WHAT MIGHT BE A BETTER WAY TO TARGET NEW SPECIAL DRAWING RIGHTS TO STRUGGLING ECONOMIES?

SEATINI

Strengthening Africa in World Trade

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INTRODUCTION

The Global pandemic has resulted in a multitude of crises affecting Low Income Countries (LICs). LICs in general are witnessing fiscal challenges in form of shrinking revenue collections, and burdensome debt repayments. Many of these countries are in the midst of a debt crisis that has been accelerated by the COVID-19 pandemic. They are now having to borrow more to finance economic recovery and also to secure vaccines. It remains worth noting that borrowing will increase public debt and present further a debt sustainability challenge. In 2020 majority of Sub Saharan African countries secured loans from the IMF and the African Development Bank for the COVID-19 response and this will push public debt levels close to 100 percent[1] of Gross Domestic Product (GDP) sooner.

Special Drawing Rights (SDRs) therefore remain one of the free feasible options that LICs can reliably count to finance their recovery efforts and that is why there are growing calls globally for the International Monetary Fund (IMF) to approve a new issuance of these resources. The SDR is an "international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. International reserves may be defined as funds or other assets that countries exchange with each other on an international level. They include such assets as gold or internationally accepted currencies like the Euro or dollar among others. A new issuance of SDRs would offer some form of debt relief to recipient countries especially the LICs as they would now use such resources to meet their public spending needs without having to acquire any new loans.

A new SDR issuance is akin to the IMF printing new money and then having it distributed amongst its members. So far SDR 204.2 billion (equivalent to about $281 billion US dollars) have been allocated to members, including SDR 182.6 billion that was allocated in 2009 in the wake of the global

1 https://www.afrodad.org/index.php/en/sdrs#presentations

financial crisis. These new resources once issued are allocated based on a quota based formula which is the IMF's unit of account. Each country receives a portion of the newly issued SDRs based on its quota shares with the IMF. Such quotas are determined by member countries' relative economic position in the World economy. This implies that larger economies will take on bigger quota shares within the IMF as compared to their much smaller counterparts. Other factors used when determining IMF members' quotas include their level of openness; economic variability and the size of their international reserves.

It is also worth noting that quotas determine a country's voting power in cases where critical decisions are to be made within the IMF body. Countries with larger quotas like the USA's that stands at 17.4 percent thus have larger voting powers for any decisions to be made within the IMF.

In a similar manner, the IMF relies on the quota system to raise financial resources necessary to meet its operations. Upon joining the IMF, each new member was required to pay a subscription to the IMF. The size of the subscription payment was to be determined by the relative quotas shares that had been assigned to that newly joining member.

When joining the IMF, member countries were at liberty to meet 75 percent of their subscription payments using their own domestic currencies. The remaining 25 percent[2] had to be paid in SDRs or foreign currencies that were acceptable to the IMF at that time. These currencies included the US dollar, the Euro, the British Pound Sterling, the Japanese Yen, and the Chinese Renminbi. This implies that these countries whose currencies were officially recognized by the IMF as reserve currencies were at an advantage as they could easily print new money that they would then use to meet their full subscription payments to the IMF. However this wasn't the same case for the rest of the other counterparts as they could only meet the 25 percent payments by mobilizing sufficient foreign currency reserves through trade or other measures.

- **The Challenge – The current quota system remains unfairly tilted in favor of larger economies**

It is therefore key to note that the current quota formula that was used to determine the shares of member countries is largely tilted in favor of larger economies like the USA given its high consideration of factors such as country's GDP size relative to others.

2 https://www.imf.org/~/media/Files/Factsheets/English/quotas.ashx

The larger quota shares in turn gave such advanced economies like the USA a higher voting power for any decisions to be made within the IMF. A case in point, the USA currently has a voting power of 16.5 percent of the total IMF votes leaving the rest of the other IMF members with a total share of 84.5 percent of voting rights and yet it is crucial that for a critical decision to be made within the body, a total majority of 85 percent must be mobilized. This leaves the rest of the other 189 economies in a weaker negotiating position with the low income economies affected the most.

The current quota system also allows such economies as the USA to have the largest take home of any newly issued SDRs with a share of 17.4 percent going to the economy in comparison to only 1.4 percent that would go to LICs. This implies that in case of a new issuance of SDRs to a tune of 1 trillion USD, the USA would have a take home of $174 billion[3] while LICs are left to only collectively take $14 billion and yet they are in dire need of these resources. This is a clear illustration of the unfairness within the current Global monetary and financial system for which the IMF spearheads.

With the rising Global inequality amongst nation states that has largely been driven by the prevailing unfair economic system and exacerbated by crises such as the current one, it therefore remains timely that critical systemic reforms are made. Key amongst them is a reform of the current allocation for newly printed SDRs according to the size of economies. This needs to be altered to provide equity. Several arguments could likely arise to protect the current allocation system and thus prevent its alteration. Some of these will likely include the fact that quotas are distributed based on IMF members' earlier subscriptions payments with advanced economies having contributed the largest share. However, it remains worth noting that a larger share (75%) of those subscription payments were made in member countries' local currencies which implies that such advanced economies were still able to print money at liberty to finance their quota subscriptions to the IMF just as their smaller counterparts would have opted given a similar case.

- **Proposals on a way forward– Detach new allocations from the current quota system**

In the event that the IMF issues new SDRs in August 2021, the distribution of the allocation among countries will likely not bear any relation to their real needs and yet countries like the United States that will have the largest take home can still print their own money and swap with other major nations for their currency needs. As can already be noted that 23 percent[4] of the US dollars currently in circulation were

3 https://www.cgdev.org/publication/making-imfs-special-drawing-rights-work-covid-19-economic-relief
4 https://www.cnbc.com/2020/08/05/the-ballooning-money-supply-may-be-the-key-to-unlocking-inflation-in-the-us.html

printed last year by the US Federal Reserve. The same can be said for Japan, the Eurozone countries, China, and other large developed countries—all of whom will be the biggest recipients. This implies that these SDRs will go to countries that are least likely to even make any use of them. The above mentioned economies have actually already accumulated excess reserves and might not need a single penny of the new issuance with China for example having an excess of over $3 trillion dollars[5] in reserves.

To address this imbalance therefore, we recommend the following;-

- The current quota system be detached from new allocations to be made once a new issuance has been approved. A new allocation formula should therefore be designed to guide the distribution of newly issued SDRs in emergency situations like the current one.
- The allocation formula should be proportionate to the burden faced by recipient countries and should offer more consideration to the most vulnerable economies by attaching more weights to their challenges.
- Such factors that should be weighted within this formula could include poverty levels; percapita health expenditure; vulnerability to climate disasters e.tc.

Conclusion

By detaching new SDR allocations from the current quota system, this would ensure that these resources are directed towards those countries that need them the most and will most likely make adequate use of them. At the same time, this will hold back on the likely political resistance that would arise in case a total quota reform is proposed (though still remains important) as this would imply a shift in voting powers in disfavor of the largest economies. A temporary or even permanent new allocation system that is detached from current quotas will be a huge step ahead towards reforming the current monetary system an option that has to date not been explored. There is no better time than now to make such proposals and reforms. As Rahm Emanuel famously said in 2008, "never let a serious crisis go to waste!"

5 China for example having an excess of over $3 trillion dollars in reserves.

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