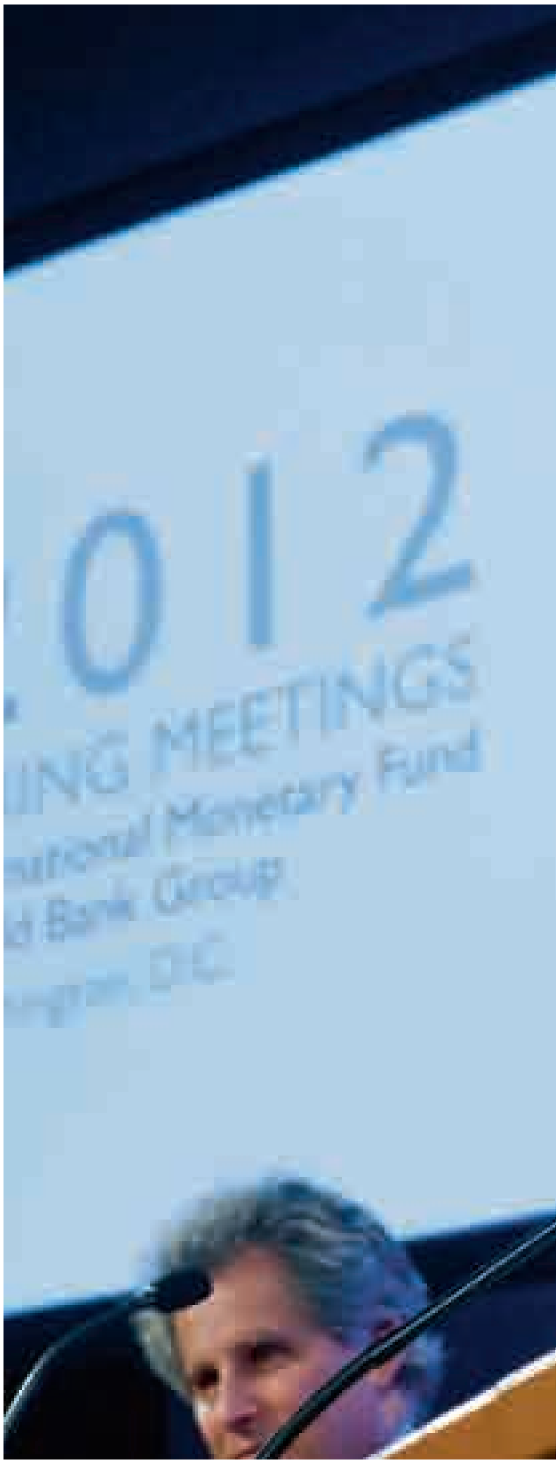
Strengthening the International Monetary Fund

Although the lending capacity of the IMF is set to double, its balance sheet is still relatively small, certainly in the face of massive sovereign debt, but the expertise of the IMF could be more widely used



By Domenico Lombardi, president, Oxford Institute for Economic Policy, and senior fellow, Brookings Institution

At the spring meetings of the International Monetary Fund (IMF) in April 2012, several member countries pledged more than $430 billion to increase the institution's resources. In practice, the IMF's lending capacity will double to some $800 billion once these pledges kick in. While a few countries have already made an unconditional commitment, some need to consult their constituencies at home before they can finalise any pledges – including Brazil, China, India and Russia.

No doubt the Los Cabos Summit will provide the opportunity to finalise those commitments and reiterate the membership's support for the IMF. As it stands, the IMF has already activated the contingent facility of the New Arrangements to Borrow, and its promised doubling of the capital base – as endorsed at the G20 Seoul Summit in November 2010 – may take longer than initially envisaged. As a result, these renewed commitments by the membership could not have been more timely.

Yet it would be a missed opportunity if the summit were to turn into an accounting exercise about the IMF's finances. The aim of having leaders of systemically important countries focus on IMF issues is to provide political momentum for bolder discussions on IMF policies. In fact, the crucial question that leaders should ask themselves is not 'how much' but 'why'. That is, what exactly is the strategy underlying the doubling of the IMF's lending capacity?

So far, the answer has been rather unclear. Following the demise of the Bretton Woods exchange rate system in the 1970s, the IMF lost its credit union character and has since become a lender to small and medium-sized developing economies. Its financial capacity has steadily declined in relative terms, but the segmentation of its borrowing clientele has enabled the IMF to cope with the rationing of resources imposed by its main shareholders.

