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IMF Special Drawing Rights

Exiting the COVID-19 crisis via a historic cash injection?

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Summary

On August 23 2021, the International Monetary Fund (IMF) performed the long desired payout of special drawing rights (SDRs) to the tune of 650 billion US dollars. Especially for countries of the Global South, the SDRs are a welcome cash injection. Unlike the EU and the USA with their economic recovery programs worth trillions, developing countries have so far only been able to mobilize few financial resources to cope with the impacts of the crisis, and for this reason too, they are lagging behind in vaccination campaigns for their people as well as in the sustainable restoration of their economies. The IMF measure therefore holds the potential to contribute to more just relations between the North and the South in the crisis.

However, this only applies to a certain degree. In accordance with its statutes, the IMF has to pay out shares of SDRs to all its Member States, the size of which depends on their respective quota. Since economically powerful countries hold larger IMF quotas than poorer countries, more than half of the SDRs were allocated to rich countries which were not in need since they enjoy sufficient access to other financial sources. Some countries have already agreed to rechannel their SDRs in a second step

to the benefit of more needy countries. This would reduce the proportion of unused SDRs and thus further enhance the effectiveness of the IMF measure. To achieve this, the G7 Summit has set a target of 100 billion US dollars. Various channels can theoretically be used for this purpose, ranging from existing IMF facilities through multilateral development banks to specialized funds for vaccines or measures to tackle climate change.

Owing to its high IMF quota, Germany has unwittingly become a chief beneficiary from SDR allocation, having raked in the huge sum of 25.5 billion SDRs (30.8 billion euros), more than 5 percent of the entire allocation. In Germany, the context is more complicated than in other countries since allocations first go to the German central bank (Bundesbank), while the Federal Government holds responsibility for financing development cooperation and environment policy expenditure.

The Federal institutions are therefore called upon to come up with an arrangement over the next few weeks which would allow Germany to contribute its fair share and allocate the SDRs to their true purpose. This is all the more important since, in the future, SDRs could more and more frequently be playing a role not only in international crisis management, but also in development and climate financing in general.

Introduction

In August 2021, the IMF took the long awaited decision to perform a new allocation of special drawing rights (SDRs) to the tune of 650 billion US dollars. This measure can be regarded as the financially most significant response on the part of an international organization to date to combating the economic impacts of the corona crisis.

The operation aims to provide additional finance for countries in severe need. At the beginning of the COVID-19 crisis, in spring 2020, emerging economies and developing countries in particular were suffering from a record flight of capital. In just a few weeks, private investors withdrew almost 100 billion US dollars and transferred them to what they believed to be safer havens in the Global North. This caused foreign exchange reserves to drop to critical levels in many countries. Payment defaults threatened to trigger systemic debt and financial crises. The lack of foreign exchange also meant that important goods, including food and medicine, could no longer be imported in sufficient amounts.

In the countries of the Global North, the central banks formed an important pillar of crisis response. Only through massive asset purchases by the central banks were the governments in Europe and the USA in a position to conduct an expansive fiscal policy and finance the arising budget deficits at favorable conditions. The government was thus empowered to finance social protection programs and subsidies of hitherto unknown extent and thus mitigate the impact of the crisis on the economy and the population. Neither was financing vaccination programs a problem for the rich countries under these conditions.

Governments in the soft currency countries of the Global South did not have this option, which is why the crisis had a greater impact there and is more persistent. The United Nations warned that the unequal capacity among countries to respond to the crisis would lead to a diverging world, to a further drifting apart of richer and poorer countries. Development progress achieved in the Global South with a considerable effort over decades is being nullified by the crisis. In many places, Agenda 2030 is threatening to become derailed, while the Sustainable Development Goals are running the risk of getting out of reach.[1]

Since the onset of the crisis, there have been discussions in the United Nations framework regarding how the international community can support developing countries in financing the consequences of the crisis while also continuing the implementation of the Agenda 2030 for Sustainable Development in crisis conditions. In the UN Special Process on “Financing for Development in the Era of COVID-19 and Beyond”, the political option of a special SDR allocation was soon addressed.

The German Federal Government supported the special allocation right from the start. Federal Chancellor Merkel devoted her short speaking

1 https://news.un.org/en/story/2021/04/1089542

What are Special Drawing Rights?

SDRs are an international reserve asset which was introduced by the IMF in 1969. Their value is based on a basket of five hard currencies (US dollars, euros, pounds sterling, yen, renminbi). Within certain limits, they can be changed into these currencies and used for payments at any time. The SDRs' advantage compared to loans from conventional IMF facilities is that they do not have to be repaid, and that their use is not subject to any policy conditions.

