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22-20 The IMF Should Enhance the Role of SDRs to Strengthen the International Monetary System

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ABSTRACT

The special drawing right (SDR), issued by the International Monetary Fund (IMF), has the potential to strengthen dramatically the international monetary system. Established in 1969 and allocated twice during its first decade, the SDR was in the institutional closet from 1980 until 2009, when $250 billion in SDRs was allocated to members of the IMF to help address the global financial crisis. In 2021 another $650 billion in SDRs was allocated to help address the coronavirus pandemic. The SDR has proved itself as a crisis instrument. This paper addresses critically the arguments against SDR allocations. It proposes regular annual SDR allocations, along with measures to make the SDR more attractive to critics and measures to build out the SDR system in support of the international monetary system. The paper includes an appendix on the history of the SDR. A second appendix analyzes SDR use following the 2009 and 2021 allocations and finds that contrary to the popular myth, many countries other than low-income members of the IMF benefited directly in multiple ways from those allocations.

JEL Codes: F32, F33

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INTRODUCTION

The International Monetary Fund (IMF) is the principal institution of international monetary cooperation. The dedication and expertise of its management and staff are essential to its success. The IMF's institutional centrality in the post-World War II international economy and financial system rests on two key pillars.

First, the IMF's financial resources are prepositioned. This allows it to support a member of the system expeditiously. The hat does not need to be passed around each time a need for financial assistance arises.

Second, the IMF can allocate special drawing rights (SDRs) to members, enabling each holder to borrow foreign exchange directly from other members. Unless members agree to cancel outstanding SDRs, they are permanent additions to countries' international reserves, unlike currency reserves that, once spent, disappear from the system. The central monetary role for the SDR is enshrined in the IMF Articles of Agreement in an obligation, not currently realized, to make the SDR the principal reserve asset of the international monetary system.

Neither IMF quota resources nor SDRs can be deployed without the consent of a majority, or in the case of SDRs a supermajority, vote of members. It is IMF members, not the management, that control the institution on important issues. Management may propose, but the executive board (representing the members) disposes. The IMF's Articles of Agreement do commit members to cooperate. At some times members find it easier to fulfill that commitment than at other times.

Today the IMF is at an existential crossroad.

The structure of the IMF's resource pillar is decaying. Members have not agreed to augment the Fund's standing financial resources (quota subscriptions) since 2010. As a result, the distribution of voting power, which is a function of members' shares of total quotas, has been frozen and is increasingly inconsistent with global economic realities. The stalemate over increasing IMF quotas and adjusting their distribution threatens to undermine the IMF's legitimacy. Unless corrected, the political and financial underpinnings of the IMF will weaken, and the collective commitment to cooperation through the IMF that has supported more than 75 years of remarkable global growth and prosperity will fray.

On SDR allocations, the second pillar, IMF members have failed to capitalize on the potential of this tool. The SDR was created to supplement existing reserve assets and support the Bretton Woods regime of fixed exchange rates. Countries established par values against the US dollar, which in turn was tied to gold at the fixed price of $35 per ounce. The structure was supported by the United States standing ready to sell gold at that price to governments that had acquired US dollars in preventing their exchange rates from appreciating, as well as to buy gold from them when they needed dollars. The SDR's establishment came too late to preserve the Bretton Woods exchange rate regime. SDR allocations first were made in 1970-72, starting before the United States closed its official gold window in August 1971, and a second set of allocations was made in 1979-81 (table 1). Not until 2009 was there another SDR allocation. It was agreed on in connection with the 2008-10 global financial crisis and was followed by a fourth allocation in 2021 in connection with the coronavirus pandemic.[1]

1 Agreement was reached in 1997 on a special allocation of SDRs primarily to countries that had joined the IMF after the second allocation. However, the United States did not give its approval until 2009 in the context of the global financial crisis, and so the special allocation went into effect that year. See appendix A for a brief history of the SDR.

Table 1
Allocations of special drawing rights, 1970-2021

Date	SDR allocation		Cumulative SDR allocations	
	Billions of SDR	*Billions of US dollars*[a]	*Billions of SDR*	*Billions of US dollars*[a]
1970-72	9.3	9.3	9.3	9.3
1979-81	12.1	15.8	21.4	27.9
August 28, 2009	161.2	252.1	182.6	285.6
September 9, 2009	21.5	33.8	204.1	321.3
August 23, 2021	456.5	647.5	660.6	937.0
Memo: September 30, 2022	n.a.	n.a.	660.6	845.5

n.a. = not applicable; SDR = special drawing right

a. The US dollar/SDR exchange rate on the date of the allocation is used for the conversion into US dollars; the average January 1980 rate was used for the second allocation.

Note: Figure for September 9, 2009, allocation includes SDRs that were allocated to members joining the IMF after this date.

Sources: International Monetary Fund and author's calculations.

In this paper I focus primarily on the second pillar of the IMF—the SDR—and make recommendations to strengthen its role and thereby the international monetary system.[2] The IMF and its members should once again rethink the role of the SDR as a tool of the institution. They should examine whether some of the current provisions governing how SDRs are used and exchanged promote or hinder the SDR's potential roles in the international monetary system. In this context my principal recommendation is that the IMF should decide to allocate SDRs annually. To make this recommendation more palatable to members that generally oppose SDR allocations, I propose raising the interest rate on the SDR. I also propose changes in the operation of the IMF and the technical arrangements governing SDR use that would strengthen and update their functions in today's international monetary system. Finally, I propose doubling the protected collective quota share of low-income members of the Fund, which in the last increase in quotas was 3.3 percent, in the 2023 quota negotiations.

The IMF allocates SDRs to its members in proportion to their paid-in quota subscriptions; they are recorded on members' balance sheets as both assets and liabilities of the holder, which is either the central bank or the finance ministry. Countries receive interest on their SDR assets and pay the same rate

2 The SDR may be, and is to a limited extent, used as a unit of account. In principle, SDR-denominated instruments can trade in private markets. The World Bank issued an SDR-denominated bond in China in 2016. The SDR also might replace the US dollar and other international currencies in international finance. These other potential features of the SDR may be useful by-products, but without the SDR playing its central monetary role, it is difficult to envision that it would be positioned to play any other role on a large scale.

of interest on their SDR liabilities. To the extent that a country's SDR holdings exceed its cumulative allocations, it receives net interest and vice versa.[3] Members receiving SDRs can transfer them to other members in exchange for convertible, or hard, currencies to meet their external financial needs.[4] They also can be used to discharge obligations to the IMF, other members, or other designated SDR holders.

The SDR was established in 1969 to supplement existing reserve assets and thereby to serve the purposes of the IMF.[5] Those purposes include promoting international cooperation, reducing international balance-of-payments disequilibria, and lending to members in support of adjustment policies that minimize disruptions to national and international prosperity. In other words, the purpose of the SDR is to support the international monetary system and to smooth the international adjustment process.

Starting in the early 1960s, the concept of what became the SDR was discussed as a mechanism that could also be employed to address objectives additional to its primary purpose of supplementing the supply of reserves; for example, it was proposed to use the mechanism to provide financial assistance and spending power to low-income countries. Today echoes of these debates are heard from well-intentioned advocates of recycling the SDR issued in August 2021 to various worthy causes. In my view such proposals are unfortunate and unwieldly. They distract from the SDR's basic monetary purpose as international reserves. Use of the SDR for nonmonetary purposes is unwieldly due to the contortions necessary to do so: First, countries transfer their SDRs to the IMF or another institutional holder as prescribed by the IMF; second, that institution must take additional steps to mobilize the national currencies for use in their operations or to establish an elaborate structure on a capital base of SDRs while preserving the liquidity of the SDR. If countries want to support laudable activities such as climate adaptation or health infrastructure, they should do so directly and openly and not camouflage their support using their SDR holdings.

Total SDRs outstanding are SDR 660.7 billion, or $922.1 billion at the US dollar value of the SDR at the end of December 2021.[6] In the wake of the 2021 allocation, the SDR's share of foreign currency reserves plus SDR holdings in December 2021 was 7.1 percent, significantly less than the shares of the US dollar and euro (55 percent and 20 percent respectively) but a third more than the next largest share—the Japanese yen (IMF 2022f).

3 The interest rate is set weekly as the weighted average of the short-term government interest rates on the amounts of national currencies in the SDR basket. On September 30, 2022, the rate was 2.007 percent per annum. The SDR's value tracks a basket of fixed amounts of five currencies: the US dollar, Japanese yen, euro, pound sterling, and Chinese renminbi.

4 The transfer system has two tiers: First is a market managed by the IMF staff in which members that have voluntary trading arrangements (VTAs) accept SDRs from other members in exchange for their currency or one of the other currencies in the SDR basket. Second is a designation mechanism that comes into play when the IMF staff cannot identify another market participant. This second mechanism has not been used since 1987.

5 See IMF Articles of Agreement, Article I.

6 One SDR was then equal to $1.399593. On September 30, 2022, it was equal to $1.279880.

SDR allocations in 2009 and 2021 played a useful crisis management role. Many countries small and large, and low- and middle-income, used their SDRs through various mechanisms to relax the external financial constraint on their domestic economic policies and thus contributed to global economic and financial adjustment (see appendix B). As the IMF Articles of Agreement intended, SDR additions to existing reserve assets allowed members to address actual and potential maladjustments in their international payments while avoiding policies destructive of national or international prosperity.

If the SDR is going to continue to play its role in addressing economic disruptions, its share of international reserves should be at least maintained, thus avoiding the need to take emergency action after a crisis occurs. The most direct way of doing so is via annual allocations. SDR allocations are a zero-cost way of augmenting countries' international reserves without distorting the pattern of international payments by placing burdens on countries, in particular the United States, that issue international currencies. The managing director of the IMF is required to report to the governors of the IMF before the start of every five-year basic period on support, or lack of it, among IMF members for an SDR allocation during the forthcoming basic period.[7] Regular annual allocations would be consistent with the role envisioned for the SDR in the IMF Articles of Agreement, "the special drawing right [should be] the principal reserve asset in the international monetary system" (IMF Article VIII, Section 7).

Before turning to my proposal for annual SDR allocations and related proposals with respect to the SDR and the international monetary system, I will review the arguments against SDR allocations and provide my counterarguments.

ARGUMENTS AGAINST SDR ALLOCATIONS

The arguments against the SDR and its allocation have not changed substantially since the debates of the 1960s prior to the 1969 amendment of the IMF Articles of Agreement that established the SDR.

- SDRs are not needed today to meet a long-term global need to supplement reserve assets, which are plentiful and can be borrowed in the market.
- Use of SDRs is unconditional, contributing to moral hazard in countries' economic policy choices.
- SDR allocations in proportion to IMF quota shares lead to their maldistribution.
- SDR allocations add to global inflation.
- The geopolitical views of some member countries lead them to oppose any allocation of SDRs.

7 The 12th basic period started on January 1, 2022. SDR allocation need not be made during all five years of a basic period. The managing director also may propose an SDR allocation at any point within a basic period.

Long-Term Global Need

Opponents of SDR allocations cite the criterion embedded in the IMF Articles of Agreement that an SDR allocation must meet an identified long-term global need to supplement existing reserves.[8] The IMF "originalists" argue that the SDR was established in the context of the Bretton Woods fixed-exchange-rate system; today countries can borrow international reserves and/or allow their exchange rates to adjust—in other words, they can obtain unconditional credit from the markets. If they cannot borrow from markets, they are not creditworthy, and therefore, they should not have access to unconditional liquidity supplied by other countries via the SDR. Instead, they need IMF-supported programs of economic adjustment.

The argument that the end of the Bretton Woods fixed exchange rates undercut the case for a long-term global need falls before the fact that the second decision to allocate SDRs was in 1979. Only a year earlier, the IMF Articles of Agreement had been amended to permit floating exchange rates. In other words, a judgment was made that the SDR allocation provided benefits in the reformed international monetary system, which is today's system. Moreover, experience has shown that a current ability to borrow is neither necessary nor sufficient for judging a country's medium-term creditworthiness.

Lack of Conditionality

A second argument against the SDR is that a member's use of its SDR allocation is essentially without conditions.[9] Countries borrowing from the IMF must satisfy, or pledge to satisfy, conditions on their economic policies. The strength of those conditions depends on the depth of the country's problems, its current policies, its economic circumstances, and the facility or window from which it is borrowing.

