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Global Imbalances and the Role of the IMF: A Comment on Ariel Buira and Martín Abeles

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Ariel Buira and Martín Abeles have written a thought-provoking piece on the risks of global imbalances and the possible ramifications for developing and emerging market economies. As far as the role of the IMF is concerned, their article begs two questions: What can and is the IMF doing about fostering an orderly resolution to global imbalances? And what can and is the IMF doing about protecting developing and emerging market countries from the possible fallout of an unwinding of global imbalances? Let me address each in turn.

At the outset, let me state that the IMF is a dynamic institution that is continuing to reshape its surveillance to remain effective in an increasingly integrated world characterised by significant cross-country spillovers. We have been working on modernising the *framework* for surveillance by reviewing its legal foundations and reassessing its effectiveness. This has included an increased focus on financial sector and capital markets, drawing on the enhanced expertise of the new Monetary and Capital Markets Department. In parallel, we are continuing to improve our analytical toolkit for exchange rate analysis and for modeling cross-country interactions.

The *implementation* of surveillance is also being strengthened at the multilateral, regional, and bilateral levels. In line with the authors' suggestion to "adopt a pre-emptive stance and encourage a coordinated approach to the resolution of global imbalances" the IMF's first *multilateral* consultation – a new instrument adopted last year – has been

focused on exactly this issue. It has provided a forum for systemically important members and groups of members – China, the euro area, Japan, Saudi Arabia and the United States – to discuss jointly what should be done to address global imbalances. To date, the discussions have been candid and instructive and have contributed to a better understanding of the issues and each country's position, while policies have been moving in directions advocated by the IMF to address global imbalances: strengthened public savings in the United States, structural reforms in the euro area and Japan, greater exchange rate flexibility in China, and increased investment in Saudi Arabia. Given the importance of regional spillovers, *regional* surveillance has also been expanded, through consultations with regional institutions as well as through publication of *Regional Economic Outlooks* (REOs). Finally, at the *bilateral* level, surveillance is becoming more selective, identifying the most important risks and focusing on topics at the heart of the IMF's surveillance mandate.

Helping Developing Countries

Let me turn now to what the IMF can – and is – doing to help protect developing and emerging market countries from the possible fallout of an unwinding of global imbalances, or external turbulence more generally. The first line of defense, of course, is the country's own policies; a strong macroeconomic framework and rigorous institutions can go a long way to insulating countries from market vagaries while allowing scope for appropriately counter-cyclical policies. The IMF plays its part through surveillance activities and provision of technical assistance and capacity building. With the encouragement of the IMF, many emerging market countries have used this period of a benign external environment to address balance sheet vulnerabilities – especially foreign currency and maturity mismatches – and to strengthen their fiscal and external positions. The IMF has also been exploring ways in which it can support regional reserve pooling and similar financial arrangements. In low-income countries, sizeable debt relief under the HIPC and Multilateral Debt Relief Initiatives have provided much-needed policy space. Here the challenge will be to use this space sensibly to foster growth and poverty reduction without re-accumulation of unsustainable debts. The newly refined debt sustainability framework for low-income countries, developed jointly by the IMF and the World Bank, helps countries design effective borrowing strategies tailored to their circumstances.

But the IMF also has a vital role to play through its lending activities. Indeed, as Buira and Abeles remind us, the Articles of Agreement mandate the IMF to help members address "maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." To this end, the IMF has also been using this period of relative calm to enhance its own toolkit. Beyond our traditional financing instruments – the Poverty Reduction and Growth Facility (PRGF) for low-income countries and the stand-by arrangement (SBA) for middle-income countries – we have been at work on two new instruments. The authors note the Exogenous Shocks Facility, intended to provide financial support to low-income countries experiencing a sudden and exogenous shock that requires adjustment and temporary external financing. In addition, the Policy Support Instrument (PSI) for mature stabilisers among low-income countries, and the precautionary SBA for market-access countries, are also available to support and signal sound policies and allow quick financial support in the event of a shock. For market access countries, work is also underway on designing a possible new liquidity enhancement instrument. Such an instrument could play a key role in crisis prevention both by allowing a country to draw on immediate and sizeable IMF resources to augment its own reserves, and by enhancing the credibility of policies with the IMF's "seal of approval." Again, this instrument – if it is established – would go a long way to providing the type of support that Buira and Abeles consider necessary to help protect emerging market countries from a possible adverse "unwinding" scenario.

In this connection, there is one point of Buira and Abeles with which I would take exception. They view member countries as turning away from the IMF because of onerous conditionality. In my view, this is perhaps part of the story, but the evolution of conditionality in IMF-supported programmes is much more complex. For instance, early adjustment programmes focused only on stemming aggregate demand rather than on increasing also aggregate supply, and this was viewed by many as a major shortcoming of IMF-supported programmes. It was in large part to address these concerns that the IMF became involved in structural reforms to help elicit a positive supply response rather than relying solely on demand management for external adjustment. But by the late 1990s, the increase in the number of conditions and apparent lack of programme focus raised questions regarding the effectiveness of conditionality. Many argued that conditionality was too intrusive and not tailored to country circumstances. Against this background, in 2002 the

IMF Board approved new conditionality guidelines – the first revision since 1978 – that highlight the importance of country ownership of programmes and parsimony of conditionality. Specifically, the member has primary responsibility for the selection, design, and implementation of an IMF-supported programme, and conditionality should be applied only to measures that are critical to achieve the programme goals – but to all such measures.

I believe that the new conditionality guidelines achieve an appropriate balance between minimising interference in national policymaking and providing assurances to the member country of the circumstances under which it will receive financial support (and assurances to the IMF that it will be repaid). Indeed, some interesting research suggests that IMF resources have a beneficial effect on crisis prevention even *controlling* for the country's gross foreign exchange reserves.[1] In other words, IMF support has a benefit beyond just the liquidity enhancement effect of its resources. Why would this be? It is because of the credibility that conditionality associated with IMF lending brings to the authorities' policies.

To summarise, Buira and Abeles have written a timely and thought-provoking paper. Many of their concerns are at the core of the IMF's current agenda of strengthening the effectiveness of its surveillance and programme support in an increasingly integrated global economy. These efforts are directed both at achieving an orderly unwinding of global macroeconomic imbalances and at boosting the resilience of developing and emerging market countries to a disorderly resolution should it occur.

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[1]See "Fund-Supported Programs and Crisis Prevention," available at www.imf.org/external/np/pp/eng/2006/032306.pdf