IMF Surcharges: Counterproductive and Unfair

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Executive Summary

This report finds that International Monetary Fund (IMF) surcharges are inappropriate and unjustifiable, particularly during a pandemic combined with a very uneven recovery from a pandemic-driven world recession.

The IMF's advertised headline lending rate is low, but it charges significant additional costs—surcharges— for countries more heavily in debt and for those with outstanding debt after four years. In a 2016 review of its surcharges policy, the IMF claims that the policy "appears to have broadly achieved its objectives."[1] However, our review finds that:

- IMF surcharges can have a damaging impact on the economies of countries facing deep economic difficulties, diverting hard currency from countries when they most need it. Surcharges add additional interest payments to some of the most heavily indebted borrowing countries. For example, Argentina will spend US $3.3 billion on surcharges from 2018 to 2023. This is equivalent to nine times the amount it would have to spend to fully vaccinate every Argentine against COVID-19.
- The surcharges therefore contravene the IMF Articles of Agreement. Article 1 states that IMF lending cannot be "destructive of national or international prosperity."[2]
- The IMF has two main stated rationales for requiring these surcharges from countries in crisis:

> These level and time-based surcharges are intended to help mitigate credit risk by providing members with incentives to limit their demand for Fund assistance and encourage timely repurchases while at the same time generating income for the Fund to accumulate precautionary balances.[3]

The IMF argues that it needs surcharges in order to increase its revenue and build up its equity capital (also labeled by the Fund as "precautionary balances"). But the capital base and the lending capacity of the IMF depend on political agreements such as quota reviews, new arrangements to borrow, and bilateral borrowing agreements.[4] Looking at

1 IMF (2016c).
2 IMF (2020a).
3 IMF (2016c), 20.
4 IMF (2021s).

the $1 trillion firepower figure cited[5] by the IMF's managing director amid the pandemic as an indication of the true availability of funds for lending, the IMF does not depend on revenue from surcharges; surcharge revenue is three orders of magnitude smaller (about US $1 billion in 2020).[6]

- As for "providing members with incentives to limit their demand for Fund assistance and encourage timely repurchases,"[7] this is contradicted by the circumstances faced by borrowing countries that pay surcharges: they often cannot borrow from private markets, and when they can, history shows that often other incentives have already moved them away from IMF lending.

Of the few countries that have made early repayments, most of the repayers since 2009 are high-income European countries that have support from European Union institutions, and are atypical compared to the usual recipients of IMF program loans.[8] Of the countries that did not fit the above categories, there were clear domestic and economic policy-making considerations that drove the repayments — for example, in the large early repayments made by Brazil and Argentina in 2005-2006.

In Brazil, the IMF played a major role in economic policy-making in the decades prior to the election of the Workers' Party candidate, Lula da Silva, in 2002. Economic outcomes during this period had been disastrous: e.g., from 1995 to 2002, GDP per capita had grown by just 0.4 percent annually,[9] and it actually fell from 1980 to 1994. During the summer and fall of 2002, as financial markets reacted badly to the prospect of Lula's election, the IMF negotiated a very large $30 billion loan agreement described as "build[ing] a solid bridge to the new administration in 2003."[10] This committed the next government to running large primary budget surpluses — 3.75 percent of GDP annually — through 2004, which arguably postponed, for years, the implementation of much of the Workers' Party program.

It is therefore not surprising that in December 2005, Brazil repaid early all of its $15.5 billion outstanding debt to the IMF. In January 2006, Argentina prepaid all of its $9.8

5 IMF (2020g).
6 IMF (2020e), 8.
7 IMF (2016c).
8 E.g. Ireland and Portugal where the European Financial Stability Facility (EFSF) waived a proportionate early repayment requirement, allowing early repayments to the IMF without commensurate early repayments to the EFSF. See IMF (2016c), 21, 13n.
9 Calculated from IMF (2021t).
10 IMF (2002b).

billion loan owed to the Fund. Much has been written about Argentina's long and bitter experience with the IMF and the Fund's policy conditions and failures there;[11] through the depression of 1998–2002, and in the (then record) sovereign default and debt restructuring that followed. There is no doubt that IMF conditions became a major political and even electoral issue in Argentina during this time; there was therefore strong motivation and political support for paying off this debt so as to be free from IMF influence.

The IMF also noted that in Hungary, early repayments in 2013 "may have reflected political considerations as well as the perceived stigma associated with Fund financing."[12]

- IMF surcharges penalize countries most in need simply for being in great need — i.e., currently, countries with a debt to the IMF greater than 187.5 percent of their quota. We estimate here that surcharges are 45 percent of all nonprincipal debt service owed to the Fund for the five largest borrowers. The IMF demands higher payments at a time when the borrowing countries are the most liquidity-constrained. Surcharges increase the debt burden for crisis-ridden countries, even as the IMF's own debt sustainability analyses demonstrate that a lower debt burden is necessary to ensure a higher probability of timely repayment and sustainable financing. Surcharges are procyclical, because they tend to increase the borrowers' payments to the Fund — and therefore drain government spending from the domestic economy — at times when the economy is slowing, or in recession.
- As of 2019, 64 countries spent more resources on servicing foreign debts than they did on health care expenditure for their citizens.[13] According to the UN Economic Commission for Latin America (ECLAC), "the coronavirus disease (COVID-19) pandemic unleashed the most severe economic and social crisis in the recent history of Latin America and the Caribbean. GDP is estimated to have declined by 7.7% in 2020, representing the largest contraction in the past 120 years."[14] The LAC region has been overwhelmed by COVID-19 deaths and the specter of yet another lost decade. Procyclical surcharges should not be part of the list of measures that contribute to this outcome, and/or to the ongoing crisis.

11 For a summary, see Weisbrot (2015), 144-156.
12 IMF (2016c).
13 Jubilee Debt Campaign (2020).
14 ECLAC (2021), 13.

- The IMF's outstanding loan portfolio is the largest it has ever been. The IMF estimates 53 new upper-tranche loans in the medium term.[15] Expected regular lending charges will also be record-breaking. Surcharges become unnecessary in this context. Even if lending charges are not enough to cover expenses, the IMF should withstand a dent to its reserves, just as it has tolerated pension-related losses due to crisis-related volatility in the actuarial discount rate.

Today, with many countries still in crisis, IMF managing director Kristalina Georgieva has emphasized the need for a more robust response than in 2009:

> After the 2009 crisis, we issued $250 billion in SDRs [Special Drawing Rights]. 90 percent of those SDRs were used simply to boost reserves. This is necessary today, too. But we have to do more. We have to use this unique opportunity for strategic transformation of countries — transformation that is going to be driven by this crisis.[16]

But many of these SDRs could be used up by countries paying surcharges. The IMF should take this opportunity to eliminate these regressive charges, freeing up resources in some of the most suffering economies to spend on vital services.

