Understanding International Monetary Fund Special Drawing Rights (SDRs)

by

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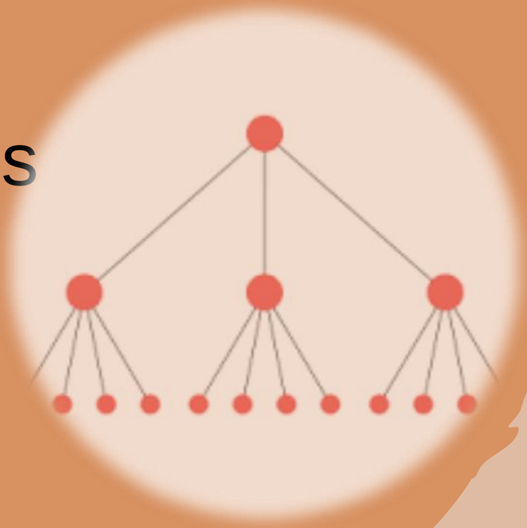
Objectives of this presentation

- ❑ Enable participants, understand SDRs to be able to engage in SDRs debates and make policy suggestions
- ❑ To highlight SDRs cases and their use – Kenya, Ethiopia, Uganda, Ghana and Senegal -
- ❑ To highlight key public debt trends in relation to SDRs, and the role of SDRs in financing covid-19 and economic recovery

Structure of the presentation

- ❑ **PART 1:** Explaining Special Drawing Rights (SDRs)
- ❑ **PART 2:** Looking at SDR Allocations to various cases
- ❑ **PART 3:** Africa’s SDRs Allocations thus far
- ❑ **PART 3:** Rechanneling/Recycling & Using SDRs
- ❑ **PART 5:** Concluding Remarks



PART 1:
EXPLAINING SPECIAL DRAWING RIGHTS (SDRs)

❑ What are SDRs

- International **financial reserve asset** created with the aim to supplement IMF member countries official reserves
- Provide and to access **useable hard currencies.** Denominated mainly in the dollars, euros, pounds, yen, renminbi
- Aim is to **create unconditional liquidity** to countries by trading SDR assets for hard currency
- Noting that **SDRs is not a currency**. It cannot be used to buy things. At best, a reserve-sharing mechanism
- The **seller provides hard currency** in exchange for SDR for **the buyer to access and use hard currency**

❑ History of SDRs

- Created in 1969 within the context of the Bretton Woods fixed exchange rate based on **the standard gold system**
- Bretton Woods system collapsed in 1973. Shift of major currencies to the **floating exchange rate regimes**
- **Less reliance on SDRs** as a global reserve asset though with a potential
- The potential for its issuance and allocation to play a role in providing liquidity and supplementing member countries' official reserves when invoked, remained

❑ History of SDRs

- SDRs is backed by five currencies - **the U.S. dollar, the euro, the yen, the pound sterling and the renminbi** as of 2015
- Ever since its creation, a total of **SDRs 660.7** billion (equivalent to about **US$943 billion**) have been allocated.
- The largest-ever allocation in history was approved in **August 2021** – about **SDRs 456** billion the equivalent of **US$650 billion**
- Aim to address long terms global reserve needs to cope with the adverse effects of the covid-19 pandemic.

❑ Administration

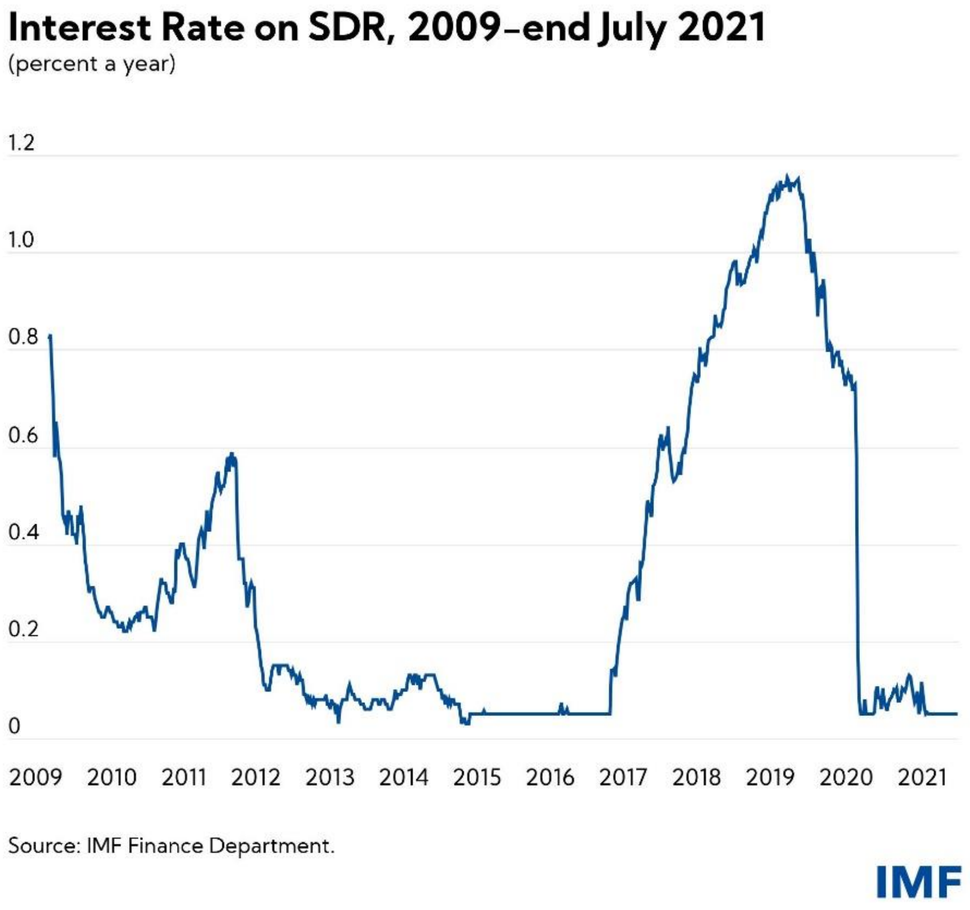
- IMF is governed by its Articles of Agreement adopted at the United Nations Monetary and Financial Conference (Bretton Woods, July 22 1944)
- The operations of the SDRs department are subsidiary to these articles following the creation of the new international reserve asset in 1969
- The Articles require that IMF General and IMF SDRs Departments be kept strictly separate. Assets in one department cannot be used to meet liabilities of the other
- This separation reflects the fact that the SDRs facility is an entirely separate financial mechanism from IMF’s main lending operations
- SDRs Articles requires 85 percent majority vote to invoke their issuance and allocations. No specific requirements are involved in receiving the required share
- The SDRs cannot be held by private entities or individuals

❑ Valuation

- The basket of currencies backing SDRs are decided upon based on **the export criterion** and the **freely usable criterion**
- A currency meets **the export criterion** if it is one of the **top five world exporters** and if the currency issuer is an IMF member country or the monetary union has IMF members
- A currency is determined **“freely usable”** if it has to be widely used to make payments for international transactions and widely traded in principal exchange markets
- The SDRs basket is reviewed every five years, or earlier if warranted, to ensure that the basket reflects the relative importance of currencies in the world’s trading and financial systems

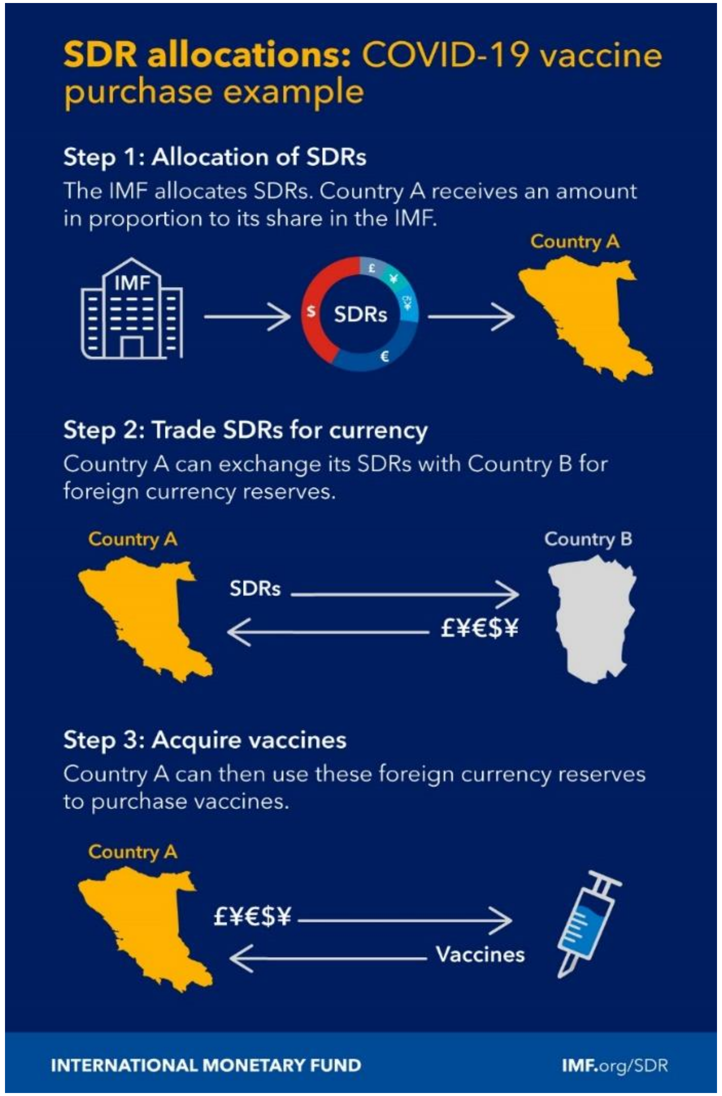
❑ Interest rates

- SDRs Historically attracts very low interest rates – even below concessional lending rates
- Typically has not reached 1.2 percent since the last back-to-back issuance
- Countries earn interest on their SDRs holdings and pays the SDRs interest rate on its cumulative allocation
- Countries that use their SDRs (exchanging them for hard currencies) hold fewer SDRs than their cumulative allocation and pay interest on the difference
- Conversely, countries holding more SDRs than their cumulative allocation will earn interest



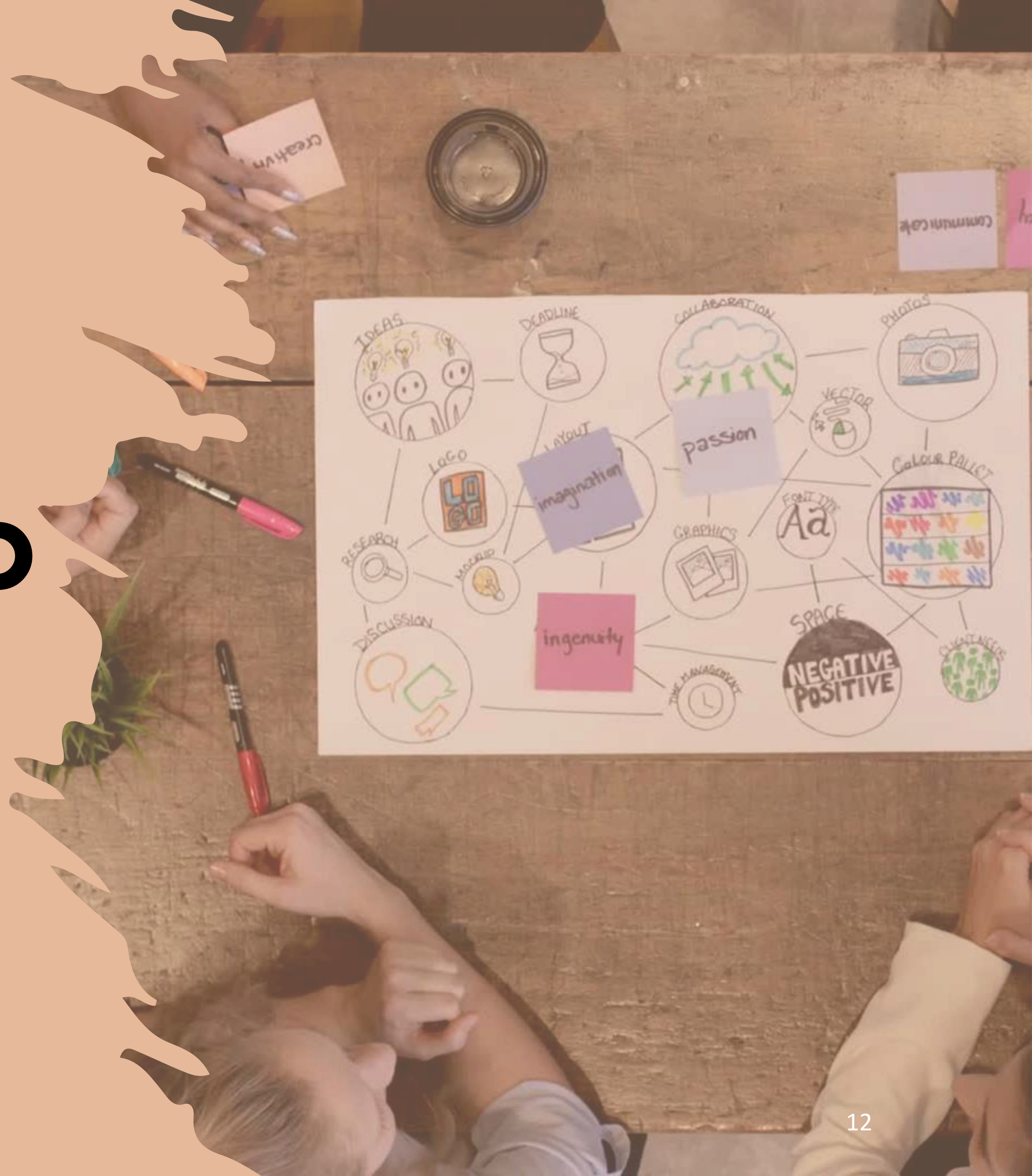
❑ Trading SDRs

- Traded through **ad hoc bilateral agreements or** through **Voluntary Trade Arrangements (VTAs)**
- VTAs are **pre-settled arrangements** among countries **mediated by the IMF** /prescribed holders and IMF to buy or sell SDRs
- In VTA, a country in need of hard currency contacts the IMF to exchange its SDRs. IMF invokes an existing VTA and proceeds to mediate the transaction
- The opposite is also true if a country is looking to acquire SDRs
- Ad hoc bilateral agreements do not require IMF mediation

