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The Role of the IMF in Sovereign Debt Restructuring

Daniel K. Tarullo*

I. INTRODUCTION

The growing importance of international economic transactions for economic activity as a whole has given rise to an increasing number of proposals for arrangements to govern those international transactions. Many, if not most, of these proposals raise important policy issues, on which there is frequent disagreement among and within countries. Quite apart from political or policy controversy, however, many proposals for international economic arrangements are analytically flawed in one of several common ways. They may draw false analogies from domestic to international circumstances. They may elide the possibility that the accommodation of many national political and legal systems in a single international arrangement will force compromises that create more problems than they solve. They may be offered without sufficient attention to the institutional features of international arrangements that can distort or otherwise modify the intended outcomes of the arrangement.

In this article I elaborate the last of these points in the specific context of proposals to give the International Monetary Fund (“IMF” or “Fund”) a greater role in sovereign debt restructuring. As has often been noted, the role of the IMF changed dramatically towards the end of its third decade in existence.¹ Yet the fundamentally political nature of Fund operations has remained constant. The fact that the Fund has a highly professional and sizeable staff might have been expected to lend the organization a more technocratic character. Indeed, everything from the quality of its publications to the feel of its headquarters suggests just that. However, as Part II will show, both the history of its creation

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¹ The evolution of the IMF's roles is discussed in Michael D. Bordo and Harold James, *The International Monetary Fund: Its Present Role in Historical Perspective*, National Bureau of Economic Research Working Paper No 7724 (2000), available online at <<http://papers.nber.org/papers/w7724.pdf>> (visited Feb 22, 2005).

and the reality of its operations show that the IMF is, at its core, a political institution.

In Part III, I show—by way of example rather than comprehensive analysis—how the political foundation of Fund governance affects a range of proposals to reform the process of sovereign debt restructuring. In many cases the IMF decision-making process may produce outcomes neither intended nor, in some instances, anticipated by reform proponents. The point here is not to endorse or reject any of these proposals but to underscore the perils of ignoring so critical an institutional characteristic. Concluding in Part IV, I suggest what the political foundation of IMF governance does, and does not, imply for reforming sovereign debt restructuring.

II. THE POLITICAL FOUNDATION OF IMF GOVERNANCE

At its inception in 1944, the Fund served two basic and related functions. First, it was to oversee the rules on international monetary relations that had been agreed during the Bretton Woods conference. These rules, set down in the original Articles of Agreement of the Fund, most significantly included the commitment of its members to maintain a par value exchange rate system.² Changes in the par value of a member's currency were to be made only in the case of a fundamental disequilibrium, and any changes greater than 10 percent were to be made only after consultation with the Fund.

Second, the Fund served as a source of assistance for members attempting to maintain the par value of their currencies in the face of downward market pressure. All members had paid in specified amounts of capital (their "quotas"), a quarter of which was generally required to be in gold. The size of member quotas (which have been adjusted numerous times since 1944) was not mechanically derived from some formula, although factors such as GDP and hard currency reserve levels were obviously important.³ A member could temporarily draw on the Fund's resources in amounts based upon its paid-in

² The original Article IV of the IMF Articles of Agreement was entitled "Par Values of Currencies." It required that the par value of the currency of each member be expressed in terms of either gold or the US dollar and that the maximum and minimum rates for foreign exchange transactions not differ from parity by more than 1 percent for spot transactions or "more than the Fund considers reasonable" for other transactions. Articles of Agreement of the International Monetary Fund, formulated at the Bretton Woods Conference July 1–22, 1944. Opened for signature at Washington December 27, 1945; entered into force December 27, 1945. 60 Stat 1401, TIAS No 1501, 2 UN Treaty Ser 39 (1945).

³ J. Keith Horsefield, 1 *The International Monetary Fund 1945–1965: Twenty Years of International Monetary Cooperation* 94–100 (IMF 1969).

quota.⁴ Where a member wished to obtain an amount greater than the amount of gold it had paid in, it was subject to increasingly demanding requirements for economic policy changes that would relieve the stress on its currency. This is the origin of the famous or, to some, infamous IMF “conditionality” policies.

Thus, with only slight oversimplification we can say that the IMF originally combined a set of universally applicable international obligations with a kind of international credit union, intended to assist countries that would otherwise be hard-pressed to comply with those rules. Both in overseeing member obligations and in providing resources to members with balance of payments difficulties, the IMF functioned as a political institution. Nominally, the governance of the Fund lay in the Board of Governors, composed of senior national government officials such as finance ministers. But this group would rarely meet more than annually and, for obvious reasons, could not closely attend the day-to-day functioning of the organization.

Nearly all important decisions were committed to a Board of twelve Executive Directors, of whom five were appointed by the largest IMF shareholders (in other words, those with the largest quotas) and seven were elected by groups of countries with smaller shareholdings.⁵ The voting strength exercised by these Executive Directors varied based on the size of the quota of the country or countries represented by a specific Director. The United States insisted that the Executive Directors be well paid, be available at the Fund’s offices, and devote essentially all their time to the job.⁶ The intention, and result, was a continuous political presence at the IMF to mediate the views of its member governments and to constrain the autonomy of its staff.

Thus, for example, all proposals to provide access to Fund resources (at least above the so-called “reserve tranche” of a country’s quota) were presented to the Executive Board for approval. Traditionally, the Board acted (and

⁴ Although the IMF is commonly thought to lend to its members, the legal nature of the transaction is a purchase of hard currency using the member’s own currency, with an obligation to repurchase its currency at later date and to pay certain fees for use of the Fund’s resources. However, such a repurchase arrangement is the functional equivalent of a loan requiring repayment with interest, and the Fund itself generally refers to its financial assistance as “lending.”

⁵ Art XII, §2(b) of the original (and current) Articles of Agreement empowered the Board of Governors to delegate any of its powers to the Executive Board except those specifically required by the Articles to be exercised by the Governors themselves. Articles of Agreement of the International Monetary Fund, art XII, § 2(b).

⁶ As demonstrated by Professor Dam, the political character of the Executive Board was intended by the United States, which opposed the British preference for an independent governing board. See Kenneth W. Dam, *The Rules of the Game: Reform and Evolution in the International Monetary System* 110–12 (Chicago 1982). More than twenty years after its publication, Professor Dam’s book remains the classic analysis of the legal and institutional features of the early IMF.

continues to act) by consensus rather than through a formal vote.⁷ Moreover, proposals for standby arrangements or other member access to Fund resources were (and continue to be) made by IMF staff. But these practices have never negated the fundamentally political character of decision making. The organization's decisions on distributing its resources are made under the influence of a Board composed of national government officials whose full-time jobs are to be Executive Directors and who are physically located within the Fund building.

