The World Economy Needs a Stimulus

IMF Special Drawing Rights Are Critical to Containing the Pandemic and Boosting the World Economy

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Introduction

IMF Managing Director Kristalina Georgieva has asked G20 governments for their backing to "boost global liquidity through a sizable SDR allocation, as we successfully did during the 2009 global crisis."[1] African and European heads of state have called on the IMF to "decide immediately on the allocation of special drawing rights."[2] Former UK Prime Minister Gordon Brown and former US Treasury Secretary Larry Summers recently wrote that "if ever there was a moment for an expansion of the international money known as Special Drawing Rights, it is now."[3]

Special Drawing Rights, or SDRs, are not well known to the general public, but economists and development experts believe they could provide crucial support to countries facing economic and public health crises caused by COVID-19. In this policy brief we explain how SDRs work and how they should play a vital role in containing the global COVID-19 pandemic and stabilizing the world economy. We also look at the benefits of SDRs for the United States and address counter-arguments.

What Are SDRs?

Special Drawing Rights, or SDRs, are international reserve assets — a sort of international currency[4] — which the International Monetary Fund (IMF) creates for its 189 member countries, much as central banks increase the supply of bank reserves at the national level. In times of economic and financial distress, countries can use these SDRs to meet external financing needs, thereby helping avert financial and/or balance of payments crises and helping maintain the confidence of financial markets. Countries can exchange SDRs for one of five foreign currencies (the US dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound) which can be used to pay for imports or to cover debt service payments.

The value of SDRs is based on a basket of these five currencies; one SDR is currently worth about $1.35. SDRs are used exclusively by governments (and usually held by central banks) and some international institutions. They are traded among these actors, but not on open

1 Georgieva (2020).
2 Ahmed et. al. (2020).
3 Brown and Summers (2020).
4 A currency fulfills three roles: it is a unit of account, a means of exchange, and a means to store value (i.e., an asset). SDRs fulfill these three roles, but they are used only by governments and some international institutions.

markets. Countries receive interest from the IMF on SDRs that they hold, and pay interest to the IMF on SDRs that they were allocated (i.e., if they bought SDRs from other countries then they are net recipients of interest, and if they sold SDRs to other countries in exchange for hard currencies they would become net payers of interest). The interest rate is based on the short-term rates of the five currencies in the SDR basket — typically much lower than interest rates paid by developing countries' governments to foreign creditors. The SDR rate of interest is currently extremely low (about 0.1 percent). SDRs are not debt — countries don't ever pay back SDRs to the IMF, nor do they have to buy back any SDRs that they have sold to another country.

Given these characteristics, SDRs are particularly useful in helping stabilize national economies during a global economic downturn. This is why the most recent and largest, to date, issuance of SDRs decided by IMF members took place during the 2008-09 global financial crisis. In 2009, the IMF allocated SDR 161.2 billion or $250 billion.[5] There are currently SDR 204 billion in circulation, worth about $280 billion.[6]

In accordance with the IMF's Articles of Agreement, SDRs are distributed to national governments in proportion to each country's quota share at the IMF (which is also the basis for contributions to and voting power at the IMF). As a result, high-income countries like the US and most European countries receive approximately 60 percent of an SDR allocation, while developing countries, such as most nations of Asia, Latin America and Africa, receive around 40 percent of SDRs.

While a consensus was almost reached at the IMF in April,[7] an issuance of SDRs requires a supermajority of 85 percent of votes of IMF members, meaning that the US — which holds a 16.5 percent share of votes — holds veto power over any issuance and has so far prevented this decision from taking place. As a matter of US law, any allocation of more than about $650 billion worth of SDRs in any five-year period requires congressional approval (allocations below that amount can be approved by the administration after a 90-day notice given to Congress).

5 IMF (2009) and Ocampo (2019).
6 IMF (2020a).
7 IMF (2020b).

Why Are SDRs Important for Developing Countries?

IMF projections indicate that the economic disruptions caused by the pandemic will lead to the worst global economic downturn since the Great Depression and will be far worse than the 2008–09 global financial crisis and world recession.[8] Developing countries — which are disproportionately affected by disruptions to global supply chains, and by the sharp fall in commodity prices triggered by the pandemic — will be hit particularly hard. Sub-Saharan Africa, already suffering from high rates of extreme poverty, could see as much as a 5.1 percentage point decrease in economic growth; the nations of Latin America and the Caribbean are expected to experience their worst economic contraction since 1930.[9]

In addition, poorer developing countries that urgently need greater quantities of foreign exchange to cover financing gaps and essential imports — such as food, medical supplies, and personal protective equipment — have been experiencing unprecedented capital outflows since early 2020, at over three times the rate seen during the 2008–09 world recession.[10] In other words, many developing economies are losing foreign exchange at the time that they need it the most.

