THE IMF'S RESPONSE TO THE GLOBAL FINANCIAL CRISIS

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June 30, 2009

Overview

- IMF's Response: multi-faceted, comprehensive and continuing
  - **Economic Forecaster**
  - **Policy Advisor**
  - **Economic Monitor/Surveyor – early warning system**
  - **Global Lender (EMEs and Advanced Economies)**
  - **Provider of Help to Low-Income Countries**
  - **Booster of World Liquidity**

Overview

- Presentation focuses on last three of these roles:
  - *How is the IMF making financing and liquidity available to members in response to the crisis, and how is it ensuring its ability to be able to continue to do so?*
- Presentation also touches on possible governance reforms:
  - *How is IMF considering enhancing its institutional arrangements so as to ensure its ability to most fully and comprehensively meet the needs of its members?*

Overview

I. Revamping Lending Toolkit for EMEs/Advanced Economies

II. Redesigning Toolkit for Low-Income Countries

III. Increasing IMF Resources Available for Lending

IV. General Allocation of Special Drawing Rights (SDRs)

V. Overview of Governance Proposals

I. Revamping General Lending

Motivation

- Fund should be first port of call, but it was not
  - Empirical evidence of benefits of early Fund engagement both for crisis prevention and crisis resolution
- Why avoidance of Fund?
  - Stigma, especially with strong performing EMEs
  - Ineffective crisis prevention instruments
  - Small-scale and back-loaded financing
- Reform efforts began pre-crisis, but crisis provided further impetus for reform
- Implication: Need for fundamental rethink of lending framework, and for swift change in light of the crisis

I. Revamping General Lending

Summary of Reforms:

- *Streamlined toolkit with two flexible windows:*
  - Flexible Credit Line (FCL) for strongest performers
  - Enhanced SBA for all members
- *Conditionality tailored to members' characteristics:*
  - "Ex ante" conditionality for strong performers
  - Review-based conditionality: elimination of structural performance criteria for all lending (including under concessional windows)
- *Increased lending limits/simplified access framework*
- *Streamlined, more incentive-based pricing*

FCL—Key Features

- Large financing to qualifying members, all of which is available upfront
- No cap on access (but not expected to exceed 1000 percent of quota)
- Flexibility to draw credit line or treat it as precautionary (all FCLs so far precautionary)
- Qualification: Very strong economic fundamentals and policies, and sustained track record of implementing very strong policies
- No conditions after approval (e.g., compliance with policy targets)
- Renewable arrangements, 6 months or 1 year (with mid-term review)
- Maturity 3 ¼ to 5 years, as for standard stand-by arrangement

I. Revamping General Lending

- Vision:
  - *More flexibility in IMF's lending tools combined with streamlined conditionality and lending terms to help Fund respond more effectively to the diverse needs of its members. This, in turn, helps members to weather better the global financial crisis and return to sustainable growth*
- Results:
  - *Three FCL arrangements approved to date, to Mexico, Poland and Columbia, with total commitment of $77 billion*
  - *Total Fund approved non-FCL credit commitments in the neighborhood of $50 billion*

II. Revamping LIC Lending

Background

- *Many LICs facing deep macroeconomic distress from 2008 food/fuel price shocks, plus current crisis*
- *Result: significant increase in demand for financing*
- *Poverty Reduction and Growth Facility remains key tool*
- *Reforms to Exogenous Shocks Facility in late Fall 2008*
- *Access limits doubled Spring 2009*
- *Increasing Diversity Among LICs*
- *G-20 Call for $6 billion of additional resources for LICs*

II. Revamping LIC Lending

Remaining Reform Agenda

- Laid out in earlier papers, endorsed by the Board; final decisions expected summer
- Concessional stand-by arrangement for LICs that are no longer facing protracted BOP problems, but have short-term financing needs
- More flexible and quick-access concessional financing options for LICs with urgent needs, including fragile states
- Increased concessionality for all IMF LIC lending; possibility of temporary interest suspension for very poorest members
- Securing additional resources from combination of new bilateral contributions plus redirecting of various sources of IMF funds
    - Recently passed U.S. legislation calls for certain actions by administration related to use of IMF resources to secure concessional assistance to LICs

II. Increasing IMF Resources

Background

- Increased demand for financing causing strain on general resources
- IMF is quota-based institution: can lend only to extent it has usable quota resources (total approximately $250 billion)
- Articles of Agreement authorize IMF to borrowing when this is necessary to replenish its holdings of currency
  - Fund has in the past relied on this power to borrow in the face of increased demand for financing; sometimes bridge to quota increase
  - Current standing borrowing agreement (NAB) provides $50 billion
- G-20 Summit: bilateral lending of $250 billion, to be incorporated into an expanded and more flexible NAB increased by up to $500 billion
  - Market borrowing to be considered if necessary
- IMFC backed proposals at its Spring 2009 Meetings

III. Increasing IMF Resources

- Step One: Increase bilateral lending
  - Negotiations underway for traditional loan agreements
  - Proposal also is now pending before Executive Board to approve first-ever issuance of notes by IMF
    - Notes of interest to BRICs and possibly other members
    - Legal form different; substantive terms similar to Fund loan agreements
- Step Two: Negotiate and conclude expanded and more flexible NAB
  - Expansion to increase membership, plus amount, per G-20 call
  - Amendment to make NAB more flexible, also per G-20