Even oversight of the rules for international monetary arrangements that prevailed from 1944 until the early 1970s was filtered through the Executive Board and thus assumed a significant political character. Consider, for example, the consequences when a member failed to keep its currencies within the designated buffer around its par value, as required by Article IV of the original IMF Articles of Agreement. When Canada unpegged its currency in 1950, the Fund staff favored disapproving the Canadian float as an obvious violation of Article IV. The Board, however, declined to do so.⁸ Had the Board chosen to object, Article IV provided that the offending nation would be denied use of the Fund's resources, though with the escape valve that the Fund could "otherwise determine." Again, then, the Executive Board could—by consensus or vote—have simply forgiven a violation of the most fundamental IMF rule.

For that matter, there was nothing except the judgment and interests of its Executive Directors to stop the Board from denying resources to a country that was in compliance with its IMF obligations and presented a good technical case for assistance. This political mediation of the Fund's original rule oversight function can be contrasted with international institutions in which a violation of an applicable rule by one state gives grounds for objection that can be pursued individually by any other state (or at least any adversely affected state). The most obvious example is the present-day World Trade Organization ("WTO"), in which a member state may bring a complaint against another state that has violated any obligation arising under a WTO agreement. An independent dispute settlement panel evaluates and rules on the merits of the complaint.⁹ Regardless of whether the resulting decision is fair and well-reasoned, or whether it elicits

⁷ Background on the consensus procedure and related issues is provided in Leo Van Houtven, *Governance of the IMF: Decision Making, Institutional Oversight, Transparency, and Accountability*, IMF Pamphlet Series No 53 (IMF 2002).

⁸ See Dam, *The Rules of the Game* at 129–30 (cited in note 6).

⁹ The process for WTO dispute settlement is set forth in the *Understanding on Rules and Procedures Governing the Settlement of Disputes*, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, reprinted in 33 ILM 1226, 1227 (1994), one of the agreements that was included in the founding documents of the World Trade Organization that came into force on January 1, 1995.

prompt and full compliance, enforcement of the rules is administered through an independent, quasi-judicial proceeding. Of course, there may be politics lurking behind this proceeding, and the political and policy views of the panelists surely affect their decisions. But the WTO mode of governance contrasts with that of the original IMF, in which rule oversight was committed to an explicitly political process.

The par value exchange rate system, already under strain, came crashing down in the early 1970s when the United States floated the dollar without consulting, much less gaining the approval of, the IMF. Increased monetary flows from expanding international economic activity put more pressure on a fixed exchange rate system. Many countries—first and foremost the United States—were unwilling or unable to adopt the policies that would have been necessary to preserve that system.¹⁰ Before long it became clear that the floats of major currencies would be indefinite, rather than temporary. Yet just as the IMF was deprived of its original purpose, a new mission appeared on the horizon. The dramatic rise in oil prices resulting from the 1973 OPEC embargo created huge balance of payments problems, particularly for non-oil-producing developing countries. The Latin American debt crisis of the early 1980s was in many ways a continuation of the problems that began in 1973. The IMF reinvented itself to address these problems and, for the last thirty years, it has been principally concerned with the balance of payments difficulties of developing countries and economies in transition, whatever their exchange rate arrangements.

Today the Fund fulfills three basic and related functions. *First*, it continues to serve as a kind of credit union, but one on which only a subset of members is now likely to draw. The so-called advanced, industrialized countries—those whose economies and finances permit most public and private debt to be denominated in local currencies—no longer need Fund resources. *Second*, the Fund monitors the macroeconomic policies of its members, and increasing numbers of financial sector microeconomic policies as well. This “surveillance” actually applies to *all* members. But, insofar as the United States or France or Japan knows it will never need Fund resources, the influence of IMF reports on the advanced industrialized countries is modest at best. Present or potential borrowers, on the other hand, obviously need to be more concerned with the Fund’s views of their economic policies. *Third*, the IMF provides a host of advisory and technical assistance services, predominantly directed toward

¹⁰ The demise of the par value system is chronicled in Robert Solomon, *The International Monetary System, 1945–1976: An Insider’s View* 86–113, 151–175 (Harper & Row 1977).

emerging market, developing, and transition economies (in other words, not the advanced, industrialized countries).¹¹

While the political foundation of IMF governance did not change, the institution acquired a decidedly asymmetrical character with the demise of the par value system. The potential targets of its assistance exclude the two dozen or so wealthiest countries in the world that supply most of the funds lent to countries with balance of payments problems. Because votes so closely track quota contributions, these countries have a dominant voting position. 22 countries out of the total IMF membership of 184 have just over 60 percent of the total voting power in the Fund. The United States, with over 17 percent of the total voting power, has the single greatest number of votes within this group. The G-7 countries alone account for about 45 percent, more than the combined voting power of the remaining 162 member countries. Of course, the radically asymmetrical allocation of voting power reflects the predictable desire of those providing financial resources to control their use. In this respect, the IMF is no different than the World Bank or the various regional development banks.¹²

There have been changes in IMF governance, to be sure. There are now twenty-four Executive Directors. A new International Monetary and Financial Committee of Governors has been established to meet twice yearly and provide more collective guidance from finance ministers. But these and other changes have not altered the basic characteristics of political control and asymmetric application of IMF practices. And, despite continuing demands from developing countries for greater influence at the IMF, it seems unlikely that the major industrial nations will cede voting control over lending decisions.¹³

Here, then, is the distilled profile of IMF governance: political control of decision making in which a minority of members holds a majority of the voting

¹¹ By omitting reference in the text to the research activities of the IMF, I do not in the least mean to deprecate either the importance or the quality of this work. Indeed, the IMF has itself produced some of the most useful papers relating to sovereign debt restructuring.

¹² Despite its nominal universalism in areas such as surveillance, the Fund operates asymmetrically here as well. It is self-evident that the impact of Fund criticism or recommendations will be increased if the country receiving those criticisms either is receiving, or thinks it may someday need, assistance from the Fund. Moreover, the Fund has quite sensibly concentrated its surveillance activities on the policies of countries that may give rise to a need for Fund assistance. See Paul R. Masson and Michael Mussa, *The Role of the IMF: Financing and Its Interactions with Adjustment and Surveillance*, IMF Pamphlet Series No 50 (IMF 1995).

¹³ The overrepresentation of European Union countries on the Executive Board presents an opportunity to provide seats for more representatives of nonindustrial countries. See Van Houtven, *Governance of the IMF* at 65–66 (cited in note 7). No one seriously believes that voting power will change meaningfully. Still, adding Executive Directors from nonindustrial countries could improve Board deliberations by increasing information flows from countries that are potential users of IMF resources.

power of an organization whose mission is now predominantly directed at the noncontrolling majority of member states, within the operating context of a large and capable professional staff. This system of governance surely affects the operation of the IMF, with consequent implications for its performance in any role assigned to it concerning sovereign debt restructuring.

