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This Economic Commentary describes how the IMF lends money to its member countries as well as the terms and conditions for the loans. The IMF has a mandate to lend money to countries with temporary balance of payments problems. A loan from the IMF gives the country short-term financial support, allowing it the time and scope to implement necessary reforms at the same time as enabling it to fund vital public functions. The conditions for the IMF's loans play a key role for the country's chances of addressing the problems that caused its financing gap and for it to be able to repay the money to the IMF later on. Here we describe how these conditions are formulated, the conditionality that an IMF programme may include and how much it costs to borrow from the IMF. The Commentary also includes a case study of Ireland's IMF programme, 2010-2013.

The IMF's lending – how does it work?

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The International Monetary Fund (IMF) lends money to member countries with temporary funding problems.[2] The amounts lent by the IMF and the countries lent to have varied over the years. In recent years, the global financial crisis and the sovereign debt crisis in certain parts of the euro area have formed major reasons for the IMF to lend money. Sweden is both a member of and a lender to the IMF. We need to know that the money lent by the IMF is subject to conditions such that the country is assisted to address its problems at the same time as it will eventually be able to repay the money. In this Economic Commentary, we describe the conditions under which the IMF lends money to its member countries. It can also be regarded as a follow-up to an Economic Commentary from 2012 that reported how the IMF funds these loans.[3]

The IMF lends money to member countries with temporary problems

Just as private individuals utilise student loans, loans for consumption and mortgage loans from banks to supplement the money they have in their wallets or bank accounts, countries borrow money on the international financial markets, for example through the issuance of government bonds. The countries use this money for purposes such as paying for vital public functions and refinancing earlier debts. If, for some reason, the country should run into economic distress and find that investors are no longer willing to lend money to the country, it will face funding problems. For example, the country may find it difficult to pay interest to its creditors or become unable to renew old loans that are falling due. In such a situation, the country can turn to the IMF for help.

The IMF can lend money as temporary funding until the country is back on its feet again, which is to say it has become able to obtain funding entirely on the markets. Borrowing money from the IMF is voluntary. It can be seen as a possibility to give a country breathing space to undertake necessary economic reforms and thus regain investor confidence. But for the problems to really be counted as temporary and for the country to be able to repay its loan to the IMF, it is important that the country is able to address whatever it was that caused it the funding problems. This is where the conditionality of the loans plays a key role. For example, the IMF can extend a loan to a borrowing country subject to the condition that the country tightens up its fiscal policy if the country's public expenditure exceeds tax revenues in a way that is not sustainable in the long term.

Unlike its sister organisation the World Bank, the IMF has a relatively narrow mandate. The World Bank has a broad mandate to finance various types of project with the aim of promoting countries' economic development. This may involve everything from building roads to increasing women's access to education. The IMF instead

1. The authors would like to thank Caroline Leung, Pernilla Meyersson, Mia Holmfeldt, Annika Svensson and Mikael Apel for their valuable comments.
2. The IMF was founded in 1944 and Sweden became a member in 1951.
3. "The Riksbank's lending to the IMF – how and why?" Economic Commentary No. 01, 2012 http://www.riksbank.se/Documents/Rapporter/Ekonomiska_kommentarer/2012/ek_kom_nr01_120220_sve.pdf.

lends money to member countries facing *temporary balance of payment problems*. The balance of payments is a statistical report of a country's international economic transactions that includes items such as trade in goods, financial claims and liabilities with the rest of the world and transfers. According to its Articles of Agreement, the IMF may only lend money to countries with temporary problems in their balance of payments. If the IMF is to lend money to a country, it is required to have at least one of the following problems:

i. a direct deficit in the balance of payments

ii. insufficient international reserves or

iii. the development of its international reserves is deemed unsustainable.

The IMF has several types of loan programmes that are adapted to meet the different needs of its member countries. Most loans place requirements on the country for economic reforms. The actual loan is funded with money from the IMF's other member countries.[4] The IMF also has special loan programmes for developing economies that have their interest costs subsidised by development assistance funds. However, this will not be discussed in this Economic Commentary.

