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# SDRS RECYCLING

## WHY IT MATTERS FOR THE CLIMATE

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If you're battling to save the climate, then the world's top economic body, the IMF, issuing the clumsily titled "Special Drawing Rights" or SDRs might seem an esoteric distraction. Or maybe the sudden appearance of \$650 billion on the world stage might seem like an early birthday present to be ripped open and spent gleefully on addressing the climate challenge.

The truth is somewhere in between. Unless the climate community engages with what this moment means, then climate is at risk of being sidelined in what may be 2021's central moment in shaping the next few years of the global economy.

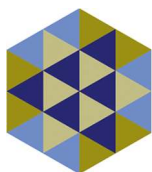
This paper is the climate community's guide to engaging with, and using, the "Special Drawing Rights" moment effectively.

### SDRs have been issued – what does that even mean?

The **SDR** is an international reserve asset – that is, they can be used to increase foreign exchange reserves. **Countries who need access to hard currencies can swap their SDRs** for dollars (or another currency) with countries who have a surplus of hard currency. The country borrowing dollars pay a very low **0.05% annual interest rates** to do so. In other words, issuing SDRs gives all countries more assets, and these can be swapped into hard currencies and spent as required.

In **August**, more than a year since the COVID-19 crisis started, the IMF finally issued long-awaited liquidity to the global economy, in the form of USD650 billion in SDRs. This is an unprecedented figure. In 2009, after the Financial Crisis, they issued just USD250bn. So at face value USD650 billion is an impressive figure.

However, the truth is that the global economy isn't just recovering from COVID-19. It has underlying systemic weaknesses, some of which predate even the 2007-2008 financial crisis. Many countries are seriously in debt. There are real doubts about future volumes of affordable and concessional finance for developing countries.



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That's why the IMF itself is referring to USD650 billion as being just "a shot in the arm." This is a long way from being a Marshall Plan for the world, and is far from sufficient to meet the growing needs of developing economies. Nevertheless, this is 'real money', and the only real money on the table. What's more, there is no realistic plan to issue more SDRs, so it's not worth waiting for them. That means that how this block of money is used matters for what it can buy now, and what precedents it will set for future global economic initiatives.

The climate community needs to actively engage in this debate. The immediate temptation may be to look for the SDRs to help move some funding of climate action. This is certainly true. However, the real prize would be to use SDRs to help kick-start real change towards a better economy. For the climate community to really impact this debate, there needs to be a greater understanding of the nexus between climate and development, and how they can reinforce each other.

## Is that all we need to know about SDRs? What else is on the table?

There is however a lot more to this debate than just the issuance of SDRs. SDRs are allocated according to a pre-determined formula based loosely on the historical size of the economy. This means that 70% of SDRs issued go directly to G20 countries against just 3% for low-income countries. Of the recent issuance of USD650 billion, **USD21 billion have gone to low-income countries and USD212 billion to other emerging market and developing countries excluding China.**

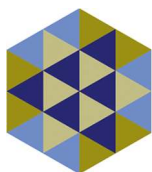
This means that just issuing SDRs to countries on the current basis will not channel sufficient foreign reserves to the countries that need them. Therefore it will not act as a stepping-stone for delivering systemic change. To address this, the G7 and G20 have tasked the IMF with creating a recycling mechanism, where richer economies could recycle – on a voluntary basis – their SDRs to countries with less access to foreign exchange. At the time of writing, neither the quantum nor the mechanism has been agreed. Some proposals have been trailed by the IMF, with **three proposals (not mutually exclusive) drawing the most attention**<sup>1</sup>:

- injecting some into the IMF's existing Poverty Reduction and Growth Trust (PRGT)<sup>2</sup>
- creating a new Resilience and Sustainability Trust Fund (RSTF), which would be managed by the IMF
- transferring some of the SDRs to some of the Multilateral Development Banks, those that are **prescribed holders of SDRs.**

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<sup>1</sup> However, there are more proposal out there see <https://www.cgdev.org/publication/challenge-reallocating-sdrs-primer>

<sup>2</sup> This is the IMF's primary mechanisms for providing concessional financial support to low-income countries. See more: <https://www.imf.org/en/About/Factsheets/IMF-Support-for-Low-Income-Countries>



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Systemic reform will be needed under any of the three proposals to ensure that the recycled SDRs deliver maximum impact. The first two options, the PRGT and RSTF, are subject to the IMF's emphasis on fiscal consolidation. That will deter many countries from accessing them. The last option, using SDRs to recapitalize the MDBs, would only deliver maximum impact if the MDBs were given a clear mandate to support economies in becoming more resilient and sustainable (including climate resilient and net-zero).

