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INITIAL CONSIDERATIONS FOR THE REVIEW OF CHARGES AND THE SURCHARGE POLICY

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- The **Staff Report** prepared by IMF staff and completed on June 21, 2024

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International Monetary Fund
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INTERNATIONAL MONETARY FUND

June 21, 2024

INITIAL CONSIDERATIONS FOR THE REVIEW OF CHARGES AND THE SURCHARGE POLICY

EXECUTIVE SUMMARY

This paper provides background for an informal discussion to engage the Executive Board on the review of charges and the surcharge policy. Directors endorsed a review of the surcharge policy, the first since 2016, and agreed in April 2024 to postpone the decision on setting the margin for the basic rate of charge, to allow for a comprehensive assessment of charges and surcharges, including the effectiveness of their incentive function, total cost for borrowing members, and the income and reserves accumulation potential. The review will also consider possible changes to commitment fees arising from the need to adjust nominal thresholds for erosion.

Charges and surcharges are key elements of the Fund's multilayered framework to mitigate financial risks. The basic rate of charge—which is composed of the interest rate on Special Drawing Rights and a margin—is designed to cover the Fund's lending-related intermediation costs and allow for a buildup of reserves. Surcharges, both level- and time-based, are intended to provide price-based incentives to limit members' size of IMF borrowing and diversify their sources of financing, while encouraging timely repayment of credit once members resolve their imbalances and regain market access. Surcharges thus help preserve the revolving nature of Fund resources, given the institution's limited lending capacity. Surcharges also strengthen the IMF's balance sheet by generating net operational income and contributing to the accumulation of precautionary balances (broadly, the Fund's reserves) at times when credit exposure rises. Commitment fees are paid on the undrawn financing under all Fund arrangements and compensate the Fund for the cost of establishing and monitoring arrangements and for setting aside resources to be used if a purchase were to be made. The upward-sloping commitment fee structure is intended to discourage unnecessarily high precautionary access and thereby help contain risks to the Fund's liquidity.

Since the last review of the surcharge policy in 2016, global economic and financial conditions and the Fund's financial position have changed significantly. Reflecting persistent economic uncertainty following the COVID-19 pandemic and geopolitical shocks, Fund credit outstanding returned to the record levels reached during the Global Financial Crisis, though it has remained moderate as a share of Fund resources. The duration of Fund arrangements has increased, and some countries have maintained high access through a series of successive arrangements, incurring surcharges owing to both the size and length of their exposures. Borrowing costs for members have also increased substantially, reflecting a sharp increase in global interest rates, which have pushed up the basic rate of charge through the floating SDR interest

rate while the Fund's surcharge rates and margin have remained stable. At the same time, the Fund has made substantial progress in building reserves against credit risks and diversifying its income sources in line with the 2008 income model.

Against this background, the cost of Fund lending has come under greater scrutiny. Members and other stakeholders have raised questions and concerns about the effectiveness and incidence of the current surcharge policy. Some highlight not only the high interest burden for surcharge payers but also the size of the margin for the rate of charge, while others question the effectiveness of the price incentives provided by surcharges. These concerns stand out more starkly as the Fund reached in FY2024 its SDR 25 billion medium-term target for precautionary balances, which provides a substantial buffer against financial risks to the Fund, lessening the need to generate income from charges and surcharges to bolster reserves.

This review seeks to ensure that the Fund's charges and surcharges remain conducive to the provision of financing at favorable terms in a global environment characterized by more frequent shocks and major transformational challenges. In view of the improved reserves position, the review will explore the scope for lightening the cost for borrowing member countries while preserving appropriate incentives and financial buffers to safeguard the soundness of the Fund's balance sheet.

This paper informs the Executive Board's first engagement on the review and is intended to help build a common understanding of broad objectives and guiding principles for possible policy reforms. Specifically, the paper sets out to achieve the following main tasks:

First, it considers relevant changes in the Fund's operating environment and assesses whether the current surcharge policy framework continues to fulfil its objectives. Key changes in the operating environment include the higher cost of borrowing from the Fund, albeit remaining lower than the market cost for current borrowers; the strengthening of the Fund's financial buffers; and the observed shift towards longer Fund arrangements as more members are facing protracted balance of payments needs in the more shock-prone world. Moreover, level-based surcharge thresholds have eroded in real terms since they were last set in 2016, bringing more countries into the scope of both level- and time-based surcharges at relatively modest levels of access. The analysis of the effectiveness of the surcharge policy delivers a mixed picture. Surcharges have played an important role in accumulating precautionary balances. The incentive mechanism to prevent excessive Fund borrowing and encourage timely repayment appears to have been effective for some members albeit with notable exceptions, especially the largest current surcharge payers, which have suffered from large and protracted balance of payments needs and a lack of alternative sources of financing.

Second, the paper discusses illustrative approaches for possible changes to the surcharges policy that could help address concerns arising from the assessment of the policy's effectiveness. A range of possible reforms are considered, from fine-tuning the parameters of the existing framework (including raising the level-based surcharge threshold to offset erosion) to more substantive changes to the surcharge policy architecture. The merits of these options are discussed

using criteria of burden relief, incentive-compatibility, income generation potential and stability, and preservation of simplicity of the surcharge framework.

Third, the paper discusses the application of the framework to set the margin of the basic rate of charge for the remainder of FY2025 and FY2026 and presents an illustrative range of possible margins. In discussing the income of the Fund in April 2024, the Executive Board agreed to amend Rule I-6(4) and extend the current margin of 100 basis points to allow for setting the margin in the context of this review. The paper notes that a margin of 20 basis points would cover lending-related intermediation costs but would be notably below the cost of financing even for relatively creditworthy borrowers. It offers an illustrative application of the rule, which suggests that the basic rate of charge with a margin of between 40 and 100 basis points would continue to be aligned competitively with respect to long-term credit market conditions, remaining somewhat below the cost of financing for relatively creditworthy borrowers, and substantially below the cost of financing that has been faced by most countries that have had GRA arrangements, while preserving a significant net income generation capacity after covering intermediation costs.

Fourth, the paper notes the erosion of commitment fee thresholds. Commitment fees were reviewed in 2023 as part of the review on the Flexible Credit Line (FCL), the Short-term Liquidity Line (SLL), and the Precautionary and Liquidity Line (PLL), which maintained the current policies. But, since the 2016 Review, when they were last modified, there has been erosion of the thresholds vis-à-vis relevant macroeconomic aggregates. Adjusting the thresholds to offset erosion would imply increasing their nominal value by 45–50 percent.

Finally, the paper discusses the combined effects of illustrative surcharge reforms and margin adjustments. A range of implementation issues are also covered, including how the surcharge and commitment fee thresholds could be adjusted in terms of new quotas in the context of the effectiveness of the 16th general review of quotas.

Based on the feedback gathered during the informal engagement, staff intends to narrow down reform options that could garner a broad consensus, for further consideration by the Executive Board.

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Glossary

AAL	Annual Access Limit
CAL	Cumulative Access Limit
EA	Exceptional Access
EFF	Extended Arrangements under the Extended Fund Facility
EFN	External Financing Needs
EM	Emerging Market
EMBI	Emerging Market Bond Index
EMBIG	Emerging Market Bond Index Global
EMDE	Emerging Market and Developing Economy
EU	European Union
FCL	Flexible Credit Line
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GRA	General Resources Account
GRQ	General Review of Quotas
IBRD	International Bank for Reconstruction and Development
IEO	Internal Evaluation Office
IMF	International Monetary Fund
PBs	Precautionary Balances
PLL	Precautionary and Liquidity Line
PRGT	Poverty Reduction and Growth Trusts
RST	Resilience and Sustainability Trust
SBA	Stand-by Arrangement
SDR	Special Drawing Rights
SDRi	SDR Interest Rate
SLL	Short-Term Liquidity Line
WEO	World Economic Outlook

INTRODUCTION

1. This paper provides background for an informal discussion to engage with the Executive Board on the review of charges and the surcharge policy. The surcharges framework was last reviewed in 2016 and thus a review is timely. Furthermore, the framework has been the subject of recent debate regarding its effectiveness and fairness. As agreed by the Executive Board in the recent discussion on the Fund's income, the paper also considers setting the level of the margin for the basic rate of charge for the remainder of FY2025 and FY2026 based on the application of the factors contained in the Rule I-6(4) framework. Moreover, the paper will look at possible changes in commitment fees to consider erosion since threshold levels were last set in 2016. Finally, the paper discusses how threshold levels of surcharges and commitment fees, which are set in terms of quotas, could be adjusted in terms of new quotas in the context of the effectiveness of the 16th general review of quotas.

2. Charges and surcharges are an integral part of the Fund's multilayered credit risk management framework. Their role is to generate income to cover intermediation expenses, help accumulate reserves to protect the IMF's balance sheet against financial risks and provide price-based incentives for measured borrowing and early repayment, thereby enabling the Fund to effectively play its role as a global crisis lender (Box 1).

Box 1. Structure of Charges, Surcharges, and Commitment Fees

Borrowing from the IMF's general resources account (GRA) is subject to charges, surcharges, and commitment fees.[1]

Charges

The basic rate of charge is levied on all GRA credit outstanding and is determined as the SDR interest rate plus a fixed margin that is set by the Executive Board every two years in accordance with Rule I-6(4).[2] Under that rule, the level of the margin should be set at a level that is adequate to cover the IMF's lending-related intermediation costs and allow for a buildup of reserves (i.e., precautionary balances (PBs)). In addition, the rule includes a cross-check to ensure that the rate of charge remains reasonably aligned with long-term credit market conditions. The level of margin has been unchanged at 100 basis points since the current rule for setting the margin was first applied on May 1, 2012.

Surcharges

There are two types of surcharges: (i) *Level-based* surcharges of 200 basis points are applied on the portion of GRA credit outstanding greater than 187.5 percent of quota; and (ii) *Time-based* surcharges of 100 basis points are applied on the portion of GRA credit exceeding the level-based threshold for more than 36 months (or 51 months in the case of borrowings under the Extended Arrangements under the Extended Fund Facility (EFF)).

Concessional Fund lending to low-income countries under the Poverty Reduction and Growth Trusts (PRGT) and lending under the Resilience and Sustainability Trust (RST) are not subject to surcharges.

Box 1. Structure of Charges, Surcharges, and Commitment Fees (concluded)

Commitment fees

Commitment fees are charged on undrawn amounts available under all GRA arrangements and refunded when purchases are made in proportion to the drawings.

The fee structure is upward sloping: (i) 15 basis points for committed amounts up to 115 percent of quota; (ii) 30 basis points for committed amount above 115 percent and up to 575 percent of quota; and (iii) 60 basis points for committed amounts exceeding 575 percent of quota. This tiered structure was established in 2009 and the thresholds were adjusted in 2016 from 200 percent and 1,000 percent of quota to 115 and 575 percent of quota, respectively.

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1/ The IMF also levies a fixed service charge of 50 basis points on each disbursement from the GRA.

2/ See the section on the margin for the basic rate of charge below for details of Rule I-6(4).

3. Global economic conditions, the level and type of Fund lending, and the Fund's financial situation have changed significantly since the 2016 Review of Access Limits and Surcharge Policies. The global economy has confronted the pandemic crisis, a post-pandemic bout of global inflation, and a sustained rise in interest rates. Fund financial support expanded sharply during the pandemic, initially with a record number of emergency assistance disbursements and then a shift to upper credit tranche (UCT) arrangements. On average, arrangements today have higher access and longer duration than pre-pandemic. The Fund's financial situation is stronger, reflecting large lending income from charges and surcharges and an increase in non-lending income from investments. The medium-term target for PBs of SDR 25 billion was reached in Fiscal Year (FY) 2024 and the Executive Board maintained it in the recent *Review of Adequacy of Precautionary Balances*, reducing the need for income generation. The Board's endorsement of the current medium-term target reflects the underlying picture of the financial risks to the Fund: higher-for-longer credit outstanding, increased credit risks, albeit relatively modest risk of new arrears, slightly eased credit concentration and the near-term bunching of repurchases, and increased capacity of the burden sharing mechanism. At the same time, although the margin has remained fixed at 100 basis points since 2011, the basic rate of charge has risen sharply by about 400 basis points, owing to the global tightening of monetary policies since 2022. This has notably increased the interest payment burden for GRA borrowers.

4. The cost of Fund lending has come into greater focus recently. Members and other stakeholders have raised questions and concerns about the effectiveness of the current surcharges policy in meeting its objectives, particularly in terms of its incentives, while arguing that surcharges are procyclical, regressive, lack transparency, and their continued accumulation to bolster reserves is not warranted given the high level of the Fund's precautionary balances (PBs) and other credit risk protections (Annex I). Some of these concerns have also been raised regarding the level of the rate of charge.

5. The purpose of this paper is to inform the Executive Board's first engagement on the review and help build a common understanding of broad objectives and guiding principles for possible policy reforms. The paper offers initial considerations regarding the effectiveness and possible reforms of the surcharge policy, and for setting the margin on the rate of charge. It first considers relevant changes in the Fund's operating environment since the last review of surcharges in 2016 and offers an assessment on how the surcharge policy framework has carried out its designated roles as a risk management tool and as a contributor to the Fund's PBs together with the income generated by the margin. Based on this analysis, the paper presents illustrative approaches for reform of the surcharge policy that could address concerns arising from the assessment of the policy's effectiveness. The merits of these approaches are discussed using criteria of burden relief, incentive-compatibility, income generation potential and stability, and preservation of simplicity of the surcharge framework. The paper further illustrates the application of the Rule I-6(4) for setting the margin on the rate of charge and presents a range of possible margins for the remainder of FY2025 and FY2026, consistent with the rule. Possible modifications of the commitment fee framework to offset erosion are also explored and considerations regarding tradeoffs across these possible reforms are also presented. A formal proposal for changes in the overall policy framework could be presented to the Board in due course, considering the feedback gathered during the informal discussion and mindful of the overall impact on income projections.

OVERVIEW OF POLICY FRAMEWORKS

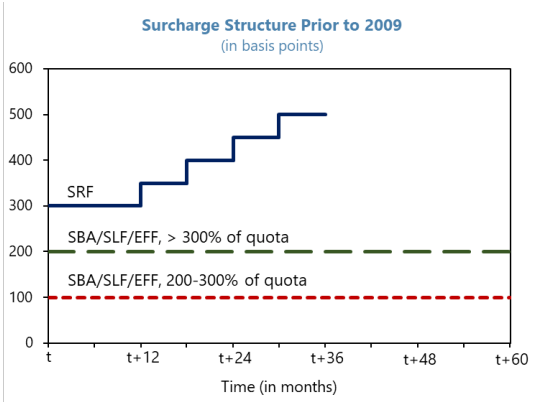
A. Surcharge Policy Framework and Objectives

6. Surcharges are designed to discourage large and prolonged use of resources from the GRA and to help accumulate PBs. PBs protect the Fund's balance sheet by absorbing possible credit and other financial losses, thereby preserving the value of reserve assets that members place with the Fund. Surcharges provide price-based incentives for members to limit the size of borrowing from the Fund and diversify their sources of financing, while encouraging timely repayment of Fund credit once members resolve their imbalances and regain market access, helping preserve the revolving nature of Fund resources. The underlying presumption is that members using Fund financing to help address large balance of payments problems should be able to gradually find alternative, cheaper financing sources.

7. The current framework of level- and time-based surcharges was introduced in 2009. It simplified the previous Time Based Repurchases Expectation Policy, which had multiple thresholds and rates. The policy framework has remained broadly unchanged since then (Box 2).

Box 2. Evolution of Surcharges

Surcharges were introduced in 1997 with the establishment of the Supplemental Reserve Facility (SRF).[1, 2] In 2000, level-based surcharges were introduced on purchases in the credit tranches and under extended arrangements, starting at 200 percent of quota with a two-step increase to discourage unduly high access requests. At the same time, a schedule of time-based repurchase expectations policy was introduced, under which, however, a member could request an extension to the maximum allowed under the repurchase obligation schedule. This resulted in a complicated system of surcharges and maturities (see figure and table below).



In 2009, surcharges were streamlined and aligned across all GRA facilities to simplify the structure of charges and to ensure consistency of terms across facilities.[3] At the same time, the time-based repurchase expectations policy was eliminated and replaced by time-based surcharges on credit outstanding under all GRA facilities, which were deemed more effective and transparent.

Repurchase Expectations Policy

Facility	Repayment period (in years)	
	Expectations basis	Obligation basis 1/ 2/
Credit tranches	2 1/4 - 4	3 1/4 - 5
EFF	4 1/2 - 7	4 1/2 - 10
SRF	2 - 2 1/2	2 1/2 - 3
SLF	n.a.	3, 6, or 9 months

1/ For the credit tranches and the EFF, a member whose external position has not improved sufficiently to meet the expectations schedule without undue hardship or risk could request an extension to the obligation schedule.
2/ For the SRF, extensions provided if: (i) the member is unable to meet the repurchase expectation without undue hardship; and (ii) the member is taking actions to strengthen its balance of payments.

The 2016 Review adjusted the level threshold and extended the trigger for time-based surcharges. The 2016 review was prompted by the forthcoming effectiveness of the 14th General Review of Quotas, which doubled the Fund's quotas. The Board concluded that the surcharges' incentive mechanism worked reasonably well and decided to maintain the surcharge rates and modestly increase the nominal SDR value of the threshold for level-based surcharges. The threshold for level-based surcharges was adjusted from 300 percent of (13th General Review) quota to 187.5 percent of (14th General Review) quota, which increased the nominal SDR value of the threshold by 25 percent, and the trigger for time-based surcharges for credit under the Extended Fund Facility (EFF) was increased from 36 months to 51 months to better reflect the expected adjustment path under such arrangements.

In 2023, the Fund expanded the publication of surcharges data, enhancing transparency. Granular data on historical and projected surcharge payments by country is available on the IMF's external website through the IMF Financial Data Query Tool.

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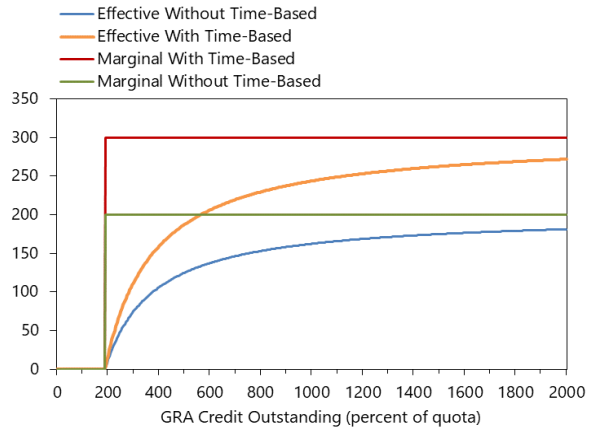
[1] See Annex I of Review of Charges and Maturities: Policies Supporting the Revolving Nature of Fund Resources (imf.org) (5/24/2005).

[2] Prior to 1981, when a flat rate of charge for all Fund credit financed with ordinary resources was introduced, the Fund operated a graduated structure of charges based on the level and duration of credit outstanding. Different rates of charge continued to apply on financing from borrowed resources until 1993. Article V, Section 8, of the IMF's Articles of Agreement states that the rates of charge normally shall rise at intervals during the period in which balances of members' currencies are held in the GRA.

[3] See GRA Lending Toolkit and Conditionality: Reform Proposals; March 13, 2009 (imf.org) (3/13/2009) and Charges and Maturities—Proposals for Reform; December 12, 2008 (imf.org) (12/12/2008).

8. While the marginal rate of surcharge is key in providing incentives to limit large borrowing from the Fund, the effective surcharge rate determines the average cost of such borrowing for members. Surcharges provide a price-based incentive for members to keep GRA credit outstanding at or below the level-based threshold by increasing the marginal rate of charge for any additional access. The effective interest rate for total GRA borrowing is defined by the sum of the basic rate of charge (applied to all GRA borrowers) and the average effective surcharge rate. In general, the average effective surcharge rate (in terms of total credit outstanding) is substantially lower than the marginal surcharge rate, with the difference falling to zero asymptotically only for very large exposures (Figure 1).

Figure 1. Current Surcharge Schedule
(In basis points)



Source: IMF staff calculations

9. Time-based surcharges are designed to further encourage early repurchases. The time-based surcharge, which kicks in roughly with the start of regular repurchases under Stand-by arrangements (SBAs) and arrangements supported by the Extended Fund Facility (EFF), reinforces the incentive for early repurchases by raising the cost of Fund financing closer to market levels, which are typically higher than the basic rate of charge. When the spread between market cost and the Fund's basic rate of charge is at or below the sum of the marginal rate of level- and time-based surcharges (300 bps), a country will be more likely to make early repurchases. This presumes that access to alternative sources of financing, such as from capital markets, has been restored, including by addressing external and domestic imbalances under the Fund-supported program.

10. Surcharges also help protect the Fund's balance sheet by contributing significantly to net operational income that can be retained for PB accumulation. Broadly in line with the Fund's lending cycle, surcharge income peaked in FY 2015 at SDR 1,463 million and fell to SDR 371 million in FY 2018, before rising again to SDR 1,407 million in FY 2023. The share of surcharge income in operational income followed similar dynamics, topping out at 52.4 percent in FY 2016, declining to 27 percent in FY 2019, and then increasing to 51.1 percent in FY 2022 (Table 1). The share of surcharge income in net operational income fluctuated between 53 percent and 110 percent during this period, reflecting the predominant role of surcharges in accumulating PBs.