Of course, one cannot conclude much from the mere skeleton of a governance system. In the first place, a *formal* system of political control does not assure *actual* political oversight on a regular or effective basis. The Fund staff might have effectively co-opted their political overseers, perhaps because of information advantages. In fact, although the Fund staff carries substantial weight with the Executive Directors, it has clearly not co-opted them. In practice, as well as in formal governance structure, the IMF is subject to control by its member states in rough proportion to their voting power.¹⁴ Still, depending on other factors, this political control could shape IMF practice in a variety of ways.

Simple intuition might suggest that control of Fund resources by countries that expect never to need them would lead to considerable parsimony, both in the size of the quota contributions the advanced, industrialized countries are willing to make and in decisions whether to make those resources available in specific cases. As to the total capital available to the Fund, there is disagreement as to whether current Fund resources are adequate to meet the needs of countries that may encounter severe balance of payments problems. One's view on this issue depends in no small part on one's view of desirable Fund policies. If one believes the IMF has engendered a substantial moral hazard by making resources too readily available, then current capital levels seem just fine (or maybe even too high). If, on the other hand, one believes that with increases in global capital flows come essentially unavoidable risks of larger financial disruptions, then regular quota increases seem necessary.

The last quota increase, in 1998, raised total quotas by about 45 percent. Discussions in the Executive Board during the 2002 regular review of quotas revealed a largely predictable split, with a number of advanced, industrialized countries warning of increased moral hazard and a number of emerging market countries warning of the dangers of serious crises.¹⁵ The voting power of the former group assured that no quota increase would be recommended to the

¹⁴ The influence of the Board of Governors is well explained in *id.*, especially at 66–68 (cited in note 7).

¹⁵ The Executive Board discussion is summarized in International Monetary Fund Public Information Notice 02/105 (Sept 20, 2002), available online at <<http://www.imf.org/external/np/sec/pn/2002/pn02105.htm>> (visited Feb 22, 2005). While the IMF summary delicately avoids mentioning which directors take which position, the affiliations of the reported speakers are not hard to deduce.

Board of Governors. There is at least some evidence, then, to bear out the intuitive hypothesis that the governance features of the IMF keep available resources below the level that many, perhaps most, potential users of those resources believe to be desirable.

When it comes to approving specific lending arrangements for countries experiencing balance of payments or other currency problems, however, intuition is not so sure a guide. As explained below, anecdotal information and a limited amount of more systematic empirical work suggest that there has been a moderate bias in Executive Board practice in favor of supporting IMF lending, even where a strictly technical analysis might counsel against making IMF resources available in the amount, or on the terms, proposed. The existence of a bias towards approval has substantial relevance for any sovereign debt restructuring proposal that assigns a significant role to the IMF. The precise relevance, in turn, depends on the reasons for the bias.

There is a widespread view that the United States and other industrialized countries sometimes have geopolitical reasons for supporting Fund lending or relatively permissive terms for that lending. The most frequently cited examples are loans to Russia in 1998 and Turkey in 2001. Despite the persistent failure of Russia to meet performance criteria in earlier Fund programs, the IMF approved making additional resources available in the summer of 1998, when Russia was reeling from its own economic policy missteps and the ripple effects of the Asian financial crisis.¹⁶ Many, perhaps most, observers with knowledge of Russia's finances were skeptical that additional Fund loans would either elicit needed changes in Russia's policies or forestall the need for additional crisis measures.¹⁷ Yet an additional program was approved. The doubts of finance officials, borne out just a few months later when Russia defaulted on some of its sovereign debt, had been trumped by the resolve of their foreign policy counterparts to support the Yeltsin government. Political leaders and national security officials believed Yeltsin to be the best hope for continuing Russia's path towards democracy and good relations with its Cold War adversaries in the West. They also wanted to avoid potential political chaos in a country that one clever commentator labeled "too nuclear to fail."

Turkey had been granted a stand-by arrangement in 1999 and access to the Fund's Supplemental Reserve Facility in 2000 without any of the private sector "participation" (in other words, debt rescheduling or write-offs) that the Fund had so recently announced would be expected as a condition of Fund

¹⁶ See IMF Press Release No 98/31 (July 20, 1998), available online at <<http://www.imf.org/external/np/sec/pr/1998/pr9831.htm>> (visited Feb 22, 2005).

¹⁷ Some of the recriminations from the July 1998 program and its failure are recounted in David E. Sanger, *A Fund of Trouble*, NY Times A1 (Oct 2, 1998).

programs.¹⁸ Moreover, Turkey maintained just the kind of “crawling peg” exchange rate that was associated with the Asian financial crisis and was actively discouraged by the Fund. Indeed, the nonsustainability of the program was revealed only two months after the December 2000 review and extension of additional resources, when Turkey was compelled to let the lira float. After President Bush took office in January 2001, there was much talk from new Administration officials of a tougher policy on approving IMF lending, in order to combat what they saw as the moral hazard effects of its lending.¹⁹ But everyone expected, correctly, that the Administration would support continuation of a program for Turkey because of that country’s geopolitical importance. Additional resources were made available to Turkey in February 2002.²⁰

The impact of geopolitics on Fund programs is hardly a recent development. Both inside and outside observers have chronicled several instances before 1990 where geopolitical imperatives appeared to motivate industrialized country support for IMF programs.²¹ One former senior Fund official, reviewing the governance of the IMF, observed that, “[m]ore than any other member, the United States has viewed the IMF as an instrument of its foreign policy objectives.”²²

¹⁸ IMF Press Release No 99/66 (Dec 22, 1999), available online at <<http://www.imf.org/external/np/sec/pr/1999/pr9966.htm>> (visited Feb 22, 2005) (announcing the stand-by arrangement); IMF Press Release No 00/80 (Dec 21, 2000), available online at <<http://www.imf.org/external/np/sec/pr/2000/pr0080.htm>> (visited Feb 22, 2005) (approving the \$7.5 billion supplemental reserve facility credit).

¹⁹ See, for example, Department of Treasury Secretary Paul H. O'Neill, *Excellence and the International Financial Institutions*, Remarks to the Economic Club of Detroit (June 27, 2001), available online at <<http://www.ustreas.gov/press/releases/po449.htm>> (visited Feb 22, 2005).

²⁰ IMF Press Release No 02/7 (Feb 4, 2002), available online at <<http://www.imf.org/external/np/sec/pr/2002/pr0207.htm>> (visited Feb 22, 2005). This stand-by arrangement technically replaced the arrangement concluded in December 1999, under which about fifteen billion dollars had already been distributed to Turkey. The new arrangement folded in the four billion dollars that remained available under the 1999 arrangement and added about twelve billion dollars in new funds.

