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Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Special Drawing Rights (SDRs), a Lifeline for the Global South and a Boost to the Global Economy

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Abstract

Multiple ongoing crises highlight the need for a reform of the financial architecture. Developing countries must have access to more resources on better terms, particularly in the case of countries in the midst of a climate emergency with the greatest need for support. One factor that stands out is limited access to concessional financing for low- and middle-income countries. Such countries are facing fiscal problems due to the COVID-19 pandemic and its fallout and must deal with high levels of debt, as well as large increases in interest payments due to the US Federal Reserve rate hikes since March 2022.

Recent issuances of special drawing rights (SDRs) have demonstrated that SDRs are effective in addressing global emergencies and primarily benefit developing countries. As one of the most important alternative financing mechanisms for countries in the Global South, SDR issuances play a crucial role in the international monetary system, allowing countries to access resources without increasing their debt levels or being subject to the imposition of regressive conditionalities (Cashman et al, 2022).

Many developing countries – mostly in sub-Saharan Africa and Latin America and the Caribbean – have benefited from using SDRs, mainly for fiscal support but also to raise foreign exchange and make payments to the International Monetary Fund (IMF). The active use of SDRs for fiscal purposes can boost economic growth, contribute to the guarantee of rights, and reduce inequalities. Such use can also help to reduce the lingering effects of the pandemic and address the need for mitigation and adaptation to the climate crisis.

Advanced economies also benefit from developing countries actively using their recently allocated SDRs. As SDRs are converted into hard currencies, they are predominantly used for importing goods and services, thus benefiting the exports of

advanced economies (Cashman, 2021). They can also free up other liquid international reserves for spending on imports.

Various multilateral and regional forums and spaces, such as the United Nations, African Union, Economic Commission for Latin America and the Caribbean (ECLAC), G-24, and G-77, have been raising the need for new SDR issuances for countries to access liquidity and meet the objectives of financial development (ECLAC and ECA, 2022)

The 2024 G20 summit in Brazil presents an opportunity for this forum to voice its support for a proposal for a new $650 billion allocation of SDRs at the IMF, which will immediately help countries in the Global South invest in achieving the Sustainable Development Goals (SDGs) and addressing the climate emergency.

The G20 should also call for the IMF to revert to the previous version of its statistical recommendations (explained below) on SDR allocation accounting to undo the artificial increases in debt levels and facilitate the fiscal use of SDRs in the Global South and donations of SDRs by advanced economies as an additional source of development financing.

To promote new SDR issuances and changes in SDR accounting, the potential role of the G20 is fundamental, given that its members have significant weight with the IMF (with over 60 percent of quotas and voting power) and any decision made by the IMF is subject to the will of these countries.

Diagnosis of the issue

The climate crisis is intertwined with the debt crisis, which a growing number of Global South countries are experiencing, largely due to external factors such as the COVID-19 pandemic and the accelerated rise in interest rates in major industrial economies. Additionally, despite having contributed less to the current ecological crisis, developing countries are disproportionately exposed to the impacts of climate change and the risks involved in the energy transition. However, climate action financing has been insufficient, mostly coming in the form of more debt. The increasing burden of debt servicing hampers progress on climate action and sustainable development. An allocation of special drawing rights (SDRs) is a unique instrument that could be employed to help address the fiscal, investment and balance of payments needs of Global South countries in the context of these dual crises.

SDRs are an international reserve asset created by the International Monetary Fund (IMF) in 1969. The unit of account value is based on a weighted basket of currencies composed of the US dollar, the Japanese yen, the pound sterling, the euro and the Chinese renminbi. SDRs boost the international reserves of IMF member countries, which can help lower borrowing costs, provide access to more financing, attract foreign investment, help prevent balance of payments and other potential economic crises, and contribute to the purchasing power stability of the national currency. The amended Articles of Agreement of the IMF mandates periodic issuances of SDRs.

To date, the IMF's SDR department has issued five allocations amounting to a total of $935.7 billion. In 2021, the IMF issued SDRs worth $650 billion in response to the pandemic (IMF, 2021). Most of these assets have been held as international reserves.

However, the IMF specifies that members can "sell or use part of their SDR allocations," exchanging them for "freely usable currencies" (IMF, 2021).

