for noncompliance with IMF obligations. Implementation of the proposed approach also requires changes in the governance processes and procedures of the IMF. These tasks are not easy.

The crux of the approach is to enhance IMF members' obligations to contribute to global economic and financial stability and to strengthen IMF surveillance of those obligations through the use of norms and a transparent peer review process that leads to improved policies and outcomes.

PROPOSED OBLIGATIONS

The obligations of IMF members in setting and implementing their economic and financial policies should be reoriented and strengthened. I envision four basic obligations.

- First, the overarching obligation for each member of the IMF should be to ensure the effective operation of the international monetary system (global economic and financial stability).
- Second, each member should be obligated to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability (internal stability).
- Third, each member should be obligated to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage (external stability).
- Fourth, each member should be obligated to promote financial stability including by fostering underlying economic and financial conditions that do not produce erratic disruptions in real effective exchange rates (financial and exchange rate stability).

Discussion of Proposed Obligations

The first obligation builds on the language in the current Article IV, Section 3(a), "The fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1, of this Article." However, this provision has been interpreted to apply to the Fund itself and to require members to cooperate with the Fund only in fulfilling its mission. In other words, currently there is an obligation on the Fund as a whole but no substantive obligation on the individual members themselves regarding the international monetary

system as such.¹ The proposed approach would not only offer clarification but also elevate the global economic and financial stability obligation to number one status. It would replace the current overarching obligation "to assure orderly exchange arrangements and to promote a stable system of exchange rates."² In plain language, the new overarching obligation would require members to take into account the external impacts of their domestic policies.

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Under the proposed approach, the existing subsidiary obligations under Article IV, Section 1 would be somewhat recast and reordered. First would be the obligation to achieve internal stability, as at present. Second would be the obligation to achieve external stability. Third would be the obligation to promote international financial stability, which would be extended to encompass exchange rate stability, but exchange rate stability itself would be specified in terms of real effective exchange rates.

The scope for the surveillance of each member's compliance with these obligations would apply to the full range of their policies—monetary, fiscal, foreign exchange, financial, and structural—to the extent that those policies affect global economic and financial, internal, external, or exchange rate stability. A country with a floating exchange rate regime would not be exempted from these obligations as is now the case. It would be recognized that policies other than intervention or capital controls can affect exchange rates. For example, countries or areas such as Japan, Switzerland, Sweden, and the euro area, on the one hand, and the United States, Australia, Brazil, and the United Kingdom, on the other, could be questioned about their

1. This interpretation is notwithstanding the language of Article IV, Section 1: Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.

An uninformed observer might think that these two provisions in the IMF Articles of Agreement would be sufficient to establish an obligation on each IMF member to promote global economic and financial stability, but that is not the case.

2. See previous footnote. The cryptic language was born of compromise between the United States and France and subsequently has been beset with ambiguity.

monetary and fiscal policies or their investment policies and the impacts of such policies on their current account positions.

Under the proposed approach, financial policies would encompass restrictions on capital flows. This would require substantial revision of Article VI, in particular the current

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provision in Section 3, which provides an open-ended blessing of controls by members to regulate capital movements as long as they do not affect current account transactions. As I have argued previously (Truman 2010a), the time has come, in any case, to revisit the issue of volatile capital flows and to reestablish the case for collective action with respect to such flows and IMF surveillance over them with a view to amending the IMF Articles of Agreement. The purpose would not be to prohibit the use of capital controls but rather to permit or even advocate their use in certain circumstances.

The proposed obligations would apply to all members of the IMF as would surveillance of each member's compliance with its obligations. However, the new multilateral obligation would apply, in particular, to members whose policies significantly affect global economic and financial stability. These need not be always the same countries. Importantly, the designation of a "significant" country would be made by the IMF staff and management. The reason is to prevent countries from opting out of this type of multilateral surveillance by appealing to the executive board.

