The International Monetary Fund (IMF)  
Rebalancing global economic weights

SUMMARY
Conceived at the Bretton Woods conference in 1944, the International Monetary Fund (IMF) officially came into existence on 27 December 1945 and started operations in 1947. Its primary purpose is to ensure the stability of the international monetary system – the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other.

The IMF has 188 member countries, all of which are represented in the highest decision-making body, the Board of Governors. This body elects or appoints the 24 Executive Directors of the Executive Board, responsible for the Fund’s daily operations.

The IMF has a quota system, which determines the maximum amount of financial resources that each country should make available to the IMF, what voting power it has and how much financing it can obtain from the IMF.

The IMF provides several facilities for concessional (i.e. at no, or below market rate, interest) and non-concessional lending that member countries can request, normally with quantitative and structural conditions attached.

In 2010, the Board of Governors agreed on a package of far-reaching reforms of IMF quotas and the IMF’s governance. These would give emerging market economies bigger influence on IMF decisions. The reforms, however, have been blocked, since the US Congress has still not ratified them.

In this briefing:
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- How the IMF decides
- IMF’s lending instruments
- General quota review and reform of governance structure
- Eurogroup representation in the IMF
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Glossary

Concessional lending: A loan with no interest or a below-market rate of interest. Also called soft loan.

Conditionality: Requirements placed on the usage or distribution of money lent to another country. They can range from provisions to reduce corruption, to more controversial requests, such as improvements in human rights or a reduction in deficit spending.

Gold Standard: A monetary system in which a country’s currency or paper money has a value directly linked to gold.

Quota: The IMF gets its money from quota subscriptions paid by member states. The size of each quota is determined by how much each government can pay according to the size of its economy. The quota in turn determines the weight each country has within the IMF – and hence its voting rights – as well as how much financing it can receive from the IMF.

Special drawing rights: An international type of monetary reserve currency, created by the International Monetary Fund (IMF) in 1969, which operates as a supplement to the existing reserves of member countries.

Source: Investopedia.

Background

The International Monetary Fund (IMF) was conceived at the Bretton Woods conference in 1944. It officially came into existence on 27 December 1945 and started operations in 1947. The responsibility of the IMF was to promote the new economic world order that the conference aimed at establishing, in an attempt to prevent a return of the economic chaos of the inter-war era. During the first globalisation drive at the end of the 18th and beginning of the 19th centuries, a Gold Standard was used between 1870 and 1914. An effort was made to revive the Gold Standard in the 1920s, but this failed and led to protectionist reactions from different countries, a decline in world trade and increasing cross-border tensions. The Bretton Woods system provided for fixed exchange rates based on a modified gold standard, where the US dollar served as an international reserve currency and where the United States promised to buy and sell gold at a fixed price. The IMF was the international body designed to manage this new global monetary system. After the breakdown of the Bretton Woods system in the early 1970s, the IMF continued in its role, the primary purpose of which is – in the IMF’s own words – ‘to ensure the stability of the international monetary system – the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other’.

How the IMF decides

Decision-making bodies

The IMF has 188 member countries, which are all represented in the highest decision-making body, the Board of Governors. Each member country appoints its own governor, normally the country’s finance minister or head of the Central Bank, and an alternate governor. The Board of Governors has delegated most of its powers to the IMF’s Executive Board, but retains the right to approve quota increases and allocations of special drawing rights. The Board is responsible for interpretation of the IMF’s Articles of agreement, on the basis of which the IMF is established and operates. The Board elects or appoints the executive directors to the Executive Board. Two ministerial committees, the International Monetary and Financial Committee (IMFC) and the Development Committee, act as advisors to the Board of Governors.
The Executive Board is responsible for daily operations of the IMF. It has 24 executive directors as members, and exercises the powers granted to it by the Board of Governors, as well as those bestowed on it in the Articles of Agreement. The five countries with the largest quotas appoint their own members, while 19 members are elected by the remaining countries grouped in ‘constituencies’. Reforms under way should mean that all 24 members of the board are in future elected by the member countries. The Executive Board appoints a managing director for a renewable term of five years to serve as chair of the board and as head of the IMF’s staff. At present, Christine Lagarde is Managing Director of the IMF, having been elected in 2011.

**IMF quotas**

Each member country in the IMF has a quota that determines the maximum amount of financial resources that the country should make available to the IMF, what voting power it has and how much financing it can obtain from the IMF. The quota is calculated on the basis of four criteria: gross domestic product (GDP), openness of the economy (the ratio of trade to GDP), economic variability and international reserves. The United States has the biggest voting power, with more than 16% of votes. Since many decisions require an 85% majority vote, this means that the United States is the only IMF member to have veto power.

