Development and financial structure of the International Monetary Fund

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The International Monetary Fund (IMF) is a forum for economic co-operation. Its main tasks are in the fields of monetary and foreign exchange policy. The idea of establishing an organisation of this kind emerged from the experiences of the Great Depression of the 1930s. During that era, as world trade sharply declined, many countries carried out competitive devaluations in order to salvage important export revenues. They also erected trade barriers. This hurt other trading nations, which thus pursued the same devaluation policy. In response to the resulting collapse of the international foreign exchange system and world trade, after the Second World War many nations wished to build up international co-operative mechanisms to maintain a stable foreign exchange system. International co-operation and the application of common rules were a way to create order and stability in foreign exchange markets and in international payments. The purpose was to promote international trade and smooth payments systems in general.

Tasks of the IMF

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The decisive step towards broader co-operation in monetary and foreign exchange policy occurred in the summer of 1944, when representatives from more than 40 Allied nations gathered for the Bretton Woods conference in New Hampshire, USA. This conference led to the formulation of guidelines and charters for the International Monetary Fund and the International Bank for Reconstruction and Development (IBRD), which later evolved into the World Bank.

The charter (*Articles of Agreement*) of the International Monetary Fund establishes the rights and obligations of its members in many areas. It can be described as a mutual code of conduct governing international payments as well as monetary and foreign exchange policy. More specifically, the charter stipulates that the purpose of the IMF is to "promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration." This organisation is intended to facilitate "balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members." The IMF's aim is to "promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation."

Finally, the IMF was to provide loans to member countries as needed in order to restore confidence in the ability of a member country's economic policy to rectify severe disruptions in its balance of payments. The primary role of the IMF was to maintain a stable international exchange system by means of a fixed exchange rate system, while the task of the World Bank was to work towards the reconstruction of war-ravaged Europe. The task of establishing trade rules was assigned to the General Agreement on Tariffs and Trade (GATT), later the World Trade Organisation (WTO).

For several decades, this allocation of tasks was clear. But during the early 1970s the dividing line became vague after the fixed exchange rate system designed by the Bretton Woods conference collapsed. Floating exchange rates, a growing private international credit market and an increase in the number of members to the current 182 countries led to gradual changes in the role of the IMF. More and more of its new members were developing countries, with balance of payment problems of a more protracted nature. During the 1980s the work of the IMF shifted increasingly towards addressing the debt problems of developing countries. The IMF still has a surveillance and advisory role, although during the past year, attention has focused on its emergency actions in Asia and Russia.

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The IMF's own financial structure and organisation are thus largely a result of historical events. This article begins with the IMF's original role in the fixed exchange rate system. It then describes the IMF's financial assistance to countries with balance of payments problems, the creation of special drawing rights and

IMF lending to low-income countries. Finally it discusses the role of the IMF today and what role it may assume in the future.

The fixed exchange rate system

The Bretton Woods system established fixed, but adjustable, exchange rates between member countries for the purpose of avoiding competitive devaluations. Within this system, all members were asked to establish a "par" value, stating the nominal value of their currency in terms of gold. They could state this par value in terms of gold or indirectly in terms of the US dollar. A par value provided a certain parity with the dollar and with other currencies. The system was firmly anchored by a guarantee from US authorities that a dollar could be exchanged for gold at a fixed rate.

Each member country was expected to prevent its exchange rate from deviating by more than 1 per cent from the established rate. Since the dollar had a fixed exchange rate in terms of gold,[1] each member country could maintain the value of its own currency by buying and selling dollars. Major deviations from the fixed exchange rate could nevertheless occur, but only after the IMF had certified that there was a fundamental imbalance. The IMF thus needed to exercise a certain amount of "surveillance" of member countries to be able to judge whether an adjustment in their exchange rates should be allowed.

