INTERNATIONAL MONETARY FUND

Allocation of Special Drawing Rights for the Ninth Basic Period: Draft Executive Board Decision and Managing Director Report to the Board of Governors

Prepared by the Finance, Legal, and Strategy, Policy, and Review Departments

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1. On June 26, 2009, the Executive Board discussed a staff paper setting forth the considerations underlying the case for a general allocation of special drawing rights (SDRs) during the ninth basic period and the key features that could be included in the Managing Director's proposal.[1] Taking into account those discussions, the Managing Director has prepared a report to the Board of Governors which includes his proposal for a general allocation of SDRs with key features along the lines described in *Proposal for a General Allocation of SDRs* (http://www.imf.org/external/np/pp/eng/2009/060909.pdf) and a draft Board of Governors' resolution approving such allocation. This report, entitled "Proposal by the Managing Director of the International Monetary Fund for an Allocation of Special Drawing Rights for the Ninth Basic Period," is attached to the draft Executive Board decision that appears below. As referred to in paragraph 13 of the attached report to the Board of Governors, the Managing Director has instructed staff to provide advice to participants regarding the macroeconomic impact associated with the SDR allocations, wherever relevant. To that end, staff is working on guidelines to provide a consistent framework for assessing the macroeconomic implications of the allocation at the country level.

2. Pursuant to the Articles, decisions on allocations of SDRs "shall be 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)). Adoption of the Board of Governors' resolution to allocate SDRs requires an 85 percent majority of the total voting power of members that are participants in the Special Drawing Rights Department (Article XVIII, Section 4(d)). Adoption of the Executive Board's decision to concur in the Managing Director's proposal requires a majority of the votes cast.

3. The draft Executive Board decision set forth below (a) provides for the Executive Board to concur in the Managing Director's proposal; (b) directs the Secretary to send to all Fund members that are participants in the Special Drawing Rights Department the report and proposed Board of Governors' resolution referred to in paragraph 1 above; and (c) authorizes the receipt of the proposed allocation by members that became participants after the

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[1] "*Proposal for a General Allocation of SDRs*" http://www.imf.org/external/np/pp/eng/2009/060909.pdf).

commencement of the ninth basic period but prior to the date of the allocation decision (Montenegro and Kosovo), as provided for in Article XVIII, section 2(d).

Accordingly, the following draft decision is proposed for adoption by the Executive Board:

Proposed Decision

1. The Executive Board concurs in the proposal by the Managing Director for an allocation of special drawing rights for the ninth basic period, which proposal, together with a proposed Resolution, is set forth in the Report attached to this decision entitled "Proposal by the Managing Director of the International Monetary Fund for an Allocation of Special Drawing Rights for the Ninth Basic Period".

2. Pursuant to Article XVIII, Section 2(d), members that have become participants in the Special Drawing Rights Department between January 1, 2007 and the day prior to the date of the allocation proposed pursuant to 1 above, and have informed the Fund that they wish to receive such allocation, shall receive an allocation in accordance with the proposed Resolution of the Board of Governors approving the allocation.

3. The Secretary is authorized and directed to send to each member of the Fund by rapid means of communication the Report and the proposed Resolution referred to in 1 above.

4. The Board of Governors is requested, pursuant to Section 13 of the By-Laws, to vote on the proposed Resolution without meeting. To be valid, votes must be cast by Governors or Alternate Governors by rapid means of communication and must be received at the seat of the Fund before 6:00 p.m., Washington time, on or before August 7, 2009. Votes received after that time will not be counted.

5. All votes cast pursuant to this decision shall be held in the custody of the Secretary until counted, and all proceedings with respect thereto shall be confidential until the Executive Board determines the result of the vote.

6. The effective date of the Resolution of the Board of Governors shall be the last day allowed for voting.

7. The Secretary is authorized to take such further action as he shall deem necessary or appropriate in order to carry out the purposes of this decision.

