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FROM RESERVE ASSET TO FISCAL CAPACITY: RETHINKING SDRS IN GLOBAL ECONOMIC GOVERNANCE

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Abstract

Global economic shocks increasingly transcend national borders, while fiscal responses remain largely confined within the nation state. Special Drawing Rights (SDRs), formally classified as a reserve asset, display several characteristics typically associated with fiscal instruments, including central issuance and collective decision-making. Their limited impact to date reflects political and institutional constraints rather than technical limitations. Drawing on insights from fiscal federalism, the analysis outlines incremental reforms through which SDRs could support global stabilisation, redistribution, and the financing of global public goods without the creation of new international institutions.

Executive Summary

The succession of global crises over the past fifteen years — the global financial crisis, the COVID-19 pandemic, the climate emergency, and the renewed wave of sovereign debt distress — has exposed a structural weakness in global economic governance: the absence of a genuine supranational fiscal capacity. While economic shocks increasingly transcend national borders, fiscal responses remain largely confined within the nation-state, leading to delayed, fragmented, and often insufficient collective action.

Special Drawing Rights (SDRs), created by the International Monetary Fund (IMF), represent a unique and underutilised instrument within this landscape. Although formally classified as a reserve asset, SDRs possess several characteristics that align them more closely with a fiscal instrument than is commonly acknowledged. They are issued centrally by a multilateral institution, created ex nihilo and distributed according to collectively agreed rules. The unprecedented SDR allocation of USD 650 billion in 2021 demonstrated both the stabilising potential of this instrument and the limitations of its current design.

This paper argues that Special Drawing Rights should be reconceptualised as an embryonic form of supranational fiscal capacity. Their limited impact to date reflects political and institutional choices, not technical constraints.

By introducing regular and counter-cyclical allocations, purpose-driven issuance, and institutionalised rechanneling, SDRs could evolve from a passive reserve asset into a scalable fiscal tool for global stabilisation, redistribution, and investment — without the creation of new institutions.

The Global Fiscal Gap

Globalisation has profoundly altered the scale and nature of economic interdependence, while fiscal governance has remained overwhelmingly national. This mismatch has become increasingly evident as global public goods — financial stability, climate mitigation, pandemic preparedness — require large-scale and timely fiscal responses that no single state can deliver alone.

Empirical evidence highlights the magnitude of this gap. According to IMF estimates, low- and middle-income countries face annual financing needs of over USD 2.5 trillion (IMF, 2022; World Bank, 2023) to meet development and climate objectives, while official development assistance and concessional finance remain far below this threshold.

At the same time, the World Bank reports that more than half of low-income countries are currently at high risk of, or already experiencing, debt distress (World Bank, 2023; IMF, 2023). These constraints significantly limit national fiscal space precisely where counter-cyclical spending is most needed.

Existing global mechanisms have proven inadequate. Emergency responses have relied on ad hoc instruments (G20, 2022), voluntary pledges, and complex negotiations among creditors, resulting in delayed and uneven outcomes. The Common Framework for Debt Treatments (Paris Club 2020), for instance, has struggled to deliver timely restructuring, reflecting coordination failures among sovereign, multilateral, and private actors. Similarly, climate finance commitments remain fragmented and largely dependent on discretionary national contributions.

In contrast, federal systems offer a useful benchmark. In federal polities, central fiscal capacities perform three core functions: macroeconomic stabilisation, redistribution across regions, and the provision of common public goods. At the global level, no equivalent mechanism exists. The result is a structural under-provision of collective fiscal responses, compounded by the growing scale of transnational shocks (Ghymers & Snoy, 2025).

It is within this context that SDRs acquire renewed relevance. Rather than being viewed narrowly as a liquidity instrument for balance-of-payments support, SDRs should be assessed against the broader question of how global governance can develop instruments capable of performing fiscal functions beyond the nation state.

