THE 2021 IMF ALLOCATION OF SPECIAL DRAWING RIGHTS: OPPORTUNITIES AND LEGAL CONSTRAINTS•

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1. Since the onset of the Covid-19 pandemic, the International Monetary Fund (IMF) has provided financial assistance to 87 countries for a total of around 117 billion USD[1].

On top of that, on the 2nd of August 2021, the IMF Board of Governors approved an historical allocation of Special Drawing Rights (SDRs) equivalent to 650 billion USD.

The SDR is an international reserve asset that can be issued by the IMF whenever a long-term global need so requires, and which is backed by the members' obligations under the Articles of Agreement[2].

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 the 190 IMF members) in proportion to their quotas[3].

As a quick reminder, quotas are at the center of the IMF governance structure and reflect each member's relative position in

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[1] Data from www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker.

[2] The power to issue SDRs was attributed to the IMF with the 1969 First Amendment to the Articles of Agreement. 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».

[3] See IMF Art. XV, Section 1 and Art. XVIII.

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the world economy. Quotas determine each member's voting power, contribution to the IMF resources, access to financing and share in a general allocation of SDRs.

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'[4] to diversify the composition of their international reserves, ease liquidity constraints and create room for additional spending[5].

Furthermore, SDRs can be used in a set of authorized transactions between IMF members (e.g., to extend bilateral loans and to settle financial obligations) or to discharge obligations owed to the Fund (such as the repayment of loans and the payment for quota increases). Additional uses can be authorized by the Executive Board with a 70% qualified majority (Art. XIX, Section 2, let. c)[6].

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

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

Actually, the only cost that receiving countries may incur relates to their use. When an IMF member exchanges part of its SDR allocation for hard currency, it will have to pay interest to the IMF on the balance between its cumulative SDR allocation and its SDR holdings (that is, on the shortfall). Conversely, when a member's SDR holdings rise above the amount allocated, it will receive from the IMF

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[4] Pursuant to IMF Article XXX (f), 'freely usable currencies' are currencies that are widely used to make payments for international transactions and are widely traded in the principal exchange markets.

[5] 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%). The next review of the SDR valuation basket will be undertaken in 2022. See www.imf.org/external/np/fin/data/rms_sdrv.aspx.

[6] 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 (www.imf.org/en/Publications/Selected-Decisions/selected-decisions-list).

interest income on the excess[7]. As a result, SDRs do not add to a country sovereign debt if not in a negligible way.

The IMF Executive Board can also grant 'prescribed holders' the power to hold SDRs. Pursuant to IMF Art. XVII, Section 3, this decision requires an 85% majority of the total voting power.

Designated 'prescribed holders' may acquire and receive SDRs (e.g., as loan repayments)[8], but they are not entitled to receive direct allocations from the Fund. Currently there are 15 prescribed holders: four central banks[9], three intergovernmental monetary institutions[10] and eight development organizations[11].

Needless to say, SDRs are not a form of currency as they may not 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'.

a) Nowadays, the exchange of SDRs is either directly arranged between members and/or prescribed holders or facilitated by the Fund through Voluntary Trading Agreements (VTAs).

VTAs are bilateral arrangements between the Fund and a member country (or prescribed holder) under which the latter volunteer to buy or sell a capped amount of SDRs in exchange for specific currencies. In this case, the IMF acts as an intermediary, assigning purchase and sale requests among VTAs with a view to ensure their equitable distribution[12].

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[7] The SDR interest rate is currently very low: 0.05%. See www.imf.org/external/np/fin/data/sdr_ir.aspx, last visited 30 January 2022.

[8] 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.

[9] The European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank.

[10] The Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund.

[11] The 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.

[12] A number of factors are taken into account by the Fund to assign sales and purchases. See IMF, *Annual Update on SDR Trading Operations*, October 2021, 13 ff., available at www.imf.org/en/Publications/Policy-Papers/Issues/2021/10/26/Annual-Update-on-SDR-Trading-Operations-498096, last visited 30 January 2022.

At present, 33 countries and only one prescribed holder – the ECB – have a VTA in place[13]. This group includes most of the G20 countries, with the exception of Argentina, Brazil, India, Indonesia, Russia, South Africa and Turkey. None of the African or South American countries stands ready to participate in SDR transactions and, among BRICS, only China does[14].

It has to be underlined that States participating in a VTA retain the right to refuse any request to exchange SDRs. This is the position adopted by the United States, which refrains from swapping SDRs for dollars to the benefit of countries «whose policies run counter to US interests»[15], among which those targeted by its unilateral sanctions.

While the United States government is openly discouraging targeted States to circumvent or mitigate the effect of sanctions by exchanging SDRs for dollars, we expect the European Union to adopt the same stance even if in a less forthright manner. In particular, the refusal of an EU country to engage in an SDR transaction with a country affected by EU restrictive measures can be based on the *effet utile* principle, according to which an EU provision must be interpreted in a way that will not defeat its purpose.

b) The designation mechanism provided for by IMF Art. XIX, Section 5 guarantees the possibility to exchange SDRs to countries that cannot find a counterparty on the voluntary market.

In this case, contrary to what happens when SDRs are voluntary traded, the requesting country will have to demonstrate that it has a balance of payments need. The Fund will then designate the member with a strong external position that will be obliged to provide freely usable currencies to the requesting country.

