



What's the Best Way to Bolster the IMF's Capacity to Lend to Low-Income Countries?

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Abstract

The IMF's concessional lending to low-income countries through its Poverty Reduction and Growth Trust (PRGT) has risen dramatically since the start of the pandemic and demand for the PRGT resources is expected to remain above pre-pandemic levels for quite some time. But the surge in lending has strained the PRGT's finances—loan resources have dwindled, subsidy costs have risen sharply, and reserves need bolstering. Projections show the risks to PRGT financing are accentuated given the Russian invasion of Ukraine and rising global interest rates. A multi-pronged decade-long effort is needed to ensure sound PRGT financing: (1) reinforce current fundraising efforts for loan and subsidy resources; (2) promote the use of the PRGT's deposit investment account; (3) terminate the reimbursement of PRGT administrative resources to the IMF's General Resources Account and (4) begin a discussion on IMF gold sales to take place in the out years. Each prong of the effort should start immediately, given the time lags involved in reaching consensus and implementation.

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Foreword

Over the past few years, the global financial community has focused on mobilizing resources to help vulnerable countries impacted by the economic fallout first from the COVID19 crisis and now from the Russian invasion of Ukraine. The IMF was quick to step up with support for low-income countries by ramping up loans from the Poverty Reduction and Growth Trust (PRGT). But the high demand for resources has now put at risk the longevity of the PRGT, which has been redesigned before COVID19 to be self-sustaining. More resources will be needed to allow the PRGT to serve vulnerable low-income countries on a continuing basis but given the fiscal constraints that IMF member countries are facing, these resources will be hard to find.

In this paper, David Andrews explains the serious constraints that the PRGT is under and underscores that the risks are heightened by the current global situation. He puts forward a four-pronged strategy to restore the self-sustaining nature of the PRGT in a way that would minimize budgetary costs to PRGT contributors. But work on each of the four prongs must begin immediately and proceed in parallel if the IMF is to retain its capacity to help the poorest of its member countries over the long term.

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Introduction

The IMF's concessional lending to low-income countries (LICs) through its Poverty Reduction and Growth Trust (PRGT) has risen dramatically since the start of the pandemic. The scale and speed of this response provided essential and timely support to LICs. The PRGT's need for additional resources to lend also saw its emergence, together with the IMF's new **Resilience and Sustainability Trust**, as a primary vehicle for rich countries to recycle or channel their excess SDR holdings to where they are most needed. The PRGT has so far been able to cover the subsidy costs of this significantly increased concessional lending, but its current resources will not sustain these lending levels over the long term, especially if the economic impact of the Russian invasion of Ukraine is prolonged. This note considers possible financing options. Recognizing the likely constraints on donor financing and the complexities that may preclude IMF gold sales as a funding source, the note makes a case for alternative approaches. We begin by looking at the lending response so far and the steps that have been taken to address subsidy needs. The IMF recognizes that more will likely be needed. Before assessing the pros and cons of various options, we also consider the uncertain scale of these financing needs.

The scale and speed of the initial response were impressive

The IMF responded rapidly to support its low-income member countries in the wake of the covid pandemic, massively increasing financing under the PRGT. Annual commitments under the PRGT, which provides subsidized 10-year loans to LICs, surged from an average of just over SDR 1 billion per year in the previous decade to SDR 6.5 billion in 2020. This was mostly emergency financing (under the PRGT's Rapid Credit Facility), disbursed in one shot without conditions. In 2021 PRGT support reverted to the early norm of three-year arrangements – with phased disbursements subject to program conditionality – but commitments again exceeded SDR 6 billion. By the end of 2021, new concessional financing had been approved for three-quarters of the 69 countries eligible to draw from the PRGT.

Demand for financing from the PRGT is expected to remain well above pre-pandemic levels for some time. The baseline scenario in the IMF's recent paper on the **PRGT finances** suggests further new commitments averaging SDR 3 billion a year in 2022–24, or still more than 2½ times their pre-pandemic level. If lending continues at this pace, the stock of PRGT credit outstanding would reach over SDR 21 billion in 2025, or more than three times its level before the pandemic.

This higher lending, coupled with the SDR allocation, is providing essential support to LICs in the pandemic. As a group, LICs suffered their sharpest decline in average per capita income in recent decades. LICs in Sub-Saharan Africa – comprising more than half of the PRGT eligible countries – saw per capita income decline in 2020 after two decades of growth averaging 3 percent. This severe

setback included an [estimated increase in the global population in extreme poverty](#) of close to 100 million in 2020, and the World Bank expects to see a further increase in poverty in LICs when data are available for 2021. At a macroeconomic level, it is also striking that even with the large-scale PRGT financing noted above and the allocation of over SDR 15 billion to LICS in August 2021—both of which, in the first instance, added directly to each country's gross international reserves—the average reserve cover for LICs in SSA was *lower* at end-2021 (2.7 months of imports) than at end-2019 (3 months).

