Latindadd
Red Latinoamericana por Justicia Económica y Social

LEARNING LESSONS:

HOW IS THE USE OF SDR´S GOING IN LATIN AMERICA?

Learning lessons: how is the use of SDRs going in Latin America?

INTRODUCTION

For Latin America, the issuance of Special Drawing Rights (SDRs) should not be a trivial matter. The resources that arrived to the region –although less than those requested more than a year ago– could be considered relevant for the reactivation process if used appropriately. Otherwise, the risk of continuing persistent structural failures, such as those that hampered economic and social development, would still remain high.

Before the pandemic, Latin America was already the most unequal region on the planet, a condition that has worsened given the increase in poverty –that is, 45 million newly poor people– and the deepest recession ever suffered on any continent. With very few possibilities for its own financing, fiscal spending in the region has been insufficient to avoid a health, social and economic collapse. Even ECLAC warns of the high probability of another lost decade, unless enough money is available and allocated to: health care, the purchase of vaccines, direct monetary transfers to the population as well as payroll subsidies, among other expenses that must be financed through public resources.

Unfortunately, the response has been greater external and internal indebtedness, in addition to measures aimed at deepening austerity. Many countries have requested flexible credit lines and have taken advantage of other programs provided by the International Monetary Fund (IMF), aimed at initiating cuts in public spending in the short term. The IMF itself recognizes that as from 2022, emerging economies and low-income countries will no longer have fiscal support in response to Covid-19. The intention is to leave the reactivation of the economy to the market –private investment– despite the fact that in previous decades its inability to generate equitable and environmentally sustainable economic growth has been demonstrated.

An initial review of the use of SDRs in Latin America will be carried out throughout this analysis, in order to identify which countries had the capacity to establish mechanisms to use those instruments in their budgets, and to assess whether those nations took into account the needs of their population or if, on the contrary, they preferred to maintain financial stability and macroeconomic balance.

THE IMPORTANCE OF SDRS FOR LATIN AMERICA

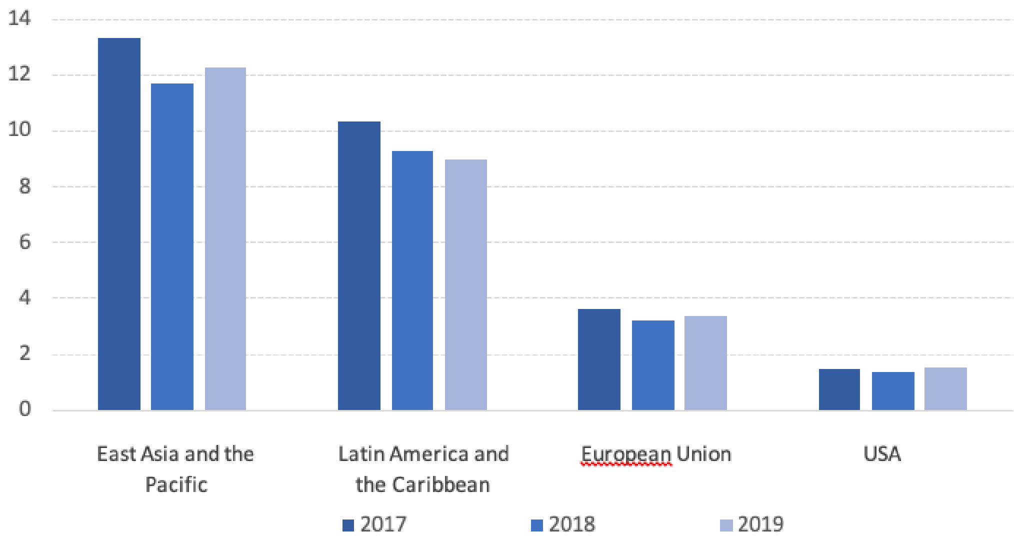
The recent issuance of USD 51.5 billion in SDRs by the IMF and received in Latin America, represent resources that –if well invested– could alleviate the current economic, social and health crisis.

