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POLICY BRIEFING AUGUST 2023

Funding climate action in the Global South with re-channelled SDRs

How would this work, following the Paris Summit in June 2023 for a new global financing pact

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EXECUTIVE SUMMARY

"Special Drawing Rights" (SDRs) are not about 'shifting the trillions' but about generating and deploying the trillions. It's meant to be an additional tool for climate finance and can help to accelerate climate action and development. For this reason, the SDR topic was one of the most important themes at the summit for a new global financing pact happened in Paris end of June 2023.

The allocation of SDRs worth $650 bn US dollars decided by the members of the IMF in August 2021 was unprecedented in its size.[1] This SDR allocation is now almost two years ago. Its main purpose was to alleviate impacts of the economic damage caused by the Covid-19 pandemic and meant to gain new financial leeway in financing the global energy transition. But we are not even half way there as by far the largest share of the new SDRs ended up in the possession of the rich industrialised countries of the Global North although meant to be allocated to developing countries.

Since this disproportion in the allocation of the new SDRs ran counter to the actual goal of supporting developing countries, the possibility of a voluntary transfer of SDRs worth $100 bn US dollars to the states of the Global South was approved by the G20. However, this would not take place directly, but via the existing Poverty Reduction and Growth Trust (PRGT) of the IMF and via the Resilience and Sustainability Trust (RST) newly founded by the IMF. After the Paris global financing pact summit countries in the Global North have submitted SDRs of $81 bn to the RST,[2] which will be used to secure new loans. The achievement of the $100bn goal celebrated at the Paris summit is still not fulfilled, because the promised $21bn from the US remain stuck in Congress.

However, it took until the end of May 2023 for a country, Rwanda, to receive loan funds (amounting to $98.6 million) from the IMF's RST programme.[3] Costa Rica and Barbados were expected to follow soon.[4]

Other proposals discussed at the Paris summit on how to increase the number of low-interest loans to the Global South have been put forward by the African Development Bank (AfDB) and by the "Bridgetown Initiative" introduced by Barbados. These are very important and feasible suggestions. Yet, they have not yet been taken up by the countries of the Global North. Only small progress could be recorded by the AfDB that (world leaders) participants had praised their proposal at the Paris summit.[5]

All proposals are based on the principle that loans in reserve currency will be cheaper for the states of the Global South and hence, providing affordable finance. They can indeed make many investments in renewable energies or other SDGs profitable that were not before. However, the problem remains that the already very high external debt of the countries of the Global South continues to rise.

This paper therefore suggests two additional mechanisms to alleviate this effect:

1. The possibility of transferring SDRs as repayment-free grants to development banks (MDBs) so they can expand their concessional loans and guarantees in countries of the Global South
2. the establishment of regular SDR reallocations, which would mean a steady and calculable supply of global reserve liquidity.

[1] See: IMF, Governors Approve a Historic US$650 Billion SDR Allocation of Special Drawing Rights August 2, 2021; https://www.imf.org/en/News/Articles/2021/07/30/pr21235-imf-governors-approve-a-historic-us-650-billion-sdr-allocation-of-special-drawing-rights

[2] See: One; Special Drawing Rights, last update June 23, 2023: https://data.one.org/data-dives/sdr/#tracking-the-use-od-sdrs

[3] See: IMF; IMF Executive Board Completes First Reviews Under the Policy Coordination Instrument, and Resilience and Sustainability Facility for Rwanda, May 24, 2023: https://www.imf.org/en/News/Articles/2023/05/24/pr23176-rwanda-imf-exec-board-completes-1st-rev-policy-coord-inst-rsf

[4] See: Plant, Mark; Declaring a Hollow Victory on SDRs Would Further Undermine G20 Credibility, May 23, 2023: https://www.cgdev.org/blog/declaring-hollow-victory-sdrs-would-further-undermine-g20-credibility

