The IMF and Special Drawing Rights: An opportunity for the UK to drive the global Covid-19 recovery

TOP LINES

● The UK has an enormous opportunity to support developing countries as they recover from the Covid-19 pandemic, through supporting an International Monetary Fund (IMF) Special Drawing Rights (SDR) issuance. This would allow struggling countries to access more funds, without increasing the UK aid budget.

● Developing countries are facing a much deeper and longer economic crisis than advanced economies. The IMF has assessed that developing countries need to spend an additional $500 billion by 2025 to respond to the pandemic and keep their economies growing at least at the same speed as the advanced economies.

● Analysis from Oxfam shows that existing IMF Covid-19 funding to developing countries has come with pressure on poorer countries to adopt tough austerity measures. Meanwhile, advanced economies have been able to borrow huge amounts cheaply to fund their economic recoveries.

● SDRs are an international reserve asset created by the IMF in the 1960s in the context of concerns over shortages of gold and US dollars. SDRs can be freely converted into major currencies and their value is based on a basket of major currencies, the current value of one SDR is £1.04.

● With the new Biden administration in place, there is an opportunity for the IMF to issue SDRs to the value of $650 billion, which would give countries a significant boost in spending power.

● However, SDRs need to be channelled from developed to developing countries. IMF rules mean that $440 billion of SDRs would go to advanced economies, and just $21 billion to developing countries.

● As President of the G7 and an influential member of the IMF, the UK must push forward ambitious proposals to increase the developing country share. Labour should call on the Government to do this. Otherwise, these reserves will sit unused on the balance sheets of advanced economies.

● Labour has a strong record on international development and has criticised the Government’s decision to cut Official Development Assistance (ODA) and dissolve the Department for International Development (DfID). SDRs present an opportunity to support developing countries without revisiting debates around aid cuts.

BACKGROUND

The Covid-19 crisis has had a significant impact on global poverty and inequality. Advanced economies, including the UK, have been able to spend generously to support vulnerable
groups and businesses, which has to some extent mitigated the worst economic effects of the pandemic.

Meanwhile developing countries, with far greater budgetary constraints and greater reliance on the informal economy, have had no such recourse. As a result, they face a much deeper economic crisis and much longer economic recovery, exacerbated by limited access to vaccines. It is estimated that nearly 100 million people entered extreme poverty in 2020, and between 2020-22, it is expected that developing countries’ lost income per capita will be -20%, compared to -11% for rich countries.¹

The impacts will continue to be felt far into the future. While students in advanced economies missed an average of 15 days of schooling in 2020; those in low-income developing countries missed 69 days. The gap between the global rich and poor is set to increase. Unless urgent action is taken, this gap could cause long-term instability and human suffering.

THE ROLE OF THE IMF IN THE COVID-19 RECOVERY

The International Monetary Fund (IMF) was established in the aftermath of the Second World War to promote global economic stability. Almost all countries in the world are members of the IMF and make financial contributions.

The IMF's principle tool is providing loans to member countries that are in financial need. This has made it an enormously influential actor in the global economy, especially over the last 40 years.

However, the IMF has also been extremely controversial. Its loans are often tied to stringent conditions which have pushed developing countries to adopt large-scale privatisation, dismantle trade policies, and cut social spending along with wider austerity. This has often had devastating effects on populations.² Although almost every country in the world is a member, the IMF is governed by the principle of "one dollar, one vote" and so it is de facto controlled by wealthier countries including the US, the UK, Japan, France and Canada.

In response to the pandemic, the IMF has increased its emergency finance, offered grants and supported efforts to pause debt repayments for countries. These are all positive developments,³ but even in the context of the pandemic, the IMF again appears to be encouraging large-scale austerity. In October 2020, Oxfam found that a large majority of IMF loans during the crisis "encourage, and in some cases require, poor countries hard hit by the economic fallout from the pandemic to adopt more tough austerity measures."⁴

Meanwhile, advanced economies have launched unprecedented stimulus packages and the IMF itself has said that responding to the pandemic and avoiding economic divergence will require low-income countries spending $450-570 billion by 2025.⁵ If countries follow this course of low spending, the most likely ramification will be a protracted recovery from the pandemic and a lost decade for the world's poorest.