If a country changes its SDRs into a currency, a low interest rate, currently at 0.05 % per annum, becomes due which has to be paid to the IMF's SDR department. Including the allocation on August 23 2021, 660.7 billion SDRs (approx. 800 billion euros) have so far been paid to the IMF Member States. The 2021 allocation is the largest in the IMF's history. Its purpose is to serve long-term demand for currency reserves and support Member States in coping with the COVID-19 crisis.

Source: IMF (https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR)

time at the first high-level event of the UN Special Process in May 2020 to explicitly pronounce Germany's approval of this policy option.[2] Informally, it has been claimed that the overwhelming majority of the IMF Member States were already backing the special allocation at an early stage.

That it was not before August 2021 when the allocation ultimately got underway is due to the USA's resistance under the Trump administration in combination with the IMF's complex governance structure. The measure called for the support of IMF members accounting together for at least 85 % of the IMF's voting rights. The IMF's plutocratic governance model, in which economic power is the most significant factor regarding voting power, gives the USA 16.5% of voting rights in the IMF, and thus a de facto veto right for all key decisions, including for SDR special allocation.[3]

Only the change of government in the USA in January 2021 led to the necessary majorities in the IMF, since the new Biden administration also gave the go-ahead for SDR allocation as part of its strategy of revitalizing US-led multilateralism.

This fundamental decision triggered a relatively complex process within the IMF. The key steps were:

» IMF experts determined the level of allocations with a technical method.

» IMF Director Kristalina Georgieva presented the proposal to the IMF decision-making bodies.

» On July 8 2021, the IMF Executive Board approved allocation.

» On August 2 2021, the IMF Board of Governors approved allocation.

» On August 23 2021, the SDRs were credited to the Member States' accounts.

De facto, not only the time but also the level of the SDR special allocation was determined by the political situation in the USA. In accordance with US-American law, parliament's consent is required if the level of the cumulative allocation of SDRs to the USA exceeds the quota in the IMF. Receiving consent would, on the one hand, have taken too much time, while, on the other, not necessarily have been guaranteed. Hence the "technical" proposal by the IMF experts remained below the politically problematic allocation level stipulated by US law[4] – with the USA constituting just one of the 190 IMF Member States.

All in all, neither the time nor the level of the allocation is needs-oriented but is instead determined by the political conditions. From the angle of possible beneficiaries, allocation already in spring 2020, when developing countries and emerging economies were acutely suffering from massive capital flight, would have been optimal. Opinions are divided regarding the optimal level of allocations. Already in March 2020, UNCTAD had called for an allocation to the tune of one billion US dollars, as part of a 2.5 billion dollar rescue package for the Global South which was also supposed to contain debt relief and fiscal transfers.[5] Civil society put demand at three billion US dollars.[6]

So one can conclude that the difficult political conditions have led to a classic "too little – too late" problem. The SDR allocation should have come

2 Cf. https://www.globalpolicy.org/en/publication/financing-development-era-covid-19-and-beyond
3 https://www.imf.org/en/About/executive-board/members-quotas
4 http://uscode.house.gov/statutes/pl/90/349.pdf
5 https://unctad.org/system/files/official-document/gds_tdr2019_covid2_en.pdf, p. 11
6 https://www.latindadd.org/2021/02/12/civil-society-organizations-call-for-quick-special-drawing-rights-allocation/

earlier, and with a greater volume. It is therefore recommendable to also add the mode of future allocations to the debate on IMF reform. If the IMF, as an institution, and the SDRs, as an instrument, are to play a more effective role in global crisis management in the future, then better approval procedures for allocation ought to be considered. For example, an automated and rule-based procedure could significantly accelerate the process and help make future allocations more needs-oriented.

Who benefits from the special allocation of SDRs?

The motive for allocation was to provide additional liquidity for countries with financial problems to stabilize their balance of payments while creating new fiscal resources to combat crisis impacts and restore the economy.[7]

However, the problem is that owing to the quota system, the IMF paid out the largest share of SDRs to the countries with the least need. The current set of IMF rules stipulates that each Member State receive a share of a new SDR special allocation corresponding to its IMF quota. In similar manner to the distribution of voting power, the quota is also based on a complex formula the key factor of which is the respective economic power.

This means that the largest share of IMF special allocations goes to the USA, totaling 79.5 billion SDRs, or 17.43 percent.[8] However, the USA has the privilege of controlling the US dollar, in which the lion's share of international transactions is dealt. The USA is the world's only country which can finance imports in its own currency, so that it has the least need for SDRs. In contrast, SDR allocations are particularly important for the developing countries because these represent valuable access to hard currency. Thus most recipients of special allocations will seek to change their SDRs into US dollars in order to make use of them in transactions.

Germany is given generous consideration, too. More precisely, the German central bank (Deutsche Bundesbank), for in Germany, the IMF law dating back to 1976 prescribes that new SDR allocations are initially paid to the independent central bank, whereas in the USA, for example, they are credited to the Exchange Stabilization Fund, which is directly accountable to the Ministry of Finance.

