ANALELE ŞTIINŢIFICE ALE UNIVERSITĂŢII „ALEXANDRU IOAN CUZA" DIN IAŞI
Tomul LVI Ştiinţe Economice 2009

REDEFINING THE ROLE OF INTERNATIONAL MONETARY FUND IN THE LIGHT OF THE CURRENT ECONOMIC AND FINANCIAL CRISIS

Gheorghe VOINEA*, Sorin Gabriel ANTON**

Abstract

By any measure, the current economic recession is the worst since the 1930s. The unprecedented global financial and economic crisis that started in 2007 has had a profound impact on the work of international financial institutions. The reform of the international financial system represents an important topic nowadays. The paper proposes far-reaching reforms of the International Monetary Fund in order to address the global financial crisis. The paper analyses reforms covering following areas: lending framework, the IMF's lendable resources, creation of a new international reserve currency, enhanced surveillance, and governance.

Key words: International Monetary Fund, reform, financial crisis, developed countries, lending framework.
JEL classification: F02, F33, G01.

1. Introduction

Before the onset of current economic and financial crisis in 2007, in the financial literature there was an ongoing debate on the **declining role of IMF** in a world of increasingly free capital mobility where the financing needs of more and more developing countries were covered by capital markets. Many authors suggested that the IMF has lost its relevance in the last years. Stiglitz considered that IMF "has failed miserably in its mission to stabilize international financial flows, arguably making matters worse" [Stiglitz, 2003, 54]. Dieter argued that during the last two decades, the World Bank and the International Monetary Fund proved to be unable to provide sufficient stability [Dieter, 2004, 54]. The governor of Bank of England, Mervyn King, observed that "the Fund's remit is unclear. Its lending activities have waned, and its role in the international monetary system is obscure" [King, 2006]. Jean Pisani-Ferry argued that the IMF has not been able effectively to exercise its mission to "oversee the international monetary system in order to ensure its effective operation" [Pisani-Ferry, 2008, 4].

Griffith-Jones and Ocampo identified three transmission mechanisms of the financial crisis from developed to developing countries: remittances, private capital flows (volumes

* **Gheorghe VOINEA**, PhD, Professor, "Al. I. Cuza" University of Iasi, Faculty of Economics and Business Administration.

** **Sorin Gabriel ANTON** (sorin.anton@uaic.ro), PhD, Assistant Lecturer, "Al. I. Cuza" University of Iasi, Faculty of Economics and Business Administration.

and associated costs of such flows) and trade [Griffith-Jones and Ocampo, 2009, 1-8]. As the withdrawals of private capital flows from the developing countries advance, the need for financial assistance is rising again. In this context, IMF is regaining its **key role in providing conditional financial assistance** to countries hit by the global financial crisis.

2. Financial literature regarding the IMF's reform

From the beginnings in the 1940s through to the present day there have been numerous calls for reform of the International Monetary Fund. Exchange rates and convertibility, the IMF role as international lender, the lending policies and its key role in international monetary management have been subject of controversy over a long time [Ingham, 2004, 278]. Many voices from the developing countries openly questioned the sincerity of IMF advice and the structure of its governance [Pisani-Ferry, 2008, 1].

Joseph Stiglitz criticized the role played by the IMF in the currency crisis of the 1990s in Argentina, Eastern Asia, and Russia. In his book, *Globalization and its Discontents*, he proposed reforms covering following areas:

a) the IMF should disclose the poverty and unemployment impact of its conditionality requirements;

b) the IMF needs to pay more attention to improve the safety nets in vulnerable countries;

c) the IMF should deal with financial crisis through bankruptcy instead of bailout of creditors;

d) the responses to financial crisis in developing and transition economies have to be placed within the social and political context of these countries [Ingham, 2004, 278-279] .

Griffith-Jones and Ocampo considered that there are three essential reforms of the IMF: i) the creation of a meaningful and truly global reserve currency, ii) the need to place the IMF at the center of global macroeconomic policy coordination giving greater voice to developing countries; iii) the need for the IMF to lend during balance of payments crises rapidly, at sufficient scale, and without overburdening borrowers with conditionalities of the past, particularly when the sources of the crisis are exogenous [Griffith-Jones and Ocampo, 2009, 3].

