CENTER FOR GLOBAL DEVELOPMENT

IMF Reform Proposals

REFORM MEASURES	PURPOSE/RATIONALE	LINKS TO OTHER REFORMS	HURDLES TO ADOPTION
Governance			
Rebalance voting shares to reflect changes in the global economy	Bolster IMF legitimacy. Greater representation for Emerging Market and Developing economies (EMDEs)	Since no quotas can be reduced, rebalancing must be part of an overall quota increase that raises IMF resources. Rebalancing could improve the targeting and efficiency of SDR allocations	85% majority for a quota increase. Major shareholders would need to concede voting power to EMDEs including China
Use an open process to select the IMF Managing Director	Bolster legitimacy	Selection of World Bank President	US and Europe would need to agree
Day-to-day operational independence from the Executive Board whose role would be to set mandates and monitor overall performance	Greater autonomy as a truth teller. Prevent possible gridlock of a divided Executive Board.	Some analysts link this to limiting the IMF's role to its core mandate	Need to amend the Articles. Resistance from shareholders desiring control over their quota resources. May require a similar change at the World Bank
Fund resources and lending			
Increase the IMF's (non-concessional) lending capacity	The US$1 trillion capacity in the GRA established in 2012 has declined in real terms and relative to possible needs.	This would ultimately require a quota increase. (In the short term the New Arrangements to Borrow could be enlarged if essential)	85% majority for a quota increase. Unlikely to be supported by EMDEs including China unless the quota increase results in major shareholders conceding voting power.
Increase lending capacity of the PRGT (A package of measures was announced on October 15, 2024)	The PRGT's Subsidy resources have been depleted by high lending since COVID. Capacity now much lower than repayments due. A higher lending capacity is needed to raise access limits.	Eliminating surcharges (see below) would have limited the scope to use IMF reserves or net income to bolster the PRGT's subsidy resources	Gold sales would have been the best option to bolster subsidy resources and raise lending capacity. But this required an 85% majority and US congressional support. A 70% majority is needed for a distribution of reserves.

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Increase lending capacity of the RST	Initial lending capacity will soon be exhausted with demands unmet	Linked to calls for greater recycling of SDR (see below)	Increasing the RST's lending capacity is less challenging than raising the PRGT's capacity which requires large subsidy resources.
Increase size of IMF programs. Ease restrictions on access.	Faster and more effective crisis response to provide more liquidity with reduced reliance on uncertain bilateral cofinancing.	May need quota increase and as well as more PRGT resources	85% majority for quota increase. Simple majority to raise access limits and revise the exceptional access policy
Establish a new facility with access triggered by a defined systemic shock	Availability to all members in good standing would avoid the stigma of regular IMF lending and provide reliable precautionary insurance to a much larger part of the membership		Pending a quota increase, the facility's design could be constrained by current lending capacity
Establish a new precautionary liquidity facility for EMDE	Would help to limit financial contagion for EMDEs vulnerable to liquidity crises but are not covered by central bank swap lines		Pending a quota increase the facility's design could be constrained by current lending capacity. Unless the facility is funded separately outside the IMF's balance sheet, implementation may require an amendment to the Articles to authorize the IMF to purchase government debt in the secondary market.
Reduce or eliminate surcharges (Reforms lowering surcharges were announced on October 11, 2024)	Lower costs of borrowing that are seen as excessive	Eliminating surcharges would have limited the scope to use IMF reserves or net income to bolster the PRGT's subsidy resources	70% majority. Need to ensure that reserves (precautionary balances) remain adequate in future.
Program design and conditionality.	Ensure that growth projections are not too optimistic. At the same time, avoid excessive austerity; target growth friendly fiscal adjustment and provide space for growth enhancing investment. Guard against increases in program conditionality and focus on measures essential to achieve macroeconomic objectives	Linked to calls for reform of Debt Sustainability Analysis (below)	As well as Executive Board endorsement, changes in program design and conditionality need to be supported by staff and senior management and closely and transparently monitored.

