Funding the IMF

Why an Increase in Quotas?

As the central institution in the international monetary and payments system, the IMF must be in a position to assist any of its member countries having balance of payments difficulties. It must also be prepared, at all times, to guard against unexpected events that might threaten the stability of the system. The IMF needs adequate financial resources to carry out these responsibilities. This is particularly important now, given the fundamental political and economic changes that are taking place in the former Soviet Union, Eastern Europe, and in many other parts of the world. This pamphlet takes a brief look at the functions of the IMF, why it needs more resources, and how these resources will be used.

What Does the IMF Do?

The International Monetary Fund is an intergovernmental financial institution of 165 member countries that collaborate with each other in economic and monetary matters to promote an agreed code of conduct. The IMF provides a forum for cooperation, having as its objective the balanced expansion of international trade in order to stimulate employment and improve economic conditions in its member countries.

A smoothly functioning international monetary and payments system is crucial in an increasingly interdependent world, and the IMF is the central pillar of that system. Its task is twofold: To foster a stable and open international environment beneficial to the growth and prosperity of individual countries and, at the same time, to encourage each country to adopt policies that are not only good for the country itself but also help to improve the global economy. In promoting cooperation among its members at various levels, the IMF works to bring about greater harmony between domestic policies and the international economy.

In its relations with its members, the IMF seeks to promote sound policies through advice as well as by providing technical assistance in many fields. It also extends financial assistance to member countries experiencing external payments difficulties, so that these countries can undertake the necessary policy reforms in an orderly manner. One aim is to help bridge the gap between when the country adopts measures and when it achieves results in the shape of a manageable balance of payments. In these cases, the IMF helps the country to develop policy corrections that address a country's particular economic problems. Ultimately, each individual government must decide what policies are consistent with its economic circumstances and social and political priorities.

The underlying principle of an IMF-supported program is that durable economic growth must be based on sound economic management, that is, on prudent budget and monetary policies and policies that promote more open and market-based economies—adapted when necessary to changing economic circumstances—that will allow a country to make the best use of its resources while paying its way in the world. At the same time, a country undertaking such reforms must be able to count on timely financial help so that it can reorient its policies to minimize disruption to its own development and to the economies of its trading partners.

IMF lending in support of economic reforms has several special features. Foremost, the cooperative framework of the IMF provides that countries with strong balance of payments and reserve positions assist those in weak positions, with the IMF serving as an intermediary. The purpose of such assistance—which is provided on a temporary basis—is to facilitate the adoption of policy adjustments agreed with the IMF. The IMF is not a development finance institution and does not provide financing for a particular project or a sector of the economy, such as agriculture or industry. By making the use of the IMF's resources dependent on the pursuit of appropriate policies, the interests of both the borrower and the lender are safeguarded.

Above all, the IMF's financial and policy assistance gives a member confidence in undertaking reforms. This reinforces the country's creditworthiness and, in many cases, opens the door to additional financing from other sources. Such "catalytic" role of IMF lending is important because the IMF's own resources can often provide only a modest amount of assistance relative to a country's total needs. This is because credit from the IMF is subject to limits in relation to borrowing members' quotas.

The Quota System

The IMF's resources consist of the subscription that each country pays to the IMF upon becoming a member and, subsequently, as a result of quota reviews. These subscriptions are called "quotas," and the totality of the quotas constitutes the capital base of the IMF—the primary source of the financing that it can provide to members.

A country's quota, which is determined in such a manner that it reflects the country's economic position relative to other members, represents its share in the IMF's capital and determines many aspects of its relationship with the IMF. These include its voting power, as well as the maximum amount of financing that it can receive under the various IMF facilities (see Annex I for details on the IMF's resources). Quotas are expressed in terms of SDRs (special drawing rights), the IMF's accounting unit.

As the world economy grows, and with it international trade and payments, as well as the magnitude of the potential financing needs of individual countries, the IMF's resources must also expand. That is why the IMF's quota structure is reviewed every five years and, if necessary, revised to better reflect changes in the world economy and in members' relative economic positions. At the latest such review, the Ninth General Review of Quotas, which was completed on June 28, 1990, the Board of Governors of the IMF approved a 50 percent increase in overall IMF quotas from approximately SDR 90.1 billion to approximately SDR 135.2 billion—that is, from about $125 billion to about $185 billion (see Annex II for the main features of the Ninth Review).

