Policy Note
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The South African G20 Presidency and Implementation of SDR Rechannelling

ROB FLOYD & RICHMOND COMMODORE, AFRICAN CENTER FOR ECONOMIC TRANSFORMATION (ACET)

KONRAD ADENAUER STIFTUNG

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Background on special drawing rights

Special drawing rights (SDRs) are a form of 'reserve asset' created by the International Monetary Fund (IMF) in the late 1960s. The value of the SDR is based on a basket of currencies, namely the British pound, Chinese renminbi, Japanese yen, euro and US dollar. The IMF, its member states and 20 other organisations hold SDRs.[1] These 20 organisations are known as 'prescribed holders'. They can buy and sell SDRs, but they do not receive allocations of SDRs as IMF member states do. The member state holders of SDRs can exchange SDRs for currency when needed; hence they can be used to create liquidity and fiscal space. Holding SDRs is essentially cost-free, but nations that exchange their SDRs for financing will face net charges on the difference between their cumulative allocations and their SDR holdings.

The IMF has the authority to allocate SDRs to member states. This is known as a 'general allocation' and the SDRs are distributed to IMF shareholders in proportion to their quota shares (linked to voting power) at the IMF. The most recent allocation was in 2021, when the IMF allocated SDR 456 billion. At the time, this was equivalent to $650 billion, the vast majority of which went to rich countries, given that SDRs are allocated proportionally. The purpose was to enhance liquidity as countries struggled with the COVID-19 pandemic. Prior to that, there was an allocation equivalent to about $250 billion in 2009 during the global financial crisis.

In 2021 the G20 committed to reallocate $100 billion of the $650 billion in SDRs to low-income and vulnerable middle-income countries. To date, these reallocations (or 'donations') have been made to the IMF's Poverty Reduction and Growth Trust (PRGT), which provides concessional resources to the poorest countries. The IMF has been able to provide nearly SDR 26 billion (about $35 billion) in interest-free loans via the PRGT. The other instrument is the Resilience and Sustainability Trust (RST), which has received pledges of SDR 31.9 billion (about $41.4 billion) from 21 holders of SDRs. The RST provides longer-term lending for low-income and vulnerable middle-income countries.

[1] International Monetary Fund, "IMF Executive Board Approves the Applications of Five Institutions to Become Holders of Special Drawing Rights", February 21, 2023. The prescribed holders are: the African Development Bank, African Development Fund, Arab Monetary Fund, Asian Development Bank, Bank for International Settlements, Bank of Central African States, Caribbean Development Bank, Central Bank of West African States, Development Bank of Latin America (Corporacion Andina de Fomento), Eastern Caribbean Central Bank, European Central Bank, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, International Development Association, International Bank for Reconstruction and Development, International Fund for Agricultural Development, Islamic Development Bank, Latin American Reserve Fund and Nordic Investment Bank.

Global financial architecture reform

Following the G20 Capital Adequacy Framework report[2] and calls by US Treasury Secretary Janet Yellen for reforms to multilateral development banks (MDBs)[3] in 2022, there has been a flurry of activity to reform the global financial architecture, particularly to better benefit African and other low-income economies. This has included efforts to boost concessional finance, address debt burdens, enhance African voices in international organisations, increase investment in green industrialisation – and rechannel SDRs. The concept of rechannelling is similar to loaning a currency, which can then be used as equity leverage. Sometimes this is referred to as donating SDRs.

While prescribed holders of SDRs are not allocated SDRs directly, the African Development Bank (AfDB) and the Inter-American Development Bank have proposed the rechannelling of SDRs from IMF member states to MDBs that are prescribed holders.[4] This would be an innovative financial instrument structured as hybrid capital that would be complemented by a Liquidity Support Agreement (LSA). In the case of Africa, SDRs would be loaned to the AfDB, whereby they would be held in the AfDB's SDR account at the IMF as capital. In this way they would be counted as equity on the bank's balance sheets. In turn, this would allow the AfDB to leverage the SDRs up to four times on the capital markets.

