International Monetary Fund
African Department

Special Drawing Rights

May 2021

Caveats

- IMF staff work on the proposal for a general SDR allocation is still in progress

- A lot of interest in SDRs has generated a diverse public discussion. This is an opportunity to clarify key concepts and avoid misunderstandings.

What is the SDR?

- Supplementary reserve asset created in 1969 in the context of the Bretton Woods fixed exchange rate system.
- Potential claim on freely usable currencies (essentially SDRs can be exchanged for freely usable currencies of other Fund members) of other Fund members
  - Not a currency nor a claim on the Fund.
  - Value based on a basket of freely usable currencies: currently U.S. dollar, euro, Chinese renminbi, Japanese yen, British pound Sterling.
- It's a unit of account

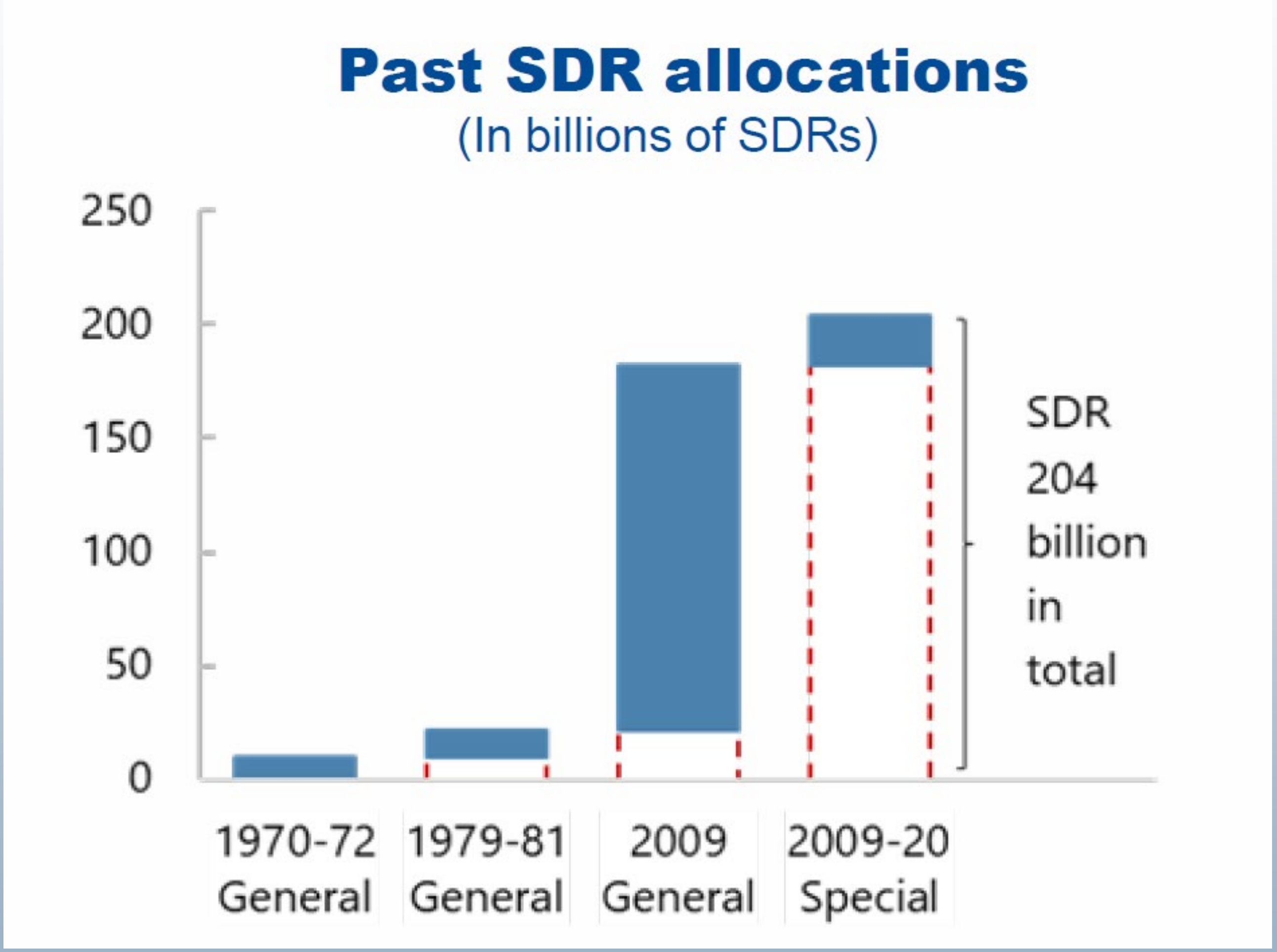
What is the SDR? (Con't)

- **SDR holdings restricted to official sector** (the Fund, participants in the SDR Department currently all Fund members), and currently 15 prescribed holders).

- General SDR allocations are made to IMF members that are participants in the SDR department (currently all IMF members) in **proportion to their IMF quota shares**.

- A special one-time allocation of SDR was provided by the Fourth Amendment to the Articles of Agreement to enable all members of the IMF to participate in the SDR system on an equitable basis and correct for the fact that countries that joined after 1981 had never received an SDR allocation.