²¹ See, for example, Jacques J. Polak, *The Changing Nature of IMF Conditionality*, Princeton Essays in International Finance No 184 (Princeton 1991); C. David Finch, *The IMF: The Record and the Prospect*, Princeton Essays in International Finance No 175 (Princeton 1989); Kendall W. Stiles, *IMF Conditionality: Coercion or Compromise?*, 18 *World Dev* 959 (1990).

²² Van Houtven, *Governance of the IMF* at 42 (cited in note 7). Van Houtven also identifies instances in which geopolitical considerations appear to have negatively affected potential beneficiaries of IMF programs—Czechoslovakia, South Africa, China, Uganda, Vietnam, and Yugoslavia. Id at 43. Van Houtven is not the only former member of the IMF staff to have remarked that the Fund’s major shareholders, especially the United States, direct Fund policy. See, for example, Morris Goldstein, *IMF Structural Programs*, in Martin Feldstein, ed, *Economic and Financial Crises in Emerging Market Countries* 363–437 (Chicago 2003).

The hypotheses that geopolitical considerations emanating from the United States or from a broader group of industrialized countries have motivated some IMF lending have both been tested empirically, though in necessarily imperfect fashion. One study found that, in at least a third of the seventeen cases studied, there had been major country intervention to help recipient countries obtain favorable terms in their IMF programs.²³ Another paper, using a cross-country panel analysis, found that a country's "political proximity" to the United States and, to a lesser degree, major European countries raised the probability and size of an IMF program.²⁴ While one would hesitate to draw strong conclusions from these studies, they do provide some support for the widely shared view that geopolitical considerations affect the composition of IMF programs.

The dynamic that produces this geopolitical effect is not hard to understand. Governments have many interests, and the tools to advance those interests are invariably limited. When those interests are considered sufficiently important, a government will use policy tools wherever it can find them.

Consider the Turkish case. President Bush—like each of his predecessors dating back to Harry Truman—wanted to elicit cooperation from Turkey, and thus to support moderate governments in Turkey in order to enhance chances for that cooperation. He could not force the European Union to accept Turkey for membership immediately. He could not, or at least preferred not to, deliver massive amounts of foreign aid. But one thing he could do was to ensure that the US Government supported an IMF program for Turkey, which drew on financial resources that the United States and others had already committed. The fact that Turkey had not entirely followed even well-conceived IMF performance criteria might create problems in the international economic arena, such as increasing moral hazard. Whatever these hypothetical problems, to American political leaders they seemed secondary when compared to the fight against terrorism and American relations with Islamic countries. In such a case, if the US Executive Director and her superiors at the Treasury Department have

²³ Tony Killick, *IMF Programmes in Developing Countries: Design and Impact* 118–19 (Routledge 1995).

²⁴ Robert Barro and Jong-Wha Lee, *IMF Programs: Who is Chosen and What Are the Effects*, NBER Working Paper 8951 (2002), available online at <<http://papers.nber.org/papers/w8951.pdf>> (visited Mar 25, 2005). The surrogate for political proximity chosen by Barro and Lee was the percentage of times a country voted with the United States or other major country in the General Assembly of the United Nations. The problems with such a surrogate are obvious: votes in the General Assembly rarely mean much, the importance attached to a few key votes far outweighs all the others, many vital issues never come before the Assembly, etc. Better surrogates that do not require considerable subjective judgment are hard to come by, however. A study that did use a subjective indicator of political proximity found that movement in a country's position towards that of the United States significantly affected a country's chances of obtaining an IMF program. See Strom C. Thacker, *The High Politics of IMF Lending*, 52 *World Pol* 38 (1999).

not independently reached this conclusion, they will surely be advised of Administration priorities through a formal or informal interagency process.

Similar, though weaker, effects occur in less dramatic cases. The United States would surely be more disposed to support an IMF program for a country that was cooperating with US drug interdiction efforts, as France would surely be more disposed to support a program for a Francophone former colony. Not every country presents a case for a geopolitical hand on the scales. But more than a few do.

Geopolitical interests provide an important exogenous explanation for a bias in favor of IMF programs for countries experiencing financial problems. National economic and constituency interests may also be directly implicated in IMF program decisions. Where present, these interests may amplify the bias in favor of an IMF assistance program.

One set of such interests springs from the effects of an emerging market's financial crisis upon financial stability and economic performance elsewhere. The spread of financial turmoil from one Southeast Asian country to another in the second half of 1997 raised the prospect of a systemic financial crisis that would freeze global capital markets and, quite possibly, produce a worldwide recession. For some time thereafter, industrialized country officials were more likely to see possibilities of spillover problems in an emerging market's crisis and thus to err on the side of providing IMF assistance, rather than have a country default on its debt and risk negative effects on international capital flows. The chances of a global capital market crisis are considered by some to be significantly overestimated. The merits of these views are, for present purposes, less important than the fact that those occupying economic policy positions tend to be quite sensitive to the possibility that a major financial disaster could occur while they are stewards of the global economy.

The prospect of a systemic crisis worried IMF officials as much as it did national government officials during the 1997–99 Asian crisis. Thus political control of the Fund by its major shareholders may not have produced outcomes much different from those that a more independent Fund would have produced. Generalized economic distress is something that everyone will try to avoid. In instances of more concentrated economic interests, though, the influence of the industrialized countries may shift outcomes. For example, the government of an industrialized country whose nationals are important creditors of a distressed sovereign has additional incentive to support a Fund program that will enable that sovereign to repay its debt. One very recent study concludes that large US banks lobby Congress and the Executive Branch to “ensure that countries in

which American banks are highly exposed fall under the IMF's insurance umbrella."²⁵

A recent manifestation of the impact of creditor interests on industrialized nation positions in the IMF can be found in a slightly different context. Following a December 2001 default on its sovereign debt, Argentina essentially refused to negotiate with its creditors and, when it eventually did so, made an offer for recomposition that was, by historic standards, unfavorable to creditors.²⁶ As the Fund considered and reconsidered its willingness to provide assistance to Argentina, the governments of several European countries with significant numbers of citizens who hold the defaulted bonds argued against IMF accommodation of Argentina.²⁷

The political influence of discrete economic interests can also be observed in the terms of some IMF programs. During the Asian financial crisis, for example, the Fund included a number of conditions in its stand-by arrangements that were of indirect or no relevance to the recipient country's rebalancing of its financial position; but which were of considerable interest to economic actors in the United States. Perhaps the most clear-cut example was the requirement in the Indonesian program, approved by the Fund in October 1997, that Indonesia implement ahead of schedule the ruling of a WTO dispute resolution panel in a case involving the auto industry that had been brought by the United States.²⁸

Before moving on to consider the significance of the political foundations of IMF governance for sovereign debt restructuring proposals, let me make two clarifying points. *First*, my contention of a political bias in favor of IMF lending may seem surprising in light of the well-rehearsed criticism that IMF programs frequently require excessive austerity measures by borrowing countries. Of course, this criticism is contested by many in and out of the IMF (though a

²⁵ J. Lawrence Broz and Michael Brewster Hawes, *U.S. Domestic Politics and International Monetary Fund Policy 1* (unpublished manuscript, Aug 23, 2004).

