The Trap of Pinning Hope on the IMF's Special Drawing Rights (SDR) in Lebanon

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Introduction

Civil Society Organizations and policy makers have been pinning hope on the International Monetary Fund (IMF)'s Special Drawing Rights (SDR) to relaunch their economies amid the COVID-19 pandemic. SDRs had been the elephant in the room during the last Annual/Fall meetings (October 16-18, 2020) and Spring meetings (April 5-11, 2021) of the IMF and the World Bank Group (WBG). The ensuing IMF and Financial Committee (IMFC) communiqué from the latter meetings echoed the G20 communiqué, released the previous day, calling for an SDR allocation of USD 650 billion.[1] This came as a result of an open letter by international civil society organizations and policy makers to the G20 Finance Ministers and the IMF in February of this year, asking them to support a new allocation of IMF SDRs in the amount of USD 3 trillion as "a multilateral solution to help middle- and low-income countries as they face fallen revenues, lower foreign exchange earnings and higher fiscal and debt burdens consequent to the COVID-19 crisis, without pushing their economies into further debt distress".[2] IMF's managing director Kristalina Georgieva has also expressed her intention to present by this month (June 2021) a formal proposal to the Executive Board to consider an allocation of USD 650 billion of SDRs - the largest allocation in history and the first since 2009 - which is most likely to take place the earliest possible, i.e. in August 2021 given procedures.[3]

SDRs are like a swap credit line. They are an international type of monetary reserve currency created and maintained by the IMF as a supplement to the existing standard money reserves of member countries. The value of the SDR is calculated as a weighted basket of five major currencies (the US dollar, the euro, the Japanese yen, the British pound, and the Chinese yuan that joined this combination of currencies in 2016) at a certain point in time and varies accordingly.[4] One SDR is currently worth about USD 1.42.[5] Members participating in the SDR Department (currently all members of the IMF) can buy and sell SDRs in the voluntary market. This foreign exchange reserve asset is issued by the IMF in crises times, and the allocation is distributed to member countries in proportion to their quota shares at the Fund (a figure based on a country's size and contributions to the IMF).[6] The prospective issuance in August 2021 is meant to provide a critical tool to help low income countries pay for the

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1 https://www.brettonwoodsproject.org/2021/04/imfc-communique-analysis-spring-meetings-2021/

2 https://www.latindadd.org/2021/02/12/civil-society-organizations-call-for-quick-special-drawing-rights-allocation/

3 https://www.imf.org/en/News/Articles/2021/03/23/pr2177-imf-execdir-discuss-new-sdr-allocation-us-650b-boost-reserves-help-global-recovery-covid19

4 https://www.imf.org/en/About/FAQ/special-drawing-right#Q6.%20Can%20existing%20SDRs%20be%20%E2%80%98recycled%E2%80%99%20or%20channeled%20toward%20other%20purposes?

5 https://www.aljazeera.com/economy/2021/4/6/what-is-an-sdr

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

COVID-19 response and deal with their economic fallouts as a result of the health crisis. Recipient countries can cash their share of SDRs into foreign currency (any currency of the five included in the basket) to pay for debt and financial needs, hence why they have been advocated for by international development experts and activists.[7]

This newfound source of international liquidity is definitely expected to be attractive for a country like Lebanon which is facing a multifaceted crisis, as it witnessed the beginning of a financial collapse since the uprising erupted in October 2019, followed by an economic stagnation that was exacerbated by the pandemic as of March 2020 and further by the Beirut Blast in August 2020. Although Lebanese experts and activists have been agnostic about the issue of SDRs, a significant group of them is awaiting the issuance of this monetary tool which – they believe – promises to rescue the country from its economic depression that is characterized by debt insolvency both nationally and internationally, a twin deficit (with exports exceeding imports and government expenditures exceeding revenues), and a stagflation or, in other terms, a hyperinflation coupled with economic stagnation whereby economic growth is even negative and the unemployment rate is very high.[8] Given the rentier nature of the Lebanese economy which now suffers the breakdown of its most predominant sector, the banking sector, and which naturally does not promise any structural reforms in the short or medium run; given the shaky political economy situation with the devaluated Lebanese exchange rate reaching an all-time low of LBP/USD 13,000 in May 2021[9] and the acting government adopting a "no policy" policy in face of the socio-economic repercussions; and given that corruption in the public sphere has become more explicit than ever and that there is no glimmer of hope for a new government to be established so as to relaunch macroeconomic activity, the receipt of the so-called "concessional and unconditional" hard currency – in the form of SDRs - cannot but sound tempting for the Lebanese ruling class and appealing for many Lebanese economists.[10]