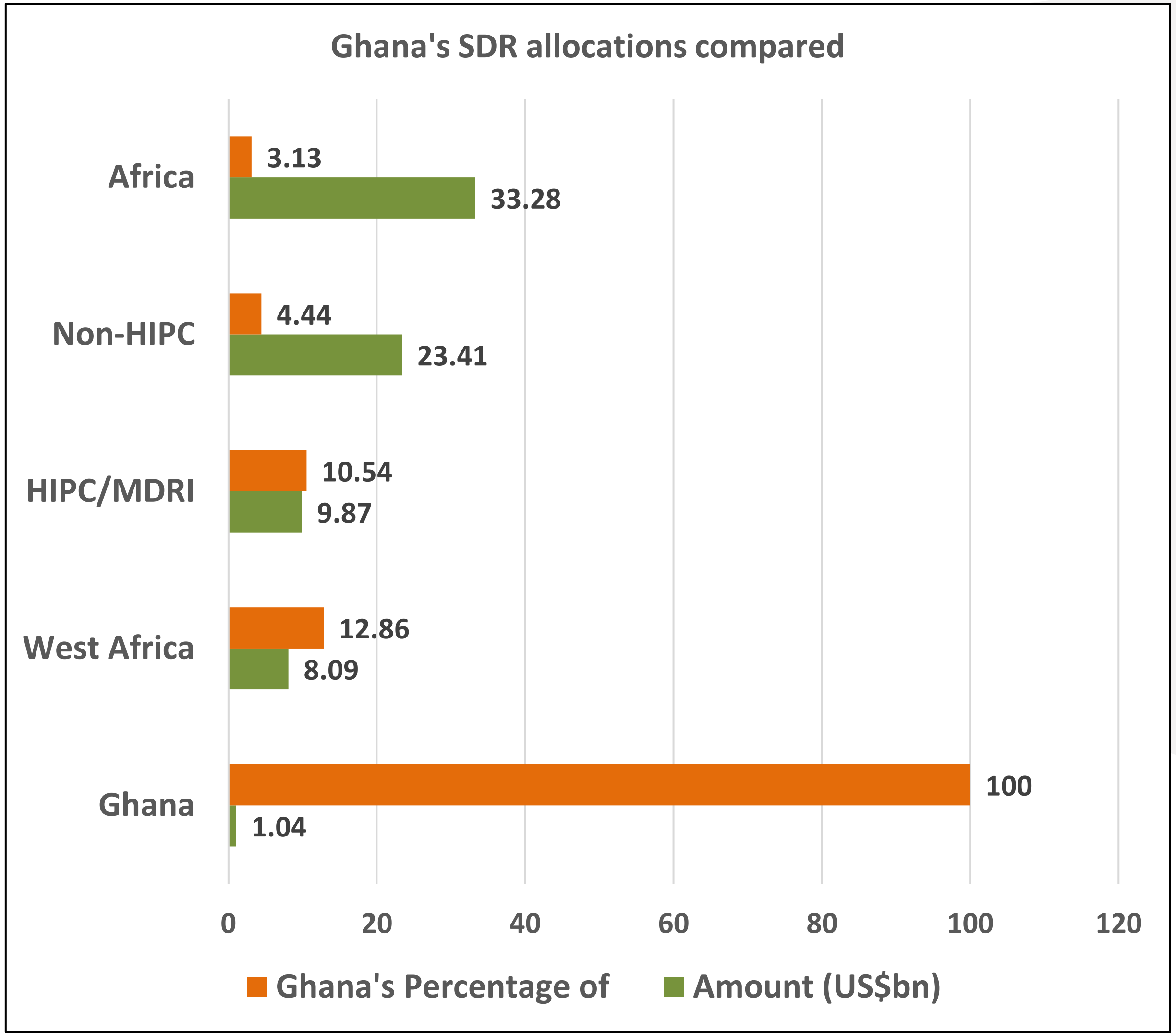


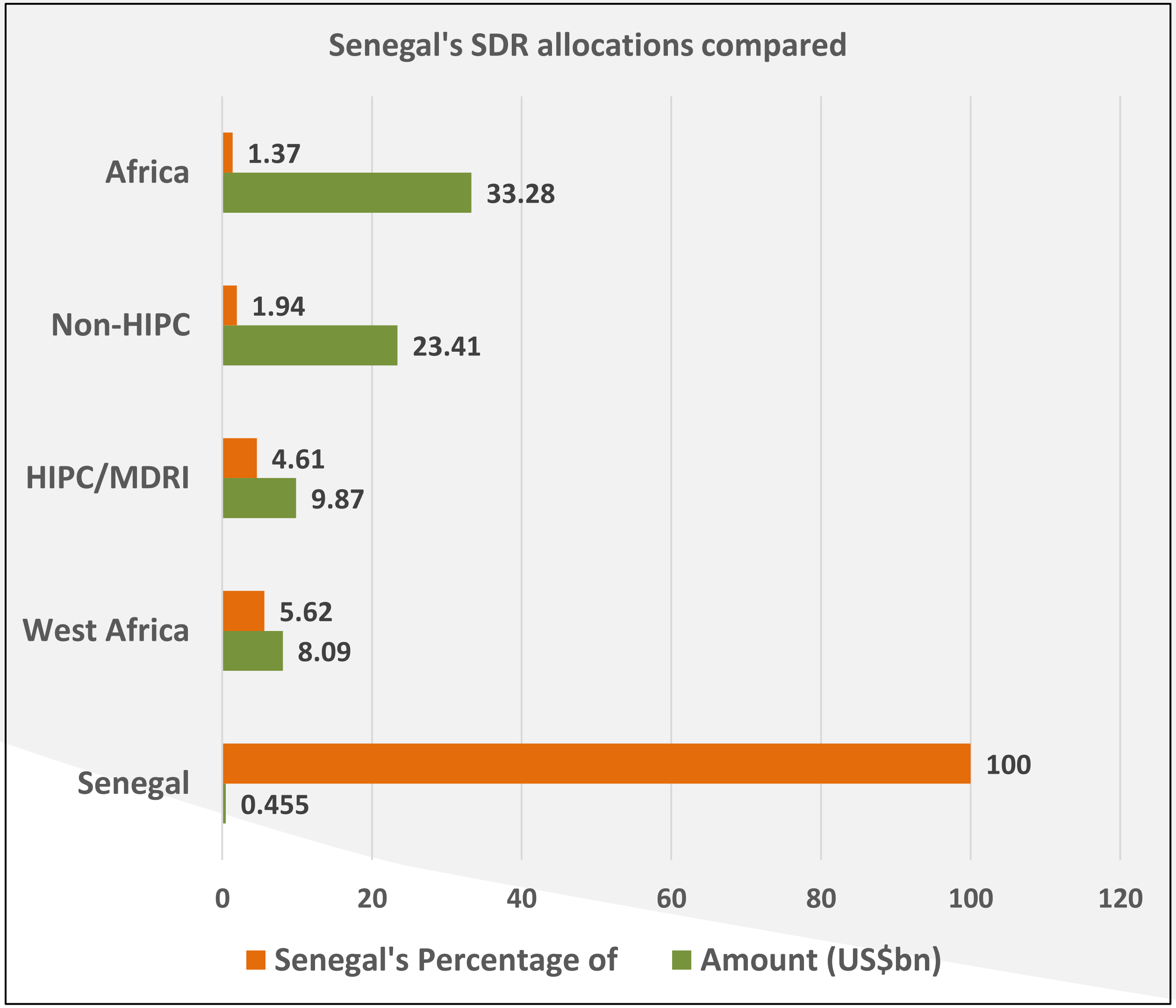
Source: *IMF publication*

PART 2:
SDRs ALLOCATIONS TO VARIOUS CASES



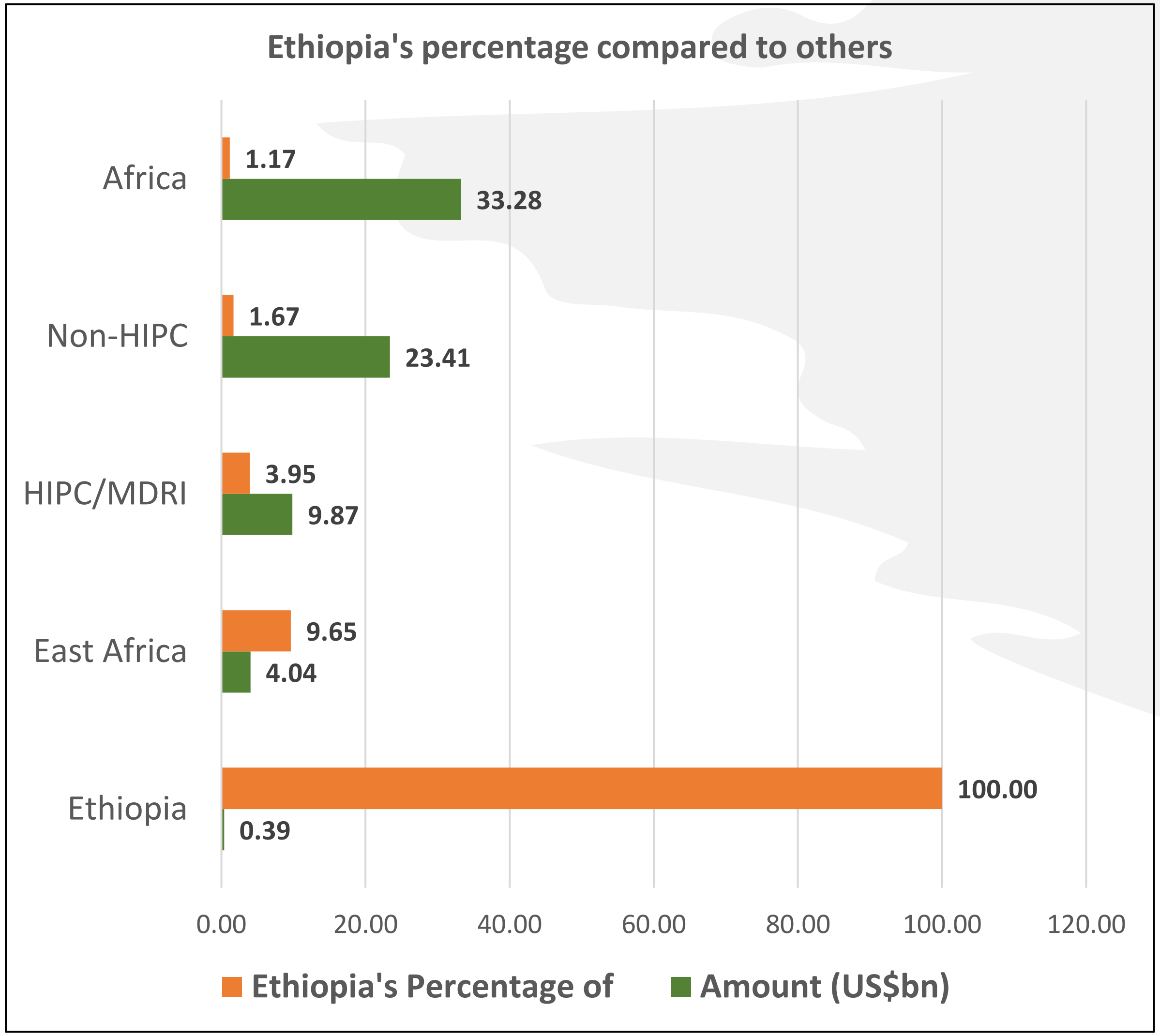
West Africa: *Ghana and Senegal SDR allocations compared*

