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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Karin Lissakers (IMF) to Larry Summers, David Lipton, Tim Geithner, & Carolin Atkinson re: IMF Decisions on the Quota Increase (1 page)	11/20/97	P1/b(1) Unclass.
002. briefing paper	re: Unresolved Quota Issues (IMF document) (7 pages)	11/17/97	P1/b(1) Unclass.
003. memo	Karin Lissakers (IMF) to Secretary Rubin, Deputy Secretary Summers, Under Secretary Lipton, & Assistant Secretary Geithner re: IMF Supplemental Reserve Facility (SRF) (2 pages)	12/17/97	P1/b(1) Unclass.
004. memo	Karin Lissakers (IMF) to Deputy Secretary Summers, Under Secretary Lipton, & Assistant Secretary Geithner re: Highlighting U.S.-Mandated IMF Reforms in Context of Asian Crisis (1 page)	01/27/98	P1/b(1) Unclass.
005. fact sheet	re: For Congressional Testimony & Briefings (IMF document) (2 pages)	01/30/98	P1/b(1) Unclass.
006. memo	Barry Newman to Mark Jaskowiak re: Senator Gramm's Four IMF Policy Changes (incomplete) (1 page)	02/09/98	P1/b(1) Unclass.

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OA/Box Number: 24126

FOLDER TITLE:

[History of the Department of the Treasury - Supplementary Documents] [33]

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RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
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P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
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RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

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1997-SE-012760

DIRK KEMPTHORNE
IDAHO

United States Senate

WASHINGTON, DC 20510 1204

November 26, 1997

Mr. Robert E. Rubin
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

This is the situation...United States companies and their employees pay taxes to support foreign competitors on the brink of economic collapse, especially when these competitors have engaged in unfair business practices that are responsible for the economic crisis and have made it difficult for American companies to sell their goods at home and abroad.

This would be the result if the International Monetary Fund (IMF) approves loans for South Korea to survive its economic crisis without requiring the country to stop subsidizing expansion of its semiconductor industry that is unnecessary and, in fact, counterproductive to the effort to stabilize the South Korean economy.

The facts are straightforward. There is a huge glut of computer memory chips in world markets. One principal cause of this oversupply is that South Korea, by subsidizing its semiconductor industry, has allowed South Korean companies to dump computer chips in world markets at below market costs. This undercuts American companies' ability to compete. The U.S. Commerce Department already has issued a finding that confirms South Korea has been unfairly dumping computer chips in world markets. Despite this finding, and the oversupply of computer memory chips in world markets, South Korean semiconductor companies are **still** building new plants to expand production further. South Korean semiconductor companies are already heavily in debt and, in light of falling computer chip prices, their ability to repay huge bank loans is in doubt. This is a major factor in South Korea's economic crisis.

As you know, the United States is the largest contributor to the IMF, and you will have great influence in shaping the financial assistance South Korea receives. Clearly, it is in the interest of the United States for South Korea to avert economic collapse. If the South Korean currency continues to decline in value, it will be hard for American exporters to compete in the world and American markets. But it seems reasonable to me for the United States to request the IMF to structure the South Korean aid package in ways that address the fundamental imbalance of the South Korean semiconductor industry.

This issue is vital to Idaho. Micron Technology, America's largest producer of dynamic random access memory (DRAM) computer chips, is headquartered in Idaho, and employs more than 10,000 people. From their perspective, an IMF loan to South Korea, which would include billions of dollars of U.S. financial assistance that does not address the concerns I have raised, would mean that they would pay taxes to bail out foreign competitors who have engaged in business practices designed to undermine the U.S. semiconductor industry.

Finally, there is a national security issue. As you know, the U.S. military has worldwide technical superiority in weapons systems, and these systems depend heavily on computer memory chips. From a national security perspective, it is not in America's interest to support policies that threaten the continued existence of its domestic semiconductor industry.

I would welcome the opportunity to discuss this issue with you further. I look forward to hearing from you, and to a successful conclusion to the financial assistance negotiations with South Korea.

Sincerely,

Dirk Kempthorne

DIRK KEMPTHORNE
United States Senator

1997-se-012992

012992

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

to: Tim Geithner
ACTION

SSISTANT SECRETARY

December 4, 1997

MEMORANDUM FOR SECRETARY RUBIN

FROM: Timothy F. Geithner TFG
Assistant Secretary (International Affairs)

SUBJECT: IMF Quota

ACTION FORCING EVENT:

On Friday, December 5, the Executive Board will discuss outstanding issues for resolution relating to the Eleventh General Review of Quotas. The principal issue of concern to the United States is the length of time that will be permitted for a member to consent to the proposed increase and the level of participation required before the overall quota increase becomes effective. We need to prevent a substantial erosion of U.S. voting power should we fail to obtain Congressional authorization and appropriation for the U.S. quota share increase in FY 99. We have veto authority over the resolution itself, as any change in quotas requires approval by an 85 percent weighted majority of the Board of Governors.

right

RECOMMENDATION: That we seek agreement on a draft resolution on the quota increase providing for participation by an 85 percent weighted majority of the Board of Governors before the increase takes effect, and a 12-month period of consent from the date of adoption of the resolution. We also would state to the Board our intent to request the increase as a high-priority item in the FY 99 Budget and push hard for passage.

Agree __________ Disagree __________ Let's Discuss ✓

BACKGROUND:

IMF staff recommend a 70 percent weighted majority vote with a one-year period of consent. This would make it possible for a quota increase to proceed without U.S. participation (before we had completed our legislative approval process), as our current voting share is 17.78 percent, and would result in a decline in our voting power below the 15 percent veto point for key issues.

- The Fund wants to see prompt action in light of its declining liquidity and continued uncertainties in Asian markets and Russia.

- We believe this strategy is appropriate because there is a strong case for us trying to persuade Congress to move quickly in order to protect our voting power.

I don't agree

EXECUTIVE SECRETARIAT

Ms. Lissakers believes it would be counterproductive to push in the Fund for a 2-year consent period (which exceeds the maximum length of initial periods for consent for previous quota increases).

- The period could be extended if the United States failed to win timely Congressional approval for the U.S. share of the quota increase thus preventing the 85 percent majority needed to give effect to the increase.

The previous quota increase, in 1992 under the 9th General Review, was implemented by a 70 percent majority after 18 months. However, implementation was tied to approval of the Third Amendment of the Articles of Agreement, providing for the strategy for dealing with members' arrears with the Fund, which required an 85 percent majority.

The Secretary of the Treasury

December 8, 1997

NOTE FOR TIM GEITHNER

FROM: BOB RUBIN

Let's discuss.

Background -- Second Bullet

I don't agree.

Attachment

1997-SE-012992 CM/AM 012992

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

December 4, 1997

MEMORANDUM FOR SECRETARY RUBIN

FROM: Timothy F. Geithner
Assistant Secretary (International Affairs)

SUBJECT: IMF Quota

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Drafted by:	Susan Hart/IMF SH 12/2	2-0129
Reviewed by:	Jim Lister/IMF	2-0112
	Anne Salladin/GI AS	2-0129
	Caroline Atkinson/IM CA	2-0489
	Barry Newman/OUSED/IMF SH for BSN 12/3	

after making changes done 12/3

1997-SE-013263

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

12/10/97

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY

FROM: Timothy F. Geithner WfM for
Assistant Secretary (International Affairs)

SUBJECT: IMF Liquidity

Attached is a note on the IMF's current liquidity. The Fund has about $44 billion in quota resources available for new lending following the commitment of $21 billion to Korea.

The ratio of the quota resources available for lending to liquid liabilities (consisting essentially of the members' reserves deposited with the Fund) is 51.1 percent. This liquidity ratio is low, and projected to decline further to about 37 percent in mid-1999 in the absence of a quota increase, and with no further new large lending programs. This is just above the nadir of 33 percent in 1983, which was remedied with a quota increase. The reserve deposits, which reflect the claims principally of large industrial countries, are however unlikely to be drawn.

At present, IMF loans outstanding from quota-based resources amount to about $57 billion, following the first disbursement under Korea's loan. An additional $34 billion has been committed under existing quota-based programs but has not yet been disbursed. These commitments were already accounted for when calculating the Fund's remaining available usable resources noted in the first paragraph above.

Attachments: Table: Liquidity Ratios
Table: Credits Outstanding
Table: Current Commitments

cc: DLipton, CAtkinson, JLister, DZelikow

12/10/97

IMF Liquidity and Financing Needs

Available resources

- The IMF currently has about **$44** billion in normal **quota resources** available for future lending commitments.

- In addition, the IMF could tap the **GAB** for a further $25 billion provided the conditions have been met.

- Implementation of the **NAB** and the recently agreed **quota increase** would provide up to $25 billion and $65 billion respectively in available funds once in place.

Potential use

- As recent events demonstrate, it is difficult to project the possible need to provide IMF financing, especially in the current unsettled financial environment. However, the commitment of further large scale emergency financing for even a few countries would virtually exhaust the remaining quota resources.

  -- However, a large portion of the IMF's future emergency financing (including subsequent disbursements under the Korean program) are expected to be provided from the new short-term contingency mechanism. The impact on the Fund's liquidity should therefore be less than that of traditional IMF lending as reflows would occur sooner, and actual disbursements might be smaller than programmed, particularly if confidence returns quickly (e.g., Turkey, Brazil, Russia).

Liabilities

- The IMF has **liquid liabilities** amounting to **$58** billion which are similar to demand deposits in a bank. The bulk of these claims are held by major industrial countries, however, and are unlikely to be drawn down significantly on the near term.

  -- Nevertheless, the ability of the IMF to meet these claims (the liquidity ratio) is important to central banks which consider these deposits an important part of their international reserve assets.

  -- Views differ, however, on the minimum acceptable for the **liquidity ratio**. The current liquidity ratio is **51.1** compared with the long-term average of 70 percent and an historic low of about 33 percent (in 1983). The IMF projects that this ratio will decline to 37 percent by mid-1999, in the absence of a quota increase, and with no further large new programs.

  -- U.S. claims on the IMF currently amount to $16.5 billion and the ability to encash them on short notice is an integral element of the current budget treatment for U.S. transactions with the IMF.

Outstanding Loans and Commitments

- Separately, tables on loans and current commitments are attached. Total Fund loans outstanding from quota resources are roughly $57 billion following the first disbursement to Korea and reflect financing provided under current IMF programs and disbursements under past programs. A balance of $34 billion remains to be disbursed under current programs, including about $15.5 billion under the Korea program.

Conclusion

- Further large IMF financing would almost certainly reduce the remaining quota resources available for lending to very low levels and raise the issue of activating the GAB.

- The situation also heightens the importance of early implementation of the **NAB** and **quota increase**, which together would provide up to $90 billion in additional loanable resources.

- However, any U.S. resources for the IMF that are included in the FY 1999 Budget could not be provided until October, when the fiscal year begins, even if the ncessary legislation were enacted earlier in CY 1998.

Summary of Indicators of Fund Liquidity, 1994–present

(In billions of SDRs unless otherwise indicated)

	1994	1995	1996	Q1 1997	Q2 1997	Q3 1997	Preliminary 5-Dec-97
Unadjusted usable resources	68.4	58.0	61.1	62.6	64.5	62.4	55.0
of which: uncommitted	65.9	50.8	51.4	56.0	58.1	55.4	32.7
uncommitted and adjusted	53.4	39.3	39.5	43.8	45.5	43.0	21.9
Liquid Liabilities	31.7	36.7	38.0	36.2	35.8	36.7	42.8
of which: outstanding borrowing	2.9	1.1	--	--	—	--	--
reserve tranche positions	28.8	35.5	38.0	36.2	35.8	36.7	42.8
Liquidity ratio (in percent) 1/	168.5	107.1	103.9	121.0	127.1	117.2	51.1

1/ The ratio of uncommitted and adjusted usable resources to liquid liabilities.

Credit Outstanding
from Quota Resources

Total Credit Outstanding	Africa	Asia	Europe 1/	Middle East	Western Hemisphere
$57 billion	$4.6 billion	$12.8 billion	$20.7 billion	$0.5 billion	$18.5 billion
	of which: Algeria $2 billion	of which: Thailand $1.6 billion Indonesia $3 billion Korea $5.5 billion	of which: Russia $13.4 billion	of which: Jordan $0.5 billion	of which: Argentina $5.9 billion

1/ Essentially transition economies, plus Cyprus and Turkey

Current Stand-by and Extended Arrangements
(SDR billions)

Stand-bys & EFFs	Amt. Committed	Amt. Purchased	Undrawn Balances
Latin America	**1.1**	**.8**	**.3**
of which: Argentina	.7	.6	.1
Asia	**27.0($36)**	**8.0 ($11)**	**18.8($25.4)**
of which:			
Indonesia	7.3	2.2	5.1
Korea	15.5	4.1	11.4
Thailand	2.9	1.2	1.7
Pakistan	.5	.04	.4
Philippines	.8	.5	.2
Transition Economies	**9.2** ($12.4)	**3.8**($19.5)	**5.3** ($7.2)
of which:			
Russia	6.9	3.3	3.6
Africa	**1.7** ($2.3)	**1.0** ($1.35)	**.7** ($.9)
of which:			
Algeria	1.2	.9	.3
Other	**.4** ($.6)	**.2** ($.3)	**.2** ($.3)
TOTAL (rounded)	**39.3 ($53)**	**13.9** ($18.8)	**25.4** ($34.3)
ESAF (non quota resources)	4.2	2.0	2.2

These are the full commitments made by the Fund under current programs, of which about $19 billion as has been disbursed. The disbursed amount is included in a separate figure for the total outstanding Fund credit, which includes amounts not yet fully repaid from past programs.

