

The International Monetary Fund in a changed global environment

The global monetary and financial system has undergone major changes since Germany first joined the International Monetary Fund (IMF) 60 years ago on 14 August 1952. The IMF has continuously adapted its policies in order to address the new challenges as they unfold and to enable it to perform its key systemic role of ensuring the smooth functioning of the international monetary system. This is true of both its primary task of economic policy surveillance to prevent crises from emerging and the provision of balance of payments assistance when crises do occur. What has remained largely unchanged, however, is the IMF's special structure as a fund and a monetary institution, which sets it apart from other international financial institutions.

This financial structure is one of the Fund's major strengths, as it does not have to draw on its member countries' budgetary resources or tap the financial markets to fund its operations. However, this set-up also imposes certain limits on the Fund's policies and the financial assistance it can grant. It is these areas which have seen substantial changes since the turn of the millennium, especially on the heels of the global financial crisis and its fallout. These changes include a greater willingness to commit extensive financial resources, an across-the-board easing of the terms and conditions for borrowing from the Fund, and the restructuring of existing lending facilities and creation of new facilities in order to make them more attractive to potential borrowers. However, these measures also mean that the Fund is incurring higher risks on its own behalf and that of its creditors, and also entail an increasing danger of "moral hazard" and risks to the stability of the international monetary and financial system.

By assuming excessive risk, the IMF would move away from its role as a liquidity mechanism and become more like a bank. Such a transformation, however, would contravene the legal and institutional rules contained in the IMF Articles of Agreement and would also run counter to its financing mechanism and its options for mitigating risk. The Fund's willingness to increasingly expand risk protection and substitute private sector funding not only risks overstressing its institutional structure; it could also diminish the prospects for success of IMF-supported adjustment programmes.

■ Changes in the IMF's policies

60th anniversary of Germany's IMF membership: a good time to take stock ...

When Germany joined the IMF 60 years ago on 14 August 1952, the Fund itself was a young institution with only 54 member countries. Since then, not only has the number of members risen considerably (to 188 at present), but there have also been major changes in the global monetary and financial system in which the IMF operates and whose functioning it is designed to support. These include changes in the global monetary system itself, such as the transition from the "Bretton Woods" system of fixed but adjustable exchange rates to a system of greater exchange rate flexibility, the strong expansion of trade and financial relationships between countries, growing interlinkages between financial markets and the inception of European monetary union. In addition, the relative economic power of the IMF's member countries has changed. Many developing countries and emerging economies are now playing a greater role in the global economy and in international institutions and bodies such as the IMF and the G20. The IMF has also faced a number of financial market and debt crises in recent decades in an environment of more intense global economic and financial relationships; the crises in Latin America, Asia and, most recently, the United States and Europe have left, and are still leaving, their mark on the IMF.

... of important developments within the IMF

In order to address these new challenges as they unfold, the IMF has been continuously adapting its policies and its financing capacities. What has remained largely unchanged, however, is its special underlying set-up as a fund and a monetary institution – reflected, in particular, by the fact that member contributions to the IMF's resources are posted as reserve assets. This sets the IMF apart from other international financial institutions such as the World Bank or the regional development banks. This financial set-up is one of the Fund's major strengths, as it does not have to draw on its members' budgetary resources or tap the financial markets in order to fund its operations.

However, this also imposes clear limits on the IMF's policies and the financial assistance it can grant. It is these areas which have changed the most since the turn of the millennium, markedly increasing risks to the IMF in both quantitative and qualitative terms.

This article will outline and assess the key changes to the IMF's policies in recent times. These changes include

- an expansion of the IMF's lending activities and changes to its risk profile,
- a substantial increase in the IMF's financial resources,
- changes to the IMF's governance and the growing importance of emerging economies and
- adjustments to economic policy surveillance as a result of lessons learnt from the financial crisis.

The article concludes by laying out ideas for the future role of the Fund which are consistent with its underlying set-up and mandate.

■ Expanded IMF lending activities and changes in its risk profile

On the heels of the recent financial crisis, the IMF strongly expanded its role as a provider of financial assistance to support its member countries in their efforts to overcome the crisis and to help avoid contagion effects. The main aim of IMF financial assistance is to ensure that crisis-stricken countries do not resort to economic and monetary policy measures that have a negative impact on others (eg competitive devaluation) and thus lead to instability and protectionism. The IMF therefore has an important systemic function.

IMF's important systemic role

Increase in both qualitative and quantitative risks

At the same time, the risks to the Fund associated with its financial assistance have also risen substantially in both qualitative and quantitative terms. The increase in qualitative risk is particularly evident in the reduction in programme efficiency, ie a worsening of the ratio of economic policy adjustment to IMF funding, as well as the Fund's decision to largely forego economic policy adjustment requirements for newly created precautionary facilities. Looking at the quantitative dimension, the volume of IMF financial assistance has grown distinctly and concentration risk has also risen.

IMF as a liquidity mechanism ...

When assessing the risks to the IMF stemming from the financial assistance it provides, it is important to note that the Fund's risk profile is not comparable with that of the credit portfolio of a commercial bank.¹ The IMF differs from other financial institutions in a number of ways and, in its original capacity, is neither a credit institution nor an insurance mechanism in the private sector sense. It is funded by member contributions that can be held as reserve assets and acts as an intermediary for the exchange of currencies. This means that the IMF offers countries experiencing balance of payments problems freely usable currencies in exchange for their own, usually less well accepted currencies. The aim is to enable a country to offset liquidity shortfalls which manifest themselves in a temporary lack of external funding or gross reserve assets. Drawing on IMF financial resources is usually made conditional on an adequate economic policy stabilisation programme and clear evidence of medium-term debt sustainability. The aim is to enable the country implementing the programme to achieve a sustainable balance of payments position and thus obtain better access to funding in private capital markets, allowing it to repay the reserve assets to the Fund on schedule.

