

# **Funding the IMF**

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## **I. Introduction**

In recent years, the IMF has experienced a decrease in the number of countries seeking its lending assistance. As an integral part of its historical mission, a decrease in its lending operations has moved the IMF to reevaluate its role in the global economy and to rethink its overall financial model in order to sustain its current position as a valued asset and financial partner in global development. This evaluation has highlighted the long-term ineffectiveness of certain IMF functions and procedures as related to the Fund's ability to finance itself.

This briefing paper will briefly review the history of the IMF's internal financing. Next, this paper will address the changes in the domestic economies that have precipitated the Fund's inability to finance itself. Finally, this paper will conclude with an examination of the suggested changes the IMF needs to make to ensure the future financing of its operations.

## **II. History of the IMF's Income**

The IMF relies, principally, on three main sources of funding: (1) loan repayments (interest charges) from debtor countries; (2) gold reserves; and (3) requested resources from its shareholders. The third group of funds largely come from developed, industrialized nations like the United States—the IMF's largest shareholder—and are in three forms: (a) quotas (dues paid by the Fund's member nations); (b) borrowing arrangements (loans the IMF borrows from creditor countries/members or from the private market); and (c) funds the IMF can pull from the Trusts (such as the trust for **HIPC**—**Heavily Indebted Poor Countries** initiative)—separate pools of assets that consist entirely of additional contributions (separate and distinct from quotas) made by member countries. It should also be noted that these sources provide for two principal types of costs: the costs of the loans themselves, and the IMF's operational costs. Operational costs range from surveillance, research gathering and technical assistance/advice provided to countries, to internal administrative costs (such as employee wages).

### a. Loan repayments

Like any creditor, the IMF receives most of its operational-cost income from the periodic interest charges that are paid by nations who borrow from the Fund. For example, countries borrowing from the IMF historically paid around 4.5% interest on loans taken, in addition to service charges. These charges are principally used to pay out interest to the country whose quota was tapped to provide the loan (i.e., *remuneration*), with any remaining sum going to the IMF. For example, in 1986 the Fund received over 2.7 billion **SDR** (**S**pecial **D**rawing **R**ights—a special type of IMF currency, the value of which is based on a basket of international currencies) in periodic interest payments, while paying approximately 1.4 billion SDR in remuneration, leaving a remaining sum of around 1.3 billion SDR for the IMF.

### b. Gold reserves

The IMF is one of the largest holders of gold reserves in the world; as of July 2006, the IMF had approximately US\$ 65 billion in gold reserves. The IMF, at times, may sell the gold or accept gold payments from its member countries—but it is strictly prohibited by its Articles of Agreement from engaging in most other gold-related transactions, such as buying gold. For example, the IMF often sells gold to help provide interstitial funding (i.e., the addition of funds to those contributed by member countries) for the HIPC and other trusts that are briefly described below.

### c. Quotas

While the Fund has relied on borrowing to help provide resources in time of need, quotas serve as the Fund's permanent and primary pool of resources that are tapped to provide loans.

Quotas serve several functions. In addition to providing liquid assets that the Fund can tap for its lending services, quotas determine a respective member country's access (borrowing limits) and its voting power. For instance, the United States has, traditionally and currently, paid the largest quota and, as a result, has the most voting power of any individual country. Additionally, member nations vote on a variety of issues—whether to increase or decrease quota size, for instance, thereby giving nations with large quota/voting power the ability to determine how much liquid assets are available for the Fund to lend at any given point in time.

Traditionally, and not in any particular order, the U.S., UK, Germany, France, Japan, Canada and Italy have been the member nations with the largest quotas/shares and the most voting power. By adjusting the IMF quotas, these countries essentially have the power to determine how much help the IMF can give to debtor nations in need of loans. However, while these countries have the power to both decrease and increase quotas, historically the quotas have only increased: between 1950 and 1992, quotas have experienced an average annual increase of 5.7%. Further, in 1998 total quotas contributed by member countries to the IMF equaled roughly US\$ 193 billion—in 2006, total quotas reached US\$ 317.3 billion. This rapid increase continued and is reflective of the IMF's dependence on quotas as its primary source to fund its lending.