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Debt			
Improve and extend the Common Framework	Need to accelerate debt restructuring by addressing the problem of "holdout creditors" and expand the Common Framework to include middle-income countries and private creditors	Linked to governance in that all shareholders would need to accept the conclusions of Debt Sustainability Analyses and the fair burden sharing of debt restructuring costs	Greater transparency of debt reporting is essential.
Improve/update debt sustainability analysis	Reduce reliance on fiscal consolidation, recognize the role of growth supported by investment in improving debt and progress towards SDG targets. Ensure that DSAs incorporate the impact of climate change including costs of adaptation and mitigation	Creditors in the Common Framework would need to buy-in to an updated approach.	Collaboration with World Bank to revise the DSA framework.
SDR allocations and usage			
Regular SDR allocations	Boost countries' international reserves and increase the SDR's share of global reserves	Share of the allocation going to EMDEs would rise after a quota reform	85% majority required.
Delink allocations from quota shares or end allocations to countries with reserve currencies	Ensure SDRs are allocated to EMs and LICs that need more reserves		Need to amend the Articles
Link SDR interest rate to longer term interest rates	Reduces the implicit subsidy paid by countries providing hard currency reserves in exchange for SDRs.	Would reduce scope for the PRGT and RST to earn a premium on deposits placed by members to build subsidy resources or	70 percent majority
Lower the voting majority for an SDR allocation from 85% closer to 50%	Prevent the type of deadlock that delayed the 2021 allocation		Need to amend the Articles
IMF to encourage SDR recycling	SDR could be used to bolster the resources of the PRGT, RST and MDBs		Central bank reluctance and institutional constraints are stalling issuance of SDR hybrid capital. MDBs should move ahead with SDR bond issuance.
Allocate SDRs directly to MDBs	Hybrid capital thus created will allow leveraged increases in MDB lending to address climate change		Need to amend Articles to allow allocations to MDBs

REFORM MEASURES	PURPOSE/RATIONALE	LINKS TO OTHER REFORMS	HURDLES TO ADOPTION
Surveillance			
More candor and truth to power	Policies of economic nationalism that challenge the IMF's core mandate "to facilitate the expansion and balance growth of international trade" need to be addressed candidly in all cases. Perceived lack of evenhandedness in addressing spillovers including from excessive debt.		2026 Surveillance Review would need to clarify the "rules of the game" including for cross border spillovers. Need for constructive and evidence based advise from the IMF on options for "industrial policies"
Expand the coverage of surveillance to include climate change mitigation.	"Climate change mitigation is a global public good that requires an unprecedented level of cross-country policy coordination". The IMF has the global reach to report and assist in this process	Clarity and consensus on the scope of surveillance is needed to allow the IMF to be more candid, speaking truth to power evenhandedly with full recognition of spillovers.	Stakeholders are sharply divided. Expanding the coverage of surveillance to include climate change mitigation could divert attention from the IMF's core mandate.
Support multilateral and bilateral surveillance with more analytical work on the macroeconomic implications of climate change	The adverse effects of climate change and the costs of adaptation and mitigation need to be captured in medium term macroeconomic balances and DSAs		Need to build on efforts already made to broaden the IMF's expertise and staffing.

Background Note on the Reform Proposals

Governance

The limited **rebalancing of voting shares** that has taken place in past quota reviews has lagged far behind the pace of geopolitical developments. For example, Japan's quota is slightly higher than China's even though China's economy is more than four times larger; India's economy is larger than those of the UK and France, but its quota is lower than both. The increasing underrepresentation of countries outside the old Western alliance is seen by many as a drag the IMF's legitimacy and an impediment to good governance.

The interplay of voting shares that have seen only minor adjustments and the majorities required for key decisions that are hard-wired in the IMF Articles of Agreement further dilutes the influence of underrepresented countries. For example, quota adjustments, SDR allocations and sales of the IMF's gold all require voting majorities of 85%, affording the US veto power by virtue of its current 17% quota share. Similarly, European shareholders could together easily block such changes. Amendments to the IMF Articles of Agreement require a supermajority comprised of three-fifths of the membership having 85% of the voting power. Some other key financial decisions, including adjusting surcharges that are widely seen as imposing an excessive burden on borrowers, require a 70% majority which de facto ensures that creditor countries with large voting shares have a strong voice in framing such decisions.

The perceived drawbacks of the current voting structure are easy to state but much harder to resolve. The countries that are overrepresented and would need to concede voting power clearly have the votes to block such a realignment. For some, conceding voting power may also risk giving up a seat on the Executive Board. Eight of the 24 Executive Directors – or 25 after a third African chair is created at the Annual Meetings – effectively represent a single country[1] and almost all would likely see some reduction in their quota shares. Responding to critiques of overrepresentation, some are also likely to stress the value of their voluntary contributions to the IMF, including financial support for the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST) and participation in borrowing agreements that have been used to bolster lending capacity at times of stress when quota resources were not considered adequate.

