INTERNATIONAL MONETARY FUND

May 27, 2021

PROPOSAL FOR A GENERAL ALLOCATION OF SPECIAL DRAWING RIGHTS

EXECUTIVE SUMMARY

This paper proposes a general allocation of Special Drawing Rights (SDRs) during the Eleventh Basic Period. At the onset of the Eleventh Basic Period (which runs from January 1, 2017 to December 31, 2021), the Managing Director did not put forward a proposal for a general allocation of SDRs but stated that she would bring the issue before the Board for discussion if and when appropriate. Against the backdrop of the COVID-19 crisis, the Managing Director in March 2021 put forward considerations for an SDR allocation and, following initial consultations at an informal briefing, Executive Directors conveyed that Fund members would broadly support a general allocation of SDRs. Subsequently, the International Monetary and Financial Committee (IMFC) in its April 8 Communiqué called *"on the IMF to make a comprehensive proposal on a new SDR general allocation of US$650 billion to help meet the long-term global need to supplement reserves, while enhancing transparency and accountability in the reporting and the use of SDRs."*

Staff's analysis makes the case for a prompt, one-step, general allocation in an amount equivalent to US$650 billion (about SDR 453 billion). Such an allocation would help "*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 [the Fund's] purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world,*" consistent with the requirements in the Articles of Agreement. While subject to uncertainty, staff estimates the long-term global need for reserve assets in the range of US$1.1 to 1.9 trillion (about SDR 0.8 to 1.3 trillion) over the next five years. An SDR allocation of US$650 billion (about SDR 453 billion) would cover about 30–60 percent of the estimated global reserve need.

In parallel, staff proposes measures to enhance transparency and accountability in the reporting and the use of SDRs while strengthening operational measures. This includes issuing a Guidance Note for staff on the treatment and use of SDR allocations. The Guidance Note will provide a consistent framework for assessing the macroeconomic implications of the allocation at the country level and outline principles that can enhance the transparency and accountability in the use of SDRs. Staff will also prepare a report about two years after the allocation covering the use of SDRs for Fund transactions and operations and broad spending patterns and macroeconomic outcomes. In addition to monthly, quarterly, and annual information on SDR holdings,

and aggregate information on voluntary trading already being published, it is proposed that the Fund start publishing changes in quarterly SDR holdings by member, broken down into Fund-related operations and SDRs trades. Staff also proposes that *the Annual Update on SDR trading Operations* be published. Finally, staff will engage with participants in the Voluntary Trading Arrangements (VTAs) to confirm or update terms and will reach out to potential new participants in the VTAs.

Should the Executive Board support the Managing Director's assessment set out in this paper, she will put forward promptly a report to the Board of Governors for Executive Board concurrence. The report to the Board of Governors would include a formal proposal for a general SDR allocation equivalent to US$650 billion during the Eleventh Basic Period. Following Executive Board concurrence, the report would be transmitted to the Board of Governors for its approval. On this basis, the proposed allocation could become effective by end-August 2021.

The Managing Director will not submit, at this stage, a proposal for an allocation or cancellation of SDRs for the Twelfth Basic Period to the Board of Governors. The transmittal of the Managing Director's report on the Twelfth Basic Period to the Board of Governors will take place by June 30, 2021.

Approved By
Bernard Lauwers, Ceyla Pazarbasioglu, and Rhoda Weeks-Brown

Prepared by the Finance (FIN), Legal (LEG), and Strategy, Policy and Review (SPR) Departments. The team was led by C. Tovar and M. Takebe (both SPR), G. Everaert (FIN), and A. Rosha (LEG); and comprised E. Pondi Endengle, N. Shenai, Y. Wu, and T. Zheng (all SPR); B. Khan, V. Kurcova, J. Mburu, F. Moreau, A. Nakafeero, M. Nkusu, E. Okosodo, M. Schmid, Z. Tan, and M. Wang (all FIN); H. Pham, and C. Thiemann (both LEG). A. Corbacho (SPR), H. Hatanpaa, M. Manno, and O. Unteroberdoerster (all FIN) provided overall guidance, under the supervision of K. Kostial (SPR), Z. Murgasova (FIN), and B. Steinki (LEG). N. Hallmark and S. Xiong (both SPR); and K. Johnson and S. Saveikyte (both FIN) provided research assistance. T. Garicoche and D. Passos Da Silva (both SPR) helped prepare the report.

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I. INTRODUCTION

1. **Against an unprecedented global health and economic crisis, the membership called on the Fund to present a comprehensive proposal for a new general SDR allocation.** The Managing Director initiated consultations with the membership in March 2021. Following broad support of Fund members conveyed by Executive Directors in an informal briefing, the IMFC called on the Fund at the 2021 Spring Meetings to make a comprehensive proposal for a US$650 billion (about SDR 453 billion) general allocation of SDRs to help meet the long-term global need to supplement reserves.[1,2]

2. **This paper proposes a general allocation of SDRs for the Eleventh Basic Period (January 1, 2017–December 31, 2021), along with measures to enhance transparency and accountability in the reporting and the use of SDRs**. The proposed US$650 billion general SDR allocation would help meet a long-term global need for reserve assets, while "*avoiding economic stagnation and deflation as well as excess demand and inflation in the world*," consistent with the criteria set out in the Articles of Agreement (Box 1). Separately, and as discussed in Section III, the Managing Director is also required to report to the Board of Governors on the case for a general allocation or cancelation of SDRs during the Twelfth Basic Period (starting January 1, 2022), no later than six months before the end of the Eleventh Basic Period (i.e., by end-June 2021). This paper also informs the Executive Board of the Managing Director's intention not to propose an additional general allocation or cancelation of SDRs during the Twelfth Basic Period at this stage, in light of the proposal set out in this paper for a general allocation during Eleventh Basic period.

3. **The remainder of the paper is organized as follows.** Section II discusses the case for a general allocation of SDRs, while Section III describes the key legal parameters of an SDR allocation and key features of the proposed allocation. Section IV discusses post allocation issues, including transparency and accountability in the reporting and the use of SDRs, and the implications for the SDR market. Sections V and VI outline next steps and issues for discussion, respectively. The Annexes provide background on the basic features of SDRs and SDR transactions, an overview of the concept of long-term global reserve need for past allocations, and an illustrative breakdown of the proposed US$650 billion allocation.

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[1] See Communiqué of the Forty-Third Meeting of the International Monetary and Financial Committee, April 8, 2021.

[2] For the purposes of this paper, staff used the SDR exchange rate as of end-April 2021 as published on the IMF's website. The relevant exchange rate to determine the allocation will be that prevailing on the date of the summing up of the Executive Board discussion of the current paper.

II. THE CASE FOR A GENERAL ALLOCATION OF SDRs

A. Global Context

4. The world economy is facing an unprecedented health and economic crisis that could affect the stability and smooth functioning of the international monetary system. The COVID-19 crisis is complex, uncertain, and truly global, posing risks of extended scarring. The crisis has also substantially weakened external positions in many countries, raised external financing needs, exacerbated debt vulnerabilities, and deepened poverty. It may also compound pre-pandemic trends of low productivity growth and rising inequality. While uncertainty remains high, the 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 (Figure 1).

Figure 1. Global Output Gap
(In percent of potential GDP)

Source: IMF, World Economic Outlook.

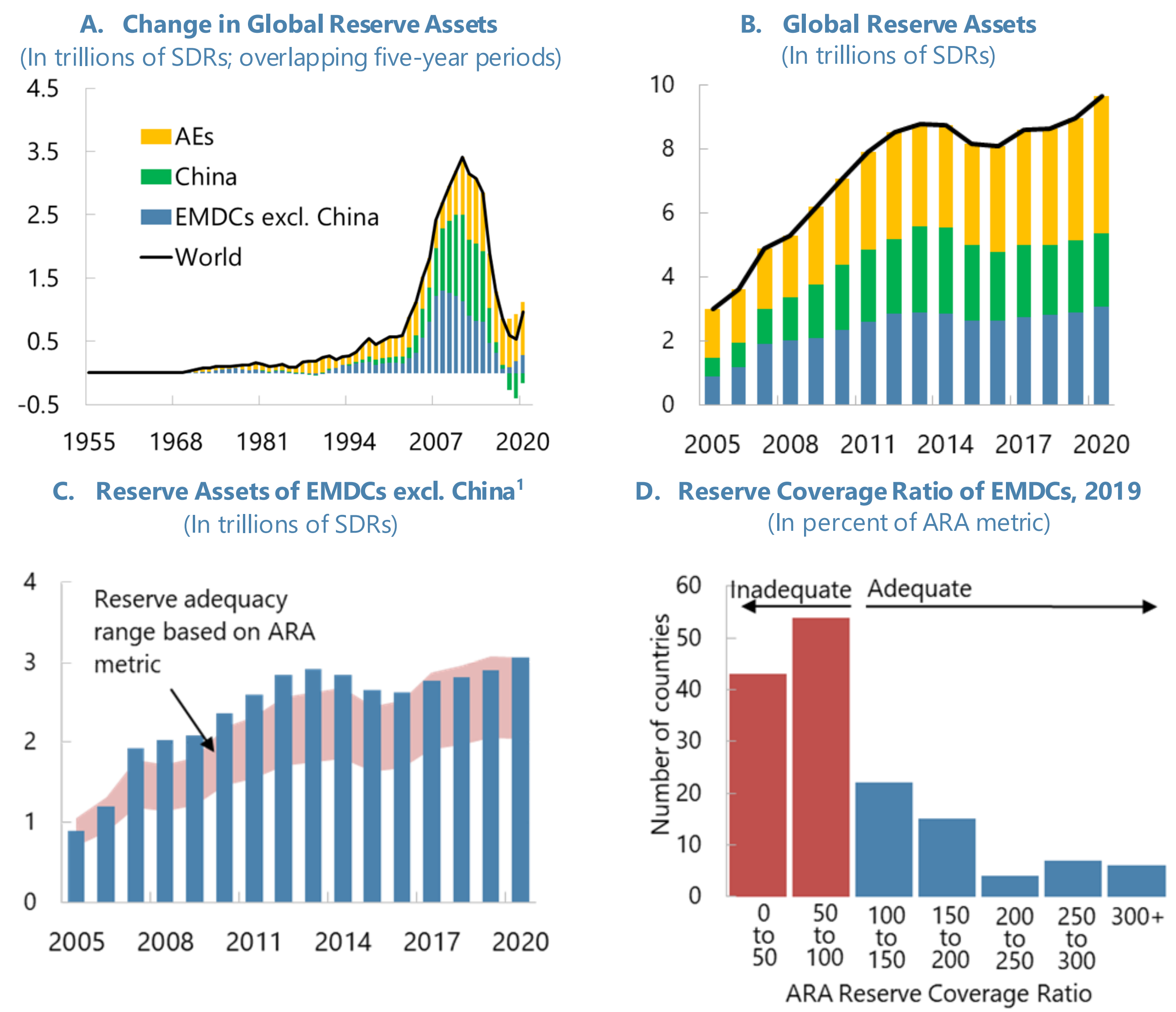
5. Although aggregate global reserve assets have been rising since 2009, the pace of reserve accumulation decelerated sharply since 2011 (Figure 2). Reserve accumulation was mainly driven by current account surpluses and private capital inflows in Emerging Market and Developing Countries (EMDCs) in an environment of low-for-long interest rates. According to the Fund's Assessing Reserve Adequacy (ARA) metric,[3] reserves in EMDCs excluding China remained slightly above the adequacy range on an *aggregate level* for most of the period since the 2009 general SDR allocation. This trend was driven by a narrow group of countries (particularly some countries in Asia and oil exporters) whose reserve levels were well above the adequacy ranges. Meanwhile, in advanced economies (AEs), reserves remained relatively stable throughout the period in terms of historical reserve coverage ratios.

6. Although aggregate reserve levels for EMDCs have been adequate in recent years, many individual countries entered the COVID-19 crisis with an inadequate level of reserves and further drew down their reserve buffers to respond to the crisis. Before the pandemic, more than 60 percent of EMDCs had inadequate reserve assets according to the Fund's ARA metric (Figure 2D). As the pandemic unfolded, many EMDCs outside of Asia saw their current account balances deteriorate alongside the

[3] The ARA metric was initially proposed in 2011 to assess reserve adequacy for emerging market economies by supplementing traditional guidance. It is a weighted sum of four indicators—broad money, exports, short-term debt, and other liabilities—that aim to capture risks from resident outflows, loss of export income, rollover of external debt, and nonresident outflows, respectively. The ARA metric is not used for advanced economies (AEs), which partly reflects that AEs may not require the same level of reserves as EMDCs given their deep and liquid financial markets. See IMF (2011b) for a more detailed discussion.

contraction in exports and global economic activity (Figure 3A). At the same time, bold monetary policy support by central banks of major AEs at the onset of the crisis contributed to stabilizing global liquidity conditions and allowed several EMDCs to maintain market access. Nonetheless, the capital outflow shock has been larger and more persistent than in past crises, and capital flows have yet to recover to their pre-COVID levels (Figure 3B). Overall, EMDCs outside of Asia lost US$95 billion in reserves in 2020, while EMDCs in Asia increased their reserves by US$180 billion.

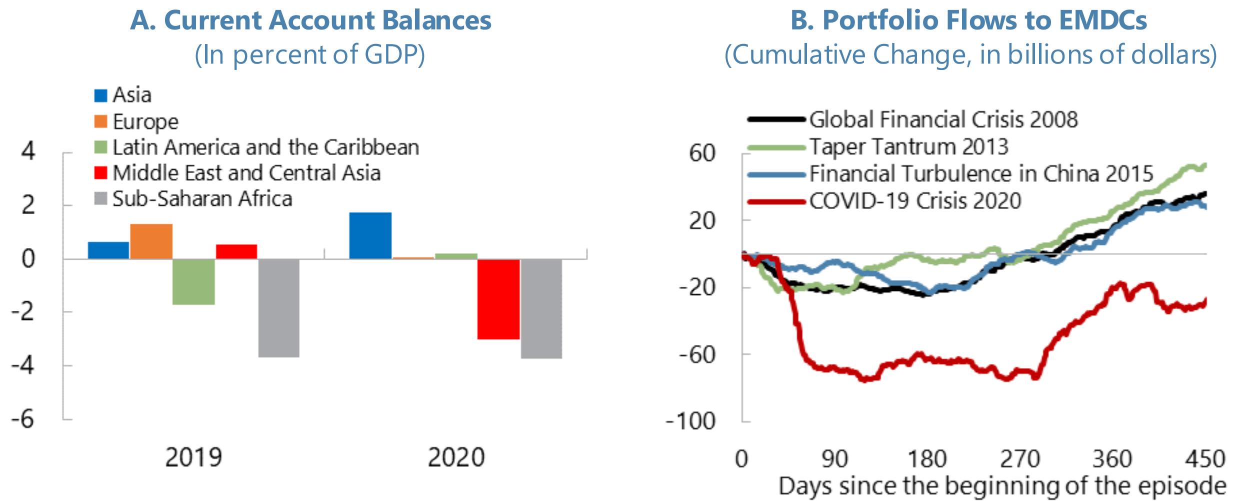
Figure 2. Total Global Reserve Assets



Sources: IMF, International Financial Statistics; and Fund staff calculations.

