International Monetary Fund and financial crises in the global economy

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ABSTRACT

The rapidly evolving global economy as well as new challenges with economic and social implications make the problem of financial crises, including currency crises, extremely important in the current situation. Especially given the fact that the crises affect various countries and regions of the world. Serious currency crashes have occurred in developing countries with marked structural problems, but also in mature economies which possess fully developed market mechanisms and efficient systemic solutions. In addition, the severely destructive impact on the global financial balance and the scale of potential losses caused by such turbulences indicate that there is a need for a responsible and effective preventive policy on all decision-making levels. It seems that adequate responses and actions on the global level, in addition to actions simultaneously taken by regional organisations and by various countries themselves, can be a basis for creating conditions conducive both to the stabilisation of the entire global economy and to its sustainable growth. The aim of the present study is, therefore, to present a synthetic overview of the crucial qualitative features of currency crises, and to analyse the response of the International Monetary Fund – as one of the key international financial organisations – to the threats resulting from currency crunches. Numerous controversies surrounding the essence of currency crises as well as the functioning and activities of the IMF provide a substantive focus for the present analysis.

Keywords: International Monetary Fund, international financial organisations, financial crisis, currency crisis, globalisation.

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The dominant feature of the world economy today is its changeability and, consequently, instability, which gives us ample scope for developing future scenarios for various markets. Though the concept of change as an evolution is not a new phenomenon, the scale, dynamics and scope of economic processes that can be observed today go far beyond the traditional meaning of this term, surprising us with their suddenness and force, and frequently turning into a revolution. Change has accompanied the economy from the very beginning; after all, civilisation and economy have developed over centuries through constant modifications, improvements, introduction of new technologies for manufacturing goods or services, or implementation of more effective methods of organisation and resource management. Consequently, observers could almost always note fluctuations in prices, supply and demand, changes in manufacturing conditions as well as a number of other factors which were the reason why a substantial risk was inherent in the economic activity. However, for a dozen or so years we have been able to speak of a sudden and unprecedented development of many new economic processes or an emergence of new attributes in well-known processes. That is why changes observed today and their unprecedented dynamism create an economic environment marked by an increasing sense of insecurity or even threat.

In this context, the challenges associated with currency crises seem to be particularly important, as they often are just a prelude to even more serious economic downturns. A sudden fall in the value of a national currency against foreign currencies launches mechanisms of great destructive power. A sequence of serious problems turns into an avalanche of unfavourable events and leads inexorably to a climax which rapidly wreaks havoc in national economies, bringing with it huge losses. Two aspects of currency crises are particularly worrying in the light of the events from the 1990s and the beginning of the new millennium. First of all, it is their increasing frequency and then the so-called “contagion” effect which manifests itself in a very rapid and relatively easy transfer of these financial turbulences to other regions. As a result, a third characteristic feature of modern currency crises emerges, namely their destructive impact on the entire global economic system. Even the countries not directly connected to the infected area can relatively quickly begin to feel the negative consequences of an economic downturn in a different region of the world. This system of “communicating vessels” that today’s global economy seems to resemble is conducive to rapid spread of such serious problems. That is why not only developing countries but also countries with stable and well-developed economic structures may have to struggle with thus defined imbalance, i.e. with a currency crisis itself or with its consequences. As a result, it would be difficult to treat the crises that have arisen in recent years as one-off incidents that are exceptions to the generally positive developmental trend in the world. They seem, rather, to be an immanent feature of today's capitalist economy and that is why this is such an important issue in contemporary economic and political sciences. For the consequences of currency crises go far beyond the purely economic sphere, as they affect such fundamental matters as state governance, efficiency of state institutions or the quality of implemented systemic solutions; they also have a number of social references.

The fundamental issue that emerges here concerns the notion, often used today, of “global governance” which signifies a capability to influence and shape various processes on the global scale. Undoubtedly, international financial institutions are those institutional entities we expect to take global actions to stabilise and remedy the situation. The International Monetary Fund can be regarded as one of the major global actors with respect to the subject of the present publication. However, are its actions adequate to the emerging threats? Can the current structure of the organisation cope with today’s demands? These serious questions, which provide a framework for this paper, are at the same time one of the key decision-making areas when it comes to shaping and creating realistic conditions for a long-term sustainable economic growth in the world.

