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IMF AND ITS CHANGING ROLE IN LENDING POLICY - AN EVALUATION

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Abstract: *The International Monetary Fund is an international organization which was came into existence to work for foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. Further, the IMF loans are meant to help member countries tackle balance of payments problems, stabilize their economies, and restore sustainable economic growth. This crisis resolution role is at the core of IMF lending and the IMF has been trying to help the poor member countries through its lending policy. In the light of the above, it is necessary to examine the process of lending policy of the IMF and trends in the allocation of lending facilities among the member countries. Finally, the paper concluded that, IMF's success cannot be measured simply in terms of the objectives and hopes of the founders of the Fund. It has been pointed out that the Fund has not been successful in its fundamental objectives. The Fund has tried to establish a properly functioning international monetary system which is very essential for the expansion of free and multilateral world trade.*

Key Words: *IMF, Lending, Policy, Financial, Loans, Member Country, Allocation*

1. INTRODUCTION

The **International Monetary Fund** is an international organization headquartered in Washington D C, in the United States, of 188 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. Formed in 1944 at the Britton Woods Conference, it came into formal existence in 1945 with 29 member countries and the goal of reconstructing the international payment system.

The IMF was created over 50 years ago as a key pillar of the post world war 2nd international economic order. The ultimate goal of the IFIs of that era was to create a more open and global economy. Now that a high degree of economic globalization has been achieved, a new international financial architecture is needed. The Asian financial crisis of 1997-1999 was in many ways a turning points. It provided dramatic proof that the globalization of capital flows has left national economies more vulnerable than ever to panics and other external developments .The crisis also raised questions about the role of the IMF in the newly globalized economy.

The IMFs original role was principally to manage the fixed exchange rate system which collapsed in the 1970's. It has adapted itself into on organization that makes loans to developing countries and provides them with economic policy advice often unrelated to exchange rate stability. By conditions its loans upon compliance with its policy advice the IMF has evolved into the international finance policeman of the world economy. As the Asian crisis dawned, the fund offered advice and formulated new programs of conditional financial assistance to Thailand, Indonesia, and other affected Asian states. Some aspects of these IMF programs have been criticized for contributing to the panic, adding fuel to the calls for a new international financial architecture. As its influence has grown, the IMF has resisted adapting its policies to changed conditions and challenges. Following the example of the world bank , the Fund now monitors the compliance by states with fundamental principles of goods "governance "unlike the world banks, however, the IMF has resisted pressure to respect these principles in its own operations . This is no longer acceptable. The IMF must accept that economic globalization entails a new set of responsibilities for those international institutions entrusted with the stewardship of the global economy.

Though the IMF has been giving lot of financial assistance to the member countries, the funds have not been reached properly to the poor member countries. Consequently, the IMF has reformed its lending policy so that the IMF lending has to reach the member countries. Hence, it is very necessary to evaluate the changing role of IMF lending policy, in this direction; the present study is an attempt to analyze the various aspects of IMF and its lending policies.

2. OBJECTIVES

The present paper has two important objectives, such as follows

- To examine the process of lending policy of the IMF
- To examine the trends in the allocation of lending facilities among the member countries

3. METHODOLOGY

This paper is purely based on secondary data. The secondary data are collected from various, books, journals, Annual Progress Report, IMF data base and websites. The study has been used some tables, charts and graphs to present the work scientifically and systematically.

4. LENDING FACILITY OF THE IMF

A country in severe financial trouble, unable to pay its international bills, poses potential problems for the stability of the international financial system, which the IMF was created to protect. Any member country, whether rich, middle-income, or poor, can turn to the IMF for financing if it has a balance of payments need—that is, if it cannot find sufficient financing on affordable terms in the capital markets to make its international payments and maintain a safe level of reserves.

IMF loans are meant to help member countries tackle balance of payments problems, stabilize their economies, and restore sustainable economic growth. This crisis resolution role is at the core of IMF lending. At the same time, the global financial crisis has highlighted the need for effective global financial safety nets to help countries cope with adverse shocks. A key objective of recent lending reforms has therefore been to complement the traditional crisis resolution role of the IMF with more effective tools for crisis prevention.

