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# The Riksbank's lending to the International Monetary Fund – how and why?

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**This Economic Commentary describes how the Riksbank's lending to the International Monetary Fund (IMF) works and why it is important for the Riksbank to lend money to the IMF. The Commentary also includes an historical review of the action taken by the Riksbank within the framework of the IMF's lending operations. The decision by the Executive Board of the Riksbank to promote a parliamentary decision that will entitle the Riksbank to temporarily increase the lending capacity of the IMF by up to SEK 100 billion is presented against this background. The decision is justified by the fact that the IMF needs to strengthen its lending capacity since the need for loans has increased in many countries as a result of the ongoing debt crisis in the euro area. By taking such action, the Riksbank can also help to stabilise the situation in Europe in the longer term, as the IMF's lending is linked to requirements for necessary reforms in the borrower countries.**

The collapse of Lehman Brothers in 2008 rocked the global economy to its foundations and there is still great uncertainty about the prospects for economic development, not least in the euro area. Several countries in Europe have turned to the International Monetary Fund (IMF) for financial support and there is a risk that more countries will need to do so. In order to be prepared to meet a possible increase in the need for loans, the IMF needs to increase its lending capacity by USD 500 billion. As this is a case of a temporary strengthening, short-term bilateral loans from the IMF's member countries are the quickest and easiest way for the Fund to increase its lending capacity. The euro-area countries have agreed to jointly lend EUR 150 billion to the Fund in the hope that other countries will also contribute, not least the other EU countries. In December 2011, the Executive Board of the Riksbank decided to promote a parliamentary decision that will entitle the Riksbank to provide further loans to the IMF totalling up to SEK 100 billion. One of the important reasons why Sweden should contribute further funds to the IMF is that these funds can be used to mitigate the effects of the debt crisis in the euro area.

## A global economy requires global responsibility

Sweden is a small open economy that is highly-dependent on exports: 50 per cent of Sweden's Gross Domestic Product (GDP) consists of exports, over 70 per cent of which go to Europe. Sweden's and Europe's financial systems are also closely interlinked. This means that Sweden has a strong vested interest in contributing to measures that aim to stabilise the situation in Europe. For a small country like Sweden, it is especially important that there are strong international organisations that can promote clear and even-handed rules and regulations that can contribute to crisis management at the global level. Sweden therefore actively participates in various forms of international cooperation and the IMF, of which Sweden has been a member since 1951, is one example. It is the State of Sweden that is a member, but when Sweden joined the organisation the government appointed the Riksbank as the point of contact with the IMF. The Riksbank is responsible for Sweden's financial commitments to the IMF, but every loan commitment requires a parliamentary decision.

## The IMF helps its member countries with "emergency loans"

When the IMF was founded at the end of World War II it was given the task of overseeing the international currency system of the time and of working for stable exchange rates and fewer trade barriers. The number of members has increased over the years and at present the IMF has 187 member countries; in other words almost all the countries of the world are members. Lending to crisis-affected countries has always been a cornerstone of the IMF's activities. The countries that have needed to borrow from the Fund have varied over the years, as have the total lending volumes – 80 per cent of the member countries have needed financial support from the Fund at some point since the organisation was founded. Sweden belongs to the minority that has never needed to seek help from the IMF. However, during the crisis of the 1990s, Sweden subjected itself to "enhanced surveillance" by the IMF, similar to what Italy asked for at the G20 summit in Cannes in 2011.

The decision on whether a country is eligible to borrow from the Fund is made by the IMF's Executive Board, which has 24 members who together represent all of the Fund's member countries.[1] Sweden shares a seat on the Board with the other Nordic countries and the Baltic countries. The IMF has several types of lending facility that are designed to meet the different needs of their member countries. However, a majority of the Fund's lending is conducted through the traditional IMF programmes that include surveillance and requirements to implement economic reforms.[2] This reduces the risks associated with all lending. In this case, the particular risk is that the behaviour of the borrower may change and become more risky once the loan has been provided, a so-called moral hazard problem. The fact that the IMF sets clear conditions (so-called conditionality) provides incentives for the countries concerned to come to terms with the problems that have forced them to seek financial support. The conditions are also a way for the IMF to ensure that the money is repaid so that it can subsequently be lent to other countries. When a loan programme is designed, the IMF and the borrower country agree on a so-called "Letter of Intent" which describes the economic and financial measures that the borrower country should implement. Loan disbursements are then usually paid per quarter and each payment is preceded by an evaluation of the measures taken by the country so far, which have to be approved by the IMF Executive Board.