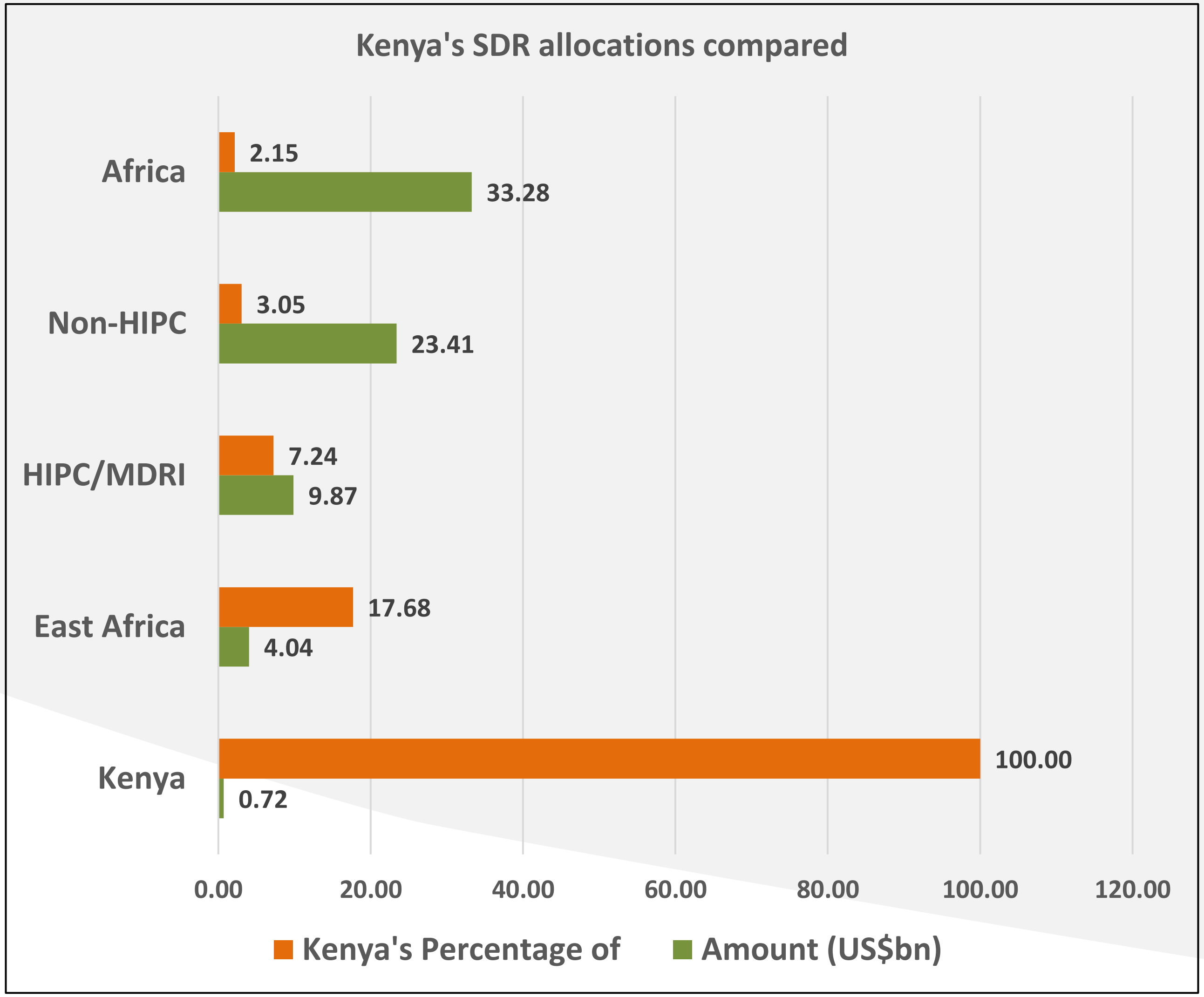




Source: *computed from IMF sources*

East Africa: Ethiopia, Kenya & Uganda SDR allocations compared





Source: *computed from IMF sources*

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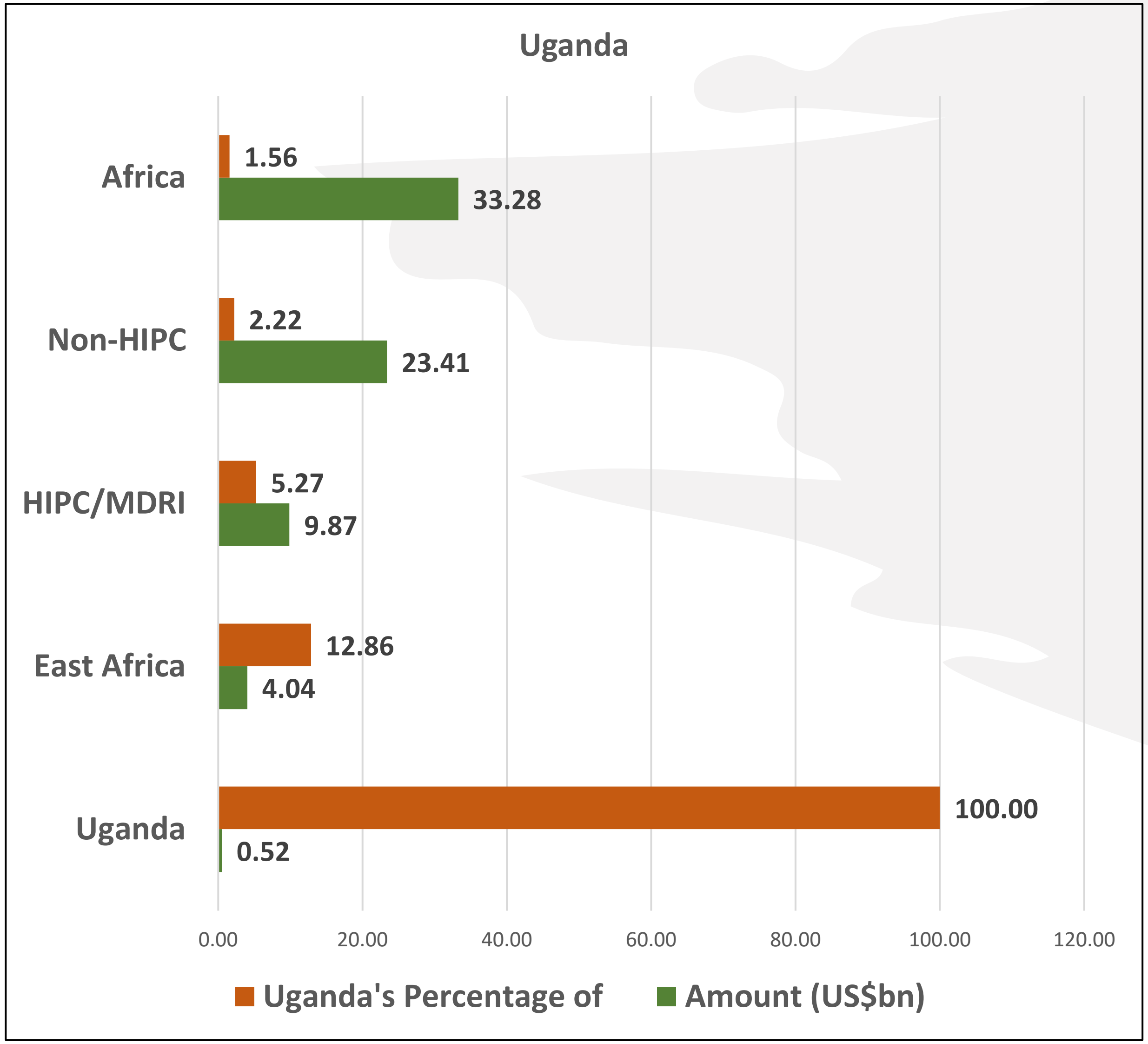
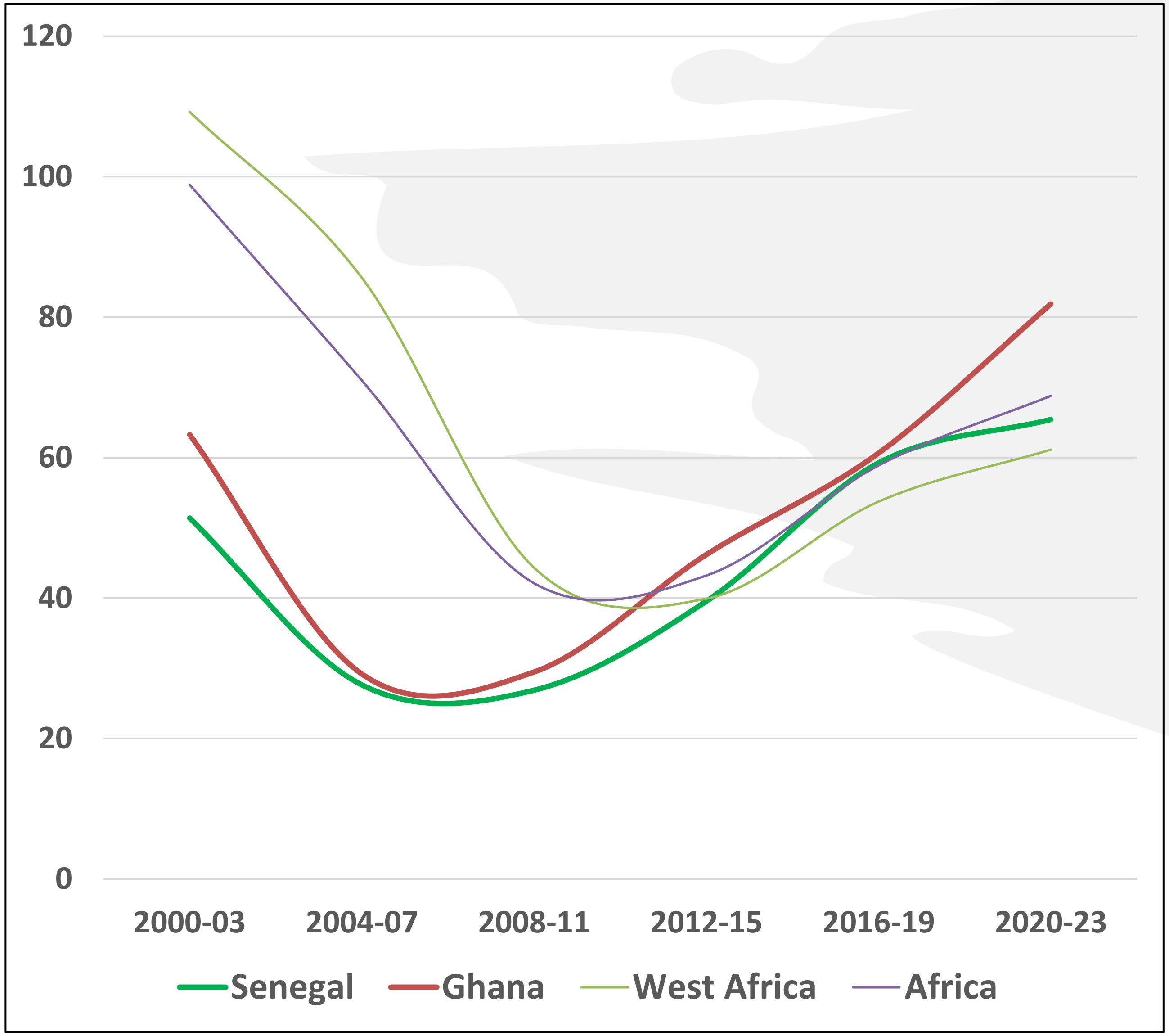


- The usefulness of SDRs depend on their overall macroeconomic health, current debt sustainability status and its external fiscal position
- Generally, SDRs is a debt – a cheaper one however
- SDR are more useful to countries in moderate to low risk of debt distress than to countries in debt distress and high risk of falling into debt distress
- Interest rates – though very low - adds to debt burdens

Source: *computed from IMF sources*

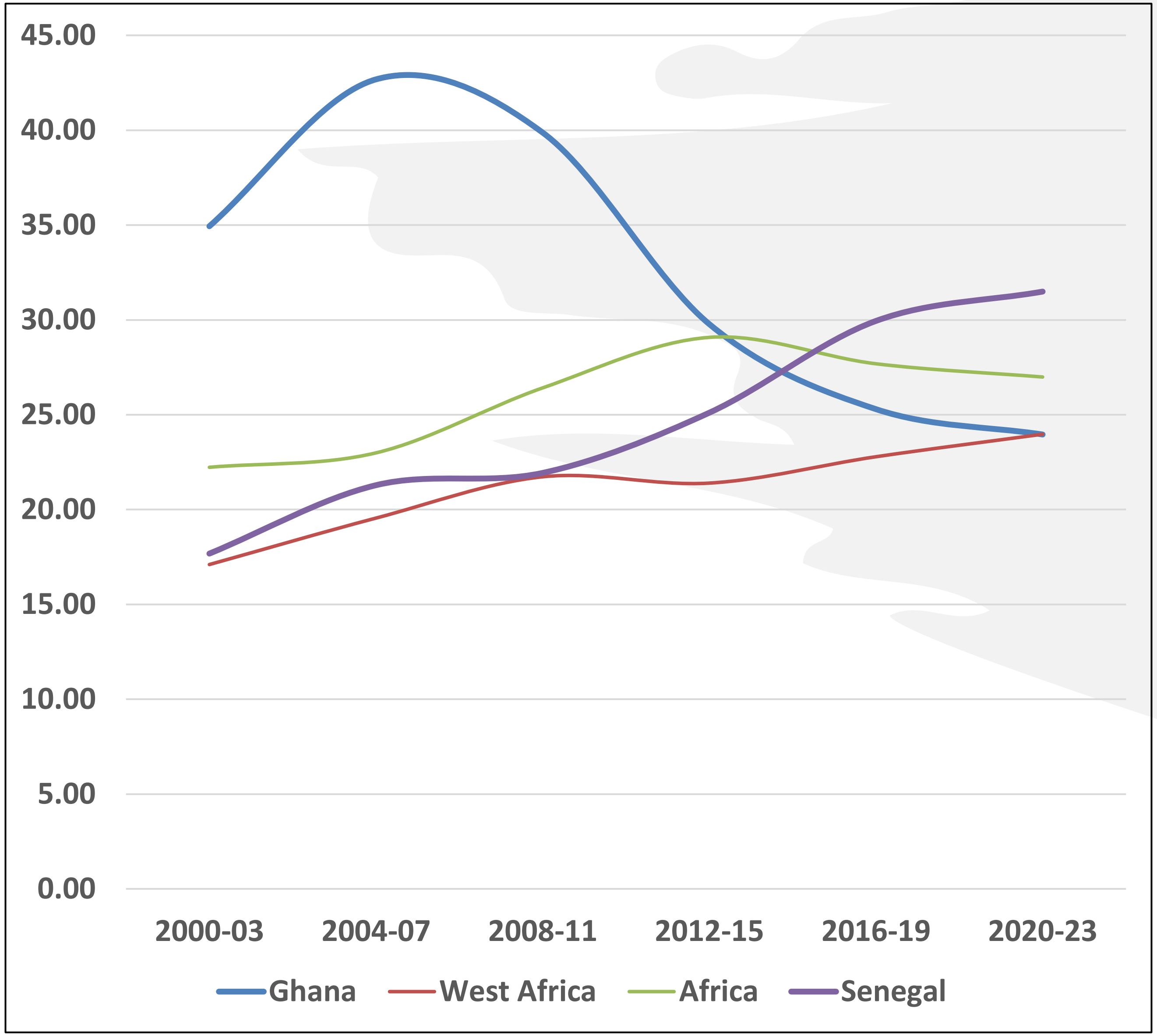
West Africa: Debt to GDP trends in Ghana and Senegal