... which imposes a uniform rate of charge for providing funds

The IMF, moreover, does not charge the borrowing country interest, in the usual sense of the word, for drawing on IMF financial resources, instead levying a fee which is based on

the SDR interest rate. The size of this fee depends solely on the amount drawn and the timeframe of the arrangement. These fees are uniformly applied to all of the Fund's borrowers and do not vary according to the borrowing country's credit rating or risk. The rationale for this is that the Fund's financial assistance is provided only temporarily to offset liquidity shortfalls and will therefore be repaid within a short space of time. There is no provision for assuming credit default risk.

The IMF has two special features that help to ensure that its loans are repaid. One is that it enjoys what is known as "preferred creditor status". This status is not enshrined in law but is nonetheless recognised internationally. It means that the IMF's repayment claims are senior to the claims of all other (foreign currency) creditors. The other is that the IMF is able to revolve the repayment obligations of programme countries almost indefinitely. Follow-up programmes entailing new funds which facilitate the repayment of due amounts are designed to further strengthen a country's capacity to pay so that it can subsequently re-exchange the funds it has obtained from the IMF under its own steam. As the amounts due are, in a sense, serviced on time and the Fund's financial assistance is not a loan, it is not necessary – unlike with private creditors – to make any adjustments on the Fund's balance sheet, such as write-downs on credit claims.

However, this conceptual elimination of credit risk for IMF loans does not mean that the IMF is free of financial risks. The IMF faces a specific kind of liquidity risk stemming from the revolving nature of the reserve assets provided by creditor countries combined with the possibility that debtor countries' loans might have to be prolonged in order to avoid loan defaults. This means that, in connection with IMF financial assistance, "credit augmentation risk", ie the

Elimination of credit risk for IMF claims is an essential component of the IMF's funding mechanism ...

... yet these claims are not entirely risk-free

¹ See Deutsche Bundesbank, Potential financial risks faced by the International Monetary Fund, Monthly Report, September 2005, pp 75 to 89. See also the box on the liquidity mechanism on p 65.

risk that a follow-up programme might be necessary, takes the place of ordinary default risk. Such a prolongation, which might be needed multiple times, is not in line with the IMF's mission, which is to provide only short-term liquidity assistance.

Adjustment programmes as "collateral" for financial assistance

In principle, the IMF combats such credit augmentation risk by requiring that countries receiving assistance implement a sufficiently ambitious economic policy adjustment programme. IMF financial resources can usually be drawn only in tranches, depending on the fulfilment of previously agreed milestones in adjustment measures (also known as "conditionality"). Programme countries are expected to take all necessary measures to meet their repayment obligations to the IMF on time. This underscores the particular importance of a prudent lending policy and liquidity planning. However, should the IMF's policies cause its risk to increase, member countries' financing contributions could no longer be deemed highly liquid and low-risk. This would jeopardise their status as reserve assets and ultimately call into question the institutional framework for funding the IMF.

Programme efficiency as primary measure of risk

What this makes clear is that the initial efficiency of the adjustment programmes has a decisive impact on the credit augmentation risk in IMF programmes. In this context, "programme efficiency" is the ratio of a country's lasting liquidity gains denominated in foreign currency – ie the improvement in its balance of payments – caused by economic policy adjustment to the size of its repayment obligations to the IMF. Put differently, it is the ratio of a country's external adjustment to its access to IMF resources. The lower the programme efficiency, the lower the probability that the country will be able to meet its financial obligations to the Fund on time. This may ultimately threaten the IMF's financial integrity.

Programme standards to ensure programme efficiency

To ensure sufficient programme efficiency, the IMF member countries have agreed on certain programme standards. These standards com-

prise a compendium of preconditions and minimum requirements governing the use of the individual facilities and limits for maximum access amounts and periods (see box on page 65). Changes in the international economic and political environment often lead to adjustments to the Fund's toolkit and thus also its programme standards. Particularly over the past few years, there has been a tendency to weaken the programme standards in order to simplify access to Fund resources and broaden the range of risks that can be covered by recourse to Fund resources. In addition, the IMF has taken a more tolerant stance on access amounts, programme periods and repayment schedules, especially in its programmes for euro-area countries.

The design of IMF adjustment programmes has undergone various changes including, first and foremost, the reform of IMF financial assistance in 2009. Since the outbreak of the financial crisis in 2008, the IMF has begun to accept programmes which are less ambitious with regard to the duration and substance of the economic policy adjustment process. In some cases, the IMF even tolerated the use of its financial resources as a fiscal stimulus to domestic demand.²

With regard to programme efficiency, such use of IMF financial resources is problematic. Lasting improvements to a country's balance of payments are very difficult to achieve through fiscal stimuli. If the country is not implementing an accordingly ambitious adjustment programme at the same time in order to structurally improve its balance of payments position, there is a danger that IMF-funded economic policy measures will also promote domestic demand for import goods, thereby supporting an unsustainable balance of payments trend – all the more so if the availability of external (market-based) funding is overestimated. Experience has shown that, in most cases, foreign

Problematic weakening of programme standards in recent times ...

² See IMF, Staff Guidance Note on the Use of Fund Resources for Budget Support, March 2010.

