POLICY BRIEF

Innovative Use Options for the IMF's Special Drawing Rights

Debunking Common Concerns of German Policymakers

1 Introduction

In 1969, the International Monetary Fund (IMF) created the Special Drawing Rights (SDRs) as an asset to supplement the official reserves of its member countries and maintain global financial stability. The SDRs are not a currency per se, but are based on five freely usable currencies predominant in the global economy – the US dollar, euro, Chinese renminbi, Japanese yen, and British pound sterling.[1] Whilst not well known among the public, SDRs are an effective tool for boosting liquidity in times of crisis.[2]

The allocation of SDRs is based on quotas – the stakeholder shares of IMF member countries. This results in high-income countries (HICs) receiving the most SDRs, despite the greater financial needs of low-income countries (LICs). Given the increasing debt burden, limited fiscal space, and the urgent need to mobilise climate and development financing, the innovative use of SDRs has become a critical priority. Two trust funds at the IMF and mechanisms by multilateral development banks (MDBs) have, in recent years, emerged as destinations for countries to rechannel their unused SDRs. SDR-denominated bonds present another yet-to-be implemented proposal.[3] Finally, the issuance of new SDRs, with potential tweaks to their allocation, have featured on policy platforms such as the third iteration of the Bridgetown Initiative.[4]

However, obstacles persist due to concerns raised by core stakeholders. The European Central Bank (ECB), who coordinates amongst its members – which hold one-fifth or USD 200 billion worth of SDRs – has been especially critical.[5] Among the countries in the IMF and ECB that have yet to support SDR innovations is Germany. As the largest European holder of SDRs, its central bank – the Bundesbank – has expressed reservations about rechannelling, citing legal constraints as well as risks to the reserve status of SDRs and costs arising from their use.[6] Understanding the root causes of these concerns, and the other aspects that have led to Germany's restrictive stance, is key to alleviating the reservations and advancing SDR usage.

This policy brief argues for Germany to discontinue blocking SDR innovations. Each SDR mechanism offers unique benefits and serves as a non-budgetary resource to meet Germany's multilateral agenda. Recent cuts to development financing and the coalition government's breakdown due to fiscal disagreements

[1] IMF (2023a) 'What is the SDR?' Available at: https://www.imf.org/en/About/Factsheets/Sheets/2023/special-drawing-rights-sdr. (Accessed: 27 December 2024).

[2] Lowery, T. (2023) 'SDRs: The money hack that could help poor countries fight climate change and poverty,' Global Citizen. Available at: https://www.globalcitizen.org/en/content/what-are-special-drawing-rights. (Accessed: 30 December 2024).

[3] Paduano, S. & Setser, B. (2023) 'The magic of an SDR-denominated bond,' Documents, 679. Available at: https://elischolar.library.yale.edu/ypfs-documents2/679. (Accessed: 27 December 2024).

[4] Bridgetown (2024) Bridgetown Initiative 3.0. Available at: https://www.bridgetown-initiative.org/bridgetown-initiative-3-0. (Accessed: 30 December 2024).

[5] Paduano, S. (2023) 'SDR rechanneling and ECB rules,' FinDevLab. Available at: https://findevlab.org/sdr-rechanneling-and-ecb-rules. (Accessed: 20 December 2024).

[6] Berensmann, K. & Walle, Y. (2024) 'Leveraging the FFD4 preparatory process to remove barriers to channelling Special Drawing Rights to multilateral development banks,' International Development Blog. Available at: https://blogs.idos-research.de/2024/12/02/leveraging-the-ffd4-preparatory-process-to-remove-barriers-to-channelling-special-drawing-rights-to-multilateral-development-banks. (Accessed: 27 December 2024).

highlight the urgency for this kind of alternative financing. This brief first provides background on the creation of SDRs, the ensuing debates, the ideas for innovative use which emerged from the 2021 issuance, and the position that Germany has taken regarding these. It then outlines four innovative use options – rechannelling to both IMF funds and MDBs, SDR bonds, and new issuances – and evaluates the merit of the arguments in favour of and against them. Germany embracing SDRs would constitute a significant shift, catalysing buy-ins from its partners and strengthening its global agenda.

1.1 The creation of special drawing rights

SDRs were conceived to meet the liquidity needs arising from the breakdown of the Bretton Woods system and the cessation of gold convertibility. These events placed immense pressure on traditional reserve assets – the US dollar and gold – and as global trade expanded, states increasingly struggled to maintain their reserves. The resulting liquidity shortfalls spurred demand for a new, less dependency-prone reserve asset. SDRs were designed to complement other reserves and reduce the reliance on a singular currency or volatile commodity. Constituting a basket of major currencies and exchangeable between IMF members to meet liquidity needs, SDRs increased resilience against exchange rate fluctuation.[7] The creation of SDRs had diverging reactions:

1. For the United States, SDRs posed a challenge to the dollar's dominance as a reserve currency. It was feared that SDRs would dilute the dollar's influence, a key pillar of American power.
2. Europeans tended to support SDRs as a means to reduce reliance on the US dollar.
3. Developing countries viewed SDRs as an opportunity to receive access to unconditional liquidity without the austerity-driven conditionalities imposed by traditional financial institutions.
4. While initially proposed to address the liquidity issues of HICs, SDRs were extended to all IMF members at the cost of accepting allocations based on the IMF quota. This became a source of contention as it was feared that SDRs would only serve to reinforce existing inequalities and an over-reliance on a system already disadvantageous to poorer nations.

