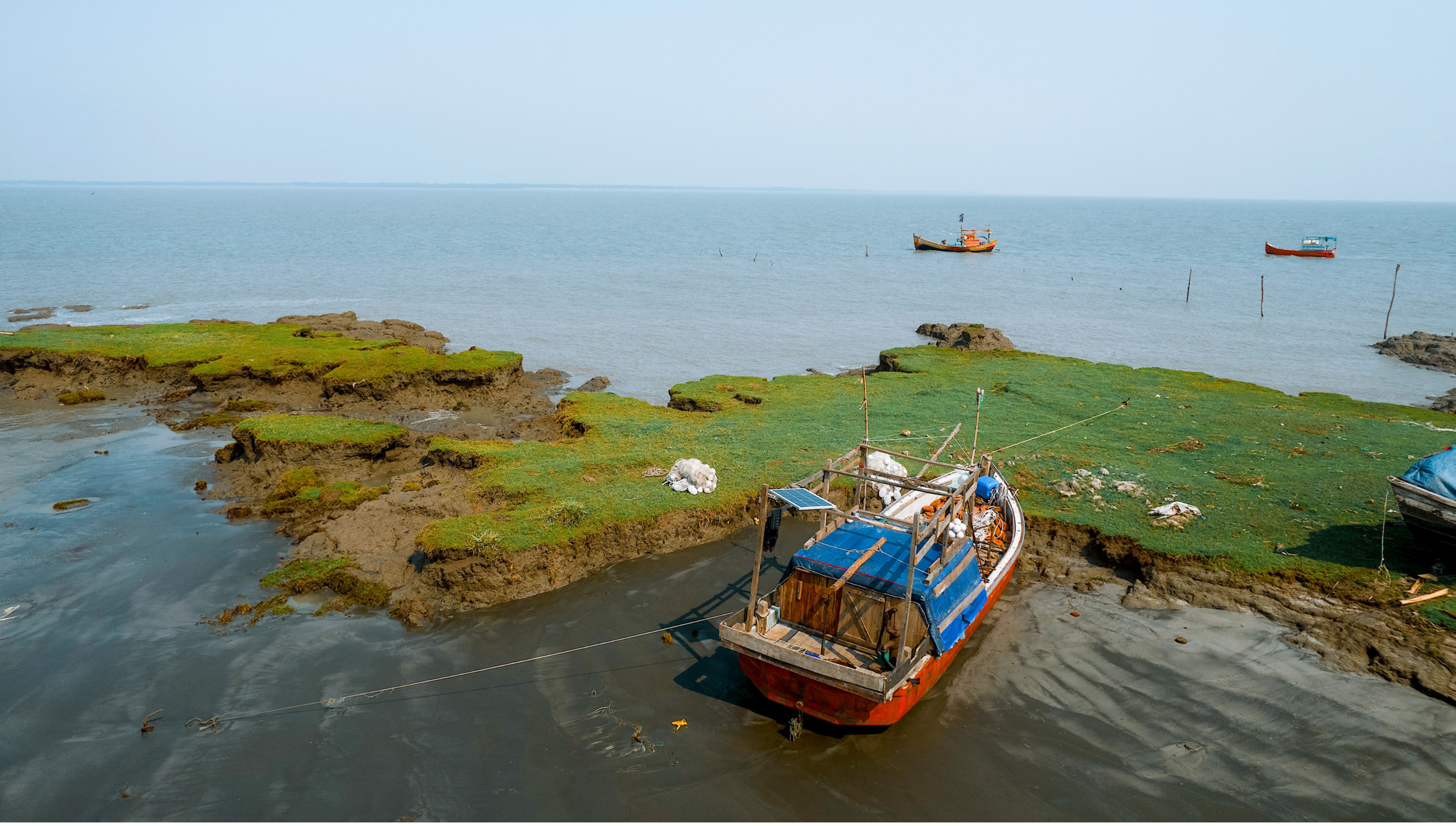

Adapting Our Financial Architecture in a Crisis-Prone World:

A Civil Society Proposal for Special Drawing Rights Reform

April 2024

Developed by: ActionAid and Bretton Woods Project, building on a convening held on 14 October 2023 in Marrakech.