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The United States assumed a relatively passive role in the Bretton Woods system, for the natural reason that par values in dollars were determined and adjusted by the authorities of other countries. The adjustments of exchange rates that occurred were almost exclusively devaluations against the dollar, since the IMF found it difficult to persuade countries with undervalued currencies to revalue. In the early 1950s, the US held about 70 per cent of the world's gold reserves, and the ability of the dollar to meet the requirement of convertibility to gold was hardly questioned. After the American authorities had pursued both expansive monetary and fiscal policies during the second half of the 1960s, total dollar reserves outside the US soon began to exceed American gold reserves. Confidence in the dollar deteriorated, and central banks began to take advantage of their opportunity to convert dollars to gold. On August 15, 1971, the American government ended convertibility of the dollar into gold. The fixed exchange rate system collapsed.

[1] USD 35 per ounce.

It is naturally worth asking whether an institution that had as one of its most important tasks to oversee this fixed exchange rate system was really needed after the system was abandoned. But as mentioned above, the purpose of the IMF is to create order and stability in the foreign exchange market and in international payments. The fixed exchange rate system was an important tool for achieving this. The Fund's task of creating order in foreign exchange markets remained. After the collapse of the Bretton Woods system, some countries chose floating exchange rates, and others chose to join new international fixed exchange rate systems. The role of the IMF in the international financial system was thus not as clear as before. Its role as a discreet advisor to the central banks and governments of member countries naturally changed in response to international developments and the needs of its member countries.

Financial assistance in response to balance of payments problems

To make it easier for countries to avoid having to abandon fixed exchange rates, under the Bretton Woods system the IMF could extend loans during the period a country needed to restore its balance of payments. The purpose of these loans was to make the economic policy adjustments smoother, so countries would not need to use more desperate methods, such as exchange and trade restrictions. Since the very suspicion that a country might use such methods could have an adverse impact on various trade partners, another important purpose of these IMF loans was to bolster market confidence.

For this purpose, the Bretton Woods conference agreed that the IMF should be provided with financial resources in the form of members' currencies and gold. If necessary, these resources could be lent temporarily to member countries with payments deficits, in order to provide them with extra currency reserves.

As in the case of exchange rate adjustments, the IMF would ensure that the country took steps to rectify its balance of payments problems.

Severe balance of payments disruptions, that is, disruptions in a country's payments, refer to both surplus and deficit situations, but for natural reasons the situation is more acute if a country is having major trouble financing a payments deficit. A country can finance such a deficit by means of investments from abroad, borrowing abroad or via its currency reserve. As a rule, a chronic deficit cannot be financed exclusively by means of investments from abroad or loans without building up an external debt that must later be refinanced. Sooner or lat-

er, the country must take economic policy steps to reduce its deficit. It can reduce the deficit by adjusting its economic policies in such a way that domestic demand falls and imports shrink, or by devaluating its currency in order to boost exports and decrease imports. According to the Articles of Agreement, a country may be allowed to restrict capital flows. But the fundamental idea behind the IMF's loans and calls for economic policy adjustment programmes was to avoid trade and exchange restrictions.

Devaluation of a country's currency is part of its adjustment of economic policy.

An adjustment in economic policy is absolutely necessary in order to rectify fundamental economic imbalances and was later added as an explicit condition for the extension of loans from the IMF. Devaluation of a country's currency is part of its adjustment of economic policy. Trade restrictions and the abolition of currency convertibility were to be avoided, however.

To assess a country's need for financing, the IMF had to examine the actual balance of payments position and project the country's overall future balance of payments trend. Underlying economic factors determined the formulation of programmes. As new needs arose in member countries, the IMF developed new loan facilities, in the form of standardised rules and systems for providing balance of payments assistance.

The expansion of international credit and capital markets enabled industrialised countries to seek private financing of their balance of payments deficits.

When it was evident that a growing proportion of member countries' payments deficits were attributable to sharply higher oil prices, the IMF established a special oil facility. During the 1970s and 1980s the IMF continued to tailor its lending operations to the changing needs of existing member countries and the needs of new members. The number of members grew, especially in Africa and Eastern Europe. However, the expansion of international credit and capital markets enabled industrialised countries to seek private financing of their balance of payments deficits. The need for IMF loans to industrialised countries thus ceased in the mid-1970s.

The IMF's loan facilities vary in terms of the kind of payments problems and financing needs they address and the conditions attached to the loan. The following is a brief chronology of some of the organisation's most important loan facilities.

