

Reform is needed. Reform is



By Joseph Stiglitz

After the East Asia crisis, there was much talk of reform, of a new global financial architecture. But there was just talk; as the global economy recovered, the impetus for reform faded

THE financial crisis that began in America's sub-prime mortgage market has now become a global recession - with growth projected to be a negative 1.5 percent, the worst performance since the Great Depression. Even countries that had done everything right are seeing marked declines in growth rates, and even deep recessions. And much of the most acute pain will be felt by developing countries.

A UN commission of experts on reforms of the international monetary and financial system, which I chair, has just published its preliminary report. It focuses especially on the impact of the crisis on developing countries and the poor everywhere, which is likely to be severe. An estimated 30 million more people will be unemployed in 2009 compared to 2007. The increase could even reach 50 million. Progress in reducing poverty may be halted. The report warns that: "Some 200 million people, mostly in developing economies, could be pushed into poverty if rapid action is not taken to counter the impact of the crisis".

While this is a global crisis, responses are undertaken by national governments, who quite naturally look after their own citizens' interest first. Particularly invidious are protectionist measures, such as the US "buy America" provision in its stimulus package. In fact, the World Bank reports that 17 of the

group of 20 countries have engaged in protectionist measures, after making a commitment not to do so in their meeting in Washington in November. By focusing on national, as opposed to global impacts, the global stimulus will be less - and the global recovery weakened.

While there is a consensus that all countries should undertake strong fiscal stimulus measures, many developing countries do not have the resources, and it calls for a concerted approach for additional funding, both for spending and liquidity support for countries and corporations in developing countries that are strained by the current credit crunch.

The existing system, with the US dollar as reserve currency, is fraying. The dollar has been volatile. There are increasing worries about future inflationary risks. At the same time, putting so much money aside every year to protect countries against the risks of global instability creates a downward bias in — aggregate demand — weakening the global economy

Developed countries should contribute 1 percent of stimulus spending; there should be an immediate issue of special drawing rights (SDRs), the "IMF money" that can be used especially to help those facing difficulties, and an expansion of regional efforts, such as the Chang Mai initiative in Asia.

It is important that any assistance be

A new



By Dominique Strauss-Kahn

At a time of global economic crisis, the world has come together to radically overhaul the framework for IMF lending

THE International Monetary Fund should be an essential port of call for emerging-market and developing countries facing financing needs. With its ability to mobilise large financial resources and buttress policy credibility, the IMF can help mitigate the large economic and social costs often associated with crises. Against this background, the world has come together in the midst of the crisis to radically overhaul the framework for IMF lending.

Now and in the future, the world needs the IMF to respond flexibly and effectively to its members' needs. First and foremost, our financing packages should be large enough relative to the size of the problem to make a difference. In addition, the absence

provided without the usual strings. Conditions such as those which force developing countries to contract spending and raise interest rates are counterproductive; the intent of the assistance is to help them expand their economies, thereby assisting the global recovery. Deficiencies in current institutional arrangements for disbursing funds - for example, through the IMF - have long been noted, but the reforms so far are insufficient. Countries with funds are often reluctant to give money to institutions in which they have little voice; and which have advocated policies that they do not support; and countries are often reluctant to borrow, given the stigma associated institutions. creation of a the voice of and the born There ar be learned fr is a need for cannot be jus beyond the enforcement allowed bank Inadequate c in incentive s risk taking ; which did not The Co

is in the air. We can't afford to fail

new lending plan for the IMF

of an IMF insurance facility with acceptable terms has been a major gap in the global financial architecture, especially for the more dynamic emerging-market economies. This is despite all the evidence of the value of early access to IMF financing, before a tough situation deteriorates into a crisis.

Moreover, while it remains essential to attach policy conditions to IMF-supported programmes, they should be focused squarely on solving a country's critical problems, so that the conditions will be relevant rather than intrusive.

With our members' support, we are implementing important reforms to our lending policies that will encourage countries to approach the IMF early on, before crises become severe and almost intractable. The reform comprises

fundamentals and policy frameworks. Some observers have dubbed the new facility "EZ loan", though few countries meeting the qualifying criteria would consider their policy achievements - and their commitment to maintaining that record - anything but "easy." For others, conditionality will be more tightly focused on core areas, and "structural" conditions that require hard-to-time legislative measures will be judged in a less formalistic manner.

Second, for those not qualifying for the new instrument, the IMF's workhorse lending facility, the standby arrangement, will be made more flexible along several dimensions. These include permitting high financial access even before a crisis materialises, and allowing disbursements to be more front-loaded.

Third, the amount of lending available from

policy package as insufficient financing.

Taken together, these steps address the core problems - the stigma associated in the past with IMF conditionality, the availability of early pre-crisis financing, and the overall size of rescue packages - that have sometimes diminished the effectiveness of the fund's role as a crisis lender. Emerging markets that approach the IMF early on for pre-crisis financing will find shelter from the winds of global deleveraging, which in turn will help contain the spread of the crisis.

The IMF has already moved quickly to help many of our member countries in this time of crisis, including by protecting social spending in order to cushion the impact of the crisis on the most vulnerable. The lending reforms adopted this week will enable us to be even more flexible and responsive in assisting even more countries.

At the same time, these reforms are only a part of a much larger plan for IMF renewal. Still in the pipeline are initiatives to increase concessional lending to low-income countries hit by the crisis, to strengthen the fund's surveillance and early warning capacity, and to improve its governance structure in ways that recognise the larger role of emerging-market countries in the world economy.

It is my hope that further action in all these areas will be taken in the coming months. Together, they constitute a turning point in the way the IMF works, and will allow it to serve its global membership even better. **COURTESY THE GUARDIAN**

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three core elements:

First, policy conditions associated with future IMF lending will be better tailored to country circumstances. A new flexible credit line makes high-volume financing available - even before a crisis has struck - without any ex post policy conditionality to qualifying countries with strong economic

the IMF is being raised substantially. Normal limits on access to IMF resources are being doubled - a development consistent with the growing consensus that the fund's lending capacity needs to be at least doubled given the severity of this crisis. This is extremely important, since few things are as fatal to the credibility of a

countries face, especially with debt and capital account management.

The other important commission recommendation concerns the creation of a new global reserve system. The existing system, with the US dollar as reserve currency, is fraying. The dollar has been volatile. There are increasing worries about future inflationary risks. At the same time, putting so much money aside every year to protect countries against the risks of global instability creates a downward bias in - aggregate demand - weakening the global economy. Moreover, the system has the peculiar property that poor countries are lending trillions of dollars to the US, at essentially zero

interest rate, while within their country there are so many needs to which the money could be put. The Commission argues that a new Global Reserve System is "feasible, non-inflationary, and could be easily implemented".

After the East Asia crisis, there was much talk of reform, of a new global financial architecture. But there was just talk; as the global economy recovered, the impetus for reform faded. This is a more severe crisis. It will last longer. Hopefully, this time, we learn our lesson.

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The writer is recipient of the 2001 Nobel Prize in Economics

associated with turning to these institutions. The commission urges the creation of a new credit facility, in which the voice of the new providers of finance and the borrowers are both better heard.

There are several important lessons to be learned from the crisis. One is that there is a need for better regulation. But reforms cannot be just cosmetic, and they have to go beyond the financial sector. Inadequate enforcement of competition laws has allowed banks to grow to be too big to fail. Inadequate corporate governance resulted in incentive schemes that led to excessive risk taking and short sighted behavior, which did not even serve shareholders well.

The Commission recommends the