The flaw in this argument is that using SDRs is not borrowing from the IMF. It is borrowing directly from other member countries, and the country using its SDR must pay interest to those countries. This argument is not about policy conditionality, it is about whether the IMF should be in the business of allocating SDRs. That decision was made in 1969 and has not been reversed. Moreover, the IMF is unable to place conditions on member countries' use of their owned reserves acquired either by borrowing or by generating current account or capital account surpluses. Why should the Fund have the power to place conditions on a member's use of its SDR holdings? Of course, all uses of reserves are subject to ex post review as part of the IMF's surveillance of members' policies and prospects.

8 IMF Articles of Agreement: Article XVIII, Section 1. Principles and considerations governing allocation and cancellation

> (a) In all its decisions with respect to the allocation and cancellation of special drawing rights the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world.

9 Technically, the country must have a "need" to use its SDRs and should not use them merely to diversify its reserve holdings, but these are not binding conditions.

Flawed Distribution of SDRs

The argument that the distribution of SDRs is flawed has been frequently heard from the other side of the SDR debate. In the 1960s representatives of some countries argued that SDRs should be allocated disproportionately to countries with the greatest need for additional international reserves—to emerging market and developing countries and low-income countries. Advanced countries would then have to acquire them by transferring real resources to those counties. This topic was revisited in the 1970s during the deliberations of the Committee on Reform of the International Monetary System and Related Issues (Committee of Twenty, or C-20) in the form of discussions of establishing a link between a portion of each SDR allocation and aid to low-income countries—an SDR/aid link.[10]

Today this argument has been turned on its head. Opponents of the 2021 SDR allocation argued that the allocation would go to countries that do not need additional international reserves and only a small portion of an allocation would go to, and be used by, low-income countries.

It is correct that the combined quota share of low-income countries currently has been constrained by agreement to be at least 3.3 percent of total quotas.[11] That the second part of this argument is incorrect is shown by the analysis presented in appendix B on SDR use following the 2009 and 2021 allocations. Although the low-income countries used a larger proportion of their new allocations, the middle-income emerging market and developing countries accounted for a much larger share of total use of those allocations. Between 85 and 90 percent of SDR use during the first eight months after these allocations was by middle-income countries.[12]

Opponents of SDR allocations also argue that the high-income countries do not need the SDR. However, the opponents do not explain what harm is done to the international economy and financial system by increasing these countries' SDR holdings. These countries do not have to use their SDRs, and they are free to lend them to other countries or to "recycle" their SDRs through loans to the IMF; for example, to the IMF's (2022b, 2022c) new Resilience and Sustainability Trust (RST).

SDR Allocations Contribute to Inflation

In the 1960s and 1970s, inflation was a major concern of policymakers in many countries and of the IMF as well. Until recently, inflation concerns have been quiescent, and we do not know whether current concerns will last more than two or three years.

But the inflation argument against SDR allocations has always been specious. The argument is that SDR allocations will be directly inflationary by adding to central bank liabilities and monetary aggregates or by stimulating global aggregate demand. The argument is unsupported by the historical evidence as well as the analysis by Richard N. Cooper (IMF 2011a) and others. In summary, allocations add to both the assets and liabilities of central banks; they do not

10 See IMF (1974).

11 This percentage is larger than what would be indicated by the IMF's current quota formula.

12 "Use" is defined as the gross declines in holdings of SDRs after the allocations.

increase the reserves that banks hold at the central bank. If the central bank supplies a currency other than its own in exchange for SDRs, that transaction takes place on the asset side of its balance sheet. If the central bank supplies its own currency in return for an increase in its SDRs, any transaction would be small relative to the stock of banks' reserves at those central banks accepting the SDR. Moreover, not all SDR transactions flow through the accounts of central banks. And they do not contribute to inflation if the central bank successfully pursues its basic policy objective of limiting inflation.

Even if many countries simultaneously spend their SDRs on goods and services after an allocation to support expansionary economic policies, the aggregate size of any effect would be trivial. Half the current stock of SDRs is less than $500 billion: That is less than one-half of 1 percent of global GDP, which is more than $100 trillion.

This argument against the SDR is an argument about the stock of international reserves, not about flow increases in reserves in the context of deficient global aggregate demand. It applies to countries' stocks of reserves in any form, of which more than 90 percent is in holdings of national currencies. It follows that even under current circumstances in which inflation has become a global challenge, those countries that might use their SDR holdings to support their economies are unlikely to provide much of a boost to global demand. Moreover, many of those countries have yet to recover from the adverse effects of the pandemic on economic activity in their economies.

The SDR Is against Our Philosophy

The broadest critique against the SDR is grounded in countries' attitudes toward international cooperation in general and international institutions of cooperation. This critique takes several forms.

First is opposition to foreign aid in any form. This criticism is not unique to participation in the SDR mechanism or membership in the IMF for that matter.

Second, at a technical level, opposition is grounded in the cost to the United States or to other countries holding more SDRs than their allocations because of their facilitating the use of SDRs by other members.[13] However, for the United States these costs are minuscule. For more than 20 years, the US Congress has required the US Department of the Treasury to report on the cost to the United States of participation in the SDR regime. In its latest report (US Department of the Treasury 2021), the total net interest cost to the United States—the difference between the interest the United States receives on its holdings of more SDRs than its allocations and the cost to the US Department of the Treasury of borrowing to supply dollars in exchange for those SDRs—has been $52 million (not billion) over the past 20 years, $2.6 million a year on average through the end of FY2020. On the other hand, over the same period the United States recorded a cumulated capital gain of $724 million on its holdings, or $36.1 million per year.

In a world in which many problems are not confined within national borders but there exist political pressures to put the short-term interests of a country first and undervalue the longer-term benefits of cooperation, knee-jerk opposition

13 See Adam Lerrick (2003) for this argument. He also focuses on the exchange value risk of holding excess SDRs.

to SDR allocations is not surprising. This opposition includes the view that some countries that will receive SDRs—such as Belarus, China, Iran, Russia, Syria, and Venezuela—do not share the political values of other members. As is reported in appendix B, almost all these countries have not used their SDR allocations—their holdings approximately equal their cumulative allocations. However, these countries' combined share of IMF quotas is only 10.8 percent, or 4.4 percent excluding China, which is a net holder of SDRs.[14] The question is: Should the benefits of an SDR allocation to the other 184 countries with 89.2 percent of quotas be denied because some countries that will potentially benefit do not, in the view of some, deserve to benefit? Those valuing the longer-term benefits of cooperation will answer no.

THE CASE FOR REGULAR ANNUAL SDR ALLOCATIONS

The case for moderate, regular annual allocations of SDRs has five main elements.

First, SDR allocations have zero cost to the recipient country until or unless it uses its allocation. SDRs are an insurance policy, in the form of a potential line of credit, with a low premium that only kicks in when the policy is activated via a transfer of SDRs to another holder.

Second, their cost is low compared with the positive resource costs of ex ante reserve accumulation via borrowing from global financial markets or devoting real resources to generate current account surpluses rather than domestic investment.

Third, from a global perspective, the accumulation of reserves in the form of SDR allocations involves less distortion of the global economic adjustment process than doing so via undervalued currencies and other policies that boost countries' current account positions.

Fourth, when SDRs are used, they do not disappear from the system. SDRs are outside assets in the sense that the assets cannot be extinguished, except via cancellation by the IMF. They move around within the system. In contrast, once spent on goods and services or to service debts, foreign currency reserves disappear from the system.[15]

Finally, the case for regular annual SDR allocations rests on the additional assumption that on average there is a continuing annual collective demand for increases in international reserves. International reserves consist of foreign currencies, SDRs, reserve positions in the IMF, and gold. Generally, gold is at the bottom of the pile and is excluded from most reports on total reserves. Reserve positions in the IMF vary with the need for other countries to borrow from the Fund. Increases in those positions are generally offset by reductions in foreign currency holdings, except in the case of countries such as the United

14 At the end of July 2022, China's SDR holdings exceeded its cumulative allocations by 8.1 percent, reflecting its capacity to draw on its substantial holdings of foreign exchange reserves in exchange for SDRs. (On the same date, the excess holdings of the United States were only 4.1 percent.) However, the concern about China is also that countries will use their SDRs to repay debts to China or Chinese entities that otherwise should be rescheduled.

15 Clark and Polak (2004) note that this last advantage reduces the systemic risk associated with relying on borrowed reserves in addition to their efficiency gains by substituting for other means of accumulating reserves.

States or members of the eurozone that may provide their own currencies rather than reduce their foreign currency holdings when their quotas are tapped for IMF lending.

Thus, in the absence of an SDR allocation, the annual change in total holdings of foreign currencies is one proxy for the annual demand for increased international reserves.[16] The annual changes in those holdings have different signs and vary in size from year to year. For example, from the end of 2013 to the end of 2021, the total increase was about $1.2 trillion, an annual average of only $155 billion; holdings declined in four of those eight years. However, from the end of 2016 to the end of 2021, the total increase was $2.2 trillion, an annual average of $442 billion; holdings rose in all but one of those years (IMF 2022f).

The IMF (2021c) projected a 13 percent increase in global demand for international reserves from 2020 to 2025—the midpoint in a range of $1.1 to $1.9 trillion, or $300 billion a year.[17] A bit more than 40 percent of that increase was met by the SDR allocation of $650 billion in 2021. During the remaining four years (2023-25) of the 12th basic period, the US secretary of the treasury in principle could vote for another $650 billion SDR allocation, or $152 billion each year, without the prior consent of the US Congress.[18] My illustrative figure is not extreme. Richard N. Cooper (2010) suggested the possibility of regular annual SDR allocations of $200 billion a year.

It is also possible, but by no means assured, that in the wake of the sanctions applied on Russia following its invasion of Ukraine, countries' demand for reserves in the form of assets denominated in national currencies will decline, and the attractiveness of a neutral asset such as the SDR will increase. Time will tell.

The central question in analyses of the demand for increases in international reserves is whether that demand is (1) motivated by the need for additional insurance against an uncertain future; (2) the by-product of mercantilist policies directed at increasing exports, reducing imports, and running trade and current account surpluses; or (3) a passive response to national and international economic and financial developments. The literature's answer to this question is far from definitive. Ghosh, Ostry, and Tsangarides (2016), for example, found support for three hypotheses: precautionary demand against current account crises, precautionary demand against capital account crises, and mercantilism. However, no one explanation dominated their results, and each explanation was more strongly supported in some periods for some countries than others.

Analyses of the 2009 and 2021 SDR allocations for periods longer than those summarized in appendix B should provide some fresh answers to these long-standing questions. They should also shed some light on the role of the SDR in smoothing the global adjustment process. Studies of these allocations would

16 The data (IMF 2022f) reflect the effects of changes in exchange rates on the dollar value of reserves denominated in non-dollar currencies.

17 In 2021 foreign currency reserves increased by only $220 billion (IMF 2022f).

18 US law limits the treasury secretary from voting for increases in US holdings of SDRs that exceed the US quota in the IMF during any basic period. Consideration of SDR allocations is for five-year basic periods. The 12th basic period began in January 2022. The Congress has 90 days to override a secretary's decision to vote for an SDR allocation that meets this legal test.

have to deal with the fact that they were made under crisis circumstances. A trial period of annual SDR allocations under more settled conditions might shed more consistent light on these important issues.

INCREASING THE ATTRACTIVENESS OF SDR ALLOCATIONS

To increase the attractiveness of SDR allocations, the IMF management, staff, and members should rethink the role of the SDR in the international monetary system and how to make the SDR as a reserve asset more usable.[19] For example, the traditional view is that the SDR is a reserve asset, reserve assets must be liquid—requiring that they can be immediately converted into foreign currencies at face value—and the reserve asset status of the SDR must be preserved.

