SPECIAL DRAWING RIGHTS (SDRs) FOR PEOPLE'S RECOVERY IN KENYA

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Abstract

The study reviewed Special Drawing Rights (SDRs) allocations, use, and reporting by IMF member countries, with a focus on Kenya. SDRs are a form of international reserve asset that the IMF created to augment official reserves held by its members that serve as a financing tool and are utilized as an alternative line of credit by developing economies. The August 2021 SDR general allocation was made to build resilience and stability of the global economy and help the most vulnerable economies deal with the economic consequences of the COVID-19 pandemic. The US$ 650 billion allocation approved in August 2021 benefited all IMF member countries, with over two-thirds of the allocation (US$ 418.4 billion) going to advanced economies, the balance falling well short of developing countries' financial needs. Kenya received an allocation of US$ 737.6 million worth of SDRs, (2.18% of Africa's US$ 33.8 billion allocation) half of which the Central Bank of Kenya (CBK) on-lent to the National Treasury for budgetary support. The National Treasury in the draft Budget Review and Outlook Paper (BROP) reports IMF's SDR allocation of Ksh 40.8 billion as part of government borrowing that financed its fiscal deficit in FY 2021/22 part of which went into cushioning the poor from the adverse effects of the COVID-19 pandemic, purchase of COVID-19 vaccines and external debt redemption. The review established that compared to other sources of global liquidity, the allocation was insufficient which supports a case for an additional allocation. Further, given the lower utilization levels of SDRs by developed countries they could channel their unused SDRs to developing countries through the Poverty Reduction and Growth Trust (PRGT), Resilience and Sustainability Trust and regional development banks to support their recovery process.

Key words: Special Drawing Rights, People's Recovery, Channelling

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List of Acronyms and Abbreviations

AFRODAD	African Forum and Network on Debt and Development
CBs	Central Banks
CBK	Central Bank of Kenya
CSOs	Civil Society Organizations
DRC	Democratic Republic of Congo
ECA	Economic Commission for Africa
ECF	Extended Credit Facility
ECLAC	Economic Commission for Latin America
EFF	Extended Fund Facility
EMEs	Emerging Market Economies
FY	Financial Year
G20	Group of twenty
GDP	Gross Domestic Product
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
KIIs	Key Informant Interviews
KSH	Kenyan Shilling
KQ	Kenya Airways
LDCs	Low-Income Developing Countries
LICs	Low-income Countries
PRGT	Poverty Reduction and Growth Trust
SDR	Special Drawing Rights
SDRM	Sovereign debt Restructuring Mechanism
USD	United States dollar
VTA	Voluntary Trading Arrangements

1 Introduction

1.1 Background and Context

A Special Drawing Right (SDR) is an interest- bearing international reserve asset created by the International Monetary Fund (IMF) in 1969 to provide liquidity and to supplement the operating capital of its member states. SDRs are IMF's units of account, not a currency in itself but a potential claim on the freely usable currencies of IMF members. As such, SDRs can give a nation additional liquidity, thereby boosting its foreign exchange reserves and lowering its reliance on more expensive domestic or external debt. They represent a claim on the currency of IMF member nations, for which they may be exchanged[1].

SDR was defined in the context of the Bretton Woods fixed exchange rate regime based on the gold standard and its value was set at 0.888671 grams of fine gold, which was also equal to one US dollar ($1) at the time[2] following the collapse of Bretton Woods system in 1973, which caused a shift of major currencies to the floating exchange rate regimes. The value of one SDR is now determined by a basket of five currencies. For inclusion in the basket, a currency must fulfil the export criteria and the freely useable condition. If the issuer of a currency is one of the top five global exporters and it also is a member of IMF or a monetary union consisting of IMF members, it meets the export criterion. For a currency to be classified as "freely usable" by the IMF, it must be extensively employed to deliver international payments and extensively traded on the major exchange markets. The United States dollar, Euro, Japanese yen, Chinese renminbi, and British pound sterling currently make-up the basket of currencies that determine the value of one SDR.

Every five years, or sooner, if necessary, IMF reviews the SDR basket to ensure that it accurately mirrors the relative significance of currencies in the world's trading and financial systems. The evaluations go over the most important aspects of the SDR valuation techniques, such as the assessment criteria used to determine SDR basket currencies and the initial currency weights used to calculate the proportion (units) per each currency in the basket. The evaluations are also used to determine if the financial instruments that make up the SDR interest rate (SDRi) basket are adequate. The SDRi is used to calculate the interest rate that members pay on non-concessional borrowing from the IMF, and it is also used to pay members for their remunerated creditor seats in the IMF. It also refers to the interest levied on SDR allocations and the interest payable on SDR holdings. SDRi is determined weekly grounded on a weighted average of representative interest rates on short-term government debt instruments in the money markets of the SDR basket currencies, with a floor of 5 basis points.

At the United Nations Monetary and Financial Conference- Bretton Woods, July 22 1944, the IMF's Articles of Agreement were adopted. Following the introduction of the new international reserve asset in 1969, the SDRs department's operations are subordinate to these articles. The IMF General and IMF SDRs Departments must be kept completely apart, according to the Articles. One department's assets cannot be used to pay another department's liabilities. The fact that the SDRs facility is an entirely different financial mechanism from the IMF's primary lending operations is reflected in this division. Invoking SDR Articles' issuance and allocations requires a vote with an 85 percent majority.[3] Receiving the required share does not involve any conditions. Private companies or individuals are not permitted to hold SDRs.

IMF member countries may hold SDRs as part of their reserves, trade them for freely useable currencies, or apply them to a variety of Fund-authorized transactions such as loan repayments, financial obligations, pledges, and endowments with other SDR Department participant or prescribed holders. SDRs could also

[1]IMF (2022, July 29). Retrieved from Factsheet: Special Drawing Rights: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

[2] https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

[3]IMF (2022). Special Drawing Rights; Q&A. Retrieved from International Monetary Fund: https://www.imf.org/en/Topics/special-drawing-right

be used in transactions and procedures involving the IMF, including payments for quota expansions, interest on loans, and loan repayments.

The IMF provides a methodology for examining the macroeconomic implications of new SDR allocations, associated statistical treatment and governance, and how an allocation may influence debt sustainability to help guide countries and better ensure transparency and accountability. The principal users of Special Drawing Rights (SDRs) are developing economies, who are far more reliant on them than developed economies. An examination of net SDR positions reveals a considerable difference in SDR use rates between developing and developed economies at 42.9 percent and 5.9 percent respectively.[4]. SDRs are convertible into actual currency among IMF member nations.

