FROM ALLOCATION TO ACTION ON SDRs

A year and a half into the COVID-19 pandemic, the gap between wealthier countries and poorer ones continues to widen. Advanced economies are poised to bounce back quicker due to widespread vaccination and generous fiscal support. Meanwhile, low- and middle-income countries have seen a historically unprecedented rise in extreme poverty. Even before the pandemic, the poorest countries faced a challenging economic landscape. This has been further exacerbated as domestic resources, private investment, and other critical financing flows declined, leaving lower income countries with little room for fiscal manoeuvre. Hard fought progress has been eroded and longer term development priorities — from job creation to building effective healthcare systems to arresting a climate disaster — are under threat.

To date, global economic response efforts to the pandemic leave much to be desired, despite unprecedented stimulus spending in rich countries. Some rich countries have increased concessional development financing — but there has also been significant backtracking on commitments from key actors such as the UK, which cut its aid budget. Leading global institutions haven't fired on all cylinders. An equitable recovery from the pandemic requires substantial new and additional financing.

The historic allocation of $650 billion in Special Drawing Rights (SDRs) offers one critical and sizable new source of financing. But very little of that went to the poorest countries. That means rapid action to channel or recycle those SDRs is vital.

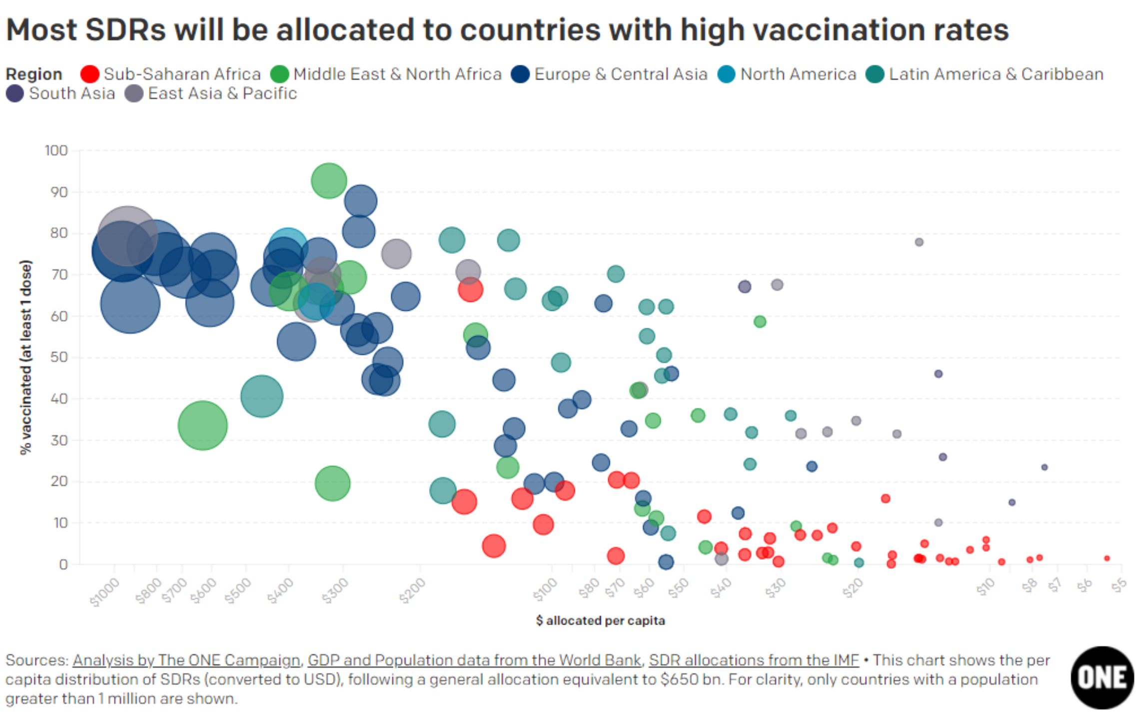
ONE is calling for urgent and concerted action to amplify the impact of the new $650 billion SDR allocation:

- ➔ Advanced economies should commit to recycling their SDRs to support response and recovery efforts.
  - As a first step, by the end of 2021, advanced economies commit to a rapid **channeling of an initial 25% of their SDRs to reach $100 billion**.
- ➔ **IMF member countries should be more flexible on preserving the reserve asset characteristic of the SDRs, and should clear political roadblocks to accelerate the technical design of the proposed Resilience and Sustainability Trust** so that it is operational by mid-2022.
- ➔ Multilateral development banks, in particular the World Bank and African Development Bank, as **prescribed holders, should work with the IMF to swiftly develop viable options for SDR channeling** for agreement ahead of the 2022 Spring Meetings.