One can understand and appreciate why in the early days of the SDR supporters were determined that the SDR would be as "reserve-like" as other reserve assets. The definition of reserve assets is:

> Reserve assets are those external assets that *are readily available* to and *controlled* by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rates, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as the basis for foreign borrowing). (IMF 2013, 111; emphasis added)

To insist in 1969 that the SDR satisfy the definition of a reserve asset was fundamental to the role envisaged for it in the international monetary system at the time. Great pains were taken that the SDR could be easily exchanged for convertible currencies at fair value. Reserves, technically outside reserves, were scarce, which was a major rationale for the SDR. Today, in contrast, many countries have large total holdings of reserves but small holdings of outside reserves. Moreover, what countries call reserves does not always match the official definition. They may be invested in corporate bonds or the bonds of development finance institutions that are not "readily available" in the sense that they can be converted into cash at short notice and at their balance sheet value. Indeed, many countries segment their reserve portfolios into liquid assets and investments.[20]

To facilitate members' more flexible use of their SDR holdings, the IMF might rethink whether use of SDRs must preserve their "reserve asset" character. In a more contemporary approach, a member country should be free to lend its SDRs to another country, the IMF, a development bank, or some other approved holder without strings attached to preserve the "reserve asset" character of the SDR.[21] In other words, member countries might be set free to treat SDR holdings the same way they treat their other holdings of reserves, some of which are less liquid than others, and to decide for themselves whether the SDR should be at the top, the bottom, or the middle of their piles of reserves.

19 The last such review was conducted by the IMF (2018) and focused on multiple roles for the SDR.

20 See Lazard (2022).

21 Credit risk ad provisions governing the repayment of loans of SDRs via set-asides are separate matters.

Some critics will observe that the central bank holders of SDRs will object. However, a country's central bank does not always hold its SDR allocation; the finance ministry sometimes does, as in the case of Japan, the United States, and United Kingdom. Even when the central bank holds the SDR and other reserve assets, its management of those assets is often subject to direction, formal or informal, from the country's finance ministry. The finance ministry may emphasize its interest in maximizing the return on a country's reserves, which is why a portion of them may be held in illiquid assets that do not meet the technical definition of reserves.

One specific reform of the SDR would be to raise the interest rate on SDR assets and liabilities. If this reform were adopted, some opponents of the SDR might modify or reverse their opposition to SDR allocations. Conceptually, the SDR is an asset that countries use to access international liquidity. But the SDR also is a long-term or perpetual liability. A country that activates all or part of its SDR holdings must pay interest of its net use of the SDR—the extent to which its holdings are less than its cumulative allocations. Because of the low interest rate on net use of SDRs, such usage involves a long-term subsidy to most net users of SDRs. In effect, these countries engage in long-term borrowing of currencies from other members of the IMF at a low short-term rate.

The provision of foreign currency in exchange for SDRs also imposes a fiscal or opportunity cost on the country facilitating the mobilization of another country's SDRs. To provide foreign currency to the SDR user in exchange for increasing its SDR holdings, the country must forgo earnings on its reserve assets, which generally yield more than the SDR interest rate.[22] From another perspective, raising the interest rate on the SDR closer to a market rate would reduce a distortion in the system.

Table 2 illustrates two alternative SDR interest rates: (1) the weighted average of the long-term interest rates for issuers of the currencies in the SDR basket; and (2) a 50-50 blend of that average with the SDR interest rate based on their short-term interest rates. For the period 2000-2008, the SDR-basket weighted average long-term interest rate for four of the five issuers of currency in the basket exceeded the SDR interest rate by an average of about 130 basis points.[23] For the period 2009-19, the difference was about 187 basis points. A 50 percent blend of the two rates would have cut these differences in half.[24]

22 The United States or a country in the eurozone may supply its own currency, but that too must be borrowed locally at a rate that averages more than the country's short-term interest rate.

23 The source—Organization for Economic Cooperation and Development, Monthly Monetary and Financial Statistics—does not provide a comparable long-term interest rate for China. However, the average of 2020 10-year rates for the five currencies using the SDR basket weights produces an average of only 7 basis points higher than one excluding the higher Chinese rate. Using 10-year rates slightly overstates the average cost of funds to these countries. The US Department of the Treasury (2021) uses the average cost of funds to calculate the fiscal cost to the United States of participating in the IMF, including with respect to the SDR.

24 At the end of September, the comparable gap between the long-term rates of the four currencies in the SDR basket exceeded that SDR rate by 108 basis points, and for the five currencies 105 basis points. Source of long-term rates: Bloomberg.

Table 2
Alternative SDR interest rates, 2000-2019 (percent)

Interest rate	Average 2000 to 2008	Average 2009 to 2019
SDR rate	2.945	0.358
Long-term rate	4.252	2.223
50 percent blended rate	3.598	1.291
Memo: EMBI yield	8.921	5.864

SDR = special drawing right; EMBI = Emerging Market Bond Index

Note: The long-term interest rate is the weighted average of the long-term rates of the euro area, Japan, the United Kingdom, and the United States using the 2015 weights in the SDR basket, rescaled.

Sources: International Monetary Fund and Organization for Economic Cooperation and Development, Monthly Monetary and Financial Statistics.

These figures illustrate the cost to countries that accept SDRs, given their own borrowing costs or earnings on foreign exchange reserves. They also illustrate the extent of the subsidy associated with SDR use. Interest rates on external borrowing by emerging market and developing countries are substantially above both figures. The average Emerging Market Bond Index (EMBI) yield for 2000-2008 was 8.921 percent, and for 2009-19 it was 5.864 percent.[25] These rates exceeded the 50-50 blend rates by 532 and 457 basis points respectively.[26] On December 31, 2020, the average yield on the broader Emerging Market Bond Index Global (EMBIG) index was 4.55 percent.[27] For the period 2016-19, the average yield of only 3 of 55 constituent countries in the broader EMBIG index was less than 3 percent—Poland, Latvia, and Slovak Republic—compared with an average SDR rate of 63.5 basis points and the SDR weighted average long-term rates on the sovereign debt of four of the five currencies in the basket of 1.53 percent.[28]

Thus, under this proposal, the subsidy element for use of the SDR, and the opportunity cost to those accepting the SDR, would remain, albeit slightly reduced. Under the blend option during 2009-19, the subsidy would have been reduced by only 17 percent on average for countries in the EMBI index. The increase in their interest payments on these perpetual loans would be very small. As of September 2022, the SDR holdings of 19 of the 26 low-income countries were less than their allocations; they were net users of their SDRs (table B.7 in appendix B). Use of the 50-50 blended SDR interest rate (2.40 percent) rather than the SDR interest rate (1.84 percent) for that month would have increased their collective annual interest payments from $88 million to $114 million.

25 *Source:* IMF staff.

26 At the end of September 2022, the comparable excess was 517 basis points.

27 *Source:* State Street Global Advisors.

28 *Source:* Data from the Institute of International Finance. The average yield for Poland was 2.73 percent, for Latvia 2.25 percent, and for the Slovak Republic 2.35 percent.

It should be noted that the countries that are net users of their SDR allocations and the countries that hold more SDRs than they have been allocated do not fit in simple categories in terms of their income groups. At the end of September 2022, about a third of the 190 members of the IMF were net holders of SDR—their holdings exceed their cumulative allocations. They included 7 of the 26 low-income countries, 12 of the 54 lower-middle-income countries, 11 of the 54 upper-middle-income countries, and 33 of the 56 high-income countries.[29] Two-thirds of members were net users of their SDRs—their holdings were less than their allocations. Thus, it would not be only the low-income countries that would experience an increase in their interest payments on their use of SDRs if the interest rate were raised. A broader range of countries might therefore resist an increase in the SDR interest rate.

With respect to countries that have increased their SDR holdings and presumably would be expected to increase their holdings further if there were regular annual allocations, this reform would help blunt the criticism of the unconditional nature of SDR credit by raising its cost. It would also help blunt the criticism that countries increasing their SDR holdings and providing currency in exchange bear an interest cost.

The SDR interest rate is the same as the rate of remuneration on the IMF's use of a member's currency in its normal lending operations from the IMF's general account.[30] Under my proposal that link would have to be severed. However, those lending operations are conditional, and the credit advanced must be repaid, in contrast with use of SDRs. It follows that differential interest-rate treatment would be appropriate. The SDR interest rate is 100 basis points below the basic interest rate on borrowing from the IMF. This means that it is cheaper for a country to mobilize its SDRs than to borrow from the IMF, and borrowing from the IMF normally is associated with conditions on the borrower's economic policies. Although the size of a country's holdings of SDRs may be less than its need to borrow from the Fund, limiting the scope for this type of arbitrage, it is anomalous that the cost of conditional borrowing from the Fund is more than the cost of a country's unconditional use of its reserves.

A counterproposal that might reduce opposition of some IMF members to regular annual SDR allocations would be to reintroduce the reconstitution requirement as suggested by James M. Boughton (2015). That requirement obligated a member to hold a specified percentage, initially 30 percent, of its SDR allocation on average during the basic period. Aside from the mind-boggling chore of keeping track of members' compliance with this obligation, it is inconsistent with the monetary character of the SDR and inconsistent with the SDR's playing a larger role in the international monetary system.

SUPPORTING PROPOSALS

To support the SDR's role in the international monetary system and its evolution, I propose two technical changes in the procedures for activating SDR holdings and in the general operation of the IMF. First, expand the list of freely usable

29 See table B.7.

30 The rate of charges (borrowing from the general resources account) is 100 basis points higher than the rate of remuneration.

currencies, and second, encourage members that issue these currencies to provide their own currencies rather than US dollars in exchange for SDRs under the system of voluntary trading arrangements (VTAs).[31] These reforms would promote the adaptation of the SDR as called for by Boughton (2015). They would also help promote the SDR's role in the international adjustment process by reducing the demand for US dollars, which tends to appreciate the dollar and expand the US current account deficit.

Expand the List of Freely Usable Currencies

The number of currencies classified as freely usable by the IMF should be expanded from the current five that are included in the SDR basket. This change would on the margin facilitate the mobilization of SDRs, support the evolution of the international monetary system by recognizing its multicurrency evolution, and reduce the burden on the US dollar.[32] This change would also recognize the evolution of the international monetary system and the increasing role of nontraditional reserve currencies as described by Arslanalp, Eichengreen, and Simpson-Bell (2022).

The combined share of quotas of IMF members issuing the freely usable currencies in the SDR basket is 56 percent. If the Australian and Canadian dollars and the Swiss franc were classified as freely usable currencies, the quota share of such currencies would increase to 61 percent. These three currencies have long been included in the IMF's survey of the currency composition of foreign exchange reserves.[33] They account for more than 4 percent of the allocated total (IMF 2022f). The Singapore dollar and Swedish krona should also be classified as freely usable currencies. Each of these currencies as well as the eight others accounts for more than 2 percent of over-the-counter foreign exchange turnover in the most recent BIS (2022) survey.[34] Including these currencies on the list of freely exchangeable currencies would further boost the quota share of countries issuing them to 63 percent.

Expanding the number of freely usable currencies would not imply an increase in the number of currencies in the SDR basket. Issuance of a freely usable currency is a necessary but not sufficient condition for its inclusion in the basket.[35]

31 SDR transactions can also take place via bilateral agreements between members. Under a VTA a member agrees, in principle, to purchase SDRs from or sell SDRs to another member up to specified upper and lower limits on its holdings as a percentage of its allocations. A member does not commit to agree to every transaction proposed by the IMF, which manages the system. As of September 20, 2022, 39 members and one prescribed holder (the European Central Bank) have VTAs in effect.

32 I advocated this reform in Truman (2021).

33 The IMF Articles of Agreement, Article XXX, Section (f), defines a freely usable currency as one determined to be "in fact, widely used to make payments for international transactions and . . . widely traded in the principal exchange markets."

34 Shares of turnover sum to 200 percent because there are two currencies on each side of a transaction.

35 To be included in the basket, the currency also must be issued by a country whose exports of goods and services in the most recent five-year period have the largest value. The Fund currently applies this criterion to the top five countries or monetary unions.

Encourage Issuers of Freely Usable Currencies to Provide Them in IMF Operations

IMF members that issue freely usable currencies should also agree to provide their own currencies in exchange for SDRs or when they are called on to finance borrowing from the IMF. This presumption would both promote the liquidity of the SDR and support the evolution of a more robust multicurrency system.

