**FfD4 seminar series**

# Expanding the Role of SDRs: Opportunities, Challenges, and Institutional Boundaries

**Date: Monday, 3 February 2025**

**Time: 8:30 – 9:45 a.m. EST**

**Location: Ford Foundation and Virtual**

**Co-organizers: UN Foundation, UN DESA FSDO**

## Background

**Since 1969, the International Monetary Fund (IMF) has issued an international reserve asset, known as the special drawing right (SDR).** Under the IMF Articles of Agreement, SDRs are intended to be the principal reserve asset in the international monetary system, but the advent of floating exchange rates and open capital accounts led to a significant loss of interest in SDRs for several decades. Since the global financial crisis in 2008, there has been a renewed interest in the potential of SDRs. Out of the four general SDR allocations, two were made post-2008, including the largest ever allocation, equivalent to about $650 billion, in the aftermath of the COVID crisis in 2021. Discussions have focused on three issues: improving SDR allocation, scale and frequency of issuance, and qualitative changes to expand the use of SDRs.

**Improving the SDR allocation system:** SDRs issuance decisions are made by the IMF Board of Governors after recommendation by the IMF Executive Board; and SDRs are allocated in proportion to IMF member's quota shares. The 2021 allocation, which had to be endorsed by IMF shareholders representing 85 per cent of IMF voting rights, has been widely praised as a significant multilateral achievement. However, the process's length and complexity, the scale and distribution of the allocation, and the underlying system also sparked considerable disappointment and frustration, intensifying debate surrounding the role of SDRs. As the majority of SDRs are issued to reserve currency issuing countries, those SDRs have little prospect of use. In response, international discussions have identified mechanisms to re-channel SDRs from countries that are not using them to the countries that need them. So far rechanneling has only been achieved through two IMF-administered trusts: the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST), which was established in October 2022. Meanwhile, civil society, thought leaders, and some policymakers have called for rules of allocation based on need. If SDRs are rechannelled to multilateral development banks as capital, they can be leveraged for much greater volumes of lending to developing countries.

**More scale/ more regular issuance:** Quantitatively, increasing the issuance of SDRs as global international reserves could address weaknesses in the international monetary system, aligning with the IMF's historical mandate to support external adjustment, provide international liquidity, and bolster reserve adequacy.

**Qualitative changes on the uses of SDR:** Some proposals seek to expand the role of SDRs beyond their function as international reserve assets. Qualitatively, expanded SDRs issuance could also have as its objective complementary purposes, reflecting the IMF's evolving understanding of its mandate. Some proposals suggest utilizing SDR as a tool for climate or development finance. However, these ideas have faced strong political pushback from some IMF members that advocate for a narrower focus on the IMF's historical mandate and emphasize the SDR's role strictly as a reserve asset. These member states stress the importance of maintaining a clear distinction between the IMF and the World Bank's mandates (Holzmann, 2023).

**Political support for greater use of SDRs**: Beyond the legal and technical feasibility of any SDR-related policy proposals, achieving political consensus is crucial. First, issuing more SDR requires sufficient political support of the IMF members.[1] Secondly, reforms to the objectives, allocation metrics or operational aspects of SDRs would require amendments to the IMF's Articles of Agreement. This seminar aims to explain the SDR system and highlight both the potential and the important practical, legal and financial constraints associated with the use of SDR, with a view to exploring how the Fourth International Conference on Financing for Development (FfD4) can take meaningful steps towards better using SDRs, building on the agreements in the Pact for the Future.

## Tentative programme

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| 8:30 – 8:35 | **Welcome**<br>- UN Foundation |
| 8:35 – 8:45 | **Opening remarks**<br>- Shari Spiegel, Director, Financing for Sustainable Development Office, UN Department of Economic and Social Affairs |
| 8:45-9:10 | **Panel discussion – reflecting on the proposals**<br>*Panel members:*<br>- Carlo Sdralevich, Division Chief, Finance Department, IMF<br>- Mark Plant, Center for Global Development<br>- Hassatou N'Sele, Vice President, African Development Bank Group |
| 9:10-9:40 | **Interactive discussion with delegations** |
| 9:40-9:45 | **Concluding reflections**<br>- Co-Facilitators (tbc)<br>- Hosts |

## Seminar series

The Financing for Sustainable Development Office of UN DESA has participated with experts and academics in substantive meetings to support preparations for the Fourth International Conference on Financing for Development (FFD4). These discussions have brought together key stakeholders – academics, experts from international organizations, experts from capitals, experts from think tanks, civil society, and private sector – to consider select number of financing policy questions that Member

[1] Any decision to authorize a new SDR issuance requires 85% of the total voting power (article XVIII). Furthermore, any changes concerning the decision to resort to a general allocation of SDR and its subsequent distribution would require modifying the IMF's Articles of Agreement. Amendments need to be accepted by three-fifths of the members, having 85% of the total voting power (article XXVIII).

