Center for Sustainable Development at BROOKINGS

POLICY BRIEF
SEPTEMBER 2021

Debt service risks, Special Drawing Rights allocations, and development prospects

Homi Kharas and Meagan Dooley

Introduction

On August 23, 2021, the International Monetary Fund (IMF) issued $650 billion equivalent in new Special Drawing Rights (SDRs) to its members. The SDRs do not change any country's net wealth—each country has a liability that exactly equals the new assets it has been issued—but they do represent a sizable injection of liquidity because the SDRs can be voluntarily exchanged on demand for hard cash—U.S. dollars, euros, yen, renminbi, or other tradable currency. If SDRs are converted and the cash is used to pay down debt, then SDRs can be a mechanism to replace more expensive debt with cheaper debt, improving country creditworthiness. Alternatively, cashed-out SDRs can be used to supplement public revenues to increase spending for countries whose development prospects have been particularly hard hit by the pandemic.

This brief looks at SDR allocations from two perspectives:

- To what extent can SDRs ease the debt service burden falling due in the next five years in developing countries?
- To what extent can SDRs ease a recovery in development prospects?

The focus of the brief is on developing countries only. We exclude those economies classified as high income by the World Bank. We start by discussing the impact of the current, statutory allocation of the new issuance of SDRs, and then speculate on the impact of any voluntary reallocation that may occur if countries with surplus SDRs choose to on-lend a portion of this surplus to other countries. A range of "what-if" scenarios are presented to identify the impact of a hypothetical $100 billion reallocation of SDRs.

Debt service

COVID-19 has complicated an already tenuous debt sustainability situation. Governments took on additional debt in order to respond to both the health and economic impacts of the pandemic. Though developing countries were faced with more limited fiscal space than their advanced economy counterparts, emerging markets still added 9.7 percentage points of GDP to their gross general government debt, while low income countries added 5.2 percentage points.[1]

Developing countries, excluding China, have $1.5 trillion in external, public and publicly guaranteed debt service due over the next 5 years. Using credit ratings from Trading Economics,[2] an aggregator of ratings from various issuers, we find that 42 percent is owed by investment grade developing countries (BBB- and above) who will likely be able to meet these obligations or refinance them on international markets. Another 42 percent is owed by speculative grade countries (B- to BB+) who face obstacles to market access and have been negatively impacted by a recent rise in credit-risk spreads. Some of these countries may need official international support to meet these obligations, depending on the longevity of the economic impacts of COVID-19. A final 16 percent is owed by substantial risk countries (CCC+ and below). Sixty percent of the countries in this group are currently eligible for the G-20 Debt Service Suspension Initiative (DSSI) and the G-20 Common Framework for Debt Treatment, so have avenues to pursue debt relief and restructuring if needed, although only 3 countries have as yet applied for debt relief under the Common Framework. Of the remaining substantial risk countries, 5 have already defaulted (Argentina, Belize, Ecuador, Lebanon, and Suriname) and 5 others are upper-middle-income countries (UMICs) whose issues will need to be resolved on a case-by-case basis. This leaves 5 countries, mostly fragile and conflict affected, including Eritrea, Sudan, and Syria, who hold $29 billion in upcoming debt service, who do not have an immediate mechanism for redress if a liquidity crunch should occur, although Sudan will receive debt relief under the Heavily Indebted Poor Countries Initiative.

About 20 percent of public and publicly guaranteed debt service due over the next five years is owed to multilateral creditors, who are able to offer lower rates and longer maturities than other creditors. This ratio ranges from 41 percent of debt service in low income countries (LICs), 26 percent of debt service in lower middle-income countries (LMICs), and 15 percent of debt service in UMICs. Looked at another way, 14 percent of

—

[1] IMF (2021). Fiscal Monitor—April 2021. p. 4.
[2] Using Trading Economics ratings as of April 2021. Countries with missing credit scores interpolated based on Kharas and Noe (2018).

investment grade developing country debt service is due to multilateral creditors, compared with 27 percent for speculative grade countries, and 18 percent for substantial risk countries.