Current IMF procedures governing valuation in transactions converting SDRs into national currencies are outdated. Those procedures limit the currencies that may be supplied in exchange for SDRs to freely usable currencies. This list is restricted to the five currencies in the SDR valuation basket; in the transaction, the supplier of the SDR is generally given its currency preference, normally the US dollar. The reality is that the depth and breadth of foreign exchange markets ensure that IMF members will receive fair value when converting any currency from an expanded list of freely usable currencies to another freely usable currency in exchange for their SDRs. The case for requiring the IMF or member countries to internalize the small transactions costs in foreign exchange transactions is an anachronism.

THE 2023 QUOTA NEGOTIATIONS AND THE SHARE OF LOW-INCOME MEMBERS

The IMF's resource structure is decaying. IMF members regularly solemnly commit themselves to the principle that the IMF is a quota-based institution. But the last agreement to increase the IMF's quota resources was in 2010, and it was only implemented in 2015. The 15th review of IMF quotas failed to produce an increase in quotas. Instead, the Fund's access to borrowed resources shifted from temporary bilateral agreements to the more permanent New Arrangements to Borrow. Consequently, quota resources continue to account for less than 50 percent of resources available for nonconcessional IMF lending operations. The semipermanent new arrangements to borrow account for 39 percent. Bilateral borrowing arrangements, which are temporary, are the last-ditch source of 15 percent (IMF 2022e).

Members have agreed to complete the 16th review of IMF quotas by December 15, 2023. An increase in total quotas and a redistribution of quota shares in the direction of faster-growing members is crucial to maintaining the IMF's central role in the international monetary system that it has occupied for more than 75 years. Nevertheless, the outcome of this Rubik's Cube-type of exercise is uncertain. Geopolitical conflict could well block agreement. The United States and Japan may oppose a significant or any increase in China's IMF quota share, and European members of the IMF, which as a group have an oversized quota and voting share, would be delighted to hide behind them.

The 16th review could end in a stalemate. Such an outcome would have adverse consequences for the IMF and the future of international economic cooperation. If the review successfully increases total quotas, it also will boost the combined quota share of emerging market and developing countries as a group because their faster growth rates since the last agreement on increased quotas in 2010 will result in larger calculated quota shares. Therefore, their share of any future SDR allocation will also increase.

In the 14th review of IMF quotas in 2010, the quota shares of 54 lower-income member countries were protected from declines. Their combined quota share was held at 3.3 percent. My proposal is that as part of the hoped-for agreement in the 16th review, the combined quota share of the low-income countries should be boosted to 6.6 percent.[36]

This initiative would have two major implications. First, these countries as a group are frequent borrowers from the IMF because of their economic and financial vulnerability. Increasing their quota shares would expand the scale of support that they can receive from the IMF in programs linked to policy reforms. Second, as a by-product these countries would receive a larger share of SDR allocations when those allocations occur. This would contribute on the margin to what some observers consider a more equitable distribution of an SDR allocation and obviate some of the need to go through the contortions of SDR recycling that have been associated with the 2021 SDR allocation.

A successful outcome to the 16th review of IMF quotas is a long shot. Including my proposal in that outcome is a longer shot. However, my objective is to stretch readers' minds when they think about the future of the IMF and the SDR's role in that future.

CONCLUSION

The core argument in favor of my proposal for regular annual SDR allocations is that they are superior to endogenously generated reserves in that they are outside assets that are costless, continually available, and reasonably liquid, and they reduce pressures on countries to add to their foreign currency reserves by running larger current account surpluses (or smaller deficits) that divert domestic saving from needed domestic investment and distort the international adjustment process.

I have analyzed the arguments against SDR allocations and demonstrated that they are weak. I recommend an in-depth review of the SDR and its traditional role in the international monetary system. I also have made a specific proposal to address at the margin one of the criticisms of SDR allocations. Raising the SDR interest rate would increase the financial conditionality of SDR use and reduce the costs to those providing hard currencies in exchange for SDRs. I have also proposed expanding the list of freely usable currencies and the role of these currencies in the operation of the IMF, including in the VTA system. These changes would enhance the multicurrency aspect of the international monetary system. Finally, I have proposed doubling the quota share of low-income members in the forthcoming quota review. This would provide more scope for lending to these countries with policy conditions and would tilt the distribution of SDRs toward them without dramatic, negative macroeconomic consequences. Each of these reforms would benefit all IMF members by contributing directly and indirectly to enhancing the international monetary system.

36 These figures are illustrative because the list of the "poorest and smallest members" (IMF 2020, 6) have not yet been decided for the 16th quota review. Regardless of the list of such countries used in the 16th review, their combined quota share from the 14th review is larger than what any new formula is likely to produce.

I have focused in this paper on the role of the SDR as an official asset rather than as a market instrument or a unit of account becoming more like a currency.[37] In my view a necessary condition for an expansion of the SDR's role in these other areas is that the SDR first become more than a crisis management instrument.

None of my proposals require an amendment to the IMF articles. They focus on enhancing the originally intended role for the SDR.

If there were an appetite among IMF members for more substantial reforms affecting the SDR, such as establishing a different key for allocations of SDRs, that would require an amendment of the Articles of Agreement, which is always a long and tortuous process.

Another reform that would require an amendment of the articles would be to pre-position an SDR allocation to be triggered by a more than 50 but less than 85 percent majority vote of the IMF executive board on the recommendation of the managing director (Cooper 2011). This reform could also be introduced without an amendment. IMF governors could approve by the required 85 percent majority an allocation of SDRs up to a specified amount to be triggered by the recommendation of the managing director that was approved by a pre-agreed, but less than 85 percent, majority vote of the executive board.

I have rejected the proposal to reinstitute the reconstitution provision as inconsistent with the monetary role for the SDR. I have also not considered the proposal to establish a substitution account of SDRs for members' holdings of US dollars and other national currencies. There may have been a case for that proposal in 1974 and 1980, when it was considered but failed to generate the necessary support. Today the increased number of traditional and nontraditional reserve currencies that have developed without adverse consequences for the working of the system weakens that case further.

I have also not touched on the proposal of Jacques J. Polak (1996) to transform the IMF into an entirely SDR-based institution operating more closely like a national central bank. For better or worse, the current reality is that countries are not ready to embrace a global central bank.

My proposals are evolutionary rather than revolutionary or counterrevolutionary.

37 For a recent discussion of promoting an expanded role of the SDR in the international monetary system, see Coats (2021) and also IMF (2011a, 2018).

APPENDIX A
A BRIEF HISTORY OF THE SDR

In the United States, SDRs are unknown outside of a small circle of aficionados and a slightly larger group of politicians and their staff, who sometimes have only a superficial and inaccurate understanding about the instrument. In brief, SDRs are allocated by the IMF to its members in proportion to shares of their paid quotas.[38] SDRs are international reserve assets as well as liabilities, but they are not a currency. SDRs exist in a closed system and a structure that constrains their issuance and use.[39] Members can transfer SDRs to other members in exchange for convertible, or hard, currencies to meet their external financial needs. They can also transfer SDRs to the IMF or to other members of the Fund to meet their obligations.[40]

Robert McCauley once quipped to me that the SDR is a Rorschach blot test: a mechanism to augment international reserves to aid the global adjustment process, a source of aid for poor countries, a potential and preferable rival to the US dollar as a reserve asset and a currency, a unit of account to increase the liquidity of sovereign bonds, or all the above and more. The focus of this paper has been on the first, historic role of the SDR as supporting the global economy and adjustment process.[41]

The SDR has had a tortured 60-plus-year history. Its birth followed intense, protracted discussions during the 1960s. Two allocations were agreed to during the first decade of its existence. During the following three decades, the SDR struggled to remain relevant. During the 2008-10 global financial crisis and the COVID-19 pandemic, SDR allocations were revived.

38 The SDR's value tracks a basket of specified amounts of five currencies: the US dollar, Japanese yen, euro, pound sterling, and Chinese renminbi. Each member pays or receives interest on the difference between its cumulative allocation and its current holdings of SDRs. The interest rate is set weekly as the weighted average of the short-term government interest rates on the amounts of national currencies in the SDR basket. On September 30, 2022, the interest rate was 2.007 percent per annum, and the US dollar value of the SDR was $1.279880. If a member cannot meet its SDR interest obligation, the SDRs are temporarily created to cover the obligation until the member corrects its arrears.

39 Pforr, Pape, and Murau (2022) write about the "SDR system."

40 Members can also engage in SDR transactions with other prescribed holders of SDRs, of which there are currently 15, including international development institution the European Central Bank.

41 Other potential features of the SDR may be useful by-products, but without the SDR playing its original role, it is difficult to argue convincingly that it would be positioned to play any other role.

Birth of the SDR[42]

A fundamental reform of the international monetary system has long been overdue. Its necessity and urgency are further highlighted today by the imminent threat to the once mighty U.S. dollar.

—Robert Triffin, December 8, 1960[43]

The 1960 presidential campaign between John F. Kennedy and Richard M. Nixon unfolded against the backdrop of increasing concerns about US post-World War II political and economic dominance, including the technological advances of the Soviet Union and the weakness in the US balance of payments.

Although the United States had current account surpluses throughout the 1950s, US net private capital outflows exceeded those surpluses. Under the Bretton Woods international monetary system of par value exchange rates pegged to the US dollar, other countries were required to acquire dollars to prevent their currencies from appreciating. The result was a buildup of official claims on the United States. Some countries used those dollars to buy gold from the United States. France was a major purchaser of gold. Other countries let their dollar holdings accumulate.

Robert Triffin (1959a, 1959b, 1959c, 1960a, 1960b) foresaw a dilemma for the United States and the international economic system: Either official dollar holdings would soon exceed the remaining US gold stock, precipitating a run and a crisis, or the United States would act preemptively and tighten its macroeconomic policies to increase its current account surpluses and stem the outflow of dollars, precipitating an unwelcome contraction of the global economy.

Shortly after Triffin sounded his warning, private and official groups began to meet to discuss the issues and proposals that he and others had raised, including exchange rate flexibility. They issued reports about the future of the international monetary system and what to do to undergird it. In 1965 the United States became more open to considering proposals for a supplementary reserve asset. This openness coincided with a change in leadership at the US Department of the Treasury from Secretary C. Douglas Dillon and Under Secretary for Monetary Affairs Robert Roosa to Joseph Fowler and Fredrick Deming.[44] The shift in the US position was endorsed by their predecessors and coincided with increased US concern about the future of the other principal reserve asset—sterling.[45]

Representatives of the finance ministries and central banks of the G-10 countries began an intense series of meetings. The SDR negotiations concluded in March 1968. Not entirely coincidentally, this was the same month in which

42 For more detail on this and the following section, see Solomon (1982) and De Vries (1976, 1985).

43 Triffin 1960b, 233. Triffin's analyses appeared in Triffin (1959a, 1959c) and were reprinted in Triffin (1960a). He also appeared before the Joint Economic Committee the year before (Triffin 1959b). Triffin (1978) provides a nice history of the evolution of his thinking.

44 Solomon (1982, 82) reports a statement by Fowler in July 1965 that President Lyndon B. Johnson had authorized him to say, "The United States now stands prepared to attend and participate in an international monetary conference that would consider steps we might jointly take to secure substantial improvements in international monetary arrangements."

45 Solomon (1982) reports that in June 1965, shortly before the Fowler statement, Johnson had established a study group chaired by the undersecretary to develop the US position in the monetary negotiations and to consider the special situation of the United Kingdom.

the central banks of the eight countries participating in the London gold pool disbanded that arrangement. This briefly inaugurated a two-tier gold price regime in which official transactions continued to be at $35 per ounce. In early 1969 the SDR amendment to the IMF Articles of Agreement came into force with five major provisions.

- An 85 percent weighted majority vote was necessary to allocate SDRs based on the managing director's prior assessment that there was broad support for an allocation.[46]
- The decision had to satisfy the criterion of a long-term global need to supplement existing reserve assets.
- The SDR's value was set at 1/35 troy ounce of fine gold, which at the time was equivalent to the fixed price at which the United States would sell gold to or buy gold from official holders of dollars at $35 per ounce.
- A member's use of SDRs was subject to a requirement that its holdings be reconstituted to average 30 percent of its cumulative allocations over each five-year basic period.
- The initial SDR interest rate was 1.5 percent per annum.

The First Decade of the SDR

In my judgment, the experience up to now with the operation of the special drawing rights facility has been highly successful, and it can be stated that the SDR has become established as a reserve asset.

