



INSIDE MONEY

Cooperative Solutions
from the IMF

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How to Use this Guide

This study guide is designed to aid classroom use of Inside Money, a 12-minute animated educational video created by the International Monetary Fund (IMF). The guide is intended for students in economics and international relations courses at the secondary level. It includes a summary of the video; background information; pre-viewing, post-viewing, and research activities; a glossary; and a list of resources.

Objectives

After viewing the video and using this guide, students should be able to:

- Describe a country in an economic crisis.
- Discuss the role of the IMF in the world economy.
- Explain how the IMF aids countries in economic crises.

About the IMF



The International Monetary Fund (IMF) was established in 1944 to help all nations avoid the inward-looking and destructive economic policies that contributed to the Great Depression and the outbreak of World War II. Since then it has worked to increase international prosperity by encouraging countries to adopt policies conducive to their sustained economic growth and financial stability, to open their economies to foreign trade, and to support one another when adjustment is needed.

These purposes of the IMF have stood the test of time. Indeed, policies promoted by the IMF have contributed to more than half a century of unparalleled increases in global prosperity. Nearly all the world's countries (184 in late 2004) have become IMF members. They have done so willingly because

they see the advantages of engaging in international economic policy cooperation through the IMF, the central institution of the international monetary system.

The IMF undertakes three main activities. First is monitoring economic developments and policies, a practice known as surveillance. Second is providing temporary financing to members with balance of payments problems. Third is providing technical assistance in public finance, central banking, exchange rate systems, and statistics. A nonprofit organization, the IMF operates much like a credit union, its main source of funds being membership fees, or quotas. These quotas, based on a country's economic size and openness, affect members' voting power in the IMF and how much they can borrow from it. ▶

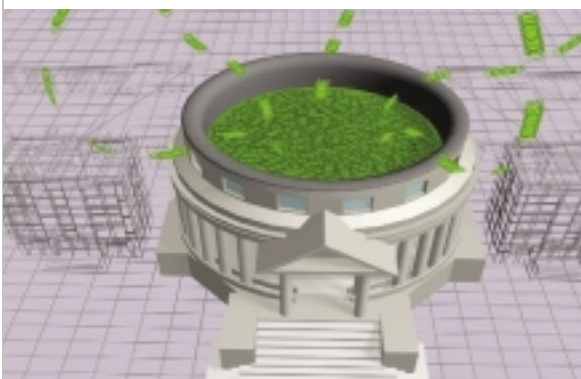


Program Synopsis: Alleviating a financial crisis in a fictional country

Inside Money is an animated news magazine show in which two news broadcasters analyze the economic crisis in the fictional country of Ruritania, and then explain the IMF's role in helping to alleviate and resolve that crisis.

Ruritania is described as a beautiful country, but with its economy in a shambles. Ruritania's economic crisis is similar to that often seen in developing countries: living standards are falling and the government is overspending on wasteful subsidies and unproductive jobs. Complicating matters further, revenues paid to the government have declined—leading the Central Bank to print so much money that inflation rises.

Ruritania's government leaders offer their individual solutions to this dire economic situation. The country's president proposes bor-



rowing from abroad. The Central Bank's head proposes raising interest rates, which would cut business and consumer spending. The Finance Minister's solution is to reschedule the government's foreign debt—that is, spread payments over a longer period of time. The video explains that another option for Ruritania is to simply go into arrears and not service its debt.

Whatever is done, the government must reduce spending to reverse the trends in the nation's economy. The challenge for Ruritania's policymakers is to do so without further damaging vital components of the economy: essential services, such as health care and schools, and exports, a key element in the country's revenue stream.

The IMF's role in the world economy is briefly discussed: promoting financial and exchange rate stability, and the growth of trade and



incomes. Surveillance is also discussed: how the IMF assesses the health of the global economy and the role of Article IV reports, which assess individual countries' economic health.

The importance of a country's balance of payments is then detailed with animated visuals, with emphasis on what happens when there is a balance of payments problem or crisis—that is, when spending is exceeding income and the associated deficit is not being readily financed, as in Ruritania. Several policy options are discussed, such as devaluing the currency, which would make exports cheaper and imports more expensive.

