COVID-19
Report
ECA-ECLAC

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Special Drawing Rights (SDRs) and the COVID-19 crisis

Key messages

- Developing economies are the primary users of Special Drawing Rights (SDRs) and are much more dependent on them than developed economies. The analysis of net SDR positions shows significant differentiation in SDR utilization rates between developing economies (42.9%) and developed economies (5.9%). More than 70% of the 190 IMF participant economies are under pressure, with SDRs holdings below their SDRs allocations.
- The SDR allocation of US$ 650 billion implemented in August 2021 benefits all countries, but with about two thirds (US$ 420 billion) of this going to developed economies, the balance will fall woefully short of developing countries' financial needs.
- The new SDR allocation improves global and developing economies' balance-of-payments positions by increasing the share of SDRs in the reserve assets for all countries, thereby providing a direct liquidity boost to developing countries, without raising debt burdens.
- To address low- and middle-income countries' development financing needs, leveraging SDR reallocation through on-lending vehicles, such as the Liquidity and Sustainability Facility (LSF), a trust for middle-income countries, multilateral and regional development banks as well as the Poverty Reduction and Growth Trust (PRGT), is essential to provide an appropriate window for financing development and global public goods (e.g. procurement of vaccines and creation of a vaccine facility).
- The coronavirus disease (COVID-19) pandemic is the worst global crisis since the Second World War, with developing countries suffering more devastating economic and social effects than developed countries. These effects are not limited to the short run but will extend into the medium- and long-run horizons. Governments' increased pandemic-related expenditure (on health facilities, cash

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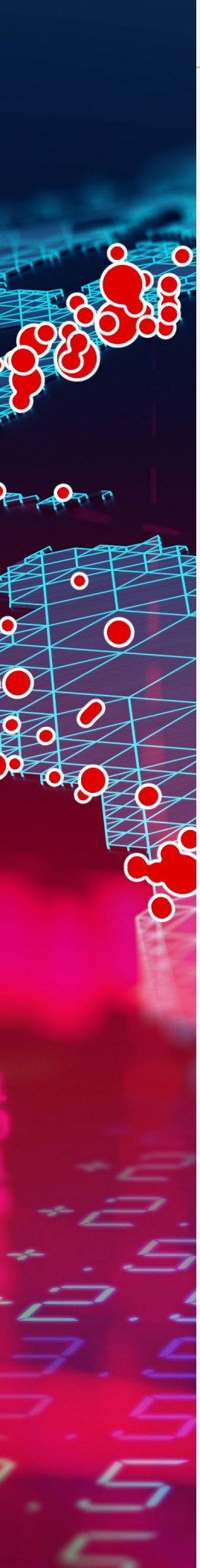

transfers and income support to firms and individuals, especially informal workers) combined with the drastic fall in tax revenues have increased their fiscal deficits and heightened their debt vulnerabilities.

- The generalized increase in fiscal imbalances and indebtedness has given rise to greater liquidity needs across developing countries, despite considerable heterogeneity in their fiscal positions and debt profiles. Moreover, COVID-19 has impacted some of these economies at a time of record debt levels. The widening internal financing gap is compounded by the deterioration in the balance-of-payments positions of some economies resulting from the decline in exports of goods and services and disruptions in the global supply chain.
- In response to these fiscal pressures, the IMF initiated programs to ease the liquidity constraints of low- and middle-income countries through several emergency financing lines. In parallel, the Group of 20 (G20) countries also initiated a standstill on the official bilateral debt service of 73 low- and lower-income economies lasting from May 2020 to December 2021. However, the liquidity provided through these initiatives has not been commensurate with the financing needs of low and middle-income countries.
- Easing liquidity constraints and expanding fiscal space for all developing countries requires alternative mechanisms in addition to existing credit facilities. The new general allocation of US$ 650 billion in Special Drawing Rights (SDRs) implemented on 23 August 2021 provided the most expedient mechanism to provide concessional liquidity at scale to all countries regardless of their level of income. Aside from its agility and financial effects, SDRs are the only democratic device to enhance policy space in developing economies, as it comes with no strings attached (in other words, conditionalities).
- SDRs have several advantages over other IMF credit facilities and financing lines, including the fact that they do not generate debt, have a very low cost of use, and can reduce the risk premium for highly indebted countries. The new issuance of SDRs can help boost the level of international reserves of developing economies, strengthen their external positions, reduce their liquidity and default risk, and free up resources to meet the Sustainable Development Goals (SDGs).
- The new allocation will however, benefit developed economies disproportionately unless they agree to voluntarily on-lend their unutilized holdings of SDRs to developing economies. A major argument for reallocation is that in contrast to developing economies, developed economies have ample fiscal space and are less dependent on SDRs as attested by their low levels of SDR utilization. The rate of SDR utilization can be used as a benchmark for determining the value of SDRs that developed countries can channel to developing countries.
- Four modalities are proposed for the reallocation of SDRs. The first involves bolstering the International Monetary Fund's Poverty Reduction and Growth Trust (PRGT). The second is a proposal to create a fund for middle-income countries to finance SDG-related investment projects. The third is to allocate SDRs to fund the Liquidity and Sustainability Facility (LSF) proposed by the Economic Commission for Africa (ECA) and the Pacific Investment Management Company (PIMCO). The fourth modality is to use SDRs to enhance the lending capacity of development banks and bolster regional financing institutions.

A. The pandemic and developing countries' financing needs

- The policy responses of governments to offset the effects of the pandemic have been costly. The liquidity needs of countries have increased substantially and contributed to rising debt levels and increased external debt servicing costs with adverse implications for recovery and countries' capacity to build forward better. Table 1 shows the negative effects of the pandemic on the external debt of all developing regions measured either as a percentage of exports of goods and services or of GDP.[1]

[1] The external debt to GDP ratio may overstate the increase in debt as it also captures the decline in GDP. In this sense the ratio of external debt to exports of goods and services is a more accurate indicator of the effects of the Pandemic on debt levels.

Table 1 | Selected regions and groupings: external debt indicators for emerging markets and developing economies, 2019–2020
(Percentages)

Region	External debt as percentage of exports of goods and services		External debt percentage of GDP		External debt service as percentage of exports of goods and services	
	2019	2020	2019	2020	2019	2020
Emerging markets and developing economies	116.6	136.4	...	....	42.1	48.2
Emerging and developing Asia	86.0	95.7	18.8	19.5	47.2	50.1
Emerging and developing Europe	120.9	141.9	46.8	51.7	42.5	49.8
Latin America and the Caribbean	192.6	226.7	47.9	56.3	50.9	59.0
Middle East and Central Asia	125.0	176.6	46.8	53.9	22.2	31.8
Africa	102.9	100.9	39.3	43.7	25.0	24.3
Africa (excluding North Africa)	172.5	228.1	42.6	46.1	28.5	35.9

Source: International Monetary Fund (IMF), World Economic Outlook Database, October 2021 [online] https://www.imf.org/en/Publications/WEO/weo-database/2021/October.
Note: Since most countries experienced an economic contraction in 2020, the external debt-to-GDP indicator may overstate the increase in debt.

- In Africa, 24 countries have recorded a debt-to-GDP ratio above 60% as of December 2020. The debt-to-GDP ratios of Angola, Mozambique, Sudan, Zambia, Cabo Verde, Eritrea and Congo exceeded 100%. As of June 2021, IMF reported 6 countries, (i.e., Sao Tome and Principe, Mozambique, Sudan, Zimbabwe, Somalia and Congo) to be in debt distress. These figures may increase if proactive measures are not taken to bailout countries.
- For its part, Latin America and the Caribbean is the most indebted region of the developing world with a general government debt reaching 77% of GDP and an external debt as a percentage of exports of goods and services equal to 226.7% in 2020. Latin America and the Caribbean also has the highest debt service in terms of exports of goods and services (59%). The region also has the largest number of countries with government debt-to-GDP ratio above 100% (47% of the total) which are found mostly in the Caribbean (table 1).
- The rise in debt and debt costs has not only significantly reduced the policy space of developing countries to undertake countercyclical policies to combat the short-run effects of the pandemic but also constrained their policy autonomy for longer-term economic and social development.
- In contrast, developed countries implemented massive fiscal stimulus packages to complement expansionary monetary measures unconstrained by liquidity ceilings and macrostability considerations. This is a stark reflection of the asymmetry in policy space autonomy of both types of economies.[2]
- While international financial institutions, including IMF and multilateral development banks, have increased their support particularly to low-income countries, their resource injections have not been commensurate with the financing needs of developing economies. Between the start of the pandemic in March 2020 and March 2022, IMF granted funding equivalent to US$ 171 billion to 90 developing economies. This drops to a mere US$ 75.4 billion —a figure similar to the US$ 75 billion in IMF funding commitments between January and September 2009, during the global financial crisis— when the amount for flexible credit lines is excluded (table 2).
- However, the overall financing needs of developing countries were estimated at US$ 2.5 trillion as of March 2020. Current needs may actually be higher when the additional financing needs imposed by the pandemic are taken into account. Nevertheless, even the conservative estimate exceeds the IMF lending capacity, estimated at a total of US$ 1 trillion.
- Furthermore, taking into account the Fund's lending commitments as well as the unusable quota resources and the prudential balances, a more precise computation puts its lending capacity at a lower figure of roughly US$ 800 billion.

[2] From the outbreak of the pandemic to March 2021, advanced economies mobilized 16.4% of GDP in additional expenditures and tax credits and 11.3% of GDP in loans, capital and guarantees, compared to 10.7% and 7.2%, respectively, in emerging markets. The response capacity in low-income developing countries was even lower, with additional expenditures and tax credits equivalent to 1.7% of GDP and 0.2% of GDP in loans, equity and guarantees (IMF, 2021d). See also ECLAC (2021a).

Table 2 | Selected regions: International Monetary Fund financial assistance to address the effects of COVID-19, with and without flexible credit lines, by region, 2022
(Billions of dollars and percentages)

Region	With flexible credit lines *(billions of dollars)*	Share *(percentages)*	Without flexible credit lines *(billions of dollars)*	Share *(percentages)*
Asia and Pacific	2.6	1.5	2.6	3.4
Europe	6.7	3.9	6.7	8.9
Middle East and Central Asia	5.4	3.2	5.4	7.2
Africa	38.0	22.2	38.0	50.4
Latin America and the Caribbean	118.3	69.2	22.7	30.1
Total	**171.0**	**100.0**	**75.4**	**100.0**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), International Monetary Fund (FMI), "IMF Financing and Debt Relief Service", 2021 [online] https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker.
Note: Latin America and the Caribbean is the only region with flexible credit lines. These were provided to Chile, Colombia, Mexico and Peru, totalling US$ 96.5 billion and representing 56% of the total financial assistance provided by IMF. Data for Africa include Algeria, Djibouti, Egypt, Libya, Mauritania, Morocco, Somalia, Sudan and Tunisia. The most recent data refer to March 2022.