How will the SDR allocation affect countries' ability to meet their debt service obligations? Developing countries, excluding China, got $173 billion in the new SDR allocation, 27 percent of the total, equivalent to 12 percent of the total debt service falling due in the next five years. By region, the Middle East, Africa and Europe and Central Asia got the highest coverage of debt service obligations. UMICs received $99 billion (15 percent), LMICs received $65 billion (10 percent) and LICs received $9 billion (1 percent). The LIC allocation was equal to 21 percent of debt service due over the next 5 years, compared with 10 percent for LMICs and 12 percent for UMICs (see Table 1).

TABLE 1

New SDR allocation to developing countries by country grouping, compared with total external debt service, public and publicly guaranteed, due 2021-2025

Country Grouping	SDR ($bn)	% total allocation	Total debt service, PPG, due 2021-2025	SDR/debt service
Africa	$34	5%	$258	13%
East Asia & Pacific (ex. China)	$22	3%	$194	11%
Europe & Central Asia	$31	5%	$238	13%
Latin America & Caribbean	$47	7%	$490	10%
Middle East	$16	2%	$112	14%
South Asia	$24	4%	$203	12%
Upper-middle income (UMIC)	$99	15%	$818	12%
Lower-middle income (LMIC)	$65	10%	$635	10%
Low income (LIC)	$9	1%	$41	21%
Investment grade	$79	12%	$632	12%
Speculative grade	$69	11%	$624	11%
Substantial risk	$25	4%	$239	11%
Total (ex. China)	$173	27%	$1,495	12%

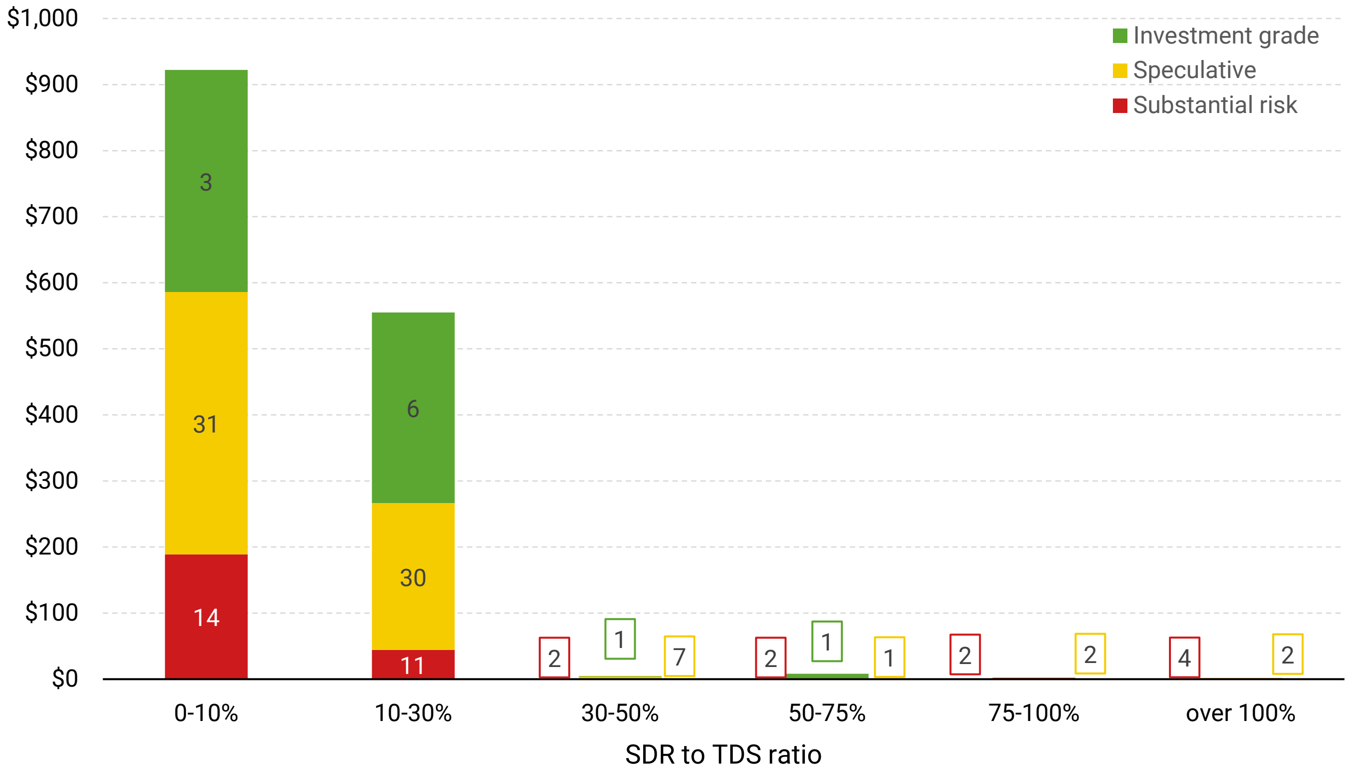
Source: IMF (2021) and World Bank International Debt Statistics (2021). Regional and credit worthiness ratings exclude high income countries.

