György Csáki

The International Monetary Fund and the global economic crisis, 2008–2009[1]

Thanks to transmission mechanisms, the severe financial crisis that broke out in the United States in 2007–2008 became global almost immediately. As the disappearance of immense amounts of virtual money dried out international financial markets, the global liquidity crisis promptly turned into a global credit crunch, triggering an immediate recession in sectors like the construction and the auto industries where products are mainly (or almost exclusively) purchased on credit. In combination with the credit crisis, the severe setback in specific industries first pushed the US economy into crisis and then dragged the vast majority of the global economy into recession.[2]

This current crisis is the first truly global crisis of the world economy. Considering the circumstances of its outbreak and its anticipated impact, it is obviously comparable to no other turmoil but the great Depression of 1929–1933. The world, however, has learnt the lessons of the 1929 crisis. Back then, the collapse of the New York stock exchange and the financial crisis in the USA could only become a global crisis (the most devastating one in known history) because the protagonists of the world economy responded to it with a wave of restrictive measures and a devaluation contest evolved among them. The architecture of the international economy in the post World War II era was based on those very experiences.[3] *Now it seems that the main lessons of 1929–1933 learnt in the past sixty years by collective historic memory are as follows: First, in a time of recession, consumption must be stimulated instead of pursuing a restrictive economic policy; second, the crisis can only be avoided through cooperation and, if it still breaks out, cooperation is the only way out of it. Consequently, the institutional frameworks of multilateral international cooperation on economic policy matters are becoming increasingly valuable in the current crisis, too. More than thirty years after the dissolution of the Bretton Woods system, its institutions are in the limelight again. Regulatory weaknesses that led to the crisis can only be eliminated through the global coordination of financial regulation. (Garten, 2008) Global imbalances threaten the survival of liberal trade now. (Wolf, 2008) Obviously, global problems call for global answers – actually a coherent entirety of global answers. A well-known columnist of the Financial Times writes straightforwardly (albeit with some irony of course) about the need for world government. (Rachman, 2008)*

The new situation makes old answers irrelevant but new answers only evolve from debates – and international organizations do engage in debates. The subtitle of the December 2008 report of UNCTAD asks: "We will never learn?" The introduction of the policy brief ends with the fol-

lowing firm statement: "The current IMF approach asking for pro-cyclical policies in crisis countries is inadequate. UNCTAD has long argued that multilateral coordination is the only viable solution." (UNCTAD, 2008, issue 1) According to the analysis, "Unless there is a fundamental rethinking of the exchange rate mechanism and the cost involved in the traditional "solution" of assistance packages without symmetrical intervention, the negative spill-over of the financial crisis into the real economy will be much higher than needed."[4] (UNCTAD, 2008, issue 2)

Hereinafter this paper reviews what and how the International Monetary Fund[5] has done since the outbreak of the crisis to overcome it as quickly as possible and to foster the balanced and sustainable development of the world economy in the post-crisis era.

THE IMF IS A BENEFICIARY OF THE CRISIS!

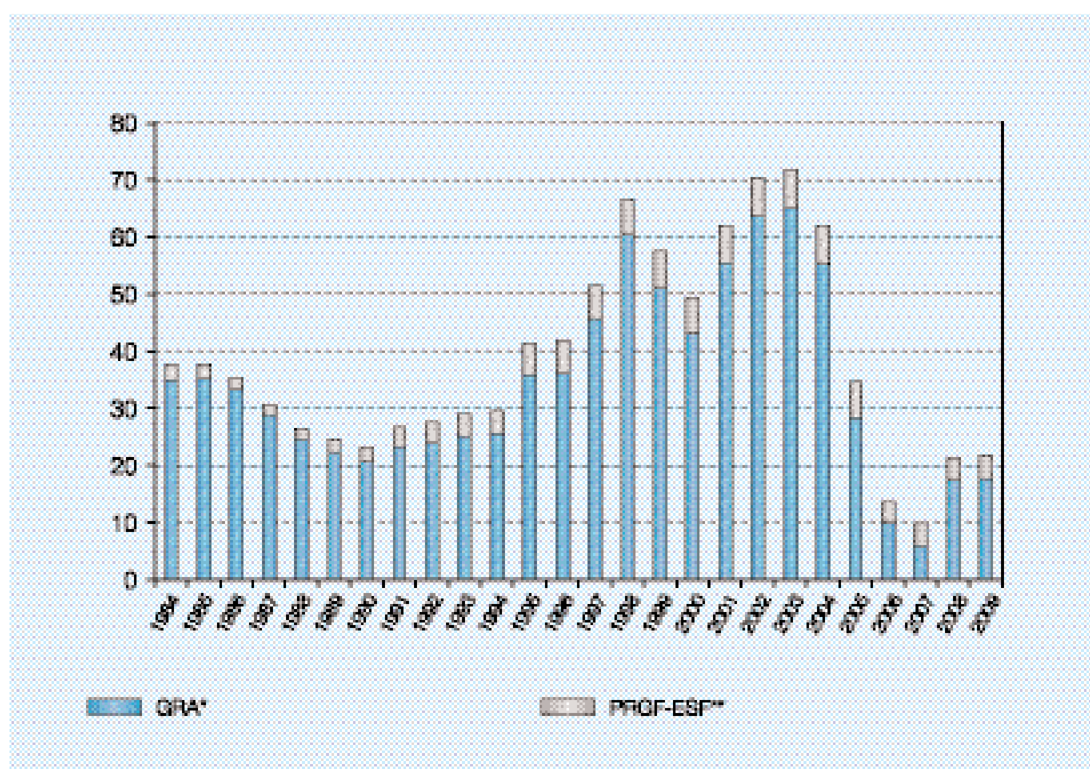
Strangely enough, the crisis brought about the revival of the IMF – the International Monetary Fund has found a central role in the global economy in organizing and orientating international cooperation on economic and economic policy matters.

The IMF completely lost significance by 2005–2006 after its biggest debtors (Argentina, Brazil, Mexico and Turkey in the late autumn of 2005 then Indonesia in early 2006) all repaid their loans before the expiry date. It seemed that demand only existed for the "softest" types of IMF loans that are considered quasi-aids. While the total value of loans provided by the IMF exceeded 70 billion SDR (i.e. USD 100 billion) in 2002–2003, it dropped to 10 (!) billion SDR by 2007. *(See Chart 1)*

Chart 1

IMF LOANS PROVIDED, 1984–2009

(SDR billion)



The indispensable reform of the organization came to a halt after 2006 as the rearrangement of voting rights failed. The largest creditors to the world economy, Japan, China and India, are dissatisfied with their quotas held in the IMF (i.e. with their vote percents) since e.g. China has a smaller vote than the Benelux states…[6]

By early 2006 it was obvious that this situation could not be sustained any longer. *The governor of the Bank of England* (who by tradition is also the IMF governor of his country) "proposed radical reform of the IMF, warning that without it the institution would slide into obscurity". In order to avoid this, *Mervyn King* suggested that "day-to day duties should be removed from the IMF managing director and Board of directors who should monitor and criticize the member countries' economic policies" instead. The representation of member countries in the IMF must be reduced. There is no need for a resident board in Washington. A non-resident board with six or eight meetings a year would be sufficient. (Gilles – Balls, 2006) The IMF's role as a "last resort" creditor decreased dramatically and only had an effect in the poorest countries. The *Financial Times* editorial on the same day put it even more sharply: "For long, the IMF has not been the supervisor of the Bretton Woods system anymore." Europe is overrepresented in the IMF (France and Great Britain possess 4.95–4.95 percent of total votes while China has 2.94 percent only). What is the IMF's role in today's globalized financial system? (…) The IMF is the relic of an era when global communication was not available yet." (The Financial Times, 2006)

Leading Financial Times columnist on world economy matters *Martin Wolf* used rather tough words: "Let us be brutal: the IMF is on the brink not just of "obscurity", as Mr King suggests, but of irrelevance. … If the International Monetary Fund did not exist, we would not re-invent it!" (Wolf, 2006] Wolf says three questions need to be addressed: First, how has the world changed since the 1944 conference at Bretton Woods? Second, what (if anything) is its contemporary role? Third, what changes are needed if it is to play it? Possible new roles are as follows: The IMF could function as an advisor, albeit not providing loans; it would be a mistake if the IMF did not address insolvency and liquidity deficit issues; the IMF could direct international reserve-pooling.[7] According to Wolf, the true mission of the IMF would be to act as a firmly thinking, independent organization providing truly independent global supervision in today's international financial system. However, "this is what the largest shareholders want the least" added Wolf sceptically.