Latin American countries have funded themselves through greater indebtedness and remittances, in the face of deep and recurring decisions of fiscal austerity and the deficits in external accounts within the region. The latter has to do with the fact that exports of raw materials and the enormous benefits to foreign investment, as well as capital outflows due to factor income, do not allow the region to be the main destination for concessional financing or productive investment. Consequently, the SDR represent 1.9% of the total public debt in Latin America, in 2020. Governments should consider that the fiscal use of these resources could serve to avoid an accelerated debt increase, since they remain an important source of foreign currency.

Indeed, SDRs represented 31.4% of foreign direct investment in 2019, which was of great help considering the significant drop in investment flows in the region in 2020, levels that have not yet been recovered in 2021. Additionally, SDRs represented 4.3% of exports in 2020 and 60.9% of the region's current account deficit in 2019[1]. The aforementioned is key, since the region does not have enough funding sources compared to high-income countries, therefore, alleviating its deficit would mean to spend public resources to cover its domestic demand.

However, some countries chose to increase their international reserves, similarly to what happened with the SDR issuance in 2009. It is noteworthy that while high-income countries have very high levels of debt and very low levels of reserves (as shown in Figure 1), their economic approach to the crisis has been to promote higher fiscal spending to get out of the crisis.

Figure 1. Total international reserves in months of imports, 2017 to 2019



Source: Prepared by the authors based on World Bank data.

1 Data obtained from FLAR, the World Bank and UNCTAD

In this sense, the current issuance of SDRs should consider other uses as a priority, breaking with traditional measures of financial and macroeconomic stability and seeking to meet the needs of its population. Table 1 describes several countries in the region that have a comfortable reserve situation, which would allow them to use those SDRs for fiscal spending, as new income for their countries.

Table 1. Latin American countries with adequate reserve levels, first quarter 2021

(Value in millions of dollars and months of imports)

Country	International Reserves	Months of imports
Brazil	347,413	18.6
Mexico	199,302	4.2
Peru	79,922	19.2
Colombia	58,362	11.8
Chile	40,220	5.4
Argentina	39,593	7.4
Guatemala	18,700	8.7
Paraguay	9.970	9.6
Uruguay	15,831	19.1

Source: Prepared by the authors based on FLAR and WTO data

It should be also considered, that some countries in Latin America and the Caribbean have low levels of reserves, such as El Salvador, Jamaica, Bolivia or Ecuador. Table 2 shows some of them. Even so, and considering its needs, Ecuador has decided to use its SDRs for fiscal purposes.

Table 2. Latin American countries with very low reserve levels, first quarter 2021

(Value in millions of dollars and months of imports)

Country	International Reserves	Months of imports
Costa Rica	7,169	4.4
Ecuador	5,779	2.8
Bolivia	4,526	6.4
El salvador	2,523	1.9

Source: Prepared by the authors based on FLAR and WTO data

In this sense, in August 2021 Latindadd published a manual for the use of SDRs, prepared together with the Ecuadorian economist Andres Arauz, aiming to guide governments, congresses and other economic authorities, as well as civil society on how to use SDRs for fiscal purposes. The objective is that countries that do not need an increase in reserves, use those SDRs for fiscal purposes. However, very few countries have done so up to date, except for Ecuador, Paraguay and Colombia to some extent, although Argentina is also expected to do so in order to meet its debt repayments.

Since these resources were created from thin air, the possibility to have access to them would help countries to meet needs in other fields, such as: health, education and social protection, among others. Therefore, including them as new money in the fiscal spending budgets of these countries would represent a recovery option, rather than using them to leverage more debt. Table 3 presents data on debt service for a few Latin American countries as a percentage of GDP and also as a percentage of health budgets, in order to highlight the weight of debt service.

Table 3. Debt Service in selected Latin American Countries, 2019-2020

(Value as a percentage of the National Budget, GDP and health spending)

Country	National Budget (2020)	GDP (2019)	Health spending (2020)
Colombia	21.8%	6.08%	287%
México	11.3%	5.07%	216%
Perú	7.8%	3.02%	131%
Paraguay	5.6%	5.39%	83%
Bolivia	5.5%	2.70%	74%
Costa Rica	4.4%	5.22%	138%

Source: Prepared by the authors based on data from the World Bank and the Ministries of each country

THE IMF RECOMMENDS THE USE OF SDR´S

The IMF states in its guide for the use of SDRs the IMF states that these resources "represent a form of unconditional liquidity" and "they can be used to obtain currencies from other participants, in transactions by agreement", that is, their only possible destination is not reserves, but they can be exchanged for fiscal purposes. The IMF's position is so clear that it even indicates that SDRs can be used for "financial obligations payments, loans, promises, donations, swaps and long-term transactions", as well as for "financing additional expenses".