[1] According to the ARA metric, a reserve coverage ratio ranging between 100–150 percent is considered adequate.

Figure 3. External Sector Developments in EMDCs



Sources: IMF, World Economic Outlook; Institute of International Finance; and Fund staff calculations.

B. Evidence of a Long-Term Global Need for Reserve Assets

7. To assess the long-term need for reserve assets, staff first estimated the difference between the level of reserves in 2020 and the adequate level projected for 2025. The assessment period covers five years, which is in line with the usual timeframe considered when assessing the case for an allocation of SDRs at the onset of a basic period. The long-term need for reserve assets is calculated separately for non-reserve currency issuing AEs and EMDCs and then aggregated to obtain the global long-term need.[4,5] The methodologies are in line with those employed by staff for the assessment of the case for a general allocation of SDRs during the Eleventh Basic Period in 2016.[6]

- For **non-reserve currency issuing AEs**, staff projected the adequate level of reserves through 2025 required to maintain traditional reserve coverage metrics on imports, short-term external debt, and broad money at their 2018–2020 averages.[7] The adequate range is then determined by the highest and the lowest levels indicated by the three metrics.

- For **non-reserve currency issuing EMDCs**, staff relied on the Fund's ARA metric. The ARA metric is applied to each country using World Economic Outlook (WEO) forecasts over a period of five years.

[4] According to the Fund's Currency Composition of Official Foreign Exchange Reserves (COFER), the U.S. dollar, Euro, Chinese renminbi, Japanese yen, Pound Sterling, Australian dollar, Canadian dollar, and Swiss franc are distinguishably identified as reserve currencies.

[5] In October 2016, the Chinese renminbi was included in the SDR basket.

[6] See IMF (2016a) for further details.

[7] Results are robust to the selection of different time periods to compute the average.

The range to assess the adequate level of reserves for 2025 is set between 100 and 125 percent of the ARA metric.[8]

Box 1. Framework for Considering a General Allocation of SDRs

The basis for considering a general allocation of SDRs is Article XVIII of the Fund's Articles of Agreement. Article XVIII, Section 1(a) provides that: "*In all its decisions with respect to the allocation and cancellation of SDRs the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such a 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.*" In addition, before making a proposal, the Managing Director is required under Article XVIII, Section 4(b) to "*conduct such consultations as will enable [her] to ascertain that there is broad support among participants for the proposal.*"[1] In accordance with Article XVIII, Section 2(b) and (e), all participants in the SDR Department are eligible to receive their shares in the SDR allocation in proportion to their quotas.

The Articles do not specify how the long-term global need requirement is to be assessed.[2] In practice, the assessment has generally followed a two-step process. First, staff projects the long-term global need for reserve assets. Second, staff analysis informs whether this need could, and should, be met through an SDR allocation.

Legislative history and experience from past allocation decisions provide guidance on the interpretation of the concept of long-term global need.

- First, the quantification of the need to supplement members' international reserve assets has been based on standard indicators of reserve adequacy.
- Second, a global need does not require all or even most IMF members to experience an inadequacy of reserves, but reflects a broad assessment that the projected level of global reserves, in the absence of supplementation, would be inadequate or result in a suboptimal performance of the global economy. This can occur as long as the group of countries facing the need accounts for a significant share of the world economy.
- Third, an assessment for the long-term implies that SDR allocations or cancellations are not intended to respond to, or deliberately seek to ameliorate, cyclical or short-term economic fluctuations. Rather the focus is to address a "long term" global need. Article XVIII, Section 2 stipulates that the Fund's decisions on general allocations (or cancellations) of SDRs take place in the context of consecutive basic periods of normally five years of duration. This five-year horizon provides guidance, including on the horizon for assessing risks of global deflation and inflation. However, current conditions do influence the assessment of a long-term global need by providing the starting point (e.g., current level of reserves).
- Fourth, SDR allocations could be deemed appropriate even if there are alternative ways to supplement reserve assets, e.g., borrowing from the market.

[1] The persons to be consulted and the consultation procedures are left to the discretion of the Managing Director. In practice, these consultations have been conducted with Executive Directors and the officials of Fund members.
[2] For more information on the concept of "long-term global need" and the past assessments of this concept, see Annex II; IMF (2011a); IMF (2009a).

8. **Staff estimates the long-term global need for reserve assets to be in the range of US$1.1 to 1.9 trillion** (about SDR 0.8 to 1.3 trillion). This estimate is higher than the estimated need of about US$0.7

[8] For a few LICs that do not have necessary data for calculating the ARA metric, staff used the traditional three-month import coverage benchmark when available.

to 1.7 trillion (about SDR 0.5 to 1.2 trillion) at the time of the 2016 assessment. The need for non-reserve currency issuing AEs is estimated at US$0.3 to 0.6 trillion (about SDR 0.2 to 0.4 trillion) over the next five years, broadly in line with the 2016 assessment. The need for non-reserve currency issuing EMDCs is estimated at US$0.8–1.3 trillion (about SDR 0.6 to 0.9 trillion), explaining most of the increase since 2016 (Table 1).[9]

Table 1. Estimated Long-Term Global Need for Reserve Assets
(In trillions of U.S. dollars)

	Total		Non-reserve currency issuing AEs		Non-reserve currency issuing EMDCs	
	Combined (A)+(B)		**Standard Metrics (A)**		**ARA Metrics (B)**	
	5yr	10yr	**5yr**	10yr	**5yr**	10yr
Lower band	**1.1**	2.1	**0.3**	0.8	**0.8**	1.3
Upper band	**1.9**	3.1	**0.6**	1.1	**1.3**	2.0

Sources: IMF, World Economic Outlook; and Fund staff calculations.
Note: The lower (upper) band takes as reference 100 (125) percent of the ARA metric. For methodological details, see IMF (2016a). The long-term global need for reserves assets for low-income countries (LICs) is estimated in the range of US$0.2-0.3 trillion.

9. The Covid-19 crisis has increased the long-term global need for reserve assets. Staff analysis suggests that the pandemic may have increased the global need for reserve assets by about US$0.2 trillion compared with pre-pandemic trends,[10] accounting for roughly half of the increase since the 2016 assessment.

10. There are upside and downside risks to these estimates. On the one hand, the global economy faces significant uncertainty and risks that are not captured in the baseline. An adverse turn in the course of the pandemic could worsen the medium-term economic outlook and require countries to further build up their reserve assets.[11] In particular, uneven vaccine access and a divergent recovery between AEs and EMDCs could imperil capital flows to EMDCs, as AEs unwind their policy support. In addition, a reassessment of market fundamentals (e.g., in response to adverse COVID-19 developments) could trigger a widespread risk-off event in financial markets, while a sharp rise in global risk premia could expose financial and fiscal vulnerabilities. As a result, some EMDCs could face challenges meeting their external financing needs and thus might need to draw down their reserve buffers. On the other hand, the long-term global need for reserve assets could be lower if an upside risk materializes. For example, greater progress with vaccinations could uplift the medium-term global economic outlook and ease external financing conditions for EMDCs.

[9] Estimates over ten years are reported as a reference. As shown in Table 1, the demand for reserve assets is estimated to roughly double in 10 years, further supporting the case for a long-term global need for reserves.

[10] The pre-pandemic trend for the 2019–2024 period was calculated based on WEO projections as of October 2019.

[11] For a more detailed discussion on risks, see World Economic Outlook, April 2021.

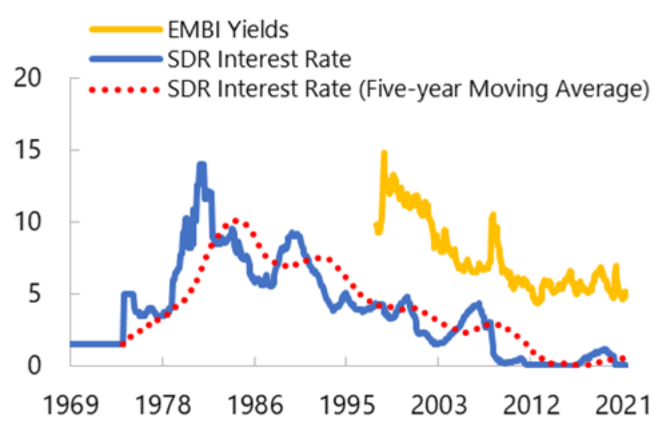
C. Supply of Reserve Assets and Sources to Meet the Global Reserve Need

11. Countries that need to supplement their reserve assets can rely on several funding sources, but these sources would cover only part of the reserve needs. Countries can meet their reserve needs by running current account surpluses, through net private capital inflows, and/or official financial support, which is critical especially for vulnerable countries with limited access to capital markets.[12] The April 2021 WEO estimates that for countries that need to supplement reserve assets, these sources of financing would cover about US$0.5–0.6 trillion by 2025, compared with the estimated global need of US$1.1–1.9 trillion.

12. Aside from helping cover the demand for long-term global reserve assets, supplementing reserve assets through a general allocation of SDRs offers several advantages over other funding sources.

- **SDRs are less costly.** Borrowing from the markets or accumulating reserves through current account surpluses together with foreign exchange intervention bear direct and indirect costs. In contrast, the SDR allocation is cost free.[13] If SDRs are used and holdings fall below the level of cumulative allocations, countries would pay the SDR interest rate on the difference between their allocations and holdings.[14] The SDR interest rate stood at 5 basis points at end-April 2021, which is lower than the interest rate of foreign currency-denominated debt for EMDCs and several AEs (Figure 4).[15]

Figure 4. SDR Interest Rate
(In percent)



Sources: IMF and Bloomberg L.P.

[12] Some countries might also be able to access foreign assets that are not included in reserve assets (e.g., sovereign wealth funds).

[13] There is a very small levy (about 0.00167905 percent of participants' cumulative allocations) to cover the operational cost of the SDR Department. In FY2021, administrative expenses were SDR 3.4 million.

[14] Members earn interest on their SDR holdings and pay charges on their allocation. Therefore, the use of SDR holdings reduces interest earned but could be compensated by the benefits derived from the alternative use of these SDRs.

[15] While the SDR interest rate may increase over time, it is likely to remain at a lower level than the cost at which most, if not all, EMDCs borrow. The reason is that the SDR interest rate is calculated as the weighted average of short-term interest rates of freely usable currencies, which tend to serve as benchmarks for short-term global financial transactions. See Annex I for further details on the SDR interest rate.

- **SDRs do not contribute to excess global imbalances**. Compared to accumulating reserves by running persistent and large current account surpluses, SDRs supplement existing reserves without contributing to global imbalances.[16]

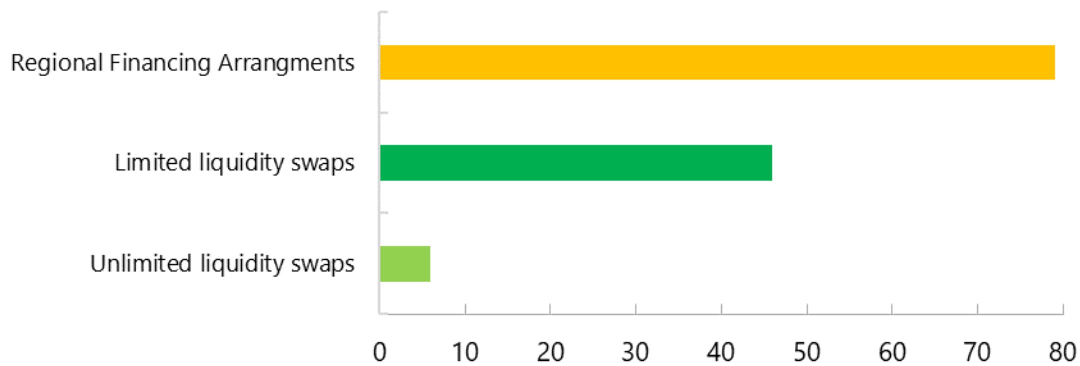
- **SDRs face no immediate rollover risk.** SDRs are similar to owned reserve assets and, therefore, are continuously available. Unless SDRs are cancelled or a reconstitution mechanism is reintroduced, SDRs do not face rollover risk.[17]

- **SDRs benefit all members.** Other liquidity sources, such as bilateral swap lines and regional financing arrangements, have limited country coverage and are not designed to meet a long-term global need (Figure 5).[18]

- **SDRs provide rapid unconditional liquidity.** An SDR allocation can be distributed rapidly to all members, thus complementing a fragmented and layered global financial safety net.[19]

Figure 5. Coverage of Regional Financing Arrangements and Liquidity Swaps, 2020

(Number of Countries)



Sources: Bank of England; Central Bank websites; Regional Financing Arrangements annual reports; and IMF staff estimates.
Note: *Unlimited liquidity swaps* are estimated based on known past usage or, if undrawn, on average past maximum drawings of the remaining central bank members in the network. *Limited liquidity swaps* include all arrangements with an explicit value limit and exclude all Chiang Mai Initiative Multilateralization arrangements, which are included under Regional Financing Arrangements. Two-way arrangements of liqudity swaps are counted as one swap.

[16] IMF (2018a) discussed the risks of excess global imbalances and how the SDR could help address them. The paper explored whether a broader role for the SDR could contribute to the smooth functioning and stability of the international monetary system by looking into three concepts of the SDR: the reserve assets administered by the IMF; SDR-denominated financial instruments; and the SDR as a unit of account.

[17] Up until 1981, SDR Department participants were subject to a reconstitution requirement under which a participant was allowed to use all of its SDRs, but had to eventually reconstitute its holdings by acquiring an amount of SDRs sufficient to increase its average daily holdings to the required minimum. The requirement was subsequently abrogated. See Annex I for further details.