Generally, holding of the SDRs by IMF member is regarded as an asset, while the allocation of the SDRs is recorded as the incurrence of a liability of the member receiving. The IMF also provides for a mechanism that in case a country decides to stabilize its reserves, it can exchange its SDRs with another Central Bank for foreign currency. This mechanism allows a country to obtain hard currency immediately to finance investment projects. But if a country has less SDRs than it has been allocated, it will have to pay interest, equal to 1.566% as of 30th August 2022.[5].

1.2 SDRs Use and their Economic Benefits

The IMF maintains that SDRs have no set purpose or objectives. The usage of SDRs is a country's prerogative and sovereign decision. Countries can employ them in transactions by trading their SDRs into freely usable currencies or in processes approved by the Fund.[6] In accordance with the SDRs' Articles of Agreement, the use of SDR holdings needs to be structured to maintain macroeconomic sustainability, including external and monetary sustainability. SDRs are typically managed by central banks, albeit occasionally by the country's treasury. Central banks may either keep SDRs as international reserves or lend them to their respective governments, depending on the domestic statutory provisions.

SDRs provide numerous benefits to IMF member states, among them:

i. SDRs are a credit line that is automatically extended to all nations, regardless of their degree of revenue generation, setting SDRs apart from other financing alternatives whose availability is based on existing macroeconomic conditions like the Fund's Flexible Credit Line.
ii. SDRs boost country reserve assets without requiring governments to cover all the expenses typically related to reserve accumulation.
iii. SDRs are not subject to any additional policy conditionalities or limitations.
iv. SDR allocations do not incur additional external debt, since there is no requirement for principal repayment.
v. SDR usage attracts a low variable interest rate [7].
vi. By releasing resources for domestic expenditure on public goods, SDRs may be a tool for economic and social growth in addition to enhancing financial stability. SDRs can also be utilized as leveraged capital to increase the number of resources available for public spending.

Despite the advantages of SDRs, there are three main factors that limit their channelling and utilization

i. On the SDRs that are being lent out, countries must pay interest. Although this expense is reasonably low, it nonetheless creates a liability for the SDR lender.

[4] ECA, ECLAC. (2022). COVID-19 Report: Special Drawing Rights (SDRs) and the COVID-19 crisis. United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Economic Commission for Africa (ECA).

[5] IMF. (2022, August 30). SDR Interest Rate Calculation. Retrieved from International Monetary Fund: https://www.imf.org/external/np/fin/data/sdr_ir.aspx

[6] IMF (2021). Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations. International Monetary Fund.

[7] SDRi stood at 1.566 per cent as of 30th August 2022. (https://www.imf.org/external/np/fin/data/sdr_ir.aspx)

ii. Considering governments see SDRs as a reserve asset, they need confidence that SDRs that have been lent out can be quickly recalled. Therefore, any on-lending agreements must include a mechanism that ensures the SDRs' liquidity.
iii. Only eligible IMF member nations and specified holders are permitted to hold SDRs. In actuality, not every entity qualifies to receive SDRs. Therefore, it is important to consider these criteria when evaluating the on-lending SDR parameters.

1.3 Purpose of the Study

The purpose of this study is to contribute to an inclusive economic recovery through effective utilization and reallocation of Special Drawing Rights (SDRs) in a manner that strengthens public service delivery and financing for key sectors including health, education, and social protection and does not add to unsustainable debt burdens and prevents fiscal consolidation. Further, this study aims to inform the public and strengthen the capacity of civil society organizations, citizens, and media in Kenya on SDRs so that they are better informed and can engage in debt and SDRs allocation advocacy and public campaigning to influence budget decisions and fiscal policies at the national level and SDRs reallocation at the global level. A budget analysis and tracking report will also be produced as part of the investigation. These assessments will result in a forward-looking policy brief that will affect national, regional, and global policies and practices on transparent and accountable SDR use at the national level, as well as rechanneling principles. This will ensure evidence-based lobbying and engagement with the ministries of finance/treasury and health, IMF country missions, G20 nations, and IFIs during the IMF/WB Annual Meetings.

1.4 Objectives of the Study

The overall objective of the study is to contribute to an inclusive economic recovery through effective utilization and reallocation of Special Drawing Rights (SDRs) in a manner that strengthens public service delivery and financing for key sectors including health, education, and social protection. Specifically, the study seeks to:

i. Track Special Drawing Rights (SDRs) allocation at the national level in response to economic issues caused by the Covid-19 epidemic in FY 2021/22
ii. Identify and evaluate the use and execution of SDR allocation and implementation in Kenya
iii. Identify the challenges to the country utilizing its SDR allocation in a way that promotes inclusive and green recovery
iv. Make recommendations that would drive evidence-based budget and policy advocacy for SDR financing at the national level.

1.5 Justification of the Study

In August 2021, the International Monetary Fund (IMF) allocated SDR 520.2 million (US$ 737.6) Million worth of Special Drawing Rights to Kenya, an equivalence of Ksh 83.7 billion, as part of the multilateral lender's bailout of all governments globally to alleviate balance-of-payments constraints for Covid-19-affected economies.[8] Information on SDR use and support programs is not readily available to the public. The study intends to fill this identified gap by tracking how the resources were used particularly in economic recovery post pandemic effects. This would back informed recommendations that would drive evidence-based budget and policy advocacy for SDR financing at the national level. Based on the research findings, a capacity building workshop for targeted stakeholders will be undertaken to allow them to be more informed of Kenya's SDRs allocation and the country's engagement with International Financial Institutions.

[8] IMF (2021, August 23). 2021 General SDR Allocation. Retrieved from International Monetary Fund: https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation

2 Research Methodology

The study will employ a mixed methods approach in integrating secondary quantitative data and primary qualitative data obtained through Key Informant Interviews (KIIs). The study undertook an in-depth desk review of materials Special Drawing Rights (SDRs) including books, published articles, reports and government publication to track SDR allocations and their use with a focus on Kenya. Based on the gaps identified, questionnaires were administered to Key Informants purposively selected based on their knowledge on SDRs allocation and use. Target respondents were IMF Country Office, the National Treasury and Planning, and the Central Bank of Kenya. Key stakeholders for the study are Civil Society Organizations (CSOs) whose insights will complement information gathered from government officials.