The creation of SDRs was groundbreaking. While their use has recently been expanded to address contemporary challenges, the original issues – allocation inequities, balance of power in the monetary system, and reducing reliance on dominant reserves – continue to shape discussions. Understanding these early debates helps understand how reforms can address existing limitations to unlock the potential of SDRs to meet 21st-century problems.

1.2 Historical SDR issuances & the 2021 issuance as a catalyst for rechannelling initiatives

Since their inception, there have been one special and four general allocations of SDRs:

1. 1970–1972 & 1979–1981: These two initial SDR issuances were designed to address liquidity constraints arising from the breakdown of the Bretton Woods system and instability following the oil crises.
2. 2009: Amid the global financial crisis, a USD 250 billion issuance supported economic stabilisation.
3. 2021: The most substantial allocation of USD 650 billion was issued to provide immediate liquidity due to the unparalleled economic disruptions caused by the COVID-19 pandemic.

[7] IMF, 2023a.

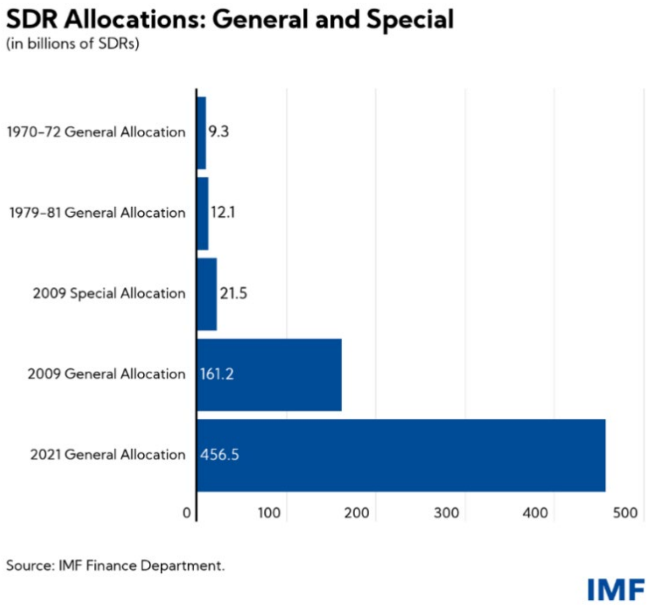

Figure 1: Historical SDR allocations in billions of SDRs (Note: in-text numbers are US dollar equivalent).[8]

Each issuance has reinforced the dual purpose of SDRs as a public good addressing liquidity shortage and as crisis-related relief. The 2021 issuance in particular underscores their potential to catalyse systemic stabilisation.[9] This issuance was not only a response to the economic devastation caused by COVID-19, but also reignited interest in the unique benefits of SDRs due to its unprecedented size. The G20 and the United Nations have both recognised SDRs as a tool for financial stability and called for rechannelling to support countries in need.[10, 11] Civil society advocates for using SDRs to tackle escalating climate impacts, rising debt, and shrinking development assistance, calling for the expanded use of this flexible instrument to fill critical financing gaps.

The 2021 issuance, however, also highlighted the inequities embedded in the allocation as HICs received USD 500 billion in SDRs, while LICs received only USD 45 billion, despite their economies being hardest hit by COVID-19. The IMF thus introduced two trust funds to channel SDRs towards countries in need:

1. The Poverty Reduction and Growth Trust (PRGT) was the first facility created to receive SDRs and provides interest-free financing to LICs. Since 2020, approximately USD 56 billion in rechannelled SDRs have enabled the PRGT to mobilise USD 34 billion in loans.
2. The Resilience and Sustainability Trust (RST) focuses on long-term issues, including climate change and pandemic resilience. To date, USD 46 billion have been channelled to the RST, which has the potential to enable USD 29 billion in financing.

[8] IMF (2023b) What is the SDR? IMF. Available at: https://www.imf.org/en/About/Factsheets/Sheets/2023/special-drawing-rights-sdr. (Accessed: 20 December 2024).

[9] IMF, 2023a.

[10] Lawder, D. & Shalal, A. (2021) 'G20 Finance Chiefs back tax deal, pledge to sustain recovery, watch inflation,' Reuters. Available at: https://www.reuters.com/business/g20-finance-chiefs-back-tax-deal-pledge-sustain-recovery-watch-inflation-2021-10-13. (Accessed: 30 December 2024).

