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Economic Commentaries

The IMF in change – loan from Norges Bank

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* The views in this commentary represent those of the authors and cannot necessarily be attributed to Norges Bank.

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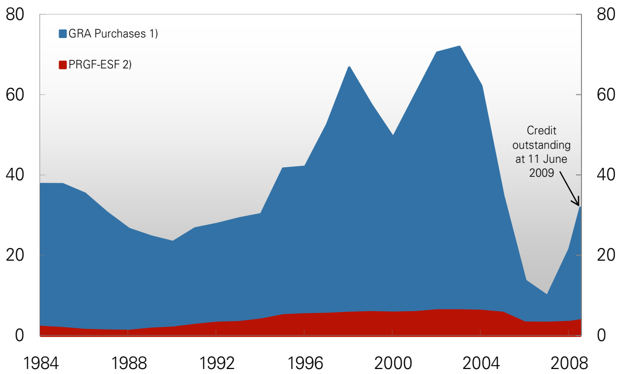
The International Monetary Fund (IMF) is important in managing international economic and financial crises. In the past year, the IMF has provided crisis-related loans to several countries experiencing balance of payments problems and has approved loans to potentially vulnerable countries. The Fund's surveillance of economic developments has been strengthened. At the same time, its functions, institutional governance structure and lending capacity are being assessed. Norway, under the auspices of Norges Bank, is now providing a loan to the IMF in the amount of NOK 30 billion to contribute to ensuring that the Fund has sufficient resources if the need for further substantial IMF lending should arise. This commentary discusses the IMF's new role in the world economy and presents the background for Norway's loan to the IMF.

Crisis management and lending in focus

The IMF's role has changed considerably over the past year. From being perceived as a "dormant" institution, which had to some extent become outdated, the Fund has demonstrated over the past year its effectiveness and relevance. Major crises underline the importance of the existence of an institution that provides economic policy advice in favourable periods and financial assistance in adverse times.

The long and stable expansion in the world economy from 2003 to 2007 entailed – naturally enough – a reduced need for the Fund's traditional role as crisis manager and funding source. This role was important during the crises in Latin America in the 1980s, the upheavals in the former Soviet Union and Eastern Europe at the beginning of the 1990s and the recurrent crises in the emerging economies later in the 1990s and early 2000s. At the beginning of 2008, IMF loans outstanding were record-low (see Chart 1). As late as in spring 2008, the Fund found it necessary to reduce staff by 400 person-years, i.e. by about 15% of the total number of employees.

Chart 1 IMF Credit outstanding at the end of the year.
In billions of SDRs. 1984 – 2008



1) Ordinary lending.
2) Lending to low-income countries at subsidised interest rates.
Source: IMF

The picture changed significantly when the financial market turbulence last year triggered the most severe economic crisis since World War II. The balance of payments of many advanced and emerging economies deteriorated substantially as a result of a sharp contraction in global growth and trade. Refinancing of foreign private and government debt became very difficult. A number of countries had to borrow from the IMF to finance balance of payment deficits (see Table 1). Some of the loans have not as yet been drawn on, but are a precautionary source of future financing. Emerging economies in Eastern Europe were particularly hard hit. As the financial crisis fed through to the real economy in many advanced economies, low-income countries were also increasingly affected by lower demand for their export goods.

IMF loans provide borrowing countries with somewhat more time to adjust economic policy. Without loans, many countries would have been forced to limit imports to an even larger extent with attendant spillover effects on other countries, as was the case in the 1930s. Borrowing countries also benefit from the IMF as a key advisor in the work on resolving their economic problems.

Two countries in the Nordic-Baltic constituency of the IMF[1], of which Norway is a member, have also borrowed from the Fund under the Stand-By Arrangement (SBA)[2] in the past year. Iceland borrowed USD 2 billion in November last year, while Latvia borrowed USD 2.35 billion in December. Both borrowing agreements stipulate that the countries shall implement economic policy measures to gradually reduce their balance of payment deficits. In connection with the IMF agreements, Norway and the other Nordic countries are providing loans to both countries. The EU has also provided a loan to Latvia. The Norwegian authorities have approved a medium-term loan to Iceland and Latvia in an amount of USD 675 billion (NOK 4.8 billion) and USD 525 million

1 The Nordic and Baltic countries have a joint representative on the IMF Board. For more information concerning Norwegian and the Nordic-Baltic coordination on IMF matters, see http://www.norges-bank.no/templates/article____12619.aspx. See also Norges Bank's website for more information about the IMF.

