Extract from the report:

Building new foundations: Reimagining the International Financial Architecture

Views and proposals from civil society

Liquidity without increasing debt: Special Drawing Rights

By Patricia Miranda

With contributions from

Liquidity without increasing debt: Special Drawing Rights

By Patricia Miranda

In a context of multiple crises, Special Drawing Rights (SDRs) are an important alternative for financing within the international monetary system, as they can generate new resources without increasing debt levels.

Countries of the Global South can use SDRs to contribute to achieving Sustainable Development Goals (SDGs) and the adaptation goals of the climate agenda through a wide range of operations, such as strengthening international reserves, repaying public debt and reducing fiscal space gaps.

Another allocation or frequent allocations of SDRs for at least five years, which aim to benefit countries that are more exposed to economic, social and climate vulnerabilities, could make a difference for millions of people. A fair distribution not linked to quotas could avoid recycling processes through new lending, thus preserving the no-debt creation spirit of SDRs.

In the short term, a change in the Balance of Payments manual would allow developed countries to rechannel unused SDRs to developing countries as grants rather than loans.

Access to fair financing that does not contribute to the debt spiral requires a reform of the International Financial Architecture that includes SDRs as a source of liquidity.

What are Special ghts (SDRs)?

Special Drawing Rights (SDRs) are an international reserve asset, created by the International Monetary Fund (IMF) in 1969 to supplement its member states' official reserves.[1]

SDRs have been created and used historically to enhance international reserves, access more financing, increase foreign investment and contribute to the stability of the purchasing power of a national currency.[2]

SDRs were created to meet liquidity needs and supplement the official reserves of member states with balance of payments crises due to a lack of US dollars and gold, which were the main assets held in foreign exchange reserves in 1969.

The value of an SDR is defined from a weighted-average basket of currencies, which has changed over time and currently includes the US dollar, Euro, British pound, Chinese yuan and Japanese yen.

1 See IMF website: https://www.imf.org/en/Topics/special-drawing-right

2 Arauz (2021).

As an international reserve asset, SDRs represent a potential claim on currencies issued by member countries and are exchangeable in official international transactions between member countries and prescribed holders.[3]

At the same time, SDRs are a unit of account that is officially used by the IMF for transactions with its members, as well as by other financial institutions and international organizations. IMF's lending amounts and transfers can also be nominated in SDRs.[4] Holders can exchange its SDRs into hard currencies with other IMF members. They can use their SDRs in a range of operations with other countries or to settle financial obligations to the IMF.

SDRs do not need to be repaid by recipient countries as they are not a credit or loan, and they do not include conditionalities, in contrast to regular IMF programmes. When a country's actual SDR holdings are lower than the amount of SDRs allocated to it, due to the active use of a portion of its SDRs, it must pay the SDR interest rate applied to the difference between the two amounts.

Conversely, when a country's holdings are higher than the amount allocated, after having received SDRs through a transaction with another country, then that country receives payments corresponding to the SDR rate applied to the difference between the two amounts. The cost of active utilization corresponds to this net interest payment. Interest rates vary and are calculated according to the interest rates of the SDR currency basket. As of August 2024, the SDR interest rate is 3.98 per cent, which is lower than interest rates in international markets.

SDR allocations

SDRs were issued for the first time from 1970-1972 with yearly instalments that reached SDR 9.3 billion. The second issuance in 1979-81 totalled SDR 12.1 billion, bringing total cumulative allocations to SDR 21.4 billion. After that, SDR issuances only reappeared almost three decades later, when a third general allocation took place in 2009, for SDR 161.2 billion, in response to the global financial crisis. This was equivalent to US$ 250 billion.

The last allocation was approved in August 2021, in response to the fiscal emergency caused by the outbreak of the COVID-19 pandemic. This was for a record sum of 456.5 billion SDRs (US$ 650 billion). This has been the largest allocation and, despite being approved 17 months after the COVID-19 outbreak, it was useful in the context of a health crisis where fiscal needs were urgent, in particular for the most vulnerable countries in the Global South. This allocation was one of the main global economic policies that also benefited middle-income countries. In the case of Latin America, the limited fiscal space and deficit registered for several years needed urgent resources without increasing debt.[5]

Allocations are credited to each country's SDR account in the IMF's SDR department. Each of the IMF's 190 member states receive an amount of these reserve assets, according to the proportion of its quota. As the IMF quota is based broadly on a country's relative position in the world economy, the richest economies received 61.4 percent of the allocation. The richest G7 countries alone received 47.2 percent.