Finally, the IMF suggests some criteria to take into account for the use of this significant SDR allocation which amounts USD 650 billion (the highest in history) establishing that "the most urgent political priority, at the issuance of this note, is to put an end to the Covid-19 pandemic everywhere "and that "countries that need to prioritize the political response to the crisis (...) must act flexibly and quickly."[2]

2 Guidance note for fund staff on the treatment and use of SDR allocations. International Monetary Fund, August 2021.

HOW HAVE THE SDR BEEN USED?

Colombia: domestic debt swap to generate liquidity in the short term

The USD 2.79 billion of SDRs allocated to Colombia did have a fiscal use and were not used to increase international reserves. However, the issuance did not mean additional resources, but liquidity. In other words, the operation carried out by the Banco de la Republica and the Ministry of Finance and Public Credit, was an exchange of debt that already existed between institutions, adding an extension of maturities.

According to the analysis carried out by Cedetrabajo, the Ministry of Finance exchanged short-term treasury securities for medium and long-term securities from 2029 to 2037. This implies a reduction in the financing needs of 2021, as well as the amortizations and maturities expected for the year 2022 in terms of public debt. The minister points out that the financing needs for next year were reduced by 44% thanks to this decision, given that they expected obligations for USD 6.4 billion, which now will only amount USD 3.7 billion.

According this mechanism, the Ministry of Finance transferred to the Banco de la Republica class B treasury securities equivalent to the SDRs allocated to Colombia. This purchase allowed the ministry to have access to liquid resources under special guarantees since: it will not need to pay these repayments to other creditors, but to its own bank, and then, this institution will transfer its profits to treasury at the end of the fiscal period.

However, it should be noted that a class B treasury title has an effective interest rate of 7% and upon maturity its principal amount should be paid to the Banco de la Republica. Therefore, the purchase mechanism consists of paying public debt through SDR, which is not a debt with an economic agent, but a debt with its own central bank. Also, this decision will not affect the total assets of the central bank, nor the monetary base nor the debt level.

Therefore, despite their fiscal use, these will not represent additional resources, but greater liquidity. However, this liquidity is expected to be used as fiscal spending to meet the country's most pressing needs on health, social and economic matters.

The budget for 2022 –which will be approved in the coming days– will reveal if this situation is fulfilled and thus it should be monitored.

Ecuador: uses SDRs to finance its 2021 Investment Plan

Since the allocation of USD 950 million in SDR on August 23, there has been a debate regarding the use of these resources. The dollarization in the country restricts its access to primary issuance funding, a problem that became more noticeable when facing the pandemic crisis and the reactivation of the economy. The government announced that the SDR will be used for fiscal purposes and that these resources will help solve the country's deficit, which will reach USD 4.5 billion by the end of the year

Thus, Ecuador will have money to finance its public budget. The Ministry of Economy and Finance explained that they will invest this money in: capital spending, to support programs or projects included in the 2021 Annual Investment Plan, such as: roads, hospital construction, the purchase of machinery or equipment, the purchase of vaccines or the payment of aid vouchers aimed to vulnerable sectors affected by the pandemic. However, the debt that the government has with the Ecuadorian Social Security Institute (IESS in Spanish) is also a potential candidate for the use of SDRs.

Although there is a greater incentive to use the SDRs to solve the fiscal problems and the pandemic situation, there are also other debts and possible destinations for these resources. For example, the payment of international arbitration awards against Ecuador amounting to USD 900 million, according to the Investment Plan, could also be considered. Therefore, it is important and necessary to monitor these resources, so they are used in the best possible way.

Paraguay: uses SDRs for social investment in health, education, housing and others

With the arrival of the SDRs in Paraguay, the country has USD 250 million freely available. Thus, the Central Bank of Paraguay (BCP in Spanish) used these resources to execute mitigation programs related to the COVID-19 pandemic following the Economic Consolidation Law sanctioned on August 25, according to which the BCP can use these and other funding sources to execute programs for USD 365 million.