It is vital to all creditors to have a good insight into the specific situation of the borrowers and the continuous surveillance conducted by the IMF gives the Fund unique knowledge about its member countries. For instance, the Fund conducts regular assessments of all the member countries in which both the real economy and the financial sector are examined. The assessment of the financial sector has been given greater focus in recent years. This is a direct result of the lessons learned during the global financial crisis, when the weaknesses that developed in the financial system were underestimated. This knowledge means that the Fund can identify when there is a risk that problems will spread between countries and regions and IMF can thus contribute to preventing international economic crises.

## Sweden has always contributed to the IMF's resources

All of the member countries place a sum of money at the IMF's disposal and these resources form the basis for the funding of the Fund's lending. They can be regarded as a form of capital subscription. How much each member should provide is determined using a formula that takes into account factors such as the size of the country's economy and how open the country is to international trade and financial flows.

Sweden and the Riksbank have always actively supported the operations of the IMF.[3] The Riksbank has on several occasions contributed to various loan arrangements with the aim of temporarily strengthening the IMF's lending capacity. The first time was in 1962, when the Riksbank participated in the creation of the "General Arrangements to Borrow" (GAB) that the IMF can use in situations when extra lending capacity, over and above the capital subscriptions, is required. The GAB was initiated by the so-called G10 countries, which include Sweden.[4] GAB was then expanded in 1983, partly as a result of a major loan programme for Mexico. Fifteen years later the "New Arrangements to Borrow" (NAB) was set up with a wider circle of members that also included some of the emerging-market economies. This was triggered by the fact that

1. Loans are only provided to the IMF's member countries within the framework of the lending facilities that the IMF's Executive Board have agreed on. There are, in other words, clear regulations governing when and how the IMF may lend money.
2. The IMF programmes for Latvia (2008), Iceland (2008), Greece (2010), Ireland (2010) and Portugal (2011), for example, all contained conditions regarding the implementation of reforms. In Europe, it is only Poland (2009, renewed 2010), that has used one of the more insurance-like facilities, the so-called Flexible Credit Line (FCL).
3. Here we discuss only the occasions on which the Riksbank has contributed directly to the IMF's funding, but there are also other ways to contribute to international crisis management. During the 1990s, the Riksbank funded bridging loans to around 10 central banks while awaiting the implementation of IMF programmes. In recent years, the Riksbank has entered into swap agreements to help other central banks in the short term and the government has decided to contribute to the funding of IMF programmes by providing bilateral loans directly to the countries concerned.
4. The "Group of Ten" is an informal association of countries comprising Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

Brazil needed financial support which, in combination with a programme for Korea the year before, required the use of a substantial part of the IMF's lending capacity.

In purely technical terms, the GAB and NAB loan arrangements work in the same way as the capital subscriptions, meaning that they are commitments to provide loans that the IMF can use when the need arises. The difference is that a capital subscription is a permanent arrangement, while the extra loan arrangements can be regarded as "supplementary resources". A decision by the IMF Executive Board is required to activate them. When the supplementary resources are activated, the total sum that the IMF can ask the Riksbank and other members to provide increases.

Governments and central banks can also decide to provide temporary bilateral loans to the IMF. Bilateral loans are the quickest way to increase the IMF's lending capacity and the idea is that these loans should be withdrawn when the demand for loans decreases, or that they should act as bridging loans until more long-term funding is in place. The Riksbank has also participated in such initiatives; the last time was in 2010. The background to this is that the G20, at its summit in London in 2009, promised to increase the IMF's resources to meet the increased need for loans that followed in the wake of the global financial crisis. Several countries provided bilateral loans to the IMF which then acted as bridging loans. These commitments were later transferred into NAB in 2011, an initiative that the Riksbank also participated in. Increasing the NAB is a more long-term commitment as the NAB do not have a given final date.

## Loans to the IMF can be compared to lines of credit, with low risk and low return

The Riksbank's financial commitments to the IMF (capital subscriptions, NAB, GAB and bilateral loans) can be compared to a loan pledge or guaranteed lines of credit. This means that the IMF can ask the Riksbank to provide funds from the foreign exchange reserve when the Fund needs these for onward loans to other countries. The loan agreements between the institutions set the limit for how much the IMF can request from the Riksbank. The IMF makes quarterly forecasts of the proportion of the 'loan pledges' they expect to have to use, which helps the member countries' financial planning. The IMF usually asks the Riksbank to provide US dollars. So far, the Fund has only used a limited part of the Riksbank's total commitments, corresponding to an average of just over 22 per cent. This is partly because, the mere knowledge that money is available can help to calm the financial markets, which in turn means that a smaller proportion of the resources actually need to be utilised.

