



What Are Special Drawing Rights and How Can They Be Used to Finance Climate Adaptation and Mitigation?

A Factsheet for United States Policy Makers

What are Special Drawing Rights (SDRs)?

SDRs are reserve assets created by the International Monetary Fund (IMF). SDRs are allocated to IMF member countries in proportion to their quotas, which are based on a country's relative weight in the global economy. The value of SDRs is derived from a mix of four major currencies: the U.S. dollar, the Euro, the Japanese yen, and the U.K. pound. SDRs were created in 1969 during a shortage of both dollars and gold, but they have been used more recently in response to the global financial and economic crisis that struck in 2008.

Why should SDRs be used for climate finance?

SDRs can contribute to the urgent adaptation and mitigation needs of developing countries. They are not a "silver bullet" solution to climate financing, but are one among several alternative financing mechanisms which should be seriously considered as a source of funding.

The use of SDRs for climate finance can help to reduce the amount of money the US Government must appropriate from Congress to meet the commitment President Obama and Secretary Clinton made in Copenhagen to raise \$100 billion per year by 2020 for climate mitigation and adaptation. A small US investment in the interest payments of

SDRs would leverage a significant amount of climate finance at a time when deficit reduction will make the appropriations process more difficult.

How can SDRs be used?

A government can use SDRs to build up reserves at its central bank (since increasing reserves provides an instant credit boost and usually means that a country can borrow on better terms), or it can convert its SDRs into hard currency. When a government converts its SDRs into hard currency, it is required to pay a small interest charge, applicable until that government converts the currency back into the form of SDRs. Currently, with interest rates low in response to the financial crisis, the interest rate for SDRs is less than 0.5 percent. However, there is no fixed price for interest rates on SDRs, so rates will likely rise along with other interest rates as the global economy recovers.

When were SDRs last used?

In April 2009, the G20 called for an allocation of SDRs in response to the global financial and economic crisis. In less than five months, the IMF made a general allocation of SDRs worth about U.S. \$250 billion. Based on their IMF quotas, wealthy countries received two-thirds of the SDRs, or approximately U.S. \$165 billion. However, because

developed country governments can raise funds on world markets at about the same cost as the SDR interest charge, they generally do not need additional reserves.

How can SDRs be used for Climate Finance?

There are at least three proposals for how SDRs can be used for climate finance:

1. In December 2009 philanthropist George Soros proposed that developed countries lend \$100 billion worth of the SDRs from their 2009 allocation to capitalize a Green Climate Fund. He suggested that the surplus value of the IMF's gold reserves could cover the interest payments on these SDRs.¹
2. In March 2010 the IMF released a staff paper which proposed that developed countries use their reserve assets (including SDRs) as the initial capital base for a Green Climate Fund. The Green Fund would issue low-cost "green bonds" to private investors and other holders to generate additional finance for mitigation purposes. Developed countries would subsidize the Green Fund from their own resources to provide developing countries with grant funding for adaptation needs. The authors of the IMF paper make clear that they are not proposing that "the IMF itself would create, finance, or manage the Green Fund."²
3. ActionAid has proposed that in *addition* to developed countries transferring SDRs from their 2009 allocation to a Green Fund—which should be under the authority of the UNFCCC—the IMF should also issue new, regular allocations of SDRs to fund climate needs. For new allocations of SDRs, ActionAid proposes that both

developed and developing countries should convert their SDR allocation into cash to be transferred to a UNFCCC fund.³ The fund would then make grants to developing countries for climate adaptation and mitigation, based on rules established by its governing body.

How Much Money Could SDRs Generate?

Developed countries could immediately contribute at least \$100 billion from their 2009 SDR allocation. There is no technical limit on the value of future allocations of SDRs.

Would New Allocations of SDRs Lead to Inflation?

New allocations of SDRs at the levels discussed in this brief—approximately \$100 billion per year—would not lead to inflation. World GDP is approximately U.S. \$60 trillion dollars. Injecting another \$100 billion into the economy each year—only about one-sixth of one percent of world GDP—should not have any inflationary effect.

Who would pay the interest charges?

Traditionally, any country which converts SDRs into hard currency would have to pay an interest charge. However, when SDRs are used for climate finance (particularly for adaptation) developing country governments should not bear any of the costs involved. This follows from the "polluter pays" principle, in which adaptation finance is a form of compensation for the measures developing countries are forced to take to deal with climate impacts their emissions did not create. Therefore, the interest on SDRs should be paid by developed countries. Alternatively, governments may collectively decide that the global climate crisis warrants the cancellation of interest charges on SDRs, or even of principal repayments of SDRs.

¹ George Soros, "Using SDRs to Fight Climate Change," speech at Copenhagen climate conference. December 2009. See news article: <http://www.prnewswire.com/news-releases/george-soros-announces-plan-to-generate-additional-100-billion-for-climate-change-relief-78946352.html>

² The International Monetary Fund Staff Position Note. "Financing the Response to Climate Change." March 2010. <http://www.imf.org/external/pubs/ft/spn/2010/spn1006.pdf>

³ For more details on ActionAid's proposal for a new UNFCCC Fund, please see Equitable Adaptation Finance: The Case for an Enhanced Funding Mechanism Under the UN Framework Convention on Climate Change by ActionAid. http://www.actionaidusa.org/assets/pdfs/climate_change/equitable_adaptation_finance.pdf

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