The role of the International Monetary Fund in a changing global economic environment

The role of the IMF and the World Bank in an environment shaped by market economy principles has increasingly become the subject of controversial discussions, with reform proposals ranging from the abolition of the Bretton Woods institutions to their merger. However, the majority of critics concede that the IMF and the World Bank have important tasks to fulfil even in a changed global environment. For these tasks to be fulfilled effectively, there must be a division of labour in line with the clear mandates which define the IMF as a monetary institution and the World Bank as a development organisation. In keeping with this division of labour, macroeconomic surveillance and consultation are at the core of the IMF's activities. The Fund's surveillance is complemented by its readiness to help overcome balance of payments problems by providing catalytic liquidity assistance if there is insufficient access to the capital markets. Even in the case of financial crises the IMF should provide only limited liquidity assistance in order to give precedence to the private sector's responsibility for crisis management. Against the background of the IMF's and the World Bank's activities in the past few decades and in view of the annual meetings of the two Bretton Woods institutions in Prague, a number of measures aimed at reforming the IMF will be discussed and evaluated in this article.

Adaptation of IMF and World Bank to changes in the global economic environment

Advance of market principles ...

Developments in the global economy have been marked by profound changes in the past few decades. One key feature of this radical change is the advance of market principles. The associated sharp rise in the cross-border exchange of goods, services and capital and the increasing interlinkage of national financial markets to form a global financial network are the result of far-reaching deregulation and thus more effective competition. These trends have meant that many emerging market economies and countries in transition have become more closely integrated into a world economy that is exhibiting a greater division of labour and increasing interdependence. These changes have been boosted by productivity leaps stemming from rapid technological advances in the areas of communication and data processing.

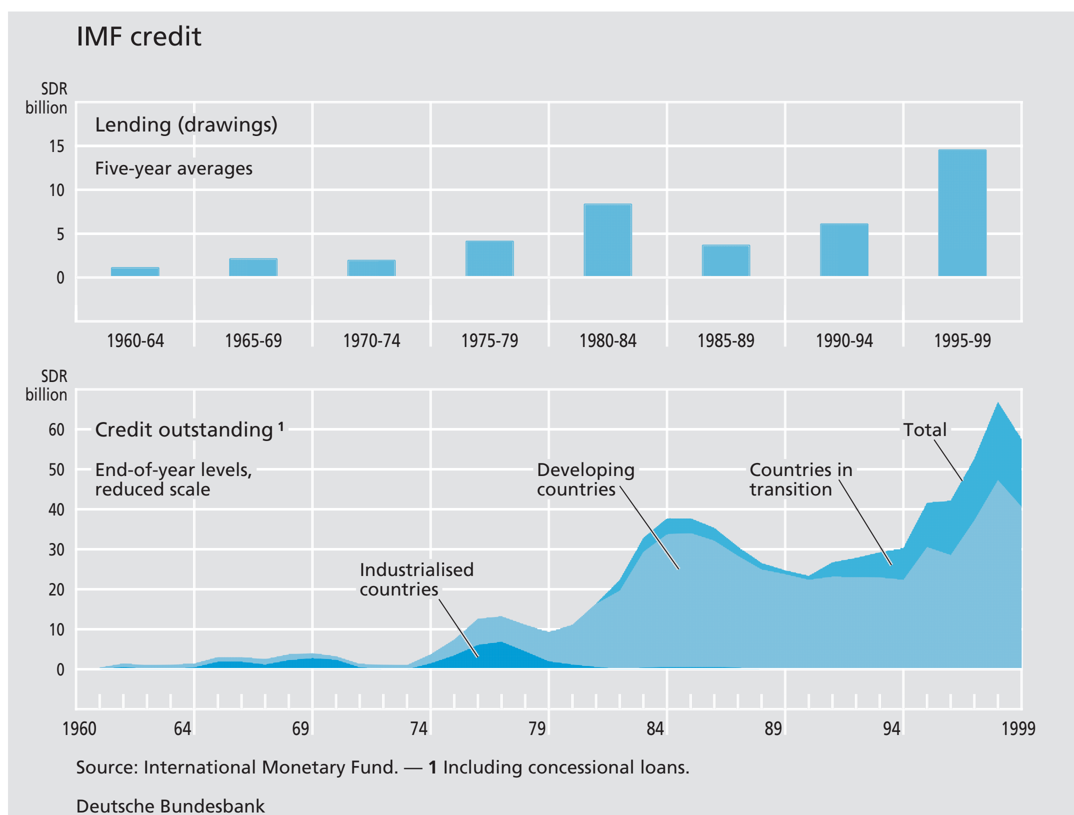
... brings adjustment pressures to bear on IMF and World Bank

