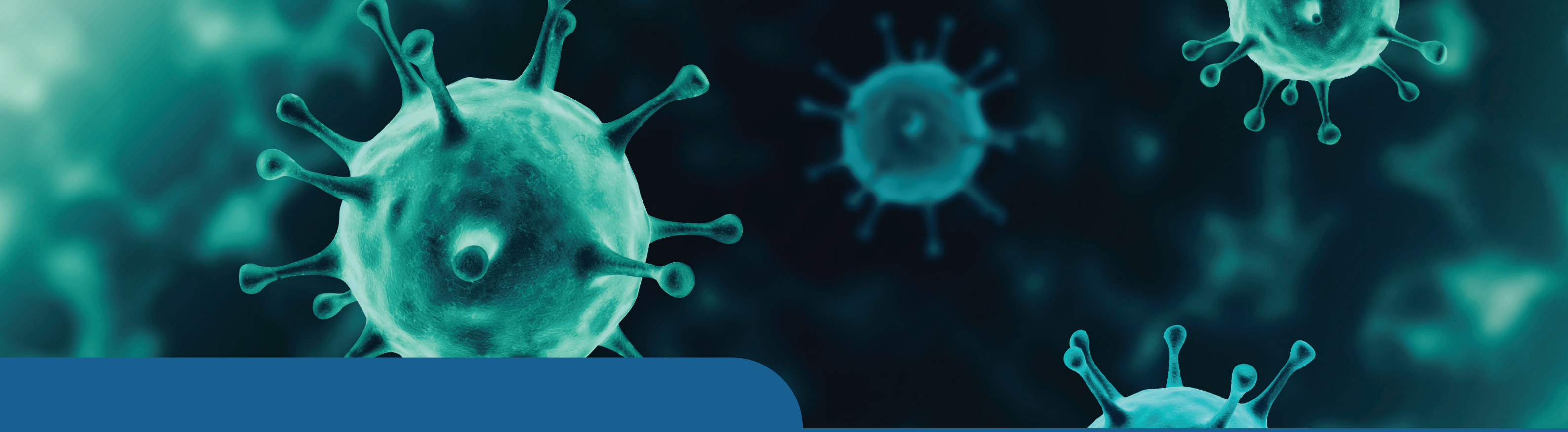

United Nations
Economic Commission for Africa

ECA POLICY BRIEF

Making special drawing rights work for COVID-19 economic relief

The COVID-19 pandemic has given rise to a fiscal crisis, in particular in commodity-dependent countries, which had already exhausted their fiscal space through massive infrastructure spending financed largely through commercial loans. In 2019, over half of African countries had fiscal deficits above 3 per cent of gross domestic product (GDP), while 22 African countries had debt-to-GDP ratios above the average for Africa as a whole (61 per cent of GDP in 2019).

Notwithstanding their fiscal constraints, African countries have pledged $44 billion of their own funds to respond to the crisis, representing 2.0 per cent of the continent's GDP in 2019. In contrast, as at 29 April 2020, G20 countries had disbursed $6.3 trillion in crisis-related fiscal support, representing 9.1 per cent of their 2019 GDP.

In response to these fiscal pressures, the G20 countries and IMF have initiated programmes to ease the liquidity constraints of low- and middle-income countries. The G20 countries are providing a standstill on the bilateral debt of 73 developing countries. Similarly, IMF is providing $10 billion in financing to African countries through its Catastrophic Containment and Relief Trust and its Rapid Credit Facility. However, given the enormity of the financing needed to adequately respond to the crisis, these funds can be viewed only as a first step in a series of response measures.

It is in this context that many prominent individuals have advocated for additional support to be provided to developing countries in the form of special drawing rights (SDRs). The requests range from a call for new SDR allocations, to a request for wealthy countries to donate or lend portions of their current SDR allocations to low- and middle-income countries that are experiencing liquidity crises.

What are SDRs?

SDRs were created in 1969 by IMF to provide countries with resources in times of liquidity shortfalls. Just as a central bank can print currency, so IMF can create SDRs. To date, a total of SDR 204.2 billion (equivalent to $282 billion) has been allocated to countries, including an allocation of SDR 182.6 billion in 2009 in response to the 2008 financial crisis.

New SDRs have been created several times in IMF's history. However, doing so requires a vote in favour by those holding at least 85 per cent of total IMF voting shares. Since the United States of America holds a 16.51 per cent share, its agreement is essential if more SDRs are to be created.