However, this paper raises major caveats about the economic and governance impacts that the SDRs might have in Lebanon for context-specific reasons in addition to the unspoken flaws that SDRs entail on the macro and global level as an international tool. The following sections depict the arguments that debunk the risk of SDRs in Lebanon from a political economy perspective. Some of the arguments stem from the position of Lebanon in the inter-country inequality caused by SDR allocations and thus focus on the impact of SDRs on Lebanon as simply one of the low- and middle- income countries, whereas some

[7] https://www.degruyter.com/document/doi/10.1515/ev-2020-0012/html
[8] https://www.mei.edu/publications/lebanons-economic-crisis-tragedy-making
[9] https://www.the961.com/lira-rate/
[10] https://www.worldbank.org/en/country/lebanon/publication/economic-update-april-2021

other arguments revolve around the SDR's impact on Lebanon in particular from a country-specific lens and given the current circumstances prevailing in the Lebanese economy.

A macro solution for a micro problem

If the USD 650 billion SDRs are issued by the IMF to the global market in August, Lebanon would get 0.13% of them (i.e. USD 845 million worth of SDRs) as per its quota.[11] This is a big sum of money that Lebanon will not judiciously employ, knowing the fiasco or at least haphazard policies that the political elites have been adopting, allowing the economy to spiral into chaos and more than half of the population to sink into poverty.[12] Yet, this amount will not be enough for Lebanon to solve its indebtedness problem or mitigate its economic turmoil, as its public debt is USD 93.4 billion (around 170% of GDP), its gross external debt is more than USD 33.6 billion and its balance of payment is at a deficit of about USD 10.5 billion.[13] This also indicates that there will not be any excess resources to finance the response to the COVID-19 pandemic, which is the key driver for the international financial institution (IFI) to issue the SDRs. As Lebanon suffers from a deep economic crisis, it is most likely to spend the SDRs outside the purpose for which they were allocated.

SDR allocations can be made to the central bank and reside on its balance sheet or to a governmental body such as the ministry of finance.[14] In either case in Lebanon, these authorities have become suspicious, lacking credibility and not conveying confidence. Moreover, there is no macroeconomic structural plan, neither with the IMF nor independently, nor there is a default plan that Lebanon has hitherto set in response to the overlapping crises. Assuming "unconditionality" of SDR allocations, as proclaimed, this would offer the corrupt authorities more space for misappropriations and embezzlements, and would result in more arbitrary economic measures that can further deteriorate the situation.

While SDRs are supposed to bolster Lebanon's monetary policy by increasing foreign exchange reserves, they might, for instance, be used to reproduce the Ponzi scheme as a temporary camouflage. The central bank could cash them and inject them in commercial banks for them to re-lend the corrupt and bankrupt government that would issue SDR-denominated bonds to the national market or, in the best case scenario, for the banks to pay their depositors. In the latter case, if the central bank keeps the parallel exchange rate markets and its "no-policy" policy of neither floating nor pegging the exchange rate, the cashed sum from SDRs could be confiscated in "fresh money" by the intertwined

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11 https://www.imf.org/external/np/sec/memdir/members.aspx

12 https://www.aljazeera.com/news/2021/3/22/were-sick-of-them-lebanon-economy-freefalls-as-leaders-bicker

13 https://www.byblosbank.com/economic-research-

14 https://www.cgdev.org/publication/can-special-drawing-rights-be-recycled-where-they-are-needed-no-budgetary-cost

business and political elites, and the depositors would be paid at a significantly reduced rate or, in another way, only part of their deposits. Furthermore, although there has been a lot of skepticism about the success of the money exchange platform that the Lebanese central bank governor, Riad Salameh, aims to launch to cap the parallel exchange rate market, the success of this platform would also provide space to play around with the exchange rates, as the parallel exchange rate markets will remain anyway. Among the many additional scenarios, one could imagine that the central bank could use the SDRs to finance the prevailing subsidy scheme despite all the flaws it has been manifesting, from smuggling to benefiting the rich and the poor equally.[15]