The Road Ahead

The Ninth Quota Review coincides with the start of a new decade. Much of the work of the IMF in the 1990s, which the enlarged resources will support, will be a continuation of the work begun earlier. But the recent historic efforts by countries in Eastern and Central Europe and the states of the former Soviet Union to completely dismantle the structures of a command economy and replace them with a market-based system have resulted in a sudden expansion of the responsibilities of the IMF and, consequently, have led to increased demands on its resources. This is why it is more important now than ever before that the new quotas come into effect without further delay. According to the terms of the quota resolution, two requirements must be met for this to happen: The first requirement, which has already been met, is that members having 70 percent of the total quotas on May 30, 1990 consent to the proposed increases in their quotas. The second requirement is that three fifths of current members having 85 percent of the total voting power must accept the Third Amendment of the IMF's Articles of Agreement. This amendment provides for the suspension of voting and related rights of members that fail to fulfill their obligations under the Articles. As of May 1, 1992, 95 members, accounting for 64.9 percent of the total voting power, had accepted the proposed Third Amendment. It is a matter of urgency that those members that have not yet taken the necessary steps to meet the two requirements do so as soon as possible.

What will be the prevailing economic environment that will affect the IMF's activities? The past decade has been a period of momentous change for IMF members. It has witnessed one of the longest periods of economic expansion in the industrial world together with a vigorous expansion of world trade. The most remarkable feature of this period has been the shift in attitudes toward reforms in economic policymaking. The political and economic transformations in countries in Eastern and Central Europe and in the states of the former U.S.S.R. are, of course, the most dramatic evidence of this shift, but unprecedented changes are taking place among many other member countries as well. It is important for the well-being of the global community that this momentum be sustained and nurtured by adequate levels of financial assistance.

There is, however, a weakening of the expansion process in the decade that has just begun that will be superimposed on the fragility of economic growth in much of the developing world. Although the severity of the debt problem has abated, and a number of indebted countries have made remarkable progress, many others are in a precarious situation either because they failed to adopt or to follow through with strong policies or because they received inadequate financial support. Another concern is the large and protracted external payments imbalances among the major industrial countries, which, along with exchange rate instability and volatile commodity markets, pose a threat to the durability of growth in the world economy.

In the new decade, just as in the past, the IMF and its membership will have to cope with all of these developments in the world economy as well as with others that are impossible to foresee. To be prepared to deal with the unpredictable is probably the most important challenge facing the IMF and its membership.

The 1990–91 crisis in the Middle East illustrates vividly how vital it is for the IMF to be adequately equipped so that it can respond promptly to members' unforeseen needs. It is also a reminder of the vulnerability of countries to sudden shifts in the world economy. The crisis had widespread adverse repercussions—in terms of higher (although temporary) oil prices and disruption of trade—and worsened the plight of a number of member countries that were already in balance of payments difficulties. By quickly adapting some of its existing financing instruments and through accelerated disbursements the IMF was able to assist member countries that were most severely affected.

Before examining what the focus of the IMF's assistance will be in the 1990s, it is useful to consider why an expansion of the IMF's lending capability is needed now.

Increasing Quotas

In order for the IMF to carry out its global responsibilities and to meet the needs of individual members, it must be assured of an adequate level of financial resources. As the central institution in the international monetary system, the IMF must be able, in the face of changing circumstances, to give complete confidence to its members—and to markets—that it can fulfill its responsibilities.

An institution that is shrinking in relative size would not give the membership that confidence. The need for financial assistance from the IMF will remain high in the coming years, not least considering the expected demand from the states of the former U.S.S.R. Moreover, the external reserves of many indebted countries are low, and a large number of IMF members do not have ready access to financing from world capital markets. Judging from past experience, such countries are extremely vulnerable to sudden shifts in international financial flows. Some of these may be systemic in nature, but the IMF has to be ready for all such developments.

In all these endeavors, the IMF is expected to provide only a small proportion of the total financing required. Its role remains essentially catalytic; that is, its financing stimulates additional market financing rather than replacing it. Nevertheless, the IMF cannot fulfill its catalytic role simply by giving advice on a set of adjustment policies; policy advice usually carries weight when accompanied by financing. Significant financial assistance from the IMF is essential for it to be a credible and effective catalyst.

The IMF must also be in a position to support members' efforts at establishing and maintaining currency convertibility and unrestricted exchange systems, as well as encouraging trade liberalization, since an open and nondiscriminatory trading environment fosters growth and adjustment. It strongly supports the Uruguay Round of trade negotiations, which is currently in its final stages. A basic objective of these negotiations is to encourage countries to dismantle trade barriers as part of their economic reforms. However, if countries run into temporary payments problems, the IMF has to assure them that sufficient resources would be available.

Over the years, the IMF has borrowed to supplement its own resources when members' needs for temporary balance of payments assistance have been large in relation to quotas. But borrowing has proved to be costly and has taken time to negotiate. In the context of the discussion on the Ninth Quota Review, the Interim Committee concluded at its September 1988 meeting that the IMF should reduce its reliance on borrowing and, as far as possible, depend on its own capital—that is, on its quota-based or subscribed resources.

