Erkki Liikanen: The crisis management role of the IMF

Statement by Mr Erkki Liikanen, Governor of the Bank of Finland and Governor of the Fund for Finland, at the Joint Annual Discussion, World Bank Group and International Monetary Fund, Istanbul, 6 October 2009.

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I am honoured to address this distinguished audience on behalf of the Nordic-Baltic Constituency, consisting of Denmark, Estonia, Iceland, Latvia, Lithuania, Norway, Sweden, and Finland. We are gathered here in Istanbul about a year after the dramatic events of autumn 2008 when the financial system came close to collapsing. Fortunately, today's meeting is taking place in a calmer setting.

Dealing with the crisis has been challenging

The countries in my constituency are small, open, export-oriented economies. When trade collapsed as a result of the crisis, we were all hit. The crisis has hit the countries in my constituency in differing ways. Some have negotiated programmes with the IMF that support their efforts to build the basis for sustainable recovery.

International cooperation, covering a wide range of policies, was crucial in avoiding a full melt-down of the global financial system. Prompt actions by monetary and fiscal authorities and joint international efforts all played a critical role.

A well-functioning global financial system is needed to set the stage for economic recovery. Although the worst is clearly over in the financial markets, credit channels are still impaired. Looking forward, a key question is whether the financial system is able to provide sufficient credit to support economic recovery.

For about two years now we have been witnessing the biggest financial and economic crisis since the Great Depression. Solutions have been sought open-mindedly, cooperating on a broad international basis. This has been challenging for policy makers. It will be equally challenging to design and communicate well-timed exit strategies from the extraordinary policy measures that have been taken.

Finally we are seeing the first signs of global recovery. In the medium term, a rebalancing of the global economy will be crucial in ensuring sustained growth. The Fund will play an important role in advising member countries on policies that are also optimal from a global perspective.

The Fund has carried out major reforms

The first full-fledged Early Warning Exercise, launched here at our meetings in Istanbul, is one example of a cooperative effort to promote global financial stability. The joint IMF-FSB exercise has benefitted from the Fund's macro-financial knowledge, complemented by the FSB's regulatory insight. We recognize that the Early Warning Exercise is still a work-in-progress, and we are looking forward to its further integration into the Fund's analytical work.

The Fund has thoroughly reformed its lending facilities and conditionality. Member countries can now get larger amounts of financing with streamlined conditionality. Structural conditionality in particular has been revamped to focus on objectives rather than on specified actions. These measures also aim to address long-standing criticism about the intrusiveness of Fund lending. Clearly, the Fund is "listening and learning".

As a result of global efforts, agreement was reached on tripling the Fund's resources and doubling its capacity for concessional lending to low-income countries. The Fund's relevance is no longer being questioned.

As the crisis is now hitting low-income countries, it is important to make sure that these countries do not lose the achievements they have made during the past decade. A new set of concessional lending facilities will enable low-income countries to get larger amounts of financing on more flexible terms. These countries will also get extra support in the form of relief from interest payments. Indeed, low-income countries have not been forgotten.

The Nordic-Baltic Constituency is doing its share

Delivery of financing in order to meet the agreed tripling of the Fund's resources is proceeding. Member countries are providing considerable sums as bilateral loans or note purchases at this stage. My Constituency has a long-term commitment to the financing of the Fund. For us, continuing to finance our share is our duty.

One example is the current NAB, where my Constituency is well-represented. Fair global burden-sharing will be key in reaching agreement on a new NAB, which should be a bolster to the Fund's quota-based financing. Going forward, we need to assess the optimal size of the Fund and strike the right balance between quota-based and temporary resources.

Another example is the SDR voluntary trading mechanism. About one third of the countries that for years have been the market-makers for SDRs are from my Constituency. We shall not shy away from continuing our support, but it is important to expand the number of voluntary agreements.

We have also been actively involved in crisis management in our own region. The Nordic countries have committed sizable bilateral loans to Iceland and Latvia.

However, to scale up our financing in line with the commonly agreed initiatives, we need the support of our citizens. If we finance, we want to have a say.

In addition, delivery of the financing to support a doubling of the Fund's concessional lending is moving ahead. As you may know, my Constituency is already a notable donor and we stand ready to provide support.

A reformed Fund back in action

The Fund has often been criticized for its actions – sometimes rightly so, sometimes unjustly so. But when the crisis hit, the Fund was seen as the natural choice to be the fire fighter: to respond rapidly to help countries meet their financing needs arising from the crisis.

The Fund stepped up to the challenge and reformed itself in order to respond to the needs of its member countries more effectively and in a more flexible manner. It is time to put the new toolkit fully into action.

Further reforms are needed and a review of the quotas is a key element. The reforms should be transparent and based on sound economic and financial criteria. As a starting point, all countries should ratify the 2008 quota and voice reform. It is vital to deliver on our promise to increase the voice and participation of low-income countries.

For the Fund to be relevant to all its members, it is important to achieve a further shift in quotas from over-represented to under-represented countries as defined by the quota formula. The size of the quota increase will ultimately depend on the long-term financing needs of the Fund.

The role of the IMFC should be enhanced so that it can, with the support of the Executive Board, be even more actively involved in setting the strategic orientation of the Fund.

At the same time, an institution should not reform merely for the sake of reforming. The current Executive Board and IMFC have universal membership. Where else can you find such a setting; where an institution can deliver when needed and the decisions are anchored globally because every member is represented?

Looking forward, once recovery is on a firm footing, the Fund should again look beyond its crisis management role. I am pleased that our discussions here in Istanbul have shown that there is broad support among its membership for a strong Fund in normal times, too.