TREASURY CLEARANCE SHEET

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MEMORANDUM FOR: ☐ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ________

FROM: Assistant Secretary Geithner
THROUGH:
SUBJECT: IMF Liquidity

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☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

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☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ________

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Barry Newman	SH for BSN	12/10	OUSED/IMF	623-7761
Susan Hart/IMF	SH	12/10/97	OASIA/IMF	622-0129
REVIEWERS				
Caroline Atkinson	SH for CA	12/10/97	OASIA/IM	622-0489

SPECIAL INSTRUCTIONS

☐ Review Officer Date ☐ Executive Secretary Date

DO F 70-02.1 (04/89)

Drafted by:	Barry Newman/OUSED SH for BSN Susan Hart/IMF SH 12/10/97 2-0129
Reviewed by:	Jim Lister/IMF Caroline Atkinson/IMSH for CA

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☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other __________

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)	sent to RER (courtesy)			
Barry Newman	St	sent to LS	/IMF	623-7761
Susan Hart/IMF	S	(courtesy)	IMF	622-0129
	sent to [illegible]	SS 12/11		
REVIEWERS	12/11/97 NC/DI/PA/AK			
Caroline Atkinson	SH		M	622-0489
	Please Log In			

SPECIAL INSTRUCTIONS

☐ Review Officer Date

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Drafted by: Barry Newman/OUSED, SH for BSN
Susan Hart/IMF SH 12/10/97 2-0129

Reviewed by: Jim Lister/IMF
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[History of the Department of the Treasury - Supplementary Documents] [33]

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
005. fact sheet	re: For Congressional Testimony & Briefings (IMF document) (2 pages)	01/30/98	P1/b(1) Unclass.

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1998-SE-001586

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

February 6, 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Timothy Geithner TFG
Assistant Secretary (International Affairs)

SUBJECT: Update on Conditions and IMF Legislation

Here is a brief update on the state of our preparations for how to respond to the various proposals out there for conditions on the IMF legislation.

- Dan Tarullo has organized a small working group with officials from Treasury, the USED offices at the IMF and World Bank, the NEC, and State and Labor to develop a list of initiatives on the labor front we could promote in the IMF, the MDBs, and in other fora. Attached is the first draft of the IFI-related proposals. Helen Walsh is coordinating this for us with the active involvement of Karin Lissakers.

- We are in the process of producing an analysis of the proposals on the Barney Frank and Phil Gramm lists. This paper, which we'll give you sometime on Monday, will explain what we believe we can and cannot do in response to each proposal on each list.

- We are also producing a short note on the alternative ways we could try to accommodate the congressional push for conditions on the IMF legislation, from the "use our voice and vote to promote" type approach to other possible approaches. This note will also explain the types of conditions we feel we could not accept, such as certain types of mandated voting requirements.

This material should provide the basis for a more informed discussion on Tuesday to assess how we should proceed.

Attachment

cc: Lipton, Robertson, Knight, Froman

- **Unconditional Release of Indonensian labor leader Muchtar Pakpahan:**

  Pakpahan is the founder of Indonesia's only independent union federation (300,000 members). He has been a frequent target of the Suharto government and has been imprisoned since 1994. In addition to his release from prison, Pakpahan must be allowed to remain in Indonesia and continue his work;

- **Broaden IMF conditionality to include specific labor rights and environmental protections:**

  The IMF currently imposes highly intrusive conditions on recipient countries -- including conditions related to labor markets. However, rather than strengthen internationally recognized worker rights, IMF interventions have often weakened those rights, particularly the right free association and collective bargaining, the foundation of other worker rights. New conditions must be established to ensure that labor rights and the environment are included in IMF conditionality. In addition to general conditions with regard to all IMF lending, some tangible improvement in the labor rights situation in Indonesia must be demonstrated;

- **Increase transparency of IMF activities:**

  The IMF should establish a presumption that its activities and documents should be disclosed to the public. A similar approach at the World Bank has increased public accountability and support for the Bank's activities. Of course, some IMF activities must remain secret, but the presumption of openness should be the rule – with exceptions made with proper justification.

- **Establish a new Deputy Assistant Secretary at Treasury whose sole responsibility would be to monitor IMF reforms and to report on the social consequences of lending by multilateral organizations;**

- **Provide for the release of IMF funds in several tranches – with the release of each tranch preceded by a report on the effectiveness of the IMF in meeting concerns about labor rights and the environment;**

- **A clear and forceful statement from the Administration concerning East Timor, emphasizing that the Indonensian Government should begin discussions with East Timor through Bishop Belo (1996 Nobel Peace Prize recipient) and Xanana Gusmao (imprisoned Timorese leader);**

- **Ensure that a "safety net" is provided to address the social consequences of austerity measures imposed by the IMF on South Korea.**

CONDITIONING THE EXPANSION OF IMF FUNDING
Phil Gramm

In my opinion, you will have no luck in expanding IMF funding in this Congress, unless such funding can be conditioned on changes in IMF policy. I suggest that the bill which provides new IMF funding be amended to condition that funding on the adoption by the IMF of policies which require that beneficiary countries institute four policy changes:

I. MAKE MONETARY AND FINANCIAL POLICY TRANSPARENT;

II. OPEN MARKETS TO ALLOW FOREIGN COMPETITION WITH DOMESTIC PRODUCERS ON A MORE EQUAL FOOTING;

III. END CRONY CAPITALISM AND DOMESTIC SUBSIDIES; AND

IV. REFORM BANKRUPTCY LAWS TO ENSURE THAT FOREIGNERS ARE GIVEN NATIONAL TREATMENT WITH DOMESTIC CREDITORS IN ANY BANKRUPTCY PROCEEDING.

Proposed Changes To Leach Bill

TITLE I — INTERNATIONAL MONETARY FUND

"sec 61. Quota Increase

(a) IN GENERAL --- The United States Governor of the Fund ~~may~~ *is authorized to* consent to an increase in the quota....

TITLE III — POLICY PROVISIONS

sec. 1623 Advocacy of Certain Provisions

"The Secretary of the Treasury shall instruct the United States Executive Director of the International Monetary Fund to use the voice and vote of the Executive Director to do the following:

(1) Make the International Monetary Fund a more effective mechanism for promoting market-oriented reform, trade liberalization, and economic growth though ---

(A) *appropriate* liberaliz~~ing~~*ation of* ~~the~~ pricing, trade, investments, and exchange rate regimes of countries to open ~~countries~~ *them* to the competitive forces of the global economy.

> *Comment: Given that the discussion of the capital account amendment is ongoing, we may want the USED to have the discretion in the future to support IMF programs with either "Chilean-type" capital controls or some kind of debt standstill.*

(B) *advocating policies which increase competition in the provision of goods and services, including public services, and limit the scope of services provided by governments to those which they can most efficiently provide. Such policies should include, inter alia,* privatiz~~ing~~*ation of* industry to eliminate government monopolies, clos~~e~~*ing* loss-making enterprises, *putting in place adequate regulatory frameworks,* and reduc~~e~~*ing* government ~~control~~ *ownership* over the factors of production; and

> *Comment: 1) expand focus from just privatization, to increasing competition in the provision of goods, including public services. 2) stresses importance of having a strong regulatory framework in place so public monopolies don't turn into private unregulated monopolies. Finally to clarify that legitimate government regulation of firms and workers for health, safety and other reasons is appropriate.*

C) economic deregulation by eliminating ~~red tape~~ *inefficient and overly burdensome regulations* and ~~establishing a foundation to~~ *strengthening the legal framework* support*ing* private contract rights.

(2) Make the International Monetary Fund a more effective mechanism, in concert with

appropriate international authorities and *other international financial institutions* ~~the International Bank for Reconstruction and Development~~, to strengthen financial systems in developing countries......

> *Comment: to encourage collaboration with regional MDBs as well*

(3) ~~Ensure~~ *Vigorously promote* that the International Monetary Fund ~~does~~ not become a lender of last resort for private investors, including commercial banks, and accordingly ~~should~~ advocate policies which include...

> *Comment: difficult for USED to ensure outcomes (for example that some investors won't get paid off). Language in previous legislation has generally been "vigorously advocate" or "vigorously promote."*

C) consideration of provisions in debt contracts that would foster dialogue and consultation between a sovereign debtor and its private creditors, and among those creditors;

(D) consideration ~~by the Executive Board of the International Monetary Fund~~ of extending the scope of ~~its~~ the International Monetary Fund's policy on lending to members in arrears *and of other policies* so as to ~~encourage and expedite such a~~ *foster the* dialogue and consultation *referred to in the previous section*.

(5) ~~Ensure that~~ *Promote the design of* International Monetary Fund programs and assistance ~~are structured~~ so that governments ~~which~~ *that* draw on the International Monetary Fund channel public funds away from unproductive purposes.....

> *see previous comment on "ensure"*

(6) ~~Ensure~~ *Vigorously and continually promote* that International Monetary Fund policies and procedures endeavor to support internationally recognized worker rights such as freedom to join an independent trade union and bargain collectively, including by:

(A) considering labor market policy in the context of achieving macroeconomic stability and providing the foundation for sustainable growth; *and*

(B) further enhancing collaboration between the International Monetary Fund and the International Labor Organization~~; and~~.

~~C) encourage recipient governments not to discriminate against guest workers.~~

> *Comment: we should not press, and there will be significant opposition to, the IMF's expanding its conditionality to cover immigration policies that are not covered by section 6(A) & (B) above.*

(7) ~~Ensure~~ *Vigorously advocate* that International Monetary Fund programs and assistance are structured *to the maximum extent feasible* so as not to exacerbate or precipitate ethnic strife within a recipient country.

> *Comment: Neither the ED, nor the IMF, can ensure that there will not be ethnic strife. To the extent there is strife, often it is in response to the balance of payments crises the IMF program is intended to address. In addition, the ED should have the discretion of supporting programs which call for cuts in unproductive expenditures (such as spending on bloated military and internal security forces) even if recipient governments argue such cuts will precipitate ethnic strife.*

(8) ~~Ensure~~ *Urge* that the International Monetary Fund recognizes that macroeconomic developments and policies can affect and be affected by environmental conditions and policies....

(10) Facilitate greater International Monetary Fund accountability and enhance International Monetary Fund self-evaluation by *encouraging review of the effectiveness of the Office of Internal Audit and Inspection and the Executive Board's external evaluation pilot program and if necessary* establishing an operations evaluation department modeled on the experience of the International Bank for Reconstruction and Development....

> *Comment: In 1996, in large part to U.S efforts, the Executive Board agreed to establish, on a two-year trial basis, an external evaluation program. In addition, the Fund's internal evaluation unit was strengthened. We should give these initiatives a chance before pressing a new approach.*

(11) Coordinate with the International Bank for Reconstruction and Development and other international financial institutions (as defined in section 1701(c)(2)) in *promoting structural reforms which facilitate the provision of* ~~advancing~~ credit to small businesses....

> *Comment: To clarify that the IMF's role is to promote policy reforms, not provide credit directly to small businesses.*

DRAFT

Possible Measures to Advance Core Labor Standards (CLS) in the IFIs

I. NON-IMF IFIs

(A) Child Labor Emphasis: Fully implement child labor policy in World Bank and seek to extend to other MDBs.

(B) Labor Clause in MIGA Contracts: Continue to press for language in MIGA contracts that would deny payment in the event the insured company denies workers' rights (especially child labor or forced labor) or violates national labor laws.

(C) World Bank Strategy: Call on World Bank and ILO to produce a paper laying out the priority countries/industries where labor issues are problematic and a strategy for MDB engagement.

(D) Labor Fund in Latin America: Continue work in FSO negotiations to create special fund for environment, labor and education initiatives.

(E) Procurement Standards: Continue to seek language in IDB bidding documents that would have successful bidders commit to fair labor practices and respect for laws regarding child labor.

(F) ILO/UNICEF Coordination: Press for ILO/UNICEF representatives to join selected project appraisal missions in countries where there is a high risk of child/forced labor.

(G) Union Consultations: Press for MDB staff to meet with union reps while devising relevant programs/projects.

(H) Analytical Foundations: Call on the World Bank and IMF to hold a seminar on labor and macroeconomic linkages, especially regarding collective bargaining and right of free association.

II. IMF MEASURES

IMF Board. Seek Board support for IMF staff to draft a guidelines paper — similar to that done on corruption — on how staff should address the issue of core labor standards and labor market issues in the context of Fund adjustment programs and country reviews.

Article IV Consultations. Call on staff to incorporate assessment of labor market conditions as they relate to the macroeconomic situation in countries where ILO has identified poor worker rights record. Urge staff to meet with unions and NGOs during Article IV consultations, particularly in these countries.

DRAFT

Program Design

- Where relevant, seek to incorporate in IMF programs a strong recommendation to the government using Fund resources that it engage in tripartite consultations (government, business, labor) as part of implementing the structural components of its Fund program.

- Push for IMF staff reports to have appropriate focus on labor market implications of IMF-supported adjustment programs; when labor market flexibility is examined as a priority issue, insist that CLS are also examined.

- Ensure that fiscal treatment of social safety net issues take account of need for labor market-related measures.

IMF/ILO Relations

- Ask staff to report to the Board on the ILO/IMF pilot collaboration project.

- Recommend systematizing such collaboration in key program countries where worker rights are found to be poorly protected.

- Incorporate ILO recommendations on strengthening worker rights in IMF or related World Bank programs in countries where worker rights are poorly protected.

3. ILO. Have U.S. representative at ILO try to ensure that ILO has permanent representation on the ground in key countries with poor worker rights records. [FYI: The ILO pulled, or was asked to pull, its representative in Indonesia, a Dutch national. The Indonesians said they wanted an Asian. The ILO then offered to send a Japanese representative, which Indonesia rejected. As far as I know there is still no ILO representation in Indonesia. Moreover, the World Bank canceled a labor issues conference it was to sponsor with the ILO in Jakarta, to protest the arrest of Pakpahan. Seems to me that would have been all the more reason to press ahead with the conference to focus world attention on the situation.]

4. **U.S. Annual Report on Core Labor Standards.** Provide a higher profile to U.S. efforts on core labor standards through an annual report to Congress on the status of core labor standards in IFI member countries, including efforts by the IFIs. The report would be a companion piece to the annual human rights report and could be prepared either by State Department or the Labor Department in cooperation with U.S. labor unions.

1998-SE-002066

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

February 11, 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Timothy Geithner CZ for
Assistant Secretary (International Affairs)

SUBJECT: Legislative Strategy on the IMF

Here's a brief update on the state of our internal work on developing substantive proposals in response to the various suggestions emerging from the Hill on conditions.

1. We have made some progress internally identifying a series of specific initiatives we could undertake in the IFIs in response to the proposals from the Hill on labor standards and transparency. Attached are the current drafts of these lists, produced by Helen Walsh, Mark Jaskowiak, and Barry Newman with input from the rest of us.

These are the two areas where there is the most broad-based and specific pressure for conditions. But as the Phil Graham list and the Leach/LaFalce bill suggest there is a long list of other areas where members of Congress would like us to commit to advance certain objectives in the IFI or would like to see progress on in the IMF as a condition for our appropriation. A more comprehensive list of the proposals out there would include:

- Labor.
- Orderly workouts, greater burdensharing by private creditors.
- Strengthen financial systems.
- Environment.
- IMF Transparency and Governance.
- Social safety net reinforcement.
- Trade liberalization.
- Corruption, governance, crony capitalism.

