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THE REALLOCATION OF SPECIAL DRAWING RIGHTS TO THE BENEFIT OF THE AFRICAN CONTINENT: A PROPOSAL FOR EURO AREA COUNTRIES

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ABSTRACT

The paper describes the main features of the Special Drawing Rights (SDRs), the international reserve asset issued by the International Monetary Fund (IMF). After the historic allocation of SDRs equivalent to US $650 billion in August 2021, it has been argued that the wealthiest economies should 'redirect' (or 're-channel') at least some of their new SDRs to the benefit of the most vulnerable countries. The paper discusses how to overcome current legal challenges to facilitate the reallocation of the SDRs held by Euro area countries to an ambitious Next Generation Africa plan.

Keywords: Special Drawing Rights, International Monetary Fund, Africa, Europe

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1. Introduction

On 2nd August 2021, the IMF Board of Governors approved a historic allocation of Special Drawing Rights (SDRs) equivalent to US$650 billion.

SDRs are an international reserve asset that can be issued by the IMF whenever a long-term global need so requires, and which is supported by the obligations of members under the Articles of Agreement.[1]

The decision to create SDRs is taken by the IMF Board of Governors with a qualified majority of 85% of the total voting power. SDRs are then allocated to members participating in the SDR Department (currently all 190 IMF members) in proportion to their quotas.[2]

Once they receive their allocation, IMF member States can either 1) hold SDRs to strengthen their international reserves and improve market access or 2) exchange them for 'freely usable currencies'[3] to diversify the composition of their international reserves, ease liquidity constraints and create room for additional spending.[4]

Furthermore, SDRs can be used in a number of authorised transactions between IMF members (e.g. to extend bilateral loans and to settle financial obligations) or to pay off obligations owed to the Fund (such as repaying loans and paying for an increase in quotas). Further uses can be authorised by the Executive Board with a qualified majority of 70% (Art. XIX, Section 2, let. c).[5]

In particular, IMF members do not have to meet any requirements to initially receive their share of a general SDR allocation from the Fund; they can trade SDRs on the voluntary market (on which see below) even in the absence of a balance of payments need and without entering into an IMF macroeconomic adjustment programme; moreover, they are decoupled from any kind of conditionality or repayment obligation. In fact, SDRs do not have to be repaid, do not have a maturity date, and do not have a scheduled amortisation plan.

SDR allocations thus provide each member with a supplementary, unconditional and almost costless reserve asset.

The IMF Executive Board can also grant the power to hold SDRs to 'prescribed holders', that is international organisations (e.g. multilateral development banks) or supranational institutions that

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[1] Pursuant to Art. XVIII, Section 1 of the IMF Articles, the issuance 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 in the world».
[2] See IMF Art. XV, Section 1 and Art. XVIII.
[3] The IMF Executive Board finally determined that the US dollar, the euro, the renminbi, the yen and the pound sterling (the currencies included in the SDR basket) are 'freely usable currencies'.
[4] The value of the SDR is calculated by the IMF on the basis of a weighted basket of currencies. Currently, the currencies in the SDR basket are the US dollar (with a weight of 41.73%), the euro (30.93%), the Chinese renminbi (10.92%), the Japanese yen (8.33%) and the British pound sterling (8.09%).
[5] On the additional uses of SDRs, see IMF, *Selected Decisions and Selected Documents of the IMF*, 2020, in particular those based on Art. XIX, Section 2 (https://www.imf.org/en/Publications/Selected-Decisions/selected-decisions-list).

perform central bank functions on behalf of more than one member of the IMF (e.g. the European Central Bank – ECB).[6]

Designated 'prescribed holders' may acquire and receive SDRs (e.g. as loan repayments),[7] but they are not entitled to receive direct allocations from the Fund.

Needless to say, SDRs are not a form of currency as they cannot be used as a means of payments by private entities or individuals.

IMF members can convert SDRs into hard currency in two different ways: a) on the so-called 'voluntary market' or b) through the 'designation mechanism'.

Nowadays, exchanges of SDRs are organised either directly between members and/or prescribed holders or facilitated by the Fund through Voluntary Trading Agreements (VTAs). At present, 33 countries and only one prescribed holder – the ECB – have a VTA in place.

Countries that cannot find a counterparty on the voluntary market can rely on the designation mechanism by which the Fund will designate the member with a strong external position which will be obliged to provide freely usable currencies to the requesting country.

2. Rechanneling SDRs to the benefit of vulnerable countries

In October 2021, the G20 countries declared their readiness to contribute the equivalent of $45 billion of their newly allocated SDRs to help vulnerable countries.[8] This is seen as a key step towards a total global ambition to rechannel $100 billion to the countries which are most in need.

