International Monetary Fund (IMF) bailout

Why in news?

Recently Sri Lanka secured a $3 billion bailout from the International Monetary Fund (IMF) amid the worst economic crisis.

What is IMF?

- **Establishment** - The IMF was established in 1944 in the aftermath of the Great Depression of the 1930s.
- **Aim** - To bring about international economic coordination to prevent competing currency devaluation by countries trying to promote their own exports.
- **Membership** -IMF has 190 countries as its members.
- **Headquarters** –Washington, D.C., United States.
- **Role** - IMF is the last resort lender for countries facing severe economic crises.
- The IMF fosters international financial stability by providing
    - Policy advice
    - Financial assistance
    - Capacity development
- IMF provides financial support to countries hit by crises in order to restore economic stability and growth.
- IMF does not lend for specific projects.
- **Resources of IMF** - IMF funds come from three sources
    - Member quotas
    - Multilateral borrowing agreements
    - Bilateral borrowing agreements

What is the IMF bailout?

- **Bailout** - Means extending support to an entity facing a threat of bankruptcy.
- **Lending** - The IMF lends money countries the form of Special Drawing Rights (SDRs)
    - Special Drawing Rights (SDRs) is a basket of five currencies, US dollar, Euro, Chinese Yuan, Japanese Yen and British Pound
- The bailout can be executed in the form of loans, cash, bonds, or stock purchases.
- **Reasons for bailout** - Countries seek IMF bailouts for the following reasons
    - To resolve macroeconomic risks
    - To solve currency crises
    - To meet external debt obligations
    - To buy essential imports
    - To push the exchange value of their currencies
- **Conditions** - The countries are expected to meet following conditions for the IMF

bailout
    - Structural reforms such as fiscal transparency, tax reforms.
    - Reforms in state-owned enterprises.
    - Reforms in macroeconomic variables like monetary and credit aggregates.
    - Reforms in international reserves.
    - Reforms in fiscal balances and external borrowing.

What about the crisis in Sri Lanka and Pakistan?

- **Sri Lankan economy crisis** - Sri Lanka witnessed a sharp rise in domestic prices and the exchange value of their currencies plunged.
- Currency crisis are usually the result of mismanagement of the currency by its central bank.
- It is partly contributed to decline of foreign tourists during the Covid-19 pandemic.
- **Pakistan economy crisis** – It is a part of 2022-2023 political unrest in Pakistan.
- The crisis caused severe economic challenges for months due to which food, gas and oil prices have risen.

- **General factors that lead to economic crisis**

    - Inappropriate fiscal and monetary policies
    - Large current account and fiscal deficits
    - High public debt levels
    - Exchange rate fixed at an inappropriate level
    - Weak financial system
    - Political instability and weak institutions

What are the pros and cons of IMF bailout?

Pros	Cons
• Ensures the survival of a country amid economic turmoil • Ensures that the functioning of essential industries and economic systems • Provide technical expertise to the affected country on how to implement reforms to strengthen the economy and institutions	• Can result in reduced government spending and higher taxes, measures • Can also create a sense of dependency on external funding • Affects the investing environment in the country

Quick facts

India and the IMF

- India is a founder member of the IMF.
- India has not taken any financial assistance from the IMF since 1993.
- Repayments of all the loans taken from International Monetary Fund have been completed on May 2000.

- Finance Minister is the ex-officio Governor on the Board of Governors of the IMF.
- RBI Governor is the Alternate Governor at the IMF.
- India’s current quota in the IMF is SDR (Special Drawing Rights) 5,821.5 million making it the 13th largest quota holding country at IMF and giving it shareholdings of 2.44%.
- India has invested SDR 750 million through nine note purchase agreements with the IMF.

Note purchase agreements is usually a temporary bilateral arrangement for an initial period of one year which may be extended by a period of up to two years and the principal of the notes is to be denominated in SDR

References

1. The Indian Express │IMF Bailout
2. Department Of Economic Affairs │IMF and India

