Does the IMF Need More Financial Resources?

by Ariel Buira

The Fund is best known as a financial institution that provides resources to member countries experiencing temporary balance of payments problems on condition that the borrower undertake economic adjustment policies to address these difficulties.
Fund support covers a range of operations, which go from dealing with the more traditional type of balance of payments crises arising from fiscal imbalances and excessively expansionary monetary policies, to lending to emerging market countries faced with speculative attacks, potentially leading to or already faced with financial crises, to promoting growth and poverty reduction through structural reforms in low income countries.

The Fund is a cooperative international monetary organization whose responsibilities derive from the purposes for which it was established. On those purposes, as stated mainly in Article 1 of the Articles of Agreement, I shall base my comments today. As you will recall, the purposes include:

--To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

--To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity.

Are Fund resources adequate for its task? In June 2005 the Fund's total resources stood at SDR 221 billions (US$322 billions). Its usable resources were SDR 126 billions (US$ 184 billions), of which uncommitted resources were SDR 112.4 billion (US$ 164 billions) and its one year forward commitment capacity was SDR 91.3 billion (about US$143billions).[1]

You may think that since current Fund resources are not fully utilized, there is no need to increase them. I am afraid that this is a circular argument. Being prudent and in keeping with the wishes of the major shareholders who do not favor quota increases, Fund management and staff have followed lending policies that maintain a part of Fund resources liquid. But is this policy consistent with the purposes of the Fund?
Or in keeping with its purposes, should Fund resources increase in line with the members needs, keeping pace with the growth of the world economy, the expansion of international trade, and the importance and volatility of capital movements, in order to allow countries to correct payments imbalances without resort to a contraction in output? Are Fund resources

[1] Measures resources available for new commitments in the coming year. Equals uncommitted usable resources plus expected repayments one year forward minus the prudential balance.

sufficient for it to attain its purposes? How effectively does the Fund perform these functions?

While at first sight, the Fund's liquidity position appears adequate. Note that as globalization proceeds and countries become more open to trade and capital movements their vulnerability increases. For example, Collier (2002) describes how a large negative commodity shock of around 7% of GDP to a primary exporter can trigger a cumulative contraction in the economy, through a Keynesian type multiplier leading to an additional loss of output of around 14% of GDP over the next two or three years,[2].

In addition, most countries, including emerging market economies, when faced with payments difficulties, do not have significant access to financial markets or other sources of external finance. Moreover, the new type of financial crisis, associated with the capital account and the volatility of capital flows, calls for much larger amounts of support than the more traditional one resulting from trade or current account imbalances.

As Calvo, Izquierdo and Mejia (2003) and Calvo and Reinhart (2000) have documented the cost of a sudden reversal in capital and current account adjustment is much more substantial in emerging markets (EM) than in developed countries. The average magnitude of a sudden reversal in capital flows is around 6.1 percent of GDP in emerging markets while it is only 1.1 in developed economies.[3]

In order to assist countries deal with commodity shocks and the volatility of capital flows, and in particular of sudden reversals in capital flows, you might expect Fund resources to increase considerably over time. However, as shown by Table 1 below the opposite has been the case, and Fund resources have declined sharply over time, as measured by different indicators relative to quota resources. In particular, note the long term decline in the resources of the Fund as a proportion of current payments.

While Board members agreed in recent quota review discussions that volatility of capital flows should be included in the quota formula, the current quota formula only computes a country's vulnerability through current account variables,[4] such as trade openness and export volatility, but excludes volatility of capital movements. In addition, the Fund has responded to the increase in risk owing to more financial integration and volatility, by adding a new financial facilities emphasizing crisis prevention. The main of these was the Contingency Credit Line. Unfortunately, the design problems of the CCL made it unattractive to potential users and after five years without any commitments, rather than correct its shortcomings, the Executive Board recently decided to cancel it.

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[2] Paul Collier (2002). "Primary Commodity Dependence and Africa's Future". The World Bank.