[18] There are other differences between an SDR allocation and bilateral swap lines (BSLs). Traditional BSLs, such as those of the U.S. Federal Reserve, tend to provide short-term liquidity. The BSLs also increase short term-liabilities and, therefore, it mechanically increases the ARA metric. By contrast, the SDR allocation increases long-term foreign exchange liabilities and therefore does not increase the ARA metric.

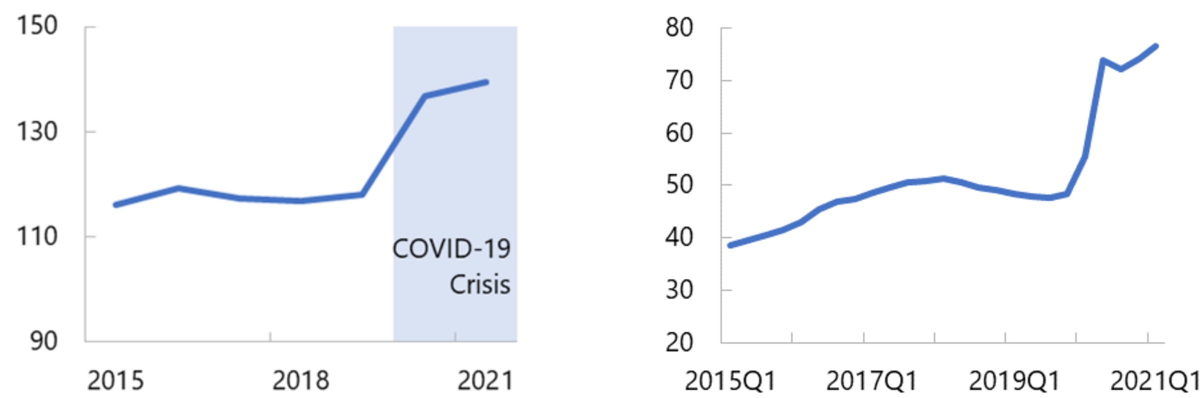
[19] See IMF (2016b) for more discussion.

13. The global supply of reserve assets could become more constrained over the long term. In response to the COVID-19 crisis, AEs (especially G7 countries) substantially increased their government debt issuance, which is a major source of reserve assets (Figure 6). As AEs recover, government debt issuance is expected to decline, and the extraordinary liquidity injection by major central banks will eventually unwind, tightening the supply of global liquidity.

Figure 6. Supply of Reserve Assets

A. General Government Debt of G7 Economies
(In percent of GDP)

B. Major Central Banks' Balance Sheets
(In percent of GDP)



Sources: IMF, World Economic Outlook April 2021; Haver Analytics; and Fund staff calculations.
Note: Major central banks include the U.S. Federal Reserve, the European Central Bank, and the Bank of Japan.

14. However, there are some potential risks and drawbacks of supplementing reserves with SDRs. As determined by the Articles of Agreement, the distribution of the SDR allocation is made in proportion to quota shares,[20] which does not reflect individual members' reserve needs.[21] Also, some recipient countries could unduly delay needed macroeconomic adjustment and reforms, or use SDRs without realizing the potential costs and risks, including the interest charges associated with the use of SDRs at variable interest rates.[22] Fund advice, both in surveillance and program engagement with the membership, as was done in the context of the 2009 allocation, will focus on mitigating these risks where relevant.[23] The proposed guidance note, together with the existing set of principles and best practices laid

[20] The only special SDR allocation was made in the context of the Fourth Amendment of the Articles of Agreement. It took four years (1993–1997) from the initial mandate by ministers until the agreement was reached at the Executive Board. It then took more than twelve years to reach the 85 percent threshold for the amendment to become effective. This special allocation was not selective but rather it aimed to provide all members—including many new members from the former Soviet Union—with the same cumulative allocation in terms of quota, to allow members to participate equitably in the SDR system given they were joining after the previous SDR allocations had been made. In the current context, an amendment to the Articles of Agreement for a special allocation of SDRs that would benefit only some members would likely require protracted negotiation. Moreover, a "targeted" allocation would be unprecedented. See further details in Section III.B.

[21] For example, the SDR allocation can boost reserve levels of members that have inadequate reserve assets and, at the same time, increase some members' reserves beyond the Fund's ARA adequacy range.

[22] In IMF (2018) staff reviewed the experience of the 2009 allocation concluding that there was "*little evidence of widespread moral hazard*" in the use of the SDR allocation.

[23] See IMF (2009a).

out in the Fund's frameworks on governance and operations, will also be used to guide Fund advice on mitigating these risks.[24]

D. Macroeconomic Considerations for an SDR Allocation

15. A US$650 billion general allocation of SDRs would help avoid global economic stagnation by:

- **Instilling global confidence.** The SDR allocation would send an immediate and powerful signal of a multilateral response to the crisis and help boost global confidence. Higher confidence with greater global reserve provision would increase the resilience of the global economy and foster global financial stability, which is likely to reduce sovereign risk premia and facilitate the global economic recovery (Box 2).

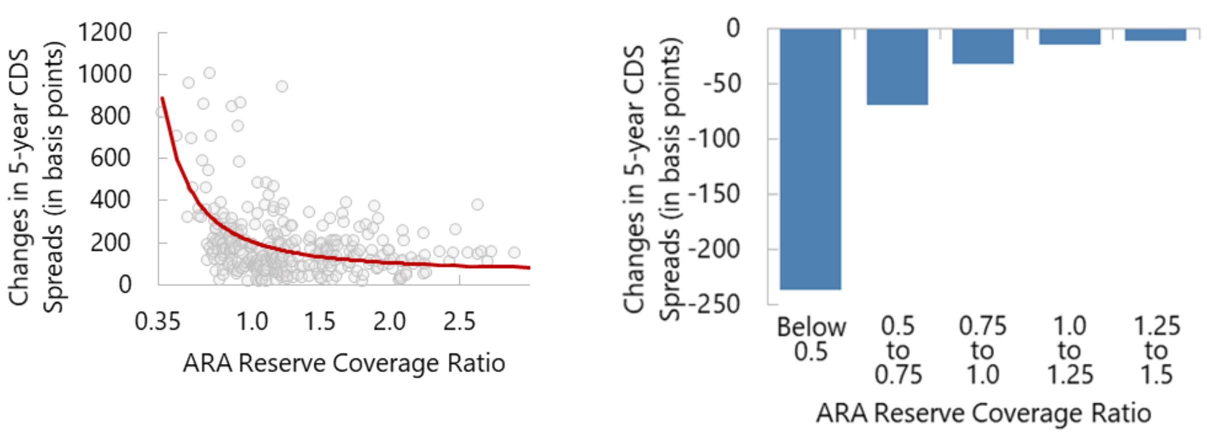
Box 2. Impact of an SDR allocation on Sovereign Risk Premia

Staff used a two-step approach to quantify the relationship between an SDR allocation and sovereign risk premia. The first step used annual cross-country panel estimates to determine the link between sovereign risk premia—captured by five-year credit-default swaps (CDS) spreads—and reserve adequacy, measured by the ratio of countries' reserves relative to the Fund's ARA metric. The second step used the estimated parameters to simulate the impact of a US$650 billion allocation on countries' risk premia.

The analysis shows that by boosting countries' reserves an SDR allocation would likely be associated with lower sovereign risk premia (Box Figure 1). There is a statistically significant, negative, and non-linear relationship between reserve adequacy and sovereign spreads. The average reduction in sovereign spreads would be particularly large for countries with lower reserve coverage prior to the allocation. The simulation shows that the potential reduction in CDS spreads can be as large as 240 basis points for countries with reserve coverage below 50 percent of the ARA metric prior to the allocation.

Box Figure 1. Impact of an SDR allocation on Countries' External Financing Conditions

A. CDS Spreads and Reserve Adequacy Levels **B. Impact of an SDR allocation on CDS Spreads**



Sources: Bloomberg L.P.; Haver Analytics; and IMF, World Economic Outlook; and Fund staff estimates.
Note: The estimated fitted regression line is obtained from a nonlinear least squares regression of CDS spreads, while controlling for the ratio of countries' reserves relative to the ARA metric. The unbalanced panel uses annual data between 2000 and 2018.

[24] See Section IV.A.

- **Helping liquidity-constrained countries to smooth needed adjustment and avoid contractionary and/or distortionary policies.** Non-reserve currency issuing EMDCs are expected to face gross external financing needs of over US$3 trillion in 2021–2025.[25] By supplementing existing reserves, the SDR allocation would help smooth needed adjustment over time and mitigate the need to rely on overly contractionary or distortionary macroeconomic policies.[26]

16. The SDR allocation is not expected to generate *global* inflationary pressures.[27] The allocation per se does not exert any inflationary pressure. Even if countries spend their SDRs, this is unlikely to cause global excess demand and global inflation.[28] As noted in Figure 1, the global output gap is large and negative. Moreover, the proposed allocation of US$650 billion represents a small share of global GDP (about 1 percent) and money supply (about 4 percent of major central banks' base money).[29] And by boosting reserves and confidence, an SDR allocation would help stabilize foreign exchange market conditions and mitigate the exchange rate pass-through to inflation. For similar reasons, while current conditions differ from those at the global financial crisis, there is no evidence suggesting that the 2009 allocation was inflationary.[30]

17. The general allocation of SDRs has significant benefits for EMDCs, particularly for LICs. The SDR allocation is distributed in proportion to quotas of members who are participants in the SDR Department (see section III.B). Based on Fund members' quota shares as of end-April 2021, EMDCs would receive about 42 percent, of which 3.2 percent would be LICs (Table 2 and Annex III). Specifically, LICs would receive US$21 billion (about SDR 14.6 billion). This complements the financing provided from the Poverty Reduction and Growth Trust (PRGT) during the COVID-19 crisis. For many LICs, the SDR allocation would represent a significant share of GDP (Figure 7A). However, even with the allocation, international reserves levels in many LICs would remain well below their adequacy ranges as measured by the ARA metric (Figure 7B).[31]

[25] Gross external financing needs are defined as the sum of the current account deficit, short-term debt, and amortization on medium- and long-term debt.

[26] Smoothing adjustment in the current context should not be interpreted as excessively delaying needed macroeconomic adjustment or reform.

[27] In some countries, the use of the SDR allocation could result in higher demand pressures and therefore generate inflation. However, the case of the SDR allocation is built on a global basis.

[28] By supporting the global economy, the SDR allocation could help mitigate potential risk of deflation.

[29] If any freely usable currency (i.e., U.S. dollars, euros, British pounds, Japanese yen, or Chinese renminbi) is provided in exchange for SDRs by countries other than the issuer of the freely usable currency, there is no monetary effect. These foreign exchange reserves are simply transferred from one country to another, with an equivalent change in the composition of reserves in both countries. Money supply could be generated only if the central bank issuing the freely usable currency provides them in exchange for SDRs and does not sterilize its impact. See Cooper (2011) for a more detailed discussion.

[30] The sales of 2009 SDRs that were not related to IMF operations (excluding prescribed holders) amounted to about SDR 3.4 billion from September 2009 to August 2010. For further discussion, see the Annex I in IMF (2016a).

[31] See a broader discussion of LIC's financing needs over 2021–25 in IMF (2021).

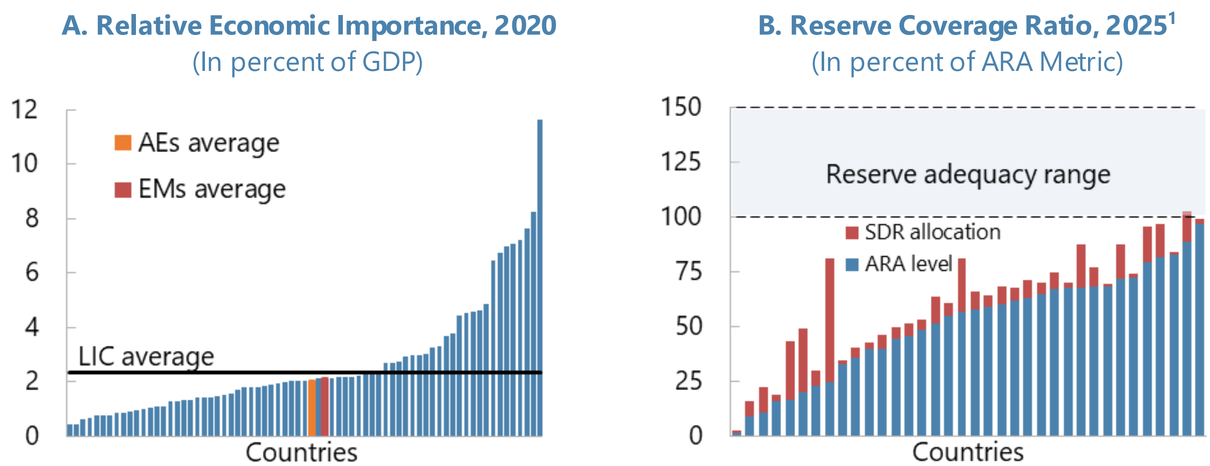
Table 2. Illustrative Distribution of an SDR allocation of US$650 billion[1]

	Allocation (In billions of U.S. dollars)	*Memo: Quota Share (In percent)*
G7	**283**	*43.5*
Other AEs	**93**	*14.3*
EMDCs[2]	**274**	*42.2*
o/w excl. China	233	*35.8*
o/w LICs[3]	21	*3.2*

Sources: IMF; and Fund staff calculations.
[1] Distribution of allocations based on paid quota shares as of end-April 2021.
[2] Country groupings are based on IMF quota classification.
[3] Defined as 69 PRGT-eligible countries.

18. Given the previous considerations, the general allocation of SDRs will also contribute to the attainment of the Fund's purposes as set out in Article I of the Articles of Agreement. Specifically, it will promote international monetary cooperation, facilitate the expansion and balanced growth of international trade, shorten the duration and lessen the degree of disequilibrium in the balance of payments of members, and maintain orderly exchange arrangements.

Figure 7. Impact of a US$650 Billion SDR Allocation on LICs



Sources: IMF, World Economic Outlook; and Fund staff calculations.
[1] The figure only shows countries with inadequate reserve coverage ratios as captured by the ARA metric. The blue bars indicate the ARA coverage ratios in 2020.

E. Summary: The Case for a US$650 Billion General SDR Allocation

19. The proposed general SDR allocation of US$650 billion (about SDR 453 billion) is derived from the global reserve needs' estimates and seems of a sensible order of magnitude.

