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Economic Commission for Africa

Recycling special drawing rights for post-pandemic recovery in Africa

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I. Introduction

The coronavirus disease (COVID-19) pandemic is expected to have a long-lasting impact on the developing world. At the onset of the global health crisis, it quickly became clear that, without adequate support for vulnerable economies, the shock of the pandemic would further widen the development gap between advanced and developing countries.

In Africa, the socioeconomic consequences of COVID-19, including negative impacts on the health sector, disruptions in supply and demand and the ensuing job losses, have dampened the effects of the previous two decades of growth and progress on poverty reduction. The pandemic has also exacerbated the continent's liquidity problems and other finance issues. In many countries, shrinking fiscal revenue, coupled with the rising demand for public expenditure to support health systems, businesses and vulnerable households, has put considerable pressure on government coffers, thus increasing national debt levels. For many countries that were already struggling with high indebtedness prior to the emergence of COVID-19, debt servicing costs have become unsustainable, leading to debt distress. By the end of 2020, more than 50 per cent of African countries had debt-to-gross domestic product (GDP) ratios of at least 60 per cent, with nearly 17 per cent registering debt ratios of 90 per cent or above (International Monetary Fund (IMF), 2021a). While the developed world was able to respond to the COVID-19 crisis using large fiscal stimulus packages, countercyclical expansionary monetary policies and massive vaccine procurement, developing countries, including those in Africa, lacked the liquidity required to respond appropriately to the crisis and to make the transformative investments needed for a faster and more enduring recovery.

As an immediate response to those fiscal challenges, the Debt Service Suspension Initiative of the Group of 20 bilateral creditors, developed with the support of the World Bank and IMF, eased the financing constraints for low- and lower-middle-income countries, including 32 African countries. Created in May 2020, the Initiative suspended debt service payments totalling $12.9 billion for 48 countries out of the 73 that were eligible. The objective was to free up resources to create fiscal space for urgent pandemic-related expenditure. The Debt Service Suspension Initiative expired in December 2021 (World Bank, 2022a). Furthermore, IMF provided assistance through its emergency financing instruments, balance-of-payment support and debt service relief. Forty-five African countries have received such financial assistance from IMF, totalling approximately $37.7 billion (IMF, 2022a).[1] Among the 31 beneficiaries worldwide granted temporary debt service relief under the Catastrophe Containment and Relief Trust, 24 were African countries.[2] IMF originally established the Catastrophe Containment and Relief Trust in 2015 to support its poorest and most vulnerable member countries during periods of catastrophic natural disasters and public health disasters. The Trust provides grants to pay debt service owed to IMF, and debt flow and debt stock relief on countries' debt service to the Fund, which creates additional fiscal space by freeing up resources for immediate balance-of-payment needs, containment responses and recovery. Debt relief under the Catastrophe Containment and Relief Trust is currently provided to countries that are also eligible for assistance made available through the Poverty Reduction and Growth Trust, discussed below in the section "Recycling through trust funds of the International Monetary Fund".

1 The data cover the period from March 2020 to March 2022.

2 Benin, Burkina Faso, Burundi, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mozambique, Niger, Rwanda, Sao Tome and Principe, Sierra Leone, Togo and United Republic of Tanzania. For more details, see www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/49/Catastrophe-Containment-and-Relief-Trust.

While these initiatives have been valuable in countries' immediate responses, additional financing is required to tackle long-term structural challenges, accelerate recovery and achieve the Sustainable Development Goals on the continent. For an adequate response to COVID-19, IMF estimates suggest that African countries will require at least $285 billion over the period from 2021 to 2025, with $245 billion needed in sub-Saharan Africa alone (IMF, 2021b; IMF, 2021c).

In August 2021, IMF implemented a new general allocation of special drawing rights (SDRs), its largest ever, of SDR 456.5 billion,[3] equivalent to approximately $650.2 billion, for its 190 member countries. The allocation was intended to supplement countries' reserves, build resilience to COVID-19 and support investments for a speedy recovery, in particular in vulnerable countries. Because general allocations of SDRs are distributed to countries in proportion to their IMF quota shares, advanced economies received the largest amount, with only 38.6 per cent of the new SDRs (equivalent to some $250.9 billion) accruing to emerging and developing countries (see table 1). Africa received about $33.8 billion, or 5.2 per cent of the total allocation, which falls far short of the continent's financing needs if it is to launch an effective COVID-19 response.

According to recent IMF estimates, Africa will need at least $518 billion to revert to its pre-pandemic economic trends (IMF, 2021b). Meanwhile, even before COVID-19, the minimum estimate of the Sustainable Development Goals financing gap in Africa was roughly $200 billion (United Nations Conference on Trade and Development, 2014). SDRs clearly represent a more stable and less costly source of long-term financing in a context of high indebtedness levels coupled with steep borrowing costs in international capital markets. Thus, SDRs constitute an appropriate means of boosting needed investment towards faster recovery and the achievement of the Sustainable Development Goals in developing countries, in particular those with minimal external positions.

In the present paper, the merits and feasibility of alternative mechanisms for recycling SDRs from developed economies to low- and middle-income countries in Africa are discussed, as is the significance of such resources in the context of the continent navigating COVID-19 and other external shocks, including climate change and the conflict between the Russian Federation and Ukraine. In section 2 of the paper, background on the recent general allocation of SDRs and the advantages of that instrument compared with other financing sources is provided, and SDR utilization across countries and the implications of the current allocation for highly indebted economies are discussed. In section 3, an overview of proposed SDR recycling mechanisms and their feasibility in African countries is provided, while section 4 concludes with a number of policy implications and recommendations.