But the surge in lending has strained the PRGT's finances

The PRGT is distinct from the IMF's much larger quota-based lending operations on its main balance sheet (**the General Resources Account or GRA**). The resources it lends to LICs are borrowed from its richer member countries under voluntary agreements. Lenders are paid the SDR interest rate, but borrowers from the PRGT pay a subsidized rate – currently zero and never more than 0.5 percent. The PRGT's subsidy and reserve accounts cover these subsidy costs, and the reserve account also provides additional security to lenders; its resources can be used to repay loans if repayments by LIC borrowers are delayed. (A fuller description of this structure can be found [here](#)). The sharp rise in lending has put stress on all aspects of this structure – loan and subsidy resources and the coverage of the reserve account.

As PRGT lending surged, loan resources dwindled. However, this constraint was rapidly eased as richer countries agreed to lend more. An initial request in April 2020 resulted in new lending commitments of almost SDR 17 billion from 16 countries. (This included commitments to recycle additional SDRs, even before the new allocation in August 2021). Coupled with a further SDR 12.5 billion that was requested under the second round of funding launched in mid-2021, the PRGT should have sufficient loan resources—even if demand were to remain at SDR 6 billion per year through 2024 rather than fall back to the SDR 3 billion a year assumed in the baseline scenario.

Subsidy costs have also risen sharply. It might seem paradoxical that subsidy costs would be a concern when interest rates are still near historic lows. Indeed, for much of 2020 and 2021, the SDR interest rate was just 0.05 percent, so actual subsidy payments in this period would have been negligible. However, loan approval is also, in effect, a commitment to pay subsidies throughout the life of a 10-year PRGT loan, and it is, therefore, the future path of rates that determines the total subsidy cost. The surge in loan commitments since the start of the pandemic has already entailed future subsidy costs that are estimated to be much higher than before the pandemic, even if interest rates only gradually increase. Fortunately, the PRGT's subsidy and reserve accounts are large enough to cover the subsidy costs of lending at elevated levels for some years—but there are limits to this process, and restoring the future lending capacity of the PRGT will ultimately require a large injection of new subsidy resources.

Before the pandemic, the PRGT was “self-sustaining” but will now need an injection of money.

The PRGT's reserve and subsidy accounts (effectively an endowment) could generate enough income to cover the expected subsidy costs of lending commitments averaging SDR 1.4 billion per annum over the long term (if not in perpetuity). This annual level of commitments was expected to be sufficient to meet the long-term needs of LICs. But clearly, lending since the pandemic has far exceeded these levels. The IMF's baseline projection implies that commitments in the five years from the start of the pandemic (2020–24) will be about SDR 21.5 billion, or about three times the level that could be accommodated in this self-sustaining framework. *The fundraising effort launched in July 2021 seeks a total of SDR 2.8 billion to meet these additional subsidy costs and raise the sustainable lending capacity of the PRGT from SDR 1.4 billion before the pandemic to an average of SDR 1.65 billion per annum from 2025.* (See Box 1 for the author's explanation of these calculations and the self-sustained lending capacity of the PRGT)

BOX 1. The estimated costs of restoring and raising the PRGT's lending capacity

Restoring the PRGT's annual lending capacity to SDR 1.4 billion will cost about SDR 1.7 billion.

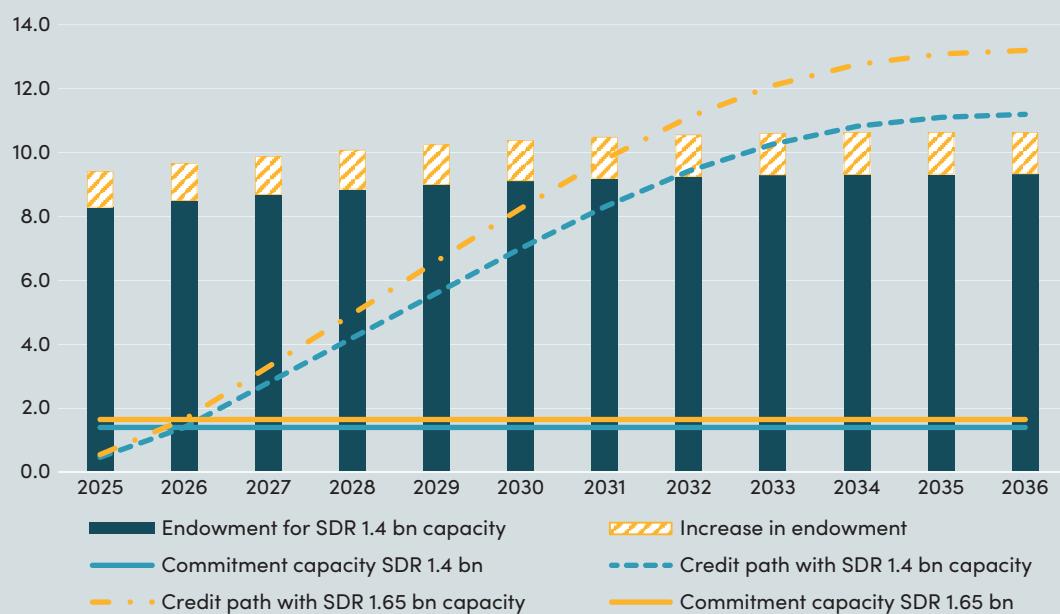
PRGT lending commitments are expected to total SDR 21.5 billion over the five years 2020–2024. Before the pandemic, the self-sustainable lending capacity was estimated at SDR 1.4 billion a year, so for the five-year period, commitments would be SDR 14.5 billion higher than could be covered by the income from the endowment without reducing future lending capacity. Assuming the SDR interest rate averages about 1.5 percent while these loans are outstanding, these commitments imply additional subsidy costs of about SDR 220 million a year, or a total of around SDR 1.7 billion, given the average maturity of PRGT loans of about 7½ years.