- Debt vulnerabilities have heightened in Ghana and Senegal – especially after the period 2004-07
- Debt *(expressed as percentage of GDP)* remain in an upward trend during in the period leading up to the Covid-19 pandemic – albeit slowing down for Senegal
- Debt to GDP trends for these cases reflect continental and regional debt trends which took a steep upward trend after the period 2008-11
- Ghana and Senegal like the rest of West Africa have been accumulating more debt

Source: *WEO data*

West Africa: Investment trends to GDP in Ghana and Senegal



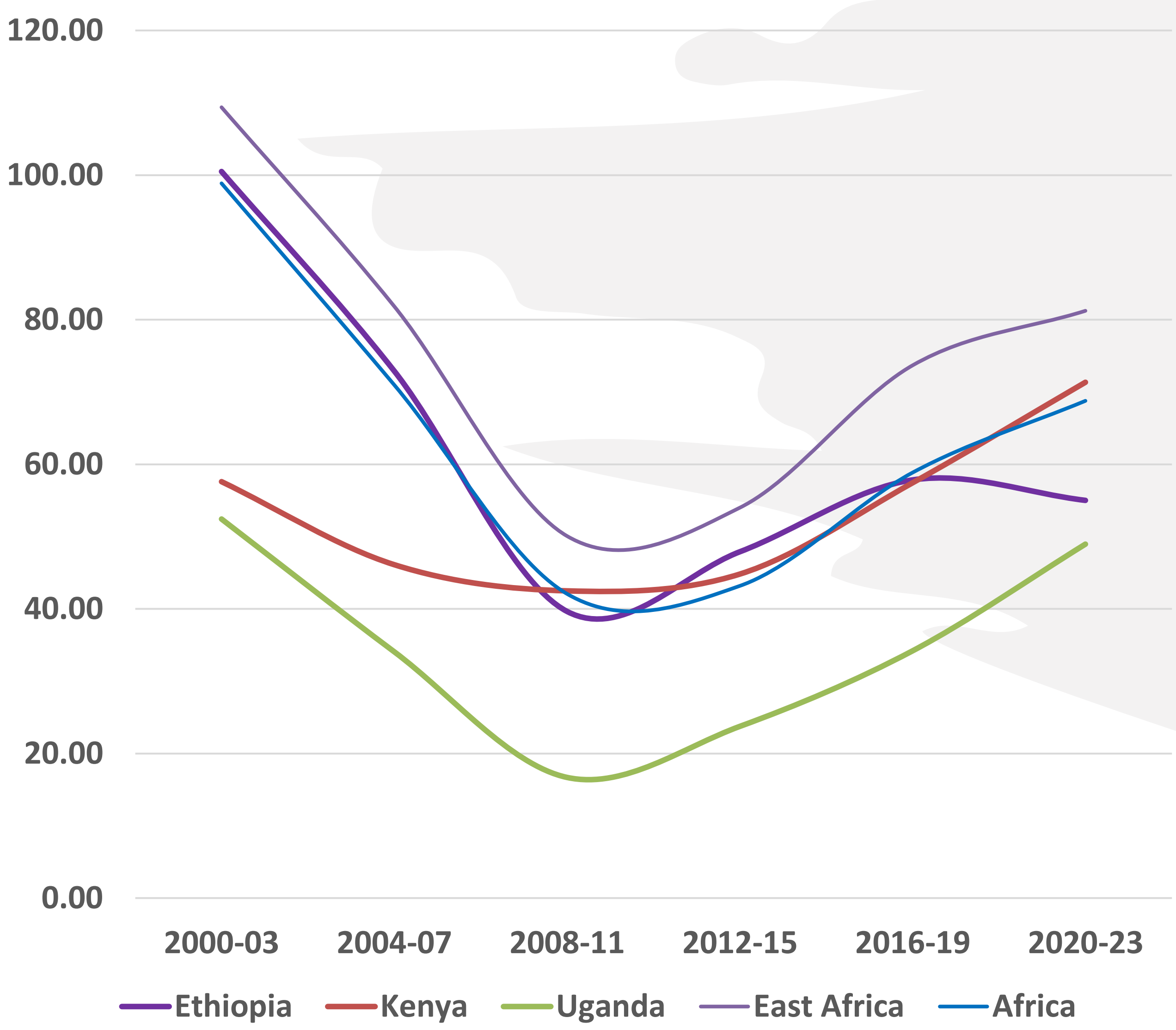
- Investments to GDP rates has been on a downward trend since the period 2005-07 – meaning more dent accompanied by limited investments

- The trend for Senegal has been on a steady rise since for the past 20 years – depicting increasing use of debt for public investment projects

- The Senegal case clearly contrast the Ghana case and the cases for the West Africa region and Africa as a whole where investment rates as percentage of GDP are either declining of have been slow

Source: *WEO data*

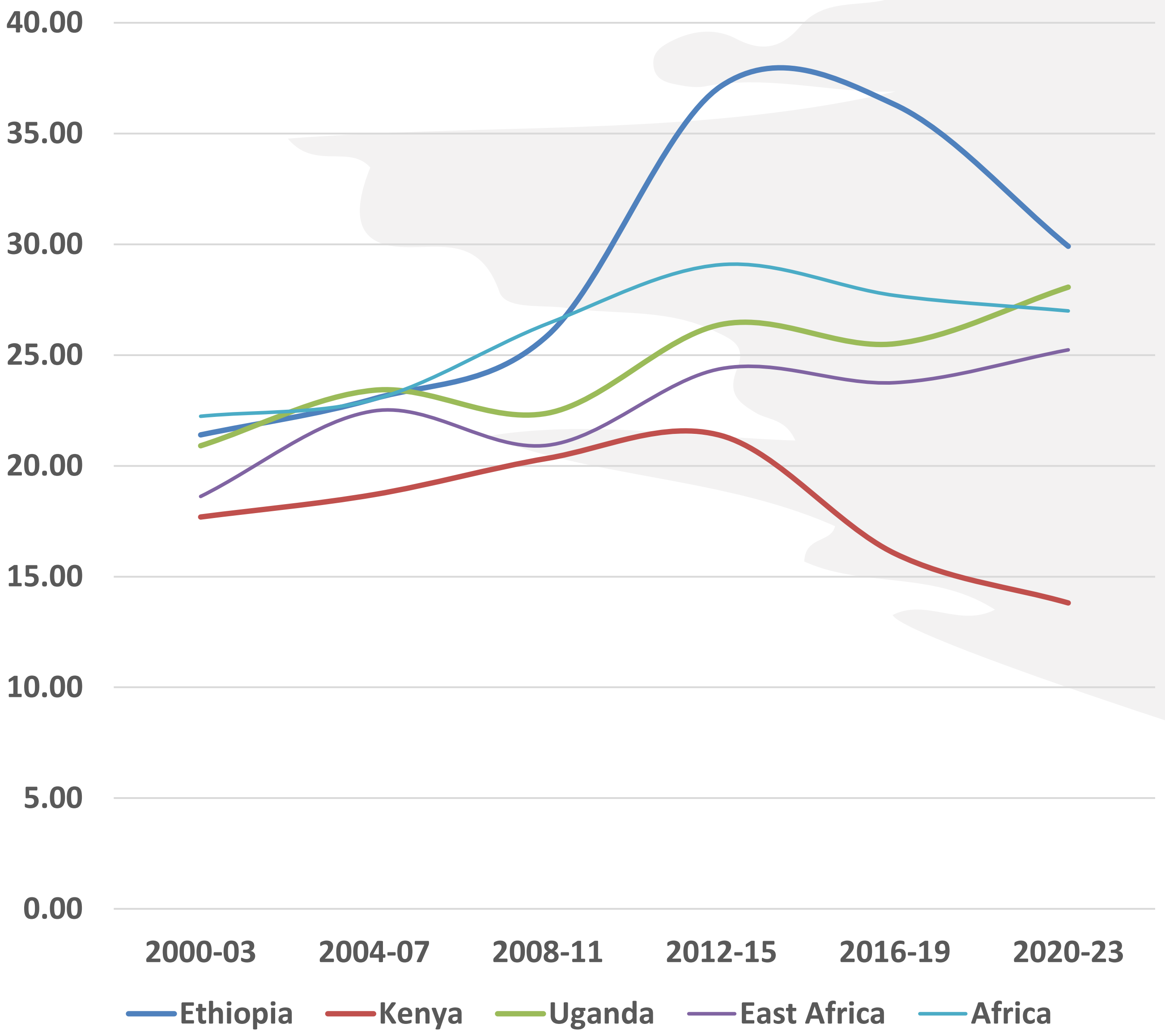
East Africa: Debt to GDP trends in Ethiopia, Kenya and Uganda



- Uganda has the lowest debt to GDP rates among the cases albeit on the rise after the period 2008-11. It rates remain below regional and continental level
- Kenya's rate have been on a steady rise after dropping about a decade ago while Ethiopia's rates have fluctuated – dropping to about 40 percent in 2008-11 and picking up there after
- On an overall basis, debt to GDP figure are on the rise for all countries and for the East Africa region

Source: *WEO data*

East Africa: Investment trends to GDP in Ethiopia, Kenya and Uganda



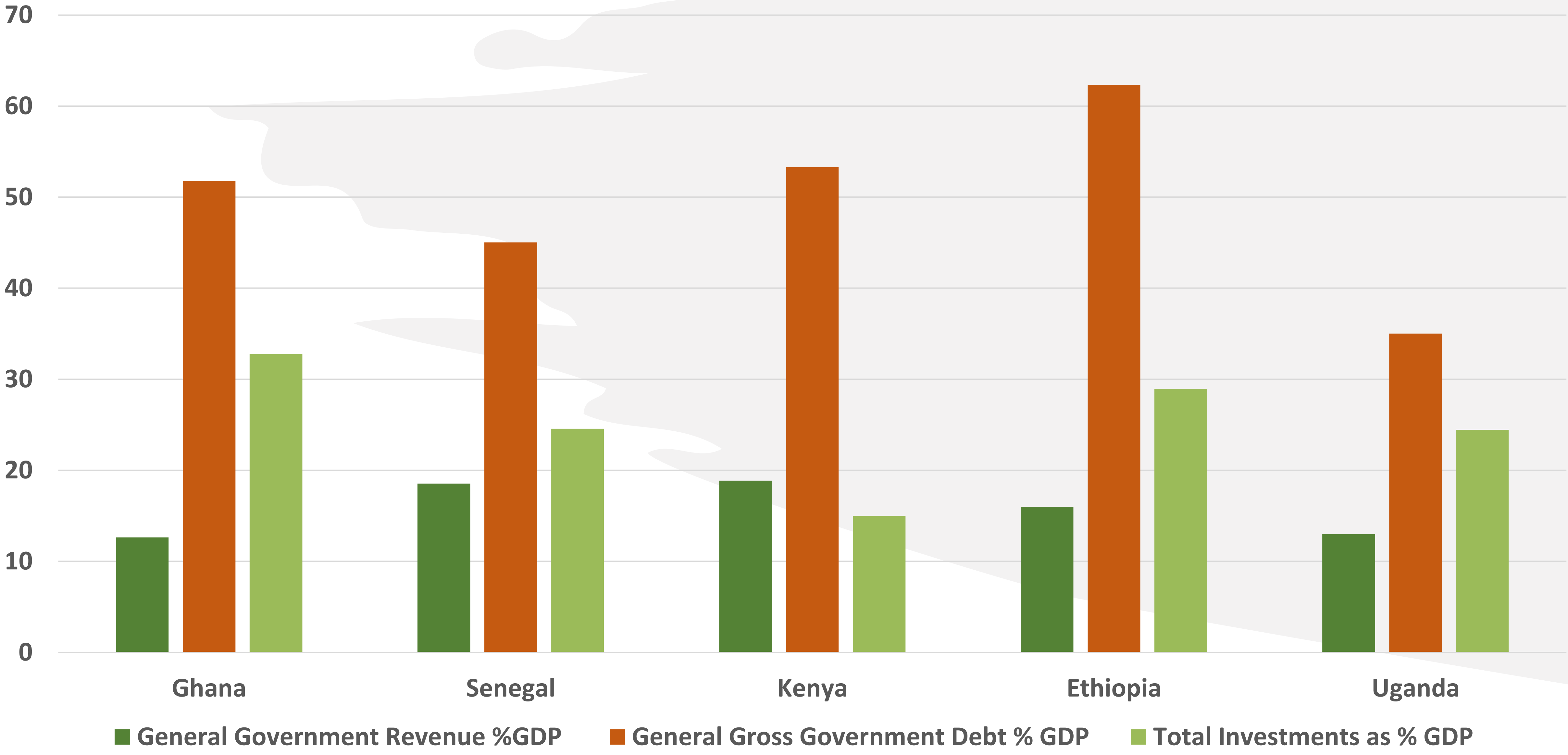
- Investments to GDP rates has been on a steady rise on the case of in Ethiopia and Kenya for the within and after the period 2012-15.