For example, a $50 billion rechannelling of SDRs could result in $200 billion for investments in the Sustainable Development Goals (SDGs). The AfDB could do this by using recycled allocated SDRs as a base to issue bonds on international capital markets, to de-risk additional private sector investments through blended finance and to employ securitisation to attract further capital for development projects. Additionally, there would be little cost or risk to SDR holders, as the proposal includes the LSA facility to liquidate SDRs if needed. The AfDB would also pay interest on the SDRs. Given that the total SDRs of all MDBs are restricted to about 0.1% of the world's reserves, there would not be a broad financial systemic risk.

In reality, as discussed below, there are hurdles to rechannelling because in some countries the central bank holds the SDRs, while in other countries it is the Treasury. In some countries there are also restrictions on using reserve assets such as SDR for fiscal purposes.

If rechannelling were realised, it would be an important change to the global financial architecture, allowing significant innovation and increased concessional finance to those countries most in need.

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2 G20 Independent Expert Panel, "Boosting MDBs' Investing Capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks", World Bank Public-Private Infrastructure Advisory Facility, October 1, 2022.

3 US Department of the Treasury, "Secretary of the Treasury Janet L. Yellen Convenes Multilateral Development Banks to Urge Scaled Up Infrastructure Investment and Private Sector Capital Mobilization", press release, October 18, 2022.

4 Akinwumi A. Adesina, "Unlocking Transformative Potential: Rechannelling SDRs Through Multilateral Development Banks Will Spur Sustainable Development in Africa", International Banker, newsletter, September 19, 2023.

Holders of SDRs were reluctant to commit to rechannelling without clear guidance from the IMF, as the issuer. However, in May 2024, the IMF Executive Board approved using SDRs for purchasing hybrid capital instruments from prescribed holders.[5]

Evolution of dialogue on rechannelling SDRs

A number of SDR holders have indicated their support, in principle, for SDR rechannelling to the AfDB. Yet none has formalised that support, owing to many factors. In this regard, the European Central Bank (ECB) has noted that[6]

> [n]ational central banks (NCBs) 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. Retaining the reserve asset status of the resulting claims is paramount. This requires that the claims remain highly liquid and of high credit quality. The direct financing of MDBs by NCBs of EU Member States through SDR channelling is not compatible with the monetary financing prohibition.

This ECB opposition has – for the time being – decreased the number of countries that may agree to rechannel SDRs to the AfDB. Other IMF member states that have relatively large holdings of SDRs and do not face the same constraints as EU members include Australia, Canada, China, Qatar and Saudi Arabia. To date, none of these countries has offered strong statements of support on rechannelling to the AfDB. It seems unlikely that the US will participate, given such a decision would require authorisation from the US Congress.

The UK does not face a legal constraint, but rather one based on precedent, as HM Treasury and the Bank of England usually only purchase senior bonds issued by financial institutions with a minimum rating of AA. The proposed hybrid capital is considered more junior. Canadian officials have informally noted related challenges. Japan seems to want more LSA guarantees before committing to rechannelling, possibly with eight contributing countries rather than five. China's lack of participation may be more geopolitical, based on the fact that its rechannelling would not result in enhanced voice or increased voting shares.

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[5] IMF, "Use of SDRs in the Acquisition of Hybrid Capital Instruments of the Prescribed Holders" (Policy Paper, IMF, May 10, 2024).

[6] BIS, "Christine Lagarde: IMFC Statement", November 16, 2021.

Implications for Africa

Africa's financing needs are well known. According to the AfDB's *African Economic Outlook 2024* report, the annual financing gap is more than $400 billion through 2030. However, rechannelling SDRs through MDBs could increase financing for Africa by about $46.2 billion a year over the next 10 years.[7] The AfDB also noted this would require rechannelling $100 billion to the MDBs, although the latest IMF guidance indicated a cumulative limit of $15 billion. According to the AfDB, combined with SDR rechannelling, additional reforms such as changes to the MDB capital adequacy frameworks, IMF lending into arrears and fairer credit ratings could together equal nearly $170 billion per year. While this is only around 40% of total needs, the impacts could be significant.