The self-sustained capacity of the PRGT is related to the size of the endowment, the rate of return it generates, and the interest rate paid to lenders. After the injection described above, the annual lending capacity would, on the assumptions of the baseline scenario, be restored to SDR 1.4 billion in 2025. Given the average maturity of PRGT loans, this level of annual commitments implies that the stock of new PRGT credit supported by the restored endowment would reach a plateau of about SDR 11 billion after ten years. At this point, the endowment would also peak (at over SDR 9 billion) when the interest it earns (at the SDR interest rate plus the assumed investment premium of 0.9 percent) plus any interest charged to countries borrowing from the PRGT would be just sufficient to cover the SDR interest paid to bilateral lenders on the stock of PRGT credit outstanding and the administrative costs of operating the PRGT.

Increasing the size of the endowment with raise the lending capacity of the PRGT. The chart shows the evolution of the credit stock and the endowment assuming annual commitments of SDR 1.4 billion (in blue) and the path of the same variables assuming annual commitments of SDR 1.65 billion (in red). In the latter case, the credit stock would peak at about SDR 13 billion. In both cases, the SDR interest rate is assumed to average 2.5 percent, which also means that borrowers from the PRGT would pay 0.5 percent per annum. The administrative costs of the PRGT are

assumed to average SDR 65 million per year. Under these assumptions, the endowment needs to be about SDR 1.3 billion larger in 2035/6 to generate enough income to cover costs. However, the injection of funds in 2025 can be smaller – about SDR 1.1 billion. It takes approximately ten years for the increase in annual commitments to be fully reflected in the stock of credit, and during this period, the endowment's income will more than cover subsidy costs, allowing the endowment to grow to the required level in 2035/6. The bottom line is that, on these assumptions, raising the annual commitment capacity by SDR 250 million (to SDR 1.65 billion) requires an injection of grants into the endowment in 2025 of SDR 1.1 billion or roughly 4½ times larger than the resulting increase in the self-sustained capacity.

FIGURE 1. PRGT: commitment capacity, credit stocks and endowment size, in billions of SDRs



This estimate of the cost of raising the capacity of the PRGT is not very sensitive to changes in the SDR interest rate. As is clear from the chart, the endowment is not much smaller than the stock of credit, and this means that when the SDR interest rate rises, the income from the endowment rises by almost as much as the higher interest payments to lenders to the PRGT. (If the SDR rate were to average 3.5 percent from 2025 rather than 2.5 percent as assumed above, the required injection to the endowment would be only SDR 0.1 billion or 8 percent high).

The cost is, however, sensitive to changes in the administrative costs paid by the PRGT. For example, increasing these costs by just 10 percent raises the cost of increasing the capacity to SDR 1.65 billion by over 15 percent. In this connection, it is notable that IMF's estimates of the PRGT's future lending capacity assume that these administrative costs are stable at SDR 65 million after 2025; in contrast, the suspension of reimbursement of these administrative costs for five years (discussed below) is estimated to provide savings of SDR 0.5 billion for the PRGT.

This injection of funds is also needed to bolster PRGT reserves. While both the subsidy and reserve accounts generate income to meet subsidy costs, the reserve account can also be used to repay lenders if borrowers fall into arrears. Until recently, the reserve account was at least 40 percent of the stock of PRGT credit outstanding, thus providing a strong assurance that lenders could be repaid even in the event of large-scale arrears. But by end-2021 this coverage ratio had fallen sharply to below 30 percent and, in the absence of new resources to bolster reserves, it would fall close to 20 percent in 2024. This low level of reserve cover could then call into question whether there were adequate safeguards for the PRGT in meeting LICs' needs, especially if these exceed the baseline scenario through 2024.¹

The structure of the financing package increases reserves and subsidy resources, drawing on contributions from donors and the IMF itself. The total requested financing of SDR 2.8 billion envisages member-country contributions of SDR 2.3 billion, some of which would accrue to a newly created Subsidy Reserve Account. As its name suggests, this would bolster subsidy resources and at the same time provide an additional reserve that could be drawn upon to repay lenders. The financing package also includes SDR 0.5 billion of so-called "internal resources". Under the PRGT's self-sustaining framework, income generated by the endowment is intended to cover the administrative costs (mainly staff costs) of running the PRGT as well as the cost of subsidizing PRGT loans. In line with this principle, the reserve account usually reimburses the IMF administrative budget (or strictly speaking the General Resources Account) for these annual costs of running the PRGT. In July 2021 this reimbursement was suspended for five years – this will save the PRGT an estimated SDR 0.5 billion that would have been debited from the reserve account – thus constituting the IMF's contribution.

