Building a new, better SDR BY JAYATI

With much of the developing world teetering on the edge of a debt crisis, the calls for a new issuance of special drawing rights (SDRs, the International Monetary Fund’s reserve asset), have grown louder and more urgent. But to have the desired effect, the International Monetary Fund (IMF) must modify its allocation criteria and clarify how SDRs can be used to support low- and middle-income countries through the current economic turmoil.

One proposal currently being considered is to expand SDR allocation beyond individual countries to include multilateral development banks and dedicated funds. The idea of channelling SDRs to multilateral institutions like the World Bank and regional development banks, which are uniquely equipped to assist emerging and developing countries, has become increasingly popular in recent years.

The Bridgetown Initiative, led by Barbadian Prime Minister Mia

Mottley, has called for a new issuance of SDR500bn ($650bn) “or other low-interest, long-term instruments” to support the creation of a multilateral agency that would accelerate “private investment in the low-carbon transition, wherever it is most effective.”

Similarly, the recent report by the High-Level Advisory Board on Effective Multilateralism (of which I was a member) recommends the “immediate, and thereafter regular” annual issuance of additional SDRs to aid countries facing foreign-exchange shortages. The report also suggests that IMF shareholders amend the organisation’s Articles of Agreement to permit “selective SDR allocation.” This proposed change aims to facilitate a more targeted and effective distribution that prioritises the most vulnerable countries over the world’s largest economies, which receive the lion’s share of SDR allocations under the current rules.

Another proposed amendment stipulates that “specific conditions” would automatically trigger SDR allocations to ensure a “swifter global response.” Notably, the report emphasises that eligibility for SDR allocation should not be conditional on the recipient country adopting an IMF-supported fiscal consolidation program.

Unfortunately, these proposals were not even discussed during the Spring Meetings of the IMF and World Bank in April. But we must continue to pursue these reforms, because increased international liquidity, delivered in a timely and efficient manner, is needed more than ever.

By modernising the outdated system of SDR allocation, the international community could also narrow the climate-finance gap. But, first, the many developing countries currently at risk of a severe debt crisis must receive immediate budgetary support. Unless we create a global financial safety net, the United Nations Sustainable Development Goals stand little chance of being met.

The ongoing financial turmoil highlights the current system’s inherent inequities. Over the past few weeks, governments that control global reserve currencies, such as the United States and Switzerland, have pumped massive amounts of liquidity into the banking sector to rescue private banks. In contrast, debtor countries that have applied for debt relief under the G20's Common Framework for Debt Treatments have been waiting for years for a fraction of those sums.

The sovereign-debt crisis currently engulfing the world's poorest countries, which also happen to be the countries most affected by climate change, requires immediate action. At a minimum, low- and middle-income countries grappling with balance-of-payments challenges should be given the opportunity to bolster their foreign-exchange reserves through a new SDR allocation.

But even if a fresh allocation is eventually agreed upon, countries must understand how to make the most of it. Unfortunately, the IMF's vagueness on this issue has caused much confusion, with some asserting that SDRs belong to central banks, not governments, and others insisting that they are loans rather than assets distributed by the IMF.

Consequently, many recipient countries' newly allocated SDRs simply augment foreign-exchange reserves. While this can have a positive impact by increasing a country's perceived creditworthiness, it can also hinder more effective uses of SDRs, particularly in times of acute shortages and fiscal constraints.

The Ecuadorian economist Andrés Arauz has highlighted these concerns, arguing that there is no legal basis for central banks to appropriate SDR allocations. The IMF's own guidance says that members "enjoy a large degree of freedom in how to manage the SDRs allocated to them," including the extent to which "central banks are involved in their management and whether the budget can directly use them for budget support." According to the Fund, SDRs are "allocated and held by the member and instructions for its use come through the fiscal agency of the member" (emphasis added). In other words, governments can use SDRs as they see fit.

The confusion over the nature and status of SDRs stems, in part, from the IMF's own misclassification of these assets. As

Arauz points out, prior to the release of the IMF's latest balance-of-payments manual (BPM6) in 2009, SDR allocations were treated as equity rather than as liabilities that recipient countries must repay. The BPM6, however, reclassified them as liabilities, essentially treating them as debt. This change, which was made without clear reasoning or transparent discussion, must be contested, because it can deter the use, transfer, and recycling of SDRs, preventing allocations from fulfilling their potential.

Some countries, particularly in Latin America, have demonstrated creativity in their use of SDRs. Ecuador, for example, used them to finance its 2021 investment plan. The same year, Paraguay channelled its allocation to investments in health, education, housing, and other public expenditures, and Argentina used its $4.6bn allocation to pay off maturing debt, fulfilling its obligations to the IMF.

In other countries, central banks' perceived role as the custodian of SDRs did not completely restrict alternative uses. Colombia, for example, used SDRs to facilitate a domestic debt swap between the government and the central bank and generate short-term liquidity. Although Mexico's central bank asserted its ownership of the country's SDRs, the Mexican government acquired international reserves from it through a currency exchange in late 2021.

The current crisis is an opportunity to construct a fairer, more sustainable international monetary system. A sensible reform agenda must include increased SDR issuance and the creation of more efficient and equitable distribution mechanisms. To achieve this, the G7 countries, as the IMF's largest shareholders, must demonstrate a modicum of wisdom and leadership. – Project Syndicate

l Jayati Ghosh, Professor of Economics at the University of Massachusetts Amherst, is a former member of the UN Secretary-General's High-Level Advisory Board on Effective Multilateralism.