The main destination of these USD 365 million is to face the pandemic, allocating these resources to the social and health sector, according to the Plan, as follows: USD 262 million to health and social programs, USD 23 million to the Institute of Social Security (IPS in Spanish), USD 10 million to exemptions of basic services and subsidies to independent professionals, USD 20 million to micro, small and medium enterprises and self-employed people, USD 25 million to FOGAPY, and USD 15 million to housing construction, among others.

Although all the SDRs will be allocated to the Consolidation Plan –and they represent around 68% of the required resources– the rest will come from loans, the issuance of treasury bonds and Petropar. The foregoing implies greater responsibility regarding the proper management of these resources and in compliance with the economic and social consolidation plan, which is why it is necessary to monitor all these programs.

Argentina: uses the SDR to cover debt maturities

The USD 4.6 billion in SDRs assigned to Argentina will be used to pay its obligations with the IMF. In this process, the Central Bank will buy the SDRs, in exchange of a non-transferable bill from the Ministry of Economy. In 2021 Argentina will pay USD 4.16 billion to the IMF and the rest will be paid at its due date in January 2022.

This decision was made during the negotiation process with the IMF. Additionally, the objective is to give some space to the nation's budget, which did not have the resources to pay these maturities. Also, the idea is to provide greater confidence and certainty to the international financial community.

Mexico: the government bought international reserves from Banco de Mexico

The USD 12.1 billion of SDRs allocated to Mexico generated a strong controversy over ownership and use between Banco de México (Banxico) and the Government. Banxico had warned that it would keep the SDR as international reserves, but it sold reserves for USD 7,021 million to the Mexican Government in mid-September 2021, reducing their level by 3.4%. It is believed that these dollars will be used to pay the debt of the state oil company Pemex. The SDR were paid in Mexican pesos, but their origin is not yet known.

From Latindadd we had warned that Banxico made a misinterpretation of its functions as a provider of treasury services of the Federal Government – according to articles 3 and 18 of the Banco de Mexico Law, the Bank "will hold" international reserves, but will not own them. The SDR belong to the countries, that is the Mexican State and not Banxico.

In a future document we will talk about the use of SDR made by other countries in the region.

Conclusions

The lack of knowledge of some officials regarding the use of SDRs, in addition to the orthodox vision of some economic authorities and the ambiguity of the International Monetary Fund, imply that most of the countries in the region are not taking advantage of the issuance. The reasons were related to the urgency of having access to funding to get out of the crisis deepened by the pandemic. As a result, an issuance corresponding to 69.1% of the total emissions made during the entire history of the IMF was authorized.

Discussions about the origin, the commitments assumed and the possibilities of use still persist. In simple terms, the SDRs originate from a decision to increase international reserve assets. These are not the result of financial gain or wealth creation. They are created out of thin air. In this sense, the IMF member countries that receive these resources are committed to return them if they withdraw from the organization. Otherwise, they are not obliged to repay them, but they do have to pay an annual interest rate of 0.05%, the lowest in the market at the moment. It is practically a gift, which forces the countries authorities to decide what to do with these resources, which is the main discussion.

In most of Latin American countries there is a separation of functions between the treasury and the central bank. Constitutionally, central banks administer international reserves, but they do not own these resources. The resources belong to countries. In emergency situations, such as the current one, governments can instruct their central banks to transfer resources such as SDRs to governments. The latter was explained in the SDR Manual published by Latindadd.

Only Ecuador and Paraguay resorted to this instruction to increase their fiscal spending. Colombia, made an accounting movement to have more liquidity, instead of new resources, and Argentina decided to increase its liquidity by paying off its debt.

The rest of the countries have decided to leave the SDR as reserves. Some, in reality, have very low reserve levels, so this decision is probably positive and would strengthen their external sector. Others do not have reserve problems and accumulating more of them implies to continue the same external debt policies to cover urgent fiscal needs.

Latindadd presents these analyzes so that Latin American civil society organizations have elements to carry out advocacy actions before their economic authorities and motivate them to be more vigilant in the use of essential resources to get out of the crisis.

Latindadd
Red Latinoamericana por Justicia Económica y Social

This document was prepared by Mario Valencia, Colombian economist specializing in debt of LATINDADD