Endorsed by: Action Corps, African Women's Development and Communication Network (FEMNET), Alternative Law Collective (ALC), Center for Economic and Policy Research (CEPR), Centre for Citizens Conserving Environment & Management (CECIC), Christian Aid, Climate and Community Project, CNCD-11.11.11, European Network on Debt and Development (Eurodad), Friends of the Earth US, Global Policy Forum Europe, Latindadd, MENA Fem Movement For Economic, Development And Ecological Justice, Oxfam, Partners In Health, Recourse, Southern and Eastern Africa Trade Information Negotiations Institute, World Economy, Ecology & Development (WEED).

ACKNOWLEDGEMENTS

Authors: Lara Merling (independent consultant), Jon Sward (Bretton Woods Project), and Niranjali Amerasinghe (ActionAid USA).

We appreciate the advice and feedback on drafts received from the following contributors: Bhumika Muchhala (Third World Network), Didier Jacobs (Oxfam), Emma Burgisser (Christian Aid), Michael Galant (Center for Economic and Policy Research), and Patricia Miranda (Latindadd).

Editor: Arianna Kandell (ActionAid USA).

Design and layout: Jenna Farineau (ActionAid USA).

Cover Photo: Southern Bangladesh. Nihab Rahman/ActionAid.

TABLE OF CONTENTS

SUMMARY: THE ROLE OF SDRS IN A TIME OF MULTIPLE CRISES

The Covid-19 pandemic exposed an often-overlooked reality: States are embedded in a highly unequal global financial architecture, with significant consequences for their policy and fiscal space. These dynamics constrained their relative capacities to respond to Covid-19 and related crises, as low- and middle-income countries' (LMICs) fiscal and policy spaces became radically circumscribed, especially as compared to their wealthier country counterparts. Among the key reasons for this is States' variable position in the global currency hierarchy – with rich economies holding a monopoly on freely tradeable international currencies. These dynamics have existed for decades, and both constrain the fiscal space and perpetuate the indebtedness of LMICs.

We contend that these structural challenges must be addressed head-on in order to meet global challenges, such as averting the worst impacts of climate change and resolving a worsening LMICs' debt crisis. While not a silver bullet, Special Drawing Rights (SDRs), an international reserve asset issued by the IMF, have the potential to act as a buffer against some of the worse impacts of the current grossly unequal international financial architecture (IFA). However, key reforms to the SDRs system are necessary in order to fulfill that potential and expand their role.

This paper proposes reforms across three largely complementary areas: changes to make SDRs allocations more regular and predictable; reforms to the accounting rules for Special Drawing Rights that would modernize their usage in a manner comparable to other reserve assets and increase their liquidity; and changes to the allocation of SDRs to make their distribution more reflective of countries' needs, rather than according to the IMF's flawed quota formula. Importantly, while each of these areas are critical in their own right, the full ambition of the SDRs can only be realized by concerted efforts to bolster the needs-based dimension of the SDRs system. As such, we call for:

- an immediate new allocation of SDRs, to provide immediate liquidity to LMICs and act as a bridge to further reforms;
- reforms designed to simplify and reduce the cost of countries using SDRs in ways comparable to other reserve assets;
- the IMF and its shareholders to support regular SDRs allocations that are needs-based, and to simplify the process for triggering these new issuances.

