EXPLORING THE ROLE OF THE IMF IN INTERNATIONAL ECONOMICS

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ABSTRACT

The International Monetary Fund (IMF) has been one of the key actors and at the same time one of the most controversial actors of International Economics since its establishment. There is no definitive answer to the effectiveness and even necessity of the IMF as an international economic organization when some nations see the IMF as a savior and others as the devil in disguise. In such a cloudy environment, it is important to understand how the Fund engages in arrangements, the difficulties of such engagements and to observe as well as rethink the approach of the Fund during times of crisis. To more accurately understand how the IMF and its policies developed into what it is today and why the IMF is an important actor in the development of international economic relations, it is necessary to delve into the foundations and institutional methodology of the Fund. The purpose of this paper is to analyze the approach utilized by the International Monetary Fund in its aim to mitigate crises and sustain a functional international economy, creating an understanding of the benefits and shortcomings of the Fund as well as its functionality. In the turbulent environment that the world finds itself in, following a pandemic, the role of the IMF will be crucial in determining the future of international economics. Therefore, the role of this paper is to shed light on the functionality of the IMF and provide a clear picture of the instruments and approaches the Fund may use in the following months and years. The data and studies which have been utilized for this paper have been collected from international organizations as well as academic research, reviews, and reports, as stated in the references section of this paper.

KEYWORDS:

FREE-MARKET, LIBERAL ECONOMICS, GLOBALIZATION, FINANCIAL CRISIS

JEL CLASSIFICATION CODES:

F33, F65, G01

1. INTRODUCTION

The International Monetary Fund has been a key factor in the development of international economics and a key actor in times of economic crises. States have constantly depended on the International Monetary Fund in such crises, and most have accepted the conditionality presented by the IMF for potential aid in the form of loans. Most observers would agree that the foundations of the IMF were laid during the Bretton-Woods conference in 1944 in New Hampshire, with the economist's John Maynard Keynes and Harry Dexter White being at the forefront of the initiative of what is one of the most powerful international economic organizations of today's world. The IMF has acted as a savior of last resort and has rushed to the aid of failing economies and helped in the management of balance of payments and thus financial management since its creation in 1944, after the Bretton-Woods conference (Fitzgerald, 1996). The end of the Second World War brought a new world order in which the capitalist West and socialist East were struggling for dominance and control, and in this background, the IMF acted to promote the Western economic policy and help the development of the war-torn states of the post-war era. The scope of the IMF would increase over the years as more states joined the organization, especially after the dissolution of the Soviet Union in 1991 and the de-facto victory of capitalist economic policy, thus the IMF became a global economic organization. From its foundation, the International Monetary Fund has adopted the role of a safeguard and savior during financial and economic crises, engaging in arrangements with struggling states, to avoid a contagion effect and crises of a global scale. The interventions of the IMF that include a program and agreement with a member-state have always been a matter of criticism. The agreements that are made usually follow a pattern of policies that are compatible with the economic principles of the Fund and its leading investors and member-states. The Fund prioritizes the well-being and interests of the global financial market and investors over the long-term stability and continuity of the national economy of a member-state in crisis. Although the motivation of the Fund in its interventions is not oriented towards the protection of national economies, but rather the global markets, the policies and interventions impact the economies of nation-states. The purpose of this research will be to analyze the methodologies used by the IMF in mitigating crises and to determine if the used methodologies and the Fund itself are efficient for Global Markets or should a new approach be considered. This paper will work in line with the following research questions:

1. What are the specific instruments and approaches of the IMF during financial crises?
2. How effective is the IMF in mitigating the effects of financial crises and what are the post-intervention effects?

2. RESEARCH DATA AND METHODOLOGY

The research methodology of this paper combines qualitative analysis with descriptive analysis. Investigating the history and significant occurrences, regulations, and trends that have influenced the used IMF methodologies are also part of the research. Comparable and descriptive strategies that will support qualitative analysis will be utilized to better comprehend the complex dynamics and enigmatic aspects of the instruments and economic approaches applied by the IMF in different countries. Examining both primary and secondary sources, such as historical records, policy documents, scholarly literature, and expert interviews, will be a part of this research. The data and studies will be collected from international organizations as well as academic research, reviews, reports, and different websites to reach conclusions on the stated Research Questions and the subject of the paper.