The video details the steps needed to achieve a long-term solution to the crisis, and the role of financial assistance from the IMF. A baseline scenario is explained: the key macroeco-

omic variables that must be assessed before specific policies can be proposed. These variables refer to the country's balance of payments, national income accounts, monetary system, and government budget.

The video notes that the measures to fix Ruritania's problems might be politically unpopular. That could lead the political leaders to try to avoid dealing with the problem, such as by printing more money. The result would be further increases in inflation and more economic chaos.

The video explains that Ruritania might be tempted also to continue its cycle of spending and borrowing—but at some point its foreign reserves would run out, foreign lenders and investors would become nervous about the risk to their money and pull it out of the country—a move known as capital flight—and the exchange rate would collapse.



The video discusses how the IMF helps the country to introduce an adjustment and reform program aimed at reversing these economic trends. A loan from the IMF, supported by financing from other institutions and member countries, eases the adjustment, so that the country can continue to provide basic social services. The interest rates on IMF loans are linked to the relatively low rates paid by the world's most creditworthy economies.

The video points out that these loans are not disbursed all at once, but are released in stages as the country meets targets by dates—a strategy called conditionality, in which the country sticks to its plan and make the changes it agreed to. This ensures the IMF's members that the loan will be used productively and repaid.

Other elements of the adjustment and reform plan are also detailed in the video: that the country's central bank must raise its interest



rate, which makes its currency a more attractive investment, reduces the growth of the money supply, and helps keep inflation in check. Once the country has obtained the IMF's approval for its policy program, other foreign lenders and donors will step in to aid the country. The video explains that IMF-supported programs are tailored to specific countries, but common to all is the aim of sustained economic growth through policies that promote financial stability and openness to international trade.

Some of the kinds of reform that may be part of the policy program are also noted, including changing the way banks operate, lowering trade barriers and privatizing inefficient state-owned industries.

The video shows how the plan should results in a stronger foundation for Ruritania's economy—raising living standards for Ruritarians. ▶



Background Information

An International Institution for Real Countries



demand in the domestic economy, or a sharp depreciation of the domestic currency. Without IMF lending, countries with balance of payments difficulties would have to adjust more abruptly or take other measures damaging to national and international prosperity.

As the only international agency whose activities involve dialogue with almost every country in the world on economic policies, the IMF is the main forum for examining an individual country's economic policies in a global context.

Many countries in the world at one time or another experience a crisis similar to that in Ruritania. At any given time in recent years, roughly one-third of the IMF's members have been borrowers from the institution.

Any member country of the IMF can turn to the Fund for financing if it has a balance of payments need—that is, if it needs official borrowing to be able to make external payments and maintain an appropriate level of reserves without taking “measures destructive of national or international prosperity,” as the IMF's Articles of Agreement put it.

Such measures might include restrictions on trade and payments, a sharp compression of




It is also the main institution for discussing issues vital to the stability of the international monetary and financial system. These include countries' choice of exchange rate arrangements, the avoidance of destabilizing international capital flows, and the design of internationally recognized standards and codes for policies and institutions. When looking at individual countries, the IMF focuses mainly on a country's macroeconomic policies—policies relating to the government's budget, the management of money and credit, and the exchange rate—and financial sector policies, including the regulation and supervision of banks and other financial institutions. It assesses the macroeconomic performance of a country by examining the country's total spending (including consumer spending and business investment), output, employment, and inflation, as well as the country's balance of payments with the rest of the world.



In addition, the IMF pays due attention to structural policies that affect macroeconomic performance—including for example labor market policies that affect employment and wage behavior.

The IMF advises each member on how its policies in these areas might be improved to allow the more effective pursuit of goals such as high employment, low inflation, and sustainable economic growth—that is, growth that can be sustained without leading to such difficulties as inflation and balance of payments problems.

By working to strengthen the international financial system and accelerate progress toward reducing poverty—as well as promoting sound economic policies among all its member countries—the IMF is helping to make globalization work for the benefit of all. 