- Using various benchmarks and estimates, and notwithstanding uncertainty, future needs for additional reserve assets are expected to be large, ranging from US$1.1 to 1.9 trillion in the next five years. Moreover, there are factors that suggest these needs could be larger.

- While other sources are available to meet at least a portion of these needs, meeting them in part through a general SDR allocation would help strengthen members' external positions, build confidence, foster the resilience and stability of the global economy, and contributes to the global economic recovery. The allocation has clear advantages in terms of immediate crisis response, mitigation of long-term economic scarring due the pandemic, and longer-term crisis prevention.

- The 2009 allocation covered about 30 to 60 percent of the long-term global reserve need. Using the same percentage translates to a suggested allocation range of US$0.3–1.2 trillion (about SDR 0.2–0.8 trillion) in 2021. As elaborated above, staff analysis suggests that an allocation within this range would be consistent with the requirements set in Article XVIII. Considering non-SDR funding sources, the allocation would cover a significant share of the residual long-term global reserve need.

- The allocation would thus help meet a long-term global need for reserve assets, while "avoiding economic stagnation and deflation as well as excess demand and inflation in the world," consistent with the criteria set out in the Articles of Agreement. By doing so, it also furthers the Fund's purposes as set in the Articles of Agreement.

III. KEY FEATURES OF THE ALLOCATION: LEGAL ASPECTS

A. Decision-Making Process

20. Under the Articles of Agreement, decisions on allocations (and cancellations) of SDRs are made by the Board of Governors on the basis of proposals of the Managing Director concurred in by the Executive Board (Article XVIII, Section 4(a)). Before making a proposal to allocate SDRs, the Managing Director must: (i) satisfy herself that such an allocation would be consistent with the relevant economic criterion (i.e., as discussed above, that it would satisfy a long-term global need to supplement reserve assets in a manner that would avoid stagnation, deflation, excess demand and inflation); and (b) conduct such consultations as will enable her to determine that there is broad support among participants (Article XVIII, Section 4(b)). The Executive Board's decision to concur in the Managing Director's proposal requires a majority of the votes cast. Adoption of the Board of Governor's resolution to allocate SDRs requires an 85 percent majority of the total voting power of members that are participants in the SDR Department (Article XVIII, Section 4(d)); currently all Fund members are SDR Department participants.

21. In light of the above, and to the extent that the Executive Board supports the proposed SDR allocation set forth in this paper, the Managing Director would submit for Executive Board consideration a report to the Board of Governors. This report would include a formal proposal for a general allocation of SDRs in an amount equivalent to $650 billion and be accompanied by a draft Board of Governors resolution. If the Executive Board concurs with the Managing Director's proposal, the

Managing Director's report would be submitted to the Board of Governors with a request for a vote without meeting on the proposed resolution pursuant to Section 13 of the By-Laws.

B. Basic Periods and Distribution of the Allocation

Basic Period for the Allocation

22. Decisions by the Fund on general allocations or cancellations of SDRs take place in the context of consecutive basic periods of normally five years of duration (Article XVIII, Section 2(a)). Allocations shall normally take place at yearly intervals within each basic period. The Articles, however, provide flexibility, in particular a basic period can be less than five years and allocations can take place at other than yearly intervals (Article XVIII, Section 2(c)). The Managing Director must make a proposal to the Board of Governors no later than six months before the end of each basic period regarding a general allocation or cancellation for the next basic period (Article XVIII, Section 4(c)(i)). If the Managing Director ascertains that there is no proposal consistent with Article XVIII, Section 1(a) that has broad support among participants, she must report so to the Executive Board and then to the Board of Governors, no later than six months before the end of a basic period (Article XVIII, Section 4(c)(i)). The Eleventh Basic Period began on January 1, 2017 and is scheduled to end on December 31, 2021. The Twelfth Basic Period will commence on January 1, 2022.

23. A proposal for an SDR allocation or cancellation may be made at any time during a basic period. In particular, if no decision has been taken with respect to an allocation or cancellation for a basic period, the Managing Director may make a proposal during the course of that basic period, at her own initiative or at the request of the Board of Governors or the Executive Board, whenever she is satisfied that the conditions under the Articles are met (Article XVIII, Sections 4(c)(ii) and 4(c)(iv)). The Fund has not made a decision on the allocation (or cancellation) of SDRs for the Eleventh Basic Period.[32] Consequently, at any time before the end of the current Eleventh Basic Period (i.e., by end-2021), the Managing Director may propose that the Fund approve a general allocation of SDRs for this period.[33]

24. It is proposed that the SDR allocation for the equivalent of US$650 billion proposed in this paper be made in a single tranche. As discussed above, a single-tranche SDR allocation would help meet the long-term global need for reserve assets, while providing an immediate boost to global reserves and instilling global confidence during the COVID-19 crisis. This will support the global recovery and prevent further damage to the global economy and the stability of the international monetary system.

[32] See *Report of the Managing Director to the Board of Governors and to the Executive Board Pursuant to Article XVIII, Section 4(c)* (06/29/2016).

[33] The Managing Director's report to the Board of Governors in June 2016, which notified the Managing Director's decision not to propose any allocation or cancellation of SDRs for the Eleventh Basic Period, stated that: "*During the course of the [Eleventh] Basic Period, I would bring the issue of a general allocation of SDRs before the Executive Board for further discussion, if and when appropriate, in accordance with Article XVIII, Section 4(c)(ii). The Board of Governors or the Executive Board may also request that I make proposals at any time.*" See *Report of the Managing Director to the Board of Governors and to the Executive Board Pursuant to Article XVIII, Section 4(c)* (06/29/2016).

25. With respect to the Twelfth Basic Period that will start on January 1, 2022, the Managing Director will circulate a separate brief report to the Executive Board for information and comments shortly. This report would then be sent to the Board of Governors by June 30, 2021 to meet the requirements under the Articles. As explained above, the Managing Director is required to report to the Board of Governors no later than six months before the end of the current Eleventh Basic Period (i.e., by end-June 2021), on whether she would propose a general allocation (or cancellation) of SDRs for the upcoming Twelfth Basic Period (starting January 1, 2022). Because the proposed general allocation for the Eleventh Basic Period, once approved by the Board of Governors and implemented as proposed in this paper, would help address the long-term global need for reserve assets, the Managing Director will inform the Board of Governors of her intention not to put forward a proposal for another allocation of SDRs for the Twelfth Basic Period at this time.[34] Consistent with the framework described earlier, during the course of the Twelfth Basic Period, the Managing Director may make proposals for a general allocation or cancellations of SDR, at her own initiative or at the request of the Board of Governors or the Executive Board, if the Managing Director is satisfied that the conditions under the Articles for such proposals are satisfied.

Distribution of Allocation

26. The SDR allocation is made in proportion to quotas of members who are participants in the SDR Department (Article XVIII, Section 2(b)). Under the Articles, the general rule is that "*the rates at which allocations are to be made shall be expressed as percentages of quotas on the date of each decision to allocate*" and that "*the percentages shall be the same for all participants.*" However, the Articles also provide that, when making the decision to allocate, the basis for allocation may be "*the quotas or net cumulative allocations on dates other than the dates of the decisions to allocate*" (Article XVIII, Section 2(c)(iii)).

27. It is proposed that the allocation be based on participants' paid quotas in the Fund as of the date of adoption of the Board of Governors resolution.[35] Specifically, the rate for the proposed general allocation of SDRs would be approximately 95.13 percent of eligible participants' quotas on the date of the adoption of the Board of Governors resolution on the SDR allocation, taking into account certain assumptions on eligibility and opting out discussed below. This rate is the percentage, rounded to the nearest one hundredth of one percentage point, that results from dividing an amount of SDRs equivalent to US$650 billion (based on exchange rate as of end-April) by the total of quotas of those participants. For

[34] The Articles of Agreement authorizes the Fund to cancel SDRs; however there have been no cancellations to date. A cancellation may be made by the Fund based on an opposite finding of that required for allocations: namely an assessment that there is an excess of global reserve assets and hence a long-term need to reduce the existing stock of SDRs created in previous allocations. In light of staff's findings in this paper, there is no case for a cancellation of SDRs at this time.

[35] As of end-April 2021, only five countries (Eritrea, Marshall Islands, Palau, Sudan, and the Syrian Arab Republic) had yet to pay their quota increases under the 14th General Review of Quotas. Unless these members make their quota payments before the effective date of the general SDR allocation, their shares of the allocation would be based on their current (pre-14th General Review) quotas. Staff has alerted the authorities of these members. In the case of Sudan, under the Board of Governors Resolution No. 66-2 approving the 14th General Review quota increases, Sudan is precluded from consenting to, or paying for, its quota increase due to its overdue financial obligations in the GRA. Accordingly, unless Sudan can clear arrears to the Fund and pay for its' quota increase prior to the effectiveness date of the SDR allocation, Sudan's share of the proposed allocation would be based on its current (pre-14th General Review) quota.

the actual allocation calculations, it is proposed that the USD/SDR exchange rate to be used for purposes of converting the US$650 billion proposal and the percentage share of quotas would be that of the date of the summing up of the Board discussion of the current paper.[36]

Eligibility and Opting Out

28. All Fund members that are participants in the SDRs Department are eligible to receive allocations of SDRs made under the Managing Director's proposal. Under the Articles, however, a member that is a participant in the SDR Department may opt out of receiving an allocation. Such opt out requires (a) that the Governor for the participant does not vote in favor of the decision; and (b) the participant notifies the Fund in writing prior to the allocation of SDRs under that decision that it does not wish SDRs to be allocated to it under the decision (Article XVIII, Section 2(e)).[37] The rate of allocation specified above assumes that all SDR department participants would receive allocations under the Managing Director's proposal (see list of participants and proposed allocations attached in Annex III), i.e., that no member would opt out of the allocation.

New Participant

29. As is customary, it is proposed that the Executive Board adopt a decision permitting new members who joined the Fund in the Eleventh Basic Period to participate in the allocation. Under the Articles, a member that becomes a participant after the commencement of a basic period, will only be able to receive allocations made during that basic period if the Fund decides that it may do so. Such decision may be adopted by the Executive Board by a majority of the votes cast.[38] Andorra joined the Fund and became a participant in the SDR Department on October 16, 2020, after the beginning of the Eleventh

[36] The USD/SDR exchange rate as of the date of the summing up of the Executive Board discussion was used to determine the 2009 allocation rate. The current proposal is consistent with the approach used in 2009. It implies that the actual allocation, when implemented, would be expected to be about $650 billion, but this U.S. dollar equivalent could differ due to changes in USD/SDR exchange rate. Furthermore, the nominal size of the SDR allocation could be higher if one or several of the five members who have not yet consented to and/or paid for their respective quota increases under the 14th General Review of Quotas do so prior to the effectiveness of the allocation. In the case of Sudan, if Sudan's quota increase under the 14th General Review of Quotas increase becomes effective prior to the effective date of the general allocation, the total SDR amount to be allocated to all participants would be increased by SDR 0.44 billion to SDR453.09 billion, equivalent to about US$ 650.63 billion (based on exchange rates as of April 30). If the other members would also make their quota payments to effect their quota increases under the 14th General Review of Quotas prior to the effective date of the general allocation, the total SDR amount would increase by another SDR 0.80 billion to SDR 453.89 billion, equivalent to about US$ 651.78 billion (based on exchange rates as of April 30).

[37] In the event that there is lack of recognition, or lack of clarity regarding the recognition of a member's government, that member would not vote on the Board of Governors resolution but would receive its share of the proposed SDR allocation. The government would continue to not be able to use SDRs (including the newly allocated SDRs) pending resolution of the recognition issue. A similar approach was followed in the 2009 allocation for the two members with government recognition issues as of that time.

[38] In the context of the 2009 allocation for the Ninth Basic Period (January 1, 2007 – December 31, 2011), the Executive Board's decision to concur on the Managing Director's report to the Board of Governors on the allocation also included the approval for members that became participants between January 1, 2007 and the date of the allocation to receive their shares of the allocation if they had informed the Fund that they wish to receive such allocation. This decision allowed the Republic of Montenegro, which became a participant on January 18, 2007, to receive its share of the 2009 allocation.

Basic Period on January 1, 2017, and a Board decision is thus necessary for Andorra to benefit from the SDR allocation. The calculations underlying the rate of allocation discussed above also assume that Andorra would be eligible for and participate in an allocation.

IV. POST ALLOCATION ISSUES

A. Transparency and Accountability in the Reporting and Use of SDRs

30. Enhanced transparency and accountability in the reporting and use of SDRs can further strengthen the effective functioning of the SDR Department and help ensure that SDRs contribute to macroeconomic stability. Staff proposals presented in this section respond to the call made by the IMFC to enhance transparency and will also contribute to promote accountability, while respecting the unconditional reserve asset characteristic of SDRs.

Enhancing Transparency and Accountability in SDR Reporting

31. The Articles of Agreement provide that the Fund may publish reports as it deems desirable to carry out its purpose. In addition to an Annual Report which the Fund is required to publish,[39] Article XII, Section 7(b) provides that "*the Fund may publish such other reports as it deems desirable for carrying out its purposes*." Rule J-3(b) of the IMF's Rules and Regulations also provides for the issuance of a summary statement of the operations and transactions conducted through the SDR Department, and of the position of each participant and each other holder, at intervals of three months or less.[40]

32. The Fund already publishes a range of information about the SDR. Information on participants' SDR allocations and holdings is made available in the Fund's annual and quarterly financial reports. These published reports also include aggregated information on changes in SDR holdings by transaction type. Separately, the IMF Finances webpages, publishes monthly information on SDR allocations and holdings of participants.[41] The periodic IMF Financial Operations publication also provides extensive information on the functioning of the voluntary SDR trading market and includes details on the operating modalities, capacity, trading by region, and aggregate transaction volumes.[42] In addition, as part of reporting to the Executive Board, on an annual basis, staff prepares a confidential non-published Board paper *Annual Update on SDR Trading Operations* on the functioning of the voluntary trading market and related Designation Plan. Table 3 summarizes the IMF's reporting on the SDR market.

[39] Article XII, Section 7(a) reads: "*The Fund shall publish an annual report containing an audited statement of its accounts, and shall issue, at intervals of three months or less, a summary statement of its operations and transactions and its holdings of special drawing rights, gold, and currencies of members.*" The annual reports are publicly available at: Annual Report of the Executive Board.

[40] The IMF *Rules and Regulations* are available at By-Laws, Rules and Regulations of the International Monetary Fund - Sixty-fifth Issue; November 2019.