3 The conversion of the general allocation from SDRs to dollars is based on the exchange rate on 31 August 2021 (SDR 1 = $1.42426) (see table 1).

II. Allocation of special drawing rights and their role in the continent's socioeconomic recovery

SDRs are an international reserve asset that has been issued by IMF since 1969. They are held by the Fund, its member countries and 15 other institutions called "prescribed holders", which, under the Articles of Agreement of IMF, may comprise non-participants in the SDR Department, non-members and official entities.[4] SDRs serve as a unit of account of IMF and other international organizations, and they are internationally acceptable in exchange for foreign currency. The value of an SDR has been expressed in terms of a basket of international currencies since July 1974.[5] SDRs are allocated in line with IMF members' quotas, which capture countries' relative positions in the global economy, including with regard to national income, trade, international reserves and economic stability (IMF, 2022b).

SDRs are flexible financing instruments that can be used not only as foreign exchange reserves but also for such operations as the repayment of loans, payment of interest on debt obligations and acquisition of convertible currencies, or for budgetary purposes. Furthermore, all participants in SDR allocations and holders of SDRs can buy and sell their SDR holdings and borrow, donate, lend or pledge SDRs in support of other countries (IMF, 2022b). Transfers of SDRs between IMF members are based on bilateral agreements, and the operations are then recorded by the Fund. In situations in which there are insufficient numbers of voluntary buyers, IMF can intervene by designating countries with strong balance-of-payment positions to exchange SDRs for currencies to support countries with weak external positions. However, that mechanism has not been used since 1987 (Viterbo, 2021; Gallagher and others, 2021). IMF member countries are advised to prioritize sustainable macroeconomic policies and pursue transparency in the utilization of their SDR holdings (IMF, 2021d).

SDRs offer particular benefits for African countries, especially in the wake of the COVID-19 pandemic. First, unlike regular IMF lending programmes, SDR allocations provide a means of financing to vulnerable economies without any conditionalities attached, and thus generate no reform-related social costs. While the mandated policy reforms attached to conventional IMF lending facilities have helped to accelerate needed reform in borrowing countries, those conditionalities have also been criticized for creating distortions in government spending, which can lead to adverse social effects (Stubbs and others, 2020).

Second, as supplements to IMF member countries' reserve assets, SDR holdings strengthen their external positions, thus reducing their exposure risks in international capital markets. Between 2007 and 2014, several African countries entered the global capital market with stable macroeconomic conditions, but speculative sovereign credit ratings resulted in higher risk premiums relative to their counterparts from other global regions (Olabisi and Stein, 2015). As a consequence of the COVID-19 pandemic, developing countries' credit ratings are being downgraded owing to their economic difficulties, further increasing their borrowing costs. Therefore, by providing a buffer for countries' reserves, SDRs increase market

4 The current prescribed holders include four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States and Eastern Caribbean Central Bank), three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund and Arab Monetary Fund) and eight development institutions (African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development, International Development Association, Islamic Development Bank, Nordic Investment Bank and International Fund for Agricultural Development) (IMF, 2020a).

5 The "standard" basket of currencies comprises the dollar, euro, pound sterling, yen and yuan.

confidence by signalling macroeconomic stability, stronger debt repayment capacity and reduced risk of default, leading to a lower liquidity premium for Eurobond market participants.

Third, SDRs provide liquidity at a lower and more stable cost compared with the cost of borrowing on international capital markets. The new general allocation has therefore helped to reduce African countries' exposure to market volatilities and to limit the risk of a debt crisis, in particular in the current context of rapidly rising interest rates on the global market (Clark and Polak, 2002).

Fourth, SDRs do not generate additional debt. Unlike traditional debt instruments, including concessional IMF facilities, the principal is not reimbursable. However, net users of SDRs are required to pay an SDR interest rate on the difference between their cumulative allocation and their holdings (a rate often below the market interest rate),[6] which is then allocated to net holders of SDRs, making participation in the SDR market beneficial to both buyers and sellers. According to recent IMF debt sustainability data, 16 low- and lower-middle-income countries in Africa are at high risk of debt distress, and 6 are already in debt distress (IMF, 2022d). For such countries, this characteristic of SDRs makes them a more sustainable financing instrument than traditional debt instruments. Furthermore, SDRs can be used to pay off existing debts to IMF and to help reduce debt vulnerabilities in highly indebted countries across Africa.

Since the introduction of SDRs in 1969, IMF has allocated a total of SDR 660.7 billion[7] to its member countries. The most recent general allocation prior to 2021 was the 2009 allocation of SDR 21.5 billion, which was implemented in the aftermath of the 2008 global financial crisis with the aim of stabilizing the financial conditions of member countries. The 2021 general allocation of SDR 456.5 billion was by far the largest in the history of the Fund (IMF, 2022b). Although SDRs are allocated to all IMF member countries regardless of their income level, the share received by each country is linked to its IMF quota share. The initial allocation was therefore unequal and was biased in favour of developed countries. The developing world, however, tends to be more dependent on SDRs for its balance-of-payment and budgetary needs (Gallagher and others, 2021).

