Delivering on Change

The IMF has created a new support framework for the world's low-income countries

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AS THE global financial crisis has swept from developed to developing countries, the IMF has undertaken an unprecedented reform of its policies toward low-income countries, culminating in the announcement of significant new resources underpinned by new lending instruments.

This wide-ranging effort has transformed the Fund's relationship with member countries that are striving to overcome the impact of a crisis not of their own making. The initiative reflects close consultation with low-income countries and responds to the call by the heads of state of the Group of Twenty (G-20) industrial and emerging market economies for swift policy action to meet the needs of the developing world.

The reform effort has sharply increased the financial resources available to low-income countries, overhauled the Fund's lending framework, streamlined loan conditionality, and reduced to zero the interest charges on concessional IMF loans for low-income countries through 2011, while permanently increasing concessionality of Fund lending to those countries.

Extensive support

Over the past two decades, low-income countries have made extensive use of the IMF's concessional facilities, and most have achieved marked improvements in macroeconomic performance and high rates of growth. In fact, of the 78 countries currently eligible for the Poverty Reduction and Growth Facility (PRGF), four-fifths have received Fund financing, and three-quarters have been supported under the PRGF or its predecessor. Over the period from 2000–07, low-income countries with sustained Fund engagement (of 10 years or more) witnessed high real GDP growth of 5.3 percent on average, supported by inflows of foreign direct investment of 4.2 percent of GDP and aid flows of 12 percent of GDP, while maintaining average inflation at 6.9 percent and average debt burden below 40 percent of GDP in 2007.

But the current global financial crisis is threatening to erode the hard-won gains of many low-income countries. This crisis, which originated in advanced economies and then spread to emerging countries, is now—through its third wave—threatening the remarkable economic achievements many low-income countries have made over the past decade. Earlier this year, an IMF study on the impact of the crisis on low-income countries warned that the financial crisis, combined with the sharp rise of food and fuel prices in 2008, had created much higher financing needs, which if not met would push millions of people in low-income countries further into poverty. The international community, including the IMF, showed a strong commitment not to let that happen.

It is in that context that the IMF has revisited several aspects of its financial support to low-income countries, and in response, the IMF's Executive Board approved on July 23, 2009, a historic reform package to upgrade its concessional financial facilities for its low-income country members.

Delivering on promises

By adopting these measures, the IMF has transformed its relations with low-income countries and responded directly to an international consensus on how to respond to the global crisis. In March 2009, Tanzania's President Jakaya Kikwete and IMF Managing Director Dominique Strauss-Kahn convened a conference in Dar-es-Salaam to address these issues. The IMF committed at the meeting to increase its support for its low-income country members through more financing, greater flexibility, enhanced policy dialogue, and a further strengthening of the voice of low-income countries in the Fund. These commitments were conveyed to the G-20 London Summit in April 2009, where Strauss-Kahn also asked the donor countries to facilitate a major increase in the Fund's concessional lending. With the recent adoption of the comprehensive package of reforms, the IMF has delivered on these promises.

The reforms, which will make the Fund's lending instruments more flexible and tailored to the increasing diversity of low-income countries, centered on four pillars:

- increasing the resources available for low-income countries,
- improving financing terms and permanently increasing concessionality,
- reforming lending instruments for low-income countries and increasing their flexibility, and
- reinforcing the emphasis on poverty reduction and growth.

Significant scaling up of resources. In the months leading to the approval of the new architecture by the Executive Board, the IMF had already taken steps to substantially increase its assistance to low-income member countries. The IMF has agreed to increase its concessional resources by up to $17 billion—some of it from the sale of IMF gold—between now and 2014. IMF lending to low-income countries is expected to approach $4 billion a year in 2009 and 2010, compared with $1.2 billion in 2008, thereby exceeding the G-20 call for additional lending of $6 billion over the next two to three years. For individual countries, the limit on the amount of financing they could obtain from the IMF on an annualized basis has been roughly doubled.

In addition, the Fund's membership has also backed a $250 billion allocation of Special Drawing Rights (SDRs) that will be distributed to all member countries according to their quotas in the IMF. This would translate into an allocation of more than $18 billion of SDRs to low-income countries to bolster their foreign exchange reserves and alleviate financing constraints.

