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Channelling Special Drawing Rights to Multilateral Development Banks: Overcoming Remaining Legal and Political Obstacles

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Summary

In 2021, the G20 committed to reallocate USD 100 billion of the International Monetary Fund's (IMF) recent allocation of Special Drawing Rights (SDRs) to low-income and vulnerable middle-income countries. However, most of these donations have been made to the IMF's Poverty Reduction and Growth Trust (PRGT) and Resilience and Sustainability Trust (RST), which have a leverage ratio of less than one. As a result, there have been growing calls to channel SDRs to multilateral development banks (MDBs), which can leverage them up to three to six times. In this respect, the African Development Bank (AfDB) and the Inter-American Development Bank (IDB) have proposed an innovative mechanism structured as a hybrid capital instrument complemented by a Liquidity Support Agreement (LSA). In May 2024, the IMF Executive Board approved using SDRs for purchasing hybrid capital instruments from prescribed holders, significantly boosting the prospect of this initiative. Nevertheless, the level of participation in both the SDR channelling and the LSA remains relatively low.

Against this background, this Policy Brief assesses the current positions as well as the institutional and political challenges of key players concerning the hybrid capital proposal, and it outlines how these challenges could be overcome. Some countries, including France, Japan, Spain and the United Kingdom, have announced their support for the proposal. Nevertheless, these countries have yet to translate their support into concrete action, and the precise extent of their contributions remains uncertain. Other potential donor countries with strong external positions and no legal restrictions, such as China, Qatar, Saudi Arabia, Canada and Australia, have not expressed interest in this proposal or have not done so openly. A third group of potential donor countries face legal challenges in channelling their SDRs to MDBs. In particular, it is unlikely that the United States will use its SDRs to purchase hybrid capital issued by MDBs, as this would require congressional authorisation, which seems unlikely given the current political climate. Similarly, EU member states are being advised against using SDRs outside of the IMF by a – still informal – position of the European Central Bank (ECB). To overcome these challenges, several actions are required of the various stakeholders.

- First, potential donors with minimal legal constraints should act to channel their SDRs through the proposed hybrid capital vehicle.
- Second, Eurozone countries should request that the ECB provide a clarification of its informal position on the channelling of European SDRs to MDBs. We discuss in this Policy Brief that there are sound reasons why the ECB could and should decide favourably.
- Third, in the event that the ECB fails to formally rule on this mechanism in a timely manner, or rules unfavourably, EU member states should support this proposal by participating in the "second layer" LSA through their development budgets.
- Fourth, African governments and the African Union (AU) should advocate on behalf of the AfDB in different fora such as the World Bank and IMF's Spring and Annual Meetings, the G20 and regular summits such as with China and the EU.
- Finally, global and local civil society organisations (CSOs) and think tanks should advocate for potential donor countries to channel their SDRs to MDBs and provide enhanced analysis and research on the topic to inform policymakers and leaders both in donor and recipient countries.

Introduction

In the face of multiple crises – including climate, health and debt crises, as well as ongoing wars in Ukraine and the Middle East and other geopolitical tensions – achieving the Sustainable Development Goals (SDGs) has become a distant prospect. Furthermore, inequalities both between and within rich and poor countries have widened. The contemporary economic context is characterised by high interest rates and sustained inflationary pressures, accompanied by an increase in the level of indebtedness (Berensmann, Laudage Teles, Sommer, & Walle, 2023). These developments have resulted in a shortage of development finance, while the need for financial resources to achieve the 17 SDGs is accelerating.

The allocation of SDRs totalling USD 650 billion by the IMF in 2021 represents a significant source of financing for developing countries. The allocation of new SDRs provides additional reserve funds to all countries without any conditions being imposed. Moreover, it does not result in an increase in a country's debt level. In this manner, the IMF thus contributes to the stability of the global economy in accordance with its original mandate.

Nevertheless, the effectiveness of the new SDR allocation was constrained by the fact that a considerable proportion of the SDRs were allocated to wealthy countries that were not in need of them, due to the quota distribution within the IMF. The IMF essentially calculates the quota shares according to a country's relative weight in the global economy and their share in global trade. At approximately USD 21 billion, low-income countries have only received 3.2 per cent of recent SDR allocations. To partially address this inequitable distribution and help vulnerable countries close the financing gaps exacerbated by the multiple crises, the G20 agreed in the summer of 2021 to redistribute SDRs worth USD 100 billion from wealthy to vulnerable countries. However, the question of how to effectively use these donated SDRs has remained a controversial topic.

