

The role of the International Monetary Fund in preventing and managing crises

As a global financial institution, the International Monetary Fund (IMF) plays a key role in shaping international monetary cooperation. It contributes to the stability of the global monetary and financial system by working with its member countries, providing either policy advice or, if required, financial assistance to help prevent and manage economic and financial crises.

In order to be prepared for future developments, the IMF continually reviews its policies. It often faces high expectations in an environment that is in constant flux and shaped by politics. At the same time, it is confronted with the challenge of how to meet these expectations within the framework of its mandate.

This article outlines the IMF's key tasks in crisis prevention and management. In addition, it discusses the organisation's financial resources and Germany's membership, the 70th anniversary of which was this year.

As the fourth largest member of the IMF, Germany is actively committed to international monetary cooperation and supports the IMF in its work, with the Bundesbank discharging its legally mandated tasks. Besides exercising the financial rights and obligations arising from Germany's membership, these tasks also include the Bundesbank's involvement in Germany's representation in the IMF.

■ Major waypoints

Founding conference held in 1944, Germany joins in 1952, ...

The IMF was established as an international financial organisation in 1944 at the United Nations conference in Bretton Woods, New Hampshire, United States, a gathering of delegates from 45 nations. It began its operations in 1946, after a sufficient number of countries had ratified the IMF Articles of Agreement, thereby accepting the IMF's objectives, the rules for international monetary cooperation and the new international monetary system, as well as the resulting obligations. Germany joined the IMF 70 years ago, on 14 August 1952.¹

... creation of new reserve assets in 1960s

At the end of the 1960s, there were concerns that the fixed exchange rate regime in place at that time would no longer be able to function properly in the event of a global shortage of reserve assets. As a result, the IMF was empowered to create what are known as special drawing rights (SDRs) as a reserve asset and allocate them to its members (see the box on pp. 109 ff.).

End of fixed exchange rate regime in 1970s

One of the biggest changes to occur was the comprehensive reform of the international monetary system in the 1970s. This involved the transition from a monetary system of fixed exchange rates against the US dollar, which was pegged to gold, to a system of monetary cooperation without a gold peg and in which members were free to choose their own exchange rate regimes. However, they remained obliged to work with the IMF to safeguard orderly exchange rate arrangements and support a stable exchange rate regime.

Numerous other countries joined IMF, ...

Germany joined the IMF in 1952 as its 53rd member. Over the years, membership has grown to 190, making the IMF a truly global institution. This is one of the main reasons why the IMF is able to play an effective role in promoting international monetary cooperation. At the same time, global stability is strengthened by the fact that many countries have accepted the rules enshrined in the IMF Articles of Agree-

ment and the rights and obligations that come with membership.

The substantial expansion of IMF membership has also brought with it a sharply growing number of members classified as developing or low-income countries,² which are confronted with economic policy challenges that, in part, differ in nature from those faced by advanced economies, for example. Low-income countries currently make up more than one-third of IMF members. Their increasing importance is shaping the IMF's role and policies, as reflected in, amongst other things, the establishment of trust funds providing concessional financing for this group of countries. Resources for these trust funds are mobilised from members on a voluntary basis and are managed separately from the IMF's own resources (see also the box on pp. 126 ff.).

... including many low-income countries

Financial crises – such as the Asian crisis at the end of the 1990s, the global financial crisis of 2008 and the European debt crisis of the early 2010s – as well as various regional debt crises pose constant challenges to the IMF. Within the scope of its mandate, it provides its members with assistance in addressing these challenges in the form of tried and tested, modified or new instruments. The IMF responded swiftly and decisively to the COVID-19 pandemic, too, significantly stepping up financial assistance to support its members. In addition, it is grappling with the far-reaching economic fallout of the Russian war of aggression against Ukraine due to the global disruptions it has caused, which are placing heavy burdens on many, especially poorer, countries. As a global institution, it is an

Financial crises in 1990s and 2000s ...

¹ To mark the 60th anniversary of Germany's IMF membership, various important aspects of the work of the IMF and Germany's membership were discussed in the September 2012 Monthly Report; see Deutsche Bundesbank (2012). Now, ten years later, this article takes a fresh look at the IMF and its work.

² The term "low-income countries" is used here to refer to member countries that are classified by the IMF as eligible for access to concessional financing. The IMF's most recent review of eligibility determined that 69 countries may access this financing; see International Monetary Fund (2020a).

Special drawing rights and their use

In the 1960s, concerns increasingly emerged about the future functioning of the international monetary system due to a possible global shortage of reserve assets. There were fears that such a shortage could occur, in particular, in the event of an insufficient US current account deficit in the Bretton Woods global gold-dollar-based monetary system of fixed exchange rates (1944-73). It was assumed that in such a situation countries would no longer be able to generate enough US dollars through their foreign trade to finance imports and the shortage of foreign exchange would subsequently force them to take restrictive measures. These are considered harmful to global economic prosperity.¹ In order to address these feared risks to the international monetary system and to the global economy, the International Monetary Fund (IMF) was, with the first amendment to its Articles of Agreement in 1969, granted the right to create special drawing rights (SDRs) as a reserve instrument and to allocate them to its members. SDRs can only be allocated to all member countries at the same time.² The allocations are distributed to individual members in proportion to their quota, which is reviewed on a regular basis.³

SDRs are not a currency in the usual sense, as they cannot be used as a general means of payment. A country may exchange them for currencies classified as freely usable by the IMF⁴ and they can be used to carry out transactions with the IMF.

Since SDRs were introduced, the concerns about a global shortage of reserve assets have proved largely unfounded.⁵ Moreover, with flexible exchange rates, for which many countries opted after the end of the Bretton Woods global monetary system,⁶

interventions to stabilise the exchange rate were no longer an economic policy priority. The long-term and global need to supplement existing reserve assets, as defined in the IMF's Articles of Agreement as a condition for new SDR allocations, has consequently been established only rarely and to a limited extent.⁷ New SDR allocations were made only in connection with the global financial crisis as of 2008 and most recently during the COVID-19 pandemic. These allocations to 190 members at last count were significantly higher than previous ones (2009: SDR 161.2 billion; 2021: SDR 456.6 billion). The focus was placed for all practical purposes on efforts to provide additional financial assistance to low-income

1 For an SDR allocation, the IMF's Articles of Agreement require that there is a long-term global need to supplement existing reserve assets and that an allocation does not contribute to excess demand and inflation in the world. The IMF's Articles of Agreement also provide for the possibility of cancelling SDRs based on these considerations. See International Monetary Fund (2016), Art. XVIII Section 1(a).

2 Through an amendment to the IMF's Articles of Agreement in 1998, an exceptional "equity allocation" of SDRs was agreed to those countries that had joined the IMF after previous allocations and had therefore not yet received any SDRs.

3 Each member country receives a quota expressed in SDRs. The quota reflects the member's relative position in the world economy. It determines the capital contribution a country is obliged to make to the IMF and the share it receives in an SDR allocation, as well as determining the member's voting power within the IMF.

4 These are currently five currencies which are simultaneously part of the basket of currencies on which the value or exchange rate of the SDR is based: US dollar, euro, renminbi, yen, and pound sterling. The IMF regularly reviews the composition and weighting of the currencies in the SDR basket of currencies.

5 See, for example, Bordo and McCauley (2017), p. 7, James (1996), p. 173, and Hauptmann (1977), p. 35.

6 The reform of the international monetary system was formalised by the second amendment to the IMF's Articles of Agreement in 1978 and leaves members free to choose their exchange rate regime.

7 The first SDR allocation of SDR 9.3 billion was made from 1970 to 1972 to the 115 member states at that time. A second allocation of SDR 12.1 billion was made from 1979 to 1982 to then around 140 members. A cancellation of SDRs, which the IMF's Articles of Agreement also allow for, has not occurred so far.

countries and emerging market economies, which were hit particularly hard by the crisis. In so doing, the de facto expansion of the purpose of SDRs as defined in the IMF Articles of Agreement towards a development and emergency financing instrument for a section of its membership was conceded.

The fact that the SDR allocation in August 2021 was coupled to the financing needs of low-income countries during the crisis is because SDRs can be used flexibly. From an economic point of view, an SDR allocation⁸ is comparable to granting members an overdraft facility.⁹ Unlike IMF financial assistance, there are no economic policy conditions or fixed repayment schedules when making use of allocated SDRs. While the extent to which individual countries use allocated SDRs can be traced retrospectively via IMF statistics, information on the type of use is based on voluntary disclosure by member countries.¹⁰ The value of SDR transactions must be reported to the IMF or the transactions are brokered by the IMF; it is not necessary to explain their purpose. In addition, SDR allocations can give rise to financial transactions without an exchange of SDRs being observable: following a new SDR allocation, for example, a country can retain its SDR holdings and reduce existing foreign exchange reserves instead; other countries will use an SDR allocation as collateral in order to expand the monetary financing of government by the central bank.

The information available so far, however, can be used for an initial assessment of the SDR allocation carried out in 2021: how many and which countries reduced their SDR holdings following the allocation and presumably also used them to finance the balance of payments?¹¹ In the first nine months following the allocation, only a

limited number of IMF member countries already significantly reduced their newly allocated SDRs, i.e. exchanged them or used them for payments to the IMF. Up to April 2022, a total of 38 low-income and emerging market economies reduced their SDR holdings by at least 50% of the newly allocated SDRs.¹² Countries in this group share a number of common features. One particularly striking aspect is the overrepresentation of emerging market economies with high risks to their debt sustainability and with a loss of market access, along with countries suffering acute debt crises. Well over half of the emerging market economies in the group fall into one of these categories. Of the low-income countries, more than 60% are exposed to high debt risk or find themselves in an acute debt crisis. However, the strong use of SDRs by countries with unsustainable external debt potentially conflicts with the general recommendations of the IMF, which advise members not to use the policy space pro-

⁸ Each SDR allocation involves the transfer of the SDR holdings and an equivalent liability to the IMF. This is because SDRs can be cancelled by the IMF and must be returned if a country leaves the IMF. Therefore, although an SDR allocation increases a country's gross foreign reserves, net foreign reserves remain unchanged. However, in the net international reserves statistics the SDR liability is treated as a long-term liability item and is therefore not taken into account in some cases.

