Global Economy and Development at BROOKINGS

Policy Paper 2011-13

GLOBAL VIEWS

The Euro-Area Crisis: Weighing Options for Unconventional IMF Interventions

Domenico Lombardi
Senior Fellow, Brookings Institution and President, Oxford Institute for Economic Policy

Sarah Puritz Milsom
Research Analyst, Brookings Institution

DECEMBER 2011
The Brookings Institution
1775 Massachusetts Ave., NW
Washington, DC 20036

Introduction[1]

What started in the fall of 2009 as a fiscal crisis in a smaller European economy—Greece, which accounts for just 2 percent of the total euro area's GDP—has evolved into a systemic crisis of the eurozone. This crisis now threatens not only to cause a meltdown of the entire European economy but also to destroy the social and political fabric that several generations of European leaders have worked to create over the last few decades.

While national governments are primarily responsible for the unfolding of the current events in Europe, the incomplete architecture of the euro area has created unprecedented scope for contagion by exposing each member of the monetary union—albeit to varying degrees—to the vulnerabilities of other members.

Italy is a case in point. The sluggish growth of its economy and its high (and increasing) stock of public debt are not new phenomena, but the crisis of the peripheral economies has provided the trigger for market investors to focus on Italy's long run ability to service an increasing debt pile.

Escalating market pressure has led to the formation of an emergency cabinet led by economist Mario Monti, charged with the task of pursuing an ambitious reformist agenda (see Box 1). Meanwhile, the euro1.9 trillion of Italian public debt—equivalent to 120 percent of its GDP—serves as a harsh reminder to the finance ministries in Europe and abroad of the unpredictable consequences a potential fallout of a country like Italy could have on the global economy.

Given the sheer size of Italy's debt, existing instruments—such as financial assistance programs via the European Financial Stability Fund (the European rescue fund) and the IMF—are inadequate as a financial backstop due to the limited lending capacity of both institutions.[2] Acknowledging this limitation, EU leaders committed to "consider…the provision of additional resources for the IMF of up to EUR200 billion (USD 270 billion)" with the idea that the international community could provide matching funds "to ensure that the IMF has adequate resources to deal with the crisis."[3]

Meanwhile the European Central Bank has tried to address the crisis through a number of unconventional instruments, although it has fallen short of serving as a proper lender of last resort—a role outside of its mandate. At the end of June 2011, the ECB extended the liquidity swap arrangement with the U.S. Federal Reserve to provide U.S. dollar liquidity to euro area banks unable to access the interbank dollar market. In October, the ECB announced that by year-end it would conduct two supplementary 12-month refinancing operations to keep liquidity abundant for a longer period, which were supplemented in December by the unprecedented introduction of three-year liquidity refinancing operations.

… the European Central Bank has tried to address the crisis through a number of unconventional instruments, although it has fallen short of serving as a proper lender of last resort—a role outside of its mandate.

Box 1. Italy and the IMF

Italy's quota position within the IMF stands at 3.31 percent of the total with SDR 7.88 billion. The latest Article IV consultation with Italy—concluded in March 2011—found that Italy was suffering from a weak structural economy, with growth rates slowing over the past 10 years and weakening productivity relative to some of its European counterparts. The IMF recognized that high levels of public debt coupled with disappointing growth exposed Italy to vulnerability from external shocks.

Since Italy joined the IMF in 1947, it has entered into two arrangements with the fund—the first stand-by program was in 1974 and the second shortly thereafter in 1977. In 1974, Italy suffered from a large current account deficit and experienced inflation higher than that of any other industrial country at the time—the result of expansionary policies aimed at maintaining employment and stimulating the sluggish economy. When oil prices spiked in 1973 it became clear that Italy was suffering from sizeable balance of payments pressures. Italian authorities requested a stand-by arrangement for SDR1 billion. Despite short-term balance of payments stabilization success, a second arrangement was requested in 1977, which, combined with favorable terms of trade gains from a depreciating dollar, ended with major improvement in the country's external account.