2. There are a variety of possible ways we could try to accommodate the pressure for conditionality. Here's a list of ideas based on our discussions yesterday with Ed Knight, Neal Wolin, and the OASIA team.

- Legislative language committing us to use our "voice and vote to promote" various objectives.

- A statement by Camdessus or policy statement by the institution supporting some list of objectives or initiatives.

- A policy statement by the Secretary outlining our commitment to some list of objectives or new initiatives.

- An Executive Order setting up a process for a coordinated interagency approach to pursuing some issue (such as some broad initiative on labor rights) and/or the substantive objectives that would guide such an initiative.

- Periodic reports by the Treasury on the extent to which the IMF, or the IFIs more generally, are meeting the objectives we established.

We are less warm to the suggestions that the Congress condition the appropriation on the IMF satisfying a set of conditions ex ante, tranche our appropriation with disbursements limited to certain performance criteria the IMF has to meet, or mandated voting requirements.

As you may have seen, there is a new drumbeat of support even from some unlikely sources, such as the *Financial Times*, for Congressionally imposed conditions on the IMF legislation.

3. We need better intelligence than we now have on what key members believe they need. And, in addition to all the big issues in Linda's list, we need to decide how to respond to the requests from Frank, Leach, LaFalce and others to discuss their specific proposals now. We need to decide what we think about the timing of mark up in the House.

Also attached is another copy of our memo last week, which includes the annotated Leach/LaFalce bill.

Attachments:
Labor in the IFIs
IMF transparency
Annotated responses to Frank and Gramm lists
Memo of 2/6/98

cc: Robertson, Knight, Lissakers, Lipton, Atkinson, Schuerch, Jaskowiak, Walsh

February 10, 1998

Openness in the IMF

The U.S. believes that a more transparent and accountable IMF would strengthen the institution. Consequently, greater public access to IMF documents and enhanced IMF receptivity to opposing views would be desirable provided it is done in a manner compatible with preserving the confidentiality necessary for the IMF to fulfill its responsibilities effectively. To this end, the U.S. would propose the following measures:

- <u>Public Information Notices (PINs)</u>: Expand the use of PINs by requiring that they be issued after every Article IV consultation, program discussion and program review. The mandatory issuance of PINs would provide information on IMF staff assessments of a member's economic situation and policies as well as a summary of the Executive Board's review of the country for all 182 members on a regular basis. At present, the release of PINs is voluntary.

- <u>Letters of Intent (LOIs)</u>: The Fund should require that members issue their LOIs as a condition for obtaining IMF loans. Publication of the LOIs will enable the public to know in detail the economic commitments which a country undertakes as part of an IMF-supported stabilization and reform program. At present, the release of LOIs is voluntary.

- <u>Article IV Reports</u>: A country should be allowed to issue, on a voluntary basis, the full IMF staff report on the annual consultations on economic developments and policies. At present, the release of Article IV reports is prohibited.

- <u>Recent Economic Developments (REDs)</u>: The IMF should release all RED reports as a means of providing up-to-date detailed background information and statistics on each member country. At present, the release of REDs is voluntary.

- <u>External Evaluations</u>: The IMF Executive Board should commission at least 2-3 external evaluations annually by independent experts on key policy issues such as the ongoing review of ESAF and the proposed evaluation of surveillance. The evaluation reports should be published immediately upon completion.

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
006. memo	Barry Newman to Mark Jaskowiak re: Senator Gramm's Four IMF Policy Changes (incomplete) (1 page)	02/09/98	P1/b(1) Unclass.

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DRAFT

Possible Responses to Legislative Suggestions on IMF Funding Requests[1]

(1) Unconditional Release of Pakpahan:

- USG shares this objective, and is pursuing on many diplomatic fronts. [Awaiting NSC/State Input on details.]

(2) Broaden IMF conditionality to include specific labor rights and environmental protections:

- This presumably would require the USED to vote against programs for any country that falls short of some as-yet unspecified definition of adequate worker and environmental protection. Even if there were specificity, we would oppose such "mandated voting" requirements on a number of grounds, most generally and importantly because it would reduce U.S. leverage and influence by forcing us to withdraw from the debate on programs in the affected countries. Programs likely would be approved without U.S. input, affecting not only the issues in question but other policy and bilateral imperatives of value to the U.S. (See separate paper detailing these objections - Attachment 2.)

- The U.S. is willing to use its "voice and vote" to urge and advocate the adoption of policies and procedures to advance the causes of labor and environmental protection. This can be accomplished in a number of ways, from seeking Board support for a labor guidelines paper to broadening and further institutionalizing cooperation between the IMF and ILO. (See separate paper for details on possible measures to advance core labor standards in the IFIs -Attachment 3.)

- [Further, the U.S. is considering proposing the addition of the cause of core labor standards to the agenda of the Birmingham Summit, with specific mention of the role of the IFIs as advocates.]

(3) Increase transparency of IMF activities

- The U.S. agrees with the presumption that the IMF's activities and documents should be disclosed to the public to the greatest degree compatible with the need for confidentiality of some sensitive national economic data. To this end, the U.S. is willing to propose in the IMF the following measures to increase transparency:

  - A Public Information Notice (PIN) should be issued on a mandatory basis after every Article IV consultation, program discussion and program review. The PIN would summarize the country's economic and financial conditions and the Board's discussion of the program.

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[1] See Attachment 1

DRAFT

- All Letters of Intent (LOIs) should be published on a mandatory basis.

- A country should be allowed to issue, on a voluntary basis, the IMF Staff Report on an Article IV consultation.

- All external reviews of IMF policies and programs should be published on a mandatory basis, beginning with the current ESAF review immediately upon completion.

(4) Establish a new Deputy Assistant Secretary at Treasury whose sole responsibility would be to monitor IMF reforms and to report on the social consequences of lending by multilateral organizations.

- Treasury is willing to consider the commitment of additional staff resources to such functions, with the quantity, rank and title of such positions yet to be determined.

(5) Provide for the release of IMF funds in several tranches - with the release of each tranche preceded by a report on the effectiveness of the IMF in meeting concerns about labor rights and the environment:

- The proposed quota increase cannot go into effect until members representing 85 percent of existing quotas have consented to their increase. Thus, failure of the United States to consent to its increase blocks all increases.

- A member's increase also cannot go into effect until it has paid the full amount of its increase. Accordingly, authorizing U.S. consent but appropriating the U.S. increase in tranches would permit other countries to put their quota increases into effect but delay effectiveness of the U.S. increase until the final tranche is appropriated.

- Under this scenario, the U.S. share of total quotas would drop by nearly one third, and the U.S. voting share would thus decline substantially below the 15 percent level, which represents a veto on important IMF decisions.

  - As the proposed quota increase also requires that a member consenting to its increase must make payment within 30 days, U.S. failure to make that payment would prevent the United States from ever taking up its increase unless the IMF Executive Board extended the period.

(6) A clear and forceful statement from the Administration concerning East Timor, emphasizing that the Indonesian Government should begin discussions with East Timor through Bishop Belo (1996 Nobel Peace Prize recipient) and Xanana Gusmao (imprisoned Timorese leader):

Possible New* U.S. Measures to Advance Core Labor Standards (CLS)[1] in the IFIs

I. MDBs

(A) Child Labor Emphasis: Seek to extend World Bank's Child Labor Policy to other MDBs. World Bank policy seeks to address child labor more proactively, by integrating child labor considerations into reviews of Country Assistance Strategies, programs, social assessments and other operational documents; introducing new projects to reduce the harmful effects of child work; emphasizing child labor issues in other projects, e.g., education; bringing child labor issues into policy dialogue in countries where harmful child labor is a serious problem; undertaking more research and increasing staff awareness of the problem; strengthening partnerships with NGOs and the ILO; and including appropriate safeguards in projects to ensure that the Bank does not inadvertently contribute to the problem.

(B) Labor Clause in MIGA Contracts: Press for language in MIGA contracts that would deny payment in the event the insured company denies workers' rights (especially child labor or forced labor) or violates national labor laws.

(C) World Bank Strategy: Call on World Bank and ILO to produce a paper laying out the priority countries/industries where labor issues are problematic and a strategy for MDB engagement.

(D) Labor Fund in Latin America: Broaden our proposal for a special environmental fund in the Fund for Special Operations (FSO) negotiations to include labor and education initiatives. [close hold; sensitive negotiation underway]

(E) Procurement Standards: Seek language in MDB bidding documents that would have successful bidders commit to fair labor practices and respect for laws regarding child labor.

(F) ILO/UNICEF Coordination: Press for ILO/UNICEF representatives to join selected project appraisal missions in countries where there is a high risk of child/forced labor.

(G) Union Consultations: Press for MDB staff to meet with union reps while devising relevant programs/projects.

(H) Analytical Foundations: Call on the World Bank and IMF to hold a seminar on labor and

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[1] "Core Labor Standards," as defined and used in this context by Treasury, include: (a) the right of association; (b) the right to organize and bargain collectively; (c) prohibition against use of forced labor; (d) prohibition against exploitative child labor; (e) non-discrimination.

* "New" is in addition to those measures committed during Fast Track discussions.

macroeconomic linkages, especially regarding collective bargaining and right of free association.

II. IMF

(A) Operational Guidelines Paper: Seek Board support for IMF staff to draft a guidelines paper — similar to that done on corruption — on how staff should address the issue of core labor standards and labor market issues in the context of Fund adjustment programs and country reviews.

(B) Article IV Consultations. Call on staff to incorporate assessment of labor market conditions as they relate to the macroeconomic situation in countries where ILO has identified poor worker rights record. Urge staff to meet with unions and NGOs during Article IV consultations, particularly in these countries.

(C) Tripartite Consultations: Where relevant, seek to incorporate in IMF programs a strong recommendation to the government using Fund resources that it engage in tripartite consultations (government, business, labor) as part of implementing the structural components of its Fund program.

(D) Labor Implications of IMF Programs: Push for IMF staff reports to have appropriate focus on labor market implications of IMF-supported adjustment programs. When labor market flexibility is examined as a priority issue, insist that CLS are also examined.

(E) Social Safety Nets: Ensure that fiscal treatment of social safety net issues take account of need for labor market-related measures.

(F) IMF/ILO Relations

(1) Ask staff to report to the Board on the ILO/IMF pilot collaboration project.
(2) Recommend systematizing such collaboration in key program countries where worker rights are found to be poorly protected.
(3) Take account of ILO recommendations on strengthening worker rights in IMF or related World Bank programs in countries where worker rights are poorly protected.
(4) Have U.S. representative at ILO try to ensure that ILO has permanent representation on the ground in key countries with poor worker rights records.

III. Status of Fast Track Commitment on IFIs include:

(A) Enhanced Internal Deliberation. Secretary Rubin to consult with Secretary Herman and propose the formation of an interagency team including Labor, State and Commerce Departments to explore worker rights issues more broadly and to examine ways to furtehr incorporate these issues more systematically into the work of the IFIs. **Status:** Treasury/Labor staff consultations have been enhanced.

(B) Securing International Focus on Priorities. Secretary Rubin will highlight USG priorities in his speech at the World Bank/IMF Annual meetings. The U.S. will propose a Summit of the Presidents of the IFIs and the DG of the ILO to reinforce the commitment of the institutions to working together. **Status:** Secretary Rubin's speech included a strong statement on labor. Treasury has not yet formally called for the Summit.

(C) Heightening IFI Priority to Labor Issues.

-- Actively promote joint IMF/World Bank Conference on worker rights issues. **Status:**

-- Continue to promote vigorously its proposal for the development of a draft screening mechanism. **Status:** The World Bank's Child Labor paper adopts a number of elements of our screening mechanism, and provide a good basis for development.

-- Propose that the World Bank establish an office dedicated to the analysis of labor issues. **Status:** staff are being detailed to an office which handles social issues, including labor.

-- Explore ways to ensure IFI budgets contain sufficient resources to conduct screening operations and similar analytical functions. **Status:**

-- Urge MDBs to investigate ways to increase technical assistance and direct lending to promote the adoption of fair standards and worker rights. **Status:** There have been a number of loans.

-- Urge the IMF to examine the link between core labor rights and long term macroeconomic performance, for possible inclusion of such rights in the Fund's new governance policies. **Status:**

-- Urge IMF to further emphasize the importance of labor-related issues in its annual country reviews. **Status:**

-- Pursue vigorous follow-up on World Bank's Child Labor paper. **Status:** Child Labor report has been finalized and we are continuing to press for concrete progress.

1998-SE-002489

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

February 26, 1998

ASSISTANT SECRETARY

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN

FROM: Timothy Geithner TG
Assistant Secretary (International Affairs)

SUBJECT: Cost of U.S. Participation in the IMF

I wanted to follow up the recent discussion on this subject with some preliminary numbers on the impact of interest rate differentials and valuation gains/losses.

The central conclusion is that, despite large net valuation losses in FY 96 and 97, the gains in earlier years are likely still to dominate the results, showing a cumulative net gain. We are in the process of refining these calculations. Meanwhile,

- Valuation gains/losses on our reserve position dominate the interest impact in any one year and indeed over the last 18 years. As the dollar has depreciated relative to the SDR about 35 percent during this period, gains are larger -- perhaps on the order of $4 billion. Given the recent increase in our reserve position as a result of the large IMF programs, we are now more vulnerable to losses should the dollar appreciate sharply, although larger gains are also possible.

- Remuneration (interest) we receive on our reserve position is generally less than the sum of what we pay on associated Treasury borrowing (assumed to be at the 3-month Treasury bill rate) and the interest foregone on SDRs transferred to the IMF as the reserve asset portion of a quota increase. The shortfall may amount cumulatively over the past 18 years to $1 - 1.5 billion or so.

    - $625 million reflects net "adjustments" to remuneration to reflect the financial cost to the IMF of arrears of some debtors. (We do expect to get all of this back.)

    - The remainder largely reflects the tendency for the SDR interest rate to be lower that the T-bill rate.

(A partial table is attached to give you an idea of the nature of the calculation. The typed numbers are fairly firm, while the pencilled numbers are rough estimates.)

Thus, we expect the outcome to show, as a conservative estimate, total gains since 1979 of $2 to 3 billion. (We estimate the cumulative cost of participation at that point in time to have been close to zero.)