[5] See: AfDB, June 23, 2023; https://www.afdb.org/en/news-and-events/press-releases/summit-new-global-financing-pact-international-community-welcomes-african-development-bank-initiative-imf-special-drawing-rights-62363

1. WHAT ARE SDRS AND WHY CAN THEY PLAY AN IMPORTANT ROLE IN FINANCIAL SUPPORT TO THE GLOBAL SOUTH?

The IMF's Special Drawing Rights as an international reserve currency

SDRs are a quasi-currency of the IMF,[6] which can be exchanged between the central banks of IMF member countries, thus making it easier for them to obtain foreign exchange, i.e. the reserve currencies of other countries - especially US Dollars and Euros. Therefore, the new SDRs are particularly important for the poorer countries of the Global South. With the most recent reallocation of $650 bn, the value of SDRs in circulation more than tripled from $293 bn US dollars to a total of $943 bn.[7]

Historical background

The IMF holds Special Drawing Rights since 1969. This global reserve currency is convertible with the currencies of IMF member countries. Its created by the IMF upon the decision of the member countries. Its original purpose was to defuse tensions in foreign exchange markets of the „Bretton Woods" fixed exchange rate system. But as early as 1973, the SDR was hardly used because the fixed exchange rate system had collapsed. It was not until the financial crisis year of 2008 that the G20 decided to commission the IMF again to create new SDRs in a significant amount. These new SDRs, worth $250 billion, were intended to help mitigate the consequences of the 2008 financial crisis by providing IMF member countries with additional internationally accepted liquidity.

SDRs as a means of financing climate protection investments

Since 2009, various proposals from academia and NGOs suggested to also address the global climate crisis with the help of new SDRs.[8] However, further allocation of new SDRs have regularly failed due to the resistance of the USA who can veto IMF decisions and who saw the creation of additional SDRs as potential competition to the dollar as the global reserve currency.

For the new Biden administration, however, these concerns seem to be less important than the huge economic impacts triggered by the Covid-19 pandemic in addition to the climate crisis. Nonetheless, the US government's decision to allocate $21 bn of its own SDRs to the RST is currently blocked by Congress.[9] Similarly, it is difficult to foresee a majority in Congress for a further SDR allocation.

The SDR allocation worth of $650 billion

As stated above, the additional liquidity in international reserves created by new SDRs back in August 2021 intended to particularly help finance the global Covid-19 recovery process in the Global South. The global pandemic has made exports difficult for many countries in the Global South, cutting them off from a significant portion of their foreign exchange earnings. The problem was exacerbated in many countries by the lack of tourism and lower remittances from workers who were working in the Global North and could earn less money due to the pandemic. This also made it much more difficult to finance the import of vaccines,

[6] The IMF refers to the SDRs as an international reserve asset.

[7] See: IMF, Factsheet Special Drawing Rights, 5 August, 2021; https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

[8] The World Future Council has also repeatedly called for this financing option with detailed proposals since the climate conference in Copenhagen in 2009 (COP15). See: World Future Council (2011), Financing climate protection with newly created SDRs: https://www.worldfuturecouncil.org/de/financing-climate-protection-newly-created-sdrs/

[9] See: One; Special Drawing Rights, last update March 7, 2023: https://data.one.org/data-dives/sdr/#tracking-the-use-od-sdrs

medicines and capital goods for the construction of medical and other infrastructure. The same applies to imported goods that are needed for the global energy transition and other climate protection investments.

The problem of the unequal distribution of new SDRs

The intended positive effects of the $650 bn in global liquidity created by the new SDRs have been heavily diluted because new SDRs are issued in proportion to countries' shares in the IMF's capital. This quota system means that the poorer states of the Global South, which need the new liquidity the most, receive the fewest new SDRs. According to the IMF, in the last SDR allocation worth $650 bn, only 21 bn reached the low-income countries. Even if the countries from emerging markets (emerging plus developing countries) were included, at $274 bn only 42% of the new allocation would arrive.[10] However, since some of the countries from "emerging markets" already belong to the high-income states with large foreign exchange reserves, new SDRs worth well over $400 bn will thus end up in the possession of the rich states (like the USA, Japan and Germany), which they actually hardly need, since they have sufficient foreign exchange reserves.