Even if SDRs are spent on COVID-19 socio-economic responses such as in-kind donations, cash transfers, etc., these forms of aid would either be subject to thefts or would be used to leverage the clientelistic system that has been in place for decades in the country, as they will be administered by the public authority receiving the SDRs. In all cases, SDRs would increase the level of moral hazard in the Lebanese economy which could follow suit to Venezuela that disobeyed the international community in 2019 and used its SDRs to repay its official creditors.[16] Not only SDRs will not be enough or not 'be made enough' to close fiscal gaps, meet external obligations or counteract the drastic foreign exchange shortage in Lebanon, they also are not likely to restore the level of confidence in the Lebanese market that has defaulted on USD 1.2 billion worth of Eurobonds, and thus on all its maturing Eurobonds, only one year ago.[17] Thus, while SDRs are perceived by IFIs' experts as a long term solution to a short term problem (the COVID-19 crisis), they actually constitute a short term solution for a long term problem in the case of Lebanon which only needs structural and sustainable reforms.

In addition, bearing in mind Lebanon's political economy landscape, responding to the COVID-19 pandemic in the country, specifically, does not require the injection of foreign exchange reserves in the form of "unconditional" cash, but targeted aid to the poorest and most vulnerable social groups in the form of conditional cash-based transfer cards, food cards and e-cash – similar to the UNHCR and WFP's response to the refugee crisis.[18] This should be administered by civil society to avoid the reproduction of typical political and governance dynamics, and should definitely be also accompanied by long term reforms to the social protection and health infrastructure in Lebanon. Both the targeted aids and the sustainable reforms lie outside the scope of the prospective SDR allocation, irrespective of means. Even more, Lebanon

[15] https://timep.org/commentary/analysis/the-weight-of-lebanons-unsustainable-subsidies-program/

[16] https://som.yale.edu/blog/the-g20-s-impasse-on-special-drawing-rights-sdrs

[17] https://www.brettonwoodsproject.org/2020/10/an-imf-bailout-for-lebanon-can-make-things-worse/

[18] https://datacatalog.worldbank.org/dataset/lebanon-multi-purpose-cash-assistance-impact-evaluation-well-being-syrian-refugees-2020

already has USD 195.78 million in SDRs from previous allocations that are not traced or declared so as to know if they were/are deployed for the benefit of the Lebanese people amid dire times or not.[19]

A volatile tool for a volatile economy

SDRs are not backed by a tangible commodity like gold, which makes their value unstable. As the SDR value is the average of the five aforementioned currencies, it is less valuable than the strongest (the USD) and thus among the first to go when reserves are sold off.[20] This adds another layer of risk to the national economy of any recipient countries, such as Lebanon, especially because the USD has been volatile since the Federal Fund rate was reduced by the Federal Reserve during the health crisis, and because the Chinese Yuan, which is known not to be the most stable, has joined this basket of currencies in recent history.[21] Knowing how all economic parameters are enormously sensitive to changes in money supply, this should be spelled as a dangerous situation to be in for a fragile economy.

SDRs have a targeting problem, as all countries – developed, emerging and developing – receive it according to their quotas in the IMF and regardless of their needs, which makes the allocations often insufficient to cover low-income countries' needs for liquidity.[22] Nonetheless, despite this common insufficiency, SDRs constitute a factor for inflation and currency devaluation, especially for small recipient countries like Lebanon, and that is through several channels.[23] First, they decrease the global demand for foreign exchange reserves and have an inflationary effect on the global level, which consequently affects the inflation rate in small open economies that are integrated in the international market like Lebanon whose balance of payment is also dependent on the big economies where inflation would hit significantly. On a more national level, SDRs increase the total money supply in the recipient country and lead to intensive expansionary fiscal policy, and thus to hyperinflation. A study by the European Central Bank in 2016 proved that countries that received SDRs worth 10% or more of their total foreign exchange reserves during the 2009 allocations faced relatively higher inflation rates.[24] Apart from this, in Lebanon, amidst the prevailing currency devaluation and the existence of the uncontrolled black market for the exchange rate, there is – again – fear of trading the foreign currency withdrawn from SDRs for LBP. In case of further currency devaluation of the LBP, this would-be aid money would lose its value being in local currency. This could also repeat many fiasco scenarios whereby aid money was confiscated by the authorities in "fresh dollars" while it was disbursed to the