The IMF is not a development bank and, unlike the World Bank and other development agencies, it does not finance projects.

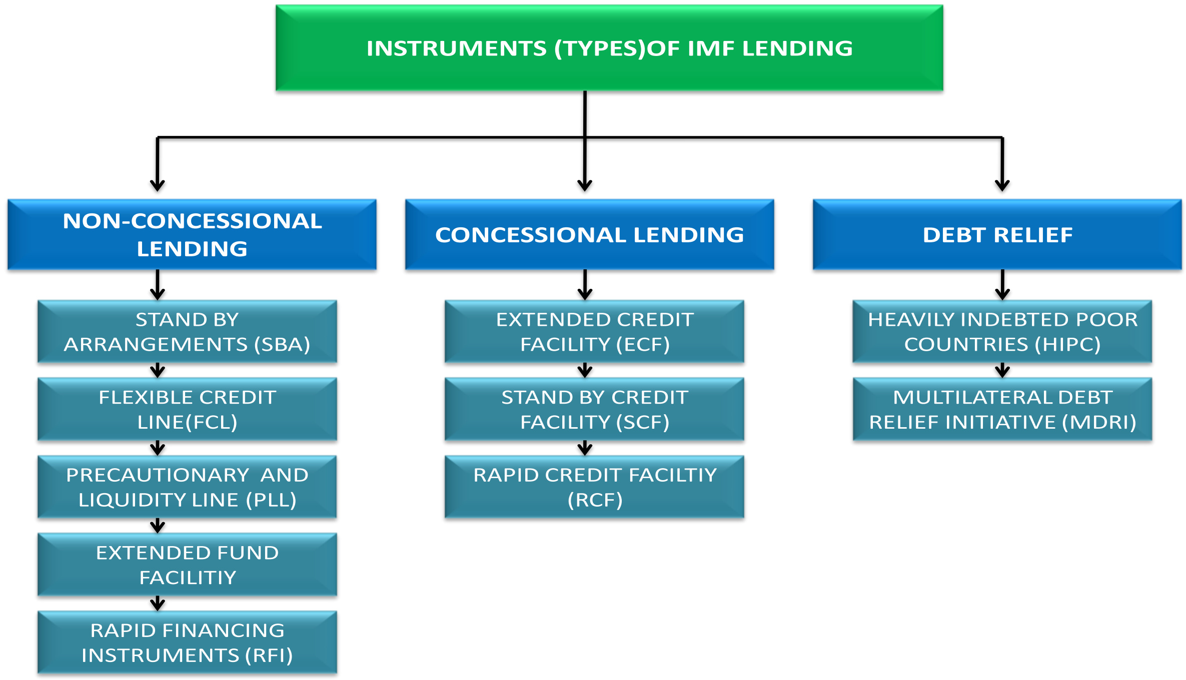
4.1 The Changing Nature of IMF Lending

The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF lending. In the 1990s, the transition process in Central and Eastern Europe and the crises in emerging market economies led to further surges of demand for IMF resources. Deep crises in Latin America and Turkey kept demand for IMF resources high in the early 2000s. IMF lending rose again in late 2008 in the wake of the global financial crisis

4.2 The Process of IMF Lending

Upon request by a member country, IMF resources are usually made available under a lending "arrangement," which may, depending on the lending instrument used, stipulate specific economic policies and measures a country has agreed to implement to resolve its balance of payments problem. The economic policy program underlying an arrangement is formulated by the country in consultation with the IMF and is in most cases presented to the Fund's Executive Board in a "Letter of Intent." Once an arrangement is approved by the Board, IMF resources are usually released in phased installments as the program is implemented. Some arrangements provide strong-performing countries with a one-time up-front access to IMF resources and thus not subject to policy understandings.

