**The IMF response to the crisis: Crisis prevention and political influence**

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*In the wake of the global crisis the IMF has increased its exposure and modified its lending approach. This column looks at IMF loan arrangements in developing countries since 2008 and suggests that the Fund has played a role in dampening contagion effects. However, its lending operations have also been influenced by political similarity between borrowers and G7 governments.*

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In response to the global financial crisis, international financial institutions have greatly boosted their lending to developing countries to help them cope with the crisis and to sustain the economic recovery. The IMF reversed the dramatic downsizing process experienced in the first part of the new millennium and significantly increased its lending capacity. Besides the discussion on additional budget increases, there is an on-going and intense debate about reforming the IMF (see the Vox columns by Williamson 2009 and Truman 2009). The main issues focus on the necessity to complement the traditional functions of providing short-term financial assistance and promoting external balance stability in member countries with a wider responsibility of crisis prevention, supporting financially prudent countries that, although not suffering actual reserve shortage, are vulnerable to external shocks and liquidity runs (Meltzer 2011).

Since 2008, the Fund has endowed itself with effective instruments to prevent sudden falls in investors’ trust and the eruption of liquidity crises. Although it is too early to draw any rigorous evaluation of the new IMF lending facilities, anecdotal evidence suggests that borrowers were able to cope with the global crisis, avoiding large scale banking crises and disruptive exchange rate movements and protecting social spending (IMF 2011). The key issue is, therefore, to understand to what extent the IMF lending policy has been driven by this “non-statutory" objective and whether it has determined a substantive change in the actual IMF approach to crises.

**The politics of IMF lending**

The resurgence of the IMF in the policy arena has also revived slumbering concerns and criticisms with regard to the Fund’s politically-oriented lending behaviour which is thought to have benefited its major shareholders, who control the IMF Executive Board, and their foreign allies, producing inefficient allocation of the IMF and national government resources.

The Icelandic case, for instance, has been subject to close scrutiny, because of the involvement of British and Dutch governments and Nordic countries in the IceSave dispute. While the IceSave agreement was not explicitly part of the programme conditionality, there is no doubt that the British and Dutch governments have used these levers to extract stiff terms over the Icesave repayment (The Economist 2010a). More generally, the fact that the IMF’s conditionality framework does not explicitly allow for conditions laid down by bilateral creditors undermines the transparency of the Fund’s agreements with member countries (Gylfason 2009).

Political considerations and strategic interests were also at stake in the IMF $15 billion support package to Ukraine, that, according to some sceptics, “was a prize Ukraine won from America for giving up its supply of enriched uranium” (The Economist 2010b).

A vast scientific literature ranging from political science to political economy has given solid arguments to these concerns, discussing the determinants of IMF loan arrangements and stressing the overwhelming influence of the US and the other G7 countries in shaping the Fund lending decisions at advantage of their political and economic interests.[1](http://www.voxeu.org/article/imf-response-crisis-crisis-prevention-and-political-influence#fn)

**The IMF response to the crisis**

In a recent paper (Presbitero and Zazzaro 2012), we reconsider the political influence hypothesis and the new crisis-prevention role of the IMF by focusing on the lending arrangements signed by the IMF and low- and middle-income countries during the crisis, from January 2008 to June 2010. In particular, we try to answer two main questions:

1. Was IMF lending during the current global crisis directed at preventing the spread of the crisis and the risks of contagion?
2. Was participation in IMF arrangements sensitive to the politico-economic interests of the Fund’s large shareholders?

The results of the analysis of the determinants of the likelihood to signing a loan arrangement and of the size of the loan show that[2](http://www.voxeu.org/article/imf-response-crisis-crisis-prevention-and-political-influence#fn):

1. Political and economic interests matter. The political similarity between the borrower and G7 countries is positively correlated with the probability of entering a loan agreement, while financial exposure of foreign banks and the amount of G7 direct foreign investments in a developing country significantly increase the size of the loan the latter can obtain.
2. The IMF has played an effective crisis prevention role. The harsher the unexpected crisis in the country, the larger the loan granted by the IMF, especially for large states.
Moreover, the exceptional nature of the crisis is associated with an actual change in IMF lending policies, which only in the post-crisis period the Fund started giving weight to the severity of the expected economic downturn in member countries, in order to prevent contagion.

**A structural change in the IMF lending framework?**

On the whole, our results lend some novelty, even if they still provide evidence to support the critics of the IMF. On the one hand, the evidence on the post-2007 loan agreements shows that the political influence hypothesis cannot be discarded. Besides, there are additional findings suggesting that Western donors exert their influence on the Fund to allocate money toward countries where their multinationals and financial systems are more exposed. On the other hand, the loan allocation was consistent with some of the standard macroeconomic variables that should drive IMF lending and, more important, the Fund partially played a crisis prevention role and channelled more resources where the economic downturn was more severe than expected. Whether this resurgence of economics within IMF lending is either an exceptional response to the crisis, or the first signal of a change in its strategy is a matter for future research.

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1 For a comprehensive review of this literature see Steinwand and Stone (2008) and Moser and Sturm (2011).

2 The discussion of how to measure political and economic interests and the unexpected extent of the crisis is somewhat technical. We omit it here; interested readers can find all details in Section 3b of the paper.

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