- *Stand-By Arrangements*, originating in 1952, intended to provide short-term balance of payments assistance for deficits of a more temporary and cyclical nature, not primarily for structural problems. A stand-by loan is disbursed over

a period of 1–2 years and repaid within a 3–5-year time frame. This facility is still actively used.

- *The Compensatory and Contingency Financing Facility*, originating in 1963, is intended to compensate for shortfalls in export earnings and/or temporarily excessive increases in cereal import costs that are beyond a member country's control.
- *Emergency Assistance* is a loan facility that was intended to provide balance of payments support in case of a sudden and unforeseen natural disaster. This facility has no attached. The loan is not divided into different disbursement tranches, either. During 1995 this facility was expanded to cover *post-conflict* situations.
- *The Special Oil Facility* from 1974 was intended to provide financial assistance to countries affected by deteriorating terms of trade related to the oil crises.
- *The Extended Fund Facility* was created in 1974 and is intended to rectify balance of payments problems stemming from structural problems. The loans thus have longer maturities and normally comprise larger amounts in relation to a country's quota subscription.
- *The Systemic Transformation Facility* was a special loan facility for countries in the former East block, aimed at facilitating their transition to a market economy. This facility no longer exists.
- *The Supplemental Reserve Facility* was established in 1997 to provide assistance to member countries experiencing exceptional balance of payments problems, owing to large short-term financing needs resulting from a sudden loss of market confidence. These problems are ordinarily reflected in heavy pressure on a country's capital account and currency reserve.

The creation of a new reserve currency, Special drawing rights (SDR)

During the 1960s, the shortage of reserves and liquidity in the international exchange system was a global problem.

During the 1960s, the shortage of reserves and liquidity in the international exchange system was a global problem and was believed to be hampering the long-term growth of international trade. Within the Bretton Woods system, there was no mechanism for increasing the total quantity of international reserves for IMF members. The only way of expanding these reserves was to enlarge the gold supply or allow a continued American external deficit, thereby enabling other countries to build up dollar reserves.

During the 1960s, capital movements were primarily attributable to underly-

ing trade and payments. Capital movements not directly related to an underlying real trade transaction were largely prohibited by means of highly regulated capital markets. A new reserve currency – the Special drawing rights (SDR[2]) – was created in 1969 as a complement to gold and as a counterweight to the dominant role of the dollar.

The IMF created reserves by introducing liability items in the balance sheets of national central banks and including a corresponding SDR asset item in a country's currency reserves. Put simply, the IMF inflated the balance sheets of central banks. By creating the SDR, the IMF gained a rudimentary central bank function, that is, it pumped liquidity into the financial system.

Via the IMF, a central bank could convert its SDRs into foreign currencies when its balance of payments situation made this necessary. When asked to, countries with strong payments balances agreed to buy SDRs and sell the currencies that the central bank of another country needed. The use of special drawing rights did not obligate a country to take any action in the form of economic policy measures.

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The IMF guaranteed that all those that had been allotted special drawing rights could convert them to other foreign currencies when payments problems arose. Special drawing rights could thus circulate as a means of payment among IMF members in a system whose participants mutually pledged to supply each other with currencies in exchange for SDRs. Today, in practice a number of member countries have signed transaction agreements with the IMF to buy and sell SDRs. Since November 1987, the Riksbank has had such a transaction agreement with the IMF.

The members of the IMF include countries that lack international creditworthiness and thus cannot borrow in international capital markets. Countries that are creditworthy today can also lose that position and be excluded from international lending markets. These countries may need to use SDRs during a transitional period in order to finance necessary imports and other payments. Today, however, SDRs are largely used to settle principal payments on IMF loans.

As international credit markets opened up, shortages of reserves no longer posed a problem for creditworthy countries and were thus no longer a global problem. According to the IMF Articles of Agreement, in order for new SDR

[2] SDR 1 was equivalent to SEK 10.8347 on November 6, 1998. The value of one SDR is based on a trade-weighted index of the G5 countries' currencies and is used as the IMF's unit of account.

allocations to occur, there must be a long-term global need to supplement existing reserves. Since no such need is considered to exist any longer, SDR allocations ceased after 1981, although the SDR system itself continued to operate. Countries that have become members of the IMF after 1981 – one fifth of Fund members – have thus not been allocated any SDRs. During 1997, the IMF decided to resolve this problem by carrying out a special allocation of SDR 21.4 billion. It is also amending the Articles of Agreement to ensure automatic SDR allocations to new members.