INFOBOX 1

What makes SDRs such a unique, global, and powerful financing tool.

For a global sized problems like climate change and SDGs, we need a global size financing tool. SDRs are such a tool. SDRs are a well recognized global reserve asset or rather a global reserve currency. They can be created – like all other global currencies – and all IMF member central bank accepted SDRs as foreign exchange. For the use of SDRs no national budget had to be burden, because SDRs are new money.

SDRs can be used in several ways: as collateral for guarantees, or as "hybrid capital" to make loans affordable for Global South countries and to give MDBs the opportunity to leverage their lending. And as donation for MDBs to increase their concessional lending and as investment donation for poor, highly indebted countries from the Global South. Using SDRs for climate action and poverty alleviation is possible and ultimately simply a question of political will!

[10] See: IMF, Special Drawing Rights: https://www.imf.org/en/Topics/special-drawing-right/seven-things-you-need-to-know-about-sdr-allocations

2. NEW POSSIBILITIES FOR THE USE OF (SURPLUS) SDRS OF THE GLOBAL NORTH

That the distribution of new SDRs on the basis of quotas leads to a situation that is contradictory to the actual intention of the allocation – the significant improvement of access to reserve currencies for the countries of the Global South. This has been recognised also by many states of the Global North. Under the current regime, the countries that receive the most SDRs are those that need them least, because they themselves have a reserve currency (US Dollar, Euro, Yen) or one that is easily convertible into it. Therefore, the possibility was raised that countries of the Global North could voluntarily transfer parts of their SDRs, which they receive free of charge from the IMF to countries of the Global South.

2.1 The establishment of the Resilience and Sustainability Trust (RST)

The IMF allows for the voluntary on-lending of SDRs through its Poverty Reduction and Growth Trust (PRGT). In addition, to overcome the limitations of the PRGT, the IMF launched the Resilience and Sustainability Trust (RST), through which the bulk of on-lending of SDRs will take place. The G20 countries have called on all economically able countries to fill the new RST through the voluntary on-lending of SDRs worth $100 bn.[11] Currently, $81bn have been voluntarily on-lent, but only one loan - to Rwanda - has actually been approved. The $21 bn pledged by the US government to the RST has not yet been approved by the US Congress.[12]

The IMF forwards the SDRs received to its new RST to provide new loans. Loans made through the new RST system have a long maturity and bear interest at the SDR rate. This makes the loans considerably cheaper for countries in the Global South compared to the market interest rates that would otherwise be due. However, the IMF imposes the condition that only countries already participating in existing IMF support programmes can access the RST loans. Thus, they are automatically integrated into the IMF's existing austerity and structural reforms and are controlled accordingly by the IMF.[13] Since these restrictive controls often lead to domestic political problems, RST loans, even if they are granted at favourable conditions, limited their attractiveness for many countries of the Global South.

R

Recommendations regarding the new Resilience and Sustainability Trust (RST)

- The G20 member states should continue to re-channel SDRs to the RST, also above the first $100bn ambition goal.
- The G20 member states should request the IMF to disburden the terms of credit from the condition that borrowers from the RST had to participate in existing IMF programs.

2.2 Further proposals for the use of unused SDRs of the Global North.

Since the on-lending of unused SDRs from Global North countries through the RST has been widely accepted, three further proposals in particular have been discussed that go beyond lending through the RST.

