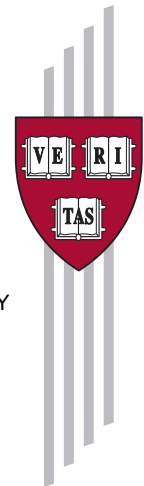


UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT



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## **G-24 Discussion Paper Series**

# **Burden Sharing at the IMF**

**Aziz Ali Mohammed**

*No. 24, December 2003*



**UNITED NATIONS CONFERENCE ON  
TRADE AND DEVELOPMENT**

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HARVARD UNIVERSITY**

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**Research papers for the Intergovernmental Group of Twenty-Four  
on International Monetary Affairs**



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## PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

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# **BURDEN SHARING AT THE IMF**

**Aziz Ali Mohammed**

**G-24 Discussion Paper No. 24**

December 2003





## *Abstract*

*In the context of the financial governance of the IMF, what are the equity implications of the manner in which the IMF distributes the cost of running its regular (non-concessionary) lending operations as well as the modalities of funding its concessionary lending and debt relief operations? While the IMF charges borrowers roughly what it pays its creditor members for the resources used in its regular lending operations, its overhead costs (administrative budget plus addition to Reserves) are shared between the two groups of members in a less equitable manner. With the overhead costs inexorably rising to meet an increasing number and range of responsibilities being placed upon the institution – largely at the instance of the IMF’s principal creditors by virtue of their dominant majority of voting power – the under-representation of the IMF’s debtors undermines the legitimacy of its decision-making. With regard to the concessionary lending and debt relief operations, some of the IMF’s funding modalities have involved a substantial contribution by IMF debtors, sometimes under pressure. While this has been accepted as part of an intra-developing country burden-sharing exercise, it has also meant a significant burden shifting away from the developed countries in the cost of meeting their responsibilities to the poorest members of the international community.*



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# BURDEN SHARING AT THE IMF

Aziz Ali Mohammed\*

## I. Introduction

An important aspect of governance at the IMF relates to the cost of running the institution and the sharing of that cost between the industrialized countries (the IMF's principal creditors) and low-income countries and emerging market economies (primarily borrowers). Much larger issues of equity are involved with respect to the distribution of quotas (or capital shares) and of voting power in the IMF. This subject has attracted growing attention in recent years. A contribution to the literature by a former Secretary of the IMF from 1977 through 1996<sup>1</sup> concludes that:

The system of quotas and voting power in the IMF has, over the years, created distortions and lacks equity. A group of 24 industrial countries controls 60 percent of the voting power, while more than 85 percent of the membership – 159 out of 183 IMF members – together, hold only 40 percent of the votes. ...

The existing imbalance is seen as evidence of the lopsidedness of governance of the international monetary system. Thus a more equal distribution of quotas and voting power between the developing world and the industrial countries should enhance the IMF's governance and credibility.

Rather than enlarging upon this theme, this paper takes the fundamental inequity in the system of quotas and voting power in the IMF – and hence the structure of decision-making power structure – as a fact under which both IMF and the World Bank Group must operate at the present time. The focus instead is on the narrower issue of *financial* governance at the IMF, and for purposes of the analysis, burden sharing is defined to cover equity considerations relating to how the cost of running the institution is distributed between the IMF's creditors and debtors, and among different groups of debtors. This definition covers a broader set of issues than is encompassed by the existing burden-sharing mechanism in the IMF.

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## II. Cost of IMF lending through the General Resources Account

The financial operations of the IMF are conducted through several channels. The principal channel (in terms of the volume of lending) is the “General Resources Account” (GRA<sup>2</sup>) through which the non-concessionary transactions of the IMF take place. Borrowing countries pay interest on amounts they draw from their credit tranches,<sup>3</sup> with the rate of interest being derived from a formula for setting the *basic rate of charge* for the use of IMF resources. That charge is based on the income that the IMF must earn in order to cover:

- the *remuneration* that the IMF pays members whose currencies are used in lending transactions,<sup>4</sup> with the *basic rate of remuneration* equal to the rate of interest on the SDR;<sup>5</sup>
- the administrative budget of the IMF; and
- a target level of net income for addition to reserves.<sup>6</sup>

Based on the net income target, the expected SDR interest rate, projected credit extension and the outlook for administrative expenses, the IMF estimates the basic rate of charge as a proportion of the SDR interest rate.<sup>7</sup> The decision on the rate of charge requires annual renewal, with a qualified majority of 70 per cent of total voting power. For financial year 2003 (1 May 2002 through 30 April 2003), the basic rate of charge has been set at 128 per cent of the SDR rate.

