A State of Play on SDRs: What To Make of 2023, What to Watch in 2024

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Key messages:

- This policy brief provides an overview of the Special Drawing Rights (SDR) agenda: what is being done with the world's $108 billion in SDR rechanneling pledges, and what is left to do.

- It covers the primary conduits for rechanneling SDRs: the IMF's Poverty Reduction & Growth Trust (PRGT) and Resilience & Sustainability Trust (RST). It notes that in order for the PRGT to be scaled up and receive more SDRs, IMF members must urgently address shortfalls in the PRGT's subsidy account — one solution being small sales of the IMF's $186 billion in gold. It also notes that in order for the RST to be scaled up and receive more SDRs, the IMF must develop the institutional capacity to develop RST programs more quickly.

- Given the financial and operational constraints on the PRGT and RST, this paper covers rechanneling to the multilateral development banks (MDBs). It discusses the power and appeal of the hybrid capital proposal, as well as the legal, technical, political, and geopolitical limitations in its uptake. Given the limitations placed on countries' foreign-exchange reserves (including their SDRs), it advocates a shift to 'normal currency' hybrid capital for countries that cannot contribute SDRs — thus making use of more manageable budget resources.

- It also re-introduces the proposal for an SDR-denominated, cash-settled bond. Particularly with respect to the International Development Association (IDA), it discusses how the inexpensive, long-term financing offered by an SDR bond would be valuable for MDBs that are currently only able to access more expensive and shorter-term financing from capital markets. In addition, it discusses how an SDR bond would align with countries' rules on the use of foreign-exchange reserves.

FDL short notes

Introduction

In August 2021, the members of the International Monetary Fund (IMF) agreed to a $650 billion allocation of Special Drawing Rights (SDR). Yet SDRs are allocated in line with countries' IMF quotas, which is roughly a measure of the size of their economy. The ten largest advanced economies hold 55% of quotas, whereas all of the world's 27 low-income countries hold just 3.3%. This means the largest and richest economies that are least likely to need or use SDRs hold the vast majority of them. As a result, in October 2021, the G-20 pledged to rechannel $100 billion in SDRs to "vulnerable countries." Total rechanneling pledges have since reached $108.15 billion.

How do SDRs work ? *A two-paragraph primer*

SDRs are the IMF's reserve asset — all IMF members receive SDRs and can exchange them for dollars, euros, sterling, yen, and yuan. The SDR is both an asset and liability of the IMF member: IMF members pay the SDR interest rate on the SDRs they have been allocated by the IMF, and they receive the very same SDR interest rate on the SDRs they actually hold. This means that if their SDR holdings drop below their allocation, they pay more interest than they receive — thereby paying the SDR interest rate to "use" their SDRs (exchange them for hard currency or rechannel them).

This is a good bargain for lower income countries. As the SDR interest rate is a function of the three-month government bond yields associated with SDR currencies, SDRs allow all IMF members to access hard currency at the inexpensive borrowing costs of advanced economies. Although the SDR interest rate is near an all-time high of 4.099%, it remains much more affordable than what many countries could otherwise access.

The 2021 allocation and rechanneling pledges have been an excellent step in the right direction for the IMF and its members. Expanding access to foreign reserves during a time of elevated financing stress, as the 2021 allocation, was the objective of the SDR system at its creation in 1968, yet one which the IMF has over the past half century failed to fulfil. With the 2021 allocation, as the IMF subsequently reported, access to SDRs reduced members' sovereign risk premia significantly without having any meaningful effect on global inflation. IMF members were able to use these funds as they deemed fit — most notably, to support pandemic-related spending, as 62% of low-income countries reported, as well as to conduct debt repayment and clear arrears.