The IMF's Purposes

From Article I of the IMF's Articles of Agreement:

The purposes of the International Monetary Fund are:

- i. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- ii. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- iii. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- iv. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
- v. To give confidence to members by making the general resources of the Fund



temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

- vi. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

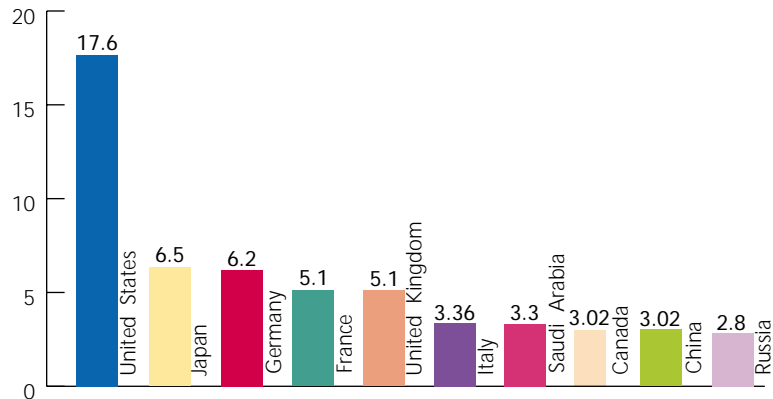
The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article. ▶

Growth in IMF Membership

Largest members by contribution (percent of total quotas)

Members with Ten Largest Quotas

(percent of total quotas)



[Source: IMF]

Principal Users of IMF Financing 1947–2004

Mexico	Korea
Argentina	Brazil
Turkey	Indonesia

The IMF—Key Facts

Current membership	184 countries
Managing director	Rodrigo de Rato, a Spanish national
Staff	approximately 2,800 from 141 countries
Total quotas	\$313 billion (as of May 31, 2004)
Loans outstanding	\$107 billion to 87 countries, of which \$10 billion to 60 on concessional terms (as of December 31, 2003)
Technical assistance provided	194 person years during FY2003
Surveillance consultations concluded	136 countries during FY2003, of which 100 voluntarily published their staff reports

Pre-Viewing Activities

1. Provide students with the glossary and the guide's synopsis of the program, the background information on the IMF, and the charts. Ask students if they have heard of the IMF. If so, ask them what the initials stand for.
2. Have several students explain their perceptions of the IMF's role in the world economy. Discuss their ideas about how the IMF is funded and who controls it.
3. Introduce the video as an example of one role the IMF plays in the world economy. ▶



Post-Viewing Activities

1. Ruritania is a fictional country with very real problems. These include:
 - An economy that is growing too slowly (or not at all).
 - Falling living standards.
 - Shrinking tax revenues.
 - A growing budget deficit.
 - A high external debt.
 - Diminishing foreign currency reserves.
 - Rising inflation.

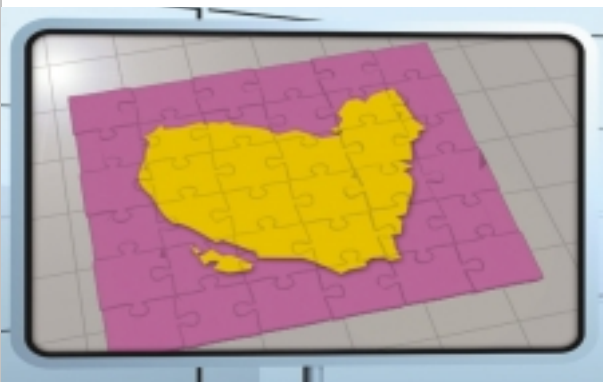
Review these factors with the students and discuss how each of them feeds on the others, creating a dangerous economic downward spiral.

2. The key factor leading to Ruritania's economic crisis appears to be excessive spending by the government. In the video, the announcer notes that some of this spending is going to fund unproductive jobs and to provide wasteful subsidies for certain industries and companies. Such a scenario is sometimes associated with government corruption problems. This excessive spending leads to budget deficits, without increasing the country's productivity or output.