These top line estimates hide much country level heterogeneity. Figure 1 below shows the distribution of countries by the ratio of SDRs to total debt service due over the next 5 years. 22 speculative and substantial risk countries received SDR allocations that cover more than 30 percent of debt service due, of which 6 countries (Algeria, Central Africa Republic, Iran, Liberia, Somalia, and Zimbabwe) received SDRs in excess of their total debt service due over the next 5 years. For these countries, the SDRs are a welcome source of relief. However, for the remaining 86 speculative and substantial risk countries, owing $850 billion in debt service, the SDR allocations cover a modest fraction of their upcoming debt service obligations.

FIGURE 1

New SDR allocation as a share of total external debt service, public and publicly guaranteed, due 2021-2025

Total debt service due in billions USD, and number of countries in each category (labels)



Source: IMF (2021) and World Bank International Debt Statistics (2021).

The new allocation of SDRs will thus be a huge boon to some individual countries, providing needed liquidity over the next 5 years that could be used to help with growing debt burdens. Yet many speculative and substantial risk countries may need additional support. Where there are strong prospects for economic growth and for growth in government revenues, countries may be able to refinance their debt. However, in countries with slow or stagnant growth due to COVID-19, there may be a need for additional liquidity support. The next section, therefore, reviews development prospects.

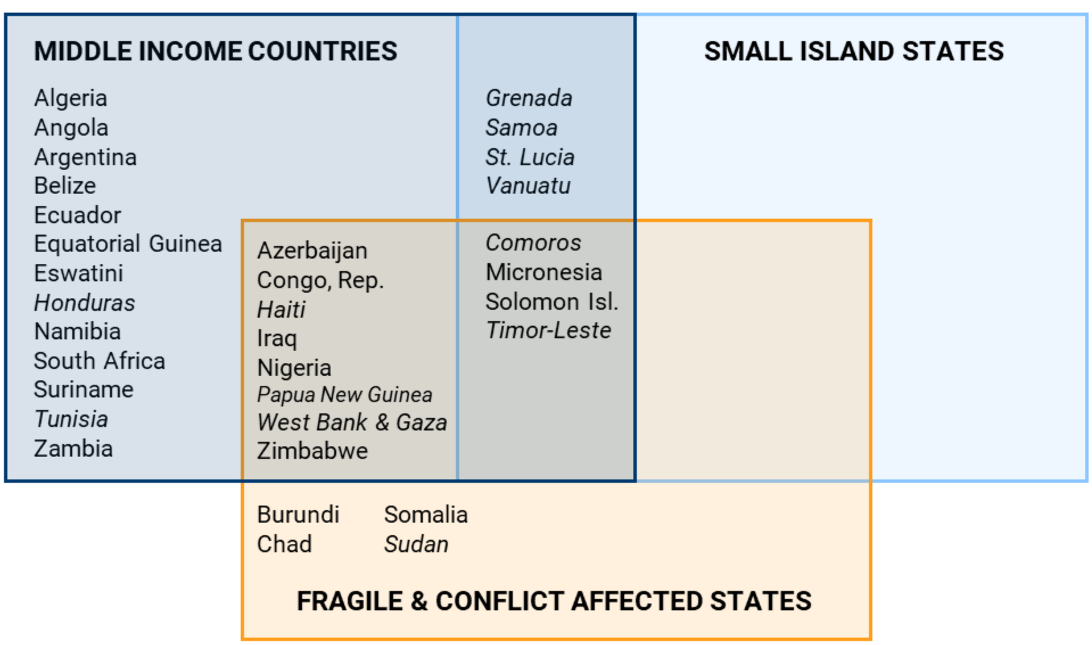
Development prospects

In its April World Economic Outlook, the IMF identified 48 emerging market and developing economy (EMDE) countries where the consequences of COVID-19 are likely to be long-lasting. In these countries, real per capita GDP in 2025 in 2017 PPP terms is forecast to be below the level in 2019. Fifteen of these countries are high income, leaving 33 developing countries in the group of those most seriously affected by the crisis. These countries are overwhelmingly middle-income (only 4 are low income), mostly either fragile and conflict affected (16 countries) or small island states (8 countries). Twelve are members of the V-20, a group of 48 climate vulnerable states, including low-and middle-income, least developed, arid, isthmus, landlocked, mountainous, and small island developing countries from Africa, Asia, the Caribbean, Latin America, and the Pacific. Eighteen are eligible for support from the IMF's Poverty Reduction and Growth Trust, while the remaining 15 seriously affected countries have no specific initiative from which they can receive international support.

Geographically, 16 countries are in Africa, 8 are in Latin America and the Caribbean, and 6 in East Asia and the Pacific. The remaining three economies are Azerbaijan, Iraq, and West Bank/Gaza. The West Bank/Gaza territory, of course, receives no SDRs. Figure 2 shows the breakdown of countries among these groups and the overlap between them.

FIGURE 2

Countries with lower GDP per capita in 2025 than 2019 by country grouping



Source: Authors' calculations based on IMF April WEO database of GDP per capita in 2017 PPP dollars.