The use of the 3-month T-bill rate as the assumed cost of Treasury borrowing associated with use by the IMF of the dollar portion of our quota subscription is sometimes challenged.

- Some might argue that we should apply the average cost of Treasury borrowing, which may be 150 to 200 basis points higher. The cumulative impact of such a factor could offset the gains we are currently estimating.

- However, our traditional approach reflects the practice of compensating for short-term fluctuations in Treasury cash balances by changing the size of the next weekly auction of 91 day Treasury bills. A decision to fund some of the public debt at longer maturities is a debt management decision unrelated to participation in the IMF. Given the relatively unpredictable nature of IMF programs, with reflows of dollars as well as outflows, it is reasonable to use the 3-month Treasury bill.

cc Under Secretary Lipton

Attachment: Partial table on estimated cost of U.S. participation in the IMF

COST OF U.S. PARTICIPATION IN IMF
(in millions of U.S. dollars)

	cumulative transfers of $ to IMF (end of period)			cost of implied associated Treasury borrowing	cumulative transfer of reserve assets to IMF	foregone interest on transferred reserve assets	TOTAL INTEREST RELATED COST	remuneration received by United States	NET GAIN (+) OR LOSS (-) ON INTEREST RELATED COST AND REMUNERATION	valuation gain (+) or loss (-) on U.S. reserve position in IMF	TOTAL GAIN OR LOSS ON U.S. PARTICIPATION IN IMF
fiscal year	under U.S. quota (1)	U.S. loans to IMF (2)	TOTAL (3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1979	0	0	0	0	0	0	0				
1980					0						
1981					1340						
1982					1340						
1983					1340						
1984					2730						
1985					2730					1500 e	
1986					2730					1400 e	
1987					2730					578	
1988					2730					136	
1989					2730					-50	
1990					2730					741	
1991					2730					-174	
1992					2730					694	
1993					5689		300		-50	326	275
1994					5689		350		-50	406	350
1995					5689		480	408	-75	284	200
1996					5689		575	475	-100	-675	-775
1997	6,300	0	6,300	350	5689	230	580	439	-140	-761	-900
TOTAL	--	--	--								

TREASURY CLEARANCE SHEET NO._________

DATE:_______

MEMORANDUM FOR: ☐ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER __________

FROM: Assistant Secretary Geithner
THROUGH:
SUBJECT: Cost of U.S. Participation in the IMF

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt
☐ Under Secretary for International Affairs
☐ International Affairs
☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC
☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds
☐ Other __________

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
J. Lister	imf-cost-memo.f25	2/25/98 revised 2/26 per CA	International Monetary Policy	622-0112
REVIEWERS				
C. Atkinson	CA	2/25/98	DAS, Intl. Monetary & Financial Policy	622-0489

SPECIAL INSTRUCTIONS

☐ Review Officer Date ☐ Executive Secretary Date

DO F 70-02.1 (04/89)

JUN-30-1998 16:03 TREASURY IMF 202 622 5117 P.01/02

1998-SE-007743

BARNEY FRANK
6TH DISTRICT, MASSACHUSETTS

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NEWTON, MA 02158
(617) 332-3920

Congress of the United
House of Representa
Washington, DC

June 23, 1998

To: Rick S.
From: Mark J.
Seen this?

The Honorable Robert E. Rubin
Secretary
Department of the Treasury
1500 Pennsylvania Ave. N.W.
Washington, D.C. 20220

Dear Bob,

I'm enclosing a piece from the New York Times of last Saturday. You will note that it attributes to you the view that "lawmakers" who "complain about human rights or labor law violations in countries getting loans" are introducing into consideration of the IMF funding issues "they have absolutely nothing to do with it."

As I say, I realize that the article never directly quotes you as saying this, and I believe that it in fact misrepresents your position. My sense from reading this is that your reference to the "unrealistic" issues that "have absolutely nothing to do with" the IMF deal with the anti-abortion matters. I certainly strongly hope this is the case.

But even if it is true that this misrepresents you and attributes to you views about the human rights issues and labor issues which in fact relate essentially to the anti-abortion issue, the fact that it misrepresents you shows our problem.

That is, if Reuters is this confused about your position, you shouldn't be surprised that some Members of Congress are. For us to pass this we need to persuade Democrats that you in fact do make the distinction and that you believe as you have told us that these issues are linked -- that is, the human rights, labor issues, and the moral hazard question which is also referenced here. But I repeat, the fact that the Reuters people make this confusion is symptomatic of a confusion that others are making.

Thus, I urge you to make sure that your staff and yourself correct this article, and also take greater pains than apparently have been taken so far to clear up this confusion.

To repeat, because I know that things are often misunderstood even when explicit, I do not accuse you of believing what this article says you believe. I point it out to you as an example of the kind of ambiguity about your views which exist -- indeed this is not even ambiguous but wrongheaded -- and to stress again the importance of your doing whatever you can to dispel this sort of mis-impression, both because it's the right thing to do, and because we will not get the IMF bill passed without it.

BARNEY FRANK

BF/mg
ENCLOSURE

I.M.F. Needs Money, Too

WASHINGTON, June 19 (Reuters) — Treasury Secretary Robert E. Rubin warned today that a new rescue package for Russia could drain the resources of the International Monetary Fund and urged Congress to make more money available soon.

Mr. Rubin said in an interview that if there is a new lending program for Russia, "that obviously would deplete the resources further and expose the United States to risks that are totally nonsensical to take."

Russia, one of the fund's biggest borrowers, with a $10 billion line of credit, is seeking $10 billion to $15 billion more from a special short-term lending program for countries facing temporary cash shortages.

Mr. Rubin said the fund is already short of cash, and he called on the Republican leadership in the House to support a package of $18 billion in funds for the I.M.F. without attaching "unrealistic" strings.

The Senate approved the Administration's request for more money for the I.M.F. in March but the package has stalled in the House despite intensive lobbying by Mr. Rubin and business groups. Some lawmakers want to tie new funds to anti-abortion measures; some complain about human rights or labor law violations in countries getting loans; others say bailouts encourage banks to act irresponsibly.

"What is going to get this thing out is separating the I.M.F. from other issues that have absolutely nothing to do with it," Mr. Rubin said.

1998-SE-005682

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

May 6, 1998

MEMORANDUM FOR PRESIDENT CLINTON

FROM: Robert E. Rubin R.E.R.

SUBJECT: Gephardt Support of IMF Funding

I wanted to draw your attention to House Minority Leader Gephardt's strong expression of support for IMF funding in his speech yesterday to the Economic Strategy Institute (see attached). This support is especially important in light of the letter he, Barney Frank, David Bonior and several other House Members sent me last week expressing serious Democratic concerns with respect to capital account liberalization in the IMF charter. I have spoken to Dick directly about this issue, and Larry Summers has met with Barney Frank and will be meeting with David Bonior in order to address their particular concerns. In his speech, Dick states:

> "IMF replenishment is insurance against future global economic crises and is in our deep national self-interest. The Republicans are playing a dangerous game of chicken with our economy -- they are jeopardizing our growth ... blocking IMF funding at every turn this spring.
>
> ... We must not abandon efforts to fund the IMF ... In the last two weeks, the issue of capital account liberalization has come up ... This is a serious issue that requires serious debate ... However, we must not risk support for IMF funding on this issue."

I very much appreciate Dick's firm reaffirmation of support for the Administration's IMF funding package, and we will continue our intensive joint efforts to secure its passage. We will also consult closely with Dick and his colleagues as we continue to consider the capital account liberalization issue.

NEWS FROM THE HOUSE DEMOCRATIC LEADER

For Immediate Release:
May 5, 1998.

House Democratic Leader Richard A. Gephardt
H-204, U.S. Capitol

Remarks of House Democratic Leader Richard A. Gephardt before the Economic Strategy Institute, Washington, D.C.
"The New Internationalism: Nexus Between American National Interests and Globalism"

I'm very pleased to be here today. This meeting is a critical annual assessment of where U.S. and international economic policy has been and where it's headed. Clyde Prestowitz and the Economic Strategy Institute are to be commended for helping to provide an honest, open forum. They help ensure that all points of view are heard.

That's especially important at this time. In the wake of the defeat of last year's fast track effort it's important to have an open, honest discussion about what course we should be following. It's important to understand what the debate was all about, and what it was not about.

The vote on fast track wasn't a victory for protectionism. It wasn't about organized interests pressuring legislators. It wasn't about fear of open markets. And it certainly wasn't about stopping trade.

The vote on fast track was a signal that citizens all across this country, as well as their elected representatives, want those in charge to fight for their interests. Americans are interested in a clear, consistent approach to globalization that recognizes that we're in a world economy and there's no going back. But they are concerned that even though we are in a global economy, we still have national interests. These are universal interests as well.

And, as the leader of the world economy, Americans demand we fight for standards and conditions that ensure that trade is truly a force for progress rather than downward pressure on living standards and ideals.

Fast track was a fight about what our trade policy for the future should be. The message was that the public doesn't believe that the status quo is good enough. They embrace internationalism yet demand a change in our future trade policy.

Some commentators portrayed the position against last fall's fast track as a blanket opposition to free trade. In the heat of the moment, it's often impossible to have a real debate about the issues. But we must make sure that these misunderstandings do not obscure the real issues at hand.

I supported President Bush's request for fast track in 1991 and was prepared to support President Clinton's request in 1997. The U.S. has one of the lowest average tariff rates in the world. Since we face protectionist barriers all around the globe, it is critically important to see those reduced as a simple matter of our national interest.

One way to get those barriers to our competitive products eliminated is through the leverage of our market. Regrettably, this effort – primarily the use of Section 301 and Super 301 – has largely been abandoned.

A second way is through multilateral efforts like the World Trade Organization. I supported the creation of the WTO because I believe, ultimately, that our interests lie in having international rules that are fairly applied and adjudicated. But, as with the Fuji-Kodak case, I don't believe that jurisdiction should be given to the WTO where rules have not been negotiated and defined.

If we have negotiated rules, then the US and other countries should abide by them. But until there are defined rules we must fight unilaterally for the interests of our farmers, workers and businesses.

The third way is the use of trade agreements – bilateral, regional, or multilateral. This is the primary approach of this Administration.

I want new trade agreements to be negotiated in order to improve the status quo. But they cannot be ratified without some justification – they must produce an improvement in the condition of trade. Too often, negotiated agreements do not live up to this standard.

Since the planned first use of fast track trade negotiating authority was to expand NAFTA, its success or failure is an appropriate point for the start of the debate.

An important component of free markets are free labor markets. By refusing to address the enforcement of Mexican labor laws, the NAFTA endorsed the artificial limits on collective bargaining, wage increases and all of the other components of free labor markets.

Mexico has started down the road of genuine democratization. Opposition control of the legislature has presented interesting challenges to the ruling PRI. New independent trade unions are being formed. The current political turmoil and economic crisis have brought progress on the margins. Yet, Mexico's labor laws remain unenforced in practice for the vast majority of workers. Their bargaining power remains severely limited by the current political, legal and economic system.

Employment of Maquiladora plants along the border has almost doubled since NAFTA, but environmental enforcement has not kept pace.

I am not seeking to impose US standards on the world. But to start, I want other countries to be required to enforce their laws. The rule of law should be the basic component of any trade initiative. Over time, we all want standards to be increased — this will occur through negotiations as well as the political demands of the citizens of the world.

Just as the business community expects its intellectual property to be protected and the laws to be enforced, our workers should expect the product of their mind and muscle to be protected.

Developing countries aren't going to adopt our minimum wage – we're having enough trouble getting the Republicans to increase ours to the level it should be. But, the minimum wage laws these nations have adopted should be enforced. And, as development in their country increases, as their productivity, quality and entrepreneurial spirit yield results, workers should be able to bargain for and share in the profits from their hard work.

This isn't a matter of high-minded idealism. It is a matter of hard-core pragmatism. If we can't create middle-class consumers around the globe, we won't have anyone to buy our products. And we'll see the continuing downward pressure on our wages.

And there are provisions in U.S. law -- health, safety, environmental protections -- which must not be diminished. Right now, it appears the WTO is attempting to weaken US environmental laws through its dispute resolution process. We can't stand for such action; it is beyond the WTO's mandate to lower environmental standards and I hope the Administration opposes this decision.

The American people understand that globalization is a fact of life — but they want policymakers to put it in context. And while it is a fact of life, its face, its contours, its complexion are all up to us. Today, I want to spell out what steps we need to take to ensure a high and rising standard of living for our people, and people all across the globe.

First, we have to combat efforts of the Republican leadership of Congress to derail the funding package for the International Monetary Fund. President Clinton and Secretary Rubin have energetically and passionately worked to get Congress to act on this issue. Two weeks ago 80 percent of Democrats in the House joined together to advocate the inclusion of IMF funding that the President has requested. But Speaker Gingrich led the Republican opposition to this amendment.

IMF replenishment is insurance against future global economic crises and is in our deep national self-interest. The Republicans are playing a dangerous game of chicken with our economy -- they are jeopardizing our growth. While the Asia region is quiet at the moment, the contagion could still spread to other nations. Right now, the IMF doesn't have the resources to bailout another major economy. The Republican leadership have allowed the radical isolationist wing of their Party to hijack our trade agenda, blocking IMF funding at every turn this spring.

I was the first elected leader in December to support the President's request. I did so without being asked. This was a logical extension of my position on fast track. A country on the brink of bankruptcy isn't going to enforce its labor or environmental laws — it will probably undermine them. It will try and export its way to growth and erect barriers to imports.

Recently, I joined with Secretary Rubin in advocating the IMF package before the Chamber of Commerce. I urged the representatives of the business community to redouble their efforts to pass the IMF funding. Don't jeopardize our economic security. Don't succumb to the myopia of the Republican leadership. Don't jeopardize our efforts to build a new trade coalition — one that has the support of a wide spectrum of Americans.

We must not abandon efforts to fund the IMF. This could turn out to be a tragic mistake.

It's time to get the IMF package passed. Obviously the IMF isn't perfect and is in need of renewal and reform. The IMF must become more transparent and better promote stronger human rights, labor, and environmental standards in recipient countries. However, before you remodel a building, you have to shore up its foundation.

I believe that we need an IMF that promotes economic growth with equity, not one that is a rubber stamp for winner-take-all economic plans.

Because it's in our self-interest, we need to replenish the IMF to provide a backstop to the economies in Asia and elsewhere around the world. But we must also demand immediate and far-reaching reform as well.

