Global Counsel

Funding the fund

Blog post by Chief Economist Gregor Irwin, 17 December 2018

Last week the US announced it will oppose a further increase in IMF quotas, because the Trump administration believes the fund has ample resources already and countries have adequate alternatives to draw on if they get into difficulty.

In many ways, this is hardly surprising. The US has long been difficult when it comes to IMF quota reform. The US Congress dragged its heels on the last big quota increase agreed in 2010, only finally consenting during the lame duck session in December 2015, shortly before President Obama left office.

The prospects for the latest attempt to raise quotas have never looked good. The current US administration ranges from being sceptical to outright hostile in its approach to international institutions.

This decision, however, leaves the IMF with a looming funding problem. It also raises fresh questions about its future role and its legitimacy in the eyes of many countries. And it's another front in a deepening conflict between the US and China for influence over the global economy.

The IMF is a credit institution, which provides the primary line of defence for governments that get into balance of payments difficulty, often because of fiscal problems. In recent years, it has lent not only to emerging countries, but also to several European states who got into fiscal difficulties following the global financial crisis.

Its lending activities are financed through three main channels (Fig. 1). The first is IMF quotas, which account for just under half of IMF resources. This is the permanent bit of the IMF's $1,349 bn balance sheet. It also draws on bilateral loans that provide a third of its financial firepower, and a scheme called the New Arrangement to Borrow (NAB), which makes up the rest.

The problem is that these bilateral loans could expire next year and the NAB comes up for renewal in 2022. The US says it is open to extending these arrangements. But there are reasons why this might not wash with many other IMF members.

One problem is that quotas serve multiple purposes in the IMF governance system. As well as determining financial contributions and (notionally at least) borrowing rights, they also determine voting shares when directors are appointed and decisions are taken by the IMF board or its governors.

The current quota shares are now well out of line with where the IMF's quota formula suggests they should be (Fig. 2). That formula is based on different measures of economic weight including, most importantly, the global GDP share. It shows that the US quota share ought to be trimmed from 17.4% to 14.7%. European shares also need to be reduced. The Chinese share, by contrast, ought to double, from 6.4% to 12.9%.

The way a quota increase works is by concentrating the increase in those countries that are underweight according to the formula. So any quota increase means taking quota share – and voting power – from the US and giving it to China. The US fears this will eventually (although not likely this time round) mean its vote share falls below the 15% it needs to veto major IMF decisions. Moreover, Washington can see where this must inevitably lead, with China overtaking the US as the biggest shareholder at some point in future. The IMF's constitution says it should be based in the home of its largest shareholder. In principle, that would mean the fund eventually moving to Beijing.

If the US blocks a quota increase – which it can do with its veto – is the fall-back plan of rolling over those bilateral loans and extending the NAB likely to work? Don't bank on it. As Fig. 1 shows, the US has been a bit mean when it comes to contributing to these financing mechanisms. Its share of the NAB is lower than its quota share and it has not provided any bilateral loans at all.

There is no immediate threat to the IMF's lending capacity. But at a time when the outlook for monetary policy and the global economy is uncertain, we should not be surprised if more sovereigns need IMF support in the next few years. Investors in sovereign debt should hope that a disagreement over the seemingly obscure issue of IMF quotas does not lead to the fund becoming a casualty in a widening economic conflict between the US and China.

Fig. 1 IMF funding sources

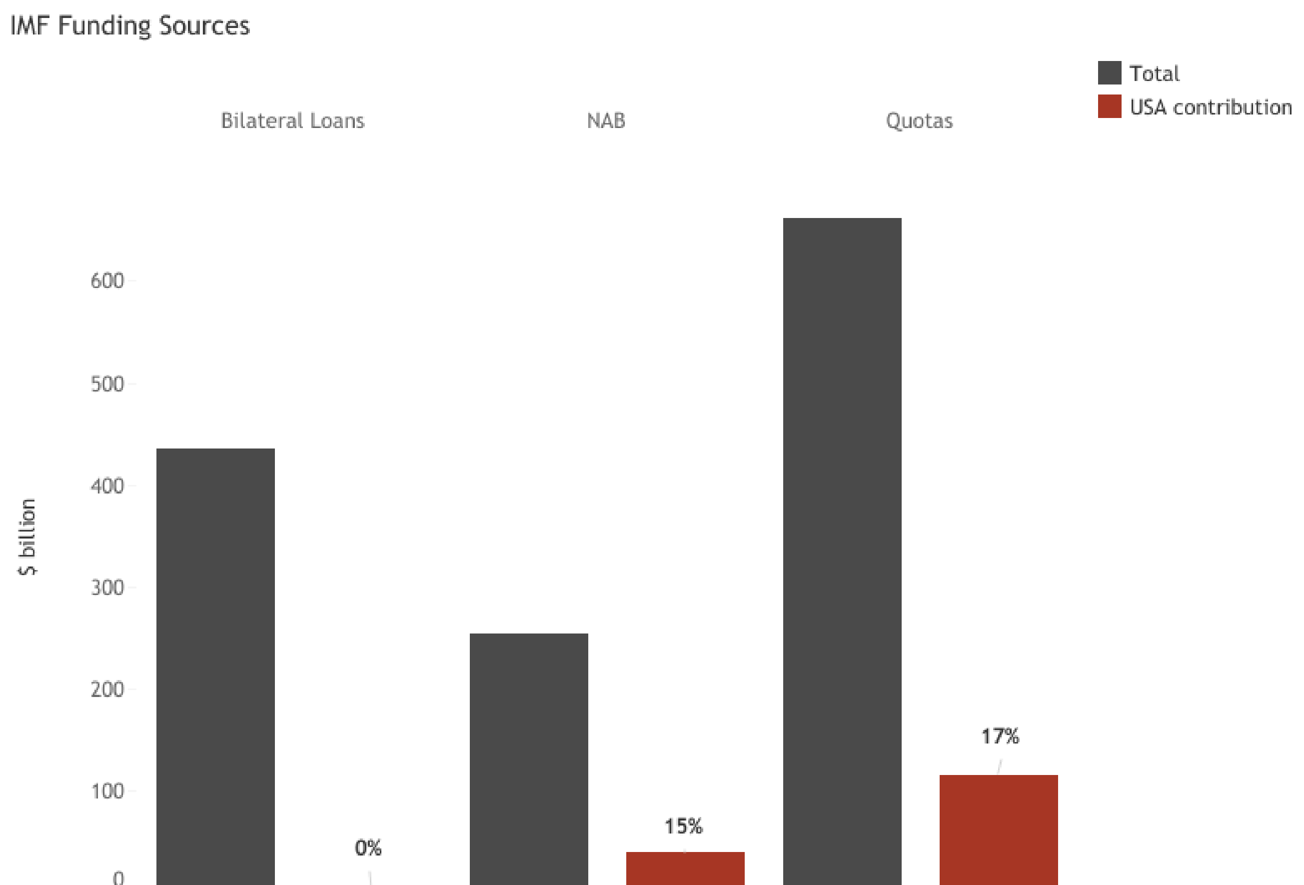

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Fig. 2 Current quota versus formula