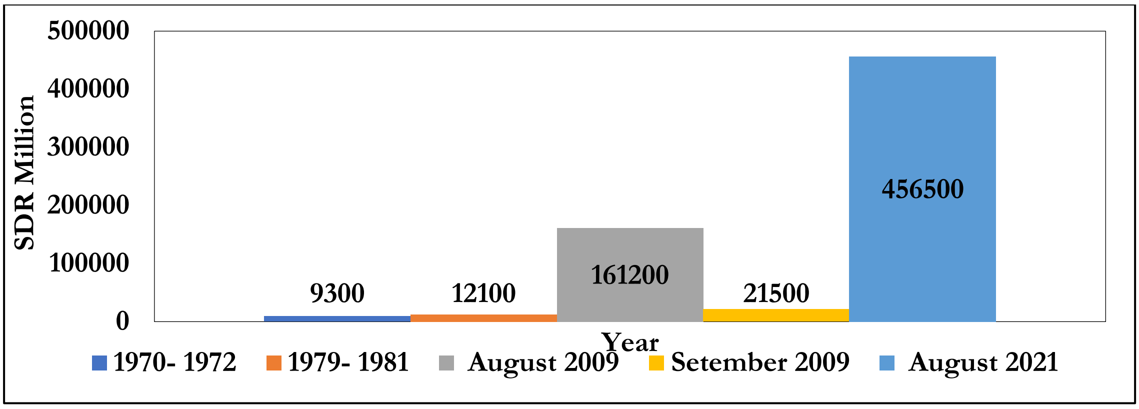
3 Study Findings and Discussion

3.1 Historical allocations of SDRs

In line with Section 2(b) of Article XVIII of the SDRs' Articles of Agreement, SDRs are allocated in accordance with participants' paid Fund quota shares, decisively determined by a quota formula largely based on the size and openness of a country's economy.[9] The distribution is done uniformly at 95.8 per cent of the member states' quotas with over two-thirds of this going to developed economies. Four general SDR allocations and one exceptional one-time allocation have been made thus far. In 1970–1972, SDR 9.3 billion was allocated in annual instalments; in 1979–1981, SDR 12.1 billion was issued in annual instalments; on August 28, 2009, SDR 161.2 billion was issued. A special one-time transfer of SDR 21.5 billion, known as the Fourth Amendment special allocation, went into effect on September 9, 2009, totalling SDR 660.7 billion (about US$ 935.7 billion). The largest issuance in Fund history is the SDR 456.5 billion approved in August 2021.[10].

According to IMF (2022), as of August 2021, a total of SDR 660.7 billion (about US$935.7billion) had been allocated to IMF member states, including the largest single allocation of SDR 456 billion equivalent to US$ 650 billion approved on August 2, 2021, to address long-term global needs for reserves giving developing countries an immediate boost in liquidity without increasing their debt.[11]

Figure 1: Historical allocations of SDRs, SDR millions



Source: Author's computations based on IMF, 2022 update on SDR Allocations

[9] IMF (2010). Articles of Agreement of the International Monetary Fund. International Monetary Fund.

[10] IMF (2022). Special Drawing Rights; Q&A. Retrieved from International Monetary Fund: https://www.imf.org/en/Topics/special-drawing-right

[11] IMF (2022, July 29). Retrieved from Factsheet: Special Drawing Rights: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

3.1 Distribution of the 1st and 2nd SDR General Allocations (1970-72), (1979-81)

The first general SDR allocation that followed shortly after establishment of the SDR mechanism in 1969 was made broadly in equal instalments on January 1st of: 1970, 1971, and 1972. The total amount allocated was SDR 9.3 billion. The decision to make the first allocation was based on the long-term global need following the marked decline in world reserves (gold and U.S. dollars) in the mid-1960s. Other factors that informed the allocation included a greater reliance on trade restrictions globally, a rise in the adoption of capital controls, and a growing dependence on international financial support from the Fund and other entities to finance payments deficits. The size of the allocation was determined by the anticipated growth in reserve demand by member states as well as the rate of expected growth of gold and foreign currency reserves over the course of the basic period.[12]

The second general SDR allocation happened during the period between 1979 to 1981. On January 1st of 1979, 1980, and 1981, a total of SDR 12.1 billion was allotted in three equivalent annual instalments. Given the significant changes to the global monetary system that had occurred since the Fund's SDR creation, grounds for a second SDR allocation were agreed upon. To assess the long-term global requirement for reserve augmentation, the Fund had to consider the effects of the development of international capital markets as well as the wider adoption of more flexible exchange rates. The size of the second SDR allocation was based, similarly to the first allocation, on the anticipated growth of global reserves relative to international trade.

Table 1 Allocations of SDRs - Amount and Timing (1970- 72), (1979-81) (SDR Millions)

Year of SDR Allocation	1970	1971	1972	1979	1980	1981	Cumulative Allocation	Percentage share of total cumulative allocation
Industrial countries	2,510	2,160	2,160	2,680	2,680	2,630	14,810	69.10%
Developing countries	900	790	800	1,360	1,360	1,420	6,620	30.9%
Total	3,410	2,950	2,950	4,030	4,030	4,050	**21,430**	

Source: Author's computation based on IMF, (2001)- Based on International Financial Statistics

3.2 Distribution of the 3rd General and Special SDR Allocations, (2009)

On August 28, 2009, the third general allocation of SDRs 161.2 billion, an equivalence of US$250 billion, went into effect in the wake of the global financial crisis. The allocation was intended to supplement the foreign exchange reserves of the IMF member states thus providing liquidity to the world's economic system. Participant states in the SDR Department received the general SDR allocation in proportion to their current quotas in the Fund at the time, which were largely based on their relative position in the global economy. The allocation gave emerging economies and developing nations approximately US $100 billion, with over US$18 billion going to low-income countries (LICs).[13]

[12] IMF (2001). SDR Allocation in the Eighth Basic Period—Basic Considerations. International Monetary Fund.

[13] IMF (2009, July 20). Press Release No. 09/264: IMF Executive Board Backs US$250 Billion SDR Allocation to Boost Global Liquidity. Retrieved from International Monetary Fund: https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr09264

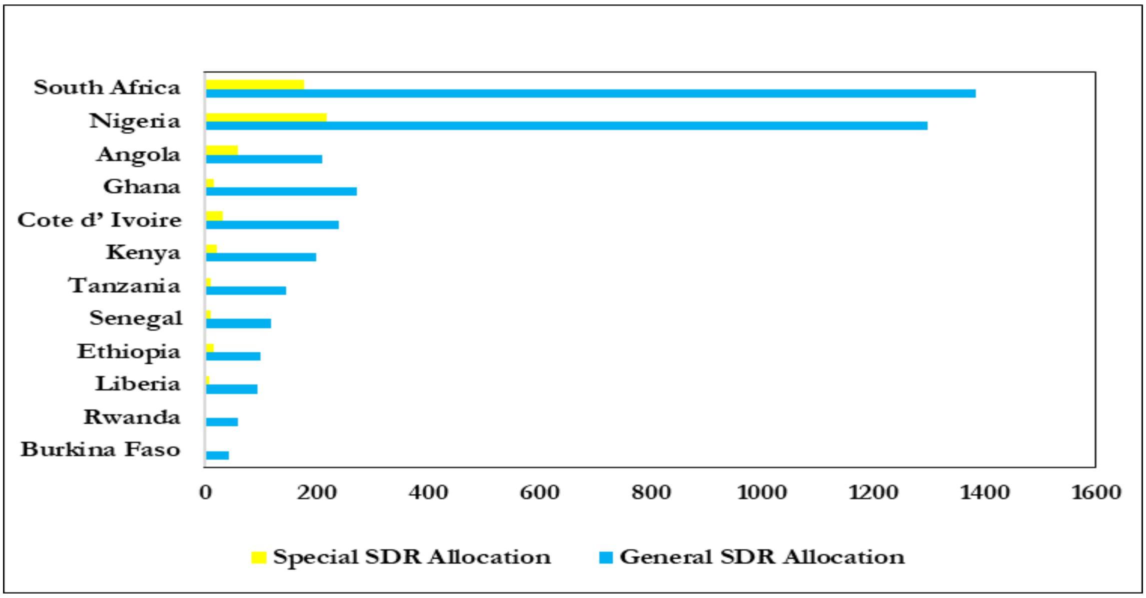
Table 2: General and Special SDR Allocations for Sub- Saharan recipient countries for the year, 2009 in millions of SDRs