In the last two weeks, the issue of capital account liberalization has come up — this is part of an effort to amend the IMF charter. This is a serious issue that requires serious debate. People from diverse points of view have raised concerns about this change at the IMF. However, we must not risk support for IMF funding on this issue.

The Democratic coalition is prepared to work aggressively with the President and the Treasury to replenish the IMF — to strengthen its foundation. Then we should take the time to review and reform the IMF to ensure that it can successfully meet the challenges of the future.

Democrats support the President on replenishment for the IMF because it is the right thing to do. But the Republicans must abandon their isolationism and join us to restore confidence to world financial markets.

Ultimately, if the IMF program is to be successful, Japan must play a constructive role in resolving the Asia crisis by reforming its own economy. America cannot absorb all the new exports from the region. But right now, Japan is doing the opposite of what's needed; attempting to export its way to economic recovery.

I have been talking for years about the failure of Japan to make the transition from export-led to domestic consumer demand-led growth. The time to bring about lasting change is now. If Japan refuses to change, it risks being pushed to the sidelines and having its role in the world economy diminished.

I find it ironic that those of us – Clyde, myself, Chalmers Johnson, many others – who demanded change in the past were labeled "Japan-bashers." Today, our views are accepted as common wisdom and common sense.

From crisis comes opportunity. And at every opportunity in concert with our allies we need to be persistent in our efforts to change Japan. I favor devoting major portions of the G7 summit in England and the 50th anniversary of the WTO in Geneva to bring about change in the systemic problems of the Japanese economy.

We have to move beyond jawboning to concerted action.

The Asia crisis is the immediate issue. The longer term issue is how do we move forward on further trade integration. I've already talked about fast track – what the fight was about. I intend to continue my fight for a progressive replacement for fast track. One that recognizes the complexity of the issues and the role that Congress must play. One based on the need for a new architecture for world trade.

The supporters of the Republican effort should not underestimate my resolve or that of those who were part of the coalition opposing their efforts last fall. At the same time, they should not overestimate the power of their money – this was an issue of principle, not politics.

I welcome a dialogue on this issue. And one of the ways to build a bridge between the views is with confidence building measures.

Just prior to the vote on fast track, a number of proposals were offered to address labor and environmental issues. They were too little, too late. They were many of the same proposals that had been offered before and not successfully implemented. A commitment to and understanding of these issues would begin to build confidence in the process for those of us who opposed fast track last fall. Let me be specific about some steps that must be taken to help rebuild a pro-trade coalition in this country.

A re-authorization package for Trade Adjustment Assistance must be developed -- one that isn't just marginal reform, but that recognizes the real need to ensure that the victims of trade know that they aren't going to be abandoned. That today's losers can become tomorrow's winners. It must be fully funded, accessible and responsive to the task at hand.

This isn't welfare, it's the center span of that bridge to the future.

It means getting serious about using the provision which requires U.S. representatives at multilateral lending institutions to use their voice and vote to promote workers rights.

It means that labor and environmental issues shouldn't be treated as "academic issues" or be relegated to part of a debate about "civil society" in the negotiations on a Free Trade Agreement of the Americas. They are trade issues and should be given equal status with all other trade issues.

The one issue I thought everyone could agree on was the need to wage a fight against the use of child labor. No one should profit by robbing kids of their childhood.

Some time ago I wrote to Speaker Gingrich asking him to work with me on a bipartisan package to begin to address the scourge of child labor. I haven't heard back from him. But for the children around the world, the sound of silence coming from this Republican-controlled Congress is deafening. I now ask the Speaker to begin the process and join me in bringing before the House of Representatives a resolution endorsing the global march against child labor.

Soon, I will push for other legislation that has been introduced as well as offer new legislation to prohibit the importation of products made with child labor. And I challenge every business in the country to pledge that they won't profit at the expense of the world's children. On an issue of such a basic American value, common ground should be easy to find.

There are many other steps that can be taken, steps that will show the American people that their message during last fall's debate was heard.

We must further a trade policy that promotes our values. American values, but universal in their importance. Whether it's human rights, children's rights, environmental rights, religious and political freedom, workers rights, America must stand on the side of what's right in the world.

Kim Dae Jung put it best when he said: "I believe that the fundamental cause of the financial crisis, including here in Korea, is because of placing economic development ahead of democracy."

There are too many voices that put commerce above values.
We've got to stand for something more than money. A world trading system that degrades our principles — that suppresses democracy and the fundamental rights of all people is unacceptable. It offends our values and ultimately leads to instability and corruption.

We need to use the leverage of our commercial and moral leadership to create a new architecture of trade. A blueprint that will create healthy and growing countries while also ensuring that the benefits of this growth are felt by the working people whose efforts bring about this growth. A new architecture that will promote both sides of the coin of "democratic capitalism."

Contrary to the theories of the Chinese leaders, human rights are universal rights. Lincoln embraced this basic belief -- that the Declaration of Independence "gave liberty not alone to the people of the country, but hope to all the world, for all future time."

He was right. Just ask Wei Jingsheng — the yearning for freedom and democracy is not a matter of cultural imperialism — it is a matter which touches the souls of all human beings the world over.

We must pursue a trade policy for the next century. Not just a new American Century -- where our commercial goods reign supreme. But a new American Century where American values have greater currency than our money.

###

Contacts: Laura Nichols/Erik Smith (202) 225-0100

For Exec Sec

DRAFT - 4/6/98, 11:10 am

~~The Honorable William Jefferson Clinton~~
~~President of the United States~~
~~1600 Pennsylvania Avenue, NW~~
~~Washington, D.C. 20500~~

MEMO

Dear Mr. President:

Enclosed is a copy of House Minority Leader Gephardt's speech of yesterday to the Economic Strategy Institute, "The New Internationalism: Nexus Between American National Interests and Globalism." In case you have not yet had the opportunity to review it, I wanted to draw your attention to Dick's strong expression of support for our IMF funding requests. I think this is especially important in light of the letter he and several House colleagues sent me last week, in which they noted serious Democratic concerns with respect to the issue of capital account liberalization at the Fund. I've since spoken to Dick directly about the issue, and Larry Summers has met with Barney Frank and will be meeting with David Bonior as well to address their particular concerns.

"We must not abandon efforts to fund the IMF... Democrats support the President on replenishment for the IMF because it is the right thing to do," says Dick in the speech. More specifically, he states, "In the last two weeks, the issue of capital account liberalization has come up...This is a serious issue that requires serious debate...However, we must not risk support for IMF funding on this issue."

I much appreciate Dick's firm reaffirmation of support for the Administration's IMF funding package, and we will continue our intensive joint efforts to secure passage. We will also be sure to consult closely with Dick and his colleagues as we continue to consider the capital account issue.

Sincerely,

Robert E. Rubin

ASW
General Counsel

5-6-98
DATE

Originator: Mark Jaskowiak
25852

To PA/NCC 5/6/98

NCC to RER 5/6/98
(signature)

RER signed 5/6/98

Please log in.

Thanks

1998-SE-007940

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

July 2, 1998

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Timothy F. Geithner TFG
Assistant Secretary (International Affairs)

SUBJECT: Legislative Proposals for IMF Transparency Reforms

House and Senate Appropriations Committees are scheduled to begin action on FY99 Foreign Operations bills in mid-July (commencing with the House subcommittee on July 15), and are now expected to include IMF funding in those bills. The amounts and related conditionality are still undecided, but House appropriations staff have requested that we begin serious substantive discussions this week, especially on transparency reforms, which loom as among the most prominent and pivotal in the debate. (Other serious issues also remain outstanding, including provisions relating to Korean directed lending and certain reporting requirements; we will address these separately.) While we expect mark-up and perhaps even floor action prior to the August recess, the ultimate shape of IMF funding legislation is unlikely to be determined until September, primarily a function of the ongoing controversy over funding for international population programs.

The purpose of this note is to lay out some substantive reform proposals on transparency and a few thoughts on how to pursue them in the legislative context at this point. As has been the case throughout the debate on IMF funding, most of the transparency reform proposals carry some degree of merit, and we have generally agreed with their essential premise, namely that the Fund needs to become a more open institution. The primary difficulty arises from the form of many of the legislative proposals, which would condition the NAB and/or quota increase (mostly the latter) on the adoption of reforms by the IMF.

The attached matrix attempts to summarize the major demands for reform, comparing them to current IMF policy, our position and assessments of what is achievable at the IMF. Here are some initial suggestions on an approach. We should be prepared to support three significant sets of transparency-related reforms that embrace most of the Congressional proposals:

> *(1) The mandatory or presumptive issuance of PIN s (Press Information Notices containing summaries of Executive Board discussions) on staff reviews of country programs, Article IV consultations, and staff policy papers.*

(2) Release and Presentation of Financial Data: Regular release of current IMF liquidity data, including U.S. share of operating budget, and lagged release of the entire operational budget. Improved audit procedures for, and more accessible presentation of, the IMF's financial statements.

(3) Mandatory release of LOIs (Letters of Intent) and PFPs (Policy Framework Papers) for Fund programs, permitting a narrow range of exemptions from release, e.g. intervention targets and the identity of vulnerable financial institutions.

We should be prepared to accept one or more, or some combination, of the following legislative formulations:

(1) Requirements that the U.S. use all "necessary and appropriate means," or similar constructions stronger than the standard "voice and vote" language, to achieve the above reforms.

(2) Conditioning of funding on Treasury certification that the G-7 supports and will seek to implement these reforms in the Fund, similar to the language of the Senate bill requiring program conditions on trade liberalization and crony capitalism.

(3) A statement by Camdessus, in a form and context acceptable to Congress (perhaps at the annual meeting in September), in support of the above reforms.

cc: Lipton, Robertson

Attachment: Transparency Reform Matrix

SENSITIVE

Summary of IMF Transparency: Proposals, Policies, Possibilities

Category/Item	**Proposed Reforms[1] (Congress)**	**Current IMF Policy**	**Current or Proposed U.S. Position**	**Possible IMF Deliverable?[2]**
(1) Staff Reviews of Country Programs	Public Release w/ redactions w/in 90 days	No public release in any form	Mandatory PIN[3] issuance (Current)	Presumptive PIN issuance (i.e., issued unless the country objects)
(2) Staff Reviews of Article IV Consultations	Public Release w/redactions w/in 90 days	Voluntary PIN issuance	Presumptive PIN issuance; Voluntary release of Staff Review document (Proposed)	Presumptive PIN issuance
(3) Staff Policy Papers (Non-country issues)	Public Release w/redactions w/in 90 days	Selective public release	Release, at least in summary form (Proposed)	PIN issuance
(4) Minutes of Executive Board Meetings	Public release w/redactions w/in 90 days	Embargoed for 30 years	<u>Options:</u> (a) If PINs above achieved, no need for further releases (b) Redacted summaries w/in 90 days (c) Release full minutes after 10 years.	(a) probably the maximum achievable; (b) a more remote possibility, but perhaps not impossible

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[1]Mostly as stated or implied conditions precedent from HR 3331 (Saxton-Armey bill), Gingrich-POTUS/Armey-RER letters, or HR 3580 (House Approps. Committee bill).

[2]May be able to achieve consensus among membership, given adequate investment of time and political capital at the Fund.

[3]PIN (Press Information Notice): As used here, per current Article IV policy, refers to a summary of the *Executive Board discussion* of the related issue or document, *not a summary of the document itself.*

SENSITIVE

Summary of IMF Transparency: Proposals, Policies, Possibilities

Category/Item	Proposed Reforms (Congress)	Current IMF Policy	Current or Proposed U.S. Position	Possible IMF Deliverable?
(5) Operational Budget	Public release (implicitly on regular, current basis)	Some liquidity info in annual report; country list not released.	Release liquidity data on regular basis (including U.S. share); release country list with 3/6-month lag (Proposed)	Release quarterly liquidity data (including U.S. share, released by Treasury)
(6) Audit of Financial Statements; more "user-friendly" financial disclosures.	Presumption that F/S are publicly audited, with corporate-like audit committee; general view that current F/S unclear or concealing	External audit firm does not sign F/S, audit committee is loosely institutionalized and accountable	(a)Release of signed, fully audited statements; (b) establish more permanent, functional committee accountable to Exec. Board; (c) improve format, readability, clarity of financial data. (Proposed)	Yes - (a) & (b) already in progress
(7) LOI's & PFP's (Policy Framework Papers)	(No specific proposals, but a general assumption toward mandatory release)	Voluntary release by borrower	Mandatory release (with narrow range of highly sensitive exemptions, e.g. intervention targets and identity of vulnerable financial institutions) (Current on mandatory release)	Presumptive release, with exemptions?

SENSITIVE

Summary of IMF Transparency: Proposals, Policies, Possibilities

Category/Item	Proposed Reforms (Congress)	Current IMF Policy	Current or Proposed U.S. Position	Possible IMF Deliverable?
(8) Independent evaluation of Fund operations	Various proposals, ranging from 182-member IMF advisory board to internal IBRD-like evaluation unit.	Selective, periodic external evaluations of specific policies	Support more systematic and more frequent external evaluations, beginning with immediate assessment of Asian crisis programs; presumption of public release of all reports. (Proposed)	Yes
(9) Non-IMF participation in field missions	Permit outside groups (NGO's, labor, etc.) to participate in IMF staff discussions w/governments	Not permitted; staff increasingly meets separately with local groups	Expand and regularize separate staff consultations with local groups (Proposed)	Yes
(10) Executive Board Reports to Interim Committee	(No specific proposals)	No public release in any form	Publish (Proposed)	Publish, perhaps in summary form?

1998-SE-008119

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

July 8, 1998

Recommended Telephone Calls

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: Linda L. Robertson
Assistant Secretary
Legislative Affairs & Public Liaison

FROM: Rick Sinkfield
Deputy Assistant Secretary

SUBJECT: Calls to Chairman Ted Stevens, Chairmen Bob Livingston and Sonny Callahan, Minority Leader Dick Gephardt and Rep. Dave Obey, regarding the deteriorating situation in Russia and Asia, particularly in Indonesia and the expected increase in multilateral assistance, and the ramifications for Congressional passage of the IMF.

DISCUSSION:

Chairman Stevens (224-3004): Chairman Stevens continues to firmly back the IMF and remains committed to keeping the full $18 billion in the Senate Foreign Operations bill. There is an outside chance that this bill could be marked up in the Subcommittee next week, July 16th. He will be very appreciative of receiving a debrief on your Asia trip, given his longtime interest in the region, particularly Australia and Indonesia. Note: there was a recent FT article describing the exceptional effects of the Asian crisis on New Zealand and Australia. He has also been a reliable prognosticator of the House Republican Leadership behavior, so you may want to share with him our best information for verification purposes.