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What SDRs Are — and Why They Matter Fiscally

Special Drawing Rights were created in 1969 to supplement existing reserve assets in a system constrained by the availability of gold and US dollars. Formally, SDRs are neither a currency nor a claim on the IMF itself, but a potential claim on the freely usable currencies of IMF members. Their value is based on a basket of major international currencies, and their allocation is decided collectively by IMF members.

Despite their technical classification as a reserve asset, SDRs exhibit several features that distinguish them from traditional reserves (Ghymers & Snoy, 2025). First, they are created through a collective political decision, not accumulated through trade surpluses or capital flows. Second, they are issued centrally by a supranational institution. Third, their creation does not require prior taxation or borrowing, but instead relies on the credibility of the institutional framework underpinning them (IMF, 2021; IMF, 2022).

From a fiscal perspective, these characteristics are significant. In economic terms, SDR allocations resemble a form of collective monetary-financed fiscal transfer, albeit one that is indirect and uneven (BIS, 2022; Gallagher et al., 2023). When SDRs are allocated, member states receive additional fiscal space: they can hold them as reserves, exchange them for hard currency, or use them to reduce borrowing needs. During the COVID-19 crisis, empirical studies showed that SDRs helped stabilise reserves, lower sovereign spreads, and support public spending in vulnerable economies, even when they were not actively exchanged (Georgieva, 2021; IMF, 2022; Arslanalp et al., 2022).
However, the fiscal potential of SDRs is constrained by their distribution mechanism. Allocations are based on IMF quotas, which reflect countries' relative economic size rather than their financing needs. As a result, the majority of newly issued SDRs accrue to advanced economies, which often have limited use for additional reserves.

This has generated widespread calls for the rechanneling of SDRs from high-income to low-income countries, through mechanisms such as the Poverty Reduction and Growth Trust and the Resilience and Sustainability Trust.

Crucially, these debates implicitly acknowledge the fiscal nature of SDRs, even as official discourse continues to frame them as a purely monetary instrument (Ghymers & Snoy, 2025). The tension between their formal classification and their de facto effects lies at the heart of the current policy impasse. Treating SDRs strictly as reserves has limited their deployment, while recognising their fiscal dimension opens the door to a more systematic and purpose-driven use.

Special Drawing Rights as a Proto-Fiscal Capacity

Fiscal Capacity Beyond the Nation State: A Federal Benchmark

In federal systems, fiscal capacity performs functions that are structurally distinct from monetary policy. While monetary authority ensures price stability and liquidity, fiscal authority enables macroeconomic stabilisation, redistribution, and the provision of collective goods. Crucially, these functions are exercised at the level where economic externalities materialise.

The literature on fiscal federalism emphasises that stabilisation is most effective when conducted at the central level, particularly in the presence of asymmetric shocks and constrained subnational budgets (Oates, 1972; Musgrave, 1959). Empirical evidence from federations such as the United States shows that between 20% and 30% of regional income shocks are absorbed through federal fiscal transfers and automatic stabilisers, significantly reducing the amplitude and persistence of crises (Hanif et al.,2020).

At the supranational level, however, this logic breaks down. Global economic shocks — pandemics, financial crises, climate-related disasters — generate negative spillovers across borders, yet fiscal responses remain nationally bounded. Countries with limited fiscal space are forced into pro-cyclical adjustment, while surplus countries face weak incentives to act collectively. The result is an under-provision of stabilisation and investment at the global level (Rodden, 2006; Bordo, Markiewicz & Jonung, 2011).

This structural asymmetry mirrors what the European Union experienced before the creation of instruments such as Next Generation EU. The EU's response to the COVID-19 crisis illustrated how the absence of a central fiscal capacity can amplify divergence, while its partial introduction can mitigate it (European Commission, 2021; Fabbrini, 2022). At the global level, no comparable mechanism exists. SDRs therefore deserve to be assessed not as an anomaly within monetary governance, but as a potential — albeit incomplete — response to this fiscal vacuum.

SDRs as an Embryonic Supranational Fiscal Instrument

When examined through a fiscal lens, SDRs display several core attributes of a supranational fiscal instrument.