Table 1. Basic Information on Level and Time-Based Surcharges
(As of the end of the fiscal year – April 30)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Fund credit outstanding at year-end (SDR millions)	90,182	81,238	55,228	47,798	48,300	37,884	63,694	73,575	89,788	93,031	96,741	90,801
o/w subject to surcharges	56,952	55,624	32,416	22,628	19,827	10,245	32,889	36,817	45,551	50,066	51,895	49,281
Amount of surcharge income collected (SDR millions, by year)	1,241	1,398	1,463	787	583	371	419	752	931	1,234	1,407	1,429
from level-based surcharges	1,151	1,126	991	554	424	284	374	709	863	925	1,009	1,007
from time-based surcharges	89	272	473	233	159	87	45	43	68	309	398	422
Amount of surcharge income collected (in percent)												
in percent of operational income	43.7	57.7	50.2	52.4	36.5	27.6	27.0	32.6	44.8	51.1	47.2	39.1
in percent of net operational income	61.9	80.8	68.0	110.1	75.9	72.1	61.9	53.2	106.6	85.9	76.3	57.8
Margin for the rate of charge (SDR millions)	918	853	742	515	486	434	506	667	867	905	941	943
Commitment fees (SDR millions)	473	29	505	96	333	323	83	374	70	283	196	225
Precautionary Balances at year-end (SDR billions)	11.5	12.7	14.2	15.2	16.7	17.5	17.7	16.0	20.0	20.9	22.6	25.1

Source: IMF staff calculations.

B. Framework for Setting the Margin for the Basic Rate of Charge

11. Together with surcharges, the margin for the basic rate of charge is a key determinant for the total cost of borrowing from the Fund. The margin, applied on top of the prevailing SDR interest rate (SDRi), is determined every two financial years for the next two-year period, with a comprehensive review before the end of the first year. Rule I-6(4) requires the margin to be set at a level adequate to cover the intermediation expense of the Fund, considering income from service charges, and generate net income for placement to reserves, considering the current level of PBs, any floor or target for PBs, and the expected contribution from surcharges and commitment fees. The rule further specifies that the level of the margin should ensure that the cost of Fund credit be neither too high nor too low in relation to long-term credit market conditions (the "market test"). The rule also permits, in exceptional circumstances, that the margin be set at a level other than that required to cover intermediation expenses and generate net income for placement to reserves.

12. Since the adoption of the current rule in 2011, the Board has set the margin at 100 basis points based on the exceptional circumstances clause. Invocation of the clause reflected that non-lending income remained consistently below expenses for the Fund's non-lending activities. In the Fund's income model approved in 2008, Rule I-6(4) was designed to move away from reliance on lending income for financing the Fund's non-lending activities, with the expectation that these activities would instead be financed with the Fund's non-lending income. However, through FY2023, the latter remained constrained by low investment returns. Lending income, including from the margin, has not only covered the intermediation (lending) expenses, and contributed to the buildup of reserves, but also until now covered some non-lending expenses.

13. In the context of the recent discussion of the Fund's income position, the Executive Board decided to extend the current margin period set to expire at end-April 2024. Most Directors favored consideration of the margin in the context of the review of surcharges, as this would provide a more holistic perspective on policies that affect the cost of Fund credit. To do so,

the Board amended Rule I-6(4) to maintain the margin at the level of 100 basis points over the SDRi until the completion of the review of surcharges, but no later than April 30, 2025, at which time the Board would set the margin for the rest of FY 2025 and FY 2026.

C. Commitment Fee Framework and Objectives

14. Commitment fees compensate the Fund for the cost of establishing and monitoring arrangements and for setting aside resources to be used if a purchase were to be made. They also serve to discourage unnecessarily high precautionary access and thereby help contain risks to the Fund's liquidity.

15. The design of the current fee structure was introduced in 2009 and has been discussed and reviewed on two occasions since then. The current thresholds under the upward-sloping fee structure, expressed in percent of quotas, were agreed by the Executive Board in 2016, in tandem with surcharges and access limit thresholds, when they were increased by 15 percent in nominal SDR terms. More recently, the Executive Board discussed some aspects of commitment fees in the context of the 2023 review of precautionary facilities without making any changes to their structure.

RECENT CHANGES IN THE FUND'S LENDING AND OPERATING ENVIRONMENT

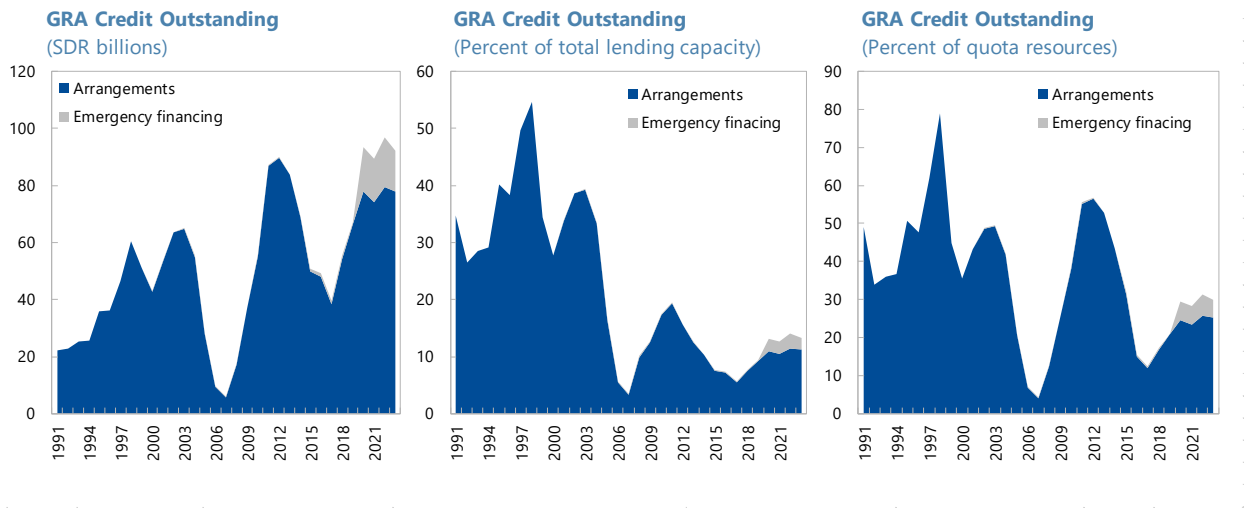
16. After the last comprehensive review of the surcharge policies in 2016, the global economy embarked on a long-awaited cyclical recovery from the Global Financial Crisis (GFC). By 2017–18, global growth was rising on the back of stronger activity, expectations of more robust global demand, reduced deflationary pressures, and financial market optimism. As the recovery continued to strengthen, the IMF urged policymakers to seize this opportunity to bolster growth, make it more durable, and equip their governments better to counter the next downturn.

17. However, the cyclical recovery was cut short by the outbreak of the COVID-19 pandemic and multiple subsequent shocks, with the medium-term outlook remaining weak amid high debt levels and elevated global interest rates. Many emerging market and developing economies (EMDEs) emerged from the pandemic with limited room for maneuver due to dwindling policy buffers, leaving them more vulnerable in a context of tightening financing conditions, with several countries forced to address their external imbalances in a difficult environment.

18. As a result of these developments, demand for Fund lending has increased greatly since the last comprehensive review of surcharges in 2016 and is expected to remain high. Demand for GRA lending in 2016–17 was relatively low, with 31 new arrangements approved during that period and GRA credit outstanding falling below SDR 40 billion by end-2017, equivalent to less than 6 percent of total lending capacity. Although demand was already increasing during 2018–19, the COVID-19 crisis boosted it further to record levels, mainly in the form of emergency financing. In nominal terms, by 2022, GRA credit outstanding had surpassed the previous peak reached during

the GFC, hovering just below the SDR 100 billion mark. However, as a share of the Fund's lending resources—whether total lending capacity or quota resources alone—credit outstanding remained well below previous peaks, such as during the emerging market crises of the 1990s or the GFC (Figure 2). More recently, GRA credit has receded somewhat, albeit remaining at historically elevated levels. As discussed in the context of the 2024 *Review of the Adequacy of the Fund's Precautionary Balances*, credit outstanding is projected to remain relatively high in the coming years.

Figure 2. GRA Credit Outstanding



Source: IMF staff calculations.

19. As would be expected in a more shock-prone environment, Fund arrangements have become longer and larger:

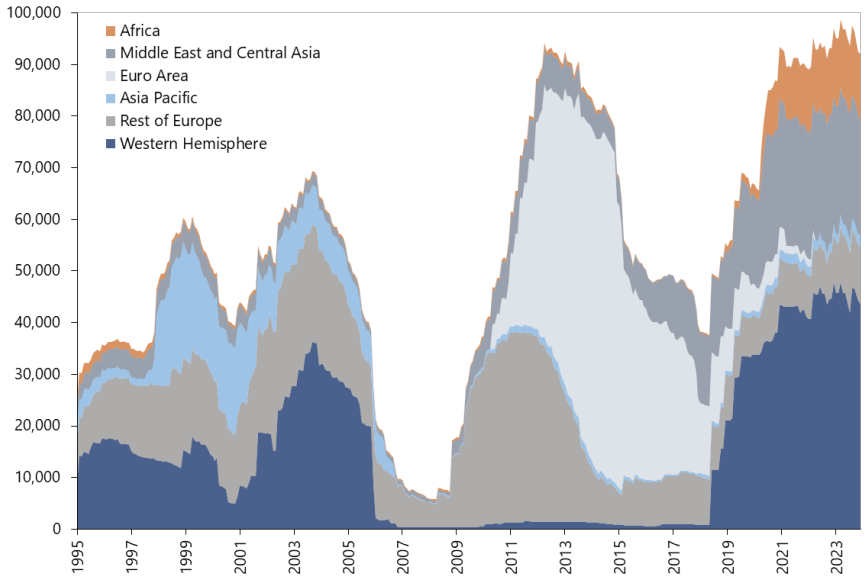
- The number of GRA lending arrangements approved in the post-COVID years rivals that of the GFC, but the structure of lending has changed compared to the pre-pandemic period, including the GFC. As countries confront more persistent balance of payments needs, amid a weak medium-term growth outlook, elevated financing pressures, underlying structural problems, and in some cases challenges in executing necessary policy adjustment, GRA demand has moved toward Extended Arrangements with longer maturities. There are currently four Extended Arrangements for every SBA.[1] The regional concentration of large programs also shifted in recent years, moving from European crisis programs to large emerging market and developing economies (EMDEs) in other regions, particularly the Western Hemisphere and the Middle East and Central Asia (Figure 3).

[1] In addition, some members are requesting RSFs to help them prepare for longer-term structural challenges, such as climate change, which further lengthens overall Fund exposure. Similar developments can be observed for concessional lending under the Poverty Reduction and Growth Trust (PRGT).

- The level of access and the number of successor arrangements have also increased, as EMDEs have been seeking larger Fund financing, while they seek to resolve persistent structural problems. Since 2020, access under the GRA increased for both normal and exceptional access (EA) cases, with the five largest cases now accounting for about 70 percent of Fund credit outstanding. Repeated use of Fund resources has also been on the rise: nearly one in three GRA arrangements approved since the pandemic was a successor to a previous GRA arrangement within the last three years. In total, 13 member countries had repeated GRA programs during 2013-22.

Figure 3. Fund Credit Outstanding Concentration by Region

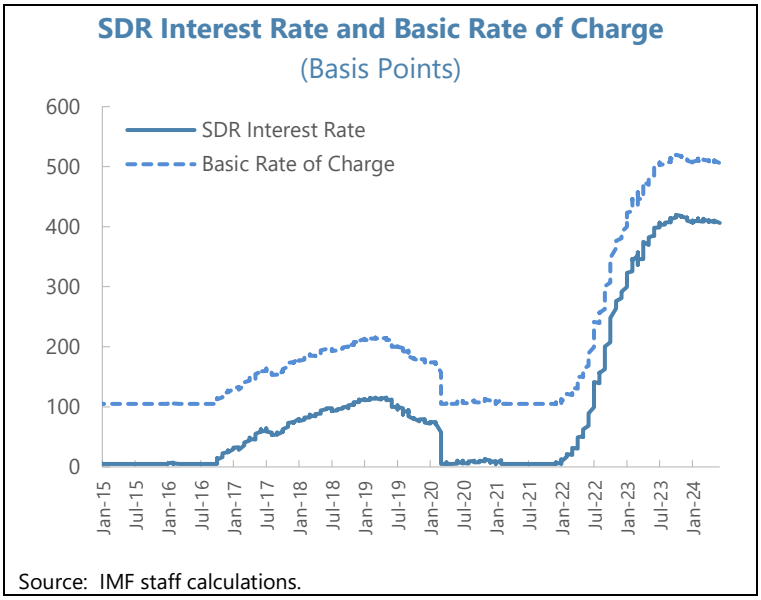
(Millions of SDRs)



Source: IMF staff calculations.

20. The sharp turn of global interest rates following the recent monetary tightening significantly affected the operating environment of the GRA.

- **Interest burdens of all GRA borrowers have increased considerably since 2021.** This has been driven by a sharp jump in the SDRi of about 400 basis points since October 2021, which pushed up the basic rate of charge (Text figure).



Source: IMF staff calculations.

- **Higher interest rates have led to a significant improvement in investment (non-lending) income**. Reflecting the upward shift in the interest rate outlook, investment income increased substantially in FY2024, exceeding non-intermediation expenses, and is expected to remain robust in coming years along with lending income (see the section below discussing the margin for the basic rate of charge).

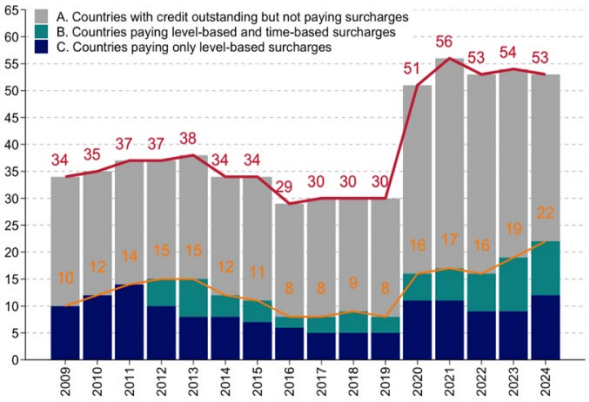
EXPERIENCE WITH THE SURCHARGE POLICY

A. Surcharge Incidence

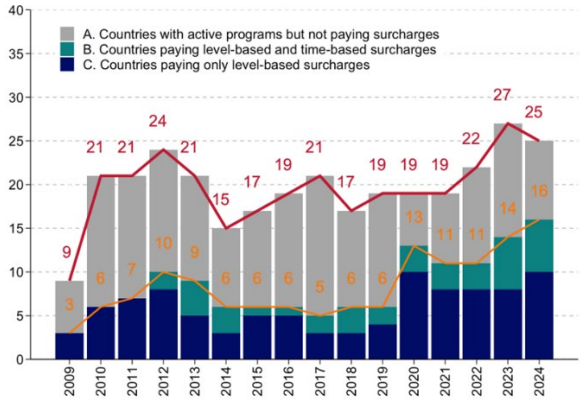
21. The number of members paying surcharges has increased to a historical high. The number of surcharge-paying members has tended to rise and fall with major economic shocks. After reaching a peak of 15 during the European sovereign debt crisis in 2012–13, the number of surcharge payers declined to single digits during 2016–19 (Figure 4). With the COVID-19 pandemic and subsequent shocks, including Russia's war in Ukraine, the need for IMF financial support and the number of countries paying surcharges rose again significantly, reaching in March 2024 a maximum of 22 out of 53 countries with GRA credit outstanding (about 40 percent). Among surcharge payers, the proportion of countries paying both level- and time-based surcharges declined from one half during 2014–15 to about one third during 2016–19, but subsequently rose again to one half in early 2024, reflecting in part the shift to larger and more repeated Fund arrangements. The share of surcharge payers among countries with active GRA arrangements also rose after the pandemic and is currently at historic highs. As of end-January 2024, 16 out of 25 countries with an active program paid surcharges (64 percent), of which six members paid both level-based and time-based surcharges (Figure 4).

Figure 4. Surcharge Incidence Among Countries with GRA Credit Outstanding and Active Programs

Number of Countries Paying Surcharges Among Countries with Credit Outstanding



Number of Countries Paying Surcharges Among Countries with Active Programs



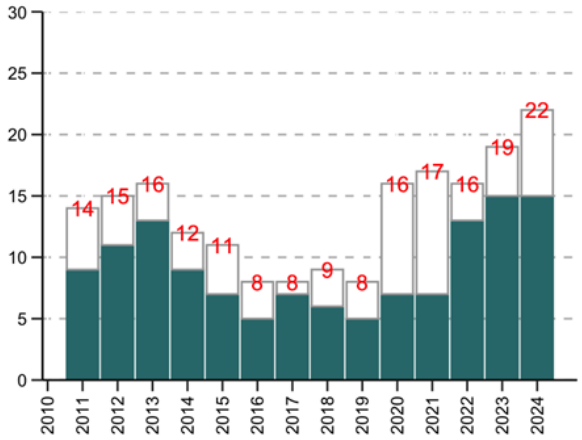
Source: IMF staff calculations.

22. Borrowers are also paying surcharges for longer periods, including because of an increase in successive arrangements. The number of prolonged surcharge payers, defined as countries that paid surcharges for three or more consecutive years, has increased to a record number of 15 out of 22 surcharge payers in 2024, compared to 13 out of 16 in 2013, in the aftermath of the GFC (Figure 5).

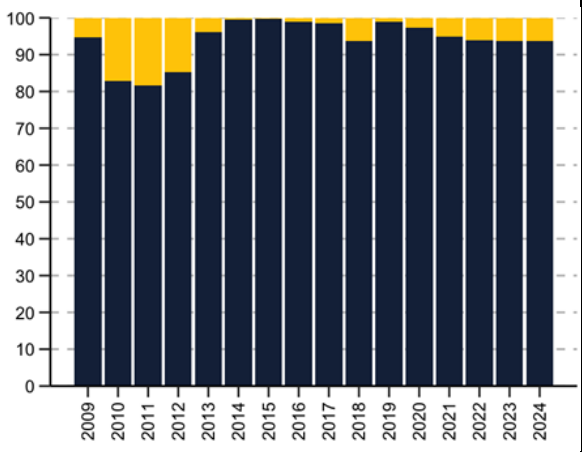
23. A small number of users of Fund resources have consistently accounted for the bulk of the Fund's total surcharge income. Reflecting in large part the heavy concentration of credit, which is inherent to the Fund's mandate and role as a crisis lender, the top five surcharge payers have consistently contributed more than 90 percent of the total surcharge income over the past ten years (Figure 5). In the aftermath of the European debt crisis, European countries (Greece, Romania, Portugal, and Ireland) dominated the top surcharge payers. After the pandemic, the top surcharge payers became large emerging market borrowers (Argentina, Egypt, Pakistan, Ecuador, and Ukraine).

Figure 5. Concentration of Surcharge Income

Number of Countries Paying Surcharges and Countries Paying Surcharges for Three or More Consecutive Years[1/]



Share of Top Five Surcharge Payers in Total Surcharge Payments



1/ The bar shows the number of countries paying surcharges for each year, while the green share shows the number of countries paying surcharges for three or more consecutive years in that given year.

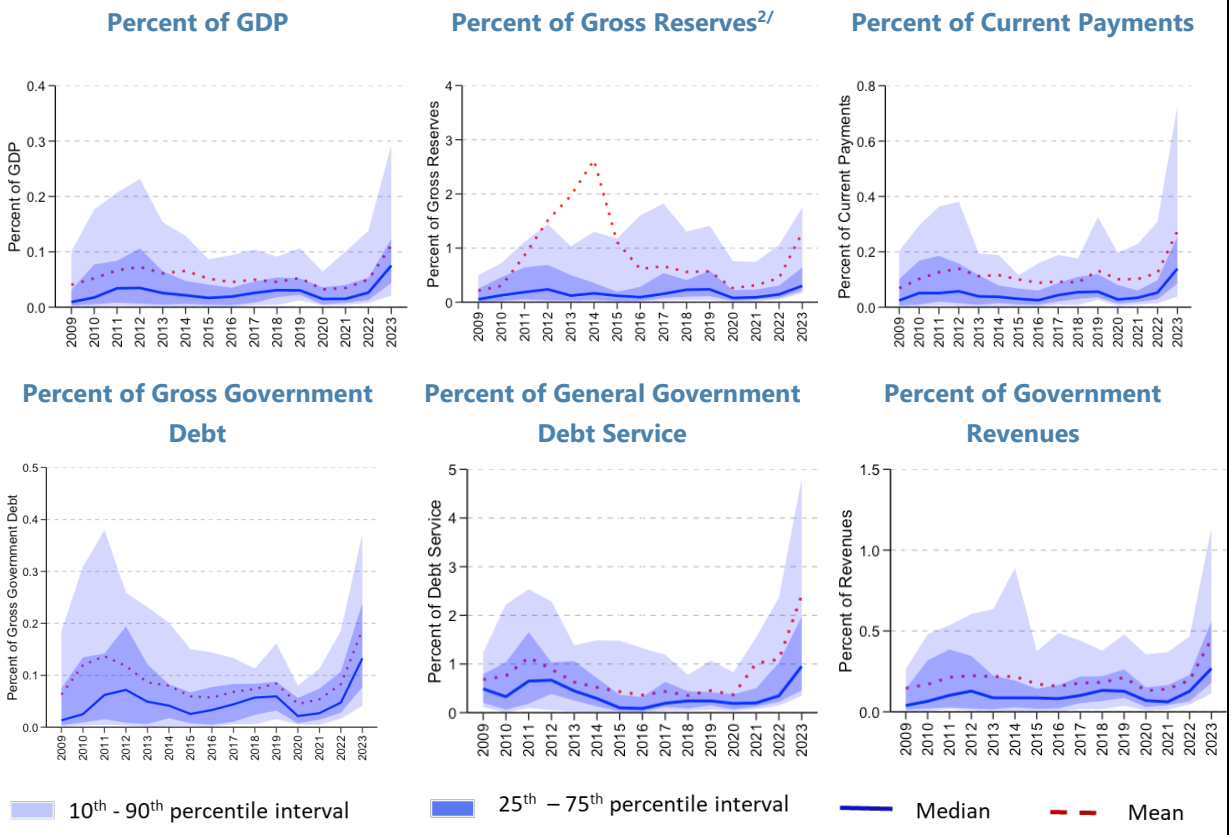
Source: IMF staff calculations.