Using the AfDB's $46.2 billion projection, research conducted by the African Center for Economic Transformation shows that, if the amount were apportioned based on African countries' 2020 GDP data, projecting from 2020 to 2021, it could have a massive development impact.[8] For example, this could lead to 118 292 more people with increased access to clean water in Burkina Faso; or 304 357 more girls and women with increased access to basic sanitation in Kenya; or 624 406 Moroccans with increased access to clean fuel. If the SDRs were rechannelled in the volumes indicated above, it could mean 31 976 additional children in primary schools in Mozambique; 38 150 more children in lower secondary education in Niger; and 537 958 more people with increased access to basic sanitation in Ghana.

African leaders have rallied behind the proposal to rechannel SDRs to the AfDB. African heads of state and government have published articles and given speeches, the AU has urged rechannelling and ministers of finance have endorsed rechannelling through the Marrakech Declaration, the High-Level Working Group on the Global Financial Architecture and the Africa Caucus Meeting of Governors of the IMF and World Bank.

While the rechannelling of SDRs to the AfDB would provide much-needed fiscal support, it would also start to address long-standing imbalances in the global financial architecture. For example, only 5.2% of IMF quotas are held by African governments and the share of quotas has decreased for some African governments over time. Algeria, Egypt, Nigeria and South Africa are the largest holders of quotas, while 39

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[7] African Development Bank, *African Economic Outlook 2024: Driving Africa's Transformation – The Reform of the Global Financial Architecture*, Report (AfDB, 2024).

[8] In this exercise, we applied the Government Revenue and Development Estimations (GRADE) model, developed by the University of St Andrews, to evaluate the potential impact of increased revenue on the SDGs. The simulations relied on the AfDB's projection of an additional $46.2 billion in funding for Africa from rechannelled SDRs allocated to MDBs in its 2024 *African Economic Outlook* report. This projected amount was apportioned among the target countries based on their 2020 GDP in constant US$ terms and subsequently input into the GRADE model to estimate its potential impact on various SDGs. It is important to note that these development projections are illustrative, dependent on model assumptions and should be regarded as indicative rather than definitive outcomes.

other African countries each represent less than 0.1% of all IMF quotas.[9] Another example of this imbalance was the 2021 SDR allocation, which provided comparatively small benefits to African economies. While $650 billion was allocated, African governments only received 5%, or $33 billion. G20 and other advanced economies collectively received more than $500 billion.

Policy recommendations for the South African G20 presidency

Other than the ECB's concerns about the reserve asset status, there are few technical hurdles to rechannel SDRs to the AfDB, if there is political will. The IMF has provided clear guidance. IMF member states with large holdings have largely been supportive in principle, and the AfDB's 'prescribed holder' status is uncontested. Thus, the primary hurdles are political. The South African G20 presidency will need to address these political hurdles with diplomacy, but also with urgency and savvy.

The following recommendations directly support South Africa's G20 priorities as outlined by the South African government. In particular, this entails efforts to achieve the SDGs, meet the objectives of Agenda 2063, ensure adequate financing for development, address debt vulnerability and reform the international financial architecture. Given that the G20 presidency will rotate to the US in December 2025, it is important that South Africa work closely with the AU during its presidency to build capacity and understanding on SDR rechannelling within the AU.[10]

1. South Africa and the AU should seek an alliance of key G20 EU member states that would, through the ECB Governing Council, **formally request that the ECB provide legal and technical clarification on rechannelling**, as well as realistic options to overcome those technical and legal challenges. The Governing Council is responsible for adopting the guidelines and formulating monetary policy for the euro area.

   Key partners for this action would be G20 EU member states that have indicated support in principle and have significant political voice at the ECB, including France and Germany.

2. South Africa and the AU should coordinate a group of **bilateral partners to support the LSA,** which can be financed through development budgets. The proposed LSA from the AfDB and Islamic

[9] Trevor Lwere, Rob Floyd and Hannah Ryder, "Reimagining the IMF's Quota System and Representation in Africa's Interest" (Policy Brief, G20 Brazil 2024, T20, Task Force 3, 2024).

[10] Government of South Africa, Department of International Relations and Cooperation, "G20 Troika High Level Address by Minister Lamola, United Nations, 25 September 2024", accessed November 28, 2024, https://dirco.gov.za/wp-content/uploads/2024/09/G20-address-by-Minister-Lamola-2024.pdf

Development Bank guarantees the reserve asset status of the contributed SDR by retaining 25% of the SDRs. This ensures that contributing countries can withdraw funds if there is a balance of payments crisis. Importantly, the LSA can accept financing separate from SDR rechannelling. This can be done as fiscal transfers or guarantees from national treasuries and development budgets. In this way, countries not rechannelling SDRs can contribute to guarantee the SDRs of those who did rechannel, freeing up SDRs to be used as hybrid capital.