Provision of IMF financial assistance

The IMF's liquidity mechanism

Upon request, the IMF provides member countries experiencing balance of payments problems with the reserve assets they require via a currency exchange. If a member country requests that the IMF provide it, for example, with US dollars or euro because the country is unable or cannot afford to obtain them on the market, it purchases this hard currency from the IMF with the equivalent amount in its own currency. The IMF levies charges for committing or providing such funds. When repayment of these reserve assets is due, the member country exchanges them for its own cur-

rency – in other words, it uses reserve assets to repurchase the currency it had transferred to the IMF. In the intervening period, if the country's currency depreciates against the reserve assets it has acquired from the IMF, it must transfer more of its own currency to the IMF. This ensures that the IMF's holdings in the country's currency always match the value of the reserve assets it has provided to that country. Although the commonly used term "IMF loans" reasonably describes the economic function of these transactions, they are, strictly speaking, currency "purchases" and "repurchases", and are designated as such by the IMF itself.

IMF financing facilities using the IMF's general resources*

Facility	Purpose	Period of repayment in years	Charges	Regular access limits as a percentage of the member country's quota
Stand-By Arrangement (SBA)	Financial assistance via one to three-year programmes for countries with short-term balance of payments problems	3¼-5	Rate of charge ¹ plus surcharge of 200 basis points (bp) on the amount of credit outstanding above 300% of quota; surcharge of 300 bp if credit outstanding remains above 300% of quota after 3 years ^{2,3}	200 per year 600 on a cumulative basis
Extended Fund Facility (EFF)	Financial assistance via three to four-year programmes focusing on structural reforms to solve long-term balance of payments problems	4½-10	Same as SBA ^{2,3}	200 per year 600 on a cumulative basis
Flexible Credit Line (FCL)	Flexible facility spanning one to two years, designed for countries with very strong economic policies; once a country has entered into an FCL agreement, it can draw large sums at any time without any conditionality or need for approval from the Executive Board	3¼-5	Same as SBA ^{2,3}	No predefined limits
Precautionary and Liquidity Line (PLL)	Flexible facility for meeting actual or potential balance of payments needs of countries with sound economic policies; six to 24-month programme; a country can draw funds at any time once it has entered into a PLL agreement	3¼-5	Same as SBA and FCL ^{2,3}	Generally 250 for a six-month arrangement; 500 per year and 1,000 on a cumulative basis for one to two-year arrangements
Rapid Financing Instrument (RFI)	Financial assistance to countries facing an urgent balance of payments need in order to cushion the impact of exogenous shocks (commodity price shocks, natural disasters, post-conflict situations etc); low programme requirements; repeated access possible	3¼-5	Same as SBA and FCL ^{2,3}	50 per year; up to 100 on a cumulative basis

Source: IMF. * Concessional lending facilities not included. **1** The rate of charge is derived from the market-based SDR interest rate; it is currently 1.08% (SDR interest rate of 0.08% plus 100 bp). **2** An additional one-off service charge of 0.5% is levied on each amount drawn from the IMF's general resources. **3** A refundable commitment fee is levied at the beginning of each 12-month period: 15 bp for committed amounts up to 200% of quota; 30 bp for committed amounts above 200% and up to 1,000% of quota; 60 bp for committed amounts exceeding 1,000% of quota.

trade deficits can be reduced only over the longer term, whereas the private capital inflows necessary to fund them tend to be volatile and can dry up quickly. This tends to increase the threat of future balance of payments problems, which can run counter to the aim of IMF programmes: to bring about lasting improvements in the balance of payments position.

... and not very rigorous application of criteria for very high access ...

In parallel to the changes in connection with programme design, the financing volume of the IMF programmes was expanded further; as part of the 2009 reform, the access limits were doubled to 200% of a member country's quota³ per year and 600% of quota cumulatively. How much a country may draw within these limits depends, in particular, on the extent and urgency of the balance of payments need, the intensity of the country's adjustment efforts and its capacity to repay. In exceptional cases, a specific procedure can be activated that also permits a country to draw funds in excess of these limits. This "Exceptional Access Framework" (EAF) was established in 2002. It may only be activated under four conditions: (1) the member country must be exposed to acute and exceptionally high capital outflows; (2) at the same time there must be a high probability of debt sustainability; (3) the country has to be likely to regain access to the market within the time Fund resources are outstanding; and (4) the adjustment programme must have reasonably good prospects for success. In practice, however, these criteria were not always rigorously applied in the years following the EAF's introduction, which undermined its credibility.

... have led to a dilution of the rules for IMF loans ...

The EAF was reformed in 2009. As a result, exceptional access to IMF resources above the usual limits can now not only be granted in the event of acute, but also potential future balance of payments problems. On the heels of the recent programmes for euro-area countries, the EAF was modified once again. The IMF is now tolerating exceptional access to funds even for countries with a precarious debt

situation and dim prospects for regaining market access if those countries could be a potential source of substantial contagion effects or systemic risk to the international financial system.

Identifying and quantifying such contagion effects and systemic risk, however, is difficult in specific cases and depends on the assumptions made. In view of the high risks caused by an already precarious debt situation, such cases would urgently require a thorough, convincing risk analysis based on clear and uniform benchmarks. However, as potential contagion effects and systemic risk are always fraught with uncertainty, it is extremely difficult to provide such an analysis. At all events, it would be essential for the IMF to ensure that financial assistance from other creditors is available in case the debtor country ultimately becomes so over-indebted that it cannot repay the funds it has obtained as assistance from the IMF.