In the time of the current crisis, however, the IMF is more and more frequently referred to as being the only financial organization with global reach that could coordinate the provision of required resources. Ted Truman, senior associate of the respected *Peterson Institute for International Economics* put it simply: (Truman, 2009) "When the leaders of the G-20 countries gather in London on April 2, they will have one policy instrument immediately available to address the global economic and financial crisis cooperatively, concretely and credibly." They could undertake a "commitment to an immediate, one-time allocation of $250 billion in special drawing rights (SDR) by the International Monetary Fund (IMF) to its member countries"[8]

The IMF can make an impact amidst the global economic crisis in three ways:

❶ By preparing global, regional and country-specific studies, i.e. by revealing the global economic situation in a thorough and professional manner and by providing explicit advice;

❷ Like central banks, the IMF is also able to exercise "verbal intervention": orientate the key players of the world economy through the

speeches, statements, presentations of its executives;

❸ Loan granting – as a quick response to the 2008 crisis, the IMF significantly reformed its loan granting policy by revamping loan arrangements and disbursement practices and by elaborating new loan schemes.

IMF ANALYSES REGARDING THE CRISIS

It was the June 2008 issue of *Finance & Development,* the joint quarterly of the IMF and the World Bank that first mentioned a crisis in express terms, actually in more than one articles: "The current crisis is the worst to hit mature financial markets in decades, and it is not yet over". (Kodres, 2008, page 9) In *Kodres*' approach, the road to the crisis was characterized by low nominal interest rates, excess liquidity, low volatility on financial markets and large investor risk appetite which evolved from overall self contentedness. As favourable circumstances appeared to be lasting, many money market players began to believe a new paradigm of financial markets. Investment in riskier assets became the norm, often with little understanding on the part of investors of the underlying risks and insufficient capital to support them. "Despite repeated warnings from the official sector that financial stability could be compromised by the intense »search for yield,« private sector incentives continued to encourage further risk taking. By the spring of 2007, even top managers in some of the largest financial institutions began to express public concern, particularly about structured credit securities backed by subprime mortgages and the leniency of the loan covenants and conditions backing leveraged buyout activity. But, given still-low interest rates and ample liquidity, demand for structured credit products carrying the AAA rating and earning higher-than-normal yields continued unimpeded until mid-2007. Supervisors had insufficient information and clout to halt the proliferation of overpriced securities." (op. cit. page 9) "Like former credit crunches, this crisis also stemmed from the softening of lending standards. The crisis which evolved in the subprime mortgage market spread on quickly: the complexity and lack of transparency of structured credit instruments concealed their real dimensions and the leverage of positions taken, often before the financial institutions themselves. The quick escalation of the crisis surprised and intimidated many investors. Solving the problems will not be easy because the incentives that underpinned the crisis are deeply ingrained in private sector behaviour and, in some cases, are even encouraged by regulation. But the problems deserve serious attention because the effects of the crisis are set to reach a broad swathe of average citizens in many countries" (op. cit. pp. 9–10)

An article by *Randal Dodd* and *Paul Mills* (Dodd – Mills, 2008) analysed the starting point of the problem, pointing out that "any of the myriad problems in the U.S. mortgage market could have been contained, but together they caused a crisis that spread across the globe." The US mortgage market could break loose and high-risk lending could become "systemic" because property prices rose sharply in the US and never decreased since 1929. "What have we learned from this contagion? First, securitization has moved some credit risks from the banking system, but not as much as anticipated and at the expense of transparency. It is taking a long time to discover where the losses have accumulated. Second, over-the-counter markets are not necessarily liquid when under stress. The disruption to interbank markets has been more profound and long lasting than anyone anticipated before August 2007, meaning that institutions must be able to survive considerable periods on their own resources. Third, risk management at individual banks has focused on protecting the institution

while largely ignoring systemic risks. As a result, individually rational actions to ensure survival have resulted in collectively irrational outcomes. And, finally, crisis resolution has become extremely complex in a world of dispersed risks and derivatives. Central banks have been required to innovate rapidly to contain the outbreak, and yet the crisis has persisted. Fighting this epidemic has proved far harder than the doctors imagined." (op. cit. page 18)

In the same issue of *Finance & Development,* an article by *Jaime Caruana* and *Adyta Narain* discussed the new requirements for banking supervision. (Carauna – Narain, 2008) The article concludes that "we must remember that Basel II is not an overall guide to how banks should run their businesses. Capital requirements cannot prevent banks from making mistakes – or substitute for banks' own responsibilities for assessing risk and managing it appropriately. Capital requirements can, and should, help create the right incentives for risk taking and support good risk management generally. Other elements of a bank's operating environment, such as accounting rules and market incentives, can also play an important role in shaping risks. Achieving consistency between these various competing influences – accounting, risk management, and regulation – will continue to be an open challenge for policymakers." (op. cit. page 28)

The December 2008 issue of Finance & Development was devoted entirely to the crisis, viewing it in a historic perspective and on a historic benchmark but also addressing several elements which are relevant in the current crisis.[9] The introductory study was written by IMF chief economist *Olivier Blanchard.* The first sentence in the article sets the tone for the entire issue: "The global economy is facing its worst crisis in 60 years. In the first half of the 2000s, a benign environment led investors, firms, and consumers to expect a permanently bright future and to underestimate risk. Housing and other asset prices shot up, risky assets were created and sold as being nearly riskless, and leverage increased. So when housing prices turned around, and subprime mortgages and the securities based on them turned sour, the stage was set for the crisis. In the context of rapid global integration and deep and complex interconnections between financial institutions, the crisis quickly moved across assets, markets, and economies. The rest is history, or, more precisely, history in the making." (Blanchard, 2008)

As for Olivier Blanchard, the short term action plan is clear though not easy: "Governments must attack the crisis on two fronts. They must implement and refine the policies adopted in the past few months to deal with the financial crisis. And they must take strong measures to sustain demand, limit the fall in output, and restore confidence and private spending."[10] In this difficult situation "Changes in policy and ambiguities about future policy are in some cases making things worse rather than better. Until the programs are clarified, and rules of the game more clearly established, private investors are unlikely to be enthused, worsening the crisis and delaying the adjustment in the financial system." (op. cit.) The IMF's chief economist thinks that governments will have to face dramatically worse budgetary positions after the crisis and that the financial environment will change dramatically, too.[11] "Governments will face a number of questions about how to manage their presence in the financial sector. The goal here should be to maintain a level playing field with privately owned institutions, and to steadily allow the return of the financial sector to private hands. Experience from many past banking crises provides a useful guide on how best to do this." (op. cit. page 10)

In order to avoid the repetition of the current crisis, better regulation is needed. "The crisis has shown the limits of the current regu-

latory and supervisory frameworks at both the domestic and international levels. The challenge is, therefore, to design new rules and institutions that reduce systemic risks, without imposing unnecessary burdens and stifling innovation. Implementation will take time; the design has already started, and will be further explored by the working groups created at the G-20 meetings. The contours of reform are however already clear." (op. cit. page 10) Blanchard underlines two elements of these "contours": *Measuring systemic risk will require better, more accurate information; New and better national rules will be necessary, both at the individual institution and at the macroeconomic level.*

In a quite remarkable study, *Noel Sacasa,* senior financial expert at the IMF's Monetary and Capital Markets Department summarizes the main question raised by the crisis along with the possible prompt responses. The article identifies the main actions to take: "The financial crisis has exposed weaknesses in the current regulatory and supervisory frameworks. The recent developments have made it clear that action is needed in at least four areas to reduce the risk of crises and address them when they occur. These are (a) finding a better way to assess systemic risk and prevent its buildup in good times; (b) improving transparency and disclosure of risks being taken by various market participants; (c) expanding the cross-institutional and cross-border scope of regulation while safeguarding constructive diversity; and (d) putting in place mechanisms for more effective, coordinated actions" (Sacasa, 2008, page 11)

This is necessary because there are at least three areas which did not receive sufficient attention in the past decades and therefore they could contribute significantly to the formation of systemic risks:

❶ global macroeconomic imbalances resulted in lower interest rates during the past decade, inducing more risk-taking and contributing to the creation of asset price bubbles worldwide;

❷ changes in financial sector structure and the failure of risk management to keep up with financial innovation during the past two decades rendered the system more prone to instability;

❸ leveraged financial institutions have inherent incentives to take on excessive risks without internalizing systemic risk, which is the main reason they need to be regulated.