3. Reform agenda

3.1. Reform of the lending framework

The IMF has implemented in the last two years a series of reforms that modernized its operations and strengthened its lending framework. In march 2009, the IMF Executive Board has approved a major **overhaul to the Fund's lending framework** by:

- enhancing the flexibility of the Fund's traditional Stand-By Arrangement (SBA),
- modernizing IMF conditionality for all borrowers,
- introducing a new Flexible Credit Line (FCL),
- doubling access limits for nonconcessional resources,
- adapting and simplifying cost and maturity structures for its lending, and
- eliminating facilities that were seldom used [„IMF Overhauls Lending Framework", 2009].

In the last year, the Central and Eastern European(CEE) economies have been hit very hard by the deep and protracted slowdown of the world economy. The combination of falling export prices, rising import prices, falling demand from trading partners (especially form the European Union), relatively low foreign exchange reserves compared with high external debt levels, and *reduced access to international financial markets* are expected to weaken growth prospects for the CEE countries. Taking these developments into account, the overall financing needs of these countries for the next two years are large. In order to address the financial gap of these countries, the IMF and other financial institutions have provided external financial support. Table no 1 describes the loans granted by the IMF to the CEE countries since October 2008. All these Stand-By Arrangement entail **exceptional access** to IMF resources and were approved under the Fund's fast-track Emergency Financing Mechanism procedures, which enable rapid approval of IMF lending to its member countries.

Table no. 1 - Loans from international financial institutions for the countries from Central and Eastern Europe granted since October 2008 (US$ billion)

Country	**Amount (from IMF)**	**Other lenders**	**Date of approval**	**Instrument/Period of time**
Ukraine	US$16.4 billion	-	November 5, 2008	Stand-By Arrangement, 24 months
Hungary	US$15.7 billion	EU and World Bank	November 6, 2008	Stand-By Arrangement, 17 months
Latvia	US$2,35 billion	EU, EBRD, WB and other bilateral creditors.	December 23, 2008	Stand-By Arrangement, 27 months
Belarus	US$2.46 billion	-	January 12, 2009	Stand-By Arrangement, 15 months
Serbia	US$530.3 million	-	January 16, 2009	Stand-By Arrangement, 15 months
Romania	US$17.1 billion	EU, WB, EBRD, EIB, IFC	May 4, 2009	Stand-By Arrangement, 24 months
Serbia	US$4 billion	-	May 15, 2009	Stand-By Arrangement, 27 months
Poland	US$20.58 billion	-	May 6, 2009	Flexible Credit Line, 12 months

Sources: [IMF, 2009]

In many cases, the large external financing suport has been provided jointly by the International Monetary Fund,the European Union, and the World Bank. For example, in the case of Romania, the total international financial support package will amount to €19.9 billion (about US$26.4 billion), with the European Union providing €5 billion (or about US6.6 billion), the World Bank €1 billion (or about US$1.3 billion), and the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the International Finance Corporation (IFC) a combined €1 billion (or about US$1.3 billion). The Stand-By Arrangement entails exceptional access to IMF resources, amounting to 1,111 percent of Romania’s quota.

One of the key objectives of the IMF-supported economic program aims to maintain adequate liquidity and strong levels of capital in the banking system. As a result of the global financial crisis, the banks from Central, Eastern and South-Eastern Europe face sharply slowing economic growth, tough external financing conditions, higher risk aversion, and a tense liquidity situation [Deutsche Bank Research, 2008, 1]. Due to the high ratio of FX-denominated credits (e.g. in the Baltics, Ukraine, Hungary and Romania), the strong FX depreciation represents an important challenge for the Central, Eastern and South-Eastern European banks. In 2008 and 2009 credit slow down sharply due to the local and foreign funding constraints. The main sources of external bank funding (international bond issuance, syndicated loans, and parental intrabank funding) have declined in the last twelve months.

In the last months the Fund's traditional Stand-By Arrangement have proved to be more flexible, with fewer conditions than before and tailored to the individual country needs. The high access precautionary Stand-By Arrangements with Central and Eastern European countries approved in the last months are good examples of more flexible IMF lending.