Three options have emerged as the most prominent: (i) the PRGT, which provides loans at particularly favourable conditions, currently at 0 per cent interest, to low-income countries; (ii) the RST, which was established in 2022 with the objective of assisting low- and vulnerable middle-income countries in building resilience to external shocks and addressing climate and pandemic challenges; and (iii) the channelling of SDRs to MDBs. Additional proposals and a comprehensive comparative analysis of the three aforementioned channels can be found, for instance, in Zattler (2024).

The channelling of SDRs alters their nature for recipient countries, as additional reserve funds that are freely available are transformed into loans that are contingent upon certain conditions. This is exemplified by the PRGT and the RST, which are the only vehicles used to channel SDRs thus far. At the same time, there is a growing call for a more effective utilisation of these SDRs through MDBs, as they have the potential to leverage the SDRs up to three to six times. The AfDB and IDB have proposed a mechanism structured as a hybrid capital instrument, complemented by an LSA. This approach would treat the SDRs as equity on MDBs' balance sheets. In May 2024, the IMF Executive Board approved using SDRs for purchasing hybrid capital instruments from prescribed holders, which includes most MDBs, significantly boosting the prospect of this initiative (IMF, 2024b).

This instrument enjoys a wide range of international support, not only from African countries, the Bridgetown Initiative and civil societies, but also from Western governments, including those of France, Spain, Japan and the United Kingdom. However, the willingness to participate in the proposal – by channelling SDRs or contributing to the two layers of LSA – remains relatively low. This innovative mechanism offers a viable alternative to direct capital increases of MDBs, which are becoming increasingly challenging due to budget cuts to the development ministries in several OECD countries. Therefore, it is crucial to identify and address the key challenges associated with implementing this proposal. Against this background, this Policy Brief has three main objectives.

First, it assesses the current positions as well as the institutional challenges of key players – including China, European countries and the United States – on this topic. Second, it analyses the legal and political arguments of the ECB and the national central banks (NCBs) as to why they appear to advise against the channelling of European SDRs to MDBs, while developing counterarguments for why they should reconsider their stance and contribute to global sustainable development. Third, it highlights the importance of continued advocacy by potential recipient countries, think tanks and CSOs to get the required level of participant countries to make this innovative mechanism a reality.

SDR channelling to MDBs

Since the majority of MDBs are prescribed holders of SDRs, they represent an alternative to the IMF trust funds. Additionally, as part of proposals to reform International Financial Architecture (IFA), there is currently an ongoing debate about enhancing MDBs' financing capacities. The channelling of SDRs to MDBs is one element of this.

SDR channelling to MDBs has three main advantages over using IMF trust funds. First, MDBs can leverage the SDRs they obtain by selling hybrid capital. According to the AfDB, this could generate a three- to four-fold leverage effect (this could be higher for other MDBs such as the World Bank (Zattler, 2024)). This is a particular advantage of channelling to MDBs, especially considering that neither the PRGT nor the RST typically has a leverage ratio greater than one. Secondly, MDBs have valuable regional knowledge when working with their clients. In this context, MDBs are in a unique position to be able to combine long-term funding with technical assistance, policy dialogue and advisory services (African Development Bank [AfDB], 2024; Plant, 2023; Zattler, 2024). Thirdly, a key advantage for donor countries is that channelling SDRs to MDBs does not necessitate raising additional funds. This is not the case for the PRGT or the RST, for which donor countries provide SDRs as loans to trust funds at SDR interest rates, but donations must be made to cover these rates, so that recipients receive loans on concessionary terms (for example, 0 per cent for the PRGT).

Box 1: What are Special Drawing Rights?

In 1969, the IMF introduced SDRs as a form of global currency reserve. Furthermore, SDRs serve as the IMF's unit of account. The value of SDRs is determined by a weighted basket of five currencies, with the US dollar, the euro, the renminbi, the yen and the pound accorded a certain degree of weight in this calculation.

It is important to note that SDRs are not a currency in themselves; rather, they are a right to exchange them for other currencies. This right can be exercised when needed, for example to finance imports. The exchange is conducted by the IMF on the basis of agreements in which countries declare their willingness to engage in voluntary exchanges of SDRs up to a specified limit (Voluntary Trading Arrangements, VTAs). SDRs can only be utilised as a means of payment to a limited extent, with their use being restricted to the IMF, member states and a select group of entities designated as prescribed holders (currently primarily comprising MDBs).