While the amounts provided by quotas are substantially larger than those provided by interest charges, quota money is normally only used to fund loans, not operational costs. The IMF taps income from its interest charges to fund a majority of its operational costs (surveillance, technical assistance, research and statistics, intermediation, etc.), thus making interest-income more important, in a particular sense, to the IMF's ability to function.

#### d. Loan borrowing

Again, while quotas have been and remain the Fund's primary revenue source, the Fund has also engaged in borrowing of its own (mostly from member countries)—such borrowing peaked in 1986 at 14.6 billion SDR, or roughly an amount equal to 16% of the IMF's total quotas for that period.

The **General Arrangements to Borrow (GAB)** was established in 1962 as a borrowing facility between the IMF and the G10 (in 1962, the G10 consisted of eight industrialized nations—Belgium, Canada, France, Italy, Japan, the Netherlands, the UK and the US—and the central banks of two others—Germany and Sweden; the composition of the G10 has since changed); the G10 agreed in advance to a maximum amount it would loan to the Fund in the event the Fund needed additional resources to finance drawings made by member nations. The GAB has been utilized ten times throughout the IMF's history, most recently in 1998 when the IMF used a GAB of approximately 6.3 billion SDR to help finance an Extended Arrangement (a long-term loan that usually involves reforms—i.e., conditions—which need some time to be

implemented and take effect) for Russia. The IMF repaid the GAB less than a year later, following quota increases.

In addition to borrowing through the GAB, the Fund engages in bilateral loan arrangements. For example, in the early 1970s, after experiencing a surge in their surplus, oil exporting countries (particularly Saudi Arabia) served as a useful source of borrowed funds for the IMF that were not prearranged loans such as the GAB. The loans to the IMF were good investments for these countries, and the large surpluses provided a pool of available resources the Fund could use to help bridge the gap in the financing of its operations. From 1972 to 1974, the Fund borrowed approximately 8.3 billion SDR from sixteen oil exporting countries, with approximately 1.2 billion SDR coming from Saudi Arabia alone. Between 1981 and 1982, Saudi Arabia loaned about 9 billion SDR to the Fund.

#### e. The trusts

In an effort to provide further relief to the developing countries that need it most, the IMF and its member countries established several initiatives, and trusts respective to each initiative, to provide a source of *loan financing* in critical times of need. For example, the HIPC Initiative has an accompanying trust that consists of grants and deposits pledged from some 93 member countries, as well as contributions the IMF has itself made from the sale of some of its gold holdings. Currently, the trust accompanying the HIPC has some US\$ 23 billion in pledged loan resources.

The initiatives under which these trusts disburse monies are principally reserved for low-income countries, thus making eligible only those countries in the direst of circumstances. For further, and more in-depth, discussion of the HIPC, please see the FAQ on this topic that can be accessed [here](#).

### **III. Decline in Revenues**

#### a. Early payback of loans from principal debtor countries

In recent years, due to principal debtor countries opting to repay loans early, a low-credit environment has emerged. There just are not as many countries with outstanding loan balances

on which interest needs be paid to the IMF. For instance, in December 2005, Brazil made the largest payment ever by a member country to the IMF when it completely paid off its US\$ 15.5 billion debt. The next couple months saw Argentina completely pay off its US\$ 9.75 billion debt, and Uruguay pay US\$ 630 million—a significant portion of its outstanding debt to the IMF. All of these early and substantial payments have cost the IMF an extraordinary amount of would-be interest payments.

For example, during the fiscal year 2006, the IMF received US\$ 2.5 billion in interest payments from borrowing countries, but subtracted from this amount was nearly US\$ 2.2 billion of interest *paid by the IMF* to its member countries based on their quota subscriptions that were tapped for IMF loans. This left US\$ 300 million in monies that the IMF earned from interest payments. Compare that to the US\$ 1.3 billion earned—after remuneration—during 1986, as noted above, and the decline in the IMF’s interest-charge income is startlingly apparent.

The other significant factor contributing to the low-credit environment is the fact that countries are not seeking new loans from the IMF to replace those that have been paid down by others: The total amount of loans that need be repaid to the IMF—which was nearly 72 billion SDR in 2003—has been whittled down to approximately 13 billion SDR in 2006. As of October, 2007, that number has dropped further to about 10 billion SDR. These numbers evince a precipitous and persistent drop in countries seeking loans from the IMF. This conclusion is corroborated by the fact that only two member countries have borrowed from the IMF during 2007: Gabon and Peru.