Historical SDR allocations



By comparison, Executive Board to consider new allocation of **US$650 billion** (MD-March 2021)

How are SDRs converted into usable reserves

- SDRs may be used directly to pay IMF obligations in SDRs or may be exchanged for freely usable currency.
- **Voluntary Trading Arrangements (VTAs)** are intermediated by the Fund and handle most SDR transactions.
    - VTAs are arrangements between the Fund and a group of 31 SDR participants and one prescribed holder who have agreed to exchange SDRs for specific currencies within set trading limits.
- A participant or a prescribed holder may use SDRs, without the requirement of a balance of payments need.

How are SDRs converted into usable reserves (Con't)

- Participants and prescribed holders can also enter into bilateral transactions with each other, which is less common.
- **"Designation mechanism":** backstop in the Articles; not used since 1980s. In event that there are not enough voluntary buyers of SDRs, IMF can designate members with strong balance of payments positions to provide freely usable currency in exchange for SDRs.
  - SDR participants with strong external positions are required to provide freely usable currencies against SDRs from Fund members with balance of payment needs.

What is the “cost” associated with using SDRs

- Members that reduce their SDR holdings vs. their allocation—pay interest on the difference between their allocation and holding.
- Members that hold more SDRs than their allocation—receive interest on the difference between their holding and allocation.
- **SDR interest rate (SDRi):** determined on a weekly basis based on a weighted average of short-term interest rates in government debt instruments in the money markets of the 5 SDR basket currencies, with a floor of 5 basis points.
- The SDRi is lower than the interest rate of foreign currency-denominated debt for most of EMDCs.

Global Context: Why is increase in SDR allocation being advocated

- Already in 2016, Fund staff demonstrated there was a long-term global need to supplement reserves.
- **COVID-19 crisis is now likely inflicting long-term scars on the global economy**: weakened external positions in many countries, raised external financing needs, exacerbated debt vulnerabilities, and deepened poverty and inequality.
- **Global adjustment process is expected to be prolonged** with a global negative output gap persisting into the medium term amid higher liquidity and solvency risks.
- These weak global prospects impact the ability for countries to meet future reserve needs, supporting the case for the allocation.

Revisiting the case for a general allocation of SDRs

- Decisions by Fund on general allocations/cancellations of SDRs take place in the context of consecutive basic periods of normally five years. The 11th Basic Period began on January 1, 2017 and will end December 31, 2021.
- In 2016, the case for an SDR allocation in the 11th basic period was assessed, but Managing Director concluded that she was not in a position to propose an allocation of SDRs. She, however, stated that she would bring a proposal for a general allocation of SDRs for further discussion, if and when appropriate, in the Eleventh Basic Period.
- With the COVID-19 crisis, the long-term global macroeconomic environment has substantially changed, making it necessary to revisit the case for an allocation in the Eleventh Basic Period.

Assessing long-term global need to supplement existing reserve assets

- The **need** to supplement members' international reserve assets has been based on standard indicators of reserve adequacy.
- The need can be considered **global** as long as a group of countries with reserve needs account for a significant share of the global economy.
- An assessment for the **long-term** implies that SDR allocations or cancellations are not intended to respond to cyclical or short-term economic fluctuations.
- SDR allocations could be **appropriate** even if there are alternative ways to supplement reserve assets.
- An SDR allocation is **one** of several **financing sources to meet the long-term global need for reserves**.

Advantages of a general allocation of SDRs vs. alternatives

- Benefits all members.
- Provides **rapid unconditional liquidity**.
- **Supplements reserves at lower cost than alternatives.**
- Does not contribute to excess global imbalances.
- **Does not entail immediate rollover risk**.
- Help **avoid economic stagnation and deflation**
- Unlikely to generate global excess demand and inflation given the large negative global output gap.

Other Macroeconomic Implications and Benefits

- **Boosts** global **reserves** and resilience
- Sends powerful **signal of a cooperative multilateral response** and instills global **confidence**
- **Smooths** needed adjustment and **avoids contractionary and distortionary policies** in liquidity-constrained countries

Zimbabwe's experience with the 2009 allocations

- In 2009, Zimbabwe was allocated SDR 262 million under the **general allocation** and SDR 66.4 million under the **special one-time allocation** provided by the Fourth Amendment to the Articles of Agreement.
- At the time of the 2009 allocations, **Zimbabwe had arrears** to the PRGT and predecessor Trusts totaling about SDR 89.4 million.
- Under a **General Allocation**, a participant's right to use SDRs **cannot** be suspended on account of arrears to the General Department or to Fund Trusts. However, the Fourth Amendment provided for a limited exception to this principle of separation.

Zimbabwe’s experience with the 2009 allocations (Con’t)

- Under this exception, the SDRs allocated under the Fourth Amendment to a participant with overdue repurchases and charges in the GRA, overdue principal and interest on loans in the SDA, overdue charges and assessments in the SDR Department and overdue liabilities to the Fund as Trustee would not be made available to the participant, but rather would be **deposited and held in an escrow account in the SDR Department**. These SDRs would be released to the participant only upon the discharge of all such overdue obligations to the Fund.
- Therefore, only SDR 66.4 million allocated to Zimbabwe as special allocation was escrowed, though Zimbabwe’s arrears to the PRGT and predecessor Trusts exceeded the amount of the special allocation.

How will the allocation be distributed?

- EMs and LICs would receive 42.2 percent, or about US$274 billion of the proposed SDR allocation

- **LICs (69 PRGT eligible countries) would receive 3.2 percent, or about US$21 billion**

- Zimbabwe's illustrative allocation is about US$965 million (in line with its paid quota share: about 0.1485 percent).