[11] United Nations (UN) (2023) 'Our Common Agenda – Policy Brief 6: Reforms to the International Financial Architecture'. Available at: https://indonesia.un.org/en/238877-our-common-agenda-policy-brief-6-reforms-international-financial-architecture. (Accessed: 19 December 2024).

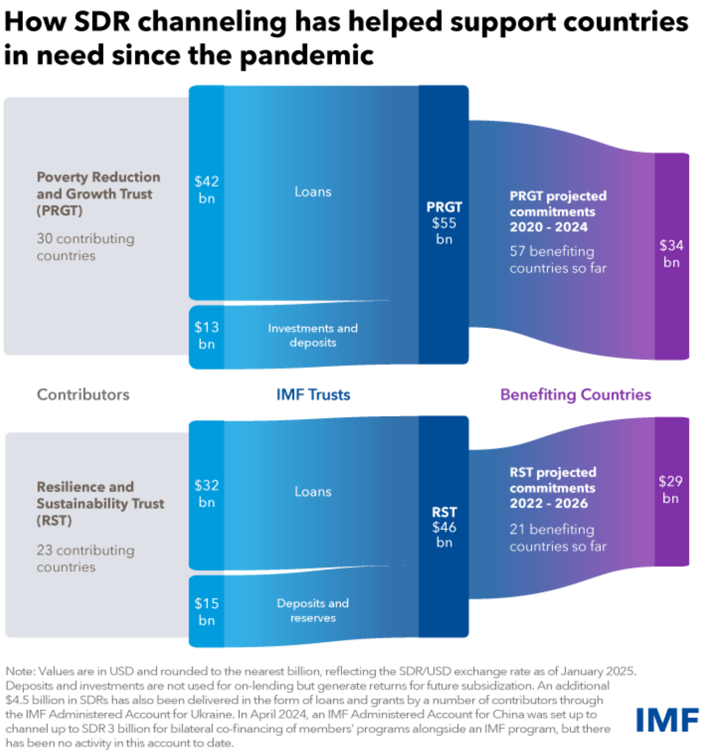

Figure 2: Overview of financing through the PGRT and RST.[12]

Complementing the IMF efforts, MDBs have developed their own mechanisms to amplify the impact of SDRs. In 2024, the African Development Bank (AfDB) and the Inter-American Development Bank (IDB) introduced a hybrid capital instrument leveraging SDRs to mobilise resources fivefold. The MDBs may issue long-term fixed-interest bonds and thus enhance their lending capacity without additional donor resources.[13] The IMF Board's 2024 decision to allow MDB rechannelling was a milestone. Although continuing opposition – notably from the ECB – is hindering the implementation, other MDBs are currently exploring similar mechanisms.

The 2021 issuance demonstrated SDRs' potential to provide immediate fiscal space, fund critical needs, and stabilise economies. Yet, it also served to highlight structural shortcomings within their allocation. There is currently an opportunity to transform SDRs into a cornerstone of international economic resilience. Achieving this vision requires concerted efforts to overcome a range of legal and political barriers.

1.3 The German position on SDRs

Germany's stance on SDRs reflects a complex balance between fiscal conservatism and legal constraints. While acknowledging the importance of SDRs in addressing liquidity needs, Germany has been reluctant to embrace mechanisms that expand their usage. Concerns include the impact on the reserve status of SDRs, financial liabilities tied to SDR utilisation, and the compatibility of the new mechanisms with ECB directives.

[12] IMF (2024a) Special Drawing Rights. Available at: https://www.imf.org/en/Topics/special-drawing-right. (Accessed: 13 February 2024).

[13] IDB (2024) 'IDB and AfDB welcome IMF Executive Board's decision approving use of SDRs for Hybrid Capital Instruments'. Available at: https://www.iadb.org/en/news/idb-and-afdb-welcome-imf-executive-boards-decision-approving-use-sdrs-hybrid-capital. (Accessed: 27 December 2024).

Unlike other major SDR holders, Germany has opted not to rechannel its SDRs to the PRGT and RST, instead providing equivalent funding of USD 7.3 billion from its federal budget. This represents 20% of the USD 36.13 billion SDR allocation that Germany received.[14] The decision not to rechannel underscores the country's fiscal caution. German officials reference the 1976 IMF law as a legal basis for this caution, arguing that budget contributions ensure control of SDRs and compliance with domestic legal provisions.

Regarding the rechannelling to MDBs, the Bundesbank has consistently emphasised the ECB's prohibition on monetary financing under Article 123 of the Lisbon Treaty and the need to preserve the classification of SDRs as a reserve asset. It has argued that rechannelling to MDBs would violate this prohibition, as the ECB considers such mechanisms equivalent to monetary financing.