Sacasa summarised the desirable priorities of regulatory reform as follows: *1. Due to systemic risk and procyclical risk-taking, both capital requirements and macroeconomic policy must be made more countercyclical. 2. Mark-to-market accounting must be reassessed. 3. Securitization must be made more compatible with incentives. 4. Liquidity management must be strengthened. 5. Risk management models and systems must be reassessed.* (op. cit. pp. 13–14)

The study[12] that probably received the most attention discussed the severity of the crisis and the probability that it lingers on. It sharply contradicted with the forecasts in the October 2008 *IMF World Economic Outlook* and the 6 November Update. The title of the article by *Stijn Claessens – M. Ayhan Kose – Marco Terrones* speaks for itself and so does the editorial highlight: *"When crises collide. Recessions accompanied by credit crunches or asset price busts are deeper and longer lasting."*[13] (Claessens – Kose – Terrones, 2008) The authors examined 122 recessions that broke out between 1960 and 2007. The average duration of these downturns was 4 years (with the shortest and longest lasting for 2 and 13 quarters respectively), their amplitude (i.e. the extent of the setback) was 2 per cent at an average. 28 credit crises, 28 real estate market crises and 58 securities market crises were identified by the authors who also found that the duration of credit and real estate market crises exceeded the average. Credit

crises usually lasted for two and a half years and entailed a 20 per cent decrease of borrowings in the private sector. Real estate market crises took even longer – four and a half years at an average, with the real prices of property falling 30 per cent. Recessions and/or crises often break out in more than one country simultaneously: we have had four global recessions in the past four decades: in the mid 70s, the early eighties,[14] the early nineties and in 2001. The authors came to the following final conclusion: "The global economy has been experiencing a financial storm of historic proportions. The lessons from the earlier episodes of recessions, crunches, and busts are sobering, suggesting that recessions following this storm may be more costly, because they are likely to take place alongside simultaneous credit crunches and asset price busts. Furthermore, although the effects of the current crisis have already been felt gradually around the world, past evidence suggests that its global dimensions are likely to intensify in the coming months. Nevertheless, the nature of a recession in a particular country can be shaped by many factors – including the financial health of its firms, banks, and households prior to the recession, and the policy measures that authorities employ to mitigate its adverse effects. Continued decisive policy actions at both the national and global levels could help meet the evolving challenges of the crisis."[15] (Op. cit. page 28)

Naturally, the March 2009 issue of Finance & Development also kept the crisis in the limelight through the articles in "The World in Crisis" section[16]. The study of *Jean Pisani-Ferry* and *Indhira Santos* analyse the more general consequences of the crisis, in particular its impact on globalization (Pisany-Ferry – Santos, 2009) It is also obvious that a lot of crisis management experiences have been compiled in the past decades but there is no memory of a truly global financial crisis in people's minds. Globalisation was criticised before the crisis already as not everyone had access to the benefits of global free trade and movement of capital and jobs. "Although economists, corporations, and some politicians were supportive, critics argued that globalization favoured capital rather than labour and the wealthy rather than the poor." (Op. cit. page 8) The authors are of the opinion that globalisation in the form as it unfolded and operated in the past two decades was a cause of this crisis in many ways. Although microeconomic failures were real and represented a starting point, "their effect would have been much more contained absent the insatiable appetite for AAA-rated U.S. assets. It was the combination of strong international demand for such assets, largely in connection with the accumulation of current account surpluses in emerging and oil-rich economies, and an environment of perverse economic incentives and poor regulation that proved to be explosive. (…) Discussion at the international level was further complicated by political overtones: (…) the United States has insisted that the key macroeconomic problem in the world economy was not its current account deficit, but rather China's high propensity to save." (Op. cit. page 9) As another mistake, "it was hoped, until autumn 2008, that economies immune from the direct fallout of the subprime crisis would sail through the storm with sufficient strength to pull along the entire world economy. (…) But it is now apparent that growth is declining sharply in all regions of the world." (Op. cit. page 10) Pisani-Ferry and Santos also believe that while unregulated globalization undoubtedly played a role in the outbreak of the crisis, the crisis also imposes a backslash on globalization, bringing it to a halt at least temporarily. "The drivers of the recent globalization wave – open markets, the global supply chain, globally integrated companies, and private ownership – are being undermined"[17] (Op. cit. page 10) It is obvious

that once the world economy emerges from the crisis, the global economic environment and governance will change. "The main test remains fostering international cooperation at a time when there is a big temptation to look for solutions at home. It is in deeper multilateralism, rather than in nationalism, that many of the answers to the current challenges lie. But what exactly should global actors and national governments do?" (Op. cit. page 11)

"VERBAL INTERVENTIONS" BY THE IMF

The IMF's "verbal interventions" mainly consisted of lectures, articles and statements by IMF managing director *Dominique Strauss-Kahn,* first deputy managing director *John Lipsky* and chief economist Olivier Blanchard.

Welcoming the Washington summit of G-20 countries, Strauss-Kahn said on 15 November 2008 (IMF, 2008/a) that "A new world economic order is developing that is more dynamic and more inclusive than any we have yet seen[18]". Naturally, the managing director was pleased to acknowledge that the G-20 intended to assign a key role to the IMF in managing the crisis. Strauss-Kahn explained: "I welcome the emphasis on fiscal stimulus, which I believe is now essential to restore global growth. Each country's fiscal stimulus can be twice as effective in raising domestic output growth if its major trading partners also have a stimulus package."

Also reflecting to the G-20 summit at a lecture presented at the John Hopkins university on 17 November 2008, first deputy managing director of the IMF John Lipsky outlined his views on the main short-term crisis management tasks and also on what needs to be done in the long run after the crisis. In the introduction he said that *"In several important ways, the coming months will represent both a test and a turning point for the global economy, for international financial markets and for global governance.* While the efforts agreed last weekend may fall short of something that could be given as grandiose a label as a new international financial architecture, nonetheless their scope and importance shouldn't be underestimated." Lipsky welcomed the G 20's endeavours regarding the future of the world economy, underlining that proposed reforms *"will only be successful if grounded in a commitment to free market principles,* including the rule of law, respect for private property, open trade and investment, competitive markets and efficient, effectively regulated financial systems." Lipsky also expressed his pleasure that the G-20 Leaders pledged to initiate a new push to reach agreement on the Doha Round of multilateral trade negotiations before the end 2009 but he also added as a cutting remark that we should not be "ignoring the widespread scepticism that a deal would or could be reached in the foreseeable future."

Lipsky emphasised that as the global inflationary pressure eases, many developed and emerging countries may further loosen up their monetary policies. "It is appropriate, therefore, that fiscal expansion will play a central role in helping to sustain domestic demand." Lipsky pointed out that *"the Liquidity Shock must be prevented from becoming a solvency crisis. In emerging economies, the focus must be dealing with immediate liquidity and exchange rate pressures. As these emerging economies likely will remain under pressure for some time from global financial deleveraging. As a result, liquidity provision will continue to be critical to emerging economies' ability to weather this storm."*

Thinking on a longer timeline that extends beyond the current crisis, Lipsky underlined three important issues regarding the future of the global financial architecture: *the global financial system must be improved; systemic risks must be evaluated more accurately; far more efficient and harmonised crisis manage-*

ment mechanisms are needed to manage potential future crises.