INTRODUCTION: POSITIONING SDRS IN A GLOBAL MONETARY 'NON-SYSTEM'

The Covid-19 pandemic and the economic shocks that followed brought to the forefront the practical consequences of asymmetries and power imbalances within the broader International Financial Architecture (IFA). Wealthy countries that are issuers of internationally tradable "hard currencies"[1] were able to immediately respond to shocks through large discretionary spending measures – estimated to be around 10 percent of their GDP.[2]

A response of the same magnitude was not possible for LMICs that are not issuers of such currencies and had to borrow in international financial markets to finance their additional spending, or rely on emergency support from the International Monetary Fund (IMF) or other international financial institutions.[3]

In a world where capital moves freely with few regulations on international flows, LMICs were also left vulnerable to the volatility in global financial markets. The impact of shocks exposed LMICs to capital flight, exchange rate devaluations, and even higher financing costs. Subsequent monetary tightening in wealthy countries that increased interest rates in response to post-pandemic inflation dealt an additional blow to LMICs and further increased financing costs, along with risks of a full-blown debt crisis.[4]
Conversations about the need to reform the overall IFA are once again being brought to the forefront, as this challenging international context further delays progress towards achieving the UN Sustainable Development Goals (SDGs), and is hampering countries' abilities to respond to climate emergencies and make needed investments towards their national climate plans.[5] The current IFA was designed in the aftermath of World War II, reflecting the dynamics of that world order, and is not fit to address the challenges the world faces now.

Since the 2008 financial crisis, swap arrangements between the US Federal Reserve and its counterparts in wealthy countries have become the norm, providing robust dollar liquidity.[6] For most LMICs, however, the main source of international liquidity during a crisis remains the IMF, an institution dominated by the US and European shareholders, where financing comes attached with stringent conditionalities and austerity measures.[7]
In the aftermath of both the 2008 financial crisis and the pandemic, allocations of IMF Special Drawing Rights (SDRs) were the one liquidity tool made available to all IMF member countries without conditions attached.

Despite the crisis-linked use of SDRs in these two general allocations, their original intended purpose was much broader. The SDR system was established in 1969 in response to country demands for a tool to address asymmetric access to liquidity. The founding of SDRs involved a fierce debate about their role in the international financial architecture and how they should be distributed.[8] Perhaps the most notable example of this was the

1. See Ocampo, *Resetting the International Monetary (Non) System* (2017), for additional context on different currencies and the international financial system.
2. IMF, *Fiscal Monitor* (2021).
3. For middle-income discretionary spending in response to the pandemic was on average 4% of GDP and for low-income countries around 3%. See IMF *Fiscal Monitor* October (2021).
4. UNCTAD, *Trade and Development Report.*
5. UN, *Our Common Agenda Policy Brief* (2023).
6. Federal Reserve, *Central Bank Liquidity Lines* (2024).
7. Muhlich and Zucker-Marques, *Closing the Global Crisis Finance Gap: Why and How the IMF Should Address Weaknesses in the Global Financial Safety Net*, (2023).
8. See Ocampo, *Resetting the International Monetary (Non) System* (2017), for a detailed account on the history of SDRs and the IFA.

SDR 'development link proposal,' originally developed by UNCTAD in 1965 and an important part of newly-independent countries' agenda in the 1970s, which was rejected by the US and Germany.[9] Instead, what followed was the creation of a 'non-system' based on the US dollar that requires, *inter alia*, that LMICs effectively self-insure against currency volatility beyond their borders.[10] In this context, despite small allocations occurring in 1979 and 1980, SDRs largely fell into obscurity.

The 2021 allocation of the equivalent of $650 billion worth of SDRs renewed interest in this tool. In the context of the crisis, the 2021 allocation provided by far the largest amount of debt-free liquidity support to LMICs, despite the structure of the allocation directing roughly one-third of newly issued SDRs their way.[11] Despite this inequitable distribution, the benefits of the allocation were progressive, with many LMICs using and exchanging their allocations.[12] The success of the 2021 allocation illustrates the potential of SDRs as a tool to increase the available liquidity of LMICs, create additional fiscal space, and support their efforts to achieve climate and development goals.

Taking a climate and economic justice lens, this paper outlines the characteristics and types of uses for SDRs that can harness the benefits of this tool to address some of the imbalances in the IFA. The purpose of the paper is to propose demands and reforms, developed with consideration of the originally envisioned role of SDRs, as a multilateral mechanism to create liquidity, reduce the exposure to external shocks and volatility of LMICs, and reduce the power asymmetries in the IFA.

