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IMF emergency loans for low-income countries

At the London summit on 2 April 2009, the leaders of the G20 agreed that the IMF will be the major instrument to respond to the financial and economic crisis, and agreed to quadruple the Fund's resources from $250bn to $1trillion.

But is the IMF fit for purpose? Not long ago, the IMF imposed harmful conditions in many countries in providing urgently needed credit. What will be the consequences of the G20 decision for the tens of millions already suffering from the multiple food, financial, economic and climate crises?

Analysis of ten IMF agreements signed in the last six months shows that the IMF is still urging stringent fiscal and monetary policies and unnecessary, if not harmful structural reforms on low income countries. If the Fund is to provide funding to poor countries to meet the financial gaps created by the crisis, it has to change and it has to do so soon. Reacting poorly and reacting late can mean starvation and distress for millions.

Recent reforms at the IMF: too little, too slow

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

The Fund has also recently reformed some features of the Exogenous Shocks Facility (ESF) to ease low income countries' access to Fund resources in the event of external shocks. However, these changes are too few 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 channeled on highly concessional terms to avoid indebtedness that may strangle these countries in the near future.

In March 2009, the Fund also phased out Structural Performance Criteria, one type of condition attached to their loans. Although overdue, this leaves unchanged other structural as well as macroeconomic conditionalities.

These have been strongly criticized for obliging developing countries to adopt unnecessarily stringent fiscal and monetary policies. If this continues, it will prevent increases in government expenditure to stimulate economic activity in 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 previously imposed as conditionalities may no longer come as conditions, but will still feature in IMF country programs. Although programs are the outcome of the Fund and government negotiations, the Fund has strong leverage because of its ostensible technical expertise and control of the purse strings. Countries are monitored and assessed on progress in areas defined in IMF programs, even if these are not the subject of strict conditionalities.

IMF conditions and advice at a time of crisis

Restrictive IMF conditions and policy advice, which have already been problematic in 'normal' times of economic growth and increasing aid flows, become more dangerous in times of crisis. Poorer countries must have the fiscal space necessary to pursue the counter-cyclical policies needed, including those

[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

currently being used by rich countries, especially as the current financial and economic crises come on top of severe poverty as well as energy and food price crises.

Forthcoming Eurodad research shows that *IMF programs for low income countries are allowing extremely limited additional flexibility in fiscal and monetary policies.* Limited flexibility is granted on a very short-term temporary basis, while requiring the rapid return to tighter fiscal and monetary objectives. Of the ten countries for which the new IMF program was assessed:

- five have to reduce their fiscal deficits;
- all have to make spending cuts; five of the ten programmes urge governments to pass on food and fuel price rises to consumers.
- five programmes pushed for wage bill freezes or cuts;
- all have to repay nonconcessional debt"[2]. None of them have the flexibility to defer debt payments. Indeed, for Senegal, the Fund also requires -- as a condition -- that "any proceeds from asset sales be used for settlement of payment delays".

Slightly greater flexibility with structural reforms was found compared to before.[3] However, all programs, without exception, still foster unnecessary, if not harmful structural reforms, such as raising utility tariffs, tax reforms aimed at strengthening indirect – over direct -- taxation, privatization, or trade liberalization.

Tightening fiscal and monetary policies

In more than half the countries assessed, the IMF program seeks to *reduce the deficit below 5% 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% 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 $1.6bn before the crisis,[4] further budget cuts will undoubtedly jeopardize the possibility of reaching the MDGs by 2015.

There is no doubt that long-term macroeconomic imbalances are bad for the poor. However, IMF programs 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] Fiscal tightening can thus condemn a whole generation of children to malnutrition as a result of the crisis.

The PRGF for the Republic of Congo aims at the apparently sensible objective of "achieving long-term fiscal sustainability to ensure that future generations benefit from Congo's current oil wealth." The IMF staff estimate 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, the 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 program in Malawi – where the IMF staff argues that "a policy stimulus does not seem warranted at this stage" given its current growth rate – aims for 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

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

drains an important share of resources available as "any proceeds from asset sales will be used for settlement of payment delays, and repaying non-concessional debt."[8]

Whereas settling arrears is fundamental to ensure access to finance, priorities should be carefully weighed 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 to low-income countries to enable them to maintain spending during this crisis which they did not cause.[9] He argues: ""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". Such views do not seem to have persuaded the IMF.

Seven of the programs aim to lower inflation rates, of which four seek to *keep inflation below 5%* in 2009. In the medium term, the programs of the Kyrgyz Republic and Sao Tome also aim at keeping inflation in single digits. And in the Kyrgyz Republic, there is an explicit call to raise interest rates as a measure to control inflation. The program in Armenia goes further and includes moving to full-fledged inflation targeting.

Lowering inflation often comes hand in hand with the objective of shifting 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 lose their reserves defending a de facto fixed exchange rate – as was the case in Armenia which lost about $600 million, close to half its reserves, in 2008. This comes after years of sticking to hard currency pegs in what has proved to be a vain attempt to improve confidence in the economy.

Policy decisions to reverse existing exchange rate regimes should consider avoiding "polarized exchange rate regimes" – that is, either "hard pegs" or totally flexible exchange rates. A growing number of macroeconomists recognize the advantages of intermediate exchange rate regimes, to strike a balance between conflicting demands faced by developing country governments. Intermediate regimes provide greater flexibility between hard pegs, which require strict fiscal and monetary discipline, and freely floating exchange rates regimes, which can increase the costs of trade.[10] IMF programs are, to a large extent, silent about nuanced policy options and greater intervention in exchange rate markets – including some capital account management or regulation.

Turning a blind eye to the crisis?

Assessment of IMF programs to 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 virtues of counter-cyclical policies and the need to coordinate stimulus measures worldwide, programs for low income countries, as currently designed, rule out any possibility of fiscal stimulus for them.

The few examples of greater flexibility are extremely timid and exceptional. The rule in Fund programs and conditions continues to be stringent fiscal and monetary policy. Greater recognition of the need to maintain social and pro-poor spending is welcome, but it is often hard to see how such priority spending will be maintained in the context of the further budget cuts, fiscal consolidation, and efforts to rebuild international reserves that the IMF continues to demand.

Low income countries have less scope than richer ones to institute expansionary policies, given their level of available resources. However, IMF programs are largely blind to countries' needs. The IMF programs assess resources available and then prescribe spending cuts or structural reforms to limit government expenditures. The IMF is well aware of the budgetary needs of the countries. However, it has failed to highlight funding shortfalls and warn the international community to mobilize additional external resources, or to agree to debt reductions. Likewise, fiscal reforms for domestic resource

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, J. E., *et al.*: *Stability with Growth*. Oxford University Press, 2006, p. 119.

mobilization have failed to advance taxation policies that could substantially increase government revenues.

The Fund has a very checkered and controversial history. It has played a part in encouraging and persuading governments to implement liberalization policies that have left them vulnerable to the current financial and economic crisis. Many remain skeptical about the IMF's ability to reform and doubt whether the IMF should play any part in the current crisis response. Many also insist that the resources for poor countries to cope with the crisis they have not created should be on highly concessional terms as compensation.

The funding needs of low income countries have skyrocketed as a result of the crisis. According to the Fund's own estimates, an additional $216bn will be needed in 2009 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 any additional conditions attached.

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