Chairman Livingston (225-3015): Chairman Livingston is prepared to include the full $18 billion for the IMF in the Foreign Operations bill that he takes to the floor and is reviewing and vetting drafts this week. He believes that it is no less politically difficult to carry both requests than to split the NAB and the Quota. However, he is very concerned about the political ramifications that a new Russia program could cause, particularly in light of Armey/Saxton/Shultz/Sachs criticisms of the IMF role in Russia. He and his staff will be looking to us to assist them in defending IMF actions when the bill comes to the floor. With respect to the overall bill, he is receiving a high degree of criticism from the Democrats and the Administration about the overall funding levels and specific accounts (Egypt/Israel, etc.) **There were also wire reports today, suggesting that Mexico City has been delinked from the IMF. This could mean that it has been linked to fast track. You should definitely raise this issue with him.

Chairman Callahan (225-4931): The readout on Chairman Callahan is consistent with Rep. Livingston; however, he has tended to be more concerned about Indonesia than with Russia, because of his constituent interest.

Rep. David Obey (225-3365): You should apprise him of the situation in Indonesia and Russia. He has been one of the strongest supports of U.S. economic engagement in Russia. He is critical to keeping Democratic support for the IMF, since he will be the key Democrat in any future appropriations conference. You should seek his opinion on how we will fare with the Democrats in light of an expanded Indonesia program and an expanded Russia program. It would also be useful to reassure him that the Administration is not planning to abandon the Democrats over fast track. (We are proposing the D/S Summers meet next week with the Democrats that were assembled a couple of months ago to discuss Indonesia. You should raise this proposal with Mr. Obey. We believe that it makes sense for Mr. Gephardt or Mr. Obey or both to call the meeting.)

Minority Leader Gephardt (225-0100): You should apprise him of the situation in Indonesia and Russia and seek his counsel on how to manage these problems and relations with House Democrats. While there have been signs of weakening Democratic support and concerns raised by some Republican friendlies, we believe that Democrats are still the overwhelming core of support for the IMF. Nevertheless, we believe that Leader Gephardt has to be vigilant about keeping Dems in line, not only on the IMF, but also on important, tangential issues like possible amendments to the ESF.

The Habibie Government's Steps on Political Reform

While the political situation in Indonesia remains unstable and the economic situation is increasingly dire, the Habibie Government has taken initial steps toward making Indonesia a more democratic and open society. There is as of yet no consensus among key political players in support of Habibie's timetable for political reforms and elections (a general election in May 1999 and an Assembly session to elect a new president and vice president at the end of 1999), but Habibie and his government have taken a number of significant steps including:

Release of political prisoners

- Habibie has granted amnesty to or dropped charges against approximately 20 political prisoners including Muchtar Pakpahan, leader of the formerly banned Indonesian Prosperous Trade Union, political activist Sri Bintang Pamungkas, and 12 East Timorese indicted for anti-government activity. The GOI has pledged to review the cases of all other political prisoners.

Reform of political laws

- Habibie has called for redrafting of a number of the major political laws, including those affecting elections and the formation of political parties. New Parties are already forming freely. *

- The Ministry of Justice has formed a team to review the Anti-Subversion Law. The Justice Minister has publicly expressed his belief that the Law should be abolished. Indonesia's National Commission on Human Rights also supports its abolition.

- The Indonesian People's Consultative Assembly has set a date of November 10 for a special session to revise or repeal the "five political laws" governing political activity and to decide on a date for a general election.

- On June 25, the GOI launched a National Plan of Action to provide a five-year framework for national policies and strategies for promoting and protecting human rights. The actions of the Habibie government to date indicate that this could be more than mere window dressing.

- The GOI has announced its intention to ratify the United Nations Convention Against Torture. The GOI has also pledged to work toward ratification of the Convention on the Elimination of Racial Discrimination.

Labor Rights

- In addition to releasing Pakpahan and officially recognizing his labor union, on June 5 the Indonesian Government ratified the ILO Convention 87 governing the freedom of association and protection of the right to organize.

- In April, the Indonesian government indicated it would also ratify ILO Conventions 105 (on abolition of forced labor); 111 (on employment and occupational discrimination); and 138 (on minimum age of workers).

Political Debate/Press Freedom

- President Habibie has allowed a free political debate in the press and on TV. Previously banned publications have begun publishing again.

- There has been a sea change in the atmosphere for freedom of the press since Soeharto's departure. Political debate in the media has been lively and unfettered and has focused on many subjects previously off limits.

On East Timor

- Although there has been no major breakthrough on reaching a final resolution to the situation in East Timor, the Habibie Government has clearly distanced itself from many of the policies of the previous regime. A GOI proposal for broad autonomy for East Timor covering all areas except foreign policy, external security, and fiscal policy has generated serious discussion at the UN, in Lisbon, and among East Timorese leaders.

- The GOI has allowed increased access to (but has made no indication of its intent to release) imprisoned Timorese leader Xanana Gusmao, and Habibie has met with Bishop Belo.

- Although there have been three recent incidents in which security forces killed Timorese, the GOI has apologized, initiated investigations, and pledged to hold to account those responsible. We are continuing to press the GOI to undertake confidence building measures in the immediate term to improve the human rights and security situation on the ground for the East Timorese.

1998-SE-008664

Date:	20 July 1998
Note To:	Secretary Rubin Froman Lipton Geithner Atkinson Zelikow Flanders
From:	Deputy Secretary Summers
Message:	This was prepared at my request by the CEA. I think it is interesting.

Critiques of IMF plans and of the official response to the Asian crisis and counterarguments

Critique #1: Monetary policies (high interest rates) have worsened the crisis

Exponents and their arguments:

Exponents of this view are many (Sachs, Stiglitz, Feldstein, Portes-Ito, Wade, Mahathir, ...). The arguments are various:

1. Monetary policies of high interest rates have worsened the crisis. They have not prevented currency depreciation, have led to widespread banks and corporate bankruptcies and exacerbated the recession caused by the crisis. Because companies are now generally unprofitable and not paying corporate taxes, the net-of-tax interest rate has risen sharply.

2. While high interest rates were necessary at the onset of the crisis to slow down currency depreciations, the current credit crunch in the region is leading otherwise solvent companies to bankruptcy exacerbating the recession. There is a vicious circle at work: the credit crunch leads to further economic downturn; this in turn causes higher non-performing loans and higher credit risk; these in turn cause further retrenchment in credit supply that worsens the recession.

3. According to some critics, lowering interest rates will strengthen the economy and cause the currency to appreciate.

4. Some argue that since we are happy with very low interest rates in Japan, why shouldn't we prescribe the same for the rest of Asia?

Counterarguments:

1. In early stages of a currency crisis, only tight money and high interest rates can prevent a crisis and/or limit the amount of currency depreciation. Looser monetary policies would have led to further currency devaluations that would have been disastrous/contractionary given the large stock of foreign currency denominated foreign liabilities.

2. Part of the severity of the crisis was caused by the unwillingness of government to increase interest rates before the onset of the crisis and even after the currency crisis had started. For example, Malaysia kept its policy of low interest rates until the beginning of December, exacerbating the currency plunge.

3. The argument that lowering interest rates will cause the currency to appreciate, i.e. that there is a currency/interest rate Laffer Curve, is "as silly as it sounds" (quotation from Krugman 1998).

Also, for countries seeing their exchange rates in near free fall and with little reserves, there are not many options: increasing the interest rate is the only way to defend the currency.

4. One of the risks of reducing interest rates might be further currency depreciation that could have very harmful effects given the large size of currency denominated foreign debt. For example, the Korean won has recovered over 20% of its value since the bottom values in January and the Thai Baht has also partly appreciated. Do we want to jeopardize this?

5. Japan is very different from the rest of Asia because it is a rich country, is a very large foreign creditor and has large current account surpluses. Large devaluation driven by looser interest rate policies in Japan today - or in the UK and Italy in 1992 - did not have deflationary/recessionary consequences because these countries were either net international creditors and/or had a very small amount of currency denominated foreign debt.

Caveats:

1. It is harder to implement a successful reform of the financial system if there is a recession and interest rates are high. A credit squeeze can prevent solvent domestic firms from getting working capital and exploiting the export opportunities deriving from a currency depreciation. A possible solution: make sure that credit goes to solvent firms and/or subsidize borrowing by firms.

2. High interest rates are ineffective in stabilizing exchange rate if other policies are out of line and lead to a lack of credibility of the overall government policy; in this case high interest rates do not calm investors' expectations and may make things worse.

3. While a tight money policy at the beginning of the crisis was necessary, it is an important issue to see whether interest rates may be too tight right now. One would have to consider specific country circumstances to make such a judgement. There may be room for monetary easing now that currencies have stabilized. For example, the current view on Wall Street (JP Morgan, Morgan Stanley, Goldman Sachs) is that it is time to cut interest rates in the Asian region as a way to reverse the severe recession. According to Goldman Sachs, the current credit crunch afflicting the crisis economies is giving way to a vicious cycle: retrenchment in credit leading to further economic downturn leading to higher non-performing loans and credit risk leading to more retrenchment in credit supply.

4. Feldstein suggests reducing the net interest cost to business borrowers by requiring commercial banks to limit the interest rates on existing business loans to the rates that such firms paid in the spring of 1997. The government would then compensate the banks for capping interest rates in this way by expanding the government fund that is intended to recapitalize banks.

5. One should consider the potential benefits for Asia and the world economy of a global monetary expansion in the G-7 area. The U.S. may be going towards a period of very slow (or zero) growth for a couple of quarters. Also, there is a sharp slowdown in growth in the UK as

monetary policy is very tight now following renewed inflationary pressures; some easing in the UK may be warranted. Moreover, the recovery of growth in continental Europe is still shaky and Europe is running a very large current account surplus. So, as short-term interest rates converge to the same value by January 1, 1999, the common European interest rates should be kept closer to current German/French rates rather than ratcheted up. Finally, a monetary easing in Japan may be helpful for growth and will have less effects on the yen if it is part of a global monetary expansion. As currently the risks of a global slowdown (or outright global recession) are increasing, one should consider the potential benefits of a joint G-7 monetary expansion that will prevent a further worsening of the Asian crisis and the threat of a spread of the recession to the global economy.

Critique 2: Fiscal policy requirements in IMF plans have been too tight and worsened the crisis

Exponents and their arguments:

Sachs, Portes-Ito, Wade, several regional commentators, IIF.

1. Fiscal policy requirements in IMF plans have been too tight and unnecessary.

2. Asian countries had very low budget deficits (as a % of GDP) and very low public debt before the onset of the crisis, unlike typical IMF clients in past crises.

3. Also, during a recession, you want an easier fiscal policy to stimulate aggregate demand. Tight fiscal policy has made the recession worse.

4. A coordinated fiscal expansion would stimulate aggregate demand with no adverse external balance consequences.

Counterarguments:

1. Loose fiscal policies at the onset of the crisis would have made things worse by reducing the credibility of the policy makers. Fiscal tightening prevents a crisis or further currency drops once the devaluation has occurred. For example, Brazil avoided a run on its currency once a speculative attack occurred, by announcing a cut in the fiscal deficit equal to 2% of GDP.

2. While Asian fiscal deficits and debt were low before the crisis, the fiscal cost of bailing out the financial system will be in the 10 to 20% of GDP range in most countries; so the implicit public deficit anddebt was much larger than official figures. In fact, the implicit public liability deriving from the public bailout of the financial system (and it debt dervice burden effect on the deficit) became explicit when the financial systems collapsed and their liabilities were taken over and/or guaranteed by the governments. Even if one wants to smooth over time these bailout costs, the

extra burden of servicing this extra debt will be in the 1-2% of GDP range per year. Therefore, a primary adjustment of this size is necessary to prevent an explosion of the debt to GDP ratio over time. The IMF suggested that its fiscal requirements were exactly in the amount necessary to service these bailout costs.

3. The size and magnitude of the recessionary effects of the crisis were unexpected (at least by the country governments) and grew over time. It would not have been possible initially to persuade the countries of forecasts of negative growth. As the recession became worse in these countries the IMF progressively loosened its fiscal conditions to allow for countercyclical/ cyclically-adjusted fiscal deficits. The latest IMF plans allow for a fiscal deficit of 8% of GDP in Indonesia, 4% in Korea and 2% in Thailand.

4. Fiscal adjustment at the onset of the crisis was required to reduce the current account imbalances that could no longer be financed.

Caveats:

1. The IMF might have been slow in making its fiscal criteria more flexible; it eventually got it right but perhaps it did so too late. A recent IIF study suggests that the revision of fiscal targets downward might in part reflect the inadequate recognition by the IMF of the severity of the incoming recession; the author suggests that more explicit attention to cyclically adjusted fiscal targets would have been useful.

2. The solution to overcapacity in a crisis economy is unlikely to be contractionary fiscal policy.

3. One may want to consider the benefits of a coordinated fiscal expansion in the region. Already, countries such as Hong Kong, Singapore and China (less affected by the crisis) are moving in that direction. However, it would be a mistake to think that the external financing constraint disappears just because expansion is joint. Only a global fiscal expansion would allow the region to expand without hitting the current account constraint.

Critique #3: The IMF should 'stick to its knitting', not be too intrusive

Exponents and their arguments:

This critique was advanced by Martin Feldstein in his May/June Foreign Affairs article. The same arguments have been made by regional commentators resentful of IMF intrusion and imposition of structural changes in these countries' economic regime (the famous image of Camdessus menacingly standing over Suharto as he signed the IMF agreement). The argument is that the IMF should not impose major structural reforms (in financial markets, governance policy, labor markets, competition policy, trade liberalization) but should instead concentrate on its traditional macro adjustment (monetary and fiscal) tasks.

Counterarguments:

Note: Fischer replied to Feldstein in July/August Foreign Affairs.

1. Main counter-argument: the crisis in Asia was due to structural problems rather than traditional macro imbalance. Therefore, dealing with the crisis means addressing these structural problems. For example, structural weaknesses in financial sectors were a main determinant of the crisis (poor supervision and regulation following liberalization, implicit and explicit government bailout guarantees leading to moral hazard and large amounts of nonperforming loans, lack of transparency and disclosure, lack of incentive-compatible deposit insurance schemes).

