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# Putting SDRs to good use in Africa

## Boosting the capital base of regional development finance institutions to build back better

Almost 18 months into the COVID-19 pandemic, the International Monetary Fund's (IMF) board approved the issuance of new special drawing rights (SDRs) on August 2, 2021. The IMF proceeded with the allocation of these SDRs a few weeks later on August 23, 2021. SDRs are a composite currency unit based on a basket of leading currencies (US dollar, euro, Japanese yen, UK pound and Chinese yuan), that can be converted by IMF member countries into freely usable currencies to finance imports.

To date, the US$650 billion SDR allocation is the most ambitious and consequential global response to the pandemic by the international community, both in size and scope. It has benefited all IMF member countries and is the largest issuance in the Fund's history. It is more than double the cumulative amount of SDRs issued during the IMF's first 75 years and triple the amount injected by the Fund into the global financial system to bolster the foreign exchange reserves of its member countries during the 2008-09 financial crisis.

The unconditional SDR allocation provides breathing space on the balance sheets of all IMF member countries, especially the most vulnerable low-income countries, in proportion to their existing quotas in the Fund. It will help confront the monetary and fiscal challenges of the economic crisis induced by the pandemic. The allocation will also act as a financial multiplier, increasing the fiscal space in the short term and fortifying prospects for financial soundness and global financial stability in the medium and long term.

Across Africa, the newly issued SDRs will reduce countries' exposure to exchange rate volatility and liquidity constraints associated with balance of payment pressures. They will help replenish dwindling foreign exchange reserves, which decreased by 27% in 2020, and finance essential imports such as COVID-19 vaccines. In addition to preventing liquidity crises from morphing into solvency crises, the newly issued SDRs will sustain investors' confidence and improve the prospects of a synchronised global recovery.

However, the quota-based SDR issuance has constrained Africa's allocation to about US$33 billion, which represents about 5% of the overall allocation. And the allocation is heavily skewed towards the largest economies on the continent: Egypt, Nigeria, and South Africa. Together these three countries accounted for over 30% of the total allocation to the region, with South Africa receiving the largest amount of US$4.2 billion.

But across Africa the impact on foreign exchange reserves has been more significant, even though the allocation is markedly smaller than the amount received by other regions. For instance, the newly issued SDRs have more than doubled Zambia's gross international reserves and raised Zimbabwe's by more than sixfold. In contrast, it raised Egypt's by just over 6%. In part this reflects the fact that the marginal allocation was always expected to be more impactful in low-income countries.

Compared to other regions, the SDR allocation to Africa is dismally low, however. The region's amount is lower than the allocations to both France and Italy, which together received US$33.8 billion, representing over 5.2% of the total allocation. Collectively the European Union received US$139 billion (over 21% of the total allocation) and Asia received US$94 billion (15%). High-income countries, most of which enjoy the exorbitant privilege of issuing reserve currencies and do not need SDRs as much as low-income countries, received nearly US$400 billion. This represents about 60% of the total allocation (65% including China).

The low allocation of SDRs to the region is commensurate with its share of global gross domestic product (GDP) which ultimately determines IMF quotas. Africa accounts for a paltry 3% of global GDP at current price. In part, this reflects invariance in the drivers of growth and trade in a region which remains heavily commodity dependent. The latest United Nations Conference on Trade and Development biennial "Commodities and Development Report 2021" classified 45 countries as such. This structure of production highly exposes African countries to global volatility and adverse commodity terms of trade shocks. It also undermines growth, especially in a world where trade has been largely dominated by manufactured goods with increasing technological content.

Raising Africa's quotas at the IMF and its share of the SDR allocation hinges on significantly boosting investment in the structural transformation of African economies. This will accelerate the diversification of exports for a speedy income convergence – as Asia has successfully done over the last few decades.

But across the developing world most regional development finance institutions (DFIs), which have a development mandate and are best placed to support economic transformation through the provision of long-term financing, are often constrained by capital. This leads to the persistent, impossible trade-off between the pursuit of development objectives and the mitigation of pressure on their capital base. African DFIs are not exempt from these challenges, especially considering the scale of financing gaps in a region where the chronic deficit of infrastructure across all sectors has been a major constraint to productivity growth and structural transformation for decades.

But DFIs in emerging and developing market economies should not have to choose between financing development and preserving capital adequacy ratios. The new SDR allocation provides the opportunity to strengthen the financial firepower of these regional DFIs in the pursuit of their dual objectives. The reallocation of newly issued SDRs towards fresh equity will strengthen the capital base of these banks and enable them to better deliver on their development mandates. In essence, this enables them to build back better post-pandemic to set the region on an irreversible path of increased diversification of sources of growth and trade.

In this regard, the steps taken by African leaders to reallocate a portion of their SDRs towards increasing the capital of its regional DFIs, such as African Export-Import Bank (Afreximbank), is a very positive development. Afreximbank has disbursed over US$9 billion since the outbreak of the pandemic to help its member countries deal with the immediate fall-out from COVID-19. In March 2021, Afreximbank issued a guarantee in an amount of US$2 billion that enabled African states to procure 400 million doses of Johnson & Johnson COVID-19 vaccine. At the same time, Afreximbank has invested in the expansion of manufacturing output in the pharmaceutical industry, ensuring the region builds back better post-pandemic.

But strengthening the financial wherewithal of these DFIs should not be exclusively the responsibility of African governments, which are their main shareholders. It should also be supported by the international community which has been championing the delivery of sustainable development goals. Luckily, boosting the capital of these banks has been on the global development agenda for some time. A decade ago, recapitalizing these banks emerged as one of the key objectives in the recommendations outlined by G20 leaders to maintain key investment in sustainable development and set the world on a strong and synchronized recovery from the 2008-2009 global financial crisis. Doing so now is perhaps even more urgent, considering the scale and magnitude of the COVID-19 crisis.

"The best way to predict the future is to create it," Abraham Lincoln once said. Putting the newly issued SDRs to good use across Africa will create a more predictable future for the region, one that is even more resilient to global shocks and volatility. Boosting the capital of African DFIs and accelerating the transformation of African economies through trade will be an important step in the creation of that future.

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