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## **IMF financial package for low-income countries: Much ado about nothing?**

This briefing analyzes announcements made at the end of July by the IMF regarding the level of their financial commitments to low-income countries (LICs) through 2014, the decision to allocate \$250 billion worth of Special Drawing Rights (SDRs), and a reform of the facilities through which the IMF will lend to LICs. We are awaiting further information from the IMF in order to bolster these analyses - namely the policy paper on the new loan facilities, which may not be available for several weeks. We will update this briefing as information becomes available.

### *Highlights include:*

- The IMF says it will likely lend about \$4 billion to LICs in 2009, and again in 2010, and that it could lend "up to \$17 billion" through 2014. But it has yet to secure about \$14 billion of that \$17 billion. The IMF is only willing to provide \$2.3 billion out of the total amount and it is asking donors to contribute \$14 billion. This amount is not yet secured, and it probably will not be additional to existing aid pledges.
- The IMF is dedicating as little as \$785 million from gold sales proceeds to programs for LICs - and none for debt relief, as had been demanded.
- The IMF will reduce interest payments on outstanding concessional loans from 0.5% to zero. This applies to the interest on both old and new loans as calculated through 2011. However this is only worth about \$110 million to all low-income countries over the course of two and a half, or less than \$1 million a year on average.
- The IMF is re-designing its LIC lending programs. However this is largely a renaming exercise and there is no indication that conditionality frameworks on LIC loans will change substantially, meaning that LICs are likely to continue contending with pro-cyclical demands for cuts in spending, inflation rates, and deficits.
- The SDR allocation did not include measures recommended by civil society, such as provisions for transfers from rich countries to poor ones, modification of developing countries' costs in converting SDRs to hard currency, or plans for special, targeted allocations on the basis of need.
- **ACTION:** A "holiday postcard" that you can send to your IMF Executive Directors and/or Finance Minister urging changes in IMF policy is included.

At the end of July, rushing before its summer recess, the IMF Executive Board approved two packages on issues crucial to the world's poorest countries as they grapple with the effects of the devastating economic and financial crisis. The first one was advertised, in a press release published by the IMF on 29<sup>th</sup> July, as "IMF Announces Unprecedented Increase in Financial Support to Low-Income Countries." Along with that support comes a re-structuring of the facilities used by the IMF to lend to low-income countries (LICs). The second was the IMF Executive Board endorsement of the \$250 billion allocation of Special Drawing Rights (SDRs) - the IMF's reserve asset - to increase liquidity in the global economy.

While many civil society organisations would have preferred that funds were channelled through a different institution, and through regional financing arrangements, the G20 chose the IMF in April (see annex for more details). Unfortunately, the changes agreed in July do not meet the demands made by global civil society for preventing a build-up of new debt, providing enough new resources to meet the significant financing shortfalls being experienced by developing countries due to the impacts of the crisis or ending harmful conditionality.

### *What is in the July package for low-income countries?*

Despite claims by the IMF that it is mounting "a historic effort [...] to help the world's poor" which "should help prevent millions of people from falling into poverty," the Fund is failing to deliver on most civil society demands. Although some of the measures announced by the Fund, such as a relief on interest payments for all loans to low-income countries through 2011, are positive, they are not sufficient in size and scope to provide the additional financing that low-income countries need in order to meet foreign exchange shortfalls and address the debt distress and balance of payments problems they are experiencing.

#### **Preventing a build-up of new debt**

The IMF has announced that concessional lending for low-income countries "is expected to reach up to \$4 billion per year in each of 2009 and 2010, (and) a total of up to \$17 billion could be provided over the period through 2014." But of course this money is not free of conditionality, nor is it even certain to materialize.

The Fund has also committed to provide "exceptional relief of all interest payments on outstanding concessional loans due to the IMF (by low-income countries) through the end of 2011 - effectively, an interest rate of zero on these loans for this period." Although this is welcome, such relief is insufficient to cope with the needs of low-income countries. It is also far less impressive than proposals put forward by civil society organisations and official agencies such as UNCTAD, which has called for a debt moratorium to enable LICs to make payments for vital imports rather than service foreign debt. Table 1 shows the potential value of the interest relief, finding it to be worth less than \$110 million between now and the end of 2011. Since that interest relief is spread over two and a half years and probably around 60 countries<sup>1</sup>, on average it is worth less than \$1 million annually to each country that qualifies.

Even with the 'interest relief', there is deep concern about the debt sustainability of developing countries. The accumulation of new IMF debt at the height of the global economic and financial crisis, although interest free (through 2011), may sow the seeds for significant problems in the future. Indeed, many experts are now worried about the spectre of a new debt crisis in developing countries.