The IMF has two main lending programmes: a Stand-By Arrangement (SBA) and an Extended Fund Facility (EFF). The greatest difference between them is the time horizon involved. An SBA programme runs for a maximum of three years and is aimed at assisting the country to deal with short-term balance of payment problems. An SBA programme has a repayment time of between three and a half and five years. An EFF programme is aimed at countries with more serious problems with their balances of payment and who therefore need more time to rectify their economic situations. An EFF programme can therefore run for up to four years and have a repayment time of between four and a half and ten years.

Loans include conditions that are adjusted to the country

When the IMF lends money to countries in crisis, special conditions are always attached to the loan. This is so that the IMF can be assured that the countries will both be able to repay the loan and deal with the causes of the balance of payment problem. The word *conditionality* is often used in discussions of the conditions for borrowing from the IMF.

Over the years, the IMF has been criticised for its comprehensive conditionality, as well as for how it has been designed. For example, during the Asian crisis, the IMF's lending was subject to the condition that the countries involved should introduce floating exchange rates and undertake capital account liberalisation. As these countries already had major imbalances, these measures had serious consequences for the region when exchange rates dropped and money flowed out of the countries. This has contributed towards many countries in Asia building up large international reserves as a kind of insurance against having to borrow from the IMF again.

In response, the IMF revised its conditionality and, during the first decade of this century, the guidelines on conditionality were adjusted with the aim of limiting it to only cover the measures considered necessary to achieve the programmes' macroeconomic goals.[5] In addition, the IMF introduced a new type of loan programme that was to act as an alternative towards the accumulation of large reserves. This new loan programme means that countries that are able to demonstrate a sound economic policy would be able to prequalify for a credit line from the IMF that they would then be able to utilise without any conditionality. This is known as the Flexible Credit Line (FCL). Poland, Colombia and Mexico have had such insurance programmes since 2009 without having claimed any money.

The IMF has conducted many assessments of its various loan programmes and one of the most important factors for reaching the programme targets that has emerged is the country's "ownership" of the programme. This means that the country's

4. See Economic Commentary No. 01, 2012, mentioned above, for details of the funding.

5. The IMF's guidelines on conditionality were changed in 2002 and 2009 as a consequence of reviews.

government understands the advantages of implementing economic reforms rather than viewing them as something imposed on them by the IMF. It is therefore very important that the IMF jointly formulates the conditionality together with the borrowing country, so that its government supports the conditions and is prepared to push the process of change in that direction. The aim of conditionality is to create long-term stability in the country so that it is able to fund itself. There is more than one way of getting a country back on its feet after a financial crisis and a programme with broad support in the country will have significantly better chances of succeeding.

IMF programmes are formulated jointly by the IMF and the borrowing country

When a country wishes to borrow money from the IMF, the initial step is that the country and the IMF staff jointly put together a proposed programme of measures to address the country's problems. These measures are then presented in what is known as a *Letter of Intent*, which is usually signed by the country's government. This is then presented to the IMF's Executive Board, together with an assessment from the IMF staff of how they expect the country's debt situation to develop.

One condition for the IMF's Board to approve the programme is for the measures and loan to lead to the country's debt situation improving over the medium term. The IMF assesses this in a *Debt Sustainability Analysis*. If they deem that the country has excessive debt, debt restructuring will be required if the IMF is to extend a loan to the country. This involves the country and its creditors, such as investment funds and banks that have purchased the country's bonds, renegotiating the country's debts by means such as extending maturities or writing down the amount of the outstanding debt.

