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Jozef Makúch

Governor of Národná banka Slovenska

On12 January 2010 the President of the Slovak Republic Ivan Gašparovič officially appointed Docent Ing. Jozef Makúch PhD to the office of the Governor of Národná banka Slovenska with the participation of Prime Minister Robert Fico and Minister of Finance Ján Počiatek.

Photo: Marián Garaj

Jozef Makúch has been a Member of the Bank Board of the NBS and, following the proposal of the Government, he was elected to the highest post of the central bank on 10 December 2009 by Members of Parliament of the Slovak Republic.

Jozef Makúch is the fourth Governor of the NBS in rank since its establishment in 1993. His predecessors were Vladimír Masár (1993-1999), Marián Jusko (1999-2004) and Ivan Šramko (2005- up to the appointment of Jozef Makúch).

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The financial and economic crisis that the world is now going through has also brought with it positive moments of catharsis, reassessment and self-reflection, as well as unexpected twists. Thoughts on reassessing the role and tasks of the International Monetary Fund are not new; they have been resonating since the 1990s. The Mexican and Asian crises gave rise to a discussion about the need for reform of the international financial architecture, but – until the current crisis erupted – no reform proposals managed to secure sufficient political support. It is not so long since Andrew Crockett, in his report on sustainable long-term financing of the IMF, aptly noted the paradox that the Fund generates revenues only in situations where its policy has been unsuccessful.

At the time when Crockett submitted his proposals for reform of IMF income model, the Fund's best days appeared to be behind it. This was a time when also voices from academia were calling the Fund's existence into question, and when the Fund's budget situation was deteriorating to the point that it was expected to make a real loss – a loss that member countries were evidently reluctant to finance. The Fund therefore not only began to seek new ways to increase its resources, but also to make savings on the expenditure side of its budget.

Changes at the IMF accelerated by the global crisis

The global economic and financial crisis, however, gave the development of the IMF an astounding dynamics, as it accelerated and solved "interminable" processes that had been dragging on for years. In discussions held during that time, unyielding positions among IMF members ensured that their talks kept failing to produce any real result. The quota review discussion was typical of this state of bureaucratic "blind alleys", and those who took part in the quota formula talks will agree that they had the same charm, only they were curtailed by the emergence of the crisis.

The development of this undoubtedly influential and important institution has undergone many changes since its founding at Bretton Woods in 1944. On one hand, these have reflected global macroeconomic developments, and, on the other hand, they have shaped the international monetary system. Even the Fund's "intellectual fathers" – Harry Dexter White and John Maynard Keynes – had quite different views about the basis of the international monetary system. The IMF's Articles of Agreement represented a compromise, or rather an illustration of the distribution of powers and influence that prevailed in the wake of the Second World War. The Fund's development reflected real historical events, such as economic crises, debt and credit crises, defaults, and oil price shocks. Taking account of the political distribution of powers and the economic situation following the Second World War, currencies were pegged at fixed rates to the US dollar, backed by gold standard. The transition from fixed parities to a system of floating exchange rates in the 1970s represented another response, this time ending the gold standard for the US dollar, to emerging differences in the economic development of IMF members and to the level of their foreign exchange reserves. The promotion of SDRs on the basis of central exchange rates at the IMF and the termination of the SDR peg to gold reflected continuing macroeconomic developments that have formed the backdrop to the United States' rising fiscal deficit and indebtedness, and the related weakening of the US dollar as most extensive reserve currency in the world. It is now clear that the time is ripe for the implementation of further changes – this time in regard to the Fund's mission and governance, and particularly to extending the influence of large emerging economies.

Current mandate of the IMF

For the purpose of comparison, and in order to better understand the thinking on how the IMF's role has changed, let us briefly sum up the current tasks of the Fund. The IMF is defined as an institution whose purposes are:

- to ensure stability of the international monetary system and to provide consultation and collaboration on international monetary problems;
- to facilitate the expansion and balanced growth of international trade, especially through the elimination of foreign exchange restrictions, and thereby to promote a high level of sustainable economic growth and to raise living standards;

- to ensure exchange stability, so as to avoid competitive exchange depreciation among IMF members;
- to make the Fund's general resources temporarily available to members that have balance of payments problems;
- to provide technical assistance, expertise and training in areas within the Fund's competence.

Modernization promoted by the G-20

In the recent period of positive economic developments, the IMF/WB spring and annual meetings were arid affairs – the biggest surprise being the decision on the meeting venue – but those days are now long gone.

Moves to modernize and expand the Fund's competence are now being initiated by the most influential "G" group of countries – the G-20 comprising: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the United Kingdom, the United States, and the European Union (represented by the European Commission and the European Central Bank). Although not an institutionalized grouping, this is a group of those countries that are able to provide accelerated liquidity to global markets, a fact that supports respect for their decisions on how to address the global crisis.

The G-20 has identified the IMF as the international institution best prepared to handle the task of quickly acquiring additional financial resources from members (through appropriate tools) and of ensuring that they are provided to those members that have asked for assistance in dealing with the current economic and financial crisis.

It is indisputable that the IMF has the expertise, staff and technical resources to perform what is basically the role of the world's central bank; it has at its disposal the structure, tools, and experts, and to a certain extent the resources, too. However, this "rediscovery" of the IMF's mission also raises questions about whether its management should not be more flexible and effective and whether to extend its competences in order to prevent further global crises. Since this initiative came from the G-20, the powers of the G-20 and IMF vis-à-vis each other should be defined as well.

The Manuel Report

The Committee of Eminent Persons on the IMF Governance Reform, established in September 2008 and chaired by Trevor Manuel, a former Finance Minister of South Africa, submitted its final report, the so-called "Manuel Report", in March 2009. The Report proposes a new governance framework, specifically the abolition of the International Monetary and Financial Committee (IMFC) and the activation of a Council with decision-making powers (the IMFC, composed of finance ministers, at present has only an advisory role). The Council would meet at the level of ministers/governors at least twice a year, during the IMF/WB spring and annual meetings, and it should concern itself with *strategic decisions* and the selection of the IMF's Managing Director. The decision on the Managing Director is currently taken by the Executive Board, made up of 24 Executive Directors, nine of whom are from European countries. The Report asserts that in order to enhance the legitimacy of the IMF, it is essential to introduce a transparent and open selection process of the Managing Director, as well as his three deputies, and the selection should not be determined on the basis of nationality. This argument is a response to the unwritten rule that the position of the IMF's Managing Director is filled by a European candidate and one of the Deputy Managing Directors by a candidate from the United States.

The Executive Board would, according to the Report, continue to be the IMF's executive body; it would at the same time serve as an advisory body to the new Council and be responsible for supervision over the IMF's management. In order to improve the efficiency of the Executive Board, reduce the running costs and enhance the allocation of tasks between the Executive Board and management, the Report recommends that some of the Executive Board's responsibilities be delegated to management. Regarding changes to the IMF's institutional structure, the Manuel Report also responds to the need for greater involvement of developing countries in the decision-making processes and structures and recommends adjusting the composition and number of representatives on the Council and the Executive Board, in the latter case by *reducing the number* of Executive Directors from 24 to 20 and introducing direct elections of Executive Directors. This proposal would, argues the Report, help to reduce the number of European Executive Directors from the current nine, since three of them are appointed (France, Germany and the United Kingdom) and six are elected (Belgium, the Netherlands, Italy, Spain, Switzerland, and the Northern countries).

Another recommendation of the Manuel Report is to strengthen the decision-making process by extending the range of decisions subject to double majorities (i.e. a majority of countries and a majority of member votes) and by lowering the voting thresholds on certain decisions (from 85% to 70–75% of member votes).

In response to the current crisis, the Committee proposes expanding the Fund's surveillance mandate beyond exchange rates, to cover also, for example, macroeconomic policies. Regarding the supplementation of resources, the Committee proposes that the completion of the 14th General Review of Quotas be brought forward to 2010 (from 2013) and that IMF resources be increased in the short-term through bilateral loans or by extending the Fund's landing arrangements: General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB). For the long-term, the Report recommends that consideration be given to an SDR allocation and to implementing its proposals by no later than 2010.

Proposal for management structure changes

As regards the role of the IMF, the views of Stanley Fischer, who is currently the Governor of the Bank of Israel and was formerly a First Deputy Managing Director of the IMF, have attracted not a little interest. He goes even further, and suggests abolishing not only the IMFC, but also the Executive Board. These, he says, would be replaced by a new Council consisting of G-20 politicians – on which point he agrees with the Manuel Report. In his view, the Fund should conduct assessments to detect vulnerabilities and the build-up of risk in the financial sector, and it should issue confidential warnings to systemically important countries whenever developments in their economies or financial sectors give cause for concern. He calls for surveillance of the financial sector and for responsibilities in this area apportioned between the IMF and the Financial Stability Board (FSB). The FSB is already the second grouping, after the G-20, in respect of which the Fund's future competences should be profiled. Promoting his proposal for a change in the IMF's management, Fischer argued that although the compositions of the IMF's Executive Board and G-20 are similar, only their ‚blending' would, like the Manuel Report, open the issue of reducing the number of Executive Directors, from 24 to 20, and especially the allocation of positions, which in this case would mean Europe losing four Executive Directors. Naturally, there was not long to wait before the representatives from the respective countries gave their reactions – at the IMF/WB annual meetings in Istanbul. Responses on their part ranged from the emotional to stoic silence, while an unnamed Asian delegate remarked that the old (i.e. European) countries were sticking to their positions as if in the trenches.

By contrast, the Egyptian Finance Minister and IMFC chairman, Boutros Boutros-Ghali, advocates the view that the IMFC should acquire executive power so as to be at the forefront of strengthening the IMF, which should coordinate policy across the world, and therefore: „become the chief among the ‚family of Gs' that coordinate economic policy".

Just as not all family members are necessarily bound by love, however, so the IMF's situation was complicated by the declaration of BRIC countries (Brazil, Russia, India and China) that called for their voting rights to be in proportion to the resources provided through the New Arrangements to Borrow (NAB). That would represent 16% in total, which would in practice give them a veto on decisions. The only country that currently has a veto is the United States, with 17% of the voting rights.

How the Fund's role is seen by the G-20, the most influential group

G-20 Leaders statements showed that they support innovative measures to establish credit arrangements that ensure the effective and flexible use of funds for the purpose of reducing global risks. There was also a call for increasing the legitimacy and effectiveness of the IMF, which in practice means its critical role in supporting global financial stability and balanced growth. They see the means for this in the reform of Fund's lending facilities, the creation of the FCL, and increasing the Fund's capacity so as to assist countries in coping with financial volatility. In addition to its current tasks, the IMF would be responsible for the surveillance of risks facing the global economy and the international financial system. The G-20 leaders condition these changes on the modernization of the IMF's governance, but they stress that the organization should be quota-based and that quotas should reflect the economic performance of the memberhip in the global economy. They also agreed that the Fund should implement at least a 5% shift in quota share, from over-represented to under-represented member countries, as well as a protection of voting rights to the poorest member countries. The IMF should therefore aim to prepare a further increase in quotas, to consider the size and composition of its Executive Board, and to ensure the effective and greater involvement of IMF Governors in strategic decisions.

The influence of large emerging economies must be extended

Views on the future form of the International Monetary Fund have so far only been set out, and it remains to be seen whether they will take definite shape in April this year. However, none of the member countries doubts the need to increase the influence of large emerging economies and to adjust quotas and voting shares so as to take account of their current economic performance without reducing the voice of the Fund's poorest members. Problems, though, are emerging in the case of over-represented countries whose quota share and voting shares should be reduced.

A general consensus is also seen on strengthening the global role of the IMF, on the accelerated supplementation of the Fund's lending capacity, and on a more flexible way of releasing these resources. The idea of expanding the Fund's mandate to include macroeconomic surveillance has broad support, although the recommendations for changing the Fund's governance and activating a new Council to take most of the strategic decisions have proved somewhat controversial.

The fact that the initiative to reform the IMF's mandate, tasks and governance has come from the G-20 gives cause for optimism that the proposals will gain also the political support from IMF members without which they could not be implemented. It does seem, however, that the 2010 target for implementing all the Manuel Report recommendations – including the review of quotas, the extension of the IMF's mandate, and the reform of its governance – is too ambitious.

How to reconcile EU integration with the governance of the International Monetary Fund?

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The advent of the euro opened a new chapter in the history of international monetary cooperation. A new player – the euro area – entered the field, with its new currency and a new central bank, the European Central Bank (ECB) and the Eurosystem, which comprises the ECB and the national central banks (NCBs) of those countries that have adopted the euro. The purpose of this article is to shed light on how the advent of the single currency has affected the functioning and governance of the International Monetary Fund (IMF). It will do so by answering four questions: what did the euro imply for economic policy-making in the euro area countries? What, in turn, did the new economic policy framework imply for the international monetary and financial architecture? How did the IMF and the European Union (EU) representatives in the IMF adapt to this new reality? And, finally, how effective is the EU coordination process in IMF matters?

The inception of the euro as the single currency of the euro area in 1999 had important repercussions on the European Union's policy framework. Herewith, one of the milestones in the process of integrating economic and monetary policies of the EU Member States was reached. With the introduction of the single currency, the responsibility for the conduct of monetary policy was transferred to the EU level and assigned to the newly established ECB. Exchange rate policy was also moved to the EU level, and entrusted to the EU Council, the Eurogroup and the ECB. Whilst fiscal, financial and structural policies remained predominantly in the hands of the EU Member States, stronger coordination mechanisms were put in place in these areas, though to different degrees:

- **Fiscal policy**: It was felt that the proper functioning of Economic and Monetary Union (EMU) required a "hard coordination" framework that would foster sound fiscal policies and thus support the conduct of the single monetary policy. To that end, the Treaty laid down basic principles for the conduct of fiscal policy, with the detailed implementation rules being specified in the Stability and Growth Pact (SGP). The Lisbon Treaty provides for a further consolidation of this hard coordination framework, in particular by strengthening the role of the European Commission and changing the voting procedures in the Council.
- **Financial markets policy**: In order to foster the integration and stability of EU financial markets, a special EU framework – the Lamfalussy framework – was put in place, which combines the legislative tools of the EU Single Market, as far as regulatory matters are concerned, with arrangements to promote financial supervisory convergence and cooperation. Following the 2009 de Larosière report, which draws lessons from the financial crisis, this framework is bound to be further enhanced by the creation of three European supervisory agencies, as well as the establishment of a European Systemic Risk Board in charge of macro-prudential risk assessments and recommendations.
- **Structural policies**: The introduction of a single monetary and exchange rate policy put a premium on reforms aimed at rendering the euro area's national economies more flexible, resilient, and competitive, so as to facilitate adjustment to economic shocks. A "soft coordination" of structural policies was thus put in place under the banner of the Broad Economic Policy Guidelines and the Lisbon Strategy.

The establishment of a new economic policy framework – brought about by the creation of the euro – made it necessary to devise arrangements which would permit an adequate representation of the euro area and EU in multilateral cooperation processes and ensure an appropriate involvement of the relevant EU institutions in international organisations and fora. Accordingly, based on the principles laid down in the Treaty, the European Council and the ECOFIN Council put in place various arrangements for the international bodies involved.