2 The SBA (Stand-By Arrangement) is a traditional IMF borrowing arrangement. It was designed to address member countries' short-term or medium-term balance of payments difficulties. The arrangement stipulates criteria for the borrowing country's economic policy during the term of the SBA with a view to ensuring the sustainable development of the country's economy in the future.

(NOK 3.7 billion). Norges Bank, Sveriges Riksbank and Danmarks Nationalbank also provided short-term borrowing facilities for Sedlabanki Islands in 2008.

The IMF's lending capacity

Over the past ten years, the IMF's financial resources, and consequently the capacity to combat crises, have fallen markedly in relation to various measures of the size of the world economy. The strong growth in lending over the past year has also reduced the Fund's capacity to provide new loans (see Chart 2). At the summit in April this year, the G20 countries therefore supported a proposal to treble IMF resources to USD 750 billion, of which one third was to be made available in the near term in the form of bilateral loans from member countries or purchases of securities issued by the IMF.

The IMF functions as a credit union. IMF loans to member countries are financed by member countries' quota subscriptions. In addition, the IMF can borrow from a group of member countries under the New Arrangements to Borrow (NAB)[3], which can be activated if the quotas are not sufficient to finance the loans. This arrangement can be renewed every five years. Participation in the NAB does not increase influence in IMF decision-making. The IMF can also increase member countries' financial reserves by allocating the international reserve asset SDR[4]. The SDR is mainly used between central banks. A central bank in a country can sell SDRs against settlement in reserve currencies such as USD or EUR. SDRs cannot be spent in the private market.

In practice, it takes time to increase quotas or expand the NAB. In the short term, the IMF's financial resources must therefore be increased through bilateral loans from member countries, or through these countries' purchases of securities issued by the IMF. It is natural for countries with large international reserves such as Norway to contribute more to IMF financing. Norway's support to the IMF during times of international crisis is consistent with our fundamental interest in supporting the work of multilateral institutions. As a small, open economy it is also in our interest to dampen fluctuations in the global economy.

3 The NAB is a multilateral arrangement providing the IMF with drawing rights in a total amount of SDR 34 billion on the 26 participating member countries. Norway's participation in the NAB amounts to SDR 379 million, or a good USD 550 million. The IMF has not drawn on the NAB so far. The NAB is renewed regularly, with the next renewal due in 2013.

4 The SDR was established by the IMF in 1969 with a view to strengthening international liquidity. A total of SDR 21.4 billion was allocated in the periods 1970 to 1972 and 1979 to 1981. In 1997, the IMF approved a special one-time allocation of SDRs. This allocation is yet to enter into force as some member countries have not officially approved the allocation.

Bilateral loan agreements with the IMF and Norway's loan to the IMF

In February 2009, Japan offered to provide a loan of USD 100 billion to the IMF in the form of a drawing arrangement. In a letter to the Ministry of Finance on 12 March, Norges Bank proposed that Norway should also hold discussions with the IMF on a drawing arrangement for the IMF.[5] At the end of March this year, Minister of Finance Kristin Halvorsen sent a letter to the IMF concerning a possible loan from Norway.[6] Following negotiations between the IMF and Norges Bank, the Government presented the matter to the Storting (Norwegian parliament). The Storting approved the loan agreement between Norges Bank and the IMF on 15 June 2009. The agreement was signed on 26 June 2009.[7] A number of other countries have also stated their willingness to provide loans or purchase securities issued by the IMF: the EU with EUR 75 billion, Canada, Switzerland, Russia and Brazil with USD 10 billion each. China has indicated that it may make USD 50 billion available. In addition, the US Congress has authorised an expansion of its credit arrangement with the IMF with an appropriation of USD 100 billion to the NAB.

In relation to GDP, the loan from Norway is about half the size of Japan's loan and about twice the size of that offered by the EU. The loan can only be used as lendable resources under the IMF's ordinary arrangements to borrow, as for financing via the ordinary quota resources and the NAB.