An increase in quotas expands the IMF's capacity for financial assistance by strengthening its resources. These consist of the currencies that members provide by way of quota subscriptions and the IMF's holdings of SDRs. Although the IMF can use the currency of any member in its operations, in practice it uses the currencies of only those members that are in sufficiently strong balance of payments and reserve positions. It is important to note that the IMF has to make sure that its holdings of "usable" currencies are adequate at all times in relation to potential needs.

The IMF is a monetary institution in the sense that claims on it are readily encashable by members that have a balance of payments need; hence, it is important for the IMF to maintain sufficient liquidity at all times, in order to ensure the immediate usability of members' claims on the IMF and thereby maintain members' confidence in and support for the institution.

Tasks Before the IMF

How will the IMF utilize its enlarged resources? In the coming years, the main, although not the exclusive, focus of its support is expected to be to help countries to make the transition to market economies, resolve their debt difficulties, and reach their goal of attaining durable growth.

Trend Toward Market Economies

The fundamental economic and political transformations that are taking place in Eastern Europe and the states of the former U.S.S.R. present some of the most challenging tasks for the IMF. As described below, the IMF is providing wide-ranging assistance to member countries in Eastern Europe and to the states of the former U.S.S.R. in their efforts at structural reform and moving away from a command economy. As is the case with policymaking in any country, these states themselves bear the primary responsibility for the restructuring that they have embarked upon, but it is also in the self-interest of the global community to ensure that they succeed. Given the growing interdependence among countries and the spillover effects of economic growth, all countries stand to gain from the economic reform in the states of the former U.S.S.R. As Michel Camdessus, the Managing Director of the IMF, remarked in April 1992, "For the IMF, there is no more important task than to assist countries to become integrated into a growing world economy. The IMF was created to do that, and it has been a large part of our work since 1945. It has always been a demanding task, but never more so than now."

The difficult transition from central planning to a market economy is not uncharted territory for the IMF. Among IMF members are countries at different stages of economic development, as well as having a wide variety of economic structures. Besides, in almost forty-five years of working with its members, the IMF has had extensive experience in the design and implementation of sound economic programs and has also gained valuable insights into the types of policies that have the best chance of success. The IMF, for instance, has assisted China's far-reaching reforms since 1980. What is unprecedented, however, is the willingness of the Eastern and Central European countries and the states of the former U.S.S.R. to radically alter and open up their economies in a very short space of time.

The reforms in Eastern Europe and in the states of the former U.S.S.R. are no doubt dramatic, but equally striking, although less well known, are the changes that are taking place in many other countries that earlier favored central planning. In Asia, the Lao People's Democratic Republic and Viet Nam are implementing far-reaching, market-oriented reforms. In Africa, several economies with varying elements of central planning—including Algeria, Ghana, Guinea, and Madagascar—are introducing significant changes in their economic systems. And in a number of countries in Latin America, a radical reassessment of the role of government in economic management is under way, as well as considerations of new approaches to public expenditure and foreign trade policies. The IMF has an obligation to continue to support all its members' reform efforts.

The IMF and the Former Soviet Union

As of June 1, 1992, seven of the former Soviet states, Armenia, Estonia, Georgia, Kyrghyzstan, Latvia, Lithuania, and Russia, had become members of the IMF, and the Board of Governors of the IMF had approved the membership resolutions of all the other states. These states are expected to become members within a very short time as soon as they have taken the necessary legal steps to carry out the obligations of IMF membership and the terms and conditions of the resolution. Each state will have to pay its subscription (22.7 percent in SDRs or in currencies selected by the IMF and the balance in its own currency) within six months after accepting membership.

Although the former Soviet Union had taken part in the Bretton Woods Conference in 1944, which established the IMF, it decided not to join the organization. There were few contacts between the then-Soviet Union and the IMF until mid-1990 when the Group of Seven (the seven major industrial countries) asked the IMF to undertake a study of the Soviet economy. In October 1991, the IMF and the former U.S.S.R. signed a special association agreement. Under this temporary arrangement, the IMF advised the individual states on economic policy and technical matters, in preparation for membership. At present, the IMF is working with the authorities of the individual states in formulating programs of economic reform so as to ease their integration into the world financing and trading networks. IMF assistance is concentrated in such areas as economic policy, tax policy and administration, central banking, and national accounts and statistics, with the aim of helping the authorities to stabilize the economy and transforming it to a market-based system. After the states become members, they will be eligible for financial support from the IMF.

The IMF and Eastern Europe

The IMF is working closely with member countries in Eastern Europe in a variety of ways. Bulgaria, Czechoslovakia, Hungary, Poland, and Romania have adopted comprehensive and far-reaching programs of stabilization and economic reform. The IMF's help in the reform process encompasses policy advice, technical assistance, and financial support.