SDRs are neither loans nor debt, and they do not have to be repaid to the IMF. However, exchanging them for freely usable currencies incurs a below-market annual interest rate, currently approximately 4 percent (IMF, 2024a).

It has been argued that SDRs are only reserve assets and should be used (exchanged) only in exceptional circumstances for balance of payments purposes and exclusively by central banks. However, it is appropriate to incorporate them into the budget and use them as fiscal resources. The proportion that should be saved or spent should be the sovereign's decision, not a central bank's decision (Arauz, 2021). Even the IMF, in the context of the vaccination and economic recovery needs of emerging and developing countries, noted at the time that "A general allocation of Special Drawing Rights (SDR) [...] should be completed quickly so as to provide liquidity buffers for countries and help them address their essential spending needs" (Gopinath, 2021).

If SDRs are managed only as central bank assets, governments lose the opportunity to use the equivalent amount of SDRs for priority spending (Latindadd,2021). Some countries in Latin America have clearly established institutional ownership of SDRs and made practical use of them. Although SDRs are generally recorded in the reserves of each country, i.e., on the balance sheets of central banks, this does not mean that banks control them given that SDRs are resources that belong to the state as a member of the IMF. Thus, the government of Argentina used its SDRs to, first, increase pandemic-related spending and, then, to extinguish foreign debt payment maturities with the IMF itself (Marchini et al, 2023). Guinea-Bissau, São Tomé and Príncipe, and Senegal used part of their allocations to fund their COVID-19 pandemic response, investing in vaccines and improving health services (IMF, 2023). Ecuador allocated its SDRs to its Ministry of

Economy and Finance for the Ministry's use, although it is difficult to track and identify their end use. Meanwhile, in Paraguay, a law was passed in advance to allocate the SDRs directly to the Ministry of Finance; they were subsequently spent on a social agenda, including specific benefits for women and indigenous peoples (Marchini et al, 2023).

Advanced economies also benefit from developing countries actively using their recently allocated SDRs. As SDRs are drawn down from countries' international reserves, they are predominantly used for importing goods and services, thus benefiting the exports of advanced economies (Cashman, 2021).

Recommendations

In the current context, marked by the climate crisis, the slowdown in economic growth, and the increase in the burden of external debt, a decisive response by the international community is required. Using its significant influence at the IMF, the G20 countries should:

1. Call for a new $650 billion allocation of SDRs

A new issuance of SDRs is an essential measure for providing the financial support that countries in the Global South need to fund key public services as well as climate change adaptation and mitigation and to achieve the Sustainable Development Goals (SDGs).

SDR issuances are beneficial (Arauz and Amsler, 2024) for both the countries that receive them and the global economy because they can be actively used for a wide range of operations and because they make it possible to alleviate the burden of external debt and create additional fiscal space (Arauz and Amsler, 2024):

- SDR issuances are regressive in their accounting allocation but progressive in their actual utilization. Approximately 60 percent of an allocation goes to high-income countries due to unfair and outdated governance and quota distribution. Low- and middle-income economies are the ones that benefit from the active use of SDRs. Out of a total of 95 countries that have actively used SDRs, 94 are developing countries, which use their holdings mainly for fiscal support purposes but also to raise foreign exchange and meet payments to the IMF.
- For countries in sub-Saharan Africa, the SDRs issued in 2021 were truly a lifeline. The total $23 billion received was crucial. This region used 34.8

percent of its SDRs for balance of payments purposes and 80.5 percent for fiscal purposes.

- For countries in Latin America and the Caribbean, the 2021 SDR issuance resulted in a 9.4 percent average increase in their international reserves. Together, they received approximately $51.5 billion, almost 8 percent of the total allocated globally.
- In Latin America, Venezuela has been prevented from accessing its allocation due to political issues. In fact, the governments of countries that have not been recognized by the IMF and the central banks of countries that face unilateral coercive measures from the United States Office of Foreign Assets Control (OFAC), such as Russia, Belarus, Iran and Syria, have not been able to use their SDRs at all.
- Since the last issuance, countries in the region have experienced tangible fiscal benefits and relief in their external accounts. Out of a total of 32 countries, 19 have benefited by actively using their SDR allocations for various purposes. Of the effectively accessible SDRs issued, 15.9 percent of those allocated to Latin America have been used to exchange them for foreign currency and make payments to the IMF. A total of 47.4 percent have been used for fiscal support purposes.
- SDR issuances are the main alternative financing mechanisms available for developing countries. They cannot be replaced by proposals for SDR "rechanneling," the foreseeable result of which would be to raise the level of indebtedness of Global South countries. Additionally, the main rechanneling model proposed by the IMF, the Resilience and Sustainability Trust (RST), involves an increase in conditionality and offers significantly less financing