Member Country	General SDR Allocation (August 28, 2009)	Special SDR Allocation (September 9, 2009)	Total
Burkina Faso	44.6	3.5	**48.2**
Rwanda	59.4	3.7	**63.1**
Liberia	95.8	7.2	**103.0**
Ethiopia	99.1	17.7	**116.8**
Senegal	119.9	10.4	**130.3**
Tanzania	147.4	11.7	**159.1**
Kenya	201.2	21.5	**222.7**
Cote d' Ivoire	241.1	32.0	**273.1**
Ghana	273.5	17.3	**290.9**
Angola	212.2	60.8	**273.0**
Nigeria	1,299.7	218.6	**1,518.2**
South Africa	1,385.1	179.9	**1,565.1**

Source: (IMF, 2017) General and Special SDR Allocations of 2009

The SDR allocation was made in support of implementation of a US$1.1 trillion plan to address the global economic and financial crisis by restoring credit, growth, and jobs in the global economy, which was endorsed by the International Monetary and Financial Committee (IMFC) and adopted at the G-20 summit in London in April 2009. Separately, on August 10, 2009, the 4th Amendment to the Fund's Articles of Agreement that provided for a special one-time SDR allocation, became effective.to make up for the fact that members who joined the IMF after 1981 never received an allocation before. The IMF member countries received the special allocation on September 9, 2009. The special allocation yielded a total of 21.5 billion worth of SDRs, approximately US$34 billion.[14]

Figure 2: County Comparison; 2009 SDR Allocations in Sub- Saharan Africa



Source: Authour's analysis based on (IMF, 2017) General and Special SDR Allocations of 2009

[14] IMF (2017, July 28). General and Special SDR Allocations. Retrieved from International Monetary Fund: https://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm

3.3 Distribution of the 4th general SDR Allocation, (2021)

The fourth and most recent general allocation of SDR 456.5 billion, which went into effect on August 23, 2021 and is approximately equivalent to US$650 billion, aimed to address the long-term global need for reserves, foster confidence, and support a resilient and sustainable global recovery. It is advantageous to all member states and aids developing and low-income nations that are struggling to deal with the COVID-19 crisis' effects. This general allocation, which is by far the largest to date, is an outstanding illustration of how nations have worked together to combat the COVID-19 pandemic adverse effects. It was envisioned that the allocation would benefit the vulnerable nations who were struggling to deal with the adverse effects of the COVID-19 pandemic.[15] Approximately US$375 billion (SDR 264 billion) of the US$650 billion was granted to industrialized economies, while the remaining US$275 billion (SDR 193 billion) was allocated to emerging and developing economies , including approximately US$21 billion (SDR 15 billion) to low-income countries (LICs).[16] Industrialized and emerging economies all-together received approximately US$ 418.4 billion (64.4%) worth of SDRs, leaving about US$ 231.6 billion (35.6%) to developing economies. [17]

The most recent SDR allocation aimed to increase the percentage share of SDRs in all countries' reserve assets, giving developing nations a direct liquidity injection without increasing their debt loads. This would improve balance of payments positions of the world's largest economies and even those of developing economies. On August 23, each participant in the SDR Department (comprising of all 190 IMF members) had their SDR allocation credited to their SDR accounts in accordance to their IMF quotas.

Table 3: SDR allocation and share of total August 2021 in country grouping

Country grouping	Billions of dollars	Percentage Share of total allocation
Industrialized and Emerging economies	418.4	65
Developing economies (Inclusive of LICs)	231.6	35
Total	**650.0**	**100**

Source: ECLAC, 2022; SDRs and COVID-19 Crisis on the basis of IMF "2021 General SDR Allocation"

The allocation of the US $ 650 billion worth of SDRs by developing regions of the world reveals that, Asia, Africa, the Caribbean, developing Europe, and Latin America and the Caribbean received US$ 139.4 billion, US $33.8 billion, US $ 51.5 billion, and US$ 6.9 billion respectively, constituting 21.5 percent, 5.2 percent, 7.9 percent, and 1.1 percent of the total US $ 650 billion allocated. The least developed economies (LDCs) garnered 2.4% of the total (**Table 4**).

Table 4: SDR allocation and share of total August 2021 per recipient region

Region	Billions of dollars	Percentage Share of total SDR 650 billion
Africa	33.8	5.2
Developing Europe	6.9	1.1
Asia	139.4	21.5
Latin America and the Caribbean	51.5	7.9
The Caribbean	2.4	0.4
Least Developed Countries (LCDs)	15.3	2.4

Source: ECLAC, 2022; SDRs and COVID-19 Crisis on the basis of IMF "2021 General SDR Allocation"

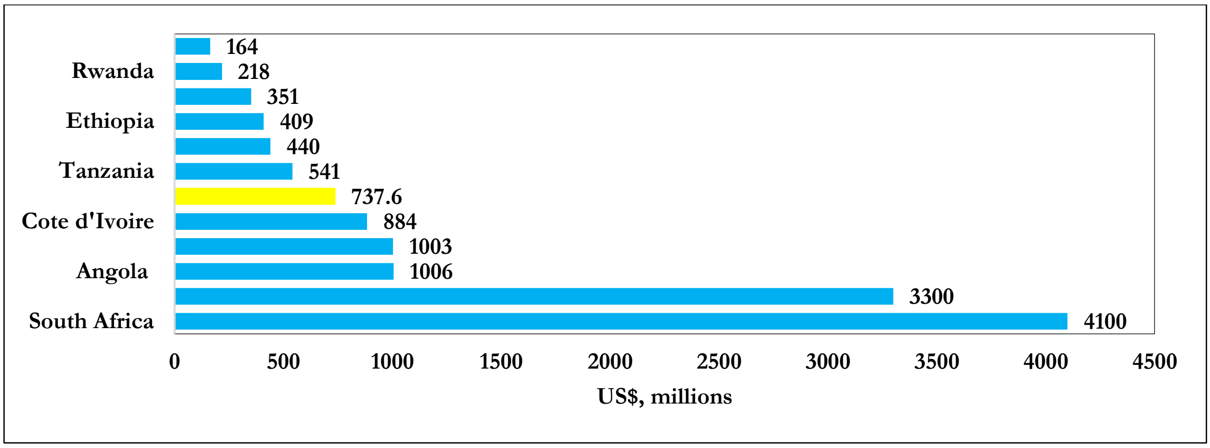
[15] IMF (2021, August 23). 2021 General SDR Allocation. Retrieved from International Monetary Fund: https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation

[16] IMF (2021). Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations. International Monetary Fund.

