



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.

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

PDF Reference URL: <https://www.drishtiias.com/printpdf/imf-bailouts-1>