THE POLISH INSTITUTE
OF INTERNATIONAL AFFAIRS

BULLETIN

No. 118 (194) • September 20, 2010 • © PISM

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International Monetary Fund Reviews Its Anti-Crisis Package

by Marcin Menkes

In an effort to create a "global financial security network", the International Monetary Fund has expanded its anti-crisis toolkit for preventing and counteracting financial crisises. The IMF Executive Board decided to extend the terms and enhance the availability of loans under the existing Flexible Credit Line (FCL) and to establish a new Precautionary Credit Line (PCL) for members with a sound monetary and fiscal policy which nonetheless do not meet FCL's stricter requirements. While those decisions raise hopes for a long-awaited credit policy reform, the scope of the changes introduced so far remains limited.

IMF's Credit Policy. Critics of the Fund's crisis management policy are concerned in particular with its delayed reactions made in response to crises instead of launching preventive measures earlier, and also with its too creditor-friendly credit policy running contrary to the organisation's founding principles. Whereas the IMF had been founded to strengthen global financial stability by providing assistance to states facing financial difficulties, the credit policy implemented tended to ensure debt repayment rather than restore members' liquidity (the financial resources provided to members were not to be used to actually counteract problems facing their financial markets and institutions). Not only did the Fund fail to provide the necessary financial support, but equal conditions and recommendations for beneficiaries of its programmes—regardless of the roots of the crisis in question—undermined confidence and facilitated the escape of private financial institutions, often depriving member states of yet another source of financing. The Asian crisis in Indonesia and South Korea can be quoted as an example of such unadjusted "one-fit-all" recommendations, with the Fund's policies also behind the disastrous flight of private capital from Argentina and Mexico. The current financial crisis and the scale of demand for aid from the highly industrialised countries that had been implementing policies endorsed by the Fund prior to the crisis, might hopefully bring a long-awaited review of the credit policy, which in the past was often responsible for deepening problems instead of solving them. The recent decisions approved by the IMF are aimed at boosting the Fund's preventive capacity, at the same time signalling a cautious change in its credit policy.

Flexible Credit Line. In response to the G20 call to strengthen the "global financial security network", on August 30 the IMF Executive Board expanded the Flexible Credit Line. Established in 2009, the FCL is available to members with "robust policy frameworks and strong track records in economic performance" which may draw upon approval on the credit line at any time or treat it as a precautionary instrument, without the requirement to accept any further conditions of the Fund, as is typical in other IMF programmes, such as the Short-Term Liquidity Facility—an earlier anti-crisis instrument replaced by the FCL. The changes adopted include: (1) double prolongation of the credit line either to one year, or two years with an interim control after the first year; (2) removing the implicit access cap of 1000% of the member's quota, with the amount of the FCL provided to be agreed upon with each beneficiary individually, according to its financial needs; (3) strengthening procedures by requiring early Executive Board assessment of the contemplated level of access and the resulting impact of such access on the IMF's liquidity.

Only three states—Columbia, Mexico and Poland—have established the Flexible Credit Line; Poland renewed its FCL in May 2010 in the maximum amount of SDR13.69 billion (ca. $20.3 billion, 1000% of quota) for another year, with the FCL to boost the currency reserves of the Polish central bank.

Preventive Credit Line. The PCL constitutes a novel anti-crisis measure, available to a wider group of member states. States applying for the PCL will be assessed in five broad areas: (1) external position and market access; (2) fiscal policy; (3) monetary policy; (4) financial sector soundness and supervision; and (5) data adequacy. Most importantly, while strong performance is required in all those areas, the new credit line may be provided also to states with moderate vulnerabilities in one or two of those dimensions. Unlike the first credit line, borrowers will be required to accept the Fund's conditions in financial and fiscal policy, with the implementation of the recommendations to be evaluated in six-month interim reports. Frontloaded access to the PCL is limited to 500% of the member's quota, but it may be increased to 1000% of the quota after 12 months since the establishment of the credit line. Similarly to the FCL, the mere establishment of the credit line does not oblige the member to use the money (and consequently to pay an interest rate).

Other Changes in IMF's Credit Policy. The latest decisions conform with broader anti-crisis and preventive efforts of the Fund. Last June, the IMF declared that it would allocate an additional $17bln to provide financial assistance to low-income countries that are experiencing financial difficulties, with interest rates on Poverty Reduction and Growth Trust loans waived through December 2011.

Another anti-crisis instrument currently under discussion, the Global Stabilization Mechanism, would allow for assistance to be provided to groups of states, thus overcoming the stigma attached to individual beneficiaries in a dire financial situation.

Assessment of Recent Changes. While members with an established Flexible Credit Line may welcome the latest decision with satisfaction, this narrow group is unlikely to be expanded, as the FCL establishment requirements remain rigorous, the PCL assessment criteria are vague and the Fund has not disclosed which states are seen as the potential borrowers. Furthermore, recourse to the PCL means the Fund's intervention in the domestic policy of the beneficiary, with practice confirming that the IMF perceives its competences in this respect very broadly; alongside the stigmatisation of a state compelled to ask for external financial assistance, this has so far been the main argument of the Fund's critics. Hence it is difficult to predict how many states will actually apply for the establishment of the PCL. The recent example of Hungary is symptomatic in this respect. Its IMF bailout of SDR221 mln (the first EU state to have obtained an IMF bailout during the 2008 crisis) expires in October, so Hungary seems to be a perfect candidate to establish a Precautionary Credit Line. Any speculation on the matter, however, is cut short by the government, which reiterates its determination to regain “economic sovereignty” (as reaction to the IMF's rejection of the Hungarian budgetary plan last July, during negotiating on the last tranche of the loan), which it emphasises Hungary is capable of achieving on its own, through market mechanisms.

At the same time, the intensified reformatory steps launched recently by the IMF should be welcomed with hope. While the 1997 Asian financial crisis stimulated cooperation between the G20 states in stabilising the global financial market, it seems that the unprecedented crisis of 2007 may generate deeper changes. Whether or not it will bring about a reform of the IMF may become clear after the November G20 summit in Seoul, with numerous proposal in this respect on the summit's agenda.