2. Similarly, good governance (avoid crony capitalism, reform corporate governance, have more transparency and disclosure, create good bankruptcy laws, liberalize foreign direct investment policies) is crucial to avoid future crises.

3. This is a unique opportunity when it may be politically possible to make some of the reforms that Asia should have made anyway.

Caveats:

1. One may wonder whether it was important to stress changes in labor market laws, trade liberalization and competition policies in IMF plans. Were all the conditions of IMF loans really necessary to fix these countries? After all, labor market rigidities, competition policy problem and trade restrictions are often observed in many countries (including several advanced industrial economies). Note that the IMF has shown flexibility on these issues, e.g. in Indonesia, as economic conditions in the region have gotten worse.

2. Also, creditor countries should not use bailout packages to obtain **bilateral** trade and investment concessions that are not directly relevant to solving the crisis. There is a perception that the crisis has been used to unilaterally ram through concessions on many unrelated issues.

Counter-variant of the above critique: the IMF should be more intrusive

According to some misguided critics (especially in the Senate), the IMF is not intrusive enough, rather than too intrusive. They argue that IMF conditionality should include measures to safeguard labor standards, protect the environment, others to prohibit abortion. One could argue that these arguments are misguided as the conditionality test should be whether these measures are necessary to overcome the crisis countries' currency and banking problems. The above measures do not pass this test; financial reforms do.

Critique #4: IMF plans to close insolvent banks led to bank runs on solvent banks driven by sheer self-fulfilling panics; this led to the collapse of the financial system

Exponents and their arguments:

1. Sachs made this argument discussing the bank runs in Indonesia following the first IMF plan requiring the closing of 16 insolvent banks. Note also that an internal IMF document conceded that its requirement that 16 insolvent Indonesian banks be closed as part of the bailout plan partly backfired, as an unexpected run on the banking system occurred. The report, however, did not in fact imply that the IMF bore any responsibility for worsening Indonesia's crisis and the bank runs. It attributed most of the blame to President Suharto's government, which it strongly criticized for failing to enact promised reforms in exchange for the $40 billion international rescue effort.

2. This is not the first time an IMF order to close banks might have contributed to a panic. When some banks were closed early in the Mexican crisis in 1995, depositors also reacted by hastily withdrawing their money from many banks.

Counterarguments

1. You need good incentive-compatible deposit insurance scheme to avoid bank panics and runs on otherwise insolvent banks. The IMF is not at fault if such schemes were not in place.

2. If the IMF made an error, it was that it did not close enough banks, not that it closed too many. Initially only 16 out of 270 banks were closed. To restore confidence, you need to convince the public that all the bad banks have been closed and the remaining open ones are solvent. In Indonesia, the first batch of bank closing did not take care of all insolvent banks. In fact, 14 more banks were closed recently and, as early as September 1997, lists of unsound Indonesian banks were circulating widely and had more than 16 banks on them.

3. The prompt reopening of a closed bank owned by one of President Suharto's sons suggested to the public that the bank closure decisions were heavily affected by political considerations. This reduced the confidence of the public and led to the bank runs.

4. The requirements imposed on Indonesia by the IMF, including the closing of insolvent banks, are similar to those demanded of Thailand and South Korea, the other Asian nations that have needed enormous international bailouts in recent months. Neither of those nations appears to have experienced a bank run of the magnitude of the one that hit Indonesia.

5. Studies of bank restructuring (Dziobek and Pazarbasioglu, IMF 1998) suggests that countries that were the quickest to diagnose the problem, assess the losses and restructure their banking systems were generally the ones experiencing the better recovery patterns from the crisis. So, if there was an issue with bank closing it is that enough was not done, not that too much was done.

6. The case against closing banks is pretty weak. If some banks/financial institutions are insolvent and you let them continue operations you make things worse: a) moral hazard is exacerbated as

they will take bigger risks and gamble for salvation (take the extra money and gamble it); b) the public sector's cost of their eventual bailout becomes even larger. See the S&L crisis, the Japan banking crisis and many other episodes.

7. Not all bank runs are undesirable. Informed runs, where depositors shift funds from weak to strong banks, are a desirable element of the adjustment to banking problems.

Caveats:

1. While banks' cleanup and restructuring are good in the medium run, its short-run effects may be recessionary as credit squeezes may occur and resources have to be reallocated across sectors. In the case of Asia, such effects may be large as legal procedures and resources for cleaning up the banks are limited.

2. Also, otherwise solvent firm may now be suffering of a credit squeeze as the restructuring of the financial sector is occurring very slowly. Should policy makers try to help/subsidize firms that are otherwise solvent and now suffering of the effect of a credit crunch?

Critique #5: Need to step in to prevent banking disruptions and firm bankruptcies

Exponents and their arguments:

Feldstein, Wade, Stiglitz.

Policies of high interest rates, tight credit, banks and firms closing have worsened the crisis. They have led to widespread banks and corporate bankruptcies and exacerbated the recession caused by the crisis. When a crisis hits you need to help solvent institutions; otherwise you throw away the baby with the dirty water.

Counterarguments:

Many banks and firms were already insolvent before the onset of the crisis. For example, 8 out of the top 30 chaebols in Korea went bankrupt in the first half of 1997 before the won collapsed. Similarly, the Thai finance companies were bankrupt before the fall of the Thai Baht. And many Indonesian banks were insolvent before the collapse of the rupiah.

Counter-variant of the above critique: There is a need to step in to force closing of bad banks and raising of prudential standards and regulation

See responses to critiques #3 and #4 for elaboration of arguments in favor of this counter-critique. In essence you need to clean up banks and firms to guarantee a rapid recovery from the crisis.

Critique #6: Need to lean on Western banks and other investors to take more of a hit and bear the responsibility of their actions (moral hazard issue)

Exponents and their arguments:

Calomiris, Litan, Schultz-Simon-Wriston, Sachs, Schwartz, Meltzer, Hale, etc. Note that the goal of ensuring that the private sector takes full responsibility for its own decisions in order to reduce moral hazard is a mainstream view accepted by many, not just critics of the IMF (see the Birmingham Chairman Statement and the G7 Finance Ministers Report).

1. Many creditors (especially commercial banks) made very risky investments but were effectively bailed out by crisis countries' government guarantees of private debts and by IMF-led bailout plans. While the residents of the crisis countries suffer because of the severe recession, the creditors are being bailed out and do not bear a fair share of the burden of the crisis.

2. Hale: The U.S. did not play early on as effective a role in rescheduling Indonesian loans as it had in Korea. The IMF, by default, should have assumed such a role but it was reluctant to take responsibility for debt rescheduling ahead of the banks themselves. The result has been one of the most unnecessary economic tragedies in the modern era, the collapse of the Indonesian economy.

Counterarguments:

1. Many private creditors (especially bond-holders and equity investors) took a huge hit during the crisis. Only commercial banks were largely spared. Even the banks were partly hurt as several (e.g. Citibank or Chase) have large mortgage, loans and credits card operations in the region: the recession has hurt their profitability in these countries.

2. This issues has been recognized by US/G7/IMF and there is now a Halifax II process to develop ideas/reforms to help make sure that private creditors bear the costs of their decisions. The Birmingham Chairman Statement speaks explicitly of "ensuring that the private sector takes full responsibility for its own decisions in order to reduce moral hazard". So does the G7 Finance ministers Report.

3. Eventually creditor commercial banks (and other creditors) have been 'bailed in' in Korea as well as Indonesia. Orderly workouts of debt are already occurring. An early rescheduling of the Indonesian debts was not possible give the uncertainty about their size, the existence of a very large number of banks and corporate debtors and creditors. Only Halifax II types of reforms may be able to deal with the problem of orderly debt workouts in the presence of a large number of bondholders and debtors.

Caveats:

1. Already after Mexico and as part of Halifax I, proposals were submitted to address the creditors fair burden sharing issue but many of the proposals recommended in the Rey Report were not implemented. The risk is that the same might happen this time around. We should make sure that all the talk in Halifax II will lead to some substantial action; we should avoid another Asian crisis in the next few years.

2. Litan argument: the Fund and the U.S. government might have gone too easy on the banks. In the case of Korea, for example, foreign banks have demanded local government guarantees on bank loans before rolling them over, without forgiving any amounts due. To be sure, some of the banks have added modestly to their loan loss reserves to account for possible future writeoffs, while claiming to be charging interest rates that do not fully reflect the risk of the loans rolled over. Still, the new rates reportedly are higher than those the banks were previously charging.

3. The IMF should not wait until Halifax II reforms are approved; it should make rescheduling demands on private bankers and creditors when developing its programs. It cannot merely announce economic reforms and then depend on the private sector to respond positively.

4. Future crises may be even harder to solve without serious reforms of the international financial architecture; these reforms are becoming urgent. As the share of bonds in debtor countries liabilities grows, orderly workouts will become very hard to implement without serious changes in the nature of debt contracts and without changes in IMF policies towards arrears and debt standstills. Proposals to be seriously discussed are many. First, rewriting bond/loan contracts to: a. clarify the representation of investors (modify loan contracts to include collective representation clauses designating a trustee to speak for creditors or even form standing steering committees of creditors); b. permit a qualified majority vote to restructure lending terms (to prevent a minority from blocking a restructuring until it is bought out by other creditors or the debtor government); c. require the sharing of debt service payments (sharing clauses specifying that any additional payments obtained by a creditor would have to be shared with the entire class diminish the incentive for free riders to hold up a settlement). Second, encourage the IMF to consider lending before a government has reached an agreement with its creditors to clear away its arrears. Third, give the legal authority to the IMF to approve formally debt standstills.

Critique #7: Need to reduce US/G7/IMF role to reduce moral hazard

Exponents and their arguments:

Calomiris, Sachs, Feldstein, Schultz-Simon-Wriston, Meltzer, Vasquez, Wall Street Journal Editorial page, conservatives inside and outside Congress, etc. Note that the goal of avoiding the potential moral hazard problem of IMF packages is a mainstream view accepted by many, not just critics of the IMF.

1. Officials in debtor countries may take excessive risks because they know that the IMF will be

there to bail them out.

2. Because of the expectation of IMF bailouts, investors and creditors will not monitor their investments, will not appraise risks and are too willing to lend. A big moral hazard problem.

3. The IMF plans bail out wealthy investors in creditor countries.

Counterarguments:

1. To argue that countries will follow bad policies and inflict on themselves an economic crisis because they know that they will be bailed out by the IMF is a bit silly. Countries try to avoid to go to the IMF; politicians whose countries have a crisis are booted out of power. Also, conditionality gives incentives to policymakers to do the right thing. So, if there is a moral hazard problem deriving from IMF plans, it affects more the creditors than the debtors.

2. Many private creditors (especially bond-holders, equity investors and others who lent to banks and firms) took a huge hit during the crisis. By the end of 1997, foreign equity investors had nearly lost three-quarters of the value of their equity holdings in some Asian markets. Many Asian firms and financial institutions will go bankrupt and their domestic and foreign lenders will have large losses. Only commercial banks were largely spared. Even the banks were partly hurt as several (e.g. Citibank or Chase) have large mortgage, loans and credits card operations in the region: the recession has hurt their profitability in these countries. Also, in Korea the banks have been now bailed in and the same will happen in Indonesia.

3. This moral hazard issue has been recognized by US/G7/IMF and there is now a Halifax II process to develop ideas/reforms to make sure that the IMF does not systematically bailout countries experiencing a crisis.

4. The alternative of leaving countries and their creditors to sort out debt is not ideal. The experience from the interwar period and the 1980s is that such solutions take a long time and that countries that have undertaken them have been denied market access for a long time with serious costs in terms long-run growth. Mexico regained market access in a few months; same thing for Korea and, pretty soon for Thailand.

5. The IMF tries to help countries to avoid a standstill because of a fear of contagion. A standstill in one country, when markets are nervous, would be likely to spread to other countries and possibly other continents.

Caveats:

1. The response to Russia may make the moral hazard problem worse. Also, Pakistan may be another example of IMF-related moral hazard at work. Security risk arguments (nuclear bombs in Russia and Pakistan) and systemic risk arguments (possible contagion form Russia to Eastern

Europe) have been put forward to justify IMF bailout packages.

2. Already after Mexico and as part of Halifax I, proposals were submitted to address the IMF-related moral hazard issue. However, in 1997-98 we had again major IMF bailouts (Thailand, Indonesia, Korea and Russia). So, who is next? Pakistan? South Africa? It appears that the moral hazard problem is now worse than it was before. Also, some proposals recommended in the Rey Report were not implemented and the risk is that the same might happen this time around.

3. When are we going to let one country go without bailing them out, force them to declare a moratorium on external debt payments and let the market and the private sector arrange for a orderly workout? While a crisis period may not be the ideal time to do that, we cannot allow repeated bailouts to occur for the foreseeable future. Are we going to bail out Pakistan, Ukraine, South Africa, Romania, Brazil, India if a crisis occurs in these countries? When will we start to implement a policy of letting the private sector workout with a crisis country its private and public liabilities? It may be time to let one of these countries deal with a currency/financial crisis without IMF exceptional packages. Even if the IMF should intervene, the amount of its financial support should be limited and should not cover all the short-term debt service obbligations of these countries.

Critique #8: Need to be more sympathetic to measure that slow down capital (especially short-term forex bank inflows). Excessively rapid financial liberalization may be dangerous

Exponents and their arguments:

Sachs, Rodrik, Stiglitz and World Bank, Krugman, Wolf, Tobin, Mahathir, Wyplosz, Soros, etc.

1. Already 20 years ago Carlos Diaz Alejandro suggested that financial liberalization often leads to financial crash. Many episodes of currency crisis have been associated with a financial crisis that followed a period of liberalization. This is often the case when the financial system is weak.

2. Hot money can be highly destabilizing in a world where rumors, panic, fads may lead to very sudden and rapid reversals of capital flows even when there are not changes in fundamentals. Multiple equilibria are possible and an economy may be suddenly thrown in a bad attack equilibrium.

3. The speculative attack in Asia was not caused by fundamentals but by a sudden shift in expectations

4. Rodrik suggests that, in a large sample of countries, there is no correlation between capital account liberalization and economic growth. A liberal capital account is not necessary for successful economic performance.

5. Many point to the experiences of Chile, Colombia and Slovenia with capital controls on short-term inflows as a successful way to prevent short-term hot money inflows.