The adjustment pressures prompted by these changes have also confronted the Bretton Woods institutions with major challenges. These institutions were given different, yet complementary mandates by the 1944 Bretton Woods conference. The International Monetary Fund (IMF) was to act as a monetary institution promoting and monitoring an open and stable international monetary system. At the heart of the international monetary framework of Bretton Woods was a par-value system which provided for the financing of temporary balance of payments problems through liquidity assistance from the Fund. As a rule, short-term IMF credit was to facilitate real economic adjustments without requiring changes in the parities. The International Bank for Reconstruction and Development (IBRD), by contrast, was given not only the mandate to finance reconstruction (which was initially considered to be the primary task) but also to support less developed member countries by funding development projects and programmes under market conditions. The IBRD's affiliated organisation, the International Development Association (IDA), which was founded in 1960, was commissioned with the task of granting financial assistance to poorer developing countries on "soft" terms (interest-free, longer maturities and longer grace periods).[1]

Free choice of exchange rate regime and surveillance of exchange rate policy since the seventies

In the past few decades, the IMF has responded to the changes in the underlying economic conditions by extending and modifying its surveillance and financing activities. In the early seventies the Bretton Woods system of fixed exchange rates collapsed because of sharp economic divergences in major industrialised countries. The second amendment of the IMF Articles of Agreement, which entered into force in 1978, was the formal response to the changed reality of the heterogeneous exchange rate practices that had evolved in subsequent years. Members were now free to adopt the exchange rate system they wished, although they were obliged to subject their exchange rate policy to firm surveillance by the Fund. The consultations with the member

1 The term "World Bank" is often used for the IBRD alone, although it sometimes also refers to the entire World Bank Group, i.e. the IBRD and all its affiliated organisations. In the publications of the IBRD and the IDA the term "World Bank" stands for these two financial institutions only.



Source: International Monetary Fund. — **1** Including concessional loans.

countries, pursuant to Article IV of the IMF Articles of Agreement (as amended in 1978), play a significant role in this process. These consultations allow for a detailed examination of a country's economic and financial policies, above all, from a national and international perspective.

Large-scale IMF financing as a result of oil crises and debt crisis in the seventies and early eighties ...

However, the fact that major countries adopted floating exchange rates did not relieve the strain on the IMF's financing activities; instead, members' actual drawings have, on average, clearly exceeded previous levels since the mid-seventies. This mainly reflected massive balance of payments imbalances stemming from the two oil crises in the seventies and the impact of the international debt crisis at the beginning of the eighties, when the return of many debtor countries to the capital markets was conditional on the adoption of an IMF adjustment programme. At the end of 1977 the IMF's outstanding credit amounted to just over SDR[2] 13 billion, and in the mid-eighties it reached a temporary peak of nearly SDR 38 billion.

... and increase in the IMF's structural adjustment financing in the eighties and nineties

At the beginning of the nineties the IMF had to concentrate more on addressing the specific needs of its new members, particularly those which had formerly been centrally planned economies. In the case of these countries, IMF financial assistance was increasingly provided not only for the purpose of overcoming temporary balance of payments problems but ultimately of alleviating

2 The SDR (special drawing right) is the IMF's unit of account, which is defined by a basket of major currencies. At the end of August 2000 SDR 1 = € 1.47.

general economic weaknesses. Since structural problems often played a major role in this context, the IMF started to finance structural adjustment programmes. These "extended" financing activities of the IMF date back to the mid-seventies. Longer-term financial assistance to countries with balance of payments difficulties that are primarily of a structural nature is provided by the Fund under the Extended Fund Facility (EFF), established in 1974. In the second half of the nineties this facility became more important. An arrangement under the EFF of more than SDR 13 billion was approved for Russia alone in 1996 although only just under SDR 6 billion was actually drawn. In addition, balance of payments assistance has been available on concessional terms – albeit not from the IMF's General Resources Account – since 1976. These resources were first made available within the framework of a specific trust fund and then under the Structural Adjustment Facility (SAF) established in 1986, which, in 1993, was incorporated into the Enhanced Structural Adjustment Facility (ESAF) created in 1987. Last year the ESAF was assigned the additional task of fighting poverty and was renamed the Poverty Reduction and Growth Facility (PRGF).

Ambivalent impact of private capital market expansion on IMF lending

The aforementioned trends coincided with a quite dramatic increase in international capital flows, particularly in the nineties. Private capital has evolved into the primary source of funds for an increasing number of countries in the past decade. By accessing the international capital markets, many countries have been able to finance investments by means of capital imports and thus achieve higher growth rates and a higher standard of living. However, a considerable number of IMF members still have virtually no access to the international capital markets and therefore have scarcely benefited from the dramatic expansion in these markets. Between 1994 and 1998, according to IMF data, 45 out of 119 net borrowers among the developing countries obtained more than two-thirds of their external financing from official sources.[3] For a small number of countries the IMF has actually become a quasi-permanent source of funds as they successively drew on the Fund's resources over lengthy periods.

Large-scale crisis packages in the second half of the nineties ...