**IMF’s lending instruments**

**Concessional lending to low income countries**

In the framework of the Poverty Reduction and Growth Trust (PRGT), the IMF provides low income countries (LICs) with different concessional lending instruments – that is, the loans to LIC bear no interest or a below-market rate of interest. The Extended Credit Facility (ECF) offers support for the medium to long term, the Standby Credit Facility (SCF) provides flexible support to LICs with short-term financing and adjustment needs, and the Rapid Credit Facility (RCF) provides rapid financial support for LICs facing urgent financing needs. To receive loans, the requesting country must set targets for the macroeconomic and structural policies it plans to implement, described in a letter of intent, which is often accompanied by a memorandum of economic and financial policies (MEFP). Pay-outs of assistance are made only if these targets are met (‘conditionality’). Countries that need policy advice and support can request non-financial assistance under the Policy Support Instrument (PSI).

**Non-concessional lending**

Non-concessional lending is provided mainly through the four facilities mentioned below. As with concessional lending, certain conditions must normally be fulfilled for assistance pay-outs to be made.

The Stand-By Arrangements (SBA) has historically been the most important instrument for non-concessional lending to countries facing external financing needs. The country
concerned must agree to address its balance of payments problems through achieving targets described in a letter of intent and in an MEFP. The Flexible Credit Line (FCL) is provided by the IMF for countries that find themselves in a cash crunch but have very strong fundamentals, policies, and track records of policy implementation. FCL is not conditional on specific policies being implemented. So far, Colombia, Mexico, and Poland have used the facility. The Precautionary and Liquidity Line (PLL) provides financing to meet actual or potential balance of payments needs of countries with sound policies, and is intended to serve as insurance or help resolve crises under wide-ranging situations. The Extended Fund Facility (EFF) can be used by the IMF to assist a country facing serious balance of payments problems in the medium term, where time is required to address the structural weaknesses. EFF has increasingly been used in the recent crisis. Greece, Cyprus and Pakistan, among others, have requested EFF support.

Table 1: IMF Facilities

<table>
<thead>
<tr>
<th>Programme/Concessionality</th>
<th>Type of country</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extended Credit Facility (ECF)</td>
<td>LIC</td>
<td>Main tool for providing medium-term lending to LICs. Currently zero interest rate until end-2016, 5½ year grace period, maturity 10 years.</td>
</tr>
<tr>
<td>Concessional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Standby Credit Facility (SCF)</td>
<td>LIC</td>
<td>For short-term lending to LICs. Can be used on a precautionary basis. Currently zero interest rate until end-2016, 4-year grace period.</td>
</tr>
<tr>
<td>Concessional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rapid Credit Facility (RCF)</td>
<td>LIC</td>
<td>Emergency lending. Zero interest rate. 5½-year grace period, final maturity of 10 years. No programme-based conditionality.</td>
</tr>
<tr>
<td>Concessional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stand-By Arrangements (SBA)</td>
<td>All</td>
<td>For short-term lending. Length typically 12–24 months, and repayment within 3½-5 years of disbursement. May be provided on a precautionary basis.</td>
</tr>
<tr>
<td>Non-Concessional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Extended Fund Facility (EFF)</td>
<td>All</td>
<td>For medium- and longer-term lending. Use has increased substantially in the recent crisis period. Typically longer than SBAs – up to a maximum of 4 years. Repayment due within 4½–10 years.</td>
</tr>
<tr>
<td>Non-Concessional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy Support Instrument (PSI)</td>
<td>LIC</td>
<td>Fund programme without a borrowing arrangement.</td>
</tr>
<tr>
<td>Flexible Credit Line (FCL)</td>
<td>All</td>
<td>For countries with very strong fundamentals, meeting pre-set qualification criteria. Not subject to access limits. Single up-front disbursement rather than phased. Repayment term the same as for SBA.</td>
</tr>
<tr>
<td>Non-Concessional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Precautionary and Liquidity Line (PLL)</td>
<td>All</td>
<td>For countries with sound fundamentals and policies. Duration 6-months or 1-2 years. Repayment term the same as for SBA.</td>
</tr>
<tr>
<td>Rapid Financing Instrument (RFI)</td>
<td>All</td>
<td>Emergency lending. Repayment within 3½–5 years.</td>
</tr>
<tr>
<td>Non-Concessional</td>
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</tr>
</tbody>
</table>

Source: IMF (Adapted from Griffiths and Todoulos, 2014).

Apart from financial and technical assistance, the IMF reviews country policies and national, regional, and global economic and financial developments through a formal system known as surveillance. Key surveillance elements are the IMF's comprehensive annual country assessments, known as Article IV consultations.