3. THE ROLE OF IMF IN THE FINANCIAL CRISIS

To understand the importance of the role of the IMF in financial crises, it is important to determine the types and causes of financial crises. Financial crises are associated with drastic changes in credit volume and asset prices, disruptions in financial intermediations and external financing, large-scale balance sheet problems or large-scale government intervention (Claessens & Kose, 2013). These issues are not independent from each other and usually follow each other consequently in the event of a financial crisis. According to an IMF working paper (Claessens & Kose, 2013), There are four main types of financial crises, and these are: Currency Crises, Sudden Stops, Foreign and Domestic Debt Crises and Banking Crises. A currency crisis occurs when a speculative attack has taken place on the domestic currency resulting in rapid devaluation and intervention by the government to save the currency by sharply raising interest rates or expending substantial amounts of international reserves, or imposing capital controls. A sudden stop crisis refers to crises relating to capital accounts or balance of payments. This type of crisis is defined as an unexpected fall in capital inflows or a sudden trend of outflow in international capital. A foreign debt crisis is tied to a country not being able to service its foreign debt, and a foreign debt crisis can be a sovereign or private case and at times both. Domestic debt crises occur when a government fails to realize its domestic fiscal obligations. The way this occurs could be purposeful inflation, de-basing the currency or simply declaring a default. A banking crisis is tied to the failure or potential failure of banks which results in the suspension of convertibility of their liabilities or demand of government intervention to bailout the banks by extending liquidity and capital assistance.

The International Monetary Fund (IMF or the Fund) has been a key player in international economics in recent history, acting to promote international trade, financial stability, and global monetary cooperation between nation-states. The IMF has played an active role in the management of financial and economic crises internationally and has intervened in countries struggling with economic crises, providing resources, funds, and guidelines to said countries. With the help of its very tightly organized web of institutions, IMF can very rapidly and efficiently provide member-states with financial and technical assistance when necessary. Even though the aim of the IMF and its operations seems a positive one, there have been cases in which the IMF and its policies have been viewed negatively and avoided. In this regard, there have been several studies that conclude that the IMF causes more harm than benefit to states which suffer economic crises, while some also claim that the IMF is a crucial institution which has saved numerous states from total economic meltdown. Thus, the IMF and its effects on a member-state are quite controversial and open for debate; an example of this debatable involvement can be seen in the case of the Republic of Türkiye during its "lost decade" in the 1990s.

It is worth noting that the necessary requirements attached to the financial arrangements of the IMF follow a certain trend of economic policy which is in line with the implication of free-market policies and financial sector liberalization. The policies which are obligated by the Fund are policies that tend to align with the economic doctrines of the United States and the liberal West (Li, Sy, & McMurray, 2015). This reality also puts to question the political neutrality of the IMF in domestic affairs, since the program and technical assistance involves a wide array of policies that directly affect the domestic political climate of a receiving state. In fact, a very valid criticism can be made about the attitude of political neutrality since not only is it a paradox but also it hinders the IMF from considering the political implications when structuring their programs which may convert an economic crisis to a crisis at domestic politics and in some cases worsen both. Having observed these studies and conflicting cases regarding the IMF, it is clear to see that the organization and its actions are open for discussion and quite controversial.

3.1 The Credit Potential of the Fund

To be able to engage in a rescue program during times of financial crisis, the IMF utilizes its credit potential. The way the Fund sources its potential and operates to allocate and provide aid in the event of economic crisis is three-fold: Membership Quotas, Multilateral borrowing, and Bilateral borrowing (IMF, 2021). Membership quotas are based on the member-states' relative position in the global economy. Multilateral borrowing is ensured by several member-states and institutions, which are ready to provide additional resources in an extraordinary situation and Bilateral borrowing ensures agreements with international creditors for resources in the extraordinary event of the previously mentioned resources being entirely used. Along with the mentioned membership quotas, the arrangements made for the alternative sources of funding are known as New Arrangements to Borrow (NAB) and General Arrangements to Borrow (GAB). NAB commitments are mostly realized with G7 countries and are seen as back-up plans to the quota mechanism (The Bretton Woods Update, 2012). NAB commitments are usually utilized when large sums of funds are required for IMF programs, or in the event of a global crisis or potential global crisis. The GAB commitments are part of an older mechanism in comparison and involve pledges from 11 states that are considered developed economies. These wide-ranging sources help the IMF to have the capacity for intervention and rescue packages when it is necessary to provide aid to failing economies or financial sectors.