Different groups of countries asked for SDRs issuance after the pandemic. African leaders called for additional SDRs for pandemic recovery in 2021[6] and a

3 Prescribed holders are the following official entities approved by the IMF to hold SDRs: African Development Bank (AfDB), African Development Fund (ADF), Arab Monetary Fund (AMF), Asian Development Bank (ADB), Bank for International Settlements (BIS), Bank of Central African States (BEAC), Caribbean Development Bank (CDB), Central Bank of West African States (BCEAO), Development Bank of Latin America (CAF), Eastern Caribbean Central Bank (ECCB), European Central Bank (ECB), European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank (IADB), International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), International Fund for Agricultural Development (IFAD), Islamic Development Bank (IsDB), Latin American Reserve Fund (FLAR) and the Nordic Investment Bank (NIB).

4 XDR is the code standardised for the SDR as a unit account.

5 Miranda (2020).

6 https://african.business/2021/09/economy/unga-african-leaders-call-for-additional-imf-sdrs-for-pandemic-recovery

multilateral financial system reform with new SDR issuances in 2023.[7] Latin American leaders in the Community of Latin American and Caribbean States (CELAC) 2021 declaration called for SDR allocation to access liquidity for developing countries, including middle-income countries.[8] Also in 2021, civil society organisations (CSOs) called on the G20 to urgently support a new allocation of SDRs to the tune of US$ 3 trillion.[9]

Fiscal use of SDRs

In the 2009 special allocation, SDRs were no longer reserved for meeting external needs, but were also used as an instrument of fiscal support, which further enhanced their positive impact. Eighteen countries used more than 50 percent of the allocation received. In Latin America, Ecuador was the first country to use SDRs for fiscal support.

After the last allocation, in 2021, SDRs have been widely used in the Global South, where a limited fiscal space led countries to draw on them for fiscal purposes instead of increasing public debt.

SDRs can be used for fiscal purposes. This varies according to domestic laws and sovereign decisions on their use within each country. The following are some of the main paths for this purpose:[10]

- **SDRs belong to the member state, not the central bank:** To apply this modality, the ministry of finance, prior to receiving the issued SDRs, needs to officially notify the central bank that SDRs should be credited, upon arrival, in favour of the ministry. The corresponding accounting and financial procedures should be executed by the central bank.

  A central bank is generally the fiscal agent of the state. In other words, it is the bank where the finance ministry manages its resources. This does not mean that the central bank substitutes the state or the finance ministry.

- **Exchange Stabilization Fund SDR Certificates:** Under this modality, ministries of finance issue SDR certificates to be acquired by the central bank. Therefore, the ministry could have liquidity from the central bank denominated in foreign or local currency to carry out budget expenses. In this scenario, the original SDRs are not exchanged abroad. Depending on the national monetary laws, this path will most likely need a legal reform or legal interpretation.

  In other words, the establishment of a fiscal or parafiscal instrument is identical to the Exchange Stabilization Fund (ESF) of the US Department of the Treasury. Once the SDRs are received, the ESF issues securities denominated in SDRs, called 'SDR certificates'. The ESF sells these securities to the Federal Reserve Bank of New York (NY Fed). Following this transaction, the ESF receives dollars in its account at the NY Fed and the NY Fed remains the holder of the SDR certificates.

- **Dividend based on extraordinary income:** According to current monetary laws, a central bank's profits at the end of the year are transferred to the country's ministry of finance given that, in the vast majority of cases, the central banks are entirely state owned. Therefore, after SDRs are credited, the significant increase in the equity of the central bank would make this transfer to the ministry of finance possible. If the national central bank insists on an incorrect but common legal argument, the SDRs are assets and the exclusive property of the central bank and not of the state.

  Considering the current crisis reflects more a fiscal problem than a balance of payments problem in most countries, this path could be feasible for several countries.

---

7 https://media.africaclimatesummit.org/Final+declaration+1709-English.pdf?request-content-type=%22application/force-download

8 https://www.gob.mx/cms/uploads/attachment/file/668541/Celac_2021_Declaracio_n_de_la_Ciudad_de_Me_xico__18sep21.pdf

9 https://latindadd.org/arquitectura-financiera/civil-society-organizations-call-for-quick-special-drawing-rights-allocation/

10 Arauz (2021).

- **Monetary financing:** This path is an alternative in case the central bank refuses to recognize that SDRs are the property of the state and that it would not be willing to record them as income in its budget. This scenario is almost implausible, but in central banks with a tradition of misunderstanding autonomy, or at the suggestion of certain external entities, it is unfortunately possible.

  It consists of financing from the central bank to the finance ministry through commonly used monetary financing mechanisms; central banks can purchase securities issued by ministries of finance.