⁹ A country's SDR holdings decline when it uses SDRs. If a member's SDR holdings are below its allocations, the IMF charges interest on the difference at the SDR interest rate. If SDR holdings are greater than allocations, the country receives the SDR interest rate on the difference from the IMF. The SDR interest rate is based on the money market rates of the five currencies in the SDR basket (US dollar, euro, renminbi, yen, and pound sterling) and currently stands at 1.566% (as at 1 September 2022).

¹⁰ The IMF collects and summarises this information as part of its bilateral surveillance. See International Monetary Fund (2022e).

¹¹ It is also conceivable that a country exchanges SDRs in order to optimise the composition of its own reserve assets in terms of interest income or exchange rate risk.

¹² Countries usually drew on funds quickly following the allocation at the end of August 2021, in the subsequent months in most cases. 26 of the 38 countries have already used at least 90% of their SDR allocation.

vided by the allocation to delay any debt restructuring needed, not to pursue unsustainable macroeconomic policies or postpone necessary macroeconomic adjustments and reforms.¹³ Like the requirement that IMF loans should be utilised as efficiently as possible, these recommendations make sense as, in economic terms, levels of SDR holdings below allocations bear similarities to an external foreign currency debt with a variable interest rate and without a fixed maturity.

A more comprehensive assessment of the SDR allocation of August 2021 will be possible once the IMF has presented its own evaluations. A critical view of SDR allocations would be warranted, in particular, if countries postpone necessary reforms in the face of the sudden availability of liquidity. It should also be noted that it is not possible to allocate SDRs in a targeted manner

and the use of SDR holdings results in an interest burden; this may place additional strain on low-income countries that would benefit more from concessional financing and grants.

¹³ See International Monetary Fund (2021a).

important part of the multilateral world economic order. Its contribution to rules-based cross-country cooperation in the global monetary system is vital for prosperity.

... required IMF to evolve

The global economic situation, the international monetary system and the IMF's policies have changed in many ways since it was established. The mandate and core elements of the institutional structure, as well as the special characteristics of the IMF as a monetary institution, have remained largely unchanged. This offers the IMF numerous, albeit not unlimited, ways in which to support its members. Over time, the IMF has continually refined and enhanced its policies, particularly in the areas of economic policy advice and surveillance, as well as in the way that financial assistance is provided and structured. This, as well as the IMF's financial resources and the role of Germany and the Bundesbank in the IMF, will be discussed in the following sections of this article on the basis of selected factors.

The IMF's economic policy advice

As a multilateral institution, the IMF is a stabilising force for the global economy. It is often called upon to respond quickly to sudden challenges in member countries and to support them within the framework of its mandate. One of the IMF's most important tasks is crisis prevention through economic and financial policy surveillance. Compared with the financial assistance it provides, this task is often less firmly in the public eye.

IMF as a stabilising element ...

Since the establishment of the IMF, the global monetary and financial system has been constantly changing and evolving. The IMF has repeatedly responded to these changes by modifying its policies and strategic direction. Over the past decade, the world economic environment and international challenges have undergone further transformation: the increasing dangers of climate change have become more

... in a changing global monetary and financial system

of a policy focus and require a global, cooperative solution. Digitalisation efforts have progressed, private crypto tokens have emerged and many central banks are working to develop central bank digital currencies. Emerging market economies have continued to catch up economically, albeit unevenly. Despite a slight decline since the 2008 financial crisis, cross-border capital flows remain large. These can trigger positive effects in recipient countries, impacting on growth, economic development and stability, for example, but they also entail risks. Abrupt capital outflows can pose a threat to macroeconomic stability and the stability of the financial system, especially in emerging market economies with limited resilience. Moreover, the increasing debt held by many countries has reached worrying levels in the last few years. The COVID-19 pandemic and, most recently, the Russian war of aggression against Ukraine have shown how global economic disruptions and burdens can emerge and existing vulnerabilities can be exacerbated in a very short space of time.

Crisis prevention: the IMF's core task

Crisis prevention through regular bilateral surveillance, ...

The IMF's surveillance activities are carried out with the overarching objective of promoting the development and stability of the international monetary and financial system, thereby preventing crises. In this context, the IMF benefits from its role and experience as a global institution. Under the IMF Articles of Agreement, all 190 members are required to undergo regular, usually annual, Article IV consultations³ in which their economic policies are assessed for compliance with the objectives outlined in the Articles. Based on an in-depth analysis of a country's economic developments and policies, the IMF prepares a report containing economic policy recommendations. The rationale behind this "bilateral surveillance" is that the economic policies of one country may have an impact on other members. The best way to promote global stability is therefore to ensure that all

members pursue a stability-oriented economic policy at home and, in doing so, contribute to the stability of the international economic and financial system.

In addition to this regular surveillance for all members, the IMF pays particular attention to the economic policies of those countries that have agreed on a credit programme for the purpose of resolving balance of payments problems. In such cases, the IMF assesses the implementation of agreed reforms. This intensified level of surveillance may continue following the completion of a credit programme (post-programme monitoring). Separately from the provision of financial assistance, too, the IMF has tools with which it can more closely monitor countries' economic policies on an advisory or programme basis. These tools include Staff Monitored Programs (SMPs), the Policy Coordination Instrument (PCI), the Policy Support Instrument (PSI) and the Debt Sustainability Framework (DSF) developed specifically for low-income countries, which analyses the debt sustainability of these countries.

... which can be stepped up as required

Targeted analyses of the financial system

These bilateral surveillance measures and non-financial programmes are complemented by targeted analyses of the financial system. In response to the Asian crisis, the IMF introduced the Financial Sector Assessment Program (FSAP) in 1999. The IMF and the World Bank conduct comprehensive and in-depth analyses of members' financial sectors, review the application of international regulatory and supervisory standards and make recommendations. In doing so, the IMF makes an important contribution to identifying and mitigating risks in the financial sector and to making national financial systems resilient and sustainable. Members with sys-

Particular focus on financial sector

³ Named after Article IV of the IMF Articles of Agreement, in which surveillance of members is specified as a task to be conducted by the IMF.

temically important financial sectors – one of them being Germany – are required to undergo the FSAP every five years. Germany was recently assessed and the final report published in mid-July 2022 (see the box on p. 132). In order to improve the coordination of surveillance, it was also decided that FSAP findings would be integrated to a greater extent into the annual Article IV consultations. In 2021, the FSAP instrument was reviewed and refined, amongst other things with regard to new macroeconomic risks related to climate change and digitalisation. The review also focused on improving the analysis of links between banks and financial institutions that are not part of the banking sector.

Multilateral surveillance

Complementary multilateral surveillance of global risks and spillovers, ...

Bilateral surveillance is accompanied by multilateral surveillance. The latter's aim is to identify global risks or risks that could spill over from one member to other countries or to the global economy and to recommend containment measures. To this end, the IMF analyses and assesses global macroeconomic and financial sector developments.

... inter alia via flagship reports

Key instruments for multilateral surveillance are the World Economic Outlook, which provides detailed analyses of the global economic situation; the Global Financial Stability Report, which focuses on imbalances and vulnerabilities within the global financial system; the Fiscal Monitor, which examines the state of members' public finances; and the External Sector Report, which assesses the external positions of the world's largest economies.⁴ In addition, the IMF has been collaborating with the Financial Stability Board (FSB) to conduct an Early Warning Exercise (EWE) every six months since 2009. This is designed to identify at an early stage risks and undesirable developments that are low-probability but high-impact to the global economy.

Periodic surveillance review

The IMF periodically reviews the framework and focal points of its surveillance and, if necessary, modifies them to keep up with changes in the global economy. The last major change came in the form of the Integrated Surveillance Decision (ISD) in 2012. After the global financial crisis revealed weaknesses in surveillance, various tasks – and not least bilateral and multilateral surveillance – became better coordinated. For example, surveillance prior to the ISD focused heavily on members' exchange rate policies and neglected other policy areas (fiscal, monetary or financial stability policies) that could have a negative impact on other countries. An important objective of the ISD was to better identify and assess spillovers between economies. This concerns, for example, the impact of monetary policy decisions by major central banks on emerging market economies. In multilateral surveillance, from then onwards greater focus was placed on issues that require coordinated policy action in order to ensure global stability. Financial system analysis was also ramped up considerably once again.

Surveillance expanded and improved in wake of global financial crisis

In addition to assessing and refining the surveillance framework, the IMF periodically reviews surveillance practices. As part of the last review of this kind in 2021, the Comprehensive Surveillance Review, several innovations were introduced to improve the quality of surveillance. The Article IV consultations are to focus on a small number of topics that are considered particularly important. Cross-country analyses are also planned for topics that affect multiple countries at the same time. However, this approach entails the risks of analyses on core macroeconomic issues being conducted to only a limited extent and of analyses potentially lacking the breadth necessary to provide sound advice.

Surveillance practices are regularly reviewed ...

Overall, surveillance is to be focused more heavily on potential risks and developments

... and modified as required

⁴ The latest issues of these flagship reports can be found on the IMF's website: www.imf.org

that are difficult to assess – i.e. on possible deviations from the assumed baseline scenario – and to devote more attention to climate change (see the box on pp. 115 f.) or digitalisation. A more detailed analysis of distributional issues is also planned.

Issues relating to international capital flows

Role of international capital flows and evolution of Institutional View

International capital flows have always played a prominent role in the context of the IMF's economic policy advice. While the IMF had long advocated a progressive opening-up of cross-border capital flows, a reassessment of the overall advantageousness of the free movement of capital began following the Asian crisis and intensified in the wake of the global financial crisis. The IMF subsequently developed the Institutional View on the Liberalization and Management of Capital Flows (Institutional View for short) as the basis for its policy advice. The balanced approach of the Institutional View attempts to combine the advantages of capital account liberalisation with protection against the disadvantages of volatile capital flows, e.g. by employing capital flow management measures (see the box on pp. 118 f.).