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19 https://www.aljazeera.com/economy/2021/4/6/what-is-an-sdr

20 http://countrydata.bvdep.com/eiu/help/sdr.htm

21 https://www.brettonwoodsproject.org/2016/02/imf-to-add-chinas-currency-to-sdr-basket/

22 https://som.yale.edu/blog/the-g20-s-impasse-on-special-drawing-rights-sdrs

23 https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1880.en.pdf?9597dd3e416df3f4e8640eca5648c127

24 https://som.yale.edu/blog/the-g20-s-impasse-on-special-drawing-rights-sdrs

beneficiaries in LBP (e.g. the World Bank loan of last year that was confiscated by Riad Salameh). [25] Even worse, knowing the trend of intensively printing LBP banknotes (the central bank printed LBP 13 trillion Lebanese pounds last autumn only)[26] that has been going for two years now, there is an even bigger fear that the latter would print the equivalent of the received SDR amount in LBP in order to actualize the virtual currency in local terms instead of actualizing it in any of the five currencies of the SDR basket. This would increase the money mass in circulation, would further aggravate the devaluation of the Lebanese Lira, and would aggrandize the import-led inflation rate.

More importantly, SDRs work like a credit line and are not debt free as pretended. Whenever a country withdraws from its SDRs, it needs to pay an interest rate for their net use, which is equivalent to around 1.6% per annum. This interest rate was actually the "higher of 0.050% and the combined market interest rates for the three-month government securities of the currencies in the SDR basket" which is quite high for developing countries.[27] Now, the 0.050% has also recently increased to 0.069%, which means a further increase in the overall liability.[28] "This SDR interest rate provides the basis for calculating the interest rate charged to member countries when they borrow from the IMF", in general.[29] This drives developing countries, including Lebanon, into more indebtedness and increases their fiscal burdens, thus undermining the praised countercyclical effect of SDRs amid crises. Additionally, as the IMF has recently acknowledged the targeting problem of SDRs, the international community has been encouraging the recycling of SDRs whereby developed countries, which have an excess of SDRs, can "donate" their SDRs to poor countries through – most commonly - the IMF's Poverty Reduction and Growth Trust (PRGT). This donation happens in the form of a reallocation via SDR loans which earns additional interest rates through the PRTG – not to mention the difficulty and length of the recycling procedures. Mark Sobel, a former IMF hand at the U.S. Department of the Treasury, argues that "borrowing from the IMF at a 0% interest rate made it

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25 https://www.almodon.com/economy/2021/2/5/%D8%B1%D9%8A%D8%A7%D8%B6-%D8%B3%D9%84%D8%A7%D9%85%D8%A9-%D9%8A%D8%A8%D8%B1%D8%B1-%D9%85%D8%AF-%D8%A7%D9%84%D9%8A%D8%AF-%D8%A5%D9%84%D9%89-%D8%A3%D9%85%D9%88%D8%A7%D9%84-%D8%A7%D9%84%D9%81%D9%82%D8%B1%D8%A7%D8%A1

26 https://www.arabianbusiness.com/banking-finance/452546-inflation-spirals-out-of-control-as-lebanon-drowns-in-excess-pounds#:~:text=growing%20economic%20crisis-,The%20central%20bank%20printed%20LBP13%20trillion%20in%2050%2C000%20and%20100%2C000,9%20tonnes%20of%20paper%20money.