B. Cost of Fund Borrowing and Surcharge Burden

24. The total cost of Fund borrowing increased substantially after 2021. Figure 6 shows the sum of basic charges and surcharges on Fund borrowing relative to several macroeconomic metrics for all GRA borrowers. The dispersion of the total borrowing cost widened during global distress episodes. In the current global monetary policy tightening cycle, the increase in the total cost of Fund borrowing for the largest borrowers has been more pronounced than for other GRA borrowers. While the increase in the total cost of Fund borrowing for surcharge payers since 2021 has been lower than the increase in the market cost of borrowing, the burden metrics for mean and median GRA borrowers have increased significantly since 2021.

Figure 6. Total Cost of Fund Borrowing Relative to Key Macroeconomic Metrics[1/]

(Percent)



1/ The total cost includes basic charges and surcharges. The sample covers all GRA borrowers.
2/ The spike in the distribution and mean of the burden as percent of gross reserves during 2011-2014 is driven by few extreme outliers (with very low reserves), mainly Ireland, Greece and Portugal.
Sources: IMF staff calculations and World Economic Outlook.

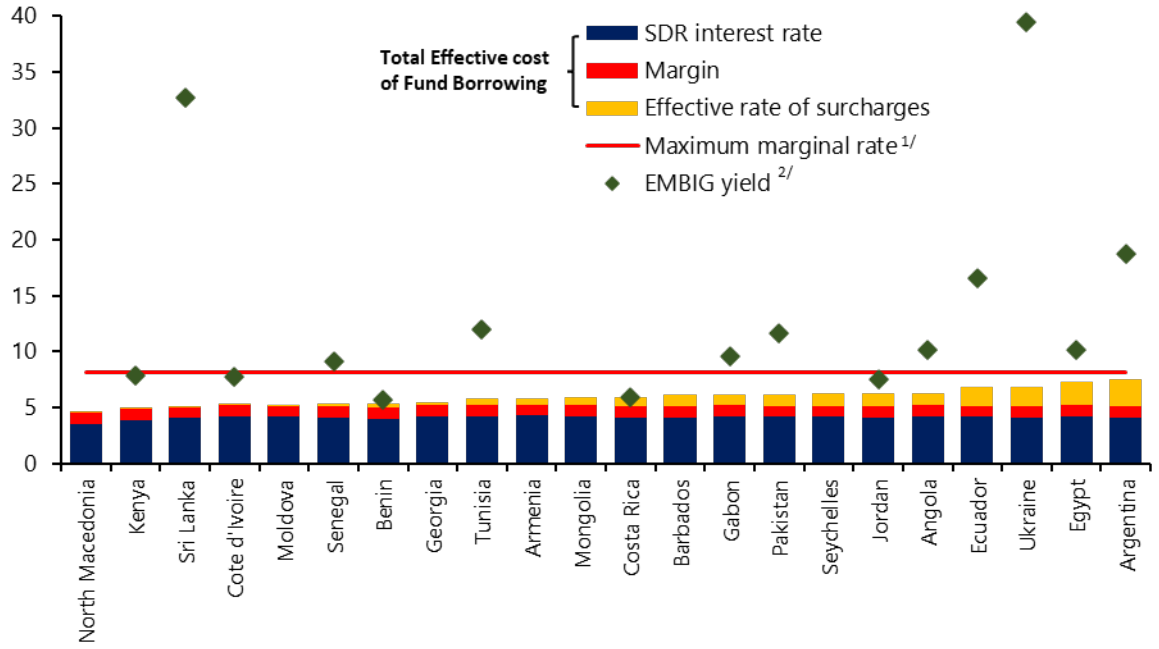
25. The increase in the cost of borrowing from the Fund has been driven by the basic rate of charge. Most of the current interest burden of Fund borrowing comes from the higher basic rate of charge, reflecting the global monetary tightening cycle. During October 2021-March 2024, the basic rate of charge increased from 105 basis points to 511 basis points, with the entire 406 basis points increase accounted for by a higher SDRi since the margin has remained unchanged at 100 basis points.[2] The effective surcharge rate varies widely among surcharge payers (Figure 7). For all 22 members paying surcharges as of end-March 2024, the average effective surcharge rate was 0.89 percent. For 14 surcharge payers, the effective rate was less than 1 percent, but for the largest two borrowers the effective surcharge rate exceeded 2 percent (2.4 percent for Argentina and 2.1 percent for Egypt), reflecting their high and protracted credit exposure to the Fund. However, even

[2] It is worth noting that increases in the SDRi do not affect the Fund's net lending income, as members' reserve tranche positions are remunerated at the SDRi and funding costs therefore rise in tandem with the income received from the basic rate of charge.

for the largest surcharge payer, the effective surcharge rate of 2.4 percent accounted for less than a third of the total effective cost of borrowing from the Fund of 7.5 percent.

Figure 7. Current Total Effective Cost of Fund Borrowing for Surcharge Payers and Market Rates

(end-March 2024; in percent)



1/ Maximum marginal rate for surcharge payers. Corresponds to the SDR interest rates as of March 31, 2024, plus 100 basis points of margin, 200 basis points of level-based surcharge rate, and 100 basis points of time-based surcharge rate.
2/ Due to data availability of the EMBIG yield, Costa Rica shows the seven-year USD benchmark government yield, while Benin and Kenya show the seven-year benchmark government Eurobond yield. For some of the countries there is no market cost data available.

Source: Bloomberg and IMF staff calculations.

26. The cost of borrowing from the Fund has been consistently lower and more stable than market financing:

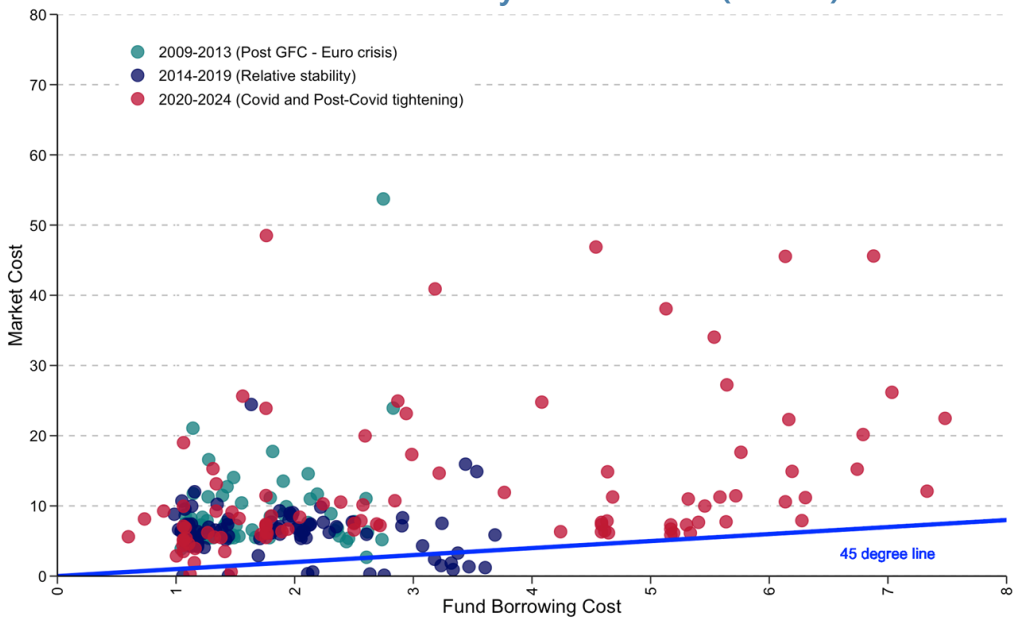
- **For borrowers subject to surcharges, the cost of market financing remains above the effective cost of borrowing from the Fund** (Figures 7 and 8). The market cost also exceeds the maximum marginal cost (assuming application of both level and time-based surcharges) for most non-PRGT eligible surcharge payers.[3] The scatter plot in Figure 8 shows that this holds also over time, as for surcharge payers, regardless of the cycle, the market cost has persistently exceeded the effective cost of borrowing from the Fund, with very few exceptions (the dots below the 45-degree line) that correspond to European countries like Greece and Portugal,

[3] The effective marginal rate for presumed PRGT blenders is substantially lower because they can access part of their IMF financing on concessional terms.

which quickly regained access to market financing on favorable terms once their balance of payment difficulties had been resolved.

- **The cost of borrowing from the Fund has also been less volatile than market costs.** The difference between the market financing cost, as proxied by EMBI yields, and the effective cost of Fund borrowing generally widens during global downturns, including during and after the COVID pandemic period.[4] Also, while the cost of borrowing from the Fund rose significantly after 2021 driven by the global interest rate cycle, it increased much less than market costs (Figure 9).[5]

Figure 8. Market Cost and Cost of Fund Borrowing for Individual Surcharge Paying Countries for Different Cycles Since 2009 (Percent)



Note: Each point represents the combination of the year's average Fund effective cost and market cost grouped in three different lending cycles.
Source: IMF staff calculations.

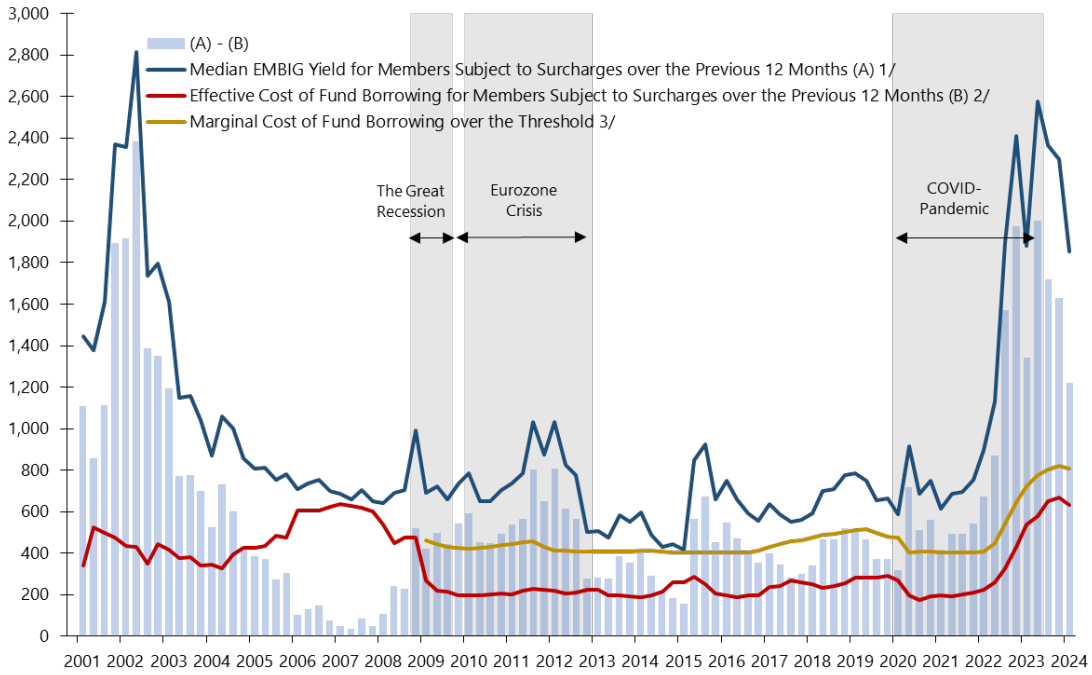
[4] The effective cost of Fund borrowing is calculated as the quarterly payment of basic charges and surcharges, in percent of average outstanding credit.

[5] The difference is larger for countries that lost market access, since median adjusted yields plotted in Figure 8 (which reflect secondary market prices) generally underestimates their true market borrowing cost.

Figure 9. Market Rates and Cost of Fund Borrowing

Market rates and cost of Fund borrowing for surcharge-paying members since 2001

(In basis points)



Sources: Bloomberg and IMF staff calculations.

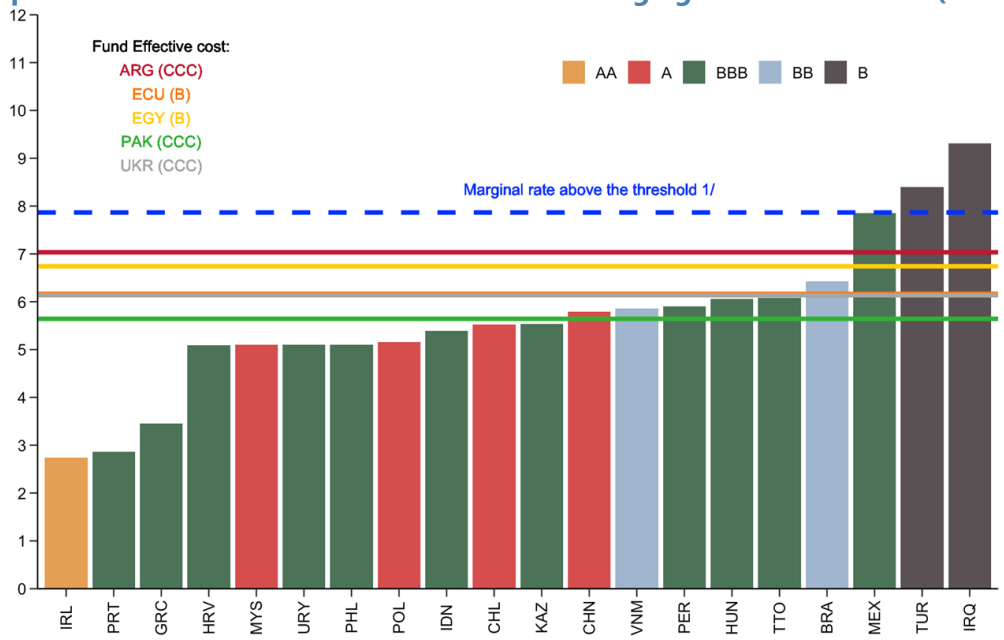
1/ For simplicity, the sample includes EMBIG yields for members whose credit outstanding exceeded 300 percent of quota in the previous 12 months (the higher level-based surcharge threshold before the 2009 reform) until 2015. From 2016 the threshold is updated to 187.5 percent of quota in the previous 12 months. The yields for Greece, Ireland and Portugal are calculated using sovereign five-year euro bond yields. The sample size is limited by data availability in periods of low number of high access arrangements.

2/ The unweighted average of effective cost of Fund borrowing for members in the sample.

3/ The marginal rate in case a country would make GRA borrowing over the level-based surcharge threshold of 187.5 percent of quota and with time-based surcharges (includes the average basic rate of charge).

27. Even for the largest surcharge payers, the cost of Fund borrowing compares favorably with the cost of borrowing from the market. Figure 10 compares the average market EMBI yields for 2023 for selected non-surcharge payers, grouped by their latest S&P 2023 rating (bars), while the horizontal lines show the average effective cost of borrowing from the Fund for 2023 for the top five surcharge payers. It shows that the top five surcharge payers' effective cost of Fund borrowing is near the market rate of the non-surcharge payer countries with much better ratings than the surcharge payers. For example, while Pakistan has a CCC rating, its effective cost of Fund borrowing is at a similar level to the market cost of countries like Chile or Peru. For Argentina, the top surcharge payer, for instance, the effective Fund borrowing cost is slightly lower than the market cost of Mexico. The differential is smaller (but still positive) for additional borrowing by members subject to both level-and time-based surcharges, for whom the marginal rate of Fund credit is currently close to 8 percent.

Figure 10. Average Cost of Fund Borrowing for Largest Surcharge Payers in 2023, in Comparison with the Market Cost for Selected Emerging Market Countries (Percent)



1/ The marginal rate refers to the average basic rate of charge plus level-and time-based surcharges. It thus reflects the cost for a protracted borrower with credit outstanding above the 187.5 percent of quota surcharge threshold.
Source: IMF staff calculations.

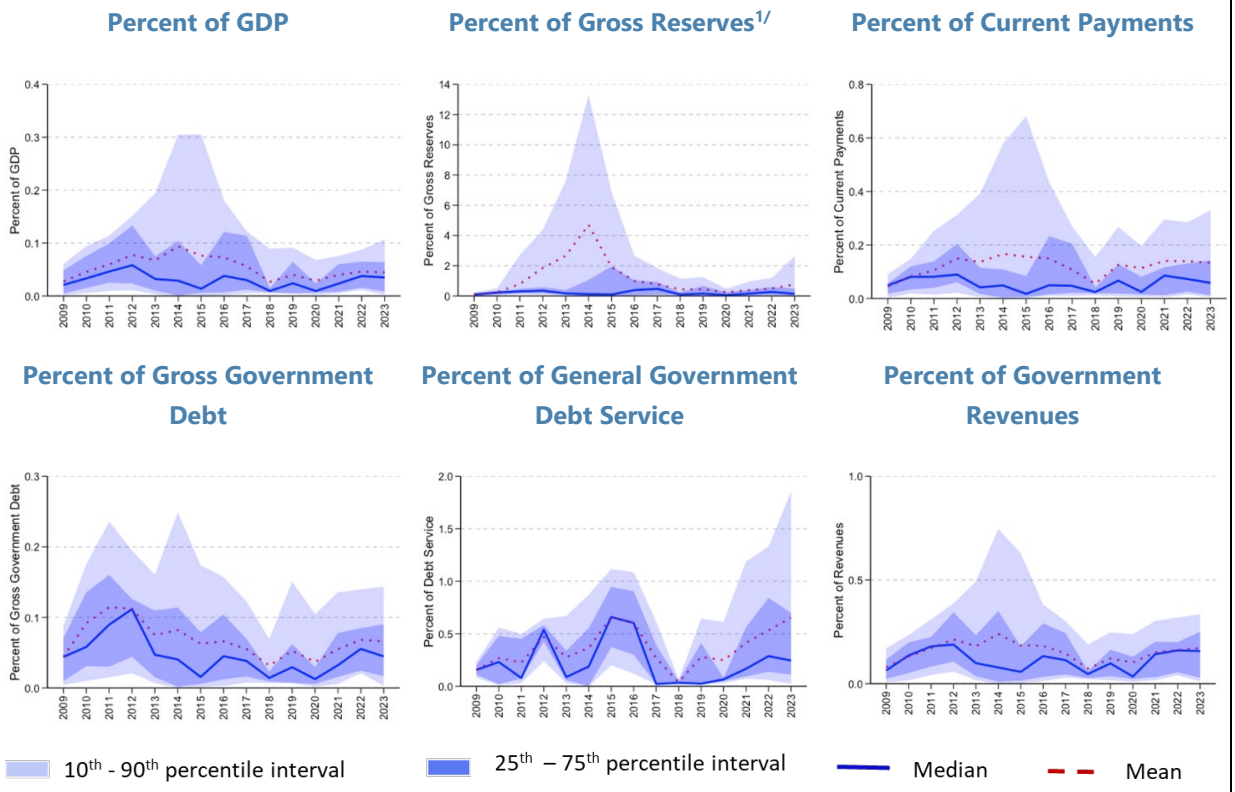
28. These cost comparisons do not include official financing. Differences in financing terms of bilateral and multilateral lenders providing assistance to members implementing Fund-supported programs can reflect differences in institutional credit risk management frameworks, financial organization, and mandates/objectives. Financing from such sources can involve a combination of longer maturities and lower costs relative to the Fund. In addition, these lenders may provide support in the form of grants or loan/grant combinations.[6]

29. The burden from surcharges has varied over time along with credit outstanding and appears to have been manageable for most payers. Figure 11 reports the time series of the distribution of total surcharge payments relative to key macroeconomic metrics. The surcharge burden rose during global distress times (such as the GFC and the pandemic and post-pandemic episodes) for all surcharge payers. While surcharges represented a substantial burden for the largest borrowers in these distress periods, the burden for the median surcharge payer remained generally modest. Crucially, however, the dispersion of the burden was relatively large, and widened considerably during distress periods, with the burden for the top payers growing disproportionately

[6] As an illustrative comparison, the interest rate for World Bank IBRD Flexible Loans with a maturity of ten to twelve years, which are the leading loan product of the World Bank for public sector borrowers of middle-income countries, was between 6.5 and 6.65 percent as of April 1st, 2024. This compares to average effective rates of Fund borrowing ranging from 6.2 to 7.5 percent and marginal rates of 8.1 percent for the five largest borrowers.

relative to the other payers, reflecting primarily their large and prolonged recourse to Fund financing.

Figure 11. Surcharges Payments Relative to Key Macroeconomic Metrics
(Percent)



1/ The pronounced spike on the distribution and mean of the burden as percent of gross reserves during 2011-2014 is driven by few extreme outliers (with very low gross reserves), mainly Ireland, Greece and Portugal.

Sources: IMF staff calculations and World Economic Outlook.

30. Overall, the data suggest that Fund lending is counter-cyclical in volume and in prices relative to market borrowing costs, but not in terms of its absolute cost.

- Reflecting the Fund's mandate as a crisis lender, the volume of credit outstanding tends to rise sharply in global economic downturns and decline when economic and global conditions improve. The Fund's lending volume is particularly counter cyclical for countries facing economic challenges independent of the global economic cycle (Figure 3).

- Borrowing costs from the Fund are considerably lower and more stable than market borrowing costs, even for surcharge payers, especially in times of global economic distress. However, Fund rates do increase when global interest rate rise, driven by the variable SDR interest rate. They also rise with the volume of borrowing and its duration, reflecting level-based and time-based surcharges, thus increase when members face particularly large and prolonged imbalances.