—Pierre-Paul Schweitzer, September 21, 1970[47]

IMF members acted quickly and in October 1969 agreed to the first SDR allocation. They agreed to a second allocation in 1978 after the collapse of the Bretton Woods exchange rate system, the 1976 agreement on a partial reform of the international monetary system, and a succession of global economic shocks.

The First SDR Allocation

In October 1969 the first SDR allocation of SDR 9.3 billion over the next three years was approved (see table 1).[48] It was justified on the grounds that over the previous four-year period ending in 1968, international reserves had declined by $4.4 billion. During the same period the US gold stock had declined by a further $4.6 billion, and $2 billion in total official gold holdings had been used to support the London gold pool before that support was terminated in March 1968 with the creation of the two-tier price system.

46 The requirement of an 85 percent majority was unrelated to the US voting share at the time; the US voting share was more than 20 percent. The requirement allowed a group of European countries to block such a decision.

47 De Vries 1976, 207.

48 The plan was to allocate SDR 3.5 billion in 1970 and SDR 3.0 billion in 1971 and 1972, but China (Taiwan) declined to receive its allocation even though it had joined the facility, with the result that only SDR 9.3 billion was allocated. These figures were in the middle of a suggested range of SDR 2.5 billion to 4.0 billion per year and were intended to provide an increase in international reserves of about 4 percent per year, about 70 percent of the annual demand for reserves of 5 to 6 percent per year as projected by IMF staff (De Vries 1976, vol. 2, 258-9).

The establishment and initial allocation of SDRs were not without controversy. In addition to continued French opposition and warnings about the continued precariousness of the US international accounts, the developing countries, supported by the United Nations Conference on Trade and Development, pushed unsuccessfully to establish a connection between an SDR allocation and increased aid flows to developing countries.

The SDR and International Monetary Reform

After the United States closed its gold window, the international monetary system entered a transitional period. The US dollar was devalued against gold as part of the Smithsonian Agreement in December 1971 and was devalued again in February 1973. A month later the widespread managed floating of the major currencies was accepted as a temporary measure that eventually became permanent. From 1972 to 1974 the C-20 unsuccessfully sought to agree on a comprehensive reform of the system. It reached a measure of agreement on an Outline of Reform (IMF 1974). The outline contained many elements that were subsequently implemented. However, the resulting second amendment of the IMF Articles of Agreement was not agreed until January 1976 and only became effective on April 1, 1978.

The SDR and the Outline of Reform

The C-20 Outline of Reform included several recommendations concerning the SDR that were included in the second amendment to the Articles of Agreement.

The most prominent recommendation was not only to retain the SDR but also to promote its role in the reformed system. Margaret de Vries (1985, 262) characterized the resulting system in the amended articles as one based on an "SDR standard" that replaced the gold, gold-exchange, and dollar standards of the past. Today most analysts (some with regret) would say that the international monetary system is firmly based on the dollar standard. The amended articles also obligated members to collaborate with the Fund and other members with the objective of "making the special drawing right the principal reserve asset in the international monetary system."[49]

In addition to endorsing an SDR standard, the C-20 also revisited the question of linking SDR allocations to international financial assistance. The C-20 deputies established the Technical Group on the SDR/Aid Link and Related Proposals (IMF 1974).[50] In 2020-22, echoes of the deliberations of the technical group have been heard in proposals to recycle some part of the $650 billion 2021 allocation of SDRs on a voluntary basis from advanced to low-income countries.

49 IMF Articles of Agreement, Article VIII, Section 7

> *Obligation to collaborate regarding policies on reserve assets*
> Each member undertakes to collaborate with the Fund and with other members in order to ensure that the policies of the member with respect to reserve assets shall be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system.

This obligation is repeated in Article XXII.

50 I served on this technical group. For more on the C-20, see Truman (2017).

The technical group met in June and July 1973. Representatives of developing countries favored the position that a portion of an SDR allocation intended for the developed countries be channeled first to the developing countries (the "link"). Their fallback position was to channel a portion of the allocation directly or indirectly from the advanced countries to the development finance institutions such as the World Bank or regional development banks. The technical group considered illustrative shares of 15, 30, and 50 percent of any SDR allocation that might be dedicated to link treatment.[51]

The C-20's Outline of Reform addressed the fundamental question of whether the SDR should also be an aid instrument and stated, "It is generally agreed that if a link were established the amount of SDR allocations and the principal characteristics of the SDR should continue to be determined solely on the basis of global monetary requirements" (IMF 1974, 47).

The Second SDR Allocation

The 1970s were a decade of economic and financial turbulence. Following the collapse of the Bretton Woods system, wide swings in bilateral and effective exchange rates were common, petroleum prices soared, inflation rose, the global economy experienced a near recession in 1975, current account imbalances widened, and external financial crises became more common (most prominently, crises in systemically important countries like Italy, Mexico, the United Kingdom, and the United States). The IMF was in the center of cooperative efforts to address countries' external financing problems throughout this period.

Multiple initiatives to augment IMF resources for program lending pushed aside consideration of another SDR allocation. There was no allocation in the second five-year basic period (1973-77). However, in 1976 IMF managing director Johannes Witteveen began consultations on an allocation in the third basic period (1978-82).

Meanwhile, the executive board modified two aspects of the SDR. In June 1974 the interest rate was set at 50 percent of the weighted average of the five major currencies in the 16-currency basket valuation of the SDR—the US dollar, the German mark, the pound sterling, the French franc, and the Japanese yen. This decision produced an interest rate of 5 percent. In June 1976 the interest rate on the SDR was raised from 50 to 60 percent of the short-term market interest rates of the five major currencies. In August 1978 the rate was raised to 80 percent.[52] At the that time, the reconstitution requirement was reduced to 15 percent from 30 percent. These steps helped lay the groundwork for a grand bargain in September 1978 on the seventh quota review and the allocation

51 It is probably a coincidence, but the G-7 leaders' communiqué (G7 2021) on June 13, 2021, called for contributions, including from rechanneling SDRs to the IMF's PRGT of $100 billion, 15 percent of the $650 billion allocation of SDRs.

52 The rate of remuneration on IMF use of members' quotas had been the same as the SDR interest rate, but it was reduced to 90 percent of the SDR interest rate.

of SDR 12.1 billion in 1979-81, raising the total outstanding to SDR 21.4 billion ($27.9 billion at the dollar value of the SDR on average in 1980).[53]

At the end of the 1970s, with the US dollar continuing its prolonged period of weakness, proposals resurfaced to substitute some or all outstanding official holdings of US dollar and potentially other currency assets with SDRs issued by an account in the IMF.[54] In 1980 the United States and the principal creditor countries failed to reach agreement on how to cover possible financial losses of the account. Holders of US dollar assets in the emerging market and developing countries also were unenthusiastic about receiving a lower return on their reserves in the form of SDR-denominated claims on the account than on their reserves in US dollar balances.[55]

The second allocation of SDR in 1979-81 solidified the SDR as a component of the post-Bretton Woods international monetary system. The SDR's survival inspired De Vries (1985) to title part 11 of her history of the IMF from 1972 to 1978 "Resurgence of the SDR in 1978."

Struggles of the SDR

Evolution of the SDR: Paper Gold or Paper Tiger?

—James M. Boughton[56]

The SDR struggled for support and relevance throughout most of the 1980s and 1990s. Representatives of developing countries continued to press for a resumption of SDR allocations, but the advanced countries expressed little interest until late in the 1990s. IMF management and staff did succeed in convincing the executive board to adopt measures to increase the attractiveness of the SDR. In 1980 they decided to raise the interest rate on the SDR to 100 percent of the weighted average of the short-term interest rates of the countries with currencies in the SDR basket as of May 1981. At the same time, the number of currencies in the basket was reduced to five. The SDR rate still did not track market rates closely, because it was reset quarterly, and even today the rate is reset only weekly. In April 1981 the reconstitution requirement was abrogated—reduced to zero. In 1987 the Fund implemented a voluntary exchange market for the SDR in which holders of SDRs could exchange them for currencies and did not have to assert a balance-of-payments need.[57] All members of the IMF had become members of the SDR department, and use of SDRs increased somewhat even though the stock of SDRs remained small.

53 The staff report on the proposal estimated the demand for additional reserves over the next five years at SDR 20 billion a year (De Vries 1976, vol. 3, 376). The SDR 21.1 billion allocated during the first three years could substitute for part of this demand, but only a small part, that otherwise would be satisfied by increased holdings of reserve currencies, limiting any inflationary effects. In fact, from December 1978 to December 1983, international reserves increased by SDR 98 billion. During this period, the dollar depreciated, and the global debt crisis led to an absolute decline in the stock of reserves in US dollar terms in 1982 and 1983.

54 The substitution account proposal had also been considered by the C-20.

55 See McCauley and Schenk (2015) for the history and an assessment of these proposals.

56 Boughton 2001, chapter 18 title. Boughton (2011) further demoted the IMF discussions of the SDR to a few pages in a chapter on IMF financing.

57 The participants in the market established VTAs with and administered by the IMF.

Managing directors dutifully reported to the executive board on possible SDR allocations before each basic period based on staff analyses of the case for an allocation. However, allocation proposals generally attracted only about 63 percent weighted support of executive directors, falling short of the 85 percent required (Boughton 2001, 945).

During the subsequent decade, the opposition of four of the G-5 countries to a resumption of SDR allocations became entrenched. France was the outlier, enabling it to curry favor from developing countries knowing that the proposals for allocations would fail. Representatives of developing countries continued to argue the development finance case for SDR allocations and for the establishment of mechanisms that channeled more SDRs toward development objectives. But those arguments went nowhere.

In January 1987 Michel Camdessus succeeded Jacques de Larosière as managing director of the IMF. Camdessus successfully led the Fund for a dozen years. He advocated an increased role for the SDR throughout his tenure.

In advance of the IMF/World Bank annual meetings in Madrid in September 1994, Camdessus put forward a two-part proposal: a new general allocation of SDRs and an amendment of the Articles of Agreement to permit a special allocation to members that had joined the Fund after January 1981—principally Russia, other parts of the former Soviet Union, and Eastern European countries.[58] He misread the position of the United States, which favored the second part of his proposal but not the first, as well as the positions of several other G-7 countries. The result was an embarrassing stalemate that stretched into the wee hours of the morning.

The Madrid "debacle" (to use Karin Lissakers's [2006] description) led the IMF's Interim Committee, the predecessor of the International Monetary and Financial Committee (IMFC), to request the Fund to conduct a study to clarify the issues and differences that contributed to the failure to agree to the SDR package when many thought agreement was in sight. In response, the IMF held a conference to consider the future of the SDR. Authors presented 22 papers on topics ranging from the origins of the SDR to proposals for reform of the SDR mechanism and its role in the international monetary and financial system. The conference and resulting publication (Mussa, Boughton, and Isard 1996) did not move the needle on the SDR's evolution.

Although the conference did not settle any issues, Camdessus successfully revived the second part of his original proposal. In 1997 members agreed to double the amount of SDR outstanding to SDR 42.8 billion via an amendment of the articles that authorized a special allocation that would bring the SDR allocations of each member up to 29.3 percent of its quota at that time. However, the United States lost interest in the proposal, as economic reform in Russia stalled, and did not approve the amendment as was required by the governors' resolution. Other countries were slow to approve the amendment as

58 Forty-five countries were in this group as of the end of 1995, of which 19 had been part of the Eastern Bloc of countries that never joined the IMF or withdrew after joining. The other major country of note was Switzerland, which joined the IMF in 1992.

well. Consequently, the amendment did not come into effect until September 2009, when the United States approved it in the context of the 2008-10 global financial crisis.[59]

Revival of the SDR

Is the SDR a Monetary Dodo?

—Karin Lissakers, September 2005[60]

At the turn of the 21st century, an objective observer might have reasonably concluded that the SDR's future was dim. The official sector in most advanced countries demonstrated no interest in the instrument. No SDRs had been allocated for 20 years. The most recent serious proposal to allocate SDRs in 1994 had been firmly opposed by several major industrial countries led by the United States. And the equity amendment to the IMF articles to bring holdings of all members up to a benchmark of 29.3 percent of quotas appeared to be in permanent limbo.[61]

Horst Köhler of Germany succeeded Camdessus as IMF managing director in May 2000. The analysis in the background paper prepared by the IMF staff (IMF 2001) for the executive board's consideration of an SDR allocation in the eighth basic period (2002-06) was similar to the framework outlined by Mussa (1996; Mussa, Boughton, and Isard 1996). Although a careful reader of the paper would conclude that the staff's case for an SDR allocation was on balance positive, the paper contained no conclusion or allocation proposal, in contrast with similar papers produced under Camdessus.