Although the dynamic developments in the international financial markets may have relieved some of the pressure on the IMF, they have also been associated with additional challenges for the Fund. Financial markets may respond to changes in the political or economic conditions by bringing about massive shifts of funds which may confront individual countries with exceptional balance of payments problems and which may result in financial crises. As the reasons for the problems shifted from the current to the capital account, the IMF's financing activities assumed new quantitative and qualitative dimensions. In the second half of the nineties alone, financial arrangements for five members[4] totalled about SDR 73 billion. Most of these arrangements were significantly larger than the total amount of IMF credit outstanding up to the mid-seventies. At the end of

3 See International Monetary Fund, World Economic Outlook, May 2000, page 195 ff.
4 Brazil, Indonesia, Mexico, Russia and South Korea.

1998 the IMF's total lending reached a peak level at nearly SDR 67 billion.

... mean problematic break with the principle of catalytic financing

The IMF's break with the principle of catalytic financing, which became evident during the financial crises in Mexico (1994/95), South-East Asia (1997/98) and Brazil (1998/99), is particularly problematic. In contrast to the traditional purpose of IMF financing, which always aimed at a "bail-in" of the private sector by imposing high-quality economic adjustment programmes and limiting the extent of official financing, large-scale financial assistance provided by the IMF (and other official lenders) has tended to compensate for private capital outflows in recent years, resulting *de facto* in a bail-out of the private sector. This strategy is highly questionable from a stability-oriented and regulatory point of view. The market economy principle, namely that investors should not only take the opportunity to make a profit but also run the risk of suffering losses, is being undermined, and in this sense the so-called moral hazard problem is being aggravated. Incentives are being distorted by encouraging more risky behaviour, and future financial crises are becoming more likely.

Significance of promoting private sector development funding increases

The advance of market economy principles has not only revolutionised the financial markets; it has also had an increasing impact on the assessment of development policy strategies in the past few decades. In the course of the nineties there was a growing belief that the promotion of the private sector plays a major role in effectively fighting poverty in the developing countries. For example, the Agreement of the European Bank for Recon-

Largest IMF arrangements ever

as of June 30, 2000; in SDR billion

Country (borrower)	Type of arrangement [1]	Date of commitment		Amount	
				committed	drawn
South Korea	SBA	Dec.	1997	15.5	14.4
Russia	EFF	Mar.	1996	13.2	5.8
Brazil	SBA	Dec.	1998	[2] 13.0	7.9
Mexico	SBA	Feb.	1995	12.1	8.8
Indonesia	SBA/EFF	Nov.	1997	[3] 8.3	[2] 3.7
Argentina	SBA	Mar.	2000	5.4	–
India	EFF	Nov.	1981	5.0	3.9
Russia	SBA	Apr.	1995	4.3	4.3
Brazil	EFF	Mar.	1983	4.2	2.7
Argentina	EFF	Mar.	1992	4.0	4.0
Venezuela	EFF	June	1989	3.9	2.0
Mexico	EFF	May	1989	3.7	3.3
Mexico	EFF	Jan.	1983	3.4	2.5
United Kingdom	SBA	Jan.	1977	3.4	2.3
Russia	SBA	July	1999	3.3	0.5
Mexico	SBA	July	1999	3.1	1.9
Thailand	SBA	Aug.	1997	2.9	2.5
Turkey	SBA	Dec.	1999	2.9	0.4

Source: International Monetary Fund. — **1** Stand-By Arrangement (SBA) or Extended Fund Facility (EFF). — **2** The committed amount originally totalled SDR 13.0 billion and was later reduced to SDR 10.4 billion. — **3** The partial amount of SDR 4.7 billion still not drawn in August 1998 was converted into an EFF arrangement. In February 2000 the committed EFF arrangement amounted to SDR 3.6 billion, SDR 0.5 billion of which was drawn on June 30, 2000.

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Multilateral development banks' financial activities

US $ billion

Item	1980/ 1984	1985/ 1989	1990/ 1994	1995	1996	1997	1998	1999	2000
World Bank Group [1]									
Commitments [2]									
IBRD	10.0	14.0	15.6	16.9	14.7	14.5	21.1	22.2	10.9
IDA	3.4	3.8	6.3	5.7	6.9	4.6	7.5	6.8	4.4
IFC [3]	[4] 0.4	0.9	1.9	2.9	3.2	3.3	3.4	3.5	3.5
MIGA (guarantees)	–	–	0.3	0.7	0.9	0.6	0.8	1.3	1.6
Total	[4] 13.7	18.7	24.1	26.1	25.6	23.1	32.8	33.8	20.4
of which: Adjustment loans	.	.	4.7	5.3	4.5	5.1	11.3	15.5	5.1
Loans outstanding [2, 5] (IBRD and IDA)	45.4	97.3	150.5	195.5	183.1	181.9	184.6	200.4	206.0
Regional development banks [6]									
Commitments [2]									
Asian Development Bank	1.8	2.6	4.5	5.5	5.3	9.3	6.0	5.0	.
Inter-American Development Bank	2.8	2.5	5.3	7.2	6.8	6.0	10.1	9.5	.
African Development Bank	0.7	2.0	2.8	0.8	0.8	1.9	1.7	1.7	.
European Bank for Reconstruction and Development	–	–	1.4	2.6	2.7	2.6	2.8	2.2	.
Total	5.3	7.1	13.9	16.1	15.6	19.7	20.5	18.3	.
Loans outstanding [2, 5]	13.5	32.3	60.1	82.1	81.7	86.2	102.4	113.7	.