The IMF’s income from charges is supplemented by *surcharges* levied on two sets of transactions. Under the Supplemental Reserve Facility (SRF) established in 1998 to provide credits to countries encountering capital account crises—and under which there are no defined access limits—a market-type rationing device has been adopted: there is a surcharge of 300 basis points initially (on the basic rate of charge) that rises by 50 basis points after one year from the date of disbursement and every subsequent six months to a maximum of 500 basis points. For other GRA transactions, there are annual and cumulative access limits on purchases in the credit tranches and under the Extended Fund Facility (EFF).<sup>8</sup> Since November 2000, however, surcharges have also been applied to these transactions to dis-

courage unduly large use of credit and to encourage prompt repayment: the surcharge is 100 basis points on credits exceeding 200 per cent of quota and 200 basis points on credits exceeding 300 per cent of quota. The income derived from surcharges is applied to IMF reserves directly and remains outside the net income target for the year (which enters into the calculation of the basic rate of charge). The IMF also receives income in the form of service charges, commitment fees, and special charges,<sup>9</sup> all borne by the IMF’s borrowing members.

## III. The burden-sharing mechanism

An upward adjustment to the basic rate of charge and a downward adjustment to the basic rate of remuneration are made for two purposes: to offset losses of income from unpaid charges, and to fund certain precautionary balances designated as Special Contingent Accounts (SCAs). The first of these Accounts, “SCA-1”, was established in 1987 as a safeguard against potential losses resulting from an ultimate failure of members in protracted arrears on the payment of overdue obligations to the IMF. Another Special Contingent Account “SCA-2” was established in 1990 as a safeguard against possible losses resulting from purchases made through a special scheme for helping members that had accumulated arrears whereby they could get back on track under a “rights accumulation programme” (RAP). The allocation of these adjustments between the debtors and the creditors of the IMF is designated as the “burden-sharing mechanism”.

Creditor and debtor members contribute equal amounts, in the aggregate, to the SCA-1, whereas creditors provided three-fourths of the amounts contributed to the SCA-2. However, SCA-2 was terminated in 1999 when it reached its target of SDR1 billion, and the amount was refunded to the contributing members after it was concluded that other precautionary balances in the GRA provided adequate protection against the risks associated with RAP-related credits. The amounts collected to offset losses of income from unpaid charges are also refunded, as and when overdue obligations are settled.<sup>10</sup> Resources accumulating in SCA-1 are to be refunded when there are no outstanding overdue repurchases and charges (or earlier if the IMF so decides).

The burden-sharing mechanism raises two equity-related aspects.<sup>11</sup> First, members that are neither debtors nor creditors (so-called “neutral” members) do not provide contributions under the Mechanism. However, the inequity involved at present is not particularly onerous since the “neutral” countries account for only 6 per cent of total quotas. Second, the distribution of the burden among members diverges sharply from quota shares. The problem has been alleviated – though by no means removed – as the IMF has moved since 1998 to allocate creditor participation in the financing of IMF credit according to relative quota shares for members that are included in the IMF’s quarterly financial transactions plan, (that is, members with sufficiently strong balance-of-payments and reserves positions).

The quarterly adjustments under the burden-sharing mechanism have been modest to date. In the last financial year (ending April 2002), there was an increase of 14 basis points on the basic rate of charge and a reduction of 15 basis points from the basic rate of remuneration to 3.39 per cent and 2.65 per cent, respectively.<sup>12</sup> The Executive Board decided in April 2002 to continue with the burden-sharing mechanism. However, it has to be recognized that the risk of loss in future could exceed the capacity of the mechanism because of a constraint mandated by the Articles of Agreement, that is, the rate of remuneration payable to creditors cannot be reduced below 80 per cent of the SDR rate of interest. And if the symmetrical sharing of costs between debtors and creditors continues to hold, the burden on debtors cannot be increased beyond whatever the creditors contribute under the burden-sharing mechanism as currently constituted.

#### IV. Additional creditor contributions to burden sharing

Creditors make an additional contribution to financing the operations of the IMF by forgoing remuneration on a portion of their reserve tranche positions.<sup>13</sup> This unremunerated portion was equal to 25 per cent of the member’s quota on 1 April, 1978, being that part of each country’s quota that was paid in gold prior to the Second Amendment.<sup>14</sup> While the unremunerated reserve tranche remains fixed in nominal terms for each member, it has become significantly lower, when expressed as a per

cent of quota, as a result of subsequent quota increases. The average is now only 3.8 per cent of quota, but the actual percentage differs widely among members as a result of the differential increases in quotas since April 1978. Jacques J. Polak has pointed out that the unremunerated reserve tranches’ range “from more than 6 per cent of its current quota for the United Kingdom to less than 0.5 per cent for Saudi Arabia.”<sup>15</sup>

The unremunerated reserve tranche has featured in past IMF staff presentations on the equity aspects of running the IMF. In a paper on IMF finances to be found on the IMF website,<sup>16</sup> the unremunerated reserve tranche is treated as a contribution by creditors in that the IMF’s operational expenses (its cost of raising funds) would have been higher if it had to pay remuneration on that portion of the currencies of creditors used in IMF transactions. The accompanying table shows the figures underlying the computation of the relative contribution of debtors and creditors, including in both cases the respective adjustments under the burden-sharing mechanism. The table starts by excluding the IMF’s cost of funds, that is, its payments to creditors, but adds back the *imputed* cost that would have been incurred if the creditors’ reserve tranche positions had been remunerated. On this basis, the relative contribution of creditors (based on the total of actual and imputed costs) has steadily declined since financial year 1982 from a peak of 72.3 per cent to 25.0 per cent in financial year 2002, with a corresponding increase in the share attributed to debtors.

