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Roundtable on the IMF Lending Rate Policy

Marrakech, Morocco, October 14th

Chairs' Summary

Columbia University's Initiative for Policy Dialogue (IPD), Columbia University's Institute of Global Politics, Boston University's Global Development Policy Center, and Suramericana Visión organized a Roundtable on *IMF Interest Rate Policy* in Marrakech during the IMF/World Bank Meetings at the official conference center (Room BB07 Taghazout). The roundtable was chaired by by Kevin Gallagher, Martin Guzman, and Joseph E. Stiglitz. The meeting was joined by one central bank governor, economic authorities from ministries of finance, central bank officers, IMF staff, IMF executive directors or alternate executive directors, academics, and practitioners. The discussion was held under Chatham House rules.

The motivation of the roundtable was to discuss the IMF lending rate policy that is set by the Executive Board. Today, it is at an exceedingly high level of 100 basis points plus the SDR interest rate. What is more, in some instances, countries also are charged surcharges. The purpose of the meeting was to critically assess the International Monetary Fund's (IMF) lending rate policy, rationale and appropriateness in the current context, and to discuss proposals for its revision to ensure that lending policies are consistent with the IMF's mandate.

Background:

The **IMF's basic rate** is composed of a fixed margin set by its Executive Board (100bp), plus the SDR interest rate (SDRi). The SDRi which is used by the Fund for calculating the interest rate charged and paid to members, is determined weekly based on a weighted average of interest rates on three-month debt in the money markets of the SDR basket currencies[1]. The margin of 100bp was initially set by the Board in 2008 in the context of the sharp decline in credit outstanding by the mid-2000's. While the IMF Executive Board agreed on a new income model in 2011, the margin of 100bp was left intact since then.

[1] USD dollars, Euros, Sterling Pound, Japanese Yen, and Chines Renminbi.

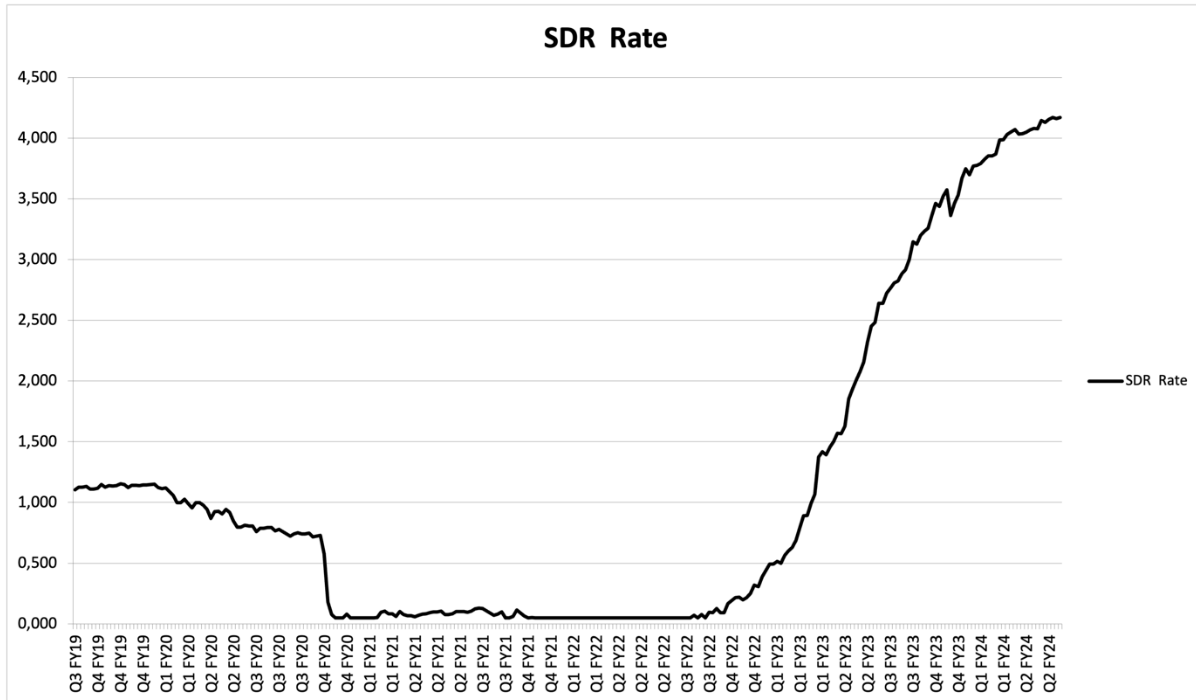
For countries that tap resources from the General Resources Account (GRA[2]) and with exceptional access paying surcharges, the total **IMF lending rate** consists of the basic rate, plus surcharge payments. For GRA loans, the IMF imposes surcharges of:

- **Level-based surcharges:** depend on the amount of credit outstanding. 200 basis points are applied on the portion of GRA credit outstanding greater than 187.5 percent of quota.
- **Time-based surcharges:** depend on the length of time credit remains outstanding. 100 basis points are applied on the portion of credit exceeding the threshold of 187.5 percent of quota for more than 36 months (51 months in case of borrowings under the Extended Arrangement (EFF)).