Subsidy needs are likely to increase beyond those now envisaged by the IMF

The funding target of SDR 2.8 billion is a first step. Recognizing there are many uncertainties in the future financing needs of the PRGT, the IMF laid out a two-stage strategy. Before the first round of funding is completed in 2024, there will be a further assessment of the long-term financing needs of the PRGT and, if needed, a second stage would be launched. This could include further use of internal resources such as gold sales to provide for a larger endowment. But before turning to these possible options, we discuss a range of factors that suggest that the financing needs of the PRGT could be higher than envisaged in the first stage of the financing strategy.

Subsidy costs will increase if interest rates rise more sharply. The recent steps to tighten monetary policy in the US, UK, and the Euro area had already brought the SDR interest rate to just over

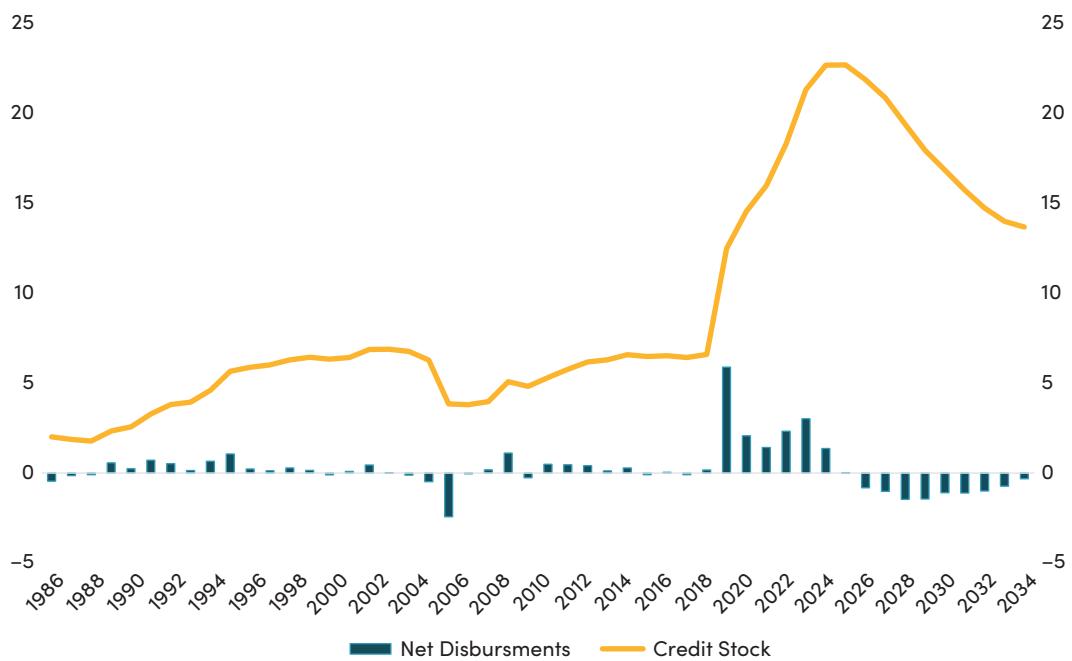
¹ In the April discussion of the 2022 Review of Adequacy of Poverty Reduction and Growth Trust Finances, the Board welcomed assurances that they would be notified if the reserve coverage ratio was projected to fall below 20 percent.

2 percent in late September 2022. The persistence of inflation also suggests that policy rates – which are closely related to the 3-month interest rates from which the SDR interest rate is calculated – are likely to continue to rise more steeply than envisaged earlier. All of which makes it very likely that the average SDR interest rate will exceed the range of 1.5 to 2 percent, which appears to underlie the estimated financing need of SDR 2.8 billion. An increase in the average SDR interest rate of 0.5 percent over the life of the loans would raise the interest paid to lenders by about SDR 0.5 billion.

The demand for PRGT financing may also be higher in the short term. The baseline scenario underpinning the first stage of fundraising assumes, as noted that the demand for PRGT financing falls back to an average of SDR 3 billion per annum for the three years 2022–24. This would still be high by historical standards. However, the pressures on LICs are now being compounded by the war in Ukraine, including its direct impact on fuel and grain prices and its adverse impact on global growth. Demand for PRGT financing could well exceed this baseline of SDR 3 billion per annum; in the first eight months of 2022, new commitments to just seven countries totaled over SDR 3 billion. Increased lending to address food insecurity – including through a possible new window of emergency financing as is now being considered by the IMF – could further increase demand for PRGT financing. The IMF's high case scenario in which commitments stay at SDR 6 billion per year through 2024 does not appear so extreme. And if this were to materialize, the additional subsidy costs – beyond the amount covered by the SDR 2.8 billion – were estimated by the IMF at about SDR 1.6 billion.