Thanks to its IMF quota of 5.6 percent, Germany receives around 25.5 billion SDRs, which, based on the exchange rate of August 23 2021, corresponds to 30.8 billion euros, which the Federal Bank intends to enter as currency reserves. They would correspondingly just extend the central bank´s balance sheet.[9] As a rule, however, "exports world champion" Germany earns sound trade balance surpluses, and, even in times of crisis, tends to be a "safe haven" rather than a victim of international capital flight, so that it really has no need for high currency reserves. This means that they are lying idle and without being used in the Bundesbank accounts.

The emerging economies and developing countries receive a total of just 193 billion SDRs (275 billion US dollars, i.e., at just below 42%, less than half of the allocation. What is most problematic about the distribution is that the poorest countries, the Low Income Countries or LICs, receive the smallest amount. All 31 LICs together, which account for 10 percent of the world's population, are only receiving SDRs to the tune of 21 billion US dollars, i.e. a mere 3% of the latest SDR allocation.[10]

The SDRs nevertheless represent a substantial sum. For comparison, in 2020, all donor countries together only provided 161 billion US dollars for Official Development Assistance, ODA. So SDR allocation to emerging economies and developing countries corresponds to global ODA spending over nearly two years. And whereas a considerable share of ODA money remains in the donor countries, or stays in the apparatus as transaction costs, the SDRs are transferred in full to IMF Member States, without being subject to policy conditions. No wonder new SDR allocation has lately been right at the top of the political agenda among the governments of the Global South.

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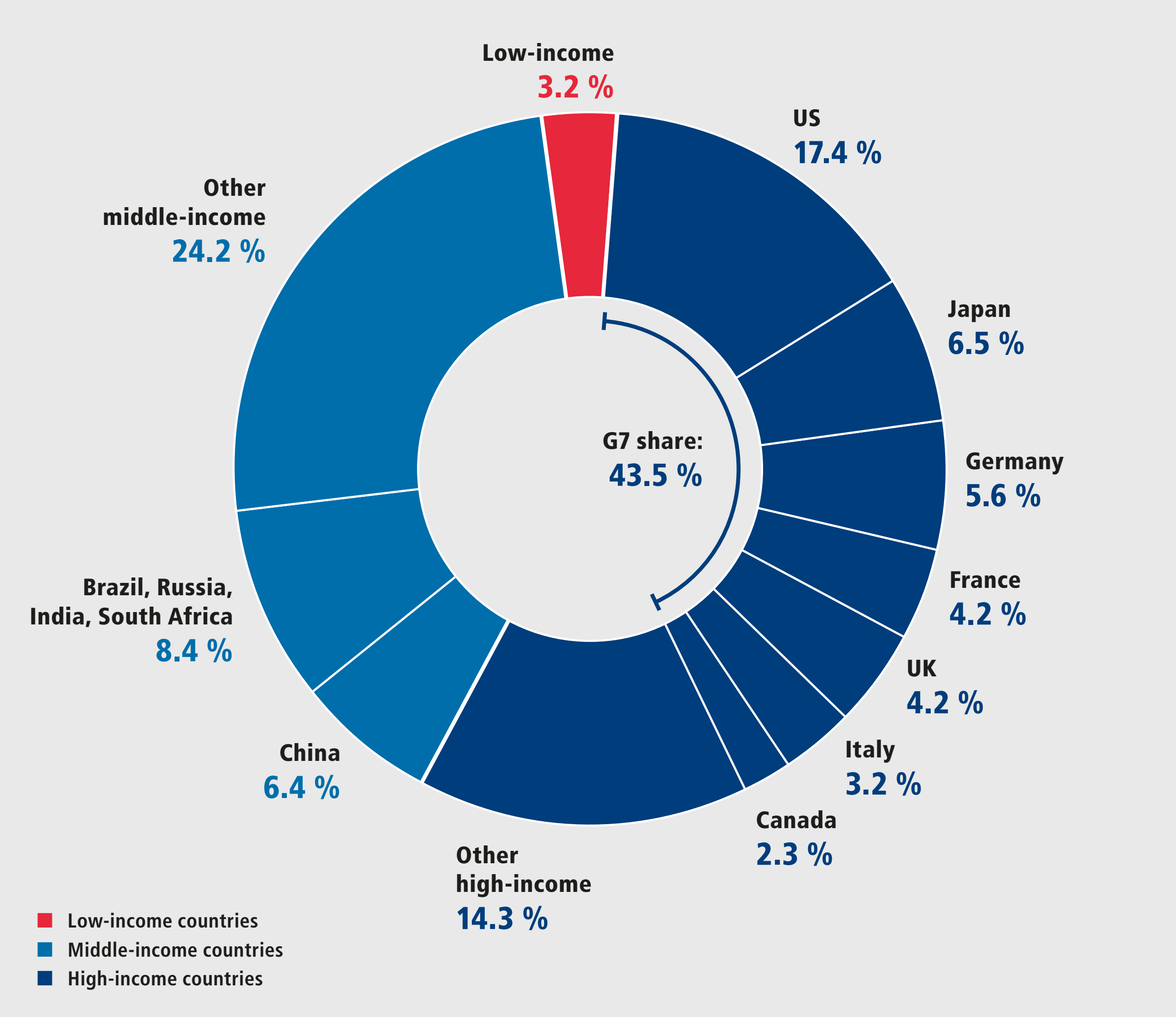
7 Cf. the statements by IMF Director Kristalina Georgieva and IMF Press Spokesman Gerry Rice in https://www.latindadd.org/2021/02/12/civil-society-organizations-call-for-quick-special-drawing-rights-allocation/, S. 11