- Kenya is faced with investment to GDP rates flow regional and continental average for the past 20 years and counting – this means more debt accompanied by lower investments rates

- Regional investment to GDP trends for East Africa and for the Africa as a whole has experienced a steady rise albeit a steady decline for Africa after 2012-15

Source: *WEO data*

Average Government Revenue, Gross Government Debt and Total Investments (percentage of GDP: 2000 -20)



Source: *WEO data*

What SDRs can do and can't do?

- SDRs provides much needed liquidity to countries – shoring up resources required to offset some degree of budgetary constraints be it to service debts, strengthen reserves or invest in development plans

- However, SDRs will only have a minute impact in debt service coverage and public spending considering the huge fiscal gaps it won't be able to address

- The additional liquidity it provides will neither free countries from debt service risks, nor provide sufficient fiscal space needed for recovery – from covid-19 shocks and other fiscal and macro economic challenges

- The bottom line with whatever meager resources SDRs provides is to ensure greater scrutiny over expenditure – ensure transparency and accountability around SDRs use

Source: *WEO data*

Using SDRs

Senegal will use two-thirds of its newly allocated SDRs in 2021 on unmet obligations, strengthening the health system, domestic vaccine production, and additional cash transfers to vulnerable households. The remainder will be allocated to the 2022 State Budget.

Ethiopia will hold onto its newly allocated SDRs in order to shore up its international reserves.

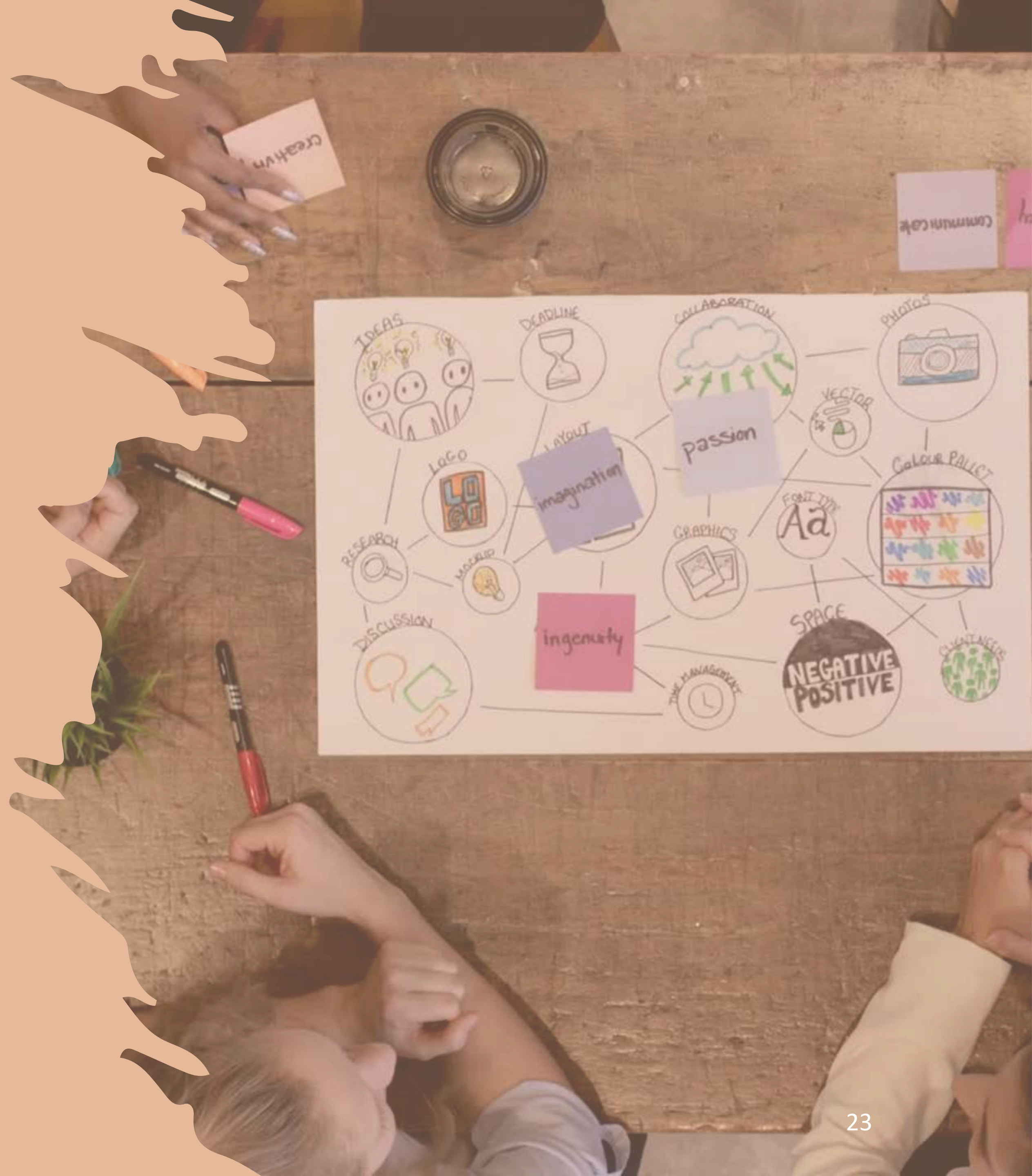
Ghana will use most of its newly allocated SDRs to finance its Ghana Cares (Obaatanpa) post-pandemic recovery program. About a third or $300 million will support the budget.

Uganda will use half of its newly allocated SDRs to finance the FY21/22 budget deficit in lieu of more expensive foreign commercial borrowing. It will be used on education, health and water and sanitation projects, including financing the reopening of schools. The Ministry of Finance's spending plan for SDRs will be monitored through special quarterly reports on budget execution.

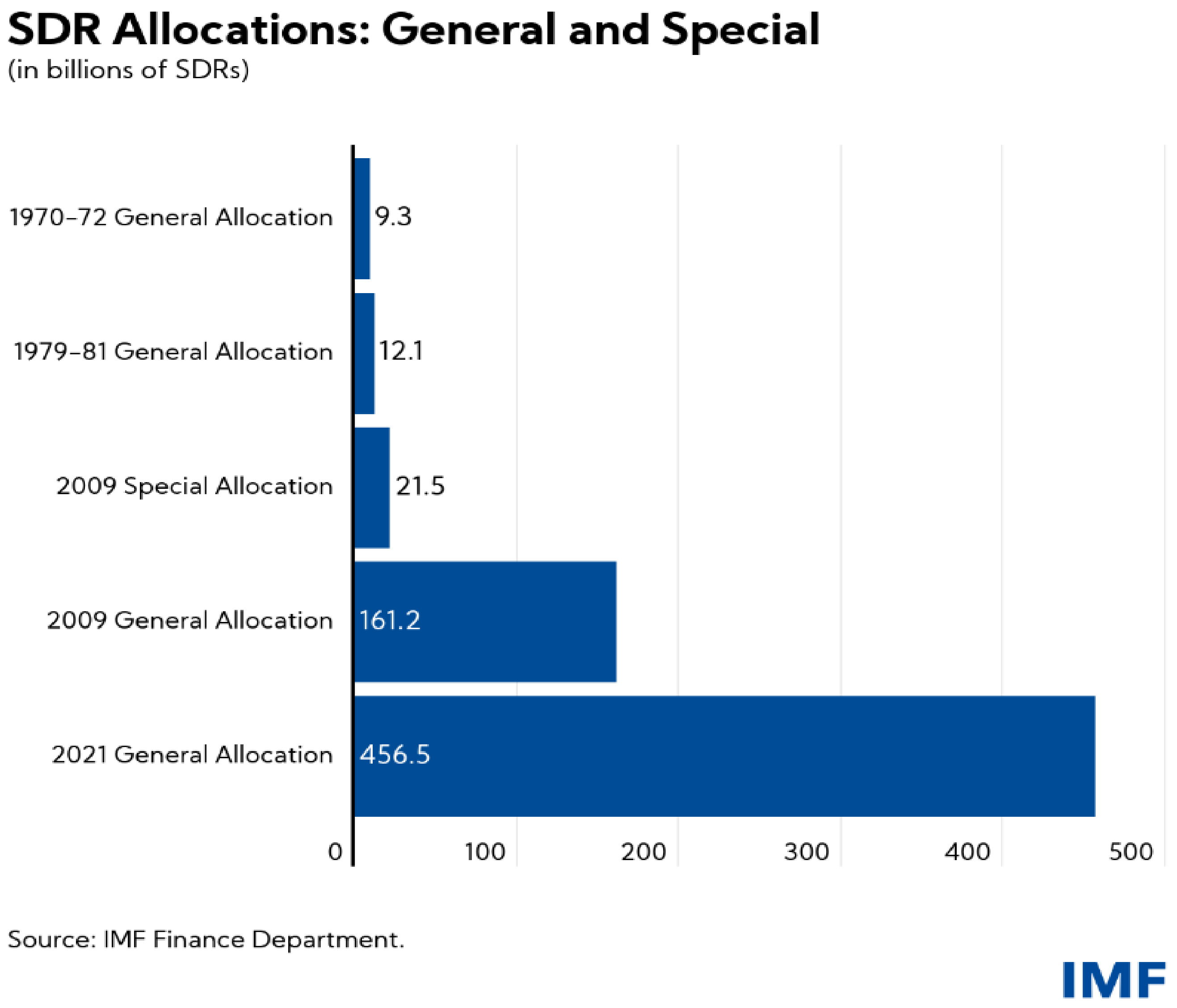
Kenya will use half of its new allocation of SDRs to boost its reserves and the remaining half will be on-lent in domestic currency by the Central Bank of Kenya to the government to help meet budget financing needs.