Because the sources of the crisis are mainly exogenous for the developing economies and their impact is very profound, the IMF should create new facilities or rethink the ***conditionalities of the existing facilities***.

In octomber 2008, the International Monetary Fund approved the creation of the **Short-Term Liquidity Facility** (SLF) dedicated to strong-performing members countries which are facing temporary liquidity issues in capital markets. According to the IMF, the purpose of this decision is to establish a "facility through which large, upfront, quick-disbursing short-term financing, using existing IMF resources, can be provided to countries with strong policies and a good track record, but which are facing temporary liquidity problems arising from developments in external capital markets" ["IMF Creates Short-Term Liquidity Facility for Market-Access Countries", 2008]. Several features of SLF – such as its capped access and short repayment period, as well as the inability to use it on a precautionary basis-limited its usefulness to potential borrowers and thus the SLF have been canceled in 2009.

The lack of a sufficiently large and attractive **precautionary** facility in the IMF's lending framework has been considered a major weakness in the global financial system. In order to address this issue, the IMF has established in March 2009 a new facility - **Flexible Credit Line** (FCL), which grants access to large amounts of rapid financing for emerging market economies with sound policies that are well integrated to global financial markets and that are facing contagion from external events outside their control. Once a country has been approved for the IMF'S FCL, disbursements are not phased or conditioned to undertake pre-agreed policy measures or meet policy targets. The access to this new credit line is particularly useful for *crisis prevention purposes*. To date, Colombia, Mexico, and Poland have been provided credits totaling US$ 78 billion. This new facility is considered to be "the biggest change in how the IMF interacts with its members since the end of Bretton Woods" [Lipsky, 2009, 30].

Comparing with Short-Term Liquidity Facility (SLF), the FCL is more flexible in many ways. According to the IMF, the FCL's flexibility includes:

- assuring qualified countries of large and upfront access to Fund resources with no ongoing (ex post) conditions;
- renewable credit line, which at the country's discretion could initially be for either a six-month period, or a 12-month period with a review of eligibility after six months;
- longer repayment period (3¼ to 5 years versus maximum rollover period of 9 months in the SLF);

- no hard cap on access to Fund resources, which will be assessed on a case-by-case basis (the SLF had a cap on access of 500 percent of quota); and
- flexibility to draw at any time on the credit line or to treat it as a precautionary instrument (which was not allowed under the SLF) ["IMF Overhauls Lending Framework", 2009].

Low-income countries may borrow from the IMF at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF) and the Exogenous Shocks Facility (ESF). As part of the reform package, the IMF has restructured the Exogenous Shocks Facility, which was established in 2006 in order to help low-income countries cope with exogenous shocks. As a result, ESF is providing now financial assistance more quickly, in larger amounts and in streamlined conditions to support member countries deal with different events such as commodity price volatility, natural disasters, and conflicts and crises in neighboring countries that disrupt trade.

The Group of Twenty leading economies (G-20) agreed on April 2, 2009 to double money for concessional lending to low-income countries over the next 2 or 3 years. Furthermore, the International Monetary Fund has doubled the maximum size of the "normal" loans under the poverty reduction and growth facility (PRGF) and exogenous shocks facility (ESF) in accordance with the size of global shocks hitting these economies.

Another facility that have been reconsidered is the **Compensatory Financing Facility**, which was established in 1963 to support member countries cope with temporary export shortfalls caused by exogenous shocks. In the last years this facility has been modified several times by broadening its coverage. Given the very tight conditionalities, this facility has not been used since the modifications introduced in 2000. In March 2009, the Executive Board of the International Monetary Fund decided to abolish the Compensatory Financing Facility, the Supplemental Reserve Facility, and the Short-Term Liquidity Facility.

