Economic Commentaries

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Give the IMF a stronger role in promoting global financial stability

Stefan Ingves, Governor, Sveriges Riksbank

Central Bank Governors and Ministers of Finance will meet in Washington on 11-13 October for the IMF and the World Bank Annual Meetings. In view of the ongoing financial sector crisis, the need for multilateral discussions is greater than ever, making these meetings particularly timely. As we learn lessons from the financial turmoil and adapt the rules for the international financial system, we need to give the IMF with its analytical strength and universal membership a stronger role in promoting global financial stability. At this juncture, the IMF should consider using its mandate to call for a multilateral consultation to develop a response to the ongoing financial crisis.

While it is too early to draw any firm conclusions from the ongoing financial sector crisis and the role for the IMF, I would like to point to three issues which I believe are crucial to restore the robustness of the international financial system:

FIRST, the Fund should complete its Financial Sector Assessment Programs (FSAP) for all member countries, both large and small. This important instrument assesses countries' vulnerability to financial shocks and provides a valuable analytical base for policy conclusions. Today, assessments have been made in a large majority of countries that are members of the IMF and the World Bank. However, the pressures on advanced countries to undergo assessments of their financial sectors have been less clear. Much of the work of the IMF during the last decade has been focused on picking up the pieces from the financial crises in the late 1990s. A lot of this work has been directed towards Emerging Market Economies. If the FSAP, being voluntary in nature, had been more fully implemented, the IMF would have obtained a more comprehensive picture of the situation at an earlier stage. In particular, the IMF should be encouraged to provide tough policy advice also to its largest shareholders.

SECOND, transparency is vital. Much of what we see today is a result of failure to understand risk-taking. Ever-increasing complexity of financial instruments has made this situation worse. Going forward, we need to build processes that help market participants understand risk-taking better. The IMF should consider making the publication of its assessments of member country economies – including FSAPs – mandatory.

THIRD, the IMF now needs to refine the FSAPs, focusing also on regions with important cross-border flows of banking activity. This would put regulatory gaps and mismatches in focus. Regional FSAPs could help identify potential risks in the financial system that could have spill-over effects on other countries. By the same token, it could facilitate coordinated policy responses in the future.

Some argue that we need to develop new institutions to deal with the aftermath of the financial crisis. They are wrong. We already have the IMF. With its global membership, it is ideally suited to be a platform for drawing firm conclusions from the crisis on what can be done to prevent such crises in the future.