ILLUSTRATIVE NORMS

In support of surveillance over each member's compliance with these obligations, the IMF staff would develop norms for members' policies and performance. In doing so, the IMF staff would draw on the advice and experience of all IMF members and other available expertise. However, responsibility for constructing the norms would lie exclusively with the IMF staff.

The norms might include, but not be limited to, the following:

1. A member country should not have a persistent current account deficit or surplus of more than *A* percent of world GDP.
2. Increases or decreases in a member's international assets broadly defined should be limited to *B* percent of GDP over any 12-month period.

3. A member should limit its inflation rate to *C* percent per annum.
4. A member should limit its cyclically adjusted annual general government fiscal deficit to *D* percent of potential GDP.
5. A member should limit its government debt to *E* percent of potential GDP.
6. A member country's monetary, fiscal, foreign exchange, and other economic and financial policies should be evaluated in light of the norm for that country's real effective (weighted average) exchange rate (REER) that can be expected to achieve both internal stability (full employment and price stability) and external stability as defined by norm (1).
7. The currency composition of a member's international reserves broadly defined should not change by more than *F* percentage points in any 12-month period.³
8. A member should avoid policies, including the intensification of capital controls, that prevent the movement of its REER toward its norm.
9. A member should avoid policies (or the absence of policies) that can be associated with persistent, significant movements in its REER away from its norm.

Discussion of Illustrative Norms

The illustrative norms can be loosely identified with the four obligations discussed in the previous section. They would not receive equal weight with respect to each obligation. In principle, all the norms are relevant to a member's obligation with respect to global economic and financial stability. However, the first two norms, covering current account balances and changes in international reserves, can be most closely identified with that objective.

The next three norms, regarding inflation and fiscal and debt positions, are most relevant to the obligation to maintain internal stability. One could imagine norms relating to the level and growth rate of potential output and shortfalls relative to potential, but my presumption is that few countries deliberately depress their growth rates. Policies that overstimulate the

3. Some technical work would be required to define each of the norms—setting the various percentages, etc.—but that may be particularly the case with this norm. One possibility would be to express the norm in terms of the sum of increases or reductions in currency shares, presumably but not necessarily adjusted for valuation effects. See Truman and Wong (2006).

economy are likely to produce inflation, which would be picked up by norm (3) related to inflation.

The next two illustrative norms relate primarily to the obligation to achieve external balance, linking that obligation to an exchange rate norm and a diversification norm. The last two norms relate primarily to the obligation to pursue financial and exchange rate stability.

Certainly other norms could be added to this list. For example, it would be attractive to have a norm for the financial system, perhaps an aggregate measure of leverage, but at present technical consensus is insufficient to support such a norm. A norm for the growth rate of money might be considered, but measures of monetary growth alone have been largely discredited as guides for policy. On the other hand, a case could be made for a norm based on the growth rate of a broader measure of debt or credit.

Consideration could also be given to norms based on policy frameworks governing financial sector supervision, the stability of the financial sector, or the various aspects of monetary or fiscal policy design and implementation. However, I do not think that such qualitative norms would be desirable or necessary. They would not be desirable because surveillance is best served by objective criteria assembled by the IMF staff rather than their more subjective judgments. Qualitative norms would not be necessary because judgment would be applied at the next stage, and that judgment could be assisted by IMF staff inputs of a more subjective nature.

The role of the norms would be to trigger subsequent consideration of whether a member is in compliance with its obligations. Thus, they would be expected to play a role somewhat similar to “indicative guidelines composed of a range of indicators . . . as a mechanism to facilitate timely identification of large imbalances that require preventative and corrective actions to be taken” (G-20 2010b, paragraph 9). They would also be expected to play a role somewhat similar to the reserve and other indicators examined by the Committee of Twenty (C-20 1974, Annex 1 and Reports of the Technical Groups on Indicators and Adjustment). The important difference is that the G-20 and C-20 indicators are or were intended to focus primarily on the adjustment process, and the proposed norms are intended to support compliance with a broader set of IMF obligations.