[3] Calvo, Guillermo, Alejandro Izquierdo, and Luis-Fernando Mejía (2004). "On the Empirics of Sudden Stops: The Relevance of Balance-Sheets Effects". NBER Working Paper Nro 10520.

[4] In the five quota formula, two include the sum of current receipts and payments and the other three include current payments and openness ratio (current receipts divided by GDP). See IMF, 2002a; 2002b.

Table 1- Actual and Calculated Size of the Fund (in billions of SDRs or in percent)

	1944[1/]	First Review 1950 [1/]	Fourth Review 1965[1/]	Fifth Review 1970 [1/]	Seventh Review 1978 [1/]	Eighth Review 1983[1/]	Ninth Review 1990 [1/]	Tenth Review 1995 [1/]	Eleventh Review 1998 [1/]	1999 [2/]	Twelfth Review 2003 [4/]
1. Agreed size of the Fund (In Billions of SDRs)	8.0	8.0	21.0	29.0	61.1 [/3]	90.0	135.2	146.1	212.0	212.0	219.1
2. Quantitative economic indicators[/5:]											
Fund size relative to each economic indicator, in Shares (%)											
a. Calculated Quotas	100.0	44.4	110.5	93.5	59.9	43.1	41.0	33.1	38.9	25.5	22.4
b. Current Payments	57.1	17.4	15.1	13.6	8.5	6.7	6.2	5.1	5.7	3.7	3.2
c. GDP	3.7	1.8	2.0	1.9	1.4	1.2	1.2	0.9	1.2	0.9	0.9
d. Reserves	29.6	22.2	36.8	44.6	33.0	27.0	34.6	24.6	27.6	18.4	13.9
e. Variability of current receipts	160.0	80.0	300.0	414.3	142.1	134.3	120.7	91.9	122.5	80.3	66.4

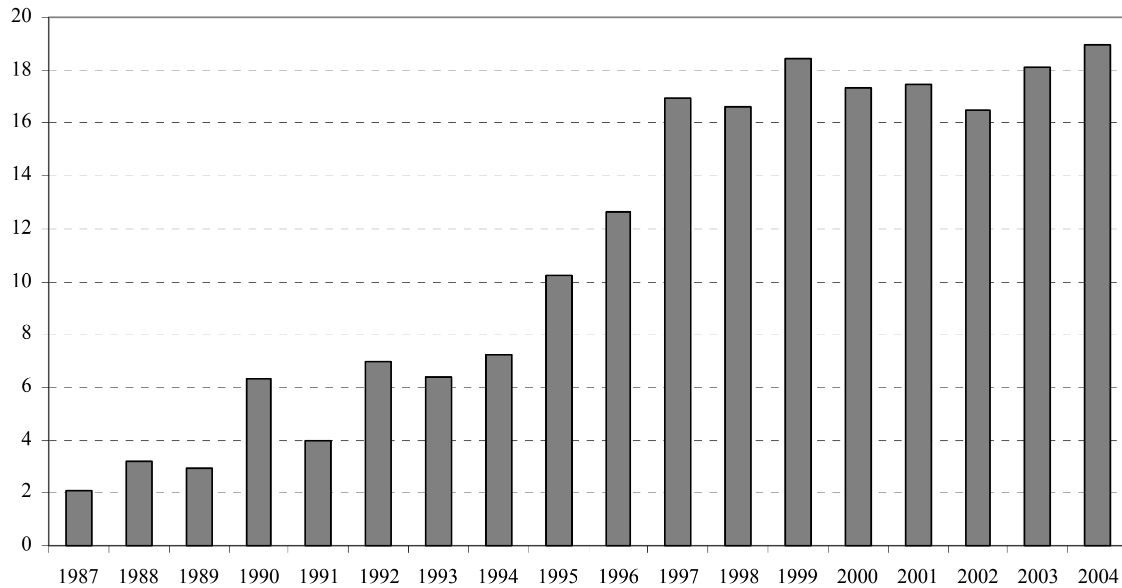
Source: IMF, Treasurer's Department and Quota Formula Review Group.
1/ Year in which the quota review was completed, i.e., when the Board of Governors' Resolution on quota increases was approved. Quota agreed in 1976 under the Sixth Review came into effect in 1978, following the coming into effect of the second Amendment of the articles. The Tenth Review did not provide for an increase in quotas, and the increase in actual quotas relative to the Ninth Review is due to the increase in the number of members.
2/ This does not include China's ad hoc quota increase of 1.682 billion SDRs in 2001.
3/ Including special quota increases for China and Saudi Arabia in 1980 and 1981.
4/ No Quota Increases approved during the Twelfth Review.
5/ Current Payments 5-year period averages, variability standard deviation of current receipts from 5-yr centered MA, Reserves and GDP end of period.