C. Incentive Function of Surcharges

31. Staff has assessed the effectiveness of incentives through a variety of approaches. Establishing conclusively whether the incentives provided by level- and time-based surcharges have discouraged excessive borrowing from the Fund and promoted early repayment is methodologically challenging because counterfactuals cannot be observed.[7] Moreover, repayment decisions not only respond to financial incentives but may also reflect other considerations, including possible reputational and confidence effects. Staff relied on quantitative evidence of repayment patterns and case studies to gain insights about the effectiveness of the current policy framework. Specifically, staff used a measure of financing pressures for each country to relate the dynamics of credit outstanding relative to the surcharge threshold with the degree of distress that countries are experiencing (Annex II). However, considering the above-mentioned methodological challenges, the results of this analysis are necessarily tentative.

32. Overall, the available evidence suggests that countries facing moderate or short-lived financing needs are more responsive to level-based surcharges. Three distinct groups of countries were identified based on how credit outstanding is affected by the level-based surcharge threshold. The effectiveness of the incentive role of surcharges appears negatively correlated with the level of financing pressures and disappears for large borrowers with more prolonged Fund financing needs and more entrenched imbalances that Fund arrangements seek to resolve. Figure 12 shows a representative country for each of the three groups (see Annex III for the other country cases).

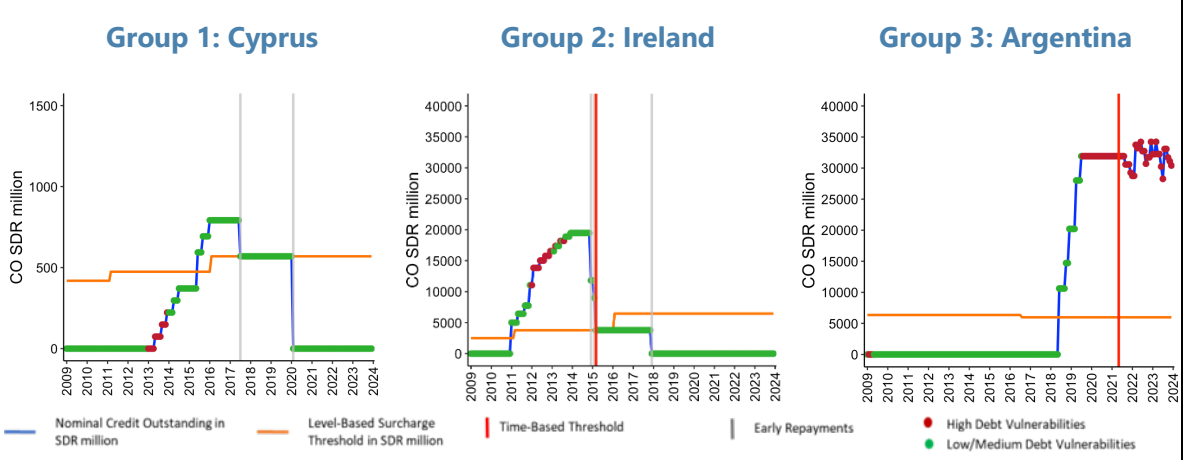
- **For a first group of countries, the level-based surcharge threshold is linked to the amounts borrowed from the Fund.** In this group of countries, credit outstanding hovered just below or very close to the threshold, which could reflect a desire to avoid surcharges. Countries in this group are relatively small borrowers that have generally experienced manageable financing pressures, and the balance of payment (BOP) needs are not that large. For instance, credit outstanding of Cyprus crossed the surcharge threshold but was swiftly brought back (see also Figure 1 of Annex II).

- **A second group comprises countries that borrowed above the threshold during times of high financing pressures, but reduced their credit outstanding towards non-surcharge paying levels once external pressures became more manageable**. At times of high borrowing from the Fund, these countries typically had high BOP needs and were not able to tap the market as an additional source of financing. However, once the BOP issues were resolved and market access was regained, these countries started to reduce their credit outstanding by making early repayments (illustrated by the gray vertical lines) in order to reduce and, eventually, avoid the payment of surcharges (see also Figure 2 of Annex II).

[7] For instance, for establishing whether level-based surcharges have contributed to a moderation of demand for Fund credit, it would be necessary to compare the actual borrowing by members with the level of borrowing that would have prevailed in the absence of surcharges, which is not observable.

- **A third group encompasses countries experiencing high and protracted financing pressures and whose credit outstanding has remained significantly above the surcharge threshold**. For these countries, there is little evidence to suggest that the level-based threshold has influenced access decisions and for many of them Fund credit has remained high for a considerable time. These countries are currently having very high balance of payments needs and have no or only very limited access to alternative sources of financing. Argentina, the Fund's largest debtor, is one such case and Figure 3 of Annex II shows other countries experiencing a comparable situation.

Figure 12. Event Study—Representative Countries



Source: IMF staff calculations.

33. The incentive mechanism of time-based surcharges appears to have worked for pre-2016 review cases related to the GFC and for some post-review cases, while the evidence on effectiveness is less clear for more recent cases, mostly associated with the COVID-19 crisis.

- Before the 2016 review, many borrowers with credit outstanding above the surcharge threshold made early repayments after they regained market access (see Box 4 of the 2016 *Review of Access Limits and Surcharge Policies*). For instance, large surcharge payers affected by the European crisis (Greece, Ireland, and Portugal) made early repurchases to bring their credit outstanding below the threshold when the spread between the market rate and the basic rate of charges fell well below the marginal rate of surcharges (Annex II). More recently, in early 2021, Morocco made early repurchases to bring their credit outstanding below the threshold. The authorities attributed their decision to repay to the fact that they wanted to avoid paying a surcharge, noting that Fund resources were more expensive than market financing at the time of repayment.[8]

[8] See "*The IMF's Engagement with Middle East and Central Asian Countries During the Pandemic*", Internal Evaluation Office (IEO) background paper to the evaluation of the "*The IMF's Emergency Response to the COVID-19 Pandemic (2023)*"

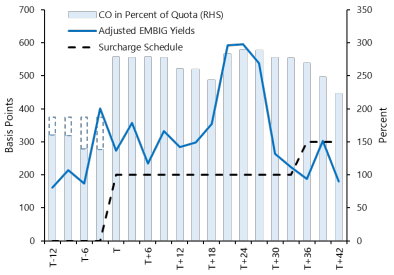
- For relatively small surcharge payers (Albania, Armenia, Jordan, and Mongolia) which paid time-based surcharges in 2023,[9] the spread between the market rate and the basic rate of charges fell below the marginal rate of surcharges by the time they were subject to the time-based surcharges (Figure 13). Despite the price incentive, these countries did not make early repurchases, possibly because of a limited arbitrage gain. In fact, for these countries, the difference between the marginal costs of Fund borrowing above the threshold and market cost has been less pronounced compared with the Euro crisis countries that made large early repurchases (Ireland, Portugal, and Greece).

- For the current top surcharge payers (Argentina, Ecuador, Egypt, and Pakistan), sovereign spreads remain far above the level- and time-based surcharge rates. For these countries, based on prices, there is no incentive to make early repurchases even when time-based surcharges have kicked in.

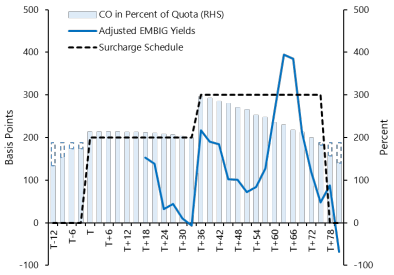
[9] Most of these countries borrowed from GRA during the pandemic period.

Figure 13. Event Analysis: Spread Between Market Borrowing and the Schedule of Surcharges for Time-Based Surcharge Payers[1/]

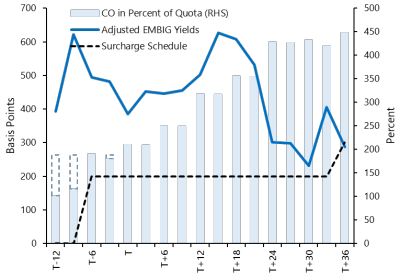
Armenia



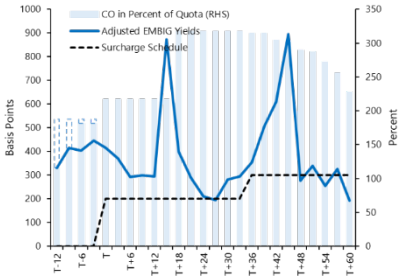
Albania[2/]



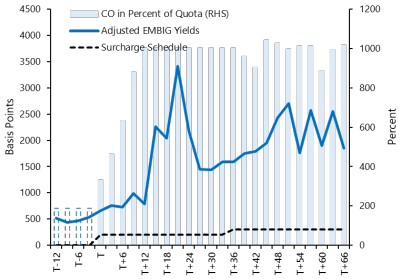
Jordan



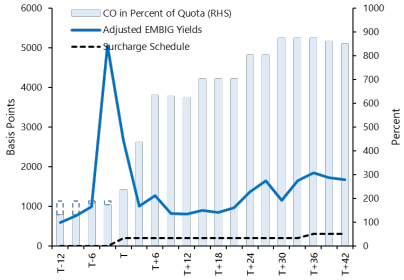
Mongolia



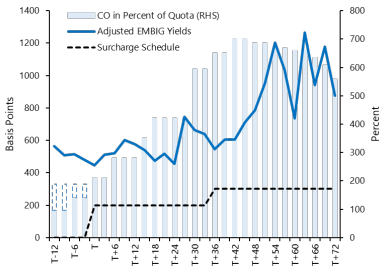
Argentina



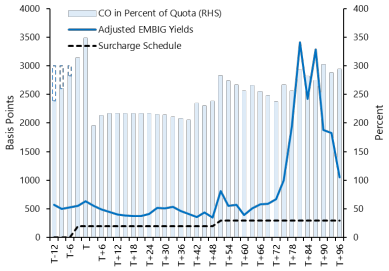
Ecuador



Egypt



Pakistan



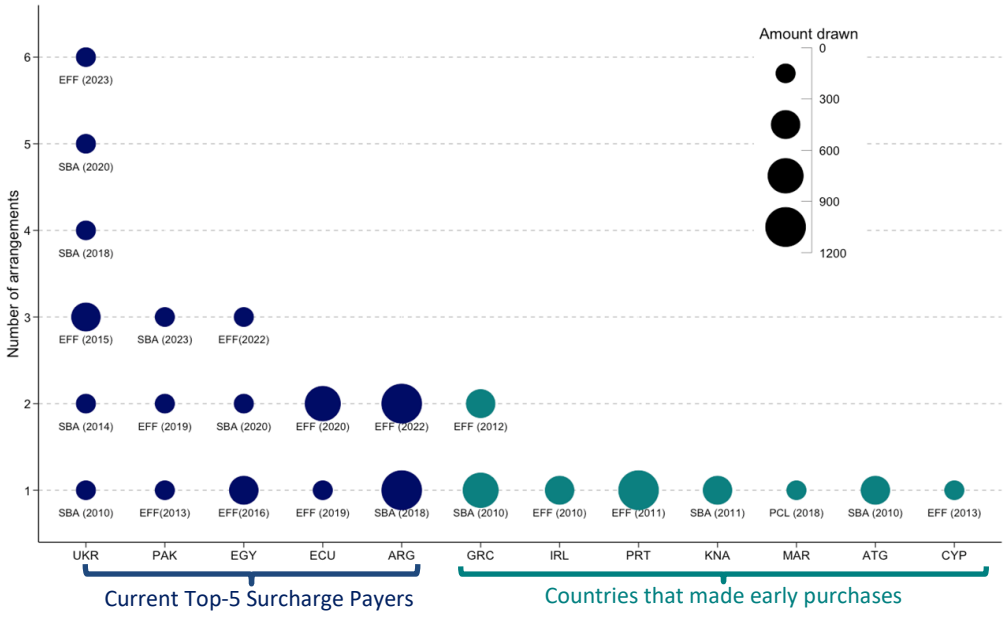
Sources: Bloomberg and IMF staff calculations.

1/ Adjusted yields are defined as the EMBIG yields net of the basic rate of charges. T refers to the date when the credit outstanding exceeded the threshold of 187.5 percent of quota.

2/ The adjusted yields for Albania are calculated using sovereign seven-year euro bond yields.

34. The more limited evidence of effectiveness of time-based surcharges in recent cases reflects the prevalence of large and persistent balance of payment problems. Arrangements supported by GRA resources are designed to resolve the member's balance of payments problem during the program period (i.e., before repurchases begin). However, all current top surcharge payers have had successor drawing arrangements (i.e., within two years of the end of the previous arrangement – see *2018 Review of Program Design and Conditionality*), which indicate these countries have faced persistent or repeated balance of payment needs. These balance of payment needs in turn reflect a combination of external shocks, deep seated structural problems that take time to resolve, and in some cases difficulties in executing necessary policy adjustments (Figure 14). In contrast, the majority of the countries that made early repurchases did not have successor drawing arrangements.

Figure 14. Surcharge Paying Countries and Successor GRA Arrangements[1/2/3/]



1/ This figure reports only GRA arrangements with drawings.
2/ Y-axis is the number of drawing arrangements since 2010.
3/ The size of the dot is relative to the amount drawn in percent of quota in each arrangement as of February 2024.
Sources: IMF staff calculations.

D. Erosion of the Thresholds

35. Erosion is an important consideration in all policies where thresholds are set in relation to quotas. As the nominal value of GDP, external financing needs, and other relevant macroeconomic and financial variables increase over time, both for individual countries and globally, thresholds set as a percentage of quotas are eroded in real terms (Annex III). As in the past, considerations regarding erosion will be a key element in the forthcoming comprehensive review of access limits, but they are also relevant for other policies, such as surcharges and commitment fees, which rely on quota-denominated thresholds. For instance, as surcharges—especially level-based

ones—are levied at least in part to compensate for higher credit risks to the Fund associated with larger exposures, erosion tightens the relative levels—in terms of relevant economic aggregates—at which the Fund assesses exposures as being sufficiently high to justify charging higher interest rates as a prudential measure.

36. Since the 2016 Review, the level-based surcharge threshold of 187.5 percent of quota has eroded against a range of standard metrics and a value of about 280 percent of quota would fully offset the erosion. The threshold was moderately increased in SDR terms in the 2016 Review, reflecting erosion based on relevant metrics, which pointed to an increase in members' average capacity to repay the Fund. Since 2016, the nominal SDR value of the level-based surcharge threshold has eroded by 32-34 percent in terms of world GDP and by 31-32 percent in terms of world's external financing needs. For EMDEs, the erosion has been deeper in terms of GDP, current payments, and capital inflows (34-37, 39-40 and 32-35 percent, respectively) and less so relative to their external financing needs (29-30 percent). If one were to exclude China and India, erosion across all metrics for EMDEs becomes marginally higher. The GDP metric is particularly relevant for surcharges because it is a key measure of the capacity of a member to sustain higher nominal levels of debt and repay obligations to the Fund. The external financing needs metric is also relevant since it reflects the balance of payment needs of a country under stress, which are the key determinant of access to Fund financing. Because of erosion, access under Fund-supported arrangement tends to increase in percent of quota (reflecting rising relevant macro aggregates), thus subjecting a higher share of credit to surcharges. Based on median and aggregate estimates, Table 2 below (also see Annex IV) suggests that a level-based surcharge of about 280 percent of quota would offset erosion across most metrics, regardless of sample and methodology.

Table 2. Level-Based Threshold Erosion Metrics 2016 – 2024

Surcharge threshold (in percentage of quota) in absolute terms in relation to global economic indicators

	Using **Median** erosion		Using **Aggregate** erosion	
	2016-2024 Erosion, percent	Level-based surcharge offsetting erosion	2016-2024 Erosion, percent	Level-based surcharge offsetting erosion
World				
GDP	34	283	32	277
Current Payments	38	302	37	296
Capital Inflows	32	275	23	245
External Financing Needs	31	271	32	277
Median across metrics	*33*	*279*	*32*	*277*
EMDEs				
GDP	34	284	37	295
Current Payments	39	307	40	315
Capital Inflows	32	275	35	286
External Financing Needs	29	265	30	266
Median across metrics	*33*	*279*	*36*	*291*
EMDEs excl. India and China (for comparability with 2016 Review)				
GDP	35	289	33	281
Current Payments	42	322	43	330
Capital Inflows	32	275	40	313
External Financing Needs	33	278	25	250
Median across metrics	*34*	*283*	*37*	*297*

Source: WEO and IMF staff calculations

EXPLORING APPROACHES FOR SURCHARGE POLICY REFORMS

37. The assessment of relevant changes in the Fund's operating environment and the experience with the surcharge policy can be summarized as follows:

- The interest burden for borrowing members has increased substantially in recent years owing to the sharp increase in global interest rates and—especially for the largest surcharge payers—more persistent financing needs, even though the cost of borrowing from the Fund remains significantly below market costs, including for the largest (and most risky) surcharge payers.

- PBs have reached the Board-established target and the income outlook for the coming years remains robust. Surcharges have played an important role in facilitating the accumulation of PBs. With PBs now at target, the reserve-building motivation for setting the level of surcharges will be less strong going forward, as long as the risk outlook for the Fund does not deteriorate substantially.

- The number of members subject to surcharges has increased and reached historical highs. This reflects both a shift in the structure of Fund lending toward longer, somewhat larger, and repeated Fund arrangements in the context of a more shock-prone global environment, as well as erosion of the surcharge threshold against relevant macroeconomic and financial metrics, which has brought more countries into the scope of surcharges, facing the maximum marginal rate under the current rate structure at relatively modest levels of access.

- Finally, surcharges have been partially effective in limiting Fund borrowing and encouraging timely repayment. They have been less effective in the case of current top surcharge payers owing to their persistent balance of payment needs, which have limited their access to alternative options of financing and therefore the role that price-based incentives can play.

38. The assessment findings provide pointers for possible reform approaches. The evidence suggests that the surcharge policy has been reasonably effective, but an increasing number of members have come into the scope of the policy and surcharges have imposed a significant burden on members by contributing to a notable increase in borrowing costs in the current high-interest environment. Based on the evidence presented in the previous sections, as well as past Executive Board discussions of surcharges, staff presents for illustration a range of possible reform approaches and discusses their merits based on the extent to which they:

- Ease the surcharge burden and make it more manageable;
- Ensure an effective incentive function of surcharges;
- Preserve the income-generation capacity of charges and surcharges; and
- Maintain the simplicity of the surcharge policy framework.

39. A fundamental question to be answered upfront is whether the Fund should continue to employ price-based incentives with the intention to moderate demand by borrowers and encourage timely repayment. In principle, abolishing or suspending surcharges would be a possible, albeit radical, reform option. This option would address concerns expressed over the added burden imposed on borrowers when their financing needs are high and the regressivity of the policy. However, it would also remove the price incentives associated with surcharges, which would run counter to the evidence that these have been at least partially effective in encouraging the desired behavior. It would also fully eliminate contributions to income and reserve accumulation, substantially reducing financial buffers. A less far-reaching variant of this option would be to preserve surcharges but refund them to borrowers once the related principal has been repaid (akin to a "security deposit"). However, this option would not address concerns about the upfront burden of surcharges since countries would still need to pay them during a crisis and surcharges would in practice likely be refunded only after members have overcome their difficulties.

40. If the Board chooses to continue employing price-based incentives, there are two broad modalities to consider. One modality would be to maintain the current framework but consider parametric adjustments of thresholds and/or rates to address some of the concerns raised in the assessment of experience with the current policy. The other is more ambitious and seeks a more wide-ranging change to the design of the surcharge framework. Each is taken in turn.

A. Parametric Adjustments

41. Adjustments to the parameters of the current policy framework could be considered, with a view to enhancing the effectiveness of incentive mechanisms and lowering the burden on borrowing countries. This type of reform, which is more evolutionary in nature, would generally preserve a significant income generation capacity for the GRA and the simplicity of the current policy framework. While there are many possible combinations of parametric adjustments, staff ran a few basic scenarios to illustrate key trade-offs related to the strength of remaining incentives, estimated income implications, and the distributional incidence on surcharge payers, compared with a no policy change scenario (Table 3).[10] The projection of the demand for GRA financing in all scenarios is based on the Fund's desk survey, which assesses the likelihood and access of Fund program requests in the next 24 months as of May 2024, considering countries' economic outlook, financing needs, and political landscape.

- **Increasing the surcharge threshold level.** An increase in the threshold level would address the erosion against relevant macroeconomic and financial metrics since the last revision, which was also an important consideration in previous reviews. This approach would reduce the surcharge burden (reflected in a lower effective surcharge rate) for all surcharge payers and increase borrowing space for countries that seek access at or just below the threshold (Text Figure). At the same time, it would to a large extent preserve the current incentive structure (reflected in an unchanged marginal rate for credit outstanding above the new threshold). In relative terms, this option would provide greater proportionate relief to smaller debtors, who could potentially fall out of the scope of surcharges.[11] A threshold increase would therefore result in a smaller number of members subject to surcharges compared to the current situation.

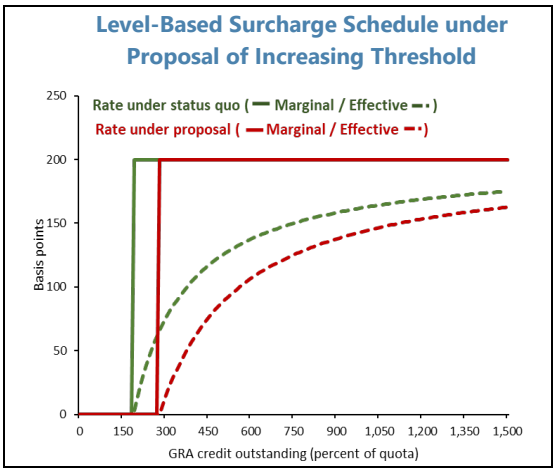
    - For illustration, an increase of the threshold to 280 percent of quota would broadly restore the erosion of the threshold since 2016 and would imply an annual lending income loss of about SDR 360 million in FY2026, with the largest three surcharge payers accounting for 45 percent of total relief (Table 4). The number of surcharge-paying members would decline

[10] This scenario comprises 6 countries that are expected to enter a new arrangement in FY2024–26 for a total demand of about SDR 11.9 billion. This approach is consistent with the approach used in the Review of the Fund's Income Position in FY 2024 and FY 2025-2026 and the Review of Adequacy of the Fund's Precautionary Balances. In all scenarios, policy changes are assumed to take effect on February 1, 2025. All projections provided are preliminary.