The IMF staff would be expected to amend the norms in light of further research and experience. However, comments are appropriate on five of the illustrative norms as presented above.

Norm (1) is deliberately specified in terms of a country’s current account surplus or deficit as a percent of world GDP. A case can be made for the conventional specification as a percent

of the country’s own GDP, but from the standpoint of global economic and financial stability, scaling by world GDP would be more appropriate. Appendix A discusses this issue in more detail.

On norm (2) concerning increases and decreases in a member’s international assets, those assets should be broadly defined to include sovereign wealth funds or similar government

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investment vehicles as well as traditional international reserves.⁴ In support of surveillance of member countries under this norm as well as norm (7) on reserve diversification, each systemically important member country—for this purpose defined by the IMF staff as countries with international assets of more than a specified size—should be required to report quarterly to the Fund its total gross and net international assets (as broadly defined), the categories of those investments, and their currency composition. In effect, the reporting requirement associated with these norms would expand the scope and application of the reserves template of the special data dissemination standard to require participation by each of the designated systemically important countries. However, publication of this information might be voluntary and not required at least for an interim period.

Turning to norm (6), it would establish a set of reference exchange rates to guide the surveillance process. That approach has long been advocated by John Williamson (1985, 2006, and 2007). I recommended a scaled-back version of the Williamson approach in Truman (2006). William Cline and John Williamson (2008) have begun a series of papers presenting a prototype of such an assessment system without the additional components in norms (8) regarding the prevention of the movement of the REER toward its norm and (9) regarding policies that tend to move the REER away from the norm. Those components are intended as guides to the assessment of policies as well as outcomes.

The Williamson approach is based on a normative view of a country’s current account position from the perspective of that

4. A separate norm that might be appropriate could be specified in terms of the level of international assets relative to the country’s GDP or some other measure.

country's internal stability, external stability, and importantly the stability of the global economic and financial system.⁵

It is also based on the concept of real effective exchange rates, weighted averages of bilateral exchange rates adjusted by movements in price levels. Because each country has a different pattern of trade, the appropriate weights differ for each country. I am skeptical whether use of a single set of weights, such as those in special drawing rights (SDR) basket, would yield acceptable outcomes.

The Williamson approach is also based on presumptions about exchange rate policies and performance such as those summarized in norms (8) and (9). Norm (9) applies to all policies that prevent the movement of a country's REER away from

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its norm. The motivation is to achieve greater exchange rate stability. It is noteworthy that the G-20 summit in Seoul stated "advanced countries, including those with reserve currencies, will be vigilant against excess volatility and disorderly movements in exchange rates" (G-20 2010b, paragraph 9). Excess volatility and disorderly movements are undefined terms. However they may be defined, it should be recognized that reducing those phenomena among the major currencies is easier said than done, but the G-20 has declared its intent.

Norm (8) applies to policies preventing movements of a country's REER toward its norm, including capital controls. Again, the G-20 leaders in Seoul expressed similar sentiments "in circumstances where countries are facing undue burden of adjustment, policy responses in emerging market economies

with adequate reserves and increasingly overvalued flexible exchange rates may also include carefully designed macroprudential measures," in other words capital controls (G-20 2010a, paragraph 6). This evolving attitude toward capital controls appears to be consistent with, and may be headed back toward, the view expressed 36 years ago by the C-20 in the *Outline of Reform* (C-20 1974, 12):

Countries will not use controls over capital transactions for the purpose of maintaining inappropriate exchange rates or, more generally, of avoiding appropriate adjustment action. Insofar as countries use capital controls, they should avoid an excessive degree of administrative restriction which could damage trade and beneficial capital controls and should not retain controls longer than needed.

APPLICATION OF JUDGMENT

For systemically important countries, a senior body in the Fund would be required to review compliance with IMF obligations as indicated by shortfalls relative to one or more of the norms. The reviews might involve more than one member of the IMF at the same time.