4.2.1 Instruments (Types) of IMF Lending



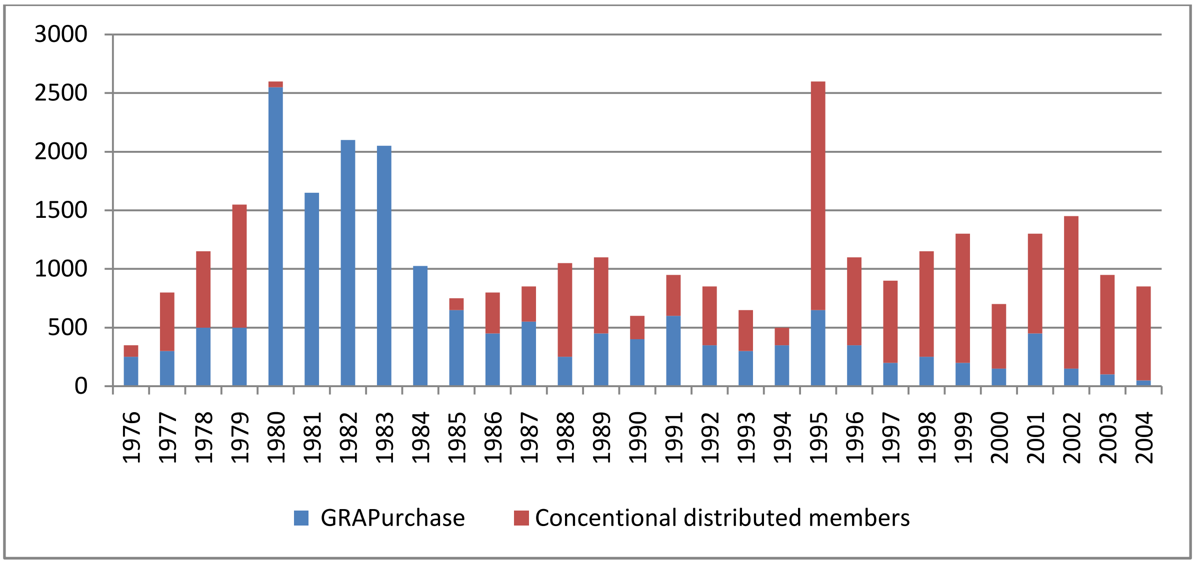
Over the years, the IMF has developed various loan instruments that are tailored to address the specific circumstances of its diverse membership. Such instruments are as follows;

5. LENDING POLICIES FOR LOW-INCOME MEMBER COUNTRIES

IMF concessional lending is provided through the Poverty Reduction and Growth Facility at a fixed interest rate of 0.5 percent, as compared to the charges levied on the use of the General Resources Account,15 which, at current market interest rates, entail a degree of concessionality (or a grant element) of about one-third of the principal. The grace period for concessional loans is comparatively longer than that for standard IMF arrangements. A borrowing low-income member begins repaying a loan five and a half years after the disbursement of the first tranche, while the grace period for a standard credit tranche is two and a half years, which can be extended up to three and a quarter years. The maturity of a concessional arrangement is, at ten years, five years longer than that of a standard IMF arrangement.

In addition to PRGF-supported programs, lending on concessional terms is available for post conflict members through the Emergency Post-Conflict Assistance. Established in 1995, the facility provides assistance to members with urgent financing needs unable to develop a comprehensive economic program due to severe capacity limitations in the aftermath of a conflict. The facility—which often plays a valuable role as a bridge to a subsequent PRGF—has a subsidized interest rate of 0.5 percent for low-income members and a maturity between 3 and a quarter and 5 years. Access is up to 50 percent of a quota's member and, so far, about 10 low-income members have benefited for an overall amount of US$181 million lent.