Conditionality

Criticisms of the conditions and requirements attached to concessional as well as non-concessional IMF loans has led the institution to successively review and modernise its guidelines on conditionality, and the IMF maintains that it has become more flexible in
its interaction with countries to solve their structural reform issues. Conditionality-free facilities, though limited in scope, have been introduced. Conditionality includes quantitative and structural conditions. Quantitative performance criteria (QPC) relate to macroeconomic variables under the control of the authorities. QPC are specific and measurable conditions that have to be met to complete a review that leads to approval of the release of a subsequent loan tranche. Structural conditions take the form of prior actions that a country agrees to take before the IMF approves financing or completes a review, and structural benchmarks, i.e. reform measures that are critical to achieve programme goals. They are used as markers during programme implementation reviews.

Eurodad analysts, however, hold that the IMF has become stricter in the use of loan conditions and bundles actions into one condition, which 'artificially brings down the number of conditions'. In theory, the borrowing country has ownership of the letter of intent and the MEFP. However, reviews by the IMF’s Independent Evaluation Office (IEO) have, according to the analysts, shown that IMF staff has been heavily involved in the drafting of MEFPs, and that the conditions touch on issues – such as fiscal policy and reducing the role of the state in the economy – that are sensitive in all countries. They conclude that the 'inclusion [of these conditions] inevitably implies that the IMF is interfering in the domestic policy of the country'.

**General quota review and reform of governance structure**

In 2010, the Board of Governors agreed on a package of far-reaching reforms of IMF quotas and governance. The reforms mean that total quotas are doubled and that the distribution of quotas is realigned to better mirror the changing relative weights of the IMF's member countries in the global economy. Both emerging-market economies' and low-income countries' situations are enhanced through stronger representation and a tripling of the basic votes, respectively. China will become the third largest IMF member country, while over-represented countries will see their quota shares drop.

As a consequence of the US veto power, the quota review, which would give emerging market economies greater influence on IMF decisions, has been blocked. The Obama administration has so far not managed to convince the US Congress to ratify the reforms. Some commentators consider that it is unlikely that the US will agree to end its veto, as this would be to admit symbolically its relative economic decline. They warn that the US in 20 years' time may have lost so much economic muscle that it will in any case lose its veto, due to changes in quotas, whereas China may acquire one.

**Eurogroup representation in the IMF**

The European Parliament's Economic and Monetary Affairs (ECON) Committee is currently preparing a report on the role of the Union in international financial, monetary and regulatory institutions and bodies (rapporteur Sylvie Goulard, ALDE, France), where one important element is the EU's and the euro area's ability to defend their strategic interests. The authors of a study from 2012, 'External representation of the Euro area', state that a united euro area would be more powerful than the USA on the IMF Executive Board. As a first step, they suggest the possibility of creating a subgroup to the Eurogroup Working Group (EWG) to coordinate euro-area Member States' positions in the IMF. A second step would be to merge national quotas via the European Stability Mechanism (ESM) in order to create a single-member position in the IMF. The Commission is due to adopt a communication on external representation of the euro area in October.
The IMF and Greece

After Greece requested financial assistance from the ESM on 9 July 2015, the Greek authorities also sent a separate request to the IMF on 23 July 2015. While the Eurogroup agreed on a third bail-out programme for Greece on 12 July (of up to €86 billion), the IMF is so far not an official partner of the ESM assistance programme (MoU signed on 19 August 2015) for Greece.

The financial terms of the third economic adjustment programme are specified in the Financial Assistance Facility Agreement and expect future IMF involvement according to recital 8 of the ESM treaty: 'The active participation of the IMF will be sought, both at technical and financial level. A euro area Member State requesting financial assistance from the ESM is expected to address, wherever possible, a similar request to the IMF'. In the view of the IMF, additional financing will be discussed when the ESM programme is reviewed.

After defaulting on an IMF loan on 30 June 2015, Greece repaid ‘the totality of its arrears to the IMF’, equivalent to about €2 billion on 20 July 2015. Greece is therefore no longer in arrears to the IMF. The original IMF commitment amounts to €58 billion (SBA €30 billion; EFF €28 billion).

Main references

Conditionally yours – An analysis of the policy conditions attached to IMF loans, Eurodad, Jesse Griffiths and Konstantinos Todoulos, 2014.


IMF Factsheets.


Trapped in history – The IMF and the US veto, DIIS Danish institute for international studies, Jakob Vestergaard and Robert H. Wade, 2014

Endnotes

1 The World Bank was also conceived in 1944 as the second Bretton Woods institution.
2 As of 10 September 2015, 204.1 billion SDRs – or about US$280 billion – were created and allocated to members.
3 The five countries appointing their directors currently are the United States, Japan, Germany, France, and the United Kingdom. Three countries each alone constitute a constituency, which guarantees them a seat on the board. These are China, Russia, and Saudi Arabia.
4 For further information on the decision-making bodies, see External representation of the Euro area, European Parliament, Policy Department A, 2012, p. 20.

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