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[13] Before the 2021 general SDR allocation the following countries already had a VTA in place. In Asia and the Pacific: Australia, China, Japan, Korea, and New Zealand; in Europe: Austria, Belgium, Cyprus, Denmark, ECB, Finland, France, Germany, Greece, Ireland, Israel, Italy, Malta, The Netherlands, Norway, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom; in the Middle East and Central Asia: Saudi Arabia; in the Western Hemisphere: Canada, Chile, Mexico, and the United States. Lithuania and Oman entered into a VTA after the 2021 allocation. Other countries are likely to follow path.

[14] On 30 September 2021, the purchasing capacity under VTAs was of 234.1 billion SDRs. Some participants are however likely to increase their maximum purchasing capacity in the near future. Also, the IMF is encouraging other members to join the voluntary trading market.

[15] See US Department of the Treasury, *Fact Sheet: How an Allocation of International Monetary Fund Special Drawing Rights Will Support Low-Income Countries, the Global Economy, and the United States*, 1 April 2021, available at home.treasury.gov/news/press-releases/jy0095.

Even if no transaction under the designation mechanism has occurred since the voluntary market was established in the late 1980s[16], it remains central to ensuring the SDR liquidity and to preserving its reserve asset character.

2. Despite their prominent features, the IMF has seldom exercised the power to issue SDRs and their role to date has been limited.

SDRs have been distributed to IMF members only four times before 2021.

The first two allocations were respectively made in the 1970-1972 period (while the par value system was still in operation) and in the 1979-1981 period (after the entry into force of the 1978 Second Amendment to the IMF Articles).

The third (special) and fourth (general) SDR allocations were approved in 2009 after being debated since the mid-1990s.

Already at the 1994 IMF-WB annual meeting, the IMF Managing Director Michel Camdessus put forward a proposal about a new *general* allocation of 36 billion SDRs to be approved together with a *special* allocation that was supposed to be distributed only among the 40 developing countries and economies in transition that had joined the Fund after 1981.

The IMF Articles, however, do not allow for selective allocations and the emission of SDRs needs to be justified by a long-term *global* need. The only way to overcome the legal requirement that SDRs be distributed in proportion to quotas is to amend the Articles of Agreement. Such a proposal was eventually put forward in 1997[17], but the required majority of three fifths of the IMF members representing at least 85% of the total voting power could not be reached at that time.

In the aftermath of the global financial crisis, the Fund reconsidered the need for a general allocation of SDRs. It was advocated that, since membership in the Fund had further increased, a simultaneous selective and corrective allocation of SDRs to the benefit of those members that had never received SDRs was needed.

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[16] The designation mechanism was used for the last time during the 1987 financial crisis when Austria, Denmark, the Netherlands and Sweden were required by the Fund to buy 12.5 million SDRs from Mexico.

[17] IMF, *Proposed Fourth Amendment of the Articles of Agreement 'Special One-Time Allocation of SDRs'*, Board of Governors Resolution No. 52-4, adopted on 23 September 1997, available at www.imf.org/external/pubs/ft/history/2012/pdf/15a.pdf

At long last, at that time the 1997 Amendment proposal eventually obtained the required qualified majority.

The Fourth Amendment to the IMF Articles entered into force in August 2009, allowing a 'Special One-Time Allocation' of 21.5 billion SDRs (about 33 billion USD). Soon afterwards, the IMF Board of Governors approved a new issuance of 161.2 billion SDRs, equivalent to 250 billion USD. Together, the 2009 general and special allocations raised the total of cumulative SDRs to 204.1 billion.

Since the outbreak of the COVID-19 pandemic in March 2020, civil society organizations started advocating the necessity of a new allocation of SDRs equivalent to 3 trillion USD, to help developing countries withstand the crisis[18]. In April 2021, however, the International Monetary and Financial Committee (IMFC) recommended a general SDR allocation of just 456.5 billion SDRs, equivalent to 650 billion USD.

This amount was determined mainly on political grounds. The US government is in fact authorized by the 1968 Special Drawing Rights Act[19] to vote in favor of SDR allocations up to a certain ceiling, which is currently set at 680 billion USD (at the current SDR/USD exchange rate)[20]. Beyond that threshold, the US Congress is called to authorize by law the US Governor to vote in favor of an SDR allocation at the IMF Board of Governors.

Under the Trump administration, Congress approval seemed impossible. Besides, a new Bill had been introduced before the House of Representatives to further strengthen congressional oversight on SDR allocations and to prevent the distribution of SDRs to States perpetrating genocide or sponsoring terrorism[21].

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[18] See the Open Letter to G20 Finance Ministers and the IMF for a quick special SDR allocation signed by more than 250 civil society organizations available at www.latindadd.org/2021/02/12/civil-society-organizations-call-for-quick-special-drawing-rights-allocation, last visited on 30 January 2022. See also, among others, K. GALLAGHER, J.A. OCAMPO, U. VOLZ, *Special Drawing Rights: International Monetary Support for Developing Countries in Times of the COVID-19 Crisis*, in *The Economists' Voice*, December 2020.

[19] United States, *Special Drawing Rights Act*, 22 C.F.R. §§ 286n -286u, 19 June 1968.

[20] This amount is calculated on the basis of the requirement established by the US Special Drawing Rights Act, Section 6, that cumulative allocations to the United States cannot «exceed an amount equal to the US quota in the Fund».

[21] 117th Congress (2021-2022), H.R.1568 - Special Drawing Rights Oversight Act of 2021, referred to the House Committee on Financial Services on 3 March 2021. The proposal did not get traction and it was shelved indefinitely.