First, SDRs are issued centrally by a multilateral institution acting on behalf of its membership. Their creation does not depend on national contributions ex ante, but on a collective decision backed by the IMF's institutional credibility. This distinguishes SDRs from trust-based financing mechanisms, which rely on voluntary donor pledges and are inherently limited in scale and predictability (Ghymers & Snoy, 2025).

Second, SDR allocations generate immediate fiscal effects. For recipient countries, SDRs expand balance sheet capacity, reduce external financing needs, and can substitute for costly market borrowing. Studies following the 2021 allocation show that countries with weaker reserve positions and higher debt vulnerabilities experienced measurable improvements in liquidity indicators and market confidence (IMF, 2022; Eichenbaum et al., 2022). In this sense, SDRs function analogously to a fiscal transfer financed at the supranational level.

Third, SDRs are inherently non-national. Unlike bilateral aid or loans, they are not linked to specific donor-recipient relationships, conditionalities, or geopolitical alignments (Tooze, 2021; Bénassy-Quéré et al., 2023). This feature enhances their legitimacy and reduces the transaction costs associated with traditional forms of international assistance.

These characteristics place SDRs in a category that can be described as proto-fiscal (Latin American Network, 2021): they do not constitute a full-fledged fiscal authority, but they perform some of its functions in a limited and indirect manner. Their impact, however, remains constrained by design choices that prioritise their role as a reserve asset over their potential fiscal use.

The Limits of SDRs: What Is Missing from a Fiscal Perspective

Despite their proto-fiscal nature, SDRs fall short of functioning as an effective supranational fiscal capacity. Three structural limitations stand out.

First, the absence of purpose.

Unlike fiscal instruments in federal systems, SDRs are not issued with an explicit stabilisation or investment mandate. Allocations are justified in terms of global liquidity needs, rather than macroeconomic conditions or collective priorities. As a result, SDRs lack automaticity and are activated only during exceptional circumstances, following complex political negotiations.

Second, the misalignment between allocation and need.

SDRs are distributed according to IMF quotas, reflecting economic size rather than vulnerability or financing gaps. The 2021 allocation illustrates this clearly: more than two-thirds of newly issued SDRs accrued to advanced economies, while low-income countries received a marginal share relative to their needs (IMF, 2021; Ocampo, 2023; Ocampo 2021).

This design severely limits the redistributive function that a fiscal instrument would normally perform.

Third, the voluntary nature of redistribution.

Efforts to correct allocation asymmetries rely on voluntary rechanneling from high-income to low-income countries (Gallagher & Ocampo, 2021). While mechanisms such as the Poverty Reduction and Growth Trust and the Resilience and Sustainability Trust represent important innovations, their scale remains modest relative to global needs. Moreover, their reliance on voluntary contributions undermines predictability and long-term planning.
From a constitutional perspective, these limitations are not accidental. They reflect a deliberate choice to frame SDRs as a technical monetary tool rather than as an element of fiscal governance. This framing has constrained their evolution and insulated them from broader debates on global public finance (Wilkie 2011).

Constitutional Constraint, Not a Technical One

The persistent underutilisation of SDRs cannot be fully explained by technical or financial considerations. Accounting treatments, reserve asset classifications, and concerns over balance sheet integrity are frequently cited as obstacles. Yet these issues are secondary to a more fundamental constraint: the absence of political consensus on the legitimacy of supranational fiscal authority (Eichengreen, 2019; Fabbrini & Puetter, 2016).

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In this sense, SDRs occupy a constitutional grey area (Majone, 2005). They embody a limited pooling of sovereignty, sufficient to allow collective issuance, but insufficient to permit purposeful fiscal deployment. This tension mirrors earlier stages of integration in federal and quasi-federal systems, where monetary coordination preceded fiscal integration, often resulting in systemic fragility.

Recognising SDRs as a proto-fiscal instrument does not imply transforming the IMF into a global treasury. Rather, it invites a reframing of existing tools in light of the scale and nature of contemporary challenges. By situating SDRs within a broader debate on supranational fiscal governance, policymakers can move beyond ad hoc solutions and begin to address the structural deficit at the heart of global economic governance.