Countries in *italics* are members of the V-20.

Collectively, these 33 most seriously affected developing countries received $26 billion in SDRs. This is equivalent to 13 percent of debt service due over the next 5 years, or 1.3 percent of GDP. LICs in this group receive 2.7 percent of GDP, compared to 1.2 percent for UMICs and 1.3 percent for LMICs (see Table 2). If smoothed out over five years, the incremental fiscal space afforded to developing countries from this allocation is quite small, averaging less than 0.3 percentage points of GDP per year.

TABLE 2

New SDR allocation to 33 developing countries with lower GDP per capita in 2025 than 2019, compared with GDP in 2021

Country Grouping	SDR ($bn)	% total allocation	GDP 2021	SDR/GDP
Africa	$16.5	2.5%	$1,211	1.4%
East Asia & Pacific (ex. China)	$0.5	0.1%	$29	1.7%
Europe & Central Asia	$0.5	0.1%	$48	1.1%
Latin America & Caribbean	$6.1	0.9%	$557	1.1%
Middle East	$2.3	0.3%	$185	1.2%
South Asia	$0.0	0.0%	$0	0.0%
Upper middle-income (UMIC)	$12.9	2.0%	$1,084	1.2%
Lower middle-income (LMIC)	$11.5	1.8%	$892	1.3%
Low income (LIC)	$1.5	0.2%	$55	2.7%
Investment grade	$0.0	0.0%	$0	0.0%
Speculative grade	$14.2	2.2%	$1,169	1.2%
Substantial risk	$11.6	1.8%	$862	1.4%
Total	$25.8	4.0%	$2,031	1.3%

Source: IMF (2021) and World Bank International Debt Statistics (2021). Regional and credit worthiness ratings exclude high income countries.

The averages disguise wide differences within countries. For Burundi, Suriname and Zambia, the SDR allocation exceeds 5 percent of GDP, potentially permitting far higher spending levels. In other countries, however, the increase is more modest. In Nigeria, SDRs are equivalent to 0.7 percent of GDP, and Ecuador, and Haiti received an additional 1.0 percent of GDP. Given the growth prospects in these 33 countries, many will likely need additional international support beyond this new SDR allocation.

Another perspective is to compare the SDR issuance to the level of official development assistance (ODA) that countries receive. Three (Angola, Algeria, Argentina) receive very small amounts of technical assistance. For these countries, the SDR issuance is the only source of concessional finance that the international community has provided. Among the low income countries, Sudan's SDRs are equivalent to half a year's worth of ODA, Burundi, Chad, and Haiti received 4 months' worth of ODA, and Somalia about one month.

Two "what if" scenarios

With the new issuance of SDRs completed, conversations are moving towards a potential reallocation mechanism to allow high income countries to on-lend excess SDRs to those in need. The G7, in their Carbis Bay Communique, have already asked their Finance Ministers and Central Bank Governors to consider the details of a global reallocation of $100 billion.[3] Among the proposals are on-lending of excess SDRs to the IMF's Poverty Reduction and Growth Trust (PRGT), with a portion perhaps being channeled through the IMF's Catastrophe Containment and Relief Trust (CCRT), and to a new IMF Resilience and Sustainability Trust (RST). This last could on-lend money for general government spending, or for specific under-funded priorities, such as adaptation and resilience.