Financial assistance from the IMF

IMF financial assistance is used to tackle crises

While the IMF's surveillance is crucial for crisis preparedness and prevention, traditional IMF financial assistance helps countries tackle crises that express themselves in the form of temporarily limited access to funds in a globally accepted currency. According to the IMF Articles of Agreement, the purpose of temporary liquidity assistance is to help countries address such balance of payments problems without resorting to measures destructive of national or international prosperity, such as import restrictions, to remedy them.⁵ Liquidity assistance is financed using the IMF's own resources. The IMF can use resources from the trust funds it

administers for concessional financing to low-income countries (see the box on pp. 126 ff. for more information on the IMF's financial resources). The main objective of IMF programmes providing concessional financing to low-income countries is to achieve sustained progress in correcting balance of payments imbalances. Development policy considerations play a role in this type of financial assistance, although the long-term general development objectives of this group of countries fall outside the IMF's mandate – responsibility for rendering assistance in that regard rests with the World Bank and other multilateral development banks as well as the United Nations.

Under the IMF Articles of Agreement, financial assistance is provided against adequate safeguards. These include, in particular, economic policy adjustment programmes agreed between a given country and the IMF. These contain necessary modifications to monetary, fiscal and exchange rate policies and structural reforms to address the causes of balance of payments problems. The IMF's financial assistance creates breathing room for these adjustment measures to be implemented. Successfully implemented programmes usually result in the country returning to a sustainable external position, winning trust on the financial markets and being able to repay the IMF in a timely manner.

Programme efficiency and catalytic effect

The special structure of the IMF as a monetary institution and fund, as well as its financing mechanism,⁶ require that financial assistance to countries be provided only temporarily and to a limited extent and that it be repaid in a timely

Programme efficiency ...

⁵ See International Monetary Fund (2016), Article I(v).

⁶ See International Monetary Fund (2018), pp. 22 ff., section 2.2: The IMF's Financing Mechanism.

The International Monetary Fund and climate change

Climate change is one of the greatest global issues of our time and presents major economic policy challenges for all countries. With its near-universal membership, the International Monetary Fund (IMF) can make a valuable contribution to tackling climate change and its repercussions, particularly in the context of its economic surveillance.

Recent years have seen the IMF steadily scale up its engagement on macro-critical aspects of climate change. These efforts have yielded a number of initiatives, including analyses and recommendations on energy price subsidies as well as the IMF's proposal to implement an international carbon price floor (ICPF), which could accelerate global emissions reductions, besides offering an alternative to carbon border adjustment mechanisms (CBAMs).¹ In addition, the IMF's analytical work involves examining the measures taken by individual members to mitigate carbon emissions and adapt to climate change, as well as the climate-related risks to financial stability.

To be even better placed to meet the challenges posed by climate change, the IMF presented a new climate change strategy in July 2021.² This strategy aims to comprehensively and systematically integrate macro-critical aspects of climate change into all areas of the IMF's economic surveillance.³ One aspect is a plan to analyse and evaluate the emissions mitigation policies of the 20 largest emitters in three-year cycles as part of Article IV consultations. Another is the intention to assess country-specific climate vulnerabilities, adaptation policies, and financing needs to build resilience. In addition to Article IV consultations, analyses of specific challenges – such as the fiscal

impact of recurring natural disasters – are planned for the countries particularly vulnerable to climate change as part of the Climate Macroeconomic Assessment Program (CMAP). Assessments of the impact of climate change on the financial sector and potential financial stability risks will be expanded as part of Financial Sector Assessment Programs (FSAPs). Cross-border issues will be addressed in the context of multilateral surveillance. This would include, for example, comparative analyses of the efficiency of various emissions reduction measures, such as a carbon tax or emissions trading systems. One key issue in this regard concerns how tax incentives and subsidies for fossil fuels can be scaled back or eliminated without leading to economic or social disruptions.

The structural challenges posed by climate change can confront countries with longer-term balance of payments problems. Against this backdrop, the IMF Executive Board decided in April 2022 to set up the Resilience and Sustainability Facility (RSF) as well as the IMF-administered Resilience and Sustainability Trust (RST), which will finance the financial support provided under the RSF. This expands the IMF's toolkit to include programmes with financial support provided at concessional terms (i.e. with lower interest rates) with long repayment periods. Access will be targeted at low-income countries and economically vulnerable middle-income countries. The idea be-

¹ See International Monetary Fund (2022a).

² See International Monetary Fund (2021b).

³ A climate change-related policy challenge is considered macro-critical if it has the potential to impact on a country's internal and external economic stability by changing trade flows, asset prices, fiscal developments or exchange rates. See International Monetary Fund (2022b).

hind RSF programmes is to support these member countries in addressing structural challenges such as climate change or pandemics. Unlike traditional IMF assistance, the aim here is to counter prospective balance of payments problems. However, RSF programmes will only be able to cover a small part of the financing needs arising as a result of climate change and its mitigation. The primary objective of RSF programmes, which the IMF coordinates with the World Bank, is to support reforms that are conducive to strengthening countries' resilience and to mobilise private and public investment in climate change and pandemic preparedness.⁴

With its enhanced economic policy advice, technical assistance and training, as well as RSF financial support, the IMF now has a set of tools it can deploy to help mitigate climate change and its repercussions, within

the scope of its mandate. The Fund is currently engaged in building up the expertise needed to successfully implement the new climate change strategy. At the same time, there are various aspects of climate change, like the development of climate scenarios or implementation of specific projects, which fall outside the IMF's institutional role and responsibilities. This makes it crucial for the IMF to cooperate closely with other global organisations like the World Bank as a means of coordinating activities and leveraging synergies.

⁴ See International Monetary Fund (2022c).

manner.⁷ Debt sustainability and sufficient capacity to repay are key prerequisites for the approval of IMF financial assistance. The aim of programme-based financial assistance is to support countries in carrying out reforms and policies that are conducive to overcoming balance of payments problems and achieving external sustainability, accompanied by solid growth.⁸ The aim of successfully implemented programmes is also to avoid long-term, risk-bearing exposures and to limit credit augmentation risk for the IMF.⁹ In this context, programme efficiency refers to when these objectives are achieved with as little use of funds and as little risk as possible. This requires striking a balance between economic policy adjustments and IMF financing.

One other important concept is the "catalytic effect" of IMF arrangements. The catalytic effect of an IMF arrangement arises from the fact that the economic policy adjustment programme agreed with the IMF strengthens con-

fidence in the economic policy and stability of the country concerned, thus mobilising (additional) financial resources from private investors, partner countries or other donors. A catalytic effect is an essential prerequisite for successful crisis management. In this way, the balance of payments can be stabilised on a lasting basis while at the same time minimising repayment obligations to the IMF as a preferred creditor.¹⁰

⁷ See International Monetary Fund (1992), p. 8: "Finally, the IMF has a financial function to fulfil, which consists of providing resources to members on a temporary basis" and International Monetary Fund (2016).

⁸ See International Monetary Fund (2020b), Guidelines on Conditionality.

⁹ See Deutsche Bundesbank (2005, 2012).

¹⁰ Repayments to the IMF are protected by its preferred creditor status. This status is not enshrined in law but is nonetheless politically supported and internationally recognised. It means that the IMF's repayment claims are senior to the claims of all other (foreign currency) creditors. Being in arrears to the IMF is problematic for a country, as this usually results in that country being excluded from external financing. See also Deutsche Bundesbank (2012).

... are key prerequisites for financial integrity of the IMF

Adequate programme efficiency and the unfolding catalytic effect of financial assistance are essential for a country to meet its financial obligations to the IMF on time and under its own economic power. This is ultimately the basis for the IMF's financial integrity.¹¹

Assistance without programme conditionality increasing

Significant changes in the size and structure of financial assistance over time

The size and design of IMF financial assistance have changed considerably over time. For example, over the past ten years, a trend has been observed in favour of newly created, precautionary credit facilities and more flexible emergency assistance not tied to the conditionality of an IMF programme. Programme-based financial assistance, by contrast, has become relatively less important. In addition, the IMF significantly expanded the size and number of its financial assistance arrangements during the COVID-19 pandemic. The recipients were mostly low-income countries that received programme-based financial assistance and emergency financial assistance from trust funds managed by the IMF.

Crisis response during the COVID-19 pandemic

IMF responds to COVID-19 pandemic with a strong expansion of its financial assistance

The IMF responded swiftly and decisively to the COVID-19 pandemic, significantly stepping up financial assistance to support its members. Between March 2020 and the end of 2021, almost one in two members of the IMF – 90 countries – received assistance totalling around SDR 123 billion.¹² One unique feature here is that the IMF responded by providing a broad range of emergency assistance¹³ that did not require programme arrangements subject to economic policy conditionality. A total of 76 countries have drawn on such emergency assistance. In addition, the IMF granted almost SDR 690 million to 31 low-income countries to finance IMF repayments due during the pandemic. These grants were drawn from the Ca-

tastrophe Containment and Relief Trust (CCRT)¹⁴ managed by the IMF.

Emergency assistance has provided rapid support to many member countries. This helped to cushion considerable balance of payments burdens in developing and emerging market economies at the beginning of the pandemic in particular. However, IMF resources, which were paid out as direct budget support, often contributed to the funding of burgeoning budget deficits and, given the lack of conditionality, could also be used to support unsustainable fiscal or exchange rate policies. The majority of the countries applying for emergency assistance in 2020 and 2021 received the maximum amount possible, with the access limits temporarily increased as a result of the crisis.¹⁵

The COVID-19 pandemic is the first crisis to which the IMF has responded with a broad-based provision of emergency assistance. In total, 76 countries were supported by emergency assistance between March 2020 and the end of 2021, in contrast to just 16 countries that had used such financial assistance in the

Emergency assistance provided rapid and extensive support, especially for low-income countries

Low conditionality of emergency assistance ...

¹¹ See Deutsche Bundesbank (2012).

¹² See International Monetary Fund (2022f). This corresponds to around US\$160 billion (exchange rate on 1 September 2022). Only SDR amounts are shown below. For details on SDRs, see the box on pp. 109 ff.

