

Unpacking the IMF Lending Rate Policy

Emiliano Libman¹ and Maia Colodenco²

Abstract

The paper examines the International Monetary Fund's (IMF) lending rate policy, particularly focusing on its non-concessional lending through the General Resource Account (GRA). It highlights how recent global economic conditions and institutional practices have led to historically high interest rates, reaching 700–800 basis points annually for certain borrowing countries. Despite the October 2024 reforms which resulted in reduced rates, significant challenges remain. The implications of this policy's procyclicality, inequities, and its impact on debtor nations' financial recoveries and global financial stability were assessed. Key recommendations include further reductions in surcharges, adjustments to the SDR rate, and other measures aimed at ensuring debt sustainability, fairer outcomes, and alignment with the IMF's mandate to promote international financial stability.

Keywords: *IMF, Lending rate, Surcharges*

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1. Introduction

In 2024, some debtor countries borrowing from the International Monetary Fund's (IMF) General Resource Account (GRA) beyond their access limits paid an effective annual interest rate of around 700-800 basis points to the Fund. After the reform of October 2024 (IMF, 2024a), this figure falls by about 100 basis points. This raises the crucial question of whether the policy, which implies a high lending rate, aligns with the institution's mandate of promoting international financial stability, or whether it necessitates reform. In this paper, we focus on non-concessional lending from IMF's GRA, for which the institution charges the lending rate. Our aim in this paper is to describe and evaluate the Fund's current non-concessional lending rate policy to assess the recent reform and proposals for future ones.

The IMF lending rate comprises several components. The most important ones are the basic rate and surcharges (if they apply). The basic rate is, in turn, composed of a fixed margin (currently at 60 basis points) over the interest rate on the IMF's Special Drawing Rights (SDRs) plus the service (50 basis points per disbursement) and commitment fees (between 15-60 basis points, refundable when disbursed). The SDR rate is a weighted average of the interest rates of the United States, the United Kingdom, Japan, China, and the Eurozone.⁴

Due to the post-pandemic food and energy price shocks and the war in Ukraine, central banks in Advance Economies have increased interest rates, thus increasing financing costs worldwide. Nowadays, the SDR rate stands around 350 basis points. In an ideal scenario, the IMF's lending should be counter-cyclical (the institution "lends when no one else does"); however, the current lending rate policy is procyclical: the IMF behaves more like a typical commercial bank (the institution "charges a premium for excess borrowing"). Total IMF credit outstanding increased from 73.5 billion SDR at the end of 2019 (about 99 billion US dollars⁵) to 111.6 million SDR as of October 2024 (about 151 billion US dollars).⁶

This rise in costs of borrowing alongside IMF lending is unprecedented in the Fund's history: historically, expansions of IMF lending had coincided with a falling SDR rate, given that economic downturns caused many countries to resort to the Fund alongside reductions in monetary policy rates of major central banks (Krahnke and Tordoir, 2023). The bulk of the interest payments largely fall on the five largest debtors to the Fund – four of them are members of the G-24 – which together explain 57.6% percent of the total credit out-standing: Argentina (27.88%), Egypt (8.50%), Ukraine (9.50%), Ecuador (5.72%), and Pakistan (6.00%).

In addition to a historically high basic rate, before the policy review of 2024, debtors who borrow beyond their access levels must pay surcharges up to 275 basis points. Those that need support from the IMF beyond their access limit already face more restrictive credit conditions and are typically affected by tighter financial constraints, for instance by climate-related natural disasters or military conflict (e.g. Ukraine, the Middle East, and so on). The current lending policy thus amplifies the spill-over effects of

⁴ See <https://www.imf.org/en/Topics/special-drawing-right>

⁵ In this paper, we assume a dollar to SDR exchange rate of 1.35.

⁶ All the IMF's operations are denominated in SDRs, created by the IMF in 1969 to supplement its member countries' official reserves. The operations used to be denominated in US dollars, as the original intention was to ensure the viability of an international system of fixed exchange rates where the US was the financial center. After the collapse of the Bretton Woods arrangements in 1974, the operations were denominated using a basket of 16 currencies, subsequently reduced to the five main currencies, the US Dollar, the British Pound, the Japanese Yen, the French Franc, and the German Deutschmark. The last basket comprises US Dollars, British Pounds, Yens, Yuans, and Euros).

monetary policy and reinforces countries' funding difficulties (Stiglitz and Gallagher, 2022).

The SDR rates reflect advanced economies' decisions on monetary policy, which were made solely to fight inflation in their countries. As documented by the literature, these policy rates are often inappropriate for dealing with macroeconomic imbalances elsewhere. There is a significant amount of research showing that financial crises are usually triggered by changes in the financial conditions in the US (Degasperis et al., 2023; Mishra and Rajan, 2016; Rey, 2015).

Today, monetary policy rates are high, just when many developing countries struggle with high levels of debt and need support. UNCTAD finds that currently, global public debt stands at a total of US\$97 trillion during 2023. More than a third is owed by developing countries. The proportion of poor countries in debt distress or at high risk of debt distress has more than doubled to almost 60% from a decade ago. What is more, half of developing countries spent about 7.80% of their government revenues on interest payments, while 15 countries are spending more on interest than on education and 46 more on interest than on health (UNCTAD, 2024). Thus, the current level of the SDR rate represents a threat to debt sustainability. As we will discuss, if the rates at which some members are borrowing from the Fund are applied to its public sector total indebtedness, then they are not compatible with public debt sustainability. Given that IMF rates are typically lower than market rates, this highlights that higher SDR rates could increase the likelihood of financial crises and are not conducive to international financial stability.

The lending rate of 700-800 basis points was applied to countries that require large and prolonged programs from the IMF's GRA account. As highlighted by the recent report from the Independent Evaluation Office (IEO, 2024), the IMF has not improved the standards when applying the criterion for extending credit above the "normal" limits of access. Moreover, the IMF suffers from pressures to lend, which translates into over-optimistic assessments of debt sustainability; indeed, as the report argues, debt restructuring has typically not taken place, suggesting that perhaps debt restructuring and smaller IMF programs could be a better option that is worth considering.

However, this high lending rate had knock-on effects for countries that borrow from the Fund's concessional windows, like the Poverty Reduction and Growth Trust (PRGT), which low-income countries can tap for lending at a subsidized rate of zero percent. As the SDR rate increases, more funds are needed to subsidize these loans, straining PRGT finances. The higher SDR rate also affects other lending arrangements of the Fund, such as the newly established Resilience and Sustainability Trust (RST), which assists countries with climate change challenges (Krahnke and Tordoir, 2023). Additionally, many low-income countries drew on their SDR allocations in 2021 when interest rates were still low. These countries do not have to replenish their holdings, but they must pay the SDR rate on the amount drawn. This has turned into expensive credit, especially for poor countries that made active use of the 2021 allocation and need highly concessional financing or grants.⁷

The above-mentioned developments prompted the IMF to take steps to modify the lending practices. In October of 2024, the Executive Board decided to reduce the basic margin, increase the threshold of quota that is affected by surcharges, and reduce the time level component of surcharges.

In a nutshell, the IMF's lending policy is a highly relevant item in the global agenda, which impacts low and middle-income countries, has negative implications for international financial stability, and, consequently,

⁷ Whenever the fund allocates SDRs each member increases their holdings. Countries receive or pay interest depending on whether their holdings of SDR are above or below the total amount allocated. SDR can be sold (for instance, to conduct transactions with the Fund) or bought, so holding changes over time.

affects high-income countries. In this paper, we describe and evaluate the Fund's current lending rate policy. We explain how this rate is determined, the negative consequences of high lending rates in the current context, and why there is a need for reform. We discuss and analyze the impacts of the recent reforms adopted in October 2024. Because we believe there is room for further improvement, we have laid out a feasible proposal for further reform, given that there are some similar precedents and no reform in the Articles of Agreement is needed.

More precisely, in the first, descriptive and analytical part, we seek to unpack how the lending rate is determined, component by component, assessing the implications of IMF lending practices, for the fund, their borrowers, and their creditors. We discuss the recent evolution of each component, in particular, the rationales for modifying the components and the grounds on which the decision was taken. We then explain the main drawbacks of a high IMF lending rate policy, in particular, its procyclicality, its unfairness, its inability to ensure adequate recovery for countries in distress (and its negative consequences for global financial instability), and its knock-out effects for concessional lending. The second, more prescriptive section will critically examine different proposals for potential reform and improvements.

2. The Lending Rate and its Role in the IMF's Framework

IMF lending is based on a system in which countries lend and borrow money from each other, relying on the SDR, which is both a unit of account, as well as an asset and liability.⁸ The lending rate is a key component of a complex web that the IMF operates using a system of interrelated balance sheets (Pforr et. al., 2022).