3.2. Supplementing the Fund's resources – condition for combating the current economic and financial crisis

In the last twelve months, the problems implied by the current financial crisis has led to a rapid increase in the demand for IMF financing. As a consequence, the Group of Twenty leading economies (G-20) agreed on April 2, 2009 to triple the IMF's regular lending capacity from $250 billion to $750 billion and to double money for concessional lending to low-income countries. There are three different ways to increase the IMF's lendable resources ["How to Increase the IMF's Lendable Resources", 2009]:

1) through bilateral borrowing agreements with members;
2) through enlargement of the multilateral New Arrangements to Borrow (NAB);
3) through placing notes in the official sector. Recently, the Executive Board of the IMF approved a framework for the issuance of notes to member countries and their central banks. Some developing countries (China, Brazil, and Russia) have already announced their intention to buy new IMF notes for a total of US$70 billion.

The global financial stability net will be broadened through a new general allocation of Special Drawing Rights (SDRs) for a total of US$250 billion, that will be distributed among all 186 IMF's member countries according to their quota. Even if this amount of money is quite small comparing with global liquidity, it may have an important impact on international reserves for emerging market and low-income countries [Lipsky, 2009, 31].

3.3. Creation of a (new) international reserve currency

Another important point in the reform's agenda consist in the creation of a (new) international currency that should replace currencies such as US dollar in countries's official reserves. This reform is more and more called by the developing countries - especially the BRIC countries (Brazil, Russia, India, and China) – whose importance in the world economy has increased significantly in the last years. For example, the People's Bank of China noted in the last annual report on financial stability that „to avoid the shortcomings of sovereign credit currencies acting as reserve currencies, we need to create an... international reserve currency that can maintain the long-term stability of its value“ [“Financial Stability Report 2009”, 2009].

In our opinion, a meaningful and truly global reserve currency should rely on the Special Drawing Rights (SDRs), the synthetic currency developed by the IMF. A super-sovereign reserve currency would overcome the inequities and the instability that are inherent in a global system reserve based on a national, or a few national currencies [Ocampo, 2007, 1].

3.4. Enhanced surveillance

In order to strengthen its oversight role, the International Monetary Fund has announced new priorities for its *surveillance of global and national economies*. According to the Statement of Surveillance Priorities, there are:

- economic priorities that show the key challenges to external stability facing the IMF membership that surveillance should help address;
- operational priorities that identify concrete actions the IMF should take to address these challenges and provide a clear benchmark to monitor performance [“Keeping a closer watch”, 2008, 3].

Table no 2. Surveillance priorities at a glance

Economic priorities	
	Resolve financial market distress
	Strengthen the global financial system
	Adjust to sharp changes in commodity prices
	Promote the orderly resolution of global imbalances
Operational priorities	
	Risk assessment
	Financial sector surveillance and real economy–financial sector linkages
	Multilateral perspective
	Analysis of exchange rates and external stability risks

Sources: [“Keeping a closer watch”, 2008, 3].

In collaboration with the Financial Stability Board (FSB), the IMF is developing an **Early Warning Exercise** with the aim to assess vulnerabilities to unexpected shocks and to draw connections to global and systemic risks.

In its efforts to increase the effectiveness and scope of its bilateral and multilateral surveillance, the IMF is trying to strength the Financial Sector Assessment Programs (FSAPs), concentrating more closely on cross-border and systemic issues. The new FSAP is aimed to be more flexible, targeted, and better integrated with macroeconomic surveillance. On the other hand, a better and expanded surveillance is restricted by the influence of big countries (the USA, the EU or China) and by doubts about the adequacy and legitimacy of IMF advice. A step forward will be the enhancement of FSAP over the developed countries (i.e., the US).

The current financial crisis has demonstrated that crises are inherent in deregulated financial system. The inadequate regulation and supervision of banks and financial markets represent major causes of the current financial crisis. In this regard, there is a growing consensus that more comprehensive and effective financial regulation is needed. One important challenge for the IMF in this area is the **oversight of capital market regulation** reforms. This new IMF's task represent a priority on the agenda for global financial reform.

3.5. Strengthening the Governance of the International Monetary Fund

One of the key issue on the reform agenda is the strengthened governance of the International Monetary Fund. In order to exercise its missions effectively, the IMF should be considered representative for all countries and have greater legitimacy. In this regard, the governance reform should focus on quota increase for emerging market and low-income countries, given their growing role in the world economy. Reforms on quota and voice agreed in April 2008 stipulates that 54 member countries will receive a growing quota, a first step in the effort to create a decision-making structure that reflects current global realities. A second round of quota reform is scheduled for January 2011 at the least.

