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LATIN AMERICA NEEDS ACCESS TO RESOURCES WITHOUT GENERATING DEBT: ISSUANCE OF SPECIAL DRAWING RIGHTS

Andres Arauz - Patricia Miranda *

Latin America is going through a multiple crisis, the perfect storm is brewing in the region, with severe sanitary limitations to face the Covid-19 and in the face of the deepest recession since the Great Depression (1872-1896), the projection of contraction for the region, according to ECLAC[1] is of around 5.3% in 2020, with a greater impact in South America.

The consequences of the crisis are already strongly felt in the world, some of the most significant impacts are the disruption in the supply chains -especially for the primary exporting countries, the paralysis of the tourism sector, the largest drop in remittances, the continuous drop in Foreign Direct Investment and the increase in capital flight in a greater magnitude than the crisis of 2008. To the loss of jobs and sources of livelihood in economies with large informal sectors, the exacerbation of gender gaps has to be added, both in the economic sphere and in the use of time. The crisis has badly affected Micro, Small and Medium-sized Enterprises (MSME), many of them forced to disappear, and the domestic business sectors have collapsed whilst trying to re-emerge with higher levels of debt.

With the shift of the epicenter of the pandemic from Europe and the United States to the countries of the South, the World Bank [2] estimates, in a downside scenario, that 100 million people could be dragged into extreme poverty. For Latin America, the result will be an increase of inequality and poverty, with almost 29 million new poor in the region[3]. The impact of Covid-19 will be devastating and long-lasting for the region. The IMF considers that this could be another lost decade for Latin America[4], with an output contraction of 9.4% in 2020[5].

[1] https://repositorio.cepal.org/bitstream/handle/11362/45445/4/S2000286_es.pdf
[2] https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty
[3] ECLAC, The social challenge in the face of Covid19, 12 May, 2020.
[4] https://blog-dialogoafondo.imf.org/?p=13241
[5] https://blog-dialogoafondo.imf.org/?p=13682

Latin American countries have a reduced fiscal space, their access to concessional financing[6] is limited, and available credits under the Covid-19 framework are insufficient. All countries in the region, with a few exceptions in the Caribbean, already had a fiscal deficit before the pandemic. Argentina, Bolivia, Brazil, Costa Rica and Ecuador registered the highest deficit levels in 2019, above the Latin American average of -2.8% according to ECLAC, and in some cases a higher debt service is projected in the next years[7].

This situation warns of the limitations to face Covid-19 and allocate resources to health and social protection with the urgency required by the evolvement of the pandemic.

Since most countries in the region are considered middle-income, the current sources of financing available are mainly non-concessional and with various schemes of conditionality[8], according to the policies of each lender .

Given the great needs to face the pandemic, the availability of resources is insufficient. Among the solutions discussed by international financial institutions, the G20 and the IMF have proposed the suspension of debt payments for low-income countries, and the provision of credits has been arranged for other developing countries.

While the G20 countries have a USD 9 billion stimulus package[9] in place to alleviate the crisis for its citizens and businesses during the pandemic, the IMF has made available $ 1 trillion dollars against Covid-19 for developing countries, more than 100 countries have requested this emergency fund, from which USD 100 billion correspond to the Rapid Financing Instrument (RFI), with a concessional interest rate (up to 1.5%) but with a short repayment term (5 years), through a quick disbursement process and without sequential conditions, to support local budgets. There are 11 countries in the region that have accessed the RFI fund (Bolivia, El Salvador, Haiti, Panama, Paraguay, Costa Rica, the Dominican Republic, Guatemala, Jamaica, the Bahamas, and Ecuador), with average disbursements of USD 300 million per country, giving countries a brief respite, but likely to be insufficient to face the magnitude of the crisis. Additionally, the other countries of the region will be able to access the resources provided by the IMF to fight Covid-19, through conventional credit programs and agreements.[10]. Argentina has a program under review with the IMF; Ecuador has a suspended program to access the rapid financing instrument; Chile, Colombia and Peru have flexible credit

[6] It refers to the type of financial conditions of a loan, being concessional when it contemplates longer payment terms, low interest rates and grace period, so that the difference between the nominal value and the net present value of the loan service is greater than zero (https://ida.worldbank.org/debt/grant-element-calculations). In the case of Official Development Aid (ODA), it is concessional when it is greater than 25%.