6 The SDR interest rate is determined weekly based on currency shares in the SDR basket, the interest rate on the financial instrument of each component currency and the exchange rate of each currency against the SDR. While the rate held stable in 2021 (at 0.05 per cent), it has recently trended upward. As at 4 July 2022, the SDR interest rate was 0.993 per cent (IMF, 2022b).

7 Past SDR allocations were implemented in the periods 1970–1972 and 1979–1981 and in 2009 (IMF, 2022b).

Table 1 2021 general special drawing rights allocation

Region/group of economies	SDR allocation (billions of US dollars) (effective 22 August 2021)	SDR allocation (billions of SDRs) (effective 23 August 2021)	Share of total allocation (percentage)
Africa	33.8	23.7	5.2
Advanced economies	399.2	280.3	61.4
All emerging market and developing economies	250.9	176.2	38.6
Emerging market and developing economies (excluding China)	209.3	147.0	32.2
Sub-Saharan Africa	24.2	17.0	3.7
Middle East and North Africa	43.7	30.7	6.7
South Asia	23.6	16.6	3.6
East Asia and the Pacific	133.7	93.9	20.6
Europe and Central Asia	245.0	172.0	37.7
Latin America and the Caribbean	51.5	36.2	7.9
North America	128.3	128.3	19.7
World total	650.2	456.5	100.0

Notes: The advanced economies include: Andorra, Australia, Austria, Belgium, Canada, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Republic of Korea, San Marino, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, United Kingdom of Great Britain and Northern Ireland and United States of America (IMF, 2022e).

The data on the 2021 general SDR allocation (effective as at 23 August 2021) are from the IMF Finance Department (IMF, 2021e) and are available at www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation. The conversion of the 2021 general allocation from SDR to dollars is done using the exchange rate as at 31 August 2021 (SDR 1 = $1.42426) (IMF, 2022c).

As shown in table 1, Africa received approximately $33.8 billion in SDRs, or nearly 5.2 per cent of the total allocation. As illustrated in table 2, the top 10 recipients of SDRs on the continent were South Africa, Nigeria, Egypt, Algeria, Libya, the Democratic Republic of the Congo, Zambia, Morocco, Angola and Ghana. Together, those countries account for more than 60 per cent of the continent's total allocation. Highly indebted small countries with debt levels exceeding 80 per cent of their GDP in 2020, including Sao Tome and Principe, Seychelles and Cabo Verde, received 0.1 per cent or less. Other countries, including the Congo, the Gambia, Mauritius and Mozambique, received less than 1 per cent of the continent's allocation.

However small, the resources generated by the new SDR allocation represent lifelines for many countries in Africa. When the issuance became effective on 23 August 2021, the shares of allocations received in countries' reserves ranged from 2.7 per cent of total reserves in Mauritius, to more than 1,000 per cent in Zimbabwe. For example, in Mozambique, the pre-allocation holdings which amounted to 0.14 per cent of its reserves as of July 2021, the new SDR allocation led to an increase of nearly 7.44 percentage points. Similarly, in South Sudan, where international reserves fell by approximately 51 per cent between 2019 and 2020, mainly as a result of the global response to the COVID-19 pandemic, the new issuance of SDRs increased the share of SDR holdings in total reserves by nearly 183 per cent (World Bank, 2022b; see also table 2).

In general, low- and middle-income countries have historically used large amounts of SDRs relative to their allocations, in comparison with high-income countries. Indeed, while overall accelerations in the use of SDRs are usually observed during periods of crisis, emerging economies and developing countries, with the exception of China, have tended to use their SDR holdings more frequently compared with advanced economies (Gallagher and others, 2021; Cashman, Arauz and Merling, 2022). Recent estimates by the Economic Commission for Africa (ECA) and the Economic Commission for Latin America and the Caribbean (ECLAC) (ECA-ECLAC, 2022) suggest that the SDR utilization rates (the difference between SDR allocations and SDR holdings divided by IMF quota) for developed and developing countries in 2021 were 5.9 per cent and 42.9 per cent, respectively.

As of June 2022, 44 countries in Africa recorded lower SDR holdings compared with their holdings at the end of August 2021 (see table 2). Furthermore, 14 countries, most of which have high levels of indebtedness or are at high risk of debt distress, had used more than half of their SDR holdings during that period (IMF, 2021b, 2022d; see also table 2). Those SDRs have mostly been used to purchase hard currency for vaccine procurement, health and social support, wages, budget financing and debt repayment to IMF. Nearly seven months after the new SDR allocation, 40 countries had allocated part of their holdings to fiscal spending and to reducing their budget deficits (Cashman, Arauz and Merling, 2022).[8] Countries that have used SDRs to repay debt obligations include Egypt, Ghana, Guinea-Bissau, Kenya, Mauritania, Namibia, Senegal, South Africa and Tunisia (Cashman, Arauz and Merling, 2022; IMF, 2022f).

In countries in which SDRs are not exchanged for hard currency, those assets have served to strengthen balance-of-payment positions and stabilize the economy (Cashman, Arauz and Merling, 2022; IMF, 2022f) or have enabled countries to free up other foreign currency reserves to meet their financing needs. For example, the following countries reported that all or part of their 2021 allocations would be retained to bolster their reserves: Algeria, Angola, Burundi, Cameroon, Central African Republic, Democratic Republic of the Congo, Gambia, Kenya, Liberia, Madagascar, Malawi, Nigeria, Rwanda, Sao Tome and Principe, Somalia, South Sudan, Uganda, United Republic of Tanzania and Zimbabwe (IMF, 2022f).