Sources: Annual reports of the multilateral development banks. — **1** Fiscal years (lasting from July 1 of the previous year to June 30 of the current year in each case). — **2** Annual averages up to 1994; in the case of regional development banks figures for bank and development fund loans are taken together. — **3** Financing approved for IFC's own account. — **4** The figure for 1980 has been estimated. — **5** IBRD including loans to the Caribbean Development Bank and the IFC; EBRD including share investments. — **6** Calendar years.

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struction and Development (EBRD), which was established in 1991, stipulates that the share of financial assistance granted to the state sector must not exceed 40 % of the volume of business. By contrast, the World Bank agreement of 1944, as a matter of principle, makes provision only for loans to governments or loans with government guarantees. The IBRD itself has hardly any suitable statutory instruments at its disposal for selectively promoting the private sector in developing countries. For this reason, two members of the World Bank Group which were primarily established for the purpose of fostering the private sector became increasingly significant in the nineties. The International Finance Corporation (IFC), founded as early as 1956, supports private enterprises in developing countries by granting loans and investment capital, while the World Bank Group's youngest member, the Multilateral Investment Guarantee Agency (MIGA), which was established in 1988, contributes to boosting direct foreign investment in developing countries by covering non-commercial risks. The share of these two institutions in the World Bank Group's total commitments (including guarantees) rose from approximately 9 % in the first half of the nineties to nearly 16 % in the second half.

Expansion of the World Bank's structural adjustment lending ...

Yet the unprecedented expansion of private financial markets and the general tendency to promote the private sector have also affected the role of the World Bank in quite a different way. Private capital inflows into developing countries rose distinctly between the early nineties and the eruption of the finan-

cial crisis in South-East Asia. In the light of the long-term net inflows of private funds (which, according to World Bank data, increased from approximately US$ 43 billion a year in 1990 to just over US$ 300 billion in 1997), the justification of the World Bank's existence was called into question at times. It is therefore not surprising that the World Bank increasingly engaged in activities which rather come into the domain of the IMF. Since the beginning of the eighties, so-called adjustment loans have provided the IBRD with an instrument that allows it to grant major loans within a relatively short period of time. As these adjustment loans are not earmarked for specific projects, they are often hard to distinguish from balance of payments assistance. The IBRD has made extensive use of this instrument, particularly in the past few years.

... and participation in crisis financing in the nineties

Although the World Bank's adjustment loans already played a major role in solving the debt crisis of the eighties, it was not until the financial crisis in South-East Asia that the World Bank made use of such loans on a large scale. In the fiscal year of 1999 adjustment loans accounted for over 50 % of total loans granted by the World Bank (IBRD and IDA); taking the IBRD alone, the corresponding figure actually was as much as 63 %. The participation of the IBRD and individual regional development banks in liquidity assistance as part of crisis packages is questionable not only because of the aforementioned problem of moral hazard. Ultimately, the question is whether such measures actually help achieve the original intention to provide development assistance and, if so, to what extent or whether, instead, they actually undermine it.

Efficient division of labour between IMF and World Bank

Need for fundamental reform instead of ad hoc adjustments

The financial crises of the nineties triggered an extensive debate about strengthening the international financial architecture in which the Bundesbank is actively involved. Whereas in the past the IMF and the World Bank made pragmatic, ad hoc adjustments to current political and economic changes, it has now become recognised that the role of the Bretton Woods institutions in a globalised world economy needs to be reviewed in a comprehensive manner.

Effective execution of clearly defined tasks requires ...

The IMF and the World Bank are not alien to a world organised according to market principles, as some of their critics claim. There are still elementary tasks to be fulfilled by the IMF and the World Bank in a world economy that is increasingly shaped by market economy principles. Open markets and stability in the international financial system are important public goods. They make a significant contribution to growth and prosperity in the world. Furthermore, there is no doubt that alleviating poverty is a recognised objective of the international community. However, it is crucial that the Bretton Woods institutions fulfil their respective tasks in a way that complies with the generally accepted view that market economy mechanisms are more efficient. Clearly defined mandates for the IMF and the World Bank must therefore be integrated into a regulatory framework which enables them to provide member countries and market participants with convincing solutions in line with market principles. The strategies of both institutions should focus on strengthening

and relying on market forces while pushing back interventionist practices.

... return to basic principles of original mandates ...