27 https://som.yale.edu/blog/the-g20-s-impasse-on-special-drawing-rights-sdrs

28 https://www.imf.org/external/np/fin/data/sdr_ir.aspx

29 https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR#:~:text=The%20SDR%20interest%20rate%20(SDRi),-SDRi%20VALUE&text=The%20SDRi%20provides%20the%20basis,creditor%20positions%20in%20the%20IMF.

significantly better for low-income countries than SDR allocations, as they need "less debt and more grants"."[30]

Finally, while conditionality may be perceived as benign in the case of a country like Lebanon and while SDRs are known to be an "unconditional" form of aid, they can frequently impose unpopular conditions on recipient countries.[31] While member States would not be required to change their domestic economic policies like when they get access to other IMF lending facilities, conditions may include concessional austerity measures and may be translated in advancing approaches/agendas through the use of SDRs such as vaccine production and private sector debt relief, which are currently being deliberated for the prospective SDR issuance of next August.[32] Lebanon neither has the infrastructure nor does it have the comparative advantage to produce any vaccine, for the time being, on the one hand. On the other hand, providing debt relief to the private sector, the most rent-seeking sector in the country and a sector that does not assume its corporate social responsibility amid the pandemic, is also surely not a priority for Lebanon amid all the turbulent socioeconomic scene.[33] Knowing that the collapsed banking sector occupies a major stake of the private sector in Lebanon further articulates these concerns. Furthermore, domestic political dynamics will inevitably come into play, and this adds to the fact that SDRs would regulate the money supply, even if temporarily. Therefore, the decision regarding whether the money supply should be expanded or contracted would end up becoming an administrative decision, in the hand of incompetent decision makers.[34]

Conclusion

Special Drawing Rights can, in theory, be promising in some contexts but, in practice and in the case of Lebanon, they entail more pitfalls than promises. Lebanon did not negotiate an IMF plan and defaulted on its debt without a plan and without negotiations with the creditors. SDRs offer a big sum of money that Lebanon will not judiciously employ, as the government has been dragging its feet on long-overdue and necessary reforms. This assumption is also based on the "nominal myopia" afflicting policy making in Lebanon despite critical times. Policy makers would keep doing their business as usual and depleting the country's resources and reserves until they reach a dead-end, instead of thinking of structural reforms. SDRs would therefore be used outside of the purpose for which they were allocated and would increase the level of moral hazard and the scope of arbitrary measures on the decision making level.

Not only SDRs will not provide sufficient resources to help heal the Lebanese economy from its continuous

[30] https://som.yale.edu/blog/the-g20-s-impasse-on-special-drawing-rights-sdrs
[31] ibid
[32] https://www.brettonwoodsproject.org/2021/04/imfc-communique-analysis-spring-meetings-2021/
[33] https://www.annd.org/en/publications/details/an-overview-of-the-private-sector-in-the-arab-countries
[34] https://www.managementstudyguide.com/special-drawing-rights.htm

decay or to respond to the pandemic as needed, they will most likely be subject to corruption – no matter what form they get translated into – and either be appropriated or taken advantage from for clientelistic purposes. Moreover, there is a considerable list of plausible scenarios that could take place, in case of an SDR allocation to Lebanon, ranging from reproducing the Ponzi scheme and taking advantage of the parallel exchange rate market to confiscate the “fresh” hard currency, to financing the unsuccessful and non-purposeful subsidy scheme.

An SDR allocation in Lebanon is nothing but a short term solution (perhaps) to long term problems and a volatile tool for a volatile economy. Unlike how they are being promoted, SDRs are not debt free and not totally unconditional. They rather have an inflationary effect and the potential to further depreciate the Lebanese Lira, while Lebanon has become extremely susceptible to even minor shocks. Therefore, it would be very difficult to imagine any successful use of these facilities in the country. This adds to the abstract nature of a too blunt of a tool, making it hard to implement on the national level.

As the prognosis is quite bleak, welcoming any new SDRs should be coupled with serious measures from within and from the IMF to ensure that they are employed amid enhanced transparency and accountability and in the right path. It is also imperative not to count on SDRs in saving Lebanon from the crises it has been drowning in, including the COVID-19 crisis, but to rather focus on developing a clear macroeconomic structural plan that helps the Lebanese authorities make strategic decisions for long term and sustainable solutions, which would build the needed basis for future SDR allocations and similar foreign interventions to be successful.