The proposal of the African Development Bank (AfDB):

One way of providing cheap credit to Global South countries without going through the RST is for Global North countries to channel their surplus SDRs directly to Multilateral Development Banks (MDBs). The African Development Bank's (AfDB) plan is that SDRs should be on-lent to the AfDB or other MDBs in the form of "hybrid capital" to achieve a leverage effect of 2 to 4. On-lent SDRs worth, say, $100bn could then be used to facilitate new lending of $200bn to $400bn. The path

[11] See: G20 Bali Leaders' Declaration, 16. November 2022: https://www.whitehouse.gov/briefing-room/statements-releases/2022/11/16/g20-bali-leaders-declaration/

[12] See: One; Special Drawing Rights, last update June 23, 2023: https://data.one.org/data-dives/sdr/

[13] See: IMF, Factsheet: https://www.imf.org/en/About/Factsheets/Sheets/2023/Resilience-Sustainability-Facility-RSF

proposed by the AfDB could thus provide significantly more loans to finance the global energy transition than the RST, which has no leverage. The loans should only be slightly more expensive than those processed via the RST. The AfDB has designed its proposal in such a way that IMF staff have confirmed that SDRs routed in this way retain their "reserve asset characteristic" (see chapter 3) as required by G20 countries.[14]

THE PLAN FROM THE AFDB: SDRS FROM IMF ARE BEING CHANNELED THROUGH THE MDBS

The AfDB plan gains many attentions at the Summit for a new global financing pact. Many important delegates praised the proposal and supported the implementation of the plan.[15]

The AfDB proposal is receiving also increasing support from civil society, such as the African Conference of Catholic Bishops, which criticised in particular that only $33bn of the $650bn of newly issued SDRs went to Africa.[16] The Conference of African Finance Ministers on 22 May 2023 called on G7 and G20 countries to reform the current SDR system and support the AfDB proposal. Among other things, it called for a reform of the quotas after new SDRs are allocated, so that the countries with the greatest liquidity needs are given greater consideration.[17]

Although the IMF has given a clear signal that the maintenance of the "reserve asset characteristic" demanded by the G20 will be met by the AfDB proposal, no G20 country has yet agreed to support it. This is all the more incomprehensible since the G20 itself has called on MDBs to come up with innovative proposals. The AfDB has presented a well-founded proposal, which is effectively free of charge for the countries of the Global North, and which is worth implementing.[18]

R

Recommendations regarding the proposal from the African Development Bank (AfDB)

- The G20 member states should approve the view from IMF staff that SDRs used by MDBs as "hybrid capital" fulfil the so called "reserve asset characteristic" demanded by G20 member states.
- The G20 member states should support the proposal from the AfDB that MDBs can use SDRs as hybrid capital to leverage their loans to the Global South.

[14] See: Plant, Mark; Funding Hybrid Capital at the AfDB is the Best Deal for SDR Donors, 9 March 2023: https://www.cgdev.org/blog/funding-hybrid-capital-afdb-best-deal-sdr-donors
[15] See: AfDB, June 23, 2023; https://www.afdb.org/en/news-and-events/press-releases/summit-new-global-financing-pact-international-community-welcomes-african-development-bank-initiative-imf-special-drawing-rights-62363
[16] See: Jubilee USA NetworK; African Catholic Bishops Urge G7 Action on Debt, Bank Reform and Aid to Navigate Africa Crises, 11. May 2023: https://www.jubileeusa.org/african_catholic_bishops_urge_g7_action_on_debt_may_23
[17] See: ECA; African Ministers call for reforms of the IMF's Special Drawing Rights system, 22 May, 2023: https://www.uneca.org/stories/african-ministers-call-for-reforms-of-the-imf%E2%80%99s-special-drawing-rights-system
[18] See: Masood Ahmed; Now Is the Time to Recycle SDRs through the African Development Bank, 22.05.2023: https://www.cgdev.org/blog/now-time-recycle-sdrs-through-african-development-bank