A 'grand bargain' to realign quotas might need to incorporate reforms that addressed the concerns of shareholders conceding power or be based on a recognition some sacrifice of control was justified to support the effective functioning of the IMF. But moving forward on a compromise that shifts voting power to China would clearly pose a serious political challenge for the US and European shareholders.

Some commentators have suggested that given the potential for deadlock between otherwise competing shareholders, **management should be given greater independence**. The Board's role would be limited to oversight of performance and setting mandates, which might need to be focused to priority areas (of global public good) as agreed by shareholders. The Board would thus cease to play an Executive role. Such a major reform requiring a

1 US, Japan, China, Germany, France, UK, Saudi Arabia and Russia, which also represents Syria.

change to the Articles may or may not be accepted by major shareholders. But it is reasonable to think that there may be greater reluctance to delegate decisions on lending – which draws upon the resources of shareholders and their central banks – than those on bilateral or multilateral surveillance.

By long-standing custom, the Managing Director of the IMF is selected by European shareholders. **A more open process for selecting the Managing Director** would bolster the organization's legitimacy. In addition, this could be seen as a complementary reform alongside a move to greater operational independence from the Board. Conversely, major shareholders may be reluctant to sanction this change especially before the outcome of any quota realignment is settled. It would need to be accompanied by a corresponding change in the selection of the World Bank President and could also call into question the practice of the US, Japan and China selecting Deputy MDs in the IMF.

Fund Resources and Lending

The lending capacity of the IMF's General Resources Account (GRA) which provides non-concessional financing was first raised to the equivalent of roughly US$1 trillion when risks in the euro area were heightened in the global financial crisis. Capacity was initially added to quota resources by entering into a series of bilateral borrowing agreements with member countries and the New Arrangements to Borrow (NAB) – a standing borrowing agreement with 40 member countries – was enlarged. The implementation in 2016 of the 14th quota review agreed in 2010 doubled quotas and allowed a rolling back of borrowing agreements. The 50% quota increase that was agreed in 2023 under the 15th quota review will not raise lending capacity. When implemented, this will be accompanied by the expiration of bilateral agreements and a rollback of the NAB so that capacity remains at about US$1 trillion.

In the short term, if quota resources were considered inadequate, the NAB could in principle be enlarged or borrowing agreements restarted. But the decision in 2023 on the quota increase and the rollback of borrowing appears to have been made on the assumption that the current lending capacity would be sufficient for the time being. The 17th quota review, which is expected to result in a realignment of quotas, could only achieve this if quotas were increased. (There is no provision to reduce the nominal quotas of overrepresented countries).

The lending capacity of the Poverty Reduction and Growth Trust (PRGT) which provides subsidized loans to low-income countries was severely constrained. Lending surged since the beginning of the pandemic (from an average of about SDR 1 billion per year to over SDR 5 billion per year) and the subsidy costs of this lending also rose. The subsidy resources of the PRGT needed to be replenished to cover the higher costs that had already been committed. In addition, future lending capacity needed to be raised to accommodate LICs' continued higher financing needs including much higher PRGT repayments from the recent surge in lending.

Fund-raising efforts from member countries made an important contribution but more was needed. This was expected to come from IMF "internal sources." Sales of a small proportion of the IMF's gold, which is held on the balance sheet at a fraction of its market value, could meet immediate costs and raise future capacity substantially. However, this required an 85% majority vote and securing the necessary support from the US would also require backing from the US Congress.

The reform measures announced on October 15 include the use of some of the IMF's reserves, ("precautionary balances") or future net income to support the PRGT. The voting threshold to "distribute" reserves or net income is lower than for gold – 70% – and US support does not require formal congressional backing. The main obstacle to the use of reserves was that shareholders needed to be convinced that precautionary balances not distributed would provide an adequate buffer against financial risks to the GRA balance sheet. The cost of sharply raising the PRGT's lending capacity – and thus the expected use of reserves – was reduced by introducing a new interest rate mechanism that maintains zero-interest lending for the poorest countries while reducing the concessionality of lending to LICs with higher incomes. And as discussed below, eliminating surcharges would have significantly reduced net income, slowing the accumulation of precautionary balances, and thus limited the scope to use some reserves to support the PRGT.