Some members, ranging from Papua New Guinea to Kenya to Iraq, fully on-lent their SDRs to their finance ministries to support fiscal policy. A few encouraging case studies have emerged, such as DR Congo committing half of its allocation ($203 million) to a local development program aimed at rural electrification and South Sudan using nearly half of its allocation ($150 million) to make overdue payments on government salaries, a sensitive political and economic issue. The largest use-case was using the SDRs to replenish and buttress

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Yet despite all this, the SDR agenda remains unfulfilled. Most notably, despite the $108.15 billion in pledges, the existing SDR rechanneling infrastructure — the IMF's Poverty Reduction & Growth Trust (PRGT) and the Resilience & Sustainability Trust (RST) — can only rechannel $61 billion in SDRs. This leaves $47.5 billion in SDRs with no place to go. In addition, the vast majority of SDRs that have been rechanneled have not actually been disbursed to vulnerable countries. Moreover, the effort to look beyond the IMF for SDR rechanneling — i.e., to rechannel to the multilateral development banks (MDBs) — has been obstructed by different laws and politics governing the use of foreign-exchange reserves in IMF member countries worldwide. As a result, it is crucial to take stock of where we stand, assess the impediments for progress, and define a new agenda for SDR rechanneling.

Rechanneling through the IMF: the options & problems

Around the time of the $650 billion allocation, the IMF rolled out a new funding strategy for the PRGT (the IMF's low-income lending trust) and announced the establishment of the RST (a new climate-oriented trust). These trusts became the primary conduits for rechanneling SDRs. The PRGT's funding strategy called for $17 billion in contributions to its loan account, while the RST was given an overall funding target of $44 billion. Given the absence of alternative methods to rechannelling surplus SDRs, the funding shortfall between the pledge to rechannel $108 billion and the ability to rechannel only $61 billion represents a pressing issue that calls for immediate action. However, devising a solution to this predicament is far from straightforward.

Why not just increase the PRGT's funding target?

The PRGT makes interest-free loans to low-income countries, but it receives SDR loans at the SDR interest rate. This means that IMF members both lend SDRs to the PRGT (collecting the SDR interest rate) and contribute subsidy resources to the PRGT (offsetting the SDR interest rate). This circuitous process creates difficulties in scaling up the PRGT. Bringing in subsidy resources is tricky because they come out of countries' budgets, which means that squabbling with legislatures is likely to occur. When the IMF announced the PRGT's new fundraising strategy in 2021 — to bring in $17 billion in SDR contributions to the PRGT's loan account — it came with an arduous effort to rake in more subsidy resources. At the 2023 IMF Annual Meetings, Managing Director Kristalina Georgieva announced that the PRGT's $3.1 billion subsidy target had finally been met, two years after the fundraising campaign got underway.

Rechanneling more SDRs to the PRGT could come as part of the second stage of the fundraising strategy — which the IMF planned to start in 2024-25 — but the challenge is that the SDR interest rate has risen substantially since 2021: from 0.05% when the PRGT's fundraising strategy was published to 4.1% today. A 400-basis point raise in the SDR interest naturally puts pressure on the PRGT's funding model. Rather than needing subsidies to offset a simple 0.05% interest rate, the PRGT now requires subsidy resources to offset a 4.1% interest rate. It will be difficult enough to merely roll over the PRGT's current SDR target; increasing it will require even more effort. There is no doubt that the IMF's low-income lending trust is well worth the effort, particularly given that demands on the PRGT are very likely to grow in the coming years and that PRGT program size ought to grow, too. But unless IMF members are confident that they can contribute more than $3 billion in subsidies, it will not be possible to lean on the PRGT as a larger SDR rechanneling conduit.

One possible solution is to explore sales from the IMF's gold reserves. Gold sales were used to endow the PRGT in the past, and the IMF's gold stock has grown sharply to $186 billion. This will require approval from 85% of IMF members, which most significantly means the approval of the U.S. Congress. That runs into stark partisan issues, but there is indeed a bipartisan case to be made. With the Belt & Road Initiative lending falling to near-zero in recent years, there is a financing shortfall in partner countries which many politicians on both sides of the aisle in the U.S. hope to fill. The difficulty is how to finance that effort, as some in Washington are averse to raising taxes and issuing debt to support the U.S.' foreign interests. This makes gold sales a convenient solution: more funds would flow to the U.S.' partners from the Washington-based lender without any draw on the U.S.' resources, and the finances of the IMF itself would of course not be jeopardized given how small the gold sale would be and how much the IMF's gold stock has grown. Recreating the IMF's 2009 gold sale, 12.5% of the IMF's gold stock, would yield $23.25 billion in subsidy contributions — which is, of course, well in excess of what is currently needed, but ensure the long-term sustainability of the PRGT. However, given that the value of the IMF's gold has appreciated by more than this (15%) since the PRGT's funding strategy was put into place, it would leave the IMF in an equivalent position.