In a lecture on the IMF's future given in Madrid on 15 December 2008, Strauss-Kahn summarised the IMF's short-term proposals and outlined a financial architecture that could lay the foundations for the more balanced and more stable development of the world economy. (IMF, 2008/c) The IMF's managing director highlighted the following action items as top priorities for the near future: – Restoring stability to financial markets; – Supporting aggregate demand; – Providing financial support to crisis-hit countries. Strauss-Kahn provided a summary of long-term action items under the title "Policies to Avoid a Future Crisis", emphasizing that changes must be introduced in the regulation of financial markets, both at the national level and in terms of international coordination; the effectiveness of international financial institutions (The Financial Stability Forum, the International Organization of Securities Commissions, the Basel Committee on Banking Supervision) must be improved and the IMF can play a pivotal role in this effort. Regarding the future of the regulatory system, Strauss-Kahn underlined the significance of early warning for threats and the ability to take firm action in emergencies.

Olivier Blanchard, chief economist of the IMF rendered a rather meaningful title to a guest article he authored (Blanchard, 2009/a): *"(Nearly) nothing to fear but fear itself".* Blanchard principally warns that in times like today when fear from the "unknown unknowns[19] dominate, and the economic environment is so complex as to appear nearly incomprehensible, the result is extreme prudence, if not outright paralysis, on the part of investors, consumers and firms. And this behaviour, in turn, feeds the crisis." Therefore, policymakers must first reduce uncertainties. Financial resources must be channelled back to riskier businesses which the private sector must fund. Therefore, once the crisis begins to fade away, governments must recycle their portfolio accumulated during the crisis into the private sector. Consequently, they must separate more clearly the role of fiscal and monetary policy, but, in the current state of play, "this is a minor wrinkle", added Blanchard with a pinch of French humour. The third element of his proposal looks familiar from the writings of Strauss-Kahn and Lipsky quoted above: "Third, [government should] undo the effects of the wait-and-see attitudes of consumers and firms on the demand side. Get them to spend more, and have the state do some of the spending itself. Offer incentives to buy now rather than later; for example, temporary subsidies to consumers who turn in a clunker and buy a new car, a measure adopted in France. Increase spending on public infrastructure (…). If tailored and communicated well, these programmes can not only stimulate and replace private demand, but also convince consumers and firms that they are not in for another Depression."

Strange but *true: even in the heydays of Keynesism, the International Monetary Fund was not as Keynesian as these days:* in today's global financial and economic crisis, which is the most severe since 1929 and broke out in the world's largest and most developed financial market, *the most frequently applied expression and economic policy advice in the IMF's communication is "fiscal stimulus".*[20] *It is indeed difficult not to think of Keynes* who wished happy new year to president *Roosevelt* in a still famous and remembered open letter in 1933, saying: *Mr. President: spend, spend, spend!"* (Keynes, 1933)

Of course, the IMF also warns for the related long-term dangers: although economic policies must continue to focus on triggering an upturn, now "we must step over the crisis and look for an exit strategy." (Lipsky, 2009) In this

context, "exit" refers to the ending of fiscal stimulus and the long-term management of state money pumped into the economies. What this calls for above all is the limitation of medium-term risks, the handling of inflationary threats and the minimizing of economic policy distortions (i.e. excess intervention by governments). These actions will be rather difficult to see through as the problem on the medium and short run is not simply the neutralisation of today's excess budget expenditures: "Market confidence in the sustainability of budget positions would be helped by formulating medium-term fiscal frameworks and by announcing an outline of measures that will be used to tackle rising health care and retirement costs." (Op. cit.) However, the one and only way to execute these immense tasks is through cooperation among the key players of the world economy and the harmonisation of economic policies, ultimately through *the fixing of today's global financial imbalances.* Today even the first deputy managing director of the IMF emphasises that "The fiscal consolidation that will be required after the crisis and the inevitable rise in private saving in advanced economies – reflecting the steep decline in financial and housing wealth and tighter credit availability – will need to be matched by an increase in emerging market domestic demand. In turn, this would be facilitated by stronger social safety nets that would reduce the need for precautionary savings, by developing more effective financial systems, and by more flexible currency management that would support more fluid rebalancing of global supply and demand." (Op. cit.)

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The global analyses and outlooks of the IMF provide a starting point for generating local prosperity forecasts all around the world. In this respect, the single most important IMF publication is the *World Economic Outlook* (hereinafter: WEO).[21]

As it turned out very soon, the title of the October 2008 outlook, *Financial Stress, Downturns, and Recoveries* was way too optimistic. (WEO, 2008/a) The executive summary kicked off with these statements: "The world economy is entering a major downturn in the face of the most dangerous financial shock in mature financial markets since the 1930s. Global growth is projected to slow substantially in 2008, and a modest recovery would only begin later in 2009. Inflation is high, driven by a surge in commodity prices, but is expected to moderate. The situation is exceptionally uncertain and subject to considerable downside risks. The immediate policy challenge is to stabilize financial conditions, while nursing economies through a period of slow activity and keeping inflation under control." (WEO 2008/a: xv.) The title of the next sub-chapter suggested considerable optimism as well: *"Recovery is not yet in sight and likely to be gradual when it comes".* (Op. cit.) In October 2008[22], IMF experts were of the opinion that a gradual recovery in 2009 is likely because of three reasons: Commodity prices are projected to stabilize, although at high levels. The US housing sector is expected to reach the bottom in 2009, ending the negative drag on growth and significantly relieving the housing sector's pressure on the financial market. Emerging economies will have a stabilizing effect on the global economy, although "the longer the financial crisis lasts, the more they are likely to be affected." (Op. cit. xvi) Accordingly, the WEO projected a 3.9 percent global growth rate for 2008 and 3.0 percent for 2009 (0.2 and 0.9 lower than the respective figures in the July 2008 forecast) and predicted that global trade would expand at 4.9 percent in 2008 and at 4.1 percent in 2009. In consistence with this optimism, the IMF anticipated a 50.8 percent rise in oil prices in 2008 and a –6.3 percent unwind in 2009.

While there have been precedents in the past decades that the IMF issued an interim analysis

between the April and October issues of the WEO, it has never happened before that an IMF forecast had to be updated in less than six weeks. The title of the update issued on 6 November 2008 (WEO, 2008/b) reflected well the deteriorating prospects: Rapidly Weakening Prospects Call for New Policy Stimulus. The analysis is based on the observation that "Prospects for global growth have deteriorated over the past month, as financial sector deleveraging has continued and producer and consumer confidence have fallen." (Op. cit. page 1) The paper points out that for the first time (!) in the post world-war era, global output will decrease in 2009 and recovery can only start at the end of the year. Consequently, the decrease of product prices became predictable. The IMF's analysis was especially firm in revaluating the financial crisis and underlined that "The financial crisis remains virulent. Markets have entered a vicious cycle of asset deleveraging, price declines, and investor redemptions" (Op. cit. page 2) The paper highlights the pressure on emerging markets which is far above the average and stresses the need for strengthening the financial sector: Financial policies have responded strongly. However, they could be reinforced, clarified, and better coordinated and thereby foster a more rapid recovery of lending and demand. Depending on how much prospects worsen, the scale of current recapitalization efforts may need to be broadened." (Op. cit. page 4)

Another WEO update was issued on 28 January 2009 (WEO, 2009/a), titled *Global Economic Slump Challenges Policies.* The introduction of the study pointed out that "World growth is projected to fall to 0.5 percent in 2009, its lowest rate since World War II. Despite wide-ranging policy actions, financial strains remain acute, pulling down the real economy. A sustained economic recovery will not be possible until the financial sector's functionality is restored and credit markets are unclogged. For this purpose, new policy initiatives are needed to produce credible loan loss recognition; sort financial companies according to their medium-run viability; and provide public support to viable institutions by injecting capital and carving out bad assets. Monetary and fiscal policies need to become even more supportive of aggregate demand and sustain this stance over the foreseeable future, while developing strategies to ensure long-term fiscal sustainability. Moreover, international cooperation will be critical in designing and implementing these policies." (WEO, 2009/a, page 1)