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Loan programmes to low-income countries

The establishment of the Trust Fund in 1976 was the first step towards a new, separate form of loans for the poorest IMF member countries. The Trust Fund was created from a small portion of the profits the IMF earned from the sale of one third of its gold holdings. Gold had lost much of its importance as a reserve asset after the Bretton Woods system ceased to exist.

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The Trust Fund comprised a separate fund, for which the IMF assumed management responsibility. When the Trust Fund was established, the IMF stated that its resources would be used for the poorest member countries.

By the early 1970s, it was obvious that the very poorest members of the IMF were incapable of stabilising their balances of payments in the short term. The fact that financing for this purpose was now separated from the other resources of the IMF meant that the organisation could now provide loans adapted to the needs of low-income IMF countries.

New soft-loan facilities were successively established to facilitate structural adjustment in the poorest countries with debt problems. The purpose of such adjustment was to restructure their economies in the medium term by means of trade and exchange liberalisation, thereby providing an incentive for increased production and helping diversify exports. The goal was to create a healthy long-term balance of payments and to generate growth. The structural adjustment programmes also acted as catalysts for other development assistance to low-income countries.

The following is an evolutionary chronology and a brief summary of each loan facility. Today only the last-mentioned loan facility, ESAF, is active.

- *The Trust Fund* was created in 1976 through the sale of gold. It was intended to provide medium-term loans to low-income countries at 0.5 per cent interest, together with an action schedule for structural adjustment. Loans from the Trust Fund ceased in 1981.
- *The Structural Adjustment Facility (SAF)* was established in 1986 and financed from repayments of loans from the Trust Fund. This loan facility was available only to low-income countries, at an interest rate of 0.5 per cent and with a repayment period of up to 10 years.
- *The Enhanced Structural Adjustment Facility (ESAF)* was established in 1987 and is financed by repayments of SAF loans as well as from special bilateral loans and grants from certain rich countries. The loan facility is designed like the SAF, but the loan amounts are larger in relation to a country's IMF quota.

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Unlike the World Bank and other development institutions, the IMF does not provide financial support to individual projects. IMF-supported programmes focus primarily on helping developing countries achieve a long-term sustainable balance of payments situation. Such institutions as the World Bank, regional development banks and other specialised organisations under the United Nations umbrella have mandates and expertise to supply member countries with advice concerning major investment decisions in particular economic sectors.

The IMF works together with the World Bank in a number of ways, however, both in connection with the loan programmes of various organisations and on other issues. The HIPC initiative is a framework developed jointly by the IMF and the World Bank. Its purpose is to find a solution to the debt problems of the very poorest and most debt-burdened countries (HIPC = Heavily Indebted Poor Countries). This initiative stands out in one respect: it involves a concerted effort by all lenders, that is, international organisations, individual countries and private lenders. The goal is to use debt relief to create a sustainable situation for the poorest, most debt-burdened low-income countries. The IMF participates in the HIPC initiative via a specially adapted ESAF loan.[3]

[3] Instrument to Establish a Trust for Special ESAF Operations for the Heavily Indebted Poor Countries and Interim ESAF Subsidy Operations.

What resources does the IMF have at its disposal?

The IMF's financial resource base consists of the quotas of its 182 member countries. The size of a quota is determined on the basis of a member country's relative economic strength in terms of GDP, foreign trade and currency reserves. The quota refers to the amount that a member country is expected to pay as a capital contribution. Expressed as a percentage, the quota also refers to a member country's share of voting power on the Executive Board of the IMF. The quota also provides a basis for the allocation of SDRs and for a member country's access to IMF loans.

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Quotas are, however, the topic of regular reviews, as specified in the Articles of Agreement. The purpose is to see whether the Fund has sufficient resources to carry out its work and whether the allocation of capital contributions among member countries still reflects their relative economic strength. At present, the Riksbank's total quota is SDR 1,614 million. In 1999 an increase in the quota will take place, and the Riksbank's total quota will be raised to SEK 2,395.5 million.