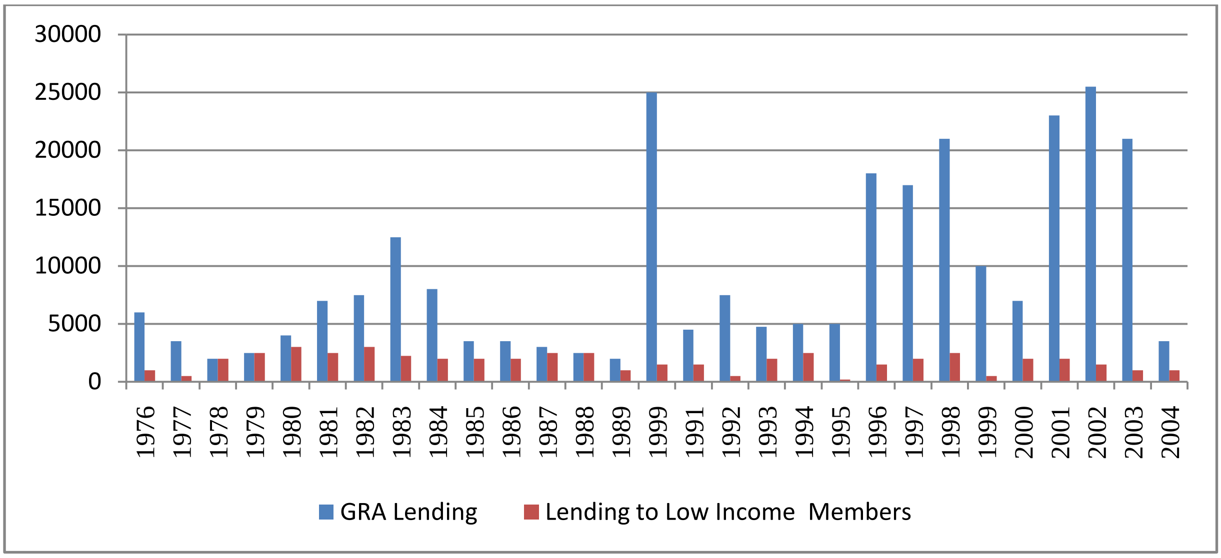
5.1 Recent Trends in IMF Lending



Source: IMF Database, 2004

Figure 1: IMF Lending to Low Income Members (SDR in Million)

Figure 1 which shows annual lending to the low-income membership. Concessional lending is thus not a new policy instrument, and over time it has been "blended" in varying proportions to GRA resources. In the period between 1976 and 2004, lending to low-income members averaged SDR 1,150 million, with concessional lending contributing about SDR 520 million against a GRA lending average of 630 million. Figure 2 also shows that, apart from the spikes observed in connection with the early 1980s and mid- 1990s, overall lending to low-income members has not increased systematically over time. What has increased is the proportion of concessional lending relative to GRA lending



Source :IMF Database, 2004

Figure 2: **Total IMF Lending to Low Income Members Compared to Total Lending to All Members**

Figure provides some answers. The bars in light gray show the amount lent by the IMF to the whole membership from its GRA Department, while those in black refer to the overall resources (concessional and non-concessional) lent to low income members only. Two aspects are noteworthy. First, the amount lent to low-income members from the concessional and non-concessional arms has been relatively modest in comparison to the overall resources lent out. This has been particularly true in the last decade, when GRA lending spiked in response to the Mexican crisis (1995), the Asian crises (1997 and 1998), and, more recently, the financial arrangements in support of Brazil, Argentina, and Turkey

Table 1: Terms of Fund Lending Facilities and Policies

Access Limit(in %of quota)		Charges/Interest	Obligation schedule (expectation schedule in parentheses)		
			Grace	Maturity	Repayment
First Credit Tranches	25	Basic Rates			
Credit Tranches	Annual:100 Cumulative :300	Basic rate plus a surcharge*	3 ¼(2 ¼)	5(4)	Quarterly Quarterly
Extended Fund Facility			4 ½ 4(½)	10(7)	Semi annual
Supplement Reserve Facility	Not specified	Basic rate plus a surcharge**	2 ½ (2)	3(2 ½)	Semi annual
Emergency Assistance	Up to 50	Basic rate***	3 ½	5(N/A)	Quarterly
PRGF	140	0.5 present	5½ (N/A)	10N/A)	Semi annual

Source: IMF

Table 1 summarizes the main features so far discussed and compares the terms of concessional lending to other main forms of IMF lending. In addition to PRGF-supported programs, lending on concessional terms is available for post conflict members through the Emergency Post-Conflict Assistance. Established in 1995, the facility provides assistance to members with urgent financing needs unable to develop a comprehensive economic program due to severe capacity limitations in the aftermath of a conflict. The facility—which often plays a valuable role as a bridge to a subsequent PRGF— has a subsidized interest rate of 0.5 percent for low-income members and a maturity between 3 and a quarter and 5 years. Access is up to 50 percent of a quota's member and, so far, about 10 low-income members have benefited for an overall amount of US$181 million lent.