- The financing facilities most frequently used by IMF include the Rapid Financing Instrument (RFI), and the Rapid Credit Facility (RCF).[3] While these financing windows are not subject to the type of macroeconomic preconditions required by the Flexible Credit Line (FCL) they are much smaller in value than the resources available through traditional IMF programmes such as the Stand-by-Arrangement, precisely because of their limited policy conditionalities.
- Available data for Latin American and Caribbean countries show that the finance provided under RFI and RCF covered on average only 23.1% and 32.3%, respectively, of countries' financing needs for 2020. This is equivalent to 0.8% and 2.1% of GDP and between 6.5% and 8.0% of international reserves (ECLAC, 2021b).
- In Africa, the Extended Credit Facility (ECF) and RCF accounted for about 0.2% and 1% of GDP and 3% and 14%, respectively, of international reserves. In the case of Asia and the Pacific, the IMF emergency facilities amounted to 1.3% of GDP, 6.7% of international reserves and 5.2% of exports of goods and services.
- For the Middle East and Central Asia, these facilities represented 2.6% of GDP, 8.3% of international reserves and 13.4% of exports of goods and services. In emerging Europe, they accounted for 1.8% of GDP, 7% of international reserves and 6.1% of exports of goods and services.[4]
- Besides IMF emergency lending facilities, countries have three other alternatives to access funding: apply for an IMF standard programme with the associated conditionalities, request loans from multilateral development banks, or tap into the international bond market.
- However, like IMF, the World Bank provided less support to offset the effects of COVID-19 than that granted during the 2008–2009 global financial crisis. The additional funds committed by the World Bank to address the pandemic in 2020 (US$ 13 billion) was less than half the amount committed for the global financial crisis (US$ 28 billion).
- Tapping into the international capital market is not an option available to all developing countries. Furthermore, the conditions for accessing private capital markets are not the same for all countries. The largest economies are the ones that use the capital market for sovereign bond issuance most frequently, while smaller economies rarely turn to it.
- In addition, factors relating to liquidity and credit risk tend to push up the cost of issuing sovereign bonds for smaller economies. The debt service cost is therefore much higher for developing

[3] The main difference between RFI and RCF is that the latter provides concessional financing and is a component of the Poverty Reduction and Growth Trust, the Fund's financing facility for low-income countries. As a result, while RFI is available to all countries, those that qualify for financing under the Poverty Reduction and Growth Trust (PRGT) tend to use RCF and/or the Extended Credit Facility. In Asia and the Pacific, all the countries that were granted financial assistance for COVID-19 used RFI and/or RCF. In the case of emerging and developing Europe, 85% of countries used RFI or both, compared with 69% in the Middle East and Central Asia, 92% in Africa, and 74% in Latin America and the Caribbean. Only one country in emerging and developing Europe region used another IMF programme, while 38% of Middle East and Central Asian countries, 24% of African countries and 36% Latin American and Caribbean countries used other IMF programmes. See, IMF (2021b). IMF also provided funding for debt service relief through the Catastrophe Containment and Relief Trust (CCRT) to 30 countries, most of which are in Africa, for a total of US$ 727 million in 2020.
[4] On the basis of IMF and World Bank data.

economies than for developed economies. A comparison of the debt service costs of South Africa, Brazil, India, Indonesia and Mexico with those of the Group of Seven (G7) shows that these costs are roughly six times higher for the group of developing economies than the latter group.[5]

- Another factor is that despite the current low nominal interest rates enjoyed by sovereign bond issuers, in some cases these rates exceed the historical trend of real GDP growth rates. This will pose a debt sustainability problem over the medium to long term.[6]
- Lastly, because capital markets are highly sensitive to international financial conditions and private investors' risk perceptions regarding issuing countries, they are particularly volatile and susceptible to sudden reversals. In the current context, the adoption of expansionary monetary policies by the central banks of developed economies, in particular, the United States Federal Reserve, has encouraged private investors in emerging economies to pursue higher returns. However, the upward trend in long-term interest rates seen since the beginning of 2021, coupled with the rising spectre of an inflation comeback, could reduce the incentive to invest in emerging economies.
- The weak response of international public financial institutions, along with the high cost of indebtedness, unequal and costly access to private capital markets and the risks that they entail, make it necessary for countries to count on a more stable, affordable and potent source of finance, such as SDRs.

B. SDRs and their advantages

- SDRs are an international reserve asset created by IMF to supplement member countries' official reserves.[7] They represent a potential claim on the freely usable currencies of IMF members and can be exchanged for these currencies. SDRs can be used by IMF members and prescribed holders for a wide range of operations, including payments of financial obligations, loans, pledges, donations, swaps and forward transactions.[8]
- IMF upholds that there is no prescribed use for SDRs. The use of SDRs is a prerogative and sovereign decision of countries. Countries can use them in transactions by exchanging their SDRs for freely usable currencies or in operations authorized by the Fund (IMF, 2021f, p. 12).
- According to IMF (2021f, p. 14) and in line with the Articles of Agreement of SDRs, the use of SDRs holdings should be designed to preserve macroeconomic sustainability including monetary and external sustainability. SDRs are generally administered by central banks and in some cases by the treasury. Depending on the domestic legislation, central banks can either retain SDRs as international reserves or on-lend them to their respective governments.[9]
- In practice, SDRs can be used to increase reserves, for budgetary purposes or to reduce the public debt to IMF. In this sense, SDRs are a highly flexible instrument whose main function goes beyond that of a reserve asset. During the global financial crisis, several economies, including Bosnia and Herzegovina, Mauritania, the Republic of Moldova, Serbia, Ukraine and Zimbabwe, used a significant part or their entire allocation for fiscal purposes.[10] In the current pandemic context, since the implementation of the US$ 650 billion allocation, 39 countries —among them Colombia, Ecuador and Paraguay in Latin America and the Caribbean— have recorded US$ 37.3 billion worth of SDRs in government budgets or have used them for fiscal purposes (Arauz and Cashman, 2022).

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5 See McCormick and others (2021).

6 Debt sustainability analysis (derived from the government budget constraint) shows that to stabilize debt ratios, the rate of growth of GDP must exceed the rate of interest paid on the debt.

7 There are five main categories of official reserve assets: gold, foreign currency reserves, IMF reserve positions, special drawing rights (SDRs) and other reserve assets.

8 See Andrews (2021a and 2021b), Gold (1980) and IMF (2021f).

9 As explained by IMF (2021k, p. 7): "Members enjoy a large degree of freedom in how to manage the SDRs allocated to them, including to what extent central banks are involved in their management and whether the budget can directly use them for budget support".

10 United States Congress (2010). It should be noted that the use of SDRs for fiscal purposes is not exclusive to developing countries. In the United States, SDRs are allocated to the Exchange Stabilization Fund managed by the country's Treasury. The Treasury has the authority to issue SDR certificates, which can by law be exchanged for cash in dollars by the Federal Reserve. In the 2022 budget, the Treasury plans to use part of the new SDR allocation to fund PRGT. See Schwartz (1997); CRS (2020).

- In the case of Colombia, the central bank sold the equivalent of its SDR in dollars (US$ 2.79 billion) to the government in exchange for government treasury bills from the Ministry of Finance and Public Credit. This transaction enabled the Government of Colombia, which has one of the highest debt-to-GDP ratios in Latin America (71.5% of GDP for the consolidated public sector for 2020), to extend the maturity of part of its debt beyond 2022. The Government of Ecuador publicly declared its intention to use its SDR allocation (equivalent to US$ 669 million) for budgetary support. Paraguay used its SDR allocation (US$ 250 million) to fund fiscal expenditure (68% of the financing required for the implementation of the Economic Consolidation and Social Support Act (*Ley de Consolidación Económica y Contención Social)* adopted on 25 August 2021, which provides resources for the health system and guarantees the continuity of the financial and assistance programmes implemented at the beginning of the pandemic.[11]
- As of the end of January 2022, African countries had drawn down US$ 4.3 billion, 13% of their US$ 33 billion allocation. This represented nearly 30% of the total US$ 14.8 billion (of the US$ 650 billion SDR allocation) that have been exchanged globally. Low-income African countries are more likely to draw down on their SDRs than the larger economies. Ten African countries drew down 88% of their SDRs; of these, eight are low-income economies in financial distress. In contrast, the five largest African economies drew down less than 2% (US$ 290 million) of their allocation.
- Based on information from 32 African countries, SDRs in Africa are largely used to reduce budget deficits (as is the case in Angola, Botswana, Cabo Verde and the Democratic Republic of the Congo) (Kavanagh, 2021), support pandemic response and recovery, settle debt payments and build international reserves. The fungibility of SDRs and foreign currencies enables countries to use other foreign currency reserves to pay for imports while shoring up reserves with SDRs (for example, Angola, Ethiopia and the Democratic Republic of the Congo). Angola will use about half of its newly allocated SDRs to finance its budget with a view to accelerating economic recovery efforts, with the remainder used to boost its international reserves, while Cabo Verde used all its newly allocated SDRs to finance the 2021 and 2022 budgets and to support pandemic recovery efforts. Similarly, Equatorial Guinea will use a significant portion of its SDR allocation to clear its internal debt arrears. Other countries have used their SDRs to support social programmes: the Comoros used part of its newly allocated SDRs in 2021 to provide cash transfers to the poor, and Chad used all its newly allocated SDRs in 2021 to address urgent social needs, including food insecurity, and to clear domestic and external arrears.
- A total of 55 countries (including Angola, Argentina, Bangladesh, Côte D'Ivoire, Dominica, Ecuador, Egypt, Iraq, Pakistan, Samoa and Tunisia) have opted to finance their debt service obligations to IMF with SDRs worth US$ 6.5 billion.[12]
- SDRs are allocated in proportion to each country's share or quota in IMF.[13] Since quota shares are proportional to economic size, developing countries receive a smaller share of SDR allocations than developed countries. Therefore, while the new allocation of SDRs is a positive development, it must be complemented by a reallocation of existing SDRs in favour of developing countries, whose capacity to respond to the crisis there is hampered by limited fiscal and financial space or structural conditions.
- To date, there have been four general SDR allocations[14] and a one-time special allocation, totalling SDR 660.7 billion (equivalent to about US$ 935.7 billion). The new issuance of SDR 456.5 billion approved in August 2021, equivalent to US$ 650 billion, is the largest in the Fund's history and is the maximum amount that can be allocated without the approval of the United States Congress, corresponding to just below 100% of each of the IMF member countries' quota. Still, any allocation of up to US$ 650 requires the approval of at least 85% of the total votes of IMF member countries and thus, necessarily, that of the United States, which holds 16.5% of the Fund's total voting power.