[41] Data are available at: https://www.imf.org/en/data/imf-finances.

[42] See IMF (2018b).

Table 3. Publicly Available Information on SDR Allocations and Holdings, Trading, and VTAs

Publicly Available Sources	Summary Data of Receipt and Use of SDRs	Holdings and Allocations by Member	VTA Trading Market Modalities and Capacity	VTA Members and Summary Trading by Region	SDR Aggregate Transaction Volumes and Trends
▪ Annual Financial Statements	✓	✓			
▪ Quarterly Financial Report	✓	✓			
▪ IMF Finances Webpages[1]		✓			
▪ IMF Finances iPad App[1]	✓	✓			
▪ IMF Financial Operations Publication	✓		✓	✓	✓

[1] Data are updated monthly shortly after each month-end.

33. **To further enhance transparency, staff proposes to publish additional information on SDR holdings, transactions, and trading.** This proposal aims to strike a balance between providing additional information about SDR use while preserving the nature of the SDR as an unconditional reserve asset and promoting the smooth functioning of the voluntary trading market. To this end, staff proposes to enhance its existing quarterly financial reports that include individual members' SDR holdings by publishing changes in those holdings by two broad aggregate categories: (i) those related to IMF operations; and (ii) SDR trading and other uses. Box 3 provides the template for reporting the quarterly changes in SDR holdings.

34. **Staff also proposes to publish the Board paper on the *Annual Update on SDR Trading Operations*.** These *Updates* would provide additional analysis on the use of VTAs and trends in SDR exchanges, such as experience with sales after the SDR allocation, and aggregate VTA trading information, such as trading ranges.[43] Staff will continue to prepare a Designation Plan, which would remain confidential and not published.

[43] For detailed discussion of VTAs, see Section IV.B.

Box 3. Template for Reporting Quarterly Changes in Participants' SDR Holdings*

(In millions of SDRs; February 1, 2021 to April 30, 2021)

Participant	Total Holdings, Beginning of the Period	Fund-Related Operations[1]	SDR Trades and Other Uses[2]	Total Holdings, End of the Period
Country A	10,000	(2000)	(1000)	7,000
Country B	20,000	5000	5000	30,000
Country C	30,000	(3000)	-	27,000
Total participants	**180,762**	**(183)**	**(57)**	**180,522**
General Resources Account (GRA)	22,038	165	-	22,203
Prescribed holders	1,397	18	57	1,472
Total allocations and holdings	**204,197**	**-**	**-**	**204,197**

* The amounts in individual country lines are only indicative for the purposes of this sample report and are not based on any actual country information. The aggregate data on all participants, GRA, and prescribed holders are actual.

[1] Fund-Related Operations include:

- *SDR Department related operations*: Assessment charge, charges on SDR allocations, and interest on SDR holdings.
- *GRA Department related operations*: Quota payments, purchases and repurchases in the GRA, acquisitions in exchange for currencies of other members, repayment of borrowings and interest, GRA charges and remuneration, service charges, and commitment fees.
- *PRGT and other Trust Operations*: Members may lend SDRs to the PRGT. These transactions mainly include PRGT pass-through lending involving participants in the SDR Department. Other transactions in the Trusts include financial contributions provided by participants to the Trusts and loan repayments from borrowers.

[2] SDR trades and other uses relate to any non-Fund transactions. They broadly include the transactions by agreement through the VTA, bilateral exchange of SDRs for currency among participants or with prescribed holders, the purchase of SDRs to replenish SDR holdings, the use of SDR in settlement of financial obligations with prescribed holders or participants and bilateral SDR loans.

Enhancing Transparency and Accountability in the Use of SDRs

35. **The SDR is an unconditional reserve asset and participants can use their newly allocated SDRs without restrictions.** Some members may decide to hold the newly allocated SDRs to boost their reserve buffers. Other members may instead prefer to buy or sell SDRs for freely usable currencies to adjust the composition of their international reserves, or ease liquidity constraints and finance additional spending. SDR participants with obligations due to the IMF may decide to use the SDRs to cover those obligations. The decision about the best way to utilize the newly allocated SDRs rests with each SDR participant.[44]

36. **Staff will prepare a Guidance Note to help country teams develop policy advice consistent with macroeconomic sustainability.** The Guidance Note will—in the context of global developments, the outlook, and policy priorities—provide a consistent framework for assessing the macroeconomic implications of the allocation at the country level, including for accounting and statistical treatment,

[44] A separate workstream will lay out options for voluntary post-allocation channeling of SDRs by members with strong external positions.

reserve management, and debt sustainability.[45] The Guidance Note will help staff provide advice consistent with prudent macroeconomic policies, aiming to ensure that countries do not postpone needed macroeconomic adjustment and reforms. It will provide guidance both in surveillance and program contexts.

37. The Guidance Note will include a section on principles that can enhance transparency and accountability in the use of SDRs. The section on transparency will highlight how Fund-endorsed frameworks of best practices on governance and policies can support transparency in the use of the SDR allocation. It will leverage the set of existing principles and best practices laid out in frameworks on: central bank governance and operations (e.g., transparency in the treatment of SDRs in central bank balance sheets or in the management of foreign exchange reserves as laid out in the Central Bank Transparency Code); fiscal governance and public financial management practices (e.g., fiscal monitoring and safeguards in on-lending SDRs from the central bank to the fiscal authorities);[46] and debt sustainability (e.g., benefiting from the joint IMF-WB multipronged approach for addressing debt vulnerabilities).

38. Staff will also prepare an ex-post report on the use of SDRs two years after the allocation. The report will review the allocation against the broad macroeconomic context and policy priorities following the COVID-19 pandemic. It will discuss broad patterns of holdings and exchange of SDRs into freely usable currencies; the use of SDRs for transactions with the Fund or ex-post voluntary channeling; and a broad characterization of public spending and macroeconomic trends (e.g., reserve buffers, inflation, and growth) following the allocation.[47] The report will also examine the potential effects of the allocation on the stability and resilience of global financial markets (e.g., sovereign risk).

B. Implications for the SDR Market

Conversion of SDRs into Freely Usable Currencies

39. In over three decades, SDR participants and prescribed holders have been able to exchange SDRs for freely usable currencies in transactions by agreement primarily through the VTAs (Annex I).[48] A participant or a prescribed holder may use SDRs freely, without the requirement of a balance of payments need, to obtain an equivalent amount of currency in a transaction by agreement with another participant. These transactions, which can be sales or acquisitions of SDRs, can be arranged

[45] While there are significant differences between 2009 and now, the Guidance Note will build to the extent possible on the 2009 Guidance Note. See *"The Chairman's summing up, Proposal for a General Allocation of SDRs, Executive Board Meeting 09/64, June 26, 2009"*.

[46] Domestic legislations and institutional arrangements play an important role in the accounting treatment of SDR allocations and holdings. They also govern the extent to which allocated SDRs can be used for budget support. In countries where central banks hold SDRs and manage foreign exchanges, central bank lending to the government would typically be guided by limits set by central bank laws or other relevant legislation.

[47] As funding sources are fungible, it is not possible to track the exact use of the SDR allocation, but staff can analyze broad spending patterns before and after the allocation, across different groups of countries.

[48] VTAs are arrangements between the Fund and currently a group of 31 SDR participants and one prescribed holder who have agreed to exchange SDRs for specific currencies within pre-agreed limits. See https://www.elibrary.imf.org/view/books/071/24764-9781484330876-en/ch04.xml

directly between two parties or can be facilitated by the Fund through the VTAs. Most transactions have been arranged through the VTA market whereas relatively few transactions were agreed directly between participants and/or prescribed holders in the SDR Department. A subset of SDR acquisitions needed to meet members' obligations to the Fund can be conducted through the GRA of the General Department of the Fund in certain circumstances.

40. **The VTAs continue to have ample buying and selling capacities to meet the demand for sales and acquisitions of SDRs.** The 32 VTAs in place as of end-April 2021 continue to successfully support requests for transactions by agreement.[49] The related capacities are determined by considering the SDR holdings of each VTA participant relative to its allocation and the minimum and maximum SDR amounts that a VTA participant is willing to hold. As of end-April 2021, the capacity of the VTAs to absorb sales of SDRs by others totaled SDR 72.5 billion and the capacity to provide SDRs in requests to acquire totaled SDR 33.8 billion. There is broad participation by the VTA members in meeting demand for sales and acquisitions of SDRs, with 30 of 32 arrangements used in the past five years.

41. **The flexibility and voluntary nature of the market contributes to the willingness of VTA members to have a VTA and actively participate.** Since the VTA market is truly voluntary in nature, staff can apply informal modalities that account for the unique preferences of VTA participants. For example, some VTA participants have preferences to transact within certain trading ranges and exchange SDRs for certain currencies. Other considerations determining the selection of counterparties includes prior and overall usage, recent or upcoming transactions assigned to the VTA participant, blackout periods for operational reasons or holidays, and the need to split large transactions among multiple VTAs. VTAs may also broaden opportunities for the VTA member to manage its own SDR reserves by participating in transactions. For example, a VTA member expressly indicating its interest to increase its SDR holdings could be prioritized in upcoming transactions.

42. **Notwithstanding the smooth functioning of the VTA market for over three decades, the Articles of Agreement provide for a designation mechanism to guarantee the liquidity of the SDR (Box 4).** The Articles provide the Fund with the authority to designate a participant to exchange SDRs for a freely usable currency at the request of another participant that has a need because of its balance of payments or its reserve position or development in its reserves. This mechanism has not been used since the late 1980s as the Fund was able to rely on voluntary transactions to satisfy the demand for exchanges. In the event, however, that the VTA capacity were not sufficient or if it were not possible to identify a willing counterparty for a transaction through the VTAs or bilaterally with another participant or prescribed holder, the designation mechanism would be activated. This demand would be met by calling on designated members with sufficiently strong external positions. The designation mechanism has important distinctions from the voluntary market as participation by those designated to exchange currency for SDRs

[49] The participants in the VTAs as of April 30, 2021 are: Australia, China, Japan, Korea, and New Zealand in Asia and the Pacific; Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Ireland, Israel, Italy, Malta, the Netherlands, Norway, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom in Europe; Canada, Chile, Mexico, and the United States in the Western Hemisphere; and Saudi Arabia in the Middle East. One prescribed holder, the European Central Bank, also has a VTA.

is an obligation and the selection process is rules-based. A Designation Plan is prepared annually for Executive Board approval and has been precautionary since 1987.

Box 4. Designation Mechanism

Article XIX of the Fund's Articles of Agreement provides for a designation mechanism. Under the designation mechanism, participants whose balance of payments and reserve positions are deemed sufficiently strong are obliged, when designated by the Fund, to provide freely usable currencies in exchange for SDRs up to specified amounts. The designation mechanism ensures that SDR participants with a balance of payments need can use SDRs to obtain freely usable currencies at short notice. Since 1987, the designation plan has been adopted on a precautionary basis as backstop in case the VTAs could not satisfy the request for SDR exchanges of participants with balance of payments need.

Each Designation Plan identifies participants subject to designation and sets maximum limits on the amounts of SDRs they can be designated to receive during the next period. The Designation Plan was prepared quarterly until October 1, 2015 when the Executive Board approved an annual frequency. In practice, the list of participants subject to designation is the same as the list of members considered sufficiently strong for inclusion in the Fund's Financial Transactions Plan (FTP). The amounts of designation for individual participants are determined so as to promote over time a balanced distribution of their SDR holdings in excess of their net cumulative allocations to their existing Fund quotas (Article XIX, Section 5(a)(i) and Decision No. 11976-(99/59) S, adopted June 3, 1999). Each participant's designation is calculated so that the participants subject to designation would, if called upon to accept the amounts designated to them, achieve a common lowest "excess holdings ratio." The excess holdings ratio is calculated as the difference between the member's SDR holdings and its net cumulative allocation as a percent of its quota.

A participant's obligation to provide currency against SDRs in designation is subject to a ceiling that limits its SDR holdings to 300 percent of its net cumulative allocation (acceptance limit), unless the participant and the Fund agree to a higher limit (Article XIX, Section 4). The annual amounts of designation for individual participants are taken as one-half of the calculated amounts of designation for the next two years. If a designation had to be made during the plan period, staff would give priority in designation to participants that have lower excess holdings ratios in comparison with other participants. If a participant's currency is no longer used for transfers under the FTP during a Designation Plan period, the participant would also not be selected for a transaction by designation. If a new participant is added to the FTP, it would not be called upon in a transaction by designation until it has been included in the next Designation Plan.

Expansion of VTA Market and Purchasing Capacity of VTAs Post-Allocation

43. **Staff expects post-allocation requests for exchange of SDRs to continue to primarily be handled via the voluntary trading market.** Staff estimates that the overall purchasing capacity post allocation is expected to increase about three-fold from the current SDR 72.5 billion to about SDR 240 billion. This assumes relevant participants confirm that the minimum and maximum trading ranges relative to respective individual SDR allocations under the current VTAs will remain in place following the allocation. This feature was introduced at the time of the 2009 SDR allocation and helps ensure a dynamic and robust VTA market.

44. **To further expand the voluntary SDR trading market, staff is taking a two-pronged approach building on the favorable experience from the 2009 SDR allocation:**

- *New Participants:* Staff has initiated broad engagement with the membership, focusing on FTP members that currently do not have VTAs,[50] as well as any non-FTP members that may indicate interest in participating in the VTAs. FTP members are already familiar with IMF transactions and are therefore uniquely well-placed to participate in the SDR trading market. If all the members in the FTP currently without a VTA were to agree on a new VTA with typical trading ranges, the VTA market could be expanded further by almost SDR 50 billion after the SDR allocation to about SDR 290 billion.

- *Additional operational flexibility under existing VTAs:* Notwithstanding the smooth operation of the existing VTAs, there are some constraints under the terms of existing VTAs which warrant revisiting. Specifically, staff will propose revisions to transaction limits in some VTAs, which are set in nominal terms, and also seek to expand trading currencies and shorten notification periods under a few arrangements that are longer than the standard five days. Changes to these operational aspects would promote broader participation across the VTAs.

45. Broadening the participation in the VTA market would be beneficial for both VTA participants and users of SDRs. The VTAs are managed in such a way as to ease operational burden for the participants. They provide an opportunity for VTA members to replenish their own SDR holdings and to actively use SDRs for reserve management practices. New arrangements with additional participants would further strengthen the principle of mutuality and cooperation that is inherent in the SDR trading. An enhanced market will support a potential increase in SDR trading as discussed in the next section.