... especially with regard to debt sustainability

There is another specific reason why higher lending volumes entail greater risk to the IMF. Its preferred creditor status is key to ensuring that the reserve assets which IMF members have contributed to the IMF remain risk-free. However, the Fund mainly achieves such risk mitigation through its preferred creditor status enabling it to pass on the default risks associated with its lending to the remaining external creditors. An IMF programme therefore has two mutually conflicting effects on private creditors' expectations regarding the timely and full repayment of their cross-border loans. On the one hand, IMF-supported economic adjustment and favourable terms of financing strengthen the country's balance of payments position and its future capacity to repay exter-

Preferred creditor status can lead to crowding-out effects

³ The quota denotes a member's capital share. It is used to measure the country's financial obligations to the IMF, the amount of funding it is entitled to access and its voting share. Moreover, during general allocations of special drawing rights (SDRs) the newly created SDRs are allocated to countries according to their quotas. The total amount of quota-related financial contributions by all member countries represents the "pool" of the IMF's regular financial resources.

nal liabilities. On the other hand, though, the IMF's preferred creditor status can cause it to crowd out the claims of other creditors by increasing the risks of these claims, which are junior to those of the Fund. This can have an adverse impact on graduation from IMF financial assistance, ie on the outlook for new financial investment by private creditors.

Maintain catalytic function of IMF financial assistance

The fundamental aim of any IMF programme is to strengthen investor confidence in a country's external funding prospects through IMF-supported economic policy adjustment. A very limited IMF share in the needed external financing volume should thus tend to serve more as a catalyst than as a substitute for private capital flows (catalytic financing function). Otherwise, the aforementioned crowding-out effect may even worsen a country's prospects for a successful return to the markets, thus reducing programme efficiency further. Such an effect is more likely the larger the IMF financial assistance is relative to the debtor country's overall funding need. A high volume of IMF financial assistance can therefore lessen a country's chances of stabilising its external funding in the long term.

Diminishing programme efficiency increases credit augmentation risk

It can thus be stated that the latest changes in connection with the IMF's programme standards and financing volumes provide grounds for concern that programme efficiency will fall. This can currently be inferred from the growing need for follow-up programmes (rising credit augmentation risk). In addition, the volumes of financial assistance have been exceptionally high, particularly in the more recent programmes, which is why these adjustment programmes have to achieve increasingly large adjustment gains in order for them to be sufficiently efficient. Current experiences in some programme countries would appear to indicate, however, that the required adjustment gains cannot always be achieved in practice.

Programme efficiency for precautionary loans not quantifiable

Most recently, the IMF toolkit was expanded by the creation of what are known as precautionary facilities, which are not tied to an economic

adjustment programme. They are designed to enable countries to protect themselves from possible contagion. As some countries suffered liquidity shortfalls during the 2008 financial crisis which were deemed to be no fault of their own, the Fund decided to introduce a Flexible Credit Line (FCL) as a type of "insurance" facility. This line allows countries that do not have an acute balance of payments problem at the time of application to obtain – once the need arises – exceptionally large access to IMF financial resources immediately, ie without further approval and without any conditionality attached. Mexico, Poland and Colombia have been granted FCLs thus far but have not actually drawn on them.

Along with the FCL, the principle of "ex-ante conditionality" was introduced, according to which the FCL is open only to countries with very strong economic fundamentals and a very good economic policy track record. The IMF therefore did away with the requirement of an adjustment programme for this instrument ("ex-post conditionality") in the event of IMF resources being accessed.

Ex-post conditionality eliminated ...

Soon after introducing the FCL, the Fund also created an additional precautionary facility to cover IMF member countries that do not fully qualify for the FCL. Originally established as the Precautionary Credit Line (PCL), which was a purely precautionary facility, it now enables countries to access liquidity immediately and has therefore been renamed the Precautionary and Liquidity Line (PLL). Unlike with the FCL, countries requesting a PLL are expected to implement a certain degree of economic adjustment, although the conditionality is not very strict; this adjustment is monitored for the first time six months after approval.

... and few controls in place, ...

By introducing the FCL and PLL, the IMF has created a lending policy which involves high credit volumes and a partial or complete lack of conditionality. This combination may expose the IMF to high financial risks if these funds are actually drawn upon. It remains to be seen to

... thus increasing potential financial risks to the IMF

what extent these IMF facilities can help to avoid contagion effects.

Higher concentration risk

Looking back over several decades, the IMF has frequently lent large volumes of funds and has provided funds to several countries in the same region simultaneously. However, owing to the tendency towards larger and larger individual loans per borrower, a greater regional concentration and the more frequent use of longer-term IMF programmes, concentration risk has increased perceptibly in recent years. At present, one sole borrower already accounts for around 20% of all outstanding lending; the three largest loans make up 55%, and the five largest borrowers 74%, of all borrowing from the Fund. A larger volume and longer maturity of lending, as well as extensive additional funds committed under precautionary facilities, are using or tying up a good deal of the IMF's available financial resources, placing a corresponding strain on its liquidity.

Substantial increase in IMF financial resources

High IMF credit commitments

Since the outbreak of the global financial crisis in 2008 and the European sovereign debt crisis in 2010, the IMF has been more active than ever before, if its activities are measured in terms of the resources now available to it and the amount of financial assistance it has committed to its members. The Fund's credit commitments stood at somewhere in the tens of billions of SDRs between the outbreak of the Asian crisis in 1997-98 and 2004 before falling into the single-digit billions of SDRs in the 2005-07 period and then shooting up rapidly on account of the crisis. At last report, the funds committed under current financial arrangements amounted to around SDR 160 billion (or around €190 billion).

