Peter Chowla

The potential development implications of enhancing the IMF's resources

In April 2009, the G20 group of leaders committed $1.1 trillion to combat the financial crisis, with the bulk of this being channelled through the International Monetary Fund (IMF). However, this substantial amount of resources may never be provided, and, if it is, may not have the intended positive effect on developing countries. Experience so far demonstrates that the IMF is still imposing damaging pro-cyclical conditions on some borrowers, and that the finance provided to low-income countries will be too small.

Where did the "trillion" go?

Of the $1.1 trillion, $750bn is to be delivered through the IMF. Of this, $500bn was for new lending, while $250bn was to be provided by an issuance of special drawing rights (SDRs), the IMF's reserve asset.

Of the $500bn, by the beginning of July 2009, only the $100bn committed by Japan in February has actually been formally signed off, with the rest being only intentions or commitments. While the IMF is reporting on its level of contributions, there is no systematic follow-up mechanism to ensure the commitments are met. As the G20 communiqué did not provide a breakdown of the $500bn, it is not possible to track who has not fulfilled their commitments. Table 1 provides a breakdown based on publicly available information.

IMF lending: Are resources sufficient?

The $500bn in new resources, if realized, would be in addition to the approximately $225bn that the IMF had available from existing quota-based resources. The most recent compiled data from the IMF indicated that as of the end of May, approximately $120bn had been committed, leaving about $105bn in uncommitted resources available for lending. This does not include the new Japanese commitment.

Developing countries and the Stiglitz Commission on financial reform have called for the IMF to increase its resources through either a general quota increase or a selective quota increase. These methods would permanently increase the size of the IMF, potentially diluting the dominant voting share of rich countries. The statement issued jointly by Brazil, Russia, India and China, at the G20 finance ministers meeting in mid-March, called for borrowing to "be a temporary bridge to a permanent quota increase as the Fund is a quota-based institution." A quota-based increase would be easy for most large emerging markets to finance, as they often have large levels of reserves which could cover the costs of such an increase.

Table 1: Status of contributions towards $500bn increase in IMF resources

Country	Contribution	Status	Date
Japan	$100 bn	Signed bilateral agreement	February 2009
European Union	$100 bn	Announcement only	March 2009
of which: United Kingdom	*$15 bn*	Draft bill pending before House of Commons	
United States	$100 bn	NAB increase approved by Congress	June 2009
China	$50 bn	Commitment to buy bonds	June 2009
Brazil	$10 bn	Commitment to buy bonds	June 2009
Russia	$10 bn	Commitment to buy bonds	May 2009
South Korea	$10 bn	Commitment to buy bonds	May 2009
India	$10 bn	Commitment to buy bonds	May 2009
Canada	$10 bn	Signed bilateral agreement	July 2009
Switzerland	$10 bn	Announcement only	April 2009
Other	$11.5 bn	$4.5bn signed, balance announcement only	various
TOTAL	**$421.5 bn**		

*As of 8 July 2009

The money that has been committed will generally be lent through one of two mechanisms – the new Flexible Credit Line (FCL) or a standard Stand-by Arrangement (SBA). FCL arrangements come with no additional conditionality, but are limited to countries that the IMF

determines to have sound policies, meaning consistent with the IMF's definition of macro-economic stability: low levels of inflation, fiscal surpluses or only small deficits, and significant levels of foreign reserves. So far, only Mexico, Poland, and Colombia have requested and been granted FCL arrangements, which typically provide access at 1000% of quota.

An important question is whether the level of resources being provided is sufficient. Under a negative scenario where many large emerging markets experience contagion and must apply for use of FCL resources, Table 2 demonstrates that more widespread use of the FCL among middle-income countries would not exhaust the Fund's resources provided that the IMF receives all the additional resources it has been promised.

Table 2: Potential size of FCL and financing needs for selected middle-income countries

Country*	Potential FCL size	Potential high-end financing needs**
Brazil	$45 bn	$253 bn
Bulgaria	$9 bn	$10 bn
Chile	$13 bn	$27 bn
Israel	$14 bn	$40 bn
Korea	$45 bn	$145 bn
Malaysia	$22 bn	$43 bn
Nigeria	$24 bn	$34 bn
South Africa	$27 bn	$50 bn
Syria	$4 bn	$10 bn
Uruguay	$5 bn	$6 bn
TOTAL for 10 countries	$208 bn	$618 bn

* Picking a sample of middle-income countries, without any indication that they are likely to need financing

** Based on rescue packages of 20% of GDP at market prices, lower than the size of the package provided to Korea in 1997/8

However, in most emerging markets that have experienced significant sudden outflows of capital and financial crisis in the context of contagion, IMF resources would not be sufficient to meet the needs of the country. For example, South Korea's rescue package in 1997/8 was roughly double the size of what would be available under an FCL. Under the current arrangements and limits, the IMF would not be able to mount rescue packages large enough on its own and, as has been done in Eastern Europe, would need to provide joint packages with sovereign lenders.