8 Cf. for country allocation: https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation

9 The German Bundesbank's reply to written inquiries by civil society

10 https://www.imf.org/en/News/Articles/2021/08/23/pr21248-imf-managing-director-announces-the-us-650-billion-sdr-allocation-comes-into-effect

Country shares of the SDR special allocation



Source: Financial Times, based on IMF data

In a survey, the rating agency Standard & Poor´s (S&P) analyzed the impact which the most recent SDR allocation had had on the solvency and creditworthiness of 44 emerging economies and developing countries valued with the rating "B+" or lower.[11] S&P first arrives at the insight that the corona crisis really has caused solvency crises. Foreign exchange revenue of the group of countries analyzed dropped by 4.8 percent in the crisis year of 2020, and hence even more strongly than their economic performance. The group's net reserves (excluding Argentina, Iraq and Turkey) had shrunken by 25% or 72.1 billion US dollars to just 220 billion US dollars within just one year.

The S&P survey concludes that with the current allocation, reserve adequacy was restored, i.e. foreign exchange reserves were raised to a sustainable level, in a mere 5 of the 44 countries examined – in Benin, El Salvador, Jordan, Zambia and Togo. The reason for this small number is that the countries analyzed are relatively small economies which received only little of the SDR pie owing to the allocation formula being based on the IMF quota.

However, if the rich IMF Member States were to declare their willingness to redistribute 42% of their share of the SDR allocation, all the countries examined would once again achieve a sustainable level of foreign exchange reserves, according to the S&P survey. The stabilization of these countries would also have a positive impact on worldwide economic growth as a whole, so that it would indirectly benefit all countries.

Already after the 2009 allocation, it became apparent that too large a share of SDR allocations was ending up in countries not in any need of them, and

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

that they were therefore lying idle in central bank accounts in the Global North. The UN demanded as early as 2011 that future SDR allocations be distributed in a more needs-oriented manner benefiting the developing countries in the future.[12] Since no reforms were carried out in this respect at the IMF in the past decade, the lion's share of the new allocations has also been received by the wrong countries.

Regarding a reform of the IMF, the urgent question arises how the distribution process can be optimized in the future to make more use of SDR allocations to support countries experiencing financial difficulties and to support implementing Agenda 2030. As far as the latest allocation is concerned, the task to address is that of making the large share of unused SDRs in rich countries usable through rechanneling.

What can the SDRs be used for?

As yet, only little experience has been gathered regarding the practical use of SDRs. After all, together with the 2009 precedent, this is only the second time that a major SDR allocation has taken place. First of all, it has to be noted that SDRs can be directly used for only a few monetary purposes, such as payments to the IMF, to multilateral development banks, or for transactions among central banks. In order to be used for "fiscal" purposes of any kind, whether it be investment programs to stimulate the economy, social welfare programs, vaccination campaigns or measures to combat climate change, the SDRs first of all have to be changed into hard currency such as the US dollar, the euro, the yen or the renminbi. This is possible at any time since the IMF set of rules oblige Member States controlling these currencies to exchange currency.[13]

Currency reserves

Frequently, SDRs are also simply kept as currency reserves in central bank accounts. This may sound unproductive, but for developing countries in particular, it is a legitimate purpose. Not only do larger currency reserves generally promote stability, their level is also a crucial criterion for the risk premium which a country and all the borrowers in this country have to pay if they wish to take out a loan on international capital markets. The higher the currency reserves, the more cheaply a country will be able to obtain capital, and therefore the lower interest expenses will be for foreign debt.

In many developing countries, the currency reserves consist of foreign exchange – usually US dollars – which had to be mobilized on international capital markets via expensive loans or bonds. SDRs can replace such expensive loans, the interest rates of which are often 10 percent or more. A country now having received SDRs worth 1 billion US dollars could correspondingly reduce its US dollar reserves by 1 billion, thus saving 100 million dollars a year in interest rates, which would release scarce funds for other purposes.

