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IMF emergency loans for low-income countries

At the London summit in early April, the leaders of twenty of the world's largest economies decided that the IMF will be the major international instrument to respond to the financial and economic crisis. They agreed to quadruple the Fund's resources from $250 billion to $1 trillion.

But is the IMF fit for the purpose? The same IMF imposed harmful conditions in some of their countries in the wake of the 1990s' crisis which sank their countries further.

Analysis of ten IMF agreements signed in the last six months shows that the IMF is still advising stringent fiscal and monetary policies to low income countries and controversial structural reforms.

Recent reforms at the IMF: too little, too slow

Recent changes at the IMF have left the terms of lending largely unchanged and therefore very unattractive to indebted governments. The new Flexible Credit Line (FCL), which is to provide precautionary credit with very low conditionality, is only be available for what the IMF calls "strong performers" – that is richer middle income or high income countries with policies judged adequate by the Fund.

The Fund has also recently reformed some of the features of the Exogenous Shocks Facility (ESF) to ease low income countries' access to Fund's resources in the event of external shocks. However, these changes are too little and too slow. The ESF still remains too expensive for low income countries. Particularly in times of crisis, large amounts of finance for these countries should be channelled at highly concessional terms to avoid new rounds of debt that may strangle these countries' fiscal space in the near future.

In March 2009, the Fund also phased out Structural Performance Criteria, one type of condition attached to their loans. Although welcome, this continues to leave unchanged other types of structural conditions as well as macroeconomic conditionality. These have been strongly criticized by some Southern country governments and independent researchers for obliging impoverished countries to adopt stringent fiscal and monetary policies. If this continues, it will prevent increases in government expenditure to maintain economic activity at this time of crisis and to safeguard pro-poor spending. As a government official in Sierra Leone stated, "IMF policies create and sustain poverty.[1]

There are also concerns that reforms that were previously pushed via conditionality may no longer come as binding conditions, but still feature largely in the IMF programme for the country. Although programmes are the outcome of the Fund and government negotiations, the Fund has strong leverage in defining the features of the programmes because of its ostensible technical expertise and because it controls the purse strings.

IMF conditions and advice at a time of crisis

Restrictive IMF conditions and policy advice, which have already been problematic in times of economic growth and increasing aid flows, would be reckless in times of crisis. Poorer countries must be given the fiscal space necessary to pursue the kinds of counter-cyclical policies currently being used by rich countries, especially as the current financial and economic crises

[1] Quoted in "Contradicting commitments: how the achievement of education for all is being undermined by the IMF", ActionAid, September 2005: www.actionaid.org/assets/pdf/contradicting_commitments4.pdf

come on top of severe poverty and food price crises.

Eurodad research shows that **IMF programmes for low income countries are allowing extremely limited flexibility in fiscal and monetary policies**. Limited flexibility is clearly granted on a very short-term and temporary basis, while emphasizing the need to rapidly return to tighter fiscal and monetary objectives. The new IMF programmes in ten countries were assessed:

- five programmes push for wage bill freezes or cuts;
- five governments have to reduce their fiscal deficits, and
- all have to make spending cuts;
- five of the ten programmes still prompt governments to pass on food and fuel price increases to their citizens.
- There is also no flexibility to defer debt payments. Indeed, for Senegal, the Fund also requires – as a binding condition – that "any proceeds from asset sales be used for settlement of payment delays, and repaying nonconcessional debt."[2]

Slightly greater flexibility is shown with regards to structural reforms compared to previous years.[3] However, all programmes, without exception, still foster controversial structural reforms, such as raising utility tariffs, tax reforms aimed at strengthening indirect taxation, financial and energy sector privatization, or trade liberalization.

Tightening fiscal and monetary policies

In more than half the countries assessed, the IMF programme intends to **reduce the deficit below 5 per cent of GDP**. In Cote d'Ivoire, Ethiopia, the Kyrgyz Republic and Tajikistan, targets are even more stringent, as the 2009 deficit is set below 2 per cent of GDP. In a country such as Ethiopia where the annual shortfall of resources needed to reach the Millennium Development Goals (MDGs) was estimated at $1.6 billion before the crisis,[4] further budget cuts will undoubtedly jeopardize the possibility of reaching the MDGs in 2015.

There is no doubt that long-term macroeconomic imbalances are bad for the poor. However, IMF programmes are not assessing the long term costs of cutting expenditures today. Only this year, $36 million would be needed to address the immediate needs of Ethiopian children. In the absence of this amount, "175,434 children under five are likely to need treatment for severe acute malnutrition in 2009".[5] However, the IMF fails to consider the threat that fiscal tightening poses to long term human and productive capacities were a whole generation of children to suffer from severe malnutrition.

The PRGF for the Republic of Congo aims at the apparently sensible fiscal policy objective of "achieving long-term fiscal sustainability to ensure that future generations benefit from Congo's current oil wealth." The staff estimates that this would occur when the basic non-oil primary deficit is in the range of 3% to 5% of non-oil GDP. However, the implication of this long term objective is an "annual deficit reduction of 3 to 4% over the next few years", which for 2009, accounts for a 3% reduction of the non-oil deficit "based primarily on nominal cuts in non-priority spending, including a further decline in fuel subsidies." Not surprisingly, Congolese authorities "express concern that the pace of fiscal adjustment may not allow for the flexibility needed to address immediate needs."[6]

Nine of the ten countries are also required to **reduce their debt levels or to cap new borrowing**. The programme in Malawi – where IMF staff believes "a policy stimulus does not seem warranted at this stage" given the current

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[2] Senegal: Letter of Intent and Memorandum of Economic and Financial Policies, December 2008.