15 IMF (2021h), 12.
16 IMF (2021n).

Introduction

The COVID-19 pandemic has had a heavy economic toll on most of the world's economies, causing the sharpest downturn since 1870 in terms of percentage of countries facing declines in per capita output, and since the Second World War in terms of world per capita output.[17] As a consequence, countries have been increasingly compelled to turn to the International Monetary Fund (IMF). Since the start of the pandemic, the IMF has approved US $116 billion in credit to 87 countries,[18] and credit outstanding has risen from US $90 billion in FY 2019 to US $130 billion in 2021.[19]

Table 1

IMF Lending During the Pandemic

	Conditionality	Amount Approved (US$ millions)
Nonconcessional Lines		
Rapid Financing Instrument	Limited	21,635
Stand-By Arrangements	Yes	10,598
Extended Fund Facility	Yes	13,308
Flexible Credit Line	Yes (ante)	51,878
Precautionary and Liquidity Line	Yes (ante)	2,700
Subtotal		*100,119*
Concessional Lines		
Rapid Credit Facility	Limited	8,183
Extended Credit Facility	Yes	7,644
Subtotal		*15,827*
Total		*115,946*

Source: IMF (2021d) and authors' calculations.

These loans not only often come with conditionalities,[20] they are opaquely priced: in addition to the headline interest rate, borrowers have to pay a variety of additional charges, including surcharges.[21] These surcharges comprise a significant portion of interest payments, and are only

17 World Bank (2020).

18 Of this, nearly half, US $52 billion, was to just three countries — Chile, Colombia, and Peru — through the Flexible Credit Line. IMF (2021d).

19 From fiscal year 2019 (end April) to fiscal year 2021. The small rise in credit outstanding compared to approved credit is because not all of the countries have drawn down this credit. IMF (2021f) and IMF (2020e).

20 Historically, IMF loans have come with often onerous conditionality, including fiscal consolidation and liberalization reforms. While, compared to previous crises, there have been more loans in this current crisis that are low-conditionality (and concessional lending during this crisis has exceeded nonconcessional lending 20:3 in terms of money lent, see Table 1), the IMF anticipates that "[f]inancial support is expected to rise and programs to become more complicated, as many emergency financing operations are followed with upper credit tranche (UCT) conditionality programs, in many cases characterized by complex debt issues." IMF (2021h), 12. See also, IMF (2020c), 3.

21 See Table 2 below.

paid by heavily borrowing countries — often the countries that are facing the severest economic crises. This paper scrutinizes the IMF's surcharge policy, arguing that it is in breach of the commitment in the IMF's Articles of Agreement that IMF measures cannot be "destructive of national or international prosperity."[22]

The IMF headline lending rate is only 100 basis points above its funding rate (the SDR rate, which is now equivalent to 5 basis points, or 0.05%). The IMF charges significant extra costs (200 basis points) above its publicized interest rate for large loans. Large loans — dubbed "upper tranche" — are those required by countries in crisis. Countries have to incur additional extra costs (100 basis points) after four years of outstanding loans.

When a country turns to the IMF for financing, it usually has few other choices; the Fund lends primarily to countries facing balance of payments crises. When a country's only choice is an IMF loan, the leverage that the IMF has over that country is immense.

The IMF has two main stated rationales for requiring these surcharges from countries in crisis:

> These level and time-based surcharges are intended to help mitigate credit risk by providing members with incentives to limit their demand for Fund assistance and encourage timely repurchases while at the same time generating income for the Fund to accumulate precautionary balances.[23]

Taking the second rationale first, the IMF argues that it requires surcharges in order to increase its revenue and build up its equity capital (also labeled by the Fund as "precautionary balances"). The Fund also argues that surcharges "encourage" early repayment to the IMF once countries are able to access cheaper funding in the capital markets. With these revolving funds, the IMF reasoning goes, it can continue its mission of lending to other countries.

Practice invalidates these two rationales. The capital base and the lending capacity of the IMF depend on political agreements such as quota reviews, new arrangements to borrow, and bilateral borrowing agreements.[24] Taking the US $1 trillion firepower figure cited[25] by the IMF's managing director amid the pandemic as an indication of the true availability of funds for

22 IMF (2020a), Article 1, Section V.
23 IMF (2016c), 20.
24 IMF (2021s).
25 IMF (2020g).

lending, the IMF does not depend on revenue from surcharges, which are three orders of magnitude smaller (about US $1 billion in 2020).[26]

There is also little evidence that the surcharges achieve their objective of encouraging early repayments. Of the few countries that have made early repayments, most of the repayers since 2009 are high-income European countries that have support from the European Union (EU) and are very atypical compared to the usual recipients of IMF program loans.[27] In other cases, early repayment seems to be more linked to a desire from policymakers to free themselves from the strictures of IMF conditionality and monitoring rather than any effect of the surcharges, and not due to a conventional return to capital markets.[28]

In their 2016 review of the surcharges policy, the IMF claims that the policy has successfully achieved its aims.[29] This paper will look at each of the IMF's claims in turn. Section 2 discusses the context in which the IMF first introduced surcharges and the mismatch of means and ends that resulted from the expansion of surcharges to the majority of IMF programs. This historical context explains why surcharges are unable to act as incentives for borrowing countries. Section 2 also shows how surcharges conceal a relatively high rate of interest, and addresses the IMF's claim that surcharges have led to early repayments. Section 3 looks at the burden that these surcharges inflict on borrowing countries. It offers new calculations of the amount that heavily indebted countries have paid or will pay in surcharges, and considers these payments in light of the IMF's commitments under the Articles of Agreement. Section 4 considers the surcharges as a source of revenue for the IMF, but argues that there are better alternatives. Section 4 concludes by arguing that quotas and bilateral borrowing determine the IMF's lending capacity, not the Fund's accumulated reserves.

The surcharge model is absolutely not suitable for an exogenous global crisis such as the pandemic, which strains most countries' public finances. Additionally, surcharges hurt crisis-ridden countries in their efforts to facilitate a quick recovery, as these charges represent a significant opportunity cost with respect to government finances and countries' international reserves. Surcharges are not fully disclosed in countries' debt statistics. Finally, surcharges are procyclical and discriminatory, and are against the spirit, and arguably the letter, of the IMF Articles of Agreement.

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26 IMF (2020e), 8.
27 E.g., Ireland and Portugal, where the European Financial Stability Facility (EFSF) waived a proportionate early repayment requirement, allowing early repayments to the IMF without commensurate early repayments to the EFSF. See IMF (2016c), 21, 13n.
28 See below.
29 IMF (2016c).