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Why not just increase the RST's funding target?

The RST does not have the financial constraints of the PRGT in that it does not require hard-to-wrangle subsidies to take in more SDRs. However, the RST is facing significant operational limitations. Out of the $41 billion in SDRs raised by the RST, only $5.85 billion in RST programs have been approved, and a mere $364 million has been disbursed. This means that less than 1% of the RST's SDRs have actually been rechanneled to vulnerable countries. The problem is institutional capacity: the IMF is uncertain about how to proceed with climate-oriented policy adjustments and relies on the World Bank to provide the climate diagnostics on which RST programs are based. The IMF has floated the idea of increasing the RST's funding target, but until the RST can effectively disburse its SDRs — which is to say, until IMF staff can design RST programs expeditiously — scaling up the RST should be avoided.

Rechanneling through the MDBs: hybrid capital

Given the limited capacity of the PRGT and RST and the challenges with scaling them up, it is clear the world needs a "second channel" — beyond the IMF — for SDR rechanneling. The first proposal was the "hybrid capital" proposal by the African Development Bank (AfDB) and Inter-American Development Bank (IDB). The second was the "SDR bond" put forward by Brad Setser and myself.

Hybrid capital: a powerful tool, but with significant constraints

What is the hybrid capital proposal? Hybrid capital would be a powerful use of SDRs for MDBs. Hybrids have had no uptake with MDBs in the past, but they are used by a wide variety of businesses that enjoy their ability to raise funds without impinging on their debt or equity: because hybrid capital is only partially debt, it does not impact credit ratings, and because it is not exactly equity, it does not dilute shareholders or change governance structures. For MDBs, the appeal of hybrid capital is that hybrids would allow the banks to raise funds without putting pressure on or adjusting their leverage ratios, which recalcitrant Credit Rating Agencies may take issue with. At the same time, hybrids would allow MDBs to raise funds without going through the protracted capital increase process needed to raise more equity. Hybrids would not change the MDBs' shareholder structure, which can be a sensitive geopolitical issue.

Under the AfDB-IDB proposal, countries contribute their SDRs to MDBs in the form of hybrid capital, which would allow MDBs to leverage the portion of the hybrid capital that is considered equity (the "equity content") using their normal leverage ratio. The hybrid would be a perpetual liability of the MDBs — which corresponds neatly with what an SDR is, a perpetual liability of an IMF member — and callable after 10 years. MDBs would pay the SDR interest rate plus a spread to contributors, offsetting their costs of rechanneling.

It is often reported that this would translate to 3-4x leverage — but it is important to point out that this is not exactly the case. In order to determine how much new firepower hybrids would provide, we have to figure out the amount that will be scored as **equity (the "equity content")** rather than **debt**. Credit rating agencies consider hybrids that have "high equity content" to amount to 50% equity and hybrids with "intermediate equity content" to amount 33% equity. In the case of the AfDB's hybrid capital proposal, S&P has determined that it has "intermediate equity content" -- so it can only leverage 33% of the SDRs contributed. This means that if the AfDB issues $1 billion in hybrid capital, it would be able to raise an additional **$1.32 billion – to arrive at this number, we take the $1 billion hybrid capital contribution, multiply it by the amount that is actually equity (33%), and multiply that by the leverage ratio (so $1 billion * 33% * 4)**. However, it is also important to note that, in theory, 25% of the SDRs contributed to the AfDB will be retained for the Liquidity Support Agreement (LSA). This means if $1 billion in SDRs is issued, only $750 million passes through as hybrid capital, of which only $250 million is scored as equity, meaning that leveraging 4x only gets you to $1 billion total. In practice, however, it seems that countries that cannot contribute their SDRs as hybrid capital will make standalone contributions to the LSA. This ends up being rather helpful – even if not originally intended - because it means that all SDRs contributed will be hybrid capital, and none will have to be retained.