On the other hand, outside advocates for the SDR continued to make proposals. A Council on Foreign Relations (1999) task force proposed special SDR allocations to fund a "contingency facility" in the IMF. Richard N. Cooper (2002) envisaged a temporary SDR allocation to deal with crises and creditor panic. His proposal was echoed by Camdessus in Camdessus, de Larosière, and Köhler (2004). The Zedillo report (United Nations 2002) advocated regular SDR allocations. George Soros (2002) advocated the use of SDR allocations not only to promote development but also to help fund global public goods.

In 2005 at a conference on the future of the IMF, former US IMF executive director Karin Lissakers answered her question about whether the SDR was a monetary dodo bird. She concluded that the SDR bird might still fly either in the form of regular SDR allocations or in response to a global financial crisis. "SDR provide a low-cost financial cushion and can help lower-income IMF members maintain higher growth, to the benefit of the global economy as well as themselves" (Lissakers 2006, 492). In my introductory paper for the conference, I

59 An SDR allocation to ease the financial constraints associated with the Asian financial crises of 1998-2000 was discussed, but the proposal never acquired any legs.

60 Lissakers 2006, 483.

61 Four years after the amendment was sent in 1997 to members for their approval, the required three-fifths of members (110) had approved, but they represented only 72.71 percent of total voting power, well short of the 85 percent required. US approval was essential because of its 17.13 percent voting share at the time, but the United States was only one of 70 countries that had not approved the amendment.

argued that the SDR should have a place in the international monetary system of the 21st century, but my best guess was that "nothing will happen with respect to the SDR in the next decade or so" (Truman 2006, 119).

In 2006 IMF managing director Rodrigo de Rato reported to the IMFC "that there is no proposal for a general SDR allocation for the ninth basic period [2007-11] consistent with the provisions of the Articles of Agreement that has the necessary broad support of participants in the SDR department, and [he had] issued a report to this effect to the Executive Board" (IMF 2006).[62] However, he noted that the IMF articles allow an SDR allocation to be proposed during a basic period. Dominique Strauss-Kahn replaced de Rato as managing director in July 2007.

When the global financial crisis entered its virulent phase in the fall of 2008, support for an SDR allocation revived. Representatives of emerging market and developing countries, participating in one of the working groups formed at the Washington G-20 leaders' meeting in November 2008 to prepare for the London meeting in April 2009, expressed strong interest in an SDR allocation. Agitation also came from the think tank community, which lobbied the British authorities to support an allocation of $250 billion in SDRs.[63] To the surprise of many senior staff in advanced countries and many of the IMF staff, the proposal was adopted.[64]

The IMF staff subsequently assembled a comprehensive report and proposal for the executive board that was discussed on June 26 (IMF 2009b). The paper emphasized that the allocation would strengthen the global financial safety net, set an example of a cooperative response to the global crisis, and build confidence. The paper argued that the allocation met the criteria in the IMF articles. The staff estimated that emerging market and developing countries, excluding China and fuel exporters, would need $400 billion to $900 billion in additional reserves over the next five years and $1.3 trillion to $2 trillion over the next 10 years.[65] The governors promptly approved the proposal, and on August 28, SDR 161.2 billion was allocated. On August 5 the United States finally completed its approval of the fourth amendment of the articles, allowing the Fund to implement the special allocation of SDR 21.5 billion on September 9. These allocations raised cumulative SDR allocations to SDR 204.1 billion ($321.3 billion at $1.57413 per SDR on that date), about 85 percent of the total IMF quotas at the time.[66]

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62 I have been unable to find the report to the executive board, but the IMF (2009a, 3) provides a summary:

> That conclusion was driven by the economic outlook—strong growth, ample global liquidity, and rapid reserve growth with sustained compression of borrowing spreads and improved access to capital markets; and by the lack of evidence of broad support among the membership.

63 See Truman (2019) for more detail.

64 Managing Director Dominique Strauss-Kahn had been informed of the US position, but he did not pass on the information to his colleagues.

65 In fact, the international liquidity of those 129 countries increased by $446 billion from 2009 to 2014 and $935 billon from 2009 to 2019 (*Source:* IMF, International Financial Statistics, International Liquidity, Total Reserves Excluding Gold).

66 The fourth amendment mandated that any new members of the Fund after the effective date receive an allocation upon joining the IMF. In addition, countries with arrears to the Fund are not eligible for an allocation until they clear those arrears. Implementation of these provisions after September 2009 led to an increase in holdings to SDR 204.2 billion as of June 30, 2021.

Although the 2009 estimates of increases in reserves over the subsequent 5 and 10 years were remarkably accurate, estimates of possible SDR use following the 2009 allocation were substantially higher than their actual use. Sales of SDRs to other members totaled SDR 3.4 billion through the end of 2010 and SDR 8.8 billion through the end of 2020, compared with a pre-allocation estimate of SDR 10 billion to SDR 30 billion (IMF 2021b).[67] The reasons for this limited use of SDRs are obscure, but holders of the newly issued SDRs may have been uninformed about or inexperienced in their use, or the IMF staff may have been less than systematically proactive about informing members of their options.

In the wake of the 2009 allocations, collective interest in the SDR and its possibilities revived. A contributing factor was renewed interest in the reform of the international monetary system after the global financial crisis plus the interest of the French presidency of the G-20 in this topic.[68] In 2011 the IMF staff produced a series of papers on various aspects of the SDR and the international monetary system. In January the staff circulated a broad-ranging paper (IMF 2011a) on the potential role for the SDR in enhancing international monetary stability.[69]

The paper identified three concepts of the SDR:

- the official SDR as defined in the articles;
- a tradable SDR in the form of SDR bonds or securities; and
- the SDR as a unit of account.[70]

In June 2011 the executive board formally considered the case for a general allocation of SDR during the tenth basic period of January 1, 2012, through December 31, 2016 (IMF 2011b). The staff proposed an allocation of $350 billion

67 Transactions with the IMF itself are excluded from these figures. The IMF (2009b, 2021a) does not indicate the time for which the estimates were prepared.

68 The international monetary system has been a traditional preoccupation of French authorities for generations. In December 2010 they launched a series of conferences on the subject. Michel Camdessus, Alexandre Lamfalussy, and Tommaso Padoa-Schioppa launched the Palais Royal Initiative in the fall of 2010. The group produced a set of reform suggestions in February 2011 and subsequently published a set of background papers (Boorman and Icard 2011). In the end, the G-20 meeting in Cannes was preoccupied with the European debt crises, and the communiqué contained a scant four paragraphs on the international monetary system.

69 The staff paper included a supplement by Richard N. Cooper analyzing whether SDR creation is inflationary. The IMF (2011a, 8) summarized his argument:

> Essentially, the global inflationary impact of SDR allocations is expected to be limited even assuming large cumulative allocations, so long as central banks issuing freely usable currencies credibly stick to their inflation targets.

70 A later IMF (2018, 1) policy paper labeled these three concepts as the O-SDR, M-SDR, and U-SDR. It did not offer any proposals for reform, but on the O-SDR, the authors opined:

> While the O-SDR currently plays a limited role in contributing to the smooth functioning of the [international monetary system] it could potentially have the greatest scope under a different legal framework. O-SDR allocations could buffer external adjustment, and help reduce precautionary reserve accumulation, although the current Articles of Agreement would need to be revised to address important challenges around scale, targeting and use of O-SDR allocations. And while O-SDRs could provide a flexible source of finance to bolster the Fund's lending capacity, for example to respond to large-scale events, changes to the allocation mechanism and options to create OSDRs outside of the current allocation process to help address gaps in the Fund's lending capacity would again require amendments to the [articles].

The paper proposed reforms in this direction that would require jumping the high hurdle associated with amending the articles.

to $400 billion to all members over three years starting in 2014 to meet part of an estimated demand for additional reserves of $800 billion to $1,600 billion over the five-year period from 118 emerging market and developing countries.[71] The staff argued that SDRs are "inherently superior" to endogenously generate reserves in that they are costless, continuously available and liquid, can be accumulated without contributing to global imbalances, and are a better store of value than holdings of individual currencies. The acting managing director subsequently reported to the IMF board of governors that there was not the required broad support among executive directors for an allocation.

This caution and uncertainty about the role of the SDR and the case for further allocations prevailed in official circles until the outbreak of the coronavirus pandemic in 2020. At that time, most governments, including several of the traditional European skeptics, joined representatives of nongovernmental organizations and think tanks to embrace proposals for another large one-time SDR allocation to help address the economic and financial strains of the pandemic.[72] The rationale underlying the proposal was like, but stronger than, that for the 2009 allocation. Members of the IMF had been hit by a common shock, the economic and financial impacts of which could not have been anticipated and prepared for in advance. In 2009 many nonadvanced countries were hit by a similar shock that they could not have anticipated. In both instances, the moral hazard argument against an allocation was weaker than might be the case for regular annual SDR allocations.

The US administration did not share the widespread judgment in favor of an immediate SDR allocation. US treasury secretary Steven Mnuchin (2020, 3-4) stated the US position at the April 16 meeting of the IMFC:

> We recognize that a number of IMF members support a general SDR allocation to the membership. In our view, an SDR allocation is not an effective tool to respond to urgent needs. Almost 70 percent of an allocation would be provided to G20 countries, most of which do not need and would not use additional SDRs to respond to the crisis. By contrast, all low income countries, including those facing urgent balance of payments needs, would receive just 3 percent of any allocation. A better, more targeted approach would be for members to enhance IMF support to low income countries by providing grants to the Catastrophe Containment and Relief Trust (CCRT) and through new grants and loans to the Poverty Reduction and Growth Trust (PRGT). Advanced economies could also explore using their existing SDRs to bolster PRGT resources or otherwise support low income countries. The Administration is currently exploring a U.S. contribution to the PRGT and CCRT.

The US position did not change throughout the Trump administration, and the exploration of a US contribution to the PRGT and CCRT did not result in any contributions.

71 The staff paper did not identify the 118 emerging market and developing countries. However, for the 129 countries identified in the source for footnote 65, international liquidity increased by only $70 billion (*Source:* IMF, International Financial Statistics, International Liquidity, Total Reserves Excluding Gold).

72 For two examples, see Collins and Truman (2020) and Main, Jacobs, and Weisbrot (2020).

On February 25, 2021, the new US treasury secretary Janet Yellen (2021) announced a reversal of the US position. The IMF allocated SDR 456.5 billion ($648 billion) on August 23, 2021.[73] The IMF (2021c) staff paper on the proposed allocation stressed the global economic context and noted that aggregate reserve accumulation had decelerated sharply since 2011 and that in 2020 the reserves of non-Asian emerging market and developing countries declined by SDR 95 billion. The IMF staff estimated that demand for increased reserves over the next five years would be $1.1 billion to 1.9 billion, of which the proposed allocation would cover 30 to 60 percent. The paper also emphasized that SDR allocations are less costly than acquisition of reserves by borrowing or current account surpluses, do not contribute to excess global imbalances, involve no immediate rollover risks, benefit all members of the Fund, and provide rapid unconditional liquidity.[74] Finally, it observed that the allocation would contribute to fulfilling the general purposes of the Fund.

The paper also sought to blunt the criticism that SDR allocations provide no benefits to countries that do not use their allocations. It presented estimates of the impact of increases in reserves on credit-default-swap spreads. It estimated that the impact of the proposed SDR allocation on the spreads of countries with very low reserves could be as large as 240 basis points (IMF 2021c).

On implementation, the paper put forward plans to upgrade the transparency of SDR operations, responding to some of the criticism of SDR allocations based on geopolitical considerations that, for example, countries would use them for the “wrong” payments to the “wrong” countries—for instance, debt payments to China. The paper also provided assurance that the existing framework of VTAs would be adequate to meet the demand for SDR transfers while outlining an effort to expand the number of participants in the VTA system and to encourage the relaxing of the upper and lower limits in the existing VTAs on their holdings as a percentage of their allocations. The paper also stated that the managing director did not at that time plan to submit a proposal for an SDR allocation in the 12th basic period that would start on January 1, 2022.