Currency crises – an overview of the problem

Undoubtedly, financial crises as such are not an entirely new phenomenon in the world economy, nor are they the basic attribute of contemporary international relations. Yet in the context of increasing globalisation and the resulting liberalisation of the economy, currency crises become particularly significant. Various systemic and macroeconomic backgrounds inside the country as well as clear links to the outside environment make such events acute manifestations of the difficulty in controlling various processes associated with maintaining the stability of the economy. Their relatively great frequency over the last few decades, diversified subjective and geographical scope as well as the destructive force released by these events make them an important research subject. Attempts to explain the mechanisms of these negative phenomena, reasons behind their origins, explosion and development as well as the limited possibilities of forecasting and preventing such crises have been, for more that ten years, an important part of the academic debate in economic sciences. They also generate considerable interest among entities responsible for economic policy, especially monetary and currency policy, in various countries.

There are numerous publications and theoretical studies focusing on the problem of currency crises and related phenomena that present a number of crucial aspects of a sudden fall in the value of a national currency. It would, however, be difficult to regard the research studies into the problem as uniform and complete, and as reflections providing unequivocal conclusions. The main research trend seems to formulate certain guidelines rather then ready-made recipes for preventing currency crises. Mutations of these extreme phenomena and constant changes in the global economy constitute a major challenge to researchers analysing the dangerous phenomenon of exchange rate "shocks". Victims of currency upheavals include both poorly developed countries with macroeconomic policies of dubious substantive value, and stable countries with mature market economies, countries which cannot really be accused of incompetent management of their national economies. What is more, many countries that have been developing extremely dynamically, achieving spectacular success with economic changes and building a strong position in the global markets, have also experienced serious currency turbulences. The "classic" models developed by Salant and Henderson, Krugman, Obstfeld, Flood and Garber, Radlett and Sachs, as well as many other researchers, models used to explain the essence of currency crises are regarded as basic analytical tools, though it is worth stressing that they do not cover the whole complex nature of these phenomena. Various non-measurable factors, often of psychological and sociological origin, can also play a significant part, just like the strictly economic determinants that initiate crises. Malfunctioning of financial markets, including information asymmetry, negative selection and the consequent moral hazard, may, in specific circumstances, also increase the risk of a currency crisis. As a result, it is not only the choice of currency regime, adequate and responsible macroeconomic policy or stable and effective systemic solutions – though undoubtedly of crucial importance – that maintain the specific resistance of an economy to a currency crisis. The behaviour and forecasts of investors, perception of events, earlier experiences, personal penchant for risk taking, group behaviour and imitation effects are just some of the potential factors that also determine the problem. The complex, multi-dimensional nature of these phenomena cannot, therefore, be easily explained and requires a number of various factors to be taken into account, factors that indirectly influence the creation of an environment conducive to monetary crises. In addition, such crises may trigger other economic problems in other spheres seemingly not related directly to the currency market itself. The fact that the causes and the mechanism of the transmission of currency crises have not been fully established makes these problems even more significant and relevant as research topics.