²⁶ See Angela Pruitt, *Argentine Bonds May Weaken More*, Wall St J, C15 (Sept 24, 2003).

²⁷ One might also hypothesize that relatively high levels of trade or direct investment with influential industrialized countries would make a Fund program easier to obtain for a financially distressed developing country. The same researchers, cited in note 24, who found geopolitical influences in Fund lending also tested whether trade levels were an explanatory variable for IMF lending decisions. Here, though, their results point in opposite directions. While Barro and Lee found that more extensive trade relations with the United States or European countries raised the possibility and size of IMF programs, Thacker actually found a *negative* correlation between US exports and IMF lending decisions. A similar result was found in Graham Bird and Dane Rowlands, *IMF Lending: How Is It Affected by Economic, Political and Institutional Factors?*, 4 J Poly Reform 243, 259 (2001).

²⁸ The commitment is contained in ¶ 39 of the attachment to Indonesia's Letter of Intent of October 31, 1997, available online at <<http://www.imf.org/external/np/loi/103197.htm>> (visited Feb 22, 2005).

number of changes in Fund practice over the years can fairly be read as tacit acceptance of at least some mild versions of the criticism). But, even to the degree it is well-founded, it is not necessarily inconsistent with the bias hypothesis.

To begin with, not all Fund arrangements are significantly influenced by the geopolitical or narrow economic interests of the advanced industrialized countries. More to the point, the Fund and G-7 governments have often taken a rather paternalistic attitude towards developing countries with balance of payments difficulties, believing they were only inducing the countries to do what was good for them.²⁹ It is quite possible for the Fund and its influential members at times to have been mistaken in their belief as to the policies most likely to return a country to fiscal stability and sustainable growth, even as the political dynamic favored lending to the country. Indeed, the conditionality attached to IMF lending renders a Fund program an inviting target for anyone looking for leverage to affect the borrowing country's policies.

Second, please note that the argument of this section has been that the governance of the IMF rests on a political foundation that has produced a bias towards making Fund resources available in circumstances, or under terms, where more technical analysis may have produced different outcomes. This is not to say that every decision in, or action of, the Fund is based on short-term "political" considerations. The industrialized countries have been major influences upon the very guidelines and policies from which they sometimes choose to depart. At times, such as after a G-7 meeting at which international financial issues are discussed, they can be very insistent that Fund practice conform to stated policy. Much that goes on in the Fund is indeed technocratic, often—though not always—in the best sense of that word.

Also, my characterization of IMF governance as resting on a political foundation is not meant to be value laden. Politics, in the sense of balancing or choosing among aims or interests in particular circumstances, is fundamental both to domestic politics and to international relations. In the latter arena, the reluctance of governments of powerful countries to delegate discretion to international organizations means that many desirable arrangements must, to be sustainable, retain an essentially political character. The by-product of some undesirable policies or outcomes may be the price to pay for the overall arrangement. Whether the IMF strikes the right balance is a question far beyond the scope of this short paper, the purpose of which is to illustrate how the

²⁹ For an example of this attitude, see United States Treasury Deputy Secretary Lawrence H. Summers, *The Global Economic Situation and The United States' Approach*, Remarks to the Philadelphia Bar Association (Oct 14, 1998), available online at <<http://www.ustreas.gov/press/releases/rr2755.htm>> (visited Feb 22, 2005).

political foundation of the IMF as it currently exists should affect thinking about proposals to reform process of sovereign debt restructuring.

III. IMF GOVERNANCE AND SOVEREIGN DEBT RESTRUCTURING

On the basis of governance structure, history, and a limited body of empirical work, the previous section verified the widespread belief that IMF lending decisions are often influenced by political considerations. Notwithstanding the apparent soundness, at least in general terms, of this conventional belief, many proposals for improvement of the sovereign debt restructuring process assign a significant role to the IMF without taking into account its implications. This section identifies some of those implications for three kinds of proposals involving a new or changed IMF role to alleviate sovereign debt restructuring problems: changing IMF lending policies; making the IMF administrator of a formal, or "statutory," sovereign debt restructuring mechanism ("SDRM"); and making the IMF a delegated monitor of debtor nation financial conditions or economic policies. My aim is not to elaborate fully the consequences for all variations within these categories of proposals, much less to pass judgment on their ultimate soundness. Again, my limited goal is to show how a consideration of the political foundation of the IMF (and other institutional characteristics) can and should affect an evaluation of the feasibility of any specific proposal.

A. CHANGING IMF LENDING POLICIES

The political setting within which current lending decisions are made is obviously relevant to proposals that the IMF adjust its lending policies in order to facilitate restructuring of sovereign debt held by private market actors. Variations on this kind of proposal may rest on quite different analyses of such critical issues as the extent of moral hazard entailed by IMF lending. Yet they share the objective of countering the tendency of creditors to oppose voluntary restructurings in expectation of an IMF loan that will permit the distressed sovereign to continue its principal and interest payments. So long as creditors believe the Fund may deliver resources to the sovereign in amounts adequate to service all existing debt, they have every incentive to resist. Proposals to adjust IMF lending policies would attempt to alter expectations that a Fund bailout is likely if only creditors are patient.

One version of lending policy proposals would establish rules for IMF lending, such as firm limits on the total resources a country could borrow (for example, a specified multiple of the country's quota) or a requirement that a

country “prequalify” for crisis lending by maintaining good macroeconomic policies that are regularly certified by the Fund.³⁰ This proposal has been heavily criticized for a variety of reasons.³¹ Of principal interest to us here is the proposal’s assumption that adopting such rules on IMF lending will take the politics out of Fund decisions.