  In this case, the central bank would receive the SDRs on the asset side of its balance sheet and increase its equity. The central bank would then buy securities from the finance ministry in dollars or in the national currency for the amount equivalent to the SDRs received. The combination of these transactions would increase the international reserves and also increase the internal assets of the central bank. The finance ministry would have an intra-sectoral domestic debt with the central bank. Since SDRs are indefinite, the debt between the finance ministry and the central bank could also be indefinite. Interest rates on those funds should not be more onerous than charges by the SDR department.

Figure 1:

Active use rates of 2021 SDR allocation by IMF, according to geographic grouping

Estimated active use during the two following years after the SDR issuance, between August 2021 and August 2023

Geographic grouping	Countries with at least 1 use	Used to obtain foreign currency or IMF payments	Used for fiscal support*
Total (95 of 190)	50 %	5 %	12,8 %
Advanced Economies (1 of 36)	2,8 %	0,5 %	0 %
Emerging and Developing Economics (94 of 154)	61 %	12,2 %	33,2 %
Sub-Saharan Africa (41 of 45)	91 %	34,8 %	80,5 %
Latin America and the Caribbean (19 of 32)	59,4 %	14,3 %	42,7 %
Emerging and Developing Economies Asia (14 of 30)	46,7 %	1,6 %	25,3 %
Emerging and Developing Economies Europe (7 of 16)	43,8 %	11 %	5,4 %
Middle East and Central Asia (13 of 31)	41,9 %	18,4 %	38,6 %

Source: Arauz (2023).
Note: (*) SDR use is expressed as percentage of SDRs allocated to the corresponding grouping.

The active use of SDRs is reflected in the fact that 61 percent of emerging market and developing economies used SDRs from 2021 to 2023. The regions that used more SDRs were sub-Saharan Africa, with 91 percent, and Latin America and the Caribbean, with almost 60 percent. In both cases, the main use was for fiscal purposes.

Some concrete examples of the use of SDRs in Latin American countries include:

Argentina: The SDRs were registered in a special account at the Central Bank of the Argentinean Republic (BCRA) to be exclusively used in accordance with the decisions of the Ministry of Economy. They were then recorded as a liability for the central bank and, following the principle of double-entry accounting, they were recorded in the BCRA's assets as reserves.

Subsequently, the Ministry of Economy instructed the central bank to pay external debt obligations with the IMF, during the agreement renegotiation with this institution. To this end, the operation consisted of issuing treasury securities as backup to request funds from the central bank to meet the government's liquidity requirements.

Argentina used SDRs creatively to repay debt to the IMF, reduced the need to cover the fiscal deficit with a monetary issuance or domestic debt (Treasury bills) between the ministry of finance and the central bank, and recovered the central bank's reserve level to sustain economic activity and imports of essential goods and services.

Ecuador: The SDRs were directly allocated to the balance of the Ministry of Economy and Finance (MEF) with the aim of using them for fiscal purposes and to increase reserves. Operationally, SDRs were allocated to the central government, recording them as a deposit in the Single Treasury Account (CUT) on assets, and as an increase in external debt with the IMF on liabilities.

Simultaneously, the Central Bank of Ecuador (BCE) registered an increase in international reserves in assets and an increase in deposits in the CUT in liabilities. The government was able to use these resources, for which a Memorandum of Understanding was signed between the MEF and the BCE. It stipulated that they would be used for international payment needs and for fiscal purposes. The main use of SDRs contributed to strengthening reserves and reducing fiscal space in the public budget.

Paraguay: Prior to receiving SDRs, the Paraguayan Congress approved Law 6809/21, which established measures to finance expenses related to the COVID-19 pandemic. However, these resources were prohibited from financing salary expenses, except those for health personnel. As established by law, SDRs were allocated to the Public Treasury Account as a financial asset through an inter-institutional agreement between the Ministry of Finance (MH) and the Central Bank of Paraguay (BCP).

In accordance with the law, the BCP granted an advance to the state, with no interest and on the condition that they should be amortized and cancelled after the effective SDR allocation, within fiscal year 2022. Regarding allocated SDRs, these were exchanged for dollars and credited to the MH account.

SDR allocation helped to temporarily expand social protection and to alleviate the deficit in the health system with coverage of medicines and outsourced medical care.

The law stipulated that the resources should be used to guarantee social safety nets for the most vulnerable populations, such as the elderly, as well as to guarantee food security for those most affected by the measures adopted within the framework of the Declaration of National Emergency due to the Pandemic.