6. According to IIF data, the reversal of capital flows out of East Asia in 1997 was dramatic, over 11% of their GDP, and a large fraction of it was due to the sudden and dramatic reduction in banking flows.

Counterarguments:

1. Studies suggests that the attacks on Asian currency were due to fundamental problems, not irrational panic of speculators.

2. Danger that temporary capital controls will lead to more widespread capital controls.

3. The right solution is not to impose capital controls but rather make sure that the financial system is sound and well supervised/regulated. After all, severe speculative attack do not seem to occur or have devastating effects in OECD countries as they have stronger financial systems.

4. When the S&L crisis hit, no one in the US suggested that we should impose controls on capital flows from NY to California. The right solution was to fix the thrifts, regulate them and supervise them better. So why should we impose controls on inter-national flows when we do no impose them on inter-regional flows? As in the S&L crisis solution, emerging markets should have strong a financial system; in the medium run this is better than controls.

5. It has been argued that the Chilean controls on inflows have problems and/or are not responsible for the Chilean success. a) Very strong prudential supervision and regulation of the banking system, more than capital controls, explains the success of Chile. b) There are leakages in the system through trade credits. c) The policy favors big corporations at the expense of small and medium ones. d) Chile has recently suffered from pressures against its currency following the Asian crisis and is now phasing out the controls on inflows to stimulate capital inflows.

6. If the imposition of capital controls is anticipated (especially controls on outflows), it may lead to capital flight and actually cause an attack on a currency.

Caveats:

1. While in the medium/long run it is better to have a strong financial system that is well regulated/supervised, in the transition to this system some controls on capital and a slower liberalization may be better. So the suggested controls are only transitory.

2. The IMF appears to be quite open minded about this issue. It appears to have realized that financial liberalization and capital account liberalization may be dangerous when the financial system is weak. So they are speaking about the optimal sequencing of liberalization (Camdessus:

"liberalize capital account flows in a prudent and properly sequenced way that will maximize the benefits and minimize the risks of freer capital movements").

3. The G7 are quite open minded about the issue of controls as well. The G7 Finance Ministers Report statement at Birmingham about "helping countries to prepare for integration in the global economy and for free global capital flows" appears to sugest implicitly the need for sequencing carefully the liberalization.

4. Even Greenspan has effectively proposed measures to reduce the amount of volatile short-term interbank capital flows through restrictions on either the lending institutions and/or the borrowing ones (see his May 7 speech).

So there may be a growing consensus for some temporary capital controls and/or restrictions on short-term capital flows.

Critique #9: Need to allow for further currency depreciations

Exponents and their arguments:

Sachs, Feldstein.

1. We need further devaluations to stimulate the East Asian economies

2. The job was only half done. Larger devaluations would have allowed countries to reduce interest rates and avoid the credit crunch.

3. Only when countries' assets are properly valued (or even undervalued) will investors come back in.

Counterarguments:

1. Depreciation will make things worse (will cause stagflation) given the large amount of currency foreign debt. It also raises the costs of imported inputs for exporters.

2. The fact that East Asian exports have not significantly increased in spite of the large devaluations suggests that the contractionary effects of devaluation may be more important than the expansionary ones.

3. We cannot afford another round of "competitive devaluations".

4. Since inflation has not kept pace with the nominal devaluation, we have observed a significant real depreciation of the regional currencies. It is hard to argue that they are now overvalued in

real terms. Note also that even before the crisis, these currencies had not appreciated in real terms by large amounts.

5. Why not have lower interest rates and a greater devaluation? While this may be a possible tradeoff, the degree of devaluation of the Asian countries up to early 1998 was certainly excessive, both for individual countries and the system overall. So it is hard to argue that we need more depreciations.

Caveats:

While further devaluations may not be a good idea, a nominal and real appreciation (from the bottom levels of the winter) may also be bad and might have to be prevented. For example, the Korean won has appreciated by over 20% since its lows and this is hurting Korean export competitiveness. Of course, the appreciation helps the financial conditions of firms and banks that had heavily borrowed in foreign currency.

Critique #10: Monetary policy is currently too tight in Japan. An aggressive monetary expansion will lead to a resumption of growth in Japan.

Exponents and their arguments:

Krugman, Greenwood, recent WSJ Op-Ed pieces, some Japanese economists.

While nominal interest rates are very low in Japan right now, the country is stuck in a liquidity trap and households are not willing to consume. Fiscal policy is ineffective and even further tax cuts may just lead to extra private savings with no effect on aggregate demand. To induce households to consume and firms to invest, the Japanese monetary authorities should pursue an aggressive policy of monetary expansion leading to an increase in the expectations of inflation. Given that nominal interest rates are close to zero, such a policy will lead to negative real interest rates and stimulate demand.

Counterarguments:

1. A very expansionary monetary policy will lead to a rapid depreciation of the Yen and stimulate Japanese net exports. While this might be good for Japan, it would have two nefarious consequences:

a. The US bilateral trade deficit with Japan will become even worse leading to serious political consequences (strong protectionist pressures in the US). Japan should not get out of its recession through a beggar-thy-neighbor increase in external demand (expenditure-switch policy) but rather through an increase in domestic demand, driven by a fiscal expansion (expenditure-increasing policy).

b. A fall in the yen will cause panic in exchange rate markets in Asia and cause another round of stagflationary currency devaluations in the entire East Asian region; the risk is that even China and Hong Kong will devalue their currencies. The fall of the yen might also spread to other regions: the currencies of Russia, Eastern Europe and Latin America may be subject to speculative attacks. The currency markets in Asia already panicked in June before the joint US/Japan currency intervention. The same will happen if the yen starts to fall again. Further devaluation in the crisis countries in East Asia would be stagflationary because of the still very large burden of currency denominated foreign liabilities. We cannot afford another round of competitive devaluations in Asia; it will be highly destabilizing.

2. It is not obvious that, given the lack of confidence of Japanese households and firms, a inflationary monetary expansion will have the desired effect on private demand. It may just lead to capital flight and accumulation of inflation-proof foreign assets rather than spending on domestic goods.

3. The last time Japan played the game of actively stimulating inflation to depreciate the yen (1972-73), the consequences were disastrous as inflation exploded and Japan was then forced to implement a sharp monetary tightening in 1974 that caused a very sharp recession. In fact, the stagflationary effect of the 1973 oil shock was exacerbated by monetary policy mistakes before the oil shock. In 1972-72, Japan followed a policy of aggressive monetary expansion as a way to actively increase inflation and prevent further appreciations of the yen that had appreciated relative to the US dollar after the breakdown of the Bretton Woods system in 1971. This monetary policy "mistake" in 1972-73 (i.e. fight yen appreciation with an active pro-inflation policy) together with very accommodative wage settlements after the onset of the oil shock explains the "Wild Inflation" ["Kyoran Bukka"] of 1974 (over 30%). The monetary tightening in 1974-75 that followed this policy mistake led to a rapid fall of inflation at a cost of a very severe recession in 1974 and early 1975.

4. Japan should fix its financial system and its banks. The lingering structural problems of the financial system are one of the most important dragging forces on economic growth.

Caveats:

1. Krugman's reply to the Yen depreciation counterargument is as follows. "An inflationary policy is definitely a weak yen policy. So? The current fear is that if the yen goes, so will the yuan, and then there will be a free-for-all of competitive devaluations and collapsing confidence. Such fears cannot be completely discounted. In the short term, capital flows are indeed highly volatile, and if the 29-year-olds in London who rule the world think that something is true, for a few hours or days it is. But let's back up for a moment and ask about the fundamentals. Suppose the yen falls another 30 percent, and that non-Japan Asia devalues by 10-15 percent, keeping its effective rates more or less unchanged. Would that be such a catastrophe? Only if a decline in the dollar

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1998-SE-009016

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

July 31, 1998

ASSISTANT SECRETARY

Information

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Timothy F. Geithner TFG
Assistant Secretary (International Affairs)

SUBJECT: Summary of Pending Legislative Proposals on IMF Funding

As we near the August recess, with prior Senate floor action now foreclosed, I thought it would be useful to provide you with a summary of the key legislative provisions contained in the latest versions of the bills moving through the House and Senate. It is designed to serve as a basis for our further discussions on strategy during the final stages of the legislative process, beginning in September. The focus here is only on major features and issues of pending legislative language; there are other less problematic issues that we will continue to address at the staff level. Among those, especially in the House bill, is a myriad of overlapping and onerous reporting requirements that we will work to streamline and condense in conference; legislative staff have been generally receptive to this suggestion.

I. Senate

The FY98 Supplemental Appropriation for IMF, passed in March by 84-16 and providing the full $18 billion, has been added to the FY99 Foreign Operations Appropriations bill adopted by the Appropriations Committee on July 21 and is now awaiting floor action. This makes the supplemental fully conference-able with whatever IMF provisions emerge in the House's version of the FY99 Foreign Ops bill. To review the major features and outstanding issues in the Senate bill:

Conditions on Availability of Funds

There are no conditions on the NAB. Availability of funds appropriated for the quota increase is subject to certification by the Treasury Secretary that the G-7 has "publicly agreed to, and will seek to implement in the Fund," policies that require borrowing countries to (1) liberalize trade restrictions, at a minimum consistent with existing international agreements, and (2) eliminate the [pervasive] practice or policy of directed lending or provision of market-distorting subsidies. We will push in conference to add "pervasive," as indicated, which the House appropriators agreed to add to their latest language. As you know, we've had discussions with the G-7 on this language and are confident that a public statement to the required effect can be obtained if and when needed as a basis for certification.

Major Outstanding Issues

(1) "Micron" Language: As now drafted, the bill would require the Treasury Secretary to certify that no IMF resources have resulted "in any form" of support to a number of specified major industries, including semiconductors, in borrowing countries. Failure to certify would require the USED to oppose program disbursements, and annual certifications would be required. This is clearly unacceptable in both substance and scope (although we believe it was intended to apply to Korea only), as we have explained to staff. Numerous subsequent discussions with Micron have failed to satisfy their complaints and thus lay the basis for mutually agreeable language, so this is likely to be an item for final resolution in conference.

(2) Central Bank disbursement reports: The bill would require annual reports by the Secretary on "the direct and indirect institutional recipients" of IMF resources in borrowing countries, including "the institutions or banks indirectly supported by the Fund through resources made available by the borrower's Central Bank." We have informed staff that this is unacceptable and must be renegotiated in conference.

Other Notable Provisions

(1) Advisory Commission: Composed of at least 5 former Treasury Secretaries, this IFI Advisory Commission would report within 180 days on the IMF's future role, "if any," and on the merits of merger with the IBRD and WTO. An obvious vehicle for the George Shultz school of thought, this is likely to be amended in conference, and we have not protested too loudly.

(2) Bretton Woods Conference: Would require the President to call a conference of IMF, IBRD and WTO representatives to consider the "structure, management and activities" of the three institutions, including merger, and their capacity to contribute to growth, exchange-rate stability and crisis response. Also likely to be amended in conference, also not identified by us as a deal-breaker.

II. House

The full Committee's markup of its FY99 Foreign Ops bill, scheduled for July 22, was called off indefinitely (no action before September), but we know the language that was to be considered and it should lay the basis for later House action and/or conference, since most of it was reported by the Subcommittee after its July 15 markup. That bill contained an appropriation for the NAB only, but has authorization language for the quota increase (as well as NAB) and specifies conditions that would apply to the quota increase should it be appropriated at some point.

Conditions on Availability of Funds

Quota Increase: (1) The draft generally follows the Senate language on Treasury certification of G-7 agreement on IMF reforms, although it helpfully drops the Senate enumeration of G-7 countries, at our request, and adds "pervasive" to the lending condition requiring elimination of directed lending and subsidies. Unhelpfully, the Chairman of the Federal Reserve would be required to provide a joint certification. (The Fed is not thrilled, but will not protest.) It also adds a third lending condition, requiring the borrowing country to "guarantee nondiscriminatory treatment in insolvency proceedings between domestic and foreign creditors, and for debtors and other concerned persons." (The Senate language requires only that the U.S. "exert its influence" in the Fund to a similar effect.) While we see no major substantive objection to this new condition, except to "guarantee," which is impractically strong, we have cautioned that the issue has not been discussed with the G-7 and therefore could pose a serious problem and delay the quota increase.

(2) The draft retains, from the House Banking Committee bill, the Sanders-Bachus provision conditioning U.S. consent to the quota increase on a certification by the Secretary that "the investors and banks have made a significant contribution in conjunction with a financing package that, in the context of an international financial crisis, might include taxpayer-supported official financing." Staff knows this is unacceptable; fidelity to the Banking Committee bill has so far prevented the minority from acceding to its deletion, which is acceptable to the majority.

NAB: The bill would subject NAB availability to certification by the Secretary that certain new disclosure policies are in effect at the IMF, and would require that Congress enact legislation approving such certification. (It also requires certification on the IMF's interest-rate policy, but the language effectively describes cases that would be satisfied by the SRF.) While most of the specified disclosure policies were drafted with our input and describe reforms that we believe are achievable, we have informed staff that it is extremely unlikely that the Executive Board would adopt the changes in time for enactment this year, thereby delaying the NAB until next year, at the earliest. (This would also make the Congressional approval clause that much more problematic, separating it from the larger bill and giving Congress greater potential leverage later.) The required policy changes are:

- Within 3 months of meeting dates, the IMF must publish summaries of Executive Board meetings on Letters of Intent, Policy Framework Papers, Article IV's and changes in general IMF policy, with redactions for national security, market-sensitive and proprietary information.

- Within 3 months of related Executive Board meetings, the IMF must publish Letters of Intent and Policy Framework Papers, with the same redactions as above.

Other Major Issue

ESF: The bill would require the Secretary to notify Congress 36 hours in advance of any ESF disbursement as part of an IMF-led stabilization effort. We've informed staff of our strong objections to any restrictions on ESF flexibility, both on substantive and procedural (i.e.

germaneness) grounds.

Other Notable Provisions

(1) Advisory Commission: Similar to the Senate's, but requires only 2 former Treasury Secretaries and limits total membership to 8. It would also report within 180 days, but its mission is stated more broadly than the Senate Shulz-oriented provision.

(2) International Advisory Committee: Requires the USED to use voice and vote to establish a permanent advisory committee to the Interim Committee, consisting of elected members of the national legislatures of the 5 appointed chairs (US, Germany, France, UK, Japan). This is reportedly a suggestion of Speaker Gingrich.

cc: U/S Lipton
A/S Robertson