The IMF funds its operation by drawing on members' quotas, multilateral⁹ and bilateral borrowing from members, as well as the charges included in the different programs under the GRA and some of the trust funds. During the financial year of 2024¹⁰, countries paid a total of 4.66 billion SDR in GRA charges (about 6.29 billion US dollars), 1.01 billion SDR of level-based surcharges (about 1.36 billion US dollars), 433 million SDR of time-based surcharges (about 584.55 million US dollars), and 9 million SDR of RST interest (about 12.55 million US dollars).

Because the exact rate that each country pays depends on many things, for instance, the type and duration of the program (which depends on income status), we consider the total credit outstanding as October of 2024 (the latest month available, as we write this paper) and the total charges from the GRA account for 2024 (including estimates from October to December, which do not account for the reform of the surcharge policy that took place during October of 2024). Next, we calculate the average annual interest rate, as the ratio of total payments for 2024 to total credit outstanding, and the ratio of projected payments from October to December of 2024 to total credit outstanding. The results are displayed in **Figure 1**. For the GRA account, the IMF charges an estimated marginal and an average rate of 6.39% and

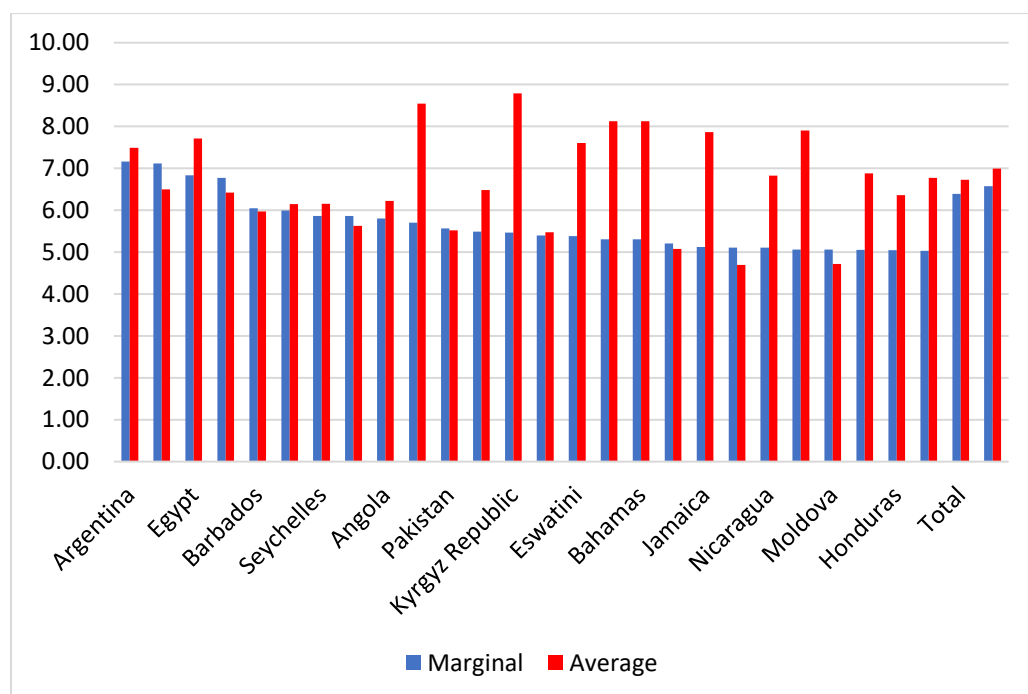
⁸ The SDR does not represent net wealth, as it is both an asset and a liability. In the SDR Department, members receive interest on their cumulative SDR holdings and are assessed charges against their cumulative allocation of SDRs, both at the SDR interest rate. As of October 2024, the IMF had allocated a total of 660.7 billion SDR. When a member "converts" their holdings to other currencies or uses them for approved operations (such as paying the Fund), their holdings fall relative to their allocation; a negative SDR Department position may be generated, and they face a charge (Shenai et. al., 2023). Contrariwise, countries whose position is larger than their allocation earn the difference.

⁹ Multilateral Arrangements (or NAB - New Arrangements to Borrow) are supposed to be rolled back as part of the agreements reached under the 16th General Review of Quotas (GRQ). The IMF made clear that the effectiveness of the rollback of NAB credit arrangements would be tied to the effectiveness of the quota increases under the 16th GRQ.

¹⁰ The financial year X+1 starts on May 1st of year X and ends on April 31st of the year X+1.

6.73%, respectively; the average for the G24 stands at 6.58% and 7.00%, respectively.

Figure 1. Average and Marginal Lending Interest Rate (Marginal Rates Above 5%)



Source: Authors' calculation based on IMF Financial Data Query Tool.

Most of the Fund lending is concentrated on a few large borrowers. The ten largest borrowers together account for more than 68% of the total portfolio of the institution. The G-24 members account for more than 64%. This is not unprecedented, and in fact, the IMF typically concentrates its lending on a few members, except during the period between the second half of the 1970s and the first half of the 1990s (Ocampo, 2017, pp. 143).

Considering payments in absolute terms, the burden falls on the five largest debtors to the Fund, which together explain 57.6% percent of the total credit outstanding: Argentina (27.88%), Egypt (8.50%), Ukraine (9.50%), Ecuador (5.72%), and Pakistan (6.00%). Except for Ukraine, these are all members of the G24. As expected, these countries are also paying the largest share of the surcharges, thus constituting the main sources of operative income for the institution, and they are also among the cases that pay the highest average and marginal interest rates.

It is important to keep in mind that the IMF only funds its operations using the resources from the basic margin and it saves the income from surcharges as precautionary balances. The rest of the charges (except for the administrative fees) compensate the Fund for the cost of borrowing, which is associated with the remunerated reserve tranche of the quotas, as well as any other borrowing that helps the institution to lend. As of 2024, the IMF holds substantial precautionary balances of \$27.7 billion, which is above the already very high target of \$25 billion. Being an institution that is backed by rich shareholders, with no borrowing from the market and very few cases of default, it can at least slow down the pace at which it accumulates balances, creating room for a reduction of charges and surcharges.

Historically, the reserve tranche was a share of the quota, payable in gold, which members could access with little trouble and without cost (unlike a traditional arrangement). Nowadays, countries cover the reserve tranche in SDR or internationally “usable currencies”;¹¹ the reserve tranche is pretty much like a term deposit: it is part of a country's international reserves, around one-quarter of the quota. However, when a member borrows from the Fund, its reserve tranche automatically falls, as the “reserve tranche position” is defined as the difference between a member's quota and the IMF's holdings of the member currency (which the country provides in exchange for the currency that it needs under a program). Likewise, when a country repays, the reserve tranche increases. The country whose currency is used in the transaction will see an increase in its reserve tranche position when a member borrows from the Fund and a decrease when the repayment is made.¹²

Let us illustrate how this system works by means of an example. If country X has a quota of 100 dollars, 75 are provided in “currency X”, while the remaining 25 are in “currency D”. Country X asks for a Stand-by arrangement and draws 200 units of “currency D”. Thus, the IMF now holds the equivalent of 275 worth of “currency X”, the reserve tranche position of country X is now 0, while country D's position will increase by 200 dollars. When country X repays, we are back to square one.

Each of the components of the lending rate is thus part of a complex system that essentially redistributes resources amongst the members of the Fund. Specifically, for its lending operations, the IMF charges a lending rate, which is composed of a basic rate, charges, surcharges (if they apply), and commitment and service fees.¹³ **Table 1** summarizes the role of each component in the lending rate. It also describes who gets the money that countries pay when they have outstanding credit to the Fund.

The basic rate is composed of a fixed margin over the interest rate on the IMF's SDRs plus the service and commitment fee. The SDR rate is a weighted average of the interest rates of the United States, the United Kingdom, Japan, China, and the Eurozone. Moreover, both the rate at which SDRs are remunerated and the lending rate are adjusted under the so-called “burden-sharing mechanism”, to allow the IMF to deal with the financial consequences of protracted arrears (the mechanism was designed to obtain additional resources when members of the fund fail to meet their commitment to the fund in time). Next, we describe each component of the lending rate one by one.

The Basic Margin. The basic margin is determined by the Executive Board on a two-year basis. It was historically adjusted to reflect the Fund's operative costs, mainly to allow the regular operation of the institution and to cover the expenses from programs. In the early 2000s, the level of credit outstanding was very low, due to a favorable international environment of low interest rates and high commodity prices that reduced the demands for assistance. Then, when the financial year of 2007 came, this would have implied a basic rate of 350 basis points (due to the reduction in the amount of credit outstanding).

¹¹ “Usable” currencies are those of members included in the Fund's quarterly financial transaction plan, which are called “creditor members”. Those are members whose external positions are considered sufficiently robust (considering indicators such as the balance of payment and reserve position, capital market access, exchange rate development, short-term external debt, and debt service). See IMF (2001).

¹² Not all the reserve tranche is remunerated. The so-called “remunerated reserve tranche position” is equal to 75% of the member quota in April 1978 (being that part of each country's quota that was paid in gold before the Second Amendment) and it has remained fixed in nominal terms, thus reducing the size as the quotas were increased. As noticed by Mohammed (2003), this has benefited the countries with the largest quotas, as the relative size of the remunerated reserve tranches has increased (in absolute terms and as a share of the quota), compared to countries with the smallest quotas.

