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Special Drawing Rights: International Monetary Support for Developing Countries in Times of the COVID-19 Crisis

https://doi.org/10.1515/ev-2020-0012

Abstract: A major issuance of special drawing rights (SDRs) through the International Monetary Fund would be a key tool to provide financial support to developing and emerging economies and limit the economic and financial fallout of the COVID-19 crisis. SDRs are an unconditional resource, and the case for such an allocation is very strong during an exogenous shock, such as the current one. An SDR allocation would enhance the international liquidity in the hands of emerging and developing countries, so that public responses to the health crisis are not imperilled by financial crises. Close to two-fifths of a new SDR allocation would directly go to developing and emerging economies. In addition, a new mechanism should be created through which countries that do not need their SDR allocation lend them to the IMF, to increase the Fund's lending capacity. Developed countries can also allocate the SDRs they do not use for official development assistance.

Keywords: special drawing rights, international monetary fund, COVID-19, global financial safety net, G-20

The COVID-19 pandemic is having dramatic effects on the global economy. It has led to a shut-down of borders, a collapse of tourism and international passenger travel, a disruption of global trade and investment, and a sharp contraction of economic activity all over the world. Developing and emerging economies have also been hit by the largest-ever outflow of portfolio capital, crumbling commodity prices, a contraction of remittances, and depreciation of their currencies. As of 20 April, 103 developing countries have approached the International Monetary Fund

This piece draws on Gallagher, Ocampo, and Volz (2020a, 2020b).

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(IMF) for emergency financing. IMF Managing Director Kristalina Georgieva has referred to the effects of COVID-19 as "the worst economic fallout since the Great Depression". Both the IMF and UNCTAD reckon that emerging market and developing countries have an immediate need of $2.5 trillion.

When the COVID-19 pandemic put global financial markets into freefall in early March 2020, major advanced country central banks intervened quickly to stabilise markets. Importantly, the United States Federal Reserve stepped in swiftly and launched swap facilities with other central banks (Tooze 2020). But with the exception of Brazil and Mexico, these benefited only advanced economy central banks. The Fed also created a repo facility through which central banks can cash Treasury bonds, but this facility only benefits countries with large foreign exchange reserves. The rest of the emerging and developing world is left to fend for itself.

The crisis has once again shown the fragility of the global financial system. It has also exposed the inadequacy of the Global Financial Safety Net (GFSN), the multi-layered system comprising nations' foreign exchange reserves, bilateral central bank swap lines, and the financial resources of global financial institutions, particularly the IMF and regional financial arrangements (RFAs). As we have laid out elsewhere, there is an urgent need to reform and expand the GFSN in response to COVID-19 (Gallagher et al. 2020). The IMF's current firepower of $1 trillion – parts of which are already committed – will not be enough to support its membership through this crisis. Several measures – including the issuance of at least $500 billion of IMF Special Drawing Rights (SDRs); a further improvement of the IMF's precautionary and emergency facilities; the establishment of a multilateral swap facility at the IMF; an increase of the resources and geographic coverage of RFAs; a coordinated approach to capital flow management measures; and significant debt relief – should be implemented very quickly.

To date, however, the international community – and the Group of 20 (G-20) leading economies in particular – has not been able to agree on such measures (Ocampo 2020), despite the commitment of G-20 leaders "to do whatever it takes and to use all available policy tools to minimize the economic and social damage from the pandemic, restore global growth, maintain market stability, and strengthen resilience". At the April 2020 Spring Meetings of the IMF and the World Bank, member countries could only agree on a doubling of the IMF's emergency facilities to 100 billion dollars and the creation of a short-term liquidity line – a kind of swap credit line – "for member countries with very strong policies and fundamentals", a rule that in the past has been applied to very few countries. The G-20 also agreed on a temporary debt standstill during 2020 for the debt service on official credits for the poorest 77 countries, a step that has already been characterized as insufficient.

This is in sharp contrast to the "Global Plan for Recovery and Reform" adopted by the G-20 in London in April 2009, which paved the way to the most important reform of IMF credit lines in history, the largest issue of SDRs, a capitalization and a massive increase in lending by multilateral development banks, an ambitious coordinated reform of financial prudential regulations, and the beginning of an effort to strengthen global tax cooperation.

It is particularly worrying that no consensus could be reached on an issuance of SDRs. SDRs are international monetary assets issued by the IMF – acting, in a sense, as a kind of central bank of the world. SDRs are based on a basket of international currencies comprising the US dollar, the Japanese yen, the euro, the pound sterling and the Chinese renminbi. The IMF has the authority to create unconditional liquidity through "general allocations" of SDRs to all its members in proportion to their quotas – or shares – in the IMF.