While not an official arrangement, last month's "Stabilization Law" submitted by then Prime Minister Berlusconi and the "Save-Italy" decree approved by the Monti cabinet broadly provides the basis for the IMF's monitoring of Italy's structural and economic reform measures. The move to request intensive surveillance from the IMF came after considerable political pressure from French President Sarkozy and German Chancellor Merkel on the sides of the G-20 Summit in Cannes. The measures committed by Italy include: bringing government debt down to 113 percent of GDP by 2014; achieving a balanced budget by 2013 and a structural budget surplus by 2014. Structural adjustments pledged by Italy include the implementation of a balanced budget rule in the constitution by mid-2012 and an increase in competitiveness by cutting red tape and by further liberalizing local public services and utilities.

Intensive surveillance falls outside of the compulsory Article IV consultations and tend to be more informal in nature. Whereas all Article IV consultation findings are brought to the executive board, intensive surveillance are rarely appraised by the board. Intensive surveillance need not originate by country request, but could also come from a country's creditors or the fund itself. From 2004, Jamaica, Lebanon and Nigeria have requested such enhanced monitoring.

Currently, Italy has two main channels for accessing IMF resources. The newly established Precautionary and Liquidity Line (PLL) "[c]an be used as a liquidity window allowing six-month arrangements to meet short-term balance of payments needs. Access under a six-month arrangement would not exceed 250 percent of a member's quota, which could be augmented to a maximum of 500 percent in exceptional circumstances." Moreover, the PLL "[c]an also be used under a 12 to 24-month arrangement with maximum access upon approval equal to 500 percent of a member's quota for the first year and up to 1,000 percent of quota for the second year (the latter of which could also be brought forward to the first year where needed, following a Board review)." Under the PLL, Italy could access approximately euro45 or 90 billion, assuming 500 or 1,000 percent access, respectively. The second channel, the Flexible Credit Line (FCL), has a higher qualification bar than the PLL and no cap on access limits. Resource allocation is assessed on a case-by-case basis to address potential, rather than actual, balance of payments needs. To date Colombia, Mexico, and Poland have accessed the FCL, but none has drawn from it. Currently, Italy would be unlikely to qualify for the FCL.

Sources: *See Italy and the IMF*, available at http://www.imf.org/external/country/ita/index.htm; IMF Press Release No. 11/424, IMF Enhances Liquidity and Emergency Lending Windows, November 22, 2011, available at http://www.imf.org/external/np/sec/pr/2011/pr11424.htm.

Following escalating market pressures in Italy and Spain over the summer, the Eurosystem reactivated the Securities Markets Programme in August by intervening for euro206.9 billion (as of the week ending December 2, 2011).[4] Unofficial reports from trading desks suggest that approximately 65 percent has been spent to buy Italian government bonds, 30 percent to buy Spanish bonds, and the remaining 5 percent for Irish and Portuguese bonds. While the ECB has not disclosed for how long it intends to continue the program, it is reasonable to assume that it may plan to do so until adequate safety nets are put in place.

Following the December 9th EU Summit (see Box 2), the strategy that the European leaders are using to stabilize the euro crisis can be articulated at three different layers: the first one is provided by the corrective measures to be enacted by euro-area national governments in the context of sharpened EU surveillance and disciplining sanctions; the second layer, or line of defense, is offered by a potential financial firewall that a stepped-up IMF can erect around the vulnerable sovereigns of the euro area, such as Italy and Spain, through lending programs with conditionality; and the third and last line of defense would be the ECB itself which would take the burden of any residual systemic pressures that the two previous layers would be unable to stabilize.

In light of these considerations, the aim of this paper is to review policy options that the international community could implement by strengthening the second line of defense, which hinges on an enhanced role for the IMF. These options all presuppose that the euro area as a whole will develop a credible and comprehensive strategy to effectively address the systemic crisis. However, given the credibility gap of European leaders in effectively resolving the current crisis, a quasi lender of last resort and a seal of approval by the international community would still be needed to stabilize markets and contain lingering uncertainty—even after a credible plan is eventually finalized.[5] Following that, the options presented—admittedly, some highly unconventional and require further technical and legal appraisal—could be leveraged to prevent contagion to the rest of the global economy and the international financial system.

This paper also aims to more broadly explore the role of the IMF in systemic financial crises in general by underscoring the need to better align the institution's policy toolkit in the context of a truly global monetary and financial system. In this respect, the IMF's current financial capacity offers an inadequate backstop against a systemic event that would prompt larger sovereigns such as Italy to request an IMF rescue package.