Source: *ONE* *https://www.one.org/africa/issues/covid-19-tracker/explore-sdrs/*

PART 3:
AFRICA's SDRs ALLOCATIONS THUS FAR

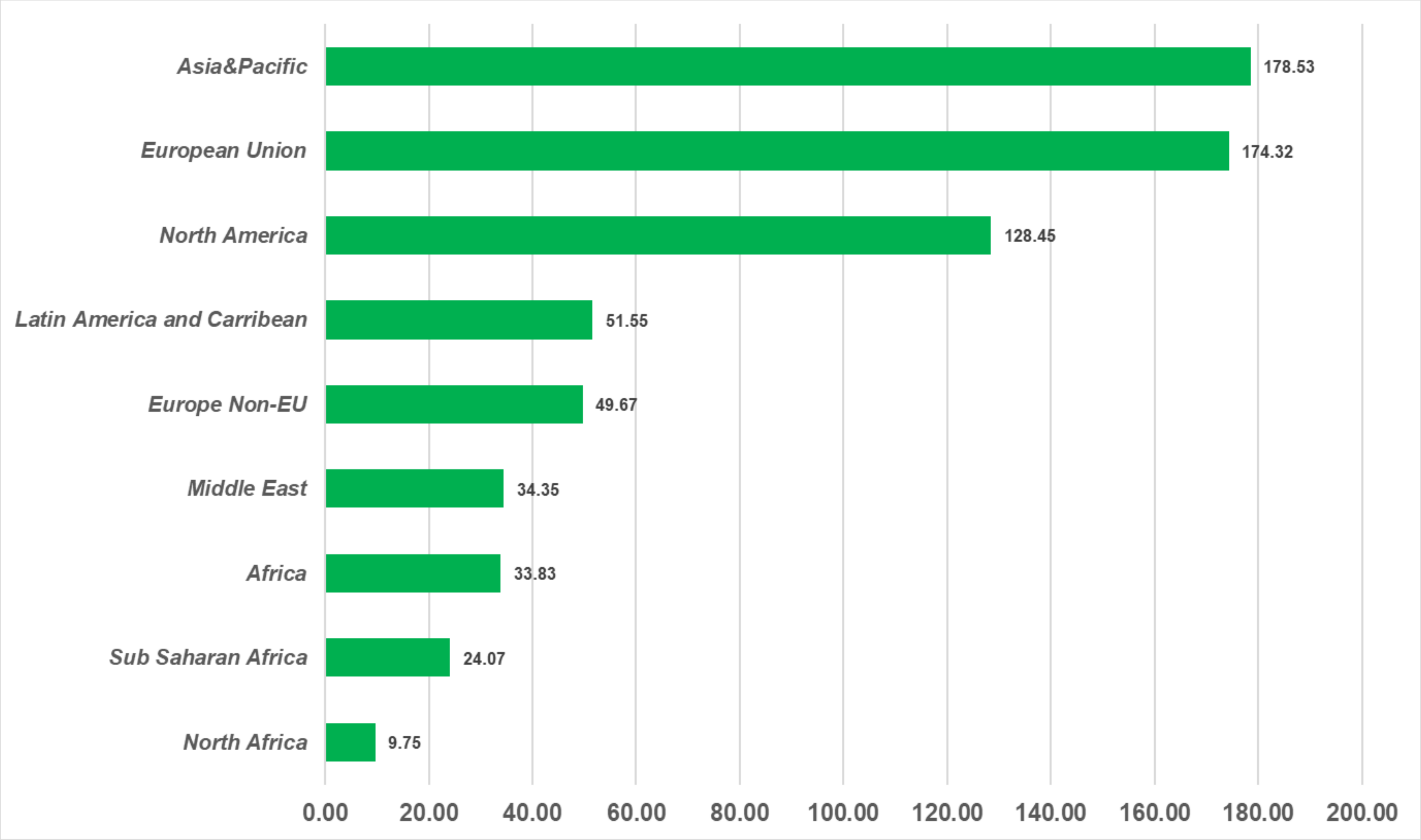


❑ Previous and current allocations



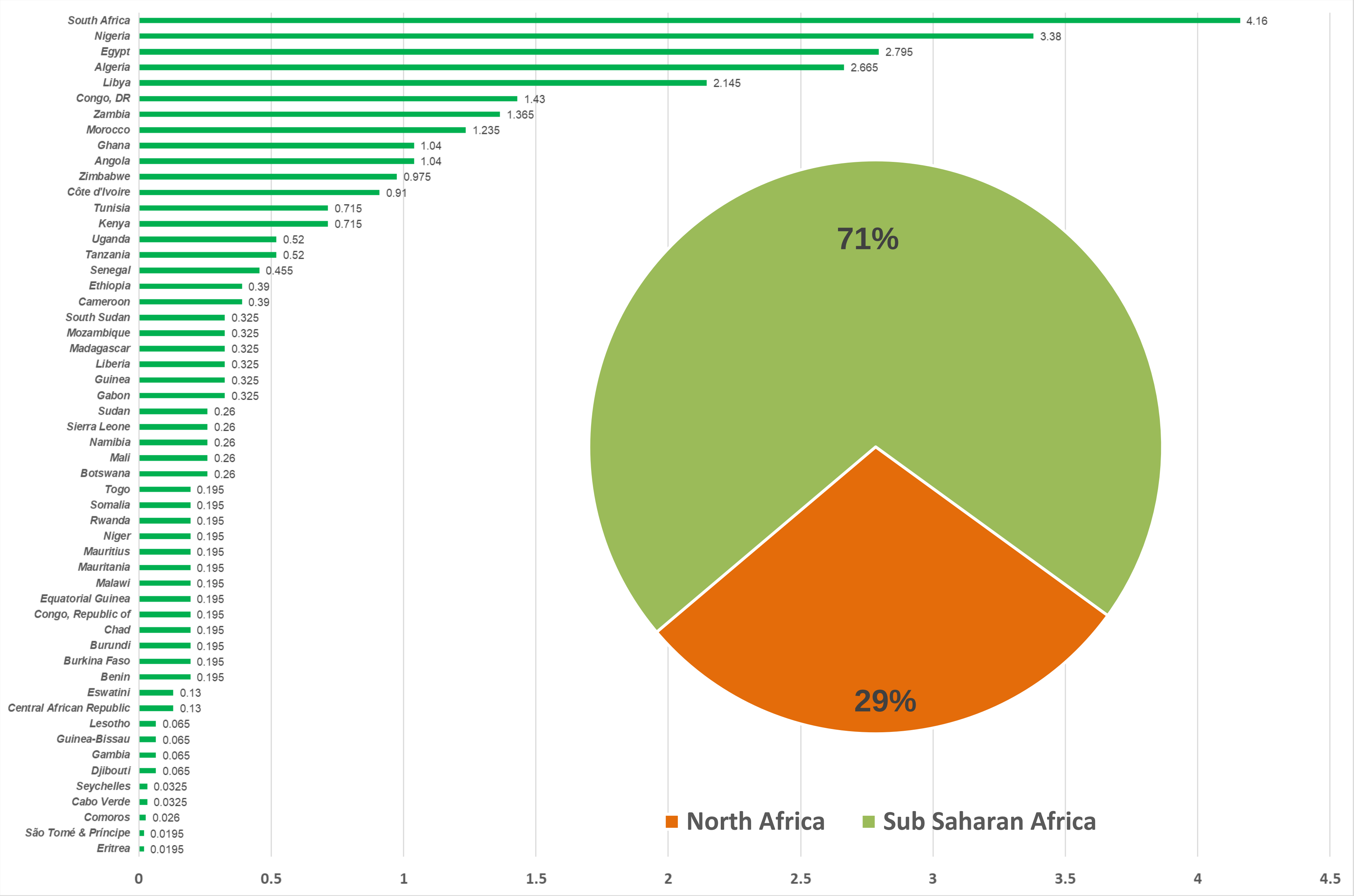
- **The biggest allocation in August 2021**
- **456.5 billion SDRs: equivalent of US$650 billion**
- **1 SDR = 1.42 US$**