[17] ECA, ECLAC. (2022). COVID-19 Report: Special Drawing Rights (SDRs) and the COVID-19 crisis. United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Economic Commission for Africa (ECA).

While the US $33 billion allocation would be beneficial to African countries, it generated less than 10 percent of the US $345 billion finance gap that they face from 2020 through to 2023.[18] African countries had drawn down US$ 4.3 billion as of the end of January 2022, accounting for 13% of their US$ 33 billion allotment. This accounted for roughly 30% of the entire US$ 14.8 billion (of the US$ 650 billion SDR allotment) exchanged internationally.

Figure 3: Country Comparison; US $ 650 billion SDRs Allocation to Sub- Saharan Africa



Source: Author's calculations based on IMF "2021 General SDR Allocation"

3.4 Historical Use of SDRs by Recipient Countries

SDRs act as a financing tool for African countries and are used by developing nations, primarily in Africa, as alternative cheap lines of credit. Recent SDR general allotments for 2021 were made to assist low- and middle-income nations in coping with the economic effects of the COVID-19 pandemic. It served as a timely financial aid tool for African nations. The African States can access or borrow these low-cost lines of credit from the IMF under the SDR system through this facility in various ways. SDR allocations allotted to African nations boosted their finances and reserves without increasing their external debt.

The recent allocation of US $650 billion in SDRs occurred at a time when Africa lacked the resources necessary to deal with its debt and liquidity crises. Since the allocation in August 2021, at least 99 low- and middle-income nations have used US$104 billion in SDRs.[19]

Low-income countries are more likely than wealthier economies to use their SDRs as the latter have access to a wider range of monetary instruments and reserve cash. Therefore, unless wealthy economies actively on-lend their unused SDR assets to emerging economies, the new allocation will unfairly benefit them. The fact that developed economies have more fiscal room and are less dependent on SDRs than developing economies, as seen by their low rates of SDR consumption, is a key argument in favour of SDR channelling unused SDRs to those countries that need it most.

SDRs could be used to boost country reserves, in budget support, or in reducing the country's public debt. SDRs are a very adaptable financial instrument that serves purposes other than operating as a reserve asset. Several economies, notably Zimbabwe, Ukraine, Serbia, Mauritania, and Bosnia and Herzegovina utilized a substantial portion or all of their SDR allotment for fiscal purposes during the global financial crisis. Andres and Cashman (2022) documented in February 2022 that, in the current Covid- 19 pandemic context, thirty-nine member nations, including Ecuador, Columbia and Paraguay in Latin America and the Caribbean, have registered SDRs worth US$ 37.3 billion in government budgets or have utilized them for fiscal

[18] Harcourt, S. (2021, March 23). SDRs are key to a global economic recovery. What on earth are they? Retrieved from ONE: https://www.one.org/international/blog/sdrs-global-economic-recovery-what-are-they/

[19] IMF (2021). Special Drawing Rights. Washington DC: International Monetary Fund, May. https://www.imf.org/-/media/Files/Countries/ResRep/ZWE/202105-imf-special-drawing-rightspresentation.ashx.

purposes. They have also documented that SDR allocations have been utilized by eighty developing economies, while thirty- two nations have converted allotted SDRs into hard currency, since the US$ 650 billion worth of SDR allocation was instituted.[20]

African countries are primarily utilizing SDRs to reduce spending deficits, aid in the recovery and pandemic response, pay off debt, and accumulate foreign reserves.[21] SDRs and foreign currencies are interchangeable, allowing countries to utilize SDRs to bolster reserves while paying for imports with other foreign currency reserves for instance the case in, Angola, Ethiopia, and the DRC. In the case of Angola for instance, in order to speed up economic recovery efforts, the authorities planned to use around half of its newly allotted SDRs to finance its budget. The remaining SDRs would be used to increase its foreign reserves. Equatorial Guinea will also spend a large amount of its SDR allotment to pay off its unsettled internal debt. Other nations have utilized their SDRs to fund social programs like in granting cash transfers to the poor, as was the situation in the Comoros, and in addressing pressing social needs including resolving food insecurity, and settling both domestic and foreign debts, as is the case in Chad.[22]

3.5 Kenya's Historical SDRs Allocations and Use

Kenya joined the IMF on 3rd February 1964 and has since had twenty- two (22) arrangements with the Fund since membership.[23] As of 31st December 2009, Kenya's position in the fund was SDR 203.98 million, thus the SDR allocation and the holding equalized thus Kenya was not required to pay interest rate. Kenya's allocation has since exceeded its holding for the past ten years; therefore, the country has been paying an interest rate (SDRi floor rate is 0.05%) until the current SDR was allocated. Kenya's historical allocations of SDRs[24] are presented in **Table 5.**

Table 3: Kenya's Financial Position in the Fund as of July 31, 2022: Balances in the SDR Department

SDR Department	SDR Million	% Allocation
Net cumulative allocation	779.90	100.00
Holdings	457.74	58.69

Data Source: IMF, 2022[25]

Of the US$ 33.8 billion allocated to Africa from the $650 Billion worth of SDRs in August 2021, the IMF allocated 520.2 SDR Million (2.18% of Africa's allocation), approximately US$ 737.6 Million worth of Special Drawing Rights to Kenya, an equivalence of KSH 83.7 billion as part of the multilateral lender's bailout of all governments to alleviate balance-of-payments constraints for Covid-19-affected economies.

[20] Andres Arauz, K. C. (2022, January 26). Eighty Countries Have Already Used Their Special Drawing Rights, but More of these Resources Are Needed. Retrieved from The Center for Economic and Policy Research (CEPR): https://cepr.net/eighty-countries-have-already-used-their-special-drawing-rights-but-more-are-needed/

[21] Kavanagh, M. J. (2021, September 22). Congo, IMF Plan Talks on Spending of $1.5 Billion SDR Allocation. Retrieved from Bloomberg: https://www.bloomberg.com/news/articles/2021-09-22/congo-imf-plan-talks-on-spending-of-1-5-billion-sdr-allocation

[22] ECA and ECLAC. (2022). *COVID-19 Report: Special Drawing Rights (SDRs) and the COVID-19 crisis.* United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Economic Commission for Africa (ECA).