Review the key factors that led to Ruritania's economic crisis: excess government spending—which leads to budget deficits; too much currency in circulation; and its balance of payments deficit—which indicates that Ruritarians are buying foreign products, while not as much income is coming to Ruritania from external sources.

3. From the video it is clear that Ruritania's baseline scenario—the outlook without policy changes—is not at all a healthy picture. The key macroeconomic variables in the baseline scenario include:
 - *Balance of payments.* Ruritania's balance of payments with its trading partners is in deficit. It is spending more for goods from other countries than it is receiving from those countries for goods from Ruritania.
 - *National income accounts.* An assessment of the growth rate of output in the economy. In Ruritania growth is either very low or negative.



- *Monetary system.* This includes interest rates and the growth of money in circulation. In Ruritania's case, the baseline scenario would show too rapid growth of money in circulation, with too little output from the Ruritanian economy, resulting in inflation.
- *The government budget.* It is clear there is a political aspect to the economic crisis. The Ruritanian government is spending more on unnecessary jobs and other unproductive activities than it can afford to.
- *The President.* Concerned with reelection and her popularity, the President is hesitant to adopt strong economic policy measures, which could meet with opposition from the public. The reason is that interest rates likely will have to rise and spending on other services will have to be curtailed. Her instinct then, is to avoid the painful "belt-tightening" and borrow more money from abroad to finance the budget deficit.
- *The Central Banker.* Less concerned with popularity, he is responsible for the money supply and the control of inflation. He is focused on the key instrument he can use to curtail inflation and spending: interest rates. He knows that by raising interest rates, access to money will be tighter, and that such an economic move should help to attract foreign investors looking for a higher return for their investments. He is not, however, immune from political pressures. He may feel pressure to print more money; but he knows in the current economic situation that this will increase inflation, devalue the currency, and perhaps cause foreign investors to pull out their funds.

Review the baseline scenario and its components with the students.

4. The three Ruritanian officials in the video are from three divisions of government and represent three perspectives on how to solve the economic crisis:

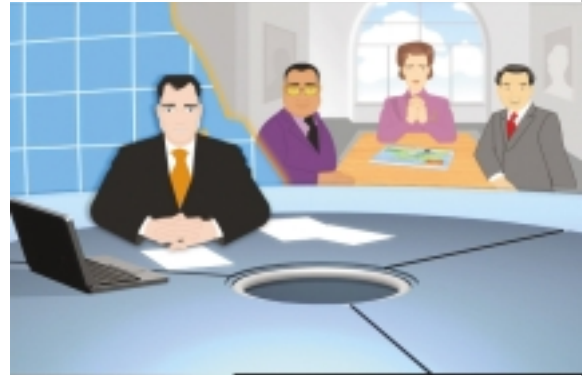
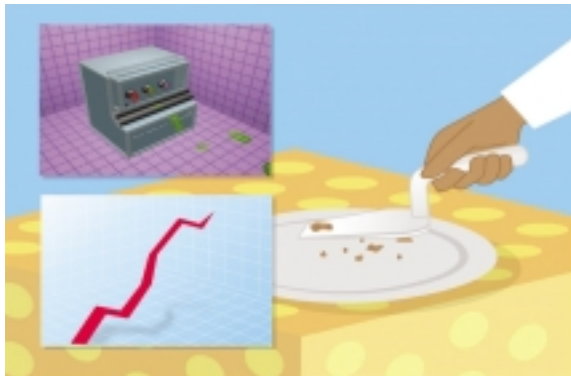
- *The Finance Minister.* Like the head of the Central Bank, he does not have the ability to manipulate the money supply. His focus is on Ruritania's existing debt with its trading partners and international finance entities. If he can convince creditors to reschedule Ruritania's debt—to consolidate its loans and

spread them out over a longer period—he knows this will free up funds for the domestic economy.

Discuss with students which of the three officials is mostly likely to resist the IMF reform plan? Why?