Policy advice. In line with normal practice, staff economists assigned to a particular country visit that country regularly, analyze the economic situation, and evaluate and discuss the policy options with the authorities. These discussions help the authorities decide on policies that are realistic and attainable in the prevailing circumstances. They ensure that all the main components of economic policy—the budget, the exchange rate, monetary policy, trade policy, as well as structural reforms—are consistent with these objectives and with each other. And, further, they bring to the attention of the authorities the consequences of these policies for the balance of payments.

Technical assistance. The type of rapid restructuring that some centrally planned economies envisage requires massive changes in their institutional and regulatory framework. Many of the institutions that are taken for granted in market economies are nonexistent and have to be built anew—for example, a central bank with a degree of independence, a competitive and autonomous commercial banking system, an established wage-bargaining process, and anti-monopoly legislation, to name a few. Creating and staffing such institutions is not an easy task. The technical assistance provided by the IMF is especially important in these areas, because the economic reforms will work only if the basic economic institutions function efficiently. The IMF is involved in the training of economic policy officials. It is helping to improve the functioning of the central bank and the financial system, including banking supervision, and the money and securities markets. It is assisting in the restructuring of the tax system and tax administration and in improving expenditure controls. And it is helping to develop better methods for the collection of statistical data.

Financial support. Since early 1990, the IMF has committed financial resources totaling about $8.5 billion in support of economic policy reforms in member countries in Eastern Europe.

Resolving the Debt Problem

The debt strategy adopted by the international community in the wake of the debt crisis of the 1980s has made the debt problem of members more manageable. The aim of the strategy is to restore countries' access to voluntary official and private financing flows to pave the way for growth to resume. Despite considerable success, however, the debt difficulties of a number of member countries are yet to be resolved. Since the beginning of the debt crisis the IMF has worked closely with all the participants in the debt strategy—debtor countries, creditor governments, private lenders, and the multilateral development banks—to ease the debt burden of members. The IMF's involvement has been wide ranging. For instance, the IMF's approval of a country's program has been prerequisite for the rescheduling of debt by official creditors grouped in the "Paris Club." The IMF has facilitated negotiations between debtors and creditors on the types and terms of financing agreements. It has also participated in the debt-restructuring agreements with commercial banks. Furthermore, it has helped to draw up "financing packages" that allow greater flexibility in the management of debt by such means as new financing instruments, pricing arrangements, and modifications in financing agreements.

In addition, the IMF has cooperated with multilateral and regional development banks to increase resource flows to debtor countries. Critical to all these efforts has been the IMF's own financial help, including concessional assistance to low-income countries. The latest of the efforts involve the reduction, rather than the restructuring, of debt in a variety of ways. These include converting a part of the debt into different types of bonds, along with the use of other methods, such as swapping debt for equity and buying back debt at a discount from face value. These innovative measures are important in that they encourage debtor countries to persevere with their reform efforts. In the long run, the debt problem can only be resolved by sustained growth and only if the underlying imbalances and distortions are corrected. Many more countries are now undertaking difficult, and often painful, reform measures, and the IMF will continue to support them in these efforts.

Revitalizing Growth

The restoration of growth in developing countries is essential not only for the sake of the well-being of these countries but also in the interest of the global community. Countries that are willing to persevere with the necessary reforms of their economies deserve strong support from the community. There is ample evidence that determined efforts by countries to pursue economic reform produce impressive results. The attainment of durable growth leading to a real improvement in the quality of life of people is of utmost concern to developing countries.

The plight of low-income developing countries, especially those in sub-Saharan Africa, has worsened steadily. There are no quick or easy solutions to their problems. Deep-seated imbalances and structural maladjustments, along with rising population pressure, hamper their growth. Natural calamities, such as the drought in southern Africa, add to their burden. Many low-income countries are embarking on growth-oriented adjustment programs that emphasize decentralization of decision making and give greater scope to market forces.

But the efforts of the countries can succeed only if they are backed by external financing on appropriate terms and in sufficient amounts. The IMF is now providing financing support to 27 African countries, including concessional, medium-term loans through its structural adjustment facility and enhanced structural adjustment facility. Many more countries are benefiting from the IMF's policy advice and technical assistance. In April 1992, the IMF added 11 low-income member countries to those eligible to borrow from the enhanced structural adjustment facility.

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To sum up, the IMF must be responsive in meeting the needs of all its members, not solely those in crisis situations. Good economic management is all-important. For this to be effective, however, it must be supported by adequate financing. The one cannot succeed without the other. The strength of the IMF is that it is able both to advise its members in designing and implementing sound policies and to support these efforts by extending financing assistance when needed and helping catalyze other sources of finance. Its role is all the more important in view of the new responsibilities that it faces in assisting the transformation of the Eastern European economies and the states of the former U.S.S.R., along with supporting debt-reduction operations, and meeting the pressing needs of the low-income countries. As soon as it becomes effective, the 50 percent quota increase that the IMF's Board of Governors have approved will help the institution to carry out its mandate for the next several years.