8 Angola, Benin, Burkina Faso, Cabo Verde, Cameroon, Central African Republic, Chad, Comoros, Congo, Democratic Republic of the Congo, Côte d'Ivoire, Egypt, Equatorial Guinea, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Nigeria, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, South Sudan, Togo, Tunisia, Uganda, Zambia and Zimbabwe.

Table 2 2021 general special drawing rights allocation and holdings by African countries

Country	Gross debt (percentage of GDP) – 2020	SDR allocation (millions of SDRs) – Aug. 2021	SDR allocation (millions of US dollars) – Aug. 2021	SDR allocation (percentage of total allocation to Africa)	SDR holdings (percentage of total reserves) – Jul. 2021	SDR allocation (percentage of total reserves)	Change in SDR holdings, Aug. 2021–Jun. 2022 (percentage of cumulative allocation)
Algeria	55.61	1878.48	2675.44	7.91	2.21	4.50	10.73
Angola	136.54	709.35	1010.30	2.99	1.74	7.33	-4.97
Benin	46.14	118.66	169.00	0.50			-1.46
Botswana	20.08	189.01	269.20	0.80	1.72	5.45	0.02
Burkina Faso	46.54	115.40	164.36	0.49			-5.62
Burundi	66.99	147.60	210.22	0.62	10.03	232.76	-25.77
Cabo Verde	158.12	22.72	32.35	0.10	0.01	4.40	-71.01
Cameroon	45.79	264.53	376.76	1.11			-34.63
Central African Republic	44.14	106.77	152.07	0.45			-64.35
Chad	47.91	134.38	191.39	0.57			0.02
Comoros	22.30	17.06	24.30	0.07	4.38	8.26	-0.13
Congo	101.05	155.27	221.14	0.65			-66.10
Côte d'Ivoire	47.74	623.38	887.85	2.63			-13.88
Democratic Rep. of the Congo	15.16	1021.71	1455.19	4.30	5.11	194.63	-33.39
Djibouti	40.88	30.48	43.41	0.13	0.58	6.32	-68.23
Egypt	89.84	1952.47	2780.82	8.23	0.52	7.14	-68.80
Equatorial Guinea	48.86	150.96	215.00	0.64			-82.80
Eritrea	184.90	15.24	21.70	0.06			-0.04
Eswatini	41.67	75.24	107.16	0.32	12.75	19.64	-41.01
Ethiopia	55.42	288.21	410.48	1.21	0.36	13.48	-70.33
Gabon	77.40	207.03	294.86	0.87			-17.97
Gambia	83.49	59.62	84.91	0.25	0.85	21.94	-1.24
Ghana	78.92	707.34	1007.44	2.98	0.12	12.78	-6.41
Guinea	43.78	205.30	292.40	0.87	5.67	19.50	-67.21
Guinea-Bissau	79.30	27.22	38.77	0.11			-2.07
Kenya	67.57	520.25	740.97	2.19	0.17	8.93	-9.15
Lesotho	50.38	66.90	95.28	0.28			-3.81

Liberia	61.89	247.66	352.74	1.04	57.37	103.45	-11.50
Libya		1507.84	2147.56	6.35			0.04
Madagascar	46.02	234.25	333.63	0.99	0.62	16.84	-1.76
Malawi	54.71	133.03	189.47	0.56	1.05	31.87	-66.72
Mali	47.43	178.85	254.73	0.75			-2.66
Mauritania	59.19	123.45	175.82	0.52	0.39	11.78	-66.32
Mauritius	99.91	136.29	194.12	0.57	1.77	2.66	0.01
Morocco	75.37	857.24	1220.94	3.61	2.44	3.39	-0.88
Mozambique	128.45	217.76	310.15	0.92	0.14	7.58	-2.92
Namibia	66.18	183.16	260.87	0.77	0.01	12.02	-0.55
Niger	44.97	126.13	179.65	0.53			18.32
Nigeria	35.00	2352.53	3350.61	9.91	5.68	9.12	-0.52
Rwanda	60.11	153.54	218.69	0.65	4.24	12.11	-70.15
Sao Tome and Principe	81.37	14.19	20.20	0.06	1.51	26.83	-67.68
Senegal	68.68	310.16	441.74	1.31			61.91
Seychelles	96.48	21.95	31.26	0.09	0.73	5.59	-3.46
Sierra Leone	73.73	198.78	283.12	0.84	31.50	40.01	-2.22
Somalia		156.61	223.06	0.66			-23.31
South Africa	69.45	2924.44	4165.16	12.32	3.89	7.57	0.01
South Sudan	35.81	235.78	335.81	0.99	0.13	182.89	-44.03
Sudan	272.92	604.02	860.28	2.54			0.00
Togo	60.28	140.70	200.40	0.59			0.07
Tunisia	89.74	522.55	744.25	2.20	0.60	7.59	-66.04
Uganda	44.10	346.00	492.80	1.46			-0.02
United Republic of Tanzania	39.15	381.27	543.03	1.61			-66.67
Zambia	128.70	937.56	1335.33	3.95	15.38	110.96	-0.02
Zimbabwe	86.15	677.44	964.85	2.85	4.96	2888.32	-19.73
Africa	71.58	23,733.74	33,803.02	100.00	-	-	-14.33