As of December 1, 2011, the IMF's forward commitment capacity stood at SDR 251 billion—approximately $390 billion or euro290 billion. However, in 2012 alone, Italy's Treasury will need to rollover approximately euro286 billion worth of debt set to expire throughout the year. It is clear that under current conditions the IMF does not have adequate financial resources to address the euro crisis head-on. Below we explore the institutional feasibility of various options that could be explored to enhance the IMF's financial firepower while taking into consideration the accompanying risks and institutional constraints for the fund and its members.

Box 2. Euro Summit: Brussels, December 9, 2011

On December 8–9, the 27 EU leaders gathered in Brussels for a summit with the key task of clinching a deal on how to tackle the eurozone crisis. The leaders attempted to address both the short-term challenges to stabilize the eurozone as well as longer-term challenge to strengthen fiscal and economic coordination in the greater EU area. Lacking unanimous support, most notably from the United Kingdom, the end result was a statement of agreement among 23 European countries, including all members of the eurozone. Other EU countries such as the Czech Republic, Hungary and Sweden have indicated they will need to consult with their respective national parliaments before joining the agreement. Leaders intend to have the pact take effect by March 2012. The main components of the agreement include:

A New "Fiscal Compact"

The 23 leaders agreed to establish a "fiscal compact" through an intergovernmental treaty that essentially mandates greater fiscal coordination and budget discipline. The new fiscal rules require that euro-area member states maintain government budgets in balance or surplus. This provision will imply that, as a rule, the annual structural deficit does not exceed 0.5 percent of nominal GDP. In addition, the balanced budget rule must be written into the states' constitutional laws and will be subject to an automatic correction mechanism should a member state deviate from the rule. The leaders also recognized the jurisdiction of the European Court of Justice to verify the incorporation of these provisions into domestic law. Furthermore, national budgets must be submitted to the European Commission. Any member in breach of the 3 percent of GDP deficit ceiling will also be subject to immediate automatic consequences unless a qualified majority is opposed.

Stabilization Tools

To address the urgent short-term needs of the euro area, the leaders agreed to "rapidly deploy" the leveraging of the EFSF as well as to accelerate the start date of the European Stability Mechanism treaty to July 2012—one year earlier than the original July 2013 target. European leaders will review the adequacy of the current euro500 billion ceiling on the mechanism in March and have also decided to keep the EFSF active until mid-2013 despite the operation of the ESM as a way of doubling the firepower available. And lastly, the member states are considering—and expected to confirm within 10 days—providing up to euro200 billion in bilateral loans to the IMF to help the institution deal with the crisis.

In an effort to quell the fears of private-sector lenders, European leaders formally reaffirmed that the haircut decisions taken concerning Greece were an anomaly and that investors will not automatically face losses in the event of a future bailout.

Source: Euro Summit Statement, October 26, 2011, Brussels: Council of the European Union.

IMF Trust and Administered Accounts

In its 66 year history, the financial organization of the International Monetary Fund has evolved to meet the ever-changing needs of the global economic and financial system. In doing so, it has offered a relatively wide spectrum of options in terms of risk and flexibility in the deployment of the financial resources made available by its international membership.

To date, the IMF's financial organization includes three key departments: the General Department, the Special Drawing Rights Department, and the Trust and Administered Accounts Department. The majority

of the IMF's financial transactions with members are handled within the General Department, specifically the General Resources Account. The latter is financed mostly from members' capital subscriptions to the IMF and is subject to the strictest safeguards in terms of the IMF's own oversight. In case of default by a borrowing country, IMF-related claims would have privileged creditor status while any residual burden would be shared by the membership in proportion to their quotas.

The Trust and Administered Accounts Department is the least well-known of the three departments. The establishment of an account in the Trust and Administered Department requires executive board approval by a simple majority. The legal authority for the IMF to establish such accounts is based on Article V, Section 2b, of the Articles of Agreement:

> "If requested, the fund may decide to perform financial and technical services, including the administration of resources contributed by members that are consistent with the purposes of the fund. Operations involved in the performance of such financial services shall not be on the account of the fund. Services under this subsection shall not impose any obligation on a member without its consent."[6]

As their financing includes voluntary resources that are independent of IMF capital subscriptions as well as the institution's own resources, trust and administered accounts are legally and financially separate from the IMF's General and SDR Departments. They provide for a wide spectrum of accounts, ranging from those involving heavier executive board involvement (trust accounts) to those preserving substantial discretion of contributors (administered accounts).