[11] Honduras will also use part of its SDR allocation, equivalent to around US$ 340 million for fiscal purposes through a concessional and long-maturity loan provided by its central bank.

[12] See Arauz and Cashman (2021 and 2022).

[13] The allocation of SDRs during the subprime crisis took only four months to be implemented. This unprecedented policy measure, together with coordinated expansionary fiscal and monetary policies by G7 countries plus China, supported low-income countries' own countercyclical responses and helped restore global growth in 2010.

[14] SDR 9.3 billion was allocated in yearly instalments in 1970–72. SDR 12.1 billion was allocated in yearly instalments in 1979–81. SDR 161.2 billion was allocated on August 28, 2009. A special one-time allocation of SDR 21.5 billion took effect on 9 September 2009 to correct for the fact that members joining IMF after 1981 had never received an allocation (the Fourth Amendment special allocation).

- SDRs offer six advantages to IMF member countries. First, they are an automatic line of credit and are available to all countries regardless of their level of income.[15] This distinguishes them from other financing options which are determined by given macroeconomic conditions (such as the Flexible Credit Line) or on the level of income (such as PRGT funding).
- Second, SDRs do not generate debt, as they do not entail an obligation for repayment of the principal.[16] In this respect, they differ from all other financial facilities and credit lines provided by IMF, including the emergency lines introduced in 2020 to combat the pandemic under the Rapid Credit Facility and the Rapid Financing Instrument.
- Third, SDRs do not carry any associated policy conditionalities. All non-pandemic IMF programmes involve conditionalities with high social and economic costs. In this sense, beyond the agility and financial effects of SDRs, a massive issuance is the only financially inclusive instrument that can expand policy space in developing economies.
- Fourth, the use of SDRs generates a very low, below-market interest rate (0.05%), which is advantageous for countries that have high risk premiums.[17]
- Fifth, SDRs increase reserve assets without countries having to incur the costs that are normally associated with reserve accumulation.[18] The increase in reserves will improve IMF members' external position, which has deteriorated in some economies as a result of the pandemic. An improved balance of payments can help to reduce country risk, and thus the cost of domestic borrowing, and enhance countries' ability to access and leverage private financing. As table 3 shows, current risk analysis of different regions in the world places most developing regions as "high" or "very high" credit risk (94% of African countries, 48% of Asian countries, and 53% of countries of the Middle East and of Latin America and the Caribbean).

Table 3 | Selected developing regions: credit risk ratings, 2021

	Africa		Asia		Middle East		Latin America and the Caribbean	
	Number of countries	Percentage of total	Number of countries	Percentage of total	Number of countries	Percentage of total	Number of countries	Percentage of total
Very low								
Low			10	23	4	21	1	21
Medium	3	6	13	30	5	26	5	26
High	24	48	15	34	7	37	17	37
Very high	23	46	6	14	3	16	4	16
Total	**50**	**100**	**44**	**100**	**19**	**100**	**27**	**100**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of CountryRisk.io [online database] https://countryrisk.io/.

- Finally, besides improving financial stability, SDRs can be an instrument of economic and social development by freeing up resources for domestic spending on public goods (ECLAC, 2021c). Alternatively, SDRs can be used as capital through which resources for public spending can be leveraged.
- Notwithstanding the benefits of SDRs, their use is governed by three broad parameters. First, countries are required to pay interest on their on-lent SDRs. While this cost is relatively low, it nevertheless represents a liability to the SDR lender. Second, since countries view SDRs as a reserve asset, they require assurance that on-lent SDRs can be recalled at short notice. Hence, any on-lending agreements must provide for a mechanism that guarantees the liquidity of SDRs.

[15] There are exceptions. The Bolivarian Republic of Venezuela did not receive its 2021 SDR allocation as IMF does not recognize its government.

[16] According to the Balance of Payments and International Investment Position Manual Sixth Edition (BPM6), new allocations of SDRs to IMF members are recorded as increases in gross international reserves (holdings of SDRs), with an equal increase in the members' long-term debt liabilities to the participants of the SDR Department (allocations of SDRs). See IMF (2009 and 2021k). However, IMF recommends that these long-term liabilities (allocations of SDRs) should not be included in the stock of debt for assessing its sustainability IMF, 2021k).

[17] A country can hold more SDRs than initially allocated by exchanging SDRs for freely usable currencies of other countries. When a country's SDR holding is larger (smaller) than its allocation, it earns interest on the difference between its holding and the allocation; when the holding is smaller, it pays interest. The SDR interest rate is variable and may increase as a result of a change in the monetary policy stance of developed countries and especially of the Federal Reserve Board of the United States. However, given the current economic and social conditions it is unlikely that it will register any significant increase.

[18] Reserve accumulation is one of the main countercyclical instruments used by developing countries, at least since the Asian financial crisis, but it is a costly instrument with important macroeconomic ramifications (for example, quasi-fiscal deficits).

Finally, SDRs can be held only by eligible IMF member countries and prescribed holders. In effect, not all entities are eligible to receive SDRs. The proposals for on-lending SDRs described below must therefore be considered in the context of these parameters.

C. Recipient countries of the SDR allocation

- Based on their quota share, developing economies received 35.6% (US$ 231.4 billion) of the new SDR issue, and the rest (64.4%, or US$ 418.6 billion) went to developed countries (figure 1).[19] The breakdown of the SDR allocation by developing regions of the world shows that Africa, Asia, developing Europe and Latin America and the Caribbean received US$ 33.8 billion, US$ 139.4 billion, US$ 6.9 billion and US$ 51.5 billion respectively, representing 5.2%, 21.5%, 1.1% and 7.9% of the total (see table 4). The least developed countries (LDCs) received 2.4%.

Table 4 | Selected regions and groupings: SDR allocation and share of total August 2021
(Billions of dollars and percentages)

Region and grouping	Billions of dollars	Share of total *(percentages)*
Developed economies	418.4	64.4
Developing economies	231.6	35.6
Total	**650.0**	**100.0**
Africa	33.8	5.2
Asia	139.4	21.5
Developing Europe	6.9	1.1
Latin America and the Caribbean	51.5	7.9
The Caribbean[a]	2.4	0.4
Least Developed Countries	15.3	2.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "Guidance note for fund staff on the treatment and use of SDR allocations", *Policy Paper*, No. 2021/059, August 2021 and "2021 General SDR Allocation", 2022 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation.

[a] The share for the Caribbean is calculated relative to Latin America and the Caribbean. See also tables A1.1 and A2.1 in annex for more detail on allocation by regional and subregional groupings.

- Since SDRs are reserve assets, it is important to examine how the 2021 SDR allocation contributed to international reserves. While the new issuance of US$ 650 billion increased the share of SDRs in total reserves for all country groupings, it accounts for a relatively small (7%) share of the reserves of the world's largest economies (the G7 countries). As a result, their significance as a reserve asset for this country grouping may be overstated (see table 5). Hence, for the G7 countries in particular, retaining the reserve asset nature of SDRs need not be a binding on-lending constraint.
- Although the share of SDRs to total reserves are low on average for developing countries as a group, they vary greatly across countries. For example, the new allocation is estimated to have increased the reserves of nine African countries by close to 100% or more, with Zimbabwe alone having the highest share of over 500%.
- In Latin America and the Caribbean, the majority of countries (83% of the total) saw a more than 5% increase in reserves after the new SDR allocation. This is a reflection of the countries' total reserve position.
- More importantly, the relative importance of SDRs as a reserve asset has increased. For developing countries, the share of SDRs in reserves rose fourfold, from about 1% to 4%, and the same trend is seen among LDCs. At regional level, following the 2021 SDR allocation, SDRs as a share of reserves was 4.4 times higher for Asia and Pacific, 4.7 times higher for Latin America and the Caribbean, and 3.2 times higher for Africa. While relatively small, these shares have increased countries' reserve assets, which helps to minimize the risk of balance-of-payments disequilibrium (deficit) as the reserve position improves.

[19] This differs from estimates in IMF (2021f), which included some countries of Europe, the Russian Federation, and developing economies under the category of emerging and developing economies.

Table 5 | Selected groupings, regions and countries: current and new issuance of special drawing rights (SDRs) as a share of international reserves, 2021
(Percentages)

Regions and groupings	Current SDR *(percentage of reserves)*	New SDR *(percentage of reserves)*	Total SDR *(percentage of reserves)*	Ratio of total SDR to current SDR Factor
Developed economies	4.01	8.81	12.82	3.2
G7	2.09	5.04	7.13	3.4
G20	4.95	10.52	15.47	3.1
Developing economies	0.95	3.07	4.02	4.2
Africa	3.64	8.05	11.69	3.2
Asia and the Pacific	0.68	2.33	3.01	4.4
China	0.36	1.29	1.65	4.6
East Asia and the Pacific (excluding China)	0.82	2.90	3.72	4.5
South Asia	0.92	5.29	6.21	6.7
Western Asia	1.33	3.23	4.56	3.4
Latin America and the Caribbean	1.63	6.03	7.67	4.7
Developing economies (excluding China)	1.40	4.41	5.81	4.2
Asia and Pacific (excluding China)	1.03	3.45	4.48	4.4
Least developed countries (LDCs)	4.10	11.80	15.90	3.9
Africa	8.40	23.78	32.18	3.8
East Asia	0.74	4.36	5.09	6.9
South Asia	2.26	4.19	6.45	2.9
Fuel-exporting countries	1.92	4.69	6.61	3.4
Economies in transition	1.30	3.40	4.69	3.6
Developing countries	1.88	4.65	6.53	3.5
Africa	2.88	4.90	7.78	2.7
East Asia	1.41	5.15	6.56	4.7
South Asia				
Western Asia	1.40	3.10	4.51	3.2
Latin America and the Caribbean	1.89	12.43	14.32	7.6

Source: International Monetary Fund (IMF), "2021 General SDR Allocation" [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation; "IMF Finances", Washington, D.C., 2021 [online] https://www.imf.org/external/np/fin/tad/query.aspx; "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237; "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237 and World Bank, World Bank Development Indicators, Washington, D.C., 2021.
Note: Calculations were based on the reserves at the end of 2020, excluding the projected increase in reserves. New SDR refers to the SDR allocation of US$ 650 billion. See also tables A1.1 and A1.2 in annex for more details on SDR allocation and groupings.

