



## IMF Bailouts

**For Prelims:** IMF, Special Drawing Rights

**For Mains:** IMF Bailouts - advantages and drawbacks

### Why in News?

The [International Monetary Fund \(IMF\)](#) recently confirmed a **USD 3 billion bailout plan (under Extended Fund Facility (EFF))** for [Sri Lanka's struggling economy](#).

- It is also **negotiating with Pakistan for a USD 1.1 billion bailout plan** on account of its severe economic crisis marked by falling currency and price rise.

### What are IMF Bailouts?

- **Bailout:** Bailout is a general term for **extending financial support to a company/country facing a potential bankruptcy threat**.
  - It can take the form of **loans, cash, bonds, or stock purchases**.
  - A bailout **may (not) require reimbursement but is often accompanied by greater oversight** and regulations.
- **IMF Bailouts:** Countries seek help from the IMF usually when their economies face a **major macroeconomic risk, mostly currency crisis** (such as the ones Sri Lanka is facing).
  - Countries seek such assistance from the IMF to **meet their external debt** and other obligations, to **purchase essential imports**, and to **prop up the exchange value** of their currencies.

### Note

- A currency crisis is generally a consequence of:
  - **Gross mismanagement of currency** by a nation's central bank (often pressured by the ruling govt. to create fresh money for populist spending).
  - Consequent rapid rise of the overall money supply, which in turn causes rise in **prices and drop in exchange value of the currency**.
- A currency crisis results in:
  - **Lack of confidence** in said currency
  - **Disruption of economic activity** (people become hesitant to accept the currency in exchange for goods & services)
  - **Reluctance among foreigners to invest** in such an economy.

### What is the IMF?

- The IMF is an international organization that promotes global economic growth and financial stability, encourages international trade, and reduces poverty.
  - It was **set up in 1945 out of the Bretton Woods conference**.

- Originally, the primary goal of IMF was to bring about international economic coordination to prevent competing currency devaluation by countries trying to promote their own exports.
  - Eventually, it **evolved to be a lender of last resort to governments** of countries that had to deal with severe currency crises.
- **India has sought financial assistance from the IMF seven times but never since 1993.** The repayment of all the loans taken from the IMF were completed by May 2000.

## How is an IMF Bailout Provided?

- **Procedure:**
  - The IMF lends money to the troubled economies often in the form of **Special Drawing Rights (SDRs)**.
    - SDRs simply represent a basket of five currencies, namely the **U.S. dollar**, the **euro**, the **Chinese yuan**, the **Japanese yen**, and the **British pound**.
  - This lending is carried out by a number of lending programs such as **extended credit facility, flexible credit line, stand-by agreements, etc.**
  - Countries receiving the bailout can use the SDRs for various purposes depending on their individual circumstances.
- **Conditions:**
  - A country may have to agree to implement certain structural reforms as a condition to receive IMF loans.
  - **Criticism of Lending Conditions:**
    - Believed to be too tough on the public
    - Often accused of being influenced by international politics
    - Free-market supporters criticise the IMF for being too interventionist
  - **Acclamation:**
    - Conditions are essential for successful lending; it may **not make sense for IMF to throw money at a country** if its **faulty policies that caused the crisis remain untouched**.
    - Countries with poor institutional functioning and high corruption are **most likely to misspend the bailout money**.

## What are the Impacts of Providing IMF Bailouts?

- **Advantages:**
    - They ensure **continued survival of the country** under difficult economic circumstances and **help solve BoP problems** without resorting to measures that can be even more harmful to national/international prosperity.
    - A **complete collapse of the financial system can be avoided** when industries too big to fail start to crumble.
    - **Insolvency of institutions** that are needed for the smooth functioning of the overall markets **can be avoided**.
    - In addition to financial support, the **IMF can provide technical assistance and expertise** to help a country implement economic reforms and strengthen its institutions.
  - **Disadvantages:**
    - IMF's strict conditions for economic policy reforms may result in **reduced govt spending, increased taxes** etc. which can be politically unpopular and **may lead to social unrest**.
    - Seeking an IMF bailout may **harm a country's reputation in the eyes of investors and lenders**, making it more difficult for the country to access international capital markets.
    - Repeated IMF bailouts can **create a sense of dependency on external funding** and **discourage countries from implementing necessary long-term reforms** to address their economic problems.
    - IMF bailouts **may be viewed as an admission of economic failure by a govt**, which can **lead to political instability** and even the collapse of the govt.
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## UPSC Civil Services Examination, Previous Year Questions (PYQ)

**Q. "Rapid Financing Instrument" and "Rapid Credit Facility" are related to the provisions of lending by which one of the following? (2022)**

- (a) Asian Development Bank
- (b) International Monetary Fund
- (c) United Nations Environment Programme Finance Initiative
- (d) World Bank

**Ans: (b)**

**Exp:**

### **Rapid Credit Facility (RCF):**

- The Rapid Credit Facility (RCF) provides immediate balance of payments (BoP) requirements to low-income countries (LICs) with no ex-post condition, where a full economic program is neither necessary nor feasible.
  - RCF was set up as part of a comprehensive reform to make the fund's financial support more flexible and better suited to suit the diverse needs of LIC including times of crisis.
- There are three areas under the RCF:
  - A "regular window" for immediate BoP needs due to a wide range of sources such as household instability, emergencies and fragility.
  - For immediate BoP needs due to sudden, exogenous shocks. an "exogenous shock window".
  - A "large natural disaster window" for immediate BoP needs due to natural disasters where the damage is estimated to be equal to or greater than 20% of the member's GD.
- **Hence, option (b) is correct.**

**Source: TH**

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