The potential human consequences of this dire economic situation are staggering. According to the World Food Program, the number of people facing acute hunger worldwide could roughly double, from 135 million to 265 million.[11] A recent study by the United Nations University World Institute for Development Economics Research has projected that as many as half a billion more people could be forced into poverty.[12] A May 2020 Report by researchers at the John Hopkins Bloomberg School of Public Health predicts that as many as 1.1 million additional child deaths could take place in the developing world as a result of potential disruptions in health systems and reduced access to food.[13]

To avoid a wide-scale international humanitarian disaster, developing countries need external support, and they need it quickly. In late March, IMF Managing Director Kristalina Georgieva said that the IMF's "current estimate for the overall financial needs of emerging market

8 Gopinath (2020).
9 World Bank (2020a) and UN News (2020).
10 Georgieva (2020a).
11 World Food Programme (2020).
12 Sumner (2020).
13 Roberton et al. (2020).

[countries] is 2.5 trillion dollars," noting that this was a "lower-end" estimate.[14] Since then Georgieva has warned that the economic picture may be even more dire than earlier IMF forecasts predicting a 3 percent contraction in output at the global level.[15]

More than 100 countries have already asked the IMF for help.[16] The IMF currently has a 1 trillion-dollar lending capacity, of which $200 billion was already committed before the crisis; nowhere near enough to meet the — at least — $2.5 trillion in financing needs cited by Georgieva. In addition, normal IMF loan agreements involving negotiations over economic policy conditions often take months to implement and many countries need immediate help.

To address developing countries' urgent funding needs the IMF managing director and numerous experts, including many current and former heads of state and finance ministers, have called for a major issuance of SDRs.[17] This would allow countries to boost their international reserves and avert potential financial collapse. It would also give them access to otherwise scarce foreign exchange, thereby allowing them to fund imports and cover debt payments.

Most wealthy countries have monetary tools and resources — such as strong, stable currencies, significant dollar or foreign exchange reserves, and access to central bank swap lines — that allow them to take salient measures to contain the pandemic and protect their economies.[18] Poorer nations do not have these tools and resources at their disposal. This is why 21 developing countries chose to use most of the SDRs that were allocated to them in 2009 within a year of that allocation to relieve the pressure of the global economic crisis on their balance of payments, thereby averting austerity measures that would have had painful human impacts.[19]

Although middle-and low-income countries would receive proportionately less SDRs than high-income countries, a major issuance of these assets would still provide them with significant financial support. **Table 1**, below, shows the US dollar equivalent of what various low, middle-and high-income countries would receive with issuances of one trillion and three trillion SDRs.

14 Georgieva (2020b).
15 Shalal (2020).
16 Pham (2020).
17 Georgieva (2020c) and Berglof, Brown, and Farrar (2020).
18 Board of Governors of the Federal Reserve System (2020a).
19 IMF (2018a).

As Table 1 shows for selected countries, if the IMF issued one trillion SDRs globally, a country like Mozambique would receive the equivalent of around $691 million in SDRs. This is equivalent to 17.8 percent of its 2019 international reserves and 4.6 percent of its GDP for that same year.[20] With a 3 trillion SDR issuance, Mozambique would receive over $2 billion in SDRs, or 53.3 percent of its 2019 reserves, and 13.7 percent of its 2019 GDP.

With a one trillion SDR issuance by the IMF, Bangladesh would receive over $3 billion in SDRs, equivalent to around 9.3 percent of its 2019 reserves.[21] If Bangladesh exchanged these SDRs for hard currency it would be able to purchase around 12 million COVID-19 test kits, or 600 million PPE, or 50 percent of its annual imports from the US.[22]