Up until now trust and administered accounts are known mostly for their role in providing resources to low-income members of the IMF. Beginning in the 1970s, the institution recognized that these members needed financial assistance on a concessional basis. This led to the establishment of the first trust account—the Trust Fund—within the IMF in 1976. The Trust Fund was financed solely from IMF profits generated from gold sales—providing $3.3 billion for concessional loans. The original Trust Fund terminated in 1981, however over the past 30 years other such arrangements have been established to provide assistance to low-income countries or members with special needs with resources from both IMF profits and bilateral member contributions. Examples include the Poverty Reduction and Growth Facility Trust (1987–2009); the more recent Extended Credit Facility (2009–present); and the joint IMF-World Bank Heavily-Indebted Poor Countries debt relief initiative (1996–present).

There are some key differences between trust and administered accounts. In the case of trust accounts, the executive board regularly reviews the allocation of their underlying resources. Typically, this entails board appraisal of a proposed lending program with its conditionality framework as well as regular reviews of a member's performance with respect to the latter.

Administered accounts involve a lighter role for the IMF's executive board while preserving the greatest discretion to the contributors of the account. The first such account was created in 1989 following a request from Japan that the IMF set up a pool of resources to assist members with overdue financial obligations to the fund.[7]

The IMF acted as the trustee and the resources—made available by Japan and other countries—were distributed in amounts determined by Japan and by the other account members that Japan had identified.[8]

In the context of the euro-area crisis, the creation of a similar trust or administered account would provide a rapid response mechanism and increase the financial resources that could be mobilized under the IMF umbrella. By potentially providing unprecedented latitude, the IMF could use those resources in a highly precautionary manner, even by intervening in secondary markets to stabilize bonds prices, subject to the parameters set by the contributors to the trust and administered accounts.

The unparalleled flexibility potentially afforded by these accounts would allow the IMF to develop a full-fledged regional approach to the euro crisis by rapidly reallocating resources across national markets with the objective of stabilizing the euro area. The accounts could also be used as "equity" in a "vehicle," which would then be leveraged to increase its overall financial capability.

While the IMF would be serving as a coordinating agency for these accounts, this "pooling" function would be broadly consistent with the traditional catalytic role that the institution has been typically acknowledged to provide—albeit, in this case through highly unconventional instruments. Trust and administered accounts would also allow the contributing membership to leverage on the highly-sought staff expertise of the IMF. In the case of trust accounts, this would include the fund's immunities and privileges, including its status as privileged creditor. To date, trust claims have been recognized as having preferred-creditor status by the Paris Club and other creditors, although that could conceivably change, particularly if a trust were to engage in lending decisions quite different from standard IMF programs.

In the case of administered accounts, however, any default risk would be borne out exclusively by contributing members. Related claims have, in fact, never been given preferred-creditor status, even when all they did was disburse resources alongside an IMF program—as in the case of the Spanish administered account attached to the Argentina program in 2000–2001.

Special Drawing Rights (SDRs)

Special Drawing Rights were established in 1969 to support the then prevailing Bretton Woods fixed exchange rate system.[9] The SDR is an international reserve asset and can be thought of as a *potential* claim on the freely usable currencies of IMF member countries. Since their creation, SDRs have played a limited role in the international monetary system. However, in the context of the current challenges facing the global economy, they represent a potentially useful policy option that warrants further examination.

