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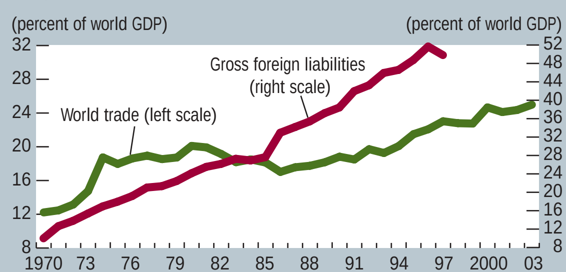
Forces Shaping the

THE EVOLUTION OF the global economic and financial environment over the past 60 years has shaped the way the IMF has carried out its work. Peering into the crystal ball, one can get a sense of some of the forces likely to shape the IMF over the next 25–50 years. Certainly, the enormous growth in the volume of international transactions is likely to continue to mean larger potential external shocks facing countries and, thus, higher financing needs.

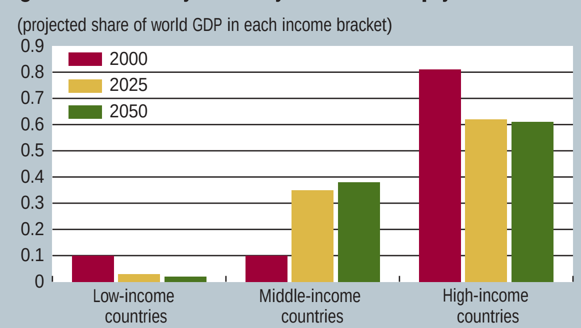
Some countries can tap international financial markets to finance temporary imbalances. However, in recent years, the IMF has seen a sharp increase in the demand for financial support from middle-income countries, many of which have only limited access to these markets, and an IMF study suggests that their number is on the rise.

Since 1970, world trade has doubled; the stock of global financial assets has quintupled.



Source: IMF.

The share of middle-income countries in the global economy is likely to rise sharply.

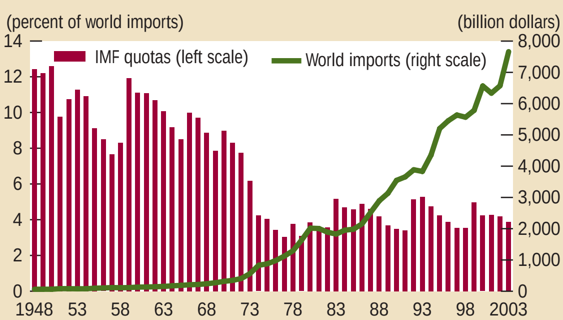


Source: IMF staff calculations.

How adequate are the IMF's financial resources—its quotas—to meet this growing demand? IMF resources have expanded broadly in line with world trade since 1970, roughly doubling every 10 years. But going forward, further steep increases may be needed.

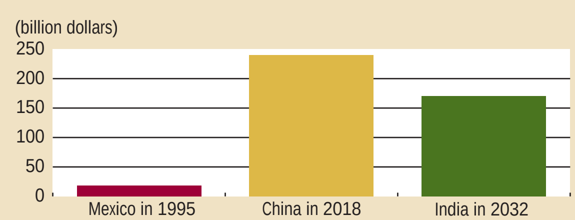
For example, how much money would be needed to help India and China if they ran into financial trouble? In 1995, the IMF provided Mexico with $18 billion (6.3 percent of the country's GDP) in financial support. By the time China and India reach similar levels of income in 2018 and 2032, respectively, the required funds could well be of a magnitude that would dwarf the present-day level of IMF resources.

IMF quotas fell from 12 percent of world imports in 1948 to about 4 percent by the early 1970s and have since stayed at that level.



Source: IMF.

Hypothetical IMF rescue packages for China and India could hit $240 billion and $170 billion, respectively, in today's dollars.



Sources: Goldman Sachs; and IMF staff calculations.

Prepared by Eduardo Borensztein, a Division Chief in the IMF's Research Department.

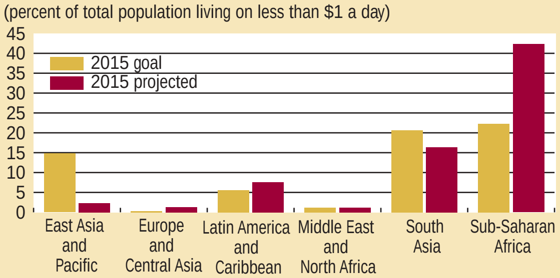
IMF of Tomorrow

How about demands from the poorest countries? Although Asian countries are projected to exceed their Millennium Development Goal of halving income poverty by 2015, sub-Saharan African countries appear seriously off track, meaning that they are likely to continue to need financial aid over the coming decades.

Aging populations in developing countries could be another source of demand for IMF resources. Over the next decade or two, these countries will benefit from capital outflows from advanced economies, where the stock of savings of aging populations will continue to rise and investment will fall in line with the shrinking labor force. But later, public pension deficits and spending by retirees may cause these capital outflows to dry up.

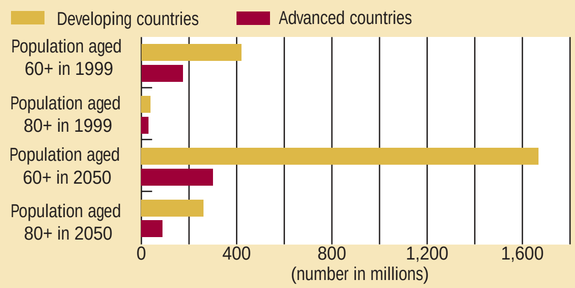
On current trends, Africa will miss the Millennium Development Goal for reducing poverty by a long shot.

(percent of total population living on less than $1 a day)



Source: World Bank staff estimates; and IMF–World Bank *Global Monitoring Report 2004.*

The number of elderly people will increase markedly in developing countries.



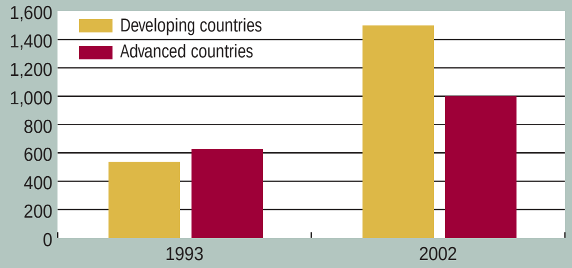
Source: United Nations.

However, other developments may temper future demands on IMF resources. In recent years, many developing countries have increased their holdings of foreign reserves as insurance against potential crises, and there has been a shift toward more flexible exchange rate regimes, which could also reduce the incidence of currency crises.

In addition, the International Country Risk Guide—an index that measures political risk—suggests that although the gap between developing and advanced countries remains substantial, the quality of institutions has been improving. This could help reduce demands on IMF resources, as countries with better institutions attract safer forms of investment (such as foreign direct investment), enjoy greater market confidence, and are better able to take unpopular crisis prevention measures.

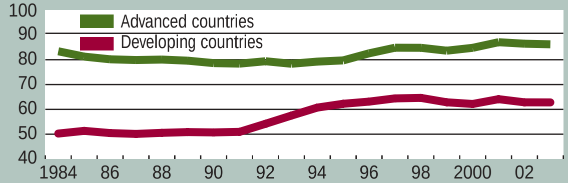
But developing countries have almost tripled foreign reserve holdings over the past decade . . .

(billion dollars)



Source: IMF.

and noticeably improved the quality of their institutions, reducing political risk.



Source: Political Risk Services.
Note: Based on International Country Risk Guide index; 100 is highest political risk.