To ensure that the Fund has the financial resources it needs to fulfil its tasks, it was agreed in 2009 to augment the IMF's resources by an exceptionally large amount.⁴ This affected both

the Fund's regular resources in the form of a doubling of its members' quota subscriptions and also the "emergency reserves" in the form of multilateral credit lines from the countries with the strongest financial positions, which were increased tenfold. The multilateral credit lines are provided under the New Arrangements to Borrow (NAB) by 40 countries or their central banks.⁵ In addition, there are credit lines arranged bilaterally between the IMF and individual creditor countries or their central banks. In 2009, bilateral credit lines served as a stop-gap for providing any potential IMF assistance required before the expanded NAB entered into force. Owing to the above measures, the available IMF liquidity rose significantly to a recent figure of around SDR 250 billion (or around €300 billion; see chart on page 70). 37 countries responded by mid-2012 to the IMF's call for further temporary bilateral credit lines by pledging an additional US\$456 billion (around €350 billion).⁶ These borrowing agreements have not yet been implemented. The IMF will only be able to access these resources once the IMF resources already available from quota subscriptions and the NAB have fallen below an agreed threshold of SDR 100 billion.

Germany's IMF Act conferred the financial rights and obligations stemming from Germany's IMF membership upon the Bundesbank. On the basis of this mandate, the Bundesbank has provided Germany's quota subscription to the IMF in the past decades. Once the quota increase has entered into effect, which is scheduled for autumn 2012, Germany's IMF quota will rise from SDR 14.6 billion to SDR 26.6 billion (or around €32 billion).

Moreover, the Bundesbank has contributed to all measures taken to strengthen the Fund's emergency reserves. It provided the IMF with a €15 billion credit line in September 2009, and

Substantial increase in regular IMF financial resources and IMF emergency reserves

Significant German contribution by the Bundesbank

⁴ See also: Deutsche Bundesbank, Financing and representation in the International Monetary Fund, Monthly Report, March 2010, pp 51-64.

⁵ Three countries have not yet ratified the arrangements.

⁶ See IMF Press Release No 12/231 of 19 June 2012.

Gradual increase in IMF resources

Type of resources	Implementation (decision or commitment of)	Resource increase (in SDR billions)	IMF resources (in SDR billions)					Ratio of quota resources to "emergency reserves"
			Total financial resources	Quota resources ¹	"Emergency reserves"			
					Total	NAB/GAB	Bilateral credit commitments	
Quota resources, NAB (25 participants), GAB (12 NAB participants) ²	Status prior to April 2009	–	247	213	34	34	0	6.3 : 1
Measures already implemented								
Quota resources ³	March 2011 (IMF, March 2008)	+ 25	272	238	34	34	0	7 : 1
Bilateral borrowing agreements I (24 participants) ⁴	2009 to 2011 (G20, April 2009)	+ 180	452	238	214	34	180	1.1 : 1
NAB (39 participants) ⁵	March 2011 (G20, April 2009)	+ 334	606	238	368	368	0	1 : 1.6
Measures adopted but not yet implemented ⁶								
Bilateral borrowing agreements II (37 participants) ⁷	(G20, June 2012)	+ 300	908	238	670	370	300	1 : 2.8
Quota resources ⁸	(IMF, Nov 2010)	+ 238	959	477	482	182	300	1 : 1

1 Quota resources reflect the subscription payments of all IMF member countries, partly paid in freely usable currencies and partly in the member's own currency. However, only the currencies of countries with large reserves (currently 51) may be used by the IMF for its lending programmes, ie currently around 83% of total quota resources. **2** Drawings on the General Arrangements to Borrow (GAB) are counted against the New Arrangements to Borrow (NAB). **3** The 2008 quota reform was designed to redistribute quota shares between member countries; it was implemented by means of selective quota increases. **4** The implementation of the committed bilateral credit lines of a total of US\$250 billion to establish bilateral borrowing agreements was carried out individually for each creditor and completed in March 2011. **5** The bilateral borrowing agreements I served as a stopgap measure until the increase in the NAB resources came into effect and were then either discontinued or merged with NAB credit lines. **6** It is assumed here that the bilateral borrowing commitments will be implemented before the quota increase takes effect. **7** The implementation of the US\$456 billion or approximately SDR 300 billion total in committed resources to establish bilateral agreements has not yet been completed. Due to the admission of an additional country to the NAB, they now comprise 40 participants with a volume of SDR 370 billion. **8** The doubling of quotas has not yet entered into force; the NAB volume will be reduced on account of the quota increase by SDR 188 billion, or about one-half.