The senior body might be the International Monetary and Financial Committee (IMFC) endowed with explicit authority in this area or the council, as provided for in Schedule D of the IMF Articles of Agreement, if the council were established. Reviews of noncompliance with obligations by other countries, as indicated by shortfalls relative to one or more of the established norms, would be conducted by the executive board as part of the regular bilateral surveillance process. All countries would continue to be subject to the bilateral surveillance process, which covers many topics in addition to compliance with IMF obligations.⁶

The reviews of the compliance of systemically important countries with their obligations could be triggered either by Fund management based upon staff analysis or by a specified minimum weighted minority of members of the Fund.

Before a final judgment is reached by the senior body, the member country would be expected to justify in writing its temporary or permanent deviation from the relevant norm or norms in light of its circumstances and its obligations in the Fund.

5. As implemented by Cline and Williamson, the Williamson approach adopts a normative standard for current account positions of plus or minus 3 percent of national GDP. As discussed earlier and in appendix A, use of shares of world GDP would be more appropriate. The Williamson normative standard comes closest to the so-called macroeconomic balance approach used, in part, by the IMF staff in their assessments of exchange rates; see Lee et al. (2008). However, the IMF staff's macroeconomic balance approach is not embedded in a framework of balance for the world economy. Moreover, the IMF staff also uses two other methods in their assessments of exchange rates that focus even more narrowly on the individual country and, therefore, often produce conflicting results: a reduced-form equilibrium exchange rate approach, in which a long-run exchange rate equation is estimated for the country, and an external sustainability approach, which focuses only on the long-run current account position for the country against a criteria of stabilizing its net foreign asset position.

6. IMF surveillance also should be strengthened, and pressure on large and/or systemically important countries as well as other countries to alter their policies would be enhanced, by the adoption of my proposal for "comprehensive prequalification" of all IMF members for various types of IMF lending arrangements as a regular part of Article IV reviews of their policies and prospects. See Truman (2010b).

The senior body would be required to render, by a simple weighted majority, an explicit up or down judgment on whether a member's policies and performance were consistent with its IMF obligations. Each member of the senior body would be required to state his or her view.

Discussion of the Application of Judgment

Except in a case where the senior body has been asked to reach a judgment by the specified minority of members (as a minimum), the management and staff might be expected to conduct a prior consultation with the member before the senior body became involved.

The focus would be on whether the country has violated one or more of its IMF obligations. A shortfall of performance relative to one or more norms would be insufficient by itself to establish such a violation. On the other hand, the senior body's decisions, and by extension the executive board's decisions

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with respect to nonsystemically important countries, would be informed by the country's performance on the relevant norm or norms, not by its performance on all of the norms. In other words, the maintenance of an obligation to promote internal stability would be insufficient to justify the violation of an obligation with respect to external stability or global economic and financial stability.

It would be reasonable to expect that a country would generally invoke its individual circumstances, in effect, to override indications from one or more norms. Its arguments might often prevail. For example, the exports of a country with a current account surplus larger than *A* percent of world GDP—norm (1)—might be predominantly petroleum or other nonrenewable resources. The senior body might decide that that country's surpluses in conjunction with its other policies did not represent a violation of its obligations, in particular its obligation with respect to global economic and financial stability. However, countries in these circumstances would not automatically be excused from IMF surveillance, and the senior body would be required to make an explicit judgment once asked. Given the many differences in countries' stages of development, there is

no magic in zero current account balances. But if a country's current account position is large and differs substantially from zero for an extended period, it should be subject to multilateral review to ensure that the grounds for such a deviation can be justified in terms of global economic and financial stability.

ACCOUNTABILITY FOR JUDGMENTS

Each individual member of the senior body would be required to address positively or negatively each issue that is raised in a review of a member and its obligations.

A transcript of those individual judgments, as well as copies of the relevant IMF staff report or reports, and any justifications offered by the member or members should be promptly released to the public without redactions.

For all countries, reports on performance relative to each of the norms should be released without redactions as part of the bilateral surveillance process.