Of the total quota, however, only 25 per cent has been paid into and pooled by the IMF. A country generally pays this 25 per cent when it joins the IMF, and this sum constitutes its "reserve tranche position". For accounting purposes, the reserve tranche position is part of the Riksbank's currency reserve, since it is a liquid claim on the IMF. The reserve tranche position is regarded as liquid, since in the event of a severe balance of payments crisis a country may, in principle, withdraw its reserve assets from the IMF at any time, without this being classified as a loan from the IMF. From the founding of the IMF until the early 1970s, this quota subscription could be paid in gold, dollars or other hard currencies. Today gold is not used. The payment is instead made in SDRs or another hard currency, as agreed with the IMF.

The remaining 75 per cent of the quota is to be paid in the member country's own currency. This portion is not pooled directly into the IMF, but is available for lending when the need arises. In principle, this functions as an "overdraft facility" for the IMF with its member countries.

Below is an example of how a capital contribution to the IMF is reported. Of the Riksbank's IMF quota of approximately SEK 16 billion, about SEK 10 billion consists of an overdraft facility that the IMF has access to. The remaining

SEK 6 billion consists of the original paid-up reserve tranche position of 25 per cent, plus the additional claim resulting from the IMF's use of its overdraft facility. The Riksbank's own balance sheet shows only the reserve position, which consists of the difference between Sweden's IMF quota and the unutilised overdraft facility (SEK 16 bn – SEK 10 bn).

Assets	The Riksbank	*Liabilities*
Quota	SEK 16 billion	
IMF overdraft facility	SEK –10 billion	
Reserve tranche position in the IMF (paid-up reserve tranche position plus utilisation of overdraft facility)	SEK 6 billion	

Correspondingly, the IMF reports the sum of all member countries' currencies on the asset side. In our example, it shows SEK 10 billion. In other words, the IMF reports the portion of the Swedish kronor that it still has access to. On the liability side, the IMF reports all the quotas of its member countries.

Our example shows the Riksbank's quota. The net amount of assets and SEK 6 billion in liabilities consists of the utilisation of the overdraft facility plus the Riksbank's original reserve tranche position.

Assets	IMF		*Liabilities*
Overdraft facilities with the Riksbank	SEK 10 billion	Sweden's quota	SEK 16 billion

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Most of the IMF's resources consist of member countries' own currencies plus SDRs. Today this sum amounts to SDR 145.4 billion. In addition, the IMF still has some remaining gold, with a value equivalent to SDR 3.6 billion. However, gold is not a liquid asset. In addition, the IMF has SDR 0.7 billion at its disposal. Beyond the IMF's general resources consisting of member countries' currencies, gold and SDRs, there are special lines of credit that the IMF can borrow from, General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB). In General Arrangements to Borrow, eleven industrialised countries have agreed to supply the IMF with extra resources of SDR 17 billion in case of a severe systemic crisis. New Arrangements to Borrow have the same purpose as GAB and comprise 25 countries that provide SDR 34 billion.

Not all member countries' currencies can be used for borrowing, since the currencies of many IMF members are non-convertible or cannot be removed from their currency reserves because the countries need them, as they are already IMF borrowers. Another problem may be that a country has volatile exchange

rates or a weak balance of payments. Currencies that are usable are thus classified as being part of the IMF's operational budget. The Swedish krona is included in the operational budget today, but this was not the case during the period 1992–96, when the country's exchange situation was volatile, its net foreign exchange reserve was small and its balance of payments was weaker than today.

About 65 per cent of the value of member countries' currencies is currently regarded as unusable for IMF lending. Of the 35 per cent that is usable, the portion that comprises a country's reserve tranche positions is excluded, that is, the one fourth paid up to the IMF, and that constitutes part of the reserves of national central banks.

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Portions of the IMF's operational budget are, moreover, pledged for future payments within the framework of existing loan arrangements, thereby reducing its usable resources further. In addition, the IMF needs to maintain a certain amount of working capital as a safety margin so that it can freely supply currencies that are in heavy demand. Altogether, this means that the IMF's actual available resources for lending are substantially smaller than one may think when adding together the capital contributions of member countries. Actual available resources fell by nearly half from SDR 43.5 billion to SDR 22.6 billion between April 1997 and April 1998 when the demand for IMF resources increased due to the Asian crisis.