Despite its reservations, Germany will be pivotal in unlocking the potential of SDRs. Its substantial SDR allocation, influential position within the ECB, and leadership in development and climate financing provide it with a unique leverage to shape SDR reforms. By addressing its concerns, such as through clearer ECB guidance on reserve classification and framing SDR innovations as taxpayer-neutral solutions to its domestic needs, Germany could be the spearhead amongst its partners, while maintaining fiscal credibility.

2 Policy Options for the Innovative Usage of Special Drawing Rights

2.1 Rechannelling via IMF trust funds

Rechannelling has emerged as a key strategy to address the inequity of the 2021 allocation. It involves donors rechannelling their SDRs towards mechanisms which incorporate the SDR interest rate – the SDRi – into the lending terms. The RST at the IMF has been created to ensure that the SDRs lent through it remain reserve assets. Central to this is an encashment system, which consists of a liquidity buffer allowing for the repayment of SDRs in cases where lenders to the funds face balance-of-payments issues. This kind of scenario is highly unlikely and no HIC has ever made use of its SDRs, yet it serves as a guarantee for the reserve status of SDRs. The encashment system also works in unison with a voluntary arrangement under which central banks agree to trade SDRs, as well as a designation mechanism obligating members with strong balance-of-payments positions to provide hard currency in exchange for SDRs.

The SDR reallocations to the PGRT and RST are cost-neutral for the SDR holders as the interest earned on holdings offsets charges on SDR allocations. When a country rechannels SDRs, thus reducing its holdings, it incurs charges equal to the SDRi. However, these are offset if the borrower pays interest at the same rate. The borrower receives interest on increased holdings while paying interest to the lender, resulting in a net-zero effect for both parties. These features of the IMF funds – the encashment system and net-zero cost – mean that rechannelling to the PGRT and RST is 'essentially risk-free' for the country lending its SDRs.[15]

However, despite the commitments made, it is doubtful how much has actually reached countries in need. The IMF states that the PGRT and RST have the capacity to mobilise USD 63 billion, yet much of this remains tied up in bureaucratic processes, limiting disbursement.[16] As shown in Figure 3, only a fraction of the SDRs has been effectively utilised, raising concerns about whether these funds are delivering on their promises.

[14] ONE Campaign (2024) 'Data Dive: Special Drawing Rights,' ONE Data & Analysis. Available at: https://data.one.org/data-dives/sdr. (Accessed: 27 December 2024).

[15] Zattler, J. (2024). Getting Special Drawing Rights Right: Opportunities for Re-channelling SDRs to Vulnerable Countries. IDOS. Available at: https://www.idos-research.de/fileadmin/migratedNewsAssets/Files/PB_9.2024.pdf. (Accessed: 20 December 2024).

[16] Arauz, A & Vasic-Lalovic, I. (2024). Three Years After SDRs Were Issued, Debt-Based SDR Rechanneling Has Failed. CEPR. Available at: https://cepr.net/publications/three-years-after-sdrs-were-issued-debt-based-sdr-rechanneling-has-failed/. (Accessed: 20 January 2025).

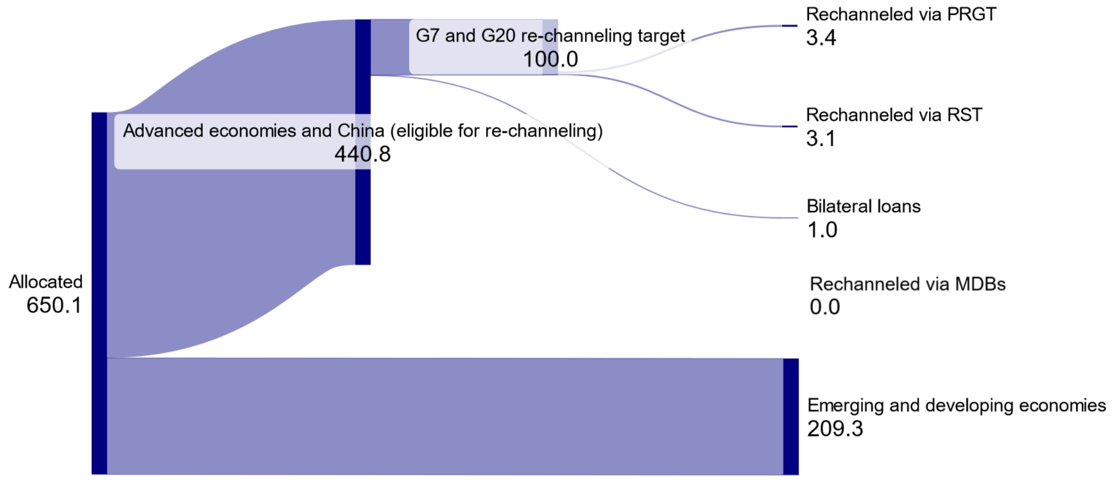

Figure 3: Effective SDR rechanneling relative to the 2021 Issuance in USD billions as of 23 September 2024.[17]

