

IMF Bailouts

March 28, 2023 • vajiramandravi.com



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Why in news?

- Recently, the International Monetary Fund (IMF) confirmed a \$3 billion bailout plan for Sri Lanka's struggling economy.
- IMF officials are also in negotiations with Pakistan for a \$1.1 billion bailout plan as the country faces a severe economic crisis marked by a falling currency and price rise.

News Summary: IMF Bailouts

Why do nations face currency crisis?

- **Gross mismanagement of the nation's currency by its central bank**
 - Currency crises are generally the result of gross mismanagement of the nation's currency by its central bank.
 - Usually, this happens under the covert influence of the ruling government.
 - Central banks may be forced by governments to create fresh money out of thin air to fund **populist spending**.
 - Such spending eventually results in a rapid rise of the overall money supply, which in turn causes prices to rise across the economy and the exchange value of the currency to drop.
 - A rapid, unpredictable fall in the value of a currency can destroy confidence in said currency and affect economic activity.
- **A country's domestic economic policies**
 - Economic policy that imperils productivity can affect a country's ability to attract the necessary foreign exchange for its survival.
- **Other factors**
 - In the case of Sri Lanka, various factors contributed to a decrease in foreign tourists visiting the country.
 - This led to a steep fall in the flow of U.S. dollars into the nation.

Why do nations seek an IMF bailout?

- **When a country faces a major macroeconomic risk**

- Countries seek help from the IMF usually when their economies face a major macroeconomic risk, mostly in the form of a currency crisis.
- For instance, in the case of Sri Lanka and Pakistan, both countries have witnessed domestic prices rise rapidly and the exchange value of their currencies drop steeply against the U.S. dollar.

- **To meet external debt requirements and other obligations**

- Generally, foreigners do not invest in an economy where the value of its currency gyrates in an unpredictable manner.
- In such a scenario, many countries are forced to seek help from the IMF to meet their external debt and other obligations, to purchase essential imports, and also to prop up the exchange value of their currencies.

How does the IMF help countries?

- **Lends money**

- The IMF basically lends money, often in the form of special drawing rights (SDRs), to troubled economies that seek the lender's assistance.
 - The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves.
 - SDRs simply represent a basket of five currencies, namely the U.S. dollar, the euro, the Chinese yuan, the Japanese yen, and the British pound.
- Countries receiving the bailout can use the SDRs for various purposes depending on their individual circumstances.
 - Currently, both Sri Lanka and Pakistan are in urgent need for U.S. dollars to import essential items and also to pay their foreign debt.
 - So, any money that they receive from the IMF is likely to go towards addressing these urgent issues.

- **Lends through several lending programs**

- The IMF carries out its lending to troubled economies through a number of lending programs such as the extended credit facility, the flexible credit line, the stand-by agreement, etc.

Are there any strings attached to an IMF bailout?

- The IMF usually imposes conditions on countries before it lends any money to them.
- For example, a country may have to agree to implement certain structural reforms as a condition to receive IMF loans.

Why IMF attaches conditions on its bailout programme?

- **Essential for the success of IMF lending**

- Countries that seek an IMF bailout are usually in a crisis due to certain policies adopted by their governments.
- It may thus not make sense for the IMF to throw money at a country when the policies that caused its crisis remain untouched.
 - E.g., the IMF may demand a country affected by high price inflation to ensure the independence of its central bank.
- Promotes institutional reforms and brings check on corruption
 - The IMF lending to troubled economies, may turn out to be a wasted effort because these economies have poor institutions and suffer from high corruption.

Why has IMF's conditional lending been controversial?

- **Too tough on the public**

- The IMF's conditional lending has been controversial as many believe that these reforms are too tough on the public.

- **Influenced by international politics**

- Critics have also accused the IMF's lending decisions to be influenced by international politics.
 - These decisions are taken by officials appointed by the governments of various countries.
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Q1) What is IMF?

The International Monetary Fund (IMF) is an international organization that promotes international monetary cooperation, exchange rate stability, and balanced economic growth. It was created in 1944 as part of the Bretton Woods Agreement, and currently has 190 member countries.

Q2) What is SDR?

SDR stands for Special Drawing Rights. It is an international reserve asset created by the International Monetary Fund (IMF) in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas, which are based on each country's economic size and other factors.

Source: [Explained](#) | [Understanding IMF bailouts](#) | [IMF](#)