Discussion of the Role of Accountability

The objective of the proposed transparency of the review process by the senior body is to increase the individual and collective accountability of the members of the body.

On the one hand, the requirement that each member state his or her conclusion would reduce the scope for mutual nonaggression pacts among the members; in other words, one country does not criticize another country so that it later will not be criticized by that country. Such behavior would be more easily exposed by the proposed procedure.

On the other hand, the requirement that each member state his or her conclusion would reduce the scope for some members to hide behind other members and pretend that what is an issue for the global economy and financial system is an issue among only a few members of the Fund. In effect, the scope for free riding would be reduced.

Some might argue that the members of the senior body, because they are government officials, inherently would be tempted to form *de facto* nonaggression pacts or free ride by hiding behind the views of others. According to this argument, the senior body more appropriately might be composed of outside experts following the practice of the World Trade Organization (WTO) in settling disputes. This model is imperfect to address the task at hand. First, in the IMF context, issues do not, or should not, take the form of a dispute between one or a few countries and another country. The issue for the IMF is a country's failure to meet its obligations with respect to the performance of the global economic and financial system and to the institution as a whole. Second, the nature of IMF obliga-

tions extends far beyond issues of commercial policies and practices and their microeconomic effects to global economic and financial stability and impacts on macroeconomic performance. No sovereign government is about to yield its responsibilities in these areas to a group of so-called independent, outside experts no matter how respected the individuals might be.

At the same time, the requirement under the proposed approach that the deliberations of the senior body be on the

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record and released to the public provides scope for outside experts individually, or in self-appointed groups, to analyze and pass judgments of their own. Such transparency should increase accountability.

Could such transparency inhibit international monetary cooperation, one of the purposes of the Fund specified in Article I? That may be a small risk. The senior body would be asked to make judgments about whether systemically important countries are living up to their obligations in the Fund. The policies of systemically important countries to a substantial degree are already a matter of public record. The leaders and officials of those countries may be sensitive to criticism, but that goes with the territory. Moreover, by definition, these countries do not rely on the IMF as a “trusted advisor.” The IMF’s relationship with the member countries would not be damaged by the publicity surrounding reviews of their economic and financial policies and performance as long as the reviews are based on objective information, which is one reason to rely upon simple norms as the point of departure.

Is it possible that some of the information provided to the senior body would be sensitive and, therefore, should be redacted before the record of the senior body’s deliberations is released? Again, that is not a large risk. In the area of exchange rates, for example, once norms have been established, they should become part of the public record.

Even if that were not the formal procedure, the information would become public anyhow. One possible exception to the prohibition of redaction might apply to information on the currency composition of international assets. In principle, such information should be made public by the systemically important countries because their management of those assets could have systemic implications. In practice, at least for an interim period, an exception might be made.

POTENTIAL CONSEQUENCES

If a majority of the senior body judges that the economic or financial policies or performance of a member country are inconsistent with one or more of its IMF obligations as indicated initially by one or more of the norms, the senior body would be required to choose, by a separate vote and specified majority, to impose appropriate consequences, in effect to enforce IMF obligations.

The potential consequences might include, but not be limited to, the following:

1. prescription of remedial policy actions;
2. intensive, follow-up reviews and public reports on the country’s policies, for example, quarterly;
3. temporarily freezing access to SDR holdings;
4. denial of participation, in whole or in part, in future SDR allocations;
5. other financial penalties, including possible fines or reduced rates of remuneration on creditor positions in the IMF and possible upward adjustment of charges for borrowing from the Fund;
6. authorization of broad trade restrictions on countries in current account surplus;
7. authorization of actions or restrictions in the financial area on countries in current account surplus;
8. authorization of restrictions on capital flows to countries in current account deficit; and
9. freezing all or part of a country’s voting rights in the IMF.