¹³ Emergency assistance is envisaged in the event of acute balance of payments needs if an adjustment programme is either not necessary (balance of payments disruption is purely temporary and manageable without economic policy adjustment) or not possible (for example, in the event of insufficient administrative capacity or, as was the case with travel restrictions at the beginning of the pandemic, where programme negotiations are made difficult). Emergency assistance may include preliminary measures, but does not impose any ex post conditionality on the recipient countries. The assistance can therefore be negotiated relatively quickly between the IMF and member countries and, after approval by the Executive Board, paid out in full over the short term. Emergency assistance comprises the Rapid Financing Instrument (RFI) and the Rapid Credit Facility (RCF).

¹⁴ The CCRT allows the IMF to provide debt service grants to the poorest and most vulnerable countries in the event of natural disasters or public health emergencies. CCRT grants were established in 2015 during the Ebola virus outbreak and modified in March 2020 in response to the coronavirus pandemic.

¹⁵ Only around one-quarter of the applications remained – due to various considerations, for example with regard to repayment risks – below the maximum possible level.

The Institutional View of the International Monetary Fund

International capital flows have always played a prominent role in the context of the International Monetary Fund's (IMF) economic policy advisory activities. Although the Fund's mandate includes the removal of restrictions on international payments for current account transactions, it does not cover rules for international capital flows. However, the IMF is authorised to monitor capital flows and provide countries with advice as part of its Article IV consultations. While the IMF had long advocated a progressive liberalisation of cross-border capital flows, in part under the influence of the Washington Consensus,¹ a reassessment of the overall advantageousness of free capital movements began following the Asian crisis at the end of the 1990s and intensified in the wake of the global financial crisis of 2008-09. This was due to considerable economic problems arising in dealing with large and volatile capital flows, particularly in emerging market economies.

The IMF subsequently adopted the Institutional View on the Liberalization and Management of Capital Flows (Institutional View) to serve as a guideline for its recommendations to its members on issues relating to capital flows. The Institutional View attempts to strike a balance, against the backdrop of past experience and academic research, between preserving the benefits of capital account liberalisation and employing capital flow management measures (CFMs). The fundamental principles of the Institutional View state that free capital flows are desirable as they can be advantageous to a country, but that they may also lead to the emergence of risks to macroeconomic and financial stability, especially in the case of large and sudden capital outflows. In order to counter such threats,

member countries can adopt temporary and targeted CFMs, which should complement but not act as a substitute for necessary macroeconomic adjustments.

In the spring of 2022, the first systematic review of the Institutional View was concluded by the IMF's Executive Board. The review was also used to integrate the IMF's work on the Integrated Policy Framework (IPF) into the Institutional View. The IPF is a coherent analytical framework for analysing and assessing the interactions between monetary policy, exchange rate policy, foreign exchange market interventions, macroprudential measures and CFMs. It is designed to enable model-based country-specific recommendations to be made on how a country can respond to volatile international capital flows. The aim of this is to support developing and emerging market economies, in particular, in designing an appropriate policy mix.

The review of the Institutional View confirmed its core principles, but also clarified or expanded some of its statements. Generally, it was stressed that each country's starting conditions, the nature of economic shocks and existing frictions play a major role in determining its optimal policy mix for

¹ The Washington Consensus describes a package of measures that was presented by John Williamson in Washington D. C. in 1989 and was promoted as a model for the reform efforts of developing and emerging market economies. Its main features were the implementation of reforms designed to open up and liberalise the domestic economy and to make fiscal expenditure policy stability-oriented. The mixed success of the recommended reforms, policy recommendations that were perceived as simplistic and the associated neglect of social issues gave rise to substantial criticism over time. The IMF has since expanded and improved its analytical approach and strategy for economic policy measures in the fields of surveillance and lending. See Irving and Ward (2021).

managing risks from capital flows. The main area in which the Institutional View was expanded is based on a finding from the IPF that the use of pre-emptive measures in the case of stability-jeopardising capital inflows can help reduce financial stability risks. By contrast, pre-emptive measures are still not considered to be effective in addressing capital outflows.² By reviewing and expanding the basis for its economic policy recommendations, the IMF is responding to new developments in the area of capital flows as well as to criticism and suggestions from the world of research and the public.

The IMF will continue to refine the Institutional View in line with new challenges and insights from academic research. Some significant areas have not yet been covered by the analysis, but are set to be incorporated in future revisions. These include advancing digitalisation and the potential impact of

private or public digital currencies on the volume and structure of capital flows. Changes in cross-border investment that occur, for example, as a result of climate change and the policy measures taken in response will also be paid greater attention. Finally, there are plans to examine the distribution effects of CFMs with a social policy objective, which have been analysed very little to date. One example of these are the capital flows for the acquisition of real estate by non-residents and the potential undesirable effects on housing prices.

² Furthermore, the Institutional View was, amongst other things, worded more precisely to clarify the measures it does not cover. These are CFMs that countries introduce for security reasons, to tackle money laundering and terrorist financing, in compliance with Basel standards for the financial sector or in response to international tax agreements to combat tax evasion. The IMF does not consider the appropriateness of or advise on these measures.

eleven years prior – that is, since the introduction of the emergency instruments in their current form.¹⁶ Economic policy conditionality, which can be imposed in the form of prior actions, played a minor role in emergency assistance during the pandemic.

... may delay economic adjustments, ...

The normally low use of emergency finance instruments and their relatively low access limits reflect fundamental thinking behind IMF financial assistance. For example, a key risk of emergency assistance is that the necessary economic policy adjustments and corrections of balance of payments imbalances are delayed. In the event of a loss of market access and uncertainty about debt sustainability, excessive recourse to emergency finance assistance by countries with impending debt problems can also lead to a delay in debt restructuring, which experience has shown ultimately goes hand in hand with higher costs for the countries concerned.¹⁷

IMF emergency assistance has enabled priority expenditure to combat the pandemic that would otherwise have been impossible or limited. In this way, it has also helped stabilise the balance of payments. Various countries receiving emergency assistance make commitments to achieving transparency concerning specific forms of expenditure and certain tenders. This has a positive impact. The implementation of such commitments can help to ensure sound budgetary management and contain corruption risks associated with short-term increases in spending during the COVID-19 pandemic, thus helping demonstrate that emergency assistance is being put to appropriate use.

... while nevertheless enabling priority expenditure to combat pandemic

¹⁶ The previous corresponding instruments (Emergency Natural Disaster Assistance, ENDA, and Emergency Post-Conflict Assistance, EPCA) were also used only in isolated cases and to a comparatively small extent.
¹⁷ See International Monetary Fund (2013).

Considerable rise in outstanding amounts

In 2020, the granting of temporarily increased emergency financial assistance to a broad group of countries led to an increase in IMF claims of almost 50% and to a doubling of the outstanding amounts of the Poverty Reduction and Growth Trust (PRGT), one of the trust funds managed by the IMF for the purposes of granting concessional financing loans to low-income countries (see the box on pp. 126 ff.). The previous record high of 2004 was clearly exceeded at the end of 2020. This sharp increase is particularly true for countries with high risks to the sustainability of their (external) public debt. With regard to the IMF's own resources, the volume of outstanding IMF credit amounted to around SDR 93 billion at the end of 2020, close to the level of the previous historical peak in 2012.¹⁸

More countries with precautionary arrangements, ...

During the COVID-19 pandemic, the IMF concluded precautionary arrangements with five member countries on access to non-concessional financial assistance, which can be drawn down if necessary. At the beginning of the pandemic, the IMF had two such precautionary financing facilities: the Flexible Credit Line (FCL) for countries with sound policies and the Precautionary and Liquidity Line (PLL) in the case of acute or potential balance of payments needs of countries with largely sound economic policies.¹⁹ As such arrangements can also be applied for by larger emerging market economies and allow access to substantial financial resources, these precautionary facilities account for more than half of the amount of financial assistance granted between March 2020 and the end of 2021. In addition, the IMF created another precautionary instrument in the second quarter of 2020, the Short-term Liquidity Line (SLL). There has been little use of SLL in practice; it was used for the first and only time in May 2022 by only one country and for only a few months.

... which may entail risks due to large volumes

One hope relating to precautionary arrangements is that they will counteract contagion effects. However, large-scale precautionary arrangements may harbour unique financial risks for the IMF if the funds are actually drawn

upon. After the funds have been drawn upon, the usual IMF safeguard in the form of economic policy conditionality is largely eliminated.²⁰ Moreover, market participants can interpret the drawdown of funds as a negative signal regarding the country's economic soundness. Consequently, there are important conditions for protecting the benefits of precautionary arrangements, on the one hand, and for mitigating risk for the IMF, on the other: the imposition of conditionality for exceptional access and the avoidance of long-term use in the event of deteriorating fundamentals. Accordingly, purely temporary use or a gradual reduction in the size of a country's precautionary arrangement until it expires can be seen as a sign of economic strength and would be consistent with the temporary nature of IMF financial assistance.

Demand for adjustment programmes declining

When looking only at traditional IMF financial assistance for the support of an adjustment programme (i.e. not the emergency and precautionary facilities described above), conspicuous developments become visible. In general, over the past 40 years, it has usually been the case that programme requests have been submitted by countries that have already used IMF financial assistance in the recent past and then faced renewed balance of payments problems (see the chart on p. 122). This was particularly true for low-income countries which experienced persistent balance of payments difficulties. In the case of programme arrangements with emerging market economies, it can also be observed that some countries made use of IMF financing regularly and at comparatively

Relatively few new countries with adjustment programmes

¹⁸ This could be traced back to the effects of the global financial crisis and the sovereign debt crisis in the euro area. Thanks to early repayments, the IMF's exposure to euro area countries, which had been extremely high, quickly declined before coming to an end in the second quarter of 2022.

¹⁹ See International Monetary Fund (2017).