Table 1

Disbursements Under Different SDR Allocations: Select Countries

	USD Equivalent with an SDR Allocation Of:		1 Trillion		3 Trillion	
Country	**1 Trillion**	**3 Trillion**	**Percent of GDP**	**Percent of International Reserves**	**Percent of GDP**	**Percent of International Reserves**
Argentina	9,263,099,682	27,789,299,046	2.1%	20.6%	6.2%	61.9%
Bangladesh	3,041,614,821	9,124,844,463	1.0%	9.3%	2.9%	27.9%
Dominican Republic	1,382,552,191	4,147,656,574	1.5%	15.6%	4.6%	46.8%
Ecuador	2,073,828,287	6,221,484,861	1.9%	70.7%	5.8%	212.0%
Guatemala	1,244,296,972	3,732,890,917	1.5%	8.4%	4.6%	25.2%
Haiti	414,765,657	1,244,296,972	4.7%	17.5%	14.1%	52.5%
India	38,158,440,481	114,475,321,443	1.3%	8.3%	3.9%	24.9%
Jamaica	1,106,041,753	3,318,125,259	7.0%	30.5%	21.1%	91.4%
Mozambique	691,276,096	2,073,828,287	4.6%	17.8%	13.7%	53.3%
Peru	3,871,146,136	11,613,438,407	1.7%	5.7%	5.1%	17.2%
South Africa	8,848,334,025	26,545,002,074	2.5%	16.1%	7.4%	48.2%
Tunisia	1,520,807,410	4,562,422,231	3.9%	19.5%	11.8%	58.6%

Source and notes: IMF (2018b); IMF (2020c). All data for 2019, other than Haiti (International Reserves, 2018) and Liberia (International Reserves, 2018).

20 World Bank (2020b) and World Bank (2020c).
21 World Bank (2020d).
22 USTR (2020). Based on a unit price of $250 for COVID-19 test kits and $5 for PPE, as cited by Matthews (2020) on April 23, 2020.

How Do SDRs Benefit the United States and Other High-Income Countries?

Unlike other forms of multilateral financial support, such as IMF or World Bank loans and grants, SDRs do not cost US taxpayers anything. They are assets the IMF creates — just as central banks like the US Federal Reserve create bank reserves — and that countries receive without charge.

But an SDR issuance would benefit the US and other high-income countries in other, far more significant ways. A new issuance of SDRs would provide developing countries with access to large quantities of foreign exchange, thereby allowing them to purchase more imports of agricultural goods, personal protective equipment, medical equipment, and other goods. US businesses, many of which are global leaders in the production of these goods, can expect to see higher production levels and greater profits. Without a major SDR issuance, global demand for US exports is likely to fall.

In 2018 the US exported more than $635 billion in American goods to developing countries, supporting an estimated 6.3 million jobs across the US.[23] Exports of services from the US to the developing world supported an additional estimated 4.4 million jobs.[24] As global demand plummets, we can expect to see this income plunge and many of these jobs disappear. During the 2009 global recession, the US saw quarterly exports of goods and services fall by 21 percent from peak to nadir, in just two quarters.[25] An estimated 2 million export-supported jobs were lost during the same period.[26] The economic damage from the pandemic is expected to be far worse, with — for instance — the amount of global trade falling by at least 11 percent, according to IMF estimates.[27] Exports from the United States to all countries fell by 20 percent from March 2020 to April 2020, the steepest decline ever recorded.[28] The economic damage being caused by this sharp drop in global demand can be significantly mitigated by a large issuance of SDRs.

23 United States Census Bureau (2020) with IMF list of developing countries, IMF (2020d). (Does not include re-exports.) Hall (2017), using 2016 data.
24 Hall (2017) and authors' calculations, using 2016 data.
25 BEA (2020a) and BEA (2020b).
26 Tschetter (2010).
27 IMF (2020e).
28 United States Census Bureau and BEA (2020).

Another way in which the US benefits from an issuance of SDRs is by the reduction of threats posed by the global pandemic. As mentioned earlier, SDRs give countries the ability to access greater quantities of foreign exchange to increase imports of personal protective equipment and other medical goods that are essential for fighting and containing the pandemic. Once COVID-19 treatments and vaccines are developed and mass-produced, SDRs will provide these countries with access to foreign exchange that can be used to import these vital goods as well. As public health experts frequently note, no country is truly safe from COVID-19 until the spread of the virus is effectively controlled throughout the world.

Counter Arguments to a Major SDR Issuance Lack Credibility

A major allocation of SDRs can theoretically cause either inflation or affect currencies' values or both. Whether that happens in practice depends on how much SDRs are allocated relative to the normal growth of the money supply, how recipient countries use them, and on monetary policy responses in the five hard currency countries.