Conditionality

The declining trend of Fund resources suggests that these are probably insufficient to allow it to provide support to member countries without a hardening of the conditionality under which it makes its resources available.
Indeed, in view of the relative decline in Fund resources, the question is: Could a hardening of conditionality be avoided? This leads to the further question: Should adjustment programs be constructed around the level of Fund resources, however diminished? Should conditionality be determined by the availability of Fund resources even when these have diminished sharply over time?

The record shows a sharp increase in the conditionality of Fund programs, particularly in the number of structural conditions per program year since the mid 1980s and during the 1990s, a trend that was initiated with the "supply-side economics" fashionable during the Reagan and Thatcher administrations. (See Figure 1).

Figure 1. Average Number of Structural Conditions per Program Year 1/



1/ Total number of structural performance criteria, benchmarks, prior actions, and conditions for completing reviews in stand-by, EFF, SAF/ESAF/PRGF-supported programs. The data from 1995 onwards is the average for Fund-supported programs with and without structural conditionality (data prior to 1995 is an average based only on programs with structural conditionality) and adjusts for the actual duration of each of these programs, thus controlling for program stoppages (data prior to 1995 is based on program duration as envisaged at the time a new program is approved by the Executive Board). See SM/05/81and SM/05/82 for a more detailed discussion of the 1995-2003 data.

Source: IMF staff estimates

In response to concerns over the proliferation of conditionality and the high rate of program failure, the Fund adopted a new set of *Guidelines on Conditionality* in 2002, which recommend the limited use of prior actions and program reviews, and the scaling-down of performance criteria. The 1979 *Guidelines,* which put considerably greater limits on conditionality than the current ones, were unsuccessful in checking the explosive growth of conditions since the mid 1980s (Polak 1991) Indeed, there is no evidence that the new Guidelines on Conditionality, that were intended to reduce the number of conditions to those that were critical to the success of the program, have led to a significant reduction in the number of structural conditions. A possible exception to this are PRGF programs, but conditionality in stand-by and EFFs has not diminished significantly if at all

The staff papers on conditionality argue that the fact that the number of conditions did not decline may be misleading. There has been a move from general review clauses to more specific and detailed conditions, which may at times mean an increase in their number. And that the high number of conditions reflects a larger proportion of programs with weak track records. What I would conclude is simply that there was a sharp increase in conditionality in the 1980s and that no decline in the number of conditions is apparent.[5]

[5] The 2003 Standby Arrangement with Turkey is associated with 38 prior actions and 42 structural benchmarks, most of them oriented toward an ambitious program of free-market reforms (IMF 2003). The Turkish stand –by for the 9 month period April –December 2004, looks a little better, but you will still find that it has no less than 30 targets (1 Prior Action, 14 BM,11PC of which 6 are quantitative, and 4 Indicative Targets) This is for Turkey, a country which is often praised as a strong performer. To stay in the Balkans, the stand-bys with Albania and Bulgaria have 32 and 33 conditions respectively. In contrast, the Stand Bys of the sixties, i.e.UK (1963, 1964) without conditionality, Peru (1963, 1964) Jamaica(1963),

Has conditionality really been streamlined, are program related conditions used parsimoniously and applied only to measures critical to the success of the program? In the light of the above, I confess I am somewhat skeptic that if the 30 plus targets of many programs were not met, the goals of the program could not be achieved.