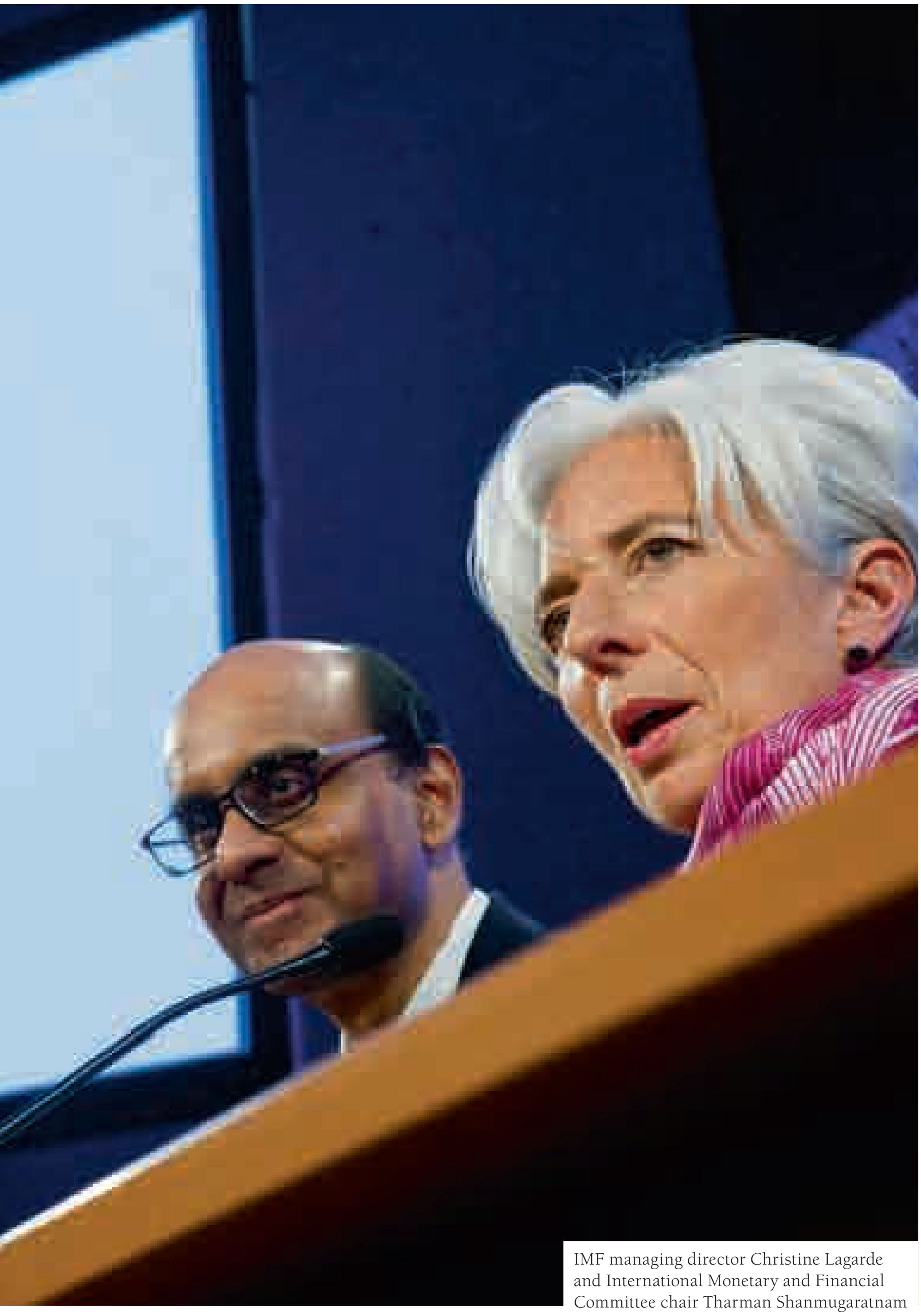
The ongoing European crisis, however, has brought pressure to bear on this fundamental limitation. With a current lending capacity of less than $400 billion, the IMF can hardly exert any systemic role in today's global financial system. For instance, given its status as a de facto minority shareholder in the rescue programmes to peripheral eurozone economies, the IMF has not been in a position to voice its concerns and its input effectively as far as programme design is concerned.