This ambitious goal can be achieved by industrialised countries in different ways.

Most of the proposals concern the rechanneling of SDRs back to the IMF, either into the existing Poverty Reduction and Growth Trust (PRGT) or into the future Resilience and Sustainability Trust (RST) proposed by the IMF Managing Director, Kristalina Georgieva.[9]

The PRGT is the key financial tool through which the IMF provides interest-free concessional lending to low-income countries. The commitment to increase the PRGT's lending capacity using SDRs, however, has received a lukewarm response from developing countries. Concerns revolve around the fact that PRGT facilities are open only to low-income countries and that they involve standard (neoliberal) conditionality.

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[6] Currently there are 15 prescribed holders: four supranational central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary organizations (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and eight intergovernmental development organisations (African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development and the International Development Association, Islamic Development Bank, Nordic Investment Bank, and International Fund for Agricultural Development).

[7] See IMF, *Executive Board Decision n. 6467-(80/71)S*, 14 April 1980. This decision was adopted to give borrowing countries the possibility to use SDRs instead of hard currencies to reimburse MDBs loans, and therefore at their convenience.

[8] See *G20 Rome Leaders' Declaration*, Rome, 31 October 2021, par. 10. For instance, the Italian government committed to contribute to the PRGT with 20% of its SDR allocation, equivalent to 4 billion USD. See Italian Ministry of Finance, Press release n. 200 of 31 October 2021, https://www.mef.gov.it/en/ufficio-stampa/comunicati/2021/G20-to-channel-45-billion-US-dollars-to-help-vulnerable-countries-aiming-for-100-billion-globally-00001/

[9] K. Georgieva, *Remarks by IMF Managing Director on Global Policies and Climate Change*, Venice, 11 July 2021, https://www.imf.org/en/News/Articles/2021/07/11/sp071121-md-on-global-policies-and-climate-change

The RST, on the other hand, has yet to be finalised and, although it is designed to provide long-term concessional lending to vulnerable middle-income countries and small developing states as well, it is expected to complement regular IMF-supported programmes, thus creating additional old school conditionality.

Other proposals concern the rechanneling of SDRs towards multilateral development banks (MDBs) which are already SDR prescribed holders.[10] Reference is made to the African Development Bank (AfDB), the African Development Fund (ADF) and the Asian Development Bank (ADB). In fact, these three organisations can rely on contributions from their wealthiest regional and non-regional members. In fact, together with countries in the region, their membership includes most of the G20 countries and about half of the members of the euro area.

Last but not least, reference should be made to a number of proposals relating to the creation of SDR-backed mechanisms designed to accelerate the delivery of vaccines, to support investment in vaccine production and to strengthen preparedness for future epidemics.[11]

3. The key role of euro area countries: looking beyond legal constraints

Euro area countries are expected to redirect at least half of their current cumulative holdings of SDRs (equivalent to €173 billion, as of August 2021) to the benefit of vulnerable countries. However, they face additional legal challenges.

Indeed, in the euro area it is the Eurosystem (the European Central Bank and national central banks) that holds and manages the reserves of the Member States.[12] Consequently, national central banks (NCBs) hold and manage the SDRs of their respective Member States. The mobilisation of these SDRs requires compliance with the monetary financing prohibition (Art. 123 of the TFEU).

This provision prohibits NCBs from granting overdraft facilities, or any other type of credit facility, to public authorities and bodies of the Member States. This prohibition however is subject to the exemptions set forth by Council Regulation (EC) no. 3603/939, including that relating to the financing by NCBs of «obligations falling upon the public sector *vis-à-vis* the IMF».[13]

[10] See, for instance, D. Andrews, *Reallocating SDRs to Multilateral Development Banks or other Prescribed Holders of SDRs*, CGDEV Policy Paper, 12 October 2021, available at https://www.cgdev.org/publication/reallocating-sdrs-multilateral-development-banks-or-other-prescribed-holders-sdrs

[11] J. Hicklin and H. Brown, *Vaccine Financing: How a Redesigned IMF Instrument Can Provide a Shot in the Arm for the Global Pandemic Response*, CGD Notes, 5 April 2021, available at https://www.cgdev.org/publication/vaccine-financing-how-redesigned-imf-instrument-can-provide-shot-arm-global-pandemic

[12] See Art. 127(2) of the TFEU.

[13] See recital fourteenth and Art. 7 of the Council Regulation (EC) n. 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty (OJ L 332, 31.12.1993, p. 1).