A consequence of the rise in conditionality is that compliance with Fund programs diminished as the higher number of conditions made programs more difficult to manage. As structural conditionality increased the rate of compliance with Fund programs declined starting in the late eighties and more markedly in the early nineties. It is apparent from Table 2 showing the distribution of disbursement ratios of disbursed resources by quartiles that compliance has remained at low levels since then.

Low compliance with program conditionality resulted in a low proportion of countries being able to fully disburse the resources allocated to them under Fund supported programs. Even after waivers and reviews, only a small proportion of programs are successful, in the sense of fully complying with the conditionality envisaged. This suggests that Fund conditionality may be considered to be excessive, and often too biased towards adjustment.

Bolivia(1963), Haiti(1963), which only had fiscal and monetary targets as well as prohibitions on exchange restrictions and multiple currency practices.

Table 2- Disbursements of Fund Supported Programs (Distribution by Quartiles)

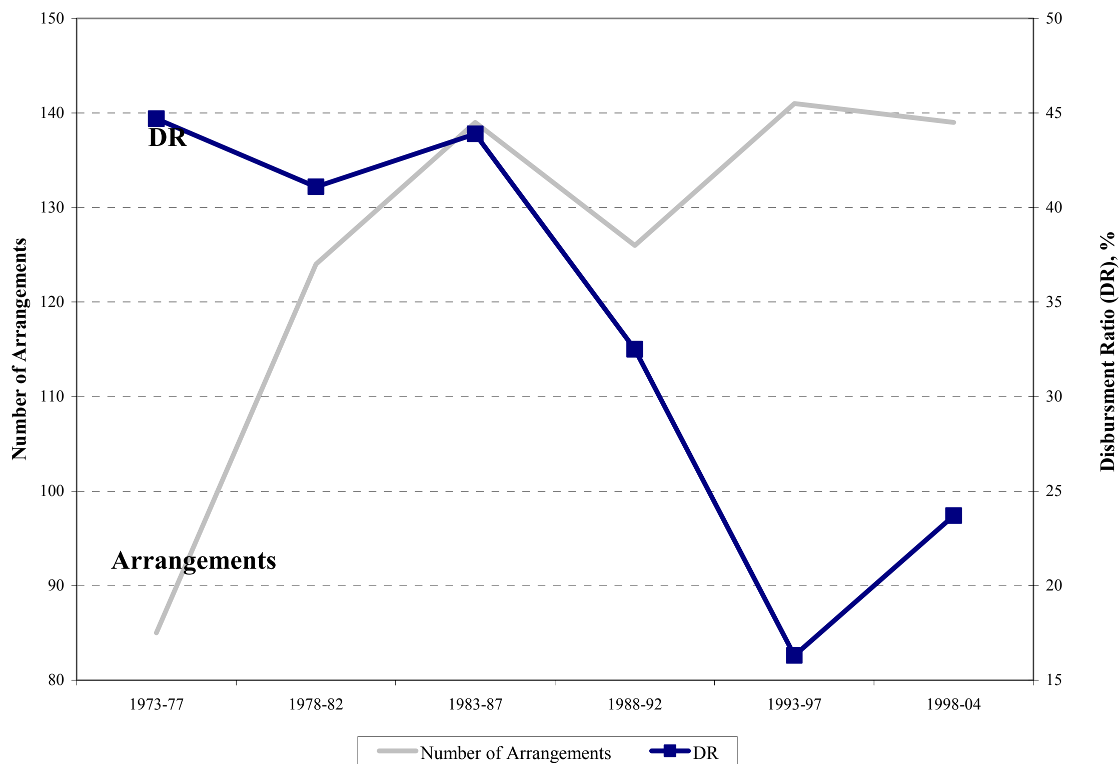
	DR<0.25 (1)	0.25<=DR<0.5 (2)	0.5<=DR<0.75 (3)	0.75<=DR<1 (4)	Fully Disbursed (DR=1) (5)	Programs with high DR (4) + (5)	Number of arrangements
All arrangements							
1973-77	36.5	7.1	5.9	5.9	44.7	50.6	85
1978-82	19.4	16.1	10.5	12.9	41.1	54.0	124
1983-87	12.9	15.8	19.4	7.9	43.9	51.8	139
1988-92	17.5	15.1	20.6	14.3	32.5	46.8	126
1993-97	27.0	19.1	26.2	11.3	16.3	27.6	141
All arrangements							
1973-97	21.6	15.3	17.6	10.7	34.8	45.5	615
Of which							
Stand-by	23.1	13.4	15.0	9.5	39.0	48.5	441
EFF	33.3	22.2	19.0	15.9	9.5	25.4	63
SAF/ESAF	9.0	18.9	27.0	12.6	32.4	45.0	111
All arrangements							
1998-04 1/	28.8	19.4	15.8	12.2	23.7	36.0	139
Of which							
Stand-by	48.2	12.5	8.9	5.4	25.0	30.4	56
EFF	50.0	0.0	16.7	8.3	25.0	33.3	12
PRGF	9.9	28.2	21.1	18.3	22.5	40.8	71