- As shown in figure 1, total SDRs as a percentage of countries' international reserves (including existing holdings) ranges from 230% in the case of Sudan to 4% in the case of Cabo Verde. The new allocation significantly increased the reserves of low-income countries such as the Republic of the Congo (69%), Sierra Leone (95%), Chad (130%), Burundi (197%) and Sudan (230%). The high levels of government debt registered in 2020 in Burundi, Congo, Sudan and Sierra Leone (69.5%, 101%, 263% and 71.9% of GDP, respectively) mean that SDRs are a timely source of liquidity.
- In Asia (comprising Western Asia, Central and Southern Asia, and East Asia and the Pacific), the new SDR allocation is estimated to have generated between 3% (Thailand) and 19% (Fiji) in international reserves and benefited low-income countries (Republic of Tajikistan), lower-middle-income countries (the Kyrgyz Republic) and small island developing States (Fiji, Papua New Guinea and Vanuatu). As in Africa, the new SDR issue has benefited highly indebted countries of Western Asia such as Bahrain, whose general government debt as percentage of GDP rose to 133%, up from 102% in 2019.

Figure 1 | Selected countries: developing regions' total holdings of special drawing rights (SDRs) as a percentage of reserve assets, after a new issue equivalent to US$ 650 billion
(Percentages of international reserves)

A. Africa

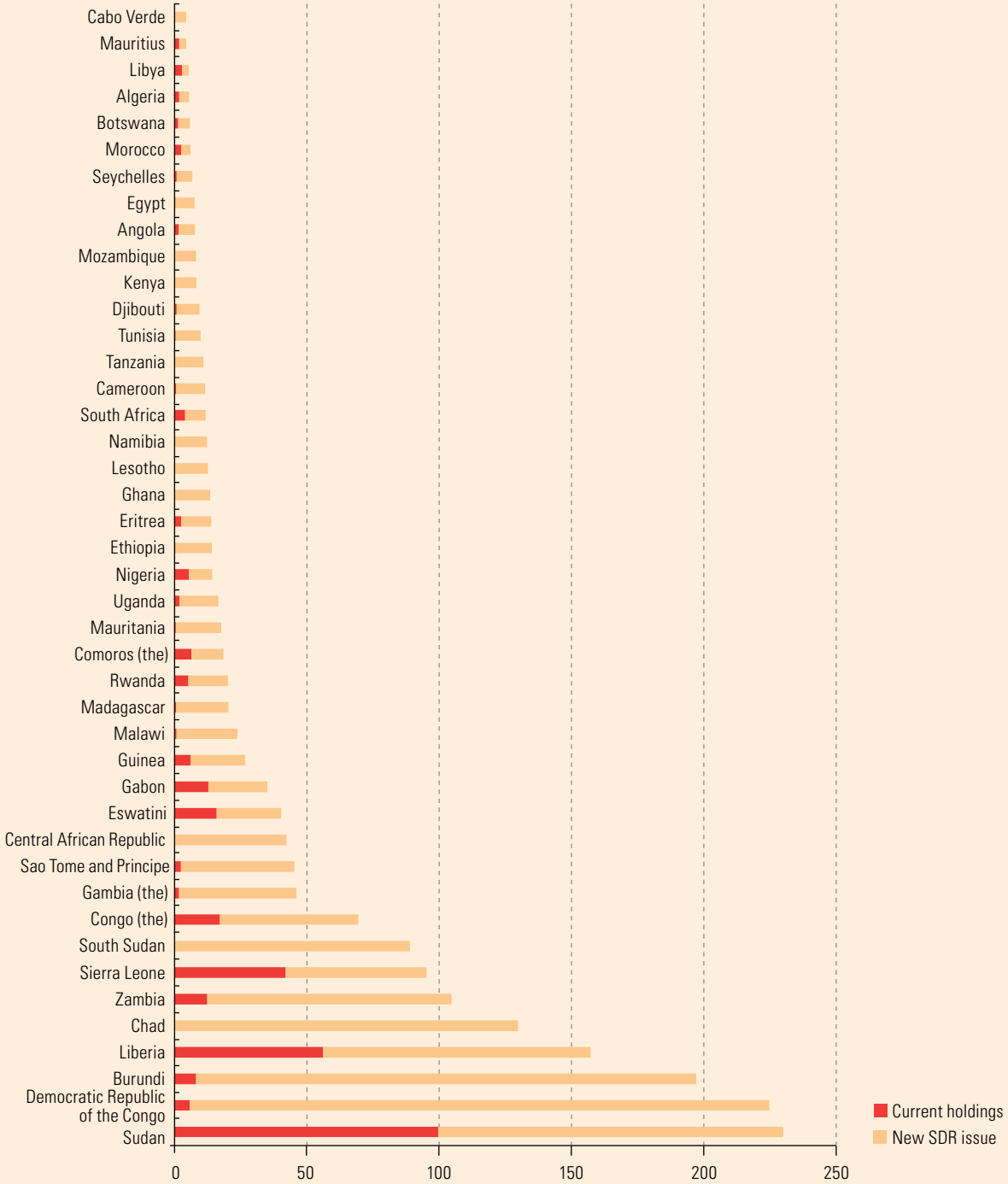


Figure 1 (continued)

B. Asia

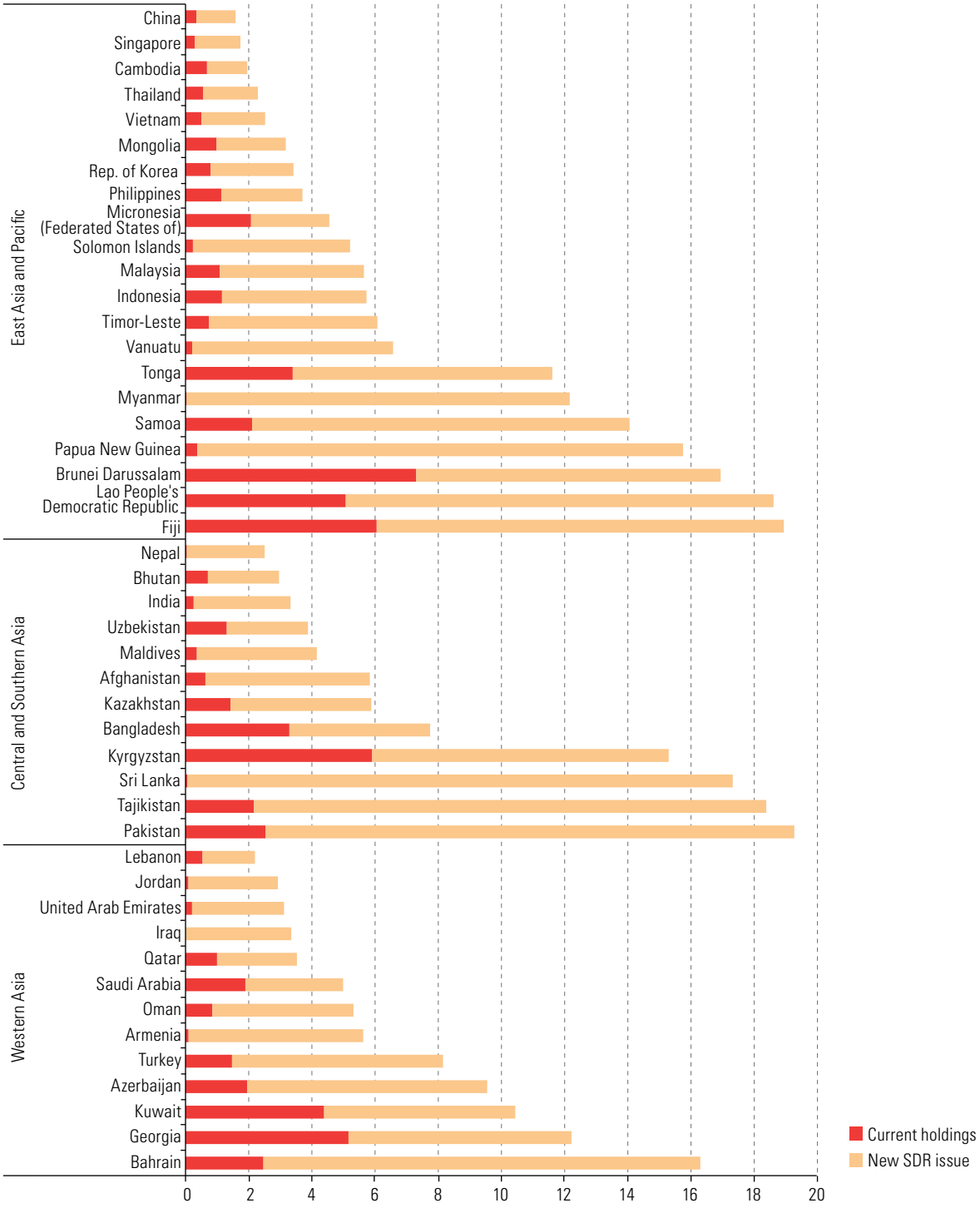
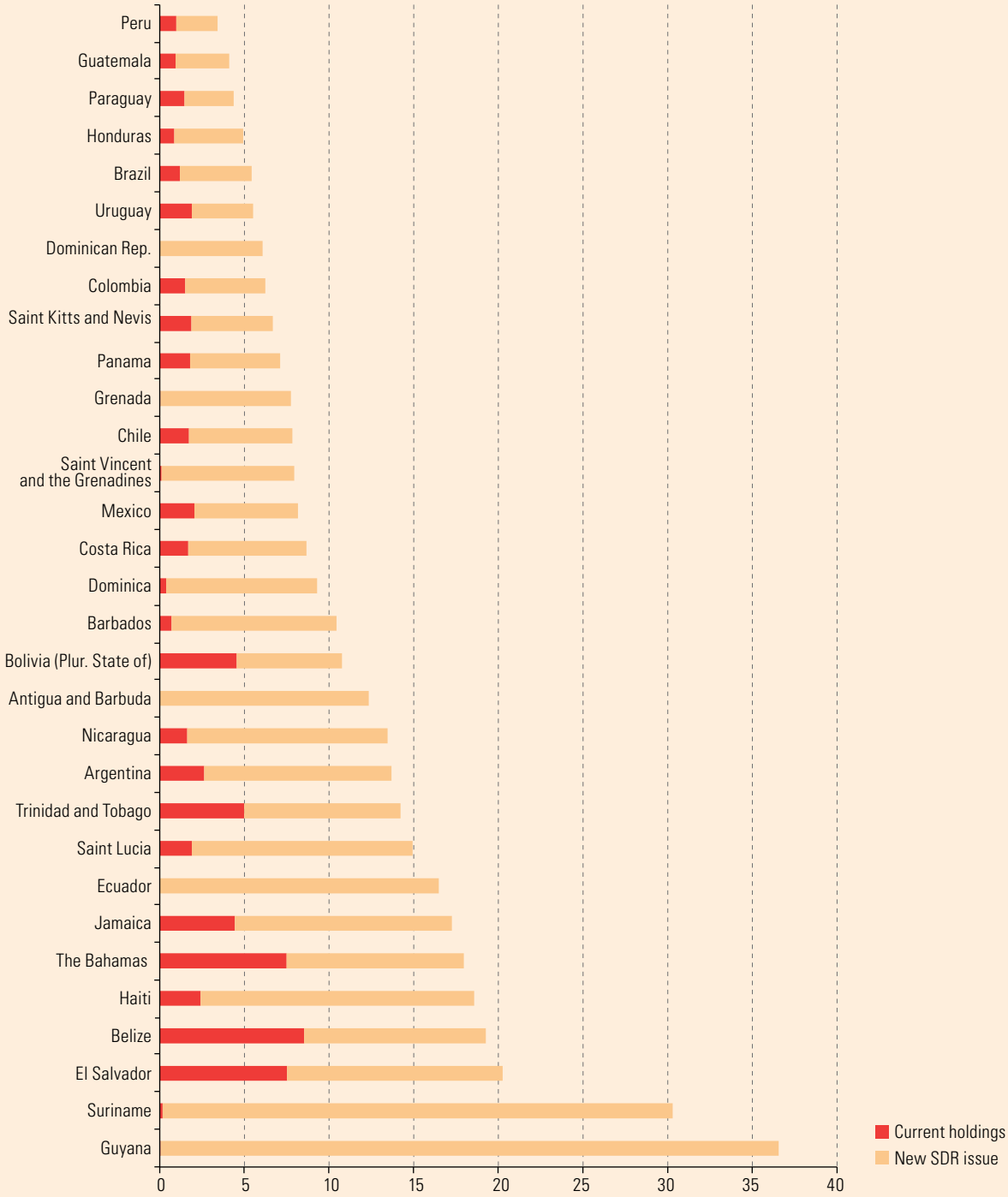