Potential Volume of SDR Transactions after a general SDR allocation equivalent to US$650 billion

46. As in 2009, it is difficult to predict the trading volumes after the SDR allocation. Sales immediately following the 2009 allocation were relatively low and significantly below the projections prepared at the time. In the first year following the allocations (September 2009 to August 2010), SDR sales not related to IMF transactions spiked briefly with a total of 21 members, mostly EMDCs' sales of about SDR 3.4 billion. Over 80 percent of these members sold at least 75 percent of their total allocations. This level of sales was significantly lower than what had been indicated in the illustrative sale scenarios prepared before the 2009 allocation, which had ranged from SDR 10 to SDR 30 billion.[51] Sales declined in 2010 and remained modest through end-2020. Many members chose to retain their newly obtained SDRs to boost reserves or to make payments for IMF obligations. Specifically, since September 2009, there have been 145 sales (SDR 8.8 billion) that were not related to IMF transactions (Table 4).

[50] https://www.imf.org/external/np/tre/ftp/2021/020121.htm

[51] The lower range scenario (SDR 10 billion) assumed sales by members with identified balance of payment needs, proxied by members with or in negotiations for an IMF program. The upper range scenario was an adverse global crisis scenario.

Table 4. SDR Sales by Participants—Not Related to IMF Transactions
(In millions of SDRs; September 2009–December 2020)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Number of Sales	29	11	11	12	11	14	24	10	8	5	5	5	**145**
Amount of Sales	2,952	532	330	276	160	302	3,512	389	106	76	139	35	**8,808**

Source: IMF.

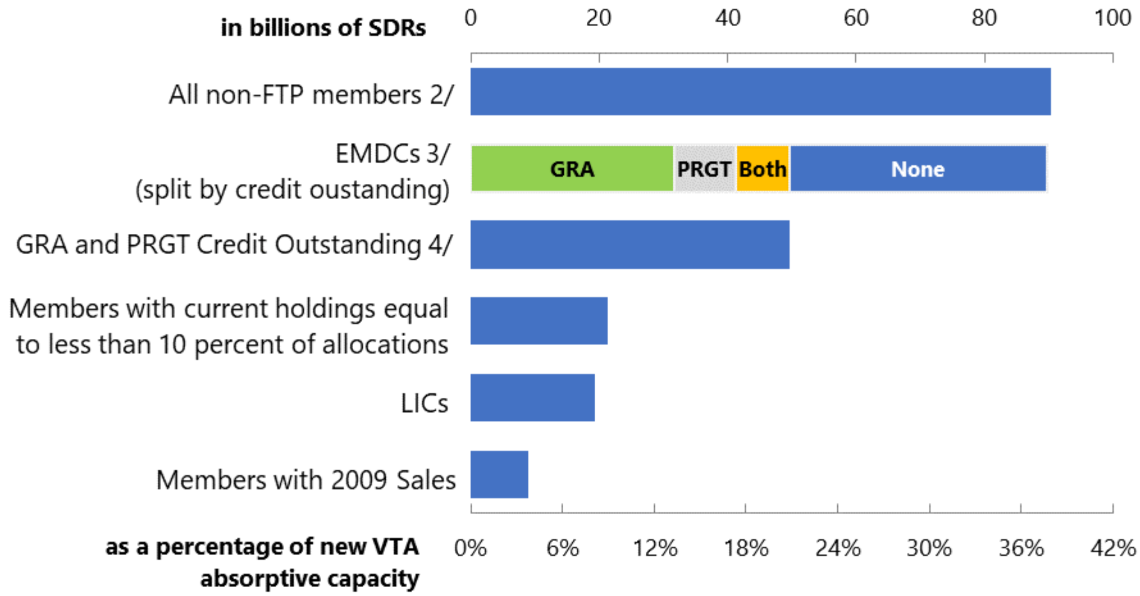
47. **There was no significant use of the 2009 SDR allocation for early repurchases (i.e., early repayments) of Fund credit.** The total amount of repurchases to the GRA in the 3-year period following the 2009 allocations was about SDR 6 billion; out of this total, only about one-tenth were advance repurchases. Many GRA borrowers are liquidity constrained, and therefore the use of SDRs for advance repayments of debt to the IMF, or other creditors, may not be optimal from their perspective. Furthermore, the total amount of repurchases made in SDRs during this three-year period was only about SDR 1 billion out of the total SDR 6 billion.

48. **Staff estimates that VTA capacity would be sufficient even in high demand scenarios and considering enhancements to the current set of VTAs as discussed above.** Staff's illustrative scenarios in Figure 8 provide estimates of the potential demand for SDR sales for certain groups of participants. For simplicity and to illustrate the impact in the case of the most significant demand, the scenarios assume that members in the categories below sell all their holdings after the allocation.

- High demand scenarios consider that (i) all non-FTP, or (ii) EMDCs members sell all their SDR holdings simultaneously. This would result in demand for sales of about SDR 90 billion. In these upper bound scenarios, the post allocation VTA capacity of about SDR 240 billion appears more than sufficient at nearly three times the level of sales.
- Other scenarios, such as sales by debtors to the GRA or the PRGT, which proxy countries with existing BOP needs, would indicate substantially lower demand for sales.

Generally, since it is anticipated that sales will increase after the SDR allocation, VTA participants should be prepared to purchase higher amounts of SDRs for currency and more frequently. Also, their SDR holdings may increase vis-à-vis their allocation due to participation in these SDR sales over time. On average, SDR holdings of VTA members are currently around 90 percent of allocations. As an illustrative example, if VTAs were to absorb SDRs under the highest demand scenario in Figure 8, average SDR holdings of VTA members would rise to just under 120 percent of allocations.

Figure 8. Demand Scenario Analysis[1]



[1] Assumes all participants in the specified category exchange 100 percent of their SDR holdings post-allocation.
[2] Excludes all VTA members (irrespective of whether they have credit outstanding in the GRA).
[3] Excludes all VTA members (irrespective of whether they have credit outstanding to the GRA) and FTP members.
[4] Excludes one VTA member with credit outstanding.
Source: IMF.

49. A survey of mission chiefs in early May 2021 further suggests that VTA capacity would be sufficient.[52] Survey results suggest that 36 percent of SDR participants, all being EMDCs, could be expected to exchange SDRs to freely usable currencies within the twelve months following the allocation. Mission chiefs expect about 12 percent of members to exchange 100 percent of the new allocation; 14 percent to exchange between 50–100 percent, and 10 percent to exchange less than half of their allocation. These survey results translate into an estimate of potential demand for freely usable currencies following the allocation of about SDR 20 to 26 billion.

C. Implications for the Fund's Risk Profile

50. The proposal for a US$650 billion SDR allocation will help mitigate strategic and reputational risks to the Fund. Key risk areas include:

- **Strategic.** The SDR allocation reduces the strategic risk of the Fund being perceived as unresponsive to the membership needs during the crisis.

[52] The survey was conducted in early May covering all 190 SDR participants. It covered two questions: (i) Do you expect the authorities to exchange SDRs for freely usable currencies within the twelve months following the allocation? And (ii) If you answered "yes" to the above question, what proportion of the new SDR allocation would most likely be exchanged? The response rate to the survey was 100 percent.

- **Reputational.** The increasing sovereign liquidity and solvency risks posed by the COVID pandemic and its potential scarring effects across the membership could make moral hazard a more pressing issue today than in the past. This, in turn, could have reputational risks for the Fund. Staff's proposed measures to increase the transparency and accountability in the use of SDRs can help mitigate these risks. Nonetheless, members' use of SDRs is ultimately not under the control of the Fund.

- **Operational resilience.** The SDR allocation may ease financing pressures on the membership and may reduce the potential demand for Fund resources especially in the near term. The allocation would improve Fund's credit risk profile by increasing the potential viability of borrowers but could worsen credit risk if it leads to moral hazard and delays in the needed adjustment. Potential additional SDR inflows to the GRA resulting from increased use by members of SDRs for transactions with the Fund would be closely monitored and are expected to be manageable.

- **Residual risks.** Staff estimates of the long-term global need for reserves are subject to uncertainty. These risks can be mitigated by regular assessments of the case for an allocation or cancellation of SDRs as mandated under the Articles of Agreement.

V. NEXT STEPS

51. Should Executive Directors support the assessment set out in this paper for a general allocation of SDRs, the Managing Director will promptly put forward a report with a proposal for a general allocation of SDRs equivalent to US$650 billion (about SDR 453 billion) for the Eleventh Basic Period. The report to the Board of Governors would include a formal proposal for a general allocation of SDRs and be accompanied by a draft Board of Governors resolution. The proposal will be circulated for the concurrence of the Executive Board to be followed by an immediate transmittal to the Board of Governors for approval. On this basis, the proposed allocation could become effective by end-August 2021.

52. With respect to the Twelfth Basic Period that will start on January 1, 2022, the Managing Director will circulate a separate brief report to the Executive Board for information and comments. The report will then be sent to the Board of Governors by June 30, 2021 to meet the requirements under the Articles. As discussed above, because the proposed general allocation for the Eleventh Basic Period, once approved by the Board of Governors and implemented as proposed in this paper, would help address the long-term global need for reserve assets, the Managing Director will inform the Board of Governors of her intention not to put forward a proposal for another allocation of SDRs for the Twelfth Basic Period at this time.

VI. ISSUES FOR DISCUSSION

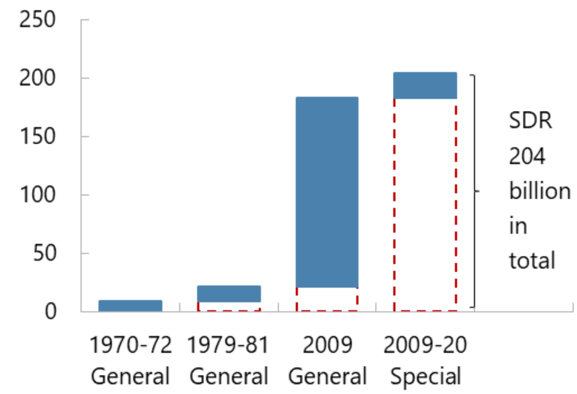
53. Executive Directors may wish to discuss the following issues:

- While recognizing the large uncertainty underlying staff's estimates, do Directors agree that there is a long-term global need to supplement existing reserve assets during the Eleventh Basic Period?
- If so, do Directors concur that an allocation equivalent to US$650 billion (about SDR 453 billion) would promote attainment of the Fund's purposes while avoiding economic stagnation and deflation as well as excess demand and inflation?
- Do Directors agree that the allocation should be implemented in a single tranche?
- Do Executive Directors agree with staff proposals to enhance transparency and accountability in the reporting and use of SDRs?
- Do Executive Directors agree with the proposed plans to expand the number of VTA participants and other measures to further strengthen the VTA market?

Annex I. SDRs and Transactions and Operations in SDRs

1. The SDR is an international reserve asset that was created in 1969 to supplement global reserve assets. The SDR was created in the context of the Bretton Woods fixed exchange rate system to supplement other reserves assets whose growth was seen as inadequate to finance the expansion of international trade and finance. The SDR is neither a currency nor a claim on the Fund. Rather, it is a potential claim on the freely usable currencies of Fund members. Currently, all IMF members are participants of the SDR Department. So far, the Fund has allocated a total of SDR 204.2 billion. This includes SDR 182.7 billion allocated through three general allocations and SDR 21.5 billion through a special allocation (Annex Figure 1).

Annex Figure 1. SDR Allocations
(In billions of SDRs)



Source: IMF.
Note: "General" and "Special" indicate a general allocation and a special allocation, respectively.

2. SDR holdings are part of members' reserve assets.[1] The reserve asset characteristic of SDRs derives from the commitment of members to hold and accept SDRs and to honor the obligations underlying the operation of the SDR system.

3. The value of the SDR is currently determined by a basket of five currencies, and the SDR interest rate is a weighted average of three-month risk-free rates in these currencies. The basket consists of fixed amounts of the Fund's five freely usable currencies (U.S. dollar, euro, Chinese renminbi, Japanese yen, and pound sterling). The effective weight of the component currencies fluctuates with market exchange rates. The basket is reviewed typically every five years.[2] The SDR interest rate (SDRi) is determined on a weekly basis based on a weighted average of representative interest rates on short-term

[1] In the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6), the allocation of SDRs is recorded as the incurrence of a long-term external liability of the member receiving them (as there could be a requirement to repay the allocation in certain circumstances).

[2] The next review will be completed by July 31, 2022. See "Review of the Method of Valuation of the SDR—Proposed Extension of The Valuation of the SDR Basket and Modification of the Date of Effect of a New Basket", March, 2021.

(three-month) government debt instruments of the five SDR basket currencies, with a floor of 5 basis points.[3] Figure 4 in the main text presents recent trends in the SDRi.[4]

4. **Members receive interest on their holdings of SDRs and pay charges on their cumulative allocations of SDRs at the SDRi**. Payments of charges by members with SDR holdings below their cumulative allocation equal the net interest receipts of other holders—the SDR Department is a closed system. Members with holdings equal to their cumulative allocations have a neutral net position. A new SDR allocation has no net income impact for the SDR Department because holdings and cumulative allocations would rise equally.

5. **There is no obligation under current Board decisions for a participant to maintain a specific level of SDR holdings.** Therefore, the SDR system provides members with access to freely usable currencies on an unconditional basis and with no fixed maturity (through VTAs, bilateral transactions or as a backstop under designation upon the representation of a balance of payments need). Reconstitution requirements for holdings of SDRs were abrogated in 1981.[5] Under the reconstitution requirements, each participant was required to maintain its average daily holdings of SDRs at not less than a specified percentage of its net cumulative allocation over successive five-year periods ending each calendar quarter. The initial specified percentage was 30 percent, but this was reduced to 15 percent two years before the requirement was abrogated. The Executive Board could, with a 70 percent majority of the total voting power, re-establish the 1969 rules or adopt different reconstitution rules. The original reconstitution requirement reflected the desire to ensure that the new liquidity resulting from the creation of SDRs would not be used to finance prolonged balance of payments deficits, generating a permanent transfer of resources from countries that accumulate SDRs to countries that use them on a net basis. The concern about the size of such transfers was greater in the past because the SDRi was set below market interest rates.