The Bridgetown Initiative proposal

Another possibility to use new SDRs from the IMF to finance the global energy transition and other SDGs is provided by Barbados' Bridgetown Initiative. It envisages a new "Global Climate Mitigation Trust", which is to be filled with SDRs of the Global North that are not needed, as well as new SDRs issued on a regular basis, to $500 bn. These SDRs are to serve as collateral for new, low-interest loans to the Global South. This would greatly increase the number of "bankable" investments in renewable energies and other SDGs, i.e. those that can be calculated by private investors. Here, too, there would be a clear leverage effect.[19] The core idea of the proposal here is also that the collateral would make lending rates significantly cheaper compared to the usual market rates. It is expected that the Bridgetown Initiative will deliver a new Bridgetown 2.0 version of its proposal in the near future.

R

Recommendations regarding the plan from the Bridgetown initiative

- The G20 member states should approve the Bridgetown plan as a useful way to enable and leverage new affordable loans to finance the energy transition in the Global South.
- The G20 member states should authorise the IMF to allocate further SDRs at least in an amount of $200 billion per year.

Using new SDR Bonds issued by MDBs

Another new proposal to boost concessional climate finance suggested the establishment of SDR bonds issued by MDBs.[20] Advanced economies which holds the majority of the existing $935 billion in SDRs need to commit to invest their idle SDR reserves into the MDBs' SDR-linked bonds. There is no shortage of potential funding, because the United States alone has $164 billion in SDRs, the euro area countries have $200 billion, Japan another $58 billion, and the UK another $46 billion. And there is no (or very little) budget cost from using SDRs in this way. This kind of SDR bond would allow all of the SDRs raised to be lent out at fully concessional (zero) interest rates to fund a wave of clean energy investments in low- and even middle-income countries. With this SDR bond, a $100 billion fully concessional facility would have a budget cost of only around $3 billion a year. In times of increasingly tight budgets is that a very effective way to scaling up concessional funding.[21]

R

Recommendation regarding the SDR bonds

- G20 states should support the establishment of SDR bonds issued by the MDBs and use this tool to boost the concessional finance for climate and SDGs

[19] See: Persaud, Avinash; Bridgetown Initiative calls for new Global Climate Mitigation Trust financed via Special Drawing Rights, 8. December 2022: https://www.brettonwoodsproject.org/2022/12/bridgetown-initiative-calls-for-new-global-climate-mitigation-trust-financed-via-sdrs/

[20] See: Setser, Brad; Paduano, Stephen; Using an SDR Bond Creatively to Boost Concessional and Climate Finance, June 1, 2023: https://www.cfr.org/blog/using-sdr-bond-creatively-boost-concessional-and-climate-finance

[21] Ibid.

3. THE „RESERVE ASSET CHARACTERISTIC“ OF THE SDRS AND WHY INFLATION SHOULD NOT BE SUBJECT TO CONCERNS

A major obstacle to the transfer of unused SDRs is the mantra of both the G7 and the G20 that SDRs should maintain its "reserve asset characteristic" also in the process of transferring them to Global South countries. In practice, this means that the SDRs cannot actually be passed on but can only be lent temporarily.

In general, "reserve assets" can be seen as assets that can be used on a global level to exchange against other currencies to finance imports. For central banks it is therefore of great importance to have as large a stock as possible of globally convertible reserve currencies or comparable assets such as gold or SDRs on their balance sheet in order to counteract unwanted devaluations of their own currency or to finance a sudden need for additional imported goods (such as expensive vaccines). This is because a central bank cannot generate foreign reserve currencies itself, as it can its own currency. To generate a net inflow of reserve currencies, a country must, for example, achieve an export surplus.

However, the importance of having a large stock of reserve assets on their balance sheets does not apply to all central banks to the same extent. Central banks from most industrialised countries in the Global North that have a strong currency or countries with high export surpluses from raw material sales usually have no problems holding sufficient reserve assets. In contrast, this is not the case for most countries in the Global South, which must import most of their industrially produced consumer and capital goods or even their energy raw materials. They need a constant inflow of foreign reserve currencies to finance current imports, while they often have problems earning the equivalent in export revenues. For these countries, maintaining the reserve asset status of their SDRs received from the IMF is very important.

