IMF Surcharges Punish Developing Countries

The current IMF's surcharges mechanism is regressive, procyclical, discriminatory against developing countries, and in violation of international human rights. Developing countries that need to incur more debt – as a consequence of a global crisis beyond their control – are being fined and are paying more money that they do not have.

The IMF knows that financial resources save lives. To tackle the pandemic, the IMF has approved 119 programmes in 85 countries at a cost of over USD 100 billion. While the IMF continues to deny its human rights obligations, the funds provided to date have been important in enabling states to try to fulfil their international human rights obligations, including the right to life, health, food and social protection. While much needed, this assistance falls far short of the USD$2.5 trillion pre-pandemic financing gap facing lower income countries identified by both the IMF and UNCTAD, with the OECD calculating that the pandemic has added an additional USD$1.7 trillion to the pre-pandemic figure.

Yet, the same countries most in need of financial assistance will have to pay more than USD$4 billion in additional surcharges on top of interest payments and other fees from the beginning of the crisis to the end of 2022. These extra charges are the IMF's largest source of revenue and account for almost half of the income during 2020-2022. Trying to help countries while penalising them for their need is not a coherent strategy and is inconsistent with human rights duties of international cooperation and assistance.

The surcharge works in two ways. One is related to the size of the loan (level basis) and the other is related to its length (time basis). Level base additional charges have been set to 200 basis points with over 187.5% unpaid credit in each country allotted IMF quota. Countries in most financial need have rather minimum quota participation. And depending on the structure of the program, if IMF credits are unpaid for 36 to 51 months or more, the additional time-based fee will be an additional 100 basis points. These extra charges can often lead to triple debt costs. This is a conspicuously lucrative business model for a non-profit organization.

The IMF practice of adding surcharges of 2-3 per cent based on how long payments of a certain amount are overdue is discriminatory, since typically developing countries, many of which already face unstainable debt levels, are burdened with these surcharges. In times of near-zero or even negative interest rates, these surcharges – which are not market driven and depend solely on the IMF's decisions – are strikingly high. They are not a tool to accelerate payment but act as a sanction for being poor, thus driving these debtor countries further into debt. As they do not help protect the IMF's investment, their existence is even less justified.

In the current pandemic context, surcharges aggravate the financial vulnerabilities that precisely lead those same countries to request financial assistance from the IMF. Under these circumstances countries need larger loans and longer repayment periods, but this leads to much higher costs. Surcharges create the wrong incentives for sovereign clients: being too shy when borrowing and being overoptimistic when promising when and how the loans will be repaid. This results in a regressive, procyclical and discriminatory mechanism against those countries most in need of financial help to save lives.

In reality, surcharges are providing incentives to limit demand for IMF assistance and encourage early repayment. This further contributes to the already deep divide in response capacity, with the IMF urging Global North countries to spend as much as they can while low and middle countries continue to suffer from lack of necessary fiscal space to meet their international human rights obligations by undertaking the necessary health and social spending demanded by the pandemic.

Discrimination against States–not treating them equally without a legitimate reason–is not permissible under international law. The Declaration on Principles of International Law Concerning Friendly Relations and Cooperation Among States in Accordance with the Charter of the United Nations stated already in 1970 that "[a]ll States enjoy sovereign equality. They have equal rights and duties and are equal members of the international community, *notwithstanding differences of an economic*, social, political or other nature."

According to the International Covenant on Economic, Social and Cultural Rights (Art.2), States must generate, adequately allocate and make use of the maximum of their available resources to move as expeditiously and effectively as possible towards the achievement of the full realization of human rights. Accordingly, international financial institutions should ensure that the terms of their transactions do not undermine the borrower State's ability to respect, protect and fulfil its human rights obligations. It is also important to remember that, as the United Nations Guiding Principles on human rights impact assessments of economic reforms establish (Art. 15.3), States cannot escape responsibility for actions or the exercise of functions that they have delegated to international institutions: delegation cannot be used as an excuse to fail to comply with human rights obligations.

The IMF argues that surcharges allow it to play the role of global lender of last resort in times of crisis, strengthening the IMF's financial capacity. This is an admission that middle-income borrowing countries - which are paying the lion's share of surcharges and who have been left out of measures to mitigate debt distress - are *de facto* financing the IMF's operations to help low-income countries. This is nonsensical when the IMF's pandemic support so far is only around 10% of their total capacity, highlighting that surcharges' main impact is to punish poor countries. Indeed, the priority right now should be expanding fiscal space through, for example, a generous allocation of Special Drawing Rights and a more robust and independent workout mechanism to achieve long-term debt sustainability for all countries. Additionally, any arrangements for the reallocation of existing or subsequent SDRs by developed states must ensure the process is totally free to those receiving the reallocation, is as simple as possible, and totally free of conditions which would impede the use of resources in accordance with the perceived needs of the recipient state.

We therefore call on the IMF to immediately suspend the use of surcharges in order to help countries to recover from the recession and to fight the pandemic. Given the current financing arrangements underpinned by the punitive use of surcharges put the onus of resourcing IMF activities on those most in need of external support, there is an urgent need for countries in the Global North to ensure, through their own contributions, that the IMF is adequately and equitably funded to undertake its mandated function. Higher financial burdens will foreclose any chance of economic recovery – which harms everybody, including the IMF - and will lead to further human rights violations worldwide.

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