THE IMF: INSTRUMENTS, STRATEGIES AND RESPONSE TO RECENT CRISES

Lecture 4

LIUC 2014

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WHAT IS THE INTERNATIONAL MONETARY FUND?

- The IMF is an international cooperative financial institution.
- Each member deposits a sum of money into a pool of resources, which is then available for making loans to those members that need financial assistance to pay their external obligations.
- It does not fund specific projects, nor does it provide direct funding to government budgets.
- It makes foreign exchange available to member countries' central banks to add to their reserves.
- Beyond financing: technical assistance, surveillance

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ORIGINS OF THE IMF

- The need for an institution like the IMF became apparent during the ***Great Depression*** of the 1930s.
- In efforts to shield their economies from the effects of the worldwide crisis, governments adopted policies that ***restricted imports and capital flows***.
- Some also sharply ***devalued their currencies*** to try to boost their own exports at the expense of those of other countries.
- The most damaging effect of these policies was a ***collapse of world trade***, which only worsened the problems in the world economy.

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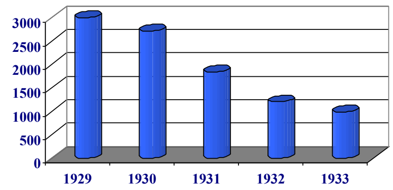
ORIGINS OF THE IMF (cont.)

World trade, 1929-1933

(in millions of U.S. dollars)



Klindleberger, C., "The World in Depression 1929-1939."

In 2012 world trade merchandise 17930 bil US$

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ORIGINS OF THE IMF (cont.)

- Several international conferences convened in the 1930s to address these problems ended in failure, but two economists, White (USA) and Keynes (GB) put forward proposals in the early 1940s for an international institution that would foster international monetary cooperation after the war.

- Negotiations for establishing the IMF were concluded at ***Bretton Woods***, New Hampshire, U.S.A. in July 1944. The IMF began operations in Washington, D.C. in May 1946. It then had 39 members.

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GOVERNANCE

- The IMF is governed by the member countries themselves, through the ***Board of Governors***, which consists of one governor from each member country. Governors are usually Ministers of Finance or heads of Central Banks. The Board of Governors meets only during annual meetings.

- The day-to-day affairs of the Fund are guided by the ***Executive Board***, a group of 24 representatives of the member countries, that meets in formal session at least three times a week. Single-country constituencies: USA, UK, Fr, Ger, Japan, SA, Russia, China

- The IMF has a staff of about 2400, headed by the Managing Director, Christine Lagarde, a French national. The staff come from over 140 of the IMF's member countries (188; *last to join South Sudan, April 2012*)

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GOVERNANCE
Funding, Quotas and Voting

- The capital base of the IMF consists of membership **quotas**, the financial contributions made by the member countries.
- The IMF uses a quota formula to guide the assessment of a member's relative position. Members' quotas are broadly determined by their ***economic* position** relative to other members.The current quota formula is a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent).
- The quota "deposits" of members are remunerated, and members pay **interest** on the loans they receive from the IMF; the Fund's expenses are paid for by the interest rate spread between the two.

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GOVERNANCE
Funding, Quotas and Voting *(cont.)*

- A member's quota determines, in particular, its **voting power** and **access to financing.**
- **Voting**: basic votes + one vote for each SDR 100.000
- **Access to financing**: The max amount of credit that a member may obtain from the IMF is based on its quota. Before the global crisis a member could borrow ex SBA up to 100% of its quota annually and 300% cumulatively. These access limits have now doubled (they are now 200 and 600% of quota, respectively).
- Access can however be increased under **exceptional circumstances** (Greece 22 times its quota, quota about 1 bill SDR, loan 22 bill SDR).

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GOVERNANCE
Quotas

- When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members that are broadly comparable in economic size and characteristics.
- The Board of Governors conducts **general quota reviews every 5-year**. *The last quota revision was concluded in December 2010.*
- Ad *hoc quota* increases outside general reviews do not occur often. The last one approved on April 28, 2008 does qualify as *ad-hoc*.

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IMF MANDATE

Article I of the ***Articles of Agreement*** says the IMF was created to:

- promote international monetary cooperation
- facilitate expansion and balanced growth of international trade
- promote exchange rate stability
- assist in the establishment of a multilateral system of payments
- make financial resources temporarily available to members experiencing balance of payments difficulties

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HOW THE IMF FULFIL ITS MANDATE?