Table 2: IMF Lending Arrangements

Member	**Date of Agreements**	**Expiration**	**Amount**	**IMF Credit Outstanding**
GeneralResources				
Account(GRA):Standby				
Arrangements	20-Sep-03	19- Sep-06	8,981,000	8,101,069
Argentina	2 -Apl-03	31-Mar- 06	171,500	111,500
Bolivia	6—Aug-03	05-Sep-06	10,000	726,412
Bulgaria	15-Jan-03	14-May -05	1,548000	0
Colombia	04-Aug-04	3-APL -06	97,000	0
Croatia	31-Jan-05	31-May-07	437,800	183,880
Dominican Republic	28-May-04	30-Jun-05	69,440	61,057
Gabon	15-Dec-03	30-Sep-05	50,000	0
Paraguay	9-Jun-04	16-Aug-06	287,279	53,500
Peru	7-Jul-04	6-Jul-06	250,000	257,677
Romania				
Total			**11,992,019**	**9,495,095**
General Resources				
Account(GRA):Extended				
Arrangements	14-May-02	13-May-05	650,000	575,097
Serbia and Montenegro	18-Apl-03	17-Apl-06	144,400	228,385
Sri Lanka				
Total			**794,400**	**803,482**
Poverty Reduction and Growth Facility Trust	Date of Agreements	Expiration	Amount	IMF Credit Outstanding
Albania	21-Jun-02	20-Nov-05	28,000	65,846
Azerbaijan	6-Jul-01	4-Jul-05	67,580	102,093
Bangladesh	20-Jun-03	19-Jun-06	400,330	148,500
Burkina Faso	11-Jun-03	15-Aug-06	24,080	78,178
Burundi	23-Jan-04	22-Jan-07	69,300	33,550
Cape Verde	10-Apl-02	31-Jul-05	8,640	7,380
Chad	16-Feb-05	15-Feb-08	25,200	63,502
Congo	12Jun02	11Jun05	580,000	526,767
Democratic Republic of Congo	6Dec 04	5Dec07	54,990	12,029
Republic of Dominica	29 Dec 03	28Dec06	7,688	4,205
Gambia	18Jul02	17Jul05	20,220	15,600
Georgia	4Jun04	3Jun07	98,000	165,745

Ghana	9May 03	8May06	184,500	294,799
Guyana	20Sep 02	12Sep06	54,550	62,392
Honduras	27Feb04	26Feb07	71,200	128,877
Kenya	21Nov03	20Nov06	225,000	116,078
Kyrgyz Republic	15Mar 05	14Mar08	8,880	136,387
Mali	23Jun 04	22Jun07	3,330	87,845
Mongolia	28Sep01	31Jul05	28,490	27,384
Mozambique	26Sep01	5Jul07	11,360	124,040
Nepal	18Apl03	18Nov06	49,910	14,260
Nicaragua	6Jul04 19Nov	12Dec05	97,500	149,995
Niger	03	30Jan08	6,580	84,290
Rwanda	13 Dec 02	11Feb06	4,000	58,788
Senegal	31Jan05	27Apl06	24,270	125,789
Sierra Leone	12Aug02	25Jun05	130,840	125,030
Sri Lanka	28 Apl03	17Apl06	269,000	38,390
Tajikistan	11Dec02	10Dec05	65,000	87,834
Tanzania	16Aug03	15Aug06	19,600	265,703
Uganda	13Sep02	12Sep05	13,500	119,968
Zambia	16Jun04	15Jun07	220,095	576,780
Total			**2,877,633**	**3,848,020**

Source: IMF Database, As of April 2005, Thousands of SDRs

Table 2 illustrates the financial arrangements currently outstanding with the membership. Overall, the IMF is engaged with 44 members for a total of SDR 14 billion in committed resources. Thirty-one of these financial arrangements are with low-income members, corresponding to SDR 3.8 billion committed (or 27 percent of the total resources committed), while 10.3 billion (or 73 percent) has been lend to other members through the GRA Department. As Table shows, those low-income countries that are currently engaged with the IMF receive financial assistance only on concessional terms.

