



Leveraging Special Drawing Rights (SDRs) for Sustaining Economic Recovery in Kenya

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Key messages

1. Accumulation and prudent utilization of public debt has enabled the government of Kenya to put the economy on a take-off phase of development and improve living standards among the populace.
2. SDR allocations have proven valuable during global crises, but the current allocation and distribution mechanism can be enhanced.
3. SDRs rechanneling presents a valuable tool for financing government operations at low interest and achieving inclusive economic recovery.

4. Leveraging on SDR allocations will support economic recovery under the Bottom-Up Economic Transformation Agenda (BETA) and address fiscal challenges posed by various shocks.

What's the issue?

Kenya, like most countries in Sub-Saharan Africa, has faced and coped with multiple shocks amid reduced fiscal headroom and increasing public debt vulnerabilities. Other than the COVID-19 global health crisis and the resulting economic effects, Kenya faced the desert locust invasion in 2020, prolonged droughts in 2021 and 2022, and the accompanying high cost of living exacerbated by the spill-over effects of the Russian-Ukraine war. These developments came when the economy had inadequate domestic resources to sustain the post-COVID-19 recovery momentum, and the mounting debt levels constrained the ability to raise new funding.

Following a series of recurrent shocks, the International Monetary Fund (IMF) supported member countries substantially. This support took multiple forms, including the Rapid Credit Facility (RCF), the Rapid Financing Instrument (RFI) and Resilience and Sustainability Trust (RST), which provided emergency loans to low-income and middle-income countries facing urgent balance of payments needs.

Most importantly, the IMF approved issuing \$650 billion in special drawing rights (SDRs) in August 2021 to help member countries supplement their foreign exchange reserves and finance their balance of payments needs during the pandemic. However, data from IMF shows that about two-thirds (US\$420 billion) of the allocation went to developed economies. Further, statistics show that developing economies have a greater dependence on SDRs than developed economies, with net SDR positions showing significant differentiation in utilization rates between the two. CEPAL and ECA (2022) noted that developing economies have an SDR utilization rate of 42.9%, while developed economies have a utilization rate of 5.9%. In addition, low voting rights in developing countries limit their participation in the decision-making process where voting power counts. As a result, the low-income countries that need more resources and SDR allocations to address their liquidity challenges are disadvantaged.

Why is it important?

Kenya, like most developing countries, receives little in SDR allocation while the needs are dire. Recurrent external and internal shocks continue to put pressure on the Balance of Payments (BoP) position due to substantial trade imbalance, high external debt payments, and limited foreign exchange reserves. Consequently, the BOP deficits are putting pressure on the country's foreign exchange reserves and making it difficult to meet external financial obligations.

Notably, when Kenya was elevated to the Lower Middle-Income Country in 2014, accessing concessional window began to shrink and, hence, the shift to commercial debt. The limited fiscal space, and the tighter international markets have made it difficult to access additional funding. Furthermore, the weakening of the shilling against the US dollar has increased the debt stock and the resultant servicing. With limited access to new debt, the high debt servicing costs are straining the country's foreign exchange reserves and reducing its ability to allocate resources to other development priorities.

Given these challenges, more access to SDRs is critical for liquidity support, debt sustainability and crisis preparedness. Firstly, additional SDR allocations could provide Kenya with a much-needed injection of foreign exchange reserves. These reserves could be used to cover import costs, service external debt, and stabilize the country's external financial position. Secondly, the increased foreign exchange reserves from SDRs could help alleviate the pressure on Kenya's external debt servicing thereby reducing the fiscal deficit and, in turn, improve the overall debt sustainability and reduce the risk of default. Thirdly, accessing additional SDRs could enhance the ability to respond to future economic shocks or crises, providing a buffer to help manage external vulnerabilities.

Fourthly, reallocating SDRs would accelerate progress towards key developmental goals in the country. The Bottom-Up Economic Transformation Agenda (BETA) has prioritized some sectors as key in enabling the government meet service delivery. The key sectors in delivery of BETA include Health; Education; Energy, Infrastructure & ICT; Environment Protection, Water and Sanitation; Agriculture, Rural and Urban Development; and Transformation of MSMEs. Hitherto, these sectors have suffered reduced allocations at the expense of interest payments.

Policy options

SDR allocations form an important part of financial resource to the vulnerable countries, particularly during periods of extreme external shocks as evidenced during the global financial crisis and the COVID-19 pandemic. However, these resources have not been sufficient to meet the financing needs, particularly for African countries.

The IMF allocation and current distribution mechanism based on the relative Quotas continue to disadvantage the vulnerable countries, who are in dire need of these financial resources. At the same time, the advanced and emerging market economies continue to benefit more from the distribution of SDR allocation, and yet they do not need them as evidenced by unutilized allocations. To address financing gaps, particularly in the face of climate change impacts, reforms are needed to broaden the reach and impact of SDRs. Importantly, reviewing distribution mechanisms, voluntary rechanneling options, and bolstering concessional financing to support vulnerable countries' development and climate resilience.

What should policy makers do?

In view of this, there is need to:

- i). Review the distribution mechanism beyond the Quota shares to take into consideration the countries that need them most and are more vulnerable.
- ii). Enhance the voluntary rechanneling mechanism of SDR allocations by member countries to help vulnerable countries, especially African countries. This includes exploring modalities for rechanneling of the SDR allocations through Multilateral Development Banks, such as the African Development Bank, to increase utilization by the vulnerable countries.
- iii). Expand IMF's capacity for concessional financing, particularly scaling up of Poverty Reduction and Growth Trust's (PRGT) loan resources¹ (currently lent at zero interest rate) through voluntary re-channeling of SDR allocations to increase resource available to the vulnerable countries.
- iv). Provide capacity building and technical assistance to countries, especially those with limited experience in utilizing SDRs effectively. This includes guidance on integrating SDRs into fiscal planning, investment frameworks, and development strategies, ensuring that these resources contribute optimally to sustainable development and climate resilience.

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1 During the COVID-19 pandemic, IMF mobilized PRGT loan resources amounting to about \$24 billion of which about \$15 billion was from use of SDRs.



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