The definition of a currency crisis is only seemingly easy. In practice, however, this is by no means a simple task and that is why it is difficult to point out just one, holistic definition of this phenomenon. The variety of crisis scenarios, their evolution over the last few years and the necessity of taking into account a number of factors, different for different economies (e.g. rate of inflation, utilisation of foreign currency reserves, interest rate changes or implemented systemic solutions) are the reasons why it is so difficult to define this process in a precise manner. According to Krugman, “there is no universal definition of currency crises” [Krugman, 2000] that would be accepted by all researchers. In the case of countries following constant or very stable exchange rate regimes, equating a fall in the value of a national currency unequivocally with a currency crisis is perhaps slightly more obvious. In such cases, with the monetary authorities clearly committed to maintaining the value of a national currency on a specific level or within a specific range with respect to foreign currencies, a potential crisis assumes a more concrete form. Even a relatively small devaluation of a national currency, but forced by the impact of external factors – exogenous to those managing the currency in a given economy – may be regarded as a crisis. In this case the key element that determines the crisis is the fact that the monetary authority has been forced – against its will and strategy – to devalue its national currency. If, on the other hand, a central bank itself makes the decision about devaluation, on the basis of its assessment of the fundamentals of the economy and of the actual situation at the time, such a controlled fall in the value of a national currency cannot be treated as a crisis *sensu stricto*. It is debatable, however, whether the very fact of resorting to central bank instruments to defend the exchange rate is a crisis in itself or whether it is only a routine intervention within the limits specified by a given system. Looking at a currency crisis from a broader perspective, we might conclude that the necessity to use reserves, even if the speculative attack on the national currency fails, is also in itself an extreme measure resembling a crisis. In economies based on floating exchange rate regimes, the national currency is quoted on a continuous basis in accordance with the situation on the market; substantial fluctuations of its value are a natural phenomenon that is part of the very essence of valuation carried out by the market forces. Hence not all, even sudden, falls in the value of the national currency against foreign currencies will be regarded as currency crises. What is important in floating exchange rate regimes is, therefore, the scale of depreciation which goes outside of the limits accepted by the investors and the monetary authority, and the release of foreign currency reserves to stabilise the exchange rate. The key to further analysis is to define the essence of a "genuine" currency crisis, especially given the fact that the variety of views and terminological proposals point to a multidimensional nature of this phenomenon. Consequently, it seems that, in addition to a definition-based approach, an attempt to list the crucial features of currency crunches can also be an adequate approach to the problem of terminological classification of such crises.

Generally speaking, a currency crisis is a substantial fall in the value of a national currency in comparison to foreign currencies within a relatively short period. A view frequently cited in literature to define currency crises is a proposal by Frankel and Rose [Frenkel, 1996] according to which a crunch on the currency market of a given country occurs when the value of a national currency falls against foreign currencies by at least 25% and at the same time the depreciation rate increases by at least 10% in comparison to the previous year. Another popular view is a definition by Osband and Rijckeghem [Osband, Rijckeghem, 2000] according to which a currency crisis takes place when the monthly currency depreciation is exceeded by 10% and when the monthly depreciation exceeds the average currency depreciation in the period from 14 to 3 months before the beginning of the crisis plus the double standard deviation in the period between 26 to 3 months before the beginning of the crisis.

Various attempts at defining the phenomenon and problems associated with this process justify an approach based on its typical features. The key characteristic is, first of all, a very strong devaluation (in the case of fixed rate regimes) or depreciation (in the case of floating rate regimes) pressure on the part of investors. This pressure may turn into a self-fulfilling forecast, because a belief that a fall in the value of a national currency against foreign currencies is inevitable may, despite the soundness of the fundamentals of the economy, eventually lead to a collapse of the exchange rate of the national currency through various actions taken by investors. An important attribute of a currency crisis is also an intervention of the central bank, which means that the monetary authority does not accept the loss of value of the national currency. The central bank reacts in a typical manner, usually by using foreign currency reserves to defend the exchange rate or by raising the interest rate. Consequently, we may speak of a crisis if the actions of the monetary authority and its resources will not be able to protect the exchange rate against collapse or when the authority deliberately gives up such a defence because of its huge cost. The fall in the value of the national currency will then become a "palpable" visualisation of a currency crisis. An important element of serious currency turbulences is a speculative attack mentioned earlier by the present author. We may say that it is also one of the attributes of this phenomenon because it manifests itself in nearly all cases of currency crises. A speculative attack is a planned and deliberate action of speculative entities, euphemistically referred to as short-term investors, oriented towards achieving specific goals – making the market react in a desired way. It is a kind of strategic game aimed at causing a "drop" in the exchange rate, which is a slang term for describing attempts to force devaluation/depreciation of the currency of a given country. In addition, such a crisis strongly correlates with a substantial reduction of the reliability of the entity experiencing the crunch. The loss of the investors' trust in the economy of a country in which they placed their financial assets may lead to frantic attempts to reduce their involvement in a market which is, also in their opinion, under threat. In real terms this signifies a sale of assets denominated in the national currency held by investors (national, foreign and speculative investors) and reconversion of the assets to a foreign currency. This type of activity very rapidly increases the supply of the national currency available on the market, which is accompanied by a decline in the demand for it among investors manifested usually in a lack of interest in the national financial assets. A direct consequence of such a situation, in accordance with the market's typical reaction, is a fall in the price of the national currency. The scale of depreciation depends on the scale of this type of investors' behaviour. If this phenomenon reaches mass proportions within a relatively short period, it will indeed cause a currency crisis. During such a sequence of events that have a negative impact on the economy, the trend can be fuelled or further strengthened by an accompanying attack on the national currency. The speculative attack itself can also be a critical moment that will initiate a frantic withdrawal of investors from a given market, and a catalyst of further development of the entire crisis process.

