Emerging IMF

Without the IMF, emerging Europe would be even worse off. The Istanbul summit has underlined its new pre-eminence. It is now developing new tools to fight future crises.

By Murat Yülek

The financial crisis is still wreaking havoc on the world. For the IMF, however, it has been a sort of blessing. Resurrected from the irrelevance it suffered prior to the crisis, the IMF now seems to be on its way to becoming a key player in the world economy. It may soon be more powerful than it has ever been since its inception in 1947.

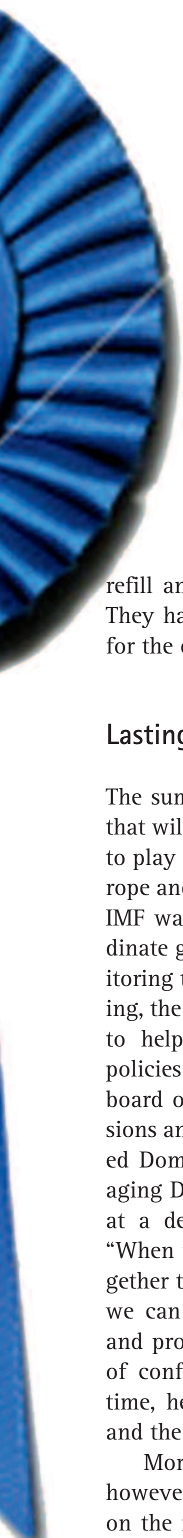
Consider the pre-crisis world. What was the role of the IMF back then again? As a funding source, IMF resources were being dwarfed by soaring private cross-border capital flows under various labels such as private equity, strategic cross-border investments or pure leverage, all facilitated by relaxed monetary policies in the US, Japan and even Europe. Emerging Europe was receiving billions of dollars in funding on easy terms. Poland, for example, successfully issued a 30-year yen bond in 2007, only four years after its 7-year yen debut on Japan's Samurai market.

On the sidelines

But if IMF funds had become irrelevant, was there at least still a strong need for economic supervision and guidance by the Washington-based organisation? The answer again was "No." In the pre-crisis world, fiscal policies of almost all major economies with the exception of the US and Japan were turning more conservative, while fiscal supervision was a de-facto domain of pundit analysts at the large international investment banks. The negative answers on both counts explain why the IMF had been pushed to the borders of irrelevance. The once prestigious institution was fading and even had to start shedding manpower through various policies.

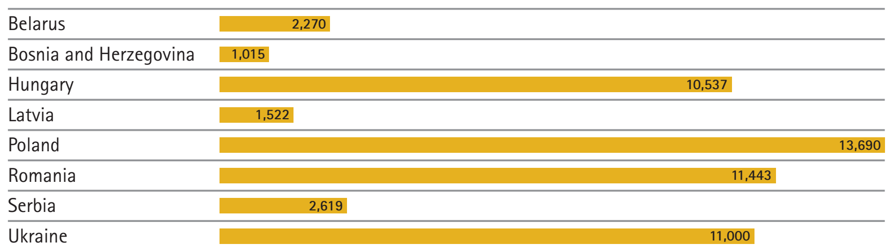
Reinforced commitment

All of that has been reversed. Since the outbreak of the crisis, the IMF has signed financing agreements amounting to USD 80 billion in favour of emerging Europe economies. The heavy involvement clearly demonstrates the commitment of the IMF to the region and the willingness of its members to help. The Istanbul summit has reinforced this commitment as the IMF member countries have promised to



IMF funds for emerging Europe during the crisis

(committed lines, in million SDR)



Source: IMF; SDR 1 = USD 1.61 as at 3 Dec. 2009

refill and even enlarge the IMF's coffers. They have also agreed to find a new role for the organisation.

Lasting pre-eminence

The summit adopted a series of decisions that will ensure that the IMF will continue to play a preeminent role in emerging Europe and beyond. Among other things, the IMF was mandated with helping to coordinate global economic policies and monitoring their implementation. At the meeting, the G20 leaders also called on the IMF to help ensure consistency of national policies with each other. The executive board of the IMF endorsed the G20 decisions and thus assumed the task. An excited Dominique Strauss-Kahn, IMF's Managing Director, announced that "we stand at a defining moment," and continued, "When the nations of the world come together to address common challenges [...], we can attain a virtuous cycle of peace and prosperity, and avoid a vicious cycle of conflict and stagnation." It was now time, he declared, for both the countries and the IMF to change.

More important for emerging Europe, however, may be the decisions touching on the institution's future financing role. The IMF's new mandate now encompasses a "whole range of macroeconomic and financial sector policies that affect global stability" as opposed to the former official job description that was limited to resolving balance of payments crises. IMF staff is already working on hammering out what that could mean. The IMF will need to clarify how much, for whom and at which conditions IMF financing will be available. It will also have amplified firepower as a decision was taken to triple IMF resources within this year. New financing instruments are being developed.

A true innovation

A novel instrument that could potentially play a key role in the future in this respect, has already been developed and is in use is the so-called Flexible Credit Line (FCL). The FCL provides financial stand-by support to countries whose macroeconomic track record is considered satisfactory. Under the FCL, disbursement of the money is not contingent on meeting future macroeconomic performance indicators set by the IMF. In other words, the IMF renounces its conditional funding in favour of past performance; hence the novelty. Many major emerging European countries have become debtors of the IMF because of the crisis. Among many others, Hungary and Ukraine had to sign large stand-by agreements with the IMF. Poland, on the other hand, has become the second country to sign an FCL after Mexico.

The best summary of what has happened in Istanbul is probably that the IMF readied itself to extinguish the next financial crisis. Its ultimate objective is to enhance peace and stability around the world. In this sense, FCLs are designed to direct capital flows to countries in need, including to emerging Europe, or at least prop up those countries where capital flight is a possibility. It may become popular with emerging Europe countries once the economies there have been able to rebuild their financial track record. ||

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