9. Ocampo, *Resetting the International Monetary (Non)System*, p24 (2017).
10. Muchhala, *Tip of the iceberg: How the for SDRs reveals the urgency for deeper reforms* (2021).
11. See Arauz, Cashman, and Merling, *Special Drawing Rights: The Right Tool to Respond to the Pandemic and Other Challenges* (2022).
12. See Arauz, *SDRs One Year Later, By the Numbers*, (2022).

This paper will discuss different options to improve the function and impact of SDRs, in the context of broader IFA reform, in order to increase LMICs' fiscal and policy space to be able to better respond to shocks and pursue a feminist, just transition. The scope, impact, contextual relevance and path towards realizing each individual proposal is discussed in further detail, situating the conversation within a broader civil society discussion about how to create a more just and equitable IFA, in which changes to the SDRs system constitute just one pillar.[13]

13. Refer to Section III of this 2023 joint civil society briefing on World Bank reform, inter alia.

HARNESSING THE BENEFITS OF SDRS: KEY DEMANDS AND REFORMS

We identify three types of SDRs focused proposals necessary to better realize their potential to reduce inequality within the IFA (see Table 1). This section will outline three key demands, explore their implications, and identify some of the challenges around securing support and acting on the proposals.

Table 1: Key asks and areas for SDRs reforms

Ask	Goal	What needs to happen
1. New allocation now	Provide immediate relief as other reforms are discussed	Break the deadlock over the decision for new allocation
2. Simplify and reduce the cost of using SDRs	Make SDRs into a more viable reserve asset that can reduce asymmetric access to liquidity	Operational changes to accounting rules, interest policy, and possible expansion of the use of SDRs as a unit of account outside the IMF
3. Support regular SDRs allocations that are needs-based, and simplify the process for new issuances	Ensure all countries have non-conditional access to international liquidity	Reforms that equalize access to international liquidity and ensure new allocations reach the countries in need

The demands and reforms outlined in this proposal are centered on enhancing the key benefits and advantages of using SDRs as a tool, considering the goal of addressing existing asymmetries and imbalances in the IFA and increasing liquidity support and fiscal space for LMICs. Expanding the use of SDRs should be achieved in a manner that preserves the main characteristics or advantages of SDRs and increases the domestic policy space of LMICs.

Overall, these reforms support SDRs allocations and usage that maintain and emphasize the following beneficial characteristics of SDRs as illustrated in Figure 1.

Figure 1: Benefits of SDRs

Speed

Once approved, new allocations take effect immediately and are quickly distributed amongst IMF members.

Debt-free support

SDRs allocated to countries are international reserve assets that strengthen the balance of payment positions of countries.

Affordable access to reserve currencies

When SDRs are exchanged following the rules in place, where there is an interest rate to cover the exchanged portion, SDRs are still amongst the most affordable finance tools for most developing countries.

Conditionality-free access to reserve currencies

SDRs can be turned into an international currency when needed without any conditionality.

No "waste" of resources if SDRs are not used

Unused SDRs are potential claims on the reserve currencies that back SDRs, so no resources are being wasted or lost if certain countries do not use their allocations.

Other proposals do offer viable options for expanding potential uses of SDRs but fail to maintain the characteristics of SDRs identified above and thus fall outside the scope of this paper. This includes proposals focused on ways to 'rechannel' SDRs to increase the financing envelopes of various facilities at the IMF or Multilateral Development Banks (MDBs) that in turn offer loans, or to issue SDR-denominated bonds to bolster MDBs' balance sheets.[14]
For the different reforms we identify to materialize, the proposals require political support from IMF member countries and in many cases its largest shareholders, including the US, which holds veto power over major decisions at the Fund. Changes to the IMF Articles of Agreement (AoA) require a supermajority of over 85 percent of votes, while some decisions around operations can be made by IMF management and staff and would only require endorsement from the IMF's shareholders through their representatives on the executive board. These political-economy considerations highlight some of the challenges ahead, as those benefiting the most from the current architecture hold significant influence over decisions regarding its reform. However, as discussed below, there is already significant support for different aspects of reform of the SDRs system from Southern governments, UN bodies, academics and civil society.