Eventually, thanks to the support of the Biden administration, the IMF Board of Governors approved the new issuance on the 2nd of August 2021. Such decision requires in fact a qualified majority of 85% of the total voting power, with the United States holding 16.50%.

The general allocation of 456.5 billion SDRs (650 billion USD) is the fourth and the largest in history. Yet, the 2021 allocation was strongly criticized for being too late, too little, and too unequal.

Too late. The veto power of the United States and other political considerations led to a regrettable delay, in spite of the urgency and gravity of the situation, which were already apparent in the first months of 2020.

Too little. Even if in 2020 official development assistance (ODA) by member countries of the Development Assistance Committee (DAC) reached an all-time high of 161.2 billion USD[22], UNCTAD estimates that, to avoid a new lost decade, developing countries need between 2 and 3 trillion USD[23]. Therefore, according to some critical voices, only a much larger allocation of SDRs would have provided enough support to developing countries to contrast the worst peace-time recession since the Great Depression[24].

It is certainly true that more could have been done, but it should also be borne in mind that SDR allocations are only one part of the picture: the IMF itself, together with other international organizations, is involved in the global response to the COVID-19 pandemic providing its financial support to member countries.

Too unequal. The approved amount of 456.5 billion SDRs is insufficient to counterbalance the inequalities deriving from the fact that, as a result of the quota-based distribution criterion, wealthy countries will benefit the most.

High-income countries will receive an amount of SDRs equivalent to 438 billion USD (or about 67% of the allocation), more than half of which will go to G7 countries (283 billion USD). These countries do not need SDRs, as the SDR amount they received is only

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[22] OECD, *COVID-19 Spending Helped to Lift Foreign Aid to an All-time High in 2020*, 13 April 2021, available at www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2020-detailed-summary.pdf, last visited on 30 January 2022.

[23] See also UNCTAD, *Trade and Development Report 2021, From Recovery to Resilience: The Development Dimension*, July 2021.

[24] See, for instance, C. HOPE, *Special Drawing Rights: Saving the Global Economy and Bolstering Recovery in Pandemic Times*, EURODADD, 10 June 2021, available at www.eurodad.org/special_drawing_rights_saving_the_global_economy_and_bolstering_recovery_in_pandemic_times, last visited on 30 January 2022.

a fraction of the additional liquidity their central banks have issued since 2020 by deploying exceptional and extraordinary monetary measures[25].

Moreover, while developing countries (low and middle-income) will receive an amount of SDRs equivalent to 212 billion USD (or 32.6% of the allocation), low-income countries will obtain only the equivalent of 21 billion USD (or about 3.2% of the allocation)[26].

To provide a telling comparison, in 2020 the debt burden of low-income countries increased by 12% to a record level of 860 billion USD and the combined debt stock of low and middle-income countries reached 8.7 trillion USD[27].

On the 23rd of August 2021, SDRs were credited on the SDR account of IMF members in proportion to their quotas.

To date, however, Afghanistan[28] and Venezuela[29] have been barred from accessing and using their 2021 SDR allocations[30]. The same happened to other two countries for the 2009 allocation (Madagascar[31] and Honduras[32]).

This treatment does not amount to an 'IMF sanction', neither is it linked to multilateral sanctions imposed by the UN Security Council. Rather, it comes from the IMF longstanding practice in the matter of *government recognition*[33]. As a matter of fact, only recognition

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[25] Reference is in particular made to the European Central Bank Pandemic Emergency Purchase Program (PEPP) and to the US Federal Reserve pandemic quantitative easing operations.

[26] Data from L. JENSEN, *An Unprecedented Opportunity to Boost Finance for Development*, UNDP Global Policy Network Brief, June 2021, 4, available at www.undp.org/sites/g/files/zskgke326/files/2021-06/UNDP-DFS-An-Unprecedented-Opportunity-to-Boost-Finance-for-Development_0.pdf, last visited 30 January 2022.

[27] Data from World Bank, *International Debt Statistics 2022*, 11 October 2021, available at openknowledge.worldbank.org/handle/10986/36289, last visited 30 January 2022.

[28] Because of the Taliban takeover in August 2021.

[29] Because of the contested legitimacy of the results of the presidential election of May 2018 between Nicolás Maduro and Juan Guaidó.

[30] See the *Transcript of IMF Press Briefing* of 16 September 2021, available at www.imf.org/en/News/Articles/2021/09/16/tr091621-transcript-of-imf-press-briefing, as well as Reuters, *Guaidó Says Venezuela's Access to IMF SDRs to be Part of Political Talks*, 14 September 2021, www.reuters.com/world/americas/guaido-says-venezuelas-access-imf-sdrs-be-part-political-talks-2021-09-14/, both last visited 30 January 2022.

[31] In 2009, the President fled the country, and a Transition Authority was formed; since then, the recognition issue was solved only in 2014 after new parliamentary elections. See, IMF, *Republic of Madagascar*, IMF Country Report n. 14/181, July 2014, 4.

[32] See IMF, *Transcript of a Press Briefing*, 10 September 2009, available at www.imf.org/en/News/Articles/2015/09/28/04/54/tr091009

[33] See L. ARDITI, *The Role of Practice in International Organizations: The Case of Government Recognition by the International Monetary Fund*, in *International Organizations*

enables a new government to exercise the country's membership rights within the Fund.

On this issue, the IMF maintains that it is guided by the view of the «international community» (that is, the view of its members representing a majority of the total voting power)[34]. Therefore, «in the event that there is a lack of recognition, or lack of clarity regarding the recognition of a member's government», said government «would continue to not be able to use SDRs (including the newly allocated SDRs) pending resolution of the recognition issue»[35].