Discussion of Possible Consequences

One of the major criticisms of IMF surveillance is that it is toothless not only in the sense that such surveillance rarely reaches crisp conclusions but also in the sense that in the few cases where the IMF does or might reach such conclusions there are no consequences for the country or countries involved. Without consequences, countries, in particular those that do not face an actual or potential need to draw on IMF resources, feel free to ignore the IMF’s views. While one might be reasonably confident that in practice the senior body would not authorize consequences beyond the first and the second—prescription of remedial actions and intensive follow-up reviews—the behavior of countries might be modified, in effect in the shadow of the courthouse door, by the potential for more extreme consequences. Today, the IMF has limited scope to penalize countries for economic or financial misbehavior. The IMF’s enforcement

tools come down to limiting access to IMF resources, limiting voting rights, or expulsion (Truman 2009).

The C-20 considered various forms of graduated pressures that could be applied to countries under a reformed international monetary system (C-20 1974, Annex 2). The pressures were divided between those on countries in surplus and those in deficit, ranked roughly by severity. The former were a charge on excess reserve accumulations, deposit of excess reserves in an IMF account, withholding of SDR allocations, a report on a country's external position and policies, and authorization of discriminatory trade and other current account restrictions. The latter were a charge on reserve deficiencies, increased interest charges on borrowings from the IMF, limited access to IMF resources, withholding of SDR allocations, and a report on the country's external position and policies. Note that these potential pressures were in the context of efforts to improve the external adjustment process alone. The proposed approach is directed at compliance with a broader set of IMF obligations.

Under the proposed approach the punishments should be tailored to fit the circumstances not only with respect to whether the country is in surplus or deficit but also with respect to the obligation that has been violated.

The specified majority associated with each consequence presumably would increase with the severity of the consequence. Normally, consequences (1) and (2)—prescription of remedial actions and intensive follow-up reviews—would start a possible sequence. They would amount to an application of naming and shaming. Because the application would be by the senior body, there might be a greater degree of shaming than of naming than is associated today with a mere conclusion by the executive board or report by the IMF staff.

The applicability of consequences (3) and (4)—freezing access to SDR holdings or limiting receipt of SDR allocations—would be enhanced if it were decided to have regular, annual SDR allocations, which I personally would favor on a moderate scale. These consequences could be applied in the context of a shortfall with respect to norm (2) on reserve accumulation as well as to countries otherwise in surplus or deficit. An additional possible variation on consequence (4) would be to redistribute the country's lost SDR allocation to other countries.

The potential for trade or other restrictions on current account transactions, consequence (6), would be highly controversial though consideration of such consequences is not without precedent.

Aaditya Mattoo and Arvind Subramanian (2008) consider the possibility of countries bringing cases against countries in persistent large surplus in the WTO under Article XV (4) of the General Agreement on Tariffs and Trade (GATT) on grounds that a country's policies, in particular with respect to its exchange rate, are frustrating the intent of the provisions

of the agreement with respect to benefits of liberalized trade. Procedurally, under GATT Article XV, the WTO is required to consult with and defer to the IMF as to whether the country has violated its IMF external financial obligations, passing the matter to the Fund before the WTO can reach a decision.

Morris Goldstein (2010) proposed a graduated process of increasing pressures on countries in surplus that would end with a request to the WTO to authorize the application of trade

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policy retaliation. Under the Goldstein approach, the IMF (executive board) would first reach a judgment and then the WTO might act.

Gary Hufbauer, Yee Wong, and Ketki Sheth (2006) examine the probability of the WTO demanding a revaluation by China under either Article XV (4) or the Code on Subsidies and Countervailing Measures and conclude that no such case would be likely to succeed on the basis of present WTO obligations.⁷

In contrast, the proposed approach leaves the entire initiative for action with the members of the IMF. The WTO might be called upon to monitor the application of the trade sanctions, but the IMF's action would not be subject to WTO approval or challenge. However, Hufbauer has suggested to me that the WTO might want, or be asked, to adopt a clarifying interpretation of GATT Article XII, regarding safeguards to countries' balances of payments, that recognized in advance any possible IMF action in this area.⁸

With respect to authorization of actions or restrictions in the financial area on countries in current account surplus, consequence (7), one could imagine several possibilities. One would be authorization by the senior body of countervailing intervention, as proposed by C. Fred Bergsten.⁹ Under the Bergsten proposal countries would be authorized by the IMF, or the senior body under the proposal in this policy brief, to engage in intervention in the currencies of countries that were deemed to be intervening to maintain undervalued exchange rates. One

7. Bringing a case under Article XV (4) would amount to naming and shaming of the country. However, the stigma would go away if the case failed.