The resources were allocated with their own code (Source of Financing 818 – Law 6809/21 of Economic Consolidation), which allowed their identification in the budget reports and, in this way, to monitor the use of SDRs once incorporated into the public budget. In total, because of Law 6809/21, a total of US$ 261 million was budgeted, of which some US$ 234 million (89.8 percent of the total) was used.

These cases show that SDRs can be used for fiscal purposes, helping to increase fiscal space while reducing the need to implement austerity measures.

Policy recommendations

SDRs are allocated following a global crisis where countries need immediate access to liquidity. However, as we face future crises – or more immediately, the current climate crisis – the key question is to what extent SDRs could contribute to prevention or serve as part of a more just and timely solution.

Key reforms in the international monetary system through SDR allocations

In the context of multiple crises, implementing structural reforms in the international monetary system is highly relevant.

Urgent responses to the climate crisis, energy transition risks as well as other urgent priorities such as global poverty and hunger are being hindered by mounting debt levels in countries of the Global South. The issuance of SDRs presents an exceptional opportunity to generate liquidity and resources without increasing these countries' debt levels.

Nevertheless, the current SDR system reproduces inequalities by being deployed during a global crisis. Key reforms would be crucial for SDRs to contribute under a fair financing approach. De-linking the quota-based distribution of SDRs would allow countries in need to have access to more liquidity. This reform would need a change in the IMF Articles of Agreement.

This proposal aims to achieve a more targeted and effective distribution to prioritize countries that are exposed to more vulnerabilities. Initiatives such as a 'development link' allows for a more progressive allocation of SDRs.

At the UN Climate Summit in Glasgow in 2021, the Prime Minister of Barbados, Mia Mottley, called for US$ 500 billion in annual issuance of SDRs to finance a transition to renewable energy and to limit the rise in global temperatures.[11]

The issuance of new SDRs remains a powerful alternative to conventional financing mechanisms. A different criterion of allocation for annual issuances for the next five years would make a real difference, based on countries' needs, such as the vulnerabilities they are exposed to.

Nonetheless, SDRs are a reserve asset and developed countries prioritise to maintain this condition. Different distribution criteria through vulnerability ratios would deliver a more focused benefit. Developed countries have a moral responsibility to increase efforts to provide fair financing without increasing the debt of the most vulnerable countries.

Recycling unused SDRs held by rich countries

As expected, SDRs allocated to rich countries were not used and rechannelling, or recycling, was discussed from the beginning as an option to balance the unequal distribution and to provide an important boost for countries in need.

Since 2021, that is exactly what has happened. The G20 and other economically stronger member states have voluntarily pledged more than US$ 100 billion of these reserves.

The initial option was rechannelling through IMF loans, under the traditional Poverty Reduction and Growth Trust (PRGT).[12] A new IMF trust fund was also set up, the Resilience and Sustainability Trust (RST)[13], which aimed to tackle long-term challenges such as climate change, digitalization and health. The RST makes it possible to rechannel SDRs to middle-income countries. It involves loans under IMF programmes, which include conditionalities.

Since 2021, 30 providing countries channelled about US$ 55 billion for the PRGT with 56 beneficiary countries. The RST had 23 partners that channelled about US$ 47 billion.[14]

According to Arauz, the quantity of allocated SDRs held by rich countries is so large that the transfer of about a quarter of them would make it possible to repay and cancel the entire debt of all countries in the world to the IMF and its trusts.[15]

---

11 https://www.reuters.com/markets/us/barbados-mottley-says-imf-must-help-finance-fight-against-climate-change-2021-12-03/

12 IMF website: https://www.imf.org/en/Topics/PRGT

13 IMF website: https://www.imf.org/en/Topics/Resilience-and-Sustainability-Trust

14 IMF website: https://www.imf.org/en/Topics/special-drawing-right#SDR%20Channeling

15 Arauz (2023).

In May 2024, the IMF Executive Board authorized the use of SDRs by IMF members for the acquisition of hybrid capital instruments[16] issued by prescribed holders, based on a proposal of the African Development Bank and the Inter-American Development Bank. The new SDR use will be subject to a cumulative limit of SDR 15 billion and a review is expected to be conducted when cumulative hybrid capital contributions surpass SDR 10 billion or two years after the authorization, whichever comes first. Nevertheless, this option still faces the restrictions of EU member states, which will not be able to be a contributor due to European Central Bank rules. Rechannelling efforts have been limited so far, especially by the claims that SDRs are a reserve asset. However, rechannelling SDRs as grants is more desirable, to avoid contributing to the vicious cycle of debt. In most rich countries that could potentially act as SDR donors, these assets are featured on the balance sheets of their respective central banks. Central banks currently follow the convention of recording their holdings of SDRs as reserve assets and the allocation of SDRs as reserve liabilities.