Currency crises in the world economy over the last decades can be grouped into three main categories. Three generations of currency crunches are usually distinguished when it comes to theory, though it has to be noted that such a classification is conventional and is by no means uniform. Yet despite its methodological deficiencies, there is a strong rationale behind such a division. It results primarily from internal differences concerning the essence of each of these crisis types and other external determinants in a given period. In addition, in the majority of cases it takes into account, to some extent, the chronology of contemporary currency crunches. First-generation models[1] expose first of all serious mistakes in the macroeconomic policy that imply a growing internal and external imbalance in a fixed rate regime. An over-expansive economic policy, with its typical attributes such as a growing budget deficit financed by additional issue of currency, leads to a situation in which the domestic demand far exceeds the supply capacity of a given economy, which inexorably ends in a serious structural deficit in the balance of payments current account. This deficit is financed by the central bank's reserves, already diminishing at that point. Their critically low level will eventually stimulate a speculative attack and force a devaluation of the national currency. Second-generation models[2], also in fixed rate regimes, refer to a possibility of multiple equilibria in the economy, depending on the development strategy chosen by the country's authorities and on their assessment of the current and future situations. What is also important is the perception and expectations of investors operating in the financial sectors of the economy in question. Here, the currency crisis is not a consequence of an inadequate macroeconomic policy and greatly diminished foreign currency reserves, but a result of a self-fulfilling speculative attack. If the investors believe that the monetary authority is highly likely to stop maintaining high interest rates (essential during a prolonged speculative attack) and thus to stop defending the national currency due to high costs both to the finances and to the economy itself, they will take the decision to launch a pre-emptive speculative attack. Third-generation models[3], also referred to as eclectic models, highlight the important contribution to crises of systemic weaknesses of a given country, shortcomings of the financial markets and psychological effects. All these phenomena are associated with a number of processes taking place in the global economy over the last few decades and referring to the increasing liberalisation of capital flows and to a general integration of the financial markets.

[1] The theoretical foundations for First-generation models were created by, for instance, Salant, S., Henderson, D., 1978 Market anticipation of government policy and the price of gold, Journal of Political Economy, 86; Krugman, P., 1979. A model of balance of payment crises, Journal of Money, Credit, and Banking, 11; Flood, R.P., Garber, P.M., 1984. Collapsing exchange rate regimes: some linear examples, Journal of International Economics, 17.

[2] The theoretical foundations for Second-generation models can be found in such works as Obstfeld, M., 1994. The logic of currency crises, Cahiers Economiques ef Monetaires, Nr. 43;Obstfeld, M., 1996. Model of currency crisis with self-fulfilling features, European Economic Review, Nr 40; Krugman, P., 1996. Are currency crises self-fulfilling?, NBER Macroeconomics Annual 1996, NBER, Cambridge.

[3] The theoretical foundations for Third-generation models can be found in such works as Dooley, M., 2000. A model of currency crisis in emerging markets, The Economic Journal, vol. 110; Edison, H., Fernald, J., Loungani, P., 1999. Was China the first domino? Assessing links between China and the rest of Emerging Asia, Journal of International Money and Finance, vol. 18; Radlett, S., Sachs, J., 1998. The East Asian financial crisis: Diagnosis, Remedies, Prospects, Brookings Papers on Economic Activity, vol. 28.