The World Bank estimated in March that developing countries may face a financing gap of $270-700bn. According to an April UN estimate, the funding needed to counter the effects of the crisis may be as much as $1trn. And the most recent *Global Development Finance* report from the World Bank estimated that the financing needs for 2009 alone for just 97 countries with sufficient data would range between $352bn and $635bn – much more than is likely to be provided through the IMF or other G20 commitments.

IMF lending: what conditionality?

A second question of interest is the conditionality policies applied to those countries that would not be able to access the FCL and would have to approach the Fund for financing under an SBA. There are two types of conditionality: structural and quantitative.

The IMF board decided in March to eliminate a whole category of conditionality, called structural performance criteria, despite having refused to limit the number of such conditions just one year previously. Structural performance criteria are conditions the IMF places on borrowing countries to force them to change economic policies or the structure of their economy during the course of a loan. However, the elimination of this kind of conditionality does not mean an end to the practice of forcing structural reform. Instead, "the IMF will rely more on pre-set qualification criteria (ex-ante conditionality) where appropriate rather than on traditional (ex-post) conditionality". That will likely mean an increase in the use of 'prior actions', conditions that must be fulfilled prior to getting a loan, rather than those required during the course of the loan. Structural benchmarks, which are not legally binding, but still force policy change, will continue to be used. Indications from recent studies are that IMF structural conditionality has not decreased overall, but has instead shifted focus and sectors.

Quantitative conditionality is also controversial. As in Asia in the late 1990s, the IMF is requiring some borrowers to undertake immediate fiscal adjustment, rather than allowing countries some breathing space to make adjustments after the global recession is over. For example, in Hungary, public sector employees have seen salary cuts in the order of 15 to 20%. Similar actions are being required of Latvia in order to bring the fiscal deficit down to less than 5% of GDP despite the massive global recession. Other countries in Eastern Europe are facing similar conditionalities; for example, Romania is programmed to cut public spending by about 1% of GDP per year in 2009 and 2010, and by a further 1.5 percentage points in 2011. At the same time, many countries are experiencing currency devaluations. The devaluations and cuts in public spending, combined with worsening global outlooks and falling exports, will worsen recessions, force more households and businesses into payment difficulties and could exacerbate short- and medium -term economic decline (see G24 Policy Brief No. 48 by Nuria Molina).

Conditionality-free facilities, as suggested by many parties, are needed to help provide the missing resources. Many, including the UN commission, have argued that more resources need to be made available through facilities not governed by the traditional governance structures of the IMF. Substantial resources are sitting with high-reserve countries dissatisfied with the IMF's current governance arrangements. These countries might be convinced to make available more money without conditions if the money would flow through facilities or arrangements over which developing countries had greater authority. Civil society has argued that the value of IMF gold sales in excess of the expected amount at the time the decision was made, be used to finance a conditionality-free debt payment moratorium.

Use of SDRs

The other method for conditionality-free financing at the IMF is an allocation of special drawing rights (SDRs), the IMF's own internally created reserve asset. An SDR allocation is a mechanism for global quantitative easing. Of the $250bn promised at the G20 summit, 67% or $168bn will be provided to high-income countries. This essentially wastes two-thirds of the resources. Only $82bn will go to middle- and low-income countries. Unlike other forms of finance, SDRs come without conditions attached, but a country must still pay interest when it uses them. The above discussion shows that the SDR allocation of $82bn will fall far short of meeting the financing needs of developing countries, particularly middle-income countries, which in times of crisis can need up to 20% of GDP in rescue packages because of sudden stops in capital inflows.

Given the volume of SDRs, they are not likely to be significant in meeting financing needs in middle-income countries. However, they might provide significant resources to low-income countries. As rich countries embark on fiscal stimulus to ensure their economies can resume growth quickly, many low-income countries are being left behind without the resources to undertake fiscal stimulus. Of the total, about $16bn worth of SDRs will go to low income countries.

LIC fiscal space

Below, we assess whether the new SDRs will be enough to support a counter-cyclical fiscal stimulus in low income countries, which Justin Yifu Lin, the World Bank chief economist, recommends should be 3% to 5% of GDP.

While SDRs will be important, alternative ways of financing fiscal stimulus in low income countries should also be considered, including grant finance, concessional lending, cracking down on tax evasion and a debt repayment moratorium. To make an assessment, we have looked at the level of SDRs to be provided, reserve levels and debt sustainability of the 78 PRGF eligible countries.[1] While civil society has been critical of the IMF/World Bank debt sustainability framework because of its lack of attention to development and social needs, we use it here as a quick guide to whether the resources being provided through the IMF are sufficient. There is significant worry about a new accumulation of debt so soon after debt relief – albeit not as extensive as some had hoped – has been provided.

Data collected for 70 of the 78 PRGF-eligible countries found that 36 had debt to GDP ratios of 30% or higher, and/or debt servicing as share of exports of 16% or more. According to the IMF/World Bank debt sustainability framework, these countries can be said to be in medium to high risk positions with regards to debt, and are thus advised against significant additional borrowing in order to finance a fiscal stimulus. For these countries, SDRs, existing reserves and aid will be the only mechanisms to finance a fiscal stimulus.