As we saw in the preceding section, under the governance structure of the IMF any “rules” on lending would be implemented only through decisions by the Executive Board. These decisions are final and unreviewable. This process creates a classic time inconsistency problem: In adopting the rules, the Executive Board will have presumably believed them to be a good guide for action, and will surely have wanted creditors to believe so. But when the moment of a specific financial crisis arises, all the reasons—including political reasons—that currently influence lending decisions would be operative and unconstrained by any institutional limitations: fear of systemic crisis, the imperative of avoiding potential instability in a country cooperating on antiterrorism measures, domestic pressures to ensure continued payments to retiree bondholders, etc. While Fund staff might more strongly resist pressures to propose a standby arrangement in apparent violation of a lending rule, it seems unlikely that the present decision dynamic will be greatly changed. Recall, in this regard, that the Board was willing to ignore Canada’s violation of what was, in 1950, the central obligation of Fund members.³²

A related consideration is that, like water running downhill, institutionalized political influence can circumvent an impediment and still reach the same destination. It may be, for example, that a requirement of “prequalification” for IMF borrowing would create awkwardness for national officials on the Executive Board who would ignore the requirement in specific cases where nonqualified countries sought loans. They might be subjected to criticism from the press, domestic legislators, or policy commentators for undermining policies they had themselves adopted. Under these circumstances, the reasons for favoring specific countries might simply find their way to the less transparent part of the process in which countries are evaluated for conformity with prequalification standards.

³⁰ This proposal is most prominently identified with the recommendations of a commission created by Congress in the legislation authorizing the 1998 IMF quota increase. Frequently referred to as the “Meltzer Commission” after its Chair, it issued its final report in March 2000. Report of the International Financial Institution Advisory Commission (2000), available online at <<http://www.house.gov/jec/imf/meltzer.pdf>> (visited Feb 22, 2005).

³¹ The criticisms are reviewed in Daniel K. Tarullo, *Rules, Discretion, and Authority in International Financial Reform*, 4 J Intl Econ L 613, 628–633 (2001).

³² See Dam, *The Rules of the Game* at 129–30 (cited in note 6).

The point of all this for the efficacy of these rules proposals is that the very creditors whose behavior the rules are intended to influence will themselves conclude that the rules will not have altered the basic decision dynamic—if not right away, then once the Fund has extended a loan in seeming violation of its previously announced rules. As a result, their expectations of the likelihood of a Fund bailout will not have been significantly altered, and their willingness to enter voluntary debt restructurings will not have been significantly increased.

Another variant on proposals for changes in IMF lending policies rejects a rules approach on the reasonable ground that rules, or even guidelines, on access limits or qualifications are essentially impossible to specify with the necessary precision. The circumstances of financial crises simply differ along too many dimensions. Under these conditions, rules are unlikely to be followed, and for good reason. This variant calls instead for adjusting Fund lending practice so as to make it a more effective catalyst for private sector participation in the resolution of the crisis through some combination of rescheduling, write-offs, or new lending, depending on the case. Among the most sophisticated of these proposals is one that calls for the Fund to distinguish situations in which the country is experiencing a temporary liquidity crisis and a short-term IMF loan will be enough to get the country through this rough patch (full bailout), situations in which an IMF loan can be an effective catalyst for needed restructuring of the country's debt (partial bailout), and situations in which the country's position is so unsustainable that no loans should be made until a debt reduction is underway (no bailout).³³

The subtlety of the analysis, which is considerably more nuanced than the above summary can capture, may ultimately make it among the more attractive of the many international reform proposals that have been advanced since the onset of the Asian crisis. Even here, though, the reality of Fund governance deserves more attention than it has received. Ironically, the authors of this proposal recognize the current influence of geopolitical and related factors.³⁴ They decry the use of Fund resources to rescue strategically important countries only because they are strategically important. Yet simply calling for an end to such practices is unlikely to be effective. While the proposal may provide a sounder analytic basis for Fund lending decisions, it would change little institutionally. The factors that lie behind current lending practices, and the decisionmaking structure that gives weight to those factors, will not have changed. In some proportion of cases, one would expect politically driven considerations to create pressure for, illustratively, a Fund decision that a

³³ Nouriel Roubini and Brad Setser, *Bailouts or Bail-Ins?* 247–248 (Institute for International Economics 2004).

³⁴ *Id.* at 372–73.

country whose policies most outside observers might have characterized as so unsustainable as to demand debt reduction should instead be a candidate for catalytic financing.

B. ADMINISTERING A SOVEREIGN DEBT RESTRUCTURING MECHANISM

Academic proposals to create a form of bankruptcy procedure for sovereigns have been generated regularly since the late 1980s. In 2001 the IMF itself—or, more accurately, the First Deputy Managing Director of the IMF—publicly advanced a proposal for a Sovereign Debt Restructuring Mechanism.³⁵ With the United States and some other industrialized countries opposed, there was little chance this proposal could be adopted. The Executive Board declined to embrace even a much modified and significantly diluted version of the proposal in 2003.³⁶ However, the Fund staff continues to work on the idea, in the event that future developments resurrect it as a live proposal.

As one might imagine, proposals of this type vary enormously. Some are almost laughable in their ignorance of how the bankruptcy law which they propose to apply to sovereigns actually works in practice. Others, including the last published version of the Fund staff proposal,³⁷ are very sophisticated. Common to nearly all the proposals is the creation of a procedure that would affect the legal obligations attendant to sovereign debt. That is, under certain circumstances, the procedure could override the contractual obligations of the sovereign that were created, and would otherwise be enforceable, under the national law governing the debt instrument or bank loan.³⁸ Various features of domestic bankruptcy law are variously adapted for this purpose: standstills, which would suspend the legal obligation to repay during some period of workout efforts; adjudication, such as decisions as to how creditors should be grouped into classes for purposes of a rescheduling or reduction of debt; cram-down authority, under which creditors could be forced to accept a rescheduling or reduction of the debt they hold; and priority financing, a means by which

³⁵ IMF First Deputy Managing Director Anne Krueger, *International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring*, Address at the National Economists' Club Annual Meeting (Nov 26, 2001), available online at <<http://www.imf.org/external/np/speeches/2001/112601.htm>> (visited Feb 22, 2005).

³⁶ The deliberations and decision of the Board are reported in IMF, Public Information Notice No 03/45 (Apr 3, 2003), available online at <<http://www.imf.org/external/np/sec/pn/2003/pn0345.htm>> (visited Feb 22, 2005).

³⁷ Anne O. Krueger, *A New Approach to Sovereign Debt Restructuring* (IMF 2002).

³⁸ Sovereign debt denominated in hard currencies is most frequently issued under the laws of New York and the United Kingdom.

lenders could make new funds available to the sovereign and be entitled to repayment of the entire amount before any debt assumed prior to the sovereign "bankruptcy" can be repaid.