5. Although Ruritania is a fictional country, its economic problems are not far removed from reality. Examples include:

- *Pakistan.* Ruritania's economic situation was paralleled by Pakistan at times in the 1990s. Economic growth was hampered by lack of investment in manufacturing, inefficient tax collection, and in the late 1990s by an external debt crisis. This deepened the level of poverty, and the country's social services and infrastructure suffered.



Under pressure from the public, the Pakistani government for a time abandoned adjustment and reform efforts that had been supported by the IMF. After a new government came to power in 1999, it committed itself to economic reforms that had been ignored in the 1990s. An agreement between the IMF and the Pakistani government was concluded in November 2000. And in September 2001, the IMF announced the success of the government's economic reform initiatives over a twelve-month period.

A three-year IMF economic reform plan was initiated in October 2001 extending to September 2004. As in Ruritania, the plan included fiscal adjustment and institutional reforms within the government to achieve the objectives of economic growth and improving social conditions. To combat poverty, the plan also included a restructuring of public expenditures, with greater support for rural



development, job creation, and social welfare programs.

Despite challenges related to security issues and the volatility of the region, Pakistan has made substantial progress in implementing these objectives. Real GDP growth accelerated to 4.2 percent in 2002, and further to 5.6 percent in 2003 while inflation declined to 2.9 percent in 2003, one of the lowest rates in Pakistan's history. In addition, its balance of payments has improved, and the central bank has built up foreign currency reserves. Tax administration reform and privatization initiatives are strengthening the country's financial system and economic condition. Encouraged by the IMF's assessment of the country's commitment to reform, in December 2001 other international lenders agreed to reschedule Pakistan's debt.

- *South Korea.* In 1997 South Korea experienced its most serious economic crisis

in 50 years. Like Ruritania, its foreign exchange reserves were almost depleted. The South Korean currency, the won, depreciated sharply against the U.S. dollar. These conditions led the country to seek help from the IMF.

When President Kim Dae-Jung took office in February 1998, he promised economic reform and his government reached agreement with the IMF on a three-year policy program. The IMF extended \$21 billion in loans to assist Korea adjust and reform its economy, restructure its financial and corporate sectors, and recover from recession. As in Ruritania, South Korea had to undertake strict difficult economic reforms. By the winter of 1999 the economy had made a significant recovery. At the end of 2000 the IMF declared the country's policy program a success.

- *Mexico* is another country with difficulties in its economic history similar



to those in Ruritania. With an economy that relies on petroleum exports, the country suffered when petroleum prices declined in the mid-1980s. Mexico's economy then suffered from the factors Ruritania faces in the video: capital flight, a depreciating currency, shrinking foreign currency reserves, and a large balance of payments deficit. After the initial shock, Mexico undertook tax reform and economic liberalization initiatives. It was not enough, however, to avert a further financial crisis.

In the mid-1990s the peso dropped dramatically in value, prompting the need for international help and stringent economic measures to curb inflation. By the late 1990s, with the help of increased productivity in the manufacturing sector and banking reforms (removing all restrictions on ownership of foreign banks) the country's economy began to turn around. In September



2000 the outgoing Zedillo administration repaid, ahead of schedule, its outstanding debt to the IMF.

The IMF subsequently noted Mexico's strong economic performance in 1999 and 2000, while warning that continued high consumer demand could cause inflation. An October 2002 IMF report praised the government's fiscal strategy. Mexico's economy is in a healthier state than it was in the 1980s and 1990s.



Discuss these examples with students, pointing out that each country is unique, and that adjustment and reform programs are sometimes more successful than at other times, depending on the situation of the country.

6. Ask students to summarize what they learned from the video about 1, 2, 3, 4, 5. ▶

Research Activities

1. Divide students into four groups. Have each group go to the IMF Web site, beginning with the student page:
<http://www.imf.org/external/np/exr/center/action/eng/index.htm>.

Have each group report on one of the following:

- Why the world needs the IMF.
- The daily business of the IMF.
- How the IMF can help in an economic crisis.
- The faces behind the institution.

Have each group report to the class on two or three persons featured on the page "Who is the IMF?" ***<http://www.imf.org/external/np/exr/center/action/eng/profiles/index.htm>***.

