Responding to urgent global needs: IMF Special Drawing Rights

As the crisis caused by the spread of COVID-19 unfolds, emerging and developing economies are facing record capital outflows which pose a threat to financial stability. Central banks in advanced economies are intervening domestically to provide liquidity and support their financial markets, with the Federal Reserve extending that support to a small number of emerging economies via swap lines. This bilateral support will not be enough. The IMF Articles of Agreement allow allocation of Special Drawing Rights (SDRs) if the international monetary system faces stress.

The IMF can play a key role in strengthening and supporting the stability of the international financial system by issuing additional SDRs, as it did in 2009. This new allocation should be accompanied by a trust fund through which advanced economy countries can reallocate their holdings of SDRs to other countries. For emerging and developing countries, SDR allocation would provide the kind of economic support that advanced economies execute through Quantitative Easing. While the G20 committed to a record stimulus of $5 trillion, it risks excluding most emerging and developing countries.

Unconventional monetary policy in advanced economies since the global financial crisis played a role in creating the current vulnerabilities. Low interest rated fuelled the boom in dollar denominated debt in emerging and developing economies, as investors sought higher yields. Both private and public debt denominated in dollars have soared, with developing countries now owing a total $3.4 trillion, compared to $840 at the end of 2007. This enormous build-up in dollar denominated debt multiplied vulnerability to the kind of shocks that are now occurring.

Unless countries are provided with adequate liquidity in a timely manner, widespread job loss and economic collapse could result. Currently, most countries are left at risk of balance of payment crises that would decimate fiscal space, lead to currency collapses, make it impossible to pay public and private debt that is denominated in foreign currencies, and cause widespread inflation for countries reliant on imports.

The IMF and governments should move forward with:

An SDR expansion proportional to the crisis and the threats to developing countries

- The pressures on emerging and developing countries than in 2009, with capital outflows that have already surpassed 2009 levels and deep supply and demand shocks.
- Levels of dollar denominated debt in developing countries are roughly four times higher now than before the onset of the global financial crisis, thus quadrupling the 2009 allocation would be appropriate.

SDR expansion paired with mutual commitments for coordinated fiscal stimulus

- A two-part multilateral agreement for: 1) SDR allocation and, 2) coordinated fiscal stimulus that is designed to protect jobs and the real economy, featuring commitments from countries on the amount and design of stimulus and support to developing countries.

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- The International Monetary and Finance Committee (IMFC) can lead on creating shared principles for stimulus measures that prioritizes the real economy, public health and social protection, job protection and respect for the core labour standards.
- The IMF can create an enabling environment for a successful SDR allocation by supporting countries in implementing capital flow management measures to prevent the leakage of newly injected international reserves.

The creation of trust for advanced economies to donate a portion of their SDR holdings to developing countries

- SDR allocations are conducted in proportion to member country quotas at the IMF, meaning about sixty per cent would go to high-incomes countries. Emerging and developing countries face a double task of fending off immediate liquidity and currency problems and conducting stimulus measures for equitable crisis response and recovery. Solidarity among countries is needed to keep the global economy afloat and leave no one behind.
- An IMF Policy Paper on SDRs concluded that such a move would be akin to SDR loans provided by some countries to the Poverty Reduction and Growth Trust (PRGT) and would be permissible under the Articles of Agreement.
- The terms of a trust should be set to ensure that the additional support is used for job protection, support for strengthening social protection and public health systems, and supporting the real economy.

Background

What are SDRs?

- The SDR serves as the unit of account of the IMF and as an international reserve asset. The value of the SDR is based on a basket of five currencies: the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling. The SDR is not a currency in itself, but SDRs are potential claims on any of the five currencies.
- SDRs are allocated to members in proportion to their IMF quotas. Currently, SDR 204.2 billion (equivalent to about US$291 billion) is allocated to members, most of which (182.6 billion) was allocated in the wake of the global financial crisis.
- SDRs are counted on the balance sheets of countries as “international reserves.”
- SDRs can be used for payments due to the IMF, traded amongst countries’ central banks, or exchanged for the currencies in the basket. Once exchanged, the obtained hard currency can be used by the government to pay for imports, and finance other spending.

Why SDRs?

- Addresses the problem of unequal access to liquidity in the current international monetary system.

- Provides IMF with additional firepower in a way that bypasses the problems of quota increases, which failed in 2019.
- SDRs supplement existing official reserves, which helps stem pressures on exchange rates resulting from capital outflows and lack of liquidity in global market
- Especially in the current context of a global crisis and low commodity prices, it is difficult for emerging markets and low-income countries to obtain hard currencies, since both the volume and value of exports is dropping. Additional SDRs can help fill that gap and avoid a balance of payment crisis.
- While the risks of "moral hazard" is sometimes cited as an argument against additional SDR allocations, a 2018 policy paper from the IMF offers a snapshot of how countries used the additional allocations, proving these concerns are concern are overblown:
    - Between 2009 and 2015, 29 countries sold some of their SDR holdings, with countries with ratings below investment grade selling a greater amount.
    - Half of IMF member countries made their payments to the 2016 expansion of IMF quotas using SDR
    - "A few" borrowing members repaid IMF loans using SDR
    - There was no evidence of widespread misuse of SDRs

Procedures for SDR allocations

- According to the IMF's Articles of Agreement, the role of SDRs is "to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world." (Article XVIII, Section 1)
- SDR allocations can be reviewed at any time if "the Fund finds it desirable to do so because of unexpected major developments." (Article XVIII, Section 3)
- Allocations are made based on proposals of the Managing Director and executive board to the Board of Governors. The request can also come from the Board of Governors.
- In 2009, the G20 agreed to the idea of the IMF issuing the equivalent of $250 billion in new SDR allocation. The IMF then drafted the proposal and approved it within a few months. A similar agreement from the G20 would facilitate a new allocation.