Figure 1 (concluded)

C. Latin America and the Caribbean



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "2021 General SDR Allocation" [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation: "2021 General SDR Allocation", 2022 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation; "IMF Finances", Washington, D.C., 2021 [online] https://www.imf.org/external/np/fin/tad/query.aspx and "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237.

- The pattern in Latin America and the Caribbean is similar to those in Africa and Asia in terms of beneficiary countries. The contribution of a new issue of SDRs as a percentage of international reserves (in addition to existing holdings) ranges from 37% in Guyana to 3% in Peru. A detailed country-level analysis shows that the new allocations of SDRs have benefitted some of the smaller economies of the region, including small island developing States (SIDS), which are also the most vulnerable owing to their small size, structural constraints, and exposure to natural hazards.
- As things stand, Guyana and Suriname have benefitted the most, with total SDR holdings equivalent 37% and 30% of total international reserves, respectively. Other smaller economies that benefitted include El Salvador, Belize, Haiti, the Bahamas, Jamaica, Ecuador and Saint Lucia.
- Some of these economies, such as Belize, Jamaica and Suriname, are also among the most indebted economies in the region. In 2020, central government public debt stood at 130.7%, 103.3% and 94.8% of GDP for Belize, Jamaica and Suriname, respectively. The increase in international reserves resulting from the SDR issue provides an important financial buffer for these economies, by reducing risk and strengthening the balance of payments.

D. Determining the value of SDRs to be reallocated from developed to developing countries (low- and middle-income countries)

- The proposal to reallocate or recycle SDRs to developing countries has gained traction in recent months. For instance, the communiqués of the Summit on the Financing of African Economies of 18 May 2021, the G7 Summit of 11–13 June 2021 and the G20 Foreign Affairs and Development Ministerial Meetings of 29 June 2021 all included language that was supportive of on-lending SDRs. However, this raises questions about how many SDRs should be on-lent and the format of such lending.
- Specific proposals on the amount of SDR on-lending include: the French President's call at the Summit on the Financing of African Economies to reallocate 100 billion SDRs to African countries;[20] the request by six African Heads of State[21] to on-lend at least 25% of the new SDR issuance, equivalent to US$ 162 billion, to boost the COVID-19 recovery and contribute to the fight against the climate crisis and; a request by the Ministers of Finance of Côte d'Ivoire, the Democratic Republic of the Congo, Ghana and Nigeria for G20 to consider on-lending at least US$ 30 billion in SDRs to a new facility that would catalyze investments in Africa, reduce liquidity premiums on middle-income countries' sovereign bonds and incentivize environmentally sustainable investments.
- IMF is currently considering recycling SDRs in three different buckets. The first proposes increasing the funding of PRGT, which is already largely financed by lending of SDRs from developed countries. The SDRs channelled to PRGT will only benefit the 69 countries that are classified as low-income and vulnerable or debt-distressed middle-income countries.
- The second option consists of a trust fund to finance climate change, digital transformation, and health-related expenditure. In that regard, IMF is considering creating a resilience and sustainability trust. According to IMF (2021c), the trust "would aim to support resilient and sustainable growth in the post-pandemic period, including resilience to climate change. It could lend at cheaper rates and longer maturities to provide fiscal space for countries to undertake green reforms and policies". The third bucket would support loans by multilateral development banks through creation of another trust fund.[22]
- The United Nations has also been championing a new issuance of SDRs along with reallocation from developed to developing countries. Recognizing, however, that mechanisms such as PRGT are limited to low-income countries, the United Nations proposes creating a new trust fund to be housed at the IMF to support middle-income countries, and SIDS in particular, in their response

[20] See [online] https://www.reuters.com/world/africa/macron-hosts-summit-financing-africas-post-pandemic-recovery-2021-05-18/.

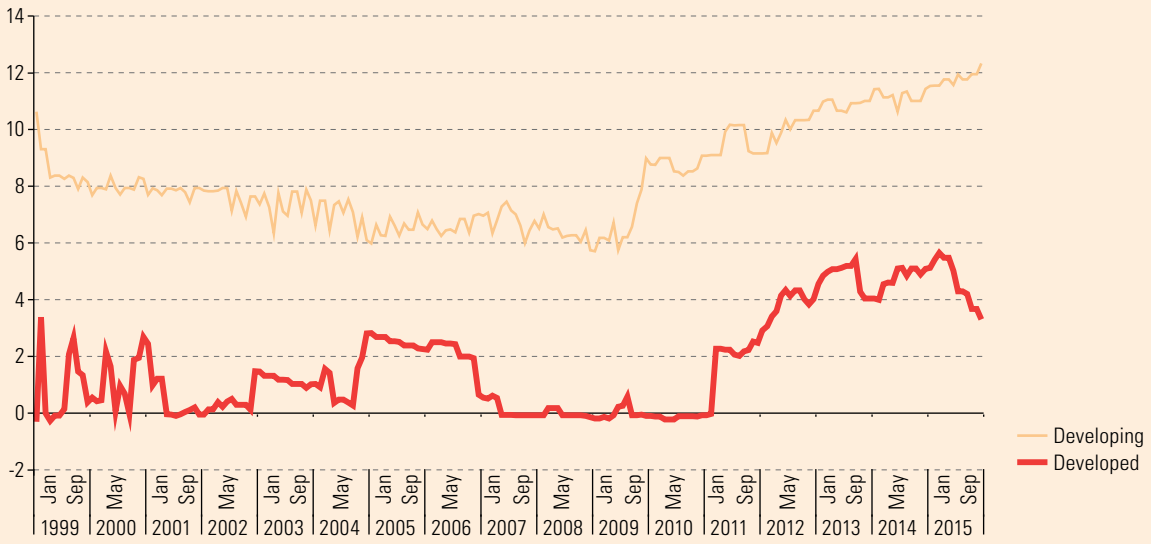
[21] Muhammadu Buhari, President of the Federal Republic of Nigeria, Nana Addo Dankwa Akufo-Addo, President of the Republic of Ghana, Abdalla Hamdok, Prime Minister of the Republic of Sudan, Roch Marc Christian Kaboré, President of Burkina Faso, João Manuel Gonçalves Lourenço, President of the Republic of Angola, and Mohamed Bazoum, President of the Republic of Niger. See [online] https://www.uneca.org/stories/covid-africa-needs-new-resources-for-a-sustainable-recovery.

[22] See Wolf (2021). The resilience and sustainability trust fund would have US$ 50–100 billion at its disposal. The countries that would be eligible to obtain finance from the fund include all low-income countries, all developing and vulnerable small States, and all middle-income countries whose per capita gross national income (GNI) is below roughly US$ 12,000. The fund could contemplate lending with 20-year maturities and a 10-year grace period and would involve a high degree of concessional finance for lower-income countries. Financial support would be granted with conditionality. As Pazarbasioglu and Ramakrishnan (2022) state, to qualify for support from the fund "an eligible member would need: a package of high-quality policy measures consistent with the [fund's] purpose; a concurrent financing or non-financing IMF-supported program with appropriate macroeconomic policies to mitigate risks for borrowers and creditors; and sustainable debt and adequate capacity to repay the Fund".

and recovery efforts (United Nations, 2021, p.9). The Organization also proposes the creation of a facility that leverages SDRs for private sector investments in emerging market economies.

