IMF bailout

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In news– The International Monetary Fund (IMF) recently confirmed a $3 billion bailout plan for Sri Lanka's struggling economy.

What is a bailout?

A bailout is the **provision of financial help to a corporation or country** which otherwise would be on the brink of bankruptcy.

About IMF bailout-

- The **IMF basically lends money, often in the form of special drawing rights (SDRs), to troubled economies** that seek the lender's assistance.
- **SDRs simply represent a basket of five currencies,** namely the U.S. dollar, the euro, the Chinese yuan, the Japanese yen, and the British pound.
- The IMF carries out its lending to troubled economies through a **number of lending programs such as the extended credit facility, the flexible credit line, the stand-by agreement, etc.**
- **Countries receiving the bailout can use the SDRs for various purposes** depending on their individual circumstances.
- Currently, both Sri Lanka and Pakistan are in urgent need for U.S. dollars to import essential items and also to pay their foreign debt. So any money that they receive from the IMF is likely to go towards addressing these urgent issues.
- The IMF usually **imposes conditions on countries before it lends any money to them**.
- For example, a country may have to agree to implement certain structural reforms as a condition to receive IMF

loans.

- The IMF's conditional lending has been controversial as many believe that these reforms are too tough on the public.
- **The IMF was set up in 1945 out of the Bretton Woods conference**.
- The primary goal of the IMF back then was to bring about international economic coordination to prevent competing currency devaluation by countries trying to promote their own exports.
- Eventually, the IMF evolved to be a lender of last resort to governments of countries that had to deal with severe currency crises.

Why countries seek an IMF bailout?

- Countries seek help from the IMF usually when their **economies face a major macroeconomic risk,** mostly in the form of a **currency crisis**.
- Such currency crises are **generally the result of gross mismanagement of the nation's currency by its central bank**, often under the covert influence of the ruling government.
- **Central banks may be forced by governments to create fresh money out of thin air to fund populist spending.** Such spending eventually results in a rapid rise of the overall money supply, which in turn causes prices to rise across the economy and the exchange value of the currency to drop.
- **A rapid, unpredictable fall in the value of a currency** can destroy confidence in said currency and affect economic activity as people may turn hesitant to accept the currency in exchange for goods and services.
- **Foreigners may also be unwilling to invest in an economy** where the value of its currency gyrates in an unpredictable manner.
- Meanwhile, **a country's domestic economic policies can**

also have an adverse impact on its currency's exchange rate and foreign exchange reserves. For example, economic policy that imperils productivity can affect a country's ability to attract the necessary foreign exchange for its survival.