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The IMF should sharpen its tools

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The International Monetary Fund, IMF, is holding its spring meetings, together with the World Bank, in Washington D.C. on 12-13 April. The ongoing financial sector turmoil demonstrates the need for joint international action to counter the risks emanating from the growing interdependence of countries, financial systems and markets. The IMF is well placed to be at the centre of this work and has shown that it can lead by adapting its orientation to a changing global environment. The Fund should now focus on strengthening its role in the intersection of financial sector and macroeconomic surveillance," writes Stefan Ingves, Governor of Sveriges Riksbank, the central bank of Sweden.

The ongoing financial turmoil has raised an important issue: Is the international community equipped with the proper institutions and tools to identify and respond to emerging risks to economic stability emanating in the financial sector? The problem is in my view not a lack of institutions. We have above all the IMF. However, the IMF needs to modify and sharpen its tools for surveillance of the financial sector. As the IMF is in the process of refocusing its activities, it has a golden opportunity to improve its role in this area.

First, an important tool for the promotion of financial stability is the joint IMF-World Bank Financial Sector Assessment Programs (FSAPs). These programmes are basically a check-up for assessing a country's vulnerability to financial shocks. The FSAPs have served the international community well. While FSAPs are voluntary, the IMF and the World Bank have at this juncture completed the assessments of almost all member countries. Now it is time to go on and improve the process by more consistently linking the identification of financial weaknesses to the assessment of the macroeconomic developments. Consequently, the findings of voluntary FSAPs need to be integrated into the yearly statutory reviews of IMF member country economies.

Second, the close interlinkages between developments in the financial sector and the health of the macro economy are at work also on a cross-border basis. The IMF with its expertise and insights in both areas in almost all countries in the world is well placed to further our understanding of complex financial market dynamics and their interactions with the real economy. Building on work already done, for example in the Nordic-Baltic countries, the IMF should consider expanding the bilateral FSAPs to cover also regions with important cross-border flows. This would enable the IMF to further strengthen its policy recommendations which, in turn, can help to avoid crises from arising.

Third, the IMF should strengthen its communication of looming risks. The IMF did in fact warn about the potential risks stemming from the US housing market on several occasions before the crisis erupted, but these warnings were not listened to. Given an explicit mandate, the IMF could help by bringing to the debate more "straight talking" truth-telling based on its own assessments of financial and macro economic developments.

Fourth, the Asian financial crisis in the late 1990's prompted the international community to work on structural measures to help avoid such crises in the future. Codes of good conduct concerning the regulation and supervision of the financial sector as well as the transparency of policies and data were agreed as means to make the financial system more robust. Today, as instruments and markets have become increasingly complex, the need for enhanced transparency is as great as ever. The relevant international committees, together with the IMF, should carry this work further and adapt the codes of good conduct to the challenges of today's integrated financial markets.

At the IMF meetings in Washington in mid-April, reforms to strengthen the legitimacy of the IMF will be approved, in particular the reform of the quota and voice in the institution. This is necessary in order to enhance acceptability of IMF recommendations in member countries. The ongoing financial sector turmoil demonstrates the need for joint international action to counter the risks emanating from the growing interdependence of countries, financial systems and markets. The IMF is well placed to be at the centre of this work and has shown that it can lead by adapting its orientation to a changing global environment. The Fund should now focus on strengthening its role in the intersection of financial sector and macroeconomic surveillance.