Of the 19 countries identified as high risk, new SDRs will bring five within or very close to the fiscal stimulus range of 3% to 5% of GDP. For four countries, while SDRs would not be sufficient on their own, their existing reserve levels would be able to finance a fiscal stimulus while still leaving reserves of greater than 3 months of imports[2]. For the remainder, SDRs will have very little impact since they fall well short of the recommended fiscal stimulus and/or reserve requirements. For these countries, additional resources will have to be provided on grant terms. Of the 17 countries at medium and medium-high risk, the value of SDRs will match the recommended fiscal stimulus in only four, with another six already having sufficient levels of reserves to finance a stimulus. The remainder will require more resources.

[1] Data on reserve levels generally came from the IMF's Regional Economic Outlook reports from April 2009, or in cases where data was unavailable, from IMF country programme documents. Data on debt sustainability indicators came from the 2009 projections contained in "The Implications of the Global Financial Crisis for Low-Income Countries", International Monetary Fund, February 2009. SDR allocations were calculated by the author based on existing IMF quota.

[2] This analysis uses the rule of thumb that reserves should cover at least three months worth of imports. This rule of thumb is not unquestioned, but we use it here as it is also frequently used by the IMF. Of course a deeper country-by-country analysis of a myriad of factors, including macroeconomic balances, inflation, reserve levels, public and private debt maturities, and other factors would be needed to determine the advisability of debt finance for fiscal stimulus.

Table 3: Ability of low-income countries to undertake stimulus

	High risk on debt sustainability*	Medium or medium-high risk on debt sustainability**	Low risk on debt sustainability***
SDRs can finance fiscal stimulus	Domenica, Grenada, Guinea Bissau, Guyana and Liberia	Central African Republic, The Gambia, Lesotho, Sao Tome & Principe	Burundi, DR Congo, Sierra Leone, Zambia
SDRs insufficient, but high reserves available	Bhutan, Lao PDR, Mauritania, Mozambique	Comoros, Kyrgyz Republic, Moldova, Mongolia, Tanzania, Vietnam	Albania, Angola, Armenia, Azerbaijan, Benin, Bolivia, Burkina Faso, Cambodia, Cameroon, Chad, Honduras, India, Mali, Niger, Nigeria, Papua New Guinea, Rwanda, Uganda, Uzbekistan, Yemen
SDRs and reserves insufficient, more resources needed	Cape Verde, Congo, Cote d'Ivoire, Djibouti, Eritrea, Maldives, Nicaragua, Sudan, Tajikistan, Togo	Georgia, Ghana, Pakistan, Senegal, Sri Lanka, St. Lucia	Bangladesh, Ethiopia, Guinea, Haiti, Kenya, Madagascar, Malawi

* > 50% debt/GDP and/or > 25% debt servicing/exports
** > 30% debt/GDP and/or > 15% debt servicing/exports
*** < 30% debt/GDP and < 15% debt servicing/exports

There are 34 further countries at low risk according to the debt sustainability framework. They have the option of increasing borrowing from the IMF to finance a fiscal stimulus on top of their use of SDR allocations. Many of these countries already have high levels of reserves that could finance a stimulus regardless of the SDRs. The nine countries at low debt risk, but without sufficient reserves or SDRs, could make use of access to IMF concessional borrowing to finance a fiscal stimulus. Of these, only two – Haiti and Malawi – have high levels of credit outstanding with the IMF which might prevent them from borrowing enough to finance a fiscal stimulus. Of course, these countries will be wary of borrowing from the Fund due to fears of pro-cyclical economic policy conditionality being applied.

According to the IMF's own conservative criteria, a large number of low-income countries could finance a fiscal stimulus from existing reserves or with an SDR allocation, the IMF has only recommended fiscal stimulus for two low-income countries – Tanzania and Mozambique – despite repeated rhetoric from the IMF managing director Dominique Strauss-Kahn about the need for counter-cyclical policy.

Conclusions

The commitments provided to the IMF by the G20 may bring both risks and benefits for developing countries. While some countries may get access to conditionality-free resources through the new FCL, this small number of countries and small amount of resources may not be enough in case of a full-scale capital account crisis. The resources will not likely be enough to meet the massive financing gap faced by developing countries this year. And most countries will likely be pushed into pro-cyclical economic policies by the IMF if they attempt to access the IMF's expanded resources.

The IMF has not made flexibility a key element of fiscal programming in its advice for most middle- or low-income countries. Any low-income countries going to the IMF for concessional lending are unlikely to be given the 'space' to undertake stimulus. And a large number of countries are going to need further resources beyond what the G20 has promised to make available, particularly in terms of transfers. Bilateral transfers of SDRs allocated to rich countries can make up some of the gap, but they are unlikely to be sufficient. Mechanisms for releasing the resources held by high-reserve countries for the benefit of other developing countries will need to be found. That will likely require new governance arrangements or credit facilities over which developing countries have greater decision making power.

Peter Chowla, *Bretton Woods Project Research assistance by Hadiru Mahdi and Rachel Whitworth.*