¹³ 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 reserves.

Table 1 Components of the IMF Lending Rate

Component	Operative Role	Distributive Role	Current policy
Basic margin	Supports Fund's operations	Fund's operative income	60 basis points per year
SDR rate	Regulates the rate of charge and remuneration	IMF non-borrowers	Weighted average of three-month t-bills of US, Japan, EU, UK, and China
Surcharges	To discourage unduly large use of credit and to encourage prompt repayment	Precautionary balances	200 basis points for credits above 300% of quota. 75 basis points for credits when the credit has been outstanding for more than 36 months (credit tranches) or more than 51 months (EFF)
Service fee	Cover the costs of a program	Fund's operative income	50 basis points per disbursement
Commitment fee	Cover the cost of a program	Refundable as a program is disbursed	Refundable when the loan is disbursed. 15 basis points for committed amounts up to 200 percent of quota, 30 basis points on committed amounts above 200 percent, and 60 basis points on amounts exceeding 600 percent of quota
Burden sharing mechanism	Distribute the costs of prolonged arrears	Deducted and added to the remuneration and lending rate, respectively	Upward adjustment to the basic rate of charge and a downward adjustment to the basic rate of remuneration (both refundable)

Source: Authors' elaboration based on Krahnke and Todoir (2023).

This level was deemed “too high” by the IMF (IMF, 2016c, page 10), and in response, an exceptional circumstances clause was added to allow the margin for the rate of charge to be set on a basis other than estimated income and expenses. It was set at 100 basis points. Consequently, the Executive Board established that the margin on the rate of charge should be set stably and predictably, and it should no longer cover the full range of the IMF's activities but should instead be set as a margin over the SDR interest rate to cover the IMF's intermediation costs and allow for a buildup of reserves.

Thus, in exceptional circumstances, the margin may be set at a level other than that which is adequate to cover estimated intermediation expenses incurred by the IMF and to generate an amount of net income for placement to reserves. In October 2024, the basic margin was reduced from 100 to 60 basis points per year.

The SDR rate. The SDR rate is also the rate of remuneration and the rate of charge; in other words, it is the rate that the Fund pays to its creditors and one of the components that their debtors pay (to cover the cost of credit). The SDR rate redistributes resources between the borrowers and the non-borrower members of the Fund. It is also the rate at which excess holdings of SDRs are remunerated (and the rate paid by those countries that used their allocations of SDRs).

The SDR rate is a weighted average of advanced economies' three-month interest rates. It is calculated as follows:

$$SDR_i = \sum_{i=1}^5 (A_i \times B_i \times C_i)$$

where A_i , B_i , and C_i are the currency amount in the calculation basket, the exchange rate against the SDR, and the three-month interest rate on treasury bills/bonds, for the i -th country respectively. Currently, the SDR basket is composed of five currencies (the US Dollar, the British Pound, the Japanese Yen, the Chinese Yuan, and the European Euro).¹⁴

The SDR rate is determined implicitly by the Central Banks of the main financial centers. However, in the past, and due to exceptional circumstances, the Executive Board has set a floor of 5 basis points, and like the other components of the lending rate, there is room for a discussion of its determination inside the Fund without significant reforms.

Surcharges. Surcharges are rate increases that are added to the interest rate charged by the IMF. They originated after the introduction of the Supplemental Reserve Facility (SRF), established in 1997 to provide credits to countries encountering capital account crises (Mohammed, 2003). Since the SRF has no defined access limits, there was a surcharge of 300 basis points initially (on the basic rate of charge), which rises by 50 basis points after one year from the date of disbursement and each subsequent six months to a maximum of 500 basis points.

In contrast, the surcharge rate was set at 150 basis points for the Contingent Credit Line (CCL) and would rise by 50 basis points one year from the date of the first purchase and every six months thereafter, up to a maximum of 350 basis points (given incentives to members to rely on this credit line and not on the SRF).

For the other GRA transactions, there have always been annual and cumulative access limits. However, since November 2000, surcharges have also been applied to these transactions to discourage unduly large use of credit and to encourage prompt repayment: the surcharge is 100 basis points on credits over 200 percent of quota and 200 basis points on credits over 300 percent of quota. A schedule of time-based repurchase expectations was introduced, from which a member could request an extension to the maximum allowed under the repurchase obligation schedule.

This resulted in a complicated scheme. To simplify it, a reform was adopted. It eliminated the Supplemental Reserve Facility, the only facility on which time-based surcharges had been levied and established. The current scheme was established in 2009, and reviewed in 2016 (IMF, 2016a; IMF 2016b) and 2024.

Nowadays, surcharges are levied based on two criteria: 1) the amount of credit; and 2) the length of repayment. The surcharge was set at 200 basis points on outstanding credit above 187.5% of quota, resulting from purchases in the credit tranches and under the Extended Fund Facility (EFF); and an additional time-based surcharge of 100 basis points applies when the credit has been outstanding for more than 36 months in the case of purchases in the credit tranches, or more than 51 months in the case of purchases under the EFF.

¹⁴ With effect from August 1, 2022, the Executive Board of the IMF has determined that the five currencies that meet the selection criteria for inclusion in the SDR valuation basket will be assigned the following weights based on their roles in international trade and finance: U.S. dollar 43.38 percent European euro 29.31 percent Chinese renminbi 12.28 percent Japanese yen 7.59 percent Pound sterling 7.44 percent. Nowadays the SDR rate stands at around 400 basis points, due to the high rates in those countries.

In October 2024, the threshold was increased to 300% of the quota, while the time-based component was reduced, from 100 to 75 basis points. The income derived from surcharges engrosses the Fund's reserves and remains outside the net income target for the year.¹⁵ During 2024, out of 52 countries paying charges for Stand-By Arrangements and Extended Fund Facilities, 23 paid surcharges.¹⁶

Service and commitment fees. Additionally to the other components, the IMF imposes a service fee, equivalent to 50 basis points per disbursement (except for the Short-term Liquidity Line, which has a reduced rate of 21 basis points), and a commitment fee, between 15-60 basis points (refundable when the loan is disbursed): 15 basis points for committed amounts up to 115 percent of quota; 30 basis points on committed amounts above 115 percent and up to 575 percent of quota; and 60 basis points on amounts exceeding 575 percent of quota. They help to cover the expenses of IMF programs. In October 2024, the threshold of 115 percent and 575 were raised to 200 and 600 percent of the quota, respectively.

The burden-sharing mechanism. To offset losses of income from unpaid charges and to fund certain precautionary balances designated as Special Contingency Accounts (SCAs), the IMF established an upward adjustment to the basic rate of charge and a downward adjustment to the basic rate of remuneration (both refundable). This is the so-called "Burden Sharing Mechanism". It was designed during a time when economies from East Europe and Latin America were facing severe financial constraints because of the debt crisis of the 1980s. Many members of the fund had accumulated prolonged arrears to the institution, straining the costs of the operations.

The first of these Accounts (SCA-1) was established in the financial year 1987, to cope with potential losses resulting from an ultimate failure of members in protracted arrears on the payment of overdue obligations to the IMF. Another Special Contingency 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 program" (see Mohammed, 2003).

The SCA-2 was terminated in 1999 when it reached a target of 1 billion SDRs, and the amount was refunded to the contributors. Currently, no country is in arrears to the IMF. Consequently, there is no adjustment for the designated SCA-1 account. However, if financial conditions deteriorate, it is likely that some countries will fall into arrears, which may require a re-utilization of the Burden-Sharing mechanism or the utilization of the institution's reserves.

3. An Evaluation of the Current Lending Rate

In this section, we describe why the IMF's lending rate policy should be reformed. Even after considering the changes implemented in October of 2024, we still consider that there are three main objections to the current lending policy. Specifically, we argue that:

- 1) It is procyclical: it amplifies the effects of international shocks.
- 2) It is unfair: it penalizes middle and low-income debtors of the Fund.
- 3) It does not help economic recoveries: it increases the financial burden of countries in distress, threatening debt sustainability and global financial stability.

¹⁵ In October, the IMF decided that part of the reserves previously accumulated would be destined to fill the finance needs of the PGRT trust fund.