Why aren't countries doing it?

The fundamental challenge is that hybrid capital is not a conventional reserve asset. "Reserve assets"— or the sort of securities that central banks and (some) finance ministries hold as official reserves — tend to be senior debt securities: a government bond, a supranational bond, or a bond issued by AA-rated corporate or above. Due to the inherently risky nature of junior assets such as hybrid capital (or equity), reserve managers do not generally invest in them. This is unfortunate in the case of the hybrid capital proposal because of the role of the Liquidity Support Agreement (LSA), which IMF staff have made clear preserves the reserve asset characteristic of SDRs contributed as hybrid capital – therefore eliminating the risk associated with being more subordinated in an MDB's capital structure. Nonetheless, what counts as a reserve asset is a matter of law for some countries (such as the

Eurosystem countries and the UAE), a matter of politics for other countries (such as the US), and a matter of technical practice and procedure for all other countries (such as the UK, China, Japan, Canada), and these designations are very tricky to circumvent:

- **Eurosystem's legal constraint:** The purchase of hybrid capital by Eurosystem national central banks would violate the EU's [prohibition on monetary financing]. ECB President Christine Lagarde has now said on [multiple] [occasions] that hybrid capital is incompatible with EU rules. This means there would need to be a fundamental change in the ECB's legal doctrine to allow the 20 Eurosystem countries, which hold $200 billion in SDRs, to go forward with the hybrid capital proposal. It is understood that the UAE faces a similarly rigid legal constraint to going forward with hybrid capital.

- **The US' political constraint:** The Exchange Stabilization Fund (where the US' SDRs are held) can deal freely in securities to manage the US Treasury's reserves. Yet when *not* conducting reserve management, Treasury must receive Congressional authorization to use ESF funds. Congress' aversion to SDRs has obstructed the US' support for the PRGT and RST, and Congress would be an insurmountable challenge for hybrid capital.

- **The UK and Japan's technical constraints:**
  - The UK does not have the EU's legal constraint or the US' political constraint. The law governing the UK's Exchange Equalisation Account is quite flexible. Yet, in practice, the Bank of England and the UK Treasury will only purchase senior bonds issued by AA-rated entities and above. As hybrid capital is more junior than this, the UK cannot purchase hybrid capital. It is understood that China and Canada have expressed similar technical impediments.
  - Japan, the IMF's second largest member and one with fewer restrictions on reserve management than other advanced economies, faces similar issues. Japanese officials have expressed that if the LSA were to have 8 (rather than 5) contributors, Japan may be able to participate, but this should be seen as an impractical hurdle that primarily denotes the country's inability to participate. Other technical limitations have included uncertainty around pricing hybrid capital and the pressure it would put on countries' "policy-ready reserves" — as further SDR rechanneling would compel countries to move up in the IMF's Voluntary Trading Arrangements queue, which entails using hard currency to buy back SDRs. While this should *not* matter for advanced economies (such as the UK) that have no exchange rate management policy and, therefore, do not use their foreign reserves, nor for countries with large foreign reserves (such as Japan), that can and should play a larger role in the VTAs, the issue of policy-ready reserves has been cited by them as well.

- **China's and others' *geopolitical* constraint**: One quieter reason why countries such as China are averse to hybrid capital is that this equity injection does not translate to increased equity (voting shares) at the MDBs. China has signalled its interest in providing more financing to the MDBs, but its reluctance to participate in hybrid capital despite its clear capacity to do so suggests that it would like to see greater contributions lead to a stepped-up role within the MDBs. This geopolitical desire — not to do hybrid capital because it does not adjust the governance structure of the MDBs — is likely to be shared by many countries that are legally, technically, and politically capable of doing hybrid capital. Nevertheless, this would be an unfortunate reason for hybrid capital to die, specifically because hybrid capital is not equity, and thus should not have the voting rights associated with equity. Hopefully, the MDBs may be able to alleviate these concerns. One way to do it would be for the World Bank to introduce a new special purpose vehicle financed through the issuance of hybrid capital, which donor countries can play a central role in shaping and overseeing.