An effective reform does not require any profound institutional changes at the IMF and the World Bank. Instead, it requires constant awareness of the essential principles of the original mandates, which define the IMF as a monetary institution and the World Bank as a development organisation. If both institutions concentrate on their specific comparative advantages in line with clear-cut mandates, they will fulfil their tasks more efficiently. By comparison, merging the IMF and the World Bank into a single body, a proposal which has occasionally been put forward as a solution, does not appear helpful as it would hardly release the desired synergy effects in practice. Instead, there would be a danger that monetary and development policy tasks would blur, and that would be a major cause of concern in regulatory terms. Furthermore, phenomena often associated with large organisations – for example, the vague formulation of objectives, indistinct priorities and an overgrown bureaucracy imposing substantial management problems – would be the likely result.

... and intensification of cooperation

Yet even if the responsibilities of the IMF and the World Bank remain clearly separated, their specific tasks will continue to be interwoven. Both institutions must therefore aim to fulfil their core tasks and to complement and support one another (instead of competing with each other) in order to avoid frictional loss and reach an optimum relationship between cost and benefit. The IMF and the World Bank should therefore intensify their cooperation accordingly. This could help reduce or even avoid overlapping fields of activity, duplication of work and inconsistencies. In this context, it is important to keep on trying to find new mechanisms and ways of collaboration. The experience gained in various projects such as the Financial Sector Assessment Program (FSAP), which is carried out jointly by the IMF and the World Bank, could form a useful basis for future cooperation.

Strengthening the IMF's surveillance and consultation functions

Crisis prevention is key

The IMF's bilateral and multilateral surveillance plays a key role in the context of efficient division of labour with the World Bank. The successful oversight of macroeconomic developments serves to prevent crises and forms the basis for effective consultation with members on policy issues. Surveillance and policy advice should focus increasingly on crisis-relevant aspects in the future. Crisis prevention must be given priority. The recent financial crises have shown that surveillance geared primarily to monetary and financial policies as well as current account developments is inadequate. In a setting of liberalised financial markets, exchange rate policies, capital account trends and the structure of foreign debt as well as the stability and soundness of the financial sector play an equally important role.

Support for orderly liberalisation of capital markets

When carrying out its surveillance and consultation functions, the IMF needs to regard the basic conditions of liberalised financial markets as a given fact. Even though the financial crises of the nineties were, in many

cases, aggravated by a premature or insufficiently prepared liberalisation of capital flows, a reversal of this trend is neither useful nor realistic. Instead, the challenge for the IMF is to ensure that in individual countries progress is made with regard to macroeconomic stabilisation and the creation of an institutional framework, particularly of a sound financial system, before there is any further liberalisation of their capital markets.

More transparency to strengthen proper functioning of markets

Effective surveillance and crisis prevention can be boosted significantly by appropriate measures to enhance transparency. The availability of informative and timely data on a country's economic situation can identify undesirable developments at an early stage and enable measures to be taken to rectify them. In addition, transparency enhances the efficiency of the markets. It supports well-informed financial decision-making, thereby avoiding excessively risky lending. In a crisis situation, transparency reduces the danger of potential overreaction by the financial markets. At the same time, transparency may be used as a lever to encourage the implementation of sound policies in member countries because the speedier adjustment of risk premiums associated with increased transparency encourages the willingness to make the necessary policy adjustments while rewarding sound economic policies. It is therefore gratifying that in the past few years the IMF has taken a number of measures to improve the transparency of its own activities and the policies of its members. In a further step, the IMF now aims to adopt a new disclosure policy encouraging its member countries to publish more country-specific IMF documents.

Limitations to transparency

Although transparency increases credibility and creates confidence, it can also conflict with the Fund's consultation function. At any rate, the line should be drawn where a disclosure of information would be counterproductive. In particular, excessive transparency must not be the very cause of a crisis. Despite its surveillance function, it cannot be the IMF's job to perform what is tantamount to country rating by providing a detailed assessment of its regular data releases. Instead, assessing data should be left to the markets.

Surveillance of compliance with standards and codes

An important means of strengthening the international financial system is the development, dissemination and application of internationally agreed standards and codes of good practices for economic and financial activities. The Financial Stability Forum[5] has identified 12 key standards for sound financial systems. Owing to its surveillance mandate and its almost universal membership (now numbering 182 countries), the IMF can claim a leading role and a coordinating function with regard to the monitoring of compliance with internationally agreed standards and codes. However, the IMF has to recognise the standard-setting authority of other institutions when it comes to refining existing standards and codes.

5 The Financial Stability Forum was convened by the finance ministers and central bank governors of the Group of Seven countries in the spring of 1999, following a proposal by the then Bundesbank President Hans Tietmeyer. The forum serves as a discussion and coordination committee for monitoring and strengthening the stability of the international financial system. It is composed of representatives of national and international authorities, institutions and bodies responsible for issues relating to financial stability.