1/ Includes precuationary arrangements and ongoing programs. Data for 1998-04 may not be strictly. comparable with earlier years

Source: IMF, Transactions of the Fund (FIN database). and staff estimates.

The argument behind conditionality in lending is that it is a way to protect the revolving character of the Fund's resources. But the sharp fall in compliance raises questions as to its validity, since how can programs that are not complied with ensure repayment? The fall in the disbursement rates over the last 20 years following an increase in conditionality in the late 80's, seems striking given the sharp increase in the number of lending arrangements over the same period of time (Figure 3).

Figure 2. No. of Arrangements and Disbursements Rates



Source: IMF, FIN Database .and Table 2

The Hardening of Conditionality

The Articles do not provide any indication as to the appropriate speed of adjustment. But the statement of purpose, of "providing members with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity" (Article I section v) suggests that the priority of the founding fathers, which included Keynes, was the protection of the levels of economic activity, and that deflationary adjustment is to be avoided to the greatest possible extent.

Do Fund supported programs currently give priority to avoiding measures destructive of national and international prosperity? The answer depends to a large extent on the amount of financing made available in each case.

The availability of resources is a major determinant of the nature and speed of the adjustment process undertaken by a country. At the extreme, a country with access to unlimited financing would not have to adjust, and if it were to do so, would be able to postpone adjustment for years, i.e., the US, as a reserve currency country has this advantage as long as holding dollars as reserve assets remains attractive. Moreover, it may choose among different adjustment paths available, the one that is more palatable and less costly in economic and political terms. On the other hand, a country undertaking adjustment with low reserves and very limited financing available to it, may of necessity, be compelled to adopt very severe, short-term programs that enter into conflict with the goal of maintaining high levels of activity, be compelled to cut investment and sacrifice some of its longer term development goals. Thus, there exists a "trade-off" between adjustment and financing of imbalances. The role of the Fund would be to seek a "golden rule", a suitable mix of adjustment and financing that fosters the necessary adjustment while avoiding the severe recessionary and destructive aspects of under financed programs.[6] Since well-financed adjustment programs would be much more attractive than underfinanced, severely recessionary ones, with their negative impact on development and social indicators, well financed programs would encourage the early correction of imbalances by member countries.

Since the harshness of a program and consequently, its viability are largely dependent on the amount of financing available, the reduction in the resources of the Fund introduces a bias for the adoption of increased conditionality and more severe, shorter term adjustments, whose rate of success is bound to diminish. The decline observed in total Fund resources over time, measured as a proportion of international trade or of GDP, would appear to have required and been associated with stiffer, more demanding conditionality.