## How can the climate community use the SDR moment?

Because SDRs are the only 'real new money' on the table, parts of the climate community are considering them as an option to fill the climate finance gap, since there is little other evidence of how to meet the **USD 100bn climate finance commitment**.<sup>3</sup> Recycling SDRs seems to be an almost 'free' way for developed countries to support building back better globally. Therefore they could be the first step to increasing resources available to countries for the climate transition.

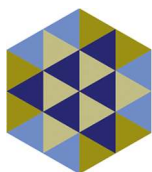
A tempting idea, certainly, but it could be short-sighted. Given the current state of the global economy, bidding to use the SDRs as a climate fund risks putting climate in competition with other priorities for the SDRs. It could also mean missing the chance to drive more systemic change.

An alternative, which could happen in conjunction with using some re-allocated SDRs to support climate finance, would be focusing on using the SDR recycling as a down-payment to drive more broadly based economic reform in developing countries. This would include helping them to grow in a more sustainable way, and protect them against the impact of climate change. For this to happen, the IMF would have to agree to a significant shift in how it assesses countries' economic stability, and therefore how it uses its funds to support them to achieve that stability. Central to this will be shifting the IMF away from its current aim of fiscal consolidation, towards an aim of more sustainable growth.

This would be the catalyst for an overdue rethink of how the international financial architecture supports countries, particularly those hit by losses stemming from natural disasters. As with COVID-19, some vulnerable countries will not be eligible for some existing funds because the IMF, and other economic actors, tend to assess vulnerability from a purely income-based perspective. This will not prove fit for purpose in a world where climate-related disasters are increasingly common and severe. As the climate crisis accelerates, the stability of economies will be undermined by climate change, particularly in those that are exposed to climate and/or to transition risks. This move should, of course, also be linked to strengthening MDB mandates to address climate transition and climate risks.

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<sup>3</sup> Germany and Canada were tasked by the UK COP Presidency to present a proposal for delivering on the annual \$100bn commitment for the 2020-2025 period



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## The climate community reinforcing other actors' work

In stepping up on SDRs, the climate community needs to be aware that SDRs are already the subject of **wider civil society calls for action**. The climate community's engagement with this would be very welcome. Key elements include:

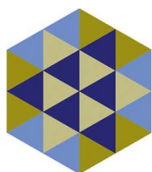
- SDRs should not be recognised as ODA. The SDRs are a reserve asset which shouldn't be used to plug a hole in ODA funding. The UK recognised this in 2009, not counting its loans to the IMF as ODA, and as such it is particularly dispiriting that the UK now seems to have forgotten that lesson – **the UK has been accounting SDRs as ODA, and it is the only country in doing so**.
- The IMF must modernise and move away from 'balancing the books' as an end in itself. If the proposed Resilience and Sustainability Trust Fund ends up being the vehicle for providing climate finance, then this will involve some level of conditionality which might include the traditional fiscal consolidation from the IMF, which doesn't align with the need to create fiscal space for climate and resilient investments.
- The vehicle to disburse SDRs funding should focus on **grants** rather than just loans. The default basis of IMF funding has been loans rather than grants, this might exacerbate the evolving debt crisis in some countries, and the provision of loans will undermine trust.

**To be successful, climate can build new coalitions** with development and health practitioners who are striving towards the same goal.

**SDRs can be a lever to improve the system to deliver for countries.** The ecosystem of support around climate finance is missing a way to support countries which – through no fault of their own – could face economic crisis due to climate change. This could be an opportunity to support vulnerable countries with concessional finance, even if they would not qualify for support based purely on income levels. Recycling SDRs shouldn't undermine countries progress to achieve their development and climate goals.

**However, SDRs are only a stepping-stone on the way to the trillions needed.**

Although welcome, the climate community should ensure countries don't see the job as done but simply a down payment on the finance needed to meet the climate and development challenges of the future.



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## About E3G

E3G is an independent climate change think tank accelerating the transition to a climate-safe world. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

More information is available at [www.e3g.org](http://www.e3g.org)

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