Four SDR allocations have been made to date (1970-72, 1979-81, 2009 and 2021). The most recent SDR allocation has led to the global SDR stock more than tripling, and it now stands at 660.6 billion SDRs. When the IMF distributes SDRs, all countries receive more money. This has a positive impact on the countries' balance of payments and is not linked to any conditions. As soon as countries utilise these SDRs, they have to pay interest, but the amount used does not have to be repaid (IMF, 2024a).

The AfDB-IDB hybrid capital proposal

The AfDB, together with the IDB, have put forward one highly innovative proposal for SDR channelling to MDBs. Under this proposal, countries would lend their SDRs to the AfDB (IDB) as a permanent loan in the form of hybrid capital. The capital is "hybrid" because it is paid in the form of a fixed-rate bond and does not grant voting rights. However, the bond's maturity must be long enough to qualify as equity and be rated as such by rating agencies. In return, the donor countries receive the current SDR interest rate, which they in turn have to pay on their reduced SDR holdings. The transfer is therefore cost-neutral.

In a second pillar, all participating countries sign a Liquidity Support Agreement (LSA), which regulates repayments in the event of a balance of payments crisis and thus – together with MDBs' multilayered credit-risk management framework – secures the reserve asset character of SDRs used to buy the hybrid capital instrument. This requires that at least five countries participate in the AfDB-IDB proposal (AfDB, 2024; Kröss, 2023; Plant, 2023, 2024). Other countries that are not directly channelling their SDRs are also invited to participate in the "second layer" LSA so that they can provide a liquidity guarantee to contributors in the event that the primary liquidity arrangement falls short of meeting the liquidity need that has been triggered.

In May 2024, the IMF Executive Board approved the use of SDRs by IMF members for the purchase of hybrid capital instruments issued by prescribed holders, up to a cumulative limit of SDR 15 billion (IMF, 2024b). IMF members that channel SDRs to prescribed holders under such capital contributions are expected to have Voluntary Trading Agreements (VTAs) in place to ensure sufficient liquidity and an equitable distribution of the potential SDR exchange into currencies in the VTA market.

The channelling of SDRs via MDBs is particularly important for Africa because the financial resources for Africa (to the AfDB) could increase by around USD 46.2 billion annually over the next 10 years (AfDB, 2024). Nevertheless, it is anticipated that other regional MDBs and the World Bank will follow suit once the AfDB-IDB proposal has obtained sufficient participation levels and made SDR channelling to MDBs a reality.

Institutional challenges: the European Central Bank and SDR channelling

The ECB's opposition to channelling SDRs from EU member states to MDBs has significantly reduced the pool of potential contributors to the AfDB-IDB proposal. Although there has been no ruling by the ECB as to whether and why it is opposed to this instrument, there have been unofficial statements indicating this position. For instance, Christine Lagarde, the current President of the ECB, mentioned in her speech at the 2021 IMF Annual Meetings that "National central banks of EU Member States may only lend their SDRs to the IMF if this is compatible with the monetary financing prohibition included in the Treaty on the Functioning of the European Union. Retaining the reserve asset status of the resulting claims is paramount. This requires that the claims remain highly liquid and of high credit quality. The direct financing of MDBs by NCBs of EU Member States through SDR channelling is not compatible with the monetary financing prohibition" (Lagarde, 2021).

Since 2021, innovative solutions, such as the AfDB-IDB hybrid capital proposal, have been put forward to address the concern that channelled SDRs will maintain their quality as a reserve asset. Moreover, the recent decision by the IMF Executive Board (IMF, 2024b) authorising the channelling of up to SDR 15 billion (about USD 20 billion) to prescribed holders (including most MDBs) answer the important question of whether SDRs used as hybrid capital could still be considered as retaining their reserve asset status.

What remains unresolved is whether channelling SDRs to MDBs could violate the monetary financing prohibition of the EU. Although it is not for the IMF to decide on the latter issue, the same document states that "under Union law SDR channelling by European Union (EU) national central banks to MDBs is incompatible with the prohibition of monetary financing" (IMF, 2024b, p. 8). This statement may reflect either the position of some EU member state Executive Directors on the IMF

Board – potentially underpinned by the position of their respective NCBs – or a general understanding among IMF staff that what Lagarde said in 2021 has not changed.