- ***Financial assistance***: the IMF makes its financial resources temporarily available to members with balance of payments difficulties.
- ***Technical assistance***: the IMF provides expert advice to member countries in areas of its competence, including monetary and exchange rate policies, tax and expenditure policies, statistics, banking supervision, and accounting.
- ***Surveillance***: the IMF monitors economic developments and policies in each of its member countries in the context of *Article IV Consultations*. The IMF also monitors the world economic situation and prospects in its bi-annual *World Economic Outlook.*

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FINANCIAL ASSISTANCE

IMF financial assistance is available only to members that face ***balance of payments difficulties***.

Financial assistance is available under various loan programs that differ in repayment terms, interest rates, country eligibility, and the conditions that are required for loan approval:

- ***Reserve tranche***; a limited amount of unconditional credit
- ***Regular credit facilities***; available under conditions of reform
- ***Concessional assistance***; only for the poorest countries
- ***Other facilities***; for special situations, such as the aftermath of war or a natural disaster

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FINANCIAL ASSISTANCE
The reserve *tranche*

- It is the 25% of quota that member countries have paid in foreign exchange. It is considered part of countries' international reserves (just like any other foreign exchange at the central bank) and is available automatically for countries that demonstrate a balance of payments "need."
- Once a member has exhausted the reserve tranche, other resources are available, but usually **under conditions (ex-ante, or ex-post).** Countries must adopt a program of economic adjustment to correct the problems that led to the balance of payments difficulties.

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FINANCIAL ASSISTANCE
Conditionality: ensuring that money is used effectively

- When a member country is seeking a loan from the IMF, it agrees to implement policy measures that will enable it to resolve its BoP problems.
- These measures also serve as a guarantee that the country will be able to repay the IMF.
- Conditionality may take the form of ex ante conditionality (pre-set rigorous qualification criteria) and/or ex post conditionality (monitoring of program implementation).

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FINANCIAL ASSISTANCE
Conditionality: ensuring that money is used effectively

- Loans are normally disbursed in ***installments***, subject to progress in implementing the program.
- Monitoring relies on different tools:
  - ✓ **Prior actions** to be taken *before* the IMF's Executive Board approves financing or completes a review;
  - ✓ **Quantitative performance criteria *(QPC)*** *specific conditions that have to be met for the agreed amount of credit to be disbursed;*
  - ✓ **Structural benchmarks** are (often non-quantifiable) reform measures that are critical to achieve program goals and are intended as markers to assess program implementation during a review. They vary across programs: examples are measures to improve financial sector operations, build up social safety nets, or strengthen public financial management.
  - ✓ **Program review** provides a framework to assess whether the IMF-supported program is broadly on track and whether modifications are necessary for achieving the program's objectives.

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FINANCIAL ASSISTANCE
Policies in IMF-supported programs

Typical policies included in IMF-supported programs

- ***Fiscal policy measures*** to reduce government deficits to a size that can be financed without causing macroeconomic problems and that makes government debt dynamics sustainable
- A ***monetary and exchange rate policy*** that supports sustainable balance-of-payments and external-debt positions
- ***Structural reform measures*** that improve the functioning of labor and product markets
- Measures to maintain or ***improve the soundness of the banking system*** and the infrastructure of financial markets

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FINANCIAL ASSISTANCE
How has conditionality evolved in recent years?

- Up to the early 1980s, IMF conditionality largely focused on macroeconomic policies. Then the complexity and scope of the structural conditions increased significantly, reflecting in part the growing involvement in low-income and transition countries, where structural problems were particularly severe.
- Following harsh criticism on the conditionality approach, a comprehensive review was undertaken to make it more focused and effective.
- It highlighted the need to: require better justification of criticality, establish explicit links between goals, strategies and conditionality, and enhance countries' ownership.
- Accordingly, the IMF has been striving to focus more sharply and be more clear about the conditions attached to its financing, and to be flexible and responsive in discussing alternative policies with countries requesting financial assistance.
- Conditionality is periodically review. Last Board discussion June 2012. No major changes.