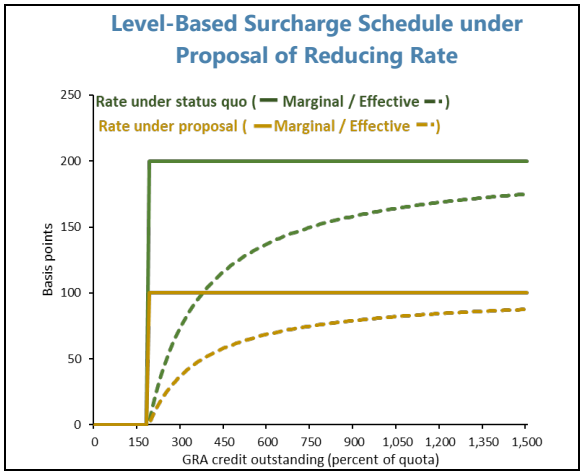
[11] For any threshold increase, the absolute reduction in surcharges payable for any member is limited to the size of the threshold increase (in percent of quotas) times the applicable surcharge rate (at most 300 basis points if a member is subject to both level- and time-based surcharges).

from 20 to 16 in FY2026 (a number comparable to the number of surcharge-paying members during the European sovereign debt crisis—Figure 4).

- Some stakeholders have called for the alignment of the thresholds for exceptional access and level-based surcharges.[12] This option would require increasing the threshold of level-based surcharges to the normal cumulative access limit (currently temporarily set at 600 percent of quota), considerably expanding the borrowing space for members at relatively low cost and reducing the gap between the threshold level and GRA credit outstanding of the largest surcharge payers. The number of surcharge-paying members would decline to only two in FY2026, implying a substantial weakening of the incentive mechanism and the income-generating capacity of surcharges, as the annual lending income loss would amount to SDR 1.1 billion.



- **Reducing surcharge rates.** Reductions in the level-based surcharge rate would lower the burden on borrowers from inception of a program, providing relief when financing needs are highest, albeit by reducing price-based incentives as marginal borrowing rates would fall for all levels of credit outstanding (Text Figure). Reductions in the time-based rate would provide relief later in time and would only impact the incentive for timely repayment. It could provide surcharge payers with extra policy space to make necessary external adjustments in an environment of persistent BOP needs originating in structural problems. Surcharge rate reductions (both level- and time-based) would lower the burden for all surcharge payers, with relief in relative and absolute terms being highest for members with larger credit outstanding.



  - Illustratively, a 50 percent reduction of the level-based surcharge rate (i.e., from 200 to 100 basis points) would imply an annual lending income loss of about SDR 520 million in FY2026, with the largest three surcharge payers accounting for 75 percent of the total. A

[12] Historically, the thresholds for access limits and surcharges have always been set at different levels, reflecting their different functions. Access limits are designed to subject large financing from the Fund to greater scrutiny of credit risks via the criteria for exceptional access, while level-based surcharges are intended to discourage large and prolonged use of Fund resources and generate income to build PBs.

50 percent reduction in the time-based surcharge rate (i.e., a 50 basis point reduction) would imply an annual lending income loss of about SDR 240 million with the largest three surcharge payers accounting for 79 percent of the total. Lowering surcharges rates would not change the number of surcharge payers compared to the *status quo*.

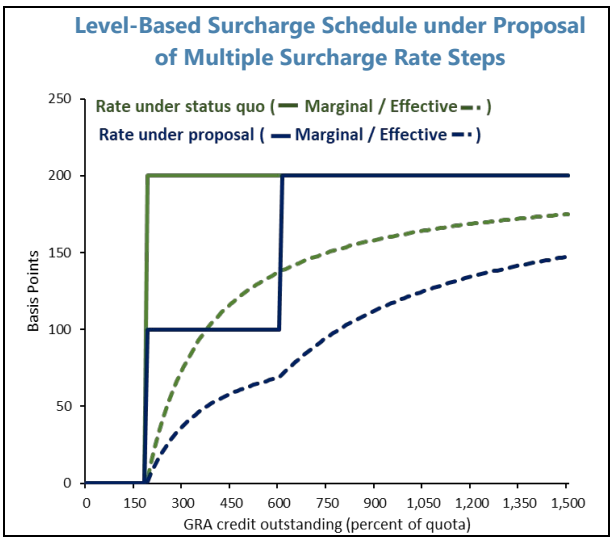
- **Extending the trigger for time-based surcharges.** This reform option could be motivated by the difficulties of members borrowing both under the credit tranches and the Extended Arrangements to quickly regain or improve market access in the current context where financing conditions remain generally tight, debt burdens are relatively large, and countries are exposed to large and more frequent shocks, which may require members to resort more often to Fund credit and for longer periods. An extension of the trigger would provide relief by giving extra time for surcharge-paying members to accomplish external adjustment, before price-based incentives for timely repurchases kick in. This approach would mainly benefit future borrowers unless the trigger is extended for a considerable period, as most of the current large surcharge payers have maintained credit exposures above the surcharge threshold for a long time.

    - For illustrative purposes, the annual lending income losses from an extension of the time-based trigger by 12-months for both outstanding credit under the credit tranches and EFFs would be modest (about SDR 30 million in FY2026) and largely benefit members that currently shoulder a relatively smaller surcharge burden. [13] The number of members paying time-based surcharges would decline from 12 to 9 in FY2026.

[13] If Executive Directors would like to pursue this approach further, staff will carefully assess the legal and policy implications, particularly with regard to the differentiation of the trigger between arrangements in the credit tranches and EFFs.

42. Some variants of the three basic parametric adjustments discussed above could be considered to further address concerns with the current policy.

- **Introducing multiple surcharge rate steps**: This approach would provide for a more gradual increase in the marginal rate with the volume of credit outstanding, thereby providing relief especially for borrowers that exceed the zero-rate threshold only moderately (Text Figure).[14] One possible anchor for this approach would be introducing a reduced rate of level-based surcharges on credit outstanding up to the normal cumulative access limit (currently temporarily set at 600 percent of quota), thereby subjecting to the top surcharge rate (and implicitly a higher risk premium) only very large financing from the Fund that requires greater scrutiny for credit risk under the exceptional access framework. For instance, a two-step structure with a level-based surcharge rate set at 100 basis points (current surcharge rate minus 100 bps) between 187.5 percent and 600 percent of quota, and 200 basis points (current surcharge rate) over 600 percent of quota, would reduce the relative burden somewhat more for surcharge payers with lower credit. Compared to an across-the-board reduction of the surcharge rate, this option would maintain price incentives at current levels for large borrowing (Text Figure). However, it would add complexity to the current surcharge framework, effectively reverting to the graduated rate structure in place before the reforms in the 2009 review.[15]

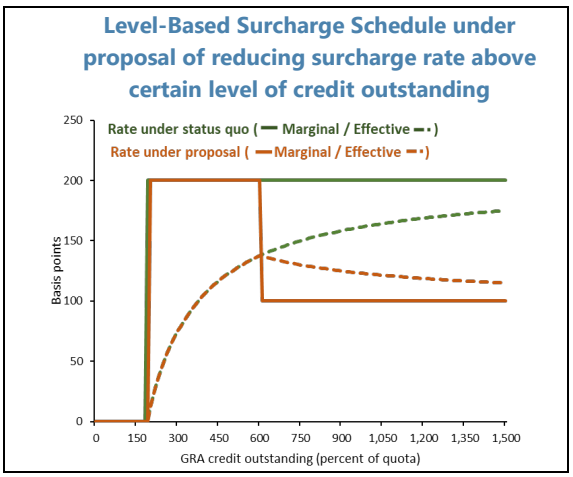


  - Estimated annual lending income losses for the illustrative two-step structure described above would be about SDR 370 million in FY2026, with the largest three payers accounting for 63 percent of the total. The number of surcharge payers would remain unchanged.

[14] In principle, a graduated structure of multiple rate steps increasing over time could also be considered for time-based surcharges.

[15] That said, it should be noted that if tiering is ultimately pursued, consideration could also be given to align tiering in the commitment fee schedule with the new tiering level for surcharges, which could help to simplify the overall system.

- **Reducing the level-based surcharge rate for credit outstanding above a certain level.** This approach could be considered to provide relief from the surcharge burden to large surcharge payers, for whom the borrowing costs from the Fund have increased notably. It would keep the current surcharge rate structure intact up to the normal cumulative access limit but lower the rate beyond that point, recognizing that for countries with very large imbalances and financing needs surcharge rates are unlikely to curb the volume of borrowing from the Fund (Text Figure). Under this option, the rate structure would become regressive, sending conflicting signals to borrowers with lower financing needs from the Fund and potentially weakening large borrowers' efforts to mobilize financing from other sources. By definition, the income loss would be fully accounted for by a reduction of the surcharge burden for the largest surcharge payers, and the number of members subject to surcharges would not change relative to the *status quo*.



  - For illustration, a reduction in the level-based surcharge from 200 to 100 basis points for credit outstanding above 600 percent of quota would reduce lending income by about SDR 150 million in FY2026, with the largest three payers accounting for almost 100 percent of the total. As noted, the number of surcharge payers would remain unchanged.

Table 3. Summary Assessment of "Parametric" Approaches for Surcharge Policy Changes

Impact on Surcharge Burden	Impact on Price Incentives	Impact on Income Generation Capacity	Simplicity
Increase the surcharge threshold			
Reduces burden for all surcharge payers, with higher relative benefit for smaller debtors.	Preserves current price-based incentives for credit above the new threshold.	Magnitude of income reduction depending on the size of threshold adjustment.	Maintains simplicity of *status quo*.
Reduce surcharge rates			
Lessens burden, with higher benefit for relatively large borrowers.	Reduces price-based incentives for all levels of credit.	Magnitude of income reduction depending on the size of rate adjustment.	Maintains simplicity of *status quo*.
Extend the trigger for time-based surcharges			
Little change in surcharge burden for current large surcharge payers.	Preserves current price incentives for credit outstanding beyond the new trigger.	Small near-term impact. Larger impact in the medium-term.	Maintains simplicity of *status quo*.
Introduce multiple surcharge rate steps			
Reduces burden for all surcharge payers (benefits of burden reduction are more uniformly distributed across borrowers).	Reduces price-based incentives somewhat for lower levels of credit but preserves them for very high levels of credit.	Magnitude of income reduction depending on specific threshold and rate adjustments. Smaller impact than zero threshold increase and rate reduction of same magnitude (over equal intervals of access).	Somewhat more complex than *status quo*.
Reduce level-based surcharge rate for credit outstanding above a certain level			
Reduces burden only for large surcharge payers.	Maintains current price-based incentives for low credit but reduces them for high levels of credit.	Magnitude of income reduction depending on specific threshold and size of rate adjustment.	Somewhat more complex than *status quo*.

Table 4. Surcharge Income under Illustrative Scenarios (FY25–29)[1/]

	FY25	FY26	FY27	FY28	FY29	Total during FY25-29
A. No policy changes						
Margin income (SDR million)	906	859	861	813	715	4,154
Surcharge income (SDR million)	1,514	1,540	1,544	1,420	1,172	7,190
Number of surcharge payers	23	20	22	22	20	
B. Threshold increased to 280 percent of quota						
Surcharge income (SDR million)	1,427	1,176	1,175	1,051	797	5,626
Lending income loss compared with A. (SDR million)	87	363	369	369	375	1,564
Number of surcharge payers	23	16	16	17	15	
Share of relief of top three surcharge payers (percent)	56.5	45.1	44.3	44.4	43.5	
C. Level-based surcharge rate cut to 100 bps						
Surcharge income (SDR million)	1,384	1,015	1,017	933	774	5,123
Lending income loss compared with A. (SDR million)	129	525	527	487	398	2,067
Number of surcharge payers	23	20	22	22	20	
Share of relief of top three surcharge payers (percent)	73.6	73.7	72.7	72.4	73.0	
D. Time-based surcharge rate cut to 50 bps						
Surcharge income (SDR million)	1,453	1,295	1,299	1,197	984	6,229
Lending income loss compared with A. (SDR million)	60	245	245	223	188	961
Number of surcharge payers	23	20	22	22	20	
Share of relief of top three surcharge payers (percent)	78.8	79.0	78.4	79.1	77.2	
E. Extension of time-based trigger by 12 months						
Surcharge income (SDR million)	1,495	1,507	1,539	1,416	1,150	7,108
Lending income loss compared with A. (SDR million)	19	32	5	4	22	82
Number of surcharge payers	23	20	22	22	20	
Share of relief of top three surcharge payers (percent)	0.0	44.0	0.0	0.0	0.0	
F. Tiered level-based surcharge rates (100bp for 187.5-600 percent of quota, 200bp for above 600 percent of quota)						
Surcharge income (SDR million)	1,422	1,169	1,164	1,047	834	5,635
Lending income loss compared with A. (SDR million)	92	371	380	373	338	1,555
Number of surcharge payers	23	20	22	22	20	
Share of relief of top three surcharge payers (percent)	69.5	62.8	62.2	63.9	68.2	
G. Tiered level-based surcharge rates (200bp for 187.5-600 percent of quota, 100bp for above 600 percent of quota)						
Surcharge income (SDR million)	1,477	1,386	1,397	1,306	1,113	6,678
Lending income loss compared with A. (SDR million)	37	154	147	114	60	512
Number of surcharge payers	23	20	22	22	20	
Share of relief of top three surcharge payers (percent)	83.6	99.4	100.0	100.0	100.0	

Source: IMF staff calculations.

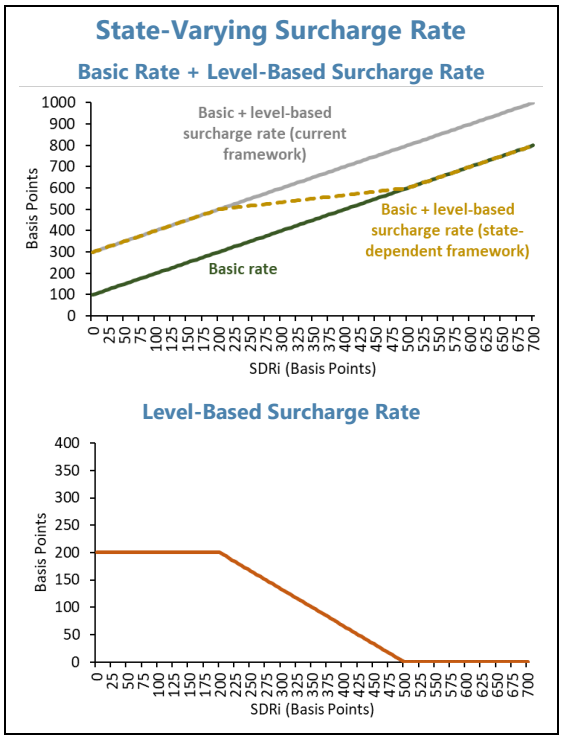
1/ Based on projected level of credit outstanding based on staff survey conducted in May 2024.

B. Broader Changes to the Surcharge Architecture

43. A more ambitious reform modality would entail broader changes to the surcharge architecture that could also address concerns related to the overall cost of borrowing from the Fund. In particular, the recent sharp increase in global interest rates and its pass-through to the basic rate of charge have raised concerns about the resulting burden for borrowing members when global economic and financial conditions are particularly challenging. Introducing a stabilizing element into the design of surcharges could help address some of these concerns. In practice, this would mean subordinating in certain states of the global economy the objectives of providing price-based incentives for limited Fund borrowing and timely repayment to a new policy objective of stabilizing the borrowing costs of members. This could be considered appropriate if the price-elasticity of demand for Fund credit were to decline in a global high-interest environment, because alternative sources of financing dry up.

44. The design of a mechanism to stabilize the cost of Fund borrowing raises several conceptual issues related to calibration and the management of financial risks to the Fund that would need to be considered carefully. While several methodologies for stabilizing the cost of Fund borrowing could in principle be considered, staff presents below two relatively simple options that illustrate their basic implications on borrowers and the Fund intended to help inform judgment by the Executive Board if this approach should be explored further. Some of the main advantages and disadvantages of the two options laid out below are further summarized in Table 5.

- **State-varying surcharge rates, inversely related to the basic rate of charge.** Stabilization relative to the global interest rate cycle could be achieved through an asymmetric level-based surcharge rate schedule that maintains the current rate (200 basis points) if the SDRi is within a range considered "normal" but reduces the surcharge rate *in tandem* with the increase in the SDRi (either in full or in partial proportion) when the latter exceeds its "normal" rate. For illustrative purposes, assuming a lower bound of 200 basis points and an upper bound of the "normal" SDRi range of 500 basis points (around the 75th percentile of the SDRi level since 1980), the surcharge rate would decline in inverse proportion whenever the SDRi exceeds 200 basis points until falling to zero when the SDRi reaches 500 basis points. Compared to parametric changes, this approach would create greater income uncertainty for the Fund as income losses depend on the trajectory of the SDRi and could at the limit



offset the entire surcharge income. In terms of incidence, under this approach a relatively higher share of the burden relief would accrue to the larger borrowers, similar to a parametric reduction in the level-based surcharge rate. Conceptually, a number of fundamental issues would have to be considered and settled in the design of how charges and surcharges should vary, which would depend on several factors such as the prevailing SDR rate and market rates, inflation, the amount of borrowing from the Fund, the presence of exogenous shocks, the rate of global growth, and the level of precautionary balances. Consideration would also need to be given as to whether the Fund should seek to stabilize nominal or real borrowing rates and whether (spikes in) global interest rates accurately reflect global business cycles and periods of crisis, so that state-varying surcharges would have a countercyclical impact when smoothing the overall cost of borrowing from the Fund. At a more technical level, properly calibrating such a mechanism (especially setting the "normal" range for the SDRi) would raise some challenges and require considerable judgment. Resolving and reaching agreement on all these issues would likely take considerable time. For further background, Box 3 provides an in-sample simulation and assesses the performance of a hypothetical state-varying surcharge rate approach for the period since 2000.

    - Based on WEO projections for the SDRi, the expected annual lending income loss of the illustrative mechanism outlined above would be about SDR 520 million for FY2026, with the largest three surcharge payers accounting for 74 percent of the total. The number of borrowers subject to surcharges would not change.

- **Fully capping the interest rate for Fund borrowing.** A more ambitious approach would seek to keep the total marginal rate of Fund credit at or below a certain level in all states and for all levels of credit outstanding. For example, the rate could be capped at 7 percent, which is close to the current total marginal rate of Fund borrowing for members subject to level-based but not time-based surcharges (i.e., a basic rate of charge of about 5 percent plus 2 percent of level-based surcharges). While providing members with greater certainty about their maximum debt service costs, this option would generate high financial risks to the Fund, as it could not only lead to a loss of all surcharge revenue but might push the Fund's lending rate below the funding cost (i.e., the remuneration of reserve tranche positions), thus generating operational lending losses. Like for the state-varying mechanism, this approach would raise conceptual challenges related to the determination of the level at which the interest rate would be capped. For example, at times of high inflation such as in the 1970s, the current level of total marginal rate of Fund borrowing for surcharge payers could be highly accommodative.

In practice, both approaches would likely have to be adjusted when global economic conditions change, particularly regarding inflation. These and other calibration difficulties suggest that designs with limited automaticity would likely have to be considered if a state-dependent stabilization mechanism is pursued, for example through a requirement to conduct a Board review if certain triggers are met.

Box 3. Simulation of a Hypothetical State-Varying Surcharge Rate

Staff conducted an in-sample simulation of a hypothetical state-varying surcharge rate mechanism since 2000. The mechanism was calibrated as described in paragraph 45 and the results are shown in the Box Figure below:

- The Left-Hand Side (LHS) chart illustrates the state-dependency of the surcharge rate under the framework: the surcharge rate decreases in inverse proportion to the SDR interest rate when it exceeds the assumed lower bound of 200 bps and approaches zero as it gets closer to the 500 basis point (bps) upper bound. Conversely, periods of interest rates below the 200 bps lower bound result in a surcharge rate of 200 bps, as in the current framework.

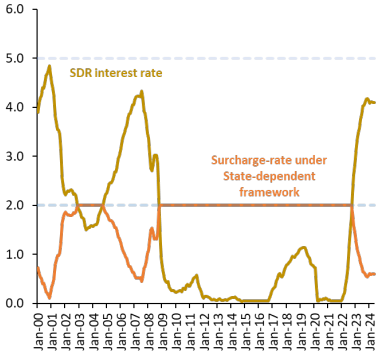
- The center chart demonstrates how the approach would have stabilized the marginal rate of borrowing from the Fund, with the marginal rate being defined as the basic rate of charge plus the level-based surcharge rate. As shown in the figure, the mechanism would have decreased the volatility of the marginal rate by smoothing the peaks during periods of high SDRi/global interest rates.

- The Right-Hand Side (RHS) chart assesses the state-varying surcharge framework in relation to the level of financial stress experienced in the global economy. It shows that episodes of rising global financial stress, like in the early 2000s or during the initial phase of the GFC in 2007-2008 would have coincided with an increase of the surcharge rate. Other episodes of increasing strains in financial conditions, such as the acute phase of the GFC or the outbreak of the Covid pandemic in 2020, would have left the surcharge rate at its highest value.

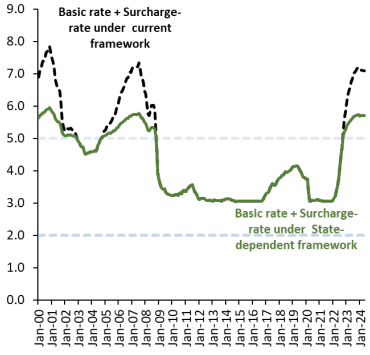
Overall, this simulation suggests that a state-varying mechanism linked to global interest rates could substantially dampen peak marginal rates faced by IMF borrowers. However, it is less clear that the mechanism would deliver stabilization relative to the global financial cycle, as surcharge rate movements could rise in times of tight global financial conditions.