If the IMF's Board approves the programme, the country will receive a first disbursement. Following this, the IMF reviews the measures taken by the country, usually every quarter. If the country complies with the conditions, the IMF's Board then decides on further disbursements.[6]

Different categories of conditions in order to improve the country's economy

The conditions usually included in the IMF's loan programmes can be divided up into four categories:

1. *Prior actions* are commitments made by the country before a programme is approved. The aim of this type of commitment is to improve the country's preconditions for successful implementation of the programme. One example of such a measure could be formal approval of a budget consistent with the programme's fiscal framework.
2. *Quantitative performance criteria* are measurable macroeconomic variables that are under the authorities' control, such as minimum level of net international reserves or the maximum size of its national debt. These are followed up at each review.
3. *Indicative targets* are used to complement the quantitative performance criteria to measure progress, for example if data is uncertain. The level of lending and the size of the budget deficit are examples of variables that could be subject to these targets.
4. *Structural benchmarks* are reform measures (often non-quantitative) that are important if the country is to manage the more fundamental problems that have led to the need to borrow from the IMF. The nature of these reform measures varies depending on the challenges faced by the country, but they could include measures to improve the regulation of the country's financial sector, a

6. https://www.imf.org/external/np/exr/facts/conditio.htm.

strengthened social safety net, improvements to regulations on corruption or strengthening the budgetary framework.

The quota share determines how much the country can borrow and what it will cost

The amount a country can borrow from the IMF is determined by the size of the quota share the country holds in the IMF. The quota share is determined using a formula that also determines how much voting power each member country has in the IMF's Board and how much money each country is to contribute towards the IMF. A country's quota share is calculated using the following variables: the size of its GDP, its openness to trade, variability[7] and the size of the country's international reserves. A country may borrow up to 600 per cent of its quota share. It is also possible to borrow more than this, but this makes the cost of the loan higher. See the table below. The first programme for Greece from 2010 was the largest ever in relation to quota share, corresponding to over 3,200 per cent of Greece's quota share at that point.

Interest and charges for loans from the IMF

SDR[8] rate	0.05 %	The interest paid on an IMF loan is based on the so-called SDR interest rate, which is an aggregate market rate determined by the IMF on a weekly basis and which can never fall below 0.05 per cent.[9]
Basic rate of charge	1 %	SDR rate + one percentage point is the basic rate of charge for borrowing.
Service charge	0.5 %	In addition, a service charge of 0.5 per cent of the entire loan amount is added.
Surcharge 1 *> 300 % of quota share*	*2 %*	In addition, the country pays two percentage points in surcharges on the share of the loan that exceeds 300 per cent of its quota share…
Surcharge2 *> 300 % of quota share and > 3 years*	*1 %*	… and the surcharge rises to three percentage points if the loan amount is outstanding for more than 3 years.
Commitment fee	*0.15-0.60 %*	Countries also pay a fee for the resources they have been promised, but this is refunded if the loan is then utilised. This is known as a commitment fee.

Source: The IMF[10]

Even if the IMF's regulations allow a country to borrow significantly more than 600 per cent of its quota share, there are limits on how much the IMF can lend, from a risk perspective. In addition, there are limits from the perspective of fairness. The IMF must have money left to lend if other countries need loans. In cases in which countries need to borrow more than the IMF can lend, the IMF requests co-financing from other international organisations and other lenders (often other countries) to put together a sufficiently large financing package.

Case study: Ireland's IMF programme

During the global financial crisis, many countries encountered serious problems in their financial sectors. These problems then spread to the real economy and had major consequences for growth, employment and other areas. One of the countries facing such problems was Ireland.

The financial crisis revealed large deficiencies in the Irish banking system and triggered a serious banking and real economic crisis. At its peak, the Irish banking system was five times the size of GDP and was subject to extreme stress at this point. The sensitivity of the banking sector led investor confidence in Ireland's economy to fall, placing severe pressure on the country's public finances. Growth had also fallen and

7. Variability of current receipts and net capital flows.
8. Special Drawing Rights (SDR) are a reserve asset created by the IMF and are included in the member countries' reserves. The value of the SDR is currently based on a basket of currencies comprising the US dollar, euro, yen and pound sterling.
9. http://www.imf.org/external/np/fin/data/sdr_ir.aspx.
10. http://www.imf.org/external/np/exr/facts/eff.htm.

there were doubts about the sustainability of fiscal policy. In 2010, the budget deficit amounted to 13.3 per cent of GDP and public debt increased from the pre-crisis level of about 25 per cent to almost 100 per cent.