[7] This is the case of Bolivia, Costa Rica, Ecuador, Argentina, El Salvador and Brazil https://www.latindadd.org/2019/04/09/america-latina-enfrenta-el-retorno-de-la-deuda/

[8] Conditionality is understood as a set of policy conditions (mainly economic and labour-related) that are part of the credit programs, such as fiscal austerity reforms, privatization of public companies, labour flexibility, or compulsory procurement contracts with companies of the creditor country, among the most common.

[9] https://www.weforum.org/agenda/2020/05/9-trillion-global-fiscal-support-covid-19/

[10] Link to see the status of the IMF emergency loans by region: https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker

agreements; Honduras and Barbados have credit programs; and other Caribbean countries such as Dominica, St. Vincent, Granada, St. Lucia and Haiti have access to concessional loans.

In sum, the solution proposed to middle-income countries to fight the pandemic is based upon new loans leading to the emergence of a new wave of debt, which will imply a new burden on debt service in the medium term, with the risk that countries might prioritize debt payment over investment in health and social protection.

In the face of an unprecedented crisis, life must be prioritized; the vast majority in our countries face the dilemma of starving or dying from Covid-19. The resources that are needed are crucial and urgent to face the health crisis and sustain the economic recovery, through tools such as a monthly basic emergency income that eases the costs of lockdown measures and allows further progress towards a universal basic income.

Within this context, both the IMF Managing Director and the United Nations Secretary General have concluded that the impact of the coronavirus-related economic crisis for developing countries will be equivalent to at least USD 2.5 trillion. Consequently, the funds available under traditional mechanisms to face the above are insufficient. For this reason, an issuance of Special Drawing Rights (SDR) is urgent for all the countries of the world.

What are SDRs?

Special drawing rights are a reserve asset created through international political agreements. The United Nations member countries, also members of the International Monetary Fund, can determine - with a majority of 85% of the votes - the creation of new Special Drawing Rights (SDR). The value of a SDR is defined from a weighted-average basket including the US dollar, the euro, the yen, the UK pound sterling and the yuan. SDRs are created politically "out of thin air," which is why many economists call it "paper gold." They are assigned to each member´s central bank. SDRs are recorded in a financial entity attached to the IMF called the “SDR Department” which has an independent accounting structure from the IMF itself.

SDRs have a historical origin close to Latin America and developing countries. The first time that the SDR was conceived was within UNCTAD in 1964, then led by the Argentine Raúl Prebisch. After years of deliberations, the IMF accepted, and the SDRs were first issued in 1969.

SDRs are not created by the IMF, they are created by the IMF Board of Governors - that is, by all member states. For this reason, in the context of the international financial crisis caused by the subprime crisis in the United States and as in line with the recommendations of the “Stiglitz” Commission, established by the President of the United Nations General Assembly in 2009, it was the General Assembly that ordered the creation of SDRs; subsequently, the G20 supported this request and the IMF Board of Governors voted for an issuance made in August 2009. A total of 187 billion SDRs were created (then USD 250 billion) and were distributed to each country. Distribution is based upon each country´s voting power in the IMF, for this reason, rich countries received almost 2/3 of the entire SDR issuance.

Even so, the SDRs received by the countries of the South were used to alleviate the crisis. As of December 2010, 107 developing countries had used part of their SDRs to meet their financing needs.

The use of SDRs can be made effective when countries receive them and exchange them with other countries or monetary organizations for any of the currencies that make up the SDR basket. Most countries choose to sell their SDRs for US dollars. SDRs´ main buyers are the United States, the United Kingdom, Japan and the European Central Bank. Other countries decide to use their newly received SDRs to make contributions to the IMF to carry out bilateral transactions.

If any country refuses to buy SDRs, the IMF has the legal ability to compel US dollar-surplus countries (for example, the United States) to buy SDRs from countries that need to sell them. However, for decades this action has not been required, since all purchases have been voluntary.

Currently, due to the hegemony of the US dollar, only the United States has the power to issue money unlimitedly, without affecting the value of its currency. This privilege has been shared through unlimited swap lines with other five central banks: Canada, the United Kingdom, Europe, Switzerland and Japan. Limited access to swaps has also reached 9 other countries (in Latin America only Brazil and Mexico). However, most developing countries do not have such unlimited access to US dollars, a type of discrimination called monetary triage[11].