²⁰ See Deutsche Bundesbank (2012).

tight intervals. In general, the IMF sees this as a clear indication of the insufficient success of the previous IMF programmes. An incomplete implementation of programme conditionality or a departure from stability-oriented economic policies before or relatively shortly after the end of the programme often play a role in this.²¹ This is problematic for the IMF in a number of ways. On the one hand, confidence in the economic policy seal of approval of IMF programmes can suffer if programmes fail to achieve their objectives in a sustainable manner. This also reduces the likelihood of programmes having a catalytic effect. On the other hand, the IMF may, as a result, be required to make available new financial resources in order to avoid jeopardising the repayments to the IMF from the failed programme. It is therefore important to implement sufficiently ambitious adjustment measures under the programme to overcome the country's balance of payments problems and to enable the programme to succeed. The higher the level of IMF financial assistance for a country, the more extensive the adjustment under the programme will have to be in order to sufficiently improve the balance of payments situation and thus ensure the capacity to repay.

Shift to instruments without adjustment programmes ...

Although the IMF's response to the COVID-19 pandemic was novel, the focus on financial assistance not tied to IMF programme conditionality observed in 2020 and the increase in exposure to low-income countries continued to follow trends that had been observed for some time. The relative importance of traditional instruments with comprehensive adjustment programmes has declined over time (see the chart on p. 123).

... has been observable for some time, ...

At the beginning of the 1980s, IMF-supported adjustment programmes were the IMF's most widely used instrument for providing balance of payments assistance to member countries.²² In the mid-1980s, the toolkit was expanded especially for low-income countries in order to include concessional instruments, which are currently financed out of the PRGT.²³ Following

the global financial and economic crisis, since 2009 the IMF has expanded its toolkit to include new precautionary financing facilities²⁴ and newly designed, more flexible emergency assistance.²⁵ The proportions of the various instruments through which the IMF provides balance of payments assistance have shifted over the past four decades. Since the mid-1980s, IMF concessional programmes have become increasingly important. This is likely to be due to the increasing share of low-income countries in its membership. Accordingly, the share of traditional, non-concessional adjustment programmes has declined. Since the introduction of new precautionary financing facilities and flexible emergency assistance from 2009 onwards, this development has continued, reaching a preliminary peak in response to the COVID-19 pandemic.

Demand for the IMF's traditional adjustment programmes has declined in parts of its membership, probably because countries have become more resilient or other sources of funding have made the IMF less attractive. Some members have stepped up their crisis preparedness, and countries in South-East Asia, in particular, have applied for virtually no financial assistance from the IMF for many years. In the past decade, global financing conditions for many emerging market economies have also been rather favourable by historical standards. By contrast, the use of Regional Financing Arrangements (RFAs), which were created or expanded in part after regional crises, remains

... likely due to lower demand and attractive alternatives on offer

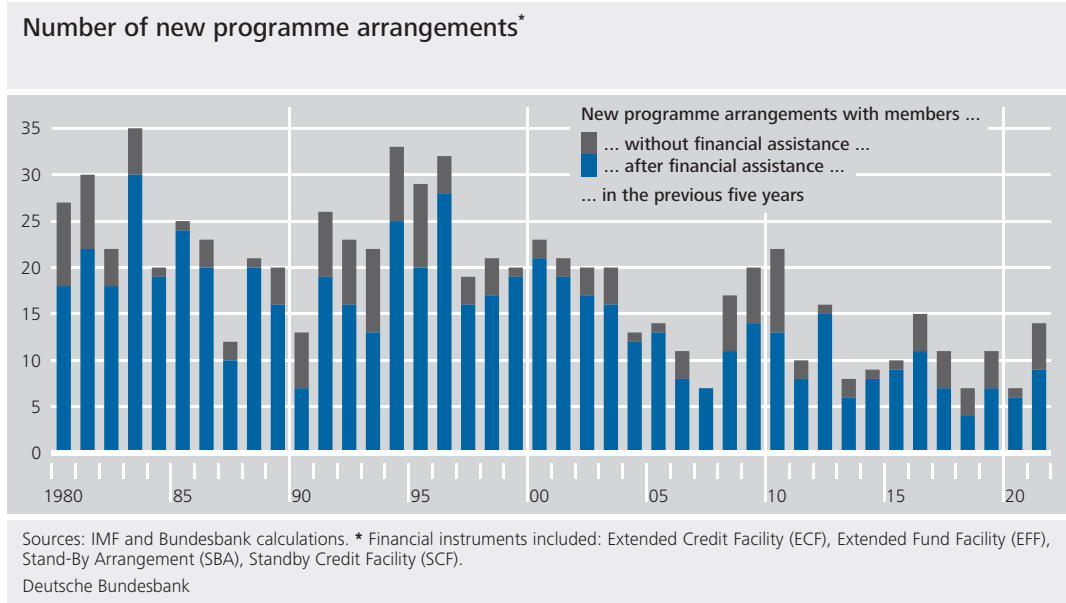
²¹ See International Monetary Fund (2019).

²² There have been a number of past IMF financing facilities with special purposes and designs. These are described in more detail in Deutsche Bundesbank (2013), but will not be expanded on any further.

²³ The practice of concessional lending to low-income countries had already begun in 1976 and has been stepped up from 1986 using stand-alone facilities. See Deutsche Bundesbank (2013).

²⁴ While precautionary lending facilities existed before 2009, such as the Contingent Credit Line (CCL) or the Short-term Liquidity Facility (SLF), these were never used. See Deutsche Bundesbank (2013).

²⁵ Prior to 2009, there were IMF instruments that were somewhat similar to the current emergency instruments, such as the Compensatory Financing Facility (CFF) or the ENDA and EPCA.



very limited. For low-income countries, a larger supply of loans from bilateral creditors outside the Paris Club²⁶ is also likely to be a relevant factor, with China's claims on low and medium-income countries reported to the World Bank rising by around 100% – or US\$80 billion – between 2013 and 2018.²⁷ Together with lower debt service to traditional creditors following previous debt restructuring initiatives, this could have led to the somewhat lower number of programme requests to the IMF in the 2010s, despite a continuous increase in debt risk over this period. At the same time, one other explanation of the decline in the share of IMF-supported adjustment programmes may be that the IMF's expanded range of new precautionary financing facilities and more flexible emergency assistance on offer since 2009 has led to some crowding-out. An applicant country with balance of payments problems might regard emergency assistance without being tied to a macroeconomic adjustment programme as an attractive option. Precautionary financing facilities with particularly strict conditionality should, if they are consistently observed, hardly be able to compete with the regular adjustment programmes.²⁸ By contrast, precautionary facilities with a limited conditionality are likely to provide some competition if countries wish to avoid a comprehensive adjustment programme.²⁹

Risks associated with lending on the rise

Another issue relevant when assessing IMF financial assistance is risk in cases where the IMF has pledged particularly high commitments to individual member countries. Finding an appropriate response to balance of payments crises that arise as a result of large capital outflows combined with uncertainty about the sustainability of public debt poses a major challenge for the IMF. Even short-term stabilisation to ward off defaults regularly requires the deployment of significant funds. Yet, at the same time, the potential for economic policy adjustment is often severely restricted (by time, social and political constraints). If, in these cases, an IMF commitment fails to produce a catalytic ef-

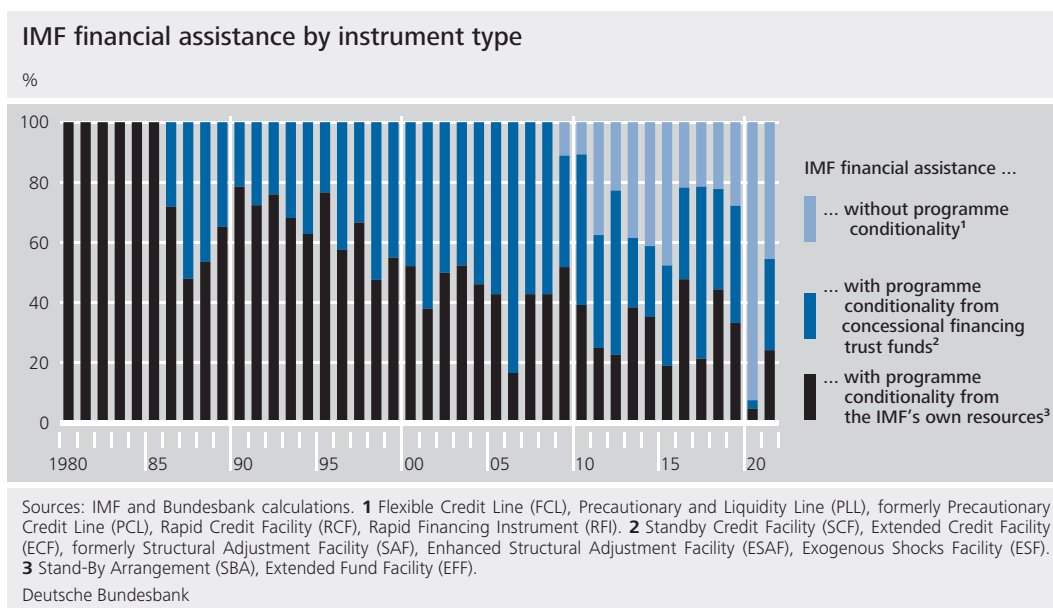
Particularly high IMF financial assistance is a risk factor

²⁶ The Paris Club is an informal body of creditor countries that becomes involved in coordinated debt restructuring negotiations when countries that are indebted to foreign governments face payment difficulties and ask for their debt service to be adjusted.

²⁷ These figures are likely to significantly understate China's actual lending to emerging market economies. In a detailed study, researchers from the Kiel Institute for the World Economy concluded that around half of China's international lending to developing and emerging market economies does not appear in official statistics. See Horn et al. (2019).

²⁸ So far, arrangements have been concluded with five countries, of which only one country has actually drawn on funds.

²⁹ Such an arrangement has so far been concluded with three countries, two of which have actually used funds.



fect (for example, a rapid restoration of market confidence or the use of extensive support from partner countries), the IMF is likely to face considerable risks. In recognition of this, the IMF has established tailored conditionality for financial assistance in excess of certain thresholds.³⁰ These criteria are designed to help ensure that deep-seated solvency problems are not treated as pure liquidity crises and that the ability to make repayments to the IMF is maintained. Moreover, a credible commitment by the IMF can reduce the threat of moral hazard on the part of those members anticipating IMF financial assistance.³¹

ment programme. Empirical evidence indeed suggests that this holds true.³² In the case of conventional IMF lending programmes over the period from 1990 to 2018, for instance, it was virtually impossible to demonstrate a positive catalytic effect of IMF financial assistance once the amount of financing exceeded 5% of the country's gross domestic product. Unlike the average arrangements over this period, these programme arrangements show no positive impact on private capital flows, in particular. Instead, there is a danger that the IMF may have crowded out private capital, as its preferred creditor status means that private investors have to expect higher losses in the event of a default.