The table does not take into account supplementary charges that are being levied on the larger users of IMF resources. It takes the debtors’ contribution as equivalent to *ordinary* charges in excess of net operational expenses, that is, in excess of the amounts needed to cover remuneration based on the SDR interest rate (and the cost of any IMF borrowing). These amounts are not trivial: in FY 2002, for example, as much as SDR314 million of income from surcharges was transferred to the General Reserve;<sup>17</sup> this compares with SDR577 million<sup>18</sup> of regular income from charges (in excess of net operational expense) that is included in the calculation of the debtors’ contribution in the table

The particular approach to measuring and distributing the cost of operating the IMF that is reflected in the table, however, has also been criticized on other grounds. The distribution between the

Table 1

**RELATIVE BURDEN ON MEMBERS OF FINANCING THE FUND'S ADMINISTRATIVE EXPENSES  
PRECAUTIONARY BALANCES AND IMPORTED INTEREST COSTS, FY 1982–2002<sup>a</sup>**

(Millions of SDRs and per cent)

FY	Items in excess of remuneration expense and cost of borrowing					Debtors' share			Creditors' share			Relative contribution (in per cent) <sup>b</sup>		
	Adminis- trative expenses	Net income	Deferred charges	SCA-1	SCA-2	Total actual cost	Charges in excess of net opera- tional expenses <sup>c</sup>	Burden- sharing contributions	Sub- total	Imputed costs NRT <sup>d</sup>	Burden- sharing contributions	Sub- total	Debtors	Creditors
1982	153.3	92.1	0.0	0.0	0.0	245.4	245.4	0.0	245.4	641.4	0.0	641.4	27.7	72.3
1983	191.4	65.4	0.0	0.0	0.0	256.8	256.8	0.0	256.8	497.0	0.0	497.0	34.1	65.9
1984	192.8	73.0	0.0	0.0	0.0	265.8	265.8	0.0	265.8	436.4	0.0	436.4	37.9	62.1
1985	224.2	(29.8)	0.0	0.0	0.0	194.4	194.4	0.0	194.4	478.2	0.0	478.2	28.9	71.1
1986	223.4	78.1	0.0	0.0	0.0	301.5	301.5	0.0	301.5	411.9	0.0	411.9	42.3	57.7
1987	190.9	86.0	182.2	26.5	0.0	485.6	276.9	117.7	394.6	349.3	91.0	440.3	47.3	52.7
1988	175.1	49.1	153.7	60.4	0.0	438.3	224.2	107.1	331.3	340.0	107.0	446.9	42.6	57.4
1989	172.7	54.2	224.8	62.9	0.0	514.6	226.9	144.0	370.9	413.6	143.8	557.4	40.0	60.0
1990	188.6	85.5	235.3	65.0	0.0	574.4	274.1	150.2	424.3	502.0	150.1	652.1	39.4	60.6
1991	189.4	69.9	210.3	69.8	142.3	681.7	259.3	181.6	440.9	500.9	240.8	741.7	37.3	62.7
1992	232.2	89.9	190.0	73.4	156.3	741.8	322.1	189.3	511.4	398.0	230.4	628.4	44.9	55.1
1993	263.3	70.6	139.4	78.3	177.0	728.6	333.9	172.1	506.0	342.7	222.6	565.3	47.2	52.8
1994	318.0	74.1	94.1	82.0	161.2	729.4	392.1	139.6	531.7	271.1	197.7	468.8	53.1	46.9
1995	288.3	85.1	96.0	85.2	130.3	684.9	373.4	101.4	474.8	293.8	210.1	503.9	48.5	51.5
1996	301.3	89.3	64.4	92.0	174.2	721.2	390.6	92.0	482.6	271.4	238.6	510.0	48.6	51.4
1997	316.8	93.8	47.4	94.8	58.6	611.4	410.6	82.8	493.4	251.2	118.0	369.2	57.2	42.8
1998	368.5	98.5	48.7	99.4	0.0	615.1	467.0	74.6	541.6	266.3	73.5	339.8	61.4	38.6
1999	392.1	106.7	42.4	107.4	0.0	648.6	498.8	74.8	573.6	243.2	75.0	318.2	64.3	35.7
2000	448.4	267.7	42.4	128.5	0.0	887.0	716.1	85.9	802.0	239.8	85.0	324.8	71.2	28.8
2001	384.6	166.6	48.7	94.0	0.0	693.9	551.2	71.5	622.7	292.1	71.2	363.3	63.2	36.8
2002	530.8	46.2	35.0	94.0	0.0	706.0	577.0	64.0	641.0	148.6	65.0	213.6	75.0	25.0