The reserve asset status of SDRs is needed by countries form the Global South but not from the Global North

For those Global North states that are most urgent in insisting on maintaining the reserve asset characteristic of their newly received SDRs at no cost, the importance of additional reserves is in fact considerably less or non-existent. **Thus, it can be considered a global consensus that rich countries and some middle-income countries with large reserves do not currently need their newly and cost-free SDRs.[22]**

Many countries in the Global North could therefore transfer their SDRs in a way that does not preserve their "reserve asset characteristic" without facing economic problems. This means that they could pass on their new SDRs as a "donation" to MDBs, for example, so that the MDBs can expand their concessional credit lines. **The insistence on maintaining the "reserve asset status" precisely from the ECB/Eurozone, which with the euro is itself in possession of the second largest reserve currency, cannot be justified from an economic point of view.** The recent meeting of African finance ministers also called on the IMF to update the "Reserve Asset Characteristic" of their SDRs so that they can be better used in international trade.[23]

[22] See: Plant, Mark; The Challenge of Reallocating SDRs: A Primer, 18.08.2021, https://www.cgdev.org/publication/challenge-reallocating-sdrs-primer

[23] See: ECA, African ministers call for reforms of the IMF, 22.05.2023: https://www.uneca.org/stories/african-ministers-call-for-reforms-of-the-imf%E2%80%99s-special-drawing-rights-system

New SDRs and fears of inflation

Since the recent global price increases, concerns have been voiced that the new allocation of SDRs could also generate a further surge in inflation. The governor of the Austrian central bank and member of the ECB's Governing Council, Robert Holzmann, called for the IMF to return to its original purpose and avoid using new SDRs for tasks other than solving pure balance-of-payments problems because this could lead to a further surge in inflation.[24]

Especially with regard to the use of new SDRs to finance the expansion of renewable energies, however, this fear of inflation is unfounded. This is because the current, globally observable surge in inflation is largely due to the sharp rise in prices for fossil energies and not to excess demand. The use of SDRs to accelerate the global expansion of renewable energies would push back the price-driving fossil energies and have a dampening effect on inflation.[25]

The use of additional SDRs to finance the global energy transition in order to meet the Paris climate targets, will support the necessary annual climate protection investments of at least \$3 to \$4tr. The corresponding surge in demand is - in relation to the current global GDP of about \$100tr - an amount from which only a very slight inflationary pressure could emanate. A much greater pressure on inflation, however, would result from the situation in which the global energy transition - for lack of sufficient financing - is further delayed. This is because the costs of climate change will lead to uncontrollable price increases in many areas.

4. NEW FINANCIAL TOOLS TO IMPROVE THE ECONOMIC SITUATION IN THE GLOBAL SOUTH

The establishment of the RST as a new instrument to re-channel surplus SDRs in order to increase the IMF's lending capacity is a step in the right direction. However, the fact that the SDRs are only tied to the structure of IMF programmes can be an obstacle. The economic potential offered by the SDRs is thus far from being fully utilized.

Proposals such as from the AfDB or from Barbados therefore avoid the diversions via the RST and could enable new low-interest loans for each SDR forwarded. However, they have not yet been taken up by the rich countries of the Global North, even though the AfDB in particular has made concrete, easy-to-implement proposals to get started. To make matters worse, the ECB has currently banned its member countries from lending their SDRs to the AfDB.[26]

But even the latter two proposals operate with loans, albeit at low interest rates, and will further increase the absolute external debt of borrowing countries in the Global South. This remaining problem can be alleviated if two further measures to use SDRs are implemented.

1. First, Global North states must transfer parts of their surplus SDRs to countries representing a clear demand, or to MDBs with "prescribed holder" status, in the form of a repayment-free donation.