Concentration risk due to high individual commitments

High individual commitments entail considerable financial risks for the IMF. In mid-2022, for example, only three countries had liabilities to the IMF in excess of the threshold for exceptional access. Yet, with a total of more than SDR 50 billion, these three countries' liabilities accounted for over half of outstanding IMF credit.

In practice, however, there are difficulties in consistently applying the criteria for exceptional access. For example, when requesting IMF financial assistance, solvency analyses are subject to considerable uncertainty, as is a country's political willingness to make economic policy adjustments. If the country in question rules out early debt restructuring or at

Criteria for exceptional access under pressure in practice

Appropriate access limits important for programmes to succeed

High levels of outstanding IMF credit can also weaken the catalytic effect of an assistance programme. Having an elevated level of liabilities to a preferred creditor, such as the IMF, may make it more difficult for a country to regain market access and thus diminish the prospects for success of an IMF-supported adjust-

³⁰ See International Monetary Fund (2015). In 2021, the access limits for low-income countries were abolished, thus also allowing exceptional access to the PRGT's lower-interest funds. Under certain conditions, this enables the IMF to provide more funds to low-income countries.

³¹ See Dreher (2004) and Lee (2008).

³² See Krahnke (2020).

least extending maturities, the IMF may come under pressure to apply its criteria with greater flexibility. Recently, it has been increasingly argued that exceptional access can also be justified in cases where sufficient capacity (usually private bondholders' claims) remains after the programme has been concluded to enable debt sustainability to be established at a later point in time by means of debt restructuring. Such an argument, however, runs the risk of scaring off private creditors entirely and eliminating the positive signalling effect of IMF financial assistance. This is likely to be the case in precisely those situations where it is uncertain whether the necessary reforms and adjustment measures will be implemented.

Rising risk of overindebtedness amplifies challenges

Overindebtedness risks, especially in low-income countries, have increased steeply in recent years. From the beginning of the 2000s up to around early 2013, the IMF classed the debt sustainability of these countries as increasingly robust, partly as a result of international debt relief initiatives. However, the picture has deteriorated sharply in recent years. Overall, the IMF currently regards just over 50 low-income countries as being at high risk of a debt crisis, which has already materialised in some cases.

International cooperation on debt issues key ...

If doubts about debt sustainability are especially high or where arrears have already occurred in the past, before making a financial commitment the IMF has to ascertain whether creditors will agree to debt restructuring or whether the conditions for IMF financial assistance will be met in the event of arrears to private or public creditors.³³ The desired catalytic effect of IMF financial assistance can only be achieved if the risks to sustainability can be lastingly reduced. By contrast, stalled negotiations on debt relief for private or public creditors, on the one hand, and an insufficiently ambitious economic policy adjustment, on the other, will hinder the arrangement of credible IMF programmes. Thus, in order to ensure the programmes are efficient, the IMF is dependent

on well-functioning international cooperation on debt issues.

The creditor structure of highly indebted countries has become considerably more heterogeneous in recent years. Non-Paris Club countries have significantly expanded their bilateral lending to low to medium-income countries over the past decade. In response to these challenges, in 2020 the Group of Twenty (G20) created an effective coordination framework for the participation of all bilateral public creditors. The temporary Debt Service Suspension Initiative (DSSI)³⁴ for the 77 poorest countries was then succeeded by the permanent Common Framework.³⁵

... given increasingly heterogeneous creditor structure

Both the above-mentioned shift toward financial assistance not tied to the conditionality of an IMF programme and the emergence of cases involving exceptional access imply that the track record of IMF financial assistance has not always been successful in recent years. In view of the simultaneous rise in the number of overindebtedness crises in emerging and low-income countries, the arrangement of conventional IMF programmes is currently a crucial challenge. Ultimately, the IMF can only provide its members with the best possible support through sufficiently ambitious adjustment programmes and ensuring debt sustainability, which, if necessary, must also involve debt restructuring. In order to safeguard its soundness even in the event of financial risk materialising, effective risk management at the IMF, including the formation of reserves, is key.

Financial assistance not always a success

³³ See International Monetary Fund (2013).

³⁴ By deferring interest and principal payments in 2020, the financial scope of the beneficiary countries was extended until the end of 2021 in order to invest in health protection, for example. In total, the participating creditor countries deferred US\$12.9 billion.

³⁵ The Common Framework for Debt Treatment beyond the DSSI, endorsed by the G20, provides a framework for coordinated debt restructuring. Restructuring is conditional on the country concerned being eligible under the DSSI and signing an IMF-supported adjustment programme. A further aim is to ensure the adequate participation of private creditors in debt restructurings.

The IMF's financial resources and risk management

The IMF's financial resources are regularly assessed and adjusted if necessary

At regular intervals, usually every five years, the IMF conducts general quota reviews, which assess the Fund's own resources (quotas) and the quota structure, adjusting them if necessary. The last decision to increase IMF quotas was made under the 14th General Review of Quotas in 2010.³⁶ The quotas were doubled to SDR 477 billion. As a result of this quota increase, the quota shares of IMF members also changed. These are key in determining, amongst other things, the voting shares in the IMF. The share of developing and emerging market economies has risen relatively sharply. This shift in the quota structure takes account of the growing role of developing and emerging market economies in the global economy and has strengthened the representation of these countries in the IMF as a whole. The 15th General Review of Quotas was concluded in February 2020, after the finalisation date had been postponed several times in the absence of an agreement, without a quota increase. The 16th General Review of Quotas is currently underway and scheduled for completion by 15 December 2023.

Commitment to quota-based IMF

The International Monetary and Financial Committee (IMFC)³⁷ has repeatedly declared its commitment to a quota-based and adequately funded IMF. Notwithstanding the IMF's comfortable resources, a moderate increase in quotas and a shift in the quota structure could be considered in order to strengthen the voting rights of those countries whose role in the global economy has grown since the last adjustment.

Credit lines increase IMF resources

Credit lines from some member countries to the IMF are a safety mechanism in the event that quota resources prove insufficient in a crisis situation. This option is specifically provided for in the IMF's Articles of Agreement and secures additional funds for loans to members. The current credit lines are divided into the permanent multilateral New Arrangements to Bor-

row (NAB), and the temporary Bilateral Borrowing Agreements (BBAs). The IMF's additional resources available from the NAB and BBAs amount to just under SDR 500 billion (see also the box on pp. 126 ff.). Irrespective of the source of funding (quota resources or borrowing), the IMF is jointly and severally liable in the event of possible defaults, which limits the risk for NAB and BBA lenders.

The NAB constitute the first possibility for expanding IMF resources. Once it has become clear that the IMF will need to supplement its resources to address a threat to the international monetary system,³⁸ lenders and the Executive Board may decide to activate the NAB in part or in full for a maximum of six months.³⁹ When drawing on credit lines under the NAB, the IMF follows the principle of burden-sharing and uses the resources provided by different lenders as evenly as possible. 38 member countries or their central banks, including the Bundesbank for Germany, currently participate in the NAB. Two other members have announced their future participation. The total NAB amount to SDR 361 billion. They have been in place since 1998 and extended several times; the last extension took place in 2021 for a further five years until December 2025.

If additional funds are required, NAB should be activated first ...

³⁶ This decision entered into force in January 2016.

³⁷ The IMFC is the IMF's policy advisory committee. At its biannual meetings, the 24 members from the ranks of finance ministers and central bank governors, representing all 190 member countries, discuss global economic developments and IMF policy issues, including the IMF management's Global Policy Agenda, and formulate a joint assessment, which is usually published in a communiqué.

³⁸ "As the Fund is a quota-based institution, the credit arrangements provided for under the terms of this decision shall only be drawn upon when quota resources need to be supplemented in order to forestall or cope with an impairment of the international monetary system." Executive Board decision on the NAB; see International Monetary Fund (2020b).

³⁹ This requires a majority of (voting) NAB participants which together account for 85% of the total NAB as well as approval by the Executive Board. The activation process is initiated by a proposal to this effect from IMF management. Once an activation period has expired, it is possible to agree further activation periods in the same way.

The International Monetary Fund's financial resources: size and distribution of contributions

Financial assistance provided by the International Monetary Fund (IMF) is funded through contributions from its member countries. This means that it is not dependent on funding from the financial markets. Financial assistance is paid out either in special drawing rights (SDRs) or in one of the five currencies that also form the currency basket for the daily calculation of the SDR value: US dollar, euro, renminbi, yen and pound sterling.¹

IMF financial assistance to member countries can be divided into two categories: non-concessional financing, which can be used by all members, and concessional financing, i.e. lending at lower interest rates. The latter is only available to low-income countries. Non-concessional financing is funded primarily from the mandatory capital contributions of all IMF members, the quota subscriptions.² 25% of these capital contributions³ are paid in SDRs or one of the five aforementioned basket currencies, which the IMF considers to be freely usable. The IMF can make direct use of this part of members' quota subscriptions. In order to be able to mobilise the remainder of the subscriptions, which are paid in a member's own currency, the IMF has a special financing mechanism (Financial Transactions Plan – FTP)⁴ that currently includes around 50 countries considered to have a strong reserve position. Issuers of one of the five SDR basket currencies can provide the necessary funds in their own currency – Germany, for example, in euro. Other countries have to make use of their reserve assets. In either case, the contributing countries receive a claim on the IMF in return, which they can record as a reserve asset.