Fitting the euro area and EU into the existing arrangements for international policy coordina-

1 *The views expressed in this article do not necessarily reflect those of the European Central Bank.*

tion was, however, not easy. The reasons were basically twofold:

- Most international institutions and fora were set up on the assumption that their members were sovereign countries. The creation of a new entity – the euro area – in charge of certain policies for its national components, without having a political personality as a fully-fledged sovereign, had to be squared with the country-based organisation of these institutions and fora;
- Most international organisations also assumed that their member states had full competence over their economic, monetary and financial policies. With the advent of the euro, this was obviously no longer the case for the euro area countries. EMU's policy framework established a multi-level system of economic governance, with the responsibility for monetary and exchange rate policies being transferred fully to the euro area level, whilst the responsibilities for fiscal, financial and structural policies remained largely in the hands of the national governments, albeit subject to EU coordination.

The recognition of the euro area and EU, therefore, required changes to the statutes and rules governing the relevant international institutions and fora, which were more or less difficult to accommodate depending on the nature (formal vs. informal), size, policy scope, and governance of the entities concerned. In many cases, the "easiest" route was chosen, with the euro area and the EU being involved along with rather than instead of the national authorities of the Member States.

These challenges were also (or – one could argue – particularly) prevalent in the case of the IMF, being a Treaty-based and country-based institution with a mandate covering a wide array of policy fields. The December 1997 Luxembourg European Council conferred responsibilities for co-operation with the IMF on issues of relevance to EMU upon the ECOFIN Council and the ECB (with the European Commission associated, as appropriate). As from 1 January 1999, the ECB was granted permanent observer status at the IMF, thus reconciling the fact that only quota-holders can be members of the IMF Executive Board with the need to have one of the key global policy-makers at the table, namely the central bank of the second most important currency in the world. The standing invitation extended to the ECB allows its permanent representative to participate in IMF Executive Board meetings on issues which fall within the ECB's field of competence or which are considered of mutual interest to the IMF and the ECB. In addition, the President of the ECB is invited to participate as an observer in the meetings of the International Monetary and Financial Committee (IMFC). Similarly, the President of the Eurogroup may be represented in the IMFC. In all cases, however, the voting power remains with the EU countries.

As the IMF's mandate pertains to issues concerning the international monetary system and macroeconomic and financial stability, the establishment of EMU inevitably had an impact on the IMF's deliverables. In particular, the advent of the euro necessitated changes to the IMF's surveillance activities, since euro area countries no longer have full control over all relevant economic policy levers. Without being exhaustive, a few examples are given below:

- Since 1999, the IMF has been conducting a special Article IV consultation with the euro area, which covers not only monetary policy and exchange rate matters but also includes fiscal, financial and structural policies at the euro area and EU levels. To that end, an IMF delegation holds discussions twice a year with the ECB as well as the European Community bodies (the European Commission, the EFC and the Eurogroup) in charge of coordinating national economic policies.
- In the context of the 2001 Article IV consultation with the euro area, the IMF prepared a Report on the Observance of Standards and Codes (ROSC) concerning the ECB's monetary and payment systems policies in the euro area. More specifically, the assessment addressed the observance of the monetary policy section of the "Code of Good Practices on Transparency in Monetary and Financial Policies", including the transparency of payment system oversight in the euro area, as well as the observance of the "Core Principles for Systemically Important Payment Systems" for the TARGET and EURO1 systems. The assessment did not address transparency aspects of banking supervision and deposit insurance, for example, as these are national competencies that do not fall within the mandate of the European System of Central Banks (ESCB).
- For the IMF's first multilateral consultation on the topic of global imbalances in 2006, the euro area – rather than individual Member States – was invited to participate together with China, Japan, Saudi Arabia, and the United States. The aim was to select economies that either were directly part of the imbalances through their current account deficits or surpluses, or that represented a very large share of global output and could thus contribute to sustaining world growth as demand and savings/investment patterns adjusted. Similarly, the euro area and EU will take part, alongside individual euro area and EU countries, in the recently launched G-20 Mutual Assessment Process, which aims at ensuring future strong, sustainable and balanced growth.
- The 2007 Decision on Bilateral Surveillance over Members' Policies anchored surveillance over monetary unions in the IMF's concept of external stability. The external stability for euro area countries has since been defined at the regional instead of national level, reflecting the fact that in a monetary union, only the balance of payments position of the union as a whole can directly give rise to disruptive exchange rate movements.

Delegates watch the Opening Plenary of the 2009 IMF/World Bank Annual Meetings at the Istanbul Congress Center October 5, 2009 in Istanbul, Turkey. IMF Staff Photo.

- Finally, in the context of the financial crisis, the IMF decided for the first time to provide balance of payments support in cooperation with the EU. Some of the non-euro area Member States (including those participating in the ERM II exchange rate mechanism) have thus received financial support through joint programmes by both the IMF and the EU. Such joint programmes represent an unprecedented degree of cooperation between the IMF and regional institutions.

The euro not only required changes in the IMF's deliverables, it also necessitated an adequate degree of coordination of positions taken by the EU on IMF matters in general, and by Executive Directors representing EU countries in the IMF Executive Board, in particular. It should be recalled that by no means does this represent a departure from the IMF's standard working methods. Indeed, given the IMF's constituency structure, coordination amongst like-minded countries has been a central feature of IMF decision-making since the very beginning. In order to bring about this EU coordination, a multi-layered structure has been set up, composed of:

- the Economic and Financial Committee (EFC) and its specialised Brussels-based sub-group – the EFC sub-committee on IMF-related questions (SCIMF),
- the Brussels-based Eurogroup Working Group (EWG);
- the Washington-based EURIMF – an informal group of representatives of EU Member States at the IMF, in which the ECB observer and a representative of the European Commission participate. In 2007, this body adopted its own terms of reference and introduced the position of EURIMF chair in order to further strengthen the EU and euro area coordination process, both in Washington and between Washington and Brussels. The EURIMF chair is selected by consensus among the EURIMF members for a period of two years; and
- the Frankfurt-based ESCB International Relations Committee (IRC).

The SCIMF and the EFC, and, if need be, the ECOFIN Council, act as the main line of coordination, with their attention focused on broader issues pertaining to the EU as a whole. The EWG, and if need be the Eurogroup, prepare positions on issues pertaining to the euro area common policies as well as other issues of systemic and strategic interest to euro area countries. A central bank perspective on international policy matters of relevance to the euro area and EU may be provided either directly to the SCIMF and EWG, through the ECB's and (in the case of the former) the NCBs' participation in these bodies, or indirectly via the IRC, which occasionally contributes to topics discussed in the forum of the EFC or EWG. The EURIMF acts as the Washington-hub of EU coordination. It permits the exchange of information on and the coordination of positions of EU representatives in the IMF Executive Board on the basis of inputs from the various euro area and EU committees and/or the ECB and the European Commission.

The mode of coordination depends, in the first place, on the relevance of the issue for common or coordinated policies. In cases where the item to be discussed in the IMF is directly and exclusively related to euro area common policies, a euro area common statement is prepared by the EWG and the EURIMF, and presented in the IMF Executive Board by the EURIMF's President. While this procedure excludes separate written statements by individual Directors of member countries of the euro area, the latter may still support the common statement by means of oral statements. To ensure transparency and allow other non-euro area Member States to associate themselves with the euro area position, non-euro area countries

2 The Executive Directors of mixed constituencies, i.e. representing non-EU countries as well, are in a specific position. In order to take due account of it, they may separately express the views of the non-EU members of their constituencies as long as they associate themselves with the EU coordinated position.

are also involved through their participation in the relevant preparatory bodies. The Article IV consultation with the euro area was the most prominent example for which a euro area common statement was issued. Similarly, multilateral consultations on imbalances, exchange rate policies or related issues gave rise to euro area common statements. Common statements may also be circulated on EU matters, although there have been very few instances of such a degree of coordination in the past (see below).

A softer form of coordination, short of a common statement, has been pursued by means of the issuance of EURIMF Presidency statements. They are typically prepared for surveillance reports on EU Member States or decisions on balance of payments support to non-euro area Member States. They may also be issued on topics that are characterised by a strong convergence of views among euro area or EU countries (see the point below). While such Presidency statements do not exclude written statements by other Executive Directors, support of Presidency statements is expected, notably through explicit reference to them in individual written statements. By the same token, the latter should not convey messages which contradict the Presidency's statement.

For topics which are only partly related to euro area common policies or for other issues of systemic and strategic interest (e.g. aspects of the World Economic Outlook and the Global Financial Stability Report, surveillance reports on key third countries), key common messages are prepared by the EWG (where the euro area is concerned) or the SCIMF and the EFC (where the EU is concerned). These messages are intended to be reflected in the statements by Executive Directors representing EU countries, without a EURIMF Presidency statement being issued.[2]

Over the years, these coordination processes have intensified, with a greater number of items for which coordination takes place, more regular meetings, and more input from Brussels and Frankfurt. All in all, progress has been made as regards the coordination of positions on EU country matters. An example of successful EU coordination is Latvia, where an EU common statement was instrumental in effectively conveying a consistent EU position. Yet, whilst on such country issues the Executive Directors representing EU countries have been aligning themselves more closely, in particular in the context of IMF-EU programmes, some discordant views can still be discerned (e.g. diverging views on the fiscal policy objectives agreed in the context of the Stability and Growth Pact).

In the context of the crisis, which has put a premium on coordination including among EU countries, progress towards speaking with one voice has also been made regarding IMF policy matters. Recent examples include quota and governance reform, IMF's other resources (e.g. bilateral loans, NAB, SDR), and the reform of the IMF's lending toolkit. Yet there is still quite a lot of unexploited potential in this regard. Joining forces on these matters more often would allow the EU Member States to make their voices heard more at the Executive Board level. In this context, expanding the scope and improving the timeliness of the input from Brussels and Frankfurt would be paramount.

The creation of the single currency and the advent of the euro area as a new entity on the global scene had three main implications for the IMF: complication, simplification, and innovation.

First, the introduction of the euro has – arguably – been a source of complication for the IMF, requiring the latter to integrate a new supranational entity into its governance, surveillance and mindset. Fitting a "currency without a state" into a state-based entity such as the IMF was (and remains) a complicated endeavour.

At the same time, however, the advent of the euro has also been a source of simplification for the IMF, as it has reduced the number of key global players and currencies. In addition, the existence of the EU's own surveillance and financing mechanisms provides a welcome first line of defence against the possibility of monetary instability and economic and financial problems in euro area and EU countries. Moreover, the existence of euro area and EU coordination processes has facilitated the IMF's workings, given the higher degree of commonality and, in some cases, singularity of EU positions. The IMF's dealings with EU Member States have also been facilitated. By way of example, the IMF's recent negotiations on extending the SDR voluntary trading arrangements with its euro area members have been facilitated by the coordinated approach engineered by the ECB and the Eurosystem.

Finally, the introduction of the euro also harbours a potential for institutional innovation. The euro has galvanised the IMF into adding a stronger regional dimension to its work, as epitomised by the initiation of the Article IV consultation with the euro area. The insertion of a stronger regional dimension into the IMF's surveillance work is clearly a valuable innovation, as the greater degree of interconnectedness of the global economy has entailed a greater potential for cross-border contagion, in particular at the regional level. The IMF has drawn the right conclusions from this increased interdependency by paying greater attention to the risks of regional spillovers and externalities (as exemplified in its Regional Economic Outlook reports). In the light of the crisis, the IMF has taken this regional approach one step further by instituting joint lending programmes with the EU for a few non-euro area Member States. This initiative shows that complementing the IMF's financial resources with those of regional entities may hold considerable promise. Indeed, in a recent speech, the IMF's Managing Director indicated that the IMF was currently thinking about ways to combine these regional resources (not just in the EU but also elsewhere) with IMF financing, so as to make both more effective. Hence, the joint EU-IMF programmes may set a valuable precedent for similar IMF initiatives with other regional entities, such as the Chiang Mai Initiative (south-east Asia) or the Gulf Cooperation Council (Middle East). All in all, this shows that, in a world where the number of sovereign countries has expanded to around 200, regional integration may provide a valuable intermediate layer of governance, complementing and strengthening the global system of international cooperation. At the same time, in setting up these joint initiatives, it will be important for the IMF to respect and internalise the regional policy frameworks and best practices, an issue which should be properly reflected in its governance framework.

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Non-concessional lending by the IMF in an evolving world[1]

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Since the IMF's inception, there have been several major changes in the world economy of relevance for its lending operations. Over the years, globalisation and financial deepening broadened the range of channels through which real and financial shocks could affect individual economies and spill over to other countries. The growing magnitude of private cross-border financing flows and rising financial linkages changed the profile of risks that members face, inter alia, by deepening vulnerabilities, amplifying the effects of various shocks, and transmitting them more quickly across national borders. The ability to influence private creditors diminished as bonds largely replaced loans, implying that private creditors were less subject to regulatory suasion. As a result, IMF members' needs to borrow from the Fund have changed in size and duration. At the same time, the massive capital movements that can trigger capital account crises dwarfed the amounts that the Fund can deploy.

In response to these changes, the Fund has over time adapted its financial toolkit. This was most recently illustrated during the financial crisis that started in 2007. In response to the deteriorating global economic situation, the IMF adapted quickly. The scale of the problems in some countries affected by the crisis led the Fund to grant exceptional amounts of financial assistance at short notice. The magnitude of the financing requirements moreover prompted the G20, at the London Summit, and the IMFC, to call for an increase in the Fund's resources, while other sources of financial support were provided to affected countries in addition to the Fund's own assistance.

Moreover, in March 2009, the Fund overhauled its lending framework. Conditionality was modernised, normal access limits were doubled, several rarely-used facilities cancelled, and the structure of surcharges and maturities schedules simplified. The Fund's regular Stand-By lending arrangement became more flexible and a new precautionary lending instrument, the Flexible Credit Line (FCL), was introduced. This new credit instrument represented a significant innovation in the Fund's non-concessional financial assistance.

The Fund's current lending framework

Since the March 2009 reform, the Fund has at its disposal four non-concessional credit instruments.

The *Stand-By Arrangement (SBA)* remains the Fund's core lending instrument. Under this arrangement, financing is provided in support of a short- to medium-term actual or potential balance of payments need. Payments are disbursed in tranches, conditional upon compliance with a number of performance criteria spelled out in a programme and assessed during regular reviews. The latest reform of the IMF's lending framework made the SBA more flexible. Unlike before, the disbursement schedule can be more frontloaded, high amounts can be made available even on a precautionary basis and the frequency of reviews and purchases can be reduced when warranted by the strength of the country's policies and the nature of its balance of payments problems.

The *Extended Fund Facility (EFF)* is designed to help countries address balance of payments difficulties related partly to structural problems that may take longer to correct than macroeconomic imbalances. A programme supported by an extended arrangement usually includes measures to improve the way markets and institutions function.

The IMF also provides *Emergency Assistance* to countries coping with balance of payments problems caused by natural disasters or military conflicts.