Higher PRGT repayments will begin to fall due in 2025, which may exacerbate sustainability problems for many LICs. The surge in lending in the pandemic will be echoed by a surge in repayments. In the decade before the pandemic, repayments averaged well under SDR 1 billion – slightly less than disbursements, so the credit stock increased gradually. But in 2025, repayments will begin to increase and, even under the baseline scenario, peak at over SDR 3 billion at the turn of the decade. After 2024, PRGT lending is assumed in the baseline to fall back to about SDR 1.7 billion a year – possibly marking a return to the earlier self-sustained model with somewhat higher capacity made possible by the fundraising efforts. A decline in PRGT lending to about SDR 1.7 billion a year from 2025 onwards would therefore entail a large and sustained net withdrawal of financing from LICs. In the ten-year period beginning in 2025, total net repayments by PRGT borrowers would be close to SDR 9 billion, bringing the stock of PRGT credit down to about SDR 13 billion. As is clear from the chart below, sustained net repayments on this scale would be unprecedented. Since the mid-1980s, when the ESAF (the precursor of the PRGT) began operations, the credit stock has typically trended upwards. The only exception to this pattern was in 2005/6 when the stock of credit fell by about 40 percent. But the corresponding “repayments” (in the lower bar chart) reflected debt cancellation financed under the Multilateral Debt Relief Initiative.

FIGURE 2. PRGT credit outstanding and net disbursements (+) or repayments (-), in billions of SDRs



Some LICs should have no difficulty making net repayments to the PRGT. But more than half of the stock of PRGT credit outstanding at the end-2021 was to countries that were assessed by the IMF to be in, or at high risk of, debt distress. Resolution of their debt difficulties will not be a rapid process. For some, the Common Framework – which is now being applied for the first time – may ultimately provide a resolution.

So, successor PRGT arrangements are likely to be needed to provide a supportive policy framework and continued financial support. As a result, prolonged high demand for financing by the PRGT will result in the stock of PRGT credit staying higher for longer, and coupled with higher interest rates, this suggests that the subsidy needs of the PRGT over the medium term could be significantly higher.

These considerations suggest that a post-pandemic self-sustained lending capacity of SDR 1.65 billion – as currently envisaged – may not be adequate. It may seem odd that the *long-term* lending capacity of the PRGT is defined in *nominal* terms – the capacity of the PRGT to support the average LIC will be eroded over time, as nominal financing needs (in dollar or SDR terms) rise with global inflation. But over the longer term, the number of LICs requiring support from the PRGT is also expected to decline as increases in per capita income and greater sustainable access to private capital allow countries not facing serious short-term vulnerabilities to “graduate” from PRGT eligibility. Whether the pace of graduation is adequate to offset the impact of inflation will always be a question of judgment. Recent developments have adversely affected this balance from both sides. Inflation is significantly higher and may remain so for some time. In addition, the severe setbacks that LICs have experienced through the pandemic are likely to slow the pace of graduation from

the PRGT. While the magnitude of this impact is not easy to quantify, the direction is clear: a larger self-sustained capacity is needed.

A larger long-term capacity would also provide a buffer to allow the PRGT to respond to future emergencies without depleting its capacity. Climate change is very likely to increase the frequency and magnitude of adverse shocks requiring immediate support. And while the RST is intended to help countries build resilience to climate change over the longer term, and strengthen pandemic preparedness, it is unrealistic to expect it to eliminate the impact of these shocks. This reality is also implicit in the design of the RST which, in all cases, would operate alongside a PRGT or GRA arrangement. The PRGT is thus likely to remain essential to meeting balance of payments needs, including those driven by the adverse effects of climate change. This should not, however, be seen as expanding the purposes of PRGT. As in the past, the PRGT would be meeting the BOP needs of countries with “protracted balance of payments problems” some of which will have been exacerbated by climate change. However, the longer (20-year) maturity of RST loans is an attractive feature that makes them more suited to the long-term challenges confronting many LICs. In this vein – and given the inherent difficulties of distinguishing between financing needs linked to climate change and other BOP needs of LICs – the RST may over time fill some of the financing needs PRGT would have met. This may ultimately mean that the capacity of the PRGT could be scaled back – an issue we return to later.

Where will additional PRGT financing come from?

All the considerations above point to the need for a larger PRGT and more subsidy and reserve resources. Thus, the immediate funding target of SDR 2.8 billion that the IMF has set is likely to be just a first urgent step to ensure that the PRGT has adequate reserves to respond to elevated demand in the short term. Under some plausible scenarios, the additional financing needs of the PRGT in a second round of financing could be as high as SDR 3 billion. For example, high demand for PRGT financing in the next three years (as a result of the war in Ukraine, a global economic slowdown, and further tightening of LICs’ already limited access to capital markets) could add SDR 1.6 billion; interest rates that are 0.5 percent higher than the Fund’s baseline projection could raise the cost of the PRGT’s subsidies by up to SDR 0.5 billion; and if it becomes clearer that the PRGT’s lending capacity over the longer term needs to be larger than the proposed SDR 1.65 billion (say SDR 1.8 billion or higher) this could add another SDR 0.7 billion. Where are these resources likely to come from? The discussion that follows focuses on two broad sets of options for additional financing: contributions from IMF member countries and various internal fund resources.