Surcharges: Designed for Liquidity Crises, But Applied to Countries with Structural Balance of Payments Problems

The IMF first introduced surcharges in December 1997 with the creation of the Supplemental Reserve Facility (SRF). Created in response to the Asian Financial Crisis, this facility was targeted at countries facing "exceptional," short-term financial needs due to "sudden and disruptive" stops in capital inflows.[30] The surcharges were time-based, with the aim of disincentivizing continued reliance on the facility, the aim being to "minimize moral hazard" by pressuring countries to "maintain participation of creditors ... until the pressure on the balance of payments ceases."[31] Overall, the aim of the surcharge-backed SRF was to "assist emerging market economies facing crises of confidence while providing strong incentives for them to return to market financing as soon as possible" by providing "short-term loans at higher rates than [the IMF] normally charges."[32]

Notably, the countries initially affected by the Asian Crisis had a strong track record of export-led growth, and the crisis was primarily a liquidity crisis caused by the sudden stop of short-term inflows in the immediate years prior; these were not solvency crises caused by structural problems with these countries' balances of payments.[33] In such a situation, where the fundamentals of these economies were sound, it was at least possible that resolving liquidity problems would enable these countries to regain access to capital markets. This is not the case for many of the countries that are now paying surcharges, which have unsustainable debt burdens, histories of defaults, undiversified export sectors vulnerable to sharp price fluctuations and, thus, very little appeal to international private lenders.

The IMF's role in the Asian crisis — which its then managing director welcomed as a "blessing in disguise"[34] — was widely criticized at the time[35] and afterward for recommending measures that turned liquidity crises into solvency crises.[36] The procyclical and economically destructive

30 IMF (1997).
31 Ibid.
32 Fischer (1998).
33 See e.g., Sachs and Radelet (1998).
34 Davis (1998).
35 E.g., Jeffrey Sachs: "The problem is that the IMF has become the Typhoid Mary of emerging markets, spreading recessions in country after country." Sachs (1998).
36 See e.g., Bosworth (1998).

measures they mandated through their programs were responsible for social catastrophes in the affected countries[37] and even the IMF's Independent Evaluation Office critically reviewed its role and claims to have learned lessons.[38] However, the surcharge policy has been rolled out to more IMF facilities in the years since, including level-based surcharges to the credit tranches (including standard IMF Stand-By Arrangements)[39] and the Extended Fund Facility (EFF) in 2000, and to the Short-Term Liquidity Facility in 2008.[40] Some of these were particularly perverse, given the initial rationale for surcharges. The EFF is designed for countries facing balance of payments problems that are viewed as being of a long-term or structural nature — in other words, countries that have profound problems that likely make them particularly unattractive to capital markets and the EFF is thus a particularly inappropriate mechanism to issue surcharges.[41]

Beginning in 2009, surcharges were standardized[42] and extended to all facilities that are included in the General Resources Account (GRA), the IMF's principal account.[43] Thus a policy for countries that were expected to only have quickly resolvable and short-term balance of payments problems, designed to disincentivize reliance on the Fund and encourage a return to international capital markets, was extended across the vast majority of IMF credit lines.

During the current pandemic, the IMF has lent to 85 countries, the largest simultaneous lending effort in its history. Policies that were designed for one, two, or five loans at a time do not make sense for a systemic global crisis. The current surcharge model is also anachronistic because it was designed with the assumption that select countries would have balance of payments or fiscal management problems, not for a situation in which a global health emergency exogenously hit all countries' economies and their governments' public finances.

37 See e.g., Kristof (1998), for a contemporary account from The New York Times of the social effects of the crisis almost one year following the signing of the IMF agreements in Thailand and Indonesia.

38 If only in the case of Indonesia, for which they wrote "the depth of the collapse makes it difficult to argue that things would have been worse without the IMF." IMF (2003), 38.

39 IMF members can withdraw 100 percent of quota in four equally sized tranches if they are facing balance of payments problems.

40 The Short-Term Liquidity Facility was a short-term large-scale financing instrument created in the wake of the 2008 financial crisis but replaced by the Flexible Credit Line in the following year.

41 IMF (n.d.).

42 The 2009 surcharge policy consisted of a level-based surcharge of 200 basis points applied when credit exceeds 300 percent of quota. There is an additional time-based surcharge of 100 basis points when outstanding credit exceeds the quota threshold for three years; see IMF (2016c). In 2016, the quota threshold was reduced to 187.5 percent of quota, and the time-based surcharge for the EFF was extended to 51 months. IMF (2016b).

43 IMF (2016c), 22.

Surcharges Do Not Disincentivize Large or Prolonged Use of Fund Credit

The logic of the surcharges policy seems to assume that there are alternatives to borrowing from the Fund. The level-based surcharge provides an incentive for borrowers to limit their use of Fund resources to beneath 187.5 percent of quota, with the aim of incentivizing smaller loans. The time-based surcharge disincentivizes prolonged reliance on Fund credit. However, these incentives only apply to countries that are able to regain access to international capital markets. Surcharges cannot disincentivize countries that have no alternatives to IMF loans; all they do is punish countries that have nowhere else to go.

In an IMF document that assessed the surcharge policy, the IMF compares its policy loan rate to one index of a historically volatile market rate from past bond issuances, ignoring the fact that timely and effective access to fresh funding at the scale required is often not available from private markets. Despite not being reasonably comparable, it concludes that the Fund's cost of borrowing is relatively cheap compared to that of private lenders. If the comparison with the bond index shows anything it is that countries sufficiently distressed to have to seek IMF loans have little realistic recourse to market financing as it is both costly and volatile. But the Fund states:

> This suggests that the current level-based surcharge of 200 basis points has not represented a <u>disincentive to seek assistance from the Fund</u> and remains consistent with the cooperative nature of the institution.[44]

It is important to remember that the 200-basis-point surcharge is only levied on loans that are large relative to quota (and thus large relative to the size of the country's economy).[45] Generally, only countries experiencing balance of payments crises require such large loans. The IMF suggests that a crisis-ridden country that requests a loan from the Fund may have had other financing options,[46] but going to the IMF is generally the last option available and widely recognized as such, due to the associated stigmas and hard conditionality of this borrowing.[47]

44 IMF (2016c), 24, emphasis ours.
45 GDP has a 50 percent weight in the current quota formula.
46 IMF (2016c), 24.
47 See, for example, Schenk (2018) and Schwarz (2002).

Surcharges Are Opaque and Conceal a High Interest Rate

The fact that the Fund has not turned borrowers away does not mean that it has not created a serious burden for borrowers — and, in fact, due to the opaque nature of surcharges, the true cost of IMF loans is not fully disclosed in countries' debt statistics.[48] The current cost of borrowing (estimated in **Table 2**) is over 400 basis points, which is relatively expensive, especially at present given the very low rates of interest in most advanced economies.