Several authors have presented arguments why the ECB could and should rule in favour of the channelling of European SDRs to MDBs (Murawski, Chikowore, Mutazu, & van Tilburg, 2024; Paduano, 2023; Zattler, 2024). These arguments are discussed in detail below.

1. The ECB has already approved the channelling of SDRs to the IMF's PRGT and RST. A key difference between channelling SDRs to the PRGT and especially the RST, versus to MDBs, has been that SDRs channelled to MDBs may not maintain the reserve asset status. However, with the AfDB-IDB innovative hybrid capital proposal and the IMF's decision, this distinction has become irrelevant. Moreover, there seems to be no good reason why the two forms of channelling should be different in terms of respecting the EU's prohibition on monetary financing (Murawski, Chikowore, Mutazu, & van Tilburg, 2024). This prohibition pertains to situations where the ECB or NCBs directly or indirectly finance budgets of EU member states. The prohibition is based on the premise that monetary financing compromises the independence of central banks, which is considered essential for preventing macroeconomic imprudence and mitigating the risk of inflation (Paduano, 2023). Since the ECB has already ruled that the channelling of SDRs to the IMF's PRGT and RST does not amount to monetary financing, it follows that the channelling of SDRs to MDBs should not be incomepatible either.
2. There are precedents where the European Investment Bank (EIB) – a European MDB – has borrowed from Eurosystem NCBs and been given access to the ECB's repo facility. This has not been considered to be in conflict with the prohibition on monetary financing. This precedent demonstrates that the fact that MDBs are not monetary institutions does not necessarily mean that their holding of European SDRs should amount to a violation of the monetary financing prohibition (Paduano, 2023). Moreover, the AfDB provides loans to African governments, in contrast to the EIB, which lends to EU governments. This distinction further weakens the rationale for prohibiting SDR channelling to the AfDB on the basis that it may amount to monetary financing of EU governments.
3. In light of the fact that the channelling of EU member states' SDRs does not appear to be in violation of EU regulations, removing this legal hurdle to the channelling of European SDRs to MDBs offers the ECB a valuable opportunity to play its part in combating climate change, which could endanger financial stability. MDBs are key players in providing much-needed finance to mitigate and adapt to the effects of climate change, and SDR channelling as hybrid capital would increase the financing power of MDBs by up to USD 80 billion, depending on the leveraging power of the respective MDB. Conversely, failing to find a solution that allows EU member states to channel their SDRs to MDBs – potentially jeopardising the AfDB-IDB proposal due to insufficient participation – would be incongruent with the ECB's professed recognition that climate change poses significant risks to the European and global economies. This would also raise doubts about its stated commitment to doing its part to address climate change, within its mandate (ECB, 2024) and may result in reputational risk to the ECB in terms of its climate-action credentials. It is worth noting that the IMF stressed in its note that "Not approving the current proposal [of channelling SDRs through MDBs as hybrid capital] may entail business and reputational risks" (IMF, 2024b).

Positions of key actors on SDR channelling to MDBs

Donor countries

China

In November of 2021, Chinese President Xi Jinping was among the first to announce China's readiness to channel 30 per cent of its newly allocated SDRs – an equivalent of USD 10 billion – to African countries at the opening ceremony of the Eighth Ministerial Conference of The Forum on China-Africa Cooperation (Xi, 2021). As regards the channels of the reallocation, China has expressed support for the IMF's PRGT and RST, but it lacks a clear position on channelling SDRs to MDBs.

There might be three reasons. Firstly, more analysis is needed to compare the advantages and disadvantages of the alternative channels and their policy implications for China. No such assessment is publicly available currently in terms of China's preference towards channelling SDRs through the IMF's trusts versus MDBs, or between different MDBs. African experts have called on China to prioritise its reallocation to the AfDB (Ryder, Kebret, & Chen, 2023), but no public position can be seen yet from China on this proposal.

Secondly, more coordination within the government is needed on this issue. Even though there are no formal legal restrictions facing Chinese authorities, they still need to go through some "technical practice and procedure" as many other countries do, such as the United Kingdom, Japan and Canada (Paduano, 2024). The People's Bank of China (PBoC) and the Ministry of Finance (MOF) share responsibilities on IMF- and MDB-related issues. The World Bank, the Asian Development Bank (ADB) and the newly established Asian Infrastructure Investment Bank and the New Development Bank are taken care of by the MOF, while the IMF, AfDB and IDB, among others, are under the authority of the PBoC. A higher level of coordination is needed as regards the channels to be chosen.