[23] IMF (2022). Kenya, At a Glance. Retrieved from International Monetary Fund: https://www.imf.org/en/Countries/KEN

[24] IMF (2022). Special Drawing Rights (SDRs) Allocations and Holdings for all members from January 01, 2009 to December 31, 2009. Retrieved 30 August 2022, from https://www.imf.org/external/np/fin/tad/extsdr3.aspx?dateyear=2009

[25] IMF (2022). Kenya: Financial Position in the Fund as of July 31, 2022. Retrieved from International Monetary Fund: https://www.imf.org/external/np/fin/tad/exfin2.aspx?memberkey1=540&date1Key=2022-07-31

Table 4: Kenya's Historical SDR Allocations

Year of SDR Allocation	Amount in SDR Million	Percent of Total SDR Allocation
August 2009 General Allocation	201.2	0.12
Setember 2009 Special Allocation	21.5	0.001
August 2021 General Allocation	520.2	0.11

Source: Various IMF issues

3.6 Usage of the SDRs by Kenya

In December 2021, the Kenyan government indicated to the IMF, during the second programme review, that half of Kenya's latest SDR allocation will be used to substitute foregone fiscal financing,[26] while the other half would be retained at the Central Bank of Kenya to boost the country's official foreign exchange reserves that have come under intense pressure from the rising cost of the imports as well the appreciation of the US dollar. The review's report indicated that there is increased demand for foreign exchange to support Kenya Airways (KQ) and to cover increased debt repayment, which will result in a country reduction in gross international reserves. Therefore, half of the SDRs would be retained at the Central Bank of Kenya (CBK) to increase official foreign exchange reserves that serve as a buffer against potential shocks on the currency.

The National Treasury projected to borrow approximately Ksh. 41.8 billion from the CBK. This amount was planned to be on-lent to the government by the Central Bank of Kenya in the form of a 30-year domestic claim with a bullet maturity and an interest rate proportional to the Shilling (Ksh) equivalent of the average SDR rate over the period 2021–2051.[27] The on-lent amount would therefore finance part of the country's fiscal deficit. We can deduce that the SDRs allocation came at a time Kenya was grappling with increased expenditure pressures partly due to the COVID-19 pandemic. The allocation, therefore, brought some relief through increased financial resources that the government could use for critical interventions including purchase of Covid-19 vaccines, social protection, education, and health.

To address debt vulnerabilities, response to the COVID-19 pandemic and global shocks resulting from the war in Ukraine, governance and economic reforms, there was EFF/ECF arrangement of about SDR 1.655 billion (305 percent of quota or about US$2.34 billion. In addition, approximately SDR179.13 million (around US$238.1 million was made available as from June 14, 2022, which was purchased under the EFF arrangement (SDR141.13 million). Out of the SDR179.13 million (around US$238.1 million), approximately SDR38 million was disbursed under the ECF arrangement to the government in form of domestic currency for budgetary support.[28] IMF in its third review of Kenya's programme reports the

[26] Kenya: 2021 Article IV Consultation; Second Reviews Under the Extended Arrangement Under the Extended Fund Facility and Under the Arrangement Under the Extended Credit Facility, and requests for Modifications of Performance Criteria and Structural Conditionality-Press Release; and Staff Report (imf.org)

[27] Kenya: 2021 Article IV Consultation; Second Reviews)

[28] IMF. (2022). Kenya: Third Reviews Under the Extended Arrangement Under the Extended Fund Facility and Under the Arrangement Under the Extended Credit Facility, and Requests for Modification of Quantitative Performance Criteria, and Waiver of Applicability for Performance Criteria-Press Release; Staff Report; Staff Statement; and Statements by the Executive Director and by Staff Representative for Kenya.

[online] Available at: https://www.imf.org/en/Publications/CR/Issues/2022/07/19/Kenya-Third-Reviews-Under-the-Extended-Arrangement-Under-the-Extended-Fund-Facility-and-521042

potential increased on-lending of the general allocation for budgetary support remains a contingency while National Treasury in the same report identifies additional borrowing of the SDRs allocation from the CBK in response to disruptions caused by the Russia Ukraine conflict[29].

The National Treasury in draft 2022 Budget Review and Outlook Paper (BROP), reports IMF's SDR allocation of Ksh 40.8 billion as part of government borrowing that financed its fiscal deficit in FY 2021/22. The government reports that it deviated from the principles of fiscal responsibility where part of the borrowed funds was used to finance 17.7 percent of recurrent expenditure and external loans redemption. According to the National Treasury, this deviation was occasioned by the need to cushion the poor from the adverse effects of the COVID-19 pandemic as well as purchase of COVID-19 vaccines. However, the government is silent on whether proceeds from the SDRs allocation were directed towards targeted programmes or specific expenditures. However, we can infer that part of the SDRs allocation was used in redemption of external loans, purchase of COVID-19 vaccine, COVID-response as well as other recurrent expenditures.

Additionally, as depicted Table 6, that the government has been using a small amount of its SDR holdings every month, rather than all at once. Perhaps, this might be part of a planned strategy agreement between CBK and the National Treasury, however, it is not clear why SDR utilization varies each month which in contrast to one-off utilization of SDRs allocation by other countries such as Malawi

Table 6: Kenya SDRs Allocation and Holding

Kenya	**SDR Holdings**	**SDR Allocations**	**Change in Holdings**	**Notes**
Jul-21	9,976,010	259,647,163		
Aug-21	529,611,080	779,896,551	519,635,070	(The 2021 general SDR allocation)
Dec-21	490,210,714	779,896,551	-39,400,366	
Jan-22	490,210,714	779,896,551	0	
Feb-22	489,082,504	779,896,551	-1,128,210	
Mar-22	489,082,504	779,896,551	0	
Apr-22	467,080,994	779,896,551	-22,001,510	
May-22	465,421,116	779,896,551	-1,659,878	
Jun-22	458,229,016	779,896,551	-7,192,100	
Jul-22	457,735,061	779,896,551	-493,955	
Aug-22	454,757,354	779,896,551	-2,977,707	
			-74,853,726	**total used since August 2021**

Data Source: (IMF, 2022)[30]

As seen in Table 2, by August 22, the government had only utilized SDR 74,853,726, which is 14.4% of the 2021 SDR allocation while the National Treasury reports it borrowed Ksh 40.2 billion from the CBK in the draft 2022 BROP, part of which went to external loan redemption and with the decline in holdings it can be inferred that

[29] IMF. (2022). Kenya: Third Review

[30] IMF (2022). SDR Allocations and Holdings for all members as of November 30, 2020. [online] www.imf.org. Available at: https://www.imf.org/external/np/fin/tad/extsdr1.aspx.

i. The government paid off debt directly in SDRs (this could only happen with debt owed to the IMF, MDBs, or other governments, not the private sector since they can't hold SDRs).

ii. The government exchanged its SDRs for a hard currency to meet its foreign currency needs which would require the government to exchange its SDRs with another government. Therefore, it is possible that the odd amounts are a result of this exchange their currencies for SDRs.