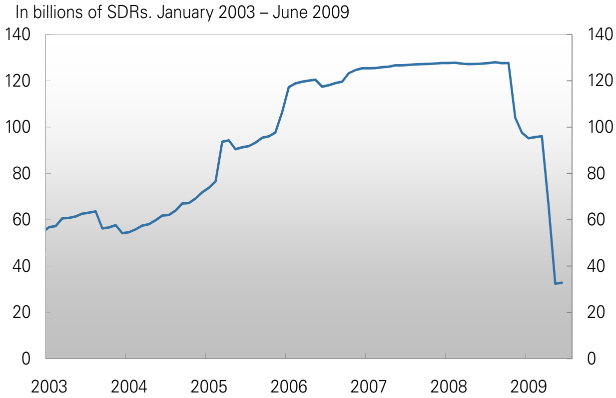
During the negotiations, the IMF raised the question of whether a share of the Norwegian resources could be used

5 Norges Bank, pursuant to an agreement with the Ministry of Finance, is the secretariat for IMF work in Norway and manages pursuant to Section 25 of the Norges Bank Act the financial claims on the IMF. The Ministry of Finance decides the views to be promoted by Norway on relevant matters vis-à-vis the Nordic-Baltic constituency and the IMF.

6 See http://www.regjeringen.no/nb/dep/fin/pressesenter/pressemeldinger/2009/norge-tilbyr-lanemidler-til-imf/letter-to-the-managing-director-of-the-i.html?id=551815 for more information.

7 See http://www.norges-bank.no/

Chart 2 Resources available for new financial commitments in the coming year as measured by the one-year forward commitment capacity (FCC).[1)]
In billions of SDRs. January 2003 – June 2009



1) The FCC increases when quota payments are made. It also increases when repurchases are made and decreases when the IMF makes new financial commitments. The FCC does not include the NAB agreement or the bilateral loan agreement with Japan
Source: IMF

under the IMF's special arrangements for low-income countries, which are provided at a subsidised rate of charge. The Government's assessment is that Norway should not make new loans available for these arrangements at present. Instead, the Government will link possible further Norwegian financial assistance to the establishment of a new IMF arrangement for low-income countries, more directly targeting short-term balance of payments difficulties.

The loan is formally a bilateral agreement between Norges Bank and the IMF, where the IMF is provided with the right to drawings in Norges Bank. The loan applies for five years, but should Norway provide resources for an expanded NAB, the agreement can be rescinded. Norges Bank enters into the agreement pursuant to Section 26 of the Norges Bank Act, which states "The Bank may enter into agreements on deposits, credit and guarantee agreements with foreign central banks and other credit institutions as well as with international economic organisations and institutions, provided that its claims are satisfactorily secured. Such agreements are subject to the approval of the King". The Ministry of Finance, with the authorisation of the Storting, has approved the loan agreement between Norges Bank and the IMF.

An institution in change – reform of lending facilities and broader area of surveillance

Since autumn 2008 the IMF has undertaken substantial changes in its activities to adapt to the new global challenges. The lending facilities are being improved, financial market surveillance is being strengthened and the organisation's governance structures are being reformed.

Traditionally, the IMF has approved a drawing arrangement for member countries with a borrowing need. During the financial crisis, member countries' borrowing needs arose much more rapidly and were even greater than earlier. The Fund's lending facilities therefore had to be adjusted. The derogation rules for faster processing of loan applications were introduced. The ordinary lending limits were doubled, for both the ordinary borrowing arrangements that can be used by all countries and the special arrangements for low-income countries. However, a number of loans have been approved in considerable excess of the ordinary limits. At the same time, borrowing arrangements have been established that take increased account of today's complex funding situation. The most widely used is the Flexible Credit Line (FCL), which is a drawing arrangement for countries with a strong economic position that have, or may face, considerable temporary liquidity needs as a result of a disruption in international capital markets.[8] Lending facilities that have not been utilised for many years have been discontinued.[9]

Access to drawing arrangements in the IMF has often been conditional on extensive reform of economic policy in the relevant member country. The economic policy conditions that have to be met have now become more flexible and delimited. They are more specifically aimed at correcting the macroeconomic imbalances that have caused the borrowing need. The conditions relating to a country's structural policy are only included if they are crucial to correcting the imbalances. The reformed lending facilities will bolster member countries' confidence in financial markets and thereby enhance crisis prevention.

Reform of the IMF's organisational structure has been assessed by a number of institutions and groups, in addition to NGOs and academia. The IMF's own independent evaluation office (IEO) submitted a report with a series of reform proposals in spring 2008. The G20 has formed working groups that earlier this year reviewed the governance structure of the IMF and the World Bank and the multilateral development banks. A group established by the IMF's Managing Director, headed by the former finance minister of South Africa Trevor Manuel, has received considerable publicity after the group's report was published in March this year. The group examined the role of and relationship between the administration, the Board and the advisory ministerial body, the IMFC. The group proposed a clearer division of responsibility between the various bodies of the IMF. The Board should be given a strengthened role in following up the strategic framework for IMF activities. It is proposed that the IMFC be converted into a formal decision-making body (council) to promote political involvement in strategically important decisions. The appointment of the IMF's managing director should be more transparent and should not be confined to European candidates. The group also proposed a broader mandate for surveillance policy, particularly against the background of the experiences gained so far from the ongoing financial crisis. The IMF is in the process of assessing these recommendations.