Direct contributions from IMF member countries

The first phase of fund-raising envisages donations of SDR 2.3 billion from member countries, but progress has been slow. Nine months after the fundraising campaign was launched, pledges

had been received for less than a quarter of this amount from 14 of 61 economically stronger countries from which contributions were sought. Given the pressures on aid budgets, this is perhaps not surprising. The amount sought is also relatively large in relation to past fund-raising. Since the start of the PRGT (formerly the ESAF), subsidy contributions have totaled SDR 6.8 billion. However, excluding amounts that were in effect financed from gold sales (distributions that were returned to the PRGT) donor contributions over this more than 30-year period were about SDR 3.2 billion. In a similar vein, it is notable that the recently created RST was designed to minimize the budgetary contributions needed for it to begin operations. *Against this background, it may not be prudent to expect a large proportion of any additional financing need to be met by conventional donor contributions.*

Internal IMF resources

Sales of IMF gold could meet the needs of the PRGT but there are significant obstacles. The market value of the IMF's gold of SDR 118 billion (US\$154 billion) greatly exceeds its book value of just over SDR 3 billion and it is certainly possible for the IMF to sell gold to unlock some of this value. Indeed, the PRGT's reserve account has been largely funded through past gold sales. As explained in an earlier [blog](#), gold sales require the support of 85 percent of the IMF's Executive Board. United States' support, which in turn requires congressional backing, would be needed to meet this high threshold. Building a sufficient majority in support of sales could also be more difficult than in the past given the roles of China and Russia, who are the two largest gold producers and together account for 9 percent of votes on the Executive Board. Reaching an early consensus on gold sales could also be complicated by the 16th quota review which is now underway. More generally, the IMF's gold is seen as providing fundamental strength to the IMF's balance sheet. As such it serves as an ultimate backstop to the IMF's unique financing mechanism, allowing central banks to carry at full value on their balance sheets their quota and loan resources that the IMF intermediates to countries in economic distress. None of this precludes gold sales, but a consensus for sales would need to be built against the backdrop of near-record levels of IMF lending: GRA credit outstanding is now over SDR 90 billion and total GRA commitments are over SDR 183 billion. In contrast, the previous round of gold sales, which also provided support for the PRGT, was geared toward establishing an endowment to support the institution's administrative budget at a time when IMF lending – and thus credit risks on its balance sheet – were running at very low levels.

The long lead time to derive profits from potential gold sales is a further complication. Approval of gold sales would also require assuaging concerns over potential gold market disruption. Since global gold stocks (above ground) are vast in relation to annual production, the market price can be very sensitive to changes, or expected changes, in official holdings. Avoiding disruption is an important facet of the IMF's policy on gold sales and concerns over such disruption may now be felt more broadly; for example, African gold mining output has risen by nearly 60 percent since 2010 and now accounts for 27 percent of the global total. One consequence of this is that sales would need

to be carefully phased and, if possible, coordinated with other expected official trades. Coupled with the time needed to obtain support for gold sales, this implies a lag of several years from initial consideration of sales to eventual funding of the PRGT. We return to this issue later.

The IMF could, in principle, use some of the (non-gold) reserves on its main balance sheet. Like gold sales, the use of reserves is one of the options that the IMF has indicated that it will consider for a second round of fund-raising. But, here again, there are practical and technical difficulties. The technical considerations mirror those that were noted above on gold's role in providing strength to the balance sheet. These reserves (precautionary balances in the IMF's terminology) also provide an important buffer against credit risks, helping to ensure that central banks can continue to count as liquid international reserves the quota and loan resources that they provide to the IMF in meeting its function as the international lender of last resort. But unlike gold holdings, these reserves are fully available on the balance sheet and thus provide a more immediate, though considerably smaller, line of defense. The most recent review (at the end-2021) of the adequacy of these precautionary balances maintained a target of SDR 25 billion (now at SDR 21 billion), with the expectation that this could be reached in about three years. But unless IMF lending falls back sharply—which seems unlikely in the near term—maintaining these reserves to ensure the integrity of the IMF's GRA financing mechanism is likely to be seen as a priority for the institution. In this context, it is also worth noting that the IMF can typically only add to its reserves from the interest that it charges when lending – that is when it is facing greater risks. One implication of this is that shareholders would need to be confident that any potential use of reserves left an adequate financial buffer for future periods of high lending.

Reserves cannot be used directly to support the PRGT. The IMF's Articles of Agreement provide for distributions of reserves to member countries but do not allow for direct transfers to entities such as the PRGT. Approval of a distribution has a lower threshold – a 70 percent majority is required rather than 85 percent for gold sales. But the recipients would be free to use these funds, distributed pro-rata to quota shares, as they wished. Approval of the distribution could be made conditional on a high level of commitments to return these funds to the PRGT. This has been done in the past, but this experience suggests that a “loss” of at least 10 percent is likely. The requirement that all member countries receive part of the distribution could also complicate the approval process, especially in a moment of fractured geopolitics; as in the recent SDR allocation, there may be no way of stopping countries considered by some to be “pariah” states from benefiting from the distribution. The process of obtaining the required approvals would also be time-consuming but once approved the distribution could be conducted much more rapidly than gold sales.