Table 2

Cost of Borrowing (in Annual Percentage Rates as of August 2021)

Components	Rate of Charge	First Year	Fourth Year
Cost of funding	SDR Rate	0.05%	0.05%
Lending margin	100 basis points	1.05%	1.05%
Burden adjustment	0.5 basis points, but variable if arrears	1.055%	1.055%
Commitment fee	15-60 basis points, refundable when disbursed	Assuming full disbursement on year 1	
Service fee	50 basis points per disbursement	1.555%	Disbursed in year 1
Size-levied surcharge	200 basis points if >187.5% of quota	3.555%	3.055%
Time-levied surcharge	100 basis points if >3 years (51 months for EFF)	**3.555%**	**4.055%**

Sources: IMF (2016a), 106-108; SDR interest rate from IMF (2021r). For burden-sharing rate, see IMF (2021q), 28, 2n.

A key motivation for the 2009 reform which rolled out surcharges across most IMF facilities, was to sustain Fund income but avoid what would have been an "implied... margin of over 350 basis points for FY 2007" as it "would have made the cost of borrowing from the Fund relatively expensive."[49] Considering that the lending rate plus the mandatory service fee plus the size levied surcharges would add up to over 350 basis points during the first year of a program, cost of borrowing from the Fund's current surcharge model fits the "relatively expensive" criterion that was vetoed more than a decade ago (see Table 2). If the time-levied surcharge is included, the cost of borrowing rises to over 400 basis points, more than what the IMF considered expensive at the time at which it defined the income model.

48 IMF country staff reports include a table with Indicators of Fund Credit as part of the sustainability assessment, but the projections of debt service presented do not separate other lending charges from the surcharges. The IMF's projected payments database does not separate surcharges from other charges and interest. Surcharges charged on each country have to be indirectly estimated by users. Country staff reports do not publish the lending rate, and do not publish the applicable surcharges.

49 IMF (2011), 4.

Surcharges Have Been Unsuccessful in Encouraging Early Repayment

Regarding countries' motivations to make early repayments, other factors are much more important than surcharges. Early repayment happens, more often than not, to avoid IMF costs altogether, including nonfinancial costs such as the stigma associated with operating under an IMF program, and constraints on economic policy.

Brazil and Argentina's large early repayments in 2005–2006 were politically motivated actions anchored in increases in international reserves, and not associated with the issuance of new external liabilities. The politics and economics of both of these cases were quite clear. In Brazil, the IMF had played a major role in economic policymaking in the decades prior to the election of the Workers' Party candidate, Lula da Silva, in 2002. Economic outcomes during this period had been disastrous: e.g., during the presidency of President Fernando Henrique Cardoso (1995–2002), GDP per capita had grown by just 0.4 percent annually,[50] and it actually fell from 1980 to 1994. During the summer and fall of 2002, as financial markets reacted badly to the prospect of Lula's election, the IMF negotiated a very large $30 billion loan agreement, which the Fund described as "build[ing] a solid bridge to the new administration in 2003."[51] This committed the next government to running large primary budget surpluses — 3.75 percent annually — through 2004, which arguably postponed for years the implementation of much of the Workers' Party Program.

It is therefore not surprising that in December 2005, Brazil repaid early all of its $15.5 billion outstanding debt to the IMF. In January 2006, Argentina emulated this move and, with support from Venezuela,[52] prepaid early all of its $9.8 billion loan owed to the Fund. Much has been written about Argentina's long and bitter experience with the IMF through the depression of 1998–2002, the Fund's policy conditions and failures,[53] and the (then record) sovereign default and debt restructuring that followed. Regardless of one's analysis of the IMF's role in this painful history, there is no doubt that it became a major political and even electoral issue in Argentina during this time; it is therefore clear that there was very strong motivation and political support for paying off this debt so as to be free from IMF influence.

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50 Calculated from IMF (2021t).
51 IMF (2002b).
52 Swann (2007) and Baribeau (2005).
53 For a summary, see Weisbrot (2015), 144-156.

Since 2009, a mere eight countries — Greece, Hungary, Iceland, Ireland, Latvia, Portugal, North Macedonia, and St. Kitts and Nevis — have made early repayments to the Fund. The IMF admits that there are other important motivations for paying back the Fund, noting that in Hungary, the early repayments "may have reflected political considerations as well as the perceived stigma associated with Fund financing."[54]

The only two cases where early repayments can be clearly identified with the surcharges policy are Ireland and Portugal. Ireland's prepayments brought the amount of outstanding debt under the surcharge threshold,[55] and public statements from the Portuguese authorities suggested that surcharges,[56] along with other considerations, including a desire to bring IMF monitoring to an early end,[57] also played a role. Both countries enjoyed access to EU and market credit that was cheaper than IMF credit, even if there had not been surcharges.[58] As such, it appears unclear whether the decision was based on avoiding IMF-related costs altogether, including the costs of stigma, as opposed to the surcharges by themselves.

Even if one considers the possibility that the remaining countries took surcharges into account when they decided to pay back their loans early, it is important to note that these countries display key differences from typical recipients of IMF credit. All, apart from St. Kitts and Nevis,[59] are EU members or EU member applicants,[60] a status that offers additional security to private lenders, meaning that these countries are likely to regain capital market access faster and that yields are likely to respond quicker to improvements in these countries' external positions, as compared with most borrowers.[61] These advantages are not open to most other countries, which often cannot pursue the policy option that the surcharges are meant to induce.

54 IMF (2016c), 23.
55 Ibid.
56 Teixeira (2018).
57 Ferreira (2018).
58 Even when Portugal fell below the threshold in 2017, IMF credit was 100 basis points more than market credit with comparable maturities. IMF (2019a), 45. It was a similar story in Ireland, see IMF (2016c), 23, graph E.
59 St. Kitts is an exception in another way: all of the other countries in this list had, or had regained, capital market access at the time of the repayments. Instead, St. Kitts financed the repayments with part of the proceeds of its Citizenship by Investment (CBI) program. This type of policy is associated with small island tax havens and is unlikely to be viable, or to bring in economically important quantities of capital, in other states. IMF (2015).
60 Greece, Ireland, and Portugal are in the EU and in the eurozone; Hungary is in the EU. Iceland applied to join the EU in 2009, and is a member of both the EEA and Schengen, but it has since frozen its application. North Macedonia applied in 2004 and is an EU candidate, but had its application tied up for years due to a now-resolved dispute with Greece over its name.
61 See e.g., Hauner, Jonas, and Kumar (2007) who compared new member states to other countries included in the EMBI and found that not only did these countries enjoy lower perceived sovereign credit risk and hence narrower yields than their peers, but also "that this effect materialized during the run-up to EU accession."