Critics often frame expanded use of SDRs as a threat to monetary stability or as a source of moral hazard. However, empirical evidence from past allocations shows no measurable inflationary impact at the global level, while the absence of conditionality reflects their role as a stabilisation instrument rather than a substitute for structural reform.

The core constraint remains political legitimacy, not macroeconomic feasibility.

Policy Proposals: Turning SDRs into a Supranational Fiscal Instrument

Among the reforms discussed in this section, establishing regular and counter-cyclical SDR allocations would be the single most consequential step toward creating a functional supranational fiscal capacity.

Reconceptualising SDRs as a proto-fiscal capacity requires neither a radical overhaul of the international monetary system nor the creation of new global institutions. Rather, it calls for a set of incremental but coherent reforms that align the use of SDRs with their latent fiscal potential. This section outlines four mutually reinforcing policy proposals aimed at enhancing the stabilisation, redistributive, and investment functions of SDRs, while preserving their role within the existing IMF framework.

Establish Regular and Counter-Cyclical SDR Allocations

At present, SDR allocations are exceptional events, triggered by crises and subject to lengthy political negotiations. This discretionary approach significantly weakens their stabilisation potential. By contrast, fiscal instruments in federal systems operate through regular and predictable mechanisms, often embedded in automatic stabilisers.

A first reform would therefore consist of establishing regular SDR allocations, calibrated to global macroeconomic conditions (IMF, 2022; BIS, 2022).

Rather than replacing crisis-driven allocations, this mechanism would complement them by providing a baseline level of global liquidity and fiscal space. Allocations could be linked to indicators such as global output gaps, financial stress indices, or aggregate reserve adequacy in low- and middle-income countries.

The economic rationale for such an approach is well established. IMF research shows that countries with limited reserve buffers are more likely to adopt pro-cyclical fiscal policies during downturns, amplifying global recessions. Regular SDR allocations would help mitigate this dynamic by easing external constraints before crises fully materialise. Moreover, predictability would enhance planning capacity for recipient countries and reduce reliance on costly market financing

Importantly, this proposal does not imply a permanent expansion of SDR issuance. Allocations could be designed to be symmetric over the cycle, with issuance during downturns and reduced or paused allocations during periods of global expansion, thereby preserving long-term balance.

Without regularity and predictability, other reforms risk remaining ad hoc and politically fragile.

Introduce Purpose-Based SDR Issuance for Global Public Goods

A defining feature of fiscal capacity is the ability to finance collective priorities. In their current form, SDRs lack any explicit functional mandate: they are allocated to members without conditions or guidance regarding their use. While this neutrality has political advantages, it also limits their effectiveness in addressing systemic challenges.

A second reform would therefore involve purpose-based SDR issuance, whereby specific allocations are explicitly linked to the financing of global public goods (G20, 2021; World Bank, 2022). Climate mitigation and adaptation, pandemic preparedness, and large-scale development investment represent particularly compelling candidates, given their cross-border externalities and chronic underfunding.

This approach builds on existing practice rather than departing from it. The creation of the Resilience and Sustainability Trust already signals a shift towards longer-term, purpose-oriented use of SDRs. However, current mechanisms rely on voluntary rechanneling and remain modest in scale. Purpose-based issuance would move one step further by embedding collective objectives at the point of allocation.

From a governance perspective, this does not require earmarking SDRs at the national level, which would conflict with their reserve asset status. Instead, it implies that new allocations are accompanied by institutionalised pathways — via multilateral development banks or IMF-administered facilities — that translate SDR liquidity into investment financing aligned with agreed priorities.

Institutionalise SDR Rechanneling Mechanisms

The asymmetry between SDR allocation and global financing needs is widely recognised. Following the 2021 allocation, advanced economies received the majority of newly issued SDRs, despite facing limited liquidity constraints.

Efforts to address this imbalance have focused on voluntary rechanneling, with G20 countries committing to reallocating part of their SDRs to vulnerable economies.

