IMF, IBRD, and Debt

IMF and IBRD

- The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank) are two separate institutions created at the 1994 Bretton Woods conference.
- These two institutions have separate functions.

World Bank

- The IBRD was originally designed to provide long-term loans for the rebuilding of Europe post-World War II.
- Main concern now – loans for projects in developing countries.
IMF

- The IMF was central to the well-being of the Bretton Woods agreement. It has several roles, including:
  
  1) Seek stability in exchange rates
  
  2) Reconciliation of country adjustments with Balance Of Payments imbalances while allowing national autonomy in macroeconomic policy – provides short-term loans to deficit countries
  
  3) Assist in preserving free trade and payments

IMF Loans

- The IMF receives the money to make such loans from its member countries
- Each country is assigned a quota – a sum paid annually to be a member of the IMF

<table>
<thead>
<tr>
<th>Country</th>
<th>1997 Quotas (in US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>$36b</td>
</tr>
<tr>
<td>Canada</td>
<td>$5.8b</td>
</tr>
<tr>
<td>Switzerland</td>
<td>$2b</td>
</tr>
<tr>
<td>Kenya</td>
<td>$272m</td>
</tr>
<tr>
<td>Total</td>
<td>$198b</td>
</tr>
</tbody>
</table>

How does this loan system work?

Suppose Kenya has a BoP problem – It can borrow up to 125% of its quota.

IMF borrowing

- As countries increase their borrowing, the IMF applies increasingly more stringent conditions before approving loans (1st 25% are automatically granted)
- This is to try and eliminate dependency on these loans
- Types of requirements “IMF Conditionality”
  - Country adopt certain monetary/fiscal policies
  - Currency depreciation
- Creates ill-will toward IMF? Intrusion on national sovereignty?
LDCs and IMF Conditionality
• There are strings attached when borrowing from the IMF
• Such things include (in addition to previous slide)
  – Halt inflation
  – Change fiscal policies
  – Remove price controls
  – Allow currency to float

LDCs and External Debt
• Debt in LDCs often tied to access to financial capital
• Latin American, Caribbean, and Asian countries have largest debt problems
• Africa countries have had the most several problems recently
• How do these countries solve their BoP problems?

LDCs and Debt
• Debt/export ratio – high ratios indicate significant repayment problems
• Debt service ratio - % of annual exports that must be set aside for payment on interest on the debt and the scheduled repayment of the debt
  – Used to determine HIPC countries
• 1996, Latin American Debt Service ratio averaged 44% (32% in 1998)
  – These are exports that must be set aside for debt service and cannot be used for purchasing imports
  – Imports must be reduced to either limit drawing down financial reserves or increasing debt
LDCs and Debt Relief

- How to solve the debt problems? There exist several approaches – these include

1) Changing domestic policies to better service debt-
   - Sees debt as temp. liquidity problem
   - “Structural Adjustment Policies”, “Austerity Policies”

2) Debt rescheduling – lower interest rates, lengthen repayment period, Grace periods

3) Debt relief - does relief enhance LDCs likelihood of repayment?
   - New Bond issues - issued by LDCs to existing lenders
   - Better for both LDCs and lenders?

4) Debt-equity Swaps
   - Lender swaps debt claim for LDC currency/shares in LDC company

Debt Crisis?

- Currently, is there a debt crisis in the LDCs?
- HIPC countries spend large sums of money repaying loans/interest rather than educating/feeding citizens
- Money originally borrowed in 1970s and 80s – badly invested? Misallocated?
- Desire by many is to “wipe out” between $150b and $300b of “unpayable debts” owed to the IMF, World Bank, private lenders – this is cancellation of debts, not rescheduling or other forms of debt relief
- Is compound interest on the debt the real problem
- Concerns over debt relief?