- As explained in the previous sections, the central arguments for requesting reallocation are twofold: firstly, the economic and social impact of the pandemic in developing countries significantly increased their financing needs, which have not been met by existing financing initiatives of multilateral financial institutions; secondly, because developed countries issue reserve currencies, they do not face the same liquidity constraints and have ample fiscal space to address the effects of the pandemic.
- The pandemic has increased the debt levels and external debt service of developing economies, which not only creates liquidity constraints but also hampers countries' capacity to respond to the pandemic. Furthermore, in a context of low growth, in some cases liquidity constraints may degenerate into insolvency crises with devastating implications for the private and public sectors. In addition, increased indebtedness can lead to higher sovereign risk and unsustainable debt service: debt servicing costs for developing economies are at least five times those of developed economies.[23]
- The new SDR allocation of US$ 650 billion is insufficient to close the financing gap of developing economies, which is estimated at more than US$ 2.5 trillion. In contrast, developed economies have unlimited access to reserve currencies and hence, greater fiscal space to respond to shocks such as the COVID-19 pandemic. Indeed, the global fiscal response to the pandemic, which surpassed US$ 11 trillion, was mainly driven by developed economies.
- Developing economies exhibit higher demand for SDR use relative to developed economies. Developing countries' use of SDRs intensifies in times of crises as they face higher financing needs coupled with tighter liquidity constraints and more limited fiscal space. This is shown in figure 2 for the 1999–2015 period, which includes the global financial crisis (2008–2009). During this period, the SDR utilization rate of developing countries, normalized by country quotas (that is, expressing SDRs as a percentage of country quotas), remained consistently above that of developed countries. Also, as reflected in figure 2, during 2008–2009, the gap between the SDR utilization rates of developing and developed countries as proportions of their respective IMF quotas widened significantly. A United States Congress study of the period from September 2009 to June 2010 reports similar findings. According to that report, the annual percentage change in holdings of SDRs by developed countries during the period was equal to zero (United States Congress, 2010).

Figure 2 | Median SDR utilization rates as a proportion of IMF quotas, 1999–2015
(Percentages)



Source: Prepared by the authors, on the basis of International Monetary Fund (IMF), "IMF Finances", Washington, D.C., 2021 [online] https://www.imf.org/external/np/fin/tad/query.aspx; and "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237.
Note: The utilization rate (in proportion to the IMF quota) refers to the difference between allocations and holdings divided by the quota share.

[23] On the basis of McCormick and others (2021). Debt service includes domestic debt and external debt. Developing and emerging economies include Brazil, India, Indonesia, Mexico and South Africa. G7 includes France, Italy, Japan and the United States.

- Available empirical evidence also shows a marked difference in utilization of SDRs by level of development prior to COVID-19. Table 2 shows the utilization rate (the difference between SDR allocation and SDR holdings divided by SDR allocation) for different developed and developing country groupings for 2019. As a result of the pandemic, 80 developing countries have used their SDRs (Arauz and Cashman, 2022).
- As attested by their lower levels of SDR utilization, advanced economies are much less dependent on SDRs than developing countries. For instance, as shown in table 6, the median SDR utilization rates of developed countries (5.9%) in G7 (5.9%) and Europe (7.79%) are much lower than for Africa (52.37%), Latin America and the Caribbean (48.77%) or East Asia and the Pacific (25.28%). This is an indication that most developed countries are net lenders of SDRs, hence their SDR holdings exceed their allocations.

Table 6 | Selected country groupings: median SDR utilization rates, 2021
(Percentages)

Grouping	Utilization rate *(median)*
Developed economies *(average)*	**5.90**
Developing economies *(average)*	**42.90**
Africa	52.37
East Asia and the Pacific	25.28
South Asia	75.32
Western Asia	12.80
Latin America and the Caribbean	48.77
Central America	59.64
The Caribbean	85.00

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "General SDR Allocation (in SDRs)", 21 August 2022 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation; "IMF Finances", Washington, D.C. [online] https://www.imf. org/external/np/fin/tad/query.aspx; "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237; "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237.

- The empirical evidence on utilization rates provides a baseline for estimating the share of the new issue of SDRs, equivalent to US$ 650 billion, that could be recycled from developed to developing economies. If advanced economies' utilization rate for SDRs is 5.90%, then they could redistribute US$ 393 billion to developing countries (see table 7).

Table 7 | Selected regions: SDR redistribution on the basis of utilization rates, 2021
(Billions of SDRs and billions of dollars)

Regions	Billions of SDRs	Billions of dollars	Billions of dollars net of interest
Developing economies	**276.5**	**393.7**	**374.0**
Africa	67.5	96.1	91.3
East Asia and the Pacific	32.6	46.4	44.1
South Asia	97.1	138.2	131.3
Western Asia	16.5	23.5	22.3
Latin America and the Caribbean	62.8	89.5	85.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "General SDR Allocation (in SDRs)", 21 August 2021 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation and "IMF Finances", Washington, D.C. [online] https://www.imf. org/external/np/fin/tad/query.aspx; "Data Template on International Reserves and Foreign Currency Liquidity", Washington, D.C., 2021 [online] https://data.imf.org/?sk=2DFB3380-3603-4D2C-90BE-A04D8BBCE237 and "2021 General SDR Allocation" 2022 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation.

- Therefore, this paper proposes that SDR reallocations be based on country SDR utilization rates. Specifically, SDR reallocations should rise in line with utilization rates and the proportion of SDRs in countries' reserve portfolios (table 7).

E. Proposed means of reallocating SDRs

- To date, PRGT has generally been the only vehicle for reuse of SDRs since the last allocation. However, its use as IMF concessional financial support is better tailored to the diversity and needs of low-income countries. To cater for developing countries that are not eligible for assistance through PRGT, other vehicles for reallocation of SDRs such as the proposed Liquidity and Sustainability Facility (LSF), the creation of a new trust fund to be hosted at the IMF, and enhanced lending capacity of multilateral development and regional banks to support middle-income countries (SIDS in particular) in their response to the pandemic and in their efforts to build forward better have been considered. This approach would enable repurposing of SDRs as a development window for specific spending purposes such as financing of development and global public goods (for example, procurement of vaccines and the creation of a COVID-19 vaccine facility).
- We propose four means of reallocating SDRs. The first involves bolstering PRGT, reforming the Trust to better address countries' financial needs. The reform would also avoid tying lending to policy conditionalities. PRGT currently covers only low-income countries and a few middle-income countries. The second form of reallocation considers the needs of middle-income countries that have been hit hard by the pandemic, creating a fund for them to finance SDG-related investment projects through concessional borrowing. SDRs would be used to capitalize the fund and leverage resources. The fund would cover more areas than the current IMF proposal to create a resilience and sustainability trust. The third means of reallocation is to lend SDRs to LSF and PIMCO. This entails compressing yield spreads on sovereign bonds by using SDRs to fund the creation of a repo (repurchase agreement) market for sovereign bonds. The fourth means of reallocation is to use SDRs to enhance the lending capacity of development banks and bolster regional financing institutions. Development banks that are prescribed holders of SDRs could issue bonds to IMF in return for SDRs, which could then be used for long-term loans at the SDR rate.[24]

1. Use of the Poverty Reduction and Growth Trust (PRGT)

- PRGT[25] is an IMF instrument that provides concessional support to low-income, lower-middle-income and upper-middle-income countries that are deemed to be in debt distress. Thirty-four of a total of 50 low-income countries (68% of the total) are PRGT-eligible countries. Ten upper-middle-income countries in debt distress are also PRGT-eligible countries (Dominica, Grenada, Guyana, Maldives, Marshall Islands, Samoa, Saint Lucia, Saint Vincent and the Grenadines, Tonga and Tuvalu).[26] In response to the pandemic, and as part of the fast-track loan mobilization effort, PRGT provided US$ 24 billion in funding to PRGT-eligible countries, 63% of which was financed with lending of SDRs.[27]
- There are two benefits of channelling SDRs through PRGT. Firstly, the lending country's assets are protected through IMF policy conditionalities and the reserve account. The reserve account provides collateral to lenders since its funds can be used to meet obligations in the event of delayed payments or default by PRGT borrowers. The reserve account was originally financed by the profits of gold sales in the late 1970s, reflows of the Trust Fund and Structural Adjustment Facility (SAF) repayments, as well as investment returns on balances held in it (IMF, 2013). The policy conditionalities provide another layer of safeguards by strengthening a country's macroeconomic fundamentals, as stated in the IMF guidelines embedded in PRGT. PRGT loan resources, including in the form of SDRs, come from bilateral agreements with IMF members, which earn interest based on the prevailing SDR rate (Andrews, 2021c).

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[24] Another option is to consider donation of SDRs for global public goods. However, countries that donate SDRs incur a permanent fiscal cost of interest on such SDRs. Furthermore, those SDRs can no longer be recorded as part of the reserves of the donor country. Since most countries prefer to retain the reserve asset status of their SDRs, donation is not an attractive option.

[25] The PRGT financial architecture consists of subsidy, loan and reserve accounts. The funds borrowed from countries at market interest rates are lent out through the loan accounts to borrowers at low rates, often subsidized from subsidy accounts. The subsidy accounts largely finance the subsidy costs, while the reserve account offers collateral to lenders, since its funds can be used to repay loans in the event of late payment. Also, the investment revenue obtained from this account may be used to cover the costs of the subsidies. PRGT is not an SDR prescribed holder even though it receives SDRs from contributing countries. When loans are provided under bilateral agreements, the lender earns the SDR interest rate on the SDR-denominated loans.

[26] See IMF (2020). In all, 69 countries are eligible for PRGT funding (IMF, 2021i). Guyana has met the PRGT graduation criteria and is set to graduate from PRGT status.

[27] See IMF (2021e). The developed countries that through bilateral agreements provided funding through SDRs include Australia, France, Italy, Japan, the Netherlands and the United Kingdom (IMF, 2021e). Use of PRGF was facilitated by an increase in the annual access limit from 100% to 150% of quota. More recently, in July 2021, IMF (2021h) approved: (i) a 45% increase in the normal limits on access to concessional financing; (ii) the elimination of hard limits on access for the poorest countries; and (iii) a two-stage funding strategy for PRGT consisting of securing SDR 2.8 billion in subsidy resources and SDR 12.6 billion in loan resources. The SDR 12.6 billion could be provided by lending of SDRs from developed countries.

- Secondly, PRGT-eligible countries currently pay no interest on borrowed funds even though IMF secures the loans at prevailing SDR interest rates. The difference is financed through the PRGT subsidy account, which is funded by bilateral contributions from members and the Fund's own resources and returns from the investment of their balances.
- Thus, in its current configuration, reallocating SDRs through PRGT would benefit both lenders and the borrowers: lenders have their assets secured and earn interest, while borrowers can access loans at no cost. However, increased lending through PRGT requires corresponding increases in the subsidy and reserve accounts to subsidize the loans and to safeguard lenders from the possibility of default. These resources will have to be in the form of grants or earned income, not loans.
- Furthermore, reallocating SDRs using the PRGT platform would currently only benefit PRGT-eligible countries, thereby excluding middle- and low-income countries that are not PRGT-eligible but have urgent financial needs. Currently, only 39 countries are listed as PRGT-eligible. Moreover, the policy conditionalities of PRGT may deter countries from accessing the Trust. Other modalities are therefore needed to broaden the beneficiaries of SDR reallocations.