Deutsche Bundesbank

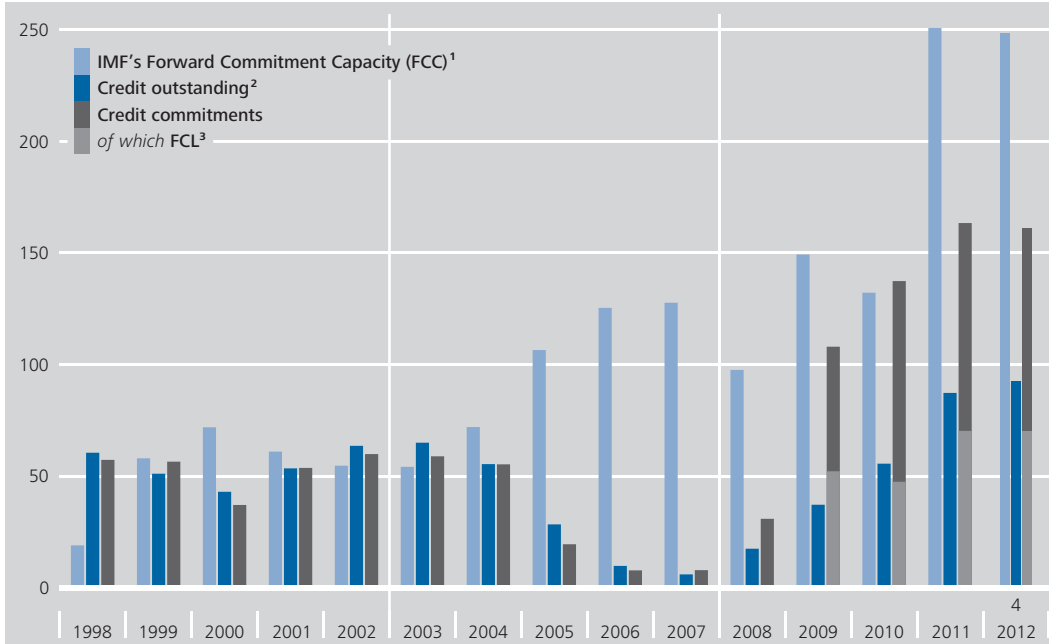
later augmented this amount to SDR 25.4 billion (around €30 billion) in accordance with its relative share as part of the increase in the multilateral NAB. When the IMF quota increase enters into force, contributions to the NAB will concurrently be reduced by around the same amount, which means that the Bundesbank's share of the NAB will fall, as agreed, from SDR 25.4 billion to SDR 12.9 billion. Within the context of the bilateral credit lines committed in 2012, the Bundesbank will provide the IMF, if necessary, with up to €41.5 billion in additional funds. This will nearly double the total funding provided by the Bundesbank from its 2011 level to around SDR 74 billion (roughly €88 billion).

The gap that already exists between the size of regular quota-based funds and that of emergency reserves initially grows when extensive credit lines are agreed. Taking the new bilateral credit commitments into account, emergency reserves are about three times the level of regular quota-based funds. Once the quota increase enters into effect and the NAB funds have been partially reduced, the ratio will fall back down to about 1:1 (see above table). However, a quota-based institution would usually be expected to have much larger regular quota-based funds than emergency reserves as the quotas are the main factor determining voting

Unfavourable ratio between emergency reserves and regular quota-based funds ...

IMF liquidity and lending

SDR billions, year-end levels



Source: IMF. **1** The One-Year Forward Commitment Capacity (FCC) encompasses the available financial resources at that time composed of quota resources, New Arrangements to Borrow (NAB) resources and bilateral borrowing agreements less a prudential balance. **2** Large loans to Brazil in 1998; to Turkey in 1999; to Argentina in 2000; to Brazil and Turkey in 2002; to Argentina in 2003; to Hungary and Iceland in 2008; to Greece and Ireland in 2010; to Portugal in 2011; to Greece in 2012. **3** Flexible Credit Line (FCL) agreed with Mexico, Poland and Columbia. **4** As at 9 September 2012 (FCC excluding bilateral borrowing agreements, quota increase and reduction in NAB volume of 2012).

Deutsche Bundesbank

shares and the subscriptions payable by all IMF member countries.

... weakens the link between funding and decision making

The increase in funding based on NAB resources and bilateral credit lines is tending to weaken the close connection between funding and decision making in the IMF; these funds, provided by only 40 and 37 countries or central banks respectively, are not reflected in the countries' voting shares within the IMF (see chart on page 71). However, it is of key importance to the Fund's legitimacy that its members' individual funding shares largely correspond to their voting shares.

Changes in the IMF's governance and the growing importance of emerging economies

The influence of the emerging economies on the IMF's decisions has increased distinctly in

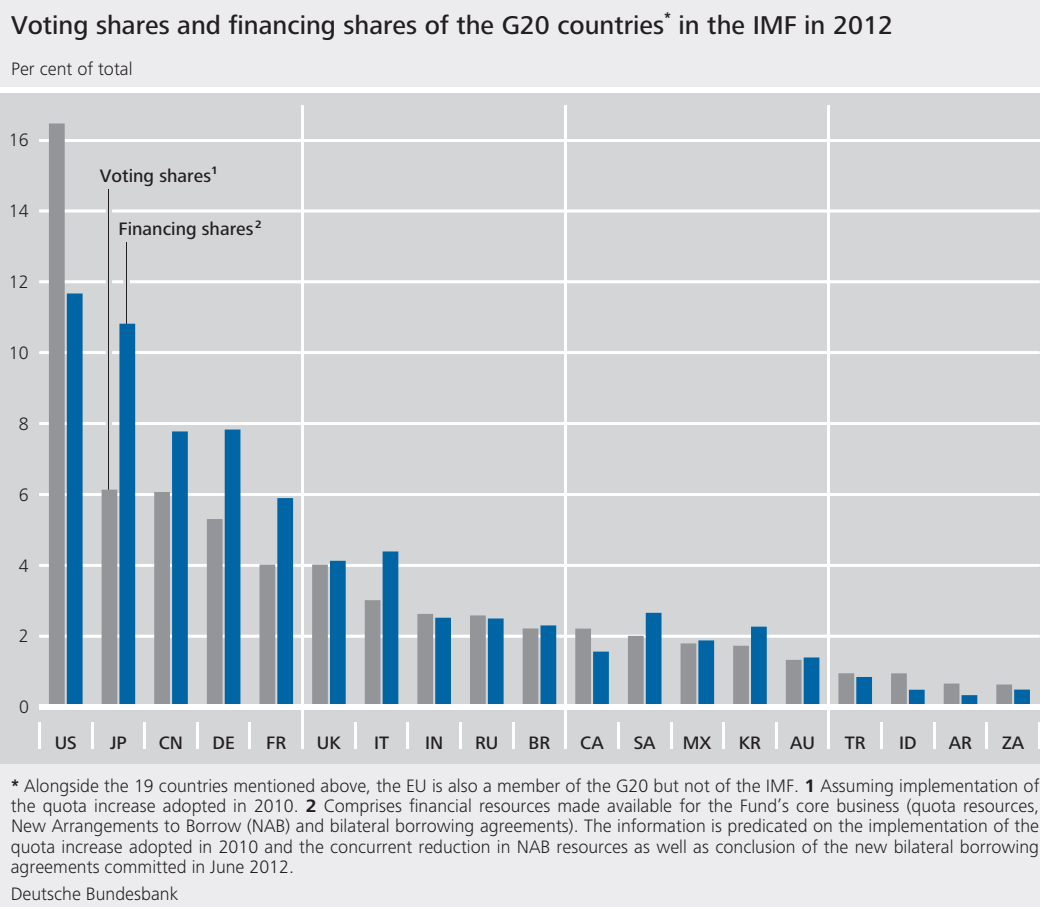
the past few years. This trend is likely to continue for the foreseeable future. The quota increase adopted in November 2010 is scheduled to be implemented in autumn 2012, which will then expand the voting power of this group of countries to just under 45%.⁷ China will supersede Germany as the third largest shareholder after the United States and Japan, and the four BRIC countries (Brazil, Russia, India and China) will be among the ten IMF member countries with the largest voting shares (see table on page 72).