3.7 Overview of the Desk Review

In summary, the desk review was able to trace and collate information on historical SDR allocations as illustrated and that the government borrowed Ksh 40.8 billion from CBK for budgetary support. As reported in the draft 2022 BROP the government borrowed to finance recurrent expenditures to cushion the poor from the adverse effects of the COVID-19 pandemic, purchase of COVID-19 vaccines and to redeem part of its external debt. However, it the National Treasury in the draft 2022 BROP does not indicate whether it utilized the SDRs allocation on specific sectors or programmes. The review also revealed existing inequalities in the allocation SDRs and the inadequacy of the approved allocation in supporting post-COVID-19 recovery. In addition to increasing the allocation to US$ 3 trillion, developed countries can use different channelling alternatives to re-channel unused SDRs to developing countries.

Nonetheless, there were information and data gaps in the review, therefore, the study conducted Key Informant Interviews (KIIs) to gather more information on guidelines on SDR use, existence of a legal framework on SDRs use, as well the which sectors benefited from the SDRs allocation in terms of budgetary support in Kenya. Findings from the key informant interviews are discussed in the next session.

3.8 Findings from the Key Informant Interviews

The IMF Resident Representative confirmed the above-described nature and arrangements relating to the SDR allocation. He referred to the publicly available IMF guidance note for particulars and accounting treatment. Regarding Kenya, the IMF Resident Representative confirmed that amount distributed in late August 2021 was approximately SDR 520 million (US$738 million), reflecting the uniform distribution at close to 100 per cent of member states' quotas. This allocation was received by the Central Bank of Kenya. He noted that the authorities' Letter of Intent attached to the December 2021 staff report for Kenya's IMF-supported program[31] had indicated that Kenya intended to keep half of the recent SDR allocation as reserves at CBK while the other half be on-lent to Government to help meet budget financing needs in FY2021/22. This was in fact what happened as reported in the draft 2022 BROP.

The study sought to gain information on SDR utilization from the Central Bank of Kenya. However, the Central Bank referred the researchers to Kenya's letter of intent to the IMF and indicated that it did was not involved in the utilization of funds that the SDR allocation availed. A review of the letter of intent dated 2nd December 2021 (appendix 1 in pg.73-74) and Attachment I - Memorandum of Economic and Financial Policies (pg.75-79) revealed that Kenya intended to keep half of the August 2021 SDR allocation as reserves at CBK while the other half was on-lent to Government to finance part of FY 2021/22 budget[32]. However, the review could not establish how much of the budget financing drawn from SDRs was allocated to key sectors such as health and social protection.

By the time we compiled this report, the National Treasury had not responded to our request for a Key Informant Interview (KII) therefore, the study could not ascertain the sectors or programmes (if any) that benefited from the 2021 general SDR allocation.

[31] IMF (2021). Kenya: 2021 Article IV Consultation; Second Reviews Under the Extended Arrangement Under the Extended Fund Facility and Under the Arrangement Under the Extended Credit Facility, and requests for Modifications of Performance Criteria and Structural Conditionality-Press Release; and Staff Report (imf.org)

[32] https://www.imf.org/en/Publications/CR/Issues/2021/12/22/Kenya-2021-Article-IV-Consultation-Second-Reviews-Under-the-Extended-Arrangement-Under-the-511263

3.9 Sufficiency and Channelling of SDRs

While the SDR allocation offered some reprieve for Kenya (and other developing countries) in terms on budgetary support questions have emerged on sufficiency of the approved allocation. Compared to other sources of global liquidity, the approved US$ 650 billion was insufficient to support post-CoVID-19 recovery and instead it had been proposed that an allocation of US$ 3 trillion would have been sufficient[33]. Such an allocation would have seen developing countries receive an estimated US$ 977 billion which would have been adequate to cover external debt service for most countries[34]. Using the same allocation criteria Kenya would have received approximately US$ 3.4 billion (more than KSh 408.5 billion) if the IMF approved an allocation of US$ 3 trillion. Such an allocation would have sufficiently covered Kenya's total debt service for the FY 2021/22 was KSH 305.3 billion. The allocation would also have addressed other financing needs in critical sectors including health, education, water and sanitation and infrastructure development.

To aid low- and middle-income countries recover from the COVID-19 pandemic more quickly, civil society organization are calling on developed economies to channel their SDRs allocations to these economies. Considering how profoundly the epidemic has affected economies, advocates of the channelling of SDRs maintain that low- and middle-income nations, particularly those in Africa, could gain more from the latest SDR allocation. Many African nations have been unable to meet their obligations to their citizens or to their creditors because of COVID-19. Therefore, in addition to a bigger allocation, another proposed intervention has been channelling allocated SDRs from developed countries to developing countries. In response, G7 and G20 countries pledged to channel US$100 billion to lower-income countries.

Channelling, nonetheless, should avail debt-free financing to developing countries and retain the basic features of SDRs by ensuring no conditionalities are attached. As it stands, there are three alternatives for channelling: first through the IMF's Poverty Reduction and Growth Trust (PRGT), however, PRGT is disadvantageous as it is available to a few countries, would add debt burdens, and cannot absorb all SDRs available for channelling. The second channelling alternative is the Resilience and Sustainability Trust which a new lending facility geared towards providing long-term financing for economies seeking to build resilience against future shocks and balance of payments stability[35]. Most advanced economies put their unused SDRs in Resilience and Sustainability Trust, but it suffers from similar limitations as PGRT in addition to restricting its purpose in building climate resilience. The third channelling option is through regional development banks such the African Development Bank (AfDB) though only United Kingdom has pledged to use this alternative.

It is also evident from the review that the current quota system works against developing countries yet in face of global shocks, their economies are more vulnerable compared to developed countries. In essence, SDRs allocation propagates the existing inequalities that are prevalent in the global financial system. Currently, the IMF uses a quota system in which a country's quota is determined by a pre-set formula where a country's GDP accounts for more than half of a countries quota. Other parameters in the formula include openness of an economy with focus on exports, variability to account for exports, and a country's reserves. The implication is that SDR allocation favours developed countries who receive approximately 67 per cent of the total allocation while low-income countries receive a meagre 1 per cent.