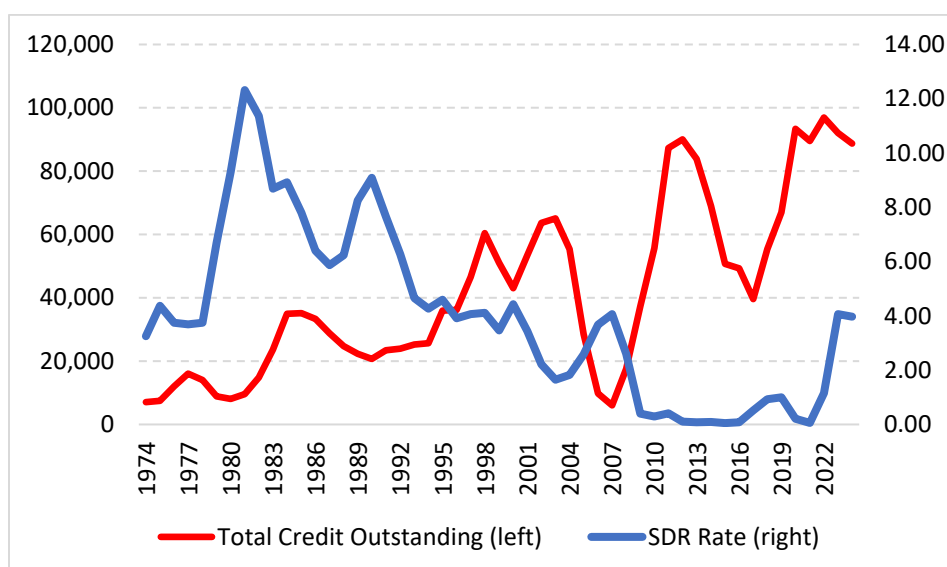
¹⁶ The list of the 23 countries that paid surcharges during 2024 is Angola, Argentina, Armenia, Barbados, Benin, Costa Rica, Côte d'Ivoire, Ecuador, Egypt, Gabon, Georgia, Jordan, Kenya, Moldova, Mongolia, North Macedonia, Pakistan, Senegal, Seychelles, Sri Lanka, Suriname, Tunisia, and Ukraine.

These are the main reasons why the current lending rate is still too high, making it more difficult for the Fund to fulfill its mandate. Therefore, the Executive Board should consider modifying the status quo.

The Current Lending Rate Policy is Procyclical

Total IMF GRA credit outstanding increased from 66.95 billion SDR at the end of 2019 (about 90.38 billion US dollars) to 88.71 billion SDR as of October 2024 (about 119.76 billion US dollars). This represents a record high. At the same time, borrowing costs rose. This is unprecedented in the Fund's history (see **Figure 2**). Historically, expansions of IMF lending have coincided with a falling SDR rate, given that economic downturns caused many countries to resort to the Fund were accompanied by reductions in monetary policy rates of major central banks (Krahnke and Tordoir, 2023).

Figure 2. SDR Rate and Total Credit Outstanding



Source: Authors' calculation based on data from the IMF' Financial Query Tool.¹⁷

Today, due to the specific combination of shocks that hit the global economy, the IMF's lending activities are procyclical for the first time. According to the IMF's estimates, the demand for its assistance is set to increase further reflecting the impact of Russia's invasion of Ukraine and inflation developments (Krahnke and Tordoir, 2023).

High SDR rates reflect advanced economies' decisions on monetary policy, which were made to fight inflation in their countries. As documented by the literature (Degasperri et. al., 2023; Rajan 2024; Rey, 2015), these policy rates are often inappropriate for dealing with macroeconomic imbalances elsewhere. When a crisis hits, countries that face worse financial conditions need to resort to the IMF to remove financial constraints, hoping to regain market access and repay the institution. However, this is more difficult because the lending rate increases due to the monetary policy of the advanced economies (which, as explained, affects the SDR rate and consequently the lending rate).

Borrowers are doubly penalized due to the existence of surcharges. Those that need support from the IMF must face more restrictive credit conditions and are typically affected by tighter financial constraints.

¹⁷ For 2024: total credit outstanding is total GRA credit outstanding as of 10-31-2024; SDR rate is the average between 01-01-2024 and 10-31-2024.

This is the case when a country is affected by climate-related natural disasters or military conflict (e.g. Ukraine). Even with the recent reforms in place, the current lending policy thus amplifies the spill-over effects of monetary policy and reinforces countries' funding difficulties, without limiting the demand for IMF credit and without encouraging early repayment (Stiglitz and Gallagher, 2022).

Debtor countries, especially those that rely on large and prolonged programs end up paying a higher SDR interest rate. Advanced economies that have not used the SDRs receive higher interest payments. Thus, high lending rates redistribute interest income from not-so-poor members (those who can access facilities from the GRA account) to rich members. Finally, because many low-income countries drew on their SDR allocations in 2021 when interest rates were still low, they should pay a high interest rate.

The High Lending Rate is Unfair

The IMF lending policy is de facto unfair. Because the IMF finances its operation using the income from countries under a program, the resources come mainly from middle-income countries with balance of payments problems. Low-income countries receive zero-interest rate loans, so they do not contribute. All the countries, via the unremunerated part of the quota, also contribute to the Fund. As the Fund's loan portfolio increases, the contribution of middle-income countries increases. In October of 2024, the IMF decided that additional resources would be allocated to the PRGT, from reserves (which are built up from surcharges) and operative income, exacerbating this element of unfairness.¹⁸

A high lending rate aggravates this issue. Due to a high SDR rate, some borrowers paid 7-8% interest rates per year on outstanding balances subject to surcharges (Stiglitz, Gallagher et al 2024); after the recent changes, they will still pay between 6-7% per year. The IMF is not a regular creditor. Countries have important incentives to avoid falling into arrears to the Fund, as other bilateral and multilateral sources of finance could be jeopardized. In practical terms, the IMF as a creditor has de facto senior status. Moreover, credit from the Fund has strings attached. Borrowing from the institution comes with conditionalities, which ensure the loans are paid. Why then do members need additional incentives to repay?

There is an additional element of unfairness in the current lending policy. The IMF has not realigned members' quotas since the 14th General Review. Given the rapid growth in some countries in the past two decades, many emerging market economies' IMF quota share underestimates their share of the global economy. For these countries, the threshold at which they should not be subject to surcharges based on the criteria of exceptional access, is underestimated. As a result, the extra costs that countries bear under a program are completely delinked from their size.

Middle-income countries that pay surcharges are not the only ones facing the effects of a high SDR rate. There are also knock-on effects for these countries who do not borrow from the GRA, but from the Fund's concessional windows, like the PRGT, which low-income countries can tap for lending at a subsidized rate of zero percent. As the SDR rate increases, it becomes hard to fundraise among rich countries with excess SDR positions, straining PRGT finances. More precisely, the resources that are required to constitute the trust fund compete with the rate at which those excess SDR positions are remunerated, which is the SDR rate.

For the same reason, the higher SDR rate also affects the newly established RST, which assists countries by delivering affordable long-term financing to support reforms to mitigate climate change and

¹⁸ <https://www.imf.org/en/News/Articles/2024/10/16/pr24372-statement-imf-md-kristalina-georgieva-rev-poverty-reduction-growth-trust?cid=em-COM-123-49129>

pandemics. It can also affect debt relief efforts, such as the Initiative or Catastrophe Containment and Relief Trust (CCRT), which provides grants for debt relief for the poorest and most vulnerable low-income countries hit by natural or public health disasters. Specifically, the CCRT provides relief on amortization payments to the IMF for 30 PRGT-eligible countries when they are hit by natural disasters. Therefore, fluctuations in the SDR rate do not directly affect the funds needed for the CCRT. This contrasts with the PRGT, which requires interest rate subsidies to be disbursed. However, if the SDR rate is high, the subsidy needs for the PRGT increase, which could make donors less willing to replenish the CCRT.

As recognized by a 2023 review of the adequacy of the finances of the trust funds (IMF, 2023), the funding of the first two trust funds was found to be under strain, owing to stronger demand for loans and sharply higher interest rates than previously envisaged, while the CCRT remains severely underfunded.

Since the pandemic, the IMF has supported more than 50 low-income countries with over SDR 17 billion (about 23 billion US dollars) in interest-free loans (or almost free, depending on the level of the SDR interest rate). The PRGT faces a shortfall of SDR 1.2 billion (about 1.6 billion US dollars) in pledges for subsidy resources and SDR 3.5 billion (about 4.7 billion US dollars) for loan resources to complete the first stage of the 2021 funding strategy.

Regarding the RST, the Fund recognized a strong and frontloaded demand for arrangements. However, on the RST resource side, pledges amount to 76 percent of the loan resource target, leaving a shortfall of about SDR 6.5 billion (about 8.8 billion US dollars) in loan resources relative to the original fundraising target. The recent increase in the SDR rate has prompted the IMF Executive Board to implement a 225-basis points cap for the lowest-income RST-eligible members.

Although it is impossible to say how much a change in the SDR will affect the resource shortfall or the subsidies that can be afforded, given the pledges, a lower SDR rate will create incentives for countries with excess SDR position to increase their pledges. What seems clear is that if nothing else changes, the PRGT and the other trust funds will not be able to provide concessional lending, at least at the current terms. This will lead to hardening conditions for PRGT-eligible countries, which are the poorest members of the IMF.

Finally, many members of the Fund have used the SDRs (in particular after the 2021 allocation) and have a negative net SDR position. They are thus facing increasing interest costs, equivalent to the difference between their cumulative net allocations and their holdings.