The application of this practice remains however prone to subjectivity and creates results that are clearly highly contentious, as demonstrated by the fact that the 'treatment' reserved to Afghanistan and Venezuela was not applied to the government of Belarus. In this case, in a statement to press, an IMF spokesperson affirmed that «As is always the case, the IMF is guided by the international community, which continues to deal with the current administration as the government of Belarus»[36]. In fact, despite sanctions being imposed by the United States, the United Kingdom and the European Union to target Lukashenko's regime after the rigged presidential elections of August 2020, IMF members continue dealing with the Belarus government.

Besides, as mentioned above, none of the countries imposing such sanctions will agree to exchange SDRs into their own currency to the benefit of Belarus if requested to do so under their VTA, even if the IMF does not expressly acknowledge that the legitimacy of the Belarus government is denied by the international community.

3. Once they receive their SDR allocation, IMF members are free to decide how to use them. Among developing countries, some might decide to keep SDRs as reserves to enhance their creditworthiness and borrow at better terms or use them for crucial imports (vaccines included); others might prefer to exchange them for hard currency.

Law Review, 2019, 1-55; R. MUNDKUR, *Recognition of Governments in International Organizations, Including at the International Monetary Fund*, in IMF, *Current Developments in Monetary and Financial Law*, Vol. 4, 2005, 77 ff.

[34] For instance, on Venezuela, see among others IMF, *Transcript of IMF Press Briefing*, 7 March 2019, available at www.imf.org/en/News/Articles/2019/03/07/tr03072019-transcript-of-imf-press-briefing.

[35] IMF, *Proposal for a General Allocation of Special Drawing Rights*, 27 May 2021, 20.

[36] See Politico, *IMF Awards Belarus $1B to Fight Coronavirus*, 23 April 2021, www.politico.eu/article/imf-awards-belarus-one-billion-fight-covid.

The first available data show that, between the 23rd of August and the 30th of September 2021, 22 members exchanged 6.9 billion SDRs for hard currencies. Of these swaps, 17% were made by low-income countries, which on average have already sold 82% of their new 2021 allocations[37].

Swapping SDRs for hard currencies does not however amount to creating room for further fiscal spending. As international reserve assets, SDRs are in fact usually credited to, and managed by, national central banks.

Whether to empower the central bank or the treasury to manage the SDRs is an entirely discretional decision of member States. The IMF Articles are silent on this point: pursuant to Art. XV, Section 1, «the Fund is authorized to allocate SDRs to *members*» [emphasis added].

As a matter of fact, the practice of States varies considerably, with SDRs being managed by national central banks, ministries of finance or exchange stabilization funds. In the United States, SDRs are credited to the Exchange Stabilization Fund (ESF) of the Department of the Treasury. Similar arrangements are adopted by the United Kingdom, where SDRs are held by the Exchange Equalization Account (EEA) of the Treasury, and by Canada, where they are managed by the Minister of Finance through the Exchange Fund Account (EFA)[38].

For developing countries, the main question is: can SDRs be used to release fiscal resources for crisis-related expenditures?[39]

Ecuador provides an interesting case-study. In 2009, the government requested its central bank to deposit on the account of the Ministry of Finance the equivalent in USD of the SDR allocation it had just received. The Central Bank of Ecuador (CBE) notified the

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[37] IMF, *Annual Update on SDR Trading Operations*, IMF Policy Paper, October 2021, 8, available at www.imf.org/en/Publications/Policy-Papers/Issues/2021/10/26/Annual-Update-on-SDR-Trading-Operations-498096

[38] See, for instance, Department of Finance of Canada, *Report on the Management of Canada's Official International Reserves April 1, 2019 - March 31, 2020*, available at www.canada.ca/en/department-finance/services/publications/official-international-reserves/2020.html

[39] See D. ANDREWS, *Can Special Drawing Rights Be Recycled to Where They Are Needed at No Budgetary Cost?*, Center for Global Development, 21 April 2021, available at www.cgdev.org/publication/can-special-drawing-rights-be-recycled-where-they-are-needed-no-budgetary-cost

IMF of its decision to exchange SDRs for US dollars[40] and transferred the dollars so obtained to the Ministry. They were registered in the government budget as capital income and soon afterwards used to finance fiscal expenditures[41]. The CBE bore the burden of paying SDR interest to the IMF.

As advocated by A. Arauz, this strategy can be followed by other developing countries for urgent priority spending[42]. Notably, in September 2021, Paraguay adopted a law providing that, as an exception to central bank legislation, new SDRs will be credited to the Treasury's account as financial assets[43]. Moldova adopted a similar legislation in October 2021[44]. Up to now, around 40 countries have recorded their SDRs – the equivalent of more than 37 billion USD – in the government budget or have used them for fiscal purposes[45].

On this point, it is important to note that the transfer of freely usable currencies obtained through the exchange of SDRs from a State's central bank to a government agency is not always possible. In fact, «central banks may face restrictions (or may altogether be prohibited) to lend to the government in perpetuity, in a currency other than the local one, or at interest rates comparable to the SDR rate».[46]

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[40] Each member State designates a fiscal agency for its operations and transactions with the Fund, those related to SDRs included. The entity selected for this purpose (typically, the central bank, treasury or stabilization fund) represents the country in its financial dealings with the Fund (see IMF Art. V, Section 1).