- <sup>a</sup> This table is based on the following assumptions: (i) the Fund's "cost of funds", i.e., its payments to creditors, are *excluded*, and the table attempts to quantify the relative contributions of debtor and creditor members to financing the Fund's "other costs", which are defined to be equal to the total of the first five items (administrative expenses, net income, deferred charges, SCA contributions) plus the imputed cost of the non-remunerated reserve tranche position; (ii) debtor members are assumed to finance administrative expenses and net income (because of the method of determining the rate of charge); and (iii) creditor members pay for the imputed cost of the non-remunerated reserve tranche positions (i.e., the table assumes zero holdings of non-remunerated reserve tranche positions by debtor members).
- <sup>b</sup> Based on the total of actual and imputed costs.
- <sup>c</sup> Contribution by debtors through charges in excess of the amount needed to cover remuneration expense and the cost of borrowing. This is equivalent to the total of administrative expenses and net income, excluding income derived from surcharges starting in FY 1998, and certain windfall gains from the introduction of a new accounting standard in FY 2000.
- <sup>d</sup> Cost of holding the non-remunerated reserve tranche (NRT) is calculated at the average rate of remuneration in effect each year.



two groups depends on assumptions of how to treat the interest forgone by the creditors on part of their credits. If this is seen as a “burden” accepted by the creditors, it must also be counted as a deduction from the “burden” of the debtors. It can also be argued that measuring the debtors’ burden on the basis of the excess of the rate of charge over the SDR interest rate overstates the debtors’ burden in two respects: it fails to consider their opportunity cost, (the interest rate at which they could obtain credits in private markets, assuming that such credits were available) and the SDR rate used to determine the basic rate of charge is a composite of short-term rates on the official paper issued by four of the most highly credit-worthy financial authorities in the world. The creditors’ share, as calculated in the table, declines in part because of the decline in the SDR interest rate in recent years.

## V. Rising cost of running the IMF

Notwithstanding the conceptual issues involved in calculating the distribution of the burden, there is no denying that the costs of running the IMF have risen over time and will continue to increase – both administrative expenses and the build-up of precautionary balances.

The IMF’s administrative budget in US dollar terms (in which such expenses are incurred) has risen from \$583 million in FY 2000 to \$677 million in FY 2002 or by 16 per cent over the two-year period. If the cost of capital projects is added, the increase in the same period is 18.6 per cent. The projected increase for FY 2003 is 10.2 per cent, without accounting for capital projects that jump from \$61.5 million to \$215 million, but the latter amount is meant to be disbursed over three years. Measured in SDR terms and using International Accounting Standards, the increase over the three-year period ending FY 2003 is 30.6 per cent. The annual increases in the administrative budget (even excluding capital projects) are likely to continue in order to meet an increasing number and variety of responsibilities placed upon the institution by the major shareholders, by virtue of their dominant majority of voting power in the institution. Among the new mandates are the intensified emphasis on financial surveillance; extensive work formulating and monitoring standards and codes; growing involvement in

anti-money-laundering measures and controlling the financing of terrorism, etc. In each of these areas, and under the rubric of poverty alleviation, improving governance, and fostering civil society participation in the development and implementation of adjustment programmes, the IMF is constantly expanding the technical assistance it provides to its members, expenditures that are approaching one third of its administrative budget.<sup>19</sup>

The second contributor to raising the cost of running the IMF is the imperative to build up its precautionary balances in the face of the increased risks confronting the institution. Among these risks are those associated with the growing concentration of IMF credit, as well as the frequency with which the IMF has been called upon to assist members facing capital account crises. Of particular significance is the large amount of credit extended to a very few borrowers; just three members – Argentina, Brazil and Turkey – accounted for almost two thirds of total credit outstanding in the GRA at the end of 2002, in itself reflecting the inadequacy of IMF resources to deal with capital account crises.<sup>20</sup> The IMF will need a substantial addition to its present level of reserves and other precautionary balances, which now total SDR5 billion.<sup>21</sup> In fact, members have indicated support for a doubling of that level and for the maintenance of the current system of accumulating these balances, under which surcharge income and regular net income are placed to reserves and only a fraction is financed – or for that matter, can be financed, given the 80 per cent floor on the rate of remuneration – through the existing burden-sharing mechanism.<sup>22</sup> Dealing with these rising costs without placing an inordinate burden on debtors in the GRA becomes the principal burden-sharing issue for the IMF in the coming years.

## VI. Gold and the GRA

Turning next to ideas for meeting the growing cost of running the IMF, one possibility is the mobilization of IMF gold. The IMF currently carries 103 million ounces of gold on its balance sheet, valued on the basis of historical cost, at a book value of SDR5.9 billion. There is a “hidden reserve” element attached to this asset when compared with prevailing market prices (of SDR26–27 billion). The IMF has been reluctant to tap this hidden reserve in the

period following the mobilization that occurred in 1976–1980 when 25 million ounces were auctioned to finance the establishment of the Trust Fund to support concessionary (low-cost) lending by the IMF to low-income countries.