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<sup>1</sup> Only 58 countries are certain to get interest relief as they have existing projected interest payments to the IMF between now and the end of 2011.

Table 1: Value of Interest relief to low-income countries

	End 2009	2010	2011
Existing credit outstanding*	\$16,331,930	\$31,085,465	\$27,013,487
Drawing down of balances **	\$775,881	\$3,854,227	\$6,932,573
New loans ***	\$462,082	\$5,642,382	\$15,815,865
<b>Total</b>	<b>\$17,569,894</b>	<b>\$40,582,074</b>	<b>\$49,761,926</b>

Source: author's calculations based on IMF data

\* Based on projected interest payments to the IMF as of 30 June 2009

\*\* Assuming all countries draw down fully the balance of the commitments made by the Fund equally over the next five half-years.

\*\*\* Assuming the IMF commits \$4 billion worth of loans in 2009 and 2010, and \$2 billion worth in 2011. Disbursements are new loans assumed to be made in six equal instalments.

To guard against this, many civil society organisations have demanded a moratorium on all debt service payments (principal and interest) for low-income countries affected by the crisis. But the IMF makes no mention of relief on the principal, and interest relief is only offered until 2011, when - according to World Bank estimates - most LICs will still be suffering the effects of the crisis, and far from reaching a recovery stage. The IMF package for LIC loans also says very little about the looming debt problem, only promoting a more flexible debt sustainability framework (DSF). While more flexibility in the DSF is welcome, as some countries are in a stronger position to leverage debt-based resources to manage the effects of the financial crisis, others are not and these countries need new financing which would not accumulate debt.

### Providing enough new resources

An additional problem with the promised financing amounts to LICs is that IMF concessional finance is currently only provided if there are enough resources to subsidise the difference between concessional and market interest rates.

Subsidy resources have to come either from the IMF's own resources or from bilateral donors. The IMF is hoping "to mobilise additional loan resources promptly, and [has] called on existing and potential lenders to be forthcoming with additional contributions." Since the Fund is only willing to contribute \$2.3 billion (SDR 1.5 billion) from its own resources, as much as \$14 billion (SDR 9 billion) will have to be "mobilized from bilateral contributions."

This actually means that the IMF cannot yet count on this money. And if donors are forthcoming, these funds are most likely to come from pledged aid money, which is by no means fresh or additional money. The result would be that funds that would otherwise be allocated to bilateral official development assistance would instead be used for IMF lending to low-income countries. In some cases this may mean essentially a transfer from bilateral grants to multilateral loans. This is a movement in the exact opposite direction from what is needed, which is a movement from conditional loans to non-debt creating grants.

IMF staff have indicated that non-traditional donors - presumably countries like China and Saudi Arabia - will be approached for funds, and that could mean fresh resources. However, this cannot be relied upon as a guaranteed source of funding, as many of these countries rightly have concerns over the Fund's governance structures and conditionality frameworks. With little trust in the Fund, they are likely to prove reticent to contribute resources in this manner.

Of the Fund's contribution from its own resources, as little as \$785 million (SDR 0.5 to 0.6 billion) will come from resources linked to the sale of a portion of the IMF's gold reserves - either directly from the proceeds or through income from the investment of those proceeds. The balance will come out of existing reserves and the profits from repayments by middle-income countries of their IMF loans.

## Reducing economic policy conditionality

The nature of the **economic policy conditions** attached to IMF loans is a looming uncertainty of the package approved for low-income countries. This is a key concern to civil society and developing countries, as the extent to which IMF financing will be able to support fiscal stimulus and allow counter-cyclical policies in low-income countries depends on whether the IMF decides to channel funds with their traditional pro-cyclical and contractionary conditions or instead make deficit and inflation targets more flexible. Also unclear is whether any flexibility in macroeconomic policies will apply only for the worst period of the current crisis, or be adopted permanently.

Despite reshuffling the structure of IMF facilities for low-income countries (see Table 2), last week's public announcement is silent about the specifics of the conditionality frameworks attached to the new IMF facilities for LICs. CSOs have been calling for all emergency assistance - rather than just the first 25 per cent of the funds available from the Exogenous Shocks Facility (slated to be integrated into the Rapid/Standby Credit Facility) - to be available without economic policy conditionality. The IMF has thus far ignored the call by civil society to establish a concessional facility for low-income countries that mirrors the Flexible Credit Line (FCL) which is a conditionality-free line of credit that has been made available to middle-income countries which have demonstrated 'sound macro-policies,' according to the IMF's yet unpublished criteria. Thus far, Mexico, Poland and Colombia have qualified for the FCL.