[41] A. ARAUZ, *Handbook for the Use of Special Drawing Rights (SDRs) for Fiscal Purposes*, Latindadd, August 2021, 13, available at www.latindadd.org/wp-content/uploads/2021/08/Handbook-for-the-use-of-SDRs-for-Fiscal_Purposes.pdf.

[42] *Ibidem*.

[43] Paraguay, *Ley 6809/2021*, 8 September 2021, available at silpy.congreso.gov.py/expediente/123761. According to Art. 33 of the Law, «Los Derechos Especiales de Giro, a ser asignados por el Fondo Monetario Internacional a la República del Paraguay, para cubrir las necesidades de financiamiento derivadas de la Pandemia del COVID-19 o Coronavirus, serán asignados a la Cuenta del Tesoro Público como activo financiero, independientemente a su fecha de emisión, y en carácter de excepción a lo dispuesto en el Artículo 60 de la Ley No 489/1995 Orgánica Del Banco Central Del Paraguay y su modificatoria.» In addition, pursuant to Art. 34, «Facúltase al Banco Central del Paraguay, en su carácter de Agente Financiero del Estado paraguayo, a llevar a cabo las transacciones y operaciones que sean necesarias para dotar de liquidez a la totalidad de los Derechos Especiales de Giro asignados al Tesoro Público, en los términos del Artículo 33, en su equivalente a Dólares de los Estados Unidos de América».

[44] See Law of the Republic of Moldova of 14 October 2021 No. 138.

[45] See A. ARAUZ, K. CASHMAN, *Eighty Countries Have Already Used Their Special Drawing Rights, but More of These Resources Are Needed*, CEPR Blog, 26 January 2022, available at cepr.net/eighty-countries-have-already-used-their-special-drawing-rights-but-more-are-needed.

[46] IMF, *Guidance Note for Fund Staff on the Treatment and Use of SDR Allocation*, August 2021, 15, available at www.imf.org/en/Publications/Policy-

The use of SDRs for fiscal purposes is therefore possible only if consistent with the domestic legal, institutional, and procedural framework.

Lastly, it is worth underlining that SDRs can also be used to repay the IMF (principal and/or interest charges) and, since the 2021 allocation, more than 50 countries have already done so. For instance, in November 2021 Argentina repaid the IMF with SDRs as part of a comprehensive strategy aimed at alleviating the country's external position[47].

4. While developing countries are looking for strategies to use SDRs for fiscal purposes, countries with a strong external position are discussing ways to magnify the impact of the new allocation by voluntarily 'redirecting' or 'rechanneling' at least part of their SDRs to the most vulnerable countries.

As we know, IMF members can use their SDRs in a wide range of operations that, over time, have been authorized by the Fund[48]. Among these, they can donate or lend SDRs to other members or prescribed holders.

The donation of SDRs to other member countries was authorized by an Executive Board decision already in 1980[49]. In this case, though, the donor country will permanently have to pay interests to the IMF unless it replenishes its SDR holdings up to its cumulative SDR allocation. As mentioned above, the SDR interest is now at its lowest (0.05%)[50], but countries should be aware of the risk that it may increase in the future.

Therefore, a more flexible solution seems that of lending SDRs back to the IMF or to other international or regional organizations. SDR loans earn interest and have to be reimbursed at a given date, but they also entail a risk of non-repayment.

Different proposals have been tabled to date.

Papers/Issues/2021/08/19/Guidance-Note-for-Fund-Staff-on-the-Treatment-and-Use-of-SDR-Allocations-464319.

47 A. ARAUZ, K. CASHMAN, *Eighty Countries*, cit. See also the Monthly Reports on the use of SDRs published by the Center for Economic and Policy Research, available at cepr.net.

48 See IMF, *Selected Decisions and Selected Documents of the IMF*, 2020, in particular those based on Art. XIX, Section 2 (www.imf.org/en/Publications/Selected-Decisions/selected-decisions-list).

49 On the use of SDRs in donations, see the IMF, *Executive Board Decision n. 6437-(80/37)S*, 5 March 1980.

50 See note no. 7.

4.1. Discussions revolve around two IMF lending tools: a) the Poverty Reduction and Growth Trust (PRGT), a path already successfully tested in the past; and b) the new Resilience and Sustainability Trust (RST) recently proposed by the IMF Managing Director, Kristalina Georgieva[51].

a) The preferred option to rechanneling SDRs is to use them to boost the PRGT, which after the COVID-19 pandemic is suffering a sizeable resource gap[52].

The PRGT is the key financial tool through which the IMF provides interest-free concessional lending to low-income countries. The Extended Credit Facility, the Standby Credit Facility and the Rapid Credit Facility are all funded by the PRGT.

To replenish PRGT resources, high-income countries may lend part of their SDRs to the IMF, to be credited to the PRGT Loan accounts (which are used to receive and provide concessional lending to low-income countries)[53]. In addition, they should also provide grants both to the PRGT Subsidy accounts (which enable the Fund to provide lending at highly concessional interest rates) and to the PRGT Reserve account (which covers lenders against the risk of a potential default of PRGT borrowers)[54]. This entire set-up is essential to preserve the nature of reserve asset of the SDRs.

In October 2021, the G20 countries declared their readiness to contribute the equivalent of 45 billion USD of their newly allocated SDRs to help vulnerable countries[55]. This is seen as a key step

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51 K. GEORGIEVA, *Remarks by IMF Managing Director on Global Policies and Climate Change*, Venice, 11 July 2021, www.imf.org/en/News/Articles/2021/07/11/sp071121-md-on-global-policies-and-climate-change, last visited 30 January 2022.