These sentences not only reflect a fast and dramatically worsening situation but also highlight the IMF's firm departure (as described in detail above) from neoliberal orthodoxy which it used to follow. This is also proved in the closing section of the analysis which points out that besides the stabilization steps taken to date (liquidity support, deposit insurance and recapitalization schemes), there is also a need to manage long-term uncertainties about the solvency of financial institutions e.g. by establishing state institutions to manage bad loans. "In current circumstances, the timely implementation of fiscal stimulus across a broad range of advanced and emerging economies must provide a key support to world growth. Given that the current projections are predicated on strong and coordinated policy actions, any delays will likely worsen growth prospects. Countries that have policy room should make a firm commitment to do more if the situation deteriorates further. Fiscal stimulus packages should rely primarily on temporary measures and be formulated within medium-term fiscal frameworks that ensure that the envisaged buildup in fiscal deficits can be reversed as economies recover and that fiscal sustainability can be attained in the face of demographic pressure. Countries that have more limited fiscal space should focus their efforts on supporting the financial sector and credit flows, while

ensuring that budgets adjust to less favourable external conditions." (WEO, 2009/a, page 5)

Analysing the new phenomena, the next issue of WEO published late April 2009 (WEO, 2009/b) further adjusted forecasts. The publication's title *(Crisis and Recovery)* already described actual world economy trends as a crisis, predicted a severe setback for the whole of 2009 and assumed that recovery (which was "deferred" to 2010) would be rather modest. "*Global economy is in a severe recession inflicted by a massive financial crisis and acute loss of confidence. Wide-ranging and often unorthodox policy responses have made limited progress in stabilizing financial markets and containing the downturn in output, failing to arrest corrosive feedback between weakening activity and intense financial strains.* While the rate of contraction should moderate from the second quarter onward, world output is projected to decline by 1.3 percent in 2009 as a whole and to recover only gradually in 2010, growing by 1.9 percent. Achieving this turnaround will depend on stepping up efforts to heal the financial sector, while continuing to support demand with monetary and fiscal easing." (WEO, 2009/b, page 1) The unparalleled severity of the situation and the continuous deterioration of the world economy since September 2008 are highlighted by the fact that "global activity is now projected to decline 1.3 percent in 2009, an 11 percentage point downward revision from the January estimate. By any measure, this downturn represents by far the deepest global recession since the Great Depression. Moreover, all corners of the globe are being affected: output per capita is projected to decline in countries representing three-quarters of the global economy, and growth in virtually all countries has decelerated sharply from rates observed in 2003–2007." (WEO, 2009/b, page 9)

When comparing the October 2008 forecast of the World Economic Outlook to the two subsequent updates and the April 2009 outlook *(see Table 1)*, it is apparent that the *IMF had to apply a series of downward revisions to its global forecasts between September 2008 and early April 2009. Parallel to that, the IMF had to use more and more serious categories in their evaluation of the world economy's situation.*[23]

Table 1 shows that the IMF lowered its global output forecast for 2009 by 3.7 percentage points and the forecast for 2010 issued in April 2009 was 2.7 percentage points more pessimistic than the related figure released seven months earlier. The macroeconomic outlook for the USA practically moved downwards parallel to that of the entire world economy, while the outlook for Japan and Russia worsened above the average (the latter obviously due to the dramatic fall of commodity prices on the world market) and anticipations decreased below the average in several important developing and emerging economies, principally in China and India. Inflationary expectations dropped significantly in each group of countries. With a view to already low former inflation rates, they may even give some ground for deflationary fears.[24] Interest rates that were not high before were pushed further down by the crisis and today we can hardly speak about positive real interest rates. (This is dangerous as it deprives governments from any elbow room in monetary policy.)

As forecasts worsened and were further adjusted downwards, the predicted start of recovery moved further and further into the future: while in September-October 2008 the IMF believed that recovery would begin in late 2009 (emphasising the anticipated low dynamics thereof), in April 2009 they forecasted it for Q4 2010. However, in June 2010, IMF first deputy managing director John Lipsky predicted that growth outlooks for 2010 would be improved slightly. (Lipsky, 2009) Lipsky's optimism was not based purely on empirical analyses. He emphasised that

Table 1.

SUMMARY OF WEO FORECASTS, OCTOBER 2008 – APRIL 2009

				Change 1.		Change 2.		Change 3.		Total change	
	2008	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010
World output	**3.2**	**–1.3**	**1.9**	**–0.2**	**–0.8**	**–1.7**	**–0.8**	**–1.8**	**–1.1**	**–3.7**	**–2.7**
Advanced economies	**0.9**	**–3.8**	**0**	**–0.1**	**–0.8**	**–1.7**	**–0.5**	**–1.8**	**–1.1**	**–3.6**	**–2.4**
USA	1.1	–2.8	0	–0.1	–0.8	–0.9	0.1	–1.2	–1.6	–2.2	–2.4
Euro area	0.9	–4.2	–0.4	–0.1	–0.7	–1.5	–0.7	–2.2	–0.6	–3.8	–2
Japan	–0.6	–6.2	0.5	–0.2	–0.7	–2.4	–0.5	–3.6	–0.1	–6.2	–1.3
Russia	5.6	–6	0.5	–0.2	–2	–4.2	–3.2	–5.3	–0.8	–9.7	–6
China	9	6.5	7.5	–0.1	–0.8	–1.8	–1.5	–0.2	–0.5	–2.1	–2.8
India	7.3	4.5	5.6	–0.1	–0.6	–1.2	–0.3	–0.6	–0.9	–1.9	–1.8
Brazil	5.1	–1.3	2.2	..	–0.5	–1.2	–1	–3.1	–1.3	–4.3	–2.8
Mexico	1.3	–3.7	1	–0.1	–0.9	–1.2	–1.4	–3.4	–1.1	–4.7	–3.4
Global trade	**3.3**	**–11**	**0.6**	**–0.3**	**–2**	**–4.8**	**–2.5**	**–8.2**	**–2.6**	**–13.3**	**–7.1**
Commodity prices (USD)											
Oil	36.4	–46.4	20.2	–10.6	–25.5	–17.6	9.7	2.1	0.2	–26.1	–15.6
Consumer prices											
Advanced economies	3.4	–0.2	0.3	..	–0.6	–1.1	–0.8	–0.5	–0.5	–1.6	–1.9
Emerging and developing economies	9.3	5.7	4.7	–0.2	–0.7	–1.3	–0.5	–0.1	–0.3	–1.6	–1.5
LIBOR											
USD	3	1.5	1.4	–0.2	–1.1	–0.7	–1.4	–0.2	–1.5	–1.7	...
Euro	4.6	1.6	2	–0.3	–1.2	–0.8	–0.8	–0.6	–0.7	–2.6	...
Yen	1	1	0.5	..	–0.2	..	–0.3	0	0.1	–0.2	...

Change 1 = 1 October – 6 November 2008
Change 2 = 6 November 2008 – 28 January 2009
Change 3 = 28 January – April 2009

Source: WEO 1 October 2008; WEO update – 6 November 2008; WEO update – 6 January 2009 and WEO April 2009. compiled by the author

"While the latest data point to a slowing of the global contraction, the timing and pace of the global economic recovery remains uncertain. Moreover, it is clear that whatever comes next will not simply be a return to the status quo ante. Rather, if a new global expansion is to be sustained, it will have to be based on rebalanced sources of growth across countries and regions. Moreover, the current crisis has made it abundantly clear that a substantial strengthening is needed regarding international collaboration in the design and implementation of economic and financial sector policies." (Op. cit.)