The LSA is a first-demand financial instrument and requires a minimum of five IMF member countries with strong external positions. While contributions to the LSA do not ultimately reach the goal of rechannelling, they could provide important momentum. This would allow countries that may face technical, legal or political hurdles in rechannelling an important avenue for supporting the AfDB rechannelling proposal.

Key partners for this action would include countries that have indicated support for the rechannelling proposal but may not be in a position to rechannel SDRs at this time. In October 2023 France said that it would participate in the scheme through the LSA.[11]

3. South Africa and the AU should **encourage new options and innovative thinking to create additional fiscal space**. For example, there have been proposals to allocate SDRs directly to prescribed holders.[12] In principle, this would avoid the challenges that countries face related to the reserve asset status. There would be little risk if allocations were to AAA-rated institutions (such as the AfDB) and any insolvency would be shared by all members of the IMF with distributed and 'shallow' liability.

   Similarly, there have been calls to reintroduce an SDR bond.[13] Such a bond could be an SDR-denominated, cash-settled financial instrument that would pay the SDR interest rate. Depending on structure, an SDR bond could have a 30-year maturity and roll over in perpetuity. This concept is not new, as the World Bank issued an SDR-denominated cash-settled bond in 2016, raising nearly $700 million. The sale of gold by the IMF is another option, although it also is not new. In 2007 the IMF sold 12.9 million ounces of gold, the proceeds of which went to PRGT subsidy resources.[14] Likewise, there are many global proposals for taxes on the ultra-wealthy or carbon emissions that can, if managed correctly, be leveraged and provide fiscal space to African governments through innovative financial

[11] AfDB, "Marrakech Meeting on SDRs Rechannelling: Accelerating Development Finance Through Multilateral Development Banks", October 24, 2023.

[12] Mark Plant and Vera Songwe, "Allocate SDRs Directly to Multilateral Development Banks", Center for Global Development, blog post, October 21, 2024.

[13] Stephen Paduano, "A State of Play on SDRs: What To Make of 2023, What to Watch in 2024" (Policy Brief, Finance for Development Lab, January 2024).

[14] Mark Sobel, "IMF Gold Sales to Support the World's Poorest Countries: A Small and Simple Step to Help Fight Global Poverty", Bretton Woods Committee, blog post, May 28, 2024.

instruments. Other, longer-term ideas have been floated by various stakeholders, for example calling for regular SDR allocations or being more explicit in making the SDR a development finance instrument.

The next year provides an opportune time for such innovative thinking, given the upcoming Fourth International Conference on Financing for Development, to be held between 30 June and 3 July 2025 in Seville. South Africa and the AU should collaborate with the UN Department of Economic and Social Affairs and other UN actors to explore options and ideas that would complement SDR rechannelling. This action could be undertaken in partnership with a wide array of think tanks, foundations and civil society organisations from across Africa and the world.

Authors

Rob Floyd

Rob Floyd is the Director of Innovation and Digital Policy at the African Center for Economic Transformation (ACET), a pan-African policy institute. Here, he also leads work programmes on global financial architecture. These include analysis on borrower coordination, advocacy support for concessional finance, research on debt and green industrialisation, and partnerships on building capacity in Africa for an African financial architecture and for governments to better engage with credit rating agencies.

Richmond Commodore

Richmond Commodore is a Senior Economist at ACET. In this role, he has managed and supported multiple projects in the areas of public and global finance, international taxation, financial inclusion, migration, development finance and trade. He has extensive experience in economic data, fiscal policy, political economy analysis, impact assessments and project management.

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Jan Smuts House, East Campus, University of the Witwatersrand
PO Box 31596, Braamfontein 2017, Johannesburg, South Africa
Tel +27 (0)11 339 2021 · Fax +27 (0)11 339 2154
saiia.org.za · info@saiia.org.za

SOUTH AFRICAN INSTITUTE
OF INTERNATIONAL AFFAIRS