PROPOSAL BY THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND FOR AN ALLOCATION OF SPECIAL DRAWING RIGHTS FOR THE NINTH BASIC PERIOD

A. Introduction

1. **Against the backdrop of the worst financial crisis since the Great Depression, the membership of the IMF has taken ambitious steps to strengthen the global financial safety net**. Efforts are well underway to increase the resources available to the Fund by up to US$500 billion. In addition, the IMFC has called for a general allocation of special drawing rights (SDRs) equivalent to US$250 billion to become effective well before the 2009 Annual Meetings.[1] In response, and having ascertained that there is the broad support among Special Drawing Rights Department participants,[2] this report puts forth a proposal for a US$250 billion general allocation.[3]

2. **The economic environment contrasts sharply with that prevailing immediately prior to the ninth basic period, when no general allocation was proposed**. In June 2006, the then Managing Director declined to propose a general allocation. That conclusion was driven by the economic outlook—strong growth, ample global liquidity, and rapid reserve growth with sustained compression of borrowing spreads and improved access to capital markets; and by the lack of evidence of broad support among the membership. However, as noted then, this did not preclude making allocation proposals later in the ninth basic period, if warranted. The sharp deterioration in economic circumstances and uncertain outlook warrants a reconsideration.

3. **The allocation, a prime example of a cooperative monetary response to a global predicament, would be a timely response to present and longer-term needs**. By providing significant unconditional financial resources to liquidity constrained countries, it would smooth the need for adjustment and allow scope for expansionary policies in the face of deflation risks. The report further agues that, over the longer run, additional reserve assets needs are projected to be large; and that the proposed allocation, while covering only a part of those needs, would help meet them in ways conducive to systemic stability.

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[1] *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, April 25, 2009,(http://www.imf.org/external/np/cm/2009/042509.htm).

[2] Chairman's Summing Up on the June 26, 2009 Executive Board discussion on the *Proposal for a General Allocation of Special Drawing Rights* (http://www.imf.org/external/np/pp/eng/2009/060909.pdf), para. 2 and 8.

[3] Article XVIII, Sections 4(a) and (b) of the Fund's Articles of Agreement provide in the relevant part that: "(a) Decisions under Section 2(a), (b) and (c) or Section 3 of this Article shall be made by the Board of Governors on the basis of proposals of the Managing Director concurred in by the Executive Board. (b) Before making any proposal, the Managing Director, after having satisfied himself that it will be consistent with the provisions of Section 1(a) of this Article, shall conduct such consultations as will enable him to ascertain that there is broad support among participants for the proposal."

4. **Accordingly, and pursuant to Article XVIII, Sections 4(a) and (b), I am now submitting to the Board of Governors a proposal for an SDR allocation during the ninth basic period**. I have satisfied myself, as required by Article XVIII, Section 4(b), that the proposal will be consistent with the provisions of Section 1(a) of that Article, which provides that: "In all its decisions with respect to the allocation and cancellation of special drawing rights the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world." I am also satisfied that there is broad support for the proposed allocation.

B. Need to Supplement Reserves: Case for a General SDR Allocation

Context

5. **The global outlook points to a deep recession and slow recovery, with risks to the downside**. The crisis has resulted in a sudden stop in capital flows to several countries, capital outflows from many, and dramatic declines in trade. Although there has been a recovery of capital flows to some countries recently, many parts of the global financial system remain strained. Renewed bouts of risk aversion could exacerbate capital flight and lead to sharp domestic adjustments and falling demand. Risks to capital flows are likely to remain until financial stability is restored. But recovery from financial crises tends to be protracted and, given the global nature of the crisis, exports are unlikely to provide substantial support to growth.

6. **The restricted availability of external financing has important implications for reserves and, therefore, confidence**. Countries have sought to protect or augment reserves through: market borrowing, which has become much more costly with limited amount of access; official swap arrangements; and borrowing from international financial institutions—the commitments of Fund resources since the crisis started have amounted to about US$155 billion. Going forward, many countries may seek to rebuild reserves depleted in the crisis and ensure adequate reserve buffers, as those with larger reserves relative to need have tended to perform better during the crisis.