During 1999–2000, the IMF conducted two off-market transactions in gold that left its holdings unchanged in order to generate resources to help finance its participation in the Highly Indebted Poor Countries Initiative<sup>23</sup> (HIPC). It sold the equivalent of SDR2.7 billion (\$3.7 billion) at ruling market prices to two countries: Mexico and Brazil. After each sale, the gold was immediately accepted back by the IMF *at the same market price* in settlement of financial obligations of these members to the IMF. The gold so accepted was included in the IMF balance sheet at the market price of the transaction instead of at the original book value of SDR35 per fine ounce. However, the equivalent of that original price was retained in the GRA and the proceeds in excess of this amount (SDR2.2 billion or about \$2.9 billion) were transferred to the Special Disbursement Account (SDA).<sup>24</sup> These funds were invested, with the investment income made available to finance the IMF contribution to the HIPC Initiative.

The rationale for the off-market transactions was to avoid causing disruption to the functioning of the gold market but it resulted in a recurring increase in the cost of IMF operations. The IMF holdings of usable currencies in the GRA were lower, and reserve tranche positions higher (on which remuneration must continue to be paid) *than they would otherwise have been* by the amount of the profit (SDR2.2 billion). This is because Brazil and Mexico paid in gold instead of paying in the usable currencies that would have allowed the IMF to reduce the reserve tranche positions of creditor members. The effect on IMF net income was estimated at SDR94 million in FY 2001, the first year in which the full income effect of the gold transactions was felt.

While the off-market gold sales were “one-off” transactions, their consequences for the IMF’s income would be of long duration. The relatively large increase in cost would have resulted in a higher rate of charge under normal procedures but the effect has been mitigated for debtors through the existing

burden-sharing mechanism i.e., by requiring members to contribute SDR94 million to SCA-1. The decision to protect the IMF’s non-concessionary borrowers from bearing the full brunt of the negative income effect of the off-market gold transactions (they still bear one-half of the cost under the burden-sharing mechanism) indicates a recognition that the burden of helping the poorest member countries (that is, those eligible under the HIPC Initiative) ought not to be shouldered exclusively by other borrowing members, some of whom might be only less poor. It does, however, enable creditor countries to shift half of the burden that they should bear in meeting their obligations to the world’s poorest.

The negative consequences for the IMF’s income position of the off-market transactions rule out any chance of resorting to this technique for helping GRA debtors; undertaking straightforward sales in the market would evoke even greater resistance from the interest groups that forced the IMF to choose the off-market route, when the objective was to benefit the poorest countries. Moreover, any transaction involving gold requires an 85 per cent qualified majority of total votes which gives the United States veto power and allows any small group of large quota countries to assemble the votes required to block a decision.

## VII. Other proposals for improving burden sharing in the GRA

If gold transactions are ruled out, the sharing mechanism already in place could be modified. The IMF staff paper cited earlier suggests an alternative on the following lines:

... the rates of charge and remuneration would initially be set equal to the SDR interest rate, and then adjusted, as under burden sharing, so as to distribute the burden of financing the Fund’s remaining expenses (administrative expense and its additions to precautionary balances, less the effect of the Fund’s interest-free resources) on the basis of the aggregate quota shares of debtor and creditor members, respectively.<sup>25</sup>

The proposal would shift from a 50:50 sharing of costs to 60:40 on the basis of current quota shares between the industrialized members and all other countries or even a higher share could be assigned to creditors since some major non-industrialized members are also IMF creditors. Recall that IMF creditors had accepted a 75:25 sharing ratio in the case of SCA-2.

The proposal does not deal with the requirement that the downward adjustment to the rate of remuneration must not fall below 80 per cent on the SDR rate of interest set in the IMF's Articles of Agreement. There is, of course, nothing in the Articles to prevent the SDR interest rate itself being lowered below that currently set at 100 per cent of the weighted composite of short-term rates of interest on the currencies in the SDR basket; this option has been rejected in the past on the grounds that it would diminish the attraction of the SDR as a reserve asset.

A more equitable solution would provide for the portion of the reserve tranche that would be free of remuneration to be expressed as a uniform proportion of members' current quotas. The proportion would be adjusted periodically to generate an amount of interest-free resources that would permit the rate of charge to remain equal to the rate of remuneration, and the latter, in turn to remain equal to the market (SDR) interest rate. Thus, creditors and debtors would both receive and pay the market interest rate on their positions in the IMF and the proposal would be robust in the sense that the distribution of the burden of the non-remunerated cost would not be affected by fluctuations in the SDR interest rate or in the level of IMF credit.

This proposal cannot be implemented, however, without amending the IMF's Articles of Agreement. Once the possibility of amendment is accepted, other solutions could also be considered, such as repealing the 80 per cent floor noted earlier. Another possibility would be to apply to the meeting of budgetary costs in the IMF's General Department (of which GRA is a part) the same principle as in the SDR Department, namely, an annual assessment to cover the cost of operating the IMF charged in proportion to quotas.