In earlier times, when its total amount of unpaid loans was substantially high, income from interest charges was adequate to fund the IMF’s operations; however, in the current low-credit environment, this is not the case.

b. Expansion of IMF’s role increases operation costs

The IMF’s role extends well beyond lending. For example, the IMF provides technical assistance to countries in need. This assistance takes several forms: Educational and personnel training to help the particular country implement effective economic policies, statistical research to help the IMF pinpoint the individual country’s needs, and, most importantly, IMF experts

remaining in the country for a period of time to advise the government on its economic and structural policies.

In recent years the IMF has increased the amount of technical assistance it provides to countries in need. For example, between 1994 and 2003 technical assistance increased from 262 person-years to 356 person-years (one person-year equals 260 days of work provided by one person.). The amount of person-years continues to increase—during 2006 the IMF provided some 429 person-years of technical assistance, an approximately 20% increase from 2003. Most importantly, total expenses on technical assistance in 2006 reached US\$ 175.8 million, roughly 19% of the IMF's administrative expenditures, up from roughly US\$ 114 million in 2004.

The IMF's recent "standards and codes" initiative has further increased administrative expenses. The initiative develops internationally recognized standards of economic and financial policies that the IMF encourages countries to adopt. The cost of the Fund's participation in the initiative peaked in 2003, at roughly 5.5% of the Fund's administrative budget, which for that year was US\$ 719 million, thus translating into over US\$ 35 million. However, the costs of the initiative have since dropped, with only 3.5% of the Fund's administrative budget allocated to it in 2006.

Nevertheless, all of these expansions in the IMF's work have contributed to a rather dramatic increase in IMF employee-salary expenditures—no doubt owing to the extra manpower needed to provide these services. For example, in 2003 the IMF had approximately US\$ 528 million in total salaries and benefits paid to its employees, a total that increased more than US\$ 100 million just two years later in 2005, with approximately US\$ 634 million in salaries and benefits expenses. Salary expenses continued to increase in 2006, with approximately US\$ 666 million paid by the Fund to its employees. Finally, total administrative expenditures increased from around US\$ 531 million in 1998 to nearly US\$ 900 million in 2005.

Combined with a decrease in the amount earned from interest charges, these expenses have resulted in the IMF losing money—the IMF initially projected a loss of US\$ 103 million for 2007, but a most recent estimate has yielded a projected loss of US\$ 165 million for 2007. The change in the recent estimate is largely a result of the IMF incorrectly predicting the amount of loans that would be repaid and the new loans taken out since the last estimate. Without change

for the better, such losses could seriously threaten the IMF's financial sustainability. For instance, in 2008 the IMF stands to lose US\$ 185 million, with an increase to US\$ 244 million in 2009. Clearly, then, the IMF needs to implement new income streams.

#### **IV. The New IMF – Reforms to Ensure IMF Funding**

In early 2007, a committee of distinguished experts convened at the Fund's request to propose solutions to the Fund's internal financing problems. This gathering resulted in the **Crockett Report**, in which the committee, including former Chairman of the U.S. Federal Reserve, Alan Greenspan, among others, made several suggestions to the Fund that would alleviate its financial problems in the short-term and lay the framework for a long-term solution. The recommendations focused on new income streams for the Fund to meet its rising costs.

##### **a. Selling of gold holdings and investment portfolio expansion**

The report recommended that the Fund sell some 400 metric tons (12.9 million ounces) of gold and invest the proceeds. The report believes that a sale of this amount, assuming a sale price of US\$ 500 per ounce, would yield around 4.4 billion SDR—and investment of those proceeds would yield 130 million SDR per year to be used for covering administrative expenditures.

The Crockett Report also recommended that the IMF expand its investment operations. Currently, the IMF's mode of investment, when compared to that of its sister institution, the World Bank, is rather conservative in the range of instruments in which it invests. The report believes that, based on comparisons to the portfolios of the World Bank and other multilateral development banks with a liberal investment policy, that the IMF could potentially yield an extra 30 million SDR in annual income from its own portfolio if it invested in a broader range of instruments. Further, the report recommended that the Fund invest part of its membership quotas—which are currently used only for Fund lending operations. In today's market, every 1 billion SDR in quotas that the Fund invests would yield 5 million SDR in additional annual income: thus, 20 billion SDR invested might yield 100 million SDR in annual income.