If, in a crisis situation, the quota resources, which amount to around SDR 477 billion, are insufficient to provide financial assistance, the IMF can borrow additional resources from its members on the basis of the IMF Articles of Agreement. Numerous members or their central banks have concluded borrowing arrangements with the IMF for this purpose. These borrowing arrangements can take two forms: multilateral New Arrangements to Borrow (NAB), which were established in 1998 and have a volume of around SDR 361 billion, and temporary Bilateral Borrowing Agreements (BBAs), which were agreed in 2020 and amount to around SDR 138 billion. At present, 38 and 42 countries provide the IMF with credit lines under the NAB and BBAs, respectively.

The following overview shows the contributions from the 20 largest IMF members to the funding of the IMF's non-concessional lending.⁵ Germany's contributions are made by the Bundesbank.

¹ At present (as at 1 September 2022), the value of special drawing rights is SDR 1/EUR 1.30139.

² Each IMF member receives a quota, expressed in SDR, that reflects the country's relative position in the world economy. This quota determines the country's mandatory capital contribution to the IMF, the country's share of SDR allocations and its voting power in the IMF.

³ Contributions are due, for example, when a country joins the IMF or following a decision to change the quota level or quota shares.

⁴ The FTP is adopted by the IMF Executive Board, usually every six months.

⁵ In addition to the countries listed in the table, 14 other countries or their central banks participate in the NAB and have agreed a BBA with the IMF: Austria, Chile, Denmark, Finland, Luxembourg, Malaysia, New Zealand, Norway, Philippines, Poland, Singapore, South Africa, Sweden and Thailand. Five other creditors participate exclusively in the NAB: Cyprus, Hong Kong, Israel, Kuwait and Portugal. Nine other countries have signed a BBA only: Algeria, Brunei Darussalam, Czech Republic, Estonia, Lithuania, Malta, Peru, Slovakia and Slovenia.

Contributions of the 20 largest IMF members

20 largest IMF members ¹	Quota			NAB contribution (as at 1 August 2022)			BBA contribution (as at 1 August 2022) ³		
	SDR million	%	FTP participation ²	SDR million	As a percentage of member's quota	NAB creditor	SDR million	As a percentage of member's quota	BBA creditor
United States	82,994	17.43	Yes	56,405	68	Government	–	–	–
Japan	30,821	6.47	Yes	67,017	217	Government	19,511	63	Government
China	30,483	6.40	Yes	31,721	104	Government	16,017	53	Central bank
Germany	26,634	5.59	Yes	25,780	97	Central bank	13,810	52	Central bank
France	20,155	4.23	Yes	18,958	94	Government	10,449	52	Government
United Kingdom	20,155	4.23	Yes	18,958	94	Government	3,954	20	Government
Italy	15,070	3.16	Yes	13,797	92	Government	7,813	52	Central bank
India	13,114	2.75	Yes	8,882	68	Government	2,945	22	Central bank
Russia	12,904	2.71	Yes	8,882	69	Government	2,945	23	Central bank
Brazil	11,042	2.32	Yes	8,882	80	Government	2,945	27	Central bank
Canada	11,024	2.31	Yes	7,747	70	Government	3,532	32	Government
Saudi Arabia	9,993	2.10	Yes	11,305	113	Government	4,878	49	Government
Spain	9,536	2.00	Yes	6,810	71	Government	4,944	52	Government
Mexico	8,913	1.87	Yes	5,075	57	Government	3,252	36	Central bank
Netherlands	8,737	1.83	Yes	9,190	105	Government	4,529	52	Central bank
South Korea	8,583	1.80	Yes	6,690	78	Government	4,878	57	Government
Australia	6,572	1.38	Yes	4,441	68	Government	1,986	30	Government
Belgium	6,411	1.35	Yes	7,989	125	Government	3,325	52	Central bank
Switzerland	5,771	1.21	Yes	11,081	192	Central bank	2,903	50	Central bank
Turkey	4,659	0.98	No	–	–	–	1,626	35	Central bank
All IMF members	4 476,272	100	51 countries	360,804	5 75.8	38 countries	138,298	5 29.0	42 countries
of which: EU countries	124,733	26.19	18 EU countries	102,004	6 81.8	14 EU countries	57,648	6 46.2	18 EU countries

¹ Largest as determined by the size of their IMF quota. ² Latest data on FTP published by the IMF (31 July 2021). ³ BBA contributions not denominated in SDR converted at SDR rate as at 1 August 2022. ⁴ As not all member countries have yet paid in their quota contributions in full, the current quota total is slightly lower than the amount agreed in the 14th General Review of Quotas. ⁵ Total contributions in relation to IMF quotas. ⁶ EU countries' contributions in relation to their quotas.

Deutsche Bundesbank

The funding of concessional lending is based on voluntary rather than mandatory financial contributions, with members providing loans or subsidies to trust funds administered by the IMF. The largest IMF trust fund in terms of resources is the Poverty Reduction and Growth Trust (PRGT). The PRGT provides financial assistance to low-income IMF members to support economic policy adjustment programmes or help in emergency situations. The Poverty Reduction and Growth – Heavily Indebted Poor Countries Trust (PRG-HIPC Trust) serves a similar purpose. It helps finance the HIPC Initiative, which provides highly indebted, low-income countries with support for debt restructuring. In emergency situations, such as a pandemic or natural disaster, the Cata-

strophe Containment and Relief Trust (CCRT) can furnish the poorest IMF members with grants to service debt owed to the IMF and the PRGT.

In April 2022, the IMF decided to set up a further trust fund. The Resilience and Sustainability Trust (RST) is scheduled to become operational in autumn 2022. Financial assistance from the RST is designed to support countries implementing reforms to address long-term challenges, such as climate change (see the box on pp. 115f.). Funding requirements for the RST are expected to total SDR 33 billion.

The table on p. 128 shows the voluntary contributions from the 20 largest IMF mem-

Voluntary contributions to IMF trust funds*

	Current PRGT loans		PRGT subsidies ²	PRG-HIPC Trust subsidies ²	CCRT subsidies ²
	SDR million	As a percentage of member's quota	SDR million	SDR million	SDR million
20 largest IMF members ¹					
United States	–	–	604	350	2
Japan	8,200	27	700	165	123
China	2,600	9	138	26	6
Germany	2,436	9	316	145	90
France	4,000	20	392	147	37
United Kingdom	5,328	26	543	87	172
Italy	2,200	15	259	72	3
India	–	–	81	23	0
Russia	–	–	115	38	0
Brazil	1,000	9	0	12	0
Canada	1,500	14	290	52	3
Saudi Arabia	500	5	119	34	0
Spain	1,605	17	79	29	21
Mexico	–	–	43	49	5
Netherlands	1,500	17	227	78	21
South Korea	1,000	12	91	18	1
Australia	500	8	73	24	0
Belgium	1,050	16	107	39	1
Switzerland	1,500	26	122	45	21
Turkey	–	–	30	0	1
All contributing IMF members	37,719	³ 8	6,832	3,023	826
of which: EU countries	14,591	⁴ 12	1,886	636	194

* See International Monetary Fund (2022g). ¹ Largest as determined by the size of their IMF quota. ² Direct subsidies only; amounts lent to the IMF by members and from which investment income earned is provided as a subsidy are not taken into account here. ³ Total contributions in relation to IMF quotas. ⁴ EU countries' contributions in relation to their quotas.

Deutsche Bundesbank

ber countries to the aforementioned trust funds;⁶ the total volume of contributions will increase as further commitments are made. Unlike the contributions to the IMF itself, which are made by the Bundesbank, Germany's voluntary contributions to trust funds administered by the IMF are financed from the Federal budget.

⁶ Contributions to the RST are omitted here, as the RST is not yet operational and not all pledges have yet been secured. Germany has pledged €6.3 billion from the Federal budget to the RST.

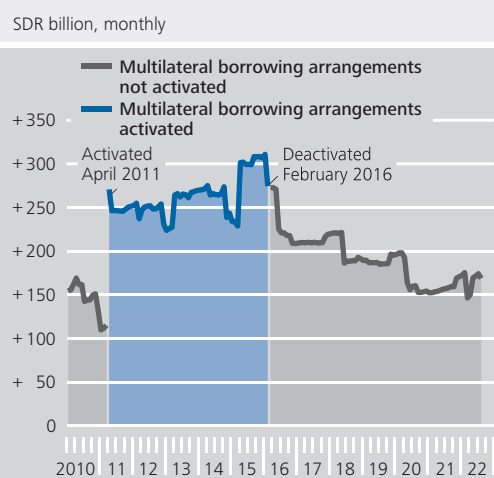
... and only then the BBAs

As the second “emergency reserve” after quota resources and the NAB, temporary BBAs were concluded directly between member countries and the IMF. They are broadly standardised between lenders in terms of form and modalities. Lenders have a say in potential activation, similar to the NAB. In total, SDR 138 billion is available through BBAs. These credit lines can be used by the IMF if additional resources are needed beyond the NAB funds. If BBAs are used by the IMF, funds are drawn as evenly as possible from the respective member countries, as with the NAB. 42 members or their central banks have currently signed a BBA, including the Bundesbank. The current BBAs run until the end of 2023 and, after approval by the lenders, can be extended by a maximum of one year.

The Fund’s financial resources are sufficient – even in times of crisis

The IMF thus currently has a total of just under SDR 1 trillion at its disposal for non-concessional lending.⁴⁰ Measured against historical highs, this is more than five times the amount of lending commitments and just over ten times the amount actually disbursed by the Fund. On an ongoing basis, the IMF calculates its one-year Forward Commitment Capacity (FCC), which indicates the amount of resources available for new lending over the next 12 months.⁴¹ If the FCC is deemed to have fallen too low, the Fund may partially or fully activate the multilateral credit lines and, if necessary, bilateral credit lines as well. The chart above illustrates that the IMF’s lending capacity has been sufficient at all times over the past decade, taking into account the credit lines which were only activated during a limited period. The multilateral credit lines were activated between April 2011 and February 2016 in the wake of the global financial crisis and the ensuing financial assistance. There was no need to activate the additionally available bilateral credit lines. Since then, quota resources have always proved sufficient, even during the coronavirus pandemic. The IMF has an FCC of around SDR 170 billion (as at the end of August 2022) and is thus comfortably equipped to fulfil new requests for financial assistance solely from quota subscriptions.