Thirdly, the current AfDB-IDB joint proposal about using the SDRs as hybrid capital of MDBs may not be fully aligned with China's preference. China considers a capital increase that is accompanied by the voting power reform as the ideal solution to strengthen the capacity and enhance the legitimacy of MDBs, whereas the hybrid capital discussion is mainly about an option to increase non-voting capital.

China would probably like to see a broader array of options for the use of the SDRs channelled to MDBs, for example in support of the highly indebted countries for the implementation of the G20's Common Framework. How the World Bank can share the burden by increasing the amount of new concessional financing for debtor countries has been a core concern of China in the G20's debt agenda. More low-cost SDRs could help the World Bank deliver its promise and incentivise China's more active participation in future Common Framework cases. Chinese scholars propose using the new SDRs as a multilateral guarantee to support lower-income countries' debt restructuring, something similar to the Brady Plan in the 1980s (Xu, Sun, & Xiong, 2023).

In sum, even without formal legal obstacles, it is the format and purpose of the channelling that could finally affect China's position on the proposal.

France

In line with the decisions of the G7 and G20 to reallocate part of SDRs to the IMF for vulnerable and low-income countries, the French authorities announced an initial 20 per cent channelling target in 2021 and increased it to 40 per cent (around 8 billion SDRs or USD 10.6 billion) at the Paris Summit in June 2023 (Delame & Liu, 2023).

When the AfDB and IDB later put forward a proposal for SDR channelling to MDBs, the French authorities also supported the proposal to leverage more finance for climate and development. This position was made official at COP 28 (AfDB, 2023). However, similar to other Eurozone countries, France is being blocked by the ECB's stance on this proposal and cannot directly channel its SDRs to MDBs. Instead, at the 2023 World Bank and IMF Annual Meetings and COP 28, France announced its willingness to participate in the (second layer) LSA (AfDB, 2023). This position still stands but caution remains on two aspects. First, France has not yet specified the volume it is prepared to guarantee as part of the LSA. This is partly because the relevance of the LSA itself depends on a minimum of five countries channelling their SDRs to MDBs. As mentioned earlier, these countries are not officially known yet, as discussions are still ongoing. Second, France is also undergoing changes to its national government. Although no radical reforms are expected at this stage on this issue and the administration remains supportive of the scheme, a certain level of uncertainty will prevail until the new budget is approved.

Germany

The German Finance Minister at the time, Olaf Scholz, welcomed the SDR allocation decision in early August 2021, emphasising the benefit for emerging and developing countries (German Federal Ministry of Finance, 2021) and supporting the decision of the G7 to redistribute USD 100 billion of SDRs to developing countries. However, the German central bank (Deutsche Bundesbank) does not seem to be prepared to transfer SDRs (Ellmers, 2021). In Germany, the Deutsche Bundesbank is the holder of the SDRs under German law, according to which the Federal Republic of Germany transferred the SDRs to the Deutsche Bundesbank (Deutsche Bundesregierung, 1978). This legal situation is unusual under international law because – as set forth in the Articles of Agreement of the IMF – it stipulates that only states can be members of the IMF, and thus holders of SDRs (Kröss, 2023). The Bundesbank and the Federal Ministry of Finance have expressed their opposition to what they called the financing of a development policy agenda with SDRs. They argue that this is not an original task of the IMF and should instead be left to institutions such as the World Bank. They further argue that doing so could lead to the expectation that the IMF will increasingly grant SDRs for reasons other than its original function as a currency reserve (Nagel & Lindner, 2024). In the course of the SDR allocation in 2021, the German government said that it would not be able to pass on SDRs and instead contributed to the RST via its budget (Kröss, 2023). For these reasons, Germany (i.e. the Bundesbank) is not expected to participate in schemes to transfer SDRs to MDBs. Moreover, the German government has yet to indicate whether it plans to participate – using its budget for development cooperation – in the second layer LSA of the AfDB-IDB proposal. Despite Germany's reputation for utilising its development budget to support MDBs (e.g. through its pioneering contribution to provide hybrid capital to the World Bank) and honour its commitments to the RST (instead of using its SDR holdings), it appears unlikely that it will contribute to the second layer LSA. This is because, in addition to the recent significant cuts to its development budget, there is strong opposition on the part of the government to the use of SDRs as a tool of development finance (Nagel & Lindner, 2024).