Have students familiarize themselves more extensively with the IMF by going to the site map at ***<http://www.imf.org/external/map.htm>***.

2. Have each group select a member country of the IMF and determine whether it is a developing country, an advanced economy, or a country in transition.

When groups have picked a country, have them determine whether the country is currently participating in an IMF-supported



program by going to the country's page at ***<http://www.imf.org/external/country/index.htm>***. From this page students may go to Article IV reports. While these may be technically difficult for the students, as groups they should be able to determine whether the country is currently implementing an IMF-supported policy program.

3. Encourage students who want to learn more to access the "About the IMF" Web site to learn more about the institution.
<http://www.imf.org/external/about.htm> ▶

Glossary

Adjustment program

A detailed economic program, which may be supported by an IMF loan, that is based on an analysis of the economic problems of the member country and specifies the policies being implemented or that will be implemented by the country in the monetary, fiscal, external, and structural areas, as necessary, to achieve economic stabilization and set the basis for self-sustained economic growth.

Article IV report

A report, usually annual, written by IMF staff, that assesses the state of a country's economy.

Balance of payments

The relationship between how much a country spends, lends, and donates abroad and the income, borrowing, and grants it receives from other countries. This includes not only a country's balance of trade, but also debts, investments, and other movements of capital between countries.

Conditionality

Economic policies that IMF members agree to follow as a condition for an IMF loan. These are often expressed as performance criteria (for example, monetary and budgetary targets) or benchmarks, and are intended to ensure that the use of IMF credit is temporary and consistent with the adjustment program

designed to correct a member's external payments imbalance.

Debt relief

Reduction or forgiveness (cancellation) by a creditor of the debt owed by a country.

Debt service

Payments of principal and interest on debt.

Developing country

Low and middle income countries in which most people have a lower standard of living with access to fewer goods and services than do most people in high income countries. There are currently about 125 developing countries with populations over 1 million; in 1997 their total population was 4.9 billion.

Good governance

Government and corporate policies that reflect fairness, openness, and impartiality.

Low income country

A country having an annual gross national product (GNP) per capita equivalent to \$760 or less in 1998. The standard of living is lower in these countries; there are few goods and services; and many people cannot meet their basic needs. In 2003 the cutoff for low income countries was adjusted to \$745 or less. At that time, there were about 61 low income countries with a combined population of about 2.5 billion people.

Middle income country

A country having an annual GNP per capita equivalent to more than \$760 but less than \$9,360 in 1998. The standard of living is higher than in low income countries, and people have access to more goods and services, but many people still cannot meet their basic needs. In 2003 the cutoff for middle income countries was adjusted to more than \$745, but less than \$9,206. At that time, there were about 65 middle income countries with populations of one million or more. Their combined population was approximately 2.7 billion.

Monetary policy

Policy relating to the money supply, interest rates, and other factors affecting the cost and availability of credit within an economy.

Multilateral organization

An international organization, such as the IMF or the World Bank, that is run by the countries that are members. The IMF and the World Bank have 184 member countries.

Surveillance

An essential aspect of the IMF's responsibilities associated with overseeing the policies of its members in complying with their obligations specified in the Articles of Agreement to ensure the effective operation of the international monetary system.

Transparency

Openness, honesty, and accountability in public and private transactions.

Online Resources

IMF Resources

What is the IMF?

<http://www.imf.org/external/pubs/ft/exrp/what.htm>

Information for students

<http://www.imf.org/external/np/exr/center/action/eng/index.htm>

About the IMF—more details

<http://www.imf.org/external/about.htm>

IMF glossary of financial terms

<http://www.imf.org/external/np/exr/glossary/index.asp>

A list of IMF educational videos

<http://www.imf.org/external/mmedia/index.asp>

The IMF at a glance

<http://imf.org.external/np/exr/facts/glance.htm>

World Bank Glossary Page

www.worldbank.org/html/schools/glossary.htm

World Bank Students (Kids) Page

<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/KIDSNEWS/0,,pagePK:107703~theSitePK:106839,00.html>



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