Fiscal spending

However, in many developing countries, in the midst of the COVID-19 crisis, there is an acute need of finance to support state budgets. The crisis has led to a scissors effect which has caused a humanitarian crisis in many countries. Traditional sources of income such as tax revenue have dried up through the recession, whereas additional spending on social welfare programs or healthcare should have taken place but was impossible for many governments of poorer countries owing to a lack of recourses. As a result, poor and vulnerable groups of the population in particular are affected by the lack of finance for healthcare and social welfare programs.

Fresh finance could for example enable countries in the Global South to at last provide their population with vaccines and thus create more vaccine justice between North and South. Overall, of course, the financial requirements for restoration after the corona crisis in the sense of Building Back Better are enormous. Here, the IMF SDR injection Kristalina Georgieva called the allocation "a shot in the arm for the global economy at a time of unprecedented crisis" [14] can at least fill some gaps. The 2009

12 https://www.un.org/en/development/desa/policy/wess/wess_current/2012wess.pdf

13 This can be done up to a certain limit set by double the amount of their own SDR allocation.

14 https://www.imf.org/en/News/Articles/2021/07/30/pr21235-imf-governors-approve-a-historic-us-650-billion-sdr-allocation-of-special-drawing-rights

allocation was already used by many countries for fiscal purposes, also by European countries such as Bosnia, Serbia and Ukraine.[15]

In order to be employed for fiscal purposes such as investments in social and health sectors, or also in infrastructure and economic development, the SDRs have to be added to the state budget. A recent survey by Ecuadorean economist and former presidential candidate Andrés Arauz for Latindadd identifies four ways in which this can be done:

1. Central banks can immediately instruct the IMF's SDR department to change the SDRs into US dollars or euros. Subsequently, the central bank credits the US dollar deposit to the ministry of finance's account at the central bank. The ministry of finance designates the amount as capital revenue in the budget and can cover expenditures. This model was used in Ecuador in 2009.

2. Countries can set up Exchange Stabilization Funds (ESFs) into which the SDRs are paid. Having received the SDRs, it issues securities, so-called SDR certificates, and sells them to the central bank, which then pays the corresponding amount in US dollars to the ministry of finance and now is holder of the SDR certificates. This is the model which the USA is applying. The precondition for this is that the SDRs go directly from the IMF to the government's ESF, and not to the central bank.

3. If the SDRs first go to the central bank, the latter can book this allocation as extraordinary revenue or otherwise in its balance, which, after the annual statement of accounts, allows a sum of the same amount to be paid out to the ministry of finance as a dividend. With a corresponding agreement, this can already be accomplished before the fiscal year draws to a close.

4. Finally, the central bank can also credit the SDRs to its balance, which raises its asset side level as well. It subsequently buys securities of the same value from the government, in national or foreign currency.

Which approach is optimal depends on the institutional circumstances of each country. However, the Latindadd survey shows that in each system, there is a way to employ SDRs for concrete budgetary purposes as well. Thus new and additional measures to counter the COVID-19 crisis can quickly be financed.[16]

What options are there for a rechanneling of SDRs?

Since the lion's share of the SDR allocations went to countries which do not need them, the question arises how this share can be channeled towards sensible purposes and effectively be used. This rechanneling is all the more urgent since the latest SDR special allocation's volume is so low owing to the political majority situation in the USA. This makes it all the more important to keep the worldwide share of unused SDRs as low as possible. The discussion on rechanneling is in full swing, and in some countries, concrete steps have already been initiated. Here too, there are different options:

Rechanneling by the IMF

Since the SDRs are, as it were, the IMF's currency, it suggests itself to also use IMF instruments for rechanneling. Member States can also pay contributions to the IMF in SDRs. Especially in the case of payments to the Poverty and Growth Trust (PRGT), this is not unusual. As an existing IMF facility, the PRGT awards loans currently interest-free to low-income countries. However, the PRGT cannot award any loans to middle-income countries.

In the current debate, the IMF itself has suggested a new instrument which middle-income countries would also have access to: a new Resilience and Sustainability Trust (RST). The RST also ought to be able to focus its operations more on individual topics, for example on financing measures in the area of adaptation to and mitigation of climate change. However, critics argue that engaging in climate financing would mean overstretching the IMF's mandate, and that such steps had better be left to specialized funds and development banks.[17]

15 For a full list, see p. 12 in http://www.latindadd.org/wp-content/uploads/2021/08/Handbook-for-the-use-of-SZRs-for-Fiscal_Purposes.pdf
16 Cf. pp. 15-20 in http://www.latindadd.org/wp-content/uploads/2021/08/Handbook-for-the-use-of-SZRs-for-Fiscal_Purposes.pdf
17 https://www.imf.org/en/News/Articles/2021/07/11/sp071121-md-on-global-policies-and-climate-change

Rechanneling by other prescribed holders

As prescribed holders, numerous development banks can also receive the contributions of their member states in SDRs and thus finance their programs. The group of prescribed holders currently comprises 15 international organizations, which together cover all of the world's major regions. It would also be conceivable to extend this group to new funds and facilities.