## VIII. Concessionary lending

Another aspect of IMF operations bears on issues of burden sharing, namely, the effort made by the international community to provide highly concessionary financing, outside its quota-funded resources, to the poorer IMF member countries. The basic rationale for this effort is that IMF support for the adjustment efforts of low-income member countries should be made available on financing terms consistent with their debt-servicing capacity.

The first effort was made through the establishment of the Trust Fund, using the proceeds of gold auctions during 1976–1980 to provide low-conditionality loans at an interest rate of one-half of one per cent, repayable over a ten-year period, with five and a half years grace.<sup>26</sup> In 1986, the IMF established the Structural Adjustment Facility (SAF) to recycle the resources being repaid by Trust Fund beneficiaries. These resources were limited in amount, however, and it was felt that stronger adjustment and reform measures than those under the SAF would call for an augmentation of SAF resources. An Enhanced Structural Adjustment Facility (ESAF) was launched in 1987 (and enlarged and made permanent in 1994), with the funds raised from bilateral contributors. Resources amounting to SDR11.5 billion were raised through September 2001 from 17 loan-providers – central banks, governments and official institutions – generally at market-related interest rates. These resources were on-lent on a pass-through basis through the ESAF Trust (re-designated in October 1999 as the Poverty Reduction and Growth Facility (PRGF) Trust) to 54 of 77 eligible countries.<sup>27</sup> In FY 2002, SDR4.4 billion in new loan resources were made available to finance future PRGF operations, raising the total loan funds available to SDR16 billion.<sup>28</sup>

While most loan providers are remunerated at a six-month SDR interest rate, ESAF/PRGF borrowers are charged a concessionary rate of one-half of one per cent, which has required the IMF to find additional resources on a grant basis or by way of deposits or investments placed in the Subsidy Account of the Trust at below-market interest rates. At the end of FY 2002, the Subsidy Account of the

PRGF Trust had received bilateral contributions of SDR2.5 billion.

With the launching of the HIPC Initiative in 1996 and its enlargement in 1999, the IMF established a HIPC Trust, succeeded in September 2001 by the PRGF-HIPC Trust. Its purpose is (i) to enable the IMF to provide assistance in the form of grants or interest-free loans to HIPC eligible countries, and (ii) to permit the transfer of subsidy resources from the PRGF-HIPC Trust to the Subsidy Account of the PRGF Trust to subsidize continued PRGF lending after subsidy resources available in the PRGF Trust are fully used. The total subsidy resources required for these two purposes are estimated at SDR7.5 billion, of which SDR2.2 billion is needed for the HIPC Initiative and an estimated SDR5.2 billion to subsidize PRGF lending. Bilateral pledges for meeting these requirements amount to about SDR3.8 billion and come from a wide cross-section of the IMF membership, demonstrating broad support for the HIPC and PRGF Initiatives. Altogether, 93 countries have pledged support: 27 advanced countries, 57 developing countries, and 9 countries in transition.<sup>29</sup> Most of the contributions from the developing countries, however, derive from the refunds they received from the liquidation of the SCA-2 (referred to earlier), and the contributions of some of them may have been the result of considerable pressure from the powers-that-be in the institution.

The IMF's "own" contributions, amounting to SDR2.6 billion, are derived from several sources:

- the net proceeds generated from the 1976–1980 gold transactions mentioned above;
- one-time transfers from Trust Fund/SAF reflows into the SDA;
- forgoing compensation for the administrative expenses related to the PRGF operations for the financial years 1998 through 2004 from the Reserve Account of the PRGF Trust;
- part of the income from surcharges levied on SRF transactions in 1998 and 1999; and
- these flows are to be supplemented by investment income earned on these contributions.

Of these, forgoing compensation for PRGF related expenses has a bearing on charges paid by GRA borrowers since a reduction in reimbursements for

PRGF operations increases net administrative expenditures that enter into the determination of the basic rate of charge. Proposals have been advanced for improved cost recovery for expenses incurred by the GRA initially for running the SDR Department and for the IMF's concessionary ESAF/PRGF programmes. While the costs for the former are trivial, the same cannot be said for the latter; these are projected at SDR52 million, or about 10 per cent of the total administrative expenses in FY 2000–2001. Hence, the decision not to seek reimbursement for PRGF Trust expenses represented a step increase in administrative expenses that directly raised the charges paid by GRA borrowers.

As noted above, the IMF has already raised the loan resources it needs to maintain a lending rate of roughly SDR1 billion a year for the next four years through what has come to be known as the "Interim PRGF." Beyond the four-year period, it is expected that sufficient funds will have been released from the "Reserve Account" of the PRGF Trust<sup>30</sup> to establish the "self-sustaining" PRGF at a level of about SDR0.7 billion annually in perpetuity.