But what about the Liquidity Support Agreement?

While hybrid capital is not a reserve asset, the proposal does include a "Liquidity Support Agreement" which is meant to guarantee the reserve asset status of the contributed SDRs. The LSA retains 25% of donors' SDR contributions and can also accept external contributions for the purpose of allowing hybrid capital participants to withdraw funds in the event that they face a balance-of-payments crisis. In other words, even though hybrid capital is a risky and illiquid instrument, the LSA gives countries a guarantee that they can pull their funds whenever they choose. IMF staff have made clear that the LSA preserves the reserve asset status of SDRs contributed as hybrid capital. There is hope that the IMF Executive Board will enshrine this in an official ruling. However, such a ruling will likely not move the needle with most countries — particularly not for countries that face legal constraints or political constraints, where an amendment to the Treaty on the Functioning of the European Union or a sea-change in Republicans' attitude towards SDRs are needed. Such a ruling would also not alleviate concerns around the VTAs, or how SDR rechanneling creates a drag on countries' policy-ready reserves.

How about standalone contributions to the LSA? There has been an effort to enlist countries that cannot contribute SDRs as hybrid capital to nonetheless contribute to the LSA using budget resources (dollars and euros). In effect, this means non-rechanneling countries would guarantee the SDRs of rechanneling countries. France and the UAE have expressed an interest in doing this. Standalone contributions to the LSA serve an important financial function: a country contributing to the LSA would in effect be guaranteeing the SDRs of a country contributing hybrid capital, which means that the SDRs contributed would not need to be retained for the LSA. This frees up more of the SDRs to scored directly as hybrid capital, meaning a greater portion of the nominal contribution can be leveraged. While it is important to continue exploring all possible angles for attracting LSA contributions, there is a challenge emerging with and from the LSA: the countries most eager to support the AfDB hybrid capital proposal are stepping forward only with standalone LSA contributions. In order for these to matter, it will be important to redouble efforts to enlist countries with laxer reserve management rules (e.g., East Asian countries, Gulf countries, etc.) to contribute SDRs as hybrid capital.

The World Bank hybrid capital proposal : SDRs with a twist

The World Bank has a particular twist on the AfDB-IDB hybrid capital proposal. The Credit Rating Agencies have apparently informed the World Bank that hybrid capital must be done in hard currency (e.g. dollars) rather than SDRs. As a result, the World Bank is asking shareholders to convert their SDRs into dollars before purchasing World Bank hybrid capital. This intermediary step creates a serious problem: there will be no country to buy all of the advanced economies' SDRs all at once. The VTAs are too illiquid for this, as is now broadly understood by the World Bank's shareholders. In its current form, the World Bank's hybrid capital proposal is impossible.

Given countries' legal, political, and technical constraints on going forward with hybrid capital, what can be done? Hybrid capital is still a good idea and should not be abandoned. As a result, a sensible way forward is to scrap the SDR element of the hybrid capital proposal and simply move forward with normal currency hybrid capital. For the AfDB and IDB, this would circumvent all of the reserve management rules that are obstructing the participation of the Eurosystem countries, the UK, the UAE, Japan, China, etc. For the World Bank, this would *also* get rid of the impossible intermediary step of selling SDRs into the Voluntary Trading Arrangements (VTAs, see below for more details). In addition, as there is no obligation to maintain the "reserve asset characteristic" of normal currency hybrid capital, MDBs could discard the Liquidity Support Agreement – freeing up 25% of the contribution that would otherwise be retained by the LSA to count as hybrid capital.