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[33] Daniel Munevar & Chiara Mariotti. The 3 trillion-dollar question: What difference will the IMF's new SDRs allocation make to the world's poorest? Retrieved from https://www.eurodad.org/imf_s_new_sdrs_allocation

[34] Daniel Munevar & Chiara Mariotti. The 3 trillion-dollar question: What difference will the IMF's new SDRs allocation make to the world's poorest? Retrieved from https://www.eurodad.org/imf_s_new_sdrs_allocation

[35] IMF (2022). Resilience and Sustainability Trust Retrieved from https://www.imf.org/en/Topics/Resilience-and-Sustainability-Trust

Additionally, the quota system implies that developing economies are disadvantaged in financial and economic decision-making at the global level. These countries have a limited voice and cannot determine their own development, financial and economic decision in a way that serves the needs of their people. Whereas some countries including the United States, United Kingdom, Germany, and France are each represented by dedicated board member, the entire of Sub-Saharan Africa is represented by two boards members accounting for 4.7 per cent vote share compared to United State's 16 per cent share of vote share[36]. However, it has been argued that changing the quota formula would not benefit developing countries, instead, institutional reforms would be needed. Different proposals have been fronted; increasing the basic votes, shift to Purchasing Power Parity (PPP)-based GDP or adopt a double majority voting system[37]; the first based on one vote for each country and that second economically weighted votes[38] . There have also been proposals on changing the way voting is done by eliminating special majorities in favour of a simple majorities in all decisions[39]. Other changes to quota system include inclusion of a population parameter in the quota formula, and removal of the intra- Eurozone trade parameter which gives the Eurozone countries an unfair advantage. Therefore, the IMF should consider some of the proposed alternatives in the scheduled review of the quota formular in December 2023.

4 Conclusion and Recommendations

4.1 Conclusion

Established in 1969, SDRs provide liquidity and supplement the operating capital of IMF's SDR Department member states. The Fund has allocated a total of SDR 660.7 billion (approximately, US$935.7 billion), including four general allocations and a one-time special allocation. SDRs are entered into the central bank balance sheet as an equal amount on the debit and credit side. SDRs are allocated in accordance with participants' paid Fund quota shares with over two-thirds of this going to developed economies. Of the US$ 650 billion recently allocated, Africa received US$ 33.8 billion. Low-income African countries are more likely than wealthier economies to use their SDRs as the latter have access to a wider range of monetary instruments and reserve cash. The fact that developed economies have more fiscal room and are less dependent on SDRs than developing economies, as seen by their low rates of SDR consumption, is a key argument in favour of SDR channelling to economies that need the additional liquidity. However, channelling must provide debt-free financing to developing countries, retain the basic features of SDRs, be available to a larger number of countries. The Resilience and Sustainability Trust that was recently approved by the IMF board complements the role played PRGT and will support absorption of additional SDRs that will be availed by developed countries.

The usage of SDRs is a country's prerogative and sovereign decision. SDRs act as a financing tool for African countries and are used by developing nations, primarily in Africa, as alternative cheap lines of credit. Recent SDR general allotments for 2021 were made to assist low- and middle-income nations in coping with the economic effects of the COVID-19 pandemic. Different countries put their SDRs allocations o different uses including boosting official foreign exchange reserves, budgetary support, debt service and stabilizing domestic currencies. While some countries (such as Malawi) utilized their SDRs all at once, Kenya has been utilizing small bits of SDRs although the government reports to have financed its budget deficit using the IMF SDR allocation.

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[36] IMF (2022). IMF Executive Directors and Voting Power. Retrieved from https://www.imf.org/en/About/executive-board/eds-voting-power

[37] Rapkin, David P., and Jonathan R. Strand. "Reforming the IMF's weighted voting system." World Economy 29, no. 3 (2006): 305-324.

[38] Rapkin, David P., and Jonathan R. Strand (2006)

[39] Leech, D. (2002). Voting power in the governance of the International Monetary Fund [online]. London: LSE Research. Online. Retrieved from http://eprints.lse.ac.uk/archive/00000648

Out of the 33.8 US $ billion allocated to Africa, Kenya received US$ 737.6 Million, an equivalence of Ksh 83.7 billion as part of the multilateral lender's bailout for all governments globally to alleviate balance-of-payments constraints for Covid-19-affected economies. A desk review on SDR allocation and use indicated that the Government of Kenya planned to use half of its allocation to fund its budget while the other half was retained at the Central Bank to boost the country's official foreign exchange reserves that have come under intense pressure from the rising cost of the imports as well the appreciation of the US dollar. The National Treasury in the draft 2022 BROP reports the IMF SDR allocation of Ksh 40.8 billion as part of its total borrowing part of which finance recurrent expenditures, was used to cushion the poor from the adverse effects of the COVID-19 pandemic and purchase of COVID-19 vaccines which led to a deviation from the principles of fiscal responsibilities that requires the government to borrow to finance development expenditures. However, the draft 2022 BROP is silent on specific sectors or programmes that were directly benefited from the August 2021 general SDR allocation.

4.2 Recommendations

In allocating SDRs among countries, the IMF uses a quota system with a country's Gross Domestic Product (GDP) partly determining its quota. Such a system avails resources disproportionately in favour of developed countries which in many cases do not need the allocation. Therefore, during the 2022/23 review of the quota formula, the system for allocating SDRs the IMF could consider moving away from the formula towards a utility based and needs based system. The shift would ensure increased efficiency in meeting the objectives of the SDRs as well as increasing the resources to countries that need them. This could be complemented by increasing the number countries under voluntary arrangements which has in the past supported programmes in developing countries.

As established in the review of SDR allocations, there is consensus that the allocated amount was insufficient to address the global liquidity needs. The role played by the SDRs a case for a new allocation and channelling of the SDRs. An additional SDRs allocation would avail resources to low-income countries: to finance public sector investment towards realization of the Sustainable Development Goals; avail more resources for climate change action; ease balance of payment pressure currently being experienced by many economies; additional resources could be channelled towards implementation of the Africa Continental Free Trade Area; and promote stability of the monetary policy. Channelling would on its part avail cheaper credit to developing countries that are yet to recover from the devastating effects of the COVID-19 pandemic.

The study established that there are information gaps on the use of SDRs. Information on SDRs allocation is readily available on the IMF website however, given that the IMF does not require countries to report on how they utilize their SDR allocation, such information is scant. Our desk review did not find any report on how Kenya has historically utilized its SDRs allocation. Whereas the government reported IMF SDR allocation as part of the government borrowing to finance its fiscal deficit in the draft 2020 BROP, there is no additional information on whether the government directed proceeds from the SDR allocation to specific sectors or programmes. This therefore limits information available to CSOs that they can use to evaluate the impact of SDRs allocation in support of additional SDR allocation and channelling of SDRs from developed countries to developing countries.

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