To counteract this negative development, the Irish authorities adopted a series of measures such as facilitating bank funding, separating the banking sector's good and bad assets, recapitalising the banks and implementing a fiscal policy austerity programme. However, this turned out not to be enough to create confidence on the financial markets. Consequently, Ireland turned to the IMF for financial support so that it could implement further reforms of the banking sector and the framework for fiscal policy.

In November 2010, the Irish Government reached an agreement with the IMF and EU for a financing programme in a total amount of EUR 85 billion. The lending programme for Ireland was an Extended Fund Facility (EFF), and was co-financed by the IMF, the EU and a number of EU countries who contributed bilateral loans. Ireland contributed EUR 15.5 billion from its own resources, including a national pension fund and its cash reserves. Ireland's IMF programme corresponded to 14.3 per cent of the country's GDP, making it about the same size as the IMF programmes for Greece and Portugal. The IMF contributed EUR 22.5 billion, i.e. just under one-third of the total programme, the EU contributed EUR 40.2 billion, and the bilateral loans amounted to EUR 4.8 billion, including EUR 600 million from Sweden.[11]

The overall programme targets, detailed interim targets and criteria were specified in a Letter of Intent signed by the Irish Minister for Finance and Governor of the Central Bank of Ireland in December 2010.[12] There were three main targets:

i. Reducing the size of the banking sector and increasing its resilience, among other things by raising the banks' capital levels and establishing a more stable funding base.

ii. Ensuring a sustainable fiscal policy over the medium term.

iii. Maintaining a strong corporate climate to ensure competitiveness, employment and growth.

The structural conditions were aimed at reorganising the banking sector and strengthening supervision of the banks. The quantitative criteria included a limit on the size of Ireland's budget deficit, in addition to which an indicative target in the form of a "ceiling" for the net government debt was set. Immediately after the IMF's Board approved Ireland's programme, the country received an initial disbursement corresponding to EUR 6 billion. The remaining payments were then made on a quarterly basis after IMF staff had assessed whether Ireland had managed to achieve the interim targets specified in the programme. Each such assessment and disbursement was approved by the IMF's Board.

IMF disbursements to Ireland by year (EUR thousands)

	DISBURSEMENTS	REPAYMENTS	CHARGES AND INTEREST PAID
2011	13,111,771		128,999
2012	6,403,904		386,569
2013	3,265,228		509,968
2014		9,121,674	773,696
2015 (as per 30 June)		(10,093,916)	(159,049)

Note. The amounts were determined in Special Drawing Rights (SDR) but paid in currency. In Ireland's case, all disbursements for the programme were in euros. In the table, the SDR/EUR exchange rate for 31 December each year has been used, except for 2015, where the amount and exchange rate for 30 June has been reported.

The IMF's assessment of the Irish programme showed that the implementation of the programme had been successful. Ireland had met all quantitative criteria at each review and had achieved almost all structural targets. The IMF programme

11. This was a loan from the Swedish Government. The money was therefore not taken from the Riksbank's foreign currency reserve.

12. http://www.imf.org/external/pubs/ft/scr/2010/cr10366.pdf.

contributed towards the financial sector being stabilised and reduced in size and improving its capacity to manage systemic risks, while the banks regained access to financing from the markets. In December 2013, Ireland's IMF programme was concluded, with the authorities deeming that no follow-up programme was necessary. In December 2014, Ireland repaid the first part of the loan to the IMF.

Concluding remarks

The IMF fulfils an important function by providing financial assistance to member countries in crisis so that they can gradually and in an orderly fashion come to grips with their problems. Borrowing money from the IMF is voluntary. It means that the country receives short-term financial support, allowing it the time and scope to implement necessary reforms at the same time as enabling it to fund vital public functions. The conditionality is formulated with the aim of reforming the economy so that the country's finances and debt situation can be seen as sustainable in the long term. This should result in other financiers feeling confident enough to make loans to the country again once the programme has been concluded. To increase the chances of the country being able to fund itself on the market again, it is important that the conditions are designed effectively and that the country demonstrates ownership of the programme.