6. **There is a total of SDR 204.2 billion allocated to participants with the GRA holding about SDR 22.2 billion as of end-April 2021.** While participation in the SDR Department is not required for Fund membership, all current Fund members are participants in the SDR Department.[6] Other SDR holders include the Fund (which holds SDRs in the GRA) and 15 international organizations prescribed by the Fund

[3] On October 24, 2014, Rule T-1 that determines the calculation of the weighted average of the SDRi was changed so that if the combined market rate falls below 0.050 percent, the rate shall be established at 0.050 percent. The Executive Board adopted this change in response to very low and negative SDRi. There is no authority under the Articles of Agreement to establish zero or negative rates.

[4] In addition, an assessment is levied on SDR Department participants to reimburse the General Department for the expenses of conducting the business of the SDR Department (recently around one-thousandth of one percent of total levied on the cumulative allocation of each participant).

[5] See Annex II of IMF (2009b).

[6] The SDR Department is separate from the General Department under the Articles of Agreement. Assets in one department cannot be used to meet liabilities of the other, except for the reimbursement of the General Department for the expenses incurred in conducting the business of the SDR Department.

(so-called prescribed holders).[7] Private sector holdings of SDRs are not allowed. The GRA holdings of SDRs are within the SDR holdings target range of SDR 10–30 billion agreed by the Executive Board in 2019 (see Annex Table 1). SDR holdings of the GRA and prescribed holders are acquired through operations and transactions (which can include payment of financial obligations (for example, charges and repurchases in the case of the GRA), loans, pledges, donations, swaps and forward transactions) with participants and prescribed holders.

Annex Table 1. SDR Department as of end-April 30, 2021
(In billions of SDRs)

	Allocations	**Holdings**
Participants	204.2	180.5
GRA	0.0	22.2
Prescribed holders	0.0	1.5
Total	**204.2**	**204.2**

Source: IMF.

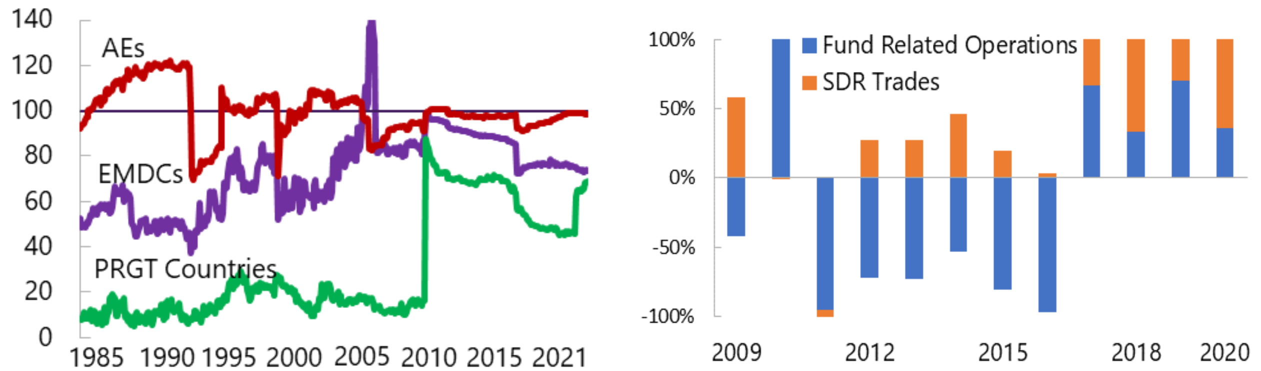
7. Among the membership, AEs have the highest holding share relative to their allocation while LICs have the lowest (Annex Figure 2). The bulk of SDRs are currently held by AEs, whose aggregate share of holdings (over 60 percent of total) is currently close to their allocation share. EMDCs have increasingly used their SDRs since 2010, and LICs currently have the lowest share of SDR holdings in relation to their allocation (60 percent on average of their cumulative SDR allocation). The recent uptick in their SDR holdings further reflects use of SDRs in the Fund's lending decisions in the wake of the Fund's unprecedented assistance to LICs during the Covid-19 pandemic. The GRA currently holds about 10 percent of cumulative allocations.

[7] Only members that are not participants, non-members, and official entities may be prescribed as holders of SDRs under the Articles of Agreement. The 15 prescribed holders are four central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary institutions (Bank for International Settlements, Latin American Reserve Fund, and Arab Monetary Fund); and eight development institutions (African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development and the International Development Association, Islamic Development Bank, Nordic Investment Bank, and International Fund for Agricultural Development).

Annex Figure 2. SDR Market Transactions

A. SDR Holdings Relative to Allocations, 1985–2021[1]
(In percent of cumulative allocations)

B. Transactions with the Fund and SDR trades[2]
(In percent, fiscal year)



Sources: IMF; and Fund staff calculations.
[1] Data through end-April 2021. EMDCs exclude PRGT-eligible countries, which are shown separately.
[2] Net flows of transactions in SDRs by participants by two broad aggregate categories: those related to IMF operations and those related t SDR trading. Negative amounts imply outflows of SDRs primarily related to payment of financial obligations to the Fund and sales of SDRs while positive amounts are inflows of SDRs (primarily related to Fund lending transactions and acquisitions of SDRs). These amounts are expressed as a percentage of the total movement of SDRs for that period.

8. **Participants use their SDRs in a wide range of Fund-related operations.** The Fund may accept and use SDRs in operations and transactions conducted through the GRA with participants (e.g., quota payments, purchases, repurchases, payment of charges, remuneration) and the Fund may pay principal and interest on its borrowing in SDRs. For example, the Fund normally receives SDRs in members' payments of charges on Fund credit and pays SDRs to members in remuneration on their reserve tranche positions in the Fund.[8] Also, following the 14th General Review of Quotas, which became effective in January 2016, around half of the members chose to make part of their quota subscription payments in SDRs rather than in freely usable currencies, including some VTA participants. In addition, the Fund has authorized the use of SDRs in operations of the PRGT, the Poverty Reduction and Growth (PRG)-Heavily Indebted Poor Countries (HIPC) Trust and the Catastrophe Containment and Relief Trust (CCRT) (e.g., borrowing, loan disbursements, interest payments, or contributions). Broadly, most SDR transactions relate to Fund-related operations versus uses of SDRs unrelated to GRA (or PRGT) operations (see Annex Box 1 and Annex Figure 3 for further details of IMF related transactions that are conducted in SDRs).[9]

[8] For an illustration of the circulation of SDRs, see Figure 4.4 on page 93 in IMF (2018b).

[9] Under Article VII, Section 1 (ii), the Fund may also require a participant in the SDR Department to sell its currency to the Fund for SDRs to replenish its holdings of that currency, while under Article V, Section 5, it may accept SDRs offered by a participant in exchange for currencies of other members, or provide a participant, at its request, with SDRs for currencies of other members. However, the Fund may not borrow SDRs.

Annex Box 1. Summary of Fund Related Operations

Fund-related transactions in the SDR Department, GRA, PRGT, the PRG-HIPC Trust and the CCRT include:

SDR Department Operations

- Use of SDR to pay assessments and charges on SDR allocation/receipt of SDR interest
- *Transactions (sale and purchase of SDRs) and other operations among SDR participants and prescribed holders, as authorized under the Articles and relevant decisions by the Fund adopted in accordance with the Articles.*

GRA Operations

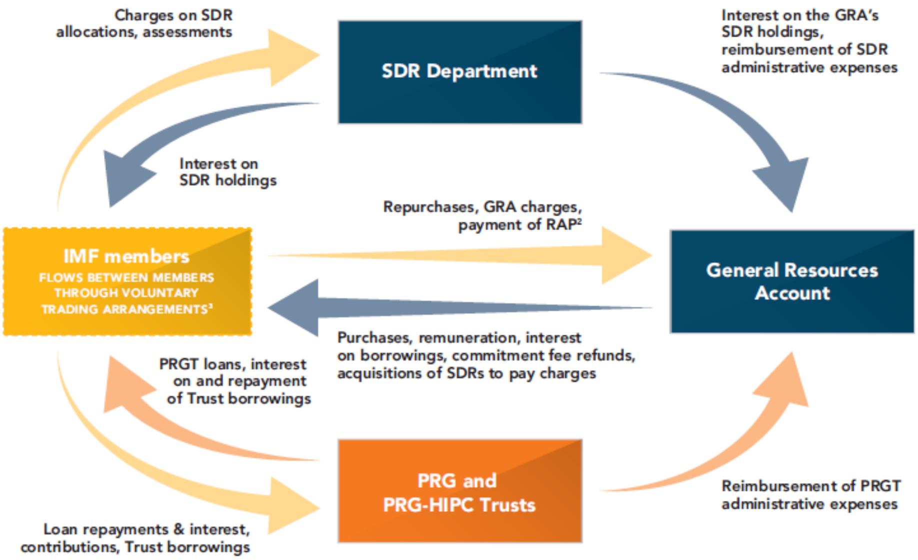
- *Quota payments*: In general, 25 percent of quota subscription is payable by each member to the Fund in SDRs or currency of another member as determined by the Fund and the remainder is due in the member's own currency.
- *Purchases and repurchases in the GRA:* IMF financing is conducted via a purchase and repurchase mechanism. Purchases by members of SDRs in the GRA and repurchases by members using SDRs as payments.
- *Acquisitions in exchange for currencies of other members:* Acquisitions of SDRs from the GRA in exchange for currencies of other members.
- *Repayment of GRA borrowings and interest:* Repayments of principal and payment of interest under New Arrangements to Borrow and Bilateral Borrowing Arrangements principal
- *GRA charges and remuneration*: GRA charges are payable in SDRs.[1] Such charges are accrued daily and billed quarterly. Members also receive remuneration on their reserve tranche position in the GRA, on a quarterly basis, if applicable.
- *Service charges:* A service charge of 50 basis points is levied on each purchase (disbursement to a member) from the GRA and is payable in SDRs on the date of the purchase. For members with standing authorization with the IMF, the charge is normally automatically debited from the member's SDR holdings.
- *Commitment fees*: Commitment fee is levied by the IMF in SDRs, as a fee for the amounts available for purchase under the GRA arrangement at each 12-month period of an arrangement. Commitment fee is refunded to a member as it makes purchases.

Concessional Lending and Debt Relief Trust Operations

Participants and prescribed holders are authorized to conduct transfers of SDRs in effecting transactions in connection with the financial operations of the Concessional Lending and Debt Relief Trusts (Trusts). These transactions mainly include PRGT pass-through lending involving participants in the SDR Department and interest payments on PRGT borrowing and lending. Other possible SDR transactions for the benefits of the Trusts include financial contributions provided by participants to the Trusts. The Bank for International Settlements (BIS) is the banker for the Trusts. It holds official SDRs on behalf of the Trusts, which cannot directly hold SDRs under the IMF's Articles of Agreement.

[1] GRA charges on credit outstanding comprise basic charges and surcharges, including possible burden sharing adjustments.

Annex Figure 3. Circulation of SDRs[1]



Source: IMF.

Note: The BIS holds SDRs on behalf of the Trusts, which cannot directly hold SDRs.

[1] Excluding flows to and among prescribed holders.

[2] Reserve Asset Portion (RAP) or 25 percent of memebers' quota increase, which must be paid in reserves assets—that is, in SDRs or currencies specified by the IMF, or in any combination of SDRs and such currencies.

[3] Since 1987, voluntary transactions by agreement have ensured the liquidity of SDRs. In the event that there are not enough vo luntary buyers of SDRs, the Articles of Agreement provide for a designation mechanism to guarantee the liquidity of SDRs.

Annex II. Application of Concept of Long-term Global Need in Past Allocations

1. The past three general SDR allocations illustrate how the concept of "*long-term global need*" was applied in practice.

2. The first allocation—SDR 9.3 billion, allocated in broadly equal installments on January 1, 1970, 1971, and 1972—followed the establishment of the SDR mechanism and took place in the first basic period.

- The evidence of long-term global need was based on the marked decline in world reserves (gold and U.S. dollars) in absolute terms and relative to world trade since the mid-1960s. Other factors included the heavier reliance on trade restrictions, growing recourse to International Financial Institutions to finance payments deficits, and increased use of capital controls.

- The decision also took into account "*the attainment of a better balance of payments equilibrium, as well as the likelihood of a better working of the adjustment process in the future*" (as required for the first allocation by Article XVIII, Section 1(b)).

- The size of the allocation was based on the projected trend in the need for reserves compared to the prospective growth in reserves. The estimate of reserve needs was broad, from about US$3.5 billion to US$6 billion a year. First, recognizing substantial uncertainties in the estimates, the future rate of reserve growth was calculated under different assumptions, in line with (i) past long-term import growth, and (ii) past average ratios of annual reserve increase to imports. Second, to assess the need for reserve supplementation, the growth of gold and currency reserves was also estimated, assuming an unchanged external position for the US.

3. The second SDR allocation—SDR 12.1 billion allocated in three similar annual installments on January 1, 1979, 1980, and 1981—took place in the third basic period (1978–81).

- The case for the allocation considered the major changes in the international monetary system since the inception of the SDR, such as emergence of international capital markets and more flexible exchange rates. The assessment of the long-term global need took into account that the demand for reserves had increased with the level of international transactions and was expected to continue to do so even with greater exchange rate flexibility. A decision to allocate did not depend on a finding that the long-term global need could be met only by SDRs.

- The size of the SDR allocation was based on the projected growth of world reserves relative to world trade, assuming that imports and reserves would grow in the same proportion. Given the variability around this assumption, the increase in reserves was projected between SDR 100–200 billion.

- In the prevailing inflationary environment, a modest allocation (relative to the estimated need) was proposed, notably to take into account possible effects on expectations.

4. The third SDR allocation—SDR 183 billion, allocated in one single tranche effective on August 28, 2009—took place in the ninth basic period (2007–2011).

- The allocation took place in the context of the global financial crisis, characterized by a sharp economic contraction and projected slow recovery from a deep recession, resulting in sudden declines in capital flows and trade, which particularly affected reserve levels of EMDCs.

- The size of the SDR allocation was based on estimates using standard metrics of reserve coverage (imports, short-term external debt, and broad money). The long-term global need was assessed in terms of the amount of reserves required to maintain the pre-crisis coverage ratios of imports, short-term debt, and broad money. For EMDCs excluding China and fuel exporters, the long-term global need to supplement reserve assets was estimated at US$400 billion–US$900 billion over the next five years and at US$1.3 trillion–US$2 trillion over the next 10 years.

- The decision also took into account the role of other sources to meet the long-term global need for reserves such as current account surplus, net private capital inflows, and official support, pointing out the benefits of the SDR allocation in terms of distribution, crisis response, and crisis prevention.