"CRISIS LENDING" BY THE IMF[25]

The IMF's "Emergency Financing Mechanism" was set up to manage the Southeast Asian crisis that broke out in 1997. Back then, loans were provided to the Philippines, Thailand, Indonesia and South Korea through this special lending mechanism.[26]

The purpose of the emergency financing mechanism is to provide financial resources much faster than usual[27] in crisis situations to member countries that need it. This mechanism can be applied when a member state slides into an extraordinary financial position

where its financial stability is at risk and a quick response is required to eliminate the threats to that country or to the international financial system. The management of the IMF obtains information on needs for activating the mechanisms and a short written report is circulated among management members; as quickly as possible, an agreement is to be reached with the government of the member country concerned, then management can start negotiations within 48–72 hours. Under the emergency financing mechanism, the final decision on lending loan can be made extremely quickly.

In the global financial crisis that broke out in 2008, the following countries applied for an IMF loan until 21 May 2009: *Armenia, Belarus, Costa Rica, Salvador, Georgia, Guatemala, Hungary, Iceland, Latvia, Mongolia, Pakistan, Romania, Serbia, the Seychelles and Ukraine.* Although the loans were awarded and disbursed extremely quickly under the emergency financing mechanism, they were provided as stand-by loans through the IMF's first and still fundamental trademark facility, the stand-by lending arrangement. As of 21 May 2009, the IMF had 16 stand-by lending arrangements in effect[28] with an aggregate value of SDR 48.038 billion (USD 74.211 billion), of which SDR 27.012 billion (USD 41.729 billion) was disbursed to date.[29] In the form of stand-by lending arrangements approved under the emergency financing mechanism since early November 2008, SDR 11.443 billion has been disbursed to Romania (USD 17.676 billion), SDR 11 billion to the Ukraine (USD 16.993 billion), SDR 10.538 billion to Hungary (USD 16.279 billion), SDR 5.169 billion to Pakistan (USD 7.985 billion) and SDR 1.522 billion to Latvia (USD 2.351 billion)[30] among others *(See Table 2)*.

Under the pressure of the crisis, the IMF significantly overhauled its lending framework. This reform was implemented at a speed unprecedented in the IMF's history[31] and basically encompassed six areas (IMF, 2009/c):

- *modernizing IMF conditionality for all borrowers,*
- *introduction of new, flexible credit line (FCL),*
- *enhancing the flexibility of the Fund's traditional stand-by arrangement,*
- *doubling access limits (credit lines),*
- *simplifying cost and maturity structures of lending, adapting them to the aforementioned changes,*
- eliminating certain seldom-used facilities.

The *modernization of conditionality* involves two areas. In the future, the IMF will not rely exclusively on traditional (ex post) conditionality as the basis for awarding and disbursing Fund resources but also on pre-set qualification criteria (ex-ante conditionality). This principle is embodied in the newly introduced *flexible credit line.*

The *Enhanced Stand-by* Arrangement was created *to increase the flexibility of the traditional stand-by arrangement* (SBA) the IMF's most widely used lending instrument since 1946. It can be disbursed for crisis prevention purposes to countries not entitled to flexible credit lines. The new SBA framework enables high-access on a precautionary basis and provide increased flexibility by allowing frontloading of access and reducing the frequency of reviews and purchases where warranted by the strength of the country's policies and the nature of the balance of payments problem faced by the country.

Non-concessional loan access limits for countries has been doubled – with the new annual and cumulative access limits for Fund resources being 200 and 600 percent of quota, respectively.[32] Through the *Exceptional Access procedures*, higher loans will be available subject to case-by-case evaluation. The evaluation mechanism has been clarified and simplified.

Table 2

STAND-BY ARRANGEMENTS OF THE IMF AS OF 18 JUNE 2009

(SDR million*)

Beneficiary	Effective date	Expiration date	Amount agreed	Drawn to date	Available
Armenia	06. 03. 2009	05. 07. 2011	368	206	162
Belarus	12. 01. 2009	11. 04. 2010	1 618	1 100	518
Costa Rica	11. 04. 2009	10. 07. 2010	492	492	0
El Salvador	16. 01. 2009	10. 03. 2010	514	514	0
Gabon	07. 05. 2007	06. 05. 2010	77	77	0
Georgia	15. 09. 2008	14. 03. 2010	477	189	288
Guatemala	22. 04. 2009	21. 10. 2010	631	631	0
Hungary	06. 11. 2008	05. 04. 2010	10,538	4,215	6,323
Iceland	19. 11. 2008	18. 11. 2010	1,400	840	560
Latvia	13. 12. 2008	22. 03. 2011	1,522	986	535
Mongolia	01. 04. 2009	01. 10. 2010	153	153	0
Pakistan	24. 11. 2008	23. 10. 2010	5,169	2,533	2,639
Romania	04. 05. 2009	03. 05. 2011	11,443	7,073	4,370
Serbia, Republic of	16. 01. 2009	05. 04. 2010	351	351	0
Seychelles	14. 11. 2008	13. 11. 2010	18	11	6
Ukraine	05. 11. 2008	04. 11. 2010	11,000	8,000	3,039
Total:			**48,038**	**27,012**	**21,059**

* 1 USD = 0,647508 SDR, 1 SDR = 1,539473 USD (22 June 2009 exchange rates), SDR interest rate: 0.42%.

Source: IMF Financial Activities - Update June 18, 2009. http://www.imf.org/external/np/tre/ activity/2009/ 061809.htm tabl2a

USE OF THE IMF'S FLEXIBLE CREDIT LINE AS OF 18 JUNE, 2009

(SDR million)

Beneficiary	Effective date	Expiration date	Amount agreed	Drawn to date	Available
Columbia	11. 09. 2009	05. 10. 2010	6,966	6,966	...
Mexico	17. 04. 2009	26. 04. 2010	31,526	31,526	...
Poland	06. 05. 2009	05. 05. 2010	13,690	13,690	...
Total			**52,184**	**52,184**	...

Source: IMF Financial Activities - Update June 18, 2009. http://www.imf.org/external/np/tre/ activity/2009/ 061809.htm tabl2a.

An especially important or should we say the *"most important"* element of the IMF's lending framework reform is the introduction of the *flexible credit line (FCL)*.[33] The FCL is for countries with very strong fundamentals, policies, and track records of policy implementation which need this facility for crisis prevention. Access under the FCL would be determined on a case-by-case basis. Disbursements under the FCL would not be phased or conditioned to policy understandings as is the case under a traditional Fund-supported program.[34] The IMF keeps emphasising that access to this facility is limited to countries with exceptional performance and very strong track records regarding all former IMF-supported programs.

The flexibility of this arrangement is princi-

pally manifested in the following (IMF, 2009/c) features:

- *Large and upfront access to Fund resources* – with no ongoing (ex post) conditions, enabling proactive action in managing economic problems;
- *Renewable credit line* – renewable at the borrower's discretion after six or twelve months;
- *Longer, 31/4 – 5 years repayment period;*
- *No hard cap on IMF credit line* and
- *Flexibility to draw at any time on the credit line* – treating it as a precautionary instrument.

In the course of qualification, the IMF expresses its confidence in the qualifying member's policies and ability to take corrective measures in economic policy when needed. The qualification process is intended to ascertain that the member has very strong economic fundamentals and institutional policy frameworks; it is implementing – and has a sustained track record of implementing – very strong policies; and remains committed to maintaining such policies in the future. The criteria for gaining access to flexible credit line resources are as follows (IMF, 2009/c):

- sustainable external positions;
- a capital account position dominated by private flows;
- a track record of steady sovereign access to international capital markets at favourable terms;
- a reserve position that is relatively comfortable when the FCL is requested on a precautionary basis;
- sound public finances, including a sustainable public debt position;
- low and stable inflation, in the context of a sound monetary and exchange rate policy framework;
- the absence of bank solvency problems that pose an immediate threat of a systemic banking crisis;
- effective financial sector supervision;
- data transparency and integrity.