High Lending Rates Will Make it Harder to Promote Economic Recoveries

For borrowers, repaying high interest rates to the IMF itself takes away much-needed cash, deepening their budgetary woes, and hampering their prospects of economic recovery. The high SDR rate may undermine the catalytic role of the IMF in crowding in private finance.

A typical IMF program does not provide all the finance needed to resolve a balance of payments crisis. The presumption is that the presence of an arrangement between the Fund and a member is a signal to private investors that sustainable policies are consistent with economic recovery, hence, the debt sustainability will be sustained.¹⁹ The more expensive it gets for countries to service their debt from the IMF – the senior creditor – the less faith private investors will have in also being repaid. The IMF has a de facto senior status, so it makes sense for private investors to suspect that the Fund will be paid first. This problem is particularly relevant for large programs, where the negative “anticatalytic effects” dominate

¹⁹ For the theoretical underpinning, see Morris and Shin. For the empirical results, see for instance, Díaz-Cassou et al. (2006), Edwards (2006), or Erce and Riera-Crichton (2015).

the positive “catalytic effects” of Fund activities (Krahnke, 2023). When a program is too large and it is sustained for a prolonged period, the IMF imposes surcharges, which significantly increase the cost of credit, and makes this scenario a more likely outcome.

In the current economic context, the balance of payments needs of countries in distress are so large that several countries have borrowed large amounts for long periods. Because both level- and time-based surcharges apply, borrowing costs increase by 275 basis points, increasing borrowing costs to 685 basis points per year (as of the last quarter of 2024). In some countries borrowing from the GRA account represents a significant share of public debt. Using data from the IMF WEO (2024), for about half of the cases, borrowing from the Fund represents more than 6% of total public debt, and in a significant number of cases such figure is above 9% (up to about 15%).

These figures may seem low, but we should keep in mind that in some cases net public debt (which in practical terms excludes from the calculation intra public sector borrowing) is much lower, thus the share of the IMF is much larger. Argentina is a case point. The share of borrowing from the IMF is around 7.6% of total public debt, but net public debt is only two-thirds of total debt (see for example, IMF 2024b): thus, borrowing from the Fund represents around 11% of net public debt. Moreover, borrowing from the GRA represents debt in foreign currency and external, which differs from other components of public debt in many ways; most importantly, foreign reserves are required to repay the Fund. Again, as a share of public debt in foreign currency or external, borrowing from the Fund is much larger.

Public finances should help to counterbalance the cost of private lending when they are excessive (i.e., during a financial panic) and to sustain investment projects where the sunk costs are too large and the return too uncertain for the private sector to step in. High SDR rate may jeopardize this particular role of public finances. To illustrate such consequences, we estimate the required primary surplus to stabilize the public sector gross debt-to-GDP ratio, relying on the IMF’s estimations from October 2024 World Economic Outlook. We assume that the entire stock of debt pays the same rate, one that is similar to the rate the IMF is charging some members.

Specifically, we consider all the countries with an active Stand-by Arrangement, or Extended Fund facility, for which the Fund projects: i) the estimated growth rate of GDP in constant domestic currency between 2022 and 2029; ii) the general government primary net lending-borrowing between 2022 and 2029; and iii) the average general government total public sector gross debt for 2022-2029. Assuming a real interest rate of 5% yearly (approximately the lending rate of 6-7% minus 1-2% inflation), we estimate the primary surplus that stabilizes the general government gross debt to GDP ratio.²⁰ Then we repeat the process, this time assuming a real interest rate of 2.25% yearly (a scenario that mimics the elimination of surcharges).

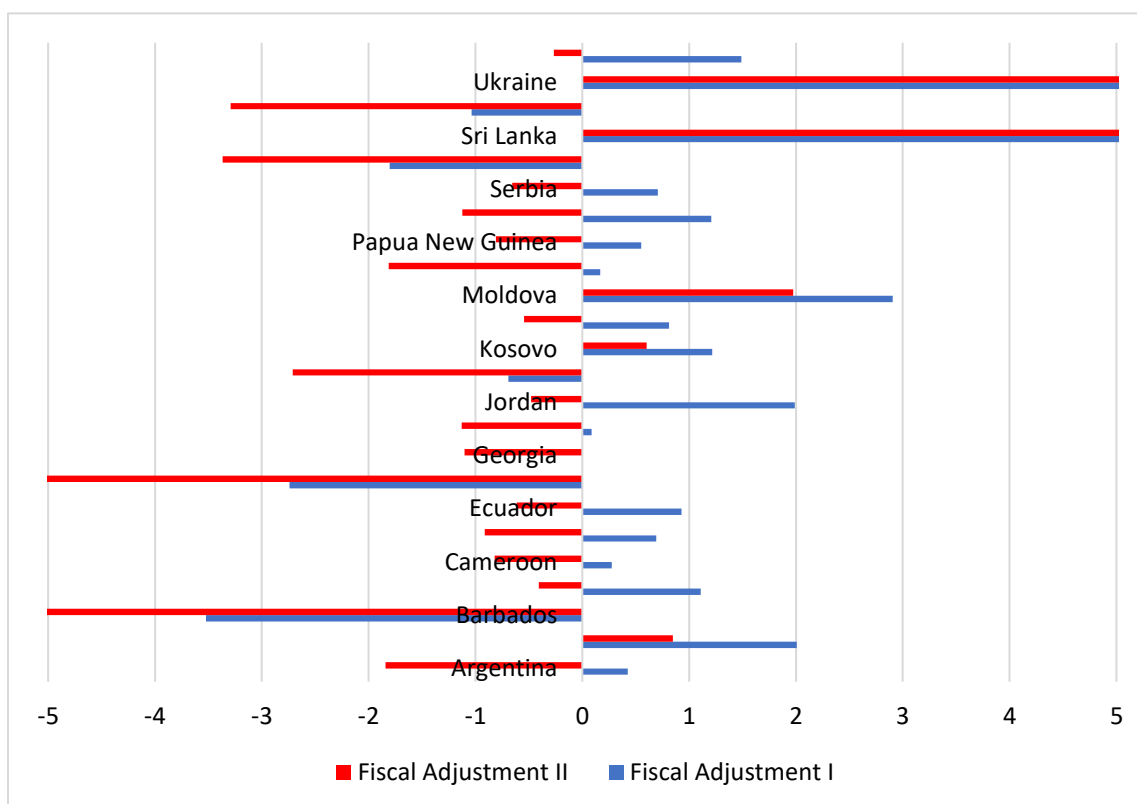
The goal of this simple exercise is to show that if the countries were to face the rate that the IMF is currently charging some countries for the totality of its public debt, in order to stabilize the debt ratios, additional fiscal adjustments could be required. However, if surcharges were eliminated, or the lending rate reduced by a similar amount, fiscal space will significantly be improved. While this exercise assumes that the average cost of capital is the same for the private borrowers and for the IMF, this is a conservative scenario. Consider a scenario of debt distress where a typical emerging market lost market access. Borrowing from the Fund is at the lowest possible rate.

Figure 3 illustrates the results under both scenarios. On average, the required fiscal adjustment to stabilize the debt ratio (i.e., the difference between the projected fiscal result and the required fiscal result) is around 1.5% of GDP sustained over time when the real interest rate is 5% yearly, vs. a fiscal expansion of

²⁰ Stability of the debt to GDP ratio requires $x = d(r - g) / (1 + g)$, where d is the time derivative of the debt to GDP ratio, x is the primary surplus to GDP ratio, r is the real interest rate, and g is the real growth rate of GDP.

0.2% of GDP (also sustained over time, when the real interest rate is 2.75% yearly).

Figure 3. Required Change in Fiscal Surplus to Stabilize the Debt to GDP Ratio in Selected Countries



Source: Data from the IMF WEO, and authors' calculation.

There are two outliers, Ukraine and Sri Lanka: to stabilize their debt ratios, they require fiscal adjustments above 5% of GDP even when the real rate is reduced by 225 basis points; excluding those cases, the figures are an additional adjustment of 0.25% of GDP and fiscal expansion of 1.41% of GDP.

4. Effects of the Current Reform and a Proposal for Further Changes

There is a need to act and explore options to reform the institution's lending practices. In October of 2024, the Executive Board decided to reduce the basic margin, from 100 basis points to 60 basis points, increase the threshold of quota that is affected by surcharges, from 187.5 percent to 300 percent, and reduce the time level component of surcharges, from 100 basis points to 75 basis points. A sizable share of the lending income of the Fund is represented by surcharges, which increase the cost of credit to 275 basis points yearly. As shown in **Table 2**, before the reform, 23 countries were projected to pay the Fund more than 8,175.29 million US dollars for the five years between 2024 and 2029, excluding the effects of the recent reforms. The largest borrowers, Argentina, Ecuador, Egypt, Pakistan, and Ukraine contribute more than 95% of the total projected payments.