There are two aspects of IMF credit potential that have to be analyzed in order to understand the functionality of the IMF credits, and these two aspects are the supply of credit and the demand for credit from the IMF. The IMF looks to increase its credit capacity by pushing for hurry-up lending when the time for quota reviews arrives and with these increases the IMF usually tends to increase its staff and bureaucratic capabilities (Dreher & Vaubel, 2004). While the IMF can control and affect the supply side of its credit capabilities, it has no control over the demand side of the spectrum. The demand for credit is dependent on the enthusiasm of borrowing member-states of the Fund. The enthusiasm of borrowing from member-states is also dependent on multiple factors, the main factors being the ability to use the loan, the factor of IMF conditionality and interest subsidies offered by the Fund. When it comes to the actual quantity of the provided loan, the specific situation of the borrower plays a part in determining how committed the IMF will be to the quantity of the provided loan.

The political and economic circumstances of the borrowing member-state are crucial variables that determine the value of the loan to be provided. The economic circumstances include the income, the exchange rate regime, and the reserves of the borrowing member-state among other critical aspects. The political aspect includes not only the stability and legitimacy of the borrowing government but also the general political climate in a borrowing state. For instance, the IMF tends to provide more generous loans when a receiving state is in a pre-election period (Dreher & Vaubel, 2004). One of the most eye-catching reasons for this trend is the opportunity for a failing government to use the IMF as a scapegoat in a failing economic situation to avoid an electoral defeat. Naturally, the preferred option would be to completely avoid IMF interventions prior to elections borrowing. However, states seldom have any alternatives to IMF lending.

3.2 IMF and Its Financial Arrangements

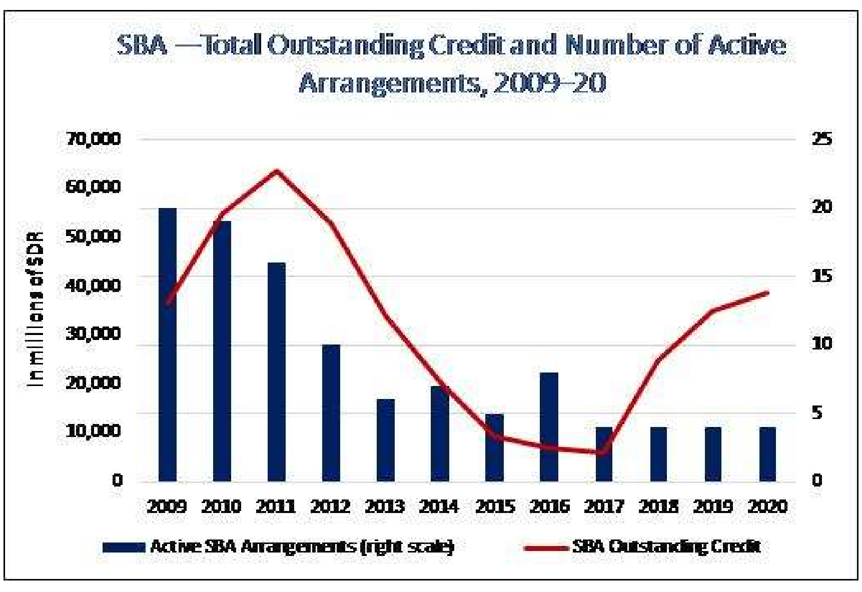
There are several types of financial arrangements that are provided by the Fund, and these arrangements depend on the specific situation of a country's economic structure. One type of financial arrangement is the General Resources Account, which is provided to all member-states of the IMF with non-concessional terms. The Fund also provides concessional financial aid through the Poverty Reduction and Growth Trust which is mainly aimed to provide aid for low-income and developing countries. The largest share of aid that has been provided by the Fund has been through stand-by arrangements, and these arrangements are mostly focused on providing short-term remedies to economic troubles. The Extended Fund Facility and Extended Credit Facility have been tailored for low-income countries with troubles that need medium-term support. For member-states that are developed and have strong financial policies, the IMF provides the Flexible Credit Line or the Precautionary and Liquidity Line, and these arrangements allow qualifying member-states to draw credits at any time without pre-conditions and the provided access to credits is large and up-front.