8. Similar action might be appropriate with respect to Article XV (4).

9. C. Fred Bergsten, "We Can Fight Fire with Fire on the Renminbi," op-ed in the *Financial Times*, October 4, 2010.

can be skeptical about the effectiveness of such action on a variety of grounds; for example, countries might merely build their respective piles of reserves higher and higher with no effect on exchange rates. However, it would be less confrontational and potentially less damaging to the global economy than the authorization of trade restrictions.

Another possible restriction under consequence (7) might be the authorization to freeze the reserves of a country that has not lived up to its IMF obligations in the countries where those reserves are being located without requiring their transfer to an IMF account.

With respect to any of the envisaged consequences, it would be essential that the senior body either specify in advance a period during which the consequence should be applied or have a procedure to review and terminate the consequence.

Finally, I would envisage that the nonsystemically important countries, which normally would be subject by the executive board to reviews of compliance with their obligations, would be subject to consequences, other than (1) and (2), only with the authorization of the senior body.

CONCLUDING OBSERVATION

The proposed approach to vitalize IMF multilateral surveillance of members' policies and performance to ensure global economic and financial stability is demanding. It would be demanding to negotiate the necessary amendments to the IMF Articles of Agreement. It would be demanding to agree upon the associated governance changes as part of broader governance reforms. It would be demanding to implement the approach. On the other hand, the payoff would be transformative for the global economy and financial system.

APPENDIX A

MEASUREMENT OF GLOBAL CURRENT ACCOUNT IMBALANCES

A country's contribution to global current account imbalances conventionally is measured relative to its own GDP. However, if the central concern is the stability of the global economic and financial system, it is more appropriate to measure surpluses and deficits relative to world GDP.

The stability of the global economy is unlikely to be affected by Azerbaijan's estimated 2010 current account surplus of 24 percent of its GDP; its surplus is only \$13 billion or 0.02 percent of world GDP at current prices and exchange rates. The stability of the global economy is also unlikely to be affected by Cape Verde's estimated 2010 current account deficit of 19 percent of its GDP; its deficit is only \$0.3 billion

or 0.0005 percent of world GDP. These countries' surpluses or deficits may affect the sustainability of the respective country's own external position and possibly, but only secondarily, the global economy if the country has an external financing crisis.

On the other hand, from a global perspective, we should be more concerned about Japan's estimated current account surplus in 2010 of \$166 billion at 3.1 percent of its GDP, but 0.27 percent of world GDP. We might be concerned about Canada's current account deficit of \$44 billion at 2.8 percent of its GDP but 0.07 percent of world GDP.

To help demonstrate these points, table A.1 lists in the top panel countries with current account surpluses of more than 0.05 percent of world GDP and also 4 percent of national GDP on average for 2011–15, as recorded for 2002–07, and as estimated for 2010.¹⁰ The lower panel lists countries with surpluses greater than 0.05 percent of world GDP but less than 4 percent of the country's national GDP. Table A.2 provides comparable information for countries in deficit. For 2010, the 11 countries listed with surpluses (table A.1) and the 10 countries with deficits (table A.2) of more than 0.05 percent of world GDP account for 55 (\$754 billion) and 78 (\$904 billion) percent, respectively, of total surpluses and deficits in 2010.¹¹

An additional 24 countries have estimated 2010 surpluses of more than 4 percent of their national GDP, and the combined total surplus of that group is \$245 billion. An additional 82 countries have estimated 2010 deficits of more than 4 percent of their national GDP, and the combined total deficit for that group is only \$152 billion.¹² While in the aggregate these surpluses and deficits are significant, it is impractical to imagine that surveillance of systematically important countries could extend to 128 countries. Scaling by world GDP provides a much more useful metric to identify countries of multilateral interest.