Long-Term Global Need

7. **Using various standard benchmarks suggests that the future need for reserve assets is likely to be large**. Focusing on the group of countries that have found themselves most liquidity constrained in the current crisis—emerging markets and developing countries (EMDCs), excluding China and fuel exporters, a sample of 118 countries—the need is estimated at US$400 billion to US$900 billion over the next 5 years, and at US$1.3 trillion to US$2 trillion over the next 10 years.[4] These estimates are derived from staff projections of

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[4] The estimates would be larger if the other countries are included.

imports, short-term external debt and broad money, which are used to extrapolate the reserves required, above and beyond the projected level of reserves in 2009, to maintain the pre-crisis coverage of these variables. Using pre-crisis benchmarks does not involve making normative judgments as to the appropriateness of these reserve levels. Rather, they are potentially indicative of the revealed preference for the desired amount of reserve assets for the sample of countries for which reserve accumulation is less likely to be a residual in the balance of payments. In any case, other estimates also suggest very sizeable global reserve needs in coming years.[5]

8. **There is both upside and downside potential to these estimates**. Coming out of the crisis, many countries may desire to have even more reserves buffers and protection against future crises. This additional demand could be as much as 10 percent, based on staff's calculations. Greater capital market integration in the long run, including of low income countries (LICs), could also raise further the precautionary demand for reserves. On the other hand, the expansion and continued rolling over of bilateral swaps and availability of bilateral, regional and multilateral loans—including under the Fund's new Flexible Credit Line and High Access Precautionary Arrangements—could reduce the demand for accumulating reserves.

Role of an SDR Allocation

9. **The need for reserves can be met through several sources**. All these sources have a role to play. Besides an SDR allocation, they include: (i) net private capital inflows, which are projected to decline in 2009-10, before recovering gradually; (ii) self-insurance, through current account surpluses or market borrowing, which can be relatively expensive; and (iii) official support, through a continuation and further expansion of bilateral, regional and multilateral loans, swaps, and credit lines.

10. **A large SDR allocation would have important benefits**, each of which would contribute to promoting the Fund's purposes as outlined in Article I, in particular promoting international monetary cooperation and exchange stability, facilitating the expansion of trade and lessening the degree of balance of payments disequilibria. It is fast, with immediate benefits in helping to alleviate foreign exchange pressures, thereby helping to forestall further downward pressures on demand. It does not involve policy conditionality, which is particularly appropriate when/to the extent there is systemic contagion. Over the longer term, it could reduce the need for pursuing destabilizing and costly reserve accumulation policies; running persistently large current account surpluses would contribute to global imbalances and could be destabilizing at the systemic level—in any event, not all countries could pursue such a policy, nor should they.

[5] For instance, the April 2009 WEO projects a large build-up in reserves, based in part on the assumption of a restoration within 2 years of net capital inflows to these countries. This reserve build up can be interpreted as the demand for reserves, to the extent that it reflects a policy of reserve accumulation.

11. **An allocation in one step in the amount equivalent to US$250 billion would help to meet the long-term global need for reserves**. Such an amount would be large enough to make a difference—of the US$250 billion, nearly US$100 billion would go to EMDCs, including LICs, thereby providing an important boost in the reserves of countries with the greatest needs. Made in one step, it would help meet the immediate need for liquidity, and signal a rapid, forceful and collaborative response to the crisis; providing the allocation in phases would inevitably curtail the strength of the crisis response. And though the absolute size of the allocation would be large, it is not so in comparison with history and is, for example, similar to the total allocation made over 1970-1972 when seen as a share of global trade. Moreover, the total amount of allocated SDRs would remain significantly lower as a share of reserves and of global capital flows than the stock of SDRs allocated by the early 1970s.

12. **The quantitative effect of such an allocation on global inflation is expected to be limited**. The size of the allocation is small relative to global GDP (⅓ of 1 percent), trade (less than 1 percent), and reserves (3 percent). It is also small compared with other forms of liquidity creation at the current time. With a global output gap projected to persist through 2014—by which point any expansionary impact of early spending of the SDR allocation should have dissipated—the allocation seems unlikely to generate global inflationary pressures.

13. **The impact on debt sustainability likewise would be minimal in most cases.** At current interest rates, the impact on debt sustainability indicators of using the new allocation would be limited for nearly all Fund members. The impact on indicators remains manageable for most members even at much higher SDR interest rates. In a small number of LICs though, use of the full SDR allocation could have non-negligible implications for debt sustainability, owing both to sizeable shares of SDR allocations to their GDP and exports and to exposure to interest rate variability. In all cases, attention would need to be paid to interest rate risks. More generally for LICs, the allocation should not be seen as a substitute for PRGF resources, which do not raise such risks and are less costly in most circumstances. I have instructed staff to advise countries on the macroeconomic impact and risks associated with the usage of SDRs, wherever relevant.