Prescribed holders of SDRs

African Development Bank
African Development Fund
Arab Monetary Fund
Asian Development Bank
Bank for International Settlements
Bank of Central African States
Central Bank of West African States
Eastern Caribbean Central Bank
European Central Bank
International Bank for Reconstruction and Development
International Development Association
International Fund for Agricultural Development
Islamic Development Bank
Latin American Reserve Fund
Nordic Investment Bank

Redirection via the ACT Accelerator or the Green Climate Fund

It is incontestable that financing vaccination campaigns and combating global warming belong to the most urgent tasks of our times. In this context, it is embarrassing that the programs of the international community combined in the Access to COVID-19 Tools (ACT) Accelerator to address the COVID pandemic in countries which are not capable of doing this themselves continue to be massively underfunded. In the field of climate change, too, rich countries have not fulfilled their pledge of years ago to make an annual 100 billion dollars available for climate financing.

So here, it would be a straightforward decision for rich countries to redirect their unused SDRs to the ACT Accelerator or to climate instruments such as the Green Climate Fund and thus make them available for sustainable development targets. One problem is that these have so far not belonged to the prescribed holders of SDRs who are allowed to make payments in SDRs. But with the respective political commitment, a solution to this problem could also be quickly found. For example, one of the prescribed holders could be inserted into the financing process, or, as described above, the countries could first change the SDRs into fiscal resources in order to then transfer them as US dollars or euros. If the resources were then paid out as grants, this would also create the advantage for the recipient that no new debts would thus arise a major advantage compared to redistribution via an IMF facility or loans from a multilateral development bank.

What is the situation like in Germany?

Already early in the corona crisis, Germany had called for an SDR allocation by the IMF. This was explicitly referred to by Federal Chancellor Merkel at the United Nations in May 2020. In early August 2021, Finance Minister Scholz welcomed the fact that a decision had at last been taken regarding allocation, and in particular stressed its value for the emerging economies and developing countries.[18] Germany also supports the resolution of the G7 Summit Carbis Bay of June 2021, in which the G7 committed to the redistribution of SDRs or an equivalent amount of budget loans and seek a global target of 100 billion dollars.[19] French President Macron explicitly called for a redistribution for the benefit of African countries.[20] So political pressure on Germany is high, also because close partners like the USA have already introduced the necessary administrative steps.[21]

18 https://www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2021/08/2021-08-03-scholz-begruesst-historische-entscheidung-iwf.html

19 https://www.g7uk.org/wp-content/uploads/2021/06/Carbis-Bay-G7-Summit-Communique-PDF-430KB-25-pages-3-1.pdf Paragraph 65

20 https://taz.de/IWF-Hilfe-zur-Pandemiebekaempfung/!5786540&SuchRahmen=Print/

21 The US government motioned parliament to use SDRs to the tune of 21 billion US dollars for loans provided by the IMF for the PRGT.

On August 23 2021, Germany received 25.5 billion SDRs from the IMF. This sum was initially credited to the Bundesbank. Germany only has very vague regulations on the handling of SDRs, unlike the USA, for example, where this is governed by a special law.[22] The term occurs just once in Article 3 of the German IMF law of 1976, which states that SDRs are to be transferred to the Bundesbank. But the IMF law makes no reference to potential purposes of using SDRs or to options for reallocation.[23]

Neither does the 1992 Federal Bank Law (Bundesbankgesetz) offer any guidelines, since it contains no provisions on SDRs. It is obvious that the legislator saw no priority in the issue of using more substantial SDR allocations in 1976 and 1992. After all, this issue only arose for the first time in 2009, and then reemerged just recently. In any case, the relevance of national legislation in this context is controversial. In the Latindadd survey referred to above, Arauz argues that the IMF Articles of Agreement define the sovereign Member States as the recipients of the SDRs and that the central banks merely act as agents who are not in a position to deny governments access to the SDRs. As an international agreement, the IMF Articles of Agreement are superior to national law, Arauz maintains.[24]

Responding to a civil society inquiry, the German Bundesbank announced that it booked in SDRs received in Germany as currency reserves. In the central bank's balance sheet, they were referred to as claims on the IMF, together with a corresponding counterpart on the liabilities side. Thus SDR allocation acted merely as extending the balance sheet.[25] The volume of the huge SDR allocation to Germany really is as high as the entire amount of foreign currency reserves which the Federal Bank previously held.[26] Since no one has so far doubted that Germany's currency reserves are insufficient for their purposes, raising these reserves by the amount of the current SDR allocation has no recognizable additional benefit, neither for Germany, nor for the rest of the world.

