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GRAY/22/3099

December 7, 2022

**Statement by Mr. Herrera, Mr. Chodos, and Mr. Hendrick on Review of the Adequacy of the Fund's Precautionary Balances
(Preliminary)
Executive Board Meeting
December 12, 2022**

- 1. We welcome the opportunity to discuss the adequacy of the Fund's precautionary balances (PB) and options for temporary relief on surcharges.** We thank staff for the informative paper and for the bilateral engagement with our office.
- 2. Precautionary balances are an important element of the Fund's multilayered framework to mitigate financial risks and safeguard member's resources.**
Precautionary balances, along with members' obligations under the Fund's Articles of Agreement, program design and conditionality, lending policies, safeguard assessments, the Fund's preferred creditor status, arrears strategies, and burden sharing mechanism, help assure the value of members' reserve positions at the Fund and support the exchange of international reserves through which the Fund provides financial assistance to members in need. Over the last twenty years, the upper layers of the multilayered risk framework have worked well. We understand that no IMF member has accumulated long-term arrears since 2001, and only a handful of members have accumulated short-term arrears in the last 15 years.¹ *Could staff confirm the number of cases of protracted and short-term arrears triggered in the last two decades?*
- 3. We agree with staff's proposal to retain the current medium-term target of SDR 25 billion and the minimum floor of SDR 15 billion.** We take notice that the current target is expected to remain within the indicative range of outstanding credit estimates in the coming years, including current arrangements, desk surveys, and model-based

¹ Oeking, A. and M. Sumlinski, 2016, "Arrears to the IMF – A Ghost of the Past?", IMF WP/16/225

estimates under the latest WEO baseline. It is welcomed that at a point where outstanding credit is close to historical peaks, precautionary balances are equivalent to 23.7 percent of lending.

4. **Regarding the indicative medium-term target for precautionary balances**, it is worth remembering that the target of PB was only SDR 5 billion in 2001 and it was doubled to SDR 10 billion in 2002, due to large financial arrangements for middle-income countries at the time. In 2010, the target was increased to SDR 15 billion, and only two years later, in 2012, to SDR 20 billion, again associated with the new lending during the global financial crisis. It was further increased to SDR 25 billion in 2020, using a similar argument, due to the expected new lending associated with the COVID pandemic. However, if we take a closer look at Figure 3, we can see that the outstanding credit in 2002 was lower than when the PB was set at only SDR 5 billion. Also, in 2010 the outstanding credit was lower than in the previous five years. In 2020, when the PB was increased to SDR 25 billion, outstanding credit was similar to the level of 2002. As well-explained by staff in Figure 1, the rules-based framework employed since 2010 has a quantitative and a qualitative component. *Given the experience with the multi-layered risk framework over the past decades, it would be appropriate to review the “rules-based” methodology employed since 2010 and to examine whether its parameters are still appropriate, and how do they compare with reserve ratios in other international financial institutions. Is it reasonable to think that based on that history, the Fund needs PB equivalent to 25 percent of outstanding credit for residual financial risks? Staff’s comments would be appreciated.*

5. We acknowledge that demand for Fund resources could increase in an adverse scenario. **However, we caution against mechanically assuming that FCL and PLL arrangements would be automatically withdrawn in an adverse scenario.** Historical experience, including some crisis episodes, indicates that the total amount drawn from precautionary arrangements in the past 20 years accounts for about 1 percent of the total approved amount. We believe that the estimates of the increase in indebtedness in the adverse scenario should only reflect the results of the model rather than ad-hoc adjustments. *We would appreciate if staff could provide model estimates of demand for Fund resources under the adverse scenario without the assumption of automatic withdrawal of FCL and PLL arrangements. Staff comments are welcome.*

6. We agree that no additional steps are needed to accelerate the pace of precautionary balances accumulation. However, we do not concur with staff judgement that a “slightly faster accumulation of precautionary balances in these scenarios than earlier envisaged is adequate”. **Against the backdrop of a more uncertain outlook amid a global slowdown and tightening financial conditions, consideration should be given to**

slowing the pace of accumulation of PBs. As stated in the Chairman’s Summing up of the Interim Review of December 2021, the Board agreed to explore temporary surcharge relief to help borrowing members free up resources to address health and economic challenges, and the need to reassess the target for PB at the next regular review.

7. **Considering that precautionary balances are expected to accumulate faster and reach the medium-term target by early FY2025 or sooner, now is the time to provide temporary relief on surcharges.** While in the interim review paper, a two-year suspension of surcharges implied a slower pace of PB accumulation and a 2-year delay in reaching the PB target of SDR 25 billion. Under the current circumstances, staff illustrates in Box 5 of the current paper that a temporary surcharge relief via a higher level-based threshold will still allow for the PB to reach the target during FY2025. In other words, this important relief for member countries in need will have a negligible impact on the convergence to the agreed target.
8. **We strongly support either a temporary reduction in the rate of surcharges or a higher threshold to trigger the surcharge policy.** As recognized by staff, although surcharges are primarily a risk management tool, they have substantially contributed to the Fund’s lending and operational income, and therefore to the accumulation of precautionary balances. It is striking that the share of surcharge income in total lending income was 47 percent in FY2022, and that the share of the top five surcharge payers remained above 90 percent of total surcharge income. As for the “surcharge” threshold, it is out of step with the current global circumstance as the average size of UCT programs has steadily increased in the last 15 years in line with increased global financial liquidity and volatility in EMDCs.
9. **The elevated level of surcharges at a time of rising interest rates imposes additional burdens to member countries in need.** There is no denial that the cost of borrowing from the Fund, including surcharges, is below market rates, but the same analysis would be true whether surcharges were halved or doubled, because most, if not all, of countries paying surcharges do not currently have market access on a level that could sustainably replace IMF resources. The comparison of surcharges with financial market costs seems farfetched. Not only is the Fund a non-commercial institution; in fact, its mandate is not lending per se, but providing assistance to solving balance of payments crisis of member countries. As we know, the Fund is an institution in a class of its own, so no comparison is fully warranted, but if we were to make financing comparisons, MDBs would be a more pertinent benchmark.

10. **We agree to continue with the normal two-year review cycle.** As in the previous cycle, we welcome an interim review if warranted, mainly due to substantial departure from the assumptions and risks embedded in the current review.