A crucial, stabilising role

In the case of Greece, the IMF had highlighted the need for private sector involvement from the start, but no one listened until it was rather late. Based on this unbalanced relationship with the other European lenders, the IMF may decide to retrench from the European crisis, mitigating its exposure to the new rescue programmes in the periphery.

As for the larger sovereigns under stress, Italy and Spain, the IMF has hardly been a feasible option. Their funding needs are too great for the IMF's meagre balance sheet and calls by the IMF for precautionary programmes for these two countries have hardly been heard in Rome or Madrid.

Some highlight the fact that, at the height of the international financial crisis, the IMF played an important, stabilising role vis-à-vis Colombia, Mexico and Poland, through its uncapped, crisis-prevention flexible credit line (FCL). Indeed, following news of their precautionary programmes, market spreads narrowed in these countries.



IMF managing director Christine Lagarde and International Monetary and Financial Committee chair Tharman Shanmugaratnam

The comparison with Italy and Spain, however, would be ill suited, even assuming that Italy and Spain might qualify for an FCL, which is unlikely. In the case of the FCL-supported countries, the IMF had the financial capacity to stabilise the countries' rollover needs, in the event their economies had been cut off from markets.

Asymmetric prospects

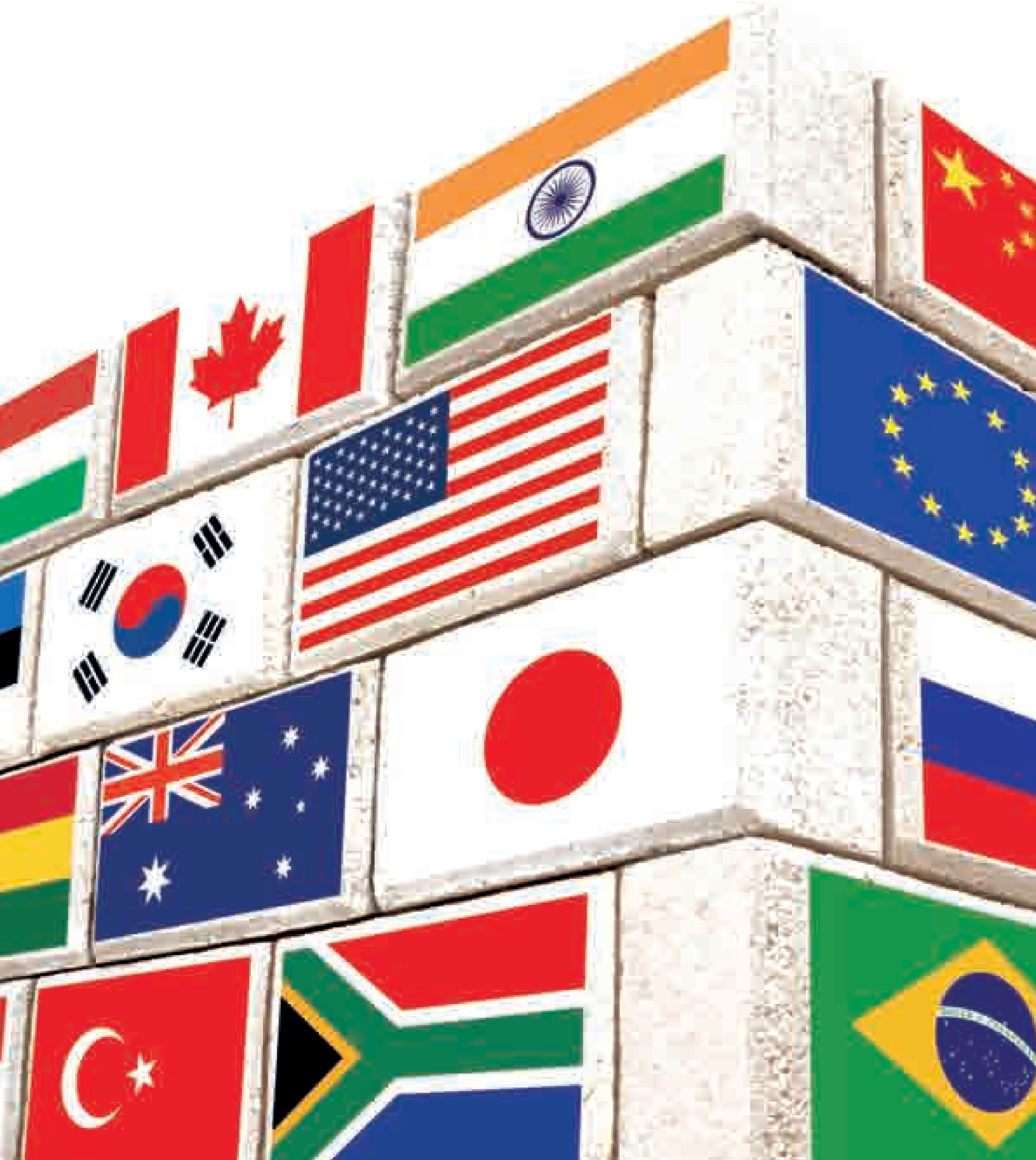
This is simply not the case for the larger eurozone sovereigns. As a result, they are confronted with an asymmetric prospect. If they request an IMF programme, they face, as each potential IMF borrower does, the risk of an (unpalatable) market reaction that could escalate the very outcome they are trying to diffuse by bringing the IMF on board: that is, an unsustainable increase in spread that would, de facto, cut their economies out of markets.