Regarding their use for other purposes, the Bundesbank has so far mainly rejected corresponding political inquiries, referring as a rule to the Bundesbank not being allowed to give away Federal reserves, or stating it is not holding responsibility. Regarding the PRGT, the Bundesbank states: "The SDRs allocated to Germany are not available for award as loans by the Bundesbank to the Poverty Reduction and Growth Trust (PRGT), which is a trustee fund administrated by the IMF. The same applies to possibly newly created, similar trustee funds. The reason for this is that such sums do not represent any obligation arising from Germany's IMF membership for which the Bundesbank would be responsible in accordance with the (German) IMF law. Donations or grants comprising SDRs to the PRGT or similar trustee funds are ruled out as well. There are no legal regulations allowing the Bundesbank to award such donations or grants."[27]

However, the Bundesbank's argument is based on the assumption that SDRs are currency reserves in the narrow sense. Here, the IMF itself has a different view, which it has once again clarified in the context of the current SDR allocation: "Once allocated, members can hold their SDRs as part of their foreign exchange reserves or sell or use part or all of their SDR allocations. Members can exchange SDRs for freely usable currencies among themselves and with prescribed holders. (&) IMF members can also use SDRs in a range of other authorized operations among themselves (e.g., loans, payment of obligations, pledges) and in operations and transactions involving the IMF, such as the payment of interest on and repayment of loans, or payment for quota increases."[28]

So from the angle of the IMF, there is no reason for Member States to adhere to more stringent restrictions. On the contrary, the purpose of the special allocation is to stimulate the world economy in general, and in particular, to create new resources for the most vulnerable countries. This can only be achieved if a maximum share of SDRs is effectively employed.

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22 https://www.govinfo.gov/content/pkg/STATUTE-82/pdf/STATUTE-82-Pg188.pdf

23 Assets (special drawing rights, sums in Deutschmarks or foreign currency or gold), to be provided to fulfill claims by the Federal Republic of Germany resulting from its membership of the International Monetary Fund are transferred to the German Bundesbank. https://www.bgbl.de/xaver/bgbl/start.xav?startbk=Bundesanzeiger_BGBl&start=//* %5b@attr_id= %27bgbl278s0013.pdf %27 %5d#__bgbl__ %2F %2F* %5B %40attr_id %3D %27bgbl278s0013.pdf %27 %5D__1629377124148

24 http://www.latindadd.org/wp-content/uploads/2021/08/Handbook-for-the-use-of-SDRs-for-Fiscal_Purposes.pdf

25 Civil society actors have addressed several inquiries to the Bundesbank. Special thanks for this above all goes to Malina Stutz (erlassjahr.de) and Wolfgang Obenland (Forum Environment and Development).

26 The item Credits in banks, securities, foreign loans and other foreign assets was at a total of 30 billion euros in late 2020. https://www.bundesbank.de/resource/blob/860410/75654099b0a3b19e9869982fa69d4a39/mL/2020-geschaeftsbericht-data.pdf p. 56

27 Bundesbank reply to a written inquiry by civil society.

28 https://www.imf.org/en/About/FAQ/special-drawing-right

There is enough demand. For example, according to the World Health Organization (WHO), the financing gap in the ACT Accelerator, with which the COVID vaccinations, tests and therapies are financed in the Global South, is at a current 16.6 billion US dollars.[29] With the amount currently residing in the accounts of the Bundesbank, this gap could be filled completely. The humanitarian crisis in the Global South could then be mitigated, and the basis for a sustainable recovery after the COVID-19 crisis could be created which would also benefit Germany. Much can be gained through the reallocation of the German SDR share, and apart from the low interest rates of 0.05% for the recipient countries and a lower Federal Bank balance, there is nothing to lose.

What role can SDRs play beyond the crisis in development financing?

The IMF special drawing rights also play a role in the discussion over innovative financing instruments. Already in 2012, the UN emphasized that SDRs could contribute an additional 100 billion US dollars to finance development and global public goods as well as to combat climate change, and could do so each year.[30] Here, the UN experts recommended the simultaneous use of two instruments: both annual special allocations and the rededication of existing SDRs.

Furthermore, in annual allocations, the distribution formula ought to be altered so that the new allocations would benefit developing countries to a greater degree. According to the proposal, at least two thirds ought to go to developing countries. Bit by bit, these could then replace their currency reserves, which nowadays consist of hard currency reserves saved with great effort or borrowed on the financial markets at sometimes excessive interest rates. While the SDRs would thus not immediately be used for development financing, they would indirectly release budgetary funds currently tied into foreign exchange reserves which could in future be used to finance sustainable development targets.