[3] "Critical Conditions: the IMF maintains its grip on low-income governments", Eurodad, April 2008: http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Critical_conditions.pdf

[4] UN Development Group: http://www.undg.org/archive_docs/4447-Moving_the_MDGs_Agenda_forward_in_Ethiopia.doc

[5] UNICEF Humanitarian Action Update, March 2009: http://www.unicef.org/infobycountry/files/ETHIOPIA_UNICEF_HAU_12_March_2009.pdf

[6] Republic of Congo: Staff Report for the 2008 Article IV Consultation, Requests for a Three/Year Arrangement Under the Poverty Reduction and Growth Facility, February 2008.

growth rate – aims at a 1.4% of GDP reduction of domestic borrowing. Tajikistan is required to settle "external payment obligations … in a timely fashion."[7] And in Senegal, debt repayment also drains an important share of resources available as "any proceeds from asset sales will be used for settlement of payment delays, and repaying nonconcessional debt."[8] Whereas paying arrears is fundamental to ensure access to finance, priorities should be carefully weighted in a country where one in every hundred women still dies while giving birth because of lack of skilled assistance.

UNCTAD Secretary-General Supachai Panitchpakdi is among those who have called for a moratorium on debt payments by Low-Income Countries to enable them to maintain spending during this crisis which they did not cause.[9] He said: ""In the current global crisis situation both debtor and creditor countries would probably be better served if scarcer foreign exchange earnings in the debtor economies were used for the purchase of imports rather than for debt servicing".

Seven of the programmes reviewed aim to lower inflation rates, of which four intend to keep **inflation below 5%** in 2009. In the medium term, the programmes of the Kyrgyz Republic and Sao Tome also aim to keep inflation in single digits. There is an explicit call to increase interest rates in the Kyrgyz Republic to control inflation. The Armenia programme goes further and includes moving to full-fledged inflation targeting.

Lowering inflation often goes hand in hand with moving to **more flexible exchange rate regimes** (as in Armenia, Ethiopia, Malawi and Mongolia). Many countries are moving to flexible exchange rates to avoid having to drain their reserves defending a de facto fixed exchange rate – as was the case of Armenia, which lost about $600 million, close to half its reserves, in 2008. This comes after years of sticking to hard currency pegs in vain attempt to improve confidence in the economy.

Policy decisions to reverse existing exchange rate regimes should take into account the importance of avoiding "polarised exchange rate regimes" – that is, either "hard pegs" or totally flexible exchange rates. Some heterodox macroeconomists highlight the advantages of intermediate exchange rate regimes, to strike a balance between conflicting demands faced by developing country governments. Intermediate regimes would provide greater flexibility then 'corner solutions', which require strict fiscal and monetary discipline, and freely floating exchange rate regimes which can increase the costs of trade.[10] IMF programmes are, to a large extent, silent about nuanced policy options and greater intervention in flexible exchange rate markets – including some form of capital account regulations.

Turning a blind eye to the crisis?

Assessment of IMF programmes to help low-income countries respond to the crisis show that, by and large, the IMF has still not changed its preference for stringent and pro-cyclical fiscal and monetary policies. Despite the Fund's increasing acknowledgement of the need for counter-cyclical policies and the need for a coordinated fiscal stimulus worldwide, current programmes for low income countries rule out any possibility of fiscal stimulus for them.

The few examples of greater flexibility are timid and exceptional. The rule in all Fund programmes and conditions continues to be stringent fiscal and monetary policy. Greater recognition of the need to maintain social spending is welcome. However, it is often hard to see how such spending will be maintained in the context of the proposed budget cuts, fiscal consolidation, and efforts to rebuild the international reserves position that the IMF continues to demand.

[7] Republic of Tajikistan: Memorandum of Economic and Financial Policies, March 2009.

[8] Senegal: Letter of Intent and Memorandum of Economic and Financial Policies, December 2008.

[9] Temporary debt moratorium needed for some poor nations, says UNCTAD Secretary-General, 30 April 2009. At: www.unctad.org/Templates/Page.asp?intItemID=4819&lang=1

[10] Stiglitz, Ocampo, Spiegel and French-Davis. "Stability with Growth", Oxford University Press, New York, 2006, p. 119.

Low income countries generally have less scope to institute expansionary policies given their available (internal and external) resources. The IMF programmes assess resources available and then prescribe spending cuts or structural reforms to limit government expenditures regardless of countries' needs. The IMF is well aware of a country's budgetary needs and highlights funding shortfalls, but rarely, if ever, offers – let alone helps with – other options to mobilise additional external resources or reduce debt burdens. Likewise, its fiscal reform proposals for domestic resource mobilisation generally neglect to propose taxation policies that could substantially increase government revenue.

The Fund has played a major role in encouraging and persuading governments to implement stabilization and liberalization policies that have left them vulnerable to the current financial and economic crisis. Many governments and organizations remain sceptical about the IMF's willingness and ability to reform, and therefore about the IMF's role in the current crisis response. After all, resources to deal with the shocks suffered by poor countries as a result of a crisis that they have not created should come on very concessional terms as compensation for the harm created.

The funding needs of low income countries have skyrocketed as a result of the crisis. According to the Fund's own estimates, an additional $216 billion will be needed in 2009 alone on top of what was previously required. Exceptional needs require extraordinary measures: a crisis waiver should be granted to low income countries, so that they can rapidly access Fund resources at highly concessional rates without onerous conditions attached.

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