Some promising alternatives

The financing needs of the PRGT are likely to be large but, at this stage, it is unclear just how large. The two-stage funding strategy that the IMF has set out recognizes this uncertainty. Given the

constraints on contributions from member countries – which would be competing with other aid priorities – attention would naturally be focused on deploying either IMF gold or reserves to meet the PRGT's needs. But given the uncertain prospects for unlocking these potential sources of financing other options are needed, two promising avenues remain: the use of SDR deposits by donors and terminating reimbursement of the PRGT administrative costs.

SDR deposits by donors

As an alternative to budgeted donations, countries can lend some of their SDRs to generate income from low-risk investments. As noted above, donors are hesitant in donating budgetary resources to the PRGT in the amounts needed. An alternative is for them to recycle excess SDRs to the PRGT, which would then be invested. They could generate a premium of some 50 basis points over the SDR interest rate paid to lenders. These excess returns would accrue to the subsidy account. This approach has already been recognized by the IMF as a source of funding for the PRGT and now the RST. The liquidity and low risks of these holdings would also preserve their reserve asset characteristics – a key prerequisite laid out by the G20 for any recycling of SDRs. Providing subsidy resources to the PRGT in this manner would also typically not require a budget appropriation or be considered as part of government spending. This modality also has the advantage that it could in principle be put in place rapidly to begin generating subsidies and is suitably flexible in the face of uncertain financing needs—recycled SDRs could revert to the donors if subsidy needs turned out to be lower than envisaged.

Central banks may be hesitant to engage in such lending depending on how the recycled SDRs are converted to usable currencies for investment. SDRs cannot be invested in market instruments so any SDR deposits would need to be converted into freely usable currencies before they are invested. If these conversions are carried out by the countries providing the SDR deposits, this implies that they are effectively lending part of their *non-SDR* reserves to the PRGT. The opportunity cost of lending to the PRGT is then the income that could have been earned through investing hard currencies, which is potentially higher than the SDR interest rate that they would be paid on their deposits. The central banks providing the deposits would also need to be comfortable with a shift in the composition of their international reserves out of freely usable currencies and into SDRs. For relatively modest deposits, these issues may not be of concern, but they may preclude the use of this option on a much larger scale.

Recycling SDRs in this manner would be a useful supplement to direct budgetary contributions.

Very large deposits would be needed if the objective was to quickly generate income to supplement the PRGT's endowment: deposits of SDR 10 billion would be needed to earn an expected \$50 million a year on average, so even with the benefit of subsequent interest earned on these annual gains, it would take 9 years to build up subsidy resources of SDR 0.5 billion. However, as we explain below, relatively modest amounts could be significant in bolstering the PRGT's lending capacity. This would require contributors to place very long-term deposits so that the PRGT could be assured

of the projected income flows, and the liquidity of these claims would need to be supported by an encashment regime.

PRGT Administrative Cost Reimbursement should be terminated

As noted earlier, the first phase of fundraising includes the suspension of reimbursement to the GRA for the administrative costs of running the PRGT, including staff costs. This will provide savings to the PRGT – which would otherwise be paid from the investment income generated by the Reserve Account resources—of about SDR 0.5 billion through 2025/26. Under the framework approved for the self-sustaining PRGT, reimbursement can be (temporarily) suspended if the PRGT lacks adequate subsidy resources and while additional financing is being sought.

The requirement that the PRGT covers its administrative costs places a significant burden on its finances. The current PRGT cost estimates assume that reimbursement begins again in 2025. If reimbursement did not resume, the self-sustained capacity would be significantly higher. On the baseline assumptions and after successful completion of the first round of fundraising, capacity would rise to SDR 1.65 billion a year. But on the same assumptions, but with reimbursement permanently halted, lending capacity would rise to about SDR 2 billion per year. Ending reimbursement would allow the endowment to increase and all the income generated by this larger endowment would be available to subsidize lending. Conversely, if reimbursement were SDR 100 million a year (a roughly 50 percent increase over the assumed payments of SDR 65 million a year) this would reduce capacity to SDR 1.4 billion (its pre-pandemic level before the new financing).

The requirement that the PRGT reimburse the GRA for its operating costs reflects in part policy considerations. Reimbursement was an integral part of the IMF's new income model approved in 2008 and was based on the principle that the GRA should not cross-subsidize the PRGT's activities. In addition, borrowers from the GRA pay a margin over the SDR interest rate that is intended to cover the operating costs of these lending operations and thus PRGT lending operations costs should be covered. In contrast, the bulk of the IMF's other activities, such as surveillance, are considered public goods and therefore not subject to any form of user charge.