52 At the request of the borrowing country, the PRGT may also disburse loans in SDRs.

53 The terms of the loan are defined by a bilateral agreement concluded between the IMF and the central bank (or ministry of finance) of the lender country, which will be paid SDR interest rates when drawings under the loan agreement are made.

54 Around 20% of loans is held in the Reserve account to meet encashment calls by PRGT creditors if they have a balance of payments need and to ensure their repayment. See D. ANDREWS ET AL., *Three Ways New SDRs Can Support the IMF's Lending to Low-income Countries*, CGDEV Policy Paper, 29 April 2021, available at www.cgdev.org/blog/three-ways-new-sdrs-can-support-imfs-lending-low-income-countries, last visited 30 January 2022.

55 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, 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/, last visited on 30 January 2022.

towards a total global ambition to channel 100 billion USD to the countries which are most in need. Notably, part of the sum committed by the G20 will be used to significantly scale-up the PRGT lending capacity.

This commitment, 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 entail standard (neoliberal) conditionality. Therefore SDRs, which are *per se* a form of unconditional liquidity, will be indirectly used by the IMF to provide conditional lending.

On this issue, the Fund maintains that only direct limitations on the use of SDRs, like performance criteria applied on countries wishing to convert their SDRs into hard currency, would be «problematic»[56]. Instead, performance criteria and targets linked to a PRGT-supported program would constitute ordinary conditionality on the use of the Fund's resources and would thus be perfectly legitimate[57].

b) While seeking to mobilize additional funding for the PRGT, the IMF is discussing the features of the RST.

The proposal to complement the PRGT with the RST received the support of the G20, which called on the IMF to design the new trust fund with a view to grant «affordable long-term financing to help low-income countries, small developing states, and vulnerable middle-income countries to reduce risks to prospective balance of payment stability, including those stemming from pandemics and climate change»[58].

The set-up of the RST will hopefully allow the Fund to provide long-term concessional lending to vulnerable middle-income countries and small islands developing states that cannot borrow from PRGT facilities to support their transition to a green economy, nor benefit

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[56] IMF, *Guidance Note for Fund Staff on the Treatment and Use of SDR Allocation*, August 2021, 11, available at www.imf.org/en/Publications/Policy-Papers/Issues/2021/08/19/Guidance-Note-for-Fund-Staff-on-the-Treatment-and-Use-of-SDR-Allocations-464319, last visited on 30 January 2022.

[57] *Ibidem*.

[58] *G20 Rome Leaders' Declaration*, 30-31 October 2021, available at www.g20.org/wp-content/uploads/2021/10/G20-ROME-LEADERS-DECLARATION.pdf, last visited on 30 January 2022.

from the G20 Debt Service Suspension Initiative (DSSI) and Common Framework[59].

While the core features of the RST – size, eligibility criteria, access limits, conditionality, duration – are yet to be finalized[60] and the debate is heating up, concerns are being raised on the fact that RST lending is expected to *top-up* regular IMF-supported programs, therefore creating additional old-school conditionality.

Although the RST can be established quickly, as no qualified majorities are required, it will first need to attract enough funding to become fully operational. In particular, it is of paramount importance that the RST preserves the nature of reserve asset of the SDRs[61] as the legal framework of several countries (e.g., euro area countries) precisely requires that, once channeled to the RST (or to any other IMF facility or trust or, more in general, to any other international organization), the SDRs recorded in their central bank's balance sheet would not lose this characteristic[62].

This entails ensuring that SDR loans remain sufficiently liquid and relatively low risk, so that lender States can quickly collect their SDRs should a balance of payments need arise[63].

The PRGT structure can provide a useful model to overcome these technical issues.

4.2. It has been advocated that SDRs should be channeled towards multilateral development banks (MDBs) that already are SDR

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[59] On the DSSI and the Common Framework for Debt Treatment Beyond the DSSI, see A. VITERBO, *Riduzione del debito sovrano e nuovi finanziamenti per lo sviluppo: questi i presupposti necessari per raggiungere gli obietti di sviluppo sostenibile a fronte dell'attuale crisi multidimensio*nale, in SIOI, *Le Nazioni Unite di fronte alle nuove sfide economico-sociali 75 anni dopo la loro fondazione*, Napoli, 2021, 165-180.

[60] The features of the RST are expected to be finalized by the IMF/World Bank Spring Meetings of 2022.

[61] A definition of the concept of 'reserve asset' can be found in IMF the Balance of Payments Manual. Reserve assets «serve a different function and thus are managed in different ways from other assets»; «they have the distinct motive to meet balance of payments financing needs and undertake market intervention to influence the exchange rate». See IMF, *Balance of Payments Manual*, Chapter 6, Functional Categories, Section F, 2013. This implies that an SDR-denominated claim should carry a limited credit and liquidity risk.

[62] On this point see, C. PAZARBASIOGLU, U. RAMAKRISHNAN, *Sharing the Recovery: SDR Channeling and a New Trust*, IMFBlog, 8 October 2021, available at blogs.imf.org/2021/10/08/sharing-the-recovery-sdr-channeling-and-a-new-trust/, last visited on 30 January 2022.

[63] The IMF preferred creditor status is considered an additional important factor in the mitigation of risk.

prescribed holders[64]. In particular, reference is here made to the African Development Bank (AfDB), the African Development Fund (ADF) and the Asian Development Bank (ADB).