In an analogous case, concern over inflation was raised in the United States during the 2008–09 financial crisis and Great Recession, when the US Federal Reserve, for the first time, began a program of Quantitative Easing (QE), in which it created more than 3.6 trillion dollars and the IMF created $250 billion in SDR.[29] Yet inflation remained subdued; it was below the Fed's target of 2 percent for virtually the entire following decade. In response to the current, sharper downturn caused by the COVID-19 crisis, the Fed has already created approximately $3 trillion (relative to a US GDP of $21.5 trillion in 2019).[30] The world economy, which is also facing a more severe crisis than that of 2008–09, is around $87 trillion (2019).[31] This calls for a much larger allocation of SDRs than in 2009. Proposals for general allocations range from $500 billion (based on political expediency) to $3 trillion (based on estimated financing needs).[32]

Only a small fraction of any SDRs created will actually be converted into hard currency and spent very soon after issuance. That is because three-quarters of SDRs would be allocated to countries that already have access to significant quantities of foreign exchange including

29 Board of Governors of the Federal Reserve System (2020b).
30 Board of Governors of the Federal Reserve System (2020b) and BEA (2020b).
31 IMF (2020d).
32 UNCTAD (2020).

through swap lines with the US Federal Reserve, and many other countries typically hold on to a large portion of their SDR allocation. This is an important fact to consider because SDRs cannot cause inflation if they are not used. But it is worth noting that SDRs not converted into hard currency and spent can still play a very significant role in stabilizing economies during the current crisis given that they function as international reserves and can prevent balance of payments crises, capital flight, and other negative shocks.

A report commissioned by the IMF, by Richard Cooper, examines in some detail the potential avenues by which the creation of SDRs could contribute to inflation.[33] He explains that an increase in inflation is "extremely improbable." The bottom line is that the creation of SDRs does not, on its own, contribute to any inflation in the US. It can only do this if the Federal Reserve changes its own monetary policy and its own inflation target. But there is no reason to expect that the Federal Reserve would change their inflation targets simply because of the creation of SDRs.

The situation could be different in other countries, especially those that decide to use their SDRs. A major allocation of SDRs represents a one-time inflow of resources, which could not support recurrent spending indefinitely. It is however unfair and condescending to reject a general allocation that would benefit responsible countries in dire need on the grounds that some countries might adopt unsustainable policies. It's worth noting that an IMF evaluation of the 2009 allocation did not find widespread evidence that countries adopted unsustainable macroeconomic policies in response to the SDR issuance.[34]

For the sake of political expediency, in the current context there has also been some discussion about reallocating existing SDRs from countries with considerable financial resources to some developing countries, rather than allocating new SDRs to every country. A reallocation would have to take the form of either donations or loans, either directly to developing countries or through the IMF. Donations of SDRs could be beneficial provided that they did not divert money from other sources of aid. In the current climate, loans should be ruled out given that potential recipients are already typically in difficult debt situations. Unlike a general allocation of new SDRs, donating SDRs would carry a cost to donors, and lending SDRs would incur a cost to borrowers. Both donations and loans would require contracts that could take time to negotiate and are likely to come with red tape and strings attached. Some highly indebted middle-income countries would likely be left out of the reallocation scheme given the desire to focus resources on low-income countries. For all these

33 Cooper (2011).
34 IMF (2018).

reasons, a general allocation of new SDRs is far more preferable. Indeed, the very idea of reallocating existing SDRs could prove to be an unproductive distraction, as SDRs are not needed to make new grants or loans to countries. The reality is that developing countries' financing gaps are so big that it is necessary to pull out all the stops: a large general allocation of SDRs is required in addition to more aid and more debt relief.

Conclusion

While COVID-19 has been contained to some degree in a number of countries — primarily in Southeast Asia and Europe — it is now spreading at an alarming rate within the developing world.[35] Of the 12 countries with the highest number of new confirmed infections, 10 are developing nations. Yet, in general, these countries lack the necessary infrastructure and resources needed to deal with a full-scale pandemic.

Similarly, many developing nations don't have access to the financial resources needed to weather the economic shock caused by the pandemic. While high-income countries generally have the possibility of engaging in major public spending programs and can borrow money at low interest rates, middle- and low-income countries often face major financial constraints, exorbitant lending rates, and unprecedented capital flight. As a result of this dire situation, the UN Development Program has warned that global human development is likely to decline for the first time on record.[36] This decline would translate to millions of unnecessary deaths and to a major increase in poverty levels in developing countries.

But this tragic scenario can still be averted if the US and the rest of the international community take decisive international action. As we have shown, a large issuance of SDRs is an easy and effective way to provide a major infusion of financial support to the countries that most need it. This is why humanitarian groups like Save the Children and Bread for the World, US allies like France and Germany, leaders of Africa and Latin America, Nobel economics laureates like Amartya Sen and Joseph Stiglitz, and many other experts and global leaders are calling for a major SDR issuance as soon as possible. Millions of lives can be saved and the global economy can recover far more quickly if the US and other IMF members urgently approve a general SDR allocation. This allocation should be significantly higher than that issued during the last global recession; in the current context an issuance of as much as 3 trillion SDRs is warranted in order to meet financing gaps throughout the developing world.

35 Zakaria (2020).
36 UNDP (2020).

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