¹ International Monetary Fund, World Economic Outlook: Managing Divergent Recoveries, April 2021 ² Global Development Policy Center, IMF Austerity is Alive and Increasing Poverty and Inequality | Global Development Policy Center, April 2021 ³ International Monetary Fund, Questions and Answers: The IMF's response to COVID-19, April 2021 ⁴ Oxfam International, IMF paves way for new era of austerity post-COVID-19, October 2020 ⁵ International Monetary Fund, Macroeconomic Developments and Prospects In Low-Income Countries—2021, March 2021
**SPECIAL DRAWING RIGHTS: A UNIQUE OPPORTUNITY**

In response to the dire Covid-induced financial situation faced by developing countries in early 2020, there were strong calls for the IMF to promote additional purchasing power for national governments. As argued by the Financial Times, the best tool available to the IMF was the issuance of Special Drawing Rights (SDRs).  

SDRs are an international reserve asset created by the IMF in the 1960s in the context of concerns over shortages of gold and US dollars. Their value is based on a basket of major currencies, the current value of one SDR is £1.04. The IMF initially allocated a set amount of SDRs to all of its members based on the size of their economies (i.e. the US received the largest amount, Australia received a lot less, and Chile less still). SDRs themselves are not a currency, but they can be exchanged for any of the currencies within the currency basket (dollars, pounds, euros, yen, renminbi). That means that if Namibia, for example, ran short of dollars to import medical equipment, it could convert its SDRs to dollars and resolve the problem.

New SDRs have previously been allocated in moments of need. The most recent was during the 2009 global financial crisis, when SDR183 billion ($250 billion) was issued to boost countries’ reserves. However, over the last year a new SDR allocation was blocked by the Trump administration, which held a de facto veto within the IMF on the issue.

With a new US administration in place, the door has now opened to a new SDR issuance. In April 2021, the G20 confirmed that it would call on the IMF to issue an allocation equivalent to $650 billion, likely to take place around August of this year. The UK’s Chancellor Rishi Sunak, when confirming the G7’s support for an SDR issuance, said that the agreement “paves the way for crucial and concerted action to support the world’s low-income countries, ensuring that no country is left behind in the global economic recovery from coronavirus”.

**THE ROLE OF THE UK IN MAKING THE SDR ALLOCATION COUNT**

A forthcoming SDR allocation is undoubtedly a positive step which will make a huge difference for developing countries. A major issue that remains, however, is how advanced economies’ SDR allocations can be used to support developing countries.

As the above quote from the Chancellor indicates, the SDR allocation is a measure to support developing countries. However, because SDRs are allocated based on economic size (US getting the most, Australia less, etc.), the SDRs will initially largely go to advanced economies. Of the $650 billion-worth allocation of SDRs, $440 billion will go to high income countries. The UK alone will receive $28 billion. In comparison, low-income countries will collectively receive just $21 billion. This is a significant sum, but it pales in comparison to the estimated financing needs of these countries (around $500 billion, cited above).

In response to this, the world’s leading economies have discussed ways to “recycle” their SDR allocations to support developing countries, and called on the IMF to explore options. These

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6 Financial Times, [New issuance of SDRs is vital to help poorer countries](https://www.ft.com/content/47d3e04d-d3d1-451e-9c39-213e7b8f6c90), 12 April 2020

7 Financial Times, [US holds off on IMF plan to boost emerging economies’ finances](https://www.ft.com/content/2f48f04f-0e57-45f8-a055-10f271f61dbf), 15 April 2020

8 HM Treasury, [Chancellor and G7 Finance Ministers agree milestone support for vulnerable countries](https://www.gov.uk/government/news/chancellor-and-g7-finance-ministers-agree-milestone-support-for-vulnerable-countries), 19 March 2021

9 G20, [Finance Communiqué](https://www.g20.org/communique-2021), April 2021
conversations are still in early stages, but it is likely that the G7/20 and IMF will finalise plans over the next few months.

The UK has a crucial role to play in these conversations and should show leadership in pushing for a significant re-channelling of developed nations’ SDRs to those in need. If this re-channelling is done in an ill-conceived manner, it could perpetuate, rather than address, the economic problems facing developing countries.