SDR allocations have to be agreed upon by a supermajority of IMF members representing at least 85 percent of the institution's total voting power. Allocations of SDRs are typically distributed in proportion to the quotas held by each member country and are determined on the basis of a long-term global need to supplement existing reserve assets.[10] Since their creation, the IMF membership has voted in favor of allocations just four times—the last two of which were in response to the 2008 global financial crisis. In August 2009, following a G-20 endorsement, a general

allocation of SDR 161.2 billion or $250 billion was implemented. An additional special allocation for SDR 21.5 billion (about $33 billion) was also approved.[11] Currently, the overall stock of SDRs issued totals SDR 204.1 billion or $322 billion, representing approximately 3.1 percent of total world non-gold reserves as of September 2011.[12]

The IMF membership could decide on a general allocation of SDRs as a way to provide confidence and generate additional financing that could be partially mobilized toward the euro-area crisis. This would provide an important relaxation of the constraints currently complicating the financing of the European rescue fund—the EFSF. Since the rescue fund relies on guarantees provided by the euro-area member states through their respective treasuries, any step up in the guarantees to the EFSF triggers a corresponding increase in the contingent liabilities to be borne out by that member's public sector budget. For France, this could entail losing its AAA rating status.

If approved, the SDRs allocated to member countries through their fiscal agents—typically, national central banks—could be mobilized for this purpose thus relaxing the constraint on the public sector budget. Operationally, euro-area member countries could use their SDRs to provide a guarantee to an EFSF's "vehicle," which could in turn leverage on such guarantees to further expand its financial capability.

Such an arrangement, where euro-area members use their SDR allocations to guarantee a vehicle, would bear zero cost for the guarantors as long as the SDRs were not called upon. If the guarantee was triggered, and assuming that the counterpart was a non-official sector entity, then the SDRs would need to be exchanged with assets denominated in any freely usable currency, such as the euro. The transaction would trigger an "open" position in SDRs for which euro-area members would bear a cost equal to the SDR interest rate, which is indexed to money market rates. For the week of December 5 to December 11, 2011, the SDR annual interest rate stood at 0.15 percent, while yields on Italian one-year bonds stood at 5.33 percent, on Spanish bonds at 4.17 percent and on French bonds at 0.66 percent.[13]

A general allocation would provide euro-area members SDRs in proportion to their quotas (they together hold 23 percent of total IMF quotas), which could be used in the way described above. In addition, it would also allow some smaller, developing economies to increase their liquidity buffers as a protection against global liquidity shocks that might arise if market turmoil continued. Other members, in particular those with large reserve assets, could join a "pool of the willing" by exchanging their SDR allocations to buy euro-denominated bonds issued by the vehicle described above. These euro bonds would yield some percentage on an annual basis, which would be a multiple of the SDR rate charged on the "open" SDR position. To give an idea, currently EFSF bonds approximately yield 3.5 percent against the SDR rate of 0.23 which an IMF member would be charged in "opening" its SDR position. Moreover, assuming that such members would have diversified in euros anyway, they would not need to hedge against exchange rate exposure.

Yet, such a special issuance would pose substantial redistributive questions within the membership of the IMF. It would also cause non-negligible procedural problems as it would require an amendment to the IMF's Articles of Agreement for which a supermajority of "three-fifths of the members, having 85 percent of the total voting power" would be needed.[14] To illustrate how arduous such a task that would be, the lat-

est quota reform package endorsed by G-20 leaders in Seoul in November 2010 and approved by the IMF board of governors one month later may not be ratified in time for the agreed-upon deadline of fall 2012. After almost a year, only slightly less than 25 IMF member countries have ratified the amendments embedded in the quota and governance reform package.

IMF's Contingent Facilities—The "Expanded" New Arrangements to Borrow

For the IMF to be better equipped to handle the crisis in the eurozone and more generally to fulfill its mandate to safeguard the stability of the global economy, its financial capacity must be enhanced.

In many ways, the IMF has been here before. Similar to today, the resources available to the IMF in the 1990s were considered inadequate to meet the challenges of the global economy. In response, the New Arrangements to Borrow was established in 1998. Originally, the NAB was a credit arrangement between the IMF and 25 member countries in which supplementary resources would be made available to the fund in order to "cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system."[15] When established, the NAB provided for SDR 34 billion (equivalent to about $51 billion) of available resources. However, in response to the 2008 global financial crisis, the "expanded" NAB came into effect on March 11, 2011, increasing the available resources to SDR 367.5 billion (approximately $580 billion). Participation in the expanded NAB was enlarged to 39 countries and institutions, including the large emerging markets of Brazil, China, India, Mexico, Russia and South Africa.

