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Free the money we need

The fiscal response of rich countries has caused an uneven global economic recovery. The IMF's reserve asset could counteract this development

The main factor limiting the global recovery is not the much-discussed increase in inflation in advanced economies, which is likely to be transient, but rather the massive inequalities between most rich countries and the rest of the world, with the exception of China. These disparities, by constraining the expansion of global effective demand, keep some poorer economies mired in stagnation, and eventually will affect investors in richer countries as well.

One major reason for the K-shaped global recovery is the huge variation in fiscal responses between rich countries and the rest. Although the Covid-19 pandemic caused government revenues to decline everywhere, the International Monetary Fund (IMF) estimated in April 2021 that advanced economies had increased their public spending in 2020 by more than 6 per cent of pre-pandemic GDP. Emerging-market economies spent only one per cent more on average, and low-income countries actually spent less.

A spark of hope

By October 2021, even as fresh waves of Covid-19 infections were causing economic havoc, 'fiscal consolidation' was already well underway in many middle- and low-income countries, owing to the rising levels of public debt accrued over the previous two years. This inevitably worsened their economic outlook and prevented even essential public spending on nutrition and health services. The only semi-bright spot in this bleak fiscal landscape for much of the developing world was the IMF's new allocation in August 2021 of USD 650bn in special drawing rights (SDRs, the IMF's reserve asset).

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Unfortunately, SDRs are distributed according to countries' IMF quotas, which depend heavily on their GDP. Low-income and middle-income

countries exchanged them for hard currency, 55 used them to pay their IMF dues, and 39 recorded them in the government budget.

countries therefore received only around USD 250 bn, while rich countries got nearly USD 400 bn, most of which they are unlikely to use. This system of SDR allocation is clearly outdated and illogical, especially given today's huge cross-country inequalities and the size and urgency of poorer countries' financing needs. Even so, the SDR allocation was a lifeline for several developing countries facing severe balance-of-payments problems and helped to prevent further economic decline.

Since August, at least 80 countries have used SDRs for various purposes. Thirty-two countries exchanged them for hard currency, 55 used them to pay their IMF dues, and 39 recorded them in the government budget, presumably to spend on health care and other priorities. Moreover, SDRs have several advantages over other types of international financing. They do not add to countries' external debt burdens, and, unlike loans from the IMF and other multilateral lenders, they are non-conditional. SDRs are accessible to all countries, including middle-income economies that may face balance-of-payments constraints but are excluded from other multilateral funding. And they are virtually costless, with an interest rate currently below 0.1 per cent. It is difficult to think of an easier way to provide external finance to countries that urgently require it.

Counter productive measures

This is why many leaders want more frequent SDR allocations. At the United Nations Climate Change Conference (COP26) in Glasgow last November, for example, the prime minister of Barbados, Mia Amor Mottley, called for the issuance of USD 500 bn in SDRs annually for 20 years to fund climate action. Since advanced economies have failed to fulfil even their relatively modest pledge at COP15 in 2009 to mobilize USD 100 bn per year in climate finance for the developing world, regular SDR allocations would provide essential resources to bolster mitigation and adaptation efforts in countries where they are most needed. In addition, the SDRs would provide some of the financing required to achieve the Sustainable Development Goals (SDGs), which currently seem out of reach.

Those who worry about the monetary consequences of annual SDR allocations should note that the proposed sum is trivial compared to the USD25tn increase in liquidity fuelled by loose monetary policies in advanced economies since the 2008 global financial crisis. At USD 943bn, SDRs currently account for only 7 per cent of the USD12.8tn in

global reserves. Even if the share of SDRs in global reserves were limited to, say, 30-50 per cent, there is clearly significant scope for more issuance.

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The more immediate question is how to use the USD400bn of SDRs allocated to rich countries that are unlikely to need them. Simply holding these excess SDR balances with the IMF is a tremendous waste, given the massive opportunity costs. Some richer economies have pledged to reallocate a total of USD100bn in SDRs, but have yet to meet that target. As a result, how to recycle or re-channel existing SDRs has become an urgent question. But the IMF's proposal to establish a USD50bn 'Resilience and Sustainability Trust' would deprive developing countries of many of the advantages of SDRs.

For starters, the amount is shockingly small. Worse, the resources are to be provided in the form of debt that must be repaid (albeit at low interest rates), and will be subject to IMF conditionalities that have far too often proved hugely counterproductive. And the money will be available only to low-income countries or those currently under IMF programs, leaving out most of the developing world. In other words, the IMF's proposed scheme is business as usual, implying little meaningful positive impact.

Other suggestions are more promising. Rich countries could channel their SDRs to regional development banks, which are authorised to hold them. Institutions like the African Development Bank could use the SDRs to enlarge their capital base and provide developing countries with more climate finance and budgetary support for meeting the SDGs. Likewise, the economist Avinash Persaud has proposed creating a USD500bn per year climate finance trust, funded by SDR issuance. The trust would auction funds to countries, with successful bids being those that promise the greatest likely reduction of greenhouse-gas emissions resulting from the proposed investment. If rich-country governments remain sluggish in their response to proposals to use what is essentially free money, they will not only be wasting a huge opportunity. Failure to ensure a more equitable and sustainable global recovery will come back to bite them.

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