Eurozone countries had additional advantages due to support from the ECB. Portugal and Ireland, as well as other eurozone countries including Greece, benefited from ECB sovereign debt purchases under the Public Sector Purchase Program (PSPP), which pushed down borrowing costs, and thereby — as the IMF said in its 2017 report on Portugal — "bolstered" the country's ability "to borrow on relatively favorable terms."[62] This quantitative easing program in the eurozone is not applicable to middle-income countries. Greece was able to make its first early repayments in 2019 because of the ECB decision to repatriate to Greece the profits they had made through Greek bond purchases in the early years of the Greek crisis.[63]

There are already strong incentives for countries to make early repayments. IMF programs often come with onerous conditionality, requiring governments to enact unpopular reforms or to limit public spending, and so encouraging governments to seek exit as soon as they are able. Second, early repayments in themselves, as the IMF notes,[64] provide a positive signal to international capital markets, increasing the likelihood that countries can regain market access and push down yields. Rather than providing "strong incentives for timely repurchases,"[65] the evidence indicates that surcharges play a small role — if any — in countries' decision to make early repayments in the majority of cases. Even assuming that surcharges do provide an incentive for repayment beyond the existing incentives, early repayment is simply not an option for the vast majority of the lower- and middle-income recipients of IMF credit.

62 IMF (2017), 6.
63 Guggenheim (2019). Also see IMF (2020d), 9, 1n.
64 IMF (2016c), 23.
65 Ibid, 1.

Surcharges Harm Borrower Countries . . .

We have estimated the standard cost of borrowing as of August 2021, as well as the particular cost of borrowing for the five largest current borrowers from the Fund (Argentina, Ecuador, Egypt, Pakistan,[66] and Ukraine). These five countries currently account for around 70 percent of outstanding credit.[67] The IMF's five largest borrowers are projected to generate US $2.7 billion in income from surcharges for the Fund in 2022.[68]

These five countries are all middle-income, without access to dollar swap lines, and — except Ukraine — all have quotas smaller than their share of world GDP.[69] As a result, they are typical of debt-distressed middle-income countries that are likely to have large financing needs but are underrepresented in their quota shares at the Fund. Their quota shares are therefore not commensurate with their financing needs;[70] hence, they are more likely to end up borrowing larger amounts relative to their quotas, leading to surcharges.

Due to lack of transparency, exact surcharge amounts are not published. Surcharges have to be estimated based on implied rates and published charges (see below). CEPR estimates that surcharges are 45 percent of all nonprincipal debt service (2018–2030) owed to the Fund for the five largest borrowers.[71]

66 N.b. Pakistan is a beneficiary of the G20 Debt Service Suspension Initiative, but this only suspends service for bilateral debt, not from multilateral lenders like the IMF. IMF (2021m).

67 In the GRA — the main account of the Fund. IMF (2021f), 18.

68 IMF (2021o), 28.

69 Ratios of IMF quota share to share of 2019 world GDP (PPP): Argentina (87 percent), Ecuador (98 percent), Egypt (47 percent), Pakistan (54 percent), Ukraine (101 percent). By way of comparison, the United States has a ratio of 110 percent as it had a 15.9 percent share of the world economy in 2019, but 17.4 percent of the quota share. Sources: GDP from IMF (2021t), quota shares from IMF (2021k).

70 The IMF Executive Board represents all 190 member countries by grouping them into 24 constituencies where the voices of the single-country constituencies far outweigh those of the multicountry constituencies. IMF (2021i).

71 In the case of two of the largest five borrowers, Ecuador and Pakistan, the latest IMF-published country staff reports contain tables that project countries' debt service payments to the Fund. In these two cases, the tables did have accompanying footnotes for projections: a "GRA rate of charge of 1.123 [percent] as of November 19, 2020, for projected charges/interest" in the case of Ecuador and a "GRA rate of charge = 1.089 [percent] as of December 17, 2020 for projected" "interest and charges" in the case of Pakistan. However, CEPR calculations determine that the annual percentage rate true cost of borrowing (2021–2030 average) for Ecuador is 2.74 percent, peaking at 3.49 percent in 2025. In the case of Pakistan, the cost of borrowing (2021–2027) averages 1.79 percent, peaking at 2.48 percent in 2023. The other countries' latest reports don't have accompanying footnotes, or mention the lending rate. The cost of borrowing for Ecuador is therefore 144 percent larger than as published in the latest country report. In the case of Pakistan, the cost of borrowing is 64 percent larger than the reported rate.

IMF surcharges penalize countries most in need simply for being in great need (see **Table 3**). The IMF demands higher payments at the moment when countries are the most liquidity-constrained. Surcharges only increase the debt burden for crisis-ridden countries, even as the IMF's own debt sustainability analyses demonstrate that a lower debt burden is necessary to ensure a higher probability of timely repayment and sustainable financing. Surcharges are procyclical, because they tend to increase the borrowers' payments to the Fund — and therefore drain government spending from the domestic economy — at times when the economy is slowing or in recession. Procyclical conditions are often attached to IMF loans,[72] and the surcharges increase this procyclicality by hitting countries that are more squeezed by both their current situation and by the IMF conditions that are attached to their loans. Surcharges are therefore against the spirit of the IMF's Articles of Agreement and should be scrapped.

Table 3 shows the annual average payments and projected payments to the IMF for three year periods from 2018 to 2029 for the five current biggest borrowers, in millions of USD.

Table 3

Annual Average Payments to the IMF, With Estimates of Surcharge Payments (US$ millions)

	Annual Average Payments				Total Payments 2018–29	
	2018–20	2021–3	2024–6	2027–9	SDR millions	USD millions
Total obligations to the IMF (IMF projections)	3,210	20,601	9,091	2,485	74,758	106,163
Principal payments	1,614	18,482	8,556	2,357	65,507	93,026
Charges/interest payments	1,596	2,119	536	128	9,251	13,137
Of which surcharges (CEPR estimate)	704	1,301	288	66	4,983	7,076
Average Annual Surcharges for the five most indebted countries (USD millions)						
Argentina	426	680	0	0	2,335	3,316
Egypt	159	369	79	1	1,283	1,822
Ecuador	0	115	153	64	703	998
Pakistan	54	104	35	0	409	581
Ukraine	65	33	21	0	253	359

Sources and Notes: Authors' calculations from IMF Country Reports and IMF Projected Payments. Argentina: IMF (2021c); Ecuador: IMF (2020b); Egypt: IMF (2021b); Pakistan: IMF (2021l); and Ukraine: IMF (2019b). Projected payments from IMF (2021j).

72 Including in loans during the COVID-19 crisis, researchers at Oxfam International found fiscal consolidation measures recommended in 84 percent of the IMF's loans, across 67 countries. Daar and Tamale (2020). See also Ortiz and Cummins (2021).

The two most debt-distressed countries in this list, Argentina and Egypt, are both contributing around 1 percent of export earnings just in surcharge payments for multiple years.[73] This a substantial use of hard currency — annually averaging around US $936 million for Argentina from 2020 to 2022 and US $369 million for Egypt from 2021 to 2023 — that could be better spent elsewhere. In fact, these sums are the annual equivalents to 44 percent of Argentina's, and 16 percent of Egypt's, imports of pharmaceutical products in 2020.[74]

Surcharge payments are also a contribution to the two countries' very substantial IMF debt service payments. Both Argentina and Egypt have multiple years where debt service to the IMF is above 10 percent of export earnings. In 2022 and 2023, Argentina is due to pay an equivalent of 30 percent of 2020 export earnings in debt service to the IMF annually. Egypt is due to pay 13 percent and 16 percent of 2020 export earnings in 2023 and 2024, respectively.[75] With this (potentially unsustainable) debt burden, every dollar of export earnings counts. Surcharges are an additional burden that, as we show in this paper, do not effectively serve their purported goal, but extract revenue better spent elsewhere, especially during a global pandemic.