Rechanneling through the MDBs: the SDR bond

Regardless of how the MDBs choose to proceed, it is important not to let the legal, technical, and political constraints obstruct the SDR agenda altogether. Yet turning the hybrid capital proposal into a non-SDR proposal also leaves an important question: what should be done with the remaining SDRs?

Re-introducing the SDR bond.

The SDR bond would be an SDR-denominated, cash-settled bond. It would pay the SDR interest rate, meaning that it too would offset the costs of SDR rechanneling. It would ideally carry a 30-year maturity and should roll over in perpetuity.

Revamping the SDR system and providing liquidity to IMF members. The most compelling case for the SDR bond relates to the market for SDRs – the Voluntary Trading Arrangements (VTAs) – and by extension to all modalities of SDR rechanneling. A significant problem that has emerged in recent years is that many countries do not want to undertake further SDR rechanneling for the simple reason that when they do this, the IMF will come to them to buy back SDRs. This is the peculiar way in which the VTAs work: when your SDR holdings fall, you are moved up the queue to buy them back. In effect, this means rechanneling obligates IMF members to spend more hard currency to top up their SDR holdings. That is considered undesirable because countries would prefer to have dollars and euros they can actually use rather than SDRs. When we zoom in on that problem, we see the real problem to be the illiquidity of the VTAs: countries claim they cannot actually use their SDRs because the market for SDRs – the VTAs – is not liquid enough for advanced economies to sell SDRs whenever they so choose. This is a big problem that needs to be solved. The IMF's Articles of Agreement state that the SDR is meant to be the "primary reserve asset of the international monetary system", yet the SDR market is too illiquid for central banks to want to hold SDRs.

An SDR bond helps address this problem by simply shifting members' SDR balance *out of the VTAs.* In effect, this is what countries do when they contribute to the PRGT and the RST: if they need the funds they have contributed, the encashment regimes of the two trusts contractually ensure they will be able to pull their money out. An SDR bond would provide a similar service, but in a much more conventional way: it would move countries' SDRs into a security they would actually wish to hold as a reserve asset – an MDB bond. Given that the SDR bond is designed to be cash-settled, if members need to sell their SDRs for cash, they would be able to do so easily in the liquid market for MDB bonds.

What is an SDR bond's value for MDBs? Beyond the benefits to the SDR system and SDR holdings, an SDR bond would also provide MDBs a uniquely long-term and inexpensive source of financing that capital markets have been unwilling and unable to offer. It is sometimes said that MDBs do not need an SDR bond as they have no difficulty issuing bonds and doing conventional market borrowing at present. This is not entirely true — particularly for the International Development Association (IDA), the World Bank's lending arm to low-income countries. Even though IDA is AAA-rated, it has been affected to a considerable degree by rising interest rates. From August 2022 to October 2023, IDA's market borrowing came to a complete halt as a result of tighter credit conditions, and upon IDA's return to the market in October 2023, its borrowing costs had spiked. Against an average coupon on IDA bonds of 1.41%, IDA's October 2023 issuance of a $2.5 billion 5-year dollar bond came with a coupon of 4.875%. Subsequent bond issues (in different currencies) were all similarly at large premia to their risk-free rates — a £800 million 8-year at 4.75%, a $2.5 billion 5-year at 4.88%, a €600 million 30-year at 3.8%, and a NOK 3 billion ($276m) 5-year at the 3-month NIBOR + 19bps (currently 4.86%). This is a serious challenge for IDA because its hybrid financing model means that higher interest rates must be offset by larger shareholder contributions in order to continue comparable levels of lending at a highly concessional rate.

If private markets cannot provide it, turn to the SDR market: The SDR bond — placed exclusively with the MDBs' shareholders — would insulate the MDBs from this market pressure. This option would allow MDBs to tap into very long-term, inexpensive financing at times when the market is reluctant to provide it. In terms of understanding the effective borrowing cost of the SDR bond, it is important to note that the SDR interest rate is not only lower in nominal terms than IDA's most recent dollar bonds, but it also allows IDA to borrow *at the risk-free rate* for SDRs. This would help put IDA's hybrid financing model on firmer footing and allow it to get back on track to boost its lending, which is otherwise projected to decline over the next three years.