Finally, since March 2009, access to the IMF's resources can also be provided under the *Flexible Credit Line (FCL)*. The FCL was created for countries with very strong fundamentals, policies and track records of policy implementation. Once approved according to pre-set qualification criteria[2], countries can tap all resources available under the credit line at any time, as disbursements are not phased nor conditioned on compliance with a traditional Fund-supported programme. In contrast with high access precautionary SBAs, the FCL is not subject to the exceptional access framework[3]. Nevertheless, access is only granted for a period of 12 months, with a review after 6

1 *The authors would like to thank W. Kiekens for his valuable comments. The opinions expressed in this article are strictly the authors' and do not necessarily represent the views or positions of the National Bank of Belgium.*

2 *These criteria include: a sustainable external (debt) position, capital account dominated by private flows, access to international capital markets, relatively comfortable reserve position, sound public finances and debt position and stable inflation.*

3 *Besides a number of procedural requirements, the exceptional access framework defines four substantive criteria: (i) (potential) balance of payments pressure on the current or capital account resulting in a need for IMF financing that cannot be met within the normal access limits; (ii) a high probability that public debt will remain sustainable established on the basis of a rigorous and systematic forward-looking analysis; (iii) prospects for the member to (re)gain access to private capital markets while Fund resources are still outstanding and (iv) a strong adjustment programme adopted by the member that provides a reasonable strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.*

months, to ensure that the country continues to be eligible. The flexibility built into the design of the FCL relates to its uncapped access[4], its long repayment terms, its unrestricted renewals, and its dual use for contingent and actual balance of payments needs. The establishment of the FCL therefore represents a significant shift in delivering Fund financial assistance, assuring qualified countries of high, automatic and upfront access to Fund resources with no ongoing (ex post) conditions.

Evaluation of the IMF's revamped lending framework

An important objective of the reform of the IMF's lending framework was to avoid the stigma associated with Fund lending, which can inhibit countries approaching the Fund *before* the onset of a crisis. The FCL was indeed created to encourage countries to approach the IMF early on, before a crisis has taken a toll on their economies.

With experience over time, the effects of the FCL on risk mitigation will have to be carefully evaluated. Such evaluation is due in March 2011, two years after the creation of the new instrument, or earlier, if total commitments under the FCL reach 100 billion SDR.

So far, the FCL seems to be successful. Shortly after its creation, Mexico, Poland and Colombia obtained an FCL. In those three instances, markets seem to have been reassured as reflected by a narrowing of these countries' risk spreads when their credit lines were announced. Nonetheless, this occurred at a time that market confidence was improving generally and investors' risk appetite reviving.

Allowing high access contingency financing moreover entails a number of risks that still need to be evaluated in light of the experience with the new lending framework. First, the Fund's resources could become overstretched. Commitments under FCLs and high access precautionary arrangements could crowd out the Fund's resources for crisis resolution. With FCL commitments growing, the Fund's liquidity will have to be managed carefully as a large stock of outstanding commitments could be drawn on simultaneously.

Furthermore, countries may be tempted to apply for excessively large amounts to over-insure against risks. This could aggravate problems of moral hazard. Access under the first three FCL arrangements all have been close or equal to 10 times the country's quota, i.e. the amount that IMF staff expected FCL cumulative access normally not to exceed. The potential costs of moral hazard must be weighted against the benefits of reducing the likelihood of crises. In this respect, the new commitment fee structure already provides incentives against demanding unnecessarily high amounts of credit[5].

Finally, as a separate lending instrument for well performing countries, the FCL might increase the stigma for non-eligible countries that request a (precautionary) SBA. Indeed, such arrangement implicitly reveals a disqualification for the FCL, and a less robust economic outlook and a weaker track record of policies, which might discomfort markets. In other words, the FCL might have created an undesirable segregation between "good" and "less good" performers.

Rethinking the IMF's financing role? The IMF as lender of last resort?

The global economic crisis has also relaunched the discussion on the mandate of the IMF, including its financing role. While the Fund has been

4 Although Fund staff expects that cumulative access under the FCL would not normally exceed 1.000 percent of quota.

5 The marginal commitment fee is equal to 15 basis points for access up to 200 percent of quota, but increases to 30 basis points for access between 200 and 1.000 percent of quota, and 60 basis points for access above 1.000 percent of quota.

Members of the media grab copies of the IMFC comminque in the press room at the Istanbul Congress Center October 4, 2009 in Istanbul, Turkey. IMF Photo.

able to meet the crisis with a range of innovative responses, some opine that the Fund's present formal mandate falls short of what is needed for an effective guardian of global macro-financial stability. They argue that the Fund should become a real "lender of last resort", offering credible alternatives to regional liquidity arrangements and the massive build-up of reserves by individual countries.

To advance these discussions, the IMFC has asked the Executive Board to address the important issue of the Fund's mandate, dealing with the scope of Fund surveillance and the Fund's financing role. The latter should be reviewed as part of an in-depth review of the international monetary and financial system, of the role of international reserves and of reserve currencies.

It should be kept in mind that such new role for the Fund would have an important bearing on the size of the Fund's resources. Even taking into account the recent decision to triple the Fund's resources, it is doubtful that this would be enough for the Fund to fulfil such a role. This issue will be discussed in the context of the quota and NAB reform, in particular with regard to the size of the Fund's permanent liquidity needs and the use of the NAB as an emergency reserve.

Furthermore, a new role for the Fund as a kind of lender of last resort would undoubtedly entail a further adaption of its lending toolkit. The IMF could reform its financing framework in different ways. While the Fund could build on its existing instruments – the FCL and the precautionary SBA – it might also decide to devise additional insurance-like facilities. Either way, both options would most likely entail an extension of countries' access to high precautionary financing and the use of ex-ante conditionality.

While these issues still need further reflection, at least a few problems seem to come up at first sight. First of all, and as mentioned above, a prior evaluation of the effectiveness of the Fund's existing precautionary instruments is needed before deciding to extend their scope. In addition, one might wonder whether Fund members should be able to draw even higher amounts of Fund resources in the context of a contingent arrangement – even if this possibility would be limited in time -, subject to ex ante conditionality only. It is indeed legitimate for the Fund, before granting access to a larger amount of resources, to review the adequacy of the country's policies in light of the circumstances that have triggered an actual need to draw an exceptionally large amount on a credit line. This is needed, not only to provide the Fund with adequate safeguards, but also, and more importantly, to ensure that a Fund arrangement gives markets the confidence that the country's policies are adequate to overcome the consequences of a significant shock. In other words, an effective crisis prevention instrument should combine both ex ante and ex post conditionality provisions.

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IMF quota reform

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The International Monetary Fund is an international financial institution that at present has 186 member countries. The financial and organizational relations between a member country and the IMF are based primarily on the member's quota.

A member's quota determines the size of its contribution to the IMF's general reserves and usable reserves, and it also determines the member's voting power in IMF decisions. The maximum amount of financing that a member can obtain from the IMF is based on its quota. The IMF may allocate special drawing rights (SDRs) – its artificial unit of account – to IMF members in proportion to their quotas.

It follows that the size of a member's quota also indicates its standing in the IMF and, in the broader context, reflects the country weight in the world economy. Given that individual economies do not develop at same pace, there is pressure for reform of IMF quotas, especially from dynamic emerging countries that seek to have a greater voice in IMF decisions and in tackling global economic problems.

Following the partition of the Czech and Slovak Federal Republic in 1993, the new Slovak Republic acquired a quota of SDR 257.4 million. In 1999, Slovakia's quota was increased to the current level of SDR 357.5 million, representing 0.16% of total IMF quotas.

An opportunity to adjust member quotas is provided by the general quota review that the IMF conducts at regular intervals of not more than five years. The most recent was the Thirteenth General Review of Quotas, at which the Board of Governors made no proposal to increase quotas. Quotas may be adjusted outside general review on an ad hoc basis, but this does not happen very often. Such an adjustment is part of the reform now being undertaken at the IMF.

Quota reform is being carried out on the basis of the ‚Singapore Resolution', adopted in September 2006 at the IMF's annual meeting in Singapore. The main aim of the reform is to better align the IMF's quota shares with members' relative positions in the world economy and to enhance the participation and voice of low-income countries, i.e. the poorest countries for whom the IMF plays a major role as a source of financing and advice.

The reform under the Singapore Resolution is

New HQ2 Building along 19th Street NW and Pennsylvania Avenue in Washington DC. Photo: IMF.

being carried out in two steps. The first step involved an ad hoc increase in quotas for four countries: China, South Korea, Mexico, and Turkey.

In the second step, which has yet to be completed, the quotas of 54 member countries (including Slovakia) will be increased.

Discussions on the second step, particularly the quota formula, went on for several years. This was due to the need to achieve a compromise acceptable to a large majority of the 186 member countries, who often had opposing views. The result of the many discussions at various levels is a new compromise formula for the calculation of quotas, as follows:

$$Q = (0.5A + 0.3B + 0.15C + 0.05D)^k$$

where

Q = calculated quota share
A = gross domestic product
B = openness
C = variability
D = reserves
k = compression factor

Gross domestic product (weight of 50%) – measured as a blend of GDP based on market exchange rates (60%) and on PPP exchange rates (40%).

Openness (weight of 30%) – measured as the average of the sum of current receipts and current expenditures (goods, services and transfers) for a five-year period.

Variability (weight of 15%) – the variability of current receipts and net capital flows, measured as a standard deviation from the three-year trend over a thirteen-year period.

Reserves (weight of 5%) – measured as a 12-month average of official reserves (foreign exchange, SDR holdings, reserve position in the Fund, and monetary gold).

The calculation includes a compression factor of 0.95; it is applied to the uncompressed calculated quota shares which are then rescaled to sum to 100. The compression factor accentuates the quota sizes of smaller of countries.

Since these changes concern also the IMF's Articles of Agreement and affect the position of all IMF member countries, their approval process has been relatively complex and protracted and is not yet completed.

On 28 April 2008, the Board of Governors adopted Resolution no. 63-2 on quota and voice reforms. On 1 April 2009, the Slovak Government agreed to increase Slovakia's quota in the IMF.

The Resolution on quota and voice reform will not become effective until the respective amendment to the Articles of Agreement is approved by three fifths of the member countries holding 85% of the total voting power. This has still not been achieved. In most member countries, including Slovakia, the legislature is in the process of approving this amendment.

Each member is required to pay to the Fund the increase in its quota within 30 days after the approval of the amendment to the IMF Articles of Agreement under which the quota will be raised.

Each member is required to pay 25% of its increase in SDRs or, out of its foreign reserves, in a currency designated by the IMF. If a member does not have sufficient reserves for this purpose, it may request the IMF for a bridging loan. The member country is required to pay the remaining 75% in its own currency into the IMF account held with the country's depository or through the issuance of a security registered with the member's depository. Slovakia's quota is due to rise from SDR 357.5 million to SDR 427.5 after the current increase has entered into force and the country has paid the respective amount.

Even though the current ad hoc quota increase has not been completed, member countries are already in discussion about raising quotas again during the 14th General Review of Quotas. At the G-20 summit held in Pittsburgh on 24–25 September 2009, national leaders agreed on shifting at least 5% of the IMF quotas from over-represented countries to under-represented countries and to use the applicable formula as the basis for the calculation. Intensive talks are now underway regarding the amount of the total increase to be set at the 14th General Review of Quotas and how it is to be implemented. There is also discussion about what results the review will have on the IMF's financial resources, on changes in the IMF's management, and on the standing of individual countries, groups of countries by economic weight, and different world regions within this significant global financial institution. According to the conclusions of this year's IMF annual meeting in Istanbul, the 14th General Review of Quotas should be completed in January 2011.

General and special allocations of Special Drawing Rights within the IMF

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The Special Drawing Right (SDR) is an international reserve asset and unit of account used within the IMF since 1969. It can only be held and used by member countries, the IMF, and certain designated institutions called 'prescribed holders' (World Bank, Bank for International Settlement, etc.). For IMF members, the SDR serves as a means of exchange to obtain freely usable currencies from other IMF members.

The reserve asset character of the SDR arises from the obligation of individual IMF members to hold and accept SDRs on the basis of the duties arising from the system of SDR operations. As from 2001, the SDR is based on a basket of four currencies: USD 44%, EUR 34%, JPY 11% and GBP 11%. The basket composition is reviewed every five years.

Under its Articles of Agreement of the IMF, the Fund has the authority to allocate SDRs to all members when there is a global need to supplement existing reserve assets. During its early history, the IMF implemented 2 general SDR allocations: SDR 9.3 billion in the 1970s and SDR 12.1 billion in the 1980s.

Special allocations

Since the number and structure of member countries had changed substantially since the last general SDR allocation (1 January 1981), the IMF was, at the end of the '90s, faced with the need to compensate the countries that joined the Fund after 1981. More than one-fifth of the IMF members had never received an SDR allocation, and some of them participated in one allocation only. The solution was found by M. Camdessus, the Fund's former Managing Director, who proposed a special one-time allocation of SDRs. The intent of this special allocation was to enable all members of the IMF to participate in SDR allocations and to receive SDRs in proportion to their IMF quotas.

At the annual meeting of the IMF and the World Bank held in Hong Kong in September 1997, the IMF's Board of Governors approved a Fourth Amendment to the Articles of Agreement of the IMF, which allowed the implementation of a special on-time SDR allocation. The special one-time allocation was intended in particular for developing countries, Easter European countries, and those of the former Soviet Union.

The main reasons behind the special allocation were:

- the low level of foreign exchange reserves in these countries;
- the restrictive policy pursued to improve the balance of payments and to replenish the foreign exchange reserves.

The first and second general SDR allocations

The first general SDR allocation took place in 1970–72 in three instalments, in a total amount of SDR 9.3 billion. The main reason behind this allocation was a relative fall in global reserves (gold, US dollar) in connection with the expansion of global trade in the '60s. Other reasons were the intense use of trade restrictions, growing demands on international financial institutions in the area of balance of payments deficit financing, and increased capital controls. The first general allocation was designed to restore the balance of payments equilibrium with a view to improving the self-regulation process in the future (a requirement laid down in the Articles of Agreement of the IMF).

The second general SDR allocation took place in 1978–81, in a total amount of SDR 12.1 billion. It was a response to major changes in the international monetary system such as the expansion of the international capital market and increased exchange rate flexibility. The growing volume of international transactions in the '70s gave rise to an increase in demand for reserves. A further increase in demand was expected as a result of increased exchange rate flexibility. Although the IMF assumed an increase of SDR 100–200 billion in global reserves in that period, SDRs were allocated in the amount of SDR 12.1 billion with regard to the inflationary expectations.

1 Belgium, Denmark, Finland, France, Netherlands, Japan, Germany, Norway, Austria, Sweden, Switzerland, United Kingdom, Venezuela.

The intent of this allocation was to shorten the transition period in these countries, to boost their economies, and to pull them out of recession. The special allocation was for a total amount of SDR 21.4 billion.

The Slovak Republic ratified the Fourth Amendment to the IMF Agreement on 5 December 2001. The Fourth Amendment became effective for all members on 5 August 2009, when the required quorum was achieved (the United States, which had opposed the special allocation, joined the other members in supporting the Amendment on 5 August 2009). The special allocation was implemented on 9 September 2009. The Slovak Republic (SR) received a special allocation of SDR 75.5 million.