Table 1

Generations of currency crises in the contemporary world economy
- selected examples

Type of crisis	Country	Year
I generation crisis	Argentina, Bolivia, Brazil, Chile, Mexico, Uruguay	1982
II generation crisis	Finland, Spain, Irland, Norway, Portugal, Italy, UK, Mexico Czech Republic	1992 – 1993 1994 – 1995 1996
III generation crisis	Thailand, Malaysia Korea, Philippines, Indonesia, Russia, Columbia Brazil, Ecuador, Columbia Turkey Argentina	1997 1998 1999 2000 2001 2001

Source: compiled by the Author

The above table contains selected examples of serious currency crunches in specific national economies. This list is, in fact, much longer. The selection presented here, on the one hand, is based on an attempt to illustrate various types of currency crises with real-life incidents and, on the other, covers those examples that seem to be the most significant both in the regional and in the global perspective. In addition, the present selection includes geographical references, which makes it relatively representative. It should also be stressed that the selected examples, though recognised and included in their respective categories of currency crises, were often related to collapses in other areas of the financial and economic systems of various countries. In some cases it would be difficult to separate unequivocally a currency crisis from other financial problems. Moreover, currency crises can also be perceived as the most “visible” and, in a way, most spectacular manifestations of general economic problems. Yet, in fact, they are usually closely linked to all the processes in a specific economy and as such can, therefore, be treated as an extreme stage of a mounting crisis in its other spheres and a result of negative changes in the investors’ behaviour. Currency crises, as numerous empiric observations have demonstrated, are not phenomena separate from the economy, sudden collapses limited to the hermetic area of the currency market, but are a culmination of the impact of adverse conditions, both in terms of “hard” macroeconomic facts and psychological as well as behavioural effects.

As has already been mentioned earlier, economic phenomena in the form of currency and financial crunches appeared relatively frequently over the last three decades. Between 1975 and 1997 serious currency crises occurred no fewer that 158 times; 2/3 of the phenomena in that period were recorded in developing countries. Developed countries too experienced currency collapses, but the number of such cases was much smaller. The situation with respect to banking crises and the so-called twin crises in various countries was similar. According to the IMF, such problems occurred much more frequently in emerging markets [IMF, 1998]. Such a distribution of financial crises in the global economy suggests that the developing countries were much more susceptible to crises in the financial and real sectors, and to the impact of external factors. It seems that this was a consequence not only of grave mistakes in the economic policies implemented by those countries (especially in the 1970s and 1980s) but also of a general weakness of their systems that created favourable conditions for such financial and economic shocks. The following table presents an approximate scale of this phenomenon in the world economy in the analysed period as well as selected consequences of currency crunches.

Table 2

Currency and financial crises in the global economy between 1975 and 1997 and their selected negative consequences

Type of crisis	Number of crises	Average recovery time after crisis (in years)	Cumulative loss of output per crisis[4]
Currency crises	158	1.6	4.3
Developed countries	42	1.9	3.1
Developing countries	116	1.5	4.8
Banking crises	54	3.1	11.6
Developed countries	12	4.1	10.2
Developing countries	42	2.8	12.2
Currency and banking crises	32	3.2	14.4
Developed countries	6	5.8	17.6
Developing countries	26	2.6	13.6

Source: compiled by the Author on the basis of: IMF, World Economic Outlook, May 1998.

It is worth noting that the values presented in the table referring to the number of currency crises should now be expanded to include the new cases from the 1990s and the beginning of the new millennium (see tab. 1). As the author has already suggested, these phenomena cannot be treated as a marginal and sporadic dysfunction of the economic systems of various countries affected by the crises, but have to be regarded as a major and to some extent constant threat to the stability not only of the infected countries but also of the entire world economy. Such a view seems all the more justified, if we take into account the substantial costs of currency and financial crunches. Depending on the type of crisis, a significant burden associated with real costs is the time economies need to recover after the shock caused by the crisis. In the case on currency crises alone it took on average as long as 19 months for the economies to reach their pre-collapse state. It took even longer to overcome the direct consequences of the crises in the banking sector and of the twin crises (over 37 months and over 38 months respectively). Interestingly, in the case of the latter two types of crises the

[4] According to the IMF cumulative loss of output per crisis is calculated by summing the differences between trend growth and output growth after the crisis began until the time when annual output growth returned to its trend and by averaging over all crises).

highly developed countries needed more time to bring the situation under control and return to previous trends. Another direct consequence of crises in the financial sphere, in addition to currency devaluation/depreciation, collapse of the banking system or upheavals in the balance of payments, is a marked decline in output and an economic slowdown. In this respect, as the data in Table 2 demonstrate, the most dangerous and most expensive crises are twin crises.