Less assured is the ability of the Bretton Woods institutions to "top-up" the relief to be made available to eligible HIPC countries to assure the sustainability of their remaining debt at the "completion point"<sup>31</sup> of their poverty reduction and growth efforts. A further mobilization of the IMF's "hidden reserves" in the shape of its gold holdings has been suggested.<sup>32</sup> But this would require actual sale, not the technique used in 1999–2000, and neither approach is considered likely for reasons cited earlier.

## IX. Summary and conclusions

The paper has reviewed aspects of the financial governance of the IMF. It has focused on how the cost of running the IMF is distributed between its creditors and debtors in the non-concessionary lending operations of the institution through its General Resources Account (GRA), and how concessionary lending by the IMF has been funded. The paper finds the existing burden-sharing mechanism to be deficient in several respects and concludes that robust proposals for alternative mechanisms for improving burden sharing would require an amendment of the IMF's Articles.

There are two elements of GRA cost: interest expenses by way of remuneration payments to creditors, and “other expenses” that include the administrative budget and a net income target for building up its reserves. The basic rate of remuneration is equal to the SDR rate. The IMF covers this element of its cost of funds by setting a basic rate of charge to be paid by debtors on their outstanding borrowing from the IMF as a proportion of the SDR interest rate. The “other costs” are covered by an addition embedded in the basic rate of charge and through a contribution made by creditors in the form of an interest-free portion of the quota resources they provide to the IMF, designated as the unremunerated reserve tranche. However, the unremunerated reserve tranche, being fixed to a historical base, has meant that the creditor contribution remains constant (or changes with the SDR interest rate) while the IMF’s “other expenses” rise steadily, and along with that, the share paid by the IMF’s debtors.

Special provisions under the burden-sharing mechanism have been made to offset losses of IMF income from unpaid charges and to accumulate precautionary balances in Special Contingent Accounts (SCA) additional to the IMF’s General and Special Reserves. These contributions are refundable to members who made them when overdue obligations are settled. One of these Accounts (SCA-1) has been built up with creditors and debtors contributing equal amounts through adjustments to the basic rate of charge and the basic rate of remuneration. However, the capacity of the burden-sharing mechanism to achieve a more equitable sharing of the rising costs of running the IMF is constrained by the 80 per cent floor on the rate of remuneration payable to creditors set under the Articles. Unless new sharing mechanisms can be devised, these costs will add ineluctably to the burden on the IMF’s GRA (or non-concessionary) debtors. Much of the increase in costs results from an increasing number and variety of mandates imposed upon the institution by the IMF’s major shareholders by virtue of their dominant majority of voting power. The corresponding disproportion in representation of the IMF’s debtors (mostly developing and transition countries) tends to undermine the legitimacy of the IMF’s decision-making.

Turning to the IMF’s concessionary lending, the IMF has made various efforts to find the necessary resources for this purpose. These efforts have included two – quite distinct – episodes of gold

mobilization in 1976–1980 and 1998–1999 and a series of approaches from 1987 onwards to garner bilateral official funding to which developing countries have also contributed, sometimes under pressure. The IMF’s debtors have provided support directly by way of voluntarily turning back the refunds received by them from the termination of one of the Special Contingent Accounts (SCA-2) and indirectly through agreeing to decisions to forgo reimbursements for the cost of administering the PRGF Trust. The artifice used to protect the interests of gold market participants in the last set of “off-market” gold sales has also involved a contribution by IMF debtors – through the burden-sharing mechanism – for covering the *continuing* higher level of remuneration expenses that this particular “one-off” transaction has entailed. While many of the IMF’s debtors have accepted these efforts as part of an intra-developing country burden-sharing exercise, it has also meant a certain burden shifting away from the developed countries in the cost of meeting their responsibilities to the poorest members of the international community.

## Notes

- 1 Leo Van Houtven 2002, *Governance of the IMF – Decision Making, Institutional Oversight, Transparency and Accountability*, Pamphlet Series No. 53, IMF, Washington, DC. See also Ariel Buira, 2002, *Reforming the Governance of the Bretton Woods Institutions* in Financing for Development, OPEC Pamphlet Series 33, Vienna, Austria, August, being proceedings of a Workshop of the G-24 held in New York, September 2001.
- 2 Quota subscriptions in the IMF are the basic source of financing for the GRA.
- 3 There is no charge if a member draws out its “reserve tranche” (previously known as the “gold tranche”), which is not considered as a credit from the Fund but rather as the use of the member’s own reserves.
- 4 In addition to remuneration, the Fund must cover interest paid on any sums it borrows from member governments under the General Arrangement to Borrow (GAB) or the New Arrangements to Borrow (NAB). For an explanation of these Arrangements, see IMF, 2001, Pamphlet No. 45 (revised), *Financial Organization and Operations of the IMF*, pp. 72–78. There are no outstanding borrowings at present.
- 5 The SDR interest rate is a weighted composite of market-determined rates on short-term official paper denominated in the currencies in the SDR basket, namely, the US dollar, the euro, the Japanese yen and the pound sterling.
- 6 The annual increase in reserves was set at 3 per cent of reserves at the beginning of the financial year for the