Both recommendations, if implemented together, could prove to be a substantial and reliable new income stream—a total of 260 million SDR in additional annual income could be

earned by implementing these two recommendations, an amount that would more than cover the losses the IMF currently faces, and those anticipated through 2009.

b. Charging for services

The Crockett Report notes that it's appropriate, logically and morally, for those countries receiving the benefit of IMF bilateral services (including technical assistance) to help foot the bill for such assistance. This recommendation directly addresses the criticism that certain countries become intellectually dependent on the IMF and what, up until now, has largely been free technical assistance. As such, this change would not necessarily yield significant additional income, but it would help countries approach technical assistance from the IMF in a disciplined manner: By charging a fee for the services, countries would have to decide if they really needed the assistance, rather than potentially wasting IMF time and resources. Currently, it is the poorest of countries receiving technical assistance. The report acknowledged that some countries are too poor to pay anything, and in such a case other countries could perhaps donate to cover costs; but in any case, the full cost of such services should be billed.

The report did not contain any projected potential income from such charges. Nevertheless, implementing such a change would curb demand for technical assistance and defray costs that would, otherwise, probably continue to rise, thus potentially saving the IMF in expenditures—an amount that could be substantial.

c. The IMF's response

In the first press briefing announcing the conclusion of the Crockett Report, IMF Managing Director Rodrigo De Rato took an initial position that is generally aligned with the committee's suggestions: He agreed that the current finance model has proved inadequate, and is so for the same reasons the committee highlighted. However, he asserted that the IMF had already taken measures to alleviate its financial strain, and, among those measures, were attempts to decrease administrative expenditures in the coming months and years.

The Managing Director, however, did not say whether the IMF would immediately adopt the specific suggestions made by the report, but instead noted that something as important as implementing a new financial model (after all, the current model has been in place for more than

60 years) would require extensive deliberation before becoming finalized. Nevertheless, at the 2007 Spring Meetings held by the **IMFC** (**I**nternational **M**onetary and **F**inancial **C**ommittee) of the IMF's Board of Governors (those who, together with the Managing Director, will ultimately decide on how and whether to implement the recommendations), the members of the Financial Committee responded favorably to the Crockett Report's recommendations: They acknowledged the recommendations as "providing a sound basis for further work...on a new income model." Further, the Chairman of the Financial Committee, Gordon Brown, made assurances that the "reform agenda for the IMF is moving forward."

The Managing Director also believed that the Crockett Report was well received all-around, and stated that he now needed to "prepare a paper for the Board" based on the new income-model recommended by the Crockett Report. Apparently, such a paper would contain specifics on the new income model the IMF is to adopt, and whether and to what extent the IMF will adopt the report's recommendations. As of April 21, 2007, that paper has not yet been submitted to the IMF's Board of Governors.

Finally, at the 2007 Annual Meetings of the IMF and the World Bank, the Managing Director commented about the Fund's commitment to financial reform, stating that there is now a "complete acceptance" among IMF officials of the need for a new financial model and *near* consensus on the details of that model. As a result of this acceptance, the IMF has planned for a reduction of expenditures, particularly by focusing and limiting the Fund's surveillance efforts to the external stability of countries (e.g., exchange rates), and reports that overall expenditures will be reduced by 6% over the three-year period from 2007 to 2010. However, as of October 2007, the Fund had not reached a consensus regarding a comprehensive income model for the future, and the policies that would entail; in other words, aside from the aforementioned reduction in expenditures, the Fund had not yet decided which, if any, of the Crockett Report's suggestions it would adopt.

## **V. Conclusion**

In conclusion, the critics will have a hard time convincing the world that the IMF is not needed—the fact that borrower countries were able to pay off their loans in advance is testament to the IMF's effectiveness in helping countries improve their economies. However, the critics are

partially correct in their observations of the IMF's work: the fact is that the IMF has been imprudent itself in increasing services to countries while failing to increase the income needed to provide those services. Nevertheless, one should expect the IMF to implement the noted reforms, and continue to play an important role in the development of the world's economies.

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