State-Varying Surcharge Rates: An Ex-Post Evaluation

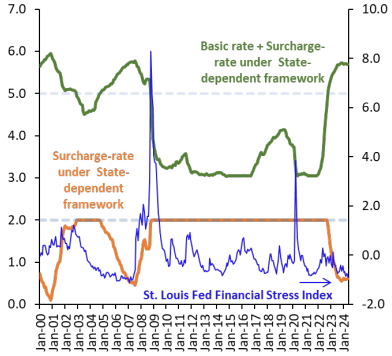
SDR Interest Rate and Surcharge Rate Under Proposal



Base + Surcharge Rate Under Current and Proposed Frameworks



State-Varying Framework and Financial Stress Cycle



Sources: FRED and FinanceDepartment

Table 5. Summary Assessment of "Innovative" Approaches for Surcharge Policy Changes

Impact on Surcharge Burden	Impact on Price Incentives	Impact on Income Generation Capacity	Simplicity
State-varying surcharge rate inversely related to the basic rate of charges			
Reduces surcharge burden, especially for large borrowers, and provides for limited debt service stability.	Reduces price-based incentives for all levels of credit, to a varying degree depending on global interest rate levels.	Increases income uncertainty and could lead to a significant reduction in income generation.	Considerably more complex than *status quo*.
Capping the total interest rate of Fund borrowing			
Reduces surcharge burden, especially for large borrowers, and provides for more far-reaching debt service stability.	Reduces price-based incentives for all levels of credit, to a varying degree depending on global interest rate levels.	Increases income uncertainty and could expose the Fund to very large income risks.	Considerably more complex than *status quo*.

MARGIN FOR THE RATE OF CHARGE

45. Reliance on the exceptional circumstances clause in Rule I-6(4), which has been the basis for margin-setting since adoption of the current Rule I-6(4) in 2011, is no longer needed given that non-lending income is currently expected to exceed non-lending expenses going forward. A desk survey conducted in May 2024 and SDR interest rates based on market projections were used to project income, while expenses were projected assuming a flat real budget consistent with the assumptions in the *Review of the Fund's Income Position for FY 2024 and FY 2025-2026*[16]. In this scenario, payouts from the Fixed-Income and Endowment Subaccounts are expected to cover the Fund's non-lending expenses going forward, representing a marked contrast from the experience over the last decade that reflected a persistently low-interest rate environment (Table 6). While there is some degree of uncertainty surrounding this projection, and investment income will continue to fluctuate depending on market conditions, this suggests that the previous rationale for invoking the exceptional circumstances clause in setting the margin is no longer applicable.

[16] See FY2025–FY2027 Medium-term Budget.

Table 6. Fund's Projected Operational Income FY2024–2026 [1/]

	FY24	FY25	FY26
	(in SDR millions)		
A. Operational Income	**3,659**	**3,825**	**3,781**
Lending income	2,682	2,642	2,603
Margin for the rate of charge	943	906	859
Service charge and other income	85	79	45
Commitment fees	225	143	159
Surcharges	1,429	1,514	1,540
Investment income	783	1,055	1,089
Fixed-Income Subaccount	783	950	982
Endowment Subaccount pay-out	0	105	107
Interest-free resources	183	116	77
Reimbursements	11	12	12
SDR Department	5	5	5
PRG Trust	0	0	0
RST	6	7	7
B. Expenses	**1,185**	**1,229**	**1,250**
Net administrative budget	1,060	1,128	1,151
Capital budget items expensed	24	31	30
Depreciation	65	70	69
Net periodic pension cost	36	0	0
C. Net Operational Income Before Provisioning (A-B)	**2,474**	**2,596**	**2,531**
Provision for loan impairment losses	0	0	0
D. Net Operational Income	**2,474**	**2,596**	**2,531**
E. Pension-related remeasurement gain	1,640	0	0
Net Operational Income After Remeasurement (D+E)	**4,114**	**2,596**	**2,531**
Endowment Subaccount - Retained Income	570	291	289
Net Income	**4,684**	**2,887**	**2,820**
Memorandum Items:			
Fund credit (average stock, SDR billions)	94.3	90.6	85.9
SDR interest rate (in percent)	4.0	3.6	3.2
US$/SDR exchange rate	1.34	1.33	1.34
Precautionary balances (end of period, SDR billions)	25.1	27.7	30.2

Source: IMF staff calculations.

1/ FY2024 is a preliminary outcome while FY2025–2026 are based on staff survey conducted in May 2024.

46. Against this backdrop, the establishment of the margin should be guided by the criteria set out in Rule I-6(4). These determine that the margin should be set at a level that is adequate to: (i) cover estimated intermediation costs; and (ii) deliver an amount of net income for placement to reserves, which shall be assessed taking into account, in particular, the current level of

precautionary balances, any floor or target, and the expected contribution from surcharges and commitment fees to precautionary balances. In addition, the margin should be set at a level to align with market conditions as measured by appropriate benchmarks (i.e., meet the "market test"). Application of each of these criteria leaves considerable room for judgment by the Executive Board, including regarding the desirable levels of net income and reserve accumulation and the application of the market test.

47. Staff has conducted an analysis to illustrate possible margins for the remainder of FY2025 and FY2026 that would broadly meet the requirements of Rule I-6(4).

- **Looking only at intermediation costs without generating an amount of net income for placement to reserves would indicate a margin of only about 20 basis points but would leave borrowing costs well below historical levels.** Under the desk survey scenario, intermediation income would reach SDR 260 million in FY2025, comfortably cover the intermediation cost of SDR 132 million. Even in a stress scenario, intermediation income (SDR 141 million) could be expected to cover intermediation costs (SDR 141 million) (Annex IV). Staff considers it prudent, however, to aim for at least some net income in establishing the margin in view of the inherent uncertainty surrounding assumptions on Fund income and financial risks. Moreover, a margin of 20 basis points would be unlikely to pass the market test. Benchmarks based on EMBI spreads provide a meaningful guide to assess the alignment of the basic rate of charge with market conditions, informed also by judgment on the global financial context and potential future developments.[17] Consistent with past practice, the level of the margin is compared to the lowest quartile of EMBI spreads (reflecting the spreads for the more creditworthy borrowers within the sample) as a proxy measure to reflect the Fund's role as a cooperative public policy institution.[18, 19] A 20 basis point margin would deliver a basic rate of charge below the long-term cost of market financing even for emerging market sovereign of the highest credit quality, which could be considered out of line with long-term credit conditions.

- **On the other hand, it would seem difficult to justify a margin for the basic rate of charge above the current level of 100 basis points with the PB target being met.** The current margin of 100 basis points would be expected to generate SDR 906 million in income in FY2025 and SDR 859 million in FY2026, substantially exceeding estimated intermediation costs and,

[17] Market borrowing spreads reflect a country-specific, time-varying credit risk premium. The EMBI-based measure provides a widely used metric of such long-term market conditions. See also Annex II, *Review of the Fund's Income Position for FY 2014 and FY 2015–2016*.

[18] While the Fund also bears credit risks when it lends to member countries, its multilayered risk framework—including policies on access, program design, and conditionality—mitigates these risks, though they can still vary significantly across individual country exposures.

[19] In the past, staff has also adjusted estimated financing costs to account for the maturity difference between the SDR interest rate (based on a floating rate composed of three-month instruments) and the EMBI measures (based on medium-term, fixed interest rate instruments). As this estimation has been subject to a few conceptual and data limitations, and the resulting adjustments have been marginal (in the magnitude of ten basis points), the assessment of the margin in this review is based solely on EMBI spreads, following the approach taken since 2020 (see *Review of the Fund's Income Position for FY 2020 and FY 2021–2022*).

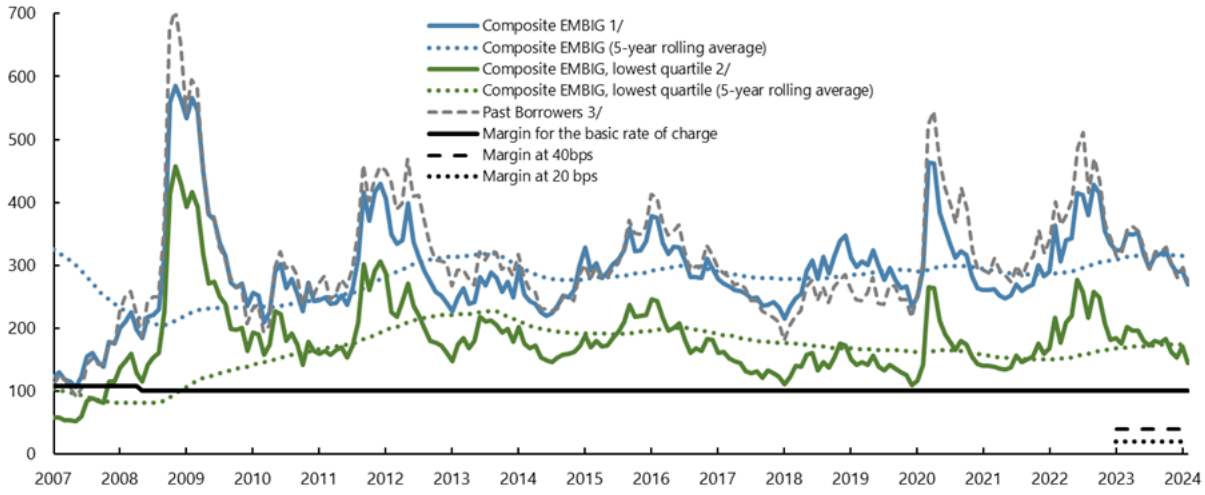
thus, contributing about SDR 774 million and SDR 724 million, respectively, to net income. While the basic rate of charge with the current margin is broadly within the range that could be considered in line with long-term market conditions, with PBs now at the Executive Board-endorsed medium-term target level, staff see no basis for setting an even higher margin that would further increase the reserve contribution from currently projected levels given the expected level of intermediation costs.

- **Against this backdrop and taking into account the considerations under Rule I-6(4), staff sees a good case for a margin within a range of 40 -100 basis points, recognizing that Rule I-6(4) leaves significant room for judgement.** A margin within this range would preserve a capacity of margin contribution to net income and reserve accumulation between of about SDR 350 to SDR 900 million. Such an approach would be prudent from a policy perspective to guard against the possibility that an unforeseen rise in credit risks might require reconsideration of the PB target and renewed reserve accumulation in the period ahead. Generating some positive net income would also serve as a protection against the structurally higher income uncertainty that comes with the growing reliance on volatile investment returns or unexpected large declines in credit outstanding, thereby reducing the likelihood that the Fund would post net operational income losses in some years and providing for greater stability in the margin, which applies to all credit outstanding, over time, an issue discussed by the Board in the past.[20,21] The indicated range could also be seen as broadly meeting the market test. From a medium-term perspective, the five-year rolling median for the lowest quartile EMBI spread stands at 166 basis points (Table 7; Figure 15). For the sample of countries with GRA arrangements since 2000, five-year rolling median EMBI spreads have stood at 317 basis points. These data suggest that a margin of between 40 and 100 basis points would equate the basic rate of charge with the average cost of financing over the last five years on market debt of countries with sovereign credit ratings averaging between BBB+ and A-. Overall, a basic rate of charge within this range would continue to be aligned competitively with respect to long-term credit market conditions, remaining moderately below the cost of financing for relatively creditworthy borrowers as in the past, and substantially below the cost of financing that has been faced by most countries that have had GRA arrangements.

[20] See *The Acting Chair's Summing Up – Review of Charges and Maturities—Setting the Basic Rate of Charge Under a New Income Model – Executive Board Meeting 08/23,* March 12, 2008 . Over the past ten years (FY2014-2023), the standard deviation of annual GRA net operational income has been about SDR 609 million.

[21] Some illustrative analysis undertaken by staff suggests that a margin set within a range between 40 basis points and the current 100 basis points would preserve some net income capacity even under stress scenarios of very low credit (Annex III).

Figure 15. EMBIG Spreads: Total Composite and Bottom Quartile
(In basis points)



Source: JPMorgan and IMF staff calculations.
1/ Weighted average of spreads from the JPMorgan Emerging Market Bond Index Global Sovereign Spread (US dollar) and the JPMorgan Euro EMBI Global Government Spread, using US dollar and euro weights in the SDR basket.

2/ Weighted average of the lowest quartile of country-specific US dollar EMBI spreads and the lowest quartile of country-specific euro EMBI spreads, using US dollar and euro weights in the SDR basket.

3/ Weighted average of the median of country-specific US dollar EMBI spreads and the median of country-specific euro EMBI spreads, using US dollar and euro weights in the SDR basket, considering a sample of members with Fund GRA arrangements between 2000 and 2024.

Table 7. Long-Term Credit Market and Comparator Spreads
(Median spread unless otherwise noted, in SDR-equivalent basis points)

	2009 - 2013	2014 - 2018	2019 - Feb 2024
Composite EMBI Global 1/			
5-year average	303	284	314
5-year median	272	281	303
Composite EMBI Global, Lowest Quartile 2/			
5-year average	215	168	173
5-year median	198	164	166
Memorandum items			
Past borrowers (5-year median) 3/	303	279	317
Margin for the rate of charge (5-year average)	100	100	100

Sources: Bloomberg, JP Morgan, and IMF staff calculations.
1/ Weighted average of spreads from the JPMorgan Emerging Market Bond Index Global Sovereign Spread (US dollar) and the JPMorgan Euro EMBI Global Government Spread, using US dollar and euro weights in the SDR basket.

2/ Weighted average of the lowest quartile of country-specific US dollar EMBI spreads and the lowest quartile of country-specific euro EMBI spreads, using US dollar and euro weights in the SDR basket.

3/ Weighted average of the median of country-specific US dollar EMBI spreads and the median of country-specific euro EMBI spreads, using US dollar and euro weights in the SDR basket, considering a sample of members with Fund GRA arrangements between 2000 and 2024.

COMMITMENT FEES

48. Commitment fees were examined in the *2023 Review of the Flexible Credit Line, Short-term Liquidity Line, and Precautionary and Liquidity Line*. At the time, the Board left the structure of these fees unchanged. The review found that the announcement of a new FCL or PLL arrangement leads to a decline in sovereign spreads and that FCL and PLL arrangements helped mitigate external financial pressures during the COVID-19 pandemic.[22]

49. Commitment fee thresholds, however, have been subject to erosion relative to relevant macroeconomic metrics, similar to the threshold for level-based surcharges. The current thresholds have been in place since the conclusion of the 2016 Review, when the Board decided to modestly increase the nominal SDR value of commitment fee thresholds against the backdrop of the imminent effectiveness of the 14th General Review of Quotas. Hence, there is a case for offsetting the accumulated erosion of the commitment fee thresholds in the current review, which would also support the attractiveness of precautionary instruments, whose signaling value of strong policies and policy frameworks increases in a shock-prone world.

50. Raising commitment fee thresholds to compensate for erosion would have a moderate impact on income. Increasing the thresholds of all steps in the upward sloping fee structure by 45-

[22] See Box 4 in the *Review of the Flexible Credit Line, the Short-term Liquidity Line, and the Precautionary and Liquidity Line, and Proposals for Reform* and Lisi (2022)

50 percent to fully offset erosion since 2016 would reduce income by about SDR 10–30 million on an annual basis.

HOLISTIC CONSIDERATIONS REGARDING POSSIBLE MARGIN AND SURCHARGE ADJUSTMENTS

51. This section offers holistic considerations regarding possible approaches to surcharge and margin adjustments. While the policies governing the margin and surcharges are separate, both are components of the borrowing costs set by the Executive Board and together they deliver the quasi-totality of the Fund's lending income. This section discusses the combined effects of adjustments to the margin for the basic rate of charge and illustrative surcharge reform options presented earlier in the paper.

52. Decisions on a package of adjustments to the margin for the basic rate of charge and surcharges should consider the combined implications for net income and reserve accumulation, the incidence of relief on members, and the overall borrowing cost from the Fund. Any reductions in the margin and surcharges will lower GRA net income that could be retained for building additional reserves, when needed, or be distributed to the membership. The incidence of any adjustments (i.e., the extent to which individual members benefit from relief) will vary depending on the desired package, with reductions in the margin of charge generally benefitting a broader universe of GRA borrowers.[23] Finally, different combinations and magnitudes of adjustments to the margin and surcharges will have different implications for the marginal and effective total cost of borrowing from the Fund.

53. For illustration, key metrics related to lending income losses and the incidence of relief under some of the options discussed in this paper are presented below. These metrics are presented for reform packages that combine an illustrative 40 bps reduction in the margin with the different parametric adjustment options for surcharges. The total lending income loss would be the sum of the losses from the respective illustrative surcharge reform option and the loss due to a lower margin (about SDR 340 million in FY 2026). Depending on the illustrative scenario, the combined annual lending income losses in FY 2026 would range between about SDR 380 to 870 million. The combined cumulative 5-year impact (FY2025-29) on net income of the illustrative options would range from SDR 1.6 billion to SDR 3.7 billion, representing a 13 to 30 percent reduction from the current policy scenario (Table 8). The incidence of relief would vary, with the three largest borrowers generally capturing higher benefit shares under options that reduce surcharge rates (Figure 16). The impact of different combinations of reform options on the effective and marginal cost of Fund borrowing, incidence, and Fund net income generation capacity is highly sensitive to the specific calibration of the reform options and potentially nonlinear. Staff will offer

[23] Currently, 52 members have GRA credit outstanding that is subject to the margin for the basic rate of charge, while 22 members are subject to surcharges.

information on these in the next paper after Executive Directors provide guidance on a narrower set of possible reform options for consideration (see further below).

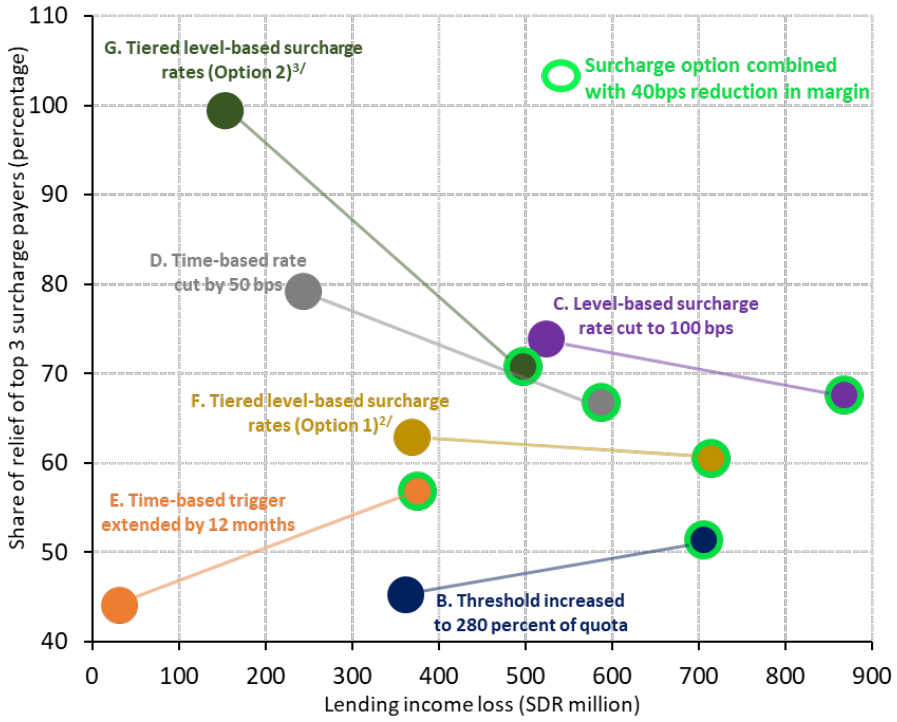
Table 8. Impacts on Net Operating Income and PBs of Illustrative Scenarios (FY25–29)[1/]

	A. No policy changes	B. Threshold increased to 280 percent of quota and margin reduction to 60 bps	C. Level-based surcharge rate cut to 100 bps and margin reduction to 60 bps	D. Time-based surcharge rate cut to 50 bps and margin reduction to 60 bps	E. Extension of time-based trigger by 12 months and margin reduction to 60 bps	F. Tiered level-based surcharge rates (100bp for 187.5-600 percent of quota, 200bp for above 600 percent of quota) and margin reduction to 60 bps	G. Tiered level-based surcharge rates (200bp for 187.5-600 percent of quota, 100bp for above 600 percent of quota) and margin reduction to 60 bps
	FY25-29	**FY25-29**	**FY25-29**	**FY25-29**	**FY25-29**	**FY25-29**	**FY25-29**
Lending Income (SDR millions)	11,818	8,864	8,361	9,466	10,345	8,872	9,917
in percent of operational income	*63.3*	*57.2*	*55.9*	*58.6*	*60.5*	*57.2*	*59.7*
Non-Lending Income (SDR millions)	6,862	6,635	6,588	6,676	6,745	6,633	6,708
in percent of operational income	*36.7*	*42.8*	*44.1*	*41.4*	*39.5*	*42.8*	*40.3*
Operational Income (SDR millions)	18,680	15,499	14,948	16,142	17,089	15,505	16,624
Less: Expenses	-6,389	-6,389	-6,389	-6,389	-6,389	-6,389	-6,389
Net Operational Income (before IAS 19 gain/loss, SDR billions))	**12,291**	**9,110**	**8,559**	**9,753**	**10,700**	**9,116**	**10,235**
Net Operating Income Loss versus Scenario A (SDR millions)		**-3,181**	**-3,732**	**-2,538**	**-1,590**	**-3,175**	**-2,055**
Precautionary Balances as of FY29-end (SDR billions)	**37.4**	**34.2**	**33.6**	**34.8**	**35.8**	**34.2**	**35.3**

Source: IMF staff calculations.