The initial **lending capacity of the Resilience and Sustainability Trust (RST)** was set out about SDR 22 billion. The bulk of this target was met partly through member countries agreeing to lend excess SDR holdings to the RST. So far lending commitments to 18 countries have accounted for about a third of this capacity. However, some 30 countries are expected to make use of the RST soon, and some countries will need to have successor arrangements given the long duration the challenges that they face.

A further round of fundraising would help ensure that resources are available to meet needs and respond to calls for greater recycling of "excess" SDRs held by advanced economies. Unlike the PRGT, financing of the RST does not require subsidy resource, thus easing the demands on member country budgets or IMF internal resources.

From a different perspective, RST resources can, by design, be used to meet balance of payments needs that the GRA cannot meet given the restrictions on use currently imposed by the Articles. As such the RST both meets a specific need and helps ensure that GRA resources are retained for their intended role in crisis prevention and resolution.

The size of programs supported by the GRA and the PRGT could be increased by easing restrictions on access and raising the norms that guide decisions in this area. For the PRGT, lending capacity is currently constrained but in the GRA there may be scope to increase access with current resources. Higher access could allow the IMF to provide liquidity support more rapidly, without having to lineup bilateral assurances of co-financing. This could also avoid risks to programs that can arise when assurances of bilateral financing are not precise or do not come to fruition. These factors would need to be balanced against concerns that by downplaying the usual emphasis on its catalytic role, the IMF could be taking on too much risk or that large IMF financing could fuel perceptions that other creditors are being 'bailed out' thus creating moral hazard.

In recent years the IMF has developed new "precautionary" credits lines, including the Flexible Credit Line (FCL), that provide a guarantee of liquidity support that can be provided without conditionality when needed. However, these facilities require prequalification based on strong economic fundamentals and sustained policy track records, and are, in practice, only available to a limited number of countries. Reforms have been proposed to **extend precautionary support** in two areas. The first, drawing on the experience in Covid, would provide rapid unconditional support to all countries in good standing under certain predefined conditions. A determination that an adverse global development – such as a pandemic – had occurred would trigger the release of financing. As

well as providing a reliable source of financial support in a global emergency, this would avoid the stigma that can deter borrowing from the IMF. A second proposal envisages additional precautionary support for EMDEs that, by virtue of their access to capital markets, are vulnerable to liquidity crises but are not covered by the IMF's existing precautionary facilities like the FCL or central bank swap lines. A novel feature of this proposal is that the IMF would provide support to limit the contagion effects of sharp stops in capital market financing by purchasing debt issued by the EMDEs in the secondary market. As such, the support would not be targeted to individual countries and, like the first proposal, it avoids the stigma or averse signaling that could arise in seeking individual support under existing facilities. If the proposed facility used IMF lending resources on its balance sheet this may require an amendment of the Articles to allow the purchase of secondary market debt. An alternative funding approach would rely on pre-arranged swap lines from advanced economies central banks that could be managed by the IMF but not held on its balance sheet.

Surcharges applied to a country's borrowing provide an incentive to repay early and allow the IMF to accumulate reserves. These "precautionary balances" are seen as an important element of risk management, protecting the balance sheet and members' quota resources that are, in effect, on-lent to the IMF's non-concessional borrowers. Depending on the duration of borrowing, surcharges raise the interest rate payable on amounts exceeding 187.5% of the member's quota by 2-3%. This is in addition to the standard cost of borrowing from the IMF which is 1% above the prevailing SDR interest rate. At end September 2024, countries subject to the highest rate of surcharges paid a marginal interest rate of 7.5%. The average rate on borrowings was lower, but in many cases the bulk of credit was subject to surcharges.[2]

There have been numerous calls to reduce, suspend or eliminate surcharges which are increasingly seen as placing onerous and counter-cyclical costs on borrowers who lack the market access that would allow then to repay early. There also appears to be scope to scale back surcharges. Precautionary balances have reached SDR 25 billion, the target level set by the Executive Board. And on the IMF's latest published projections (from April this year) these balances would rise by over SDR 2.5 billion a year over the next 5 years.