Dynamic emerging economies acquiring greater voting shares

Moreover, the G20 and IMF are debating further amendments to the quota formula in order to even better reflect members' position in the global economy. Although this discussion seems rather technical on the surface, it could have far-reaching political implications

Quota calculation once again being debated

⁷ The implementation of quota and governance reform could be delayed, however, because it has not yet been ratified by some key member countries, notably the United States.



since the design of the quota formula impacts on quota shares and thus the financing and voting shares within the IMF. It is important that, when weighting the relevant factors, the quota formula takes due account of the IMF's mandate to safeguard international payments. For all the criticisms that can be made of the current formula which has been in force since 2008, it does constitute a considerable improvement on the system it replaced, which consisted of five complex formulas. The current formula is based on criteria of relevance to the IMF, it is simple and transparent, and it leads – as intended – to a quota increase for particularly dynamic economies. These characteristics would need to be reflected in any new formula, too. Following the next general quota review in January 2014, the greater economic might of the dynamic emerging economies is very likely to be reflected in higher quota shares for these countries, even if the quota formula itself remains unchanged.

The IMF's governing bodies, too, are reflecting the increased importance of the emerging and developing world. From October 2008 to March 2011, the IMF's International Monetary and Financial Committee (IMFC) was chaired by the finance minister of a developing country (Egypt), who was then followed by the finance minister of a relatively young advanced Asian economy (Singapore). In July 2011, a Chinese citizen was appointed to the newly created post of an additional Deputy Managing Director.

Far-reaching changes to the IMF's Executive Board have also been adopted. The members with the five largest quotas will no longer have the privilege of appointing their own Executive Director – including Germany, which has been in this group of countries since 1960. Under the new procedure, all 24 Executive Directors will be elected by the countries or groups of countries they represent. Whether or not a country is represented by an Executive Director

Greater representation of emerging economies in IMF's governing bodies

Shift towards emerging economies in IMF decision making structure

Voting shares of the IMF's ten largest members and selected groups of countries*

Per cent of total

Country/group of countries	Voting shares		Change
	2009	2012 ¹	
USA	17.02	16.47	- 3.2
Japan	6.11	6.14	+ 0.4
China	2.93	6.07	+ 107.2
Germany	5.97	5.31	- 11.1
France	4.93	4.02	- 18.4
United Kingdom	4.93	4.02	- 18.4
Italy	3.24	3.02	- 7.0
India	1.92	2.63	+ 37.1
Russia	2.73	2.59	- 5.4
Brazil	1.40	2.22	+ 58.1
Total	51.18	52.47	+ 2.5
Advanced economies	60.6	55.2	- 8.9
Emerging market and developing countries	39.4	44.8	+ 13.7
G20 countries	64.0	64.7	+ 1.1
EU	32.5	29.4	- 9.5

Source: IMF website (http://www.imf.org/external/np/sec/pr/2011/pdfs/quota_tbl.pdf); Bundesbank calculations. * The selection of the ten largest IMF members is based on the outcome of the quota increase which was adopted in 2010 but has not yet been implemented; until the implementation of this quota increase – and thus also in 2009 – Saudi Arabia and Canada are still counted amongst the ten largest IMF members; under the forthcoming quota increase, they will be superseded by India and Brazil. ¹ Following implementation of the 2010 quota increase.
 Deutsche Bundesbank

it has “elected” itself or, as a member of a group of countries, by a jointly elected Executive Director depends mainly on that country’s IMF quota. Since the directors’ voting shares should be as equal as possible, countries with a relatively high quota, among them Germany, will not have to join a group. If, however, Germany’s quota share were to fall substantially, this might possibly become necessary in the future. Advanced European economies have declared their willingness to consolidate their country groups and to cede two chairs on the Executive Board to the dynamic emerging and developing economies. Work on the concrete implementation of this commitment is still ongoing.

