The International Monetary Fund in the Global Economy: Banks, Bonds, and Bailouts
Mark S. Copelovitch |
d
This is the first Amazon review of a book that came out in 2009. I read it as background to my investigation of Ukraine's IMF loans about which I wanted to write.

It offers a good overview of the IMF in the period of the late '80s through the mid-2000s. It misses the IMF activity after the crisis of 2008, and the tenure of its two most well-known chiefs, Dominique Strauss-Kahn and Christine Lagarde.

The question is, what goes into IMF decision-making on loans? Are the decisions made by IMF staff, the United States, or the principle countries which fund the IMF taken as a group?

Let me put the IMF in perspective. From my own research, the IMF's balance sheet is about 500 billion dollars. Half a trillion. Comparing that with the sovereign debt of the G5 countries:
US – 16 trillion
Japan 10.5 trillion
Germany 2.8 trillion
France – 2.3 trillion
UK – 2.2 trillion
we find that IMF borrowers as a group owe about 3% as much as the national debt of the five biggest members. If the G5 is able to use the IMF to induce foreign governments to act in ways supportive of their own interests, it is a fairly cheap investment.

We learn that the IMF consolidated its programs for truly needy countries in 1999 via the Poverty Reduction and Growth Facility (PRGF). It provides concessional loans – low interest rates, about half a percent per annum – to really needy countries. Concessional lending amounts to 1/3 of loans but only 7% of loan volume.

This book focuses on loans made to countries with stronger finances. The nature of international lending has shifted. Thirty years ago most countries borrowed from large money-center banks. The banks formed consortia, to spread the risk on one hand, and to raise the cost of default by any borrower country to the level of an international affair.

The game has since changed. More countries borrow on the bond markets. Bondholders are very numerous – there were 1500 involved in Argentina's 2001 bankruptcy – and not well coordinated. As I write this they are still sorting out Argentina's default in US Federal Court.

Under the bank lending system, the IMF could get prior agreement from the banks: we will lend if you will lend. They would go in together. Under the bond system, the IMF has to make the decision of whether or not to lend without waiting to see whether the country can sell bonds. They lend, and then the country does what it can to sell bonds.

Another way to characterize this is that there are more PNG – Private non-guaranteed – loans, loans to businesses and bonds, and fewer PPG – Public and public guaranteed – loans being made. This decreases the IMF's leverage by multiplying the number of players.

An IMF loan involves amounts and conditions. The conditions come in different levels, from demands down to suggestions.

IMF programs contain several different types of conditionality, each differing in content, specificity, and the degree to which it is "binding" on the borrower country.

Performance criteria (PCs) are the most specific and binding type of conditions. They stipulate the conditions under which additional tranches of the loan released. No compliance, no (additional) money. They may involve computed targets, such as deficit percentage, or specific actions, such as privatizations or legislation passed.

Prior actions (PAs) are measures that a country agrees to take before the IMF approves a loan. The quid pro quo for receiving the loan.

There may also be soft objectives, a statement of non-binding goals which may be taken into consideration upon program reviews. Non-binding goals may be converted to PCs over the course of a loan.

IMF loans are quite spread out. The largest loans at this writing are:
Romania $15.3
Ukraine $13.4
Greece $13.3
Hungary $11.1
Pakistan $8.2
Ireland $7.3
Turkey $5.3
Belarus $3.3
accounting for about 15% of the balance sheet. These loans are significant to the borrowing countries, accounting for 20% or more of national debt in some cases.

How much a country gets, and under what conditions, is a political consideration. Copelovitch's analysis is at the end of this review. If all of the G5 countries are exposed to the borrowing country, it will get more attention. If these countries have different policy objectives with regard to the borrower, there is more "agency slack," in other words, the IMF staff has more latitude to decide what the terms and conditions should be.

The IMF staff has its own bureaucratic objectives. Making loans and following up is their business. More loans, and more conditions, mean more work for the bureaucrats. More junkets. Quoting from the book "US Senator Lauch Faircloth (Republican - North Carolina) articulated this view most colorfully during the Asian financial crisis, when he attacked the Fund as "a set of `silk-suited dilettantes' given to a diet of 'champagne and caviar at the expense of the American taxpayer."

While Copelovitch says that political considerations are significant in the award of loans, he doesn't go into detail. In the case of Ukraine I can imagine that the big loans of the mid-90s were made to encourage the country down the path of capitalism. The loan 2010 loan facility of $15 billion, cancelled after the first $3 billion, is easier to understand.

Ukraine experience rapid growth in the early 2000s. The leaders who arose through the Orange Revolution had a European orientation. Foreign banks flooded the Ukrainian market. Ukraine was hit hard by the crisis of 2008, with which it had little to do. The hryvnya exchange rate fell from 5 to the dollar to 8, leaving many borrowers unable to service their loans. This was a major risk to G5 banks. It looked as though the Yanukovych government might continue on the path towards joining Europe. An IMF loan seemed like a good inducement.

The Program Conditions required that Ukraine engage in pension reform, cutting its social expense by raising the pension ages (55 for women, 60 for men) and ending the state subsidy of imported gas for consumers. Both moves appeared too politically costly; neither was done. The IMF cancelled the loan, and Ukraine looked increasingly to Russia for loans. As of the end of 2011, debt to Russia was $67 billion, several times its IMF debt.

Copelovitch concludes this statement of his thesis as follows: "In summary, this theoretical framework yields the following testable hypotheses.

• IMF loans will be larger and contain fewer conditions when aggregate G-5 commercial bank exposure is higher (G-5 preference intensity).
• IMF loans will be smaller and contain more conditions when G-5 commercial bank exposure is more unevenly distributed (G-5 preference heterogeneity).
• The relationship between the intensity and heterogeneity of G-5 commercial bank exposure is conditional and interactive (common agency/agency slack).
• IMF loans will be larger and contain more conditions when bond financing constitutes a larger share of a country's private external debt (staff expectations about catalytic financing).
• IMF loans will be larger and contain more conditions when non-sovereign borrowing constitutes a larger share of a country's private external debt (staff expectations about catalytic financing).
• The increased conditionality imposed in bond and non-sovereign financing cases is most likely to be in the form of prior actions (staff expectations about catalytic financing)."