Some of these proposals foresee important roles for the IMF.³⁹ The precise implications of IMF institutional characteristics obviously vary with the specific proposal, but their relevance can be illustrated with a few general comments. Consider an SDRM that would give the IMF Executive Board the authority to declare standstills, decide on the proper classes of creditors, and force all creditors to accept a debt restructuring if enough classes of creditors agreed. The most frequent objections to proposals granting one or more of these functions to the IMF are that the Fund would face a conflict of interest as both a creditor and a decisionmaker, that the displacement of national law by an international institution is an unacceptable breach of sovereignty, and that the Fund decisionmaking process is too slow to produce a reasoned judgment on a request for a standstill in a timely fashion. Less attention has been paid to how the political foundation of Fund governance might shape implementation of the SDRM and thus its effects upon sovereign debt restructuring.

The same kinds of geopolitical concerns that influence Executive Directors in lending decisions would presumably influence their approach to sovereign debt restructuring decisions. So, for example, they may be inclined to support the positions of geopolitically sensitive sovereigns on the terms for restructurings or write-downs, to the detriment of creditor positions. If this were the only effect, the issue would be a simple normative choice between the sovereign debtors and their creditors. Of course, there would be consequences beyond a relatively good deal for debtors in debt restructurings. If the Fund (or any authorized SDRM decisionmaker) were perceived by investors and lenders to favor debtors systematically, they would soon begin to demand a higher premium on their lending, since the risk of loss in sovereign lending will have increased because of the SDRM itself.

In fact, things are likely to be more complicated. Whereas the interests of creditors from industrialized country are generally served by generous IMF lending, they would generally not be served by generous restructuring terms. As noted earlier, the European governments of countries whose citizens hold large numbers of defaulted Argentine bonds have been notably cool towards that country's proposals that most of its debt be written off.⁴⁰ Thus, unlike lending

³⁹ The IMF staff, in the person of First Deputy Managing Director Anne Krueger, suggested as much in its first public advocacy of an SDRM, but, in the face of considerable opposition and in a presumed effort to maximize the chances of its proposals being accepted, quickly backed away from proposing a significant role for the IMF.

⁴⁰ See John Dizard, *Argentina's Offer that Might be Refused*, *Fin Times* 24 (Nov 8, 2004).

decisions, where the political factors usually tend in the same direction, restructuring decisions may involve a conflict among these factors.

The net effect of political factors upon the Executive Board's decisions could, accordingly, vary in direction as well as intensity. If, to take a hypothetical example, US and European creditor interests were successful in lobbying their governments to take a firm position in the SDRM process, then Japan's geopolitical interest favoring the debtor sovereign would not be enough to tilt the field in the sovereign's direction. The result might be a fractured SDRM process whose outcomes would be very difficult for sovereigns, investors, and lenders alike to predict beforehand. An investor deciding whether to buy a sovereign bond cannot know who will own other bonds of that sovereign should the country default in the future and thus how the political forces in the Executive Board will eventually align. Risk premiums would again rise, though here because of uncertainty.

C. DELEGATED MONITOR FOR CREDITORS

A third potential role for the IMF related to sovereign debt restructuring is as a delegated monitor for creditors of sovereigns. This kind of role does not directly involve the sovereign debt restructuring process, but is intended as a preventive measure to reduce the instances in which restructuring may be necessary. By increasing information flows about a sovereign's financial and economic conditions and, in more muscular versions of this kind of proposal, drawing up specific conditions for sovereigns borrowing in foreign currencies, a delegated monitor can overcome information and collective action problems that lead to inefficient lending to sovereigns. Not knowing the actual financial conditions of a sovereign may lead lenders to extend loans when they would not have done so with full information. Conversely, the lender's very uncertainty as to whether it has sufficient knowledge of the sovereign's condition may also lead it to charge a higher premium for all sovereign lending, including that to sovereigns whose financial situation is in fact very sound.

Collective action problems arise because a sovereign can effectively dilute the interests of existing creditors by issuing additional debt.⁴¹ Knowing that the financial resources of the sovereign are being subjected to additional demands, the new creditor charges a premium. Of course, the risk of nonpayment on existing debt has also risen, but existing creditors generally have no recourse. The results, again, may be both a higher premium across-the-board on foreign-

⁴¹ See Patrick Bolton and David A. Skeel, Jr., *Redesigning the International Lender of Last Resort*, 6 Chi J Int'l L 177 (2005).

currency denominated debt issued to sovereigns *and* overlending to some sovereigns.

The existing surveillance function of the IMF is a form of delegated monitoring. In its annual Article IV consultations,⁴² Fund staff visit each IMF member country and analyze its economic and financial conditions. They then prepare a report, which is discussed by the Executive Board. Although the Board discusses the report, it does not take any action. Traditionally the Article IV consultation process was rather opaque. In recent years, and particularly since the Asian financial crisis, the output of that process has been increasingly transparent.⁴³ While the permission of the relevant country is still needed, summaries of the Board discussions are now published in over 80 percent of Article IV consultations.⁴⁴ In addition, countries are increasingly approving public release of the detailed staff reports themselves.⁴⁵

In the wake of the Mexican peso crisis of 1994–95, the Fund also established the Special Data Dissemination Standard (“SDDS”) and the General Data Dissemination System (“GDDS”). The former is specifically intended to standardize and help disseminate information from countries that have or want access to international capital markets. Fifty-eight countries (including most of the industrialized countries) currently post information on their economies and financial conditions, as well as the methodologies followed in calculating and reporting those conditions. Finally, the Fund regularly reports on the extent to which countries observe certain internationally recognized standards and codes, including fiscal transparency and creditor rights.⁴⁶

While these and other Fund activities provide useful supplements to the information available to potential investors, they generally do not provide information on as timely a basis as an investor would like. More importantly, of

⁴² Article IV, § 3(b) of the IMF Articles of Agreement mandates the Fund “exercise firm surveillance over the exchange rate policies of members.” Thus the Fund jargon “Article IV consultations.” As is apparent, the Fund takes a very broad view of what constitutes the “exchange rate policies” of its members. Articles of Agreement of the International Monetary Fund, art IV, § 3(b) (cited in note 2).

⁴³ See International Monetary Fund, *The Fund’s Transparency Policy—Issues and Next Steps (Amendments to Transparency Policy Decision)*, (2004), available online at <<http://www.imf.org/external/np/pdr/trans/2004/021204.htm>> (visited Feb 22, 2005).

⁴⁴ See International Monetary Fund, *Transparency at the IMF: A Factsheet* (2003), available online at <<http://www.imf.org/external/np/exr/facts/transpar.htm>> (visited Feb 22, 2005).

⁴⁵ See International Monetary Fund, *The Fund’s Transparency Policy—Progress Report on Publication of Country Documents* (2003), available online at <<http://www.imf.org/external/np/pdr/trans/2003/040403.htm>> (visited Feb 22, 2005).