1/ Based on projected level of credit outstanding based on staff survey conducted in May 2024.

Figure 16. Lending Income Loss and Share of Concentration of Relief under Possible Margin and Surcharge Adjustments[1/]



Source: IMF staff calculations.

1/ Annual lending income loss in FY2026. The total income loss would be larger than lending income loss due to the indirect impact on investment income of lower precautionary balances.

2/ Option 1 of the tired level-based surcharge rates adjustment refers to a rate of 100bp for 187.5-600 percent of quota and of 200bp for above 600 percent of quota.

3/ Option 2 of the tired-level based surcharges adjustment refers to a rate of 200bp for 187.5-600 percent of quota and of 100bp for above 600 percent of quota.

OTHER CONSIDERATIONS

A. Implications of Forthcoming 16th General Review Quota Increases

54. Staff proposes to conceptually separate changes of surcharge and commitment fee thresholds resulting from this review from adjustments that will be needed when the 16th General Review of Quotas (16th GRQ) becomes effective.

- First, changes to thresholds approved by the Executive Board in the current review would be made based on current quotas.

- Second, the adjustment of the thresholds in relation to new quotas (when quotas increase under the 16th GRQ) would be a separate, possibly successive step. When the 16th GRQ comes into effect, the surcharge and commitment fee thresholds in percent of the current quotas would be mechanically divided by 1.5 to keep their value unchanged in nominal terms. If the effectiveness of the 16th GRQ is notably delayed beyond the currently expected timeline, the Executive Board could consider adjustments to these thresholds to account for additional erosion.

B. Other Operational Issues

55. The implementation timeline for any changes to the Fund's surcharge policy, margin, and commitment fees would depend on the scope of the envisaged reforms. Careful planning, coordination, testing and communication will be needed to ensure that the Fund's financial systems and processes are properly updated when policy changes take effect, to mitigate operational risks. Specifically:

- **Margin**: Implementing a new margin for the rate of charge would be relatively straightforward given that there is already a robust process in place to change the underlying components of the basic rate of charge on a weekly basis. The necessary changes could be expected to be completed within one month.

- **Surcharges**: The time required to implement changes in the surcharge policy would hinge on the complexity involved. From a systems configuration perspective, executing parametric changes such as threshold adjustments and/or rate changes would be a less significant undertaking compared to altering the time-based trigger, and would depend also on potential considerations regarding the treatment of existing arrangements. Depending on the scope, parametric changes could take about one to three months to execute. More fundamental changes to the current architecture of the surcharge policy, such as moving to state-dependent surcharge rates or introducing multiple rate thresholds would require more analysis by staff and conceivably a longer implementation period. [24]

- **Commitment fees**: Adjustment of the fee thresholds would be relatively straightforward, as staff could leverage the approach followed in 2016 when the commitment fee thresholds were changed following the effectiveness of the 14th GRQ.

56. Necessary changes to system configurations mentioned above could be performed concurrently. Ideally, changes to each of the relevant modules of the Fund's core banking system and related tools and applications would be initiated at the start of a financial quarter to align with the billing and financial reporting cycle and minimize disruptions for both internal and external communications. If required, changes within a quarter can also be accommodated, but these would

[24] For instance, linking the surcharge rate with the basic rate of charge or placing a 'cap' on members' borrowing costs would require more complex technical systems modifications to be implemented by the Information Technology Department.

generate higher operational risks and resource needs. Staff will provide an updated estimate of the timeline when there is greater clarity on the scope of possible reforms.[25]

ISSUES FOR DISCUSSION

57. Directors may wish to comment on the following issues:

- Considering that the Fund has reached its precautionary balances target and the robust net income outlook, and given the higher SDRi facing our membership, do Directors agree that there is scope to lower the cost of GRA borrowing for all borrowers?
- Do Directors agree that any reform should involve both broad-based relief on the basic rate of charge—based on the framework set out under Rule I-6(4)—and a reform of the surcharge policy that provides additional relief while preserving appropriate incentives and maintaining adequate financial buffers?
- Are Directors open to further explore more wide-ranging reforms to the surcharge policy that would introduce an objective to stabilize the cost of Fund borrowing, considering that this would likely take more time, or do Directors favor a focus on parametric reforms to the current framework?
- Do Directors agree that the design of level-based surcharges should be revisited in light of the erosion of the threshold against a range of metrics, and the fact that a large number of moderate borrowers are paying a relatively high marginal surcharge rate? Do Directors agree that commitment fee thresholds should also be revisited in light of erosion?
- Given the current shock-prone global environment and the structural nature of the problems facing our membership, do Directors agree that there is scope to revisit the design of time-based surcharges?
- Do Directors agree that a successful conclusion of the review and agreement on reforms should aim to be delivered by the Annual Meetings?

[25] Budget implications of proposed policy changes, especially those related to system configurations, will be provided in the follow up Board paper once reform options have been narrowed down. Changes are expected to be included in regular systems enhancement plans and prioritized accordingly.

Annex I. Issues and Concerns Raised Regarding Surcharges

1. Concerns raised about surcharges in the public policy debate have focused on their incidence and impact on GRA borrowers:

- **"Procyclical" nature**. Surcharges are considered "procyclical" as they require borrowing members to pay more at a time when they are facing economic strain and find themselves without market access and limited access to financing from other official sources.
- **Regressive impacts**. Surcharges are seen as being regressive because surcharge payers are mostly middle-income countries without access to dollar swap lines and (in some cases) with quotas that are smaller than their share of world GDP, meaning that surcharges apply at levels of Fund credit that are not commensurate with their financial needs.
- **Lack of transparency**. Surcharge data are not easily available and countries may thus not be fully aware that they are paying these charges.

2. Other concerns focus on possible flaws in the design of the surcharge policy:

- **Price-inelastic demand and lender of last resort role of the Fund**. There is skepticism whether price-based incentives from level-based surcharges are effective because the demand for Fund resources is seen as effectively price-inelastic. Countries that turn to the Fund do not have alternative financing options and, therefore, surcharges cannot disincentivize countries from borrowing from the IMF.
- **Other non-financial incentives are more relevant than the price-based incentives of surcharges**. Governments are seen as having many other incentives to avoid financing from the Fund, such as the associated stigma and negative signaling to financial markets, loss of sovereignty, potential welfare impacts through program conditionality, and domestic political costs. Hence, surcharges are not needed as a disciplining device to encourage prudent borrowing from the IMF. In this context, rather than triggered by price-based incentives of surcharges, early repayments are seen as a manifestation of a country's desire to free themselves from conditionality, IMF monitoring, and stigma.
- **Liquidity versus solvency.** Surcharges were created in response to the Asian crisis, where the implementation of a price-incentive mechanism (both level- and time-based surcharges) assumed that borrowing countries were affected by a liquidity crisis. Their use now is seen as out of context and unjustified given that many of the main payers face protracted balance of payments problems.

3. Furthermore, there are questions about the Fund's justifications for the use of surcharges:

- **Lack of evidence of effectiveness of surcharges.** The Fund is seen as not having provided sufficient evidence that surcharges are fulfilling their intended purpose of promoting prudent borrowing and preventing moral hazard.
- **Adequacy of Precautionary Balances.** Surcharges have become the largest source of the Fund's revenue. The Fund's non-surcharge income is considered sufficient to allow for a build-

up of precautionary balances and surcharges can therefore be reduced or removed without threatening the sustainability of the Fund's finances.

- **Risk management and senior creditor status**. The argument that surcharges are needed to help manage credit risk is seen as ignoring the Fund's status as preferred creditor. Preferred creditor status by itself already provides sufficient protection for the Fund and reduces the need to generate income from surcharges to accumulate precautionary balances.

4. Against the backdrop of these concerns, a range of possible surcharge policy reforms have been proposed, including:

- Immediate suspension of surcharges until a comprehensive review of the policy is completed, with subsequent reduction or possible elimination.
- Alignment of the threshold for level-based surcharges with the threshold access limits.
- Setting surcharge rates in inverse relation to the basic rate of charge (i.e., moving to state-dependent surcharge rates). The Fund would determine a "normal/equilibrium" level of the SDRi, with surcharge rates declining when the actual level exceeds the "normal" level.
- Capping the total interest rate of GRA borrowing at some (moderate) level.
- Reimbursement of surcharge payments to a country once principal has been repaid and, therefore, the purpose of securing the principal has been fulfilled and default risk no longer exists.

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Annex II. Event Studies on the Incentives Mechanism

1. This annex describes the methodology used for the case studies to analyze whether the incentives embedded in the current surcharge threshold have been effective in limiting large borrowing from the Fund and encouraging early repurchases once market access is restored. We outline the first and then present the empirical results are presented. A brief discussion of the results concludes this annex.

2. The methodology is based on the hypothesis that the incentive mechanism of the surcharge policy works, provided that countries are not in significant macroeconomic distress. The hypothesis is that if the incentives are effective, countries will try their best not to borrow above the surcharge threshold, as long as they are not significantly distressed and have access to other sources of financing. If they are having moderate difficulties, the borrowing may be slightly above the threshold for a short period of time, and countries will try to bring it back below the threshold as soon as possible. In other words, countries' credit outstanding will hover around or remain below the threshold if the incentives matter and operate as intended. Alternatively, if countries go through severe difficulties and have no alternative sources of financing, they will have to borrow significantly above the threshold to address their financial needs, potentially for a long period of time. Depending on the degree of difficulties, the threshold may or may not constrain the amount they access. The higher the distress, the less binding the threshold is, making the IMF the only option for the country, regardless of the cost.

3. Financing pressure measures are used to proxy a country's access to external financing. Countries are categorized into low/medium debt vulnerabilities and high debt vulnerability groups. At any point in time, a country is classified into the "high financing pressures (high debt vulnerability)" group if it fulfills two or more of the following conditions.

- Its gross government debt (in percent of GDP) is above the 75th percentile of the distribution.
- Its gross EMBIG credit spread is above the 75th percentile of the distribution.
- If the country has a rating below B, considering the S&P rating classification.

4. In the charts in Annex II Figures 1–3, we compare credit outstanding to the threshold of level-based surcharges, together with marks showing the degree of financing pressures at each point in time. Additionally, the charts show in vertical gray lines the points in time at which a country has made early repurchases. Finally, vertical red lines indicate the point at which time-based surcharges kicked-in for countries paying level-based surcharges, i.e., 36 months after level-based surcharge threshold was exceeded in case of Stand-by arrangements (51 months in case of Extended Fund Facilities).

5. The objective of the case studies is to visualize the dynamics of credit outstanding relative to the surcharge threshold. The trajectory of credit and the timing of early repurchases is related to the degree of financing pressures, access to alternative financing sources, and the time when time-based surcharges kick in.

6. Overall, the case studies suggest that the effectiveness of incentives provided by the surcharge policy varies depending on a country's level of financing pressures and access to alternative financing options. The studies identify three distinct groups of countries whose credit outstanding behaves differently relative to the threshold. The effectiveness of the incentive role of surcharges appears to be correlated with the level of financing pressures, but also seems to have weakened for the current large borrowers as Fund financing has become more prolonged and the imbalances that Fund arrangements try to solve have become more entrenched, limiting access to other financing sources and, therefore, the role that the price of lending can play as an incentive.

- **For the first group of countries (Annex II Figure 1), the level-based surcharge threshold appears to be closely linked to the amounts borrowed from the Fund.** In this group of countries, credit outstanding hovered just below or near the threshold, which could reflect an intention to avoid surcharges. The countries in this group are relatively small borrowers that have experienced generally manageable financing pressures. Examples of countries that have drawn just below the threshold are Colombia, Kosovo, North Macedonia, and Serbia. This group also includes countries that temporarily exceeded the surcharge threshold but quickly brought it back into non-surcharge-paying territory. For these countries, the episodes of borrowing beyond the threshold were not associated with high financing pressures, suggesting that lowering borrowing costs may have been an important consideration. Cyprus and Morocco would be examples of countries in this subgroup. Although their credit outstanding went beyond the threshold, they swiftly made early repayments to bring their borrowing back below the threshold.

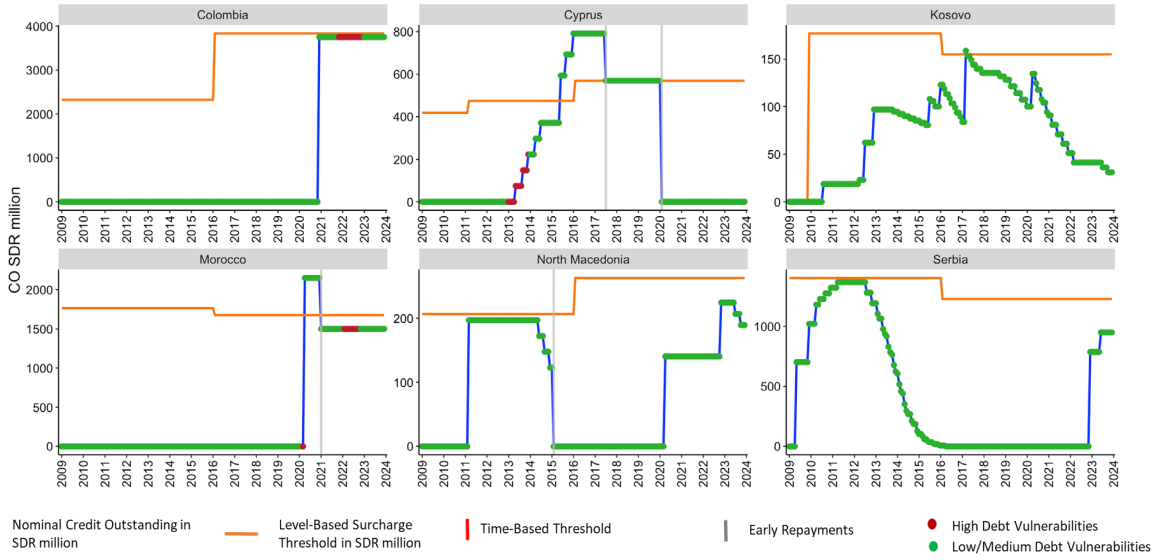
- **The second group (Annex II Figure 2) comprises countries that borrowed considerably above the threshold during highly distressed times but reduced their credit outstanding towards non-surcharge paying territory once external pressures became more manageable**. At times of high borrowing from the Fund, these countries were generally under high financing pressures and may not have had access to sources of financing other than the IMF. Consequently, countries had to access large and, in some cases, prolonged IMF resources. However, once the balance of payment issues were resolved and market access was regained, these countries started to reduce their credit outstanding by making early repayments (shown by the gray vertical lines) in order to reduce and, eventually, avoid surcharges. Some examples are Greece, Ireland, Portugal, and St. Kitts and Nevis.[1] Additionally, the plots show in red vertical lines the time when time-base surcharges were triggered for each country. The charts suggest that the time-based surcharge incentive mechanism also has an effect once the country's financing pressures were moderated, compounding the price-based incentive mechanism (more

[1] Low global interest rate was conducive for large European borrowers to resolve balance of payment issues.

on time-based incentive mechanism in the next subsection). For example, countries like Ireland, Portugal, Antigua and Barbuda, and St. Kitts and Nevis made early repurchases right before or close to the time that time-based surcharges were triggered.

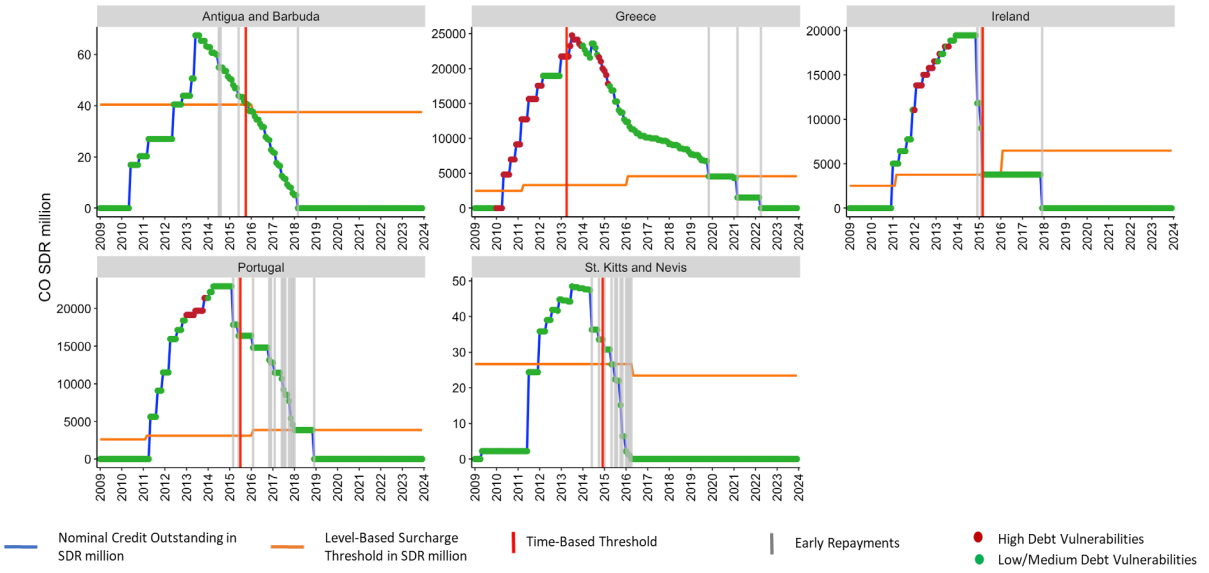
- **A third group (Annex II Figure 3) encompasses countries going through financing pressures and whose credit outstanding is significantly above the level-based surcharge threshold**. For these countries, the threshold does not appear to be binding or constraining their access decisions to any degree. These countries are currently going through significant financing pressures and have no access to alternative sources of financing. Consequently, they have little choice but to borrow from the Fund to cover their financing needs at the financing conditions offered by the IMF. Angola, Argentina, Costa Rica, Ecuador, Egypt, Jordan, Pakistan, and Ukraine are such examples. For some countries in this group, incentive mechanisms have appeared to work in the past once market access was regained and financing pressures moderated, for example Jordan (2019), Pakistan (2013), and Ukraine (2013), but these countries migrated to the second group over time.

Annex II. Figure 1. Event Study: Group 1



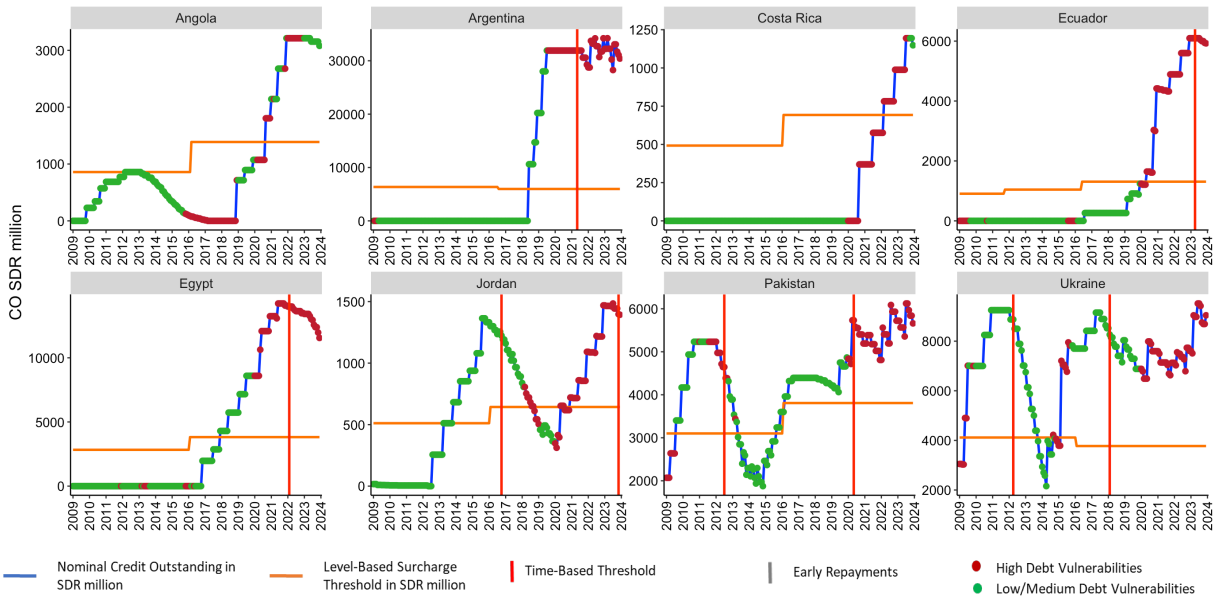
Source: IMF staff calculations.

Annex II. Figure 2. Event Study: Group 2



Source: IMF staff calculations.

Annex II. Figure 3. Event Study: Group 3



Source: IMF staff calculations.