The IMF trust funds also face operational and financial constraints in their capacity to channel SDRs, and have been unable to meet financing needs.[18] Rechannelling has been restricted by certain conditionalities. These include policy reforms with potential adverse effects; eligibility criteria, such as requiring recipients to have IMF programs in place; slow processes; as well as limited absorption capacity and leveraging potential.[19] Moreover, the PGRT relies on donor grants to offset the SDRi. As the SDRi climbs, the need for these subsidies will also rise. Delays in operationalising pledged SDRs highlight fundamental inefficiencies in these funds, recent analysis showing that the majority of SDRs committed to the PGRT and RST remain unused, leaving countries without the liquidity needed to address urgent crises.[20] Finally, the IMF simply does not have the capacity to provide for the expertise-building and policy dialogue necessary for creating robust investment programs that can meet today's unprecedented climate and development challenges.[21]

2.2 Rechannelling via MDB mechanisms

Whilst the PRGT and RST have played an important role in the rechannelling process, their limited scope, absorption capacity, and conditionalities, which are neither additional nor transformative,[22] have led to calls for extending rechannelling to MDBs, which offer unparalleled leveraging and operational efficiency. MDBs are designed to raise resources via bond issuance, which provides investors with safe, liquid assets for mobilising capital. This model ensures efficient SDR use able to accelerate a deployment of funds. Unlike the PRGT and RST, the mechanisms of the MDBs can amplify rechannelled SDRs by a factor of three to six. By using SDRs as equity, MDBs can raise significant resources from commercial markets at rates far lower than those typically available to LICs due to their credit ratings, with the SDRi also historically lower

[17] Arauz & Vasic-Lalovic, 2024.

[18] Sdralevich in Sward, J. (2024) 'The future of Special Drawing Rights as a development finance tool: What's next?' Bretton Woods Project. Available at: https://www.brettonwoodsproject.org/2024/04/the-future-of-special-drawing-rights-as-a-development-finance-tool-whats-next. (Accessed: 30 December 2024).

[19] Mutazu, T. & Chikowore, A.T. (2023). An African Perspective on IMF Special Drawing Rights Rechanneling Proposals: Opportunities and Challenges. Available at: https://sustainablefinancelab.nl/wp-content/uploads/sites/334/2023/12/An-African-Perspective-on-IMF-Special-Drawing-Rights-Rechanneling-Proposals-Opportunities-and-Challenges.pdf. (Accessed: 30 December 2024).

[20] Arauz & Vasic-Lalovic, 2024.

[21] Diamond, V. & Gupta, S. (2024). Assessing the Impact of New IMF Guidance on Resilience and Sustainability Facility Programs. Available at: https://www.cgdev.org/sites/default/files/assessing-impact-new-imf-guidance-resilience-sustainability-facility.pdf. . (Accessed: 27 December 2024).

[22] Task Force on Climate, Development and the International Monetary Fund (2024). Achieving Catalytic Impact with the Resilience and Sustainability Trust. Available at: https://www.bu.edu/gdp/files/2024/04/TF-PB-008-FIN.pdf. (Accessed: 30 December 2024).

than interest paid by LICs.[23] This leveraging capacity ensures a greater impact for each rechannelled SDR.[24] Yet, the MDB mechanisms have faced concerns from various stakeholders – chiefly among these being Germany – regarding preserving the reserve status of SDRs, the associated costs, and the legal compatibility.

A central concern for the Bundesbank has been whether the rechannelled SDRs retain their reserve status. SDRs are considered part of the national reserves, which are crucial for maintaining financial credibility. MDB mechanism have, however, been explicitly designed to preserve the classification of SDRs as reserves. SDRs remain in the MDBs' IMF accounts as hybrid capital. Rather than converting them into hard currency, MDBs use SDRs as equity on their balance sheets to issue bonds in capital markets. To safeguard the reserve status of SDRs, the hybrid capital proposal incorporates a two-layer liquidity support agreement (LSA):

- The first layer comprises a pool of five countries with strong external positions guaranteeing liquidity, which allows donors to reclaim their SDRs if they face balance-of-payments needs.
- The second layer involves a broader group of non-contributing countries, to ensure that, in the unlikely event the first layer is exhausted, donors' SDRs remain liquid.[25]

These safeguards – the first modelled after the IMF trust funds' encashment system and the second added for added security – ensure that rechannelled SDRs remain as secure and liquid as those held in a country's IMF accounts, effectively addressing the concerns regarding preserving the reserve status of SDRs.[26]

The Bundesbank cites the ECB's prohibition on monetary financing under Article 123 of the Lisbon Treaty to underpin its opposition to rechannelling to MDBs, However, this interpretation is unnecessarily rigid. First, ECB policy already allows for reserve-backed instruments, as seen in the case of the European Investment Bank (EIB), which has accessed Eurosystem liquidity without violating Article 123.[27] If reserve-backed financing is permissible for the EIB, there is precedent for extending this approach to MDBs. Second, IMF-endorsed mechanisms ensure that SDRs remain within the IMF system and are not converted into fiscal expenditures, avoiding monetary financing. Third, the ECB has shown flexibility in adapting its policy, as demonstrated during the Pandemic Emergency Purchase Programme, where legal adjustments were made in response to financial stability needs. Given these precedents, Germany, as a major shareholder in the IMF and ECB, is well positioned to advocate for the necessary adaptations to facilitate rechanneling.