The aim was to provide an immediate financial backstop since a corresponding increase in the IMF's permanent resources through quotas would take time to materialize. The NAB increase would be scaled back once the increase in the fund's own resources would come into effect at the 2012 annual meetings. At that time, it is expected that the doubling in quotas from around SDR 238.4 billion to around SDR 476.8 billion or $767 billion will kick in, assuming timely ratification by the membership.[16]

In order to serve as a more effective crisis prevention tool, the expanded NAB allows for any type of GRA financing for all IMF member countries.[17] Unlike in the case of resources entrusted to the IMF via a trust or administered account, NAB resources are a "loan" to the GRA. As such, the IMF and its full membership will bear any risks associated with their use as well as the privileged-creditor status attached to those resources.

The enhanced NAB also provides more flexibility than the original arrangement, which could only be used on a loan-by-loan basis. As it now stands, the managing director of the IMF proposes an activation period—limited to a maximum of six months—and specifies the maximum amount of aggregate calls on the participants under credit arrangements.[18] Activation only takes place when the IMF's capacity to make commitments from quota-based resources is expected to fall short. The NAB is activated when: 1) it is accepted by 85 percent of the voting power of its contributing participants eligible to vote and 2) after which, it is approved by the IMF executive board.[19]

However as it stands, the IMF's current credit capacity is limited, but the institution boasts a global membership whose support and resources can be leveraged for the IMF to play a more effective role in the euro area.

Just over a month after the expanded NAB took effect, the IMF formally completed the process to activate the new borrowing arrangement for a period of six months in the amount of SDR 211 billion (about $333 billion), which was recently renewed.

To preserve a more substantial financial role for the IMF, consideration should be given to keep the size of the contingent facility at levels comparable to the current size. Such resources would need to be activated subject to the provisions set forth above.

Conclusion

The difficulties that the Europeans are experiencing in handling the euro-area crisis highlight a potentially greater role that the IMF can play. In line with its mandate as overseer of the international monetary and financial system, the IMF has a unique set of strengths that it can offer: its staff has relevant crisis management skills that the Europeans lack; it has a surveillance mandate with credibility that is far greater than the EU regional mechanisms; and finally, it has a lending role that is especially relevant given that that the euro area lacks a lender of last resort and the EFSF has a very limited financial capacity. Moreover, the IMF's lending role generally comes with a "seal of approval" given to the policies that the institution intends to support by enhancing their credibility. However as it stands, the IMF's current credit capacity is limited, but the institution boasts a global membership whose support and resources can be leveraged for the IMF to play a more effective role in the euro area.

We have outlined a number of options that could boost the IMF's ability to play a stabilizing role by increasing its financial size but also by broadening its range of instruments. A prerequisite to the feasibility of these proposals is for the Europeans to finalize a credible strategy that would offer comfort to the IMF membership. In turn, the IMF could exert an important role in clarifying the broader stabilizing framework in cooperation with the Europeans and in exchange for its financial interventions. At the current stage of the crisis, it seems extremely unlikely that the Europeans will be able to do without the IMF given the relatively low credibility that financial markets attach to any further policy announcement or action coming from them.

References

European Central Bank. (2011, December 6). *Consolidated financial statement of the Eurosystem.* Retrieved December 9, 2011, from http://www.ecb.int/press/pr/wfs/2011/html/fs111206.en.html

IMF. (n.d.). *Data and Statistics*. Retrieved November 2011, from International Financial Statistics: http://www.imf.org/external/data.htm.

IMF. (2001). *Financial Organization and Operations of the IMF (2001), Pamphlet Series No. 45, Sixth Edition.* Washington, DC: IMF.

IMF. (2010, November 5). IMF Executive Board Approves Major Overhaul of Quotas and Governance November 5, 2010. *IMF Press Release No. 10/418* . Washington, DC: IMF.