The second proposal centers on the rededication of unused SDRs. The first major IMF special allocation in 2009 suffered from distribution according to the existing IMF quota not resulting in new SDRs going where they were needed in the Global South. Unused SDRs could be used to leverage additional development financing by being employed to buy bonds from multinational development banks in order to raise the latters capacity to award loans. They could also be paid into trustee funds as SDR equity. In 2012, the UN experts explicitly proposed the Green Climate Fund. With such a security, funds of this kind could acquire the tenfold volume of capital via bonds from the capital markets. If additionally existing risk requirements were lowered in this context, the SDRs could even retain their role as a reserve asset in the operation. The UN experts maintained that this was possible in analogy to the practice of several countries to transfer surplus currency reserves to Sovereign Wealth Funds.

The proposal to apply SDRs in development financing has also been broadly welcomed by civil society. Already in 2015, one of international civil society's chief demands on the occasion of the Third UN Conference on Financing for Development in Addis Ababa was: "Issuing 250 billion US-Dollar in new SDRs annually, with the allocation based on economic need and the majority going to developing countries, and amending the IMF's Articles of Agreement to allow this."[31] This would at least provide one supporting pillar to place financing Agenda 2030 and the Sustainable Development Goals on a sound basis.

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29 as of August 13 2021; https://www.who.int/publications/m/item/access-to-covid-19-tools-tracker

30 World Economic and Social Survey (WESS) 2012: In Search of New Development Finance; https://www.un.org/en/development/desa/publications/wess2012.html

31 https://www.globaltaxjustice.org/sites/default/files/Eurodad-FfD-position-paper-English1_0.pdf

Conclusion

In quantitative terms, the special allocation of SDRs to the tune of 650 billion US dollars represents what has so far been the most significant response by an international organization to the COVID-19 crisis. The additional funds can be used for numerous crisis-relevant purposes. Especially for countries in the Global South, which, unlike rich countries, have been able to mobilize only little finance of their own, SDRs represent a welcome cash injection, the long hoped for shot in the arm, as IMF head Georgieva put it.

However, a number of obstacles have arisen which prevent these measures from developing their impact to the full. Allocation has been delayed for political reasons, and it is only taking place 17 months after the onset of the corona crisis. Also for political reasons, at 650 billion US dollars, the allocation remains below actual requirements, which the UN has put at 1 trillion US dollars and civil society at 3 billion US dollars. Since allocations are distributed among all IMF Member States corresponding to their quota, even this measure offers the richer countries more benefit than the poorer ones. So under the current IMF provisions, it only contributes to creating more just relations between the North and the South to a limited degree.

Rich countries can, and should, redistribute their allocations. There are numerous ways and channels to accomplish this, some of which are referred to in this briefing. An optimal approach which is also emphatically called for by civil society would be to retain certain features of SDRs, including that SDR reallocation does not create any new debt, and that it is free from policy conditions.[32]

Whereas other countries have already taken steps towards rechanneling, Germany has not moved so far. The Bundesbank has interpreted the vague legal framework provided by the 1976 IMF law in its own favor and assumed control of German SDR allocation, to which the Federal Government has as yet not objected.

Despite the IMF explicitly having defined the purpose of allocation as that of providing poorer countries with resources to cope with the crisis, the Bundesbank firmly rejects any use for development cooperation purposes or global tasks such as combating the COVID pandemic or global warming, referring to its not being responsible for such tasks. However, the Bundesbank does not mention any other sensible use of the SDRs, resulting in more than 25 billion SDRs, and thus more than 5 percent of the entire IMF special allocation remaining unused and parked in Bundesbank accounts. As explained above, the amount in question would for example be sufficient to completely fill the financing gap in the ACT Accelerator and thus create worldwide access to COVID-19 tests, therapies and vaccines.

While the political discussion over the use of new SDR allocation has only just started in Germany, a number of lessons can already be learnt from the international debate. In Germany, the legislator's handling of SDRs ought to be newly clarified in the light of the special allocation campaigns of 2009 and 2021. The agenda for IWF reform should include how future SDR allocations ought to be approved and designed in order to be carried out in time and for SDRs to be distributed according to need. Urgent steps ought to be taken to prevent ending up with a too little too late allocation in the next crisis, and the problems with reallocation in a second step could be avoided if SDR allocation were to already reach its target in the first step.

Such reform steps are all the more important since the SDRs could still be looking forward to a great future. In academic debate, the view has been maintained for more than a decade that regular SDR allocations can be used as a development financing instrument, and can complement the traditional system of Official Development Assistance (ODA). Given the urgency of finding effective financing approaches for Agenda 2030 and the global climate goals, once the COVID-19 crisis is over, the slogan could indeed be: SDR to the rescue!

32 https://www.globalpolicy.org/en/news/2021-09-29/open-letter-g20-finance-ministers-central-bank-governors-and-imf-civil-society

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IMF Special Drawing Rights – exiting the COVID-19 crisis via a historic cash injection?

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