- years 1981–1984, 5 per cent for the financial years 1985–1999, 3.9 per cent for the financial year 2000, and 1.7 per cent for the financial years 2001–2002.
- 7 A mid-year review is undertaken to establish whether an adjustment to the basic rate of charge is required in view of developments during the year. At the end of the financial year, if net income exceeds the amount projected at the beginning of the year, the basic rate of charge is reduced retroactively; if it falls short of the target, the rate of charge is increased in the next financial year to make up for the shortfall.
- 8 Access is subject to an annual limit on gross purchases currently set at 100 per cent of quota and a cumulative limit on credit outstanding currently set at 300 per cent of quota.
- 9 A one-time service charge of 0.5 per cent is levied on each loan disbursement from the GRA. A refundable commitment fee is charged on Stand-By and Extended Fund Facility credits, payable at the beginning of each 12-month period on the amounts that may be drawn during that period, including amounts available under the SRF; the commitment fee is refunded when the credit is used in proportion to the drawing made. The IMF also levies special charges on overdue principal payments and charges.
- 10 Cumulative charges that have been “deferred” since 1986 to the end of April 2002 have resulted in adjustments to charges and to remuneration amounting to SDR865 million; the cumulative refunds over the same period, resulting from the settlement of deferred charges, have amounted to SDR994 million. See *IMF Annual Report for FY 2002*.
- 11 See Box 7, Pamphlet No. 45, *op.cit*
- 12 Ibid.
- 13 In addition to the unremunerated reserve tranche, the Fund’s Reserves and other precautionary balances (now totalling SDR5 billion) have the effect of lowering operational expenses because they allow the Fund to reduce the amount of currency obtained from creditor members for providing financial assistance to other members. Lower expenses allow the net income target to be met with less income from charges. The rate of charge can therefore be lower than if there were no interest-free resources.
- 14 As explained in Pamphlet No. 45 (revised), “The gold tranche was never remunerated historically, so it was natural to set aside this same amount in terms of SDR on this date as the unremunerated reserve tranche”. For countries joining the IMF after 1 April 1978 the unremunerated reserve tranche was calculated as the average, relative to quota, applicable to all existing members on the date that the new member joins the Fund.
- 15 J.J. Polak, “Streamlining the Financial Structure of the IMF”, *Princeton Essays in International Finance*, No. 216, September 1999.
- 16 See *Financing the Fund’s Operations – Review of Issues* (11 April 2001).
- 17 *Annual Report*, FY 2002 (p. 67)
- 18 As of 7 May 2003, the SDR exchange rate was 1.399 to the US dollar.
- 19 Most technical assistance is provided on a grant basis, even though it is no longer meant exclusively for poorer members.
- 20 If Brazil were to make all purchases under the arrangement approved in September 2002, the Fund’s exposure to a single country, Brazil, would rise to SDR25 billion, or about 40 per cent of total credit outstanding.
- 21 The recent rollover of large Argentine payments obligations raises questions in regard to this policy.
- 22 See Concluding Remarks by Acting Chair on the *Fund’s Policy on Precautionary Financial Balances* (18 November 2002).
- 23 The initiative is designed to assist eligible poor countries to achieve debt sustainability on condition that the debt relief provided by the international community is used to finance poverty alleviation activities.
- 24 Funds deposited in the SDA belong to the IMF exclusively, and are not part of quota resources.
- 25 Staff Paper cited in footnote 16 *supra*.
- 26 Of the \$4.6 billion in profits from the gold sales, \$1.3 billion was distributed to developing member countries in proportion to their quotas, while \$3.3 billion was made available for concessionary lending through the Trust Fund.
- 27 The change from ESAF to PRGF is claimed to be more than a change in nomenclature. There is now “an explicit focus on poverty reduction in the context of a growth oriented economic strategy” (*Annual Report*, FY 2002) p. 61.
- 28 With the exception of two developing countries (China and Egypt) all loan resources were provided by developed countries, including five of the G-7 countries (the United States and the United Kingdom being non-contributors).
- 29 IMF, 2002, *Annual Report*, pp. 62–63, are quoted extensively for the numbers in this and the next paragraph.
- 30 The Reserve Account was set up to provide security to bilateral lenders to the PRGF Trust and to cover the cost of administering PRGF operations. The balance in this Account is projected to be sufficient to cover all outstanding PRGF Trust obligations to lenders by around 2007. Once that point is reached, Reserve Account balances are freed to help subsidize the continuation of PRGF operations.
- 31 The point at which debt relief provisions are finalized for achieving debt sustainability.
- 32 See study by Nancy Birdsall and John Williamson (with Brian Deese), entitled *Delivering on Debt Relief From IMF Gold to a New Aid Architecture*, Center for Global Development, Institute for International Economics, April 2002. The study proposes mobilizing IMF gold to cover the IMF share of the cost of deepening and including additional countries in the HIPC Initiative (\$9 billion) and the establishment of a contingency facility (\$5 billion).

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