States may wish to address in FFD4. Such expert discussion is one element of the broader and comprehensive substantive preparatory process for the Conference. The technical seminar series, co-organized by the UN Foundation, and FSDO/ DESA will present key findings and recommendations to delegates preparing for FFD4.

## Additional substantive background

### 1. Debates on enhancing the role of SDR as an international reserve asset

The IMF could be encouraged to issue more SDR to boost international reserves (Stiglitz and Weisbrot, 2025). Even within this monetary role, the SDR present many advantages for member states:

- Allocations are not subject to any ex ante or ex post conditionality for member states. This is a major difference from IMF financing facilities.
- Allocated SDRs do not generate any costs for member states if they are not converted into hard currency. The interest charges for conversion of SDRs to hard currencies remain moderate, especially compared to the costs of sovereign borrowing on financial markets.
- The use of allocated SDRs is at the discretion of countries, and there are differences among countries about whether SDR allocations are controlled by treasuries/finance ministries or central banks.
  - A member state may keep the SDRs received as an additional reserve, which can improve market access and ease external financing constraints
  - A country may also use the SDRs allocated to it to repay any debts it owes to the IMF
  - A member state may also exchange SDRs for freely usable currencies in order to adjust the composition of its international reserves or pay for imports.

**The two main constraints for more SDRs as international reserve assets**:

- **SDR accumulation can represent an exchange rate risk for participating member states**. Some countries that do not need reserves tend to accumulate SDRs, from the allocation obtained and the additional SDRs received when they accept a transaction on the voluntary exchange market, called the VTA. The number and volume of SDR exchanges through the VTA have significantly increased since the general allocation in August 2021. While SDRs represent a relatively minor share of a central bank's total balance sheet, their proportion within foreign exchange reserves—and, consequently, their contribution to total exchange rate risk—can be more substantial. The SDR position—like any foreign currency position—requires the central bank to maintain a liquidity buffer to cover exchange rate risk. To reduce or neutralize this risk, the use of derivative hedging may be used, which may generate additional costs. Consequently, central banks may be reluctant to support further SDR issuance or engage in additional VTA transactions, given the potential impact on exchange rate risk management.

- **The monetary nature of the SDR is intrinsically linked to the need to preserve its status as a reserve asset.**
  - The conditions governing the issuance of SDRs through a general allocation clearly underline the reserve asset nature of SDRs. Issuance should be in the case a global need to supplement reserves. An allocation must also "avoid economic stagnation and

deflation as well as excess demand and inflation in the world (Article XVIII, b). Member states can oppose to SDR issuance to avoid the risk of inflationary pressures.

- Besides, the IMF's Articles of Agreement also highlight the SDR's role as reserve asset: "a participant will be expected to use its SDRs only if it has a need because of its balance of payments or its reserve position or developments in its reserves" (Article XIX, section 3, a). Key requirements for reserve assets are liquidity and low level of risk. This reserve asset status has had implications for SDR channeling. For instance, in the European Union, maintaining the reserve asset status of SDR loans is essential to ensure that such loans to the IMF are not classified as monetary financing, which would violate Article 123 of the Treaty on the Functioning of the European Union (TFEU). To address this, the financial architectures of the Resilience and Sustainability Trust (RST) and the Poverty Reduction and Growth Trust (PRGT) had to be carefully designed to comply with legal requirements while preserving the reserve asset status of SDR loans provided by central banks involved in SDR re-channeling.

## 2. Enhancing the role of SDR as a tool for development finance

Since the last general SDR allocation, several developments have blurred the distinction between SDRs as instruments of liquidity and reserve assets, and their use for other purposes. SDRs have been included in broader considerations on the IMF's mandate and on how climate vulnerabilities, and more broadly development issues, should be reflected in the provision and mobilization of concessional financial by multilateral institutions.

- The IMF has acknowledged that using SDRs for fiscal purposes is a spillover effect of the allocation (Bretton Woods Project, 2024). In an ex-post assessment report of the 2021 allocation, the IMF noted that financing budget expenditure was the second most common use of the allocation (IMF, 2023).
- In October 2022, the RST has been created to provide longer-term financing to address longer-term challenges, including climate change. The RST is funded by SDR-denominated loans from member states.
- In May 2024, the IMF has approved the channeling of SDRs to multilateral development banks (MDBs) by acquiring hybrid capital instruments issued by these banks (Plant and Songwe, 2024).

These developments have faced growing opposition from some member states. Beyond the legal and operational issues surrounding the maintenance of reserve asset status above-mentioned, a more fundamental debate is underway on the on the nature and purpose of SDRs. Some member states take a more conservative approach to preserving the monetary nature of SDRs. They regard certain SDR channeling options as indirect monetary financing of national development aid policies. They consider that channeling SDRs may mark a shift in nature between reserve asset and development financing instruments.

## Bibliography

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