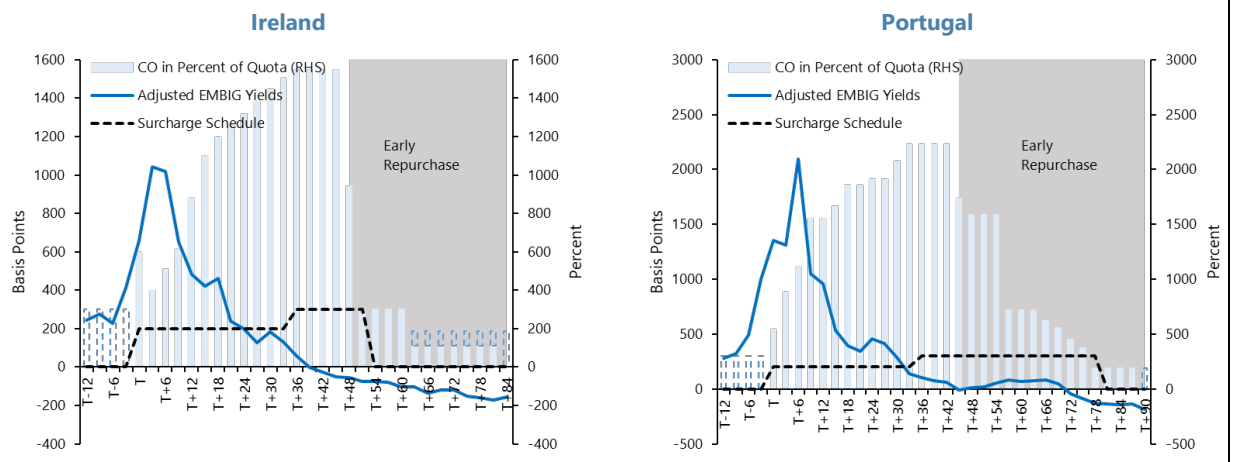
7. Staff also conducted event studies to examine whether time-based surcharges have been effective. Specifically, staff investigated the dynamics of the spread between market cost and the Fund's basic rate of charge, schedule of the surcharge rate, and whether countries made early repurchases or not. The premium charged by markets at the inception of high-access programs is usually much higher than the marginal rate of Fund surcharges, even for the countries that do have market access. This premium is supposed to narrow significantly over the duration of the program,

as countries undertake the necessary policy adjustment. The time-based surcharges of 100 basis points, the timing of which roughly coincides with the start of regular repurchases under an SBA and an EFF, are designed to encourage early repurchases, if feasible, by increasing the cost of Fund financing closer to market levels, which are typically higher than the Fund's basic rate of charge. For countries that have regained market access, this incentive kicks in when, everything else equal, the market cost, proxied by EMBIG yields, is at or below the total cost of Fund financing (the Fund's basic rate of charge plus the sum of the marginal rate of level- and time-based surcharges (300 bps)).

8. The incentive mechanisms appear to have worked for pre-2016 review cases related to the GFC and for some post-review cases.

- Before the 2016 review, many borrowers with credit outstanding exceeding the surcharge threshold made early repayments after they had regained market access. Since 2008, Iceland, Latvia, Hungary, Ireland, and Portugal made large early repurchases (see Box 4 of the 2016 Review). Although factors other than borrowing costs, including possible stigma, could have played a role in making early repurchases, access to favorable market finance appears to have been a motivating factor at least in some cases.[2] For instance, Ireland and Portugal made large early repurchases once the spread between market and Fund financing cost (adjusted EMBIG yields in Annex II Figure 4, defined as the EMBIG yields net of the basic rate of charges) had fallen below the marginal surcharge rate of 300 bps.[3]

Annex II. Figure 4. Cost of Fund Borrowing, Market Borrowing, and Credit Outstanding



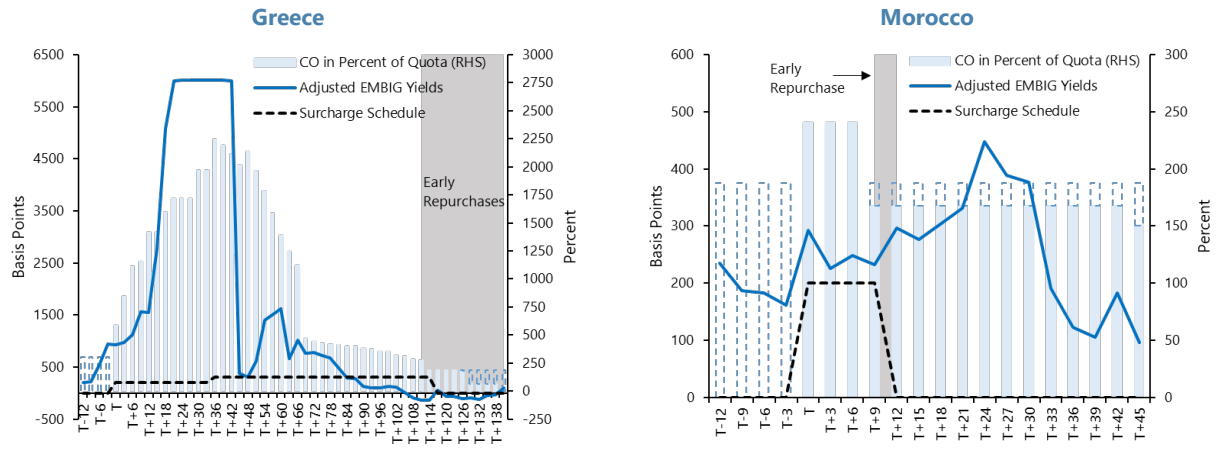
Sources: Bloomberg and IMF staff calculations.

[2] Additionally, early repurchases, especially if they fully extinguish Fund credit outstanding, could have potentially significant signaling effect that may reduce the cost of market financing going forward.

[3] In Annex II Figures 4–5, adjusted yields are defined as the EMBIG yields net of the basic rate of charges. T refers to the date when the credit outstanding exceeded the threshold of 187.5 percent of quota.

- There have been several early repurchases since the conclusion of the 2016 Review. Greece during October 2019 through March 2021, and Morocco in January 2021 made large early repurchases, arguably to bring the credit outstanding to below the threshold level. In the case of Greece, early repayment in late 2019 brought the credit outstanding below the level-based threshold when the spread between market and Fund financing cost fell below the marginal rate of surcharges (Annex II Figure 5). Morocco made early repayment in early 2021, attributing their decision to repay to the fact that they wanted to avoid paying a surcharge. Other than those, Cyprus (2017 and early 2020) and St. Kitts and Nevis (2016) made early repurchases to bring the credit outstanding to below the threshold level once market access was regained.

Annex II. Figure 5. Cost of Fund Borrowing, Market Borrowing, and Credit Outstanding



Sources: Bloomberg and IMF staff calculations.

Annex III. Measuring Erosion of Quota-Denominated Thresholds

1. Erosion vis-a-vis macroeconomic aggregates is a key factor informing the calibration of quota-denominated thresholds, such as access limits, surcharges and commitment fees. Erosion captures the decrease in the ratio of nominal thresholds (in SDR terms) to relevant nominal macroeconomic variables (also in SDR). This decrease is virtually unavoidable given nominal growth of global output and cross-border flows stemming from inflation of currencies in the SDR basket, real growth in member countries, and the Balassa-Samuelson effect.[4]

2. Estimation of erosion requires a multidimensional analysis. There is no single approach or indicator to measuring erosion that can be unambiguously viewed as "best". That is why analysis usually presents a variety of approaches that differ across four dimensions:

- **Macroeconomic variables** in the denominator: GDP (proxy for capacity to repay) and measures of cross-border flows (proxies for potential BoP needs in a program setting);
- **Country groups:** world, EMDEs (since they traditionally account for the bulk of IMF lending), or past users of Fund lending (a narrower proxy for potential users);
- **Aggregation:** central tendency among countries in the sample approximated either via median across countries or aggregate for the country sample; and
- **Time horizon:** starting point for the erosion calculations: only the most recent review vs. past points in time when access limits underwent significant recalibrations.

3. Recent policy papers analyzing erosion made different choices on these parameters. Erosion analysis has more prominently featured in the context of access limits, though the extension to other thresholds is straightforward. While the 2008–09 Review of Access Limits focused on evolution of limits vis-à-vis GDP and trade, directors' guidance called for an expanded set of metrics to judge the adequacy of access limits. The 2016 Review of Access Limits and Surcharge Policies covered erosion vis-à-vis GDP, trade, external liabilities, and external gross financing needs. The March 2023 *Temporary Modifications to the Fund's Annual and Cumulative Access Limits* and the March 2024 *Extension of Temporary Increase in Normal Access Limits Under the General Resources Account* papers ("2023/24 Reviews") used a similar set of indicators as the 2016 Review, but definitions of variables and country coverages differed.

4. For the two ongoing workstreams—Review of Access Limits and Review of Charges and Surcharges—staff proposes building on the methodologies and lessons learned from past reviews. In particular, the metrics used are the same as in 2023/24 interim review, country groups is comparable to the 2016 Review, and median erosion is proposed as the preferred measure of central tendency. The improvements, detailed in Annex III Table 1, are motivated as follows:

[4] Fast-growing countries tend to experience equilibrium real appreciation, raising their SDR-denominated output.

5. Median erosion, the preferred measure for this Review, has advantages over aggregate erosion:

- *Aggregate erosion* (2016 and 2023/24 Reviews) is computed by summing up both the numerator (relevant quota-based threshold expressed in SDRs) and denominator (metric, e.g., GDP) across countries, and then computing erosion of this aggregate ratio between the start and end years. Countries are implicitly weighted according to their share in the respective aggregate (e.g., in world GDP). These biases estimates of erosion towards large economies (which, based on historical trends, are less likely to enter Fund-supported programs).[5]

- *Median erosion* first computes country-level erosions between start and end years, and then takes the median across the sample. This reflects the erosion experienced by the *representative* member, which is a more relevant measure of central tendency for the purpose of calibrating quota-based thresholds.[6]

6. For continuity and comparability, both erosion estimates computed using the median erosion (preferred measure) and those based on aggregate erosion are presented. The increased consistency of country groupings across metrics allows for more meaningful comparisons across metrics. Specifically, this Review no longer constrains the analysis for the external financing needs alone metric to the subset of countries that had at least one drawing IMF arrangement since 1990. At the same time, results across *all* metrics for program-only countries are presented for completeness.

7. Estimates based on different methodologies, country groupings, and time horizons lead to broadly similar conclusions. Annex III Table 2—summarizing measures of erosion and corresponding increases in quota-denominated thresholds needed to offset it—suggest that a level-based surcharge of about 280 percent of quota would offset erosion across most metrics, regardless of sample and methodology. This would represent a nearly 50 percent increase from the current 187.5 percent of quota; the same percent increase would apply to other quota-based thresholds as well. These results are close for median erosion and aggregate erosion. However, beyond inherent methodological advantages discussed above, the preferred median erosion approach also delivers a narrower range of erosion estimates—both across country groups and erosion metrics—which raises confidence in the overall results of the exercise. Annex III Table 3 provides additional details on erosion over a longer horizon, though they are of less relevance to surcharges than to access limits calibration.

[5] The 2023/24 papers did not address the bias toward large countries inherent to the aggregate approach. The 2016 Review partly addressed for the EMDE subsample by excluding China and India. In hindsight, the exclusion of *two* (not more or fewer) EMDEs is difficult to anchor.

[6] For certain purposes, aggregate-based metrics are more appropriate (e.g., size of the Fund calibration).

Annex III. Table 1. Erosion Estimation Methodologies Across Recent Reviews

(Differences between the 2024 Comprehensive and 2023/24 Interim Reviews highlighted in blue)

Parameter	2016 Review	2023/24 Reviews	2024 Reviews of Access Limits and of Charges and Surcharges
Time period	2009–2015	2015–2023	2016–2024
Economic concepts and metric used as proxy			
Capacity to repay	GDP	GDP	GDP
Current account BoP needs	Trade = Exports + Imports	Current payments = Imports of goods and services + Primary income debit + Secondary income debit	Current payments = Imports of goods and services + Primary income debit + Secondary income debit
Capital account BoP needs	Non-FDI External Liabilities	Capital flows = FDI + Portfolio liabilities + Other investment liabilities	Capital flows = FDI + Portfolio liabilities + Other investment liabilities
Aggregate BoP needs	External financing needs (EFN) = – Current account balance + Amortization falling due in the next 12 months	External financing needs = – Current account balance + Amortization – Change in reserves[1]	External financing needs = – Current account balance + Amortization – Change in reserves[1/]
Country coverage			
Broadest coverage	All IMF members (World) with restriction for EFN: only countries with positive values	All IMF members (World) with restrictions: • For capital flows and EFN: only countries with positive values • Additionally for EFN: program countries[2]	• All IMF members (World) with restrictions for capital flows and EFN: only countries with positive values. • Program countries[2/]
Proxy for likely borrowers	EMDEs excluding India & China, with restriction for EFN: only countries with positive values	All EMDEs, with restrictions: • For capital flows and EFN: only EMDEs with positive values • Additionally for EFN only: program countries[2]	• All EMDEs, with restrictions for capital flows and EFN: only EMDEs with positive values • Program EMDEs[2] with same restrictions • EMDEs excluding India & China with same restrictions (for improved comparability with 2016 Review)
Central tendency	Erosion of aggregate for country sample	Erosion of aggregate for country sample	• Median erosion within country sample (preferred measure) • Erosion of aggregate for country sample (for comparability).

1/ Change in reserves is subtracted from EFN only for low-reserves countries. These are defined as countries with reserves covering less than 100 percent of short-term external debt on remaining maturity basis.
2/ Program countries are countries that had at least one disbursing Fund arrangement since 1990.

Annex III. Table 2. Estimates of 2016-24: Erosion Main Results and Robustness Checks

	Median erosion			**Aggregate** erosion		
	2016-2024 erosion, percent	Increase needed to offset erosion, percent	Implied level-based surcharge threshold, percent of quota	2016-2024 erosion, percent	Increase needed to offset erosion, percent	Implied level-based surcharge threshold, percent of quota
World						
GDP	33.7	50.8	283	32.3	47.8	277
Current Payments	38.0	61.3	302	36.6	57.7	296
Capital Inflows	31.8	46.7	275	23.4	30.5	245
External Financing Needs	30.9	44.7	271	32.4	47.9	277
Median across metrics	*32.7*	*48.7*	*279*	*32.4*	*47.9*	*277*
Average across metrics	*33.6*	*50.9*	*283*	*31.2*	*46.0*	*274*
Std Dev across metrics	*2.7*	*6.4*	*12*	*4.8*	*9.8*	*18*
EMDEs						
GDP	34.0	51.4	284	36.5	57.6	295
Current Payments	38.9	63.7	307	40.5	68.0	315
Capital Inflows	31.8	46.7	275	34.5	52.7	286
External Financing Needs	29.2	41.1	265	29.6	42.1	266
Median across metrics	*32.9*	*49.1*	*279*	*35.5*	*55.2*	*291*
Average across metrics	*33.5*	*50.7*	*283*	*35.3*	*55.1*	*291*
Std Dev across metrics	*3.6*	*8.3*	*16*	*3.9*	*9.3*	*18*
World, Program countries only						
GDP	35.1	54.0	289	33.3	49.9	281
Current Payments	41.7	71.6	322	43.3	76.2	330
Capital Inflows	31.8	46.7	275	40.1	66.8	313
External Financing Needs	32.6	48.3	278	24.9	33.2	250
Median across metrics	*33.8*	*51.2*	283	*36.7*	*58.4*	297
Average across metrics	*35.3*	*55.2*	291	*35.4*	*56.5*	294
Std Dev across metrics	*3.9*	*9.9*	*19*	*7.0*	*16.5*	*31*
EMDEs, Program countries only						
GDP	34.7	53.3	287	33.9	51.4	284
Current Payments	41.4	70.5	320	42.5	74.1	326
Capital Inflows	31.1	45.0	272	41.2	70.1	319
External Financing Needs	30.8	44.6	271	23.5	30.8	245
Median across metrics	*32.9*	*49.1*	280	*37.6*	*60.7*	301
Average across metrics	*34.5*	*53.4*	288	*35.3*	*56.6*	294
Std Dev across metrics	*4.3*	*10.5*	*20*	*7.5*	*17.2*	*32*
EMDEs excl. India and China (for comparability with 2016 Review)						
GDP	33.8	51.2	283	31.4	45.7	273
Current Payments	38.6	62.8	305	39.3	64.8	309
Capital Inflows	31.1	45.0	272	29.2	41.3	265
External Financing Needs	28.8	40.4	263	20.9	26.5	237
Median across metrics	*32.5*	*48.1*	278	*30.3*	*43.5*	269
Average across metrics	*33.1*	*49.9*	281	*30.2*	*44.6*	271
Std Dev across metrics	*3.7*	*8.4*	*16*	*6.6*	*13.7*	*26*

Source: WEO and IMF staff calculations.
Notes: Definitions of erosion metrics and country coverage are detailed in the last column of Annex Table 1. Within the current framework, the corresponding R can be obtained by tripling the AAL.

Annex III. Table 3. Longer Term Trends: Median Erosion Between Base Year and 2024

	2009-2024	**2016-2024**
World Access Limit to Indicators		
GDP	46.5	**33.7**
Current Payments	46.9	**38.0**
Capital Inflows	32.9	**31.8**
External Financing Needs	39.3	**30.9**
EMDEs Access Limit to Indicators		
GDP	50.0	**34.0**
Current Payments	52.2	**38.9**
Capital Inflows	38.1	**31.8**
External Financing Needs	43.3	**29.2**
Program Countries Access Limit to Indicators		
GDP	47.6	**35.1**
Current Payments	45.1	**41.7**
Capital Inflows	21.3	**31.8**
External Financing Needs	30.7	**32.6**
Program EMDEs Access Limit to Indicators		
GDP	50.5	**34.7**
Current Payments	51.3	**41.4**
Capital Inflows	26.2	**31.1**
External Financing Needs	34.1	**30.8**
EMDEs excl. China and India Access Limit to Indicators		
GDP	50.2	**33.8**
Current Payments	52.4	**38.6**
Capital Inflows	39.7	**31.1**
External Financing Needs	43.3	**28.8**

Source: WEO and IMF staff calculations.
Notes: Definitions of erosion metrics and country coverage are detailed in the last column of Annex Table 1. Bolded columns correspond to the first columns in Table 2.

Annex IV. Scenario Analysis for the Margin of Charge

1. Staff has performed scenario-based analysis to illustrate a range for the margin that could preserve the capacity to contribute to reserves in a range of circumstances. The approach focuses on projected income and expenses by FY 2028, i.e., the end of the two-year margin period that follows the two-year period for which the margin would currently be set. The exercise accounts for risks to the baseline and factors relevant for the accumulation of reserves, given in particular the potential for transitory effects to play an important role in the income position. The aim is to gauge the magnitude of a margin that, if set now and maintained for two cycles, would ensure a level of precautionary balances close to the current target of SDR 25 billion and be robust to uncertainty in key drivers for the generation of income (including surcharges).

2. For simplicity, the exercise tests several illustrative margins, assuming no changes in other policies, including surcharges. These are set at 100 basis points (the current margin), 20 basis points (the margin necessary to cover solely intermediation costs), and an intermediate margin of 40 basis points.

3. To capture the most relevant risks, the analysis focuses on the drivers of the largest components of income. These are, for lending income, the amount of Fund credit outstanding, and for non-lending income, returns in the FI, which are highly sensitive to interest rates. The top panel of the first table below shows the baseline projection for the relevant components of income and expenditure for FY 2025, illustrating their relative weights. The second table shows the parameters employed in two different scenarios, with the adverse scenario differing from the baseline in three respects: (i) the SDRi is assumed to decline to its 10-year historical average of 2.2 percent; and (ii) no new GRA arrangements are assumed, which would reduce credit outstanding to about SDR 71 billion by end FY-2028; which results in lower interest income.

4. The scenario analysis illustrates that margins of 40 basis points or higher would comfortably cover intermediation expenses under the baseline and provide a buffer to cover a possible shortfall in the non-lending balance or other sources under a stress scenario. The second and third scenarios of Table 1 show projected FY 2028 desk survey and stress outcomes. In the desk survey scenario, for margins of 40-100 basis points, both intermediation and non-intermediation income would remain substantially above their corresponding expenses. In the stress scenario, intermediation income would decline along with credit outstanding, though it would remain above intermediation expenses even with a margin of 40 basis points. In contrast, non-intermediation income would fall below non-intermediation expenses, as FI returns are significantly impacted by lower interest rates. In this scenario, a margin of 40 basis points would allow the deficit in the non-intermediation balance to be covered by intermediation income. While there is a high degree of uncertainty surrounding these projections, the broad conclusions from this illustrative analysis suggest that a margin of 40 basis points or higher would continue to deliver a robust level of net income that minimizes the risk of a reversal in the margin or of frequent changes (by

providing coverage of the non-intermediation balance in stress scenarios), while retaining a capacity to contribute to reserves that would be robust to a possible decline of income from surcharges or other sources.

Annex IV. Table 1. Fund Income and Expenses Scenarios[1/]
(In SDR millions)

	Intermediation 2/			Non-intermediation 3/ 4/	
	100 bps	40 bps	20 bps		Coverage
Scenario 1: FY2025 Desk Survey					
Income	984	441	260	1170	132%
Expenses	132	132	132	888	
Scenario 2: FY2028 Desk Survey					
Income	824	336	174	1385	146%
Expenses	141	141	141	946	
Scenario 3: FY2028 Current arrangements, 2.2% SDRi and Floor-level PB (stress scenario)					
Income (A)	707	283	141	844	89%
Expenses (B)	141	141	141	946	
Difference (A)–(B)	566	142	0	-102	

1/ Expenses comprises Net Administrative Budget expenditure adjusted for reimbursements.
2/ Intermediation income comprises income from the margin and service charges.
3/ Non-intermediation income comprises payouts from the fixed-income and endowment subaccounts and implicit income from interest free resources. Reimbursement for PRGT operational expenses is not included.
4/ PRGT operational expenses are not included in non-intermediation expenses.

Annex IV. Table 2. Scenario Parameters

	Desk Survey Scenario	*Stress Scenario*
SDR interest rate	Projected using market instruments (3.6 percent in FY25; 3.1 percent in FY28)	2.2 percent, near the 10-year historical average, in FY28
Net Administrative Budget expenditures	Flat real budget (SDR 1,128m in FY25; SDR 1,202m in FY28)	Flat real budget (rising to SDR 1,202m in FY28)
Endowment account payout	Determined by existing framework (1.5 percent in FY25, to be increased by GED annually)	Determined by existing framework (1.5 percent in FY25, to be increased by GED annually)
Credit outstanding (average)	Projection based on survey of desks (SDR 90.6 bn in FY25; SDR 81.3 bn in FY28)	Declines to SDR 70.7 bn (Current Arrangements) in FY28
Precautionary balances	Reaches SDR 25 billion target by end-FY24	Reaches SDR 25 billion target by end-FY24