Notes: The data on the 2021 general SDR allocation (effective on 23 August 2021) are derived from IMF Finance Department figures (IMF, 2021e), available at www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation. SDR holdings are recorded for 31 July 2021, 31 August 2021 and 30 June 2022, and are obtained from the IMF financial database (IMF, 2022c). The conversion of the general allocation from SDRs to dollars used the exchange rate of 31 August 2021 (SDR 1 = $1.42426). For the conversion of the holdings as at 31 July 2021, the prevailing rate of SDR 1 = $1.42877 (rate of 30 July 2021, as the rate on 31 July was not available) was used. The exchange rates are from the IMF Exchange Rates Database, available at ***www.imf.org/external/np/fin/ert/GUI/Pages/CountryDataBase.aspx.*** The data on total reserves (including gold) are for the end of 2020. The data are expressed in current United States dollars and are obtained from the World Development Indicators (World Bank, 2022b). The data on gross debt-to-GDP ratio are from the IMF Fiscal Monitor Database (IMF, 2021). The value for Africa was obtained from the simple average of African countries' values.

Given the high utilization rate of SDRs in Africa and the manner in which the instrument is being used, it is clear that the 2021 general allocation was timely in providing fiscal space that facilitated the efforts of African countries to address COVID-19-related shocks. More needs to be done, however, to provide the medium- and long-term development financing that Africa desperately needs for recovery, to implement the Sustainable Development Goals, adapt to climate change and address the repercussions of the conflict between the Russian Federation and Ukraine. The historic 2021 general SDR allocation needs to be complemented with additional support made available through the reallocation of existing SDRs from advanced economies with strong balance-of-payment positions to finance transformative investments in Africa.

At the Summit on Financing African Economies, held in Paris in May 2021, France joined African Governments in calling for the rechannelling of $100 billion in SDRs from rich countries to support the continent's post-pandemic recovery plan (Irish, 2021). At the summit of the Group of 20 held in Rome in 2021, developed countries pledged to channel approximately $60 billion through voluntary contributions to bolster financing in the most vulnerable countries, in line with the global objective of reallocating $100 billion in SDRs to boost the pace of recovery in poorer countries (Group of 20, 2022). Recently, several countries have pledged part of their SDR holdings as voluntary loans or subsidized resources to the IMF Poverty Reduction and Growth Trust (IMF, 2022d).

As debate around the adequacy of the SDR recycling mechanism has intensified in recent years, other mechanisms have been proposed, in addition to the Poverty Reduction and Growth Trust. The three main proposals are the newly established IMF Resilience and Sustainability Trust, on-lending through multilateral development institutions, and the Liquidity and Sustainability Facility, which are discussed in the following section.

III. Special drawing right recycling mechanisms: feasibility and implications for Africa

A. Recycling through trust funds of the International Monetary Fund

1. Poverty Reduction and Growth Trust

The Poverty Reduction and Growth Trust is the main vehicle through which IMF provides concessional loans to its poor and vulnerable member countries. Lending through the Trust was introduced in 2010 and, for many years, it has remained a means for SDR recycling from advanced economies to eligible low- and middle-income countries. To be eligible for financing from the Trust, a country's annual per capita gross national income must be below the applicable threshold (based on the International Development Association income threshold) and the country must not have the ability to access international financial markets on a durable and substantial basis (IMF, 2020b). Most countries eligible for assistance through the Poverty Reduction and Growth Trust are categorized as low-income or lower-middle-income countries and are saddled with high levels of indebtedness. Countries with relatively high income levels generally blend Poverty Reduction and Growth Trust lending, carrying a zero interest rate, and IMF non-concessional General Resources Account financing (IMF, 2022f). With a rules-based assessment, also related to income levels and access to financial markets, a country can graduate from the Poverty Reduction and Growth Trust. For example, Guyana recently graduated from the Trust framework (IMF, 2020b).

Poverty Reduction and Growth Trust lending operations rely on loan and subsidy resources obtained through grants or loans from bilateral contributors. Subsidy resources from the Trust enable it to finance the interest paid to lender countries while maintaining concessional interest rates for borrowing countries. The interest rate on loans through the Trust is set using a rules-based system; however, the rate is currently zero across all facilities (IMF, 2022g).

Lending through the Trust relies on three facilities to support eligible countries with balance-of-payment needs: the Extended Credit Facility, which provides medium-term financing, with a repayment period of 5.5–10 years; the Standby Credit Facility, which provides short-term financing with repayment over a period of 4–8 years); and the Rapid Credit Facility, which provides more flexible and rapid low-access loans to countries with urgent balance-of-payment needs when implementing a fully fledged economic arrangement is not feasible or necessary (IMF, 2022f).

At the onset of the global COVID-19 pandemic (between early 2020 and mid-2021), the Fund mobilized approximately SDR 16.9 billion as loan resources from 16 developed member countries, with the intention of providing concessional financing to poorer countries under the 2020 fast-track fundraising programme (IMF, 2021f; IMF, 2022g), with nearly two thirds provided as recycled SDRs. To meet increasing demand for concessional lending from the Poverty Reduction and Growth Trust during the pandemic and beyond, estimated additional funding needs for loan and subsidy resources over the period from 2020 to 2024 are SDR 14.9 billion, comprising additional subsidy funds of SDR 2.3 billion.

Given the growing demand for concessional borrowing owing to the COVID-19 shock, IMF proposed a two-stage funding strategy for the Poverty Reduction and Growth Trust. The first implementation stage spans the period from 2020 to 2024 and the second stage is to be implemented following a review in 2024 and 2025 (IMF, 2022g).