SDRs are not a currency but a claim on other currencies. This means that countries that are allocated SDRs can exchange them for any currency of their choice. For instance, if a country is running low on currency to pay its foreign obligations, denominated in dollars or euros, it can exchange its SDRs for the needed currency.

The value of SDRs is based on a weighted average of 5 currencies: the United States dollar (41.7 per cent); the euro (30.9 per cent); the Chinese renminbi (10.9 per cent); the Japanese yen (8.3 per cent); and the British pound sterling (8.0 per cent).

When IMF creates more SDRs, they are distributed (allocated) in proportion to each country's shareholding (or quota) in IMF.[1] Therefore, the United States would be allocated 17.45 per cent of any newly created SDRs, whereas Guinea, for example, would get 0.05 per cent.[2]

SDR allocations, holdings and interest rates

In respect of SDR holdings, a country can obtain more SDRs than it was initially granted (allocated) by exchanging currency for SDRs of other countries. In doing so, the country that receives SDRs is essentially providing liquidity to the countries that supply SDRs. When a country's SDR holding is larger than its allocation, it earns interest on the difference between its holding and its allocation.

On the other hand, when a country exchanges part of its SDR allocation for currency, its SDR holding declines below its initial allocation. Such countries are charged interest on the difference. In effect, countries with higher SDR holdings than allocations can be described as net creditors.

Table 1: Distribution of SDRs among G20 countries*

G20 countries	SDR holdings	SDR allocations	Change in SDR allocations
Argentina	1,374,213,930	2,020,039,967	-645,826,037
Australia	3,159,173,792	3,083,171,021	+76,002,771
Brazil	2,938,640,327	2,887,077,827	+51,562,500
Canada	6,203,723,338	5,988,080,401	+215,642,937
China	7,974,159,487	6,989,668,494	+984,490,993
France	8,072,126,373	10,134,203,762	-2,062,077,389
Germany	11,887,890,692	12,059,166,873	-171,276,181
India	1,048,429,985	3,978,258,337	-2,929,828,352
Indonesia	1,114,649,382	1,980,438,720	-865,789,338
Italy	5,684,679,255	6,576,111,210	-891,431,955
Japan	14,129,448,840	12,284,969,838	+1,844,479,002
Korea	2,222,288,961	2,404,445,224	-182,156,263
Mexico	2,918,634,241	2,851,195,262	+67,438,979
Russian Federation	4,855,977,752	5,671,802,571	-815,824,819
Saudi Arabia	5,818,221,624	6,682,495,468	-864,273,844
South Africa	1,482,000,801	1,785,415,141	-303,414,340
Turkey	977,066,747	1,071,329,729	-94,262,982
United Kingdom	10,109,168,873	10,134,203,762	-25,034,889
United States	36,749,528,348	35,315,680,813	+1,433,847,535
Total (in SDR)	128,720,022,748	133,897,754,420	-5,177,731,672

* ECA calculations based on IMF data (https://www.imf.org/external/np/fin/tad/extsdr2.aspx?date1key=2020-07-31).

Table 1 below provides the latest data (as at 31 July 2020) on SDR holdings and allocations for the G20 countries. SDR holdings and allocations are provided in columns 2 and 3 respectively, while column 4 shows the difference between SDR allocations and holdings. A positive figure suggests a net accumulation of SDRs

1 For technical reasons, "quotas" and votes are not in exactly the same proportions.
2 A table of quota shares can be found at https://www.imf.org/external/np/sec/memdir/members.aspx; and a table of current SDR allocations and holdings can be found at https://www.imf.org/external/np/fin/tad/extsdr2.aspx?date1key=2020-03-31.

over the initial allocation. A negative figure suggests that initial allocations have been sold for currency.

The data reveal that, on average, the G20 countries have exchanged SDR 5.2 billion of their total SDR allocations (SDR 133.9 billion), thus lowering their holdings by an equivalent of $128.7 billion. However, seven of the G20 countries (i.e., Australia, Brazil, Canada, China, Japan, Mexico and the United States of America) have holdings that exceed their allocations, implying that they have acquired additional SDRs (thereby providing currency liquidity to other countries).