- Circumstances at the time called for a one-step rather than staggered allocation. With a large output gap and an immediate need for liquidity, the allocation was consistent with "*avoiding economic stagnation and deflation as well as excess demand and inflation in the world*". Compared to the first two allocations, when the growth and inflationary environment justified a staggered approach, a one-step approach appeared more appropriate, given the large output gap over the medium-term.

Annex III. Members' SDR Holdings and Allocations and an Illustrative US$650 billion Allocation

(Data as of end-April 2021, in SDR Millions Unless Otherwise Indicated)

Member	SDR Holding	Existing SDR Allocation	Quota Share (In percent)[1]	Illustrative SDR Allocation[2]	Illustrative Cumulative SDR Allocation[3]
Afghanistan	37	155	0.068	308	463.4
Albania	154	46	0.029	133	179.0
Algeria	899	1,198	0.412	1,865	3,062.7
Andorra	15	35	0.017	78	113.9
Angola	178	273	0.156	704	977.1
Antigua and Barbuda	0	12	0.004	19	31.5
Argentina	722	2,020	0.670	3,032	5,052.2
Armenia	27	88	0.027	123	210.5
Australia	3,088	3,083	1.381	6,253	9,335.7
Austria	1,685	1,736	0.826	3,741	5,476.9
Azerbaijan	96	154	0.082	373	526.2
The Bahamas	124	124	0.038	174	297.9
Bahrain	67	124	0.083	376	500.1
Bangladesh	722	510	0.224	1,015	1,525.1
Barbados	6	64	0.020	90	154.3
Belarus	372	369	0.143	648	1,017.0
Belgium	3,901	4,323	1.347	6,099	10,422.0
Belize	20	18	0.006	25	43.3
Benin	286	59	0.026	118	176.9
Bhutan	6	6	0.004	19	25.4
Bolivia	167	164	0.050	228	392.5
Bosnia and Herzegovina	2	161	0.056	252	413.2
Botswana	59	57	0.041	188	245.0
Brazil	2,940	2,887	2.321	10,505	13,391.6
Brunei Darussalam	218	204	0.063	287	490.1
Bulgaria	614	611	0.188	853	1,463.6
Burkina Faso	153	58	0.025	115	172.1
Burundi	6	74	0.032	147	220.4
Cabo Verde	0	9	0.005	23	31.7
Cambodia	89	84	0.037	166	250.4
Cameroon	16	177	0.058	263	439.8
Canada	6,086	5,988	2.317	10,487	16,475.4
Central African Republic	0	53	0.023	106	159.3

Member	SDR Holding	Existing SDR Allocation	Quota Share[1] (In percent)	Illustrative SDR Allocation[2]	Illustrative Cumulative SDR Allocation[3]
Chad	0	54	0.029	133	187.0
Chile	469	817	0.367	1,659	2,476.3
China	7,955	6,990	6.407	28,999	35,988.9
Colombia	619	738	0.430	1,945	2,683.3
Comoros	9	9	0.004	17	25.4
Democratic Republic of the Congo	27	511	0.224	1,014	1,525.0
Republic of Congo	51	80	0.034	154	233.8
Costa Rica	85	157	0.078	351	508.0
Croatia	304	347	0.151	682	1,029.8
Cyprus	48	133	0.064	289	421.8
Czech Republic	458	780	0.458	2,074	2,854.3
Côte d'Ivoire	1,147	311	0.137	619	929.6
Denmark	1,382	1,531	0.723	3,272	4,803.5
Djibouti	3	15	0.007	30	45.4
Dominica	1	8	0.002	11	18.8
Dominican Republic	2	209	0.100	454	663.0
Ecuador	28	288	0.147	664	952.1
Egypt	111	898	0.428	1,938	2,836.4
El Salvador	162	164	0.060	273	437.0
Equatorial Guinea	21	31	0.033	150	181.1
Eritrea	3	15	0.003	15	30.3
Estonia	25	62	0.051	232	293.7
Eswatini	49	48	0.016	75	123.0
Ethiopia	9	128	0.063	286	414.0
Fiji	44	67	0.021	94	160.7
Finland	1,124	1,190	0.507	2,293	3,482.8
France	7,998	10,134	4.236	19,174	29,308.3
Gabon	120	147	0.045	205	352.2
The Gambia	2	30	0.013	59	88.9
Georgia	147	144	0.044	200	344.1
Germany	11,851	12,059	5.598	25,338	37,397.2
Ghana	1	354	0.155	702	1,055.9
Greece	10	782	0.510	2,311	3,093.0
Grenada	0	11	0.003	16	26.8
Guatemala	120	201	0.090	408	608.6
Guinea	60	102	0.045	204	306.2
Guinea-Bissau	32	14	0.006	27	40.6

Member	SDR Holding	Existing SDR Allocation	Quota Share[1] (In percent)	Illustrative SDR Allocation[2]	Illustrative Cumulative SDR Allocation[3]
Guyana	0	87	0.038	173	260.0
Haiti	23	79	0.034	156	234.3
Honduras	50	124	0.053	238	361.5
Hungary	2	991	0.408	1,846	2,836.6
Iceland	113	112	0.068	306	418.3
India	1,049	3,978	2.756	12,476	16,454.3
Indonesia	1,115	1,980	0.977	4,422	6,402.6
Iran	1,552	1,426	0.750	3,393	4,819.5
Iraq	3	1,134	0.350	1,583	2,717.3
Ireland	679	775	0.725	3,282	4,057.4
Israel	899	883	0.404	1,827	2,710.8
Italy	5,856	6,576	3.167	14,337	20,912.6
Jamaica	126	262	0.080	364	625.9
Japan	14,040	12,285	6.478	29,320	41,605.4
Jordan	10	162	0.072	326	488.5
Kazakhstan	353	344	0.243	1,102	1,445.7
Kenya	30	260	0.114	516	776.0
Kiribati	4	5	0.002	11	16.0
Korea	2,453	2,404	1.804	8,165	10,569.4
Kosovo	49	55	0.017	79	133.9
Kuwait	1,336	1,316	0.406	1,839	3,155.0
Kyrgyz Republic	106	85	0.037	169	253.7
Lao P.D.R.	38	51	0.022	101	151.3
Latvia	121	121	0.070	316	436.9
Lebanon	196	193	0.133	603	796.0
Lesotho	3	33	0.015	66	99.3
Liberia	137	124	0.054	246	369.8
Libya	1,661	1,073	0.331	1,497	2,569.3
Lithuania	138	137	0.093	420	557.3
Luxembourg	251	247	0.278	1,257	1,504.1
Madagascar	8	117	0.051	233	349.6
Malawi	4	66	0.029	132	198.4
Malaysia	824	1,346	0.764	3,457	4,803.1
Maldives	2	8	0.004	20	27.9
Mali	371	89	0.039	178	266.9
Malta	88	95	0.035	160	255.5
Marshall Islands	3	3	0.001	3	6.7

Member	SDR Holding	Existing SDR Allocation	Quota Share[1] (In percent)	Illustrative SDR Allocation[2]	Illustrative Cumulative SDR Allocation[3]
Mauritania	4	62	0.027	123	184.2
Mauritius	90	97	0.030	135	232.1
Mexico	2,837	2,851	1.873	8,479	11,330.1
Micronesia	6	5	0.002	7	11.7
Moldova	1	118	0.036	164	281.8
Mongolia	31	49	0.015	69	117.5
Montenegro	18	26	0.013	58	83.4
Morocco	618	561	0.188	851	1,412.3
Mozambique	4	109	0.048	216	325.0
Myanmar	1	246	0.109	492	737.4
Namibia	0	130	0.040	182	312.2
Nauru	0	1	0.001	3	3.5
Nepal	2	68	0.033	149	217.4
The Netherlands	4,873	4,837	1.836	8,311	13,147.9
New Zealand	868	854	0.263	1,191	2,044.9
Nicaragua	33	125	0.055	247	371.9
Niger	206	63	0.028	125	188.1
Nigeria	1,466	1,675	0.516	2,335	4,010.4
North Macedonia	2	66	0.029	133	199.1
Norway	1,526	1,563	0.789	3,572	5,135.0
Oman	99	179	0.114	518	696.7
Pakistan	293	989	0.427	1,932	2,920.7
Palau	3	3	0.001	3	5.9
Panama	121	197	0.079	358	555.5
Papua New Guinea	6	125	0.055	250	375.9
Paraguay	97	95	0.042	192	286.8
Peru	512	610	0.280	1,270	1,879.4
Philippines	856	838	0.429	1,943	2,781.4
Poland	293	1,305	0.861	3,896	5,200.7
Portugal	549	806	0.433	1,960	2,766.3
Qatar	275	251	0.154	699	950.7
Romania	990	985	0.381	1,723	2,708.0
Russian Federation	4,857	5,672	2.712	12,276	17,947.4
Rwanda	54	77	0.034	152	229.2
Samoa	3	11	0.003	15	26.5
San Marino	1	16	0.010	47	62.3
Saudi Arabia	5,827	6,682	2.100	9,506	16,188.7

Member	SDR Holding	Existing SDR Allocation	Quota Share[1] (In percent)	Illustrative SDR Allocation[2]	Illustrative Cumulative SDR Allocation[3]
Senegal	319	155	0.068	308	462.6
Serbia	9	445	0.138	623	1,068.0
Seychelles	3	8	0.005	22	30.1
Sierra Leone	156	100	0.044	197	296.8
Singapore	768	744	0.818	3,702	4,446.7
Slovak Republic	315	340	0.210	952	1,292.8
Slovenia	199	216	0.123	558	773.8
Solomon Islands	1	10	0.004	20	29.7
Somalia	36	51	0.034	155	206.1
South Africa	1,497	1,785	0.641	2,903	4,688.1
South Sudan	0	105	0.052	234	339.4
Spain	2,532	2,828	2.004	9,071	11,898.9
Sri Lanka	5	395	0.122	551	946.1
St. Kitts and Nevis	5	9	0.003	12	20.4
St. Lucia	3	15	0.004	20	34.9
St. Vincent and the Grenadines	0	8	0.002	11	19.0
Sudan	124	178	0.036	161	339.4
Suriname	1	88	0.027	123	210.7
Sweden	2,149	2,249	0.931	4,214	6,463.3
Switzerland	3,405	3,288	1.213	5,490	8,778.2
Syria	282	279	0.062	279	558.5
São Tomé and Príncipe	1	7	0.003	14	21.2
Tajikistan	22	82	0.037	166	247.6
Tanzania	6	191	0.084	378	568.9
Thailand	990	970	0.675	3,056	4,025.8
Timor-Leste	3	8	0.005	24	32.1
Togo	210	70	0.031	140	210.0
Tonga	5	7	0.003	13	19.7
Trinidad and Tobago	242	321	0.099	447	768.1
Tunisia	46	273	0.115	519	791.4
Turkey	977	1,071	0.979	4,432	5,503.2
Turkmenistan	29	70	0.050	227	296.8
Tuvalu	1	2	0.001	2	4.1
Uganda	44	173	0.076	343	516.5
Ukraine	49	1,309	0.423	1,914	3,223.3
United Arab Emirates	153	568	0.486	2,199	2,767.1
United Kingdom	9,928	10,134	4.236	19,174	29,308.3

Member	SDR Holding	Existing SDR Allocation	Quota Share[1] (In percent)	Illustrative SDR Allocation[2]	Illustrative Cumulative SDR Allocation[3]
United States	36,763	35,316	17.443	78,955	114,270.3
Uruguay	214	293	0.090	408	701.5
Uzbekistan	266	263	0.116	524	787.2
Vanuatu	1	16	0.005	23	38.9
Venezuela	9	2,543	0.782	3,542	6,084.8
Vietnam	276	315	0.242	1,097	1,411.8
Yemen	6	232	0.102	463	695.5
Zambia	125	469	0.206	931	1,399.7
Zimbabwe	1	339	0.149	672	1,011.0
Total	**180,522**	**204,197**	**100**	**452,649**	**656,847**

Source: IMF
[1] Paid in quota as of end-April 2021.
[2] Illustrative general allocation of 95.13 percent of existing quotas, which is equivalent to USD 650 billion as of end-April 2021.
[3] The sum of the existing cumulative SDR allocation and the illustrative general SDR allocation.

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The Chair's Summing Up
Proposal for a General Allocation of Special Drawing Rights
Executive Board Meeting 21/65
June 25, 2021

Executive Directors strongly welcomed the opportunity to discuss a proposal for a general allocation of Special Drawing Rights (SDRs), highlighting that the world economy is facing an unprecedented health and economic crisis caused by the COVID-19 pandemic.

Directors expressed their intention to support a general allocation in an amount equivalent to US$650 billion (about SDR 456 billion) in a single tranche. They concurred that the allocation would help meet the long-term global need to supplement existing reserve assets in a manner consistent with the Articles of Agreement, and help strengthen members' external positions, build confidence, foster the resilience and stability of the global economy, and contribute to the global economic recovery.

Directors agreed that post-allocation exchanges of SDRs for freely usable currencies should continue to be handled primarily via the voluntary trading market to avoid using the designation mechanism. To further expand this market, Directors welcomed staff's engagement with existing participants of the Voluntary Trading Arrangements (VTAs) to confirm or update their terms. They also welcomed staff reaching out to potential new participants to join the VTAs.

Directors agreed on the importance of enhancing transparency and accountability in the reporting and the use of SDRs, while preserving the nature of the SDR as an unconditional reserve asset. They welcomed staff's proposal to publish the *Annual Update on SDR Trading Operations* and additional information on SDR holdings, transactions, and trading. Noting that the liquidity provided through the SDR allocation should not substitute for warranted macroeconomic adjustments or necessary reforms, Directors supported issuing a guidance note to help members use the new SDR allocation in a manner consistent with maintaining macroeconomic sustainability. They also welcomed the proposal to prepare an ex-post report on the use of SDRs for Fund transactions and operations, broad spending patterns, and macroeconomic outcomes about two years after the allocation.

Directors looked forward to receiving, as the next step for their concurrence, the Managing Director's report to the Board of Governors for a general SDR allocation in an amount equivalent to US$650 billion in a single tranche for the Eleventh Basic Period (running through December 31, 2021), which—following Board of Governor's approval—could then become effective by end-August 2021.

Directors looked forward to discussing a menu of options for voluntarily channeling members' SDRs, in line with their national circumstances and legal requirements, to further support poor and vulnerable countries recover from the pandemic and transform their economies.