The IMF’s lending capacity



Source: IMF.
 Deutsche Bundesbank

The IMF’s risk management

Given the heightened financial risks caused by the lending activity of recent years, effective risk management by the IMF has become all the more important. The Fund’s risk management spans a variety of components. For example, in response to requests for financial arrangements, it scrutinises the sustainability of the relevant countries’ sovereign debt as well as the governance and control structures of their central banks (safeguard assessments). The aim of these assessments is to ensure that the borrower is able to properly manage Fund resources and repay them on schedule. Moreover, the IMF has a number of instruments at its disposal to limit risks even before an agreed programme is started. These span volume limits on financial assistance (access limits); disbursement in tranches based on programme pro-

Risk management already starts with programme design, ...

⁴⁰ Excluding resources from the trust funds administered by the IMF for the purposes of granting concessional financial assistance.

⁴¹ The FCC is calculated as follows: uncommitted usable resources (quota resources – credit outstanding – undrawn balances under GRA lending commitments) + IMF holdings of SDRs + member repurchases one-year forward – repayment on IMF borrowing one-year forward (e.g. from a previous credit line activation) – prudential balance of 20%. Available borrowing under activated multilateral or bilateral credit lines is factored into the uncommitted usable resources.

gress; programme design, including conditionality on economic policies and reforms; and criteria for exceptional access. The Fund's de facto preferred creditor status helps to ensure that its loans will be repaid after programmes have come to an end. Post-programme monitoring also provides it with an instrument for monitoring the capacity to repay even after programmes have been completed.

... includes a process for managing arrears ...

Being in arrears to the IMF represents a serious breach of membership obligations and poses a particular challenge for the IMF's financing mechanism, which is based on the reserve assets characteristics of financial contributions by members. In the past, this has only occurred in isolated, albeit sometimes very drawn-out, cases. Arrears can lead to escalating sanctions, including a withdrawal of membership rights. The IMF has the option of employing what is known as the cooperative arrears strategy to resolve such cases, which enables the members concerned, in consultation with the Fund, to provide evidence of their cooperation with the IMF through implementing reforms and remaining current with the IMF on new payment obligations falling due. This is intended to help mobilise external assistance and ultimately clear the arrears. Improved cooperation with the Fund makes it possible to gradually lift any restrictions on membership rights.

... and the formation of financial reserves

Financially, the Fund buffers against credit risk by forming reserves, the size of which is based on existing and expected repayment claims (precautionary balances). These reserves are essentially derived from IMF budget surpluses. In recent years, they were expanded significantly to SDR 21 billion as a result of income from more sizeable loans. However, they are still below the target level. If a member is at imminent risk of falling into arrears, the Fund can form additional reserves. However, an ultimate loss of IMF credit can only occur if a defaulting member withdraws from the Fund and fails to pay its liabilities. The Fund's gold holdings provide an important additional buffer in the IMF's balance sheet, especially in times of height-

ened financial risk and limited risk reserves. With their high hidden valuation reserves, they play a key part in maintaining confidence in the financial integrity of the IMF. This is important in order to protect the Fund's special financing mechanism and for IMF members to be able to book their financial contributions to the IMF as reserve assets on their balance sheets.

■ Germany and the IMF

The large expansion of IMF membership and the growth in the global economy have been accompanied by a significant rise in the IMF's financial strength. While the quota total based on the mandatory capital subscriptions of members has grown by around a factor of 55 from 1952 to the present day, Germany's subscription as measured by quota resources has risen by a factor of 81. This reflects periods of comparatively strong growth in the German economy and the country's global economic integration. Germany's quota thus stands at 5.6% at present, compared with 3.8% when it joined the Fund. This also forms the basis for the country's voting power in the IMF, which is currently 5.3%.

High financial commitment from Germany

Germany's financial contributions to the Fund already go well beyond the size of its quota owing to commitments made under the NAB and through bilateral credit lines. For example, the financing share made up by the Bundesbank's commitments to the IMF alone stands at just under 6.8%. When the voluntary funds transferred from Germany's Federal budget to trusts administered by the IMF are factored in, the divergence between financial contributions and voting power is even wider. However, the same is true of some other European countries, along with Japan and China.

Rights and obligations of the Bundesbank

The Bundesbank has a legal mandate⁴² to exercise the financial rights and obligations arising from Germany's membership of the IMF and is involved in representing the country within the IMF. Accordingly, it makes the financial contributions to the Fund set out in the IMF's Articles of Agreement. Germany's voluntary financial contributions to IMF-administered trust funds for providing financial assistance to specific groups of countries, often motivated partly by development policy considerations, are made by the Federal Government and approved via the Federal budget.

Participation in SDR system

Germany participates in the IMF's SDR system and in SDR allocations and exchange transactions in accordance with the procedures established by the Fund; these are executed by the Bundesbank (for more on the SDR system, see pp. 109 ff.). In agreements with the IMF, the Bundesbank and a number of other governments and central banks have agreed to voluntarily execute SDR exchanges requested by other members against their own currency or another freely usable currency. As such exchanges via balance sheets may also have monetary policy implications, the Eurosystem has agreed limits for SDR holdings resulting from voluntary purchases and sales of SDRs. Over the past few years, however, in practice the Bundesbank has actually received only a relatively small number of requests from other members for SDR exchanges via the IMF. Even the very large SDR allocation in 2021 has not changed this so far. The Bundesbank aims to keep its own SDR holdings close to the size of the SDR allocation. This minimises exchange rate and interest rate risk to the Bundesbank's balance sheet.⁴³

Germany benefits from IMF membership

Throughout its 70-year membership, Germany has never needed to request financial assistance from the IMF, but has nonetheless benefited in other ways from its membership. Notable examples include Germany's involvement in international monetary cooperation within the framework of the IMF, the benefits of the Fund's key contribution to the functioning of the international monetary system and its stability, and

the Fund's advisory activities regarding economic policy and the financial sector. Like all members, Germany is subject to bilateral surveillance by the IMF. Most recently, the Fund provided advisory services to Germany in the form of an Article IV consultation and an FSAP, which concluded in July 2022; the results were published by the Fund (see p. 132 for details).

The Bundesbank's tasks in the context of Germany's membership of the IMF are not limited to the exercise of financial rights and obligations, which are also reflected in the Bundesbank's balance sheet and explained in its Annual Report. In accordance with the IMF Act, the Bundesbank also has to be involved in Germany's political positioning when decisions are taken in IMF bodies, working in close cooperation with the Federal Ministry of Finance. This is also reflected in the country's representation at the IMF. The President of the Bundesbank is traditionally the deputy to the Federal Minister of Finance as a member of the IMFC and is Germany's member of the Board of Governors, the highest decision-making body of the IMF. In addition, the Bundesbank, like the Federal Ministry of Finance, seconds its own staff to the German Executive Director's Office at the IMF as temporary advisers and, in alternation with the Federal Ministry of Finance, staffs the positions of the Executive Director and his or her deputy. Under the IMF Act, Germany's representatives in the IMF are to act on the instructions of the Federal Ministry of Finance, which are devised in close cooperation with the Bundesbank. From the Bundesbank's point of view, its close and trusting cooperation with the Federal Ministry of Finance based on the provisions set out in the IMF Act of 1978 has proven its worth over a great many years and has supported Germany's successful participation in international monetary cooperation with and within the IMF.

The Bundesbank's other tasks in the IMF context

⁴² Act on the Articles of Agreement of the International Monetary Fund as amended in 1976 (IMF Act; *Gesetz zu dem Übereinkommen über den Internationalen Währungsfonds in der Fassung von 1976*) of 9 January 1978.

⁴³ See Deutsche Bundesbank (2021).

Article IV consultation and Financial Sector Assessment Program with Germany in 2022

In accordance with Article IV of the IMF's Articles of Agreement, the International Monetary Fund (IMF) regularly examines its member countries' economic developments and economic policies. This forms part of the IMF's economic and financial policy surveillance and is intended to help prevent crises (for a description of the IMF's surveillance, see the section entitled "The IMF's economic policy advice", starting on p. 111). Article IV consultations with Germany take place on an annual basis, with this year's occurring in the first half of 2022. IMF representatives held numerous discussions with Federal ministries, the Bundesbank and other public authorities, trade unions, economic research institutions, associations, and financial and non-financial enterprises. In its concluding statement and detailed consultation report, the IMF commended the authorities for their timely and overall well-designed policy response to the pandemic and the spillovers from Russia's war of aggression against Ukraine. It expects Germany's economic recovery to be slower than anticipated at the beginning of the year, noting that the greatest downside risk to growth is a shut-off of Russian gas supplies. It therefore recommends topping up energy reserves, transitioning to renewable energy and setting incentives to reduce energy consumption. The IMF considers additional supply bottlenecks and the impact of the sanctions imposed in response to Russia's invasion of Ukraine to be further risks to the German economy. Any fiscal support measures that are required should be temporary and targeted in order to avoid additional inflationary pressures. Moreover, the IMF notes that there is fiscal space and suggests that it be used to enhance growth potential and resilience to risks to growth in

the medium term. The consultation report was discussed at a meeting of the IMF's Executive Board on 18 July 2022, then published together with the report prepared under the Financial Sector Assessment Program (FSAP).¹

The FSAP assesses national financial sectors and examines financial stability and the quality of the regulatory framework. For Germany, which is deemed to have a systemically important financial sector, the FSAP is carried out every five years. The assessments began last year and consisted of numerous discussions with representatives from the German supervisory authorities and the financial sector as well as comprehensive analyses. The current FSAP indicates a resilient financial system with high capital and liquidity buffers in the banking system and robust public and private sector balance sheets. The IMF also commends the decisive use of macroprudential instruments and the enhancement of microprudential frameworks since the last FSAP review in 2016. According to the IMF, low bank profitability and a potential price correction in residential real estate could be sources of vulnerability. In this context, the IMF underlines the urgency of activating borrower-based measures. Given the downside risks to the real economy, the IMF recommends monitoring the fulfilment of capital and liquidity requirements closely so as to be able to respond quickly to changes in the stability situation.

¹ See International Monetary Fund (2022d).

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