The third general allocation

With regard to the current economic and financial crisis, the IMF proposed another general SDR allocation in April 2009 for an amount of USD 250 billion. The third general allocation was approved by the Board of Governors and implemented by the IMF on 28 August 2009. This general allocation was implemented as a one-time allocation in an amount corresponding to ca. 74% of the members' current IMF quotas. Thus, the Slovak Republic received SDR 265 million within the scope of this allocation.

The allocated SDRs became part of the reserve assets. SDR allocations incur an interest obligation towards the IMF at the SDR interest rate. SDR holdings earn interest at the SDR interest rate. The interest payables and receivables are cleared.

The Slovak Republic received general and special SDR allocations in a total amount of SDR 340.5 million.

lion would be needed for transforming and developing economies in the next 5 years).

The general SDR allocation brought several immediate and long-term advantages for the global economy: *an increase in reserves* (ca. USD 100 billion was allocated to transforming and developing economies, of which countries with the lowest quotas received ca. USD 15 billion, i.e. a 19% increase in their reserves), *reduced pressure on demand for funds due to the accumulated reserves, easier access to funds, and reduced reserve holding expenses.*

The quantitative effects on global inflation and money supply should, according to the IMF, be minimal, because the allocation was small in terms of volume compared with the world's GDP (ca. 0.33% of global GDP), trade (less than 1%) and reserves (ca. 3%). Central banks are prepared to sterilise a possible increase in liquidity.

The IMF is also authorised to cancel an SDR allocation, using a similar procedure as during its approval. The global need for SDRs will be evaluated by the IMF by June 2011.

Mechanisms to guarantee the liquidity of SDRs

The general and special allocations increased the volume of allocated SDRs in the global economy almost ten times. The SDR market liquidity is currently ensured by the IMF through a system of *standing arrangements*, which are concluded on a voluntary basis, or through a *designation mechanism*, which can be used by all IMF members under the Articles of Agreement.

The two allocations were preceded by 14 standing arrangements for the purchase and sale

	Total	of which: SR
	SDR (billions)	SDR (millions)
General allocation	250.0	265.0
Special allocation	21.4	75.5
Total	271.4	340.5

Reasons and expected effects of general allocation

Under the Articles of Agreement, general allocations of SDRs have to be based on a long-term global need to supplement existing reserves and implemented in such manner as will avoid economic stagnation, deflation or inflation in the world. In its decisions regarding SDR allocations, the IMF has always taken into account the level of demand for reserves and assessed to what extent this demand can be satisfied through an SDR allocation.

When the third general allocation was approved, the IMF assumed that an allocation of USD 250 billion would be sufficient to satisfy a long-term global need to supplement existing reserve assets (reserve assets in an amount of USD 400–900 bil-

of SDRs made between the IMF and 13 countries[1] and one prescribed SDR holder (ECB), for the conduct of *transactions by agreement*. The system of standing arrangements had a capacity of SDR 1.4 billion for sale and SDR 2.8 billion for purchase, but this capacity became insufficient after the implementation of allocations. Hence, the IMF suggested that the system of standing arrangements be strengthened, by modifying the limits of existing standing arrangements and signing standing arrangements with new countries. Bilateral transactions in SDRs can also be conducted between countries outside the system of standing arrangements. The IMF acts as a mediator in most of these transactions.

The designation mechanism is activated when transactions in SDRs exceed the absorption ca-

International Monetary Fund 2008 Official Board Photograph Photo: IMF.

pacity of the system of standing arrangements. Within the scope of this mechanism, the IMF quarterly specifies the countries (countries participating in the Financial Transactions Plan) and the amounts of SDRs they must, if need be, purchase from countries with balance of payments problems in exchange for reserve assets. Country are obliged to participate in this mechanism until its SDR holdings reach 300% of the total SDR allocation. For the last time, the designation mechanism was activated in 1987. At present, the IMF sees no reason to modify this mechanism.

Among countries that participated in the previous allocations, there are marked differences in the use of SDR holdings. Countries tend to use their SDR holdings to solve balance of payments problems, for transactions with the IMF (e.g. for payment for 25% of the quotas), and for reserve management. A member country is also entitled to provide SDRs to another country (e.g. in the form of a grant). The amount and purpose of SDRs utilisation by specific countries cannot be predicted.

The tasks of NBS during allocations and the possible utilisation of SDRs

The National Bank of Slovakia (NBS) manages SDRs on behalf of the Slovak Republic in accordance with the Articles of Agreement on the IMF. Within the scope of the general and special allocations under review, SDR 340.5 million was credited to the accounts maintained by the NBS. SDRs held on the SDR allocation account incur an interest obligation towards the IMF at the SDR interest rate. SDRs held on the SDR holdings account earn interest at the SDR interest rate. The interest payables and receivables are cleared. Prior to the allocations, the NBS held SDR 1.1 million on its SDR holdings account.

If the designation mechanism were activated, Slovakia would be obliged to enter into SDR transactions until its SDR holdings account balance reached 300% of the allocated SDRs. In the case of a total allocation of SDR 340.5 million, Slovakia would be obliged to provide SDR 1,021.5 million in reserve assets.

Besides conducting transactions on the basis of standing arrangements and the designation mechanism, Slovakia can also use its SDRs to pay for part of the increase in its IMF quotas (a 25% increase representing SDR 17.5 million) approved by the Slovak Government on 1 April 2009. At present, discussions are being held about other forms of SDR utilisation such as the payment of obligations arising from the prepared bilateral loan agreements with the IMF. If a member country has balance of payment problems, SDRs can also be used to obtain other reserve assets.

International initiative to bolster the lending capacity of the International Monetary Fund[1]

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This article outlines the standard mechanism to finance operations of the International Monetary Fund (IMF) and the effect of the crisis on the IMF's liquidity. It also looks at the international initiative to supplement the IMF's resources in the short-term, through bilateral borrowing and note purchase agreements, and in the medium-term, through the extended New Arrangements to Borrow (NAB). The authors conclude the article by considering the next developments in IMF resources.

The loans that the IMF extends to countries with balance of payments difficulties are financed mainly from quota subscriptions.[2] These resources may, when necessary, be supplemented on a temporary basis. As a result of the persisting financial crisis, additional resources have been committed to the IMFin an amount exceeding the total IMF quotas.

Shortage of IMF resources during the crisis

The IMF is a quota-based organisation. Each member country is assigned a quota that reflects its relative size in the world economy.

The member quota represents, among other things, the maximum amount of financial commitment that the respective member country is required to provide to the IMF's General Resources.[3] The IMF uses only the resources of its economically strong members, which are included in the so-called *Financial Transactions Plan* (FTP). This implies that the amount of IMF resources available for the financing of IMF loans changes over time.

The last decade saw no general quota increase, and thus the IMF's relative size and strength gradually declined in comparison with relevant indicators of the world economy.[4] It was a period marked by low demand for IMF financing (Chart 1) and adequate liquidity at the IMF (Chart 2), and this was one reason for the lack of political support for an increase in IMF quotas. Discussions about the adequacy of IMF resources came to the fore in 2007, following the eruption of the financial and economic crisis.

1 This article does not address IMF resources for concessional lending to low-income countries.
2 Guidelines for Borrowing by the Fund.
3 A member's quota also affects its voting power and determines the amount of financing that it can obtain from the IMF (for example, under Stand-By Arrangements, a member can borrow up to 200% of its quota annually and 600% cumulatively).
4 The most recent general quota increase (by 45% overall) was approved in 1998 during the Eleventh General Quota Review. A quota reform was approved in 2006 and 2008, and this should raise quotas for selected IMF members (by 11.5% in total).

Box 1

Financial Transactions Plan

Under Articles V and XIX of the IMF Agreement, one of the obligations arising from IMF membership is participation in the Financial Transactions Plan.

The FTP is a mechanism through which economically strong IMF member countries provide resources to IMF members in balance of payments need. The decision on which IMF members are to be placed in a creditor position is taken by the IMF's Executive Board, which selects the FTP participants usually on a quarterly basis. In making this selection, the Board assesses each country's external position, the condition of its balance of payments, the size of its foreign exchange reserves, its short-term external debt, and its overall external debt obligations. To include a member country in the plan, it is not necessary to obtain its consent. The IMF seeks to achieve broad participation, so as to secure the IMF's liquidity, but also to emphasize the cooperative nature of the organization.

The IMF Executive Board sets the expected amount of transfers, i.e. the resources that are to be provided over a given period, and the amount of receipts, i.e. the resources that are to be repaid over that period. Countries included in the FTP are required to provide the resources in a freely convertible currency (USD, YEN, EUR, GBP). The percentage ratio of total transfers in freely convertible currencies to the total quotas of countries included in the FTP determines the ratio in which the transfers will be allocated among the individual FTP participants. The total amount of receipts is distributed among creditor countries so that their reserve position (foreign exchange claim on the IMF arising from the provision of financial resources under the FTP mechanism) is mutually equal in relation to the member quota. The specific average level of countries' reserve positions, expressed as a relative percentage of the member quota, is known at the end of the respective FTP period and serves as the basis for assigning receipts in the next quarterly plan.

Where a country provides resources through the FTP mechanism, the composition of that country's member quota will change in favour of the free convertible currency and at the same time the country's reserve position will increase. The amount of the country's total foreign exchange reserves remains the same; only their structure changes. The reserve position is remunerated by the adjusted rate of remuneration, which the IMF sets on a weekly basis. Remuneration on the reserve position is credited by the IMF, on a quarterly basis, to the country's current account maintained in SDRs.

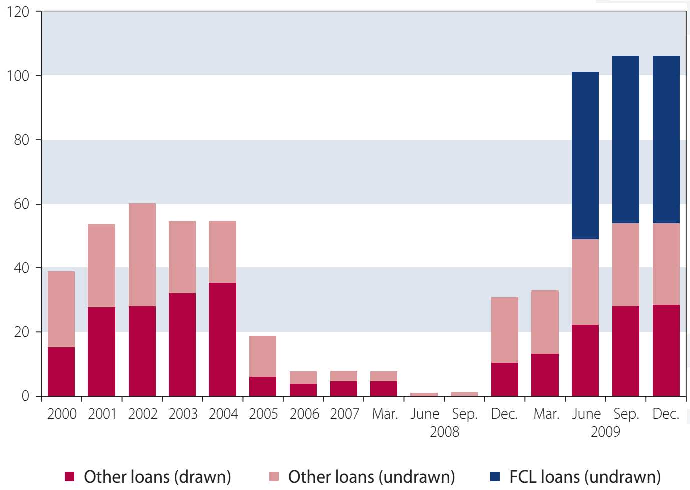
The Slovak Republic has been included in the FTP since 2005. The Slovak Government, under Resolution no. 823 of 19 October 2005, has authorized Národná banka Slovenska to represent Slovakia in the FTP and to conduct FTP operations using NBS assets. From when it joined the FTP mechanism to 31 October 2009, Slovakia contributed to 7 transfers and its total contribution represented SDR 67.8 million.

In the period from October 2008 to the end of October 2009, the IMF Executive Board approved financing amounting to more than SDR 100 billion (Chart 1), including 18 loans under *Stand-By Arrangements* and three loans under the *Flexible Credit Line (FCL)*, a new arrangement for preventive purposes. As at 31 October 2008, by comparison, only six loans were activated and they amounted to around SDR 1.2 billion. The three loans under the FCL arrangement account for approximately half of the IMF's committed resources.

The increase in approved loans has had a depleting effect on the IMF's financial resources (Chart 2). The IMF's uncommitted usable resources[5] are an important measure in this regard as they represent the undrawn quota resources from members included in the FTP, as well as undrawn resources available from activated bilateral and multilateral arrangements (which are dealt with in the next part of this article), less the full amount of undrawn balances under existing IMF loans. Whenever a loan is approved, the IMF undertakes to provide financing in the agreed amount, i.e. the IMF is required to commit these resources even where the lending arrangement has a preventive purpose (e.g. in the case of FCLs or certain Stand-By Arrangements). The effect of the crisis on the IMF's quota-based resources is illustrated in Chart 2, which shows the undrawn balances of the IMF's supplementary bilateral resources in a different colour.

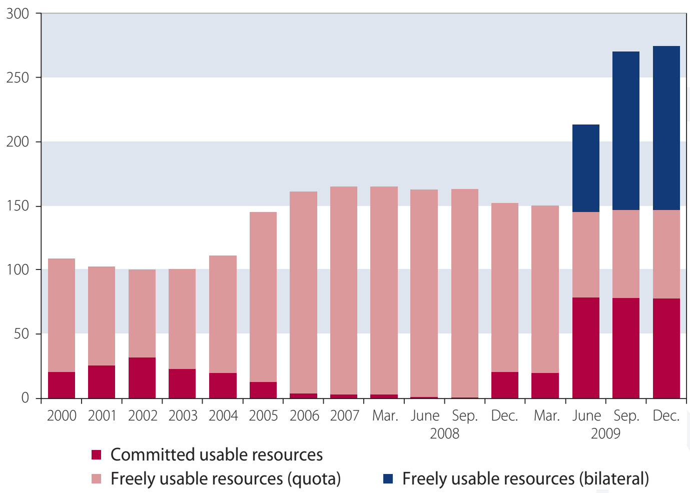
Faced with a sharp decline in its resources, the IMF had several options. Since it is an international quota-based organization, one of the first options was a general increase in quotas. Increasing quotas, however, is a protracted process; the international community had to take a swift decision in the face of the deepening crisis and adverse outlooks. The simpler and, in particular, faster course appeared to be the use of supplementary resources through bilateral borrowing agreements, a note placement program, and/or the expansion of the New Arrangements to Borrow (NAB).[6]

Chart 1 IMF Loans (2000 – 2009) (SDR bn)



Source: IMF, authors' chart.

Chart 2 Overview of the IMF's usable resources (2000 – 2009) (SDR bn)



Source: IMF, authors' chart.

5 Another indicator used by the IMF is the one-year forward commitment capacity (FCC), which represents uncommitted usable resources plus repurchases one-year forward minus the prudential balance.

6 The IMF indirectly helped to increase international liquidity by approving a general allocation of SDRs. In addition, resources were mobilized in parallel to IMF funds (for example, Hungary acquired a credit line jointly from the IMF, European Union and World Bank).

7 Brazil, India, Russia and China.

8 Back in 1981, the IMF approved framework conditions for the issuance of notes, but until 2009 it did not make any issues.

In April 2009, the G-20, as well as the International Monetary and Financial Committee (IMFC), agreed to triple the IMF's resources in two steps. First, they agreed that the IMF's resources would be immediately raised by USD 250 billion through bilateral financing from IMF members. The first bilateral agreement of this kind had been signed in February 2009 between the IMF and Japan (for SDR 100 billion). In this way, the adequacy of the IMF's resources was maintained in the short-term horizon (Chart 2).

The second step is to increase IMF resources over the medium-term by expanding the NAB with up to USD 500 billion (from the current level of SDR 17 billion). This new NAB should include also resources from bilateral financing. In November 2009, current and potential NAB participants reached a preliminary agreement on an amendment to the NAB agreement and announced an increase in credit arrangements up to USD 600 billion.