Another objection raised against the MDB mechanism argues that the SDRi, which has been historically higher than rates on German sovereign bonds, makes rechannelling a less financially attractive option. Yet, this overlooks the cost-neutral structure of the MDB mechanism: when SDRs are lent to MDBs, they pay back an interest rate above the SDRi, ensuring that the rechannelling remains cost-neutral for donors or even results in a profit.[28]

MDB rechannelling has additional benefits, as MDBs offer the kind of technical assistance enabling them to deliver transformative investments that build resilience against climate shocks and promote long-term

[23] Main, A., Weisbrot, M. & Jacobs, D. (2020) 'The world economy needs a stimulus: IMF Special Drawing Rights are critical to containing the pandemic and boosting the world economy,' Center for Economic and Policy Research. Available at: https://cepr.net/wp-content/uploads/2020/07/2020-06-SDR-Brief-1.pdf. (Accessed: 27 December 2024).

[24] Plant, M. (2023). Funding Hybrid Capital at the AfDB Is the Best Deal for SDR Donors. Center For Global Development. Available at: https://www.cgdev.org/blog/funding-hybrid-capital-afdb-best-deal-sdr-donors. (Accessed: 27 December 2024).

[25] Bilal, S., Karaki, K., Rampa, F. & D'Alessandro, C. (2024). Rechanneling special drawing rights for food security and sustainable food systems – ECDPM. Available at: https://ecdpm.org/work/rechanneling-special-drawing-rights-food-security-and-sustainable-food-systems. (Accessed: 27 December 2024).

[26] IMF (2024b). Use of SDRs in the Acquisition of Hybrid Capital Instruments of the Prescribed Holders. Available at: https://www.imf.org/en/Publications/Policy-Papers/Issues/2024/05/15/Use-of-SDRs-in-the-Acquisition-of-Hybrid-Capital-Instruments-of-the-Prescribed-Holders-549003. (Accessed: 31 December 2024).

[27] Paduano & Setser, 2023.

[28] Berensmann & Walle, 2024.

economic growth. This stands in contrast to IMF programmes, which primarily focus on balance-of-payment support and impose stringent conditionalities that could actually constrain development impact.[29]

Germany's concerns about SDR rechannelling, while grounded in fiscal prudence and institutional caution, are mitigated by the design of the mechanisms being proposed. Preserving the reserve status of SDRs, integrating the SDRi into financial structures, and addressing ECB restrictions offer pathways to overcome these barriers and address pressing challenges in the face of climate and development budget shortfalls.

2.3 SDR bonds

SDR-denominated bonds present another approach to leveraging unused SDRs while maintaining their classification as reserves. Unlike the MDB mechanisms, which use SDRs as equity to leverage resources, SDR bonds allow MDBs to raise funds directly by issuing securities backed by SDRs to which donors can subscribe. Countries pledge their SDRs as collateral for SDR-denominated bonds, and MDBs then issue these bonds in capital markets with interest tied to the SDRi. This structure creates a diversified, stable asset for investors, protecting borrowers and lenders from exchange rate volatility. Furthermore, MDB credit ratings enable them to raise funds at lower interest rates than those available to LICs. Unlike the IMF-housed trust funds, this mechanism avoids the need for additional donor subsidies to offset the SDRi, as MDBs pay back an interest rate above the SDRi, ensuring that donors incur no net costs and may even earn a profit.[30]

While they differ from hybrid capital mechanisms because they do not amplify SDRs via leveraging, SDR bonds provide distinct advantages. As straightforward debt instruments, they simplify operational requirements and avoid the need for LSAs. This makes them an alternative for donors seeking to deploy their SDRs while still preserving the reserve status. Unlike the IMF, technical assistance from MDBs ensures the impact of funds raised through SDR bonds can target long-term development needs and systematically build resilience.[31]

A concern for some might be whether SDR bonds align with the classification of SDRs as reserve assets. However, SDRs pledged for bonds remain fully liquid and risk-free, as they are not converted into hard currency but instead serve as collateral in the IMF account.[32] Analysis further suggests that SDR bonds are aligned with existing frameworks, including the ECB's monetary financing prohibitions. As mentioned above, the ECB facilitates reserve-backed instruments for the EIB. Extending this framework would align with precedence, and at the same time generate bond proceeds.[33] Moreover, the ECB underlies the Public Sector Purchase Programme, which includes the purchase of supranational MDB bonds.[34] The ECB's increased focus on climate risks relating to macrostability provides a strong rationale for supporting SDR bonds as a tool for mobilising critical resources.

