

Dig into the IMF's Tool Box to Tackle the Crisis

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With a global recession in prospect, now is the time to strengthen the provisions of the International Monetary Fund's (IMF) old Compensatory Financing Facility (CFF) and to put it back into action.

It is increasingly apparent that emerging and developing countries will be unable to "decouple" from this global financial crisis. Indeed, the developing world is in a six-fold economic shock: a significant decline in economic growth in its leading export markets, a sharp fall in export prices for commodity exporters, an unwinding of the global carry trade, an upsurge in investor risk aversion, a drop in private capital inflows, and a retreat in lending from foreign-owned banks operating in their economies.

Reflecting these woes, last month the spread on emerging-market bonds (over US Treasuries) hit 900 basis points for the first time since 2002.

The dividing line for world real gross domestic product growth to qualify as a global recession should be less than 3 percent. It looks as if that dubious distinction will be achieved in 2009. Growth in emerging and developing countries seems set to slow to less than 5 percent, while growth in the industrial economies is apt to come in slightly negative.

The deeper and more protracted is the growth slowdown in the developing world, the tougher it will be for the industrial countries to recover and vice-versa.

Crisis managers in the industrial countries are well aware of the difficulties that they face. Within the last month, there have been coordinated cuts in interest rates, large-scale efforts to recapitalize weak banking systems and guarantee bank liabilities with public money, even more massive liquidity injections by central banks, and plans for further fiscal stimulus packages.

In addition, the US Federal Reserve has expanded its network of dollar swap lines to include four emerging economies and the IMF has launched a new \$100 billion Short-Term Liquidity Facility (SLF) to provide quick disbursing finance to countries with "strong policies" that are suffering from liquidity problems in global capital markets.

But there is a rub: Crisis management policies in the industrial countries are likely to take time before they have their intended effects, the Fed's swap lines and the SLF are so far restricted to a small group of emerging economies, and only a limited set of emerging and developing countries feel that they can reduce interest rates in the face of plunging currency and equity markets.

As such, the search is on for other counter-cyclical policy initiatives that could help cushion quickly the effects of the crisis on a wider group of emerging and developing countries.

One answer is to be found in the Compensatory Financing Facility, an IMF lending window that was in effect retired in 1988 after 25 years of good service in favor of a much more complicated and hardly-used successor.

The CFF was established in 1963 to help countries suffering from "temporary" shortfalls in export revenues because of factors largely "beyond their control"; the shortfall was calculated as a five-year (geometric) moving average, centered on the shortfall year, and with projections used for the two post-shortfall years.

The reasoning was straightforward: if the shortfall was "temporary" rather than permanent, it required financing more than adjustment; and if the shortfall largely represented factors "beyond the control" of the country, it did not require any Fund policy conditionality (other than that the country was cooperating with the Fund).

In 1979, the CFF expanded, both to cover receipts from tourism and worker remittances, and to include the excess cost of cereal imports.

The CFF is rested and ready. If growth projections for the industrial countries are anywhere near accurate, we can expect the emerging and developing economies to suffer a significant "shortfall" in export earnings in 2009, relative not only to 2007 and 2008, but also relative to 2010 and 2011. A shortfall in export earnings that is primarily due to a recession in the industrial countries qualifies as largely "beyond the control" of the developing world.

In addition, the CFF's all-upfront disbursements will be quick to act. Merchandise exports, tourism, and migrant remittances are important to a wide swath of developing countries. Unlike the SLF, the CFF does not require an IMF finding that the applicant's policies have been unusually "strong." It will not divide the Fund's membership into "A" and "B" lists, and the funds will only go to countries that have a demonstrated balance-of-payments need.

Given the magnitude of this crisis, it would also make sense to increase the impact of the CFF by expanding coverage to include exports of all goods, services, and income (except investment income) and to increase the access limits from the original 55 percent of Fund quota to, say, 150 percent of quota.

Good countercyclical policy initiatives do not need to be fancy. The CFF can be implemented quickly, it can have an important, positive impact on many emerging and developing countries, and the IMF can put it out to pasture again when this crisis is clearly over. If not now, when?