

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 that were created at the 1944 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

1997 Quotas (in US\$)

US - \$36b

Canada - \$5.8b

Switzerland - \$2b

Kenya - \$272m

Total - \$198b

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?