While politically significant, this approach suffers from three weaknesses: limited scale, uncertainty, and fragmentation. As of today, only a fraction of pledged SDRs has been effectively rechanneled, and flows depend on domestic political and accounting considerations in contributing countries.

To address these limitations, SDR rechanneling should be institutionalised rather than voluntary. This could take several complementary forms:

- The establishment of standing rechanneling quotas for high-income countries;
- The use of SDRs as hybrid capital in multilateral development banks, leveraging their balance sheets;
- The creation of predictable allocation rules linking rechanneling volumes to income or reserve adequacy thresholds.

The literature on international public finance suggests that voluntary mechanisms consistently underperform in the provision of global public goods. Institutionalisation would enhance credibility, scale, and long-term impact, while preserving national ownership through collectively agreed rules.

Reframe the Accounting and Political Narrative of SDRs

Finally, any attempt to enhance the fiscal role of SDRs must confront a powerful but often implicit constraint: the way SDRs are conceptualised in political and accounting terms. The dominant narrative frames SDRs exclusively as a reserve asset, encouraging conservative balance sheet treatment and discouraging active use (Tooze, 2021; Fabbrini, 2022).

A fourth reform, therefore, concerns narrative and accounting reframing. Without altering their legal status, SDRs should be explicitly recognised as a hybrid instrument, combining monetary and fiscal characteristics. This would entail:
a) greater consistency in accounting treatment across jurisdictions;
b) clearer guidance on the macroeconomic use of SDRs;
c) explicit acknowledgement, in IMF and G20 communications, of their role in supporting fiscal space and investment.
Historical experience suggests that institutional evolution often follows narrative change. In the European context, the gradual acceptance of joint borrowing was preceded by a reframing of fiscal risk and solidarity. Similarly, recognising the fiscal dimension of SDRs would help normalise their use and reduce political resistance.

Incremental Reform, Systemic Impact

Taken together, these proposals do not transform SDRs into a full-fledged global treasury. Nor do they require treaty change or radical institutional redesign.

Instead, they leverage existing instruments to address a structural deficit in global governance: the absence of a supranational fiscal capacity commensurate with global challenges.
By enhancing regularity, purpose, redistribution, and legitimacy, SDRs could evolve from a passive reserve asset into an effective component of global fiscal governance. In doing so, they would not only improve crisis response, but also contribute to a more stable, equitable, and resilient international economic order.

Conclusion: SDRs and the Future of Supranational Fiscal Governance

The experience of recent global crises has made one reality unmistakably clear: economic interdependence has outpaced the institutions designed to govern it. While shocks have become increasingly global in nature, fiscal responses remain fragmented, discretionary, and nationally constrained. This structural mismatch represents one of the central weaknesses of contemporary global governance.
Special Drawing Rights occupy a unique position within this landscape. Conceived as a technical reserve asset, they have nonetheless demonstrated their capacity to perform core fiscal functions in moments of systemic stress. The 2021 allocation revealed both their stabilising potential and the limitations imposed by an institutional framework that treats them as an exceptional and politically sensitive instrument. These limitations are not rooted in technical infeasibility, but in an unresolved constitutional question: the reluctance to acknowledge and develop forms of supranational fiscal authority.

Reframing SDRs as an embryonic fiscal instrument does not imply the creation of a global treasury or the erosion of national sovereignty. Rather, it reflects a pragmatic recognition that global public goods require collective fiscal tools. Incremental reforms — regular and counter-cyclical allocations, purpose-driven use, institutionalised redistribution, and narrative reframing — can significantly enhance the effectiveness of an instrument that already exists and enjoys broad international legitimacy.

The choice facing global economic governance is no longer between maintaining the status quo and pursuing unrealistic institutional leaps. It is between continuing to rely on fragmented, voluntary, and reactive responses or strengthening existing supranational instruments capable of delivering timely and collective fiscal action. Special Drawing Rights already embody such an instrument. Whether they remain a marginal reserve asset or evolve into a meaningful component of global fiscal governance is ultimately a political decision — and one that will shape the resilience of the international system in the decades ahead.

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