➔ IMF member countries should agree, in principle, to **recycle more SDRs once new mechanisms are in place**, based on the scale of need in low- and middle-income countries.

SDR channeling

SDRs provide a much needed injection of liquidity, without adding to debt burdens0. The new allocation gives governments more flexibility to use their hard currency (e.g. dollars or euros) to import food or vaccines. They can also choose to hold on to SDRs to boost their reserves or use them to pay off debts. However, since SDRs are allocated according to a country's IMF quota, wealthy countries — which have the least need — received the lion's share of the new liquidity.



The scale of needs is immense: Africa is facing additional financing needs of $285 billion through 2025 just to respond to the pandemic and needs roughly $520 billion more through 2025 to get back to catching up with wealthy countries.[1] Likewise, low-income countries need around $200 billion through 2025 to step up their response to the pandemic alone, and a further $250 billion to catch up with advanced economies. A slower global recovery could add a further $100 billion to these financing needs.[2]

[1] https://www.imf.org/en/News/Articles/2021/05/18/sp051821-remarks-at-financing-african-economies-conference

[2] https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/03/30/Macroeconomic-Developments-and-Prospects-In-Low-Income-Countries-2021-50312

However, African and low-income countries received roughly $33 billion (5%) and $21 billion (3%), respectively; these will be unevenly distributed between countries, with South Africa and Nigeria — the continent's economic giants — together getting more than Africa's 23 low-income countries.[3] S&P[4] and Fitch[5] have underscored that, while positive, the allocation alone will be inadequate and that recycling SDRs could further shore up reserves and provide additional fiscal breathing space.

	Amount from $650bn allocation
G20 countries	$440 billion
Advanced economies	$398 billion
G7 countries	$281 billion
EU27 countries	$170 billion
African countries	$33 billion
Low-income countries	$21 billion

G7 leaders have backed voluntary channeling of SDRs, signalling a global ambition to raise $100 billion.[6] However, some G7 countries are considering recycling only 20% of their SDRs. Even if all G7 countries achieved this, the collective total ($56 billion) will fall far short of the $100 billion mark. Notably, Germany won't participate in this effort due to legal constraints, making the $100 billion target further out of reach.

How can SDRs be channeled?

1. Boosting concessional support for low-income countries

- The Poverty Reduction and Growth Trust (PRGT) has played a critical role in helping low-income countries weather the pandemic; it disbursed over $14 billion (almost six times the average of IMF concessional lending over the past decade) to 53 of 69 of PRGT-eligible countries in 2020 and the first half of 2021.[7]
- The PRGT has a record of effectively channeling SDRs. Following recent reforms,[8] it is expected to be the main and most immediate vehicle for channeling SDRs to low-income countries.

[3] South Africa's and Nigeria's combined IMF quota is 1.16% whereas Africa's 23 low-income countries' ($1,045 GNI per capita or less) quota is 0.95%.

[4] https://www.spglobal.com/ratings/en/research/articles/210622-an-sdr-is-born-the-imf-creates-a-reserve-asset-for-low-income-countries-12007184

[5] https://www.fitchratings.com/research/sovereigns/on-lending-could-amplify-positive-impact-of-imf-sdr-allocation-02-06-2021

[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1001128/Carbis_Bay_G7_Summit_Communique__PDF__430KB__25_pages_.pdf

[7] See the IMF's COVID-19 Financial Assistance and Debt Service Relief Tracker for country-by-country details: https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker

[8] https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/07/22/Fund-Concessional-Financial-Support-For-Low-Income-Countries-Responding-To-The-Pandemic-462520

- The IMF aims to mobilize $18 billion in PRGT loan resources (including channeled SDRs) and $3.3 billion in new bilateral contributions for subsidy resources to allow continued lending at zero interest rates through 2024. This is a rather modest effort, vis-à-vis the $400 billion in SDRs allocated to advanced economies.
- Donors will have various options for providing subsidy resources: budgetary grants; lending SDRs to the PRGT to earn income as investments or deposits; donating interest earned on their SDR holdings; and providing PRGT loans at below market rates. This will be complemented by IMF internal resources of about $700 million.