The Fund noted a shift in countries' demand for concessional lending from emergency financing to medium- and long-term arrangements to support post-pandemic recovery programmes, starting in August 2020. For instance, African countries, including Chad, the Congo, the Democratic Republic of the Congo, Kenya, the Niger and Uganda, have received financial support from the Poverty Reduction and Growth Trust under Extended Credit Facility or Extended Credit Facility-Extended Financing Facility blend arrangements (IMF, 2022g).

As of April 2022, 12 advanced economies had officially pledged to contribute about SDR 7.3 billion to the Poverty Reduction and Growth Trust. However, additional funds are needed to reach IMF targets, and bilateral subsidy contributions have so far been met with limited enthusiasm on the part of donors. Of the targeted amount of SDR 2.3 billion, a total of only SDR 0.5 billion – one fifth of the total amount – had been pledged as of April 2022 as subsidy resources to support zero-interest concessional financing. Furthermore, there are outstanding pledges of SDR 223 million in subsidy resources under the 2020 fundraising programme (IMF, 2022b). Additional contributions are expected to come mainly from developed countries with strong external positions, through donations and voluntary lending of SDRs from the 2021 general allocation.

On-lending SDRs through the Poverty Reduction and Growth Trust has several advantages. First, the mechanism is beneficial to both Trust lenders and borrowers, as it provides a framework that enables contributors to earn interest on SDRs and, at the same time, supports recovery in poorer countries. It also provides liquidity support to eligible countries on concessional terms (at a zero interest rate) under different facilities for short- and long-term financing.

Second, applying for loans from the Trust is now easier for eligible countries. Specifically, the Fund implemented a series of reforms to ensure adequate access to IMF financing in response to the COVID-19 crisis, such as increasing the normal annual and cumulative access limits to which IMF lending facilities are subject. Under the exceptional access framework of the Fund, member countries' requests for additional financial assistance in excess of established thresholds usually undergo greater scrutiny. Prior to the COVID-19 crisis, the normal annual access limit was 100 per cent in the Trust. Because of the exceptional pandemic situation, however, the Executive Board of IMF approved an increase in access limits to provide additional room for countries to borrow from the Fund. The normal annual and cumulative limits on access to funding from the Trust are currently set at 145 per cent and 435 per cent of the quota, respectively (IMF, 2021f). Another recent IMF reform eliminated the hard cap on exceptional access to financing from the Trust (IMF, 2022g).

A third advantage is that the role of IMF as a trustee gives assurance to lending countries that the loans provided under the Trust are secure, with multiple safeguards in place to reduce credit risks. Among those risk management and mitigation measures are the reserve account and the subsidy reserve account of the Trust, which were established to ensure that creditors are repaid in situations of delayed payment or default. Under the framework of the Trust, IMF holds different kinds of accounts. Loan accounts receive monies from contributors to the Trust, which are then channelled to its borrowers. Subsidy accounts contain the resources that serve as subsidies, enabling the Fund to cover the difference between the interest rate paid to loan contributors and zero-interest financing for borrowers. Those resources comprise returns on investments and funds from bilateral donors and IMF. The reserve account holds IMF resources generated from gold sales. It provides income for investments, which helps to sustain the Trust and ensure timely repayment. The subsidy reserve account complements the subsidy accounts because it generates investment income to help manage risk and sustain concessional lending. Finally, the deposit and investment account is an instrument of the Trust that enables long-term borrowing from contributors, as it generates significant investment returns (IMF, 2022g).

If lenders face balance-of-payment difficulties, they can reclaim their SDRs under the encashment regime. In such cases, IMF repays the requesting contributor using the funds committed by other lenders, because 20 per cent of the amount contributed under the encashment regime is kept as a liquidity buffer.[9] Furthermore, the Fund's programme design, debt policy advisory services and policy conditionalities constitute additional risk-mitigating mechanisms.

Notwithstanding the benefits of using the Trust as a vehicle for SDR recycling, the Trust is only accessible to its eligible members, meaning that middle-income countries facing fiscal challenges and liquidity constraints are unable to access its concessional financing. Although African economies currently account for more than half of the 69 countries eligible for assistance from the Trust, non-eligible African countries include a number of highly indebted economies, including Egypt, Gabon, Mauritius, Morocco and Seychelles (see table 2).

2. Resilience and Sustainability Trust

The loan-based Resilience and Sustainability Trust provides an SDR recycling channel for long-term concessional financing to support economic resilience, stability and climate-related investments in the developing world, including in vulnerable lower-middle-income countries that are not eligible for assistance through the Poverty Reduction and Growth Trust (IMF, 2022h). The 69 countries that are eligible under the Poverty Reduction and Growth Trust are also eligible for assistance under the Resilience and Sustainability Trust. All 54 African countries are eligible for the Resilience and Sustainability Trust, and they will be able to access the facility once it is fully operationalized.

Liquidity provided through the Resilience and Sustainability Trust is expected to bolster countries' recovery from the COVID-19 pandemic, cushion the negative spillovers from the conflict between the Russian Federation and Ukraine, support macroeconomic stability and foster sustainable growth in poorer countries. The Trust's operations will initially focus on climate change and pandemic preparedness, which have public good characteristics (IMF, 2022h). Estimates suggest that the initial resources needed, which are being mobilized from contributors on a voluntary basis, total SDR 33 billion (equivalent to approximately $45 billion).