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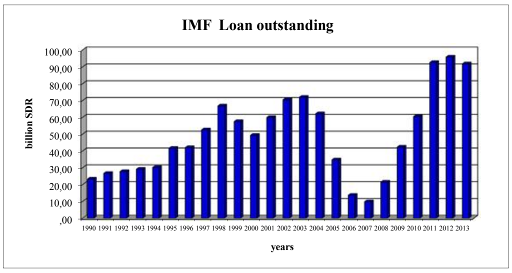
FINANCIAL ASSISTANCE



Data as of Sept 2013. As of oct 2018 total outstanding loans = 85,2 bill SDR

Forward commitment capacity 273.9 bill SDR, nov 2014

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FINANCIAL ASSISTANCE
Non concessional facilities

i. Stand-by Arrangements (SBA)

- Short-term loans to cover BoP deficits of a temporary nature. The length of a SBA is typically 12–24 months, and repayment is due within 3¼-5 years of disbursement.
- Installment release subject to periodic review of economic policies
- Total commitment for current agreements (6 agreements): **SDR 11,9 billion** (*as of Nov, 2014, Bosnia, Georgia, Jordan, Tunisia, Romania, Ukraine)*

ii. Extended Fund Facility (EFF)

- Medium-term loans, often support structural reforms. Instalment paid out over period of three years , loan repayments made over period between 4½ to 7 years
- Installment release subject to periodic review of economic policies
- Total commitment for current agreements (7 agreements): **SDR 30 billion** (*as of Novt, 2014, Greece 21 bil)*

FINANCIAL ASSISTANCE
Non concessional facilities (cont.)

iii. Flexible Credit Line (FCL) ***from March 2009***

- Provides large, upfront, quick-disbursing financing for countries with very strong fundamentals, policies, and track records of policy implementation and meeting pre-set qualification criteria.
- Particularly useful for crisis prevention purposes.
- Access is determined on a case-by-case basis, is not subject to the normal access limits. Disbursements under the FCL are not conditioned on implementation of specific policy understandings as is the case under the SBA and EFF.
- Already approved: SDR 22 billion for **Poland**, and SDR 3.9 billion for **Colombia**, SDR 47,3 billion for **Mexico.** In all cases authorities have stated they intend to treat the arrangement as precautionary and not draw on the line.
- Total commitments for current agreements : **SDR 73,1 billion** (*as of Nov 2014*)

FINANCIAL ASSISTANCE
Concessional facilities

- The new concessional facilities for Low-income countries (LICs) were established in Jan 2010 as part of a broader reform to make the Fund's financial support more flexible and better tailored to the diverse needs of LICs.
- Access limits and norms have been approximately doubled compared to pre-crisis levels. Financing terms have been made more concessional, and the interest rate is reviewed every two years.
- All facilities support country-owned programs aimed at achieving a sustainable macroeconomic position consistent with strong and durable poverty reduction and growth.

FINANCIAL ASSISTANCE
Concessional facilities *(cont.)*
i. *The Extended Credit Facility (ECF)*

- It's the Fund's main tool for providing medium-term support to LICs with protracted balance of payments problems .
- Terms:. Financing under the ECF currently carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 year
- Total commitments for current agreements (17 arrangements): **SDR 2,1 billion** *(as of nov 2014*)

ii.The Standby Credit Facility (SCF)

- Provides financial assistance to LICs with short-term balance of payments needs.
- Terms: currently carries a zero interest rate, with a grace period of 4 years, and a final maturity of 8 years.
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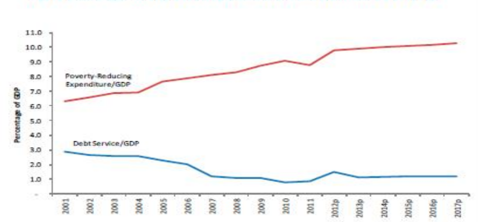
THE HIPC AND MDRI INITIATIVES

- The HIPC initiative relieves the debt of heavily-indebted poor countries
- How much debt relief?
  - A country should be in a position to service its external debts without the need for further debt relief and without compromising growth
- Multilateral Relieve Initiative
- In June 2005, the G-8 countries proposed that three multilateral institutions—the IMF, World Bank, and the AfDB cancel 100 percent of their debt claims on countries that have reached, or will eventually reach, the completion point under the HIPC initiative. In 2007, IaDB joint the MDRI.
- Cost of the Initiatives

About 100 bill US dollar in NPV-2011

Debt relief under the initiatives has substantially alleviated debt burdens in recipient countries and enabled them to increase their poverty reducing expenditure

Figure 1. Average Poverty Reducing Expenditure and Debt Service in HIPCs [1]



Sources: HIPC documents and IMF staff estimates.
[1]For detailed country data and projections, refer to Appendix III Table 2 and 3.