Moreover, note that as countries become more open to trade and capital movements their vulnerability increases. Most member countries, including emerging market economies when faced with difficulties, do not have significant access to other sources of external finance. Additionally, the new type of financial crisis, associated with the capital account and the volatility of capital flows, calls for much larger amounts of support than the more traditional one resulting from trade or current account imbalances.

Why have Fund resources declined? Why have quota increases not kept pace with the expansion of the world trade and capital flows? The majority of Fund member countries favor quota increases, however these increases call for an 85 percent majority under the weighted voting system. What countries limit the increase in Fund resources? Is the growing schism between creditors and prospective debtors relevant for the analysis of trends in the size of the Fund and the evolution of conditionality?

Finding conditionality unacceptable, no industrial country has resorted to Fund support since the late 70s. Among the last such users were Italy and the U.K.; both requested Fund

[6] In some cases, Fund lending may be constrained by balances outstanding from previous borrowing.

assistance under the lower conditionality Oil Facility; additionally the UK entered into a Stand –By program with the Fund in 1976. Since then, industrial countries developed a network of monetary cooperation arrangements and other sources of balance of payments support. As a result, only developing countries and economies in transition have resorted to Fund support in the last 25 years.

This is not to ignore that in a number of cases large, systemically or strategically important countries, (Mexico, Brazil, Russia, Korea, Turkey, etc) have received financial support well in excess of their access limits under Fund policies. But exceptional support is neither transparent nor predictable since it is not available to all Fund members, and at times comes with questionable conditions imposed by countries that contribute to the financial rescue package.[7]

Moreover, during the financial crises of 1997-98 Fund conditionality was considered to be too restrictive and inappropriate by emerging market countries in Asia. Consequently, in order to avoid having to rely on Fund support in the future, Asian countries decided to build up their reserves and develop regional monetary arrangements as a form of insurance.

The Chiang Mai initiative was established to provide liquidity support to its members faced with contagion and speculative attacks against their currencies. Its expansion to allow multilateral currency swaps and the doubling of the size of these, from $39.5 billion to over $70 billion was agreed by the Finance Ministers meeting in Istanbul on May 5, 2005. Reportedly, a fourfold increase in the size of drawings that may be made without IMF conditionality was also agreed.[8] In the words of Masahiro Kawai, a former high official of the Japanese finance ministry who will head the new regional financial integration office at the ADB, "The Chiang Mai initiative has the potential to become an Asian monetary fund"[9].

By developing a bond market in domestic currencies, the Asian Bond Fund, also aims at reducing the vulnerability of countries to risks of maturity and currency mismatches that could lead to financial crises.

As a result of this rejection of Fund conditionality and of what they rightly perceive as the lack of adequate representation in decision making, these countries have decided to avoid coming to the Fund in future.

Since they have access to financial markets only in good times and their access to market financing remains pro-cyclical, Asian countries are not moving away from the Fund because they have 'graduated" and no longer require international monetary cooperation. In fact, they are in the process of developing alternative regional monetary cooperation arrangements and accumulating high levels of reserves as a form of self insurance, the most primitive and costly form of insurance.

Why did the Fund lose influence over industrial countries and other major economies?

Firstly, the exponential growth of international financial markets has allowed industrial countries easy access to external financing, this access coupled with the growth of their own

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[7] See M. Feldstein, 1998 Foreign Affairs, vol.73 No.3

[8] Results from a doubling of the total resources available and a doubling of the proportion that may be disbursed without a Fund program.

[9] Financial Times, May 6, 2005

domestic financial markets and the development of regional monetary arrangements and in a number of cases, reciprocal credit lines among them, make it unnecessary for them to subject themselves to the conditionality associated with IMF support. This trend became apparent in the late seventies; as Europe developed its own monetary arrangements; it walked away from the Fund.

A second factor that has eroded legitimacy is the rapid economic expansion of emerging market countries, whose growing importance in the international economy and accumulation of international reserves has not been reflected by changes in the governance structure of the Bretton Woods institutions. This inadequate representation made possible the policy prescriptions required by the Fund as a condition for support during the Asian financial crises of 1997-98, which were perceived by many countries as inappropriate and contrary to their interests.