Standards and codes must not result in overregulation

As a matter of principle, standards and codes can only be implemented on a voluntary basis. If they are to be accepted and are to be effective, it is essential that they do not result in paralysing overregulation. Economic activity should never be "codified" in detail. When assessing compliance with standards and codes, the IMF should focus on the areas and aspects relevant to crisis prevention and take due account of country-specific singularities. Moreover, the Fund should be warned against paying too much attention to details that go beyond its immediate area of responsibility. While it may criticise members for, say, delayed or half-hearted implementation of anti-corruption and money-laundering legislation, any farther-reaching authority in this specific area would not be consistent with its monetary mandate. The Reports on the Observance of Standards and Codes (ROSCs) provide the Fund with an effective and flexible instrument for monitoring compliance with standards and codes of which it should make more intensive and judicious use in future.

The IMF's financing role in a setting of global financial markets

No IMF loans to potential borrowers with access to capital markets

Focusing more closely on its monetary mandate requires the IMF to make adjustments to its historically "evolved" financing role, in particular. Considering that today's international financial markets are capable of satisfying any "legitimate" financing need, the Fund should concentrate on fostering, maintaining or restoring its members' access to capital markets – mainly by providing appropriate economic policy advice and, if required, catalytic balance of payments assistance. Where a country is able to access the capital markets on sustainable terms, however, financing by the IMF cannot be justified as private creditors would be crowded out by public ones – which is problematic in regulatory terms. The Fund's liquidity assistance should therefore be limited to financing inevitable, short-term balance of payments needs; these are typically defined as a situation where a country, despite intensive adjustment efforts, is not in a position to close a balance of payments gap without relying on official financial assistance.

IMF not a lender of last resort

The IMF cannot and should not act as a lender of last resort. Such a policy would contradict fundamental market principles as it releases investors from bearing the risks and consequences of their entrepreneurial decisions and hampers potential contractual solutions between debtors and creditors from the outset. The Bundesbank has repeatedly pointed out the resulting distortion of incentives and the associated risks to macroeconomic and financial stability. Large-scale financing packages encourage moral hazard, lead to a sub-optimal allocation of resources and often serve to finance unsustainable exchange rate levels. In addition, they bring about financial burdens which can hardly be borne by drawing on the regular quota resources including existing credit lines under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB).

The arguments put forward in favour of the Fund acting as a lender of last resort are hardly convincing. There is no evidence to support

Key standards for sound financial systems

Standard	Issued by
Code of Good Practices on Transparency in Monetary and Financial Policies	**International Monetary Fund** (IMF)
Code of Good Practices on Fiscal Transparency	**International Monetary Fund** (IMF)
General Data Dissemination System (GDDS) **Special Data Dissemination Standard** (SDDS)	**International Monetary Fund** (IMF)
Principles and Guidelines on Insolvency Regimes for Developing Countries 1	**World Bank**
Principles of Corporate Governance	**Organisation for Economic Co-operation and Development** (OECD)
International Accounting Standards (IAS)	**International Accounting Standards Committee** (IASC) 2
International Standards on Auditing (ISA)	**International Federation of Accountants** (IFAC) 2
Core Principles for Systemically Important Payment Systems	**Committee on Payment and Settlement Systems** (CPSS)
The Forty Recommendations of the FATF	**Financial Action Task Force** (FATF)
Core Principles for Effective Banking Supervision	**Basel Committee on Banking Supervision** (BCBS)
Objectives and Principles of Securities Regulation	**International Organization of Securities Commissions** (IOSCO)
Insurance Supervisory Principles	**International Association of Insurance Supervisors** (IAIS)

Source: Financial Stability Forum. — **1** Currently being drawn up by the World Bank in cooperation with other bodies. — **2** IASC and IFAC are private expert committees.

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Misguided economic policies cause of financial crises

the claim that such policies are required to avoid systemic crises. Much the same holds true for the argument that a lender-of-last-resort policy would help avoid potential contagion in sound economies. There is so far no known case of an economically sound country getting into a severe crisis through contagion alone. Today there is much evidence to suggest that critical developments in individual countries were ultimately caused by deficiencies in national economic policies, often in conjunction with an inadequate or inappropriate regulatory framework. In many cases, however, these developments were aggravated by herd behaviour, which is not untypical of the financial markets. It is also worth noting that the role of the lender of last resort, which the IMF played *de facto* during the financial crisis in South-East Asia, obviously could not prevent the crisis from spreading throughout the region. Ultimately, economic policy deficiencies, such as the absence of effective banking supervision, and misjudgements by the private sector, cannot be rectified using monetary instruments.

Private sector involvement in solving crises assured by adhering to the ...

These considerations suggest that the catalytic role of IMF credit should be emphasised more strongly in the future.[6] The adjustment programmes developed and supported by the IMF must be aimed at generating the private resources required to finance balance of payments deficits by ensuring the quality of the economic policy adjustment. A credible "bail-

6 See also Deutsche Bundesbank, Recent approaches to involving the private sector in the resolution of international debt crises, Monthly Report, December 1999, page 33 ff.

in" of the private sector is inextricably linked with a consistent reduction in official financing. Neither debtors nor creditors should be able in future to rely on the international community being prepared to finance debtor countries' balance of payments needs by providing official resources. To this end, it is absolutely essential to set regular access limits on IMF resources. The appropriate procedures still need to be worked out. Basically, it would be conceivable to define the limits as a function of a country's quota or its balance of payments. In principle, the limitation on IMF credit applies even if exceptional financing needs arise in the event of a financial crisis. In the absence of such limitations there are no sufficient incentives for market participants to conclude burden-sharing agreements as they ultimately hope to be able to transfer part of the burdens to the international community.