Lending by the member countries to the IMF is also associated with very low risk. The Riksbank lends funds to the IMF which in turn lends them to a third country, and it is the Fund that bears the entire credit risk. The IMF holds a so-called preferred creditor status and thus has highest priority when loans are to be repaid. This means that it is very unusual for the IMF to incur loan losses.  This is also what makes it possible for the IMF to take a risk by lending money to countries that are already encountering problems, as the Fund always stands first in line to get its money back. The member countries do not risk loan losses with each individual loan.  On the other hand, they accept a low return for funding a buffer that the IMF uses to meet any loan losses that may arise.  When the money is lent onwards, the Fund adds an interest-rate margin, which is partly used to fund the IMF's day-to-day operations , and partly to build up this buffer.

When the IMF utilises the member countries' commitments, it pays interest on the outstanding amounts. This interest is an aggregate of the interest rates for three-month treasury bills issued in the four currencies included in the currency basket for the Special Drawing Rights (SDR): the US dollar, the British pound, the euro and the yen. The SDR interest rate is calculated on a weekly basis from the market quotations for these treasury bills and is therefore a short-term aggregate market rate. This short-term rate may be considered relatively low in comparison to other, more long-term investments that the Riksbank could make. But return is not the incentive for contributing funds to the IMF – the incentive is to create a stronger international firewall. This will reduce the risk of financial crises that generate high costs for the economy.  It also reduces the risk that the foreign exchange reserve will later have to be used for domestic crisis management.

## A possible further contribution from the Riksbank

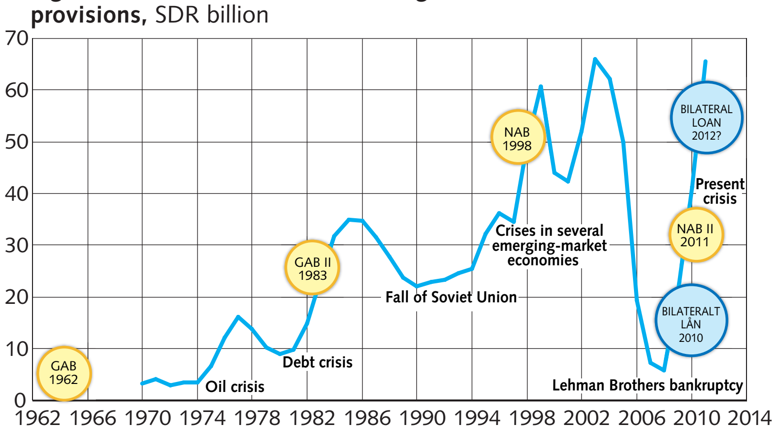
In December 2011, the Executive Board of the Riksbank decided to promote a parliamentary decision that will entitle the Riksbank to provide further loans to the IMF totalling up to SEK 100 billion. The decision was taken in conjunction with the EU initiative to provide a temporary European contribution to the IMF's resources, so as to give the Fund additional capacity to mitigate the effects of the debt crisis in the euro area. According to the decision, the Riksbank should work for a reasonable burden sharing of the EU countries' individual contributions and for the funds to be lent onwards under strict conditionality; that is to say with requirements for the implementation of the necessary reforms. The sum of SEK 100 billion was determined on the basis of an assessment of what would be a reasonable maximum contribution considering the size of Sweden's economy and to allow Sweden bargaining room in the European discussions on the additional resources. The size of the Swedish contribution is still unclear. It is also unclear how much other countries outside the EU may be willing to contribute. International negotiations are underway over the size of various countries' individual contributions, and it is expected that these amounts will be determined in the spring of 2012. When the amount is determined for Sweden, the Riksbank will make a formal request to the Riksdag, which will make the decision. Following this, the Riksbank and IMF will initiate negotiations on the terms of the loan, such as its maturity, for example.

In this Economic Commentary, we have noted that there are strong reasons for Sweden to lend additional money to the IMF. Helping to strengthen the firewalls now being constructed internationally will hopefully also strengthen confidence on the financial markets. Another important reason is that, this time, it is the euro area that is in trouble. The European economy is very important for Sweden – particularly from the point of view of exports – and Sweden's vested interest in efforts to stabilise the euro area is thus even more tangible and obvious.

It is important that the Riksbank's contribution goes via the IMF. The IMF's global mandate, familiarity with the countries and long experience of helping countries in crisis are of decisive importance, which is also something that the Riksbank places great emphasis on in international discussions. This global mandate also implies a global responsibility. As the world is so interconnected by trade and financial systems, there is a risk that the effects of the debt crisis in the euro area will spread to affect other countries and regions as well. It is thus reasonable to temporarily expand the IMF's resources so that it has enough capacity to help all of its member countries.

## Figure

**Figure 1. The IMF's historical lending and the Riksbank's extra provisions,** SDR billion




Note. Special Drawing Rights (SDR) are an arithmetical unit created by the IMF. 1 SDR is approximately equal to SEK 10. As the SDRs were not created until 1969 there is no comparable data from previous years, the series therefore only illustrates the period 1970-2011.

Source: IMF