As a result of the hardening of conditionality and the non-representative character of Fund governance, a growing chasm has emerged between shareholders and stakeholders, between those who determine IMF policies and decisions and those to whom those decisions and policies are applied. Thus, instead of a cooperative institution to which all members contribute and from which they may borrow from time to time, a distinction has emerged between creditor countries that have the power to make the rules[10] and debtor and prospective debtor countries, which are subject to those rules.

Therefore, it is not surprising that in addition to Europe, a growing number of countries in Asia and Latin American appear to be in the process of moving away from the IMF. To the extent this process advances, the IMF would cease to be a truly multilateral institution of monetary cooperation to become an institution dealing mostly with the payments problems of very low income countries in Africa and elsewhere.

Thus, questions on the role and relevance of the Fund as a multilateral institution of monetary cooperation, come to the fore and should be addressed. To my mind the preservation of its systemic role requires reviewing both governance structure and the level of resources it can make available to member countries. In fact, both must go together, since it is impossible to reduce countries' quotas in absolute terms without the countries' consent.
To conclude, the answer to whether the IMF has sufficient funds or needs additional resources depends on the role it is expected to play. The answer is usually colored by the views of the questioner on the role of the Fund, which often reflect whether his country is a potential debtor or one that has no need to resort to the Fund because it has ready access to other sources of financing. The fact remains that Fund resources have declined sharply in relation to all relevant variables (GDP, trade, capital movements, current payments, reserves); that conditionality has increased and program compliance has fallen sharply. This has eroded the usefulness of the Fund to most member countries as an institution of international monetary cooperation and many countries are taking distance from the Fund and setting up regional arrangements of monetary cooperation. I believe that at a time of

[10] Note that an agreement reached among G7 members on policy issues turns the Board discussion into a mere formality.

increasing globalization, the fragmentation of the international monetary system is undesirable. Moreover, as the system breaks down, low income countries can not be expected to fend on their own.

To my mind restoring the role of the Fund at the center of the international monetary system requires, inter alia, a large increase in its resources and a reform of its governance structure to reflect changes that have taken place in the structure of the world economy, particularly the increased importance of a significant number of emerging market countries that are substantially under-represented. Since these countries' contributions would rise in a manner commensurate to the increase in their quotas, the contributions of most industrial countries should be less than proportional.

How large should the increase in Fund quotas be? It is difficult to give a precise answer, but clearly, after falling from 57 percent of current payments in 1944 and 13.6 percent in 1970 to 3.2 percent in 2003 the resources of the Fund have been allowed to decline beyond any reasonable level. The same argument may be made in terms of quotas, which on average represent nine tenths of 1 percent of a country's GDP. Can normal access limits of 100 percent of quota, or even exceptional access of 300 percent of such quotas over a period of one to three years provide members with the support required to adjust without resorting to measures destructive of national or international prosperity? If not, what is the level of resources required, in keeping with the Fund's purposes, to restore a certain balance between adjustment and financing and to attain a reasonable rate of program success? Taken together, Tables 1 and 2 and Figure 1 suggest that it is necessary for the resources of the Fund to increase to no less than their 1978 levels in relative terms or roughly to three times their current size; and that conditionality should be further streamlined. While arguments against such increase can be easily made based on the large expansion of capital markets, it must be noted that these markets are both volatile and markedly pro-cyclical, characteristics which make placing undue reliance on them questionable. Moreover, the fact remains that even in good times, most Fund member countries have very limited access to these markets.

A second argument for increasing the resources of the Fund is that the reform of its governance structure, which is necessary to ensure its future relevance and legitimacy will be extremely difficult to achieve without a very substantial increase in quotas that takes fully into account the changes in the size and importance of emerging market countries in the world economy.[11]

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[11] On this point, see 2005 papers by Truman and Buira

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