

20100906 IMF: The Fund's Mandate—Future Financing Role (Public Information Notice)

Source: International Monetary Fund

On August 30, 2010, the Executive Board of the International Monetary Fund (IMF) approved a set of reforms to further strengthen its capacity to assist member countries in preventing crises: (i) the Flexible Credit Line (FCL) has been refined with a view to increasing its effectiveness and predictability; and (ii) a new Precautionary Credit Line (PCL) has been established to broaden the availability of crisis prevention instruments to countries that have sound fundamentals and policies but do not yet meet the qualification standard of the FCL. Directors also had an initial discussion on how to enhance the Fund's capacity to deal with contagion in systemic crises.

Background

Recent developments in the global economy highlight the need to strengthen further global financial safety nets. Last October, the International Monetary and Financial Committee asked the IMF to consider options for enhancing financing instruments to improve the global financial safety net based on sound incentives, while preserving adequate safeguards of IMF resources. More recently the G20, under the Presidency of the Republic of Korea, stressed the importance of a more stable and resilient international monetary system, calling on the IMF to make rapid progress in reviewing its lending instruments.

In response, further reforms have been approved, which build on last year's successful major overhaul of the IMF's lending instruments (see Public Information Notice No. 09/40) and enhance further the IMF's effectiveness in fulfilling its mandate to secure global stability. The key reforms approved by the Executive Board are:

- **Enhancements to the Flexible Credit Line.** The FCL, which is a crisis prevention and resolution instrument dedicated to countries with very strong fundamentals and policies, was refined by: (i) increasing the duration of the credit line (FCL arrangements can now be approved for either one year, or two years with an interim review after one year); (ii) removing the implicit cap on access of 1000 percent of quota (access decisions will be based on individual country financing needs); and (iii) strengthening procedures by requiring early Executive Board involvement in assessing the contemplated level of access and the impact of such access on the IMF's liquidity position.
- **Establishment of the Precautionary Credit Line.** This new crisis prevention instrument is designed for countries with sound fundamentals and policies, but moderate vulnerabilities. Like with the FCL, approval of PCL arrangements is based on qualification. The PCL features streamlined ex post conditionality (at a minimum monitored through semiannual program reviews) focused on reducing any remaining vulnerabilities identified in the qualification assessment. Access under the PCL arrangements is frontloaded with up to 500 percent of quota made available on approval of the arrangement and up to a total of 1000 percent of quota after twelve months.

The IMF also is considering ways to enhance its ability to respond rapidly and effectively to systemic shocks, which have the potential to trigger adverse chain reactions across asset markets and countries. A menu of options was discussed under the Global Stabilization Mechanism (GSM), which is a framework to enable the IMF to proactively channel financial systems to members hit by contagion in a systemic event, complementing other bilateral and regional liquidity support arrangements.

Executive Board Assessment

The Executive Board has today adopted a number of decisions to strengthen further the Fund's crisis-prevention role—by refining the Flexible Credit Line (FCL) and establishing the Precautionary Credit Line (PCL). Executive Directors also considered options for enhancing the Fund's response to systemic crises and underlined the importance of a strengthened global financial safety net, with the Fund playing a central role within its mandate.

Flexible Credit Line

Directors concurred that, while the experience with the FCL during the global financial crisis has been positive, its attractiveness and signaling effects could be improved further by removing the

implicit cap on access and lengthening the duration of purchase rights. While reaffirming the FCL's qualification requirements, they stressed the need for continued strict and evenhanded qualification assessments to safeguard the use of Fund resources and send clear signals to markets regarding the strength of members' policies. Directors also emphasized the need for diligence by the staff in keeping the Executive Board informed in a timely manner of developments in members with FCL arrangements.

Directors welcomed the proposed procedures regarding early Board involvement in assessments of members' need for Fund resources, and of the impact of contemplated access on the Fund's liquidity position when access is above the lower of 1000 percent of quota or SDR 10 billion. Directors generally agreed that the existing upward-sloping commitment fee schedule is adequate for guarding against unduly large precautionary use of Fund resources, although a few would have preferred higher commitment fees. Directors agreed that, in addition to other relevant factors justifying lower access, access in a successor FCL arrangement would normally be expected to decline whenever improvements in official and private financing prospects have reduced the member's potential or actual balance of payment needs in a sustained manner by the time the successor arrangement is requested.

Precautionary Credit Line

Directors supported the establishment of the PCL. As a dedicated instrument in the credit tranches for sound performers that do not meet FCL qualification standards, the PCL can provide positive market signals about members' policies and track records through the qualification assessment. While some concerns remained about certain aspects of the establishment of the PCL—including the proliferation and overlap of instruments, the perceived tiering of the membership, and the assessment process—Directors generally considered that the diverse needs of the membership would be best met by tailoring Fund financing instruments and conditionality to the varying strengths, fundamentals, and policies of its members.

Directors reaffirmed that all members, regardless of income level, are eligible to use the Fund's resources in the General Resources Account so long as they meet the applicable requirements for use. They called for rigorous and evenhanded assessments of qualification, conducted in a confidential manner and only upon request of a member. Although a wide range of views were expressed on the desirable nature and extent of ex post conditionality in the PCL, on balance, Directors agreed that the proposal to focus policy conditionality on reducing remaining vulnerabilities, with use of prior actions and performance criteria where warranted, strikes the appropriate balance and is consistent with the Guidelines on Conditionality.

A Framework for Resolving Systemic Crises

Drawing lessons from the global financial crisis, Directors welcomed the opportunity to have an initial discussion of options for strengthening the Fund's response to systemic shocks, including the proposal to establish a Global Stabilization Mechanism (GSM). Activation of the GSM, if established, triggers a systematic assessment of the appropriate elements to be deployed and would not in itself constitute an automatic Board decision to deploy such elements. Many Directors saw merit in exploring the GSM as a key tool to enhance the Fund's ability to carry out its mandate to promote global economic stability, including by coordinating global responses to systemic events with central banks, regional institutions, and systemic-risk bodies, as appropriate. Many others did not see a need for a formalized framework, noting the adequacy of the revamped lending toolkit, the existence of the emergency financing mechanism, and the risks of moral hazard. A number of Directors were of the view that further discussion of any new initiatives should await a comprehensive review of experience with the reformed toolkit.

Many Directors were open to the idea of the proposed multi-country offers to approve FCL arrangements under the GSM, provided that any such offers would be made in a consensual manner. Many others noted that making public offers could potentially send the wrong signal to markets.

Many Directors considered that, with the expanded lending toolkit, the Fund is well-equipped to address the liquidity needs of its members in systemic crises and welcomed the staff's suggestion to simplify the original design of the GSM, including by relying on existing lending instruments. A number of other Directors saw value in continuing to explore the idea of a short-term liquidity instrument with no ex post conditionality, which could be deployed to stem contagion in a systemic event upon the activation of the GSM.

On balance, most Directors were open to further discussion of options and modalities to address systemic events in the context of a simplified GSM, as a process that is centered on decisions by the Executive Board and that emphasizes close cooperation with relevant institutions, relies on existing Fund instruments and policies, and makes allowance for consensual and simultaneous offers of FCL arrangements to multiple countries. Further interaction with the membership would be critical to forge the broadest possible consensus. Directors also supported further work by the staff to explore enhanced synergies with regional financing arrangements, and looked forward to the upcoming seminar, scheduled to take place during the Annual Meetings, with representatives from regional financing arrangements.

NovaRes Team