The SDR rate is increasing, in line with the increases in the interest rates of the SDR basket currencies (figure 1). Moreover, a number of countries have been forced by exogenous circumstances to borrow sufficiently much for sufficiently long to be subject to surcharges. Thus, today, some countries may be paying to the IMF an annual interest rate of up to or even higher than 8 percent. The current global context, including the changing nature of shocks, demands looking more closely at the IMF's interest rate policy, assess whether the criteria are appropriate for today's circumstances, or whether they ought to be revised in ways that are consistent with the Fund's mandate. This entails examining the IMF basic lending rate, as well as its surcharge policy.

Figure 1

[2] The GRA is the principal account of the IMF, consisting of a pool of currencies and reserve assets, representing the paid subscriptions of member countries' quotas. The GRA is the account from which the regular lending operations of the IMF are financed. Most middle-income countries use this account as opposed to low income that can apply for concessional borrowing.



Participant's discussion on the individual components of the Fund's lending rate:

- **100 basis points**: Participants debated the rationale behind the level of the Fund's fixed component of the IMF lending rate. One participant argued that the level of the fixed component was determined in such a manner, as to cover the IMF's lending operation costs. Other participants questioned this rationale, arguing that whereas this might be true for small loans, it seems unrealistic for IMF programs with large financing envelops—an example that was quoted was Argentina, an extreme case in terms of exposure that with an outstanding debt with the IMF of $45 billion it contributes $450 million, presumably to cover the operation costs associated with that loan according to that argument.
- **SDR interest rate**: The SDR rate has increased by more than 400 basis points since the beginning of the war in Ukraine, making IMF financing more than 4 percentage points more expensive. Some participants noted that the current IMF's lending rate policy is procyclical and increasingly regressive. Two participants also pointed at a broader, structural tension between the Fund's income model and its mandate. In line with its mandate, the Fund's lending intends to be counter-cyclical. Yet, its income model is based on Central Banks' decisions of Advanced Economies, which makes financing more expensive at the precise moment in which vulnerable member states most need it.

In this context, the urgency was highlighted of revising the lending rate policy before the next shock hits developing economies. One participant argued that while the IMF lending rate is higher, which makes its lending terms procyclical, the IMF's lending volumes are still counter-cyclical—meaning that the IMF is lending more in bad times, even if at an increasing cost.

- **Surcharges**: Most participants seemed to agree that there is a legitimate debate to be had around the extent to which the Fund's surcharge policy serves its purported purpose. One of the arguments in defense of the surcharge policy was that it discourages large and prolonged use of IMF resources and provide a source of income that is used to build precautionary balance. Several participants disagreed with this view, arguing that the surcharge policy is ill founded, as it is (i) procyclical, (ii) regressive, (iii) it deprives countries in crisis from foreign exchange, making the access to international credit markets less likely and therefore impairing the possibility of repaying the IMF early, and that (iv) imposing surcharges to accumulate precautionary balances that cover the IMF from default risks is inconsistent with the preferred creditor status of the IMF. Several participants questioned why the thresholds for exceptional access and **level-based surcharges** are not aligned. The current rate for level-based surcharges (200 basis points) was deemed extremely high by more than one participant. One participant pointed out that access to IMF financing is not an automatic window. Rather, the IMF needs to authorize and approve the program. According to that participant, relying on incentives to avoid moral hazard and dis-incentivize over-borrowing from the Fund thus misses the mark. Another participant pointed out that the level of charges can incentivize countries to seek alternatives sources of funding from multilateral institutions. While going to the Fund might be the end of the road for countries, going to MDBs is still an option for some, and there is a concern of IMF lending not being cheaper than that of MDBs. Conversely, one participant argued that historical evidence suggested that countries do repay earlier due to time-based surcharges. Another participant countered that the likelihood of falling into arrears with the IMF was higher for a country paying 0.8% of GDP on interest service to the IMF, than if it was paying 0.3-0.4%--quoting the well-established literature on multiple equilibria. Finally, the question was raised whether surcharge payments were only used for precautionary balances and reserves, or also for operational costs. One participant noted that operational costs were not covered by surcharge payments, but by normal income.

Another one argued that in the light of the fungibility of money, this difference was only a matter of Fund's accounting.