There are a number of issues around re-channelling SDRs. Principally, it is clear that the preferred option for most advanced economies is the easy option – namely, the lending of the SDRs to the IMF (specifically to its fund called the PRGT), which will in turn lend to developing countries.\(^{10}\) This is a suboptimal option because (a) the amount of funding the IMF needs to boost its lending is only around US$45 billion – a small chunk of the developed countries’ SDRs, and (b) in this format countries would only receive SDRs as loans, meaning countries are likely to be pushed towards austerity and increase their national debt, at a time when government debts are already soaring (they rose by a record $24 trillion in 2020).

The UK should use its current G7 presidency to devise a multilateral system, such as a fund, into which developed countries can channel their additional SDRs. That fund could then provide quick grants to countries in need. The UK should channel its SDRs – or an equivalent sum in other reserves – to such a fund in large sums to signal to the other advanced economies the level of adequate response.\(^{11}\)

The UK should also direct funds towards initiatives such as Covax to speed up vaccine provision.\(^{12}\) Importantly, such channelling of SDRs must not count towards the UK’s already reduced ODA budget – this is additional financing that has been bequeathed to the UK by the IMF, and should not be seen as a budgetary expense.\(^{13}\)

The importance of this opportunity to avoid a lost decade for developing countries cannot be overstated. Nor can the ease with which this chance could be passed up owing to the ambivalence of the developed countries’ governments, including the UK’s. Large proportions of the UK’s SDR issuance – and those of the advanced economies more broadly – need to be channelled to developing countries such that they can ramp up vaccinations and other medical purchases, provide support to their most vulnerable, and to stimulate an economic recovery. Doing so would cost the UK nothing. Failure to act would be a moral failure.

**RECOMMENDATIONS**

1. Labour should push the UK Government to channel as large a share of the UK’s SDR issuance as possible to developing countries. IMF rules require the UK to hold on to a certain portion of its SDRs, but channelling $10 billion worth, a third of the UK’s allocation, would be permissible.

2. Labour should call on the Government to disclose their plans for the re-channelling of the UK’s SDR allocation to developing countries and to develop an approach to most benefit

\(^{10}\) International Monetary Fund, *IMF Support for Low-Income Countries*, February 2021

\(^{11}\) There are complexities in the process of donating SDRs, owing to the rules around interest payments. But as has been shown in the case of the UK, there are ways workable approaches to overcome these hurdles. See: Center For Global Development, *Can Special Drawing Rights Be Recycled to Where They Are Needed at No Budgetary Cost?*, 21 April 2021

\(^{12}\) See Gavi, *Covax Facility*

\(^{13}\) See the New Diplomacy Project on ODA: Dismantling DFID and cutting aid: What will the Conservatives do next on development policy?, 14 February 2021
those in need. Labour should argue that lending SDRs to the IMF to lend-on to developing countries is not a suitable option. It must stress that the UK, holding the Presidency of the G7, has enormous responsibility on this issue.

3. Labour should ensure that any SDRs (or equivalent funds in other reserve currencies) that are channelled to developing countries are exempt from the UK’s ODA spending. SDR re-channelling does not cost the UK anything and as such cannot be considered as a budgetary expense.

4. Labour must probe the Conservatives as to why the IMF – of which the UK is one of the most powerful members – is encouraging developing countries to undertake austerity at a time when countries need to be ramping up public spending to overcome the pandemic.

The author

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This piece is written in a personal capacity and does not necessarily reflect the views of the Bretton Woods Project.

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Further Reading

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Financial Times, *The SDR is an idea whose time has come*, 19 April 2020


HM Treasury, *Chancellor and G7 Finance Ministers agree milestone support for vulnerable countries*, 19 March 2021

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Center for Global Development, *How an Allocation of IMF SDRs To Africa Could Be Supported by A Multilateral Reallocation Initiative*, 23 February 2021

Center for Global Development, *How Might an SDR Allocation Be Better Tailored to Support Low-Income Countries?*, 4 February 2021

Center for Global Development, *What is the Best Way to Allocate New SDRs?*, 4 February 2021