The IMF has not yet published the full policy paper on the changes to the structure of the lending facilities for LICs. However, informal exchanges with the IMF staff indicate that the paper will not address issues related to the content of the Fund's macroeconomic conditions, and will instead confine the discussion to issues related to the operational design and modalities of the revised loan programmes for LICs.

Table 2: New structure of IMF concessional facilities

<b>New facility</b>	<b>Facility being replaced</b>	<b>Purpose</b>	<b>Expected conditionality</b>
<b>Extended Credit Facility (ECF)</b>	Poverty Reduction and Growth Facility (PRGF)	Provides sustained engagement in case of medium-term balance of payments needs.	Upper credit tranche conditionality (which implies conditions requiring low fiscal deficits and inflation levels)
<b>Standby Credit Facility (SCF)</b>	Exogenous Shock Facility - High Access Component	Provides flexible support to low-income countries with short-term financing and adjustment needs caused by domestic or external shocks, or policy slippages.  Targets countries that no longer face protracted balance of payments problems but may need help, and can also be used on a precautionary basis to provide insurance. Similar to the Stand-By Arrangement for middle-income countries.	Upper credit tranche conditionality
<b>Rapid Credit Facility (RCF)</b>	Exogenous Shocks Facility- Rapid Access Component  Emergency Natural Disaster Assistance  Emergency Post-Conflict Assistance	Provides limited and short-term financial support in a single, up-front payout for low-income countries facing urgent financing needs	Conditionality limited to addressing the shock

Source: <http://www.imf.org/external/np/exr/facts/poor.htm>

Civil society research on the first set of IMF crisis loans indicates that the IMF continues to attach pro-cyclical fiscal and monetary policy conditions to its loans. This means that even during a time of significant contraction in LIC foreign exchange reserves, public revenue bases and consumer demand, developing and emerging market countries are required to reduce their fiscal deficits by curbing public spending, and lower their inflation levels by increasing their official interest rates.<sup>2</sup> And a recent policy brief published by the G24 group of developing countries finds that despite the existence of high levels of foreign reserves in many low-income countries and the potential for SDR allocations to be used to finance fiscal stimulus, the IMF has only advised a few countries to actually undertake counter-cyclical economic policies.<sup>3</sup>

### *What about the SDR allocation?*

Also last week, the IMF Executive Board approved a general allocation of \$250 billion worth of Special Drawing Rights (SDRs), which was agreed to by the G20 leaders on 2 April in London (see Annex for background on SDRs). The IMF board approved the issuance of SDRs, meaning it only needs the stamp of approval of IMF member countries - which is virtually assured. Unfortunately, the plan approved does not include measures that would make SDRs more useful to low-income countries.

SDRs are widely acknowledged as perhaps one of the least onerous vehicles for provision of the immediate liquidity that low-income as well as developing countries urgently require in order to meet their financing shortfalls. Apart from the cost of drawing on the SDRs initially, the use of SDRs by developing countries would be **free of conditionality, non-debt creating and/or at a low cost**. In essence, SDR allocations would be the most counter-cyclical method for providing the urgent financing needed by LICs.

SDRs are in effect an IMF-created reserve currency, backed by the consensus of the IMF's member countries. They can be converted to hard currency, though interest charges (based on prevailing interest rates in hard-currency countries) apply until the SDRs are replenished. The interest rate is currently very low (below 0.5%), but can vary considerably, so CSOs have urged that the charges be eliminated, subsidized, or at least fixed for low-income countries. The board apparently did not consider this option, however.

Civil society organisations had also proposed a special allocation of SDRs be made, on the basis of need, to developing countries, rather than to the entire IMF membership. There is a precedent for a special allocation: in 1997 the IMF board approved a distribution of SDRs to just those countries which had joined the Fund since the last SDR allocation was completed in 1982. This required an amendment to the Articles of Agreement, but such a move could be made with adequate political will to provide resources to the countries most vulnerable and most affected by the financial crisis.