Unlike FCL-supported economies, however, there would be no way for the IMF to step in the larger eurozone sovereigns and counter adverse developments, given the IMF's limited financial capacity. Should Italy and Spain request a precautionary arrangement so as to diffuse market pressure, they could potentially escalate the very political and financial risks they are trying to avoid.

The only way the IMF option may be feasible is if the European Central Bank (ECB) were to rely on IMF conditionality to contain the moral hazard that, under an extreme scenario, the ECB's own emergency large-scale interventions would trigger. This is, however, hardly the precautionary programme that the IMF has successfully offered to other member countries.

In the IMF's almost 70 years of history, the effectiveness of its advice in shaping the policies of member countries has been invariably tied to its actual or potential role as lender. This argues for a greater lending capacity for the institution, whose resources would be drawn with conditionality and only if needed, then refunded with interest.

This is crucial for establishing the IMF's role as a fundamental interlocutor during times of systemic crisis and for providing it with actual leverage in the shaping of crisis resolution. The alternative is a subaltern institution that would be called on to top up financial needs wherever a crisis erupts. ■



The future of the World Bank: considering the options

With more and more institutions providing support for the development of poor and emerging market economies, the World Bank needs to consider its role and reinvent itself accordingly

By Johannes F Linn, Brookings Institution

Twenty years ago, the World Bank was still the biggest and most powerful international development agency. Today, it is just one of the many institutions that support the development of poor and emerging market economies. Over the next 10 to 20 years the World Bank faces three options: it can continue on its current path of gradual decline; it might be radically scaled back and eventually eliminated; or it can dramatically reinvent itself as a finance institution that bundles resources targeted on growing global needs.

Option 1: Continued gradual decline

Under the first option, reflecting a business-as-usual approach, the World Bank will continue to diminish in scope, funding and relevance, as many developing countries find it insufficiently responsive to their needs. They have seen the regional development banks growing in importance, and emerging market economies have set up their own thriving development banks without the participation of the industrial countries.

This trend will be reinforced with the creation of a 'South Bank', as supported by the recent BRICS summit.

At the same time, the World Bank's soft loan window, the International Development Association (IDA), may face reduced funding from industrial countries that are deep in fiscal crisis; from heightened competition from other concessional funds, including the new climate funding mechanisms; and from a perception of reduced need, as many of the large formerly poor developing countries graduate to middle-income status. And the World Bank's status as a knowledge leader will be increasingly challenged by the rise of the developing countries' own analytical capacity and by a proliferation of private and official agencies currently doling out advice and technical assistance.

Option 2: Breaking up the World Bank

In 2000, a US congressional commission released its report recommending far-reaching changes in the roles of the International Monetary Fund and the World Bank, designed to reduce the scope and financial capacities of these institutions in line with the conservative leanings of the commission. For the World Bank, the report called for much of its loan business to be devolved to the regional development banks. The report garnered some attention when it was issued, but appeared not to have much impact subsequently.