2. Second, a regular SDR allocation must be established, which would mean a steady and predictable supply of global reserve liquidity that does not have to be repaid like a loan and would improve the financial conditions especially for states of the Global South. In order to improve the effectivity of the allocation the IMF quota system should be adjusted in favour of the countries from the Global South.

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[24] See Holzmann, Robert; Addressing global challenges – should the IMF refocus its activities and the role of SDRs?, 31.03. 2023: https://www.oenb.at/dam/jcr:f2993518-54ba-48ea-8af0-03d0acdf3af2/20230406_addressing_global_challenges_policy-paper.pdf

[25] See Kroll, Matthias; Central banks, energy transition and controlling inflation, Policy Note, April 2022: https://www.leave-it-in-the-ground.org/wp-content/uploads/2022/04/Fossil-Inflation-Solutions-Policy-Note-LINGO-WFC-2022.pdf

[26] See: Masood Ahmed; Now Is the Time to Recycle SDRs through the African Development Bank, 22.05.2023: https://www.cgdev.org/blog/now-time-recycle-sdrs-through-african-development-bank

4.1 The re-channeling of SDRs in the form of non-repayable grants (donation)

The transfer of SDRs without repayment in the form of a donation initially means the loss of this reserve asset for the donor country. Consequently, the "reserve asset status" is also lost. **However, it can be assumed that in the course of the economic use of SDRs by countries of the Global South, most of the SDRs will flow back to the countries of the Global North, if, for example, the imports of renewable energy equipment are financed via MDBs.[27]**

This would also alleviate the problem that countries that donate their SDRs still have to pay interest on them to the IMF.[28]

INFOBOX 2

The tricky SDR interest system – How does it work?

If the IMF allocate new SDRs to a member country it pays the SDR-interest rate to the country. At the same time the country which received the SDRs pays the same SDR-interest rate to the IMF. If the country retains their SDRs the balance persists and no interest is being paid. If the country used their SDRs to exchange it in a currency of another country, the other country gets the SDRs and received now the related interest payment from the IMF. The country which gives their SDRs away had to pay further the interest rate to the IMF for the once received SDRs. Therefore, it will incur net charges on the difference between their overall obtained cumulative SDR and their remaining SDR holdings.[29]

The rationale of this interest system is to give countries with a strong reserve position an incentive to exchange their currency against SDRs. However, this arrangement disadvantages the countries (mostly from the Global South) which needed the SDRs urgently to finance their imports, in comparison to the countries with strong currency reserve position (mostly from the Global North), which will earn more SDR interests from the IMF, because they could pay the SDRs with their own (new created) currency. In the last 15 years with an interest rate close to zero this was a minor problem, but now with an interest rate at almost four percent the costs of using the SDRs are important again and burdened countries from Global South.

The SDR interest rate is the weighted average of the (three months) interest rates from the five basket currencies (USD, Euro, Renminbi, UK-Pound and Yen) and is currently at 3.87 percent (end of June 2023) [30]

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[27] See: Kroll, Matthias; Funding Climate Action and COVID-19 Recovery by New Special Drawing Rights – A Game Changer?, F20 - Policy Briefing #3/2021, November 2021: https://foundations-20.org/publication/funding-climate-action-and-covid-19-recovery-by-new-special-drawing-rights-a-game-changer/

[28] See: Plant, Mark; The Challenge of Reallocating SDRs: A Primer, 18.08.2021, https://www.cgdev.org/publication/challenge-reallocating-sdrs-primer

[29] https://www.imf.org/en/About/FAQ/special-drawing-right#Q13.%20%20How%20will%20you%20keep%20track%20of%20the%20use%20of%20the%20SDR%20allocation%20by%20countries%E2%80%94and%20improve%20transparency%20as%20has%20been%20requested%20by%20some%20members?%20%20

[30] https://www.imf.org/external/np/fin/data/sdr_ir.aspx

For as soon as the respective MDBs exchange the SDRs for the hard currencies of the Global North, they get back the SDRs they just "gave away" and the interest payments to the IMF cease. The SDRs thus returned to the central bank balance sheets of the countries of the Global North then also have full "reserve asset status" again.