The losses and additional threats resulting from the crises in the global economy are much more extensive, however. After all, currency and financial crises are extremely costly in their economic, social and political aspects. However, the costs differ depending on the specific country or even region in which such an event occurred, which is a result of structural differences and the type of external impact in a given period. That is why international financial organisations, including the International Monetary Fund, have such an important role to play in preventing these destructive phenomena and mitigating their negative effects.

International Monetary Fund and currency crises

One of the IMF's main tasks is to stabilise the world economy and to counteract economic and financial shocks. In order to achieve its goals, the organisation carries out actions which, although often not adequate to deal with real conditions and situations, do include in their programme (theoretical aspects) appropriate suggestions and recommendations for reforms. For many years, various credit tools (tranches, stand-by arrangements, special mechanisms, preventive and crisis loans) were for some countries very important instruments for financing and mitigating the consequences of crises. Today the basic instruments that can potentially be used as supporting tools in case of a collapse include typical Stand-by Arrangement (SBA), Extended Fund Facility (EFF) – geared towards long-term financing for countries requiring major structural reforms – and Supplemental Reserve Facility (SRF) that provide more short-term loans if foreign capital is suddenly withdrawn from a given economy. These types of tools have already been used on numerous occasions during serious upheavals in financial markets. However, their implementation brought mixed results. On the one hand, these resources made it possible to mitigate the consequences of crises in various economies, maintain the liquidity of the government sector and selected private financial institutions, implement remedial and support programmes, and increase the credibility of countries experiencing the crunches. On the other hand, this type of support would often bring results that were too modest and disproportionate to the outlays, or, what is even worse, it would only delay the inevitable collapse without radically changing the structural causes that underlay financial crises in various regions.

Table 3

IMF’s assistance to selected countries in crisis (in bn USD)

Country	Year	Financial support
Argentina	2001	14,2
Brazil	1998	18,1
Mexico	1995	17,8
Indonesia	1997	11,2
Korea	1998	21,1
Russia	1998	11,2
Thailand	1997	4,0

Source: IMF

It is worth noting that in certain cases the IMF has already gave assistance of billions of dollars to countries affected by crises. In addition, the Fund's activity has led to the emergence of the so-called financial packaging within which funds are available from other public and private institutions, thus increasing substantially the final volume of available assistance. What is interesting is the fact that changes within the IMF itself carried out so far have made it possible to use such support tools in the case of developing and poor economies in order to support not only the macroeconomic stabilisation itself but also selected development-oriented projects. Another important field of the Fund’s activity is monitoring and prevention of financial crises and crashes. For instance, the Financial Sector Assessment Programme (FSAP), launched by the Fund together with the World Bank in 1998, is to strengthen the financial foundations in member states and to promote good governance in this field. Drawing on experts’ analyses, the programme examines and identifies strengths and weaknesses of financial systems of various countries, assesses the risk, provides technical assistance and gives advice with regard to these countries’ economic policies. Another type of assistance is the Multilateral Debt Relief Initiative (MDRI) geared towards providing targeted support to countries with low income and at the same time substantial foreign debt.