IMF. (2011, September 13). *IMF Factsheet, Special Drawing Rights.* Retrieved November 2011, from http://www.imf.org/external/np/exr/facts/sdr.htm

IMF. (n.d.). *IMF Factsheet, Standing Borrowing Arrangements*. Retrieved November 4, 2011, from www.imf.org/external/np/exr/facts/gabnab.htm

Lombardi, D. (2011). Italy Must Secure IMF Help to Stave off Further Crisis. Washington, DC: The Brookings Institution. Available at: http://www.brookings.edu/opinions/2011/1110_imf_crisis_lombardi.aspx

Lombardi, D. (2011b). *The Euro Area Crisis: Weighing Policy Options and the Scope for U.S. Leverage, U.S. Senate Hearing.* Retrieved November 1, 2011, from The Brookings Institution: http://www.brookings.edu/testimony/2011/0922_european_debt_crisis_lombardi.aspx

Endnotes

1. We thank, but do not wish to implicate, Barry Eichengreen, Isabelle Mateos y Lago, and John Williamson for their comments on an earlier draft.

2. On the concerted role that the IMF and the ECB can play to stabilize Italy, see Lombardi, Domenico, (2011).

3. See Council of the European Union's Euro Summit Statement, October 26, 2011, Brussels.

4. See ECB (2011).

5. Requirements for a broader strategy have been commented in Lombardi, Domenico (2011b).

6. See IMF Articles of Agreement, available at: http://www.imf.org/external/pubs/ft/aa/index.htm#art2.

7. See IMF (2001).

8. The Fund created its own administered account in 1995, "The Framework Administered Account for Technical Assistance Activities," to receive and administer contributed resources from member countries to be used to finance technical assistance activities. Under the Framework Account, subaccounts were created by a host of member countries. Note that subaccounts must also be approved by the executive board (*Ibid*).

9. Their value is currently based on a basket of four key international currencies: the dollar, the euro, the yen, and the pound sterling. They are costless assets but if a member's SDR holdings rise above its allocation, the member earns interest on the excess; conversely, if a member holds fewer SDRs than allocated, it pays interest on the shortfall. In other words, SDRs provide the option of attaining a loan without maturity, whose cost is indexed to money market interest rates.

10. See Articles XV and XVIII of the IMF Charter. Decisions on general allocations are made for successive basic periods of up to five years, although such SDR allocations have been made only a few times since they were established.

11. The General Allocation went into effect on August 28, 2009. In addition, the Fourth Amendment to the IMF's Articles of Agreement, which allows a special one-time allocation of SDRs, went into effect on August 10, 2009, as a separate measure. See IMF Factsheet on Special Drawing Rights.

12. See IMF International Financial Statistics.

13. For SDR interest rates calculations see www.imf.org. Italian, French, and Spanish one-year bond yields reported by Bloomberg, as of close of business December 9, 2011.

14. As stated in Article XXVIII of the IMF's Articles of Agreements.

15. See IMF Standing Borrowing Arrangements Factsheet. The Mexican financial crisis in December 1994 led to concern that the Fund was in need of substantially more resources for future crises. In June 1995, the G-7 Halifax Summit called upon the G-10 and other financially strong countries to develop arrangements that would double the amount that was then available under the GAB. The NAB became effective in January 1998.

16. See IMF (2010).

17. Under the original NAB, was only to be used when supplementary resources to quota resources were required. Rules for fund use depended upon whether the recipient was a participant of the NAB. For NAB participants, in fact, NAB resources could be used for stand-by or extended arrangements or for outright purchases (aka an "exchange transaction") when necessary. For non-participants, NAB resources could be used to meet actual or expected requests for financing in the case of exceptional situations associated with balance-of-payments problems. The resources could not be used for reserve tranche positions or for first credit tranche stand-by arrangements.

18. Under the original NAB, the procedure for activation required that the Managing Director, following consultations with Executive Directors and participants, would solicit requests for resources in which the prospective drawer, the amount, and the period in question were identified. The process proved to be complicated and time-consuming—it took, for instance, 3 weeks to activate for Brazil in 1998—and was done on a "loan-by-loan" basis.

19. In cases where a proposal for activation is not accepted by the participants, then the IMF can borrow from 11 industrial countries or, in some cases, their central banks through the General Arrangement to Borrow (GAB). The GAB was established in 1962 by the G-10 and was expanded in 1983 to SDR 17 billion from approximately SDR 6 billion. With an associated agreement, the Fund also has access to an additional SDR 1.5 billion from Saudi Arabia. The GAB has been activated ten times, the most recent being in 1998.