Middle-income countries were also punished by the 2016 reduction in the surcharge threshold. This meant that they were unable to take full advantage of the increase in quotas that took place the same year, following the 2016 quota review. For example, before the quota review's changes went into effect, Egypt had a quota of SDR 944 million.[76] Egypt was therefore levied the surcharge if the loan was above 300 percent of its quota: SDR 2.8 billion. When the quotas were updated, Egypt's was raised to SDR 2037 million.[77] Had the surcharge parameters remained fixed, Egypt could have requested a loan for up to SDR 6.1 billion, without paying a surcharge. Despite the Fund now having more usable currency, it lowered the size-levied surcharge threshold to 187.5 percent of quota,[78] thus effectively discriminating against smaller economies that, when it comes to the levying of surcharges,

73 Argentina is due to pay an average of 1.5 percent of export earnings for the three years from 2020 through 2022; Egypt is due to pay 0.9 percent of export earnings for three three years inclusive from 2021 through 2023.

74 Argentina imported US $2.14 billion, and Egypt US $2.26 billion, of pharmaceutical products (HS30) in 2020. Ecuador and Pakistan are also due to pay significant sums in surcharges. From 2022 through 2024, Ecuador will pay an average of US $144 million annually, and Egypt will pay US $113 million annually over the same period. This is the equivalent of 15 percent of 2020 pharmaceutical imports for both countries (14.8 percent for Ecuador; 14.4 percent for Pakistan). Ukraine paid an average of US $97 million each year for 2019 and 2020. Authors' calculations from IMF country reports, projected payments, and 2020 data from UN Comtrade (n.d.).

75 Authors' calculations from IMF data.

76 IMF (2021e).

77 Ibid.

78 IMF (2016b).

would otherwise have benefited from the increase in their quota shares. Egypt must now pay surcharges if it requests a loan larger than SDR 3.9 billion, which represents just 63 percent of the threshold before the change in surcharge parameters.

Table 4

Egypt's Quota and Size-Levied Surcharge Threshold

	Before the Quota Review	After the Quota Review	After the IMF lowered the surcharge threshold
Quota (SDR)	944 million	2,037 million	2,037 million
Threshold for surcharge (percentage of quota)	300%	300%	187.5%
Threshold for surcharge (SDR)	2.8 billion	6.1 billion	3.9 billion

Source: IMF (2021e) and authors' calculations.

. . . And Thus Are Against the IMF Articles of Agreement

Surcharges are procyclical because they penalize countries at a time when they are in an adverse situation, forcing them to make greater cuts in order to repay debts. Procyclical policies that privilege scarce hard currency for surcharges above lending rates go against Article 1 of the IMF's Articles of Agreement, the purpose of which is to allow countries to overcome balance of payment crises with the least possible pain:

> To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.[79]

Demanding these surcharges during an ongoing recession caused by a pandemic goes even more against these provisions of the Articles of Agreement.

The scale of financing needs for recovery from the pandemic has been estimated at US $2.5 trillion.[80] Developing countries are in a far worse position with respect to their ability to respond to the scale of the problem. This uneven ability to respond has been most evident in the scale of fiscal response: the global response topped US $16 trillion, but this was

79 IMF (2020a).
80 IMF (2020g).

overwhelmingly concentrated in high-income countries.[81] The relatively quick rollout of emergency borrowing from the start of the pandemic signaled that the IMF understood the need for countries to access needed liquidity. Through the two upscaled facilities, the Rapid Financing Instrument and the Rapid Credit Facility, the IMF has approved loans to 85 countries, most of which is nonconcessional financing.[82] This represents less than a quarter of the IMF's alleged firepower. Kristalina Georgieva has vocally warned of a two-speed recovery fueled by the abundant liquidity of rich countries amid the stagnation of developing countries.[83]

The IMF's surcharge income and service fees will increase over the next few years, as more countries enter into lending agreements (see above):

> Going forward, another 38 members have expressed interest in new [Upper Credit Tranche] UCT programs. Moreover, 15 members are seeking emergency financing, for a total pipeline of 53 new Fund operations as of early March that are expected to come for Board approval over the next year.[84]

This means that middle-income countries that have been severely hit by the pandemic will also become victims of surcharges during a time when scarce funds are needed in the fight against the pandemic. As of 2019, there were 64 countries that spend more resources on servicing foreign debts than they do on health care expenditure for their citizens.[85]

According to the UN Economic Commission for Latin America (ECLAC), "the coronavirus disease (COVID-19) pandemic unleashed the most severe economic and social crisis in the recent history of Latin America and the Caribbean. GDP is estimated to have declined by 7.7% in 2020, representing the largest contraction in the past 120 years."[86] The LAC region has been overwhelmed by COVID-19 deaths and the specter of yet another lost decade.[87] Procyclical surcharges should not be part of the list of measures that contribute to this outcome, and/or to the ongoing crisis.

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81 IMF (2021g).
82 Overall, there has been a 20:3 split in the quantity of approved nonconcessional/concessional lending since the start of the crisis (see Table 1 above). See also Stubbs, et al. (2021).
83 See e.g., Georgieva (2021).
84 IMF (2021h), 12.
85 Jubilee Debt Campaign (2020).
86 ECLAC (2021), 13.
87 The debt crisis led to the 1980s being termed the "lost decade" in terms of economic growth. At the end of the 1990s, there was also a "lost half-decade" in some countries, especially in Argentina. Since 2014, growth has also stagnated in the region due to the fall in commodity prices and contractionary policies in many countries.

It is paradoxical that the IMF, together with the Financial Stability Board, recommends countercyclical macroprudential measures for financial institutions in crisis-ridden countries, including effective reduction of the debt burden for borrowers, but levies surcharges on borrowing by governments, effectively hindering these governments' ability to inject recovery stimulus into their national economies.

Not only are surcharges destructive to national prosperity, they are also not helpful to international prosperity. There are considerable positive externalities that would come from a lower rate of charge for IMF resources — and this has been conceded at times by the Fund. For example, the 2000 Review of Fund Facilities states:

> some Directors considered that sound reasons existed for maintaining a relatively low basic rate of charge, based upon a "cost-plus" approach. In particular, they noted the cooperative nature of the Fund and justified a "subsidy" element in the rate of charge based on the positive externalities for the world economy from stronger economic policies and crisis prevention; they also commented that direct comparisons could be misleading given other "costs" involved in using Fund resources not captured by the rate of charge.[88]

Among the costs of borrowing from the Fund are the stigma perceived by capital markets, as well as the costs of conditionality-induced recessions, among others. These directors are right that a lower debt burden represented by a lower rate of charge would generate positive externalities for the world economy. Lower debt burdens contribute to stronger economic policies because of added flexibility and a reduction in opportunity costs of debt burdens to both the government budget and the countries' international reserves.