In the scenarios below, we look at the impact of a hypothetical reallocation of $40 billion to the PRGT (some of which may be dedicated to the CCRT) and $60 billion to the RST. These figures are chosen purely for presentational purposes. We are not advocating for any particular figure and believe that more is better than less. We recognize, however, that some analysts have expressed a concern that on-lending of SDRs at scale could potentially compromise the preferred creditor status enjoyed by multilateral lenders. This is unlikely to be the case. The SDR interest rate is 0.05 percent. No principal is payable. The additional debt service on $100 billion of SDRs is, therefore, $50 million per year, a tiny fraction of the $79 billion in annual debt service to multilateral preferred creditors owed by lower-middle-income and low income countries.[4]

In fact, the indicators used by credit rating agencies to assess preferred creditor status no longer relate to the debt or debt service of preferred creditors as a share of PPG debt or debt service. This latter methodology was abandoned in 2018 by S&P and is not used by other credit rating agencies either.[5] Instead, a broader concept of the share of arrears of multilateral debt in the total portfolio is used, along with each country's track record in repaying multilaterals. Thus, the impact on preferred creditor status from an SDR reallocation would be zero unless a borrowing country enters into arrears, something which has historically been extremely rare.

—

[3] G7 (2021). "Carbis Bay G7 Summit Communique." June 13.
[4] Note that the calculated SDR rate is even lower, 0.01 percent, but the SDR interest rate has a lower bound set at 0.05%. The implication is that even if interest rates rise modestly in advanced countries, the SDR interest rate would be initially cushioned.
[5] Mahesh Kotecha (2019). "Rising Role of Preferred Creditor Status in Ratings of Multilateral Development Banks." In Bretton Woods Committee (eds), *Revitalizing the Spirit of Bretton Woods*, pg. 273-284.

Below, we look at the impact of such a reallocation of SDRs on the debt service and development challenges outlined above.

1. On-lending $40 billion to PRGT eligible countries

One suggested mechanism for SDR reallocation is to top-up the IMF PRGT, for which IDA countries and several small island states are eligible, by $40 billion. As of June 2021, 70 countries were PRGT eligible. To put the $40 billion in perspective, PRGT countries receive about $60 billion in annual net ODA. We look at what would happen if the $40 billion was lent out to PRGT eligible countries in shares proportional to their quota. 67 percent of this new lending would go to Africa, followed by 10 percent to South Asia, 8 percent to East Asia and the Pacific, 7 percent to Europe and Central Asia, 6 percent to Latin America, and 3 percent to the Middle East.

This would bring total new SDRs to PRGT eligible countries to $61 billion, including their initial share of the $650 billion allocation. LICs would receive $24 billion, LMICs would get $36 billion, and the few small island UMICs would get $2 billion. This is equivalent to 4 percent of GDP, ranging from 6 percent in PRGT eligible LICS, 3 percent in LMICs, and 6 percent in UMIC SIDS. If this was all allocated to debt service, it would cover 35 percent of debt service due over the next 5 years.