14. For limitations and issues around proposals to "re-channel" SDRs towards trusts that offer conditional loans see Arauz and Amsler, *More SDRs for Latin America and the Caribbean* (2024).

1. IMMEDIATE RELIEF THROUGH A NEW SDRs ALLOCATION

A new general allocation of SDRs is not a reform per se, but it is a much needed injection of liquidity that can be used now - and can act as a stepping stone to further reforms discussed below. Considering the success of the 2021 allocation, calls for a new allocation enjoy support from a broad coalition of civil society groups and governments.[15] Most recently, the G77 and China, in the outcome document of the Third South Summit held in Kampala, Uganda, in January 2024, called for "new issuances of SDRs, driven by the need to enable the achievement of the Sustainable Development Goals, including eradicating poverty." At COP26 in 2021, Barbados Prime Minister Mia Mottley notably called for a $500 billion SDRs allocation every year for 20 years to address the climate emergency, as part of her fledgling Bridgetown Agenda proposal.

The evidence from the use of SDRs following the 2021 allocation shows that despite only receiving one-third of the allocation, the benefits for LMICs were nevertheless significant, with many countries able to utilize them for fiscal purposes.[16] In 2021, civil society organizations called for an SDRs allocation worth $3 trillion, in order to meet liquidity needs at the time; in the end, the size of the 2021 allocation failed to reflect needs but was rather based on the amount the US Treasury could authorize without Congressional approval (i.e. the amount equivalent to the US's IMF quota share).

Given this, shareholders and the Managing Director should direct IMF staff to immediately begin assessing the need for a new SDRs allocation, with an emphasis on LMICs' financing needs, in order to present a proposal to the board for another SDRs allocation. Given countries' urgent financing needs, an additional immediate allocation could serve as a bridge to the additional SDR reforms discussed below, including more regular, predictable SDRs allocations.

15. See Global Crisis Relief and G-77, *South Summit Communique* (2024).

16. See IMF, Special Drawing Rights Allocation, Ex-post Assessment, (2023).

Demand/Reform	Context and implications	Required support
New allocation now	Given the speed of support offered, a new allocation can provide immediate relief and support, while other reforms are developed and agreed upon	Overcoming US opposition, as US holds veto over decisions for new SDRs allocations, in addition to skepticism from other shareholders. However, it is noteworthy that the G77 + China recently supported further allocations.

2. SIMPLIFY AND REDUCE THE COST OF USING SDRS

Countries can use and exchange their SDRs allocations as they please, but once exchanged for a hard currency, must pay interest to the other country involved in the transaction. The interest payments are based on the interest on the securities of the SDRs' underlying 'currency basket,' and are - with a few exceptions - favorable compared to what LMICs can obtain on other types of financing, with the significant difference that no principal must be repaid in the case of exchanging SDRs.[17] However, countries can also utilize SDRs through intra-country mechanisms that enable their fiscal use without exchanging allocations and incurring the SDRs interest rate.[18] The IMF has acknowledged the successful fiscal use in some countries and could provide technical support for other countries in creating similar frameworks and expanding their use of SDRs.[19]

Currently, central banks, the IMF, a handful of multilateral development banks, along with a select group of other official institutions are the only entities that can hold and transact SDRs.[20] An increase in transactions and financial instruments denominated in SDRs could potentially create a more liquid market for SDRs and encourage broader use of SDRs in settling international transactions without their exchange into other hard currencies.