As was argued earlier, the demand for Fund credit is effectively price-inelastic during a crisis, and therefore an easy way for the IMF to generate extra income. Effectively, the IMF is extracting rent from countries facing severe balance of payments crises that have no alternative to going to the Fund. This is not appropriate for an institution that is supposed to have a primary responsibility for international monetary and financial stability. It shouldn't be surprising that recent statements by the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development denounced IMF surcharge policy as "regressive and procyclical."[89]

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88 IMF (2005), 12.
89 See G24 (2021).

Surcharges Provide an (Unethical) Income Stream to the IMF . . .

The IMF's other argument in favor of surcharges is their contribution to its own revenue stream. Labeled "accumulation of precautionary balances," or "accumulation of reserves," according to this argument, the IMF requires surcharges to cover pensions and administrative costs and to help augment the Fund's capital reserves. This argument — boosting the IMF's own revenue — is more plausible as an explanation for the Fund's surcharge policy than the claim that surcharges encourage early repayments.

First, the Fund's financial history provides evidence for this argument. The IMF's lending margin was previously used to cover all the Fund's expenses and to accumulate reserves,[90] but a "sharp decline" in lending prior to the 2009 world recession "would have implied a margin of over 350 basis points," which would have "made the cost of borrowing from the Fund relatively expensive."[91] As a result, the margin was frozen at 100 basis points and the Fund changed its income model to rely on other income, such as that derived from profits on its holdings of gold, investment income, and surcharges.[92] However, as we shall see, surcharges have not meant that Fund credit is less expensive for the most crisis-stricken countries; rather, they have been a more opaque way of raising funds.

Second, surcharges are currently a significant source of income for the Fund (**Table 5** below). The IMF's FY2020 largest single source of operational income was surcharges, even above the standard lending margin charges. By FY 2022, it is projected that surcharges alone will be over SDR 1.3 billion. It would be safe to assume that surcharges will continue to represent around SDR 1.3 billion of IMF income per year, in FY 2023 and FY 2024. The sum of lending income from regular charges, commitment fees, and services will also increase in the next two years.

90 In 2008, the Executive Board decided that the "margin on the rate of charge should no longer cover the full range of the Fund's activities." IMF (2011), 5.

91 Ibid, 4.

92 Ibid.

Table 5

CEPR Surcharges Estimates in the Context of the IMF's Operational Income Projections

	Share	SDR (millions)				
		FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
		Actual	IMF Projection			
Operational income	**100%**	**2,313**	**2,102**	**2,956**	**3,178**	**2,991**
Lending income		1,884	1,992	2,715		
Lending Margin		667	868	990		
Service charges		91	123	104		
Commitment fees		374	70	280		
Surcharges	41%	752	931	1,341	1,304	1,227
Investment Income		**319**	**102**	**123**		
Fixed-income subaccount (reserves)		319	102	61		
Endowment subaccount payout		0	0	62		
Other		**110**	**8**	**118**		

Sources: IMF (2021q), IMF (2021h), and CEPR calculations for 2023 and 2024 surcharges.

Third, the IMF has been consistent in arguing that the buildup of its reserves is important for itself, especially in the face of credit risk.

> The contribution of the margin to reserve accumulation varies with the lending cycle. During high lending cycles (the situation we are currently in and which is likely to continue for some time), income from the margin and service charges is likely to be well in excess of the intermediation costs, providing a needed build up of precautionary balances to mitigate elevated credit risks in such periods. During low credit cycles, the margin will tend to be the main source of income available to cover intermediation costs and reserve accumulation would likely be lower, as would credit risks.[93]

And:

> Surcharges are an important element of the Fund's broad risk management framework intended to safeguard the revolving nature of Fund resources and help mitigate credit risk.[94]

The accumulation of precautionary balances has not been straightforward over the last few years. The IMF's precautionary balances have taken severe hits in 2019 and 2020 because of

93 IMF (2011), para. 21.
94 IMF (2016c), 20.

the Fund employees' pension actuarial recalculations, due to a fall in the discount rate[95] and losses in pension fund assets. Total reported losses in Fiscal Year 2020 were SDR 3.1 billion, and total reported losses in Fiscal Year 2019 were SDR 0.6 billion.[96] The discount rate recovered in Fiscal Year 2021 for SDR 2.7 billion in gains.[97]

> One year into the COVID-19 pandemic, uncertainties surrounding the prospects for recovery remain and are likely to impact actuarial assumptions such as the discount rate, and the performance of the Fund's investment and retirement plan asset portfolios. Positive projected net income should allow the Fund to continue to accumulate precautionary balances.[98]

The surcharges' contribution to the precautionary balances are small relative to the size of these recent pension-related actuarial swings. However, the impact of employee-related pensions and benefits goes beyond the actuarial dimension. According to PricewaterhouseCoopers, the IMF is projected to spend SDR 2 billion (US $2.8 billion) in the next five years on these benefits and pay-outs.[99]

Pension reform is frequently a condition for disbursements in IMF programs, with the reforms largely focused on short-term fiscal consolidation and long-term financial stability, and for this reason the Fund often favors raising the retirement age and moving from defined-benefit to defined-contribution systems — which shift risk from employers to employees.[100] The IMF's own pension scheme is a defined-benefit scheme with a normal retirement age of 62 (with early retirement options from the age of 50).[101] These are very generous pensions and the losses associated with them in recent years raise the danger of the surcharges being viewed as an effective informal subsidy on them.

Given the unfortunate expectations that more loans will be needed and foreseeable increases in interest rates will increase yields on its holdings and investments, the IMF can and should forego its surcharge policy. Just as the IMF has tolerated losses in its pension investments, it would be reasonable to tolerate a slowdown in precautionary balance increases.

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95 See IMF (2020e), 31, 11.3n.
96 Ibid, 29, sec. 11.2.
97 IMF (2021q), 28-31; and IMF (2021f).
98 IMF (2021q), 2.
99 IMF (2021q), 30.
100 For a comprehensive summary of the IMF's pension reform recommendations, see Heller (2017), which analyzed Fund discussions with 126 member countries on pensions between 2006 and 2015.
101 IMF (2020e), 28-9.