SDRs are not debt

The most agile way to democratize access to debt-free money is through an ambitious issuance of Special Drawing Rights. According to the current structure of voting power in the IMF, the vast majority of the issuance will reach developed economies, but if the issue is large enough, a significant magnitude will reach developing countries.

Unlike IMF loans, the SDR allocation does not constitute a loan, as it should not be repaid once used. Currently, the allocation has a negligible financial cost of 0.05% per year. Therefore, SDRs are debt-free money and do not require conditionality. Their allocation is universal, to the point that that military powers look at SDRs with suspicion as they provide unconditional liquidity to everyone, including geopolitical adversaries.

Faced with the simultaneous external shock across the planet, international organizations, civil society and the countries of the planet are in favor of an ambitious issue of SDRs. Almost the entire G20 has spoken in favor[12], the Secretary of the United Nations[13], African Heads of State, the World Health Organization, the IMF Managing Director[14], the ECLAC Executive Secretary, The Economist, the Financial Times Editorial Board, and several organizations of the civil society[15].

[11] https://www.thenation.com/article/economy/economy-fed-imf/
[12] https://g20.org/en/media/Documents/G20_FMCBG_Communiqu%C3%A9_EN%20(2).pdf
[13] https://www.un.org/press/en/2020/sgsm20029.doc.htm
[14] https://www.imf.org/en/News/Articles/2020/03/26/pr20108-remarks-by-imf-managing-director-during-an-extraordinary-g20-leaders-summit
[15] https://globalcovidresponse.org/endorsers

How many SDRs should be issued?

Given the voting power structure at the IMF, a US vote is required to approve the issuance. To date, the support of the current administration of the United States government for an issuance of Special Drawing Rights has not yet been obtained. The US vote on SDRs is governed by the SDR Act of 1968, which establishes two routes for the issuance of SDRs. If the issuance is equal to or smaller than the existing SDRs to date (475 billion SDRs), it can be carried out at the initiative of the Treasury Secretariat, prior communication to Congress at least 90 days before the vote. If the issuance is greater, then a law has to be passed, and the 90-day notice is no longer necessary. If a law is approved, the vote of the Secretary of the Treasury in favor of the SDR issuance becomes mandatory and not optional.

To aim for the lowest amount and avoid a law could be an option, but that would mean total dependence on a White House initiative. Formulating a law, however, would force a negotiation between Congress and the White House, reduce the wait time and increase the possible amount of the issue.

For these reasons, 31 US congressmen led by Jesus Garcia, D-Illinois, have proposed a bill (H.R. 6581) that would force the U.S. to support the issuance of 3 trillion SDRs (USD 4.1 trillion).[16] This bill would form part of one of the legislative packages resulting from a political agreement between the House of Representatives (with a Democratic majority) and the Senate and the White House.

If this law were to be approved, Latin American and Caribbean countries would receive the funds corresponding to 3 billion SDRs (outlined in the table below) within the next few days.

Below is the allocation that each country in the region would receive, as a percentage of its IMF quota, with a 1 trillion and 3 trillion SDR issuance:

[16] https://www.congress.gov/bill/116th-congress/house-bill/6581/cosponsors?r=65&s=1&searchResultViewType=expanded&KWICView=false