Bilateral financing

Under the Articles of Agreement (Article VII, Section (1)), and in accordance with the Guidelines for Borrowing by the Fund, the IMF may, on a temporary basis, supplement its resources by borrowing. The IMF has made active use of this option also in the past, particularly in the 1970s and 1980s. Although the IMF may borrow also from the private sector, it has to date used borrowing only from the official sector. The amount of USD 250 billion agreed in April 2009 represents more than 70% of the current total quota (in the 1970s the figure did not exceed 30%).

Bilateral resources are provided by IMF members' governments or their central banks, through loans and, and at the request of BRIC[7] countries, also through the purchase of IMF notes.[8] Since April 2009, commitments to a bilateral financial injection of more than SDR 200 billion have been made by around 30 countries, 21 of which are EU Member States. As at 1 December 2009, around SDR 144 billion was activated by nine IMF member countries (Table 1). The IMF began to draw these resources in July 2009 and placed its first notes in September 2009. A summary of the features of the bilateral agreements is given in Box 2.

The European Council, at its meeting on 19 March 2009, announced immediate assistance for the IMF in the form of a short-term loan of EUR 75 billion. This was subsequently confirmed by the European Commission's President, José Manuel Barroso, at the G-20 summit held in London in April 2009. Representatives of EU countries, including the Commissioner for Economic and Monetary Affairs, Joaquin Almunia, also confirmed this EU loan at the IMFC during the IMF/WB spring meetings, held in Washington in April 2009. EU Member States agreed that the amount of EUR 75 billion would be apportioned according to new quota share (in line with the quota reform of 2008) between 21 EU Member States that participate in the FTP (EU-27 apart from Bulgaria, Romania, Hungary, Lithuania, Latvia and Estonia).

Based on this principle, the Slovak Republic pledged to borrow the IMF, under a bilateral agreement, the equivalent of EUR 440 million. The draft bilateral borrowing agreement was

Table 1 Bilateral resources and their drawing (as at 31 October 2009)

Country	Signing date	Amount (mil.)	Conversion *** (EUR m)	Drawing	
				(EUR m)	%
Active bilateral resources					
Japan[1,4]	02/2009	100,000 USD	66,339	1,760	2.65
Canada[1,4,5]	07/2009	10,000 USD	6,634	176	2.65
Norway[1,3,6]	07/2009	3,000 SDR	3,202	84	2.61
Germany[1,3,6]	09/2009	15,000 EUR	15,000	337	2.25
United Kingdom[1,4]	09/2009	9,920 SDR	10,587	277	2.62
China[2,4]	09/2009	32,000 SDR	34,152	683	2.00
Netherlands[1,3,6]	10/2009	5,310 EUR	5,310	x	x
Denmark[1,3,6]	11/2009	1,950 EUR	1,950	x	x
Portugal[1,3,6]	11/2009	1,060 EUR	1,060	x	x
TOTAL			144,234	3,317	2.30
Additional bilateral resources					
* France[1,3]	09/2009	11,060 EUR	11,060	x	x
* Spain[1,3]	10/2009	4,140 EUR	4,140	x	x
** Slovak Republic[1,4,5,6]	x	440 EUR	440	x	x

Source: Bilateral agreements of the respective countries with the IMF and data on drawings: www.imf.org, www.vlada.sk.
[1]borrowing agreement, [2]note placement agreement, [3]revolving, [4]cumulative ceiling, [5]evidence of the IMF's indebtedness 6 central bank as counterparty/agent
**Signed agreement, undergoing approval process in the national parliament. **Agreement undergoing approval process at the IMF level.*
****Conversion to EUR as at 1 December 2009 (using the ECB's exchange rate).*

Box 2

Features of bilateral agreements:

- *Type of resources provided:* Loans or IMF note purchases. Notes are issued in series A and series B; the only difference concerns the matter of early repayment where a member country has balance of payments problems (series A – immediate repayment; series B – within 12 months).
- *Counterparty:* A member country or its central bank.
- *Validity period of the agreement:* Two years, or one year with an option to extend it by another year on the basis of an IMF consultation with the member country (in the case of Japan and Norway, even up to four one-year periods). A further extension of the agreement is conditional on the consent of both counterparties.
- *Joining the NAB*: A bilateral agreement may be terminated the agreement if the country or its official institution becomes a participant in the new and enlarged NAB.
- *Use of resources:* In connection with funding of all IMF loans in the General Resources Account (including the FCL), or for the repayment of the IMF outstanding indebtedness from other bilateral resources under the condition of compliance with the reciprocity principle. The IMF may not create reserves in this way.
- *Maturity:* 3-month maturity, that is extendable for additional 3-month periods, Maximum maturity of 5 years.
- *Rate of interest:* The IMF pays an SDR interest rate on bilateral resources.
- *Denomination in SDRs and payment in national currency:* The denomination of borrowings in SDRs ensures that the IMF doesn't incur exchange rate risk, since IMF loans are also denominated in SDRs. Where a member country provides resources in the national currency, the IMF will repay the principal preferentially in the national currency of that member country.
- *Limits on drawings:* In accordance with counterparties' agreement (4% to 25% of the total amount per week; 15% to 55% of the total amount per month).
- *Transferability:* With the consent of the IMF, the other party may transfer a note, or a claim arising under a bilateral loan, to a third party, i.e. another member country or prescribed holder of SDRs.
- *Equal access:* For all bilateral agreements, the IMF undertakes to ensure a broadly balanced ratio of the total amount drawn to the total amount of the agreed resources.
- *Balance of payment problems:* In the event that a country has problems with its balance of payment or reserve position, it may request a termination of further drawings by the IMF, as well as an early repayment of the amount already drawn, up to a limit of SDR 15 billion.
- *Borrowing plan:* provided by the IMF at the beginning of each quarter of the IMF´s financial year (together with the FTP plan).
- *Ceiling for drawings:* revolving or cumulative ceiling.
- *Evidence:* For drawings from Canada, the IMF is obliged to send evidence of its indebtedness. In the case of other bilateral agreements, such evidence is sent only at the request of the member country. The draft agreement with the Slovak Republic also contains an obligation to furnish evidence of indebtedness.

approved by the Slovak Government in Resolution No. 931 of 16 December 2009. On behalf of the IMF, the bilateral agreement with the Slovak Republic is due to be approved by the IMF's Executive Board during the course of January 2010. Selected aspects of the bilateral borrowing agreement between Slovakia and the IMF are included in Table 1, in accordance with the draft approved by the Slovak Government.

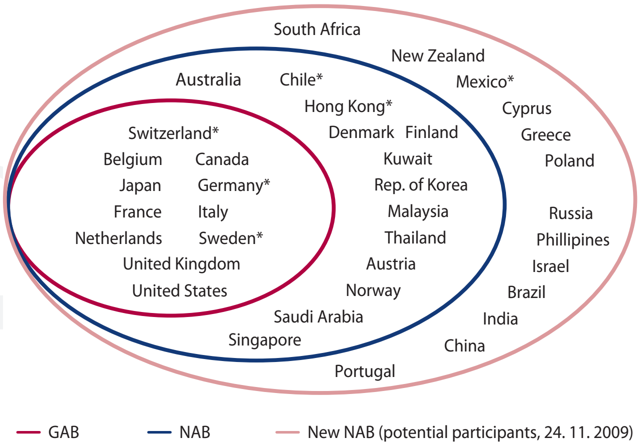
The plan for use of bilateral resources is approved by the Executive Board, together with the plan for drawing quota resources under the FTP. As with the FTP, the IMF undertakes to maintain the same burden sharing ratio when drawing bilateral resources, i.e. the same ratio between the amount drawn and the agreed amount of the bilateral resources (the last column of Table 1). Other features of bilateral agreements are described in Box 2.

MULTILATERAL FINANCING

The IMF may borrow resources on a multilateral basis – i.e. from a group of IMF members – through two standing borrowing arrangements: the *General Arrangements to Borrow* (GAB), established in 1962, and the *New Arrangements to Borrow* (NAB), dating back to 1998. The maximum amount of resources currently available to the IMF under the NAB and GAB is SDR 34 billion (SDR 17 billion under each). Both arrangements are renewed at regular five-yearly intervals. Resources are activated independently for each loan, at the proposal of the IMF's Managing Director and with the consent of countries providing more than 80% of all the resources.[9] The NAB is the facility of principal recourse. Resources under the GAB are activated only in cases where the member is a participant of both arrangements or where the call on NAB resources has been refused.

9 *NAB resources have been activated only once; the GAB agreement has been activated on ten occasions in total.*

Chart 3 GAB/NAB participants



Source: IMF, authors' chart.
**central bank*

In April 2009, in connection with the discussion on the adequacy of IMF resources, the G-20 countries agreed on the need to increase NAB up to USD 500 billion. In November 2009, NAB participants announced their intention to increase the resources available under the NAB to up to USD 600 billion. The expectation is that countries providing bilateral resources will incorporate their bilateral financing into the NAB. Many countries have already announced their contribution to the NAB, and so too has European Union, which in September 2009, following on from the ECOFIN and EFC meetings, announced that EU countries would contribute up to EUR 125 billion to the NAB.

The approval of an increase the NAB resources is expected to be accompanied by the approval of new NAB rules and an expansion of the NAB to include new participants (Chart 3). The NAB agreement should also become more flexible.

The IMF Executive Board is due to vote on the new NAB agreement within the coming months. The agreement will enter into force after the approval process is completed in participating IMF member countries.

The future of IMF resources – seeking a new balance?

The international community expects the months ahead to bring several reflections on the future functioning of the IMF. In particular, it will be necessary to carry out an in-depth analysis of the IMF's future mandate and tasks. The current crisis has, for example, rekindled interest in the IMF's role as the international lender of last resort or its role as insurer. The decision on the appropriate IMF lending capacity will be to a large extent determined by the roles the IMF will be assigned to carry out in the future.

The IMF is defined as a quota-based organization, where the quotas also serve as the principal source of IMF financing. This point was underlined by NAB participants in November 2009, when they announced an increase in NAB resources. Once the new NAB is approved, the amount of resources available to the IMF under the NAB will exceed the amount of quota resources. The IMF will in future, therefore, have to find a certain balance between the quota resources and supplementary resources provided through the NAB. We assume that the quotas of IMF members will increase.

It should not be forgotten that the whole discussion is closely linked to the IMF governance reform, since quotas determine also the voting power in the IMF. Regarding the announced contributions to the NAB, it may be inferred that the distribution of powers in the NAB will not reflect the current distribution of powers in the IMF. BRIC countries, which have long been expressing discontent with the amount of their quota in the IMF, are expected to have a stronger position under the NAB. It may therefore be assumed that the planned 14th General Quota Review will give rise to an asymmetric increase in the quotas of individual countries, thereby establishing a new balance of powers in the IMF. This is also the context of the IMFC communiqué of November 2009, which calls for a shift in quota share of at least 5%.

The time schedule is relatively tight. Approval of the new and expanded NAB is expected to be secured during the course of 2010. The General Quota Review is due to be completed in January 2011 (the original deadline was January 2013). NAB participants then intend to carry out a review of the NAB agreement, in particular, a review of the amount of resources provided through the NAB in light of the results of the IMF's 14th General Quota Review.

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The IMF and the global financial crisis

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The need for close cooperation in tackling crises that stretch beyond the borders of a single country played a key role in the birth of the International Monetary Fund. The problems of the international financial and payment system were deepened by the world economic crisis of 1929–1934, and they quickly spilled over into the financial sector. The long-standing system of fixed exchange rates between countries was destabilized, which led to a shortage of money for payment purposes and consequently to a decline in financial links between countries and in international trade. There was no international institution at which a solution could be sought. The International Monetary Fund was the result of efforts to establish a new and more stable international economic system, one in which the new institution would prevent a return to autarky and protectionism.*

Realizing the vision of the Fund's founders was not a simple matter. Each crisis in the world economy forced changes on the international financial architecture, and also became a significant spur to reforming the IMF.

1 Debt crisis – 1980s

Up until 1982, the IMF had not played a major role in tackling international monetary crises, its involvement being confined to the provision of financial assistance.[1]

In the 1980s, however, the world economy suffered a debt crisis that began to threaten the international financial system. In the 1970s and 1980s, oil-exporting countries deposited their exceptional receipts in Western banks, which in turn provided low-interest financing to other countries, particularly in Latin America. At the end of the 1970s, however, the United States raised interest rates, thus spelling the end of cheap loans for Latin American countries. The majority of these countries that had been pursuing inappropriately expansive macroeconomic policies were not prepared for this shock.

Between 1980 and 1982, economic growth declined sharply, as did the pace of export growth in oil-importing countries. This was reflected in the largest economies of Latin America (Argentina, Mexico and Brazil). Consequently, the debt burden rose and lenders reacted negatively. In September 1982, Mexico announced that it was not able to service its debt and soon other countries followed suit.

Initially, the prevailing view was that the crisis was above all about liquidity, not insolvency. Thus the option of debt write-down was relegated to the background. Commercial banks in advanced countries did not have to adjust claims on debtor countries in a way that would have consumed their entire capital and caused bank insolvencies. The new loans to debtor countries helped them mainly in the repayment of loan interest, and they were increasingly involving the official sector.

The IMF quickly became engaged in solving this crisis. Before the end of the year, it approved additional assistance for Mexico in the amount of SDR 3.6 billion, which enabled the country to continue servicing its debt. The IMF took a similar approach in the case of Brazil, providing SDR 5 billion in assistance, and it extended financial assistance to many other countries, too. As an active partner, the fund took part in meetings on debt restructuring between debtors and creditor commercial banks. The mechanism of this approach – which has in various forms been practised in subsequent years, too – was as follows:

the debtor country accepted the conditions of the stabilization programme agreed with the IMF, and the creditor banks agreed with the debtors to ease the debt repayment conditions.

At the beginning of the 1980s, this strategy contributed to a situation in which high government debts resulted in insolvencies not being declared. Further modifications notwithstanding, normal relations between debtors and creditors were not restored. In fact, debtor countries were repaying creditors more than they were receiving, which in turn caused stagnation in investment and economic growth. The government debt of Latin American countries rose by 20% in the 1980s, but their GDP per capital fell by 10%. The crisis was solved only when the world realized that no permanent solutions would be possible without genuine debt forgiveness. This was reflected in the form of the Brady Plan, introduced by the US administration in 1986. Over the next six years, this project reduced the debts of 21 developing countries to commercial banks by more

* *Autarky – a system of economic policy whose objective is to create a relatively closed and economically independent unit; independence.*

1 *In 1956, it provided sizable sums to the four countries involved in the Suez crisis – the first wave of IMF lending. In 1968, it extended credits to countries affected by the collapse of the Gold Pool. (The Gold Pool – an international agreement entered into by eight countries at the beginning of the 1960s in order to keep the gold price stable and to support the position of the dollar.) Likewise at the beginning of the 1970s, it provided financial support to G-10 countries afflicted by currency problems and oil shocks. The character of that lending, however, differed only marginally from the multitude of credits extended in quieter times (Boughton, 2001, p. 42.)*

than USD 75 billion, thereby ending the debt crisis as an international threat.