The countries of the Global North that have passed on their SDRs as an investment donation, but do not get their SDRs back in the further economic process, continue to be affected by the problem that they have to pay IMF interest on SDRs they no longer own because they gave them away. The IMF should establish a compensation procedure for this that ensures that the donating countries get back most of their SDRs. Alternatively, the donor countries could be compensated through bilateral agreements with countries that were able to increase their surplus of SDRs during the economic process.

If reformed, the new SDR system should dispense with disbursement as well as the charging of interest.

The SDR-system would be more consistent if it will forego of the use of any kinds of interest. This would significantly simplify the use of SDRs in international payments and thus facilitate the financing of global climate protection tasks.

As shown in chapter three, the fact that the Global North is still putting the brakes on the use of SDRs arguing with a - temporary - loss of reserve asset status, is not convincing. The outflow of reserve assets in the form of SDRs from central bank balance sheets is more than offset by the subsequent economic benefits for both sides. Increasing demand for investment goods from the Global South leads to economic growth in both the North and the South.

Similarly, the critics cannot explain how an expansion of the central bank balance sheet - covered by real production - should lead to inflation. The current reasons for inflation have their roots in massively increased prices of fossil energies. A significantly accelerated global energy transition towards renewable energies financed by new SDRs will curb the price increases and end their volatility.

4.2 Regular annual allocation of SDRs

Another way to increase the liquidity of reserve assets would be to establish a regular, annual allocation of SDRs, as has been called for time and again, most recently by the Bridgetown Initiative. The American economist and SDR expert Edwin M. Truman also recently examined this issue in detail and, after weighing up the pros and cons, he concluded that such an allocation would make sense.[31]

The current majority in the US Congress still blocks a continuous allocation of new SDRs. However, this does not have to remain the case in the long run, because the USA should also have an interest in keeping the SDRs and thus the IMF at the centre of the global financial architecture and in binding the Global South to itself through regular allocation. Otherwise, the US runs the risk of China and other BRICS countries filling this vacuum. Possibly even in the form of an SDR surrogate.

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Recommendations:

The IMF must support the voluntary on-lending of SDRs to MDBs in the form of repayment-free donations so that they can massively increase their share of concessional loans and direct grants.

- The G20 member states should approve a regular, annual allocation of SDRs in an amount of at least $200bn.
- To improve the effectivity of the SDR-allocation the IMF quota system should be adjusted in favour of the countries from the Global South.

[31] See Truman, Edwin M.; The IMF should enhance the role of SDRs to strengthen the international monetary system, PIIE, Working Papers 22-20, December 2022. https://www.piie.com/publications/working-papers/imf-should-enhance-role-sdrs-strengthen-international-monetary-system

CONCLUSION

The use of new SDRs to finance global climate action and other SDGs is underway. Which is good! However, progress is too slow. The situation that the RST is to get stuck into the previous (austerity) IMF programme mode is counterproductive. The two proposals by AfDB and the Barbados Initiative go further, but also remain in the conventional lending mode, which leads to further indebtedness - albeit at a slower pace - of the countries of the Global South. The economic potential of the SDRs is thus not fully exploited. The new tool of SDR bonds can be a way to use the potential in a much larger scale. But the proposals of the AfDB and the Bridgetown Initiative have not yet been taken up by the relevant states of the Global North. The G7 and the G20 countries are faced with the challenge of either finally putting the SDRs as a financing tool at the service of a just world order and using them to finance climate protection and the implementation of the other SDGs, or continuing to use the SDRs as restrictively as before and thus risking that the Global South will continue to turn away and look for alternative solutions. In view of the enormous global challenges posed by climate change alone, the former option would be preferable.

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