Global financial crises are likely to recur and require institutions like the World Bank to help provide safety nets and the structural foundations of long-term growth

While there is no imminent risk of the break-up of the World Bank, it could face a 'perfect storm' in the coming years as a result of a combination of factors: fiscal austerity and conservative governments in key industrial countries, a declining interest of the developing countries and rising concern about the fragmentation of the international aid architecture. There is an increasing overlap on the ground in the day-to-day business of the World Bank and that of the regional development banks. With their growing financial strength, institutional capacity and dynamism, and the apparently greater legitimacy of regional development banks among their regional members, shareholders might eventually decide that they would prefer the consolidation of the World Bank with the regional development banks, in favour of the latter.

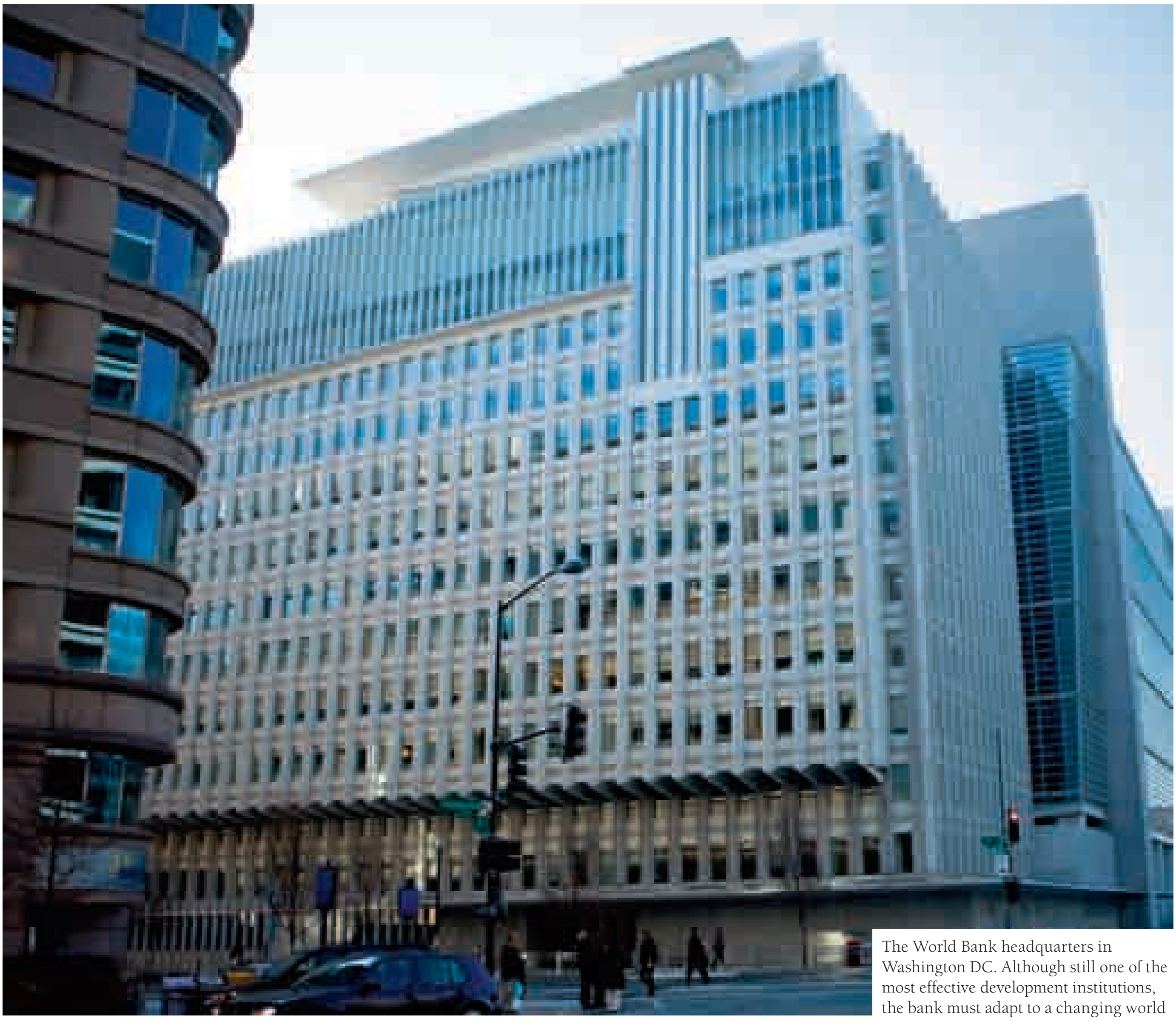
This drastic step would be difficult to take politically, financially and administratively. However, the new World Bank president, Jim Yong Kim, would be well advised to be prepared for the possibility of such a perfect storm. The more the World Bank is seen to fade away, as described under the first option above, the greater is the likelihood that this second option would be given serious consideration.