. . . But IMF Lending Capacity is Not Determined by Early Repayments, Nor by Precautionary Balances

The USD 1 trillion firepower figure prominently cited[102] by IMF Managing Director Kristalina Georgieva amid the pandemic is a clear indication of the true availability of funds for lending, especially as compared with alleged revolving funds from early repayment of disbursed loans. This amount is based on the value of contingent financial arrangements for accessing liquidity to finance more IMF lending. The IMF's capital base and its lending capacity depends on political agreements such as quota reviews,[103] new arrangements to borrow, bilateral borrowing agreements and could easily be reformed to include Special Drawing Rights issuances.[104] Thus, the main source[105] of the IMF's firepower comes from governments' commitments and loans to the IMF, not from relatively minuscule yearly profits for reserve accumulation and early repayments of outstanding loans.

While the IMF has occasionally recommended[106] early repayment, since the enactment of the 2009 surcharges reform policy[107] it has never explicitly modeled early repayment of IMF loans in country reports of IMF programs.[108] If the incentive-based mechanism outlined by the IMF in its 2016 surcharge review were truly part of policy, the IMF would be expected to explicitly incorporate the timing of market access into the loans' binding criteria and would model the liability-management operation in its programs' staff reports. As is made explicit in the Fund's recent review of its lending capacity, the IMF's Forward Commitment Capacity[109] lending capacity is contingent upon quotas and borrowing.[110] There is no evidence that the

102 Remarks by IMF Managing Director Kristalina Georgieva During a G20 Finance Ministers and Central Bank Governors Meeting in April 2020. IMF (2020f).

103 Quotas, in particular, are the main source of the IMF's lending capacity, rather than the Fund's precautionary balances. Because of accounting standards that may be in conflict with the spirit of the Articles of the Agreement, the country quotas at the IMF are registered as a liability of the Fund. This is despite the fact that quotas are of an indefinite nature and should be considered equity rather than an IMF liability, as the quotas can only be withdrawn by the unlikely event of a total withdrawal from the IMF (Schedule J of the Articles of Agreement). Despite their growth over the last two decades, the precautionary balances, also known as reserves, are an order of magnitude smaller than the size of the Fund's quotas. It is quotas, not reserves, that should be the main capital buffer against credit risks and other types of losses.

104 See Ocampo's proposal: Ocampo (2017), 73.

105 IMF (2021s).

106 See e.g., Latvia and St. Kitts and Nevis. IMF (2012) and IMF (2015).

107 IMF (2009).

108 And the IMF's own debt sustainability and external sustainability methodologies from 2002 onward do not include models of IMF loan early repayment (IMF 2002a, para. 16, 7n). See also IMF (2018) and IMF (2021p).

109 The IMF's measure of the resources available for new loans and other commitments.

110 "The Fund's total resources are composed of total quotas of all members and commitments of creditors under the NAB and bilateral arrangements." IMF (2021s), 12, box 2.

IMF considers (the unmentioned) early repayments as important for the functionality and sustainability of its lending practice.
The IMF should not be relying on countries in crisis to build up its buffers. In order to avoid the Fund making choices that would force countries in debt to suffer unnecessarily, the Fund needs to seek alternative sources of finance such as periodic countercyclical SDR issuances or SDR recycling mechanisms.

The IMF also argues that surcharges contribute to the management of credit risk. They don't. The Fund's main tool for credit risk management is the burden-sharing agreement whereby other debtors cover unpaid obligations. The IMF is a preferred creditor in all historical scenarios, given its gatekeeper role with other multilateral lenders and with capital markets for sovereign bonds. Debtor governments will virtually always make their IMF obligations first priority even while defaulting on other debt. Finally, historically speaking, the IMF has not faced significant prolonged strains on its finances.[111]

It would be reasonable to tolerate a slowdown in precautionary balance increases even if the IMF does not immediately find alternative sources to foregone surcharge income. Given the scale of this crisis, the IMF should manage its precautionary balances in ways that, at the very least, do not worsen the impact of crises on vulnerable borrowing countries.

Conclusion

In this paper, we present the IMF's justification for surcharges and show where it falls short. The IMF argues that its surcharges are incentives for early repayment and are a source of revenue to build up its buffers. As we have shown, these claims do not withstand scrutiny. With regard to the argument that the Fund needs the surcharges contribution to accumulate precautionary balances, it is possible for the IMF to find alternative sources of income, incur losses amid a pandemic, or refresh its accounting to include quotas as equity rather than liabilities.

We have further shown that the precrisis 2008 surcharge model still in force today is anachronistic. It was designed in an era of low lending, select lending, and lending not related to global health emergencies. A policy designed for a few loans at a time does not make sense

111 See IMF (2021f), 14, 23, and 35.

for a systemic global crisis that triggered 85 simultaneous income-generating loans[112] with 53 more in the pipeline.[113] The IMF designed the current surcharge model in an era of tight central banking, before the existence in high-income countries of quantitative easing, Fed swap lines, and zero interest rate policies. Middle-income countries also require expansionary macroeconomic policies, just as the high-income countries do, to recover from recessions and the pandemic. But to enact these policies they need augment their international reserves so as to avoid balance of payments crises. Surcharges have the opposite effect by draining the international reserves of borrowing countries. Also, loans to middle-income countries are considered large relative to quotas because the distribution of power at the IMF (quotas) is skewed against middle-income countries. A large loan, seen from another perspective, is a small quota. Surcharges on "large loans" are thus regressive.

Most importantly, as noted above, surcharges are procyclical and go against the spirit of Article 1, Section 1(v) of the IMF Articles of Agreement, which mandate that the IMF should be an instrument to help countries recover from crises "without resorting to measures destructive of national or international prosperity" — in other words, without unnecessary pain. Current surcharges are unnecessary pain in the middle of a global pandemic, which has made it difficult for countries to repay loans early or to recover swiftly. Because of surcharges, while the Fund staff reports published a rate of charge of 1.12 percent for Ecuador, the true cost of borrowing (2021–2030 average) is closer to 2.74 percent, peaking at 3.49 percent in 2025.

Argentina will end up spending US $3.3 billion in surcharges over the course of six years (2018–2023). This is nine times the amount it would have to spend to fully vaccinate every Argentine against COVID-19.[114] Egypt will have spent US $1.8 billion on surcharges between 2019 and 2024. This is three times the US $602 million it would cost to fully vaccinate all Egyptians.[115] A pandemic is not the moment to increase the Fund's equity buffers. It is precisely the moment to — according to its cooperative nature — act to save lives by facilitating economic recovery and access to medicines, including vaccines, and to look forward. Etymologically speaking, a surcharge literally means an added burden. This added burden is an obstacle to recovery and prosperity, and should be abolished.

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112 See Table 1 above. See also Stubbs et al. (2021).
113 IMF (2021h), 12.
114 It would cost an estimated US $360 million to give all 45 million Argentines two doses of the cheapest vaccine they have bought. Authors' calculations from UNICEF (2021).
115 It would cost an estimated US $602 million to give all 100 million Egyptians two doses of the cheapest COVAX vaccine. Authors' calculations from UNICEF (2021).

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