⁴⁶ The Fund publishes its reports of country observance patterns on its website. International Monetary Fund, *Reports on the Observance of Standards and Codes (ROSCs)*, available online at <<http://www.imf.org/external/np/rosc/rosc.asp>> (visited Feb 22, 2005).

course, the Fund has not been asked to assume the task of overcoming the collective action problem identified above. Strong versions of delegated monitor proposals, proceeding from a “common agency” perspective, would have the IMF serve as a surrogate for an overarching contract between the sovereign and all its creditors.⁴⁷ The Fund would develop and enforce the norms of behavior to which the sovereign would have been bound were it to have negotiated all its borrowings with a single creditor (in other words, if collective action problems were removed). This would effectively mean imposing limits on external borrowing, whether directly or indirectly. Proponents of this version of monitoring problems argue that it would remove many creditor uncertainties and, on net, reduce the costs of sovereign borrowing, as well as diminish the chances of overlending/overborrowing in specific cases.⁴⁸

As with the other types of proposals surveyed here, the common agency approach to delegated monitoring raises significant policy issues, not least of which are the capacity of Fund staff to “strike a delicate balance to protect foreign interests without inflicting too much harm on the country”⁴⁹ and the willingness of sovereign borrowers to subject themselves to this kind of regime. Our focus, though, is on the discrete issue of how the Fund’s governance structure and, specifically, its political foundations would affect the feasibility of this proposal. Any variant of this form of delegated monitoring would presumably include either formal decisions on the standards applicable to a country, whether it should be identified as in violation of those standards, or perhaps even sanctions. Thus the Executive Board would surely be involved.

Jean Tirole, author of one of the most interesting versions of the proposal, recognizes the potentially distorting effects of political influences within the Executive Board that are exerted by domestic interest groups.⁵⁰ This attention to institutional issues is, as the reader by now is aware, relatively unusual and to be welcomed. Tirole makes a plea for the independence of the Executive Board but, knowing this to be unlikely, suggests as a second-best remedy that the Fund reverse its movement towards transparency in recent years and keep the proceedings of Board meetings confidential.⁵¹ He hopes that Executive

⁴⁷ See, for example, Jean Tirole, *Financial Crises, Liquidity, and the International Monetary System* (Princeton 2002); Prasanna Gai and Nicholas Vause, *Sovereign Debt Workouts with the IMF as Delegated Monitor—A Common Agency Approach*, Bank of England Working Paper No 187 (2003), available online at <<http://www.bankofengland.co.uk/workingpapers/wp187.pdf>> (visited Feb 22, 2005).

⁴⁸ Tirole, *Financial Crisis* at 114–116 (cited in note 47).

⁴⁹ Id at 100.

⁵⁰ Id at 119–120.

⁵¹ Id at 120.

Directors would thereby be insulated from domestic political pressures. He acknowledges that reversing the policy of transparency will be a difficult sell. My intuition is that, quite apart from the fierce objections that closing the doors on Executive Board decisions would elicit, it would probably not significantly negate the political influences identified in Part II of this paper.

In the first place, geopolitical considerations generally do not originate with constituencies, but with governments themselves. A rule of confidentiality would surely not diminish their weight. It might even marginally increase the role of these considerations by permitting frank discussion of geopolitical imperatives among Executive Directors. Second, it may be that closed door sessions will protect Executive Directors representing countries with smaller numbers of votes from domestic recriminations, since any given official could plead inability to sway the Board. It would be far less plausible for the US Executive Director to claim an inability to carry the day. The positions of the British, French, German, or Japanese Directors would not be appreciably different. Influential constituent groups tend to learn about what goes on even in confidential official meetings. In any case, they judge by results.

IV. CONCLUSION: EVALUATING ALTERNATIVE INSTITUTIONAL ARRANGEMENTS

Even this quick review has, I hope, demonstrated how salient institutional characteristics can affect the merits of proposals for reform of the sovereign debt restructuring process. Specifically, the IMF's political foundations could shape outcomes in ways neither anticipated nor intended by the authors of some proposals for change. It is important to spell out what this conclusion implies for formulating and evaluating these kinds of proposals. It is just as important to spell out what the conclusions of this paper do *not* imply.

First, and most obviously, because any proposal can only be realized in a specific institutional setting, a proposal that omits an institutional analysis is incomplete. In some cases, the implications of institutional context may be so important as to undermine an entire proposal. Most of the time, an institutional analysis will suggest greater or lesser modifications. Recall, for example, that proposals to shift Fund lending policies so as to encourage restructurings in cases where the sovereign debtor cannot reasonably be expected to service all its debt will likely encounter the same political influences that have affected Fund lending decisions in the past. Saying they should be resisted will not make it so. But it is possible that mechanisms increasing transparency and providing a process for formal comment on lending decisions by an independent entity could make the threshold for political influence higher than it is now, even if it cannot be eliminated.

Second, a nuanced assessment of institutional context is often quite difficult to conduct. Imputing incentives to actors on the basis of their positions and inferring effects on the basis of the opportunities to act on those incentives may together be a good starting point. But institutions are complex. Formal structures and roles can be combined in many permutations, depending on institutional cultures and other forces that may be elusive for anyone who does not have substantial experience in the organization. Still, the difficulty of sorting out real from hypothetical effects is no reason to forego the analysis.

Third, the importance of the political foundation of the IMF will persist even if the current patterns of outcomes associated with IMF politics change. It is possible, though at present unlikely, that the United States and other powerful countries would use their influence in the Fund to *deny* access to Fund resources for political reasons, even for countries that the IMF staff believed to be good candidates for standby arrangements. The specific implications for sovereign debt restructuring proposals would then change, but the fact of the Fund's political foundations would remain significant.

Fourth and finally, the fact that institutional characteristics may mean a proposal will not work in practice as it was intended does not always mean that the proposal must be changed or rejected. Every plan, no matter how well conceived, will have drawbacks, including problems arising from institutional contexts. The question will always be whether the proposal—even with its flaws—is preferable to any realistic alternative, including the status quo. So, for example, even though political considerations would affect any significant Fund role in a sovereign debt restructuring mechanism, other institutions might bring even more disadvantages. An independent group of prominent former government officials to which SDRM powers are granted might well produce a consistent practice that borrowers and lenders would understand. But if it turned out to be a decidedly suboptimal practice, it might be much harder to change.

The impact of the political foundations of the IMF should not be overemphasized. The professionalism of the staff and the general commitment of the major shareholders to an economic basis for IMF policies do have an effect. Not all Fund decisions are significantly political. But many proponents of international financial reform, including sovereign debt restructuring reform, have tended to under-appreciate the significance of those foundations. It is worth considering the possibility that one reason more robust proposals for sovereign debt restructuring reform have not been adopted is the absence of satisfactory institutional channels for even the most promising of ideas.

