T20 Commentary

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Let's rethink the world

Is It Feasible and Effective to Reform IMF Lending Policies?

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In the T20 Communique released in July 2024, the International Monetary Fund (IMF) lending practices was highlighted in the first recommendations of Task Force 3 on reforming the international financial architecture. More specifically, the T20 emphasized that:

> "Because it includes major IMF shareholders with significant voting power, the G20 should work to reform IMF lending policies. First, it should **advocate a cap on the SDR interest rate**. This will protect borrowing countries from rising borrowing costs during periods of financial stress, thereby ensuring that IMF support does not deepen financial distress. In addition, the **surcharge system should be reviewed** to become countercyclical. That is, the surcharge rate should rise when SDRs fall and vice versa. These adjustments will not only align IMF practices with its mandate to promote financial stability, but will also help the G20 take the lead in promoting a more resilient and equitable international financial architecture"

Reforming IMF lending policies has never been more urgent. Amid a wave of monetary tightening in advanced countries post-COVID-19, net negative transfers to developing countries, and rising debt vulnerabilities (UNCTAD 2024; Kharas and Rivaldi 2024; Zucker-Marques et al. 2024), IMF credit outstanding reached a record high of $146 billion in August 2024, with at least 94 countries accessing some form of IMF credit and 52 of them borrowing of non-concessional resources from the IMF's General Resources

Account (GRA) (IMF 2024). Thus, reforming IMF lending policies will have a direct impact on many developing countries at a time when they need it most.

Reforming IMF lending policies requires a 70 percent majority of the total voting power, rather than the 85 percent threshold that would give the United States veto power (IMF 2020; IMF 2023). The G20 (excluding the African Union) holds 78 percent of IMF voting power (Merling 2022), meaning that a consensus within the G20 would provide sufficient support to pass reforms to IMF lending policies. What is more, IMF board deciding on lending rate changes is not without precedent. In Fiscal Year 2007, the IMF adjusted the margin for its basic rate of charges, which would have otherwise made borrowing from the IMF relatively expensive (IMF 2016, p. 114)

One of the key IMF lending reforms gaining momentum is the issue of surcharges, which are additional fees imposed on countries with borrowing levels that exceed a certain volume or time period. Surcharges have long been recognized by policymakers, academics, and civil society as counterproductive and unfair (Arauz et al. 2021; Stiglitz & Gallagher 2022; Bohoslavsky et al. 2022; Perriot 2023; Libman 2024). In June 2024, Barbados Prime Minister Mia Mottley highlighted this issue, arguing that surcharges undermine a key pillar of the IMF's lending approach: debt sustainability. Charging extra fees when countries are already facing debt vulnerabilities, she noted, is like adding fuel to the fire and worsening an already precarious situation. Nobel laureate Joseph Stiglitz and co-authors (Gallagher et al. 2024) also emphasized another key issue: with base interest rates at record highs, the total cost of IMF financing can reach up to 8 percent for some borrowers—far exceeding levels considered sustainable. Such high lending costs from the IMF drain much-needed resources, potentially worsening budgetary challenges and hindering prospects for economic recovery (Libman et. al 2024).

The time is ripe for the IMF to address surcharge reform, and the G20, which comprises its main shareholders, could advance this agenda in 2024. There are pragmatic policies that the G20 and IMF could consider, as suggested by T20 policy briefs (Gallagher et al. 2024; Libman et al. 2024). Both T20 policy briefs on surcharges emphasize the most appropriate policy in terms of efficiency and fairness is to eliminate surcharges. But if consensus is not reached among IMF shareholders, pragmatic policies could be applied, including 1) capping total interest charges, 2) aligning the current thresholds for exceptional access and level-based surcharges, 3) counting surcharge payments under the current formula as principal payments toward IMF loans, and 4) implementing a sliding scale for surcharges, which means that the surcharge rate should increase when the SDR rate decreases and vice versa.

Beyond reforming IMF lending policies concerning cost, it is essential for the IMF to overhaul its conditionality policies. When countries seek IMF programs, they often encounter stringent conditionalities and numerous studies reveal that IMF austerity programs tend to exacerbate poverty, inequality, and social unrest, rather than enhancing economic stability (Kentikelenis et. al 2016; Biglaiser and McGauvran 2022, Reinsberg et. al 2023).

Instead, countries need a growth-oriented approach that stabilizes economies without slashing essential public spending. Researchers argue that an expansionary stimulus package could drive higher growth and help countries move away from the structural issues that lead to liquidity problems in the first place (Kharas & Rivard 2022).

The urgency for reforming IMF lending policies cannot be overstated. As the world grapples with unprecedented economic challenges, the need for a more equitable and effective international financial system has never been clearer. The G20, wielding

significant influence and holding the majority of IMF voting power, is well-positioned to drive these critical changes. By addressing surcharges and rethinking conditionality, the G20 can help create a lending framework that supports sustainable economic recovery and development. The proposed reforms by the T20 are steps towards a more resilient financial architecture. Moreover, shifting focus from austerity to growth-oriented policies could offer a more constructive path to recovery for countries facing economic distress. Now is the time for decisive action to ensure that IMF lending practices better serve the needs of all member countries, fostering stability and prosperity in an increasingly interconnected world.

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