SDR loans provided by euro area countries to the IMF's PRGT clearly fall under this exemption.[14] The key fact is that these loans result in a series of SDR-denominated claims that the NCBs have against the IMF and that SDRs retain all the characteristics of reserve assets. [15]

Due to these legal constraints, euro area countries willing to lend the SDRs held by their respective central banks to international organisations other than the IMF will first have to verify the compliance of this kind of operation with the monetary financing prohibition.[16] To this end, the SDRs, once transferred as loans or donations to an MDB, will have to maintain their nature as reserve assets.

Furthermore, it will also be necessary to revise the Council Regulation (EC) no. 3603/93 to include among the exemptions from the monetary financing prohibition 'financing by NCBs of obligations falling upon the public sector *vis-à-vis* MDBs'.

The legal constraints described above can be overcome. For example, in order to channel the 'European SDRs' to the European Bank for Reconstruction and Development (EBRD) with a view to promoting green and sustainable investments in Africa while strengthening the African regional integration process through a Next Generation Africa plan,[17] the following steps will be required.

First, the IMF should designate the EBRD as a prescribed holder of SDRs. Pursuant to IMF Art. XVII, Section 3, this decision requires an 85% majority of the total voting power.

Second, the Agreement Establishing the EBRD should be amended to allow for the payment of subscriptions in SDRs (Art. 6.3 of the EBRD Statute) as well as to authorise the Bank to administer special SDR funds (Art. 18 and 19 EBRD). This can also be an opportunity to change the EBRD unit of account from the ECU to the SDR (Art. 4 and Art. 35.1 EBRD). Pursuant to Art. 56 EBRD, amendments must be approved by no less than three-fourths of the members (including at least two countries from Central and Eastern Europe), having no less than four-fifths of the total voting power of the members.

Third, Council Regulation (EC) no. 3603/93 will have to be revised to include among the exemptions from the monetary financing prohibition also 'financing by NCBs of obligations falling upon the public sector *vis-à-vis* [the EBRD]'.

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[14] For instance, Italy's contribution to the PRGT is regulated by Article 16(6-sexies) of the Decree Law of 30 December 2016 n. 244, converted by the Law of 27 February 2017 n. 19. Banca d'Italia is authorised to enter into a loan agreement with the Fund to increase the PRGT lending capacity for a maximum amount of SDRs (which is likely to increase after the 2021 allocation). In parallel, the State provides a guarantee to Banca d'Italia on the reimbursement of principal and interest due on PRGT loans to cover risk.

[15] See Opinion of the European Central Bank of 28 December 2020 on NCB participation in International Monetary Fund borrowing arrangements (CON/2020/37).

[16] The same applies to SDR donations. In 2010, the Central Bank of Austria donated part of its SDRs to the PRGT subsidy account. Even if in principle this kind of contribution should be considered development aid, the ECB assessed its compliance with the monetary financing prohibition. See Opinion of the European Central Bank of 12 March 2010 on Austria's contribution to the Poverty Reduction and Growth Trust of the IMF (CON/2010/22).

[17] See F. MASINI, *Time for a Next Generation Africa*, Centro Studi sul Federalismo, Research Paper, November 2021.

4. The way forward

Already in May 2021, at the Paris Summit on Financing African Economies, the French President Emanuel Macron called for the reallocation of SDRs to African countries.[18]

Shortly after, at the end of the same month, more than 30 African and European leaders called for a *New Deal for Africa* to mobilise innovative financial instruments to increase funding for vaccine production and increase investment in health, education and the fight against climate change.[19]

The upcoming Summit on Financing African Economies between the EU and the African Union (AU), to be held in Brussels on 17 and 18 February 2022, will offer an opportunity to discuss how to achieve these goals while strengthening the African regional integration process.

The time is ripe to discuss how to concretely redirect SDRs to Africa and implement the *New Deal for Africa.* A decision will have to be made whether to use SDRs to directly boost the resources of the African Development Bank and/or of the African Development Fund or, alternatively, those of the European Investment Bank and/or the European Bank for Reconstruction and Development.

Both are viable solutions to amplify the impact of SDRs and support the recovery and progress of the African continent towards achieving the 2030 Sustainable Development Goals.

The legal challenges outlined above may seem daunting, but they can be overcome if there is sufficient political will.

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[18] See https://www.elysee.fr/front/pdf/elysee-module-17726-fr.pdf

[19] See European Council, *Press release: A New Deal for Africa*, 31 May 2021, available at https://www.consilium.europa.eu/en/press/press-releases/2021/05/31/a-new-deal-for-africa-op-ed-article-by-president-charles-michel-and-more-than-30-european-and-african-leaders/