Neither the IMF nor other international organisations provided a sufficiently early or clear warning of the current crisis. The IMF had long highlighted the considerable imbalances in the world economy, but underestimated the

8 The FCL was established and approved by the IMF Executive Board in March 2009, and has so far been used by Mexico, Poland and Colombia.

9 Lending facilities discontinued in March 2009 included the Compensatory Financing Facility (CFF) and the Supplemental Reserve Facility (SRF). The CCF was established in 1963 to provide financial assistance to a member country experiencing medium-term export problems due to a fall in commodity prices, or increased import costs for cereal products. The CFF was last used in 1999. The SRF was established during the Asian crisis to provide financial assistance to a member country experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a disruptive loss of international market confidence. Owing to the high surcharge above the rate of charge on IMF loans, only six countries used the SRF, last in 2002.

systemic risk in financial markets and the interdependence between the financial sector and the real economy. As a response, the Fund initiated broader cooperation with the FSB[10] to develop an early warning system for financial crises. Issues relating to financial markets and spillover effects among and within countries will be given more emphasis in the analyses of the world economy in IMF's semiannual publications World Economic Outlook and Global Financial Stability Report. These issues will also be given more emphasis in bilateral surveillance of member countries (Article IV consultations[11]). In addition, the analyses of the financial sector in member countries (FSAP) will be further developed. There is now a commitment among large member countries in particular to allow the IMF to conduct such analyses. Finally, exchange rate surveillance will be bolstered to secure a stable international monetary and financial system.

The IMF is an important multilateral governance instrument for member countries and is largely consensus-based. The experiences derived from the current crisis and the reforms that have been initiated and implemented will contribute to improving the IMF's capacity to prevent, warn of and tackle future crises. It is of great importance that the IMF is clear and credible in its recommendations and has sufficient financial resources to provide assistance to countries with a temporary borrowing need. The IMF has played a key role in the international crisis so far and member countries have demonstrated that they want and need a bolstered IMF with strong confidence.

10 The FSB (Financial Stability Board, previously Financial Stability Forum) is a body established by the G20 to assess the challenges facing international financial stability, identify and propose action to address these challenges and promote cooperation and information exchange among authorities responsible for financial stability.

11 For Norway, the next Article IV consultation is scheduled for late autumn 2009.

Table 1. New SBA and FCL loans since summer 2008 (as of 11 June 2009)

	Effective date	Expiration date	Amount Agreed		Drawn upon as of June 4, 2009
			SDR (Mill)	In % of quota	SDR (Mill)
SBA loans:					
Georgia	15-Sep-08	14-Mar-10	477	317	288
Ukraine	5-Nov-08	4-Nov-10	11 000	802	4 893
Hungary	6-Nov-08	5-Apr-10	10 538	1 015	6 323
Iceland	19-Nov-08	18-Nov-10	1 400	1 190	560
Pakistan	24-Nov-08	23-Oct-10	5 169	500	2 636
Latvia	23-Dec-08	22-Mar-11	1 522	1 200	535
Belarus	12-Jan-09	11-Apr-10	1 618	419	518
Serbia	16-Jan-09	15-Apr-10	2 619	75	702
El Salvador	16-Jan-09	31-Mar-10	514	300	0
Armenia	6-Mar-09	5-Jul-11	368	400	162
Mongolia	1-Apr-09	1-Oct-10	153	300	51
Costa Rica	11-Apr-09	10-Jul-10	492	300	0
Guatemala	22-Apr-09	21-Oct-10	631	300	0
Romania	4-May-09	3-May-11	11 443	1 111	4 370
Sum			*47 944*		*21 038*
FCL loans:					
Mexico	17-Apr-09	16-Apr-10	31 528	1 000	0
Polen	6-May-09	05,05.2010	13 690	1 000	0
Colombia	11-May-09	10-May-10	6 966	900	0
Sum			*52 184*		*0*

[1)] Se section on "An institution in change" for more informatioan on the various lending facilitites.
Source: IMF Financial Activities June 11, 2009