Source IMF: HIPC and MDRI—Statistical update April 2013

How did the IMF respond to the crisis?

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IMF response to the crisis

As the world economy has been hit by the worst crisis in many generations, the IMF mobilized on many fronts to support its member countries by:

- Tripling its resources to **$750 billion** (through a number of bilateral loan agreement and an extension of the New Arrangement to Borrow (NAB))
- A general allocation of SDRs ($250 billion)
- Gold sales
- Stepping up **crisis lending**
- Providing analysis and targeted **advice**
- Becoming more **flexible** (simplification of cost and maturity structures for facilities, new flexible credit line, away with "hard" structural conditionality, doubling normal access limits)
- Reforming its **governance**

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Governance Reform

- On April 28, 2008, a **large-scale quota and voice reform** in the making for nearly two years was adopted by a large margin by the Board of Governors. Two steps reform, first step Singapore 2006 ad hoc increase (China, Korea, Mexico, Turkey)
- Main elements of the reform package:
  - ✓ new quota formula.
  - ✓ Ad-hoc quota increases to all 54 countries that were under-represented under the new quota formula.
  - ✓ Tripling the number of basic votes to increase the voice of low-income countries, as well as protection of the share of the basic votes in total voting power going forward.
  - ✓ Providing resources for an additional Alternate Executive Director for the two African chairs represented on the IMF's Executive Board.
  - ✓ Realigning quota and voting shares every five years.

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The 2010 Governance reform

On December 15, 2010, the Board of Governors approved far-reaching governance reforms under the 14th General Review of Quotas. It will:

•double quotas from approximately SDR 238.5 billion to approximately SDR 477 billion, (close to US$725 billion at current exchange rates).

•shift more than 6 percent of quota shares from over-represented to under-represented member countries.

•significantly realign quota shares. China will become the 3rd largest member country in the IMF, and there will be four emerging countries (Brazil, China, India, and Russia) among the 10 largest shareholders in the Fund, and

•preserve the quota and voting share of the poorest member countries.

To become effective, an amendment to the Articles of Agreement will need to be accepted by three-fifths of the members, having 85 percent of the total voting power. Not yet.

OUTCOMES OF THE 2008/2010 quota REFORM

	Pre-Singapore	Post-second Round (08)	New (10)
Advanced economies	61.6	60.4	57.6
Emerging Market and Developing Countries	38.4	39.6	42.4

Quota and Voting Shares Before and After Implementation of Reforms Agreed in 2008 and 2010
(In percentage shares of total IMF quota)

	Quota Shares				Voting Shares			
	Pre-Singapore (i)	As of March 2, 2011 (ii)	Post-2008 Reform (iii) (vi) (v)	Post-2010 Reform (iv), (v)	Pre-Singapore (i)	As of March 2, 2011 (ii)	Post-2008 Reform (iii) (vi) (v)	Post-2010 Reform (iv), (v)
Advanced economies	61.6	60.5	60.4	57.6	60.6	59.5	57.9	55.2
Major advanced economies (G7)	46.0	45.2	45.3	43.4	45.1	44.3	43.0	41.2
United States	17.4	17.1	17.7	17.4	17.0	16.7	16.7	16.5
Other	28.6	28.1	27.6	26.0	28.1	27.6	26.3	24.7
Other advanced economies	15.6	15.3	15.1	14.3	15.4	15.2	14.9	14.0
Emerging Market and Developing Countries	38.4	39.5	39.6	42.4	39.4	40.5	42.1	44.8
Developing countries	30.9	32.1	32.4	35.1	31.7	32.9	34.5	37.1
Africa	5.5	5.4	5.0	4.4	6.0	5.9	6.2	5.7
Asia (vii)	10.3	11.5	12.6	16.0	10.4	11.6	12.8	16.1
Middle East, Malta & Turkey	7.6	7.6	7.2	6.7	7.6	7.6	7.3	6.8
Western Hemisphere	7.5	7.6	7.7	7.9	7.7	7.8	8.2	8.4
Transition economies	7.6	7.4	7.1	7.2	7.7	7.6	7.6	7.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Memorandum items:								
EU 27	32.9	32.4	31.9	30.2	32.5	32.0	30.9	29.4
Low-Income Countries (viii)	4.7	4.6	4.3	4.0	5.4	5.3	6.2	5.9
Shifts from 2008 Reform								
Underrepresented countries (shift in p.p.)				6.2				5.8
Underrepresented EMDCs (shift in p.p.)				5.7				5.4
Dynamic EMDCs (shift in p.p.) (ix)				6.0				5.7
EMDCs (shift in p.p.)				2.8				2.6

Source: Finance Department.