... strictly catalytic financing role of the IMF

The limitation on official financing will inevitably result in the financial involvement of the private sector in solving financial crises. In such a situation lenders and borrowers are called upon to find cooperative solutions themselves. This benefits both parties, since the arrears which would otherwise arise are associated with a considerable risk – for both creditors and debtors. The IMF's role should consist mainly in providing the framework for this negotiation process by defining the financial contribution it is willing to make and providing the balance of payments projection associated with its programme. The IMF should adhere to this strictly catalytic role even in cases where a country, despite exceptionally large acute financing needs, can be expected to regain access to the capital markets in the near future. It is particularly in the case of this type of financial crisis that adequate involvement of the private sector cannot be foregone, considering the moral hazard risks and the associated disruption of the financial markets. The catalytic approach to solving financial crises by involving the private sector still leaves room for flexibility in individual cases. The decisive factor is that the principle of private sector involvement in solving financial crises will become the rule. This must be communicated convincingly to the creditor countries and market participants if expectations that may have been distorted by the crisis management exercised in the past are to be corrected. In the final analysis, this is also the best contribution the IMF can make to preventing future crises effectively.

Reviewing the IMF's role in structural adjustment and development financing

Over and above the general problem of limiting official financing, the role to be played by the IMF in longer-term financing geared primarily to structural adjustment and development needs to be scrutinised. Financial aid granted for such purposes is primarily the responsibility of the development banks. Much the same applies to alleviating poverty. It can no more be a priority task for the IMF than for national central banks. The objective of poverty alleviation in itself is unquestionable, and that is exactly why it calls for an effective division of labour between the Bretton Woods institutions. This raises the question as to whether in the medium to longer term the PRGF should be transferred from the IMF to the World Bank. The best contribution the IMF can make to fighting poverty is to ensure monetary stability in the poorest countries,

above all, thus realising an essential precondition for economic growth.

Consistent gearing of conditionality to solving balance of payments problems

Regular IMF financial assistance should continue to be provided on terms which are generally based on the relatively favourable SDR interest rate. This is justified by the special features of the other conditions of IMF programmes, which in most cases call for macroeconomic adjustments. In the future, the conditionality of IMF financing should again be focused on solving balance of payments problems as rapidly as possible and thus on bringing about a more sustainable macroeconomic situation. The fact that more and more secondary objectives have been included in the IMF's conditionality in the past few years is a matter of particular concern. Although these aspects are of major importance in the development process as such, it is evident that the IMF does not have the democratic mandate to act as a substitute political power. If the IMF was too active in those areas, this would inevitably be detrimental to the fulfilment of its core tasks. Defining a comprehensive structural conditionality is more a matter for the World Bank. Any adjustment programme and any coordination of activities with the World Bank should ensure that the borrowing countries can identify with their adjustment programmes and that they are prepared, if necessary, to bear potentially heavy adjustment burdens temporarily ("ownership").

Adjustment of IMF facilities

Avoidance of unduly long or large and repeated use of IMF resources

The revision of IMF facilities is one of the centrepieces of the envisaged reform of the Fund. The IMF's return to its catalytic and monetary role should therefore also be reflected in the revision and adjustment of its facilities. The fact that private capital markets have become much more important makes it easier, in principle, to limit or even reduce overall IMF lending. IMF credit must not result in a crowding-out or bail-out of private lenders. Credit terms should be aimed at avoiding an unduly long or large and repeated use of IMF resources. Despite regular access limits, there should be an assurance that loans will always be paid back prior to maturity if favourable economic developments allow a borrowing country to do so. In addition, more extensive use than in the past could be made of interest rate levels to ensure that the use of the Fund's resources is again focused on short-term catalytic balance of payments assistance.

Stand-By Arrangement as standard instrument

The IMF facilities should be clearly and simply structured, mutually consistent and basically open to all members. In the context of non-concessional lending, "classical" Stand-By Arrangements (SBAs) should continue to be the standard instrument to finance short-term balance of payments needs. Financial support of structural adjustments may help ensure balance of payments stability and is therefore clearly in the interest of the IMF, too. Nevertheless, it is primarily the development banks that are responsible for financing structural adjustments. Therefore, this kind of financial assistance by the IMF is only justified where it focuses on strengthening the structural and

institutional preconditions for achieving sustainable access to capital markets.