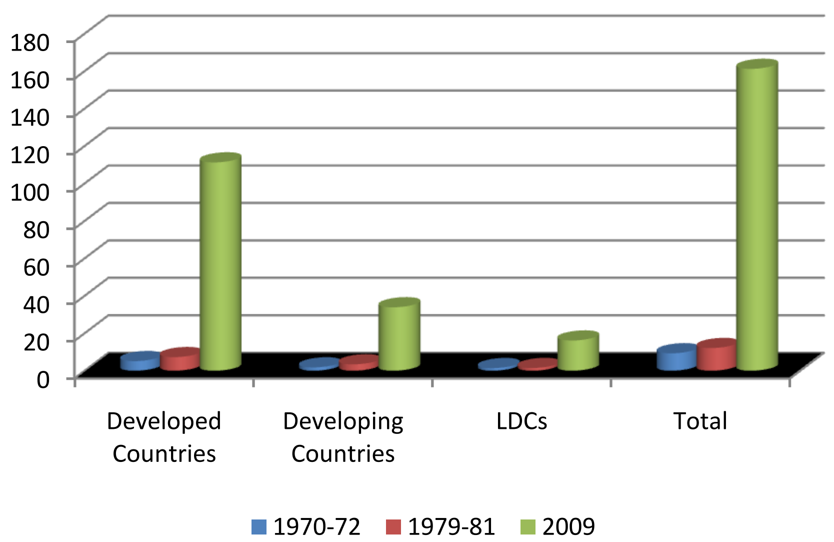


Figure 3: SDR Allocation of the IMF

The table and figure 3 represents the share of SDR Allocation of the IMF. It is very clear in given table that, the total share of SDR allocation in the year of 2009 is 161.2 billions, from the year 1970 to 2009 it becomes increase.

Table 3: Share of Country Groups in SDR Allocations (%)

Year	Developed Countries	Developing Countries	LDCs
1970-72	55	30	15
1979-81	60	28	12
2009	69	21	10

Source: IMF Database, 2009

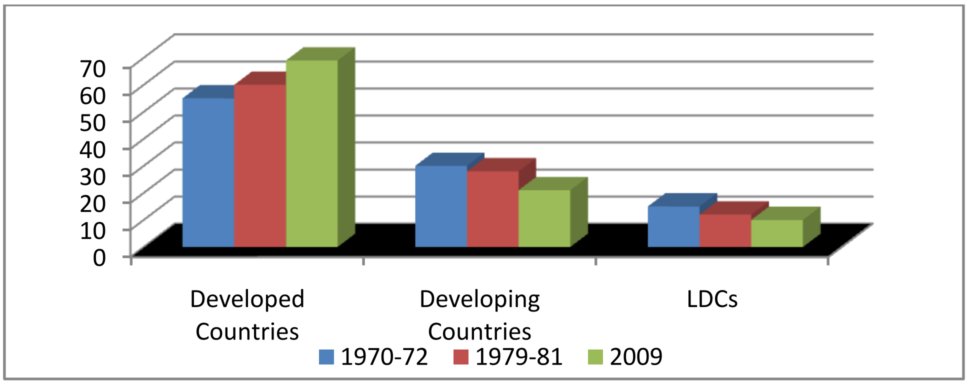


Figure 4: Share of Country Groups in SDR Allocations (%)

The table 3 and Figure 4 represents that the Share of Country Groups in SDR Allocations (%) of the IMF. It is clear in the given table that, in the year of 2009 Developed countries have 69% of SDR allocation shares in the share of country groups, developing countries have 21% of SDR allocation shares in the share of country groups and LDCs have 10 % of SDR allocation shares in the share of country groups. It shows that Developed countries have more than SDR allocation shares in the share of country groups.

6. LENDING ISSUES AND CHALLENGES

The International Monetary Fund was established at Breton Woods in the aftermath of the Great Depression and at the end of World War II, when confidence in a liberal world economy was low. The fund's purpose was to maintain exchange rate stability by lending to countries experiencing temporary balance of payments problems. In a world of fixed exchange rates, countries would only be allowed to alter their exchange rates if there were fundamental imbalances in their economies. In this way, the IMF would promote international stability and avert competitive devaluations.

