September 13 2024 Ecofin Lunch

IMF: FINANCING OF LOW-INCOME COUNTRIES

Low-income countries (LICs) are gradually recovering from recent shocks but face persistent macroeconomic vulnerabilities. The COVID-19 pandemic, Russia's war in Ukraine, and the tightening of international financial conditions have left significantly deeper scars in LICs compared to more advanced economies. Growth remains sluggish and many LICs experience difficult access to international finance, depleted external and fiscal buffers, and substantial development and social needs.

LICs face substantial financing needs, and will need both domestic reforms and support from the international community. The large financial needs reflect a global environment that is more prone to climate shocks, sudden shifts in trade due to geopolitical fragmentation, political instability and conflicts, and commodity price fluctuations. Broad support from development partners, including through a successful IDA replenishment and support from aid budgets, will be vital to meet these needs.

The IMF has a critical role to play in supporting LICs facing these challenges. This involves concessional financing, macroeconomic policy support, capacity development, and catalyzing financing from other sources. The Poverty Reduction and Growth Trust (PRGT) is the IMF's central vehicle for emergency and programmatic balance of payments financing to LICs, while providing a comprehensive macroeconomic policy and reform framework tailored to individual country needs.

With unprecedented demand for IMF support, the PRGT's finances have come under severe strain. Since the start of the pandemic, the PRGT has provided 56 low-income countries with interest-free loans, and credit outstanding has more than tripled to over €24 billion. This has allowed countries to respond to multiple shocks, including by maintaining social spending to avoid a greater increase in instability and poverty. Yet despite the success of the recent bilateral fundraising round, with generous contributions from PRGT partners including the European Union and its members, the combination of unprecedented lending volumes and the sharp increase in interest rates is reducing the PRGT's annual lending capacity to just over a third of projected demand. IMF subsidy resources are running our fast and are projected to be fully committed by 2027.

The IMF is putting forward a set of policy reforms to buttress its ability to support LICs. The current Review of the PRGT Facilities and Financing is proposing a more tailored interest rate structure, with relatively better-off LICs paying a small interest rate on their loans, while the poorest members would continue to benefit from interest-free lending. In addition, we propose a number of safeguards to ensure that our financing is well calibrated, addressing the needs of LICs within a sustainable lending envelope.

Even with these reforms, substantial additional subsidy resources are urgently needed. Some IMF internal resources can be generated by extending the suspension of PRGT administrative expenses reimbursement to the General Resources Account (or GRA). This would leave a subsidy funding gap of around SDR 5.9 billion (€7.2 billion) in the PRGT. We have explored different options for mobilizing the necessary resources to close this remaining gap:

- **A limited sale of a portion of the IMF's gold** is not a feasible option at this point as we currently lack the necessary support among shareholders to proceed.
- **Bilateral fundraising** is unlikely to generate anywhere near the amounts needed, given constrained donor budgets and competing priorities, including funding of IDA and bilateral aid budgets.
- **The use of internal IMF resources** is the only realistic option to close the subsidy gap of the PRGT.

The Fund's strong financial position creates a unique opportunity for a distribution of IMF net income or reserves. The Fund's precautionary balances have reached their SDR 25 billion (€30.4 billion) target—a historic milestone, and the outlook for GRA income over the next years is strong, reflecting continued robust demand for Fund lending and higher investment income.

A similar approach to the proposed distribution has been used successfully in the past, including in 2012-13 when the IMF made two reserve distributions based on gold sales profits to facilitate subsidy contributions to the PRGT. Almost all EU countries contributed to the effort at that time. According to the IMF's Articles of Agreement, any distribution would be made available to IMF members, irrespective of the national entity representing the member at the IMF.

In view of members' differing institutional and legal frameworks, we are offering a menu of options to facilitate very broad participation and burden sharing among our members. The IMF can transfer the member's share of the distribution straight from the GRA to the PRGT, thereby ensuring that the money "stays in the IMF", and does not affect the members domestic accounts. This can be done on a lapse-of-time/no objection procedure to secure the consent of the member. Staff is also working on options that could give members time to provide relevant financing assurances.

Engagements with the IMF's Executive Board in April and July this year demonstrated broad support for the proposed distribution of GRA resources, along with the suggested policy reforms. With EU countries accounting for more than a quarter of total IMF Quotas, members will be looking to Europe to ensure very broad participation to raise the necessary funds and help meet the financing needs of low-income countries.