Back to Basics

DALE CROSBY-CLOSE

How Does the IMF Finance Itself?

Think of it as a credit union for countries that funds itself through the interest it charges borrowers minus the interest it pays creditors

Anna Postelnyak

THE IMF MAY BE BEST KNOWN for providing loans to crisis-hit countries. But what about its own finances? How does it fund its critical functions and cover its running costs? Let's remember that the IMF is not only a global financial firefighter. It's also a source of essential policy advice and helps its member countries bring about the right macroeconomic conditions for boosting growth, creating jobs, and lifting living standards.

This unique mandate comes with a unique financial structure. Think of it as a credit union for countries—with a lending capacity of nearly $1 trillion. How does it work?

The IMF pools the resources of its members, charges interest to those that are borrowers, and pays interest to its creditor members. The difference between these two rates covers the administrative costs associated with the IMF's general, or non-concessional, lending. The IMF also earns income from investments, which covers other administrative costs, such as for surveillance and capacity development. Unlike many other international organizations, therefore, the IMF does not require its members to make annual contributions.

When countries join the IMF, they are assigned individual *quotas* based broadly on their relative positions in the world economy. These quotas determine each member's financial deposit in the IMF, how much it can borrow, and its voting rights on the Executive Board. To ensure that the IMF has sufficient lendable resources, the institution is working with its members to implement the 50 percent quota increase under the most recent general review of quotas.

Interest-earning deposits

All members initially deposit one-quarter of their quota in what the IMF calls *freely usable currencies*. These are the currencies most commonly used in international transactions and widely traded in foreign exchange markets. Today they comprise the US dollar, the British pound, the euro, the Japanese yen, and the Chinese renminbi.

This portion of a member's quota constitutes its initial *reserve tranche position*, as recorded on the IMF's books. Members receive a market-based interest rate on this position and can withdraw up to the full amount in case of a balance-of-payments need. The remaining three-quarters of a member's quota is deposited in its own currency, often in the form of a non-interest-bearing promissory note.

When the IMF provides loans to members in need, it draws only on the currencies of members whose economies are sufficiently strong to be creditors. These members are included in what is known as the *financial transactions plan*. If they are called on to lend to a country in need, they convert their IMF deposit to one of the five freely usable currencies (if their own currency is not already freely usable). The IMF then uses this to provide the loan to the borrowing country.

The amount each country lends is added to its reserve tranche position, earning market-based interest. In 2024, some 50 creditor countries received a total of about $5 billion in interest on the resources they had provided for non-concessional IMF lending.

Meanwhile, the interest rate a borrower pays equals the interest rate the IMF pays to creditors—plus a margin (currently, about half a percentage point per year). This income helps cover the administrative costs associated with the IMF's lending operations. Any remaining surplus is typically put into the IMF's reserves to build *precautionary balances* that underpin the institution's balance sheet.

Defaults and arrears

What if a borrower falls into arrears while repaying its IMF loan? This rarely happens because IMF-supported programs are designed to ensure that a borrower's economy stabilizes and its balance of payments improves so that it can repay the loan when it falls due. Programs include *conditionality*, which helps ensure that the borrowing country implements the policies agreed on with the IMF. Its central bank must also undergo a *safeguards assessment* to minimize the risk of misuse of funds. No borrowing country has ever defaulted outright on its IMF loans, although there have been cases of protracted arrears, especially during the 1980s debt crisis (there are none currently).

When a borrower falls behind in paying interest on its loan, the IMF has a *burden-sharing mechanism* to cover any shortfall in its income. Under this mechanism, all creditor and debtor members provide temporary financing in equal amounts. This is done by reducing the interest rate creditors receive on their reserve tranche positions and increasing the interest rate debtors pay on their loans. These sums are refunded once the borrowing member pays its arrears.

IMF lending is thus a safe investment for creditor countries. They earn interest on quota resources that are lent to countries in need while bearing only a fraction of the risks.

Borrowing countries also benefit, because IMF program design and conditionality support domestic reforms to strengthen their economies. This, in turn, gives them access to affordable loans. Interest rates on IMF loans are far lower than what crisis-hit countries would typically pay in private capital markets, assuming they're able to borrow at all.

More broadly, IMF lending supports the rest of the world economy by reducing the risk of spillovers. Without IMF support, crisis-hit countries would be forced to severely cut their imports, which would harm not only domestic producers and consumers that rely on imports but also their trading partners. IMF lending also reduces the risk of crisis contagion, whereby a crisis in one country triggers crises elsewhere.

> "The IMF's unique mandate comes with a unique financial structure."

Concessional loans

The bulk of IMF lending is *non-concessional,* which means the borrower pays market-based interest. In addition, the IMF provides cheaper, *concessional,* loans to its poorest members, using resources richer members have voluntarily provided for this purpose. The IMF pools these funds in the Poverty Reduction and Growth Trust (PRGT), which is separate from the IMF's own balance sheet.

When members contribute financial resources to the PRGT, they decide whether to give a grant or make a loan. Since the borrower pays little or no interest on the concessional loan it receives, the difference between what the borrower pays and what the creditor receives is covered with the help of a *subsidy account* funded by voluntary member contributions and the IMF's own resources. IMF members recently decided to create a framework that allows them to allocate part of the surplus they receive from non-concessional lending to PRGT subsidies.

At the Bretton Woods Conference, which established the IMF in 1944, US Treasury Secretary Henry Morgenthau noted that the details of the international monetary and financial agreement may seem "mysterious." And yet, at its core, the IMF is a simple credit union that funds itself through the interest it charges borrowers, minus the interest it pays to creditors, to the benefit of both and to the world economy at large. **F&D**

ANNA POSTELNYAK *is a senior research officer in the IMF's Strategy, Policy, and Review Department.*