In times of desperate need of rapid aid, the Fund engages the Rapid Financing Instrument and Rapid Credit Facility. These arrangements are usually designed to address specific crises such as an urgent need for a balance of payments tied to natural disasters or commodity price shocks (IMF, 2021). Since the IMF provides different types of financial arrangements, naturally these arrangements depend on the type of crisis which a member-state is facing.

In order to further understand the anatomy of IMF financial aid, it is necessary to examine the preferred type of arrangement based on the type of crisis that is being confronted. It is no surprise that the different types of arrangements and programs offered by the Fund have different outcomes and not every arrangement promises the same effectiveness. For instance, studies suggest that programs that offer aid from general resources, usually tailored for middle-income states, have less impactful outcomes on economic growth when compared to programs involving low-income states which rely on concessional lending with much more lenient terms (Sokolova & Balima Weneyam, 2020).

Firstly, the lenient approach of the programs for low-income countries allows these countries to focus further on growth without being strained too much by IMF conditionalities, secondly, these programs usually are followed by critical structural reforms which create an impetus for growth and confidence in the financial sectors.

Figure 1: Total outstanding credit and number of active arrangements with regards to stand-by arrangements (2009-2020)



Source: (IMF, 2021)

Although the IMF provides various forms of arrangements and programs, the main line of lending is provided through stand-by arrangements. These arrangements are also provided in different manners depending on the specific situation of a borrowing country. Stand-by Arrangements are quite flexible, and all member-states of the IMF are eligible for a stand-by arrangement. They can have durations from 12 months to 24 months and in some cases up to

36 months. These arrangements also have several types in terms of borrowing. Some countries are allowed normal access while other member-state has exceptional access, front-loaded access, or rapid access to funds tied to stand-by arrangements. For member-states which opt-out or principally want to avoid borrowing loans from the IMF, the option of Precautionary access is provided. Precautionary access allows member-states to receive IMF policies without borrowing funds. However, this kind of arrangement also provides the member-state with the right to retain the option to withdraw funds should it be needed in the future. Although these arrangements contain the bulk of provided IMF loans, the amount of active stand-by arrangements have been going down in the last decade (see Figure 1).

3.3 The Conditions and Conditionality of the IMF

When providing countries with aid and programs, the IMF also includes certain requirements of policy adjustments to ensure that the provided loans will be repaid by the receiving state while also monitoring the progress of the state in reaching previously established goals during the program. This is known as IMF conditionality. There are several ways in which the IMF measures the compliance of a state with its conditionality, and these are categorized into four groups: Prior Actions, Quantitative Performance Criteria (QPC), Indicative Targets (IT) and Structural Benchmarks (IMF, 2021). Prior actions are steps that a country agrees to take before the IMF approves financing or completes a review, for example, elimination of price controls. Prior actions ensure that a program will have the necessary foundation for success, and this is the first step of the conditionality process. QPCs are based on macroeconomic variables under the control of the authorities. Such variables include monetary and credit aggregates, international reserves, fiscal balances, and external borrowing. ITs are quantitative indicators to assess progress in meeting a program's objectives. Sometimes ITs are set instead of QPCs because of uncertainty about economic trends. As uncertainty is reduced, these targets may become QPCs, with appropriate modifications. Finally, Structural Benchmarks are reform measures, usually not being quantifiable, which are necessary for achieving the overall goals of the program, these can be building social safety nets or establishing strong financial institutions. Although, there have been criticisms directed towards the IMF conditionality for its rigorous nature, it is understandable for the IMF to be cautious and strict when implementing arrangements and designing their conditionality.