4. Conclusions

After a period of unrestricted access to cheap private capital flows, the emerging market and low-income countries are facing nowadays financing gaps. Given the severe crisis of confidence in financial markets, the financing needs of more and more developing countries can not be covered by using traditional financial instruments. In order to address the financial gap, these countries have turned to the IMF and other international financial institutions for financial support and assistance.

In the light of the current economic and financial crisis, the IMF is redefining its role in a world economy that is facing profound economic changes. The IMF lending policies have become more flexible as in the past, with fewer conditions and better tailored to individual country needs. The increase of IMF's loanable resources to an unprecedented US$750 billion and lending reforms will give to the IMF the possibility to play a larger role in tackling the ongoing global crisis to the benefit of all its members. In the same tine, new reforms are expected in the area of governance, international currency reserves and surveillance.

References

Deutsche Bank Research, *Eastern Europe: Tough times ahead* in „Credit Monitor East Europe“, 2008, at https://www.dws-investments.com/EN/docs/market-insight/tough_times_ahead.pdf, accessed on July 10, 2009.

Dieter, H., “The International Monetary Fund and the World Bank. In need of a better performance?”, *Asia Europe Journal*, Springer Verlag, No.2/2004, pp.109-120.

Griffith-Jones, S., Ocampo, J.A., “The financial crisis and its impact on developing countries”, International Policy Centre for Inclusive Growth, Working paper, 53/2009.

Ingham, B., *International Economics. A European Focus*, Pearson Education, Harlow, 2004.

Kato, T., “The IMF’s Response to the Global Crisis”, Remarks at the Eighth Annual Regional Conference on Central America, Panama, and the Dominican Republic Antigua, Guatemala, June 25, 2009, at http://www.imf.org/external/np/speeches/2009/062509.htm, accessed on July 24, 2009.

King, M., “Reform of the International Monetary Fund”, Speech at the Indian Council for Research on International Economic Relations (ICRIER), New Delhi, 20 February 2006, at http://www.bis.org/review/r060222a.pdf, accessed on July 22, 2009.

Lipsky, J., “Preparing for a Postcrisis World”, Finance & Development, June 2009, pp. 29-31.

Ocampo, J.A., “The Instability and Inequities of the Global Reserve System”, International Journal of Political Economy, Vol. 36, No. 4, 2007.

Pisani-Ferry, J., “Will the crisis trigger a revival of the IMF?”, Bruegel Policy Contribution, 2008.

Serra, N., Stiglitz, J.(editors), *The Washington Consensus Revised*, Oxford University Press, Oxford, 2008.

Stiglitz, J., “Dealing with Debt: How to Reform the Global Financial System”, Harvard International Review, Vol. 25, 2003, 54-59.

Stiglitz, J., Globalization and Its Discontents, W.W. Norton & Company, 2002.

Voinea, Gh., Mecanisme şi tehnici valutare internaționale, Sedcom Libris Publishing House, Iasi, 2004.

***, *IMF Overhauls Lending Framework*, at http://www.imf.org/external/np/sec/pr/2009/pr0985.htm, accessed on July 12, 2009.

***, *IMF Overhauls Nonconcessional Lending Facilities and Conditionality,* at http://www.imf.org/external/np/sec/pn/2009/pn0940.htm, accessed on January 12, 2009.

***, *A Changing IMF—Responding to the Crisis,* at http://www.imf.org/external/np/exr/facts/changing.htm, accessed on July 12, 2009.

***, “Keeping a closer watch”, Finance and Development, December 2008, p.3.

***, *How to Increase the IMF’s Lendable Resources*, at http://www.imf.org/external/np/exr/facts/imfresources.htm, accessed on July 12, 2009.

***, *IMF Creates Short-Term Liquidity Facility for Market-Access Countries*, at http://www.imf.org/external/np/sec/pr/2008/pr08262.htm, accessed on July 9, 2009.

***, *Financial Stability Report 2009*, People’s Bank of China, 2009.