Table 2. Projected Surcharge Payments 2024-2029
(Pre October 2024 Reform, Millions of US Dollars)

Country	2024	2025	2026	2027	2028	2029	Total
Angola	45.0	55.1	40.9	19.5	1.7	0.0	162.2
Argentina	1029.2	1017.1	1015.1	952.0	795.6	589.1	5398.0
Armenia	0.8	0.0	0.0	0.0	0.0	0.0	0.8
Barbados	5.2	6.4	4.5	2.4	0.4	0.0	18.9
Benin	2.3	1.8	1.0	0.7	0.1	0.0	5.9
Costa Rica	17.6	17.4	16.6	18.5	13.3	5.6	88.9
Cote d'Ivoire	1.3	0.2	0.0	0.0	0.0	0.0	1.6
Ecuador	148.4	191.6	163.2	129.9	92.2	51.0	776.3
Egypt	288.3	152.6	37.4	0.2	0.0	0.0	478.5
Gabon	6.8	1.9	0.0	0.0	0.0	0.0	8.7
Georgia	1.3	0.2	0.0	0.0	0.0	0.0	1.5
Jordan	23.9	26.3	25.0	18.9	11.2	2.7	108.1
Kenya	6.9	8.7	7.6	5.0	1.4	0.0	29.6
Moldova	0.9	0.7	0.1	0.0	0.0	0.0	1.6
Mongolia	0.7	0.0	0.0	0.0	0.0	0.0	0.7
North Macedonia	0.2	0.0	0.0	0.0	0.0	0.0	0.2
Pakistan	94.4	96.6	72.8	38.8	0.9	0.0	303.4
Senegal	2.7	0.2	0.0	0.0	0.0	0.0	2.9
Seychelles	1.3	1.1	1.4	1.0	0.6	0.1	5.6
Sri Lanka	3.7	4.1	0.4	0.0	0.0	0.0	8.2
Suriname	0.6	2.6	2.5	2.2	1.9	0.7	10.5
Tunisia	3.1	0.0	0.0	0.0	0.0	0.0	3.1
Ukraine	225.2	207.6	144.6	91.5	61.9	29.3	760.2
Total	1909.7	1792.1	1533.1	1280.6	981.2	678.6	8175.3

Source: Authors' calculation based on data from the IMF Financial Data Query Tool, assuming a dollar to SDR rate of 1.35.

Table 3 estimates the impact per year of the changes adopted during October of 2024, assuming that the total GRA credit outstanding of the members remains the same. Total savings are 1.12 billion US dollars per year. Since the modifications affected the basic margin and the surcharge component, the IMF operative income will be reduced and the pace at which the institution will accumulate reserves will fall, but there is no reason to believe that this will jeopardize the day-to-day operations of the fund.

As expected, the larger savings are concentrated in the largest borrowers (Argentina, Ecuador, Egypt, Pakistan, and Ukraine). Although the reform is a step in the right direction, we believe that there is room for additional changes. Countries with surcharges and long-term programs still face high lending rates, with some paying around 6-7% year.

Table 3. *Estimated Impact of Recent Reforms*
(Millions of US Dollars)

Country	Savings on basic charges	Savings on surcharges	Total savings
Angola	16.2	36.3	52.5
Argentina	167.9	217.9	385.9
Armenia	1.1	0.0	1.1
Barbados	2.0	4.6	6.5
Benin	1.7	3.5	5.2
Costa Rica	7.7	17.9	25.6
Cote d'Ivoire	7.2	4.4	11.6
Ecuador	34.4	46.3	80.7
Egypt	53.3	105.5	158.8
Gabon	3.0	6.0	8.9
Georgia	2.3	1.5	3.8
Jordan	8.1	17.2	25.3
Kenya	7.2	13.1	20.3
Moldova	2.1	2.7	4.8
Mongolia	0.7	0.0	0.7
North Macedonia	1.4	0.0	1.4
Pakistan	36.8	95.0	131.8
Senegal	3.6	2.7	6.4
Seychelles	0.5	1.1	1.6
Sri Lanka	7.2	10.4	17.6
Suriname	1.8	3.9	5.7
Tunisia	4.8	0.0	4.8
Ukraine	53.2	104.5	157.7
Total	424.2	694.4	1118.5

Source: Authors' calculation based on data from the IMF Financial Data Query Tool, assuming a dollar to SDR rate of 1.35.

The recent decision to alter the IMF lending rate is not without precedent. For instance, the basic rate was historically adjusted to reflect the Fund's operative costs, but during the financial year of 2007, this would have implied a basic rate of 350 basis points (due to the reduction in the amount of credit outstanding). In response, an exceptional circumstances clause was added to allow the margin for the rate of charge to be set on a basis other than estimated income and expenses. The Executive Board discussed and modified the lending practices in 2014, when they established a floor of 5 basis points, in the context of low international interest rates, and when it implemented a 225-basis points cap for the lowest-income RST-eligible members.

A further reduction of the basic rate – currently 60 basis points – is not enough, and it may affect the ability of the institution to operate. A reduction of the other components of the lending rate, such as the service and commitment fees, is not recommended, as they are too small to make a difference, or they cover the operative costs of the Fund so there is no room for a meaningful reduction. Better solutions

involve putting a cap on the SDR rate, the modification or the elimination of the surcharge policy, or a combination of both. The Executive Board can change both policies without changing the IMF Articles of Agreement, so the reform is feasible in the short term.

The precise impact of the reform on the borrowers will depend on how it is implemented. A cap on the SDR rate will have some, albeit not very large, effect on the payments associated with the net SDR position. It will also have the effect of reducing the remuneration of the reserve tranches, while significantly reducing the GRA charges. The IMF will not lose any income.

On the other hand, the elimination or reduction of surcharges will significantly reduce the GRA charges without change in the SDR department and without hampering the remuneration of the reserve tranche; it will affect the income of the IMF, but it will reduce the pace at which reserves are accumulated. Complete elimination of surcharges will provide substantial relief to the largest borrowers from the GRA account, but it will not help countries with smaller and shorter programs, and it will not help the lowest-income members that benefit from the Trust Funds (which are facing funding difficulties).

Thus, like with all potential reforms, attention must be given to potential losers of any changes made. In evaluating said changes, a clear trade-off seems to emerge: the lending rate reform can either impact the Fund's income more heavily by reducing its lending income, or the IMF's non-borrowers, by asking them to cover the costs. How IMF members decide to resolve this trade-off is a political choice.

In a nutshell, the answer on how the burden of the adjustment is distributed depends on which component of the lending rate is adjusted. While a modification of the basic margin will cut the Fund's operating income, a cap on the SDR rate will affect countries with strong balance of payments positions who can exchange their currencies and allow the Fund to extend credit, and to a lesser degree those with "excess" holdings of SDR. In practical terms, the blunt of the adjustment will fall on the main economies whose currencies form the basket of the SDR. Finally, a change in surcharge policy will affect the pace of accumulation of precautionary balances.

Considering both its feasibility and the negative effects of a high lending rate, in the next subsections we simulate the costs of a reform that reduces the charges for borrowing from the Fund. The costs of the reform will fall on the shoulders of the countries with the largest quotas. In the next subsections, we provide some simulations, considering the level of credit from the GRA account outstanding, the allocations and the holdings of SDR, as well as the current level of quotas and reserve tranches, assuming that the reform takes place immediately.

Implication for the Fund and its Members

To gain further insights on the effects of a reduction of the lending rate associated with a reduction of the SDR rate, we consider how the reduction of that rate by 100 basis points may affect borrowers, non-borrowers, and the IMF.

Effects on borrowers. A reform that caps the lending rate implies that the largest borrowers of the IMF (several of them from the G24) will receive relief. Unlike the elimination of surcharges, this reform will affect all borrowers. Moreover, capping the SDR rate, effectively reducing the lending rate, implies larger debt relief than a reduction of surcharges by a similar amount, as these are only paid on the portion of the credit that exceeds 300 percent of a member's quota.

Table 4 illustrates the effects of a cap on the SDR rate, which will reduce it by 100 basis points per year, on the net incomes of the 10th largest "winners" from the reform. We consider the effects on the Net SDR positions (SDR), the reduction in GRA charges (GRA), as well as the reduction in the remuneration of the

reserve tranche or bilateral borrowing (RTP).²¹

**Table 4. Projected Effects of Reduction of the SDR Rate by 100 Basis Points Largest Borrowers
(Per Year, in Million US Dollars)**

Country	GRA charges savings	Reserve Tranche Position savings	Net SDR savings	Total savings
Argentina	419.9	0.0	68.4	488.3
Ukraine	132.9	0.0	43.4	176.3
Egypt	133.2	-3.7	38.3	167.8
Pakistan	92.0	0.0	33.4	125.4
Ecuador	86.1	-0.4	12.8	98.5
Angola	40.4	-1.5	7.6	46.5
Venezuela	0.0	-3.4	36.2	32.7
Iraq	0.0	-3.9	35.6	31.7
Sri Lanka	18.1	0.0	12.8	30.9
Colombia	31.6	-6.7	2.3	27.2

Source: Authors' calculation based on data from the IMF Financial Data Query Tool, assuming a dollar to SDR rate of 1.35.