Perceptible influence of G20 on IMF policy

Moreover, the major emerging economies have also expanded their influence on the IMF through their G20 membership. In the past few years, the G20 has become established as a key body for cooperation on international economic and monetary policy.⁸ At the meetings

of G20 leaders and also of the G20 finance ministers and central bank governors, topics of relevance to the IMF are often on the agenda. In addition, issues relating to the architecture of the international financial system and to international economic policy dialogue are addressed in G20 working groups on an ongoing basis. As the G20 members have a combined share of nearly two-thirds of voting power in the IMF, the G20 has a perceptible impact on discussions and decisions taken at the IMF.

Protecting the powers of the responsible IMF decision making bodies is key to preserving the legitimacy of Fund policy. Although the G20 carries a great deal of political weight and, as a high-ranking informal group, may also provide political recommendations and joint statements on IMF policy issues, it represents only a small number of countries, whereas 188 countries – nearly all of the world’s states – are represented in the IMF’s governing bodies (Executive Board, IMFC and Board of Governors). The legitimacy of the IMF is based on international law, with formal decision making and implementation powers codified in its Articles of Agreement. It is therefore crucial to ensure that all member countries are involved in decisions that impact on the IMF.

Protecting the legitimacy of IMF policies

Using lessons learnt from the financial crisis to adapt economic policy surveillance

The 2008 financial crisis laid bare certain deficits in the IMF’s surveillance. A 2011 study by the Fund’s Independent Evaluation Office (IEO) found that key global and national developments sometimes went unnoticed by the Fund, or were not communicated proactively enough, or were not sufficiently heeded by members, which meant that the risk of contagion was

Financial crisis exposed need for improvements

⁸ The G20 comprises the G7 countries, the EU and Australia plus 11 emerging economies which play an important role in the global economy: Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa and Turkey.

underestimated. In order to better recognise impending risks in future, the IEO calls, among other things, for a better integration of financial sector issues into macroeconomic assessments and more consistent analyses and risk assessments. In addition, it concludes that the IMF should create an environment that, to a greater extent than before, considers dissenting views and delivers clear messages, also and especially to the Fund's decision making bodies.⁹

themselves, complements IMF surveillance and can promote a sense of "ownership" of the resultant recommendations.

In adopting the new "Decision on Bilateral and Multilateral Surveillance" in July 2012, the Executive Board has also amended the legal framework for its surveillance. This decision revises the 2007 decision entitled "Bilateral Surveillance over Members' Policies" and is designed to create a stronger focus on all policies – both external and internal – which could affect balance of payments stability. It aims to better integrate bilateral and multilateral surveillance, to underscore the importance of multilateral surveillance for global economic and financial stability and to make countries more aware of the impact of their national economic policy on global financial stability. The explicit recognition that domestic stability – and national economic policies that are designed to safeguard it – are of primary importance to global stability is a welcome inclusion to the new surveillance decision. In contrast to the original intent, it is now clearly stated that no country can be obliged to subordinate its domestic stability to the goal of global stability. The principle that "stability begins at home" has retained its central importance.

*Legal framework
for surveillance
revised*

*Measures
being taken
to enhance
surveillance*

The IMF has for some time been undertaking steps to enhance its surveillance. Since 2009, the IMF has been conducting "Early Warning Exercises" (EWEs) together with the Financial Stability Board (FSB) in order to identify, at an early stage, high-impact risks to the global economy; the findings are presented at the IMF's Spring and Annual Meetings. The voluntary Financial Sector Assessment Program (FSAP) has now been made mandatory for the 25 most important national financial sectors. Moreover, beginning in 2011 a "Spillover Report" has been prepared for five systemically important economies or economic areas (USA, Japan, China, United Kingdom and the euro area). This report studies the impact of these countries' economic policies and developments on other countries and regions. The aim is to develop globally consistent policy options to reduce potential adverse spillovers. In addition, the IMF's new "External Sector Report" is the first special report of its kind that specifically examines the risks to the external stability of the most important economies. The July 2012 pilot External Sector Report also uses quantitative methods to assess the extent to which current accounts and real exchange rates can be explained by fundamentals and whether corrective policy actions may be needed. The report also looks at international capital flows and changes in reserves. Moreover, the IMF assists the G20 by contributing analyses to the "G20 Framework for Strong, Sustainable and Balanced Growth". This G20 "Mutual Assessment Process" (MAP), which is conducted as a peer review by the participating countries

■ Conclusion

IMF policies have undergone far-reaching reforms, particularly in the context of the crisis management and resolution policies of recent years. While some of the measures have been beneficial, other reforms have increased the risks to the IMF. The Fund's financing functions have been expanded and its credit conditions weakened; these reforms, in particular, have led to a deterioration in its risk profile. The largely risk-free nature of its lending and highly liquid nature of IMF resources, however, are essential elements of the Fund's financial set-up.

⁹ See Independent Evaluation Office (2011), IMF Performance in the Run-Up to the Financial and Economic Crisis.

By assuming excessive risk, the IMF would move away from its role as a liquidity mechanism and become more like a bank. Such a transformation, however, would contravene the legal and institutional rules contained in the IMF Articles of Agreement as well as its financing mechanism and its options for mitigating risk. The Fund's willingness to increasingly expand risk protection and substitute private sector funding not only risks overstressing its institutional structure; it could also diminish the prospects for success of IMF-supported adjustment programmes.

Since the financial resources of the IMF, too, are finite, the primary way in which it can en-

sure its efficacy is by focusing its activities on its strengths, in keeping with its monetary mandate. By concentrating on its primary surveillance tasks and expertise in order to avert crises and through its catalytic financing role within efficient adjustment programmes to help countries overcome temporary balance of payments problems, the Fund plays a crucial part in ensuring international financial stability. The most important factor in the success of these measures, however, is – and will remain – adherence to the principle that each individual country bears primary responsibility for its own economic growth and stability.