Similar to the Poverty Reduction and Growth Trust, operations of the Resilience and Sustainability Trust will be managed by IMF, which is tasked with maintaining the reserve asset status of SDRs and implementing a multilayered risk management framework to ensure loan repayment. The reserve

9 Seven countries currently participate in the Poverty Reduction and Growth Trust under the encashment regime: China, France, Italy, Japan, Republic of Korea, Saudi Arabia and United Kingdom (IMF, 2016).

account of the Resilience and Sustainability Trust is expected to provide strong safeguards against delays and default in payment by debtors. Three pillars will provide the main support for the Trust, namely, the loan account (which holds funds that can be loaned, which are sourced from voluntary contributions), the reserve account and the deposit account (through which the Resilience and Sustainability Trust will generate additional reserves and safeguard against risks) (IMF, 2022h). Borrowing under the Trust is tied to policy and debt reforms, with a maximum lending of 150 per cent of a country's quota. The interest rate is set to be marginally higher than the SDR interest rate, with differentiated terms across country groups and lower terms for low-income countries. The rate will be reviewed periodically to ensure the sustainability of the Trust and to maintain concessional terms for borrowers. Funds provided under the Resilience and Sustainability Trust have a higher tenor (20-year maturity period) and longer grace period (10.5-year grace period compared with 5.5 years under the Poverty Reduction and Growth Trust) than the loans provided under the Poverty Reduction and Growth Trust (IMF, 2022i).

While recycling through both Trusts will provide considerable assistance for easing financing constraints in Africa, the two mechanisms come with a number of strings attached, which often require negotiations with IMF, including with regard to benchmarks for assessment and monitoring. The mandated structural and fiscal consolidation reforms attached to the lending facilities under both Trusts are likely to deter uptake owing to their potential negative effects on already fragile social sectors affected by the pandemic (Biglaiser and McGauvran, 2022). Consequently, there is a need to make conditionalities more lenient, taking into account country-specific social challenges ensuing from the twin effects of the pandemic and the ongoing conflict between the Russian Federation and Ukraine.

B. Recycling through multilateral development institutions

In addition to IMF facility-based vehicles, proposals have been made for SDR recycling through prescribed holders, such as multilateral development institutions. On-lending SDRs through those non-traditional vehicles would complement IMF facilities by diversifying the lending windows available for concessional financing, thus increasing the amount of SDRs channelled to low- and middle-income countries. Multilateral development institutions, such as the International Bank for Reconstruction and Development and the African Development Bank, often have years of expertise in financing targeted sectoral development programmes and collaborating with African Governments, which could be leveraged to ensure that on-lent SDRs have a greater impact and lead to better sustainable development outcomes.

Two main approaches have been proposed for this channel of SDR recycling. Under the first approach, advanced economies would lend their SDRs to multilateral development banks, and the SDRs could then be used to finance concessional investment loans in Africa. The structure of this recycling mechanism could mimic existing arrangements under the Poverty Reduction and Growth Trust and the Resilience and Sustainability Trust (Andrews, 2021; ECA-ECLAC, 2022). In this case, several measures would be required to maintain concessional terms for borrowing countries and to ensure interest payment to lender countries. Ideally, a voluntary encashment regime, allowing contributing countries to reclaim their SDRs when facing balance-of-payment difficulties, would be launched to preserve the instrument's reserve asset characteristics. Furthermore, since the recipient institution would determine the terms and conditions of the loans, clear eligibility criteria and credible risk management systems would be necessary to ensure repayment in the event of delayed repayment or default. Issues regarding the maturity period of the loans from lender countries must also be considered in order to meet the financing needs of borrowing countries while also ensuring compliance with rules guiding the use of SDRs in each creditor country (Andrews, 2021).

Under the second approach, SDR contributions could be used to provide capital to multilateral development banks. That option would increase the banks' lending capacity and provide greater flexibility for recipient financial institutions (Andrews, 2021). However, in addition to the above-mentioned challenges, other issues would require careful consideration on the part of major stakeholders. SDRs are reserve assets, and using them as capital would result in greater lending capacity, which would imply additional credit risks, compromising the fundamental purpose of the instrument. Furthermore, because previous transactions within the SDR system have mostly involved converting SDRs into usable currency or using SDR holdings directly as a means of payment (Pforr, Pape and Murau, 2022), using SDRs as a capital buffer could require changes in the IMF rules of operation. For example, the Fund has not explicitly approved exchanging SDRs for equity stakes (Andrews, 2021; Plant, 2021). While details of this innovative approach are still being debated, the structure for a recycling mechanism through multilateral development institutions must be designed in order to generate consensus among the different stakeholders, including, in particular, the lending countries and IMF.

C. Liquidity and Sustainability Facility

Established in November 2021, the Liquidity and Sustainability Facility was developed by ECA in partnership with the Pacific Investment Management Company with the aim of providing low-cost liquidity for pandemic recovery and increased investment for sustainable development in Africa, with a possible extension to other emerging economies (ECA, 2020; Gabor, 2021). Initial funding for the Facility relies on external parties; it is currently operational with the support of the African Export-Import Bank, which is expected to provide $200 million for its first transaction (ECA, 2021a).