Option 3: A stronger global institution

Despite a decline in its role, the World Bank today is still one of the strongest and most effective development institutions in a world that needs strong and effective global institutions. According to a recent independent study by the Brookings Institution and the Center for Global Development, the IDA consistently ranks among the very top multilateral and bilateral aid agencies. A third, radically different, option from the first two would build on this strength to ensure that the world has an institution, 10 to 20 years from now, that helps the international community respond to the many global challenges that the world will undoubtedly face. These are: continued poverty, hunger, conflict and fragility, as well as major infrastructure and energy needs, education and health challenges, and global warming and environmental challenges.

How the World Bank might change

Moreover, global financial crises are likely to recur and require institutions like the World Bank to help provide safety nets and the structural foundations of long-term growth, as the World Bank did during the recent global crisis. How should it respond to such a broad mandate? First, the World Bank would substantially strengthen the role of its technical departments relative to the country



The World Bank headquarters in Washington DC. Although still one of the most effective development institutions, the bank must adapt to a changing world

departments and would fortify its reputation as an institution that can muster the strongest technical expertise, fielding teams with broad global visions to support systematically the pursuit of long-term sectoral and sub-sectoral strategies at country level, linked with regional and global initiatives, and involving public-private partnerships to assure that development challenges are addressed at scale and in a sustained manner.

Second, since all countries have unmet long-term finance needs and require access to global best practice in areas such as infrastructure, energy, climate change and the environment, the World Bank would open up its funding and advisory windows to all, not just developing countries.

Thus it would become the global equivalent of the European Investment Bank (EIB) and of the German Kreditanstalt für Wiederaufbau (KfW), which have successfully supported the infrastructure development of the more advanced countries along with developing countries. Third, for those countries with strong project management capacities, the World Bank would dramatically simplify its lending processes, following the example of the EIB. This would make it a much more efficient operational institution that would be a more attractive partner to its borrowing member countries.

Fourth, the World Bank would focus its own knowledge activities and its support for research and development on a search for effective and scalable solutions, linked closely to its operational engagement that would be specifically designed to support the scaling up of tested innovations.

Fifth, the membership of the World Bank would fix some fundamental problems with its financial structure and governance. It would invite the emerging market economies to make significantly larger contributions to its capital base reflecting their enhanced financial capacities. It would revamp its voting and voice rules in line with the changed global economic weights and financial contributions of emerging markets. And it would select its leadership on the basis of merit without reference to nationality.

Charting a course for the World Bank

With guidance and support from the G20, the World Bank and its new president will have to make a choice between these three options. Undoubtedly, the easiest choice is business as usual. But the leaders of the G20 should understand that Options One and Two are not in the interest of their countries and of the international community.

Clearly, the World Bank should remain a key part of the global governance architecture. But this requires that the G20 forges an ambitious long-term vision for the World Bank – something that has been lacking for the last 30 years – and then support the reform of the institution and build the authorising environment that will make it possible to achieve the vision. ■

Evonik Industries

With an eye for the world's future challenges

Politics, society, and industry are facing enormous global challenges. Today, around seven billion people are living on our planet. According to a forecast by the United Nations, this number will rise to about eight billion by the year 2025, and to nine billion by 2050. The consequences such as the growing scarcity of economically useable resources are already tangible. According to the World Health Organization, more than a sixth of the global population has no access to clean drinking water. The Food and Agriculture Organization estimates that around one billion people are suffering from malnutrition. Climate change and its implications are threatening to irreversibly damage the basis of our subsistence on the planet.

As one of the world leaders in Specialty Chemicals, Evonik Industries is determined to contribute to overcoming these global challenges with its innovative products and solutions – while at the same time harnessing the potential we see in them for our business.

We focus on economic megatrends – namely, resource efficiency, health and nutrition as well as globalization – and tap the promising markets of the future. Evonik's guiding principles in this endeavor are a strong interconnectedness and interdependence of economic success and responsibility.

In keeping with this, the Group also markets products which lead to an increase in energy efficiency during the customer's use phase, thus resulting in a decrease in greenhouse gas emissions.