This policy is open to challenge on both practical and conceptual grounds. The new income model was adopted to provide support for the IMF's administrative budget when income had fallen sharply and, against this background, reimbursement of the GRA by the PRGT was also seen as necessary to support this budget over the long term. But in the intervening years, high levels of IMF lending have dramatically changed his budget outlook; reimbursement of the GRA would contribute only modestly to the large surpluses that continue to accumulate, allowing the institution to build its reserves. From a different perspective, if the finances of the PRGT were ultimately to be bolstered by gold sales or the use of reserves – both of which are on the GRA balance sheet – this would amount to a very large element of cross-subsidization. Moreover, if reserves were ultimately to be the source of financing, this process would involve costs and losses that can be avoided by simply

ending reimbursement. The PRGT's reserve account is expected to earn a premium of 90 basis points (0.9 percent) over the SDR interest rate. But after the PRGT reimburses the GRA, thus adding to the GRA's reserves, these resources are invested under the more conservative (fixed income) mandate that aims to achieve a premium of only 50 basis points (0.5 percent) over the SDR interest rate. In addition, as noted above, any use of GRA reserves to bolster the PRGT is likely to entail a loss (as not all IMF members will be willing to direct their shares of a distribution of reserves to the PRGT). It would therefore be more efficient to retain the reimbursable amounts in the PRGT and avoid the losses arising from transfers to the GRA and back to the PRGT.

In addition to these practical considerations, the public good nature of PRGT lending also provides a rationale for ending reimbursement. The distinction between public goods and other IMF activities has always been somewhat tenuous. There is, for example, a clear public good aspect to lending operations in the GRA which, in addition to providing support to individual countries, serve to lessen the risks of financial contagion. The public good aspects of PRGT lending have been evident during the pandemic. More generally, the PRGT's role in providing sustained support for macroeconomic policies in LICs to foster growth and poverty reduction provides a global benefit. In any case, the costs of operating the PRGT could still be tracked to provide an accounting of the costs of providing this public good.

Even if the policy arguments for ending reimbursement are compelling, there may still be a legal obstacle to overcome. The PRGT's endowment was in part funded with resources from the IMF's Special Disbursement Account (SDA) which derived from gold sales profits. According to the IMF Articles of Agreement² the GRA must be reimbursed for expenses in administering resources of the SDA; this has been interpreted to include SDA resources in the PRGT. However, reimbursement has been suspended because "reimbursable expenses only arise if PRGT loan disbursements are funded with SDA resources, and that absent such use, the IMF may decide that the GRA bear the cost of the PRGT." Under the current financial structure loan resources are provided by lenders and not the SDA, so the question is if this arrangement can be made permanent. A review of the reimbursement practices under various trusts funded with SDA resources is underway.³

Combining these two sources is the best strategy

The combination of ending a requirement to reimburse the GRA and subsidy income from SDR deposits could significantly raise the PRGT's lending capacity. As noted above, if the first round of fund-raising was completed successfully, leaving a self-sustained lending capacity of SDR 1.65 billion, this could be raised to SDR 2 billion by permanently ending reimbursement of the GRA. In a more adverse scenario, in which the first phase of fund-raising yielded its target of SDR 2.8 billion, but all of this was required to meet the higher costs of lending through 2024 (either because of higher

2 Article V, Section 12(i).

3 See Annex 7, 2022 Review of Adequacy of Poverty Reduction and Growth Trust Finances.

interest rates or high lending than assumed in the baseline) this would not leave resources available to raise the future capacity above SDR 1.4 billion. In this case, ending reimbursement would bolster the lending capacity to about SDR 1.8 billion. If reimbursement could not be ended, deposits of SDR 10 billion, earning a premium of 0.5 percent, could cover most of the reimbursement costs of SDR 65 million, to achieve lending capacity of about SDR 1.7 billion a year. A combination of ending reimbursement and subsidy income from deposits of SDR 10 billion could raise the future lending capacity to over SDR 2 billion per year.

This combination may also be better suited to the current uncertainties. The scaling up of PRGT capacity described above could also be reversed if PRGT demand subsequently moderated, for example, as a result of countries turning to the longer-term financing offered by the RST. In contrast, gold sales would need to be planned well in advance and with little flexibility to change the financing envisaged.

A multi-pronged, multi-year strategy needs to start now

A multipronged effort is needed to ensure that the PRGT will meet the needs of LICs over the next decade:

1. Reinforce the effort to mobilize SDR 12.5 billion of recycled SDRs for the PRGT loan account and SDR 2.8 billion for the subsidy and reserve accounts. Without these funds, the PRGT is in danger in the immediate future.
2. Publicize the PRGT's Deposit and Investment Account and urge donors to loan SDRs to it as part of their reserves management strategy. Set a target for fundraising over the next 5 years. This will help fill the temporary gaps that may result from fluctuating demand.
3. Begin discussions on terminating the reimbursement of PRGT administrative costs to the GRA beyond 2025/26, taking account of any legal constraints posed by the SDA.
4. Begin discussion on possible gold sales to take place in the out years when the longer-term projections for support from the PRGT have settled down.

Each prong of the effort should start immediately, given the immediate needs of the PRGT and the time it will take to reach a Board consensus on moving forward. Delaying any component risk jeopardizing the viability of the PRGT beyond 2025.