	Pre- singapore	Post – 2010
China	2,98	6,39
Brazil	1,42	2,31
Korea	0,76	1,79
Turkey	0.45	0,97
Mexico	1.21	1,86
Saudi A.	3,26	2,09
Belgium	2,11	1,34
Germany	6,06	5,58
Canada	2,98	2,31
Venezuela	1,24	0,78

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Table 1. Distribution of Quotas and Calculated Quotas
(In percent)

	Quota Shares		Calculated Quota Shares 1/ 2/			
	Post Second Round 3/	14th Review 4/	2008 Reform (2005) 5/	14th General Review	Previous (2011)	Current (2012)
Advanced economies	60.4	57.6	63.8	58.2	54.7	52.6
Major advanced economies	45.3	43.4	47.6	42.9	39.5	37.9
United States	17.7	17.4	19.0	17.0	15.6	14.9
Japan	6.6	6.5	8.0	6.5	6.1	6.0
Germany	6.1	5.6	6.2	5.7	5.4	5.3
France	4.5	4.2	4.0	3.8	3.5	3.3
United Kingdom	4.5	4.2	4.4	4.7	3.8	3.5
Italy	3.3	3.2	3.3	3.0	2.9	2.7
Canada	2.7	2.3	2.6	2.3	2.2	2.2
Other advanced economies	15.1	14.3	16.2	15.3	15.2	14.7
Spain	1.7	2.0	2.3	2.2	2.1	2.0
Netherlands	2.2	1.8	1.9	1.9	2.0	1.9
Australia	1.4	1.4	1.3	1.4	1.5	1.6
Belgium	1.9	1.3	1.5	1.3	1.3	1.2
Switzerland	1.5	1.2	1.2	1.2	1.3	1.3
Sweden	1.0	0.9	1.0	0.9	1.0	1.0
Austria	0.9	0.8	0.9	0.8	0.8	0.8
Norway	0.8	0.8	0.8	0.8	0.8	0.8
Ireland	0.5	0.7	1.2	1.1	0.8	0.8
Denmark	0.8	0.7	0.9	0.7	0.7	0.6
Emerging Market and Developing Countries 6/	39.6	42.4	36.2	41.8	45.3	47.4
Africa	5.0	4.4	2.8	3.1	3.4	3.5
South Africa	0.8	0.6	0.6	0.6	0.6	0.6
Nigeria	0.7	0.5	0.3	0.5	0.5	0.5
Asia	12.6	16.0	15.8	17.7	20.6	21.7
China 7/	4.0	6.4	6.4	7.9	10.1	10.5
India	2.4	2.7	2.0	2.4	2.8	3.0
Korea, Republic of	1.4	1.8	2.2	2.1	2.0	1.9
Indonesia	0.9	1.0	0.9	0.9	1.1	1.3
Singapore	0.6	0.8	1.0	1.2	1.3	1.3
Malaysia	0.7	0.8	0.9	0.8	0.8	0.8
Thailand	0.6	0.7	0.8	0.8	0.9	1.0
Middle East, Malta & Turkey	7.2	6.7	4.8	6.2	6.4	7.1
Saudi Arabia	2.9	2.1	0.8	1.3	1.4	1.7
Turkey	0.6	1.0	1.0	1.1	1.1	1.1
Iran, Islamic Republic of	0.6	0.7	0.6	0.7	0.7	0.8
Western Hemisphere	7.7	7.9	6.6	7.0	7.3	7.4
Brazil	1.8	2.3	1.7	2.2	2.3	2.4
Mexico	1.5	1.9	2.0	1.8	1.7	1.7
Venezuela, República Bolivariana de	1.1	0.8	0.4	0.5	0.5	0.5
Argentina	0.9	0.7	0.6	0.6	0.6	0.6
Transition economies	7.1	7.2	6.2	7.7	7.6	7.7
Russian Federation	2.5	2.7	2.1	2.9	2.6	2.8
Poland	0.7	0.9	0.9	0.9	1.0	1.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Memorandum Item:						
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