2. A new trust fund to support middle-income countries: a preliminary proposal[28]

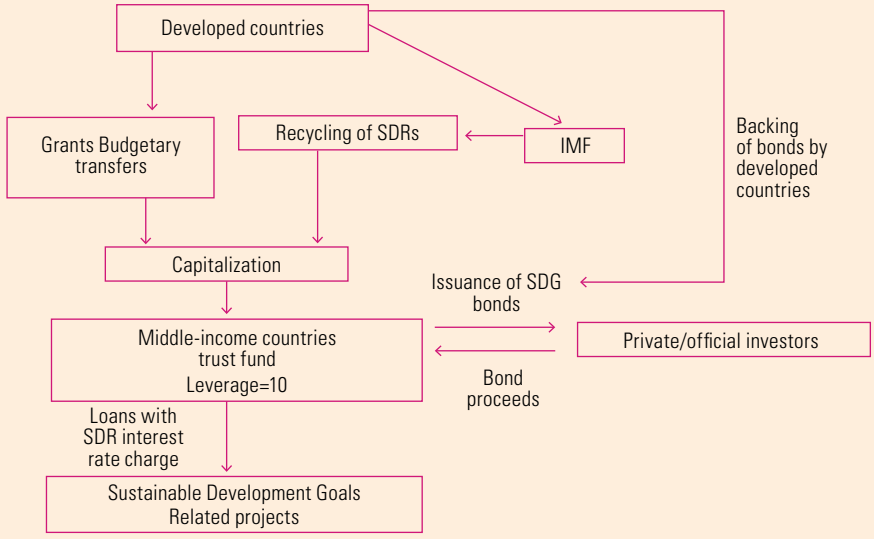
- Financial support needs to be expanded to all middle-income countries and tailored to the diversity of their economic and social development needs. In line with the recommendation of the Secretary-General of the United Nations that the "establishment of a new trust fund to be housed at the IMF should … be considered to support middle-income countries, and SIDS in particular, in their response and recovery efforts" (United Nations, 2021, p. 9), this section presents a preliminary proposal for a trust fund to support middle-income countries, largely financed using SDRs as capital to leverage resources. This is an option and proposal that needs further exploration and development.
- The purpose of the trust fund would be to finance sustainable development investment projects to support response and recovery efforts in middle-income countries, and SIDS in particular. Such a fund could leverage SDRs by capitalizing on the growing interest of private financial markets in social and sustainable bonds issued by emerging market economies.[29] Available data show that social bond issuance increased from US$ 11.6 million in 2013 to US$ 852 billion in 2021 (Environment Finance, 2021). However, sustainable bond issuance by developing and emerging economies continues to lag behind the global trend. For instance, United Nations Global Compact estimates that the Middle East and Africa accounted for a mere 1% of global green bond issuance in 2020 (ECLAC, 2021c).
- To ensure the proper design and functioning of a new trust fund for middle-income countries, several key issues must be addressed: (i) housing; (ii) capitalization; (iii) operation and size of the fund; and (iv) additional financing sources. These issues are examined in the paragraphs below.
- If the fund were housed outside IMF, it would have to be granted SDR prescribed holder status, requiring 85% of votes from IMF Executive Directors. If the fund is housed within IMF, it could follow the PRGT model and not be a prescribed SDR holder. An additional advantage of a fund hosted within IMF is that the SDRs that are recycled to the fund could still be included as international reserves (UNDP, 2021).
- In this scheme, SDRs would be used to capitalize the fund. The use of SDRs as capital faces two hurdles. As they are reserve assets, SDRs must be particularly liquid instruments. The use of SDRs as capital would transform them into illiquid instruments. Until now, lending of SDRs (recirculation) has been allowed on the condition that they maintain their reserve asset status. The first hurdle, then, is to reconcile the use of SDRs as capital and their use as a reserve asset. Secondly, the use of SDRs to leverage resources entails risk-taking, whereas reserve asset ownership entails no risk for countries lending SDRs (Andrews, 2021a).

[28] Sections 2 and 4 are based on ECLAC (2021c).

[29] Social bonds are bond issues for projects designed to have a positive social impact. Examples include affordable housing, affordable infrastructure, and community development. Sustainability bonds are bond issues to finance new and existing projects designed to have a positive environmental impact. Examples include projects connected to renewable energy, clean transport, energy efficiency, water/waste management and green buildings. They also include the financing of health-related projects (Mutua, 2021).

- One way to overcome the first hurdle is to have an arrangement whereby the country lending the SDRs can withdraw them in the event of a contingency. This type of mechanism exists in PRGT in the form of encashment of SDRs that advanced countries lend to the Trust. In that situation, SDR-lending countries sign an agreement with IMF as trustee of PRGT under which they can encash SDRs when faced with problems concerning balances of payments or international reserves.[30] For this purpose, PRGT maintains a liquid reserve account equal to approximately 20% of its loans. In practice, many advanced countries (such as Japan or eurozone countries) that lend their SDRs to PRGT do not have balance of payments or international reserve problems that would lead them to encash their SDRs, since they are issuers of international reserve currencies. Thus, the SDR encashment clause is more of a guarantee to maintain the liquidity of the SDRs.
- The creation of a reserve fund, together with certain lending policies to minimize credit risk, could help to overcome the second hurdle.
- The voluntary recycling of SDRs by developed countries would be assigned according to the quota of participating countries. The fund could offer SDG bonds in international capital markets to private investors and institutional holders backed by SDRs. If the trust fund were located at IMF this would be facilitated by the fact that in 2009, IMF established a framework for issuing securities denominated in SDRs. The sole limitation is that these instruments, which have a five-year maturity, are tradable in the official sector only (Carin, 2013).
- The proceeds of the bond issues would serve to finance projects related to the SDGs. The fund could target a conservative leverage ratio of 10, meaning that it could issue US$ 1 trillion in bonds, backed by US$ 1 billion in SDR capital. Developed countries would have to guarantee the bonds issued for them had the best credit ratings (AAA or AA) (see figure 3).
- The use of SDRs results in accrued interest on the capital base of the fund, constituting a financial liability that must be repaid. Developed countries would incur interest charges on their debit position in the IMF SDR department. This is a cost that will have to be considered. However, if SDR interest —which, at 0.05%, amounts to a concessional rate— is charged on loans, the fund could transfer this income as an interest payment to developed countries.

Diagram 1 | Proposal for a middle-income country fund



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of "Sustainable development and financing critical global public goods", *CIGI Papers Series*, No. 10, Centre for International Governance Innovation (CIGI), January; H. Bredenkamp and C. Pattillo, "Financing the response to climate change", *IMF Staff Position Note*, No. SPN10/06, International Monetary Fund (IMF), March 2010; C. Ferron and R. Morel, "Appendix I-special drawing rights", *Climate Report*, No. 46, July 2014; N. Birdsall and B. Leo, "Find me the money: financing climate and other global public goods", *Center For Global Development. Working Paper*, No. 248, April 2011.

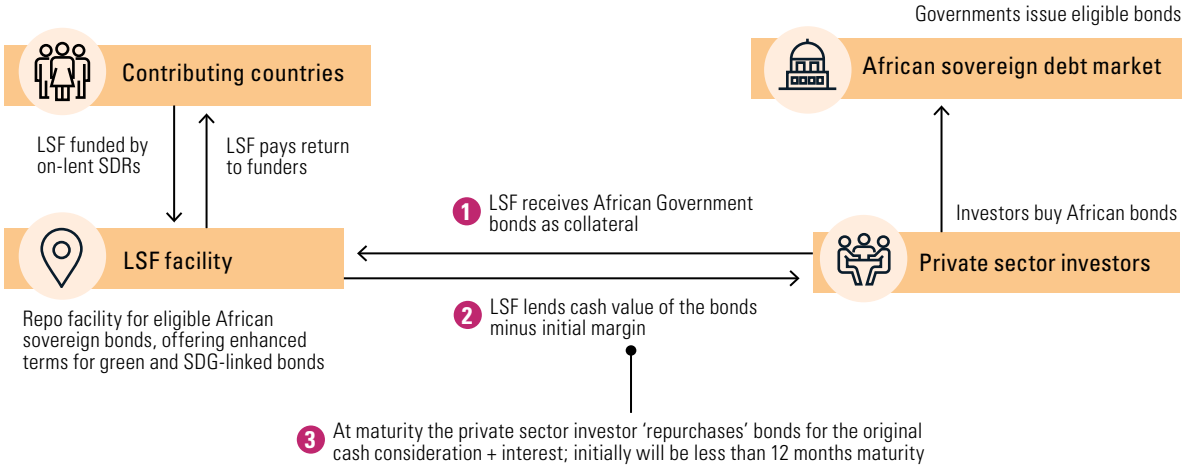
- Lastly, the trust fund would need additional sources of financing, such as grants or budgetary transfers, that could be provided by developed countries. Grants could be used to subsidize loans provided by the trust fund and to guarantee repayment to lenders, along similar lines to PRGT.

[30] See IMF (2021e) and Andrews and Plant (2021).

3. The Liquidity and Sustainability Facility (LSF)

- As countries move from low-income to middle-income status and demonstrate sound macroeconomic management, they begin to borrow from international financial markets by issuing Eurobonds. In the absence of an active repo market, there are currently limited opportunities for bondholders to refinance their positions once these bonds are purchased. As a result, such bonds tend to be illiquid. The price of this illiquidity is higher yields, resulting in higher debt service costs and heightened debt vulnerabilities for bond issuers in frontier market economies. It is therefore important to explore more affordable market access options. LSF,[31] launched by ECA and PIMCO in 2021, seeks to enhance the liquidity of emerging market sovereign bonds by creating a repo market, funded in part by US$ 3 billion in on-lent SDRs. LSF aims to improve market liquidity for African sovereign bond issuers by providing repo financing to private investors. To access financing from the facility, private investors are required to pledge African sovereign bonds as collateral, thereby stimulating demand for such instruments (diagram 2).

Diagram 2 | How LSF works: a repo facility for African bonds funded by SDRs, while maintaining risk with the private sector



Source: Economic Commission for Africa (ECA), "Liquidity and Sustainability Facility. Presentation", 22 March 2021.