During this period, the International Monetary Fund had the main role in directing the strategy for overcoming the debt crisis and in the transformation of these economies. The crisis became a major impulse in the IMF's activities and role, and, as a result of its involvement in implementing the debt strategy, the IMF became the centre of the international monetary system.

Although its contribution was recognized, the Fund was criticized by those who felt that it had represented more the interests of creditors and industrialized countries than those of indebted economies. Other critics pointed out that the IMF's mandate had been extended beyond the conventional roles set for it in the Bretton Woods agreement. Such criticisms would, in various forms, keep reappearing in following years.

At the beginning of the 1990s, many developing countries were implementing stabilization, privatization and liberalization programmes and were opening up to foreign competition, which was in many cases a condition of debt restructuring under the Brady Plan. It was this stage of the 1980s debt crisis that brought with it the seeds of the 1990s financial crises. Many developing economies that had begun to have access to the international capital market started to be classified as newly emerging market economies. This group of countries became an attractive investment opportunity, offering the possibility to achieve higher yields than in advanced countries.

2 New generation of financial crises – 1990s

The financial crises that afflicted newly emerging market economies in the 1990s were surprising in the rapidity with which they spread and with which they affected apparently prospering and well-managed economies. Compared with previous crises, which stemmed from the current account, these crises appeared in the financial account of the balance of payments. There began to be talk about a new generation of financial crises, and this time the Fund had to adopt many fundamental changes in its activities.

2.1 Mexican crisis

At the turn of 1994 and 1995, a serious financial crisis erupted in Mexico as domestic and foreign capital fled the country, foreign exchange reserves fell, the currency was devalued, and output slumped. It was clear that without official financial assistance, Mexico would not be able to meet its obligations and that its external debt would have to be restructured. The US Treasury Secretary, in cooperation with the IMF and BIS, prepared a financial assistance package worth in total USD 50 billion, of which the IMF contributed USD 20 billion, the largest amount of financial assistance that any member country had ever received.

As for dealing with such crises, the Fund was shown to be insufficiently equipped in terms of either financial resources or the means of releasing them. The conventional approach for tackling crises – where the Fund would advise the crisis-afflicted country to curb demand by pursuing a restrictive monetary and fiscal policy, as well as possibly exchange-rate devaluation – was no longer enough.

In order to get the country through the crisis period, the Fund provided loans that mostly did not exceed 100% of the quota amount.

The IMF had not been able to identify the deficiencies in the economy owing to a lack of data, particularly about the state of reserves and about the amount and structure of the external debt. When the truth came out, foreign investors reacted very negatively. These doubts began to affect other Latin American currencies, too, and, as a result, the respective countries were burdened with higher financial costs in international markets – the so-called Tequilla Effect (Jonáš, 2000).

2.2 Asian crisis

Less than three years later, in mid-1997, a crisis broke out in South-East Asia. This caught all economies unaware, since South-East Asian countries were at that time considered to be model economies.

Although the circumstances were different from one country to another, the crisis was caused by many factors.

A liquidity surplus had arisen because of low inflation, loose monetary policy, and low interest rates in advanced countries, and international financial markets had allocated this surplus to newly emerging market economies. The scope of this capital far exceeded the ability of these economies to make effective use of such resources. Fixed exchange rates played an important role in this process, since they contributed to the underestimation of exchange rate risk by both foreign investors and domestic debtors.

When these countries suffered an external shock in the form of declining external demand for their exports, investors quickly began shifting their capital out of the countries. This led to pressure for currency devaluation, an increase in the debt burden denominated in the domestic currency, insolvencies of banks and enterprises, and a decline in economic activity. Following the Thai baht's devaluation, contagion quickly began to spread across the region as investors began to fear that other countries would have similar problems.

The financial assistance that the Fund provided to Indonesia, South Korea and Thailand, amounting to USD 35 billion in total, far exceeded 100% of the member quotas of these countries. In its recommendations, the IMF urged a tightening of monetary policy so as to halt the fall of national currencies, which could otherwise lead on to an inflationary spiral and continuing depreciation. In regard to fiscal policy, the Fund had initially proposed a tightening stance, largely due to the erroneous assumption that the economic slowdown would be moderate. However, as soon as it was apparent that the countries would be affected by a serious downturn, fiscal policy was loosened. In order to address the problems of the financial and corporate sectors, the Fund proposed structural reforms.

The Asian crisis started a discussion on the need to reform the international financial architecture, with the IMF, too, being at the centre of attention.

Except in the case of Thailand, the IMF had not been able to foresee the impending crisis. This underscored the need to strengthen the established system of financial sector supervision. As private capital assumed a greater role in financing the needs of emerging market economies (EMEs) in the 1990s, so the role of the domestic financial sector in mediating these financial flows increased, too, thus creating a potential source of instability. The supervision or regulation of these countries was not prepared for the globalized financial market. This was a development that the IMF could not ignore.

The new generation of financial crises – characterized by sudden changes in investor moods and the rapid spread of financial contagion – demonstrated the need for a change of approach to the transparency of member countries. Some of the central banks that had been affected by the crisis, for example, in Thailand or Korea, had not been fully transparent when providing data about their internal reserves or the amount of external debt. When investors found out that the current amount of usable reserves was only a fraction of the officially stated amount, they panicked. Another problem arose when investors learnt that one country had not been providing accurate data; they began to mistrust other countries, too, fearing that the situation was the same there. The IMF therefore launched an initiative aimed at improving the provision of data on economic and financial development.[2]

The Asian turbulences cast doubts on whether the IMF had adequate resources. In January 1998, the 11th General Review of Quotas was completed and included an agreement on raising quotas by 45%. Then in December the New Arrangements to Borrow were established, with participants committing themselves to provide, where necessary, up to SDR 34 billion in total.

The Asian crisis likewise gave rise to a discussion on corporate governance.

The Asian countries and other EME countries felt that IMF was not reacting adequately to the crisis and that they, because of their low representation, could not address this state of affairs effectively. The crisis had a deep effect on how East Asia viewed the role of the IMF in international political dialogue and financial cooperation. That view was amplified by the conviction that the region was inadequately represented. In 1997, Japan proposed the establishment of an "Asian Monetary Fund", but the idea was blocked by opposition from the United States, as well as China. The dissatisfaction gained expression in 1999 when the former Japanese finance minister, Dr. Sakakibara, was nominated for the position of IMF Managing Director. Financial cooperation in the region was expressed in the form of the regional Chiang Mai Initiative of May 2000, which was designed to help cover short-term liquidity shortages.

The initiated reforms were not, however, implemented according to the ideas of their authors, owing to the lack of sufficient political will and consensus among the membership. In the next period, moreover, the Fund suddenly found itself in a paradoxical situation: as a result of the favourable global economy, it did not have the resources to finance its activities. The last large debtor, Turkey, was too small to be a source of financing. In 2004, the 60th anniversary of the establishment of the IMF offered an opportunity to evaluate its activities up to then and to propose future changes. All these ideas, however, were to be overtaken by subsequent developments.

3 The current financial and economic crisis

After the collapse of Lehman Brothers and the provision of emergency credit lines to AIG in mid-September 2008, global financial markets were gripped by panic, which was driven by great uncertainty about how the situation of troubled, individual institutions would be addressed.

At the heart of the current financial crisis lay an optimism fuelled by high economic growth, low real interest rates, and shortcomings in the field of financial regulation, macroeconomic policies and the global financial architecture (IMF, 2009).

In the pre-crisis period, most countries were recording strong economic growth based on rising labour productivity and stable inflation.

Short-term interest rates were low because of flexible monetary policy. Long-term interest rates were also low, as a result of global imbalances. Capital flows into the United States from countries with high reserves were stimulated by interest of official investors in secure US government securities, thereby keeping their yields low. Private investors therefore began to search for higher yields elsewhere.

In this climate of strong demand and optimistic expectations, the financial system created new structures and instruments that seemingly offered higher yield for reasonable risk. In fact, however, they were far more risky than they appeared to be. In this environment, market discipline declined, the conduct of due diligence was shifted to credit rating agencies, and the financial sector's system of compensation was based on short-term profits, which only strengthened risk-taking tendencies.

Financial regulation lacked the ability to see the concentration of risk and unsound motives that lay behind the sharp rise in financial innovations. The potential for regulatory arbitrage generated growth in the shadow banking sector.[3]

2 Based on experiences from the Mexican crisis, the Special Data Dissemination Standard and General Data Dissemination Standard were amended by the IMF in 1996 and 1997, respectively. In 1998, an initiative was launched for the purpose of processing, disseminating and monitoring internationally recognized standards and codices, and this became a key part of the efforts to strengthen the international financial architecture.

3 The shadow banking system – investment banks, mortgage brokers, hedge funds, securitization instruments, and other private funds of bank assets.

4 Tail risk is an exceptional risk associated with distributions that have fatter "tails". A normal distribution is bell-shaped (the probability of the given phenomenon occurring is highest at around the mean, and the probability declines on both sides, down to zero chance). There are, however, also other distributions in which the occurrence of these "tail phenomena" is higher. In the case of the current crisis, the risk was that the prices of assets or asset portfolios would move by more than three standard deviations from their usual prices in the probability density function.

5 The Fed attempted to address the situation when, on 27 October, it established reciprocal swap lines, or short-term credit lines, with Brazil, Korea, Mexico and Singapore. By the end of 2008, the Fed had provided a further 14 countries with loans in a total amount of more than USD 600 billion.

The result was an excessive accumulation of debt that was obscured by the intricacy and complexity of various instruments. Banks divested themselves of capital requirements by off-loading risk to affiliated entities in the shadow system – about whose activities there was little information.

Macroeconomic and financial stability were generally considered separately. The macroeconomic aspect was focused on maintaining low and stable inflation and on achieving economic growth. Only a few central banks, however, took sufficient note of the risks associated with rising share prices or indebtedness. In the context of financial supervision, attention centred mainly on the banking sector. No one, though, was able to see the broader implications of the rising risks in the shadow financial sector, nor appreciate that the trend increases in lending and property prices were generating systemic and exceptional risks.[4]

Because this crisis has affected all groups of IMF member countries, it has, paradoxically, ensured significant political support for coordinated action on implementing the required changes. This was also reflected in the international financial architecture, when the G-7 took over the leadership role from the G-20.

In 2009, at the annual meeting of the IMF and World Bank held in Istanbul, IMF Managing Director Dominique Strauss–Kahn presented a new version of the Fund's vision for the coming period, one that focused on four areas – updating of the IMF's mandate; the IMF's financing role; surveillance; and corporate governance. It is notable that all the proposed reforms, except for the mandate review, have the same focus as those that followed the Asian crisis, albeit at a qualitatively higher level.

3. 1 IMF mandate

The current crisis has shown that its causes had only very little to do with the balance of payments current account and exchange rate movements – the usual area on which the IMF focuses. The IMF was therefore called on to consider the possible expansion of its mandate, so as to allow it to act as a "guardian" of global macro-financial stability. This concerns mainly issues of the financial account of the balance of payments and financial stability.

In the second half of the 1990s, the IMF began to consider amending the Articles of Agreement in a way that would expand the IMF's mandate to include liberalization of the balance of payments financial account. The draft agreement included a new objective in the Fund's activities: to support the liberalization of capital flows. Accordingly, member countries would not be able to impose restrictions on certain types of capital flows without the IMF's approval. The Asian crisis spelled the end for these considerations by highlighting the risks associated with the free movement of capital.

The IMF then began to devote more attention to the risks of rapid liberalization and to consider this issue in the medium term perspective with emphasis on the satisfaction of certain conditions, including: financial system soundness, fiscal consolidation, and the adoption of a flexible exchange rate. Thus surveillance over the financial account was being exercised only in the context of the surveillance over exchange rate policy.

The financial account is in this regard a major source of vulnerability for national economies, but the IMF, which carries out surveillance in these economies, is only with some effort seeking how it should proceed with financial account liberalization.

It is therefore quite legitimate to discuss the extension of the IMF's mandate in this area.

That the IMF should have a central role in the field of financial stability is also starting to be considered. The crisis has demonstrated that financial sector shocks can give rise to international economic instability, even if the exchange rate system is stable. The system established in the past is not by itself sufficient to support global financial and economic stability.

Extending the mandate to include the financial stability field would involve deepening cooperation with the Financial Stability Forum (FSF). While the FSF would be focusing on microprudential questions and the coordination of the international standards issue, the IMF would address mainly macroprudential issues. This is a natural reaction to the fact that regulation and surveillance have not been providing a sufficiently robust framework within which to solve the mounting problems. In addition, there has been only limited cooperation between national financial regulators.

3.2 Financing role of the IMF

The crisis has shown that official liquidity and loans were provided in insufficient amounts. The lack of a standing official credit line was felt in the interbank market across the world,[5] and the lack of scope for a new type of insurance also became apparent. In its absence, countries attempted to insure themselves by hoarding reserves and entering into regional swap agreements, which had the potential to disrupt the optimum allocation of capital.

This gave rise to discussion about whether the IMF should act as a global lender of last resort. The idea was in the past supported by Stanley Fisher, a former deputy Managing Director of the IMF, who argued that it could prevent the emergence and spread of panic when a financial crisis broke out. For the IMF to be able to realize this vision, a solution must be found to the issue of its resources and, at the same time, to the mechanism through which member countries could draw these funds in a flexible way.

3.2.1 Resources

According to the IMF's estimate, the resources available to it before the crisis amounted to USD

250 billion. As the financial crisis gradually grew into a crisis of the real economy, so it began to be felt ever more sharply also by EMEs and developing countries. Fears grew that the IMF would not be able to satisfy claims in accordance with its mandate. The Fund's shareholders responded by tripling the resources available to it, to USD 750 billion. SDRs were also allocated in order to increase global liquidity, and they reached an all-time high of USD 317 billion.

In the end, however, the grimmest projections were not realized. The IMF committed loans worth USD 172 billion, but the drawing of them remained far below expectations. From spring to autumn 2009, the amount drawn rose from USD 32 billion to USD 53 billion, which clearly implies that the actual requirements were substantially lower than had been expected.

Nevertheless, the IMF's Managing Director, Dominique Strauss-Kahn, announced that the current strengthening of resources was only a first step and should be followed by others aimed at ensuring that the IMF could reliably cover any future requirements of member countries. It can no doubt be expected that the 14th General Review of Quotas, which is due to be completed in January 2011, will propose another significant increase in member quotas.

The IMF will also be considering the role of particular reserve currencies in the international monetary system. In this context, it is to consider whether the position of SDRs could not be strengthened. In March 2009, the governor of the People's Bank of China, Zhou Xiaochuan, suggested that SDRs become the main reserve currency of the international monetary system. In doing so, he paid a large compliment to the proposal of Keynes, originally made in the 1940s, in which he recommended the introduction of an international currency unit, the Bancor, based on the value of 30 representative commodities. Zhou therefore indirectly criticized the current international monetary system, which is based in large part on the US dollar. According to the Chinese proposal, countries should be more active in using SDRs as a means of payment at the international level.[6] The value of SDRs could also be enhanced by incorporating all major currencies, including China's, into the SDR basket.