How does it compare to hybrid capital? For MDBs, an SDR bond is not as powerful as hybrid capital. However, it is doable and allows countries to put their SDRs to work because it fits within their rechanneling rules. In terms of comparisons to hybrid capital, it is also worth exploring the "equity-like features" of the SDR bond. An SDR bond fits two of the three characteristics of hybrid capital: it has "extraordinary government support" (as it would be bought at issuance by shareholders), and it would be a source of perpetual financing. What it lacks is "loss-absorbing capacity." In terms of the Credit Rating Agencies' hybrid capital methodology, this means that the equity content of the SDR bond would certainly not be "high" (50%) or "intermediate" (33%), but it could be in the ballpark of 25%. In the more familiar qualitative categories, this would mean that an SDR bond's equity content might not be "high" or intermediate" but it could count as "moderate" or "low." Such a conversation should be taken up with the Credit Rating Agencies.

Why is an SDR bond "doable"? Whereas the hybrid capital proposal had been developed from the standpoint of the MDBs, the SDR bond was developed from the standpoint of the rechanneling countries — specifically the US, and the possibilities provided by the Exchange Stabilization Fund, which allows the US Treasury to deal freely in securities. An SDR bond solves the rechanneling constraints not only of the US, but also of the Eurosystem and the UK, because an SDR bond is a normal reserve asset like any other: it is a senior bond that settles in currency that is issued by an AAA-rated entity and would trade like any other MDB bond. It is common for reserve managers to purchase MDB bonds, and an SDR bond would be no different.

Going forward: keeping the SDR agenda alive in the G20 and beyond

The $650 billion SDR allocation and the $108 billion in SDR rechanneling pledges create a tremendous opportunity for providing new financing to the global development agenda. However, in order to move forward, we need a better and broader understanding of the challenges facing SDR rechanneling. The SDR rechanneling pledge has not been fulfilled and cannot be fulfilled with the current rechanneling infrastructure: the PRGT cannot take in more SDRs due to its subsidy constraint and the RST should not take in more SDRs due to its operational constraint. These problems should be addressed seriously and quickly, but they should also not obstruct urgent SDR rechanneling.

The question is how to move forward with the "second channel" for SDRs: the prescribed holder MDBs, rather than the IMF. While the hybrid capital proposal is a smart and powerful proposal that has done an excellent job of gaining the support of stakeholder countries, it has become increasingly clear that it cannot be done using SDRs. Legal, political, and technical constraints have closed off the path of hybrid capital for SDR rechanneling. To avoid the reserve management rules that are obstructing the hybrid capital proposal — and to better fit with the guidance of the Credit Rating Agencies — the AfDB, IDB, and World Bank should switch from SDRs to hard currency. In the process, this would, of course, leave *at a minimum* $47.5 billion in pledged SDRs not rechanneled. To absorb this cheap and perpetual source of financing, MDBs should issue SDR-denominated, cash-settled bonds that would provide them the long-term and inexpensive financing that markets cannot currently offer.

SDRs are exciting precisely because there are so many and they are so idle. The stock of the world's SDRs is currently valued at $883 billion, and the vast majority of these remain trapped on the balance sheets of advanced economies' central banks and finance ministries. The importance of mobilizing these funds is obvious and urgent – but it has also proven difficult to do. The past two years of work on SDR rechanneling, be it through the IMF or through the MDBs, has moved policy planning along, but the G-7, G-20, and indeed the MDBs still need to take decisive action. This year's G-7 and G-20 summits, held by Italy and Brazil, will provide such an opportunity. Moreover, given the difficulties pushing hybrid capital forward, MDBs such as IDA should be more cognizant of the limitations on their shareholders' SDRs and give a closer look to the SDR bond proposal. With a bit more effort these next few months, the international community can tap into hundreds of billions of dollars in idle funds – an opportunity that does not come often.

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