Options for using SDRs to inject liquidity into the economies of low- and middle-income countries

Low- and middle-income countries are beginning to run into foreign exchange reserve shortages, impeding their ability to import needed goods and services. ECA estimates that the drain on low- and middle-income countries due to the COVID-19 pandemic, in terms of reduced trade, remittances and capital inflows, is approximately $800 billion (albeit with a large range of uncertainty).[3]

There are currently two proposals on the table regarding the use of SDRs to support low-and middle-income countries in their response to the pandemic. One proposal calls for new SDR allocations. The second option, which is less ambitious but politically more palatable, calls for a re-allocation of existing SDRs to the developing countries that are least capable of responding to the crisis owing to their limited fiscal space.

Voluntary reallocation of existing SDRs to low- and middle-income countries

There is broad political support for providing assistance to low- and middle-income countries that are suffering during the current crisis. Doing so is vital to meeting the financial needs of low- and middle-income countries. To that end, the IMF Managing Director has called for $500 billion in new allocations. The problem with that proposal is that it would benefit all countries, which would be unpalatable to some countries given today's geopolitical environment.

The alternative proposal is for wealthy nations to donate or lend unused portions of their SDR holdings to low- and middle-income countries in need of support. For example, Germany could give Kenya part of its holding to augment Kenya's reserves position. This option would however be limited by the total amount of existing SDR holdings.

As shown in table 1, the current SDR holdings of all G20 countries is SDR 128.7 billion (equivalent to $179.2 billion).[4] If all G20 countries were to loan or donate all their existing SDRs, it would help in meeting the immediate financing needs of African countries (estimated at $100 billion).

Cost of SDR borrowing

The cost to G20 countries of reallocating all their idle SDRs would be about $136.2 million, based on the second quarter average SDR interest rate (0.076) and the monthly (July 2020) average exchange rate ($1=0.71833123 SDR). If countries in need were to borrow those SDRs, it would cost them about $1.9 billion, based on the second quarter average SDR rate of charge (1.076) and the monthly (July 2020) average exchange rate.

Based on the aggregate SDR quota of African countries, which is 6.44 per cent, the reallocation of SDRs holdings from the G20 countries to African countries would amount to SDR 8.3 billion (or $11.5 billion). That amount is nearly equivalent to the total debt relief offered through the Debt Service Suspension Initiative. The cost to G20 countries of reallocating[5] those resources would be about $8.8 million, while the cost of borrowing[6] for the African economies would be $124.1 million. These costs represent a small fraction of the trillions of dollars in stimulus financing disbursed by the member States

3 Plant, Mark, "Making the IMF's special drawing rights work for COVID-19 economic relief" (Centre for Global Development, 6 May 2020). Available at https://www.cgdev.org/publication/making-imfs-special-drawing-rights-work-covid-19-economic-relief.

4 At the average monthly (July 2020) exchange rate of SDRs per currency (see https://www.imf.org/external/np/fin/data/param_rms_mth.aspx).

5 Based on the second quarter average SDR interest rate of 0.076 (see https://www.imf.org/external/np/fin/data/queryoutput.aspx?origin=imf-finances).

6 Based on the second quarter average SDR rate of charge of 1.076 (see https://www.imf.org/external/np/fin/data/queryoutput.aspx?origin=imf-finances).

Table 2: Proposal for SDR quota reallocation to African countries

	SDRs (in XDR)	SDRs (in USD)
G20 countries SDRs holdings (31 July 2020)	128,720,022,748	179,193,129,745.16
Africa’s aggregate quota (in per cent)	6.44	6.44
Africa’s receipt from a G20 SDR reallocation	8,289,569,465	11,540,037,685.64
Cost of reallocating for G20 countries	6,300,073	8,770,428.64
Cost of borrowing for African countries	89,195,767	124,170,805.50

Source: ECA computations, based on IMF data, September 2020.

of the Organization for Economic Cooperation and Development, and would be a small price to pay to ease the acute liquidity constraints faced by African countries.

Conclusion

The crisis caused by the COVID-19 pandemic has unmasked the vulnerability of all countries to such shocks. Economies that were good performers before the crisis have struggled to access liquidity. Meanwhile, financial markets have penalized emerging market economies through high-risk premiums, which threaten to further elevate the debt vulnerability of those countries and to nudge them closer to the precipice of insolvency. Access to SDRs can provide the much-needed concessionary financing to improve the liquidity positions of African countries. Now is the time for developed countries to take the bold steps needed to spur economic recovery and pre-empt the looming threat of cascading insolvency.

Acknowledgements

The present brief was prepared by Bartholomew Armah (PhD), Director of the Macroeconomics and Governance Division, and Yesuf Awel (PhD), consultant in the Macroeconomics and Governance Division.