First, the Fund depends on its shareholders and pledging member-states for funds and the capacity of their credits, thus the IMF is held responsible in delayed payments of loans or failures of IMF programs by borrowing member-states. IMF has a responsibility to prevent a contagion effect at times of financial crises and to ensure that borrowing members are at capacity to repay their loans at a timely manner. To achieve such a complicated task, the Fund must have certain requirements and tasks, collectively known as IMF conditionality, which would be obligatory for a state's utilization of IMF loans.

IMF conditionality has also been praised for playing a very critical role in preventing moral hazard at times of financial and economic instability (IRC Task Force on IMF and Global Financial Governance Issues, 2019). When it comes to moral hazards tied to IMF lending, there have been two aspects that are affected by IMF policies, and these are debtor moral hazard and creditor moral hazard. Debtor moral hazard is known as the possible tendency of the government to continue borrowing from the Fund to compensate the economic instability instead of addressing the defects within their economic policies and enacting the necessary reforms. Creditor moral hazard refers to the potential attitude of creditors to continue lending loans to governments without considering if steps have been taken to rectify the economic instabilities and if the borrowing government has the capacity to repay those loans. In both these types of moral hazard, the burden would be loaded on to the IMF, with the irresponsible government and careless creditors depending on eventual IMF loans to protect their prospects. Thus, the IMF conditionality, which is tied to certain policies and requirements agreed to by the IMF and borrowing governments, prevents these moral hazards or at the very least brings these cases to a minimum.

4. THE ROLE OF THE FUND DURING THE PANDEMIC CRISIS

Following the COVID-19 pandemic, the global economic situation has turned the page to a new era of economic crisis, recession, and an increasing trend of hyper-inflation. Due to the emergence of this new crisis, national governments have once again turned to the IMF for economic and financial assistance to mitigate the crisis. The Fund has been present during this period in numerous countries to provide the required economic aid for failing economies.

According to official reports from the Fund (IMF, 2022), the IMF has provided over 170 billion dollars to a total of 90 countries during and after the pandemic crisis. These packages have included rapid financing instruments, flexible credit instruments and other instruments which are specifically tailored for arrangements designed for times of emergency. These special aid packages have been funded by the Fund's Catastrophe Containment and Relief Trust (CCRT), which had been operational since 2015 and is designed to provide grants to poor countries which are hit by extraordinary catastrophes and that cannot pay debt service. To raise funds for the trust, the Fund initiated an emergency fundraising effort at the beginning of the pandemic. The initial fundraising target was around 1.5 billion dollars, however, the funds raised were around 800 million. This underachievement was a clear example of the selfish reality behind international organizations and humanitarian efforts. Nation-states braced for impact and visibly saved resources to mitigate a potential internal crisis rather than acting in an internationalist attitude. The IMF had also prepared a report (Agarwal & Gopinath, 2021) which aimed to provide guidelines in order to hasten the end of the pandemic. The report, named "A Proposal to End the COVID-19 Pandemic", included a pledge from the IMF for the allocation of 650 billion dollars of SDR for the period and details for social and health policies necessary for curbing the rise of the pandemic.

CONCLUSION

The International Monetary Fund is a tight nit and highly efficient mechanism which has been one of the main actors for decades in which international economic relations have peaked. The Fund has several institutions and mechanisms which are used to ensure that the global economy continues to thrive, and nations continue their path to globalization. Although the role and effectiveness of the Fund are very visible, there are also questionable aspects that should be addressed, one of them being the questionable impartiality of the fund. The Fund has always received criticism due to its orthodox economic policies which may not be compatible with states that do not subscribe to liberal economic policies. This especially may become a problem when states that traditionally do not follow liberal economics engage in arrangements with the IMF. There are several case studies in which the success of the IMF in mitigating financial crises can be questioned and one of the reasons for this can be the rigorous nature of IMF conditionality. Should the Fund rethink its approach to conditionality and engage in a more flexible approach to economic and financial reforms in receiving member-states, the effectiveness and success of IMF interventions would become much more evident. However, when it comes to the importance and role of the IMF, one cannot question that as long as international trade and globalization thrive, so will the relevancy of the Fund.

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