Compliance with these criteria does not necessarily mean unconditional loan disbursement. When deciding on a potential FCL arrangement, the IMF takes into consideration all ongoing corrective actions in the country's economic policy. Between 17 April and May 11, 2009, the IMF disbursed three significant loans from the flexible credit line facility (IMF, 2009/d): Mexico received an FCL of SDR 31.528 billion (USD 48.705 billion), then Poland was granted a loan of SDR 13.690 billion (USD 21.149 billion). The third FCL loan was disbursed to Columbia in an amount of SDR 6.966 billion (USD 10.761 billion). Practically, all three countries used up the entire credit line almost immediately. This also proves the flexibility of the credit line facility since immediate drawdown is not possible with any other major IMF arrangement.[35]

The *simplification of maturity structures and costs* also represents a full overhaul. The modernization of loan repayment resulted in a longer grace period and simpler repayment schedules. Repayment along a pre-defined schedule may reduce the burden on borrowers and mitigate the IMF's credit risks without discouraging early access to IMF resources.

The *reform of facilities for low-income country members* strengthens the IMF's ability to provide short-term and emergency financing to low income countries.

Under the *simplification of the lending toolkit,* the IMF terminated some lending facilities that have not been recently used.[36]

The purpose of the *emergency financing mechanism* is to provide financial resources much faster than usual[37] in crisis situations to member countries that need it. (IMF, 2009/a) This mechanism can be applied when a member state slides into an extraordinary financial position where its financial stability is at risk and a quick response is required to eliminate the

threats to that country or to the international financial system. The management of the IMF obtains information on needs for activating the mechanisms and a short written report is circulated among management members; as quickly as possible, an agreement is to be reached with the government of the member country concerned, then management can start negotiations within 48–72 hours. Under the emergency financing mechanism, the final decision on lending can be made extremely quickly.

It was the *emergency financing mechanism* that enabled the 13 aforementioned member countries to access the stand-by arrangement much faster than usual[38]. Furthermore, *drawdown was made flexible. The combination of these two elements constitutes a fundamental reform of the IMF's oldest and key loan arrangement.*

By all means, quickly disbursed loans are of fundamental importance for the countries that received it but there is a mutual interest here: *the IMF is the sole real beneficiary of the crisis as the financial turmoil allowed it to regain its former importance in the international financial and currency system, i.e. in the global economy!* This was obviously a surprise for the IMF itself, too. The US Treasury Secretary urged the significant increase of the IMF's financial resources and the "comprehensive reform of the global financial architecture". (Beattie, 2009) G-20 finance ministers and central bank leaders have already agreed to boost the IMF's credit lines with USD 250 billion. (The Financial Times, 2009/a) While the European members of the G-20 do not support US plans for a "global stimulus package" that would try to render impetus to the world economy with contributions equalling 2 percent of the GDP of participating countries, "*Mr. Geithner* proposed a dramatic expansion of the International Monetary Fund's resources. European finance ministers, who live in fear of a contagious financial crisis in Eastern Europe, should welcome it even if it means they get less influence over the fund. (The Financial Times, 2009/b) There are lots of ways to increase the IMF's resources, but raising money quickly may require the help of some donors – notably China – who would demand a greater say in the running of the fund. Europe's weight would be cut back. This is desirable in any case, and it would be a small price for the continent to pay in order to prevent a catastrophe on its eastern frontier."

Pursuant to the agreement reached at the G-20 London summit (G-20, 2009), the IMF passed a resolution at its Spring 2009 session whereby member countries would immediately raise (i.e. double) IMF credit lines by USD 250 billion and expand from various resources the funds of the New Arrangements to Borrow (NAB) by USD 500 billion. (IMFC, 2009) Credit lines will be expanded through a raise of quotas while NUB funds that are intended to finance special lending arrangements will be provided from individual and voluntary contributions from member countries. The two largest contributions to date have been disbursed by Japan and the USA, each providing the equivalent of USD 100 billion.

SUMMARY AND OPEN QUESTIONS

The International Monetary Fund which was unable to make progress with its announced institutional, decision-making and lending reform since October 2005, *responded very quickly and effectively to the crisis that broke out in the autumn of 2008* (or rather which broke out in 2007 and became tougher than ever with the bankruptcy of Lehmann Brothers in September 2008 *and evolved into a global financial crisis at unbelievable speed*). An institution that used to be accused for decades of being slow, rigid and unable to change (on valid reasons), demonstrated unprecedented quickness, flexibility and efficiency!

The IMF gave up (probably put aside or suspended) its former neoliberal orthodoxy at breathtaking speed and began supporting and encouraging the plain Keynesian practice of "fiscal stimulus". The recent publications of senior IMF staff members (Lipsky, 2009; Blanchard, 2009/b) suggest that the IMF has accepted the inevitable need for eliminating global financial imbalances.[39]

It is strange though that the World Economic Outlook, a basic source and starting point of short-term growth predictions all around the world had to reassess its forecasts within six weeks after the October 2008 analysis. Then the update was further adjusted (downward in all key elements) ten weeks later and the forecasts in the May 2009 WEO were gloomier than ever (and thus more pessimistic than January predictions). This way, *while demonstrating spectacular improvement in the flexibility of lending and publishing several in-depth and critical (mostly self critical) analyses, the IMF was unable to orientate world economy players adequately through its single most important global analysis and forecast.*

However, some key questions about the IMF's future have remained open.

It is surprising somewhat that under the framework of "crisis lending", the IMF provides *stand-by loans on simplified and shortened credit rating* and (rather unusually in IMF procedures) on *soft conditionality.* It is unclear though whether this will be a *lasting change* in the IMF's disbursement philosophy and practice.

Since October 2005, there has not been any significant progress in the IMF's institutional reform, in the rearrangement of voting proportions, decision-making mechanisms and the IMF organization. The crisis made it even clearer that the IMF cannot function efficiently while the current voting ratios are in place. While the operability of the international financial system cannot be sustained without the active participation of China and while China can and must be a key source for expanding the IMF's resources, its quota and voting power in the General Meeting and the Board is smaller than that of the Benelux countries (as mentioned earlier)! This is obviously unsustainable. The increased role of G-20 countries and the fact that the G-20 summits in Washington (November 2008) and London (April 2009) were of decisive importance regarding the IMF's future highlighted the same trend.[40] The G-20, however, is an informal organisation with no own staff and secretariat (actually the IMF staff substitutes for the G-20 staff!) and it may easily take the place of the G-7/G-8. Still, the obvious increase in the importance of its global role cannot substitute for the long overdue restructuring and institutional reform of the IMF.

The success of plans to *increase the resources of the New Arrangements to Borrow by USD 500 billion is also questionable, along with the list of donor countries and the size of their contributions.* Between the G-20 decision on 2 April and early July, only the USD 100 million contributions of Japan and the USA could be regarded secured, with a USD 50 billion contribution from Saudi Arabia seeming likely. Plans to raise the remaining USD 250 billion through bond issuance still carry a number of uncertainties: neither the term nor the interest rates and the range of subscribers have been clarified. China seemed willing to buy long-term IMF bonds for USD 50 billion but India has some other preconditions, too. A potential failure to clarify the conditions of bond issuance and to make the necessary commitments until the October 2009 Annual Meeting of the IMF would not only put limitations to liquidity expansion but it would also mean a severe loss of face for the organisation.

Notes

1 For this study, I used a part of a manuscript titled "International economic organizations and the global economy crisis, 2008–2009" which I wrote for a research program of the Institute for World Economics of the Hungarian Academy of Sciences. The research program is named "Strategies for Hungary's social and economic breakout: Challenges in a globalized world and on a historic crossroad affected by EU integration."

2 In some dynamically emerging economies, primarily in China, India and some other Southeast Asian countries, the term "crisis" did not (yet?) apply in April 2009. They were not even in a recession, only experienced a slowdown of growth. This group of countries is the very reason that global output is not decreasing significantly even though both IMF and OECD forecasts predict a GDP decline in developed countries in 2009. At the same time, the setback in developed economies and the shrinking of markets will obviously trigger a recession in the majority of developing countries. Still, as of the Spring of 2009, there is still a visible chance that some dynamically emerging economies with a large internal market (principally Brazil, India and China) may avoid the crisis.