Analysis of 2021 global allocation



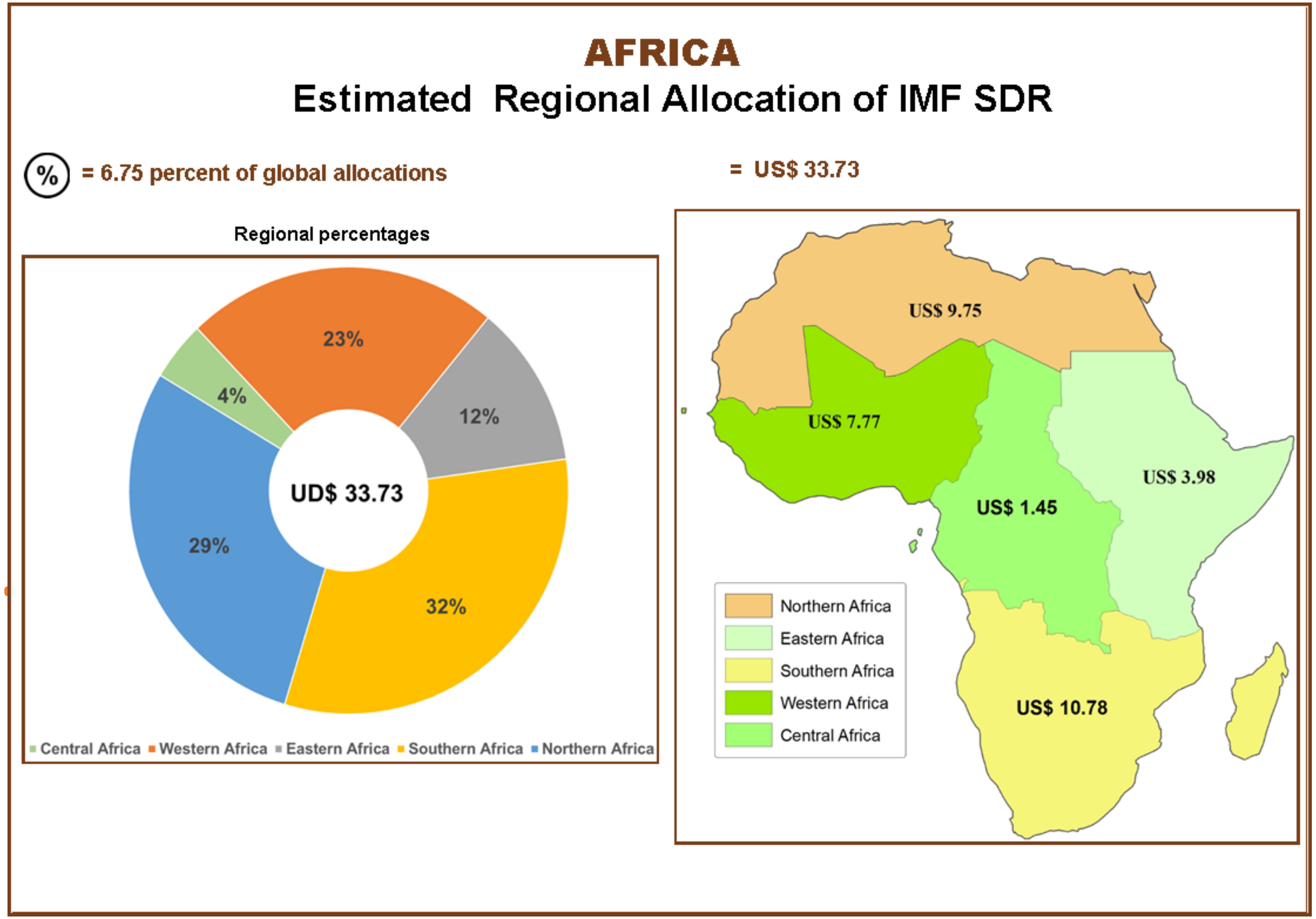
Source: *computed from IMF sources*

❑ Allocations to African countries



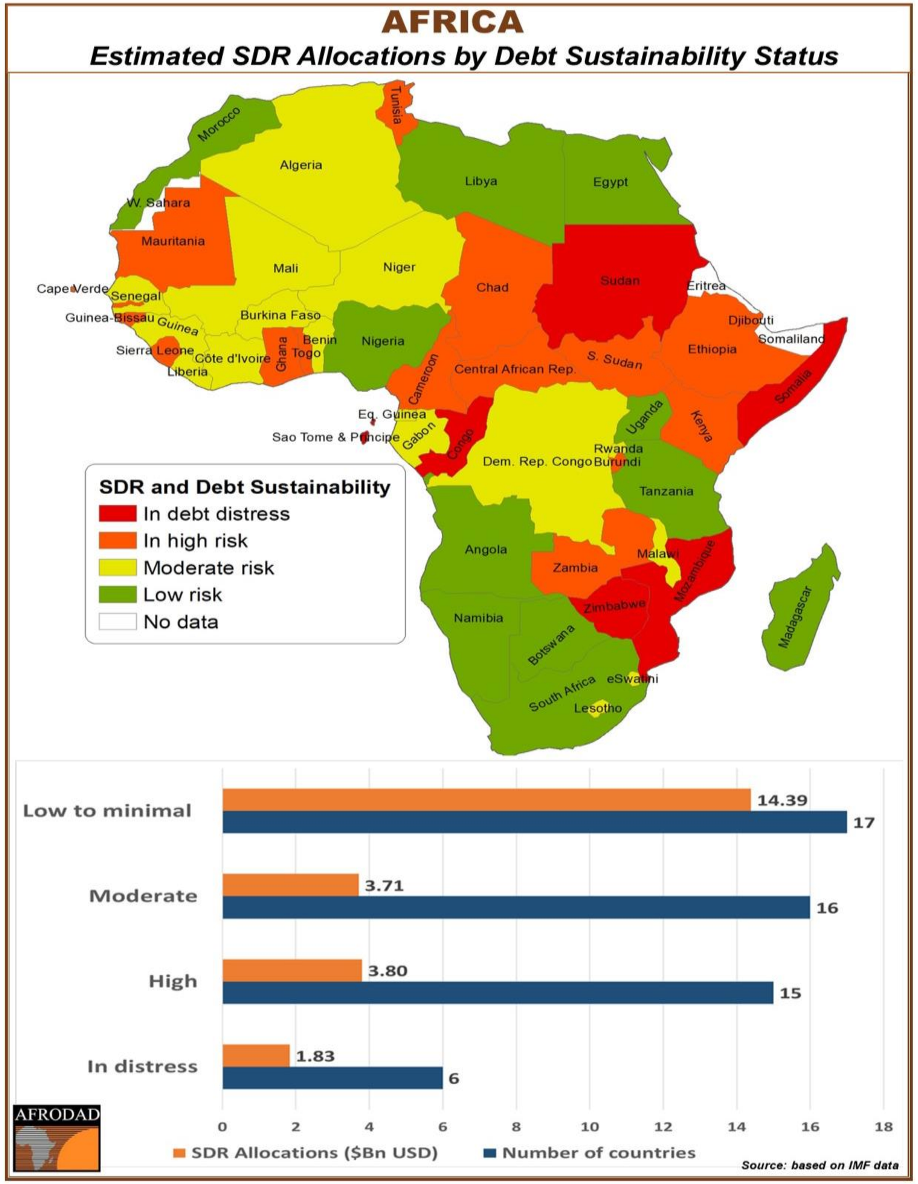
Source: *computed from IMF sources*

❑ Allocations to African countries



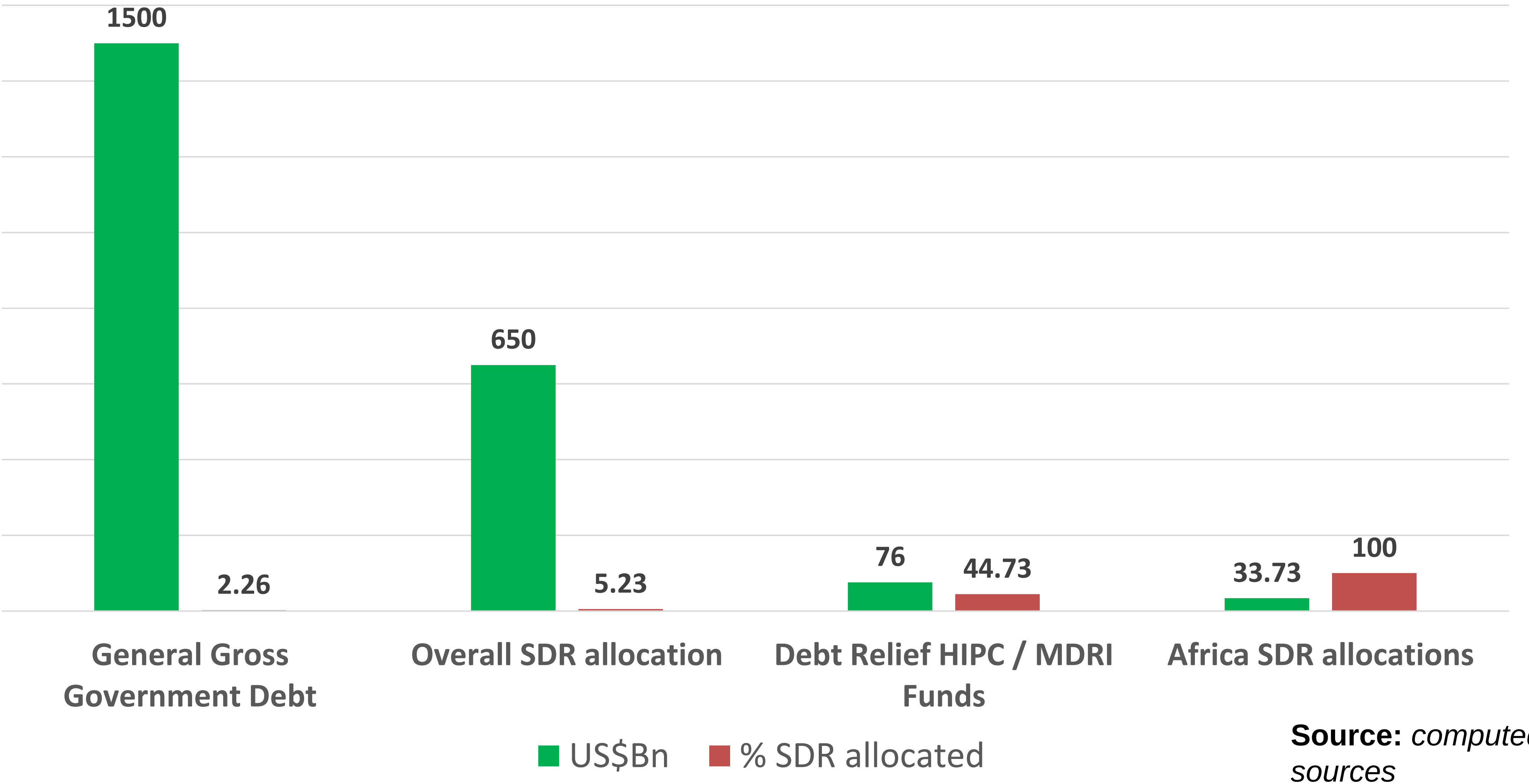
Source: *Author analysis from IMF data*

❑ Allocations to African countries



Source: *Author analysis from IMF data*

❑ Comparing allocations to some debt variables

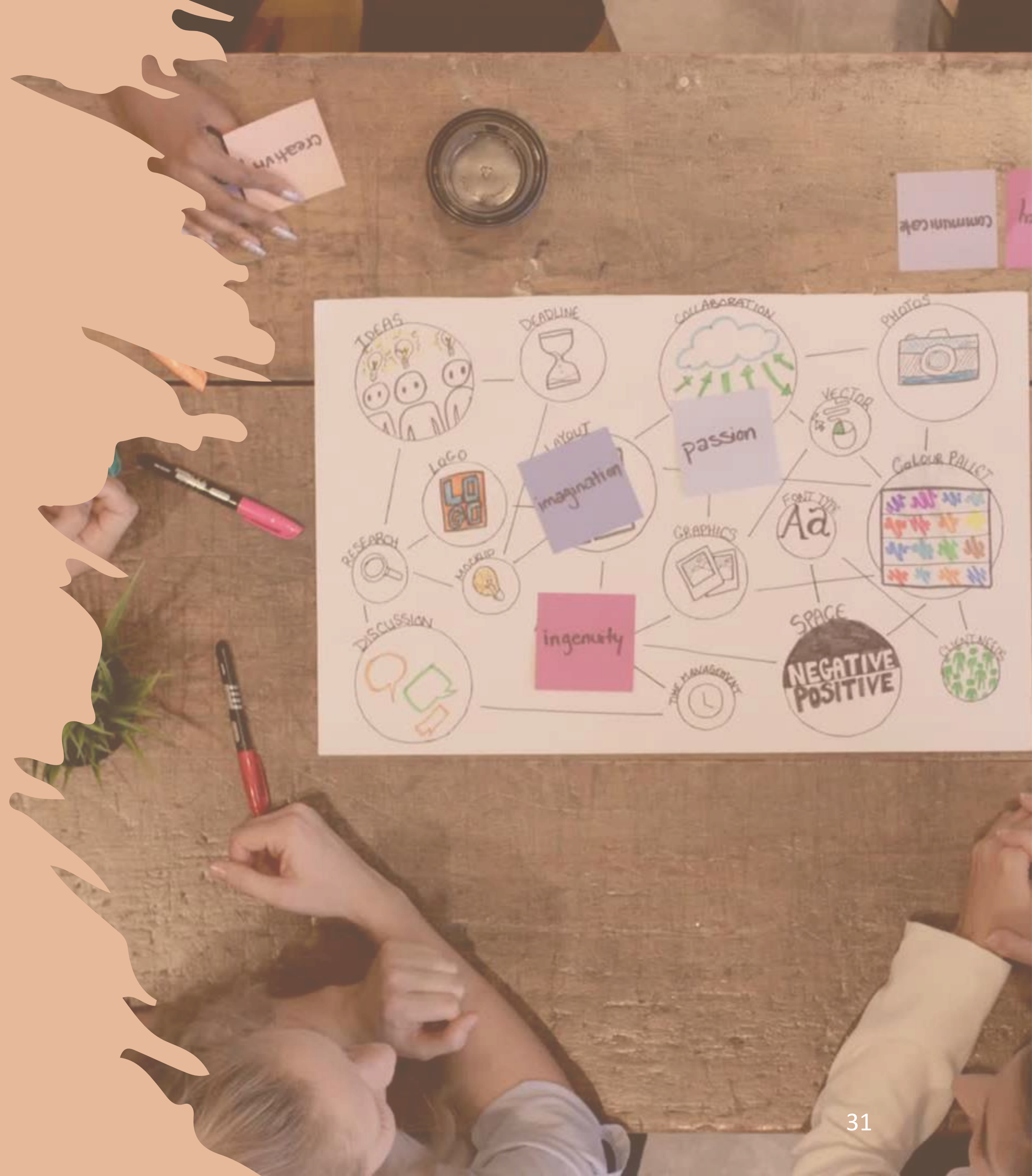


Source: *computed from IMF sources*

❑ Key determinants of SDRs allocations

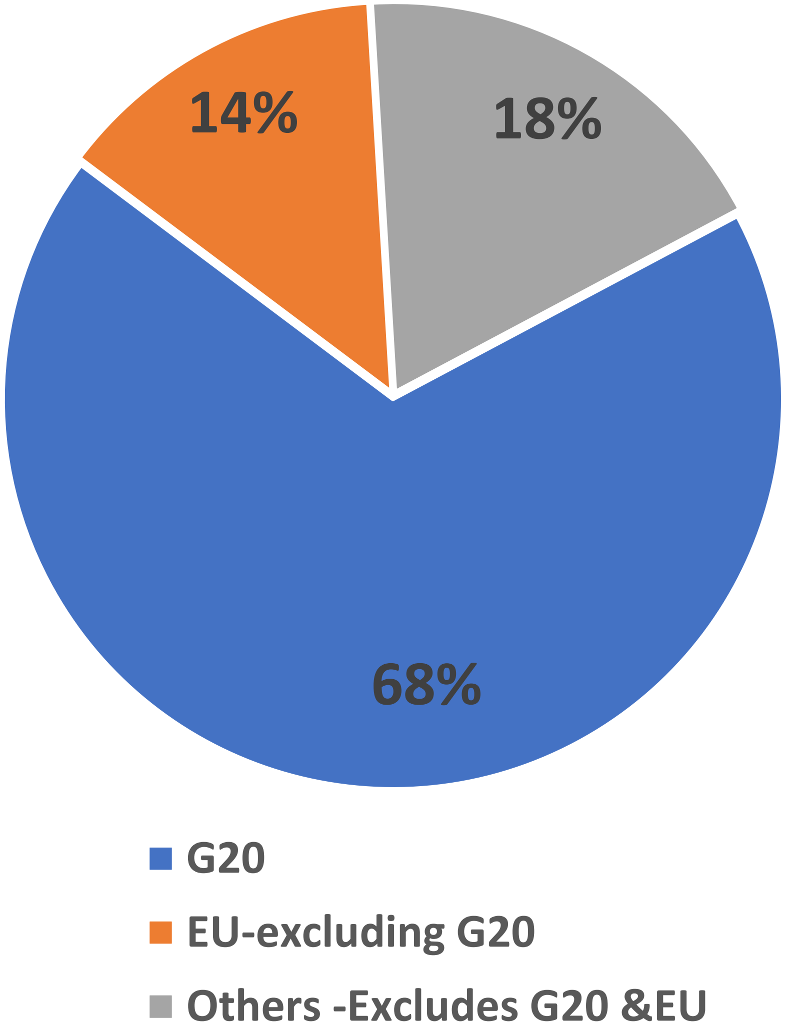
- Why African countries and others get lesser allocation
- Allocation is done through an IMF quota system
- The quota each country gets is determined by how much it is obligated to contribute to the to the IMF
- This accords countries voting rights and allotment of SDR
- The foundation is the economic power of a nation
- The stronger a country's economy, the higher quota shares it has
- Reason why the most advanced economies get the most power and the most rights
- The only way for a country to increase its SDRs is therefore to increasing its voting power by increasing its IMF quota shares

PART 4: RECHANELLING / RECYCLING SDRs



❑ Meaning of rechanneling / recycling

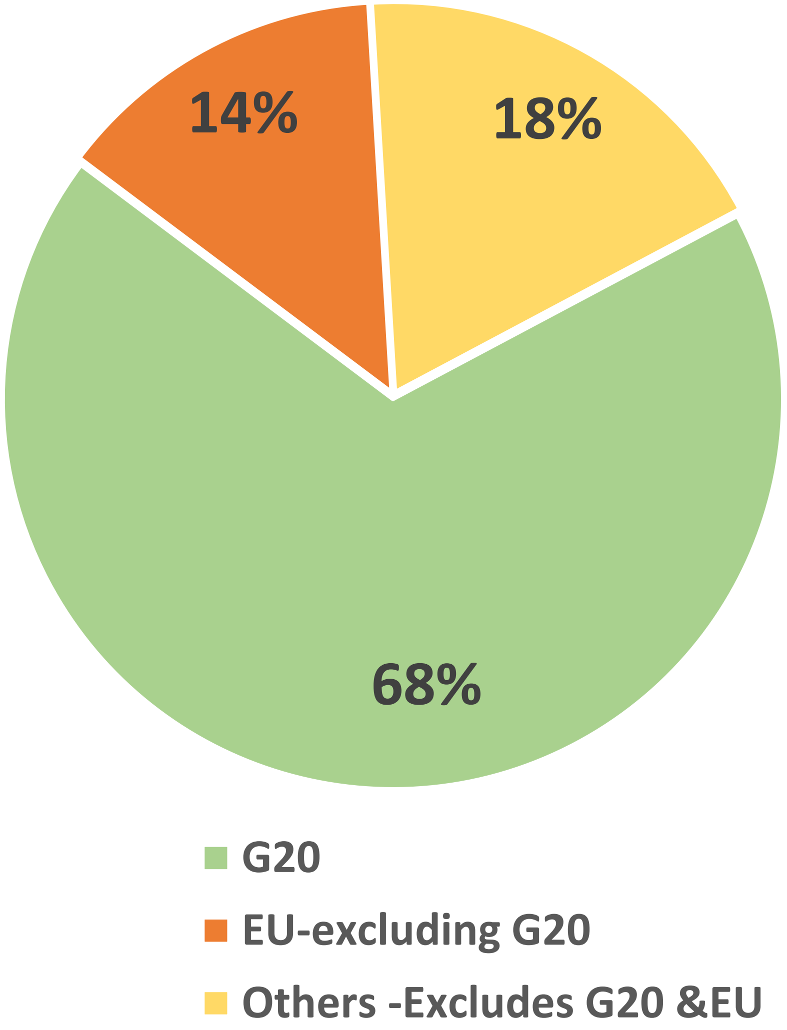
- This about making the excess SDRs available to other countries for use
- Some countries received more resources than they needed. For instance: The G20 and most EU countries have sufficient fiscal and monetary flexibility to cushion the impact of the pandemic on their economies by running up spending by about 8 percent of GDP and hence didn’t need much of SDRs**.**



Source: *computed from IMF sources*

❑ Meaning of rechanneling / recycling

- They are called upon to look for a means of making low-income countries benefit from the excess SDRs which they do not need. This is what has been called recycling or rechanneling
- The G20 gets about 68 percent of the total allocations
- The EU excluding G20 countries get about 14 percent