Nonetheless, the use of SDRs as modern reserve assets is constrained by recent accounting rules introduced by the IMF in an updated version of its *Balance of Payments Manual* for central banks released in 2009, which states that they must be classified as both an asset and a liability.[21] This constrains how SDRs can be utilized compared to other types of reserves, as countries are effectively punished once SDRs allocated to them by the IMF are no longer in their possession - limiting their liquidity. This creates barriers to the freer exchange of SDRs between countries, beyond discussions about 'rechanneling', where SDRs are not donated, but 'on lent', with donor countries able to recall their SDRs if needed[22]. This confusion is reflected, inter alia, in flagship databases and publications, including the World Bank's International Debt Statistics database, which since 2009 have reported all SDR allocations as external debt, and added them to their estimate for countries' gross debt, creating confusion between countries' SDR allocations and use of IMF credit.[23]

Effort to reform these accounting rules could enhance SDRs' efficacy, in order to achieve consistency with the IMF's Articles of Agreement, which call on: *"Each member…to collaborate with the Fund…with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system."*[24]

17. IMF, *SDRs FAQs* (2024).
18. Latindadd, *Handbook for the use of SDRs for Fiscal Purposes* (2021).
19. IMF, *Special Drawing Rights Allocation, Ex-post Assessment* (2023).
20. IMF, *SDRs FAQs* (2024).
21. As noted by Arauz and Amsler, *More SDRs for Latin America and the Caribbean*, (2024)
22. This could include, for example, rich economies donating their SDRs to a debt relief fund, or for other purposes.
23. See the World Bank *International Debt Statistics*.
24. See *IMF Articles of Agreement*, p. 26.

Demand/Reform	Context and implications	Required support
Fix issues around confusion created by accounting methodologies	The introduction of new IMF rules in 2009 that require central banks to record SDRs as an asset and a liability (instead of as equity) limits states' ability to use SDRs as an effective liquidity instrument and constrains the ability of SDRs to be utilized in the manner that other 'modern' reserves are used Reforms that revert to the pre-2009 rules and remove the 'liability' dimension of SDRs would enable freer exchange of SDRs between countries and development finance institutions, enhancing the impact of future allocations	IMF management with endorsement from IMF shareholders
Provide technical support and build capacity for fiscal use of SDRs	The successful examples of domestic fiscal use of SDRs without the need to exchange them and make interest payments can serve as the basis for technical support for other countries that seek to make similar use of their allocations	IMF management with endorsement from IMF shareholders

3. SUPPORT REGULAR SDRs ALLOCATIONS, SIMPLIFY THE PROCESS FOR NEW ISSUANCES, AND MAKE DISTRIBUTION MORE EQUITABLE

The way that SDRs are allocated under the current rules greatly limits their potential for creating a more equal IFA. The majority of countries that receive SDRs are wealthy economies, many of whom have internationally tradable currencies, and for whom SDRs have not been the primary tool for addressing liquidity needs in recent financial crises.

There are several ways that the SDRs system could be reformed over the short-to-medium term, to make future allocations more predictable, and targeted to countries where SDRs could potentially play an important role in increasing the fiscal and policy space needed to both avert a 'lost decade' for many countries in the Global South and get back on track with global climate and development goals.

There is already growing support for these proposals among select government and multilateral entities. Significantly, a May 2023 statement signed by a group of African finance ministers emphasized *"...the need for SDRs allocation decisions to be made in a rule-based analytical manner to reduce the discretionary and political nature of the allocation process, and to ensure that SDRs are directed to countries that need them the most."*

The UN Secretary-General also called for a review of the IMF's SDRs mechanism as part of his international financial architecture reform agenda (2023), proposing automatic, predictable future allocations of SDRs, as well as reviewing how to make future allocations better respond to the needs of all IMF members, in particular LMICs.

UNCTAD's 2023 *Trade and Development Report* also calls for key reforms to the IFA, arguing:

"The way forward is to strengthen public sources of development finance, including official development assistance... [and] SDRs (through more frequent ordinary issues, recycling of unused SDRs, and perhaps an SDR-aid link; also, to underline the potential fiscal use of SDRs)."