3 With a view to the topic of this study, here we disregard the other historic lesson that the Bretton Woods system rested on: After WWII, the defeated countries were not excluded from Bretton Woods in order to avoid repeating the destroying effect of the peace treaties after WWI.

4 Op. cit. page 2

5 We closed the collection of materials with the documents of the IMF's Spring meeting held 25–26 April, 2009.

6 About the loss of significance of the IMF and the reform plans outlined in 2005–2006 see Csáki, 2006

7 The term "Reserve-pooling" comes from the original text.

8 Naturally, many people thought so earlier as well. In August 2006, the Le Monde published an extensive set of articles about the perspectives for the IMF. Michel Camdessus (former IMF managing director over three cycles) was not the only one who represented the opinion that "there has never been this big an imbalance between debtor and creditor economies. The USA has never accumulated so large deficits and China has never accumulated this large surpluses. Add the geopolitical crises and the energy crisis to that and we can easily understand that in a world like this the risks of a financial crisis cannot be considered distant threats. If the IMF was to be wound up, it would have to be re-established immediately. In a time when immense opportunities co-exist with similarly immense risks, the world needs an institution that is able to bring countries to the same table." A critic of the IMF, Barry Eichengreen would like to see the IMF function as a "marriage consultant" that is able to convince the "vicious couple" to take reasonable action, i.e. persuade the USA to raise taxes and China to spend more on education, public health and infrastructure. (…) the IMF remains the most suitable forum for that." [Faujas, 2006]

9 Collins, Charles (2008): The Crisis through the Lens of History. The current financial crisis is ferocious, but history shows the way to avoid another Great Depression.; El-Erian, Mohammed A. (2008): A Crisis to Remember. The case for modernizing the multilateral framework; Ingves, Stephan – Lind, Göran (2008): Stockholm Solutions. A crucial lesson from the Nordic experience is the need for prominent state involvement in crisis resolution; Kang, Kenneth – Syed, Murtaza (2008): The Road to Recovery. A View from Japan. Strategy for addressing both liquidity and solvency issues is needed. In: Finance & Development, Volume 45, Number 4. December.

10 Op. cit. page 9

11 "The financial landscape will look dramatically different."

12 There is no better proof of attention than the fact that Samuel Brittan, the doyen of the economic policy writers of the Financial Times devoted an extensive article to present the key findings of these three authors. [Brittan, 2009]

13 Pp. 26-28. The article summarizes the main findings of an extensive study published under the title IMF Working Papers 08/274.

14 As it is well known, these two recessions in 1974-1976 and 1979–1982 were preceded by oil price explosions.

15 Op. cit. page 28

[16] Besides the study to be discussed herein: Finance & Development (2009): Deep Impact. Four countries confront the harsh and disruptive effect of the global economic downturn. Volume 46, Number 1. March.; Cottarelli, Carlo (2009): Paying the Piper. The role of medium-term fiscal policy in rebounding from the crisis; Kodres, Laura – Narain, Adyta (2009): What is to be done. The scope of financial regulation needs to be revamped and the provision of liquidity improved. Here's how; Milesi-Ferretti, Gian Maria (2009): Changing Fortunes. Finance & Development, Volume 46, Number 1. March

[17] Op. cit.

[18] In this specific context, the word "inclusive" refers to the fact that new players have entered the group of countries that define the power relations in the world economy. The reference is obviously about the BRIC countries.

[19] I.e. fear from the not objectively unknown.

[20] The Bretton Woods system was obviously the manifestation of a kind of "collective Keynesianism". Each of its three principles and the statutes of all three basic institutions were inspired by Keynesianism. The "only" exception was that instead of the artificial currency proposed by Keynes, the US dollar became the key currency of the Bretton Woods financial system…

[21] The World Economic Outlook (commonly abbreviated as WEO) is published twice a year: for the spring and annual meetings of the IMF and it is freely downloadable from the IMF home page. (Currently the issues published since 1998 to date are available for downloading. See: http://www.imf.org/external/ns/cs.aspx?id=29. The WEO database can be accessed separately and includes all tables published in WEO issues since April 1999. See: http://www.imf.org/external/ns/cs.aspx?id=28.

[22] The 1 October 2008 issue of WEO was available on 22 September already at the IMF's home page, thus it is likely to have been prepared prior to the 15 September collapse of Lehmann Brothers and therefore it actually reflected opinions and conditions as of early September 2008.

[23] As mentioned before, the terminology applied in IMF analyses progressed from setback through recession to crisis.

[24] Deflationary fears are fuelled extensively by experiences with Japanese recession and stagnation in the nineties.

[25] The term "crisis lending" represents IMF parlance

[26] "Emergency Financing Mechanism" (IMF, 2009)

[27] "At short notice" in IMF parlance.

[28] Beside the 8 countries listed, Salvador, Gabon, Honduras, Iraq and the Seychelles were in a stand-by borrowing agreement as at the end of 2008.

[29] See IMF, 2009/b.

[30] Five additional countries were granted stand-by loans of USD 1.36 billion in total as at the end of 2008: with a view to this figure, we could rightfully call the IMF's position "insignificant" as in the autumn of 2008.

[31] This unprecedentedly quick change in the more than six decades of the IMF's history probably reflects the fact that IMF management has graded the crisis since October 2008 as an extremely severe global crisis that is only comparable to the Great Depression of 1929–33. While even the IMF's institutional reform (the transformation of quotas, voting rights and management bodies) made hardly any progress since 2005, under the squeeze of the crisis the IMF was able to overhaul its entire lending mechanism within a few weeks!

[32] These are stand-by loans disbursed from the "regular lending arrangements" of the IMF, extended stand-by loans and loans provided from the extended credit facility. Concessional loans are arrangements provided to the poorest countries on especially favourable conditions and in response to one-off circumstances like natural disasters, sudden fall of export revenues, etc.

[33] The IMF considers the Flexible Credit Line an element of the modernization of conditionality. It is perfectly reasonable from the standpoint that the access mechanism reflects a significant simplification and improved flexibility of conditionality. At the same time, the FCL's declared purpose of "crisis prevention" represents a significant departure from the traditional goal of stand-by loans, the management of short term current imbalances.

[34] The FCL replaces the former short-term liquidity facility (SLF) thus its flexibility is usually measured against that of the SLF.

[35] This shows well that the flexible credit line is not only flexible in terms of conditionality but also in terms of phasing.

[36] Two credit arrangements were eliminated: the supplemental reserve facility, created in the wake of the Southeast Asian crisis of 1997 and available for financing extraordinary current account deficits triggered by sudden and extensive loss of market confidence. This arrangement was made unnecessary by the overhaul of crisis lending. The compensatory financing facility used to provide low amounts up to 20 and 10 percent of quotas to finance lost export revenues and the increasing costs of grain imports. Due to the insignificance of accessible amounts, there was hardly any demand for this facility.

[37] "At short notice" in IMF parlance.

[38] Formerly the awarding of stand-by loans was preceded by at least six months of negotiations, multiple iterations between the IMF and the potential borrower and finally by multi-step and lengthy decision preparation. The emergency financing mechanism was used during the Asian crisis in 1997, providing stand-by loans to the Philippines, Thailand, Indonesia and South Korea and then to Turkey in 2001.

[39] The IMF's first deputy managing director and chief economist explained on the same day that long-term recovery cannot happen unless internal consumption decreases and private savings increase in the USA while the opposite happens in China. So many have said for a long time that the constant and growing increase of the US current balance deficit is unsustainable (just like the mirror image of this phenomenon, the growing current balance surplus in China) that it is a cliché now. However, as undoubtedly the USA has been the engine of the world economy since 1990, it is an open question whether a significant decrease of (import) demand in the US would hinder global recovery and upswing amidst the current worldwide crisis.

[40] The unexpected growth in the significance of G-20 countries, their fundamentally changed role in the world economy deserves a separate study. Discussing it herein would stretch the scope of this paper beyond reasonable limits.

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