Source: *computed from IMF sources*

❑ Rechanneling / recycling mechanisms

The Resilience and Sustainability Trust (RST)

- The IMF is expected to put this together before the end of 2022

Enable low income and vulnerable countries to build resilience to balance of payments shocks and ensure a sustainable recovery

- Aims to absorb 50 billion USD

The Poverty Reduction and Growth Trust (PRGT)

- PRGT is a concessional lending facility that replaced the Enhanced Structural Adjustment Facility in 1999
- It lends to the world's poorest countries at concessional rates
- About 30 billion USD is expected to go into PRGT

❑ Rechanneling / recycling mechanisms

Bilateral arrangements

- G20 countries recycle their SDRs directly to other countries as loans or gifts

Multilateral development banks (MDBs)

- Like the African Development Bank or the World Bank
- The challenge is in the reserve asset characteristics of SDRs which is not consistent with lending activities of MDGs

❑ Recycling constraints

- Levels of commitments to recycle the SDRs is far below expectations – only US$ 13 billion - committed by France, Italy, Spain Netherlands and Belgium thus far of US$100 billion pledged
- Use of SDRs are governed by national laws and institutions. Jurisdictions often may not always agree on whether to commit SDRs or not
- Some G20 countries not yet unsure as to exactly how the recycled SDRs will be used
- Transparency and accountability in the use of SDRs us obliques
- SDRs creates problem of over reliance / promotes overdependency syndrome

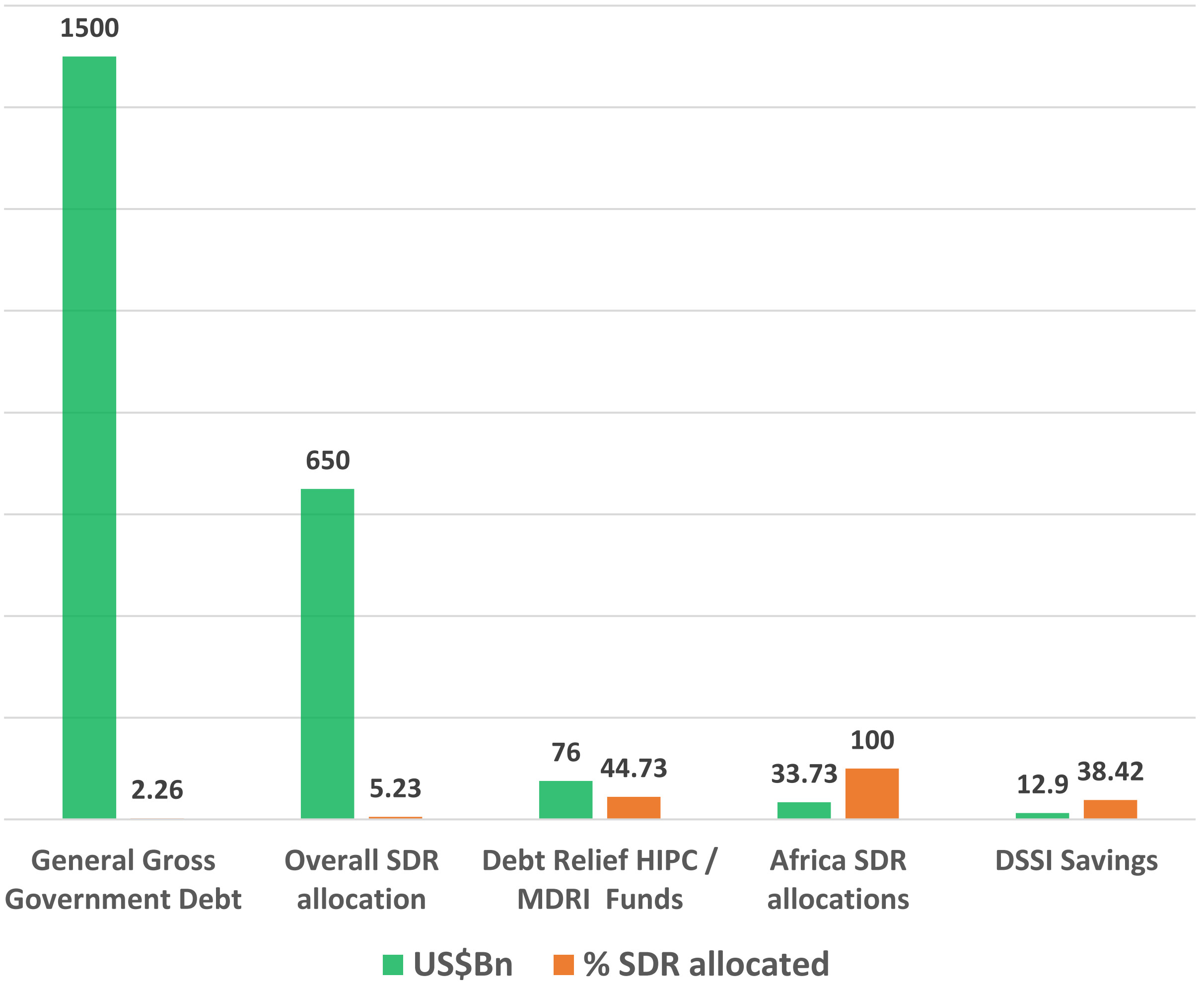
❑SDR for financing covid and economic recovery

Africa's investment and economic recovery needs are immense

- Estimates range from $93 billion to $130-170 billion per year
- Sub-Saharan Africa (SSA) spending needs to achieve all infrastructure-related to SDGs by 2030 is estimated at about 9% of regional GDP annually
- African leaders, meeting in Ivory Coast, in July 2021 issued a formal statement requesting 100 billion USD in IDA replenishment to finance economic recovery – sign that demand for financial resources is high
- Civil society has pushed for 3 trillion worth
- SDRs is a worthwhile contribution to these needs but there are still huge funding needs that cannot be covered by SDRs

❑SDRs & Debt Relief Initiative

- SDRs together with Debt Service Suspension Initiative (DSSI) provide a stimulus package that could reduce the need for additional borrowing
- However, cannot significantly resolve the African debt challenge considering its magnitude
- Graph compares SDRs to some debt restructuring packages – as a percentage of those



Source: *computed from IMF*

❑SDRs & Debt Relief Initiative

- Countries in debt distress or under the risk of debt distress can invest their SDR in debt relief or crisis-related spending

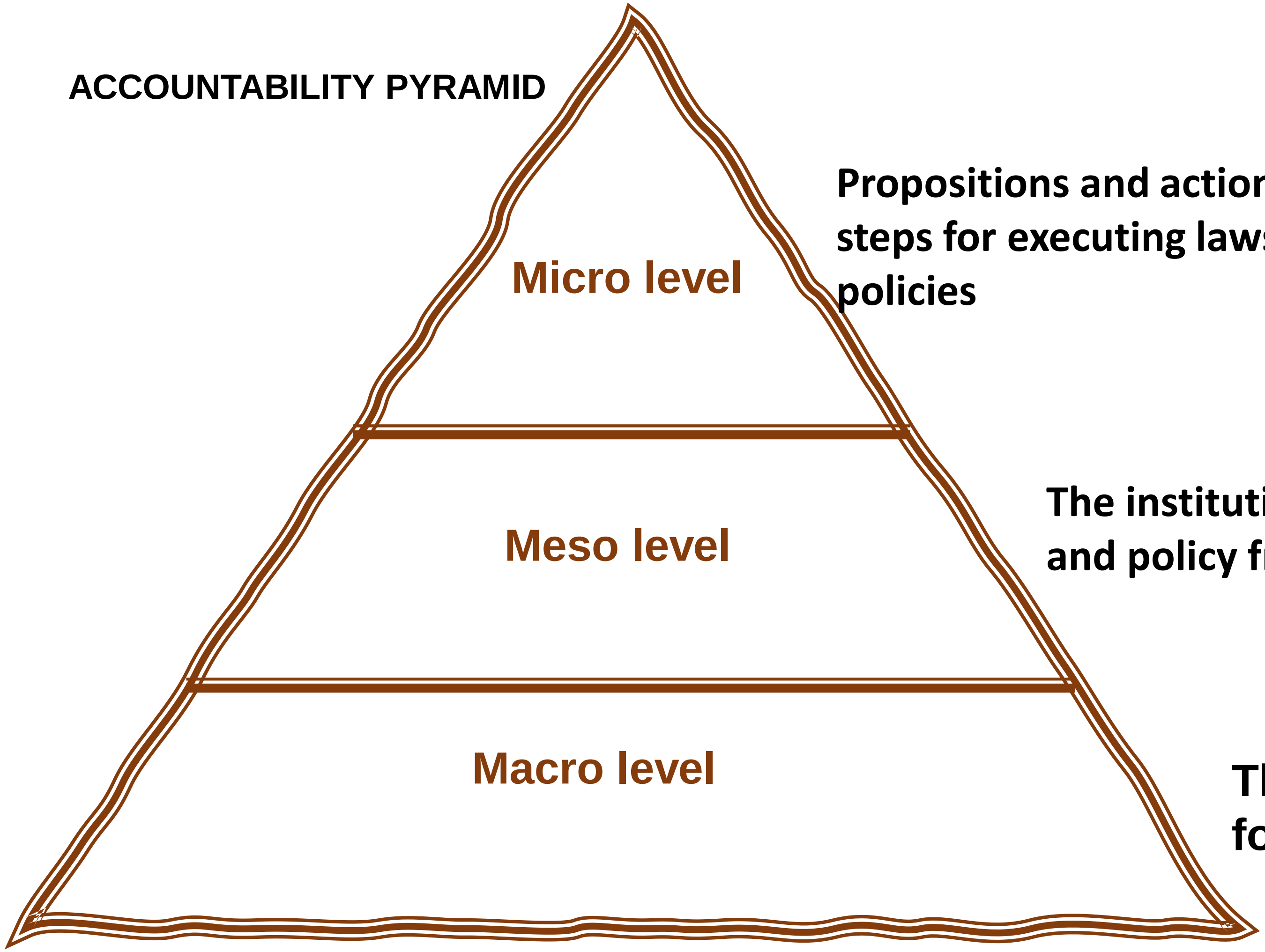
- But SDRs in no ways improves the current structural economic issues that put countries in a situation of debt overhang
- Countries in moderate and low risks of debt distress have relatively good fiscal space to maximise opportunities offered by SDRs

Source: *Author analysis from IMF data*

❑Transparency and accountability challenges around SDRs

General problem around debt governance in Africa and around the world is lack of transparency and accountability around use of debt resources

ACCOUNTABILITY PYRAMID



Propositions and actionable steps for executing laws and policies

The institutions/laws and policy frameworks

The enabling environment / the foundations of accountability

- **In Africa, the macro framework still lacking**
- **Stock at Meso and Micro levels**

Source: *Author's conception*

❑Transparency and accountability challenges around SDRs

General problem around debt governance in Africa and around the world is lack of transparency and accountability around use of debt resources

- **AFRODAD provide some important advocacy tools**

  The African Borrowing Charter

  - Required legal framework
  - Transparency and accountability
  - Adequate management and monitoring
  - Avoiding incidence of overborrowing
  - Others – highlight need for prudent borrowing choices
  - African governments taking their responsibilities for financial prudence
  - Charter available online on AFRODAD Website

- **The Harare Declaration from AfCoDD I:** A rallying call for a reformed global debt architected that emphasises continental solution, with Africa as a rule maker and based on transparency and accountability

❑Transparency and accountability challenges around SDRs

General problem around debt governance in Africa and around the world is lack of transparency and accountability around use of debt resources

- **Towards an Africa Accountability mechanism:** No amount of resources will produce the intended results without transparent and accountable systems of dealing with Africa's debts
- **Important thing is how to avoid getting into the hook**

PART 5:
CONCLUDING REMARKS

- SDRs allocation are still grossly insufficient compared to the magnitude of the development financing needs and challenges in Africa and the global south – Civil Society had asked for US$ 3 trillion but received only US$ 650 billion
- SDRs allocation mechanism perpetrates global inequalities in the capacity of nations to fulfil the development welfare needs of their citizenry instead of fixing such inequalities. there is an apparent weakness in failing to leverage SDR in a more pro-developmental manner – based on need.
- SDRs allocation follows a trickledown economics where larger allocations are made to the major economies in the hope they can be redistributed to African countries and other developing economies through other channels.
- The pursuance of SDRs without considering significant systemic fixes of north-south relations is a clear proof that African countries will still be stuck with un-enabling policies to ward off the risks of recurrent debt crisis and structural problems that have bedevilled their development process

- African countries are at the receiving end of a broken global financial architecture that drains its valuable resources through Illicit Financial Flows and weaken their potential to significantly mobilise resources internally to attain its full development capacity
- The current global economic governance supports overreliance on a development strategy funded through debts and private development capital that comes with contingent liabilities which rather hurt development efforts. This is not receiving sufficient global attention
- The responsibilities to addressing challenges involved in making use of resources like SDRs are both internal and external. While African government, the people and civil society should take their responsibility, these should be complemented by good faith on the part of Africa's development partners

THANK YOU

plan
IDEAS
DEADLINE
COLLABORATION
PHOTOS
passion
imagination
VECTOR
LOGO
LAYOUT
COLOUR PALLET
Aa
GRAPHICS
RESEARCH
ingenuity
DISCUSSION
SPACE
NEGATIVE
POSITIVE