IMF resources (SDR bn)	1997	1998
Total, members' currencies and SDRs	145.4	145.4
Less non-usable resources	–82.7	–98.1
Less amounts committed under arrangements	– 7.0	–15.3
Less minimum working balances	–12.2	– 9.4
Net uncommitted usable resources (UR)	43.5	22.6
Liquid liabilities (total of reserve tranche positions, LL)	36.1	50.3
Liquidity ratio (UR/LL), per cent	120.4	44.9

To determine whether the IMF has sufficient resources to meet demand, it uses a liquidity ratio as an indicator. It calculates this liquidity ratio by dividing net uncommitted usable resources by the total reserve tranche positions of member countries, or the IMF's liquid liability items. Short-term fluctuations in the liquidity ratio trigger no special actions. Instead it is more important to monitor long-term trends. A constant downward trend in the liquidity ratio indicates that the IMF's room for lending is shrinking. The liquidity ratio rapidly deteriorated from 120.5 per cent in April 1997 to 44.9 per cent in April 1998. At its 1997 annual

meeting in Hong Kong, the IMF approved in principle an increase in member quotas. This will provide a much-needed infusion of capital. Implementation of the quota increase should be completed by January 29, 1999.

The changing role of the IMF over time and its future role

The IMF has demonstrated considerable skill in adjusting to developments around it and to the changing needs of its members.

The IMF has demonstrated considerable skill in adjusting to developments around it and to the changing needs of its members. The end of the fixed exchange rate regime paved the way for a more flexible exchange rate system. By creating Special drawing rights, the IMF tried to satisfy the need for greater liquidity as world trade grew. The creation of this new reserve currency came too late, however. Instead, the expansion of the private credit market began to satisfy the need of industrialised countries for liquidity. The IMF also adapted its loan facilities to the new needs of member countries during the early 1970s and to the growing number of members in Africa and the former East block.

In a world of increasingly integrated financial markets, the IMF's balance of payments assistance is a complement to the loans available in private markets. When the IMF was established, it was impossible to foresee that capital markets would expand in the way they have since the 1970s. In a world without capital markets, there was an obvious role for the IMF in helping countries finance their balance of payments deficits. When capital flows became easier, countries with sufficiently high creditworthiness could finance their deficits in private capital markets. This was especially true of industrialised countries. Some of the countries that became members during the 1970s and 1980s had less access to financial markets. The demand for IMF's resources has thus increased.

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However, due to the financial crises of recent years, the IMF has faced tasks of a new nature. The heavier flow of mainly short-term capital has resulted in problems of another kind. On some occasions, large inflows of capital have been followed by large rapid outflows, caused by a sudden change in market confidence in a country's economic policies. This large outflow has then caused strains in the country's financial system and revealed shortcomings in its financial infrastructure. In addition, developments in one country have quickly affected the situation in other countries. These capital movements have increased in terms of both size and speed.

However, the IMF's resources are not sufficient to meet the enormous financing needs that may arise during severe crises of confidence. The purpose of IMF resources is to serve as a catalyst, restoring confidence in a country and persuading other countries to dare to return. It has been necessary to reorient the IMF's work towards a greater emphasis on creating financial stability. The IMF nevertheless has no formal jurisdiction over capital payments or transactions. International organisations will continue to discuss how to deal with crises of confidence. It is likely that the IMF will continue to play a central role in this work.

Financial structure

General department

General resources account
Contains the quota subscriptions of all member countries. All transactions related to stand-by loans and EFF loans occur under this account.

Borrowed resources suspense accounts
Account for NAB and GAB loans.

Special disbursement account
Profits from sales of IMF gold are channeled into this account.

Investment account
Currently inactive.

SDR department

All SDR transactions take place through this account.

Administered accounts

ESAF Trust
Contains member countries' contributions for lending to low-income countries as part of the Enhanced Structural Adjustment Facility.

ESAF-HIPC Trust
Contains member countries' contributions to the Heavily Indebted Poor Countries Initiative.

Other administered accounts
Includes various accounts to finance technical assistance activities and accounts for the IMF staff pension funds.

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