

# Fed Crisis-Liquidity Function Reviewed for Potential Use by IMF

by Andrew Mayeda

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Photographer: Andrew Harrer/Bloomberg

IMF member nations are discussing how to expand the lender’s mandate to include keeping markets liquid during a financial crisis, a role played by a group of major central banks led by the Federal Reserve in 2008.

The International Monetary Fund’s main committee of central bank governors and finance ministers is working on ways for the fund to provide a better financial “safety net” during a crisis, said Singapore Finance Minister Tharman Shanmugaratnam, who last month finished a four-year term as chairman of the panel. Singapore remains a member of the International Monetary and Financial Committee.

“In the last crisis, the Fed and some other central banks had a system of swaps that was applied to only certain financial centers, but you can’t leave it to an individual central bank to make those decisions,” he said in an interview Friday in Washington, as officials from around the world gathered for the IMF’s spring meetings. “It has to be a global player, and the IMF is the only credible institution to perform that role.”

The Washington-based IMF needs to evolve into more of a “system-wide policeman” that enforces global financial stability, rather than solely a lender to individual countries that run into trouble, said Shanmugaratnam, 58, who also serves as Singapore’s deputy prime minister.

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major hit.

## Crisis Swaps

The Fed set up foreign-exchange swap lines during the crisis with major central banks, including the European Central Bank, Bank of Japan and Bank of Canada, as well as some smaller and emerging-market nations such as Singapore, South Korea, Mexico and New Zealand.

Under the program, foreign central banks exchanged their countries' currencies for U.S. dollars, which they loaned to local financial institutions to shore up their liquidity. Outstanding swaps peaked at almost \$600 billion in late 2008.

Some emerging-market economies were rebuffed for swap agreements with the Fed, including Indonesia, India, Peru and the Dominican Republic, according to the book "The Dollar Trap" by Eswar Prasad, a former IMF official. Since the crisis began, the People's Bank of China has set up bilateral currency-swap lines with more than 20 other nations, including Indonesia. India set up a similar deal with the Bank of Japan.

Shanmugaratnam acknowledged that some central bankers don't support the notion of the IMF coordinating liquidity during a crisis. "Not every central bank agrees with this," he said. "But it requires global thinking, not individual country thinking."

## Fund Resources

IMF resources were at a historic low when the crisis hit, and reductions in staff had weakened the fund's ability to watch for signs of crisis, according to a [study](#) released last year by the fund's internal watchdog.

Shanmugaratnam said the fund has enhanced its ability to monitor the global financial system for systemic risks. It has also created new precautionary credit lines designed to prevent countries with strong fundamentals from sliding into financing problems. Countries including Mexico, Poland and Morocco have opened such credit lines with the fund.

"The IMF now has greater flexibility to respond to particular situations, taking into account the contagion effects," Shanmugaratnam said. While declining to discuss specific countries, he pointed to the fund's loan programs in Europe as examples of lending aimed at preventing spillovers that could put the global financial system at risk.

## 'Adequate' Tools

Mexico central bank Governor Agustin Carstens succeeded Shanmugaratnam as chairman of the International Monetary and Financial Committee last month.

In a separate interview, Carstens said the IMF's existing lending tools are "adequate, by and large." It'll be important for the fund to secure approval of reforms that would permanently increase the IMF's financial

resources, he said on Sunday in Washington. U.S. lawmakers have been blocking changes that would double the IMF's capital while giving more voting power to emerging markets.

Nobel laureates Joseph Stiglitz and Paul Krugman have criticized the IMF for pushing countries too hard to cut public spending when their economies are weak. Yet Shanmugaratnam said the IMF now takes a more "sophisticated" view of fiscal policy that encourages countries to be flexible in their short-term deficit targets as long as they have sound medium-term plans to contain debt.

### 'Conservative' Stance

"We don't just advocate fiscal stimulus for the sake of it," he said. "We're very conservative on fiscal policy over the medium to long term."

Shanmugaratnam said emerging markets are destined to exert growing influence at the IMF, which was conceived during World War II to help countries coordinate monetary policy and stabilize exchange rates.

It's only a "matter of time" before China's yuan is included in the basket of currencies that IMF members can count toward their official reserves, he said. The fund plans to complete its twice-a-decade review of its so-called Special Drawing Rights late this year.

"The Chinese have been preparing themselves very well for this," Shanmugaratnam said. "I don't think it'll take very long."

Shanmugaratnam also said it's inevitable the fund will one day be led by someone from an emerging market, breaking the tradition of European managing directors.

Lagarde, 59, was appointed in July 2011 for a renewable five-year term. The managing director is selected by the IMF's 24 executive directors, who represent the 188 member nations.

"I would find it very odd if you don't get an emerging market head at some point, but the best way of achieving it is sticking to the principle of meritocratic selection," Shanmugaratnam said.