The implementation of SDR bonds would require careful coordination among SDR holders, MDBs, and investors. Establishing clear frameworks for bond issuance, repayment, and compliance with legal requirements to preserve the reserve status will be essential for ensuring their success. A robust design would also mitigate concerns relating to whether SDR bonds would blur the lines between monetary and fiscal policy or create liabilities for donors. Germany, as a major shareholder of the ECB and MDBs, has a unique opportunity to champion SDR bonds. This would bolster its financial innovation leadership and complement rechannelling efforts.

[29] Plant, 2023.

[30] Paduano & Setser, 2023.

[31] Bilal, Karaki, Rampa, D'Alessandro, 2024.

[32] Bilal, Karaki, Rampa & D'Alessandro, 2024.

[33] Paduano & Setser, 2023.

[34] Paduano, 2023.

2.4 New issuance

An altogether new issuance has recently gained momentum, with the Bridgetown Initiative's third iteration advocating for a USD 650 billion allocation. This proposal faces hurdles following Donald Trump's re-election, as its approval requires 85% of IMF member votes, granting the United States effective veto power.[35] As a pivotal shareholder, however, Germany can help facilitate a new issuance and champion this cause to the Trump administration as a taxpayer-neutral way to boost the economy and increase export demand.

A new issuance will offer distinct advantages. Injecting immediate liquidity, it will circumvent the delays and complexities of rechannelling. Unlike loans from the PGRT, RST, or the MDB mechanisms, a new issuance would not burden recipients with debt and conditionalities. Countries can use their SDRs to bolster reserves, repay debt, or convert SDRs into hard currency for public spending. These factors should, in principle, also lower the interest that LICs pay when taking on loans for critical projects. These features make a new issuance, as well as SDRs in general, a versatile tool for boosting liquidity while preserving fiscal sovereignty.

Critics of new issuances often highlight that HICs would receive the majority of SDRs. While this allocation is undeniably inequitable, the actual usage of SDRs tells a different story. HICs hold SDRs as reserves and rarely convert them, meaning the bulk of active SDR utilisation occurs in LICs. The progressive use of SDRs thus mitigates their regressive distribution. This does not mean that IMF quotas should be reformed under the IMF's *Fund for the Future* initiative. However, the progress that is lacking on a meaningful IMF quota reform should not prevent the urgently needed SDR support for those countries in need.

Concerns around inflation are another common objection. Critics claim SDR allocations could contribute to inflation by increasing money supply. However, several studies indicate that SDR issuances are too small relative to global markets to have a significant impact on inflation. A report commissioned by the IMF found inflation to be 'extremely improbable',[36] supported by the abovementioned IMF verdict that the 2021 issuance did not lead to discernible inflationary pressures, despite providing an unprecedented stimulus.[37] Fears surrounding inflation are thus largely unfounded, particularly when weighed against the benefits of providing immediate liquidity to economies, which in turn would stimulate growth in LICs and HICs alike.

Germany's reluctance to endorse a new issuance may again reflect the country's fiscal conservatism and the institutional caution of actors like the Bundesbank. Yet, these apprehensions overlook the advantages of a new issuance. In comparison to rechannelling, this would not require donors to rechannel SDRs or navigate the legal frameworks of institutions like the ECB. Instead, it represents a straightforward, non-budgetary solution that aligns with commitments to global stability.

In the long term, institutionalising a system of regular, needs-based issuances would enhance their utility. By linking allocations to clearly defined criteria, such as liquidity needs or responses to climate shocks, future issuances could ensure a fairer distribution and an alignment with development goals. This would not only address historical inequities in allocations, but would also transform SDRs into a cornerstone of the global financial safety net (GFSN). Proposals include automatic SDR allocations of at least USD 200 billion per year, which, according to an IMF study, could maintain global reserve needs 'based on countries' exchange rates and capital flows', or even direct issuances towards MDBs to fund their hybrid capital mechanism.[38,39] Through its significant influence within the IMF Board, Germany is well-positioned to advocate for this reform to unlock the full potential of SDRs to address today's crises, while paving the way for a resilient financial system.

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[35] Main, Weisbrot & Jacobs, 2020.

[36] Cooper, R. (2011) 'Is SDR creation inflationary?' Supplement of: International Monetary Stability – A Role for the SDR. IMF Policy Paper.

[37] IMF, 2023c.

[38] Didier in Sward, 2024.