than a debt-free SDR allocation. Other rechanneling initiatives better suited to the needs and challenges of the Global South, where regional financial institutions play an essential role, despite modest advances such as the hybrid capital "approval" (IMF, 2024b) have thus far been hampered by broader legal and accounting issues (Arauz, 2022).

- Allocations of SDRs also benefit capital goods exporters, such as the United States, by increasing demand for their imports in developing countries (Cashman, 2021). Another issuance would thus support the global economy for both developed and developing nations.

2. Call for the IMF to modify the accounting of SDRs from liabilities to equity, as prescribed in the IMF's previous Balance of Payments Manual (BPM5).

Central banks currently follow the convention of recording their SDR holdings as reserve assets and the allocation of SDRs as reserve liabilities, as recommended by the IMF's current Balance of Payments Manual (BPM6). Because allocations are currently recorded as liabilities (IMF, 2010), countries have experienced an artificial increase in debt levels. Such recording also presents a problem for both the fiscal use of SDRs and the ability of wealthy countries to donate them. If central banks move SDRs to treasury departments or donate them, a reduction in assets will occur without a reduction in liabilities, which does not serve a practical purpose, as SDRs do not represent debt and do not have to be paid back. The BPM6 recommendation also results in an artificial increase in countries' debt-to-GDP ratios. The G20 should thus call for the IMF to revert countries' balance sheet accounting of SDR allocations back to equity instead of liabilities, as prescribed in the BMP5. Doing so would represent a relatively simple change that would have a significant impact on countries' ability to both utilize SDRs for domestic spending and donate unused SDRs.

With the accounting changes out of the way, the legal path is cleared for additional development financing paid for with advanced countries' unused SDRs. These currently unused SDRs can be donated to indebted countries to pay back IMF and Multilateral Development Bank (MDB) debt, thus preserving the solvency and credit rating of MDBs. Alternatively, they can be used for investment related to achieving the SDGs and to the climate emergency.

To promote new SDR issuances and changes in SDR accounting, the potential role of the G20 is fundamental, given that its members have significant weight with the IMF (with over 60 percent of quotas and voting power) and any decision made by the IMF is subject to the will of these countries. New SDR allocations, as well as eventual reforms in their functioning, are conditioned by the political will of IMF member countries. As shown by the experience of the historic 2021 issuance, coordinated pressure from civil society worldwide and consensus building in the international community are key to driving new allocations in the near future. The G20 has the opportunity to play an immediate, stabilizing role in the context of the simultaneous debt, climate and development crises by supporting a new $650 billion allocation of SDRs.

Scenario of outcomes

In 2009, in London, the G20 played a pivotal role in reviving a legacy instrument: SDRs. The G20 acted upon the preliminary recommendations presented by the Stiglitz Commission to the United Nations Conference on the World Financial and Economic Crisis and its Impact on Development in June 2009 (United Nations, 2009). With the SDR general allocation that took place that year, the Global South received much needed liquid resources. At the 2020 Riyadh summit, the G20 tried again to push for new issuance of SDRs, but the US and India blocked the proposal (Bretton Woods Project, 2022). In 2021, the G20 once again played an important role and supported a new allocation of SDRs. We recommend that the G20 recognize the overlapping crises affecting countries in the Global South and provide a lifeline for them while simultaneously boosting the global economy and international trade.

Recycling advanced countries' unused SDRs through donations is possible if the political will is found to bring accounting principles into line.

At the national level, active use for fiscal purposes can improve levels of economic activity – in a context of rising levels of indebtedness – while also addressing the needs of a population that is marked by inequality and that is still grappling with the consequences of the pandemic and enduring the impacts of the climate crisis.

At the global level, SDR issuances present a concrete alternative for addressing climate goals and the SDGs without deepening the debt crisis that a growing number of countries in the Global South are experiencing.

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