Crisis prevention the responsibility of each individual country

Contingency facilities, which were designed to avoid contagion effects, are not without risk in regulatory terms. In a system geared to market principles, which gives priority to autonomous crisis prevention and enhances the effective operation of the markets by improving transparency, special facilities for "sound" countries should actually be superfluous. Of course, the international community, too, is interested in effective crisis prevention; however, it is primarily the individual countries themselves that are responsible and obliged to make a contribution.

Contingency credit facilities pose problems

Furthermore, the definition of criteria governing access to such a facility will always be arbitrary (to a certain extent) and result in a dilemma. If the eligibility criteria are too generous, this will aggravate the moral hazard problem as quasi-automatic access to official financing is possible in the event of policy shortcomings in areas not covered by the eligibility criteria. If the eligibility criteria are too restrictive, such a facility will lose its attractiveness for potential users. In addition, a critical situation may arise where a country no longer meets the eligibility criteria. The termination of the right to draw on that facility, which would be necessary in that case, is likely to entail negative responses in the markets. A "genuine" crisis facility is therefore only justified if it is designed to ward off serious threats to the international monetary system.

Further need to streamline the Fund's facilities

In an initial step towards simplifying its facility structure, the IMF abolished four facilities that were no longer required at the beginning of this year.[7] It is now essential to review the remaining facilities in the light of the principles outlined above. In addition, the IMF recently took a number of measures aimed at preventing the misuse of IMF resources. When specifying these measures, it is essential to ensure that the inevitably necessary rules do not get out of hand. The IMF's human and material resources should continue to be available primarily for macroeconomic surveillance and consultation with its members in the future.

Representation in the IMF and influence on Fund policy

Quota to be based on the global economic weight and the degree of openness

The debate about IMF reform also touches on the issue of how the members' representation in the Fund and their influence on Fund policy can be adjusted to the changes in global economic and geopolitical conditions. The IMF Articles of Agreement stipulate that a member's quota determines its voting power. The quotas should continue to be based on a country's economic weight and the degree of its integration into the world economy. This principle should also be taken into account in the context of the upcoming review of the quota formulas. The inclusion of other factors such as population is hard to justify in economic terms, nor can it be derived from the IMF's monetary mandate.

7 At the beginning of this year the IMF Executive Board decided to eliminate the Buffer Stock Financing Facility (BSFF) and the Currency Stabilization Fund (CSF), to terminate financial assistance to measures of Debt and Debt Service Reduction (DDSR) and to streamline the Compensatory and Contingency Financing Facility (CCFF) by abolishing the contingency element.

Core IMF financial facilities

Facility	Access limits (as percentage of the member country's quota)	Repayment period (years)	Purpose	Outstanding credit as at the end of June 2000 (SDR billion)
Stand-By Arrangement (SBA)	100 % annually 300 % cumulatively	3 ¼ to 5	Financing of short-term balance of payments needs	20.4
Extended Fund Facility (EFF)	100 % anually 300 % cumulatively	4 ½ to 10	Financing of longer-term, larger balance of payments needs stemming largely from structural problems	15.9
Supplemental Reserve Facility (SRF)	No defined access limits	1 to 1 ½ (expectation) or 2 ½ (maximum), respectively	Financing of exceptional balance of payments needs, particularly in order to ward off threats to the international monetary system	–
Contingent Credit Line (CCL)	Expectation of a magnitude of 300 % to 500 %, but no strictly defined access limit	1 to 1 ½ (expectation) or 2 ½ (maximum), respectively	Financing of balance of payments needs arising from contagion effects in countries with "sound" economic policies	No credit line has been agreed so far
Poverty Reduction and Growth Facility (PRGF) 1	140 % to a maximum of 185 %	5 ½ to 10	Concessional financial assistance to low-income countries in the case of protracted balance of payments difficulties stemming from structural problems	5.8

Source: International Monetary Fund. — **1** Unlike the other facilities listed in this table, the PRGF is not funded by the IMF's General Resources Account, but by bilateral contributions and special IMF resources.

Deutsche Bundesbank

Adherence to the principle of country-based membership

The member countries exert influence on IMF policies through their Executive Directors (unless the Board of Governors is responsible). In this context, the major shareholders should continue to appoint their own Executive Directors in future; these should be accountable to their respective national authorities and bound by their instructions. The principle of country-based membership, which has not been called into question so far, also gives members the right to form or to join a constituency. Despite the fact that membership of the IMF is on a country basis, European Monetary Union also requires that specific questions relating to the IMF be coordinated in the appropriate bodies at a European level.[8]

Proven collaboration between Bundesbank and Federal Government

Member countries take decisions on IMF issues at their own discretion. In Germany, it is the Bundesbank that exerts the financial rights and carries out the duties of IMF membership on the basis of the IMF Act and the associated administrative agreements. The division of labour and the sharing of duties, including the taking of decisions on IMF-relevant issues, which the Bundesbank and the Federal Government practise on this basis, has stood the test of time and forms a sound basis for future cooperation.

8 See also Deutsche Bundesbank, Germany's relations with the International Monetary Fund following the introduction of the euro, Monthly Report, September 1999, page 15 ff.