New SDRs will become additional international reserves of countries, and they can be sold or used for payments to other central banks. A major SDR issuance would be a key tool to provide financial support to developing and emerging economies and limit the economic and financial fallout. An SDR allocation would enhance the international liquidity in the hands of emerging and developing countries, which are the primary users of SDRs. SDRs are an unconditional resource, and the case for such an allocation is very strong during an exogenous shock, such as the current one. Critics worry that countries could use them as a substitute for "sound policies", mixing structural adjustment and austerity. However, a global health emergency and liquidity crunch is not the time for those policies, but rather for the massive counter-cyclical monetary and fiscal policies that are being adopted by advanced countries.

In fact, it has been long argued that SDRs should be allocated in a counter-cyclical way, as it is during crises that countries need additional reserves. Indeed, the conditions that the IMF's Articles of Agreement (the IMF's charter) lays out for SDR allocations can be made – "namely that general allocations of SDRs should meet a long-term global need to supplement existing reserve assets in a manner that will promote the attainment of the IMF's purposes and avoid economic stagnation and deflation, as well as excess demand and inflation" – are currently met.

A new, large-scale SDR allocation (which we proposed early on in a number of publications) was not only supported by the IMF Managing Director, the Inter-governmental Group of 24 and other low and middle-income countries, but also by leaders of major European economies. The issuance of SDRs was blocked by two G-20 members – the US and India. A new SDR allocation would require an 85% vote, which means a positive vote by the U.S., which holds 16.51% of the voting rights and is hence able to veto any decision at the IMF. During the IMF and World

Bank spring meetings, US Treasury Secretary Steven Mnuchin argued that SDRs were "not an effective tool to respond to urgent needs" and argued that "almost 70% of an allocation would be provided to G-20 countries, most of which do not need, and would not use additional SDRs to respond to the crisis. By contrast, all low-income countries, including those facing urgent balance of payment needs, would receive just 3% of any allocation" (FT 2020).

Mnuchin is right that, given an SDR allocation would be distributed according to IMF quotas, only parts of the allocated SDRs would go to developing and emerging economies. However, the SDRs that would benefit these countries would account for close to two-fifths of the allocation. This is certainly too low, and reason why reform of IMF quotas and the rules according to which SDR allocations are distributed are necessary. Yet a new SDR issuance is the only case in which these countries share in the "seignorage" of creating international money. Moreover, ways can be found to allocate more SDRs to those who need them. For instance, as we have suggested, a new mechanism should be created by (high-income) countries who would agree to lend the SDRs that they do not use to the IMF, to increase the Fund's lending capacity. Developed countries can also allocate the SDRs they do not use for official development assistance. And, crucially, developed countries should be ready to exchange SDRs for their national currencies – dollars, euros, or other internationally-accepted money.

So why do the US and India opposes a new SDR allocation? The problem appears to be that all IMF member countries get a share in the allocation, including countries with which the US and Indian administrations are not on friendly terms. In particular, the US worries about a liquidity boost for Iran and Venezuela, countries on which the US has imposed economic sanctions, while India is opposing an SDR allocation because it would benefit its arch-rival Pakistan. But these bilateral tensions should not hinder a collective global response to the crisis.

Some have also argued that SDRs could rival the role of the USD as the global lead currency, and that the US is hence hostile to SDR issuances. We should remember, however, that the US was not only a great supporter of the creation of SDRs in the 1960s, but also of later allocations, and notably that of 2009. There is no reason why the US should see an SDR allocation as antagonistic to its role in the global monetary system, which will continue to be dominated by US dollar assets.

It is also worth pointing out that the support of the US administration for an SDR allocation would not be imperilled by domestic politics. To avoid authorization by Congress, the allocation to the US must be below the US quota, which means that the total permissible new allocation would be equal to the total quotas in the Fund – which is SDR 477 billion (USD 653 billion at May 1st exchange rates). There have been no SDR allocations within the current "basic period", 5 years after

January 2017, so SDRs outstanding (SDR 204 billion) would not count against the permissible amount.

COVID-19 does not discriminate between rich and poor countries, and until the virus is eradicated it will imperil the health of the world's people and the global economy alike. The international community needs to extend support so that public responses to the health crisis are not imperilled by financial crises. The international community missed the chance to agree on an SDR allocation this April. It should reverse the mistake and adopt this decision, which is urgent in the midst of the greatest economic crisis of generations. This is a time for bold thinking and action. An SDR allocation is not a silver bullet, and it needs to be complemented by further measures, as mentioned above. All solutions have trade-offs and limitations, but we hold that a large SDR allocation should be part of the solution.

An SDR issuance should also be the beginning of a deep discussion about the role of SDRs in the international monetary system. They were created half a century ago and constitute the only true global money, backed by all IMF members. However, it has remained as one of most under-utilised instruments of international cooperation. They should be issued regularly in proportion to the increase in the global demand for foreign exchange reserves. Beyond that, they should become the major instrument, or even the only instrument, to finance IMF programs. Indeed, the IMF should entirely become an SDR-based institution, as proposed by Jacques Polak, its then chief economist, four decades ago.

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