The aim of the proposal is to establish an international reserve currency that would be unattached to any one country. This would also solve the long-standing Triffin dilemma, according to which US current account deficits are the only main source of liquidity in the global economy while at the same time being central to the undermining of confidence in the US dollar. The Chinese proposal would have serious implications and would require support at the highest political level. The US has so far indicated that a strong dollar is in not only its interests, but also the interests of the whole world.

The current stage in increasing the IMF's resources may not be the last. It could be the first step on the way to creating a truly global and international lender of last resort.

3.2.2 Credit line

In regard to the effects of the crisis on EMEs and developing countries, the question of access to IMF funds has also come to the fore. The largest change so far has been the establishment of the Flexible Credit Line (FCL).

Following the eruption of the crisis, there has been a prevailing feeling that some form of insurance would be desirable. Since the FCL is intended for countries with strong economic fundamentals, access to it is based on ex ante conditionality and programme approval is not required. This represents a revolutionary breakthrough in IMF practice. The FCL has so far been requested by three countries – Mexico, Poland, and Columbia.

This decision was preceded by a period of discussion about the rationality of and scope for insurance. In 1998, the then US President, Bill Clinton, proposed the establishment of a Contingent Credit Line (CCL) to serve as a key preventive tool in those countries which, despite pursuing an appropriate economic policy, could fall victim to financial contagion. The CCL was intended to function like bank deposit insurance, but it proved controversial from the outset and, despite being backed by the United States, attracted no support. The CCL was cancelled in 2003 after the expiry of its validity.

Since then, the IMF's membership has been seeking a consensus on whether this sort of opportunity, or an insurance facility, is necessary for the Fund. Many countries have been warning about moral hazard, as well as about the risk that any economy that requested such insurance would be potentially vulnerable to investors fearing the worst. Proponents, by contrast, have noted that if it were established, countries would have to hold excessive reserves for the purpose of insuring themselves; there would be no need to use regional swap agreements, and, in the event of a panic, there would be less uncertainty among investors about whether foreign exchange reserves would be rapidly used up. Investors would therefore not have to follow the herd, and so even the pullout of some investors would not give rise to uncontrolled capital flight.

Many countries, however, are now seeking to go further still. As a result, the IMF has been tasked with assessing (March 2010) whether its credit programme could incorporate a credible alternative to the insurance of member countries (insurance in the form of excessive accumulation of foreign exchange reserves). In the background of this task is the submission of proposal for a global insurance facility. The IMF Managing Director has expressed the wish to take this project further and establish a long-term mechanism available to all member countries. In the event of a crisis, it could be accessed by any member, at any time, and would allow funds to be drawn without being subject to IMF conditions.

6 In 1974, SDRs were expressed as a basket of the 16 most used currencies. In 1981, the basket was reduced to five currencies and in 1999 to four currencies: the US dollar, Japanese Yen, the euro, and the British pound sterling.

3.2.3 Surveillance

Following the Asian crisis, the financial sector attracted increased attention. The IMF and World Bank launched the Financial Sector Assessment Program (FSAP) in order to assess macro-financial links, and the Financial Stability Forum was newly established to support information exchange and cooperation between financial supervisory authorities. None of these arrangements, however, provided sufficient warning in the pre-crisis period. The IMF, too, in its two multilateral surveillance publications – the World Economic Outlook and the Global Financial Stability Report – was not particularly effective in giving specific, warning information. Surveillance was fragmented between different institutions – such as the IMF, Bank of International Settlements (BIS) and Financial Stability Forum (FSF) – and the conclusions it submitted regarding mounting risks in the international financial system were too ambiguous and therefore could not trigger the adoption of adequate measures.

Integration of the fragmented global surveillance is expected to be carried out, especially through cooperation between the IMF and the Financial Stability Board (FSB)[7]. The IMF would exercise surveillance over the global financial system and would monitor and evaluate how national institutions implement recommended changes in the field of financial system supervision and regulation. The FSB, for its part, would be responsible for processing supervisory and regulatory principles and for coordinating the activities of standard-setting institutions. Both institutions should act in concert to propose changes for removing procyclicality in regulatory policy, and should cooperate closely in establishing a global early warning system.

In the first half of 2009, the IMF pilot-tested Early Warning Exercises (EWEs) – a global early warning initiative that for the first time linked the IMF's macro-financial experience and FSB's regulatory and supervisory background.

Another aim of the new changes will be greater integration of financial sector surveillance and macroeconomic surveillance, given that the link between macroeconomic risks and developments in domestic and international financial markets were underestimated. The result was a generally optimistic outlook for advanced economies and financial innovations. In this regard, participation in the Financial Sector Assessment Program should become obligatory at least for G-20 member countries and for all systemically significant economies. Before the crisis, for example, the United States had refused to implement the FSAP.

A new proposal of the G-20 is that the IMF apply its analyses to assist the mutual coordinated assessment of the economic policies of the member countries included in this grouping. This represents a certain new type of multilateral surveillance. Although the process would not be directed by the IMF, but directly by the G-20 members themselves, the G-20's strong ownership of mutual surveillance represents a sound basis for potential success. It should be noted, however, that the G-20's mutual assessment is very different from the conventional view of the IMF, since it is based on data from G-20 countries and assessments by Fund staff.

4.4.4 IMF corporate governance

In order for the IMF to be effective in carrying out its mission, it must increase its legitimacy. The membership must be persuaded that the Fund's corporate governance is fairly designated. This will not be possible unless the Fund's legitimacy is strengthened through EMEs and developing countries having greater influence within the Fund. This issue is made more pressing by the fact that advanced countries would now like these countries to be more involved in financing measures aimed at tackling the financial crisis. The key issue here is quotas.

A change has been expected following the previous quota reform, according to which overall quotas are to be increased by 11.5 percent through raising the quotas of 54 member countries (predominantly EMEs and developing countries). The implementation of this reform will not, however, bring a substantial change to the decision-making structure.

Member countries have therefore agreed to bring forward the 14th General Review of Quotas to January 2011.

The G-20 summit in Pittsburg and the subsequent IMFC meeting in Istanbul confirmed that there should be at least a 5% shift in quota share to dynamic EMEs and developing countries. This shift should be carried out on the basis of current model for calculating quotas. The model shows, however, that even with the new data there would probably not be a shift in voting power of more than 3% to the EMEs and developing countries bloc. Either it will be necessary to overhaul the quota calculation model, or to reach a political agreement on an additional shift in voting power.

Although member quotas will constitute a substantial reform, corporate governance includes other problematic issues, too, such as the strengthening of political weights in the Fund management process, the open election of the Managing Director, and changing the composition of the Executive Board.

The main wave of criticism is directed against the composition of the Executive Board, and that fact that nine of its 24 Executive Directors are currently from Europe.[8]

Although some recommend increasing the representation of EMEs and developing countries by increasing the number of Executive Directors, most countries recommend a gradual restriction of the Board's composition. The United States has already proposed that the number of Executive Directors be reduced from 24 to 20 by 2012 and that the number of Executive Directors from

7 The FSF, established in April 1999 to promote international financial stability through information exchange and cooperation in financial market supervision, was re-established as the Financial Stability Board (FSB) by a decision of the G-20 summit taken in London on 2 April 2009. Apart from the formal name change, membership of the FSF was expanded to include all G-20 members plus Spain and the European Commission, and its institutional ground was strengthened.

8 Three appointed Executive Directors (France, Germany, United Kingdom) and six elected Executive Directors (Belgium, Netherlands, Italy, Spain, Northern Countries, and the Swiss constituency).

EMEs and developing countries be maintained. Such a reduction is expected to affect mainly the European Union, and pressure is mounting for a consolidation of the European Union's representation at the IMF. Any relatively substantial change will require amendments to the IMF's Articles of Agreement and to the internal rules for the election of Executive Directors, which regulate the relevant size of constituencies.[9]

The current crisis showed that initially there was no respected political leader to coordinate the political decisions and strategy. This role was assumed by the G-20 group of countries, which replaced the G-7. In practice, there has long been felt to be a lack of political engagement with the Fund's strategic decision making. There have already been efforts to strengthen political decision making at the IMF by transforming the IMFC into a Council (at the level of ministers and governors) whose decisions would be binding on the management.

Advocates for the establishment of a Council argue that it could become a catalyst for genuine international cooperation, thereby bringing the Fund back to the centre of strategic decision-making. Opponents of the idea say that the IMFC already provides strategic management and that its position as a political advisor in no way prevents their implementation. It is not clear why a different status should increase the political engagement of ministers and governors. By contrast, a meeting of ministers at Council level would politicize the talks.

The reality is that the IMFC, or possible ministerial Council, should rather be transformed into the G-20 form so as to prevent decisions on strategic priorities being taken outside the IMF structure.

The senior representative is the Managing Director, who is both the chairman of the Executive Board and senior director of the IMF. By virtue of his position, the Managing Director sets out his own vision of how to carry out the IMF mandate. Although he does not have a vote on the Executive Board (except a deciding vote in case of an equal division), his authority and prestige can be considerable. The current criticism is directed not at this division of work, but at the process for appointing the Managing Director. The fact is that there continues to be an informal agreement,[10] that the IMF Managing Director is a representative from Europe.

The procedure for selecting the Managing Director is laid down in Article XII(4) of the IMF Articles of Agreement, where it says: "The Executive Board shall select a Managing Director who shall not be a Governor or an Executive Director." This leaves the Executive Board with a great deal of discretion in how to proceed. Although it is formally acknowledged that the selection should be open and transparent with candidates drawn not only from Europe, the practice has so far not been changed. There is now, however, generally broad support for an open selection.

Conclusion

The IMF was born out of a need for close international cooperation. Even during subsequent peripeteia in the development of the global monetary system, the importance of the Fund was confirmed. In fact, the original idea of the IMF's founders has been realized in that the international financial architecture has an institution that at times of crisis would prevent a return to autarky and protectionism. Trends in the IMF's development are leading to a substantial strengthening of the global role of the IMF, and not only in the area of membership. The IMF is steadily approaching the role of lender of last resort, which would be a sort of global insurance for member countries against the negative moods of private markets.

Expanding the IMF's mandate to include the area of financial stability will lead to deeper cooperation with the FSB and the implementation of global early warning systems. As regards surveillance, the multilateral context will be accentuated since it is essential in today's integrated world.

In order to successfully carry out this mission, it will be necessary to increase the legitimacy of the IMF. In line with changes in the global economy, the weights of EMEs and developing countries must increase, but there will also be efforts to ensure that this group of countries assumes more responsibility, particularly through greater involvement in financing.

The latest financial crisis, which this time arose in advanced economies, has not only had economic consequences, but has also had significant impact on the international financial architecture, with the G-20 adopting an initiative that ensured significant political support for coordinated implementation of necessary reforms. If the IMF is to genuinely maintain its position at the centre of the international financial architecture and carry sufficient political weight, the IMFC, or possible Council, should be transformed into the G-20 form so as to prevent political decisions on strategic priorities being taken outside the IMF structure.

9 The rules limit the individual constituencies to a 9% share of the overall quotas and do not presume joint membership of a group of countries.

10 In 1964, the US Government decided that its priority was to acquire the presidency of the World Bank. Other senior member countries, mostly from Europe, were therefore allowed to nominate the IMF Managing Director. This division of tasks continues to hold.

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Seven years of the World Bank in Slovakia

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The World Bank's office in Slovakia opened in August 2001 and closed almost seven years later, in June 2008. During the time of office's operation, the Slovak Republic deservedly earned a reputation as the leading reformer in Central Europe, and the Slovak economy became the fastest growing in the European Union. Comprehensive and significant changes in public policy enabled the country to achieve a qualitative turnaround in its international status: it gained membership in the OECD, NATO and European Union, acquired one of the top credit ratings among transition economies, and attracted an increasing share of foreign investments. In January 2009, this success was emphasized when Slovakia joined the Euro-zone.

The World Bank had the invitation and opportunity to participate in all of these long-term processes. The cooperation with the Government of the Slovak Republic could be summarized by seven loans, six grants to support the building of institutions necessary for a functioning market economy, and numerous studies and conferences.

The Slovak authorities established a solid track record of economic adjustment and broad-based reforms. As a matter of priority, Slovakia had to address fundamental systemic problems, particularly related to the transparency and effectiveness of financial flows in almost all sectors and to the building of institutional capacity. Faced with these tasks, the Government of the Slovak Republic requested support from the World Bank, whose programmes of technical and financial assistance helped to implement these reforms. The World Bank portfolio in the Slovak Republic had never been large in terms of number and size of projects (loans), but in a few years succeeded to become quite diverse.

The first framework document for cooperation with the Government – the Country Assistance Strategy – was adopted in 2001, at a time when Slovakia was intensively pursuing its objective of accession to the European Union (EU), which appeared to be a strong driver of systemic economic changes. The World Bank assistance complemented the assistance provided by the EU. An intensive dialogue with the Slovak Government led to the establishment of the World Bank office in Bratislava in August 2001. The first package of the World Bank's operations in Slovakia focused on improving the stability and efficiency of the banking sector and restructuring the enterprise sector through an Enterprise and Financial Sector Adjustment Loan (EFSAL) worth USD 200 million. In addition, a World Bank financed Social Benefits Administration Reform Project supported the development of a multi-pillar pension system and improvements in the targeting and provision of social services.

In 2002–2004, the Government of the Slovak Republic initiated another round of massive reforms. The World Bank was invited to provide assistance in improving fiscal management and introduce a system of three-year budget planning as well as improve health sector performance and policy-making capacities in the Ministry of Labour, Social Affairs and Family and Ministry of Education. In context of the EU accession, this involved mainly advisory activities that played a very important role. In 2002, for example, the World Bank prepared a comprehensive economic review focusing on Slovakia's readiness for EU accession (Development Policy Review), as well as a key document on agriculture (Food and Agriculture in the Slovak Republic: the challenge of EU Accession), published in 2003. Both documents made recommendations on how to proceed in the accession process so as to maximize the benefits and minimize the costs related to EU accession.

Furthermore, the World Bank's advice on pension reform (introduction of the second pillar) continued. Health sector reforms contributed to increased efficiency in financing and delivery of health care services. In addition, quality of health care services improved, with access to care for the population, especially vulnerable groups, being maintained. The Slovak Republic has made great strides in implementing a complex reform agenda and on May 1, 2004, acceded to membership in the EU.

The membership in the European Union means the privilege and responsibility: privilege to participate in many of the EU's policy-making institutions, policy-making process and to take a full advantage of the resources that became available from the EU itself, and to use those resources well (for example, the Cohesion and Structural Funds and other instruments). On the other hand, membership means responsibility for implementing EU legislation (acquis communautaire) as well as

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for fulfilling and complying with the Stability and Growth Pact.