As developing countries will receive less than \$100 billion worth of the new \$250 billion valued SDR allocation (low-income countries will get only about \$17 billion), the IMF board should have agreed on a system that would enable and encourage rich countries to transfer or re-allocate SDRs -- but they failed to do so. The IMF paper explaining the allocation procedures sums up the situation: "No proposal for the voluntary redistribution of SDRs has ever been put into effect. The primary obstacle these proposals face lies in the zero-sum nature of the SDR system: participants are liable to pay SDR charges on all SDRs allocated to them whether or not they hold, use, loan, or donate their SDRs. Redistribution of SDRs therefore has a real cost to the provider (unless such costs were to be assumed by others with their consent, such as the

<sup>2</sup> See Eurodad's report "Bail out or blow out? IMF policy advice and conditions for low-income countries at a time of crisis", [http://www.eurodad.org/uploadedFiles/Whats\\_New/Reports/Bail-out%20or%20blow-out.pdf?n=8936](http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Bail-out%20or%20blow-out.pdf?n=8936); and Third World Network's report "The IMF's financial crisis loans: no change in conditionalities", <http://www.twinside.org.sg/pos.htm>.

<sup>3</sup> See G24 policy brief No. 47 "The potential development implications of increasing the IMF's resources", <http://www.brettonwoodsproject.org/doc/financedebt/G24PB47Chowla.pdf>.

recipients of the redistributed SDRs)." Although some European countries had expressed interest in transferring their SDRs to low-income countries, the lack of options discussed by the IMF staff paper will probably stall the discussion and prevent any progress on this front.

Low-income countries should be compensated, not burdened with additional debt and debt servicing of financing they require to offset the shocks from a crisis that has been imposed on them. According to former UNCTAD chief economist Yilmaz Akyuz, "For political reasons as well as effectiveness, ODA grants are not the best way to achieve this. An option would be to make a one-off permanent SDR allocation to these countries, based on some criteria of need. The cost of drawing on such allocations could be financed collectively from the IMF resources, including gold sales. This should be combined with a moratorium on servicing debt owed by these countries to official creditors, without any additional interest charges."<sup>4</sup>

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<sup>4</sup> See South Centre report by Yilmaz Akyuz, "Policy Response to the Global Financial Crisis: Key issues for developing countries," available at [http://www.southcentre.org/index.php?option=com\\_docman&task=cat\\_view&gid=45&dir=DESC&order=date&Itemid=68&limit=10&limitstart=10](http://www.southcentre.org/index.php?option=com_docman&task=cat_view&gid=45&dir=DESC&order=date&Itemid=68&limit=10&limitstart=10).

## *Action Alert*

While the IMF's 24 Executive Directors, who represent 186 member countries of the Fund, are in charge of decision-making in the IMF, they receive directions from the ministries of finance in their capital cities. Advocacy needs to be targeted on the capital level, at the officials and politicians within the ministries of finance that are in charge of matters relating to the IMF. Changes can be made at or before the IMF Annual Meetings that will take place in Istanbul in October, where the IMF's Board of Governors and the International Monetary and Financial Committee (IMFC) will meet

Furthermore, in many countries, such as the US, there are bodies within the parliament (or congress) which also have jurisdiction over the IMF and World Bank. Such parliamentarians should be approached with civil society demands for change at the IMF as well. A post card or letter like the one below can be adapted and sent to any of these targets.

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### **Holiday postcard to IMF Executive Directors**

I hope you are having a nice holiday away from the grind in Washington, but most poor countries aren't getting one. In fact the changes you agreed to for low-income countries do little more than increase their debts. Little progress has been made on the minimum demands made to ensure that IMF funding for LICs is adequate, non-debt creating, free of harmful economic conditionalities and effective in combating the effects of the global economic and financial crisis on the world's poorest countries. Proposals agreed to by the IMF board at the end of July are simply insufficient, but changes can still be made before, or at, the Annual Meetings.

You need to ensure that:

- Resources are provided without economic policy conditionality. We call for making all emergency and standby assistance available without conditionality except for fiduciary conditions. Low-income countries should not be required to tighten their fiscal and monetary policies by curbing public spending or lowering inflation at a time of global recession and unprecedented revenue losses. There also should be a concessional facility for low-income countries that mirrors the Flexible Credit Line (FCL) which has been made available to middle-income countries.
- At least \$5 billion in fresh resources is generated and devoted to low-income countries. These resources could be found from a combination of IMF gold sales and other IMF income sources. It must not come from existing aid budgets or pledges.
- These resources should be provided on non-debt creating terms in order to help ease the growing debt distress levels of low-income countries. One development-oriented way in which this could be done is by placing an unconditioned moratorium on all debt service payments (principal and interest) for low-income countries affected by the crisis.
- SDR allocations should be made on the basis of need and SDRs should be issued by the IMF on a regular basis, which would require a change to the IMF's Article of Agreements. In the meantime, the disproportionate amount of SDRs that have been allocated to rich countries should be transferred to developing countries. Either a special targeted allocation should be made on the basis of need or the Articles of Agreement should be changed to allow one-off re-allocations of SDRs without interest charges. The interest costs for low-income countries should at least be fixed, and preferably eliminated or subsidised by the IMF itself (e.g. through use of the proceeds from sales of IMF gold).