It is worth reminding that the three development organizations mentioned above can rely on contributions from their wealthiest regional and non-regional members. In fact, alongside countries in the region, their membership includes most of the G20 countries and about half of the members of the euro area.

Two options are envisaged: a) SDRs can either be lent to MDBs or b) used for their recapitalization.

a) Under the first option, the MDB receiving the SDRs would subsequently on-lend them to eligible members.

On-lending will require amending the legal framework. At present, only the IMF offers SDRs as an alternative to hard currencies in its lending operations and transactions with members (which, on their side, are not obliged to accept SDRs and, when they do, usually convert them immediately)[65]. The 1980 IMF Executive Board Decision which establishes the terms and conditions for the acceptance and use of SDRs by prescribed holders is silent on this point, but to date it has been interpreted in a restrictive way[66]. Moreover, it is yet to be verified whether MDBs internal rules allow them to offering lending directly in SDRs.

To avoid further complexity, MDBs could swap channeled SDRs for freely usable currencies that they will subsequently lend to member countries. MDBs are allowed to accept or use SDRs in bilateral transactions[67] and they can quickly start operating on the voluntary trading market even if to date they have not done it yet.

Ultimately, it might prove easier and more effective to persuade advanced economies to provide additional resources to MDBs directly in hard currency.

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[64] 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 www.cgdev.org/publication/reallocating-sdrs-multilateral-development-banks-or-other-prescribed-holders-sdrs, last visited on 30 January 2022.

[65] IMF Finance Department, *IMF Financial Operations 2018*, 18 April 2018, 92, available at www.elibrary.imf.org/view/books/071/24764-9781484330876-en/ch04.xml#ch04bx07, last visited on 30 January 2022.

[66] See IMF, *Executive Board Decision n. 6467-(80/71)S*, 14 April 1980.

[67] *Ibidem*.

b) The recapitalization option is ambitious but even more challenging. New capital contributions (even in the form of SDRs) will certainly allow MDBs to significantly increase their lending capacity. Each MDB would then be free to decide how to allocate new resources among members and for what kind of priorities, enjoying more flexibility than the IMF (for which the key requirement remains a balance of payments need).

In this case, though, three issues can be identified.

First of all, as prescribed holders, MDBs are entitled to receive SDRs in transactions with their members, but doubts remain on whether IMF members are entitled to exchange SDRs for equity stakes in the MDBs capital[68].

Secondly, it still has to be established how capital contributions in the form of SDRs will be considered under the rules of each MDB, especially with regard to their capital adequacy framework[69] and with a view to maintaining triple-A rating.

Third, it should be underlined that, even if the preservation of the SDR reserve asset characteristics is not a requirement set by the Fund, it is a requisite embedded in the legislation of several countries. This requirement limits the ability of countries to use SDRs to recapitalize MDBs, especially if MDBs were then to on-lend them at long-term maturities (greater than 10 years) or employ them to take on further credit risk. Indeed, preserving the reserve asset nature of SDRs would require a near absence of credit risk. In this regard, it remains to be established whether the preferred creditor status of MDBs may be considered enough to reduce risk associated with SDR on-lending.

4.3. Lastly, reference should be made to a number of proposals related to the creation of SDR-backed mechanisms designed to serve various purposes[70].

A first group of proposals revolves around the creation of an SDR-funded credit facility to accelerate the delivery of vaccines, to

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[68] D. ANDREWS, *Reallocating SDRs,* cit., 5.

[69] The capital adequacy framework protects the risk-bearing capacity of a MDB and its ability to lend even during crises without relying on callable capital.

[70] See, also, UN Economic Commission for Africa, *ECA Announces Its Intention to Create a Liquidity and Sustainability Facility, A Vehicle for Debt Management and Fiscal Sustainability*, 23 March 2021, www.uneca.org/stories/eca-announces-its-intention-to-create-a-liquidity-and-sustainability-facility%2C-a-vehicle-for, last visited on 30 January 2022.

support investment in vaccine production and to strengthen preparedness for future epidemics[71].

Other proposals concern the setting up of credit facilities that will use SDRs as initial working capital to directly issue green, social and sustainability bonds or to guarantee their issuance by developing countries[72].

Under a third approach, SDRs would be lent to a new special purpose vehicle that will leverage them as collateral to mobilize private capital in support of developing countries[73].

In all the above cases, to be entitled to receive SDRs, the new entity will first have to be accredited among the SDR prescribed holders by the IMF and then structure its operations in a way that maintains the reserve asset nature of SDRs.

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

Indeed, one of the basic tasks of the Eurosystem – *i.e.*, the ECB and euro area national central banks (NCBs) – is to hold and manage the official reserves of Member States[74].

The Eurosystem official reserves include foreign currency and gold reserves as well as claims on international financial institutions that can be rapidly converted into foreign currency reserves. Among the latter there are the SDRs and the IMF reserve position of euro area Member States.

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[71] J. HICKLIN, 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 www.cgdev.org/publication/vaccine-financing-how-redesigned-imf-instrument-can-provide-shot-arm-global-pandemic, last visited on 30 January 2022.

[72] See, among others, N. BIRDSALL, B. LEO, *Find Me the Money: Financing Climate and Other Global Public Goods*, CGDEV Working Paper n. 24, April 2011, 20. See also ECA, *The United Nations Economic Commission for Africa announces at COP 26 it is establishing a Liquidity and Sustainability Facility (LSF) that could reach USD 30 billion to support sovereign African Eurobond liquidity and ensure debt sustainability*, 3 November 2021, available at www.uneca.org/stories/the-united-nations-economic-commission-for-africa-announces-at-cop-26-it-is-establishing-a, last visited on 30 January 2022.