Based on a report by the non-governmental organisation LATINDADD and the Centre for Economic Policy Research (CEPR),[17] an innovative proposal for recycling SDRs through grants instead of loans is the change in the accountancy registry of SDRs in central banks, through a change of the Balance of Payments Manual (BoP) rules. The BoP Manual 5[18] states that SDRs are registered as equity and assets in the balance sheet of central banks, and the BoP Manual 6[19] states that SDRs are registered as liabilities and assets.

In the first case – under the old rules – if a rich country wanted to donate its SDRs, it would imply a reduction in assets and an increase in equity. In the second case – under the current rules – a donation implies a reduction in assets without a reduction in liabilities. Therefore there is a gap in equity, and this is the main concern for central banks whose currency is part of the SDRs basket.

In terms of central bank accounting, this difference would imply that a subsequent donation from rich countries, after an SDR allocation, would increase a central bank's equity (in net terms) without involving any balance sheet imbalances, i.e. a donation with no negative (net) impact on a central bank's net worth.

Under this proposal, rich countries would be able to rechannel SDRs through donations instead of loans, without facing the problem of negative gaps in their central banks' balance sheet. This would be more congruent with the spirit of SDR issuances, but would also be key to stop feeding a debt spiral for countries of the Global South.

This kind of change needs a review of the political economy of IMF statistical standards and the Balance of Payment Manual rules, both of which are feasible with dialogue and decision-making between IMF country members.

16 A hybrid capital instrument is a financial instrument with perpetual maturity that has both equity and debt properties.

17 Arauz (2023).

18 https://www.imf.org/en/Publications/Books/Issues/2016/12/30/Balance-of-Payments-Manual-157

19 https://www.imf.org/external/pubs/ft/bop/2007/bopman6.htm

References

Arauz, Andrés (2023): More SDRs for Latin America and the Caribbean: An Effective Tool in an Era of Multiple Crises. LATINDADD and CEPR.
https://latindadd.org/informes/more-sdrs-for-latin-america-and-the-caribbean-an-effective-tool-in-an-era-of-multiple-crises/#:~:text=Globally%2C%202021%20issuance%20was%20456,equivalent%20to%2051.5%20billion%20dollars

Arauz, Andrés (2021): Handbook for the use of Special Drawing Rights (SDRs) for Fiscal Purposes. LATINDADD.
https://www.latindadd.org/wp-content/uploads/2021/08/Handbook-for-the-use-of-SDRs-for-Fiscal_Purposes.pdf

Banque de France (2023): Special drawing rights issued by the IMF and the challenge of channelling them to the most vulnerable countries (Bulletin 248/2). Paris.
https://www.banque-france.fr/system/files/2023-10/BDF248-2_EN_SDRs_web.pdf

Miranda, Patricia (2020): América Latina necesita acceder a recursos sin generar deuda: Emisión de Derechos Especiales de Giro. LATINDADD.
https://latindadd.org/todos/america-latina-necesita-acceder-a-recursos-sin-generar-deuda-emision-de-derechos-especiales-de-giro/

Patricia Miranda is Director of Global Advocacy and Coordinator of the New Financial Architecture (NAF) area of the Latin American Network for Economic and Social Justice (LATINDADD).

Published by:

Global Policy Forum Europe
Königstr. 37a
53115 Bonn, Germany
europe@globalpolicy.org
https://www.globalpolicy.org

With the support of
Brot für die Welt and Friedrich-Ebert-Stiftung

Brot für die Welt

FRIEDRICH EBERT STIFTUNG

Authors:
Juan Pablo Bohoslavsky, Bodo Ellmers, Matthew Forgette, Avantika Goswami, Chioneso Samantha Kanoyangwa, Daniel Kostzer, Maria Emilia Mamberti, Jens Martens, Patricia Miranda, Chenai Mukumba, Daniel Oberko, Ohiocheoya (Ohio) Omiunu, Oliver Pahnecke, Sehr Raheja, Maria Ron Balsera

Editorial Assistance:
Vicky Anning, Tobias Gerhartsreiter, Paul Wege

Coordination:
Bodo Ellmers and Jens Martens, Global Policy Forum Europe

Photos:
Adobe Stock

Design and Print:
Kalinski Mediendesign und Druck, Bonn. www.kalinski.media
Printed on 100% recycled paper

The views and opinions expressed in the articles are those of the authors and do not necessarily reflect the positions of the publishers, the editors, other authors, or funders.

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data are available in the internet at http://dnb.d-nb.de.

ISBN 978-3-943126-60-0

Bonn, September 2024