Pursuing these options is vital to resolving the inequalities reverberating throughout the international monetary 'non-system', in the face of multiple, overlapping crises.

Demand/Reform	Context and implications	Required support
Make SDRs allocations more regular and predictable	Further allocations of SDRs could play an important role in addressing the liquidity needs of LMICs and provide them the fiscal and policy space to pursue national climate plans and the Sustainable Development Goals	IMF management with endorsement from IMF shareholders
Lower approval threshold for future SDRs allocations to a simple majority	Overcome the problem of large shareholders like the US holding veto over allocations	IMF management with endorsement from IMF shareholders
Special allocations to address the current debt/ climate crisis	There is precedent for a special allocation in the IMF AoA; it was done once before to top up the SDRs holdings of countries that joined the IMF in the decades after its establishment Hypothetically, special allocations could be directed towards need-based recipient counties, to address the polycrisis, though the criteria would need to be clarified *NB: This represents a least-best policy option, compared to those discussed below*	IMF management with endorsement from IMF shareholders

Demand/Reform	Context and implications	Required support
Reform future allocations to make them needs-based	Decoupling SDRs allocations from the IMF quota system, which would require a new formula or process for defining 'need' Wealthy economies are the primary recipient of SDRs general allocations under the current system; however, many of these countries already issue internationally tradable currencies, and stand to benefit the least, in relative terms, from future SDRs allocations Given the failure of the IMF's 16th general review of quotas to agree to any realignment of IMF quota shares, shareholders must consider reforms to make the SDRs more effective in terms of their distribution, in order to bolster their efficacy as an international reserve, as outlined in the IMF Articles of Agreement	Change to IMF AoA

CONCLUSION

A growing number of LMICs are spending more on debt servicing than on climate and social spending combined. Loss and damage from climate change is already costing climate-vulnerable countries nearly $200 billion per year.[25] Despite the G20's commitment to rechannel $100 billion in SDRs in October 2021, as of October 2023 just $702 million of these funds had reached vulnerable countries.[26]

As suggested in this proposal, we need an immediate new issuance of Special Drawing Rights to help meet urgent and growing financing needs for LMICs in ways that won't create additional debt burdens and undue policy conditionality. But at this time of crisis, we need to go much further than that.

An unequal global financial architecture dictates how SDRs are distributed, as well as the rules for their use. To illustrate the power imbalances, one can look at how 68 climate-vulnerable countries that make up the membership of the Vulnerable 20 (V20) account for 21.7% of the global population, and 44.7% of IMF programs but only have 5.3% of IMF votes.[27] The fact that the allocation of SDRs is pegged to the IMF's quota system means that they are distributed first to those who need them least.

In this paper, we have sought to elucidate a few of the crucial ways the existing SDRs system could be modified to help make the IFA more just and fit for purpose in the 21st century. We call on IMF shareholders to direct the Fund to pursue discreet parts of this reform agenda and avert another 'lost decade' that will leave global goals on climate action and development out of reach.

There is an urgent need to create an SDRs system that is fit for purpose to help all IMF member countries achieve a feminist, just transition and pursue their development objectives. This requires SDRs allocations that are more regular, predictable, and needs-based, as well as reforms that enhance the usability of SDRs, and increase their liquidity in a manner akin to other types of reserves.

ADDITIONAL RESOURCES

Bretton Woods Project, *Reconceptualising Special Drawing Rights as a tool for development finance* (2023).

Eurodad, *Special Drawing Rights: Can the IMF's reserve currency become a transformative financial resource?* (2022).

Christian Aid, *What next for Special Drawing Rights?* (2023).

Additional materials on SDRs and overview of supporters for a new allocation can be found on the Global Crisis Relief page.

25. Per Barbados lead negotiator Avinash Persaud's intervention at the 5th meeting of the Transitional Committee on Loss and Damage on 4 November 2023.
26. According to a 2023 analysis from the Center for Global Development.
27. See Bretton Woods Project's analysis of the *V20 Annual Meetings Communique* (2023).