However, for the IMF to meet the new financing commitments, additional loan resources of $14 billion will need to be raised from existing and potential bilateral lenders. For that, a major fund-raising effort has been launched to mobilize the needed resources. In addition, new subsidy resources of $2.8 billion will be mobilized from the IMF's internal resources—including the use of resources linked to the envisaged gold sales—and through bilateral contributions to help cover the cost of concessional interest rates.

New flexible facilities. The July Executive Board decision also reformed the structure of Fund facilities for low-income countries to increase their effectiveness, and to make the Fund's concessional lending instruments more flexible and tailored to the increasing diversity of its poorer member countries. These changes recognize that while many low-income countries will continue to require sustained program relationships with the IMF to address their economic challenges, an increasing number may need IMF financial support only during particularly difficult episodes (such as the current crisis), or may feel that it is prudent to prequalify for assistance now in case it is needed later. The new structure also establishes a single instrument that provides limited financing to countries facing a range of emergency situations, thus simplifying the Fund's toolkit and closing gaps that existed in the previous structure. These reforms stem primarily from listening to the Fund's low-income country membership and responding to their evolving and diverse needs.

This new structure, established within the Fund's newly created Poverty Reduction and Growth Trust (PRGT), consists of the following:

- The *Extended Credit Facility* (ECF), the successor to the PRGF, will allow the Fund to provide sustained program engagement and financing for countries facing protracted balance of payments difficulties.
- The *Stand-by Credit Facility* (SCF), which is similar to the Stand-By Arrangement (SBA) widely available to all IMF members, will provide financial assistance and policy support to low-income countries with shorter-term or episodic financing needs emanating from a range of sources. It also allows for precautionary use, in cases where there is a potential rather than an actual financing need.
- The *Rapid Credit Facility* (RCF) will provide a limited amount of financing in response to urgent needs, with reduced conditionality. This is particularly useful when countries need financing only for a short time or when a country's capacity to implement policy is constrained.

In addition to these facilities, the *Policy Support Instrument* (PSI) will remain the Fund's nonfinancial policy support instrument for low-income countries, and can also facilitate access to the SCF and RCF, if needed.

Menu of options. These changes provide countries with a menu to choose the facility that best addresses their problems. For instance, Mozambique and Tanzania are two countries that had achieved macroeconomic stabilization and high growth under successive PRGF-supported programs. Both countries then shifted to a PSI to consolidate their economic progress without recourse to IMF financing. But when the global financial crisis hit, like many other countries, they turned to the IMF for financial assistance, through the Exogenous Shocks Facility. Under the new architecture, Mozambique and Tanzania would, for example, be able to tap the SCF under similar economic circumstances. In addition, they could also use it on a precautionary basis in case there is a possible—but not imminent—financial need.

Modern loan terms

More flexible conditionality. These new facilities were preceded earlier this year by a decision by the IMF to introduce a more flexible approach to structural conditionality under all IMF-supported programs—one that focuses more on core goals, tailored to each country, while providing greater latitude on the needed policy measures.

Improving financing terms and concessionality. In response to the particularly serious economic dislocations resulting from the current crisis, low-income countries will also receive exceptional relief of all interest payments on outstanding concessional loans due to the IMF through the end of 2011—effectively, an interest rate of zero on these loans till end-2011. In addition, the interest rate on these three facilities will be reviewed regularly thereafter under a mechanism designed to offer higher concessionality than the IMF has provided in the past.

Renewed emphasis on poverty reduction. The new architecture, under its three facilities, will preserve the practice of putting strong emphasis on poverty alleviation and growth. Countries seeking IMF financial support should indicate how their economic policy program would advance poverty reduction and growth. Also, country-owned poverty reduction strategies will remain the basis of sustained program relationships with the IMF under the ECF. Wherever possible, programs will include specific targets to safeguard social and other priority spending. So far during the current crisis, IMF-supported programs have accommodated larger fiscal deficits in most low-income countries to help offset the adverse effects of the crisis. And many programs already include explicit targets for preserving or increasing social spending. ■

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