Reforming the international financial architecture

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Overview

1- IMF crisis response
   - Increased resources and lending toolkit reform
   - Policy development (capital flows, reserves, debt restructuring, macro-pru, spillovers, risk/vulnerability, rethinking macro etc)

2- Recent program experience
   - Precautionary programs boosted confidence
   - “Wave 1” (liquidity) programs broadly appropriate
   - “Wave 2” (solvency) programs faced greater challenges, adjustment underway

3- Challenges ahead
Few crisis episodes during 2000s

- Debt crisis
- Nikkei crash, ERM Crisis
- Asian crisis
- Global Financial crisis

Systemic Crisis Indicator

Number of countries affected
IMF crisis response

EMBI Spreads

- Fed Swap lines
- Lehman Collapse

2008 2009 2010 2011 2012 2013
Central bank swap lines to the rescue
IMF crisis response

- Fed Swap lines
- G-20 IMF resource tripled
- Lehman Collapse

EMBI Spreads
IMF lending toolkit: revamped

- Weaker policies
  - Ex-post conditionality
  - SBA/EFF

- PLL

- FCL
  - Stronger policies
  - Ex-ante conditionality
IMF crisis response

EMBI Spreads

GIP CDS Spreads

2008 2009 2010 2011 2012 2013

FCL PLL RFI

Fed Swap lines

G-20 IMF resource tripled

Lehman Collapse

Greece Program

Portugal Program

Spain Monitoring
Agreed

Cyprus Program

Ireland Program

Agreed
Regional firewall architecture evolving
Managing capital flow volatility

- Synchronized Stops
  - 1997-98
  - 2001
  - 2008

- Gradual Buildups
  - 1995
  - 2000
  - 2005
  - 2010

Legend:
- Emerging
- Advanced

Capital inflow episodes (one per line)
Need for a Fund view on capital flow policy

Key aspects of the paper

- Comprehensive, flexible, and balanced approach
  - Advice for both recipient and source countries
- How to safely reap benefits of capital flows while managing risks
  - Proposes a cautious and gradual approach to liberalization
- Defines CFMs and indicates circumstances where they could be useful
  - But not as a substitute for macro adjustment
2- Recent program experience
Fund programs during the crisis

Cumulative output drop

Size of IMF financing = 100% quota

Wave 1 Programs
FCL/PLL Programs

Wave 2 Programs

2005 2006 2007 2008 2009 2010 2011 2012 2013
Wave 1: progress in overall adjustment
(percent of potential GDP)
EA programs: growing imbalances under the euro

(Percent of potential GDP)
EA programs: initial imbalances receding?
(percent of potential GDP)

Structural current account balance vs. Structural fiscal balance


EA programs
EA programs: initial imbalances receding?
(percent of potential GDP)
EA programs: initial imbalances receding?

(Percent of potential GDP)
3 - Challenges ahead

Global financial safety net
- Further reform to IMF lending toolkit? - or finetuning
- are crisis prevention instruments working?
- do we have the instruments/mandate for long term debt/competitiveness problems, or for currency unions?
- Development of RFAs and relations with the IMF
  - unfinished agenda in Europe: banking union/fiscal union
  - elsewhere, growth of RFAs and operationalization
  - more structured coordination with IMF, or current flexible approach?

Navigating the growth agenda
(programs in euro area, Caribbean, MENA; but also other AMs/EMs/LICs)
- Private sector debt overhang
- Fiscal adjustment
- Real exchange rate overvaluation
- Structural measures on the supply side
- Social/political support for reform
- EM growth drivers/decoupling
Urgent need for governance reform

Impact of recent reforms

Pre 2006 reform | Post 14th review

BRICs | Other EMDCs | Advanced Countries

9% | 29% | 62% | 14% | 28% | 58%
Thank you
3- Lessons learned and the way forward
Further reforms to the toolkit?

- Improve existing tools:
  - Adopt pre-qualification to improve FCL/PLL predictability
  - Eliminate access cap on PLL to reduce contagion risks
  - Link FCL/PLL to CB/RFA swap/credit lines to min stigma

- Introduce new tools:
  - No-money signaling programs to facilitate market access or link to RFA lending
  - Secondary market bond purchases (via dedicated SPV)
  - Target SDR allocations to boost reserves (via AA change)

- Develop relationship with RFAs, tailored to differing circumstances & needs
Challenges in Euro Area

1- Navigating the growth agenda
   - Private sector debt overhang
   - Fiscal adjustment
   - Real exchange rate overvaluation
   - Structural measures on the supply side

2- Reform of EMU architecture
   - Faster moves towards banking union
   - Use of ESM for direct bank recapitalization
   - Fiscal union

3- RFA-IMF co-ordination
   - Fine-tuning the current approach?
   - Or more structured co-ordination?
Growing trade linkages
Growing trade linkages

Index (1990=100)

Countries resized by exports + imports
Growing financial linkages

Countries resized by external assets + liabilities
Improving contingent credit lines

- What’s right?
  - Low cost, long maturities, flexible use, tailored conditionality

- What’s wrong?
  - Residual stigma, limited automaticity/predictability