In 2005, the relationship between the World Bank and the Government of the Slovak Republic entered into a new phase – assistance was replaced by partnership, with the adoption of the Country Partnership Strategy for 2005–2007. The main objective of the cooperation was to assist with building the capacities that would allow Slovakia to fully benefit from EU membership. While financial support had its place, the emerging partnership was based on facilitating the knowledge and expertise sharing, on policy advice focusing on analytical work, and on technical assistance to help the Government achieve its development objectives. The partnership was based on the recognition of the comparative advantages of both sides and on the defining of clear responsibilities, taking into account the special circumstances that each partner faced. The World Bank was engaged in those areas where it could contribute to substantial reform and provide high value added. At the sectoral level, this involved mainly the private and social sector; in terms of activities, it was strategic planning and institutional reform, the implementation of a comprehensive reform agenda, and diagnostic work. The World Bank's activities also complemented those of other institutions, such as the EU (advice regarding the formulation and implementation of public policies). The World Bank also strove to be sufficiently flexible, to be able to respond to the country's demand relatively quickly. It put in place instruments of cooperation that were the most adequate to this purpose. At that time, the Slovak Republic was facing three broad development challenges: i) to continue the prudent management of the economy and meet the obligations under the Stability and Growth Pact; ii) to converge to European income levels and be competitive in European and world markets; and iii) to reduce poverty and unemployment and to address the problems of marginalized groups of the population, especially the Roma community.

In the context of the accession process and membership in the EU, the World Bank highlighted three important challenges for development of Slovakia. The first challenge was to take a full advantage of the resources that became available from the EU itself, and to use those resources well (being well-equipped in administrative structures and skills). The second challenge was maintaining the pace of reform as country was member of the EU. There prevailed spirit of reform, dynamism and a new way of looking at economic and social problems in all new member states. During the initial process of acceding to OECD and to the EU, the requirements for successful accession heavily influenced the reform agenda in Slovakia. The reform process has been so well internalized, and so successful, that Slovakia addressed problems in some areas applying the best practices from the OECD and non-EU countries. Slovakia has introduced far-reaching and necessary economic reforms. In many areas of its reforms, Slovakia went beyond the framework of European policies. Social security networks and pension systems were overhauled. The share of agriculture in GDP was dramatically decreased. The business climate was open, the labor market was not overregulated, and the tax burden was relatively low. The third challenge was managing economic policies to promote as rapid convergence as possible.

Proceeding on the basis of dialogue with the Government of the Slovak Republic, the World Bank continued with operations in Slovakia even after the country had joined the EU. It provided assistance mainly during the initial years of Slovakia's membership, and focused in particular on the implementation of priorities to stimulate economic development. These were very closely related to the challenges that had accompanied the EU accession process. The World Bank activities during this period could be summarized as follows: Slovakia continued to have a strong demand for assistance in expertise and building of institutional capacity required for ensuring a successful start to EU membership, especially related to the ability to achieve full and effective utilizing of comparative advantage of Slovakia's membership in the EU (e.g. Structural Funds). Grants for strengthening of institutional capacity (the Institutional Development Fund – IDF) proved to be the World Bank's most appropriate instrument to build capacity in the line ministries (notable successes were the IDF grant for strengthening of the Office of the Plenipotentiary for Roma Issues, the IDF grant to supporting the capacity of legal and judicial system as well as the IDF grant supporting legal and regulatory reforms in infrastructure).

In some sectors, there has also been a demand for the World Bank financial assistance to support either sector programs or investments focused on implementation of the structural reforms (Health Sector Modernization Project in the amount of €65.58 million; Social Benefits Administration Reform Project, a loan of €26.2 million, supporting the pension reform; and Public Finance Management Reform Project, a loan of €5 million, for reforming the management of public finances). In all these cases, success of the cooperation was very much determined by the demand and strong ownership of the Government. On the other hand, lack of strong counterpart or lack of ownership and political consensus proved to be the main obstacles for successful implementation of reforms in some other areas.

Throughout this period of cooperation, the best the World Bank responded to the needs of Slovakia through a combination of analytic, advisory and financial services. Analytic work became an advocacy tool to pursue the agenda of the Government – Living Standard Assessment (2001), addressing the issues of poverty; FIAS (2001) identifying obstacles to the foreign direct investment in Slovakia; Development Policy Review (2002); analytical work in the agriculture sector (2002, 2005); Renewable Energy Action Plans (2003); comments to the Strategy of Competitiveness of the Slovak Economy till 2010 (2004). In addition, regular comparative studies at the global or regional level (Doing Business Report, EU 10 Economic Report). Positive example drawn from this cooperation is that all were prepared with strong engagement of the Slovak counterparts. Analytical and advisory work was well appreciated, both of the in-depth kind as well as in form of policy notes and workshops. There was a premium on the World Bank global and EU related knowledge and a desire for continued support for its local application through good benchmarking. Even in case there was no longer interest in financial assistance, the World Bank's technical assistance was still in demand.

The utilization of the full range of the World Bank services was constrained by perceived borrowing costs, including time-consuming and inflexible processes and procedures, which often duplicated, but were not aligned with the EU requirements. In addition, there had not been a sufficient experience and tradition with the World Bank funded projects in Slovakia. They require as special knowledge and training.

On the whole, the financial assistance provided by the WB in Slovakia was considered to be less important than the World Bank´s knowledge role. The World Bank played a useful advocacy role on sensitive issues (e.g. Roma, effective communication of reforms, education sector reform) and also role of objective, no-partisan partner able to communicate difficult messages when needed. The importance of partnership was underlined with aim to avoid supply driven approach and to focus on responsiveness and selectivity.

Following the 2006 general election, the World Bank prepared a Policy Note for the new government with the aim of directing its attention to three principal challenges the development in Slovakia faced: i) to focus on the quality of growth (increasing employment and the economy's competitiveness); ii) to protect social cohesion and reduce poverty; and iii) to strengthen public administration and capacities for the efficient utilization of EU funds. The document followed on from the dialogue and projects (in the areas of health care and social system) between the World Bank and the Government of the Slovak Republic, and it emphasized the importance of maintaining growth and convergence – which was, and remains, a key challenge for all new EU Member States, not just Slovakia.

Throughout its involvement in the Slovak Republic, the World Bank has been actively engaged in helping vulnerable groups of population, particularly the Roma. The World Bank has, among other things, supported establishing and building the capacity of the Office of the Plenipotentiary for Roma Issues. Through the Decade of Roma Inclusion, a regional initiative, the World Bank focused on the problems facing Roma in the areas of health, housing, education and employment. During these years, the World Bank's Small Grants Program supported NGO projects striving to improve the situation of marginalized groups, including Roma.

Summary

The World Bank accompanied Slovakia on its way from a planned to a functioning market economy. Implementation of an ambitious reform agenda paid off and Slovakia has made commendable progress, supporting its aim to meet the Maastricht criteria and join the Euro-zone in January 2009. It was time to end the World Bank's active involvement in Slovakia and to seek cooperation opportunities in assistance to third countries. Slovakia had joined the group of countries that are expected to provide assistance, rather than receive it. As a consequence, Slovakia decided to graduate from the World Bank's activities in autumn 2008.

Behind all the efforts and achievements, one always should see the individual people. I believe that a unique synergy between the interests of both sides, the World Bank and the Governments of Slovakia, was achieved. During seven years of engagement in Slovakia, the World Bank had the opportunity to assist in the implementation of ambitious reforms of public policies. These years were an enriching experience for each side, and we could be used in providing development assistance to the third countries.

Although Slovakia's integration objectives have been met, challenges for its further development remain. Resources need to be made available for investment in the development of infrastructure, health care and education in order to support sustained growth. But the Slovak Republic has proved that it has the ability and capacities to take on such challenges.

During the current global financial and economic crisis, the scope for fiscal policy has narrowed and the state budget is under increasing pressure from a decline in budget revenues and the rising requirements for the protection of social services and the social safety net, in particular for finding ways to stop the rise in unemployment. In this situation, the implementation of long-term structural reforms is the most essential way of dealing with the shocks and risks in the economy. Fiscal policy must support long-term growth through innovation, the creation of mutually beneficial opportunities for the economy and environment, and the building of infrastructure.

The priority in the medium-term horizon is to ensure labour productivity growth and foster an efficient and competitive business environment, so as to sustain the economic growth necessary for the acceleration of convergence. The extent to which individual countries pursue a prudent fiscal policy and revive structural reform efforts will determine their success in responding to the challenges of today.

Ducháčková, E., Lejková, Z., Kafková E., Majtánová, A., Meheš M., Szkarlat, A., Vološinová, D.:

Vývoj poistného trhu krajín Vyšehradskej štvorky v období 1995 – 2007

The insurance market in the Visegrad four countries in the period 1995–2007

Published by Vydavateľstvo EKONÓM, Bratislava, 2009, 152 pages
ISBN 978-80-225-2677-7

The conditions created by the current globalized developments in the world are, on one hand, increasing the living standards of households and the economic prosperity of enterprises, sectors and entire regions, but they are also generating potential risks that affect all entities of the market economy. The ordinary life of households, the profitability (and even existence) of firms, and the capacity of the public sector to deal with the consequences of natural elements and human activities are to a large extent affected by the increase, number and especially scope of windstorms, torrential rains, floods and inundations, and other natural disasters as well as, of course, the incidence and consequences of people's lack of caution, irresponsibility, or malevolent actions. The insurance sector helps to address not only the effects of random insurance events – and to some extent compensate for losses in respect of health, life, property and interests – but the scale of its investment activities also benefits the development of the national economy and strengthens its stability.

This multi-authored monograph provides a comprehensive overview of developments in the Slovak, Czech, Hungarian and Polish insurance market over the period from 1995 to 2007. The market reflects the transition and convergence process in connection with the accession of these countries to the European Union, and it reacts to legislative changes implementing relevant EU directives, so as to become a full-fledged partner in a single European insurance market.

The publication is divided into five chapters. The first four describe developments in the individual insurance markets of the V4 countries, including an overview of selected macroeconomic indicators and the effect of their development on the growth dynamics of the insurance markets.

Notwithstanding that four different insurance markets are under review, the authors compared them using the same selected indicators over the whole period. The implemented EU legislation and harmonized statistics at the national and European level allowed for the analysis to be based on the same data sources, differentiated by absolute values but not data structure. The reader has at his disposal a comprehensive overview of the basic indicators, focusing on the development of premiums written, claims incurred and loss ratios. Information on investment activities is based on data about the amount of technical reserves in both life and non-life insurance. The fifth chapter contains a time series and regional comparison of the macroeconomic environment that affects and, at the present time, also determines developments in individual sectors of the national economy including the insurance sector. At the end of this chapter, the authors then show the main features of the research as well as aggregated analysed indicators in the macroeconomic and insurance market fields. The text is complemented with a sizeable number of tables and charts sourced from materials published in annual reports and on the websites of central banks and insurers' associations. Other sources, too, are lucidly presented in the work.

The publication has extensive use, since it is designed not only for students studying on the respective courses at universities of economics or economics-oriented universities, but also for professionals in the insurance sector as well as members of the general public who are interested in this subject and wish to improve their knowledge about the insurance market in the V4 countries.

This monograph is a product of a long-term international cooperation between universities of economics and economics-oriented universities which dealing with insurance sector issues in their research activities. (The institutions include the Faculty of Finance and Accounting at the University of Economics in Prague; the Faculty of Business Economics at the University of Economics in Bratislava with its seat in Košice; the Faculty of National Economy at the University of Economics in Bratislava, and Cracow University of Economics.)

It maps the development of the insurance sector in the conditions of the Central European insurance market at the time before the manifestations and effects of the global financial crisis. Thus there is the potential to compare developments in the relatively stable insurance market before the crisis and the specific impacts of the crisis in the subsequent period.

Ing. František Řezáč, Ph.D.
Masaryk University in Brno

Withdrawal of Slovak korunas from circulation

Národná banka Slovenska hereby reports that of the amount of Slovak koruna cash in circulation as at 31 December 2007 – SKK 155.15 billion – a total of more than SKK 150 billion, or 96.9%, had been withdrawn from circulation by 31 December 2009, including SKK 77.5 billion, or almost 50%, by the end of 2008 and a further SKK 72.9 billion between 1 January 2009 and 31 December 2009.

From the beginning of 2009 to 31 December 2009, a total of 111.5 million banknotes were returned from circulation (including, most numerously, 33 million 1 000 koruna notes and 23 million 20 koruna notes) and more than 232.6 million circulation coins (including, most numerously, 56.5 million 50 haler coins and 53 million 2 koruna coins). Further details about the amount of cash in circulation between 31 December 2008 and 31 December 2009 are given in the following table.

As at 31 December 2009, there remained in circulation more than 20 million Slovak koruna banknotes (including, most numerously, 10.6 million 20 koruna notes and 3.7 million 100 koruna notes) and 396.3 million coins (including, most numerously, 170.5 million 50 haler coins and 103.3 million 1 koruna coins).

From 1 January 2009 to the end of 2009, the total amount of cash returned from circulation by the public directly to NBS represented more than SKK 600 million. Over the year, NBS carried out more than 38 000 transactions for the exchange of Slovak koruna cash, and the average transaction amount was around SKK 15 000.

From 1 January 2008 to 31 December 2009, NBS destroyed more than 303 million Slovak koruna banknotes and 360 million circulation coins (around 1638 tons of coins).

Exchange of Slovak koruna cash

Slovak koruna coins were exchangeable at banks until 30 June 2009. Since 1 July 2009, they have been exchangeable only at Národná banka Slovenska, which will continue to exchange them until 31 December 2013. After that date, they will cease to be exchangeable.

Slovak koruna banknotes were exchangeable at banks until 31 December 2009. Since 1 January 2010, they have been exchangeable only at Národná banka Slovenska. NBS will exchange Slovak koruna banknotes and commemorative coins issued since 1993 for an unlimited time.

Jana Kováčová
NBS spokesperson

Date	Value of Slovak korunas in circulation*	Cash withdrawn from circulation (% of cash in circulation as at 31. 12. 2007)
31. 12. 2008	SKK 77 642 407 277	50%
2. 1. 2009	SKK 72 452 577 284	53%
3. 1. 2009	SKK 69 546 245 662	55%
4. 1. 2009	SKK 66 452 416 817	57%
5. 1. 2009	SKK 63 358 083 103	59%
6. 1. 2009	SKK 60 238 140 921	61%
7. 1. 2009	SKK 55 824 694 277	64%
8. 1. 2009	SKK 51 638 755 947	67%
9. 1. 2009	SKK 47 961 062 190	69%
12. 1. 2009	SKK 43 033 842 901	72%
13. 1. 2009	SKK 39 311 419 089	75%
14. 1. 2009	SKK 36 704 013 129	76%
15. 1. 2009	SKK 34 366 738 066	78%
16. 1. 2009	SKK 32 070 738 824	79%
23. 1. 2009	SKK 21 129 818 015	86%
31. 1. 2009	SKK 16 291 819 110	90%
6. 2. 2009	SKK 13 035 930 405	92%
28. 2. 2009	SKK 8 432 533 780	95%
6. 3. 2009	SKK 8 089 152 370	95%
6. 4. 2009	SKK 7 017 709 260	95.5%
7. 5. 2009	SKK 6 450 093 199	95.8%
29. 5. 2009	SKK 6 122 684 600	96.1%
16. 6. 2009	SKK 5 909 740 278	96.1%
30. 6. 2009	SKK 5 733 725 666	96.4%
30. 11. 2009	SKK 5 007 784 499	96.8%
31. 12. 2009	SKK 4 772 830 933	96.9%

** The value of Slovak korunas in circulation includes the value of commemorative coins.*

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