SDR ISSUANCE ALLOCATION TO LATIN AMERICAN COUNTRIES					
(In million USD)					
Country	**Percentage of IMF quota**	3 trillion SDRs		1 trillion SDRs	
		SDR	USD	SDR	USD
Antigua and Barbuda	0.004	126	173	42	58
Bahamas, The	0.038	1.151	1.58	384	527
Barbados	0.020	595	819	199	273
Belize	0.006	168	231	56	77
Dominica	0.002	73	100	24	33
Grenada	0.003	103	142	34	47
Guyana	0.038	1.147	1.575	382	525
Jamaica	0.081	2.415	3.317	805	1.106
St. Kitts and Nevis	0.003	79	108	26	36
St. Lucia	0.004	135	185	45	62
St. Vincent and the Grenadines	0.002	74	101	25	34
Suriname	0.027	813	1.117	271	372
Trinidad and Tobago	0.099	2.963	4.07	988	1.357
Argentina	0.67	20.105	27.609	6.702	9.203
Bolivia	0.050	1.514	2.08	505	693
Brazil	2.32	69.65	95.649	23.217	31.883
Chile	0.37	11.003	15.11	3.668	5.307
Colombia	0.43	12.896	17.71	4.299	5.903
Costa Rica	0.08	2.33	3.2	777	1.067
Dominican Republic	0.10	3.011	4.135	1.004	1.378
Ecuador	0.15	4.401	6.044	1.467	2.015
El Salvador	0.060	1.812	2.488	604	829
Guatemala	0.090	2.704	3.713	901	1.238
Haiti	0.034	1.033	1.419	344	473
Honduras	0.053	1.576	2.164	525	721
Mexico	1.87	56.219	77.205	18.74	25.735
Nicaragua	0.055	1.64	2.252	547	751
Panama	0.079	2.377	3.264	792	1.088
Paraguay	0.042	1.27	1.745	423	582
Peru	0.28	8.418	11.56	2.806	3.853
Uruguay	0.090	2.707	3.717	902	1.239
Venezuela	0.78	23.482	32.247	7.827	10.749

Plan B – Donating SDRs

In the event that a new SDR issuance was unsuccessful, some organizations propose that rich countries donate their existing SDR to developing countries directly or through trusts administered by the IMF. While this is a fair initiative, the mechanics to implement it may be too complex.

As described by French Finance Minister Bruno Le Maire, the issuance of SDRs is a global monetary policy, while the donation of SDR is a fiscal policy. The donation of SDR has two implications. If the grant is compulsory, it may require an amendment to the IMF's Articles of Agreement, for which parliamentary ratification would take years to achieve. If the grant is voluntary, as a fiscal policy it would require budgetary approval by national parliaments in developed countries, which would also be a lengthy process. In some countries, it would also involve being framed in legislation regarding development aid or international cooperation.

For these reasons, some analysts have proposed that rich countries should lend their SDRs directly to the IMF or to trusts administered by the IMF. This would replicate the phenomenon already mentioned above, with developing countries being plunged into a new wave of debt with conditionality. Therefore, it does not seem to be a viable option for developing countries. Given the timing criterion - the urgency of the health and economic emergency arising from the pandemic - a SDR donation should follow a substantial SDRs issuance process.

SDR for budget support

SDRs can be used as budget support. There are concerns by several actors regarding the usability of SDRs. While SDRs are, in principle, distributed to central banks in member countries, this depends entirely on national legislation. For example, in the United States, SDRs are given to the Treasury Department's Foreign Exchange Stabilization Fund, not to the Federal Reserve.

In the case of Ecuador, an amount of US dollars equivalent to the SDRs received in 2009 were transferred to the Ministry of Finance to be added to the fiscal budget. The rationale used was that there had been an extraordinary increase in the Central Bank's equity, which meant that there was a transfer of capital gains to the Central Bank's sole shareholder, the Ministry of Finance. This legal framework is similar in most countries around world, so that - although SDRs are used for balance-of-payments purposes (to import medical inputs and equipment as well as a possible vaccine) - they can also be used as fiscal resources (to help alleviate the economic effects of a health emergency).

Conclusions

A new wave of external debt should not be the preferred option for Latin American countries to emerge from the crisis. Currently, debt service cancellation or deferral is available only for low-income countries.

SDRs do not constitute debt with principal repayment and can also be used as budget support. For Latin American and Caribbean countries - the vast majority of which are middle-income countries - the issuance of SDRs is a necessity.

The size of issuance is very important. A symbolic issue of SDRs would not be sufficient. A substantial issuance is fully justified, not only because of the needs of the countries of the region but also in comparison with the huge injections of liquidity by rich countries.

Given the escalation of the coronavirus in Latin America, the issuance of SDRs to deal with health emergencies and the economic crisis must be not only substantial but also swift.

(*) Patricia Miranda is the Director of Global Incidence at Latindadd.

Andres Arauz is a former Director of the Central Bank of Ecuador and is currently pursuing a PhD at UNAM in Mexico.

It is imperative to add more voices and stakeholders, from government sectors, parliamentarians and civil society in general in Latin America, to this global demand: #3trillionSDRnow.