How does this reform compare to the measures that the Fund took in October of 2024? How does it compare to the complete elimination of the surcharges? Consider the case of Argentina. Due to the recent reforms, the country will save about 385.85 million US dollars per year, 167.94 million US dollars per year from basic charges, and 217.91 million US dollars per year from surcharges. A 100-basis points reduction of the SDR rate implies, instead, a total saving of 488.28 million US dollars, 419.85 million US dollars from total GRA charges (basic and surcharges) plus 68.43 savings on its (negative) SDR net position. The complete elimination of the surcharges implies savings of 1017.05 million US dollars for 2025. In a nutshell, a reduction of 100 basis points implies saving of a similar order of magnitude to the reform of October 2024, while the elimination of surcharges will more than double those figures. Of course, a reform that reduces the lending rate could reduce it by more than 100 basis points, at the expense of the countries with robust balance of payments positions and positive net SDR positions.

However, there is an additional consideration to keep in mind. A reduction of the SDR rate also has implications for the IMF's Trust funds. An SDR rate cap would reduce the need for pledging subsidies to the PRGT and RST. A lower SDR rate (at which the Trust Fund's creditors get remunerated) lowers the needed funds to subsidize the PRGT's concessional loans, reducing pressure on PRGT finances – which are already under strain owing to stronger demand for PRGT loans. For the RST, an SDR rate cap would reduce lending rates, increasing the pace of reserve accumulation and easing the financial constraints that these funds face. This is because the contributors of the RST deposit account – which is meant to generate investment income for the trust – are remunerated at the SDR rate. Hence, an SDR rate cap would immediately increase the “profit margin” of the deposit account. Finally, an SDR rate cap would directly

²¹ The IMF gets its money from the quotas, as well as from multilateral (New Agreement to Borrow, or NAB) or bilateral sources. Currently, the New Agreements to Borrow is not active and there is no bilateral borrowing.

reduce the interest rate burden for countries that tapped their 2021 SDR allocation. Reducing surcharges instead would leave the PRGT's subsidy needs, the RST's reserves accumulation, and the cost of SDR drawings unchanged.

Effects on non-borrowers. Provided that the reform takes the form of a cap on the SDR rate, the burden will fall on all the countries that are currently not on a program. In such a scenario, the countries with the largest quotas will forgo the most, in the form of missing interest income. Additionally, some countries – i.e., their Central Banks – use the SDR as a reserve asset. It seems possible that the cap may limit their earnings. This is the case, for instance, of the Central Bank of West African States, (BCEAO), a monetary union. However, for the countries as a whole (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo), what matters is the net SDR position; moreover, they also benefit from a lower cost of credit from the GRA and the positive impact on the PRGT finances.

Table 5 illustrates the effects of a cap on the SDR rate on the 10 largest “losers”. The effects are negligible for high-income economies, which typically have a robust balance of payments position.

Table 5. Projected Effects of Reduction of the SDR Rate by 100 Basis Points Countries with the Largest Quotas
(Per Year, in Million US Dollars)

Country	GRA charges savings	Reserve Tranche Position savings	Net SDR savings	Total savings
United States	0	-287.4	-170.2	-457.6
China	0	-101.0	-57.3	-158.3
Japan	0	-107.9	-28.5	-136.4
Germany	0	-93.6	-39.5	-133.1
United Kingdom	0	-69.7	-7.6	-77.3
Italy	0	-52.1	-14.1	-66.2
Canada	0	-37.7	-10.4	-48.1
Brazil	0	-37.5	-10.2	-47.7
Russian Federation	0	-49.4	7.2	-42.2
France	0	-69.9	28.3	-41.7

Source: Authors' calculation based on data from the IMF Financial Data Query Tool, assuming a dollar to SDR rate of 1.35.

Effects on the IMF. What are the effects on the IMF's finances? If surcharges are eliminated or reduced, the IMF will need to slow down the pace of accumulation of reserves, while a cap on the SDR rate will not affect the Institution: countries with a strong balance of payments position (which lend their currencies when countries enter into a program) will receive a lower remuneration rate. The only case in which the institution may lose some operative income is a scenario where a reform involves a reduction of the basic margin, from its current level of 60 basis points per year.

To illustrate how a potential reform may affect the Fund flow of income, **Table 6** includes the projected income and regular expenses for the financial years 2024, 2025, and 2026. It shows that the Fund estimates that surcharges will contribute more than half of lending income. If they are eliminated (or reduced, let's say by half), the IMF would still have a surplus and can therefore accumulate balances using its investment income, albeit at a slower pace. If the SDR rate is capped, the IMF finances will not, in principle, be affected. Additionally, current balances are estimated to stand at around 27.7 billion SDR (or

37.4 billion US dollars during the financial year of 2025), above the IMF's target of 25 billion. Why the IMF needs more is not clear at this point.

Table 6. Income and Expenses of the IMF
(Million US Dollars)

	FY2024	FY2025	FY2026
A. Operational income	4,965.30	5,185.35	5,094.90
Lending income	3,622.05	3,588.30	3,503.25
Margin for the rate of charge	1,273.05	1,232.55	1,159.65
Service charges and other income	114.75	105.30	58.05
Commitment fees	303.75	193.05	214.65
Surcharges	1,930.50	2,057.40	2,070.90
Investment Income	1,084.05	1,424.25	1,471.50
Fixed-Income subaccount (reserves)	1,084.05	1,282.50	1,327.05
Endowment subaccount payout	-	141.75	144.45
Interest free resources	244.35	156.60	103.95
Reimbursements	14.85	16.20	16.20
SDR Department	6.75	6.75	6.75
PRG Trust	-	-	-
RST	8.10	9.45	9.45
B. Expenses	1,597.05	1,659.15	1,687.50
C. Net operational income before provisions = A – B	3,368.25	3,526.20	3,407.40
Provision for loan impairment losses	-	-	-
D. Net operational income	3,368.25	3,526.20	3,407.40
Pension-related remeasurement gain	1,827.90	-	-
E. Net operational income after remeasurement gain	5,196.15	3,526.20	3,407.40
Endowment subaccount investment income	804.60	392.85	390.15
Net income position	6,000.75	3,919.05	3,797.55

Source: Authors' calculation based on IMF (2024c), assuming a dollar to SDR rate of 1.35.

Effects on the G24 countries. As a general rule, the members of the G24 are among the borrowers from the Fund. Thus, they are most likely to benefit from a reform that involves the elimination of surcharges or a cap on the SDR rate. **Table 7** illustrates the effect of a reduction of the SDR rate by 100 basis points.

Except for the cases with the largest quotas (i.e., Brazil, China, or Mexico), the effects are positive or slightly negative. Overall, the reform will imply net savings in the order of almost 830 million US dollars per year for the G24 as a whole. Most of the effect is associated with lower payments under the GRA account. The foregone remuneration of the remunerated reserve tranche and the net income on SDRs are about -270 million and 230 million US dollars per year, respectively.

**Table 7. Projected Effects of Reduction of the SDR Rate by 100 Basis Points G-24 Members
(Per Year, in Million US Dollars).**

Country	GRA charges savings	Reserve Tranche Position savings	Net SDR savings	Total savings
Algeria	0	-6.82	-2.32	-9.14
Argentina	419.85	0	68.43	488.28
Brazil	0	-37.52	-10.21	-47.74
China	0	-101.02	-57.28	-158.3
Colombia	31.64	-6.68	2.25	27.21
Republic of Congo	0	0	12.25	12.25
Cote d'Ivoire	17.94	-1.13	2.57	19.37
Ecuador	86.1	-0.39	12.8	98.52
Egypt	133.23	-3.69	38.29	167.83
Ethiopia	2.64	-0.1	5.58	8.12
Gabon	7.45	-0.25	3.05	10.25
Ghana	0	-1.25	14.21	12.96
Guatemala	0	-0.74	1.12	0.38
Haiti	0	-0.28	2.24	1.96
India	0	-43.71	38.42	-5.29
Iran	0	-6.99	-2.33	-9.31
Kenya	18.11	-0.18	6.69	24.61
Lebanon	0	-1.71	10.72	9.02
Mexico	0	-31.17	-10.13	-41.3
Morocco	10.89	-2.03	-1.32	7.54
Nigeria	12.43	-2.37	11.27	21.33
Pakistan	92.02	0	33.35	125.37
Peru	0	-4.68	1.37	-3.31
Philippines	0	-7.28	-0.82	-8.1
South Africa	20.6	-8.81	3.61	15.4
Sri Lanka	18.11	-0.04	12.83	30.9
Syria	0		-0.04	-0.04
Trinidad and Tobago	0	-1.63	-0.12	-1.75
Venezuela	0	-3.44	36.17	32.73

Source: Authors' calculation based on data from the IMF Financial Data Query Tool, assuming a dollar to SDR rate of 1.35.