III. Increasing IMF Resources

- Sample Bilateral Commitments
  - Japan: $100 billion
  - European Union: Euro 75 billion ($100 billion)
    - Discussions regarding template for bilateral agreements, followed by bilateral negotiations with individual EU members
  - Switzerland: $10 billion
  - Canada: $10 billion
  - Norway: 30 billion Kroner ($4.5 billion)
  - China: $50 billion (notes)
  - Brazil: $10 billion (notes)
  - Russia: $10 billion (notes)

IV. General Allocation of SDRs

<u>Background</u>

- SDR is international reserve asset created by IMF in 1969 to support Bretton Woods system of fixed exchange rates
  - Two previous general allocations: SDR 9.3 billion (1970-72); SDR 12.1 billion (1979-81)
- General allocations made to IMF members in proportion to quotas:
  - SDRs held by a member forms part of its reserve assets
  - SDRs can also be used by IMF members to obtain freely usable currencies from other members
  - Reserve asset character derives from commitment of members to hold/accept SDRs and honor the obligations underlying the SDR system
- SDRs are not claim on the IMF; SDRs allocated to members are not assets of IMF; participation in SDR Department is not required for IMF membership

IV. General Allocation of SDRs

- G-20 Summit: Agreed to support a general allocation of SDRs equivalent to $250 billion to increase global liquidity
  - Of which $100b to EMEs and developing countries (based on quotas)
  - Aggregate SDRs currently outstanding: SDR 21.4 billion (approx $40 billion)
- Requirements for general allocation:
  - Finding of long-term global need to supplement existing reserve assets
  - To be done in a manner that will promote IMF's purposes
  - Must also avoid stagnation and deflation as well as excess demand and inflation
  - Approved by IMF Board of Governors based on proposal of Managing Director concurred in by the Executive Board
- Formal Executive Board concurrence contemplated for July; Board of Governors decision possible in early August
- Allocation could be effected by end-August

IV. General Allocation of SDRs

- G-20 also called for urgent ratification of Fourth Amendment of IMF Articles, which provides for special one-time allocation of SDRs

- Fourth Amendment:

  - Proposed in 1997 to address “equity” problem: many members (currently 41) joined after 1981 date of last allocation and therefore never received SDRs

  - Solution: amend Articles of Agreement to allow for a special one-time allocation to raise SDR allocation of all members to the same percentage of quotas

  - Amendments require approval of three-fifths of Fund members holding 85 percent of total voting power; U.S. non-ratification had delayed effectiveness

  - U.S. Congress has now authorized administration to accept the Fourth Amendment (previously accepted by 132 members with 78% of total voting power); approximately SDR 21.4 billion additional SDRs to be issued when effective

V. Pending and Possible Governance Reforms

Pre-Crisis "Quota and Voice" Reforms—Small but important first step in reform

- Change in quota formula to ensure quotas are more representative of countries' positions in the global economy
  - Quotas determine voting power and influence matters like access to IMF loans; also primary source of IMF's lending resources
  - Old quota formulas produced what many considered to be misaligned quotas
  - Reform included new quotas for a number of members, along with commitment to attain further realignment of quota shares in context future quota reviews
- Amend Articles to triple basic votes and establish mechanism to maintain constant share of basic votes in total voting power
- Amendment of Articles of Agreement to allow a second Alternate Executive Director for large constituencies (sub-Saharan Africa chairs)

V. Pending and Possible Governance Reforms

G-20 Summit measures

- Implement pending quota/voice reforms
- Accelerate general review of quotas and complete by January 2011
- Implement open, transparent and merit-based selection process for the heads and senior leadership of the IFIs
- Give consideration to greater involvement of the Governors in providing strategic direction to IMF and increasing its accountability
- G-20 Chairman working with G-20 finance ministers to consult widely and report back with proposals for further reforms to improve responsiveness and adaptability of the IFIs

V. Pending and Possible Governance Reforms

- <u>March 2009 Report of Committee on IMF Governance Reform (Manuel Committee)</u>:

- Package of "fundamental" reforms recommended, including

  - Accelerated quota revision process to be concluded by April 2010

  - Amend Articles to eliminate appointed chairs, thereby allowing for consolidation, including of European (10) and EU (8) chairs

  - Lower threshold for critical decisions from 85 percent to 70-75 percent, and consider double majorities for more decisions

  - Activate high-level Council of Ministers contemplated under the Articles to provide a forum for coordination and strategic decision-making; allow "direct" voting by Council that enables splitting of constituency votes

V. Pending and Possible Governance Reforms

- Executive Board elevated from daily operational decisions to advice to Council on strategic issues; Management to conduct surveillance
  - Board responsibility also to oversee work of management, and make lending and financial decisions (e.g., budget, compensation)
  - Big Issue: resident versus non-resident Board: Board to remain resident, but fewer meetings, etc.
  - Management would conduct surveillance
- Expand IMF's surveillance mandate beyond exchange rates to provide appropriate coverage of macroeconomic policies, prudential issues and financial spillovers, including coverage of capital account

➢ Manuel Committee work preceded by IMF Independent Evaluation Office report on Governance of the IMF

- IEO Report too recommended more supervisory responsibilities for Board; also considered merit of non-resident Board, but concluded against

V. Pending and Possible Governance Reforms

- Discussions are underway; next round expected in July
- To early to tell which, if any, of these proposals will be pursued, and which ultimately implemented
- Important point implicit in all current reform proposals:
  - Governance reform is not simply about assessing the adequacy of the decision-making framework
  - Rather, intended to address how Fund can become (and can be perceived as being) more legitimate, and thus more effective in coordinating shared responses to shared problems (like the current crisis)

Thank You