- LSF will not alter yields on existing sovereign bonds. However, by making African sovereign bonds the key that unlocks access to competitively priced LSF financing, the Facility will increase demand for and prices of new bond issuances, and thus lower their yields. It is envisaged that, because of the signalling effect of LSF, the impact on new bond prices will be immediate (United Nations, 2020 and ECA, 2021). The Facility is expected to save African sovereign bond issuers $11bn per year in interest payments. Its first transaction of US$ 200 million, funded by African Export–Import Bank (AFREXIM) is expected to be closed in the first quarter of 2022. LSF also seeks to drive demand for SDG-linked bonds by offering preferential rates to investors that use such instruments as collateral for LSF financing, thereby spurring green investments and accelerating pursuit of the SDGs.
- To safeguard SDR-lending countries from the risk of default or late payments, the collateral pledged by investors will be required to exceed the amount of the loans extended, by a fixed margin. Furthermore, borrowers will be required to maintain the margin (by offering additional collateral) in the event of depreciation of their collateral. As an additional safeguard, LSF will be limited to investment-grade investors and the Facility will vet counterparties based on credit risk assessments. In this regard, the risk exposure of the LSF is confined to the private sector investor and not to African sovereign bond issuers. Furthermore, countries that lend to the Facility are assured that the reserve asset feature of their SDRs will not be compromised, since the IMF retains custody of all SDRs on-lent to the Facility. This is unavoidable, since the LSF is not a prescribed holder of SDRs.
- While the initial focus of LSF is on Africa, the objective is to extend it to other regions once proof of concept has been achieved.

[31] See "ECA announces its intention to create a Liquidity and Sustainability Facility, a vehicle for debt management and fiscal sustainability" [online] https://www.uneca.org/stories/eca-launches-lsf%2C-a-vehicle-for-debt-management-and-fiscal-sustainability.

4. Development banks and regional financial institutions[32]

- Development banks and regional financial institutions that are prescribed holders of SDRs and can receive SDRs could also be part of a mechanism to reallocate SDRs. Among the development banks that are prescribed holders of SDRs are the African Development Bank, the African Development Fund, the Asian Development Bank, the International Bank for Reconstruction and Development and the International Development Association, the Islamic Development Bank, the Nordic Investment Bank, and the International Fund for Agricultural Development. The intergovernmental monetary institutions that are prescribed holders of SDRs include the Bank for International Settlements, the Latin American Reserve Fund, and the Arab Monetary Fund.
- Recirculation of SDRs through development banks can take two forms. The first is the use of SDRs for loanable funds, according to some authors (Andrews, 2021b; Andrews and Plant, 2021; and Plant, 2021). In this case, development banks could replicate the PRGT organizational model, which includes three separate accounts: loans, grants and reserves. The liquidity of SDRs would be maintained through an SDR encashment system. Credit risk could be addressed through policies such as the creation of a reserve fund to reimburse creditors in the event of default. Consideration also needs to be given to how to mitigate risk in the case of loans whose maturity may exceed that of PRGT (10 years). Lastly, although the interest rate on SDRs is to all intents and purposes a concessional rate, it is variable and could be raised. In this regard, it is proposed that a subsidy account be established to make up the difference between a concessional interest rate and the interest rate payable on SDRs.
- Development banks that are prescribed holders of SDRs could issue bonds to IMF in return for SDRs, which could then be used for long-term loans at the SDR rate. This would supplement either concessional lending programmes or focus on financing new activities. This would change the way in which concessional programmes are financed, which is through the development assistance budgets of donor developed country governments (Herman, 2020). It would also provide an avenue for concessional development financing for countries at different income levels, including both low- and middle-income countries.
- The second form of recirculation is the use of SDRs to capitalize development banks. According to Lazard (2022), the leverage ratio of multilateral banks would allow SDR 100 to produce between SDR 300 and SDR 400 in investments. If this reasoning is applied to regional development banks in Latin America and the Caribbean, SDR 100 could produce about SDR 200 in investments.
- This would substantially increase the ability to expand available resources and borrowing through leverage. This form faces the same hurdles as those raised in the case of the trust fund for middle-income countries.
- There is opposition to the use of SDRs as capital on the grounds that this runs counter to the nature of SDRs as a reserve asset, which must necessarily be highly liquid and carry very low or zero risk for the lender. The European Central Bank (2021) illustrates this, stating that "national central banks of European Union member States may only lend their SDRs to IMF if this is compatible with the monetary financing prohibition included in the Treaty on the Functioning of the European Union. Retaining the reserve asset status of the resulting claims is paramount. This requires that the claims remain highly liquid and of high credit quality. The direct financing of multilateral development banks by national central banks of member States through SDR channeling is not compatible with the monetary financing prohibition".
- The liquidity of an asset means that it "can be bought, sold for foreign currency (cash) with minimum cost and time, and without unduly affecting the value of the asset —that is there needs to be a liquid and deep market for these assets and no major restrictions impeding such transactions" (IMF, p. 2015, p. 3).
- As explained in Lazard (2022), liquidity and credit risk are not absolute, but rather state contingent concepts. In fact, central banks keep a wide array of reserve assets with different degrees of liquidity and credit quality.[33]
- In practice, existing financing arrangements such as the Poverty and Reduction Growth Trust (PRGT) maintain the liquidity of SDRs through encashment systems. This allows SDR lenders, mainly developed countries, to request early repayment of their outstanding claims in case

[32] This section is based on ECLAC (2021c).
[33] See also Plant (2022).

of balance-of-payments or reserve difficulties (IMF, 2021e). However, developed countries are less likely to experience balance-of-payments difficulties than developing countries. The European Union, Japan and the United States, in particular, issue reserve currencies and thus would not need to resort to encashment to solve balance-of-payments or reserve difficulties.

- A concrete proposal for the use of SDRs as equity by development banks has been put forward by the African Development Bank (African Development Bank, 2022; Plant, 2022). Ultimately, the solutions adopted should reflect a consensus between development banks, SDR-lending countries and IMF (Andrews and Plant, 2021).

F. Conclusion

- SDRs were conceived as an indefeasible right and subject to use at will by member countries of IMF without prior consultation (Harrod, 1965). The new allocation of SDRs of US$ 650 billion is the most expedient way to expand the policy space and respond to the liquidity needs of developing countries whose economies and societies have been hit hard by the pandemic.
- SDRs have several advantages over other financial instruments. They are provided automatically to all countries regardless of income level, they do not carry conditionalities, and most importantly, they do not generate additional debt. A new issuance of SDRs contributes to enlarging the international reserve pools of both low- and middle-income countries, strengthening their balance-of-payments positions, lowering the cost of accessing international private capital markets and freeing resources for public spending.
- However, as things stand, the new general allocation of SDRs equivalent to US$ 650 billion is insufficient to meet developing countries' liquidity needs or to expand their policy space. Because of the existing quota system, the new issuance of SDRs has disproportionately benefited developed countries (64.4% of the total), which incidentally have a lower utilization rate of SDRs relative to developing countries. Also, developed countries do not face the same fiscal constraints as developing countries, which lack adequate reserves to respond to the pandemic and build forward better. Most developing countries exhibit high levels of indebtedness, and many are in debt distress.
- Complementing the new general allocation of SDRs with an on-lending mechanism is therefore imperative. In the proposal presented in this paper, SDRs allocated to developing countries on a quota basis could be used to strengthen their external financial position. The reallocation of SDRs would mainly be used for expenditure on public goods and investments related to the SDGs, through on-lending vehicles.
- The modalities to reallocate SDRs include PRGT, a fund for middle-income countries, LSF, and multilateral and regional development banks. The feasibility of each of these options will depend on the ability of the proposed entity to hold and assure the liquidity of SDRs and to maintain the reserve asset feature of SDRs.
- PRGT is an IMF facility that largely responds to the needs of low-income and blend countries. Hence, beneficiaries would likely be bound by the policy conditionalities of the Fund and PRGT. PRGT also has a track record of on-lending SDRs and as a result would face fewer administrative hurdles to implement the SDR on-lending proposal.
- On-lending SDRs to a special fund for middle-income countries or to LSF expands the scope of beneficiaries beyond low-income countries and leverages private development financing. However, as neither the Fund nor LSF are prescribed holders of SDRs they would not be able to directly receive such resources. Furthermore, the use of SDRs for development financing raises questions about consistency with their role as a reserve asset.
- Notwithstanding these obstacles, the unprecedented fiscal challenges posed by the pandemic call for unconventional responses, including a global financial architecture that is more agile in its response to shocks. The current constraints on use of SDRs, for instance, are overly complicated and not fit for purpose. A recalibration of these rules would be a big step in the right direction.

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Annex

Table A1.1 | Selected regions and groupings: SDR positions
(Percentages, millions of SDRs and millions of dollars)

Regions and groupings	IMF quota *(percentages)*	SDR allocations *(millions of SDRs)*	Current SDR holding *(millions of dollars)*	New SDR allocations *(millions of dollars)*	Total SDR holding after new allocation *(millions of dollars)*	Percentage change in SDRs *(percentages)*
World	**100.0**	**204 197**		**650 000**		
Developed economies	60.4	128 821	178 854	392 614	571 468	219.5
Economies in transition	4.3	9 546	9 358	27 697	37 055	296.0
Developing economies	35.3	65 830	71 183	229 689	300 872	322.7
Africa	5.1	13 145	15 013	33 199	48 212	221.1
Asia and Pacific	22.3	37 097	42 204	144 947	187 152	343.4
Latin America and the Caribbean	7.9	15 589	13 966	51 543	65 508	369.1
Country groupings						
G20	68.1	133 898	183 890	442 618	626 508	240.7
G7	43.5	92 492	132 990	282 581	415 571	212.5
Least developed countries (LDCs)	2.3	5 088	5 105	14 696	19 801	287.9
Africa LDCs	1.6	3 632	3 708	10 494	14 201	283.0
Fuel-exporting countries	14.1	34 029	37 532	91 550	129 082	243.9
Developed countries	2.2	4 646	6 643	14 108	20 751	212.4
Economies in transition	3.1	6 239	7 675	20 071	27 746	261.5
Developing countries	8.8	23 144	23 213	57 371	80 584	247.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "2021 General SDR Allocation" 2022 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation; "IMF Finances", Washington, D.C., 2021 [online] https://www.imf.org/external/np/fin/tad/query.aspx and World Bank, World Bank Development Indicators, Washington, D.C., 2021.

Table A1.2 | Global SDR holdings and reserves, 2009 and 2021
(Millions of dollars, percentages and percentage points)

Region	SDR holding *(millions of dollars)*		Reserves *(millions of dollars)*		Share of SDR holding in reserves *(percentages)*		Change in share of SDR holding in reserves *(percentage points)*
	2009	2021	2009	2021	2009	2021	
World	320 118	293 738	10 421 883	13 092 652	3.07	2.24	-0.83

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), "2021 General SDR Allocation" 2022 [online] https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation; "IMF Finances", Washington, D.C., 2021 [online] https://www.imf.org/external/np/fin/tad/query.aspx and World Bank, World Bank Development Indicators, Washington, D.C., 2021.

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