Some Possible Objections to Further Reform (and Some Rebuttals)

There are some potential objections to a reduction of the lending rate, but the criticism is ill-funded. One objection might be that it is the real interest rate that matters; this suggests that a rising nominal SDR is less of a problem. However, it is not just the nominal interest rate and domestic inflation rate that matter for countries' debt sustainability. The exchange rate and the ability to generate enough export revenues to service a country's obligations in foreign currency are just as vital. All else equal, a rising SDR rate increases payments due in foreign currency. Besides, even in real terms, the SDR's interest rate is rising

fast, as Central Banks typically increase nominal rates faster than inflation (precisely to fight inflationary pressures).

Second, some may fret that an SDR rate cap would require an overhaul of all loan agreements between the IMF and its creditors (both in the GRA, PRGT, and RST). Thankfully, the bilateral loan agreements between the IMF and creditor countries as well as the New Arrangements to Borrow only refer to “the rate at which it pays interest on holdings of Special Drawing Rights”. This rate is specified in Rule T-1. Hence, changing only how the SDR rate is calculated should not trigger any immediate repercussions for the IMF’s various loan agreements. The same is likely to hold for member’s bilateral contributions to the PRGT and RST.

Third, an SDR cap may set a precedent and could lead some to worry that it may become permanent. But the current situation is unique in the history of the Fund so far. After having just coped with a pandemic, the global economy was hit by a major inflationary shock caused by Russia’s war on Ukraine. Hence, major central banks were forced to rapidly tighten monetary policy in a situation of relatively low growth, and elevated debt levels, at a time when the IMF has substantially increased its financial exposure to its membership to help it deal with a global pandemic. These unique circumstances should provide sufficient reason for member countries to make any SDR cap temporary.

A fourth counterargument is that a higher SDR is not a problem if it remains cheaper than market financing rates. Financing terms should not be entirely de-linked from alternative funding on the market. However, countries that require assistance from the Fund are in distress, have lost market access, and have problems refinancing all their external gross financing needs. Moreover, the Fund is a special creditor that lends subject to conditionality, and it should be expected to charge a lower rate (one that is consistent with a debt that is rapid in full by high probability). Finally, the IMF should lend when nobody else does it, to increase international financial stability.

A fifth counterargument is related to an ongoing discussion concerning the permissibility of re-channeling SDRs via Multilateral Development Banks, where some central banks have emphasized the importance of the SDRs retaining their reserve asset characteristics, which is typically understood to require that the SDR must be readily available for use by the Member and high quality (i.e. low credit risk). The proposed changes to the SDR rate do not impact on the status of the SDRs held by the Members.

One concern with capping the SDR rate versus adjusting surcharges is that it could negatively impact on the tradability of SDRs. SDRs can exclusively be exchanged for freely usable currencies in transactions by agreement, primarily through the Voluntary Trading Arrangements (VTAs). Transactions rely on countries’ goodwill to exchange, say, US dollar reserves against SDRs. A lower SDR remuneration could therefore discourage them from making such a trade. However, SDR holdings are small relative to overall foreign exchange reserves. A decision to cap the SDR rate temporarily would be taken by the member countries of the IMF who could commit to undertaking any SDR transactions despite a slightly lower return on potential positive net SDR holdings (which as we have shown, is nil for high-income countries). An SDR rate cap could therefore be accompanied by a VTA reform in which major creditor countries commit to maintain VTA liquidity. Notice that lowering surcharges would not negatively impact VTA liquidity, as they do not change the rate at which SDR holdings are remunerated.

Finally, there are some concerns regarding the elimination of surcharges. The latest IMF policy paper on surcharges states that the current policy allows the institution to accumulate precautionary balances, provides members with incentives to limit their demand for IMF assistance, and encourages early repayment (IMF, 2016b). Countries that request assistance from the IMF for the balance of payment needs may not have access to other sources of affordable financing (and cannot afford early repayment), while countries that do not face funding constraints often choose to pre-cancel their obligations to the

IMF. Moreover, and paradoxically, early repayment may also reduce IMF income, thus pushing the rates of those countries that are still indebted even higher (if the Fund decided to increment the basic margin) and reinforcing their financial difficulties.

5. Conclusions

During 2024, members of the IMF paid around 700-800 basis points yearly or more. After the reform of October, they will be paying 600-700 basis points per year, still a high figure. The lending rate is at a level that may threaten debt sustainability, reduce fiscal space, and affect the funding of concessional loans. Thus, it does not help the institution to fulfill its mandate.

Among the alternatives, we compared the elimination or reduction of the surcharges to the effect of a reduction of the SDR rate, which will reduce both the lending and the remuneration rates. Both policies can provide similar relief to borrowers, albeit the distributional impacts will differ. In all cases, policy reforms (as presented in this paper) could have a substantial impact on large borrowers (several of them from the G24). Depending on how it is implemented, a reform may affect the countries with the largest quotas and positive net SDR positions or IMF finances.

Neither scenario will significantly affect the countries with the largest quotas or jeopardize the ability of the IMF to fulfill its mandate. The foregone income from a reduction of the SDR rate represents a small amount, particularly for those with a strong balance of payments position. The institution already holds substantial precautionary balances, and there is no reason to anticipate a shortfall in operational income, as we do not propose to reduce the basic margin.

An important consideration should be considered. While a reduction or the elimination of surcharges will benefit the largest borrowers from the GRA account, it will not help countries with smaller and shorter programs (that are not affected by surcharges); nor will it help the lowest-income members that benefit from the Trust Funds (which are facing funding difficulties).

How to proceed if a reform is adopted? There are different ways to deal with surcharges in practice. For instance, access limits could be increased, or surcharge payments could be counted as repurchases, thus reducing the exposure of a country to the IMF (see Gallagher et. al., 2024).

Consider now a reduction of the SDR rate, which implies both a lower rate of charge and a lower rate of remuneration. This option can also provide relief, and in fact, the size will be of the same order if it is reduced by around 200-250 basis points per year, but it will affect a larger universe of borrowers, including both low and middle-income members. A reduction of the SDR rate can be achieved in several ways. One option is to establish a temporary cap that could be removed once international conditions change. Another is to adjust surcharges in a counter-cyclical fashion, for instance by increasing them when the SDR rate falls, and reducing them when the SDR rate increases, such that the lending rate does not surpass let's say 400-500 basis points per year. Notice that this is not equivalent to a cap on the overall lending rate, because the rate of accumulation of precautionary balances is bearing the burden of adjustment. A third option is to introduce a "crawling cap" that moves in the same direction as the main economies' interest rates, but at a slower pace, thus smoothing the increases in the SDR rates (see Krahne and Todoir 2023). A fourth and final, but less plausible, and less effective option is to reduce the weight of the US dollar and the UK in the SDR basket of currencies. For instance, an increase in the weight of the Yen or the Yuan will reduce the actual SDR rate, without any other change. However, this option is less appealing (as it is not clear how interest rates from advanced economies will behave), and it is uncertain how politically viable it is to alter the weights just to reduce the SDR rate).

Is there room for the proposed reform? To alter the IMF lending rate is not without precedent, as the

decision of October of 2024 (which reduced the basic margin and the surcharge component) shows. For instance, the basic rate was historically adjusted to reflect the Fund's operative costs, but during the financial year of 2007, this would have implied a basic rate of 350 basis points (due to the reduction in the amount of credit outstanding). In response, an exceptional circumstances clause was added to allow the margin for the rate of charge to be set on a basis other than estimated income and expenses.

The Executive Board also discussed and modified the basic margin policy in 2014, when they established a floor of 5 basis points, in the context of low international interest rates. There were specific reasons to set a floor. On the one hand, the Articles of Agreements constrain the Fund and do not allow negative interest payments. On the other hand, a very low SDR rate affects the function of the burden-sharing mechanism (see IMF, 2014). Additionally, a negative interest may affect the ability of the Fund to operate, as member countries will be reluctant to contribute their quota or hold SDRs if they have to pay charges.

A cap on the lending rate may have as a drawback a departure from the current practice of setting the SDR rate more or less following market-determined rates. So far, the only precedent of a cap occurred when the Fund implemented a 225-basis points cap for the lowest-income RST-eligible members. However, as we discussed, some options can effectively put a cap on the SDR, without significantly departing from current practices.

A final word on the impact of IMF finances. A cap in the SDR rate which results in a reduction in the lending rate while leaving the surcharge component unchanged will not cut the operative income: while the IMF will charge a lower SDR rate, it will also remunerate its members using a lower rate. In any case, there are ways to offset any potential foregone income. For example, a cap on surcharges would directly reduce the IMF's income as charged over the monetary policy cycle. This would translate into lower inflows for the IMF's precautionary balances across the monetary policy cycle since surcharges would be lower when monetary policy is restrictive but remain unchanged when monetary policy is accommodative. Another option is to put a cap on the remuneration rate that flows from borrowers to non-borrowers, without necessarily changing the SDR rate, thus asking the non-borrowers to cover the missing surcharge income. A final option would be to increase surcharges in a low-interest rate environment. This would mean the Fund's income goes down when monetary policy is restrictive but goes up relative to where it would be if monetary policy is accommodative.

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