6.1 Lending issues

A country in severe financial trouble, unable to pay its international bills, poses potential problems for the stability of the international financial system, which the IMF was created to protect. Any member country, whether rich, middle-income, or poor, can turn to the IMF for financing if it has a balance of payments need—that is, if it cannot find sufficient financing on affordable terms in the capital markets to make its international payments and maintain a safe level of reserves.

IMF loans are meant to help member countries tackle balance of payments problems, stabilize their economies, and restore sustainable economic growth. This crisis resolution role is at the core of IMF lending. At the same time, the global financial crisis has highlighted the need for effective global financial safety nets to help countries cope with adverse shocks. A key objective of recent lending reforms has therefore been to complement the traditional crisis resolution role of the IMF with more effective tools for crisis prevention.

6.2 Challenges

By strengthening its concessional programs to support growth and poverty reduction policies for its low-income members, the IMF has entered into an area different in several respects from its traditional stabilization programs. The latter aim to restore external viability in the short run by ensuring a rapid turnaround in the balance of payments, typically achieved by operating on the demand side, so that stability is accompanied, at least in the short term, by a reduction in growth. With PRGF arrangements, by contrast, program design has to accommodate the need of low-income economies to achieve objectives such as growth and poverty reduction rather than macroeconomic stability alone, and this new orientation requires a fundamental shift in the architecture of IMF-supported programs.

Finally, the relatively weak institutional and administrative capacity of low-income members is counteracted by means of measures aimed at strengthening their capacity to manage structural and macroeconomic reforms. While the economic underpinning of traditional IMF stabilization programs relies on a body of theories on which there is scientific consensus—to the extent there can be one in economics—the same cannot be argued about PRGF-like arrangements.

On the other hand, although macroeconomic instability is certainly an impediment to growth, identifying the economic underpinnings of growth and poverty is more challenging, and no - 17 - scientific consensus has yet emerged.

7. MAJOR FINDINGS

The present study has identified some major findings related to various aspects of IMF such findings are given below.

The Fund has proved to be a reliable source since the day of its existence. The growing membership of the International Monetary Fund simply proves the point that such an institution cannot be avoided and the member countries will definitely be in need of aids from IMF financially. It has been proved that, the IMF itself is far from perfect. Current structure of the IMF and its policies towards its different group of member countries are not satisfactory. A booming reform package for the IMF should include all aspects of its operations starting from its governance operations and policies to its lending and conditionality framework of the Fund.

8. SUGGESTIONS

On the basis of the above major findings, the present study has recommended some important suggestions as follows:

While the governance reform of the Fund should be the primary focus for the course of the reforms towards the Fund, other aspects of the IMF functions are also very much in need of serious reforms. The reforms in the conditionality of the IMF should lead to developed country ownership of the programs. The IMF should spend more time on studying the country before drafting the lending programmes for that country. The government of the borrowing country should be more involved with the IMF in drafting the program in the beginning so that the program is set more based on the strengths of that developing country. The IMF should reorganize its governance in order to improve the efficiency in various aspects such as lending, operation and financing.

9. CONCLUSION

While evaluating the overall success of the Fund, due consideration should be paid to the economic and political environments of the World in which it had to work. Its success cannot be measured simply in terms of the objectives and hopes of the founders of the Fund. It has been pointed out that the Fund has not been successful in its fundamental objectives, viz. freezing World trade from quantitative restrictions, restoration of multilateral convertibility, abolition of exchange control, preventing crisis in the balance of payments.

Activities of the Fund benefit not only the members who have sought or may seek assistance from the Fund but also other members who are in a strong position and have neither sought nor are likely to seek assistance from the Fund. In the absence of assistance from the Fund, the countries in balance of payments difficulties would have instituted restrictions against countries having surplus balance of payments which would have been harmful to the countries in a strong balance of payments position. In addition to this negative gain these countries derive, also, position benefits from the activities of the Fund along with other members. The Fund has tried to establish a properly functioning international monetary system which is very essential for the expansion of free and multilateral world trade.

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