The United States

The US government has not taken an official position on channelling SDRs to MDBs. It is generally understood that officials within the US Treasury are supportive of the principle of channelling, but it is highly unlikely the United States will channel SDRs that it holds. This is because the US Congress must authorise any such action, and there is little political support within Congress for channelling SDRs to MDBs. Current political tensions, upcoming presidential elections and concerns about Ukraine and Gaza are not conducive factors for generating the political will and bipartisanship needed for the United States to channel its SDR holdings.

Recipient countries and their institutions

African countries

African Ministers of Finance have clearly endorsed efforts to accelerate the channelling of SDRs. As countries continue to face fiscal constraints and high borrowing costs, the channelling of SDRs can lead to a significant increase in concessional finance for African countries. Indeed, they could derive greater benefits from SDR channelling than from World Bank balance sheet optimisation, which appears to primarily benefit middle-income countries.

In April 2023 African Ministers requested support to align messaging on key IFA reforms, which led to the Marrakech Declaration. The Action Framework for the declaration included intentions to continue advocacy to secure five SDR holding countries for the AfDB's proposal and begin analysis on approaches for additional SDR channelling to other African institutions.

The channelling of SDRs to Africa would also help address historical imbalances to a certain extent. AU member states collectively own only 5.2 per cent of all IMF quotas. South Africa, Nigeria, Egypt and Algeria are the largest holders of quotas, and 39 countries each represent less than 0.1 per cent of all IMF quotas. Africa also did not benefit adequately from the 2021 allocation of SDRs, whereby USD 650 billion was allocated, but Africa received only 5 per cent of the total: roughly USD 33 billion. At the same time, the G20 and other advanced economies collectively received more than USD 500 billion.

Additionally, three **African Heads of State** who are championing IFA reforms at the AU published an article in *The Economist*, where they specifically called for "channeling special drawing rights currently held at the IMF to African financial institutions so they can be leveraged for development finance" (Akufo-Addo, Ruto, & Hichilema, 2024). As early as February 2022 the **AU,** at its Heads of State Summit, urged wealthy nations to channel part of their SDRs to the AfDB.

The Bridgetown Initiative

The Bridgetown Initiative, introduced after Prime Minister Mia Mottley of Barbados hosted a high-level retreat in Bridgetown in 2022, has been advocating for significant reforms to the international financial system. In its latest iteration, the Bridgetown Initiative 3.0 took advantage of the IMF Executive Board's recent approval of the use of SDRs as hybrid capital to recall that "countries must urgently deliver on their commitments to ensure the expansion of scope and scale of re-channelling SDRs through MDBs, leading with the AfDB and IADB" (Bridgetown Initiative, 2024).

Furthermore, although channelling SDRs to MDBs could significantly enhance the lending power of MDBs, the funding would ultimately reach vulnerable countries in the form of loans, albeit with favourable terms. Consequently, it is essential to ensure that these loans do not contribute to the indebtedness of recipient countries. One way to achieve this is by directing them towards transformational programmes that are not "expenditure-based" (Zattler, 2024).

Conclusion and recommendations

The channelling of SDRs to MDBs has significant potential to increase MDBs' financing capacities at a time when development financing needs in low- and middle-income countries are rising due to a difficult macroeconomic environment resulting from multiple crises, ranging from the COVID-19 pandemic to climate change and the wars in Ukraine and the Middle East. In contrast to channelling through the IMF's PRGT and RST, channelling SDRs through MDBs is highly efficient in the sense that SDRs can be leveraged up to three to six times.

However, as this Policy Brief has shown, there is still a long way to go to secure sufficient levels of participation in this mechanism from countries with strong external positions (at least five countries) and other contributors to the second layer LSA. On the one hand, the governments of France, Japan, Spain and the United Kingdom have announced their support for the use of the SDR hybrid capital instrument to mobilise financial resources for developing countries in Africa and Latin America and the Caribbean at COP 28 in December 2023 (AfDB, 2023). On the other hand, EU member states are prohibited by an informal ECB position that member countries cannot channel their SDRs to MDBs. It is commendable that some EU member states have expressed being in favour of participating in the second layer LSA. Against this background, we recommend the following actions to overcome the remaining obstacles to the realisation of this valuable proposal.