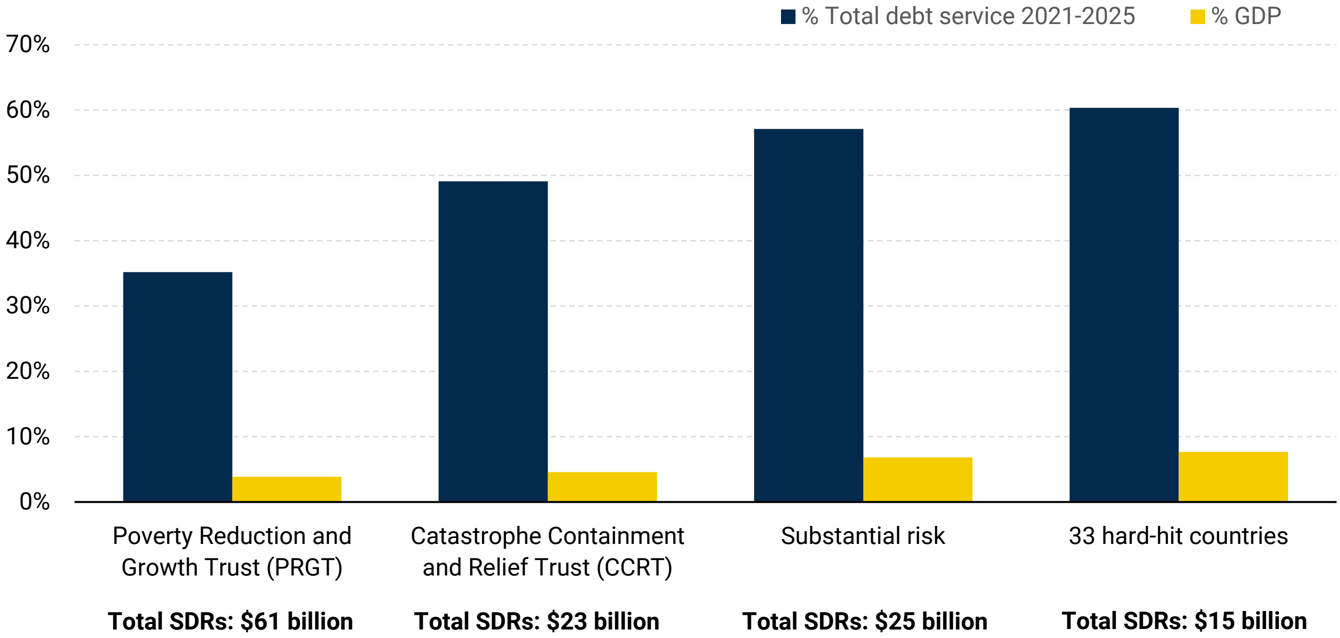
The 26 PRGT countries with a substantial risk credit rating would receive $25 billion, enough to cover 57 percent of upcoming debt service, or 7 percent of GDP (see Figure 3). The 29 low and lower-middle-income PRGT countries that are also eligible for the CCRT would get $23 billion, equivalent to 49 percent of debt service due, or 5 percent of GDP. 18 out of 33 developing countries with lower GDP per capita in 2025 than 2019 are PRGT eligible, and would receive $15 billion, covering 60 percent of upcoming debt service, or 8 percent of GDP.

At the country level, SDRs would completely cover debt service for 13 countries (Afghanistan, Burundi, Central Africa Republic, DRC, Guyana, Haiti, Liberia, Madagascar, Sao Tome and Principe, Sierra Leone, Solomon Islands, Somalia and Zimbabwe), and would cover at least 50 percent of debt service for an additional 16 countries. Sixty-two percent of CCRT eligible countries would have at least 50 percent of their debt service covered, as would 67 percent of PRGT countries with lower GDP per capita in 2025 than 2019, and 58 percent of countries with a substantial risk credit rating. This combined allocation of SDRs would amount to over 10 percent of GDP in 14 countries—in 3 of these (Liberia, South Sudan, and Zambia), SDRs would top 20 percent of GDP. It would cover at least 5 percent of GDP for another 13 countries.

The proposed top-up would have a very substantial impact on either debt servicing or fiscal space of PRGT-eligible countries.

FIGURE 3

SDR allocation as a share of total debt service 2021-2025 and GDP in 2021



Source: Authors' calculations, based on IMF (2021), World Bank International Debt Statistics (2021), and IMF World Economic Outlook (April 2021)

2. On-lending $60 billion to RST countries

A proposed RST is a Trust that would support countries that are not eligible under the PRGT. We suggest that UMICs with investment grade access to capital markets also do not need exceptional support at this time. Excluding these two groups would leave a set of 51 middle-income developing countries and we look at the impact of a quota-proportional allocation of $60 billion in SDR loans to these countries.

This group of non-PRGT countries got $100 billion in the initial allocation, so this would bring their total new SDRs to $160 billion, equivalent to 1.4 percent of GDP. LICs (only Syria) would receive a total of $640 million, LMICs would get $84 billion, and UMICs would get $75 billion. If this was all allocated to debt service, it would cover 17 percent of debt service due over the next 5 years.