Meanwhile, IMF staff and members debated mechanisms through which SDR holdings of advanced countries may be “recycled” to lower-income countries. An existential question is why advanced countries are motivated to use their SDRs to benefit these countries rather than relying on doing so directly, either through the international organizations or bilaterally. For a few countries like the United States, lending SDRs rather than appropriating funds has small budget-scoring advantages. For other countries, the motivation may involve domestic political considerations (fiscal resources technically are not diverted from domestic purposes) or international political considerations (to be seen as doing something with resources the country did not need).

73 The allocated amount is slightly less than the constraint in US legislation that the treasury secretary cannot vote for an SDR allocation in any basic period in which the United States receives more SDRs than its quota in SDR (SDR 83 billion) with approval of the US Congress. The 2021 SDR allocation amounted to 95.6 percent of each members’ quota. As required by US law, Secretary Yellen notified Congress on April 2 that she intended to vote in favor of the allocation. Congressional opposition to the allocation focused primarily on concerns that it would benefit countries that are in US disfavor, such as China, Iran, and Venezuela. On the other hand, some lawmakers favored an even larger allocation to provide more direct benefit to low-income countries.

74 These five points differ slightly from the points favoring an SDR allocation made in IMF (2011a).

Whatever the motivation, one or more mechanisms are expected to be established. They might take various forms: lending SDRs to the IMF to add to the resources of an existing or new facility; lending SDRs to one of the currently prescribed institutions that can hold SDRs, such as the World Bank; lending SDRs to another lending facility to be prescribed; and/or distributing SDRs through donations to specific entities.[75] On April 13, 2022, the IMF executive board approved the establishment of one such mechanism, the RST, through which members can channel SDRs for lending to low-income and vulnerable middle-income members (a total of 143 countries) for 20 years with a 10½-year grace period linked to economic policy commitments comparable to those required for an upper-credit-tranche IMF program (IMF 2022b, 2022c).[76] The initial projected size of the RST is a modest $45 billion. Members may also lend, and have lent, SDRs to the IMF's PRGT, which was first established in the 1970s.

Mechanisms of this type in effect link the allocation of SDRs with additional financial assistance to developing countries, as had been advocated from the start of discussions of mechanisms to augment international reserves in the 1960s.

75 This is not an exhaustive list. For an analysis of these four models, see Mark Plant (2021).

76 See David Andrews (2022) for a useful summary.

APPENDIX B
SDR USE FOLLOWING THE 2009 AND 2021 ALLOCATIONS

This appendix reviews SDR use by IMF members following the 2009 and 2021 allocations. It is motivated by the argument from some opponents of the 2021 SDR allocation that (1) many countries would receive allocations that they did not need and would not use because of their level of development; and (2) it would immediately benefit countries that are in geopolitical disfavor with the United States and some other countries, such as Belarus, China, Iran, Russia, Syria, and Venezuela. In other words, SDRs would go to those countries that did not need them and to countries that did not deserve them. Neither argument is supported by the evidence after the 2021 allocation or the years since the 2009 allocations. In general, a broad swath of IMF members has used their SDRs. The exceptions are the high-income countries, which generally have not. Many of those countries have facilitated the mobilization of SDRs through their VTAs.[77]

The 2021 Allocation

Low-income members of the IMF were not the only beneficiaries of the 2021 SDR allocation. These countries accounted for less than 25 percent of IMF members recording increases in their reserves of more than 20 percent of their level in December 2020 as a result of the SDR allocations (table B.1). Low-income countries also accounted for only 12.5 percent of the use of the new allocation in the first eight months after August 2021, where use is measured by a decrease in SDR holdings after the allocation (table B.3).

Distribution of the 2021 SDR Allocation

Table B.1 presents a summary of the 2021 SDR allocation by income group. The allocation boosted the December 2020 international reserves of the 190 members of the IMF by 5.4 percent on average. The reserves of 45 countries were increased by 20 percent or more. Fourteen of these countries were among the 26 low-income countries, although they received only 1.3 percent of the roughly $650 billion allocation (table B.2). Twenty of the larger group of 74 countries potentially eligible in 2021 for support from the International Development Association (IDA) and the IMF's PRGT received SDR allocations of more than 20 percent of their respective reserves. However, on this metric 25 other countries were also substantial beneficiaries of the allocation.

77 As part of its commitment to increase the transparency of SDR use, the IMF staff has expanded its report on the IMF finances and developed an SDR tracker (https://www.imf.org/en/Topics/special-drawing-right/SDR-Tracker), which summarizes IMF staff advice to some but not all countries on their use of SDRs and what the IMF staff knows about the authorities' intentions for use of their SDR allocations. The IMF (2021c) also committed to compile an annual report on the use of SDRs, including in VTA operations, and by August 2023 to prepare an ex post report on SDR use by members. In October 2022 the IMF (2022a) released the annual update on SDR trading operations as a policy paper.

Table B.1
Distribution of 2021 SDR allocations by income groups

Country group[a]	Number of countries	SDR allocation		Allocation greater than 20 percent of reserves	
		Billions of US dollars	*Percent of December 2020 reserves*	*Number of countries*	*Amount of allocation (billions of US dollars)*
Low income	26	8.7	24.0	14	5.7
Lower-middle income	54	64.8	5.1	5	7.4
Upper-middle income	54	141.1	2.7	8	7.9
High income	56	432.9	7.9	18	249.8
All countries	190	647.5	5.4	45	270.7
Memo: Potential IDA eligible	74	27.9	10.8	20	8.5

SDR = special drawing right; IDA = International Development Association

a. Based on 2021 World Bank classification of countries by income per capita.

Notes: US dollar rate on August 23, 2021, was $1.41847 per SDR. Individual figures may not add to totals because of rounding.

Sources: International Monetary Fund and author's calculations.

Use of the 2021 SDR Allocation

As of December 31, 2021, five months after the SDR allocation in August 2021, low-income members of the IMF had accessed only 13 percent of their new allocation (table B.2).[78] Three of the low-income countries had used at least 90 percent of their new allocation. At the same time, 21 other members had done so, including 8 lower-middle-income countries, 12 upper-middle-income countries, and one high-income country.

Low-income countries as a group reduced their SDR holdings or used a larger share of their combined new allocation of SDRs than each of the two groups of middle-income countries. But the two groups of middle-income countries accounted for more than 90 percent of the total use of SDRs during the five-month period.

Focusing on the 74 countries potentially eligible for IDA grants or blended loans as well as loans from the PRGT does not tell a different story. Eleven of these countries used 90 percent or more of their new allocations, or only 15 percent of this group of countries. Their use of SDRs accounted for only 15.5 percent of total reduction in holdings of SDRs following the allocation. Although that share exceeded their share of the allocation, the share use by the two subgroups of middle-income countries, which include some of the IDA-eligible countries, exceeded their share of the new allocation by substantially more.[79]

78 These calculations are based on allocations and holdings as of the end of July 2021. The allocation was on August 23, 2021, and in principle there could have been some use of the allocation during that month. A member's access (net) to its SDR holdings is measured by the decline in holdings after they have been boosted by the allocation.

79 The IDA-eligible group of IMF members includes all 26 low-income countries, 37 of the 54 lower-middle-income group, and 11 of the 54 upper-middle-income group.

Table B.2
Summary of use of 2021 SDR allocations, August 2021 to December 2021

Country group[a]	Number of countries	Share of allocation	SDR holdings increased	SDR holdings decreased		SDR holdings decreased more than 90 percent of new allocation		
			Millions of US dollars	*Millions of US dollars*	*Percent of allocation*	*Percent of total decrease in holdings*	*Number of countries*	*Percent of group*
Low income	26	1.3	56	1,130	12.95	6.2	3	11.5
Lower-middle income	54	10.0	2	5,967	9.21	32.7	8	14.8
Upper-middle income	54	21.8	1,608	11,095	7.86	60.8	12	22.2
High income	56	66.9	10,250	62	0.01	0.3	1	1.8
All countries	190	100.0	11,917	18,254	2.82	100.0	24	12.6
Memo: Potential IDA eligible	74	4.3	56	2,827	10.12	15.5	11	14.9

SDR = special drawing right; IDA = International Development Association

a. Based on 2021 World Bank classification of countries by income per capita.

Notes: SDR values converted to US dollars at $1.41847 per SDR, the rate on August 23, 2021. Individual figures may not add to totals because of rounding.

Sources: International Monetary Fund and author's calculations.

The same general patterns held three months later at the end of March 2022 (table B.3). The low-income countries as a group used more of their combined allocation of SDRs after eight months than they had during the first five months, as did the lower-middle-income countries. Total use by upper-middle-income countries was lower than after the five months.[80] The two groups of middle-income countries continued to account for almost 90 percent of the combined use of the 2021 allocation.[81]

The apparent low use of the new SDR allocation by lower-income countries or IDA-eligible countries should be qualified in two respects.

First, tables B.2 and B.3 focus on the direct use of SDRs through reductions in holdings via transfers to other countries for hard currency or in payment primarily to the IMF. Anecdotal reports suggest that some countries have used some of their allocations for fiscal purposes while maintaining their actual holdings unchanged. For example, the Banque Central des États de l'Afrique de l'Ouest of the West African Economic and Monetary Union has lent $2.3 billion to its eight members for 20 years at 0.05 percent against their SDR holdings. However, the members continue to be the recorded holders of the SDRs (IMF 2022d). Other countries may have similar arrangements. For example, if the finance ministry is the holder of a country's SDRs and the central bank's statues permit it, the finance ministry can in principle borrow from its central bank using its SDRs as collateral.

Second, lower income countries are also eligible to for support from the IMF's PRGT with relatively light conditions on the country's economic policies. From the start of the pandemic in March 2020 through March 2022, outstanding IMF credit to PRGT-eligible members increased by $11.1 billion in connection with various programs financed out of that trust. Credit outstanding in March 2022 was $20.5 billion. In the absence of that support, more of the countries eligible for PRGT support might have directly used more of their SDR allocation over the first eight months after the 2021 allocation.

One high-income country (Antigua and Barbuda) used most of its new allocation of SDRs to obtain foreign currency. However, as a group the high-income countries added to their holdings of SDRs in excess of the allocations. They were on balance the collective recipients of about 55 percent of the combined decrease in SDR holdings by other countries during the first five months. The remainder was transferred to other eligible holders of SDRs, primarily to the general resources account of the IMF itself, but also to the European Central Bank. However, by March 2022 the other nonnational holders of SDRs as a group had reduced their holdings compared with July 2021. In the case of the general resources account of the IMF, the initial buildup of holdings was lent out in programs.

80 The increase in SDR holdings was more than accounted for by an increase in Argentina's holdings, which appears to have been in connection with a loan disbursement by the Fund to Argentina in SDR offset in part by repayment of the Fund by Argentina.

81 Non-IDA-eligible countries accounted for 33 percent of the SDR use by the two groups of middle-income countries.

Table B.3
Summary of use of 2021 SDR allocations, August 2021 to March 2022

Country group[a]	Number of countries	Share of allocation	SDR holdings increased	SDR holdings decreased			SDR holdings decreased more than 90 percent of new allocation	
			Millions of US dollars	*Millions of US dollars*	*Percent of allocation*	*Percent of total decrease in holdings*	*Number of countries*	*Percent of group*
Low income	26	1.3	57	2,275	26.07	12.6	4	15.4
Lower-middle income	54	10.0	1,025	7,614	11.75	42.3	9	16.7
Upper-middle income	54	21.8	4,800	8,041	5.70	44.6	13	24.1
High income	56	66.9	13,583	86	0.02	0.5	1	1.8
All countries	190	100.0	19,465	18,017	2.78	100.0	27	14.2
Memo: Potential IDA eligible	74	4.3	866	4,510	16.15	25.0	13	17.6

SDR = special drawing right; IDA = International Development Association

a. Based on 2021 World Bank classification of countries by income per capita.

Notes: SDR values converted to US dollars at $1.41847 per SDR, the rate on August 23, 2021. Individual figures may not add to totals because of rounding.