Donor countries and their institutions

China should be a frontrunner in channelling SDRs to MDBs and participating in the LSA. Given that China has been among the first to donate its recent SDR allocations to low-income countries (one-third to African countries), it is time for it to consider channelling these SDRs through the most efficient means available, namely by purchasing the hybrid capital issued by the AfDB and IDB. China's participation in the AfDB-IDB proposal will not only leverage Chinese aid to African countries, but would also contribute to the feasibility of the whole proposal, as finding five donor countries with strong external positions seems to be a challenge for several legal and political reasons. It could also have positive external effects by increasing geopolitical pressure on the United States, the United Kingdom, Japan and European countries to do the same.

The Eurozone member states should request the ECB to formally clarify its position on the channelling of European SDRs to MDBs. Some European countries, including France and Spain, have been at the forefront of SDR reallocation from the very beginning. They are also among the largest holders of SDRs. It is therefore regrettable that the ECB's informal opposition to channelling SDRs beyond the IMF has excluded this important group from participating in the hybrid capital solution proposed by the AfDB and IDB. As we have discussed in this Policy Brief, there are sound reasons why the ECB could and should rule in favour of channelling European SDRs to MDBs. Moreover, in the event that the ECB fails to formally rule on this mechanism in a timely manner, or rules unfavourably, European countries should also support this proposal by participating in the second layer LSA through their development budgets.

The US government should contribute to the LSA and advocate for the AfDB-IDB proposal. Noting that the United States is unlikely to channel its SDRs to MDBs – as this requires approval by the Congress, where there is little political will for this – the US government can still advocate for the overall approach and engage in quiet diplomacy to encourage other countries with large SDR holdings to participate in this instrument. It can also contribute to the second layer LSA through its development budget. The voices of CSOs and think tanks could be instrumental in encouraging the US government to play a meaningful, constructive role in this proposal.

Donor countries with a strong external position and no significant legal restrictions, such as Japan, the United Kingdom, Qatar, Saudi Arabia, Canada and Australia, should participate in the AfDB-IDB hybrid capital proposal. These countries should fulfil their expressed willingness to do so by taking concrete action and abandoning their current wait-and-see approach regarding joining such an important mechanism.

Recipient countries and their institutions

African governments and the AU should continue to advocate for wealthy countries to channel their SDRs to the AfDB and participate in the LSA. As the African region is poised to benefit the most from an increase in the financing power of the AfDB, African governments and the AU should advocate on behalf of the AfDB in different bilateral and multilateral fora such as the World Bank and IMF's Spring and Annual Meetings, the G20 and the China-Africa summit.

As South Africa will assume the role of the Presidency of the G20 in 2025, it should build upon the work initiated by the Brazilian Presidency regarding the channelling of SDRs to MDBs. It should prioritise securing sufficient participation for the AfDB-IDB proposal. It should also coordinate closely with the AU, which now also holds a seat at the G20.

African governments also need to continue to implement reforms, improve fiscal and debt management, address corruption and low tax-to-GDP ratios, and invest in the SDGs, which will build trust and goodwill among the largest IMF shareholders.

Civil society organisations and think tanks

Global and local CSOs and think tanks should advocate for potential donor countries to channel their SDRs to MDBs and contribute to the global development and sustainability agenda. At the same time, they should provide enhanced analysis and research on the topic to inform policymakers and leaders, both in donor and recipient countries. It should be emphasised that, at a time when development budgets in several donor countries have been significantly reduced, this represents one of the most cost-effective means of providing development finance without having to secure substantial commitments from current government budgets. This advocacy has the potential to foster political support for the proposal in donor countries and even change the ECB's informal position prohibiting SDR channelling to MDBs. It is worth remembering that the IMF saw a reputational risk if it did not approve the use of SDRs to buy hybrid capital from MDBs.

Finally, it is important to remember that although SDR channelling to MDBs is a key component of the IFA reforms that will provide the AfDB (and IDB) with the much-needed balance sheet, and hence fiscal space, for African (and Latin American) countries, it is not sufficient on its own. Rather, it must be seen as part of the broader IFA reforms, which include reforms to the G20's Common Framework, increased concessional financing through the International Development Association and the African Development Fund, a shift from climate finance to financing green industrialisation, a stronger voice in international organisations such as the World Bank and the IMF, and improved approaches by credit rating agencies.

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