The 35 speculative grade countries in this group would receive $90 billion, enough to cover 18 percent of upcoming debt service, or 1.5 percent of GDP. The 10 substantial risk countries would get $26 billion, equivalent to 14 percent of debt service due, or 2.8 percent of GDP. The 12 V-20 members would get $16 billion, covering 10 percent of debt service, or 1.3 percent of GDP. The remaining 15 countries with lower GDP per capita in 2025 than 2019 would receive $44 billion, which could cover 20 percent of upcoming debt service, or 1.8 percent of GDP.

At the country level, SDRs would completely cover debt service for 3 countries (Algeria, Iran, and Turkmenistan), and would cover at least 50 percent of debt service for an additional 4 (Eswatini, Fiji, Kosovo, and Syria). This combined allocation would amount to over 10 percent of GDP in 2 countries (Suriname, Venezuela), and over 5 percent of GDP in an additional 2 countries (Jamaica, Lebanon). For most countries, it would cover 1-3 percent of GDP.

While useful, the RST would leave many non-PRGT-eligible, middle-income developing countries vulnerable to debt servicing difficulties. It would provide modest additional fiscal space, less than 0.3 percent of GDP per year in the hardest hit countries.

Conclusion

The new issuance of SDRs provides much needed liquidity to developing countries. On average, it provides enough resources to offset 10 percent of debt service owed by middle income countries in the next five years, and 20 percent of the debt service owed by low income countries. The impact on fiscal space is smaller—on the order of an incremental 1 percent of GDP.

The policy discussion is now moving to mechanisms for on-lending surplus SDRs. One proposal is to provide $40 billion to PRGT-eligible countries. We simulate the impact of using these resources for debt service coverage or for public spending. We conclude that such a reallocation would provide substantial support to PRGT countries that could be used to either reduce debt service obligations in a material way (including through dedicated resources to the CCRT), or increase public spending, or a combination of both.

We also highlight the fact that many hard-hit and speculative and substantial risk countries, are not PRGT- or CCRT-eligible. We, therefore, look at alternative approaches of providing $60 billion to these countries. In this case, the impact on both debt service coverage and public spending is far smaller. The amounts would not permit most countries to spend an incremental 2 percentage points of GDP per year over 5 years, a rough average level computed by IMF staff as the cost of offsetting the COVID-19 pandemic.[6] The SDR reallocation as currently envisaged, may not, therefore, be adequate.

The SDRs allocation and proposals for voluntary on-lending, then, should be understood as being a way of buying time, not as a solution to the development problem facing developing countries. For middle income countries, in particular, the additional liquidity will neither free them from debt service risk, nor provide the fiscal space needed for recovery. We hope that the time that is being bought will be used by rich countries to bolster public support for ODA that could provide a longer-term remedy for these problems.

A final word: While countries are free to use the SDRs that have been issued in ways that best reflect their own priorities, any reallocation of excess SDRs should contribute to global priorities, not just to individual country preferences. Among these global priorities, managing the looming debt crisis, providing resources to the hardest hit countries, and perhaps financing for specific purposes such as mitigation, adaptation, and resilience, where all countries benefit, makes sense. But if greater scrutiny over expenditure is part of the program, considerable staff work to develop a taxonomy of eligible expenditures will be required. That will not be easily put in place on a time scale that matches the urgent need for liquidity today.

—

[6] Benedek et al. (2021). "A Post-Pandemic Assessment of the Sustainable Development Goals." IMF Staff Discussion Notes No. 2021/003.

Authors

Homi Kharas is a senior fellow in the Center for Sustainable Development at Brookings

Meagan Dooley is a senior research analyst in the Center for Sustainable Development at Brookings

Acknowledgements

The Brookings Institution is a nonprofit organization devoted to independent research and policy solutions. Its mission is to conduct high-quality, independent research and, based on that research, to provide innovative, practical recommendations for policymakers and the public. The conclusions and recommendations of any Brookings publication are solely those of its author(s), and do not reflect the views or polices of the Institution, its management, its other scholars, or the funders acknowledged below.

Brookings gratefully acknowledges the program support provided by the Bill & Melinda Gates Foundation, Open Society Foundations, and The Rockefeller Foundation.

Brookings recognizes that the value it provides is in its commitment to quality, independence, and impact. Activities supported by its donors reflect this commitment.

About the Center for Sustainable Development

Launched in 2020, the Center for Sustainable Development at Brookings generates leading research and insights to advance global sustainable development and implement the Sustainable Development Goals within and across all countries. To learn more visit: www.brookings.edu/SustainableDevelopment