[39] Plant, M. & Songwe, V. (2024). Allocate SDRs Directly to Multilateral Development Banks. Center For Global Development. Available at: https://www.cgdev.org/blog/allocate-sdrs-directly-multilateral-development-banks. (Accessed: 27 December 2024).

Table 1: Overview of the innovative SDR use options

MECHANISM	BENEFITS	CHALLENGES	GERMAN POSITION	COUNTERARGUMENTS
IMF TRUST FUNDS (PGRT & RST)	• Direct support to LICs and climate-vulnerable countries • Established, tested, and funded mechanisms • Cost-neutral for donors and preserves reserve status	• Limited leverage and flexibility • Stringent eligibility criteria and conditionalities • Reliance on donor subsidies • Slow disbursement	• Hesitant but supportive via equivalent budget contributions • Concerns about reserve status and monetary financing prohibition	• Liquidity protection through encashment system, preserves reserve status • Mechanisms integrate interest costs, no net costs for donors
MDB HYBRID CAPITAL MECHANISM	• Leverages SDRs by 3–6x • Preserves reserve status with robust two-layer safeguards • No subsidies needed • In-country capacity/expertise	• Legal and political barriers • Requires ECB approval • Coordination complexities	• Strong backing for ECB's restrictive stance, with similar concerns regarding reserve status	• Mechanisms are modelled after IMF trust funds, ensuring liquidity • ECB precedent supports similar instruments for reserve-backed MDB funding
SDR-DENOMINATED BONDS	• Scalable, stable financing • Flexible, cost-efficient tools • No subsidies needed • Reduces exchange rate risks	• No leveraging capacity • Concerns over monetary-fiscal policy boundaries • Coordination challenges	• No public stance yet • Likely aligned with ECB reservations on SDR use outside IMF frameworks	• Alternative MDB financing tool • Similar SDR-backed mechanisms already operate within ECB rules • Bonds retain SDR reserve status
NEW SDR ISSUANCE	• Rapid liquidity provision to LICs without conditionalities • Bolsters reserves/fiscal space	• Quota-based inequities • Political resistance, US veto risk	• Limited engagement • Less opposition than to rechannelling	• Inflationary risks are negligible due to limited scope of issuances • HICs rarely use SDRs, progressive use by LICs mitigates inequity

3 Conclusion: Unlocking the Full Potential of SDRs

SDRs hold immense untapped potential for addressing the climate and funding deficits crises. As they are flexible, scalable, and taxpayer-neutral, SDRs can bolster international solidarity and address pressing issues. Until now, their potential has been constrained by political hesitation and institutional rigidity. Germany has the chance to transform SDRs from a crisis-response tool into a key component of resilient global finance.

The clock is ticking: climate disasters are accelerating, debt is crippling LICs, and traditional financing has been insufficient to meet these challenges. From rechannelling to IMF trust funds and MDBs, to SDR bonds, and a new SDR issuance, Germany's leadership is essential. The country should act decisively now to establish a precedent for multilateral cooperation and fulfil global commitments. To champion SDR innovations and address global financial resilience, German policymakers should consider the following actions:

1. **Direct rechannelling to IMF trust funds**
   - Rechannel Germany's unused SDRs to the PRGT and RST
   - Encourage other major SDR holders to follow suit and/or strengthen their rechannelling efforts
2. **Support the MDB hybrid mechanisms and the associated two-layer LSA**
   - Commit to the AfDB-IDB hybrid capital mechanism, ensuring reserve status through a robust LSA
   - Encourage SDR holders with less legal constraints, such as China, Japan, and the UK, to join
3. **Contemplate ECB and Bundesbank mandate adjustments to be more climate-responsive**
   - Advocate for a pragmatic ECB policy shift, and request the ECB to issue formal guidance on channelling SDRs to MDBs and propose solutions to current legal barriers
   - Support expanding the ECB and the Bundesbank mandates to include climate-related risks, building on initial progress to integrate these into macro financial stability considerations
4. **Enhance EU and MDB coordination**
   - Lead EU efforts to develop a cohesive approach to SDRs and engage with progressive EU partners to advocate for MDB hybrid mechanisms
   - Collaborate with MDBs to design and issue SDR-denominated bonds
   - Strengthen MDB-IMF collaboration to capitalise on MDBs' capacity and regional expertise
5. **Reinforce IMF leadership in the GFSN**
   - Push for a new USD 650 billion issuance to address global liquidity needs
   - Champion institutionalised, needs-based SDR issuances and engage international partners on a meaningful reform of IMF quotas
   - Advocate for the IMF to strengthen its role in coordinating innovative SDR use across MDBs and other financial institutions

SDRs are not just a financial instrument, they are a symbol of shared responsibility in addressing crises. Germany has the tools, influence, and moral imperative to lead this transformation towards a fairer, more resilient global financial system that meets urgent needs and safeguards future generations. It is time for Germany to seize this moment to ensure that the untapped potential of SDRs is fully realised.

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