Sources: International Monetary Fund and author's calculations.

These data demonstrate that many countries other than low-income countries or IDA-eligible countries used their 2021 SDR allocation during the first eight months after it was implemented using a variety of mechanisms. For example, in some cases that use involved transferring SDRs to another member to acquire foreign exchange at low cost that was used to repay higher-cost foreign currency debt. Thus, those who argued in advance of the 2021 allocation that the allocation would only benefit lower-income countries and only on a small scale were mistaken. It is also relevant that countries do not have to reduce their holdings of SDRs to benefit from an allocation; they often benefit from a reduction in their borrowing spreads (IMF 2021c).

Comparison with the 2009 Allocations

The pattern of immediate, after-crisis usage of the 2021 SDR allocation was broadly like the pattern following the SDR allocations in response to the global financial crisis of 2008-10.

In August and September 2009, the IMF allocated SDR 182.7 billion in two pieces: a general allocation of SDR 161.2 billion based on quota shares in the IMF at the time and a special allocation of SDR 21.5 billion that went primarily to countries that had not been members of the IMF when SDRs were first issued in 1970-72 and 1979-81.

Table B.4 summarizes the distribution of the 2009 allocations. Compared with the 2021 allocation (table B.1), the smaller combined allocation was a lower percentage of the reserves of all countries as of December 2008 but not substantially, because the level of reserves was also lower. This was true for all groups of countries except for the low-income group, whose combined reserves had decreased over the dozen years. In 2009 the number of countries in each group receiving a boost in reserves of at least 20 percent was about the same as in 2021. The additional reserve cushions benefited more than just the low-income countries following both allocations.

A summary of the initial use of the newly allocated SDRs by members of the IMF as of April 2010, eight months after the September 2009 allocation, is presented in table B.5.[82] The August and September 2009 allocations occurred only 11 or 12 months after the start of the virulent stage of the 2008-10 global financial crisis that many date to August 2007, compared with the 2021 allocation in August 2021, 18 months after March 2020, when the global pandemic was declared.

82 Although the first 2009 allocation was on Friday, August 28, 2009, the calculations ignore the possible use of this allocation that month but include possible use in September.

Table B.4
Distribution of 2009 SDR allocations by income groups

Country group[a]	Number of countries	SDR allocations		Allocations greater than 20 percent of reserves	
		Billions of US dollars	*Percent of December 2008 reserves*	*Number of countries*	*Amount of allocations in US dollars (billions)*
Low income	25	3.7	9.0	13	1.8
Lower-middle income	54	28.6	3.5	8	2.2
Upper-middle income	53	54.9	1.6	5	1.0
High income	54	198.5	7.2	19	125.2
All countries	186	285.5	4.1	45	130.3
Memo: Potential IDA eligible	72	13.7	8.3	23	3.8

SDR = special drawing right; USD = US dollar; IDA = International Development Association.

a. Based on 2021 World Bank classification of countries by income per capita and not including four countries that were not yet members of the IMF.

Note: Individual figures may not add to totals because of rounding.

Sources: International Monetary Fund and author's calculations.

Comparing the data in table B.5 with those in table B.3, a smaller number of countries made substantial use of their additional SDR holdings in the first eight months after the 2009 allocations, as indicated by only 14 countries mobilizing at least 90 percent of their new allocations, compared with 24 countries after the 2021 allocation. The lower-middle-income and upper-middle-income groups of countries accounted for all the increase in numbers of heavy immediate users after the 2021 allocation.

For the record, 8 of the 14 countries that used at least 90 percent of their 2009 allocations in the first eight months after the allocations also were in the group of 27 countries that had used at least 90 percent of their allocations following the 2021 allocation: two low-income countries (Chad and Malawi), one lower-middle-income country (Mauritania), and five upper-middle-income countries (Bosnia and Herzegovina, Ecuador, Guyana, Moldova, and Serbia). Some SDR critics may cite these data to substantiate their view that SDR allocations allow countries to postpone needed adjustments in economic policies. My reading of these data points to a different interpretation. Six recipients of the 2009 allocations that used them in the first eight months were in better condition in 2021, and 19 of the recipients of the 2021 allocation used that allocation in the first eight months, but they were in a different position in 2009. These data warn against generalizing about the countries that benefit from SDR allocations.

Table B.5

Summary of use of 2009 SDR allocations, September 2009 to April 2010

Country group[a]	Number of countries	Share of allocation	SDR holdings increased	SDR holdings decreased			SDR holdings decreased more than 90 percent of new allocation	
			Millions of US dollars	*Millions of US dollars*	*Percent of allocation*	*Percent of total decrease in holdings*	*Number of countries*	*Percent of group*
Low income	25	1.3	27	516	13.47	8.6	3	12.0
Lower-middle income	54	10.0	110	3,229	11.33	54.0	5	9.3
Upper-middle income	53	21.8	813	1,195	3.49	32.0	6	11.3
High income	54	66.9	3,967	323	0.16	5.4	0	0
All countries	186	100.0	4,916	5,983	2.10	100.0	14	7.5
Memo: Potential IDA eligible	72	4.3	27	1,368	9.86	22.9	8	11.1

SDR = special drawing right; IDA = International Development Association

a. Based on 2021 World Bank classification of countries by income per capita and not including four countries that were not yet members of the IMF.

Notes: SDR values converted to US dollars at $1.56392 per SDR, the rate on August 28, 2009. Individual figures may not add to totals because of rounding.

Sources: International Monetary Fund and author's calculations.

These data are, however, consistent with two facts: First, the pandemic crisis directly affected a wider swath of countries more deeply than did the global financial crisis. Second, low-income countries were beneficiaries of more targeted IMF lending in the wake of the pandemic. On the other hand, SDR use by countries potentially eligible to borrow from the IDA accounted for a substantially larger share of total use of SDRs after the most recent allocation. The IDA-eligible countries also can access the PRGT for loans with low conditionality on more concessional terms.[83] The increase in credit from the PRGT from March 2020 to March 2022 ($11.1 billion) was 10 times the amount of such lending from September 2008 to September 2010 in SDR terms.

These results suggest that the overall external financial impact of the coronavirus pandemic exceeded that of the global financial crisis. Alternatively, countries in 2009-10 were less familiar with how they could employ their SDR allocations. These explanations are not mutually exclusive.

Table B.6
Summary of use of 2009 SDR allocations, January 2010 to July 2021 (millions of SDR)

Country group[a]	**Number of countries**	**Decreases in holdings of 2009 SDR allocations by date indicated**				
		January 2010	***April 2010***	***March 2020***[b]	***July 2021***	***Memo: 2009 allocations***
Low income	26	299	330	1,528	1,498	2,448
Lower-middle income	54	1,828	2,064	8,739	8,510	18,288
Upper-middle Income	54	575	1,225	7,675	8,643	35,038
High income	56	153	206	8,497	8,897	126,835
All countries	190	2,856	3,826	26,439	27,548	182,550
Memo: Potential IDA eligible	74	684	875	4,730	4,551	8,874

SDR = special drawing right; IDA = International Development Association

a. Based on 2021 World Bank classification of countries by income per capita and not including four countries that were not yet members of the IMF.

b. From December 2015 to December 2016, member countries' combined holdings of SDR declined by SDR 13,586 million primarily in connection with payments of the hard currency portion of their increased quota subscriptions to the general account of the Fund when the 2010 14th quota review went into effect.

Notes: Andorra, Nauru, South Sudan, and Tuvalu were not members of the IMF in 2009 but received 2009 SDR allocations when they joined, which they may then have used. The data in the table therefore differ from those in table 1. Individual figures may not add to total because of rounding.

Sources: International Monetary Fund and author's calculations.

Table B.6 traces the use of the 2009 allocations by groups of countries from January 2010 to July 2021, before the SDR allocation in August. There was little additional SDR use between January and April 2010. Sixty percent of the use

83 In 2020-22 some of the emergency lending by the IMF went to countries that are not in the low-income group, but the bulk went to that group.

between April 2010 and March 2020 was in connection with transfers to the general account of the IMF, principally in connection with the increase in quotas implemented in early 2016. Additional use of the 2009 allocations prior to the 2021 allocation in August 2021 also was small.

Use of SDR Allocations by Countries in Disfavor

Critics in the United States and some other Western countries opposed the 2009 and 2021 SDR allocations because countries in disfavor for geopolitical reasons would benefit. One list of such countries is Belarus, China, Iran, Russia, Syria, and Venezuela. As of March 2022, four of them held more SDRs than they had been allocated. China held 6 percent ($3.2 billion) more. Russia increased its excess holdings between July 2009 and April 2010, reduced its holdings slightly (by less than 5 percent of its total allocations) between April 2010 and August 2021, and maintained that aggregate reduction through March 2022 as well as through July 2022. Venezuela had used most of its pre-2009 allocation before July 2009. It did not use any of its 2009 allocations by April 2010, but it reduced its holdings by about 40 percent of its cumulative allocations by August 2021 prior to the SDR allocation that year. It maintained the absolute size of the reduction through March and July 2022.

In the case of China, the concern is that other countries will use their SDRs to repay debts to China or Chinese creditors rather than rescheduling those obligations. The information available to date sheds no light on this concern. Otherwise, the geopolitical objections to the SDR allocations on the grounds that certain countries should not benefit have been overwhelmed by the positive evidence of SDR use by other countries.

A Look at SDR Use over 50 Years

The SDR was established in 1969 to supplement IMF members' international reserves. After a 40-year hiatus, the SDR has proved itself to be a potent anti-crisis tool. Since 1970, $846 billion in SDRs has been allocated.[84] Today outstanding SDRs exceed total IMF quotas by almost 40 percent.[85] As a result, they have provided many IMF members with a significant cushion, and for many countries that cushion remains in place.

Table B.7 summarizes as of the end of September 2022 the use of the SDRs allocated since January 1, 1970. The conventional view is that low-income countries immediately employ their share of any SDR allocation to delay necessary adjustment measures. The data in table B.7 tell a different story. Only 27 IMF members, less than 15 percent of the membership, hold less than 10 percent of their cumulative allocations. For the three groups of countries other than the high-income countries, the number of countries that hold more than their cumulative allocations (30) is slightly larger than those that have used at least 90 percent of their allocations (26). A slightly smaller percentage of low-income countries (15) have used at least 90 percent of their allocations than countries in the lower-middle- and upper-middle-income groups (20), but the key point is that some

84 This valuation is based on the US dollar price of an SDR on September 30, 2022, which was $1.279880 per SDR. The outstanding stock of SDR was SDR 607 billion.

85 Total IMF quotas are SDR 476.3 billion, or $610 billion at the US dollar price of an SDR on September 30, 2022, $1.279880.

countries in all three groups of countries spent most of their SDRs and others have held on to them. Each country has its own story to tell, but the lesson from table B.7 as well as the other evidence presented in this appendix is that one should not generalize about which countries benefit from SDR allocations.

Table B.7
Use of total SDR allocations as of end of September 2022

Country group[a]	Number of countries	Share of total allocations (percent)	Holdings greater than allocations		Holdings less than 10 percent of allocations	
			Amount (millions of SDR)	*Number of countries*	*Decrease in holdings (millions of SDR)*	*Number of countries*
Low income	26	1.4	112	7	946	4
Lower-middle income	54	10.1	937	12	2,123	11
Upper-middle Income	54	20.8	5,158	11	7,439	11
High income	56	67.7	12,994	33	29	1
All countries	190	100.0	19,201	63	10,537	27
Memo: Potential IDA eligible	74	5.4	811	14	5,657	14

SDR = special drawing right; IDA = International Development Association.

a. Based on 2021 World Bank classification of countries by income per capita and not including four countries that were not yet members of the IMF.

Sources: International Monetary Fund and author's calculations.

CONCLUSION

The recent SDR allocations provided important immediate financial support to a broad swath of the IMF's membership, contrary to the implicit prediction by some critics that only the poorest members of the IMF would benefit. That conclusion is supported by the evidence on the use of cumulative SDR allocations by IMF member countries. The data also do not support the view that an SDR allocation immediately benefits countries that are in geopolitical disfavor with the United States and some other countries such as Belarus, China, Iran, Russia, Syria, and Venezuela.

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