Reforms announced on October 12 will lower surcharges with effect from November 1, 2024. The threshold at which level-based surcharges apply was raised to 300% of quota and the interest rate for time-based surcharges was lowered from 1% to 0.75%. The cost of all borrowing from the GRA was also lowered by 0.4% by reducing the margin that is charged over the SDR interest rate. These reforms are estimated to reduce total interest payments substantially, saving borrowers about SDR 0.9 billion (US$1.2 billion) and will immediately reduce the number of countries subject to surcharges from 19 to 11.

A 70% majority in the Board was needed to change surcharges and the margin. Shareholders needed to be assured that reserves would remain adequate despite the resulting reduction in lending income and taking into account the expected use of future net income or reserves to support the PRGT.

2 At end August 2024, 52 countries had outstanding IMF credit and of these 19 were subject to surcharges with borrowing averaging 385% of quota – more than double the threshold for surcharges. Argentina's and Ecuador's credit outstanding was 5 times the threshold.

Debt

Geopolitical developments have also complicated long established mechanisms for restructuring of the official debt obligations. **The Common Framework** established between the Paris Club and the G20 aims to broaden the scope of official debt restructuring to embrace important new creditors, most notably China. But the pace of debt restructuring has been too slow, prolonging the difficulties of LICs such as Zambia in their efforts to emerge from debt crises. The scope of operations under the CF needs to be extended to cover the debts of middle-income countries and to ensure comparable debt treatments by private creditors. Greater transparency in debt reporting by creditors and debtors is essential. These reforms entail cooperation and coordination extending beyond IMF. However, the IMF needs to play a central role in strengthening the CF to support the institution's key role of crisis prevention and mitigation. The importance of these issues for the IMF and China's essential role in their resolution underlines their links to strengthening IMF governance in support of global public goods (could progress in this area be an element of a grand bargain on governance reform?).

SDR Allocation and Usage

There is widespread recognition that the SDR allocation in 2021 provided much-needed relief, particularly for the most vulnerable during the pandemic and its aftermath. But because SDRs are allocated based on quota shares, the bulk of the allocation was made to countries that did not face an urgent need for SDRs to bolster their reserves. Proposed reforms reflect this experience.

The IMF could do more to encourage recycling of existing SDRs via the PRGT, the RST and MDBs. This would not entail any formal changes to SDR operations but would need to overcome central banks' apparent reluctance or institutional constraints (particularly in the euro area) which have stalled further progress including of the use of SDRs to provide hybrid capital for MDBs.

Annual allocations of SDRs covering the 5-year periods stipulated in the Articles could be made by an 85% majority, and the distribution of these allocations could be enhanced by a quota reform. Approval of these allocations could easily be blocked given the high majority needed for their approval. But lowering the threshold needed for approval – to avoid a repeat of the deadlock that delayed the 2021 allocation – would require an amendment to the Articles of Agreement. Similarly, changes to improve the targeting of allocations such as delinking these from quota shares or ending allocations to countries with reserve currencies would require an amendment to the Articles, as would be issuing SDRs directly to MDBs to bolster their lending capacity.

The SDR rate of interest earned by holders of SDRs is an average of short-term interest rates on public debt denominated in the currencies of the SDR basket. Holders of SDRs are thus implicitly foregoing higher rates of interest that could be earned by holding reserves in hard currencies at longer term. **Basing the SDR rate on longer-term rates** would thus remove the effective penalty that countries pay when accepting SDRs in exchange for hard currency reserves. This would however reduce the scope for the IMF to earn an interest premium on deposits placed with the PRGT and the RST to build reserves or subsidy resources.

Surveillance

To be effective and deliver on its full potential as a global public good, surveillance must be applied evenhandedly. But there is a growing perception that the uneven balance among shareholders is inhibiting candor and preventing the IMF from speaking truth to power. The growing tide of policies of economic nationalism including the spillovers from protectionist tariffs and subsidies that are a challenge to the IMF's core mandate need to be addressed. Similarly, spillovers from excessive deficits and debt need to be highlighted.

The extent to which climate change should be reflected in IMF surveillance and more generally in the IMF's work remains a contentious issue. In broad terms, the strategy agreed in 2021 recognizes the need to incorporate the adverse macroeconomic implications of climate change and the related costs of *climate change adaptation* in all the IMF's work. The strategy also *encourages* coverage of *climate change mitigation* in surveillance particularly for largest emitters of greenhouse gases. But coverage of climate change mitigation remains effectively voluntary despite the very large potential spillovers entailed.