Broader implications of current lending rate policy:

- Several participants raised their concern that the IMF's current lending rate policy could **threaten the institution's ability to fulfil its mandate** by threatening countries' financial capacities, placing the success of IMF programs at risk, and undermining the catalytic role IMF funding is supposed to play.
- Participants' opinions diverged regarding the impact that the **presence of a super-senior creditor** such as the Fund would have **on the private's sector willingness to lend**. While one participant argued that private creditor's lending decisions depend on the underlying Fund program, and the likelihood of it being implemented by authorities, others maintained that large exposures to the IMF dis-incentivize new financing from private creditors that would be junior with respect to the creditor that has a preferred creditor status.
- The IMF's high lending rate – both in absolute terms and in historical perspective – was also said to **threaten the debt sustainability of IMF borrowers**. Several participants stated that in some countries the total debt servicing costs exceed the budget for other vital expenses, crowding out spending on education and health.
- Participants discussed how the Fund's lending rate policy related to the institution's **Preferred Creditor Status** (PCS). Some participants argued that the IMF lending rate should not be thought of as an insurance against risk, precisely because it enjoyed PCS as a lender of last resort. According to these participants, to the extent that the Fund employs the logic of private credit institutions to defend its lending policy, the justification of its PCS is eroded. Given that MDBs PCS is already being questioned, it is not inconceivable that the Fund's PCS could be challenged by private creditors. While some participants argued that the Fund did require the accumulation of precautionary balances to reduce risks springing from large and concentrated exposures, others argued that the Fund's PCS makes the accruing of precautionary balances, unnecessary and inefficient.

Looking ahead: Different proposals on the table.

- Regarding the 100 basis points, a participant suggested that the lending operation costs could be covered by an additional charge to the member country, not included in the basic interest rate.
- One of the proposals made was the adoption of a cap on the SDR interest rate (either flat or scrolling). It was argued that this would benefit all countries, would not change borrowers' incentives, and would not affect the Fund's income model. This proposal was considered feasible by some participants (requiring a 70% majority at the Executive Board) and would mirror the decision by the Executive Board in 2014 to introduce a floor at 5 basis points. One participant also remarked that a SDR cap could help in the advancement of the rechannelling of SDRs. Other participants raised concerns about the proposal of an SDR interest rate cap. Other participants expressed concerns about caping the SDR interest rate, arguing that it would lower incentives to hold SDRs. Given that the SDR functions on a cooperative basis, this was said to be potentially a large concern. The SDR interest floor instituted in 2014 was not seen as a precedent for an SDR interest cap by one participant, because a cap dis-incentivizes, rather than incentivizes SDR holdings. Another participant argued that the proposal of adopting a cap on the SDR interest rate faced a higher success rate if it was clear that this would not affect Central Banks' balance sheets.
- The option of capping the basic rate was also discussed.
- Many participants argued that the surcharge policy needs to be revised and / or surcharge payments suspended. Aligning the current threshold of exceptional access with those of level-based surcharges was identified as a lower hanging fruit. Some participants highlighted the importance of providing immediate relief to countries facing a high interest payment burden, while revisions are underway. The negotiations around the 16th General Review of Quotas was identified as an opportunity to revise the surcharge policy, given that package-deals were being discussed and the suspension and/or revision of the surcharge policy could contribute to striking this greater bargain.
- The complementarity of the revision of the IMF's SDR interest rate and the surcharge policy was pointed out by some participants.
- One participant proposed to devise a sliding scale, where the surcharge payments vary with the SDR interest rate. If the SDR interest rate increases, then the surcharges would go down, and vice-versa, if the former goes down, the latter will go up. According to this argument, this would allow the Fund to build buffers in good times. The 100-basis

points component could vary on similar lines. Others considered that such a revision would fall too short from what makes sense given the IMF mission.

Participants:

Andreas Bauer, Deputy Director, International Monetary Fund

Reza Baqir, Senior Fellow, Harvard University; former Governor, State Bank of Pakistan

Arnaud Buisse, Executive Director for France, International Monetary Fund/ World Bank

Sergio Chodos, Alternate Executive Director for the South Cone, International Monetary Fund

Maia Colodenco, Director of Global Initiatives, Suramericana Visión

Pavel Diev, Head of International Monetary Relations, Bank of France

Marouane El Abassi, Governor, Central Bank of Tunisia

Pedro Fachada, Brazil's Ministry of Finance

Martin Guzman, Co-President, Columbia University's Initiative for Policy Dialogue; former Minister of Economy of Argentina

Jeff Hall, Advocacy Director, Open Society Foundations

Tobias Krahnke, Economist

Will Kring, Executive Director, Boston University Global Development Policy Center

Chiara Mariotti, Associate Director, Open Society Foundations

Iyabo Masha, Director, G24

Mahmoud Mohieldin, Executive Director for Egypt, International Monetary Fund

Daniel Munevar, Economic Affairs Officer, UNCTAD

Armen Nurbekyan, Deputy Governor, Central Bank of Armenia

Gabriela Plump, Managing Director, Initiative for Policy Dialogue

Veda Poon, Executive Director for the United Kingdom, International Monetary Fund

Brad Setser, Senior Fellow, Council of Foreign Relations

Joseph Stiglitz, University Professor, Columbia University and Co-President, Initiative for Policy Dialogue

Sander Tordoir, Senior Economist, Centre for European Reform

Anahí Wiedenbrug, Senior Consultant of Global Initiatives, Suramericana Visión