[73] See, for instance, UNDP, *An Unprecedented Opportunity to Boost Finance for Development: The Upcoming Special Drawing Rights Allocation*, UNDP Global Policy Network Brief, June 2021.

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

Art. 30 of the ESCB Statute requires NCBs to transfer to the ECB, in proportion to their share in its capital, part of their foreign reserve assets. Even though SDRs are not subject to the transfer obligation, they remain «fully part and parcel of the official foreign reserves which the [Euro]System is to hold and manage»[75].

Art. 31(2) of the ESCB Statute also provides that, above a given ceiling, the ECB will approve any operation in foreign reserve assets that remain with the NCBs «in order to ensure consistency with the exchange rate and monetary policies of the Union».

The only transactions exempted from this requirement are those undertaken by NCBs in the fulfilment of their obligations *vis-à-vis* international organizations, such as the IMF and the Bank for International Settlements (BIS)[76].

However, these transactions are also subject to compliance with the other obligations laid down by the EU legal framework, among which first and foremost Art. 123 of the TFEU (the so-called 'monetary financing prohibition').

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 is not an absolute prohibition though: in fact, Council Regulation (EC) n. 3603/939 provides for some exemptions, among which the one concerning NCBs financing of «obligations falling upon the public sector *vis-à-vis* the IMF»[77].

In the light of the above, the recent statement by the President of the ECB, Christine Lagarde, at the meeting of the International Monetary and Financial Committee (IMFC) of October 2021 does not come as a surprise.

Remarkably, she affirmed that «National central banks of EU Member States may only lend their SDRs to the IMF if this is compatible with the monetary financing prohibition included in the Treaty on the Functioning of the European Union (TFEU). Retaining the reserve asset status of the resulting claims is paramount. This requires that the claims remain highly liquid and of high credit quality.

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[75] R. SMITS, *The European Central Bank: Institutional Aspects*, Cambridge, 1997, 200. See Art. 30(5) of the ESCB Statute.

[76] See Art. 31(1) of the ESCB Statute.

[77] 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, 1).

The direct financing of multilateral development banks by national central banks of EU Member States through SDR channeling is not compatible with the monetary financing prohibition»[78].

SDR loans provided by euro area countries to the IMF's PRGT clearly fall under this 'IMF exemption'[79]. Key is the fact 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[80].

Due to these legal constraints, euro area countries willing to lend or donate the SDRs held by their respective NCBs to international organizations other than the IMF will first have to verify the compatibility of this kind of operation with the monetary financing prohibition[81].

Furthermore, once transferred as loans or donations to an MDB, the SDRs will have to maintain their nature of reserve assets. Unfortunately, as seen above, this is not an easy problem to solve.

Eventually, Council Regulation (EC) n. 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* [a given MDB]'.

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[78] Statement by Christine Lagarde, President of the ECB, at the 44th Meeting of the International Monetary and Financial Committee, IMF Annual Meetings, 14 October 2021, available at www.ecb.europa.eu/press/key/date/2021/html/ecb.sp211014~0ebead6ce2.en.html, last visited on 30 January 2022. It is worth highlighting that, on the 5th of October 2021 the EU Economic and Financial Affairs Council met in preparation of the annual meeting of the IMF and of the IMFC to approve the EU's statement to the IMFC. See Remarks by Commissioner Gentiloni at the ECOFIN press conference, 5 October 2021 and the Statement by Minister of Finance Andrej Šircelj, in his capacity as Chairman of the EU Council of Economy and Finance Ministers, to the IMFC, Washington, DC, 14 October 2021.

[79] 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 (*Legge 27 febbraio 2017, n. 19, Conversione in legge, con modificazioni, del Decreto-legge 30 dicembre 2016, n. 244*). Banca d'Italia is authorized 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.

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

[81] 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).

Since an amendment of rules on monetary financing is highly contentious, contributing SDRs to the IMF's PRGT remains the easiest and quickest way to provide additional support to developing countries[82].

6. While the new historical allocation of 456.5 billion SDRs is certainly a step in the right direction, the existing legal framework needs to be updated and cleared of the many constraints that risk turning the 2021 SDR allocation into a missed opportunity.

Technical challenges may seem daunting, but they can be overcome if there is enough political will.

ABSTRACT

The 2021 IMF Allocation of Special Drawing Rights: Opportunities and Legal Constraints

This paper describes the main features of the Special Drawing Rights (SDRs), the international reserve assets issued by the International Monetary Fund (IMF). After the historical allocation of SDRs worth 650 billion USD in August 2021, it has been advocated that the wealthiest economies should 'redirect' (or 're-channel') at least part of their new SDRs to the benefit of the most vulnerable countries. This can be achieved in different ways, but all present legal challenges and obstacles, especially for euro-area Member States. The paper discusses several scenarios and concludes that the existing legal framework needs to be cleared of the many constraints that risk turning the 2021 SDR allocation into a missed opportunity.

[82] See, for instance, Italy, Budget Law 2022 of 30 December 2021, n. 234 *(Legge 30 dicembre 2021, n. 234, Bilancio di previsione dello Stato per l'anno finanziario 2022 e bilancio pluriennale per il triennio 2022-2024)*, Art. 1, comma 384-386, authorizing the Bank of Italy to provide new SDR loans and donations to the PRGT within a given ceiling.