10. The data, estimates, and projections are from the October 2010 *World Economic Outlook* database. The 4 percent "national standard" has been discussed in the context of G-20 efforts to achieve strong, sustainable, and balanced growth. The 0.05 percent "global standard" was chosen to yield a somewhat smaller number of countries with globally consequential imbalances in US dollar terms.

11. The corresponding percentages for the 2002–07 period are 66 for surpluses and 84 for deficits and those for the projected 2011–15 period are 46 and 78, respectively.

12. The number of countries in the category of more than 4 percent of national GDP but less than 0.05 percent of world GDP is comparable for the 2002–07 period (26 in surplus and 78 in deficit) and for the projected 2011–15 period (19 in surplus and 85 in deficit).

Table A.1 Measurement of current account surpluses (billions of dollars and percent)

Country	2011–15 average		2002–07 average		2010	
	Current account	Percent of national GDP	Current account	Percent of national GDP	Current account	Percent of national GDP
Greater than 0.05 percent of world GDP and greater than 4 percent of national GDP						
China	522	6.4	156	6.9	270	4.7
Germany	171	4.8	133	4.9	200	6.1
Norway	73	16.2	41	14.5	69	16.6
Switzerland	60	10.7	44	12.3	50	9.6
Netherlands	55	6.7	24	7.1	44	5.7
Kuwait	50	32.7	24	33.2	35	30.1
Taiwan	48	8.9	26	7.5	43	10
Saudi Arabia	42	7.4	62	21.9	n.a.	n.a.
Singapore	41	16.2	27	21.7	44	20.5
Qatar	41	20.7	n.a.	n.a.	n.a.	n.a.
Russia	n.a.	n.a.	63	8.6	70	4.7
Sweden	n.a.	n.a.	26	7.3	n.a.	n.a.
Malaysia	n.a.	n.a.	n.a.	n.a.	32	14.7
<i>Subtotal</i>	580		492		587	
Greater than 0.05 percent of world GDP only						
Japan	129	2.1	161	3.7	166	3.1
Russia	44	2.1	n.a.	n.a.	n.a.	n.a.
<i>Subtotal</i>	174		161		166	
Total	754		654		754	

n.a. = not applicable

Source: International Monetary Fund, *World Economic Outlook* database, October 2010.

Table A.2 Measurement of current account deficits (billions of dollars and percent)

Country	2011–15 average		2002–07 average		2010	
	Current account	Percent of national GDP	Current account	Percent of national GDP	Current account	Percent of national GDP
Greater than 0.05 percent of world GDP and greater than 4 percent of national GDP						
Spain	64	4.4	74	6.9	72	5.2
Australia	62	4.5	37	5.5	n.a.	n.a.
Turkey	53	5.9	n.a.	n.a.	38	5.2
United States	n.a.	n.a.	646	5.3	n.a.	n.a.
Greece	n.a.	n.a.	n.a.	n.a.	33	10.8
<i>Subtotal</i>	179		757		143	
Greater than 0.05 percent of world GDP only						
United States	482	2.9	n.a.	n.a.	467	3.2
Brazil	80	3.2	n.a.	n.a.	52	2.6
Italy	55	2.5	29	1.7	58	2.9
India	53	2.7	n.a.	n.a.	44	3.1
France	49	1.8	n.a.	n.a.	46	1.8
United Kingdom	39	1.5	53	2.4	50	2.2
Canada	38	2.2	n.a.	n.a.	44	2.8
<i>Subtotal</i>	796		82		761	
Total	975		839		904	

n.a. = not applicable

Source: International Monetary Fund, *World Economic Outlook* database, October 2010.

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