Under the framework of the Liquidity and Sustainability Facility, private creditors can access financing on the repurchase agreement market at competitive rates using eligible sovereign bonds as collateral. This concessional refinancing is intended to enhance the liquidity of African sovereign bonds and incentivize private investors' demand for those instruments. An increase in private sector demand would, in turn, raise bond prices and reduce the risk premium and yields at issue for Governments, with favourable implications for debt servicing costs and debt vulnerabilities (ECA-ECLAC, 2022). Through the repurchase agreement market, the Facility seeks to create a virtuous circle, which should correct global perceptions of the high credit risks associated with African bonds, ease access to private capital and accelerate countries' graduation from the Poverty Reduction and Growth Trust (Gabor, 2021).

Furthermore, by offering preferential repurchase agreement terms for energy- and climate-related investments and bonds, in line with the Sustainable Development Goals, the Facility could stimulate the uptake of sustainable bonds, including green, blue and other sustainability-linked bonds, which currently constitute a negligible source of finance in Africa. The Facility's repurchase agreement instrument has the potential to generate an estimated $11 billion in interest cost savings for the continent over a five-year period (ECA, 2021a).

The Facility is also a vehicle for SDR recycling, complementing traditional sources of financial assistance, including multilateral development banks, central banks, official development assistance partners and the international community at large. Channelling an estimated $3 billion in SDRs through the Facility could provide funding to scale up to a strategic amount of $30 billion, which is equivalent to nearly 20 per cent of the total value of African sovereign Eurobonds (ECA, 2021b).

The Facility provides several safeguard measures to protect lender countries and institutions against the risk of late repayment or default. While the concessional interest rates on repurchase agreement loans and low haircuts on sovereign bond collateral are set to simulate investor demand, adopting private sector collateral valuation would enable the Facility to evaluate collateral based on credit risk assessments and request additional collateral to maintain margins in situations of falling prices. Furthermore, given that on-lent SDRs are not to be directly transferred to the Facility, the reserve-asset characteristic of SDRs should be preserved (ECA-ECLAC, 2022).

While repurchase agreement transactions are among the safest in international capital markets, the risk and collateral management framework and the design of the Facility may require further consideration, as recent studies have flagged a number of potential risks posed by procyclical funding, increasing countries' vulnerability to foreign currency debt, and possible conflicts of interest for commercial bank administrators (Gabor, 2021).

IV. Conclusion

The world is facing uncertain times owing to the unequal pace of recovery from the COVID-19 pandemic and new challenges resulting from the conflict between the Russian Federation and Ukraine, including higher commodity prices and rising food insecurity in the developing world. Given current hurdles and the complex recovery scenario, ways must be found to rechannel existing SDRs to increase the financial resources available to save lives and livelihoods and promote sustainable development in countries that need it the most.

African countries have experienced tight financial conditions since the start of the COVID-19 pandemic. Falling domestic revenue, rising debt levels and the increasing cost of borrowing have not only undermined African countries' short-term response strategies but also constrained their fiscal capacity to drive social welfare programmes and long-term economic development in line with the Sustainable Development Goals (IMF and World Bank, 2020). Along with several other initiatives that are aimed at avoiding the collapse of economies, the IMF 2021 general allocation has extended a lifeline to the continent. The allocated SDRs have been a major source of financing for many developing countries, facilitating vaccine procurement and other pandemic relief programmes, debt sustainability management, macroeconomic stabilization and budget support.

The space provided by the various initiatives and the $33.8 billion allocation for Africa still falls short of current financing gaps, however. Given that the inequitable distribution of vaccines may lead to the emergence of new COVID-19 variants, thus delaying economic recovery globally, as well as impeding the achievement of the Sustainable Development Goals, additional concessional and sustainable financing is clearly needed.

SDRs create an opportunity to improve the financing framework for the acceleration of economic recovery in Africa. A wide range of recycling mechanisms has been proposed to maximize the impact of the recently issued SDRs on recovery. The main vehicles include the IMF Poverty Reduction and Growth Trust and Resilience and Sustainability Trust facilities, multilateral development institutions and the Liquidity and Sustainability Facility.

It is clear that the Poverty Reduction and Growth Trust and the newly established Resilience and Sustainability Trust complement each other and could facilitate access to short- and long-term concessional financing for all African countries. Those recycling mechanisms will undoubtedly have a number of attached conditionalities, however, which could deter uptake owing to the perception that an additional social burden could be placed on vulnerable groups.

Second, using multilateral development banks as recycling vehicles has so far been received enthusiastically by various stakeholders because leveraging the expertise of recipient institutions in development project finance should improve outcomes in vulnerable countries. As banks endeavour to generate appealing proposals for donor countries and IMF, ways must be found to maintain the reserve asset characteristics of SDRs.

Third, the Liquidity and Sustainability Facility is an innovative framework with the potential to positively change the experience of African Governments in international capital markets by countering misconceptions regarding African bonds and African countries that participate in international financial markets. Care must be taken, however, in its design and implementation stages to ensure that the Facility reaches its goal of improving market access for African countries.

Unlike bilateral donations of SDRs, the proposed recycling mechanisms do not offer "perpetual loans" to beneficiaries; rather, they provide avenues for concessional borrowing. Consequently, appropriate debt sustainability management, with an emphasis on ensuring the transparency and adequacy of public expenditure, is critical at the country level for optimizing the benefits of reallocated SDRs. Advocacy must continue at the global level to increase the number of pledges and the effective contributions of SDRs by advanced economies. As Africa continues to struggle with the impact of the COVID-19 pandemic and the repercussions of the current geopolitical crisis, opportunities to rechannel SDRs towards building a better post-pandemic world should be understood as beneficial not only to developing countries but also to the developed world.

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