The potentially broad scope of action as well as well-developed instruments, including the IMF's still large financial resources, may prove to be very useful in the globalised world, provided that they are used effectively. The IMF’s actions, however, are often criticised because of the mistakes made by the organisation as well as its earlier controversial decisions. This is why we are again confronted by the questions formulated at the beginning of this synthetic study. The variety of structural determinants that manifest themselves in various countries suggests that the IMF may need to adopt a more targeted approach when dealing with countries under threat or crisis or already affected by it. However, the criticism of the organisation often focuses on the schematic nature of its recommendations and remedial programmes which, after all, are an important part of its activity. Remedial plans for some countries of the South-East Asia or Latin America seem to confirm these doubts. Moreover, the Fund’s “mechanical” financial assistance and the rigorous conditions that have to be met to obtain it limit its availability even in justified cases, which undermines the effectiveness of the Fund’s methods. On the one hand, such assistance distorts the fundamental principle of the market economy. For if the IMF offers various types of financial assistance, given the current rules, it becomes, in a way, the lender of “last resort”. The climate of outward security thus created may intensify the moral hazard phenomenon and the dysfunctionality of financial markets in their basic functions which, after all, concern the ability to allocate resources in an effective manner. The assistance and its actual form, though absolutely necessary in many cases, should not be granted without a thorough analysis of each individual case. On the other hand, some financial instruments are beyond the reach of those economies that need them because of the boundary conditions of their implementation. It is evident that the Fund’s actions are inconsistent and that they are heavily influenced by politics. Despite some questionable effects of programmes implemented as prerequisites for obtaining support, some countries (e.g. Russia) regularly enjoy the Fund’s generous support, while others (e.g. Argentina) have had great difficulties in obtaining the Fund’s assistance despite following its recommendations. In addition, the organisation is accused of being one of the most principal sources of the growing debt of the poorest countries and an expansive agency of the US in the world economy [Paloni, Zanardi, 2006]. A considerable threat to the functioning of the IMF, resulting from its weakening position and diminishing reliability, is the fact that some countries, particularly in Asia and Latin America, obtain financing from other sources, usually in the form of regional banks or private financial institutions. Moreover, the continuing controversy surrounding the activity of the institution is associated with problems with enforcing transparent and comparable economic data that would make it possible to assess the true condition of various economies in realistic terms. A lot of countries affected by crises present incorrect or incomplete data concerning their economies. Of crucial importance are the reservations concerning the very essence of the functioning of the IMF. Many observers emphasise its low effectiveness and the fact that at least in some respects it has lost sight of its mission. They also criticise the very functioning of the organisation, often regarded as rigid and unable to cope with the changing conditions in the global economy [Buira, A., (ed.), 2005]. In particular, the fact that the developing countries, whose share in the world economy has increased substantially, are underrepresented is often raised as an example of the lethargic approach to adapting the institution to modern conditions. The reluctance of the developed countries, the main stakeholders and managers, to change the voting parity and strengthen the role of the developing countries is particularly striking. As Boorman has observed, the Fund is suffering because of an outdated management structure that determines its low effectiveness. He points to the evidently less important role of the lender, the significantly smaller influence on the economic policies pursued by various countries and the vaguely defined stabilising function in the present circumstances [Boorman, 2008]. Also, as the present author has noted before, the credibility of the institution has been damaged after a series of controversial decisions and recommendations addressed to countries plagued by crises-related problems. The so-called Washington Consensus, an element of many remedial programmes, that has been promoted by the IMF as a set of recommendations concerning the necessity of introducing comprehensive reforms in developing countries and making their economies market-oriented has sparked off numerous heated debates. The opponents of this concept even believe that it is a manifestation of market fundamentalism the effects of which may be contrary to what is intended. All these reservations question the IMF’s fulfilment of its original mission set out in its articles of agreement and at the same time signal a severe crisis of this organisation's identity.

Reform of the IMF

This is why many opinions stress the need for significant and comprehensive changes in the functioning of the IMF. Many believe that the institution's mission should be redefined in a clear manner, if it is to play a central role in the international financial system today. Truman claims that the IMF needs a real capability to stabilise the global economic system and to prevent financial crises [Truman, 2006a]. However, no single reform will restore the IMF’s earlier position as an acknowledged and universally respected institution with a global impact. Genuine change requires the implementation of many reforms in various aspects of the IMF's functioning. Due to the transformations that have occurred in the international financial architecture, such an approach is relatively commonly regarded as necessary [Truman, 2006b]. Some selective changes introduced over the last few years seem to be insufficient to reform this financial organisation.