Energy-saving tires are just one example. Evonik's silica-silane system used in modern automobile tires achieves a significant reduction in fuel consumption without compromising the tires' wear performance. What's more, road users' safety has even improved with the decisive wet grip thanks to Evonik's technology.

Another example is the energy-saving light bulb. Modern energy-efficient lamps or compact fluorescents consume less electrical energy than conventional light bulbs. By using special oxides from Evonik such as fumed aluminum oxides, the lifespan of energy-saving light bulbs can be increased significantly. This, in turn, paves the way for additional manufacturing-related CO_2 emission savings.

Insulating materials are another lever for further emission savings. Evonik has already spent 50 years developing indispensable additives, especially foam stabilizers, which are of major significance for producing and optimizing foam properties. Innovations are made possible thanks to ultrafine cell structures, which improve the foams' heat-insulating properties and, thus, also make a contribution to climate protection. The foam stabilizers are based on organically modified siloxanes, so they are derived from a type of chemistry in which Evonik already has broad expertise.

Other products of Evonik Industries help to meet the demand for meat, milk, and eggs and, thereby, contribute to a sustainable protein supply in the nutrition of the global population. Evonik is the only company worldwide to produce and market all four key amino acids for advanced animal nutrition such as DL-methionine and L-lysine, benefitting human beings, animals, and the environment.

Just as vitamins are vital for human beings and animals, amino acids are, too. They are the building blocks for all proteins forming skin, meat, and muscles. The body produces most of the amino acids itself. However, some of them have to be ingested daily, if deficiency symptoms are to be avoided. Traditional animal feed such as soy or corn lack one or various amino acids. For instance, if you only feed a chicken with vegetable proteins, it will suffer from a methionine deficiency. Evonik can efficiently fill such gaps: Just one kilogram of the essential methionine and two kilograms of lysine can replace 54 kilograms of fish meal and 34 kilograms of soybean meal. The decisive advantage here is that for each kilogram of weight gain in the animal, only about half as much nitrogen is released in the manure as for feeds with high protein content. It thus reduces over-fertilization of soil and minimizes the risks of groundwater contamination. In addition, it reduces the need for energy-intense imports of soybean meal as domestic wheat production more and more replaces the soy imports and is sufficiently available to meet the demand.

Isophorone chemistry is another of Evonik's core businesses. With over 40 years of experience and as one of the leading companies in this field, Evonik covers the whole production chain of isophorone and its derivatives. Main applications comprise eco-friendly coating systems and high-performance composites among others. The latter are used in the construction of wind turbines. However, this is not the only product that Evonik supplies for the expansion of wind power. We also produce innovative adhesive additives for the rotor blades of wind turbines. They ensure the right degree of viscosity, stability, and a simple adhesive application procedure on the rotor blade halves, when bonding the rotor blades.

Linking innovative drive and closeness to the customer is one crucial success factor and engine for profitable growth at Evonik. By drawing up new and optimized products or applications for our customers every day, we are making a valuable contribution for more resource efficiency and sustainability.

One of Evonik's latest products is hydroxy-terminated polybutadiene. With a new production site currently under construction in Marl, Germany, the company is bolstering an innovative polymer material which is used, for example, in sealants for highly insulating, triple-glazed windows or lightweight designs for the automotive industry.

Furthermore, Evonik has developed a new manufacturing process for MMA (methyl methacrylate), the starting material for acrylic glass. Like the traditional ACH sulfur process, the new AVENEER® process is based on the starting materials ammonia, methane, acetone, and methanol – but without the additional use of sulfuric acid. With no more need for the recycling of sulfuric acid, the process saves costs and conserves resources.

The new technology also stands out for its flexibility both in terms of location and the technology used. First, AVENEER® can be used at typical chemical sites all over the world, and second, it allows the retrofitting of existing plants at Evonik. The feasibility of the process has already been proven at pilot plant scale. The Group is now planning to construct its first full-scale production plant.

All these examples clearly demonstrate the central role of industry as creator and facilitator of smart solutions for the global challenges ahead. A strong and successful industry is key to further advancing on the path to new technologies and greater efficiency – this needs a broad, research-conducting and manufacturing industry as the basis, in particular, of a Green Economy. For Evonik, an innovative corporate culture, a holistic approach to societal questions, and value-adding actions are the key to success.

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