A Factsheet - October 2008

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How the IMF Helps to Resolve Balance of Payments Difficulties

Balance of payments difficulties can arise—and, in the worst case, build into crises—even in the face of strong prevention efforts. The IMF assists countries in restoring economic stability by helping to devise programs of corrective policies and providing loans to support them.

Why do balance of payments problems occur?

Bad luck, inappropriate policies, or a combination of the two may create balance of payments difficulties in a country—that is, a situation where sufficient financing on affordable terms cannot be obtained to meet international payment obligations. In the worst case, the difficulties can build into a crisis. The country's currency may be forced to depreciate rapidly, making international goods and capital more expensive, and the domestic economy may experience a painful disruption. These problems may also spread to other countries.

The causes of such difficulties are often varied and complex. Key factors have included weak domestic financial systems; large and persistent fiscal deficits; high levels of external and/or public debt; exchange rates fixed at inappropriate levels; natural disasters; or armed conflicts or a sudden and strong increase in the price of key commodities such as food and fuel. Some of these factors can directly affect a country's trade account, reducing exports or increasing imports. Others may reduce the financing available for international transactions; for example, investors may lose confidence in a country's prospects leading to massive asset sales, or "capital flight." In either case, diagnoses of, and responses to, crises are complicated by linkages between various sectors of the economy. Imbalances in one sector can quickly spread to other sectors, leading to widespread economic disruption.

How IMF lending helps

IMF lending aims to give countries breathing room to implement adjustment policies and reforms that will restore conditions for strong and sustainable growth, employment, and social investment. These policies will vary depending upon the country's circumstances, including the causes of the problems. For instance, a country facing a sudden drop in the price of a key export may simply need financial assistance to tide it over until prices recover and to help ease the pain of an otherwise sudden and sharp adjustment. A country suffering from capital flight needs to address the problems that led to the loss of investor confidence: perhaps interest rates that are too low, a large government budget deficit and debt stock that is growing too fast, or an inefficient, poorly regulated domestic banking system.

Before a member country can receive a loan, the country's authorities and the IMF must agree on a program of economic policies. A country's commitments to undertake certain policy actions are an integral part of IMF lending. They are designed to ensure that the funds will be used to resolve balance of payments problems. They would also help to restore or create access to support from other creditors and donors. A country's return to economic and financial health allows the IMF to be repaid, making the funds available to other members.

In the absence of IMF financing, the adjustment process for the country would be more difficult. For example, if investors become unwilling to provide new financing, the country has no choice but to adjust—often though a painful compression of imports and economic activity. IMF financing can facilitate a more gradual and carefully considered adjustment.

IMF loan programs are tailored to the specific circumstances of individual countries. In recent years, the largest number of loans has been made through the Poverty Reduction and Growth Facility

(PRGF), which provides funds at a concessional interest rate to low-income countries to address protracted balance of payments problems. However, the largest amount of funds is provided through Stand-By Arrangements (SBA), which charge market-based interest rates on loans to assist with short-term balance of payments problems. The IMF also provides other types of loans including emergency assistance to countries that have experienced a natural disaster or are emerging from armed conflict.

Globalization has vastly increased the size of private capital flows relative to official flows and IMF quotas, albeit unevenly so. Many emerging market countries currently see an unmet need for insurance against large and volatile capital flows. In recent years, the IMF has been re-examining its instruments that help prevent and respond to crises to ensure they continue to meet emerging-market members' needs. Low-income countries have differing needs. Some require debt relief, and others concessional financing. Meanwhile, some no longer need financing, but seek the reassurance of policy support and signaling.

Fast Facts on IMF Lending
(as of August 28, 2008)

Loanable funds	$201.0 billion
Loans outstanding	$18.3 billion to 65 countries
of which: concessional loans	$6.3 billion to 57 countries

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