When it comes to the operational aspect of the IMF's activity, it is worth pointing to the necessity of redefining the conditions for granting financial assistance to various countries and to the cost of such assistance. The Fund should limit its activity as the lender of last resort, adopt a more individualised approach to the problems of specific economies and change the voting parity within the organisation. Proposals concerning currency crises include the introduction and promotion by the IMF of international standards with regard to financial practices, and support of the creation of strong financial institutions in developing countries [Weiss, 2004]. Recognising the need for transformation, in 2005 and 2006 the IMF itself presented its medium-term development strategy [IMF, 2006]. The document highlights several key principles of the institution's further functioning. The crucial proposals include a reform of the system of surveillance of member states in order to tackle systemic threats to the global imbalance and currency crunches, a reform of the voting parity and power in the decision-making process in order to strengthen the representation of developing countries and to introduce new instruments to support those countries that follow responsible economic policies but may occasionally experience financial difficulties. The change strategy also includes new rules of selecting the general director of the Fund. According to another proposal, the Fund's managing bodies should be composed of experts and not of representative of the member states' governments. This would make the IMF resemble a central bank and strengthen its effectiveness [Kenen, 2007]. There are also proposals for the IMF to maintain, though in a modified form, its leading role in stabilising international financial relations, and for the IMF's active involvement in the implementation in various member countries of regulations more closely integrated with the Fund's surveillance procedures. In addition, experts point to the need for the Fund to manage the resources at its disposal in a more active manner, especially given the fact that the changing external conditions, particularly the substantial fall in the demand for the IMF assets of developing countries, imply problems with maintaining appropriate financial liquidity of the whole organisation. According to The Economist, the current general director of the IMF proposes a substantial reduction of expenditure and strict discipline with respect to cost monitoring. There are plans to reduce the number of employees by 15%, which is supposed to generate savings of USD 100m [The Economist, 2008a]. Given the growing financial deficit, estimated at USD 400m by 2010, such an action may prove necessary. What is interesting is the fact that the Fund is considering selling some of its gold reserves in order to increase its revenue and changing its rules concerning securities it currently owns. Apart from the right to buy government bonds, it is also exploring a future possibility of buying commercial bonds and even shares [The Economist, 2008b]. Regardless of the option the IMF will finally choose, it seems that a major reorientation of its business model is unavoidable. In the long term, the organisation must find a way of financing its activities safely, regardless of the scale of its lending action. In addition, the IMF should become more active when it comes to involving the private sector in actions aimed at preventing crunches in financial markets. The institution's important operational aspects should include coordination of the work of various dispersed decision-making centres and close cooperation not only with other institutions but also with central banks and private entities. A reform of the IMF is undoubtedly necessary because of the challenges associated with a broadly defined globalisation as well as changes that have a direct impact on the functioning of this institution. Moreover, the potential transformations of the IMF should be a crucial element in the construction of a new order in the international financial architecture, stabilisation of the global currency sphere, and at the same time they should contribute to the creation of favourable conditions for the reduction of foreign debt and for the improvement of the economic situation in world's poorest countries.

Conclusions

Is the IMF, therefore, an institution that the global economy needs in the 21st century? It seems that the answer should be in the affirmative given the potential (though not fully utilised) this organisation has. The global economy needs efficient institutions that will coordinate economic policy on the supranational level, institutions that could rectify market dysfunctions in specific situations with its authority and real instruments. After all, we should not forget that currency crises are not the only problems in today's economic relations. The growing imbalance in the global economy, manifesting itself in huge current account deficits of some countries and at the same time huge surpluses in others, the geographically and socially wide-spread poverty, frequent crunches in financial and commodity markets are just some of the processes that carry a risk of long-term lack of stability, and slowdown. The recent serious credit crunch in the United States and its negative consequences for a number of many other countries signal a need for constant monitoring, advice and prevention of destabilisation of the entire world economy. The IMF can play a vital role on the global scene but the manner, scope and philosophy of its actions need to change. Its stabilising mission, initially defined at the Breton Woods conference in 1944, is still valid, but the conditions in which that mission is to be carried out have changed. The future position of this institution depends to a large extent on the improvement of its effectiveness and on the rebuilding of its credibility on the international stage. This requires reforms within the organisation itself, reforms that have been postponed so far. What is necessary now is the political will, especially of the United States and other developed countries, to carry out profound changes in the functioning of the institution which, after all, is regarded as one of the pillars of the whole global economy.

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