2. Creating a new IMF administered trust

- IMF staff is working on a new vehicle for vulnerable low- and middle-income countries and small island economies as part of an effort to expand the number of countries (beyond the 69 PRGT-eligible countries) that can benefit from channeled SDRs.
- This proposed Resilience and Sustainability Trust (RST) is intended to help countries recover from the pandemic while addressing longer term structural challenges, including combating climate change and improving healthcare systems. The G7 has given the green light to IMF staff to continue fleshing out the details of the RST and China has expressed its support.
- Key factors under consideration include: ensuring consistency with the IMF's mandate and its existing lending framework; broad participation of borrowers and lenders; additionality and complementarity rather than duplicating and competing with other IMF facilities (as well as MDB financing); defining clear governance and financial frameworks; and safeguarding loaned resources.
- Eligibility criteria and conditionalities still need to be determined. Nonetheless, emphasis will be placed on lending for policy reform commitments that are related to macroeconomic stability (e.g. addressing balance of payments needs) rather than on project financing to differentiate and not substitute MDB lending. RST program maturities are expected to be longer than 10 years — the current duration of other IMF programs.
- The RST is expected to be operational in late 2022. As this is still in the works, there is no clarity on the amount of SDRs that could be channeled via the RST.

3. Channeling SDRs via prescribed holders

- The IMF's Articles of Agreement permit certain designated official entities known as prescribed holders to hold and use SDRs.[9] Of these, given their mandate, MDBs such as the World Bank and the African Development Bank, are under consideration as possible vehicles through which SDRs can be channeled.

[9] There are 15 prescribed holders: four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and eight development institutions (African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development and the International Development Association, Islamic Development Bank, Nordic Investment Bank, and International Fund for Agricultural Development).

- However, there is not a precedent for channeling SDRs through prescribed holders. Significant technical, political, and operational/legal hurdles have to be cleared first in order for these institutions to absorb channeled SDRs.

Challenges and roadblocks

At the same time, there are uncertainties around potential demand from low- and middle-income countries to use channeled SDRs. The IMF is assuming healthy demand for PRGT resources through the second half of the decade, in light of the pandemic's aftershocks and immense financing needs. However, channeling SDRs through the PRGT or the newly proposed RST could have limited participation from eligible countries if they come with onerous terms. Thus, a more flexible and tailored approach to policy conditionalities that accommodates increased fiscal deficits and avoids premature cuts to social spending is necessary.

Likewise, supply side unknowns remain. Channeling SDRs is completely voluntary, so there is no expectation or obligation for donors to participate. This isn't cost free; a country is charged interest when SDR holdings fall below its allocation. Moreover, mobilizing substantial grant contributions (to cover subsidy resources for elevated PRGT lending) when aid budgets are under threat will be a tall order.[10] While G7/G20 countries support recycling, they have also emphasized that their SDRs continue to be treated as reserve assets, which could be a constraint; this is particularly relevant for the design of RST. For instance, national legal requirements and credit risk exposure of lenders have to be considered and addressed. Time to sort out the details coupled with political will and bold leadership from lenders are needed.

	Amount from $650bn allocation (USD billions)	SDR recycling/channeling scenarios			
		20% (USD billions)	25% (USD billions)	50% (USD billions)	75% (USD billions)
Canada	14.99	3.00	3.75	7.49	11.24
France	27.40	5.48	6.85	13.70	20.55
Germany	36.21	7.24	9.05	18.11	27.16
Italy	20.49	4.10	5.12	10.24	15.37
Japan	41.90	8.38	10.48	20.95	31.43
United Kingdom	27.40	5.48	6.85	13.70	20.55
United States	112.83	22.57	28.21	56.42	84.63
G7 Total	**281.23**	**56.25**	**70.31**	**140.61**	**210.92**
China	41.44	8.29	10.36	20.72	31.08
EU27 Total	**169.58**	**33.92**	**42.39**	**84.79**	**127.18**
G20 Total	**440.49**	**88.10**	**110.12**	**220.25**	**330.37**

[10] Selling a portion of the IMF's gold holdings is another option to replenish subsidy resources but this isn't currently under consideration.

Advanced Economies Total	**397.51**	**79.50**	**99.38**	**198.75**	**298.13**