## ***Annex: Background information on the IMF low-income country facilities and special drawing rights (SDRs)***

The political commitment on both increasing the IMF's resources and a new allocation of SDRs was taken by the G20 leaders at their meeting in London on 2 April 2009. Although the overall numbers announced in London may have seemed impressive at first sight - \$1.1 trillion in total - there was very little in there for the world's poorest countries. Moreover, it was unclear to what extent the money put on the table was truly new money pumped into the system to increase liquidity and boost global demand, as opposed to money "recycled" from financial packages previously pledged by donors or the International Financial Institutions (IFIs).

The biggest concern for civil society, though, was the blank check given to the IMF - the main winner in the April G20 deal - for roughly \$750 billion out of the \$1.1 trillion. In return, virtually nothing was asked of the IMF in terms of reforming past malpractice in crisis management and crisis prevention. The track record of the IMF in crisis management at the end of the 1990s had disastrous consequences. Civil society groups and many developing countries feared that funding channelled through the IMF would come with the same old macroeconomic conditions attached, which would prevent recipient countries from adopting the kind of counter-cyclical policies that industrialised nations had already started to adopt, with an unprecedented fiscal stimulus amounting to more than \$3 trillion.

But if the IMF was to be used, there were a minimum set of requirements that civil society put forward to prevent the IMF from using the crisis to revert to "business as usual" and instead ensure the new funds would be effective in combating the effects of the crisis.

The IMF would have to deliver on three crucial things:

- **Allow, and support, counter-cyclical macroeconomic policies** so developing countries could undertake the most appropriate actions to boost growth and implement measures to combat poverty. This means that **IMF finance should not come with economic policy conditions attached** - because, among other reasons, the current crisis is an external shock which has little to do with domestic structural problems;
- Ensure that adequate resources are available for developing and low-income countries which face the greatest constraints to access international capital markets or other sources of finance. This would mean that **fresh resources must be found and devoted to low-income countries**;
- Provide for adequate terms of finance so the funds channelled did not create a new debt crisis in the world's poorest countries, which had no responsibility in the outburst of the global economic and financial crisis. This would require highly concessional finance - with close to zero or zero fixed interest rates - prioritising **non-debt creating forms of finance such as debt relief** in order to help ease growing debt distress levels of low income countries.

### **Special Drawing Rights (SDRs)**

ActionAid, Third World Network, Eurodad and other civil society groups have been calling for the enhanced use of SDRs<sup>5</sup> to provide additional liquidity for developing countries and particularly for low-income countries. SDRs could be a good source of finance for developing countries as once allocated they can be **converted into a hard currency** (through voluntary arrangements with governments holding or issuing hard currencies) **and have no conditions attached**.

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<sup>5</sup> For further details, see ActionAid factsheet on "Special Drawing Rights (SDRs) and the Global Reserve System" (2009): <http://www.actionaid.org/assets/pdf/ActionAid%20Factsheet-%20Special%20Drawing%20Rights%20%20the%20Global%20Reserve%20System.pdf>; the Bretton Woods Project article on SDRS "Inside the institutions: Special drawing rights", <http://www.brettonwoodsproject.org/sdrs65>; or the IMF's factsheet on SDRS, <http://www.imf.org/external/np/exr/faq/sdrallocaqs.htm>.

However, a general allocation of IMF SDRs is done according to countries' quotas. This means the richest countries get the biggest share of the pie, since they hold the highest quotas. The US, therefore, gets over 16% of the total number of SDRs issued, Japan about 10% and so on. With the \$250 billion allocation, only some \$81 billion will go to developing countries, and **only about \$17 billion will go to low-income countries** (about \$10 billion for Africa - less than 5% of the total value of the SDRs being issued). G7 countries, which have many financing options already, are rewarded with over 45% of the SDRs.

Civil society organizations have been urging the following actions:

- Rich countries should transfer their share of SDRs to developing countries;
- A special targeted allocation, or perhaps regular allocations, on the basis of need should be made;
- The interest costs for low-income developing countries should at least be made fixed, and preferably eliminated or subsidised (e.g. through use of the proceeds from sales of IMF gold).

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