14. **It will be important to keep the global need for SDRs under review.** As is required under the Articles, such a review will take place no later than 6 months before the end of the current basic period; i.e. by June 2011, and will involve consultation with Executive Directors.

C. Elements of the Proposal

Eligibility to Receive Allocations During the Ninth Basic Period

15. Under the proposal, all existing Fund members that are participants in the Special Drawing Rights Department would be eligible to receive allocations made pursuant to the

resolution of the Board of Governors approving this proposal for a general allocation. This includes two countries (Montenegro and Kosovo) that have become Fund members and Special Drawing Rights Department participants after January 1, 2007; i.e., after the start of the ninth basic period. Pursuant to Article XVIII, Section 2(d), these participants will be eligible to receive the proposed allocation only if they are authorized to do so by the Executive Board. On July 17, 2009, the Executive Board provided such authorization.

Timing for the Allocation for the Ninth Basic Period

16. Although Article XVIII, Section 2(a) provides that decisions of the Fund to allocate SDRs shall be made for "basic periods" and that allocations "shall take place at yearly intervals" within each basic period, Article XVIII, Section 2(c) also provides that allocations may take place at other than yearly intervals.

17. Pursuant to the above authority, it is proposed that the full amount of the allocation take place 21 days after the adoption by the Board of Governors of the relevant resolution to allocate SDRs. Current circumstances call for a one-step rather than a staggered allocation. As discussed in paragraph 11 above, made in one step, the allocation would help meet the immediate need for liquidity, and signal a rapid, forceful and collaborative response to the crisis, while addressing at the same time the long-term global need to supplement reserves.

Allocations as Percentages of Quotas

18. Article XVIII, Section 2(b) provides 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, under Section 2(c) of the same Article, when making the decision to allocate, the basis for allocations may be the quotas of participants on dates other than the date of the decision to allocate.

19. In light of the fact that, as discussed above, the full amount of SDRs would be allocated 21 days after the decision to allocate, it is proposed that the allocation be based on participants' existing quotas. Given the amount that is proposed to be allocated, the rate for the proposed allocation is 74.1309799813 percent of eligible participants' quotas on the date of the adoption of the Board of Governors' resolution on the allocation of SDRs. This rate is derived by dividing an amount of SDRs equivalent to US$250 billion by the total of quotas of those participants, using the official SDR/USD exchange rate as of June 26, 2009.[6]

[6] The exchange rate of reference is 0.644737, corresponding to the date of the Executive Board discussion of the *Proposal for a General Allocation of Special Drawing Rights* (http://www.imf.org/external/np/pp/eng/2009/060909.pdf).

20. The total amount of SDRs to be allocated would be reduced if a participant entitled to receive allocations "opts out" of the allocation. Consistent with Article XVIII, Section 2(e), a member may opt out of the allocation only if (a) the Governor for the participant did not vote in favor of the decision and (b) the participant has notified the Fund in writing prior to the first allocation of SDRs under that decision that it is does not wish SDRs to be allocated to it under the decision.

Operational Considerations

21. The proposed large allocation is likely to lead to a marked increase in the volume of transactions in which freely usable currencies are requested in exchange for SDRs. With a view to ensure the smooth execution of these transactions on a fully voluntary basis, discussions are underway to expand, prior to the implementation of the SDR allocation, the so-called two-way trading arrangements, under which participants or prescribed holders stand ready to buy and sell SDRs. If needed, however, SDR transactions could be executed using the designation mechanism, whereby members with sufficiently strong external positions would be obliged to provide freely usable currencies in exchange for SDRs, up to specified amounts. In this way, members with a balance of payments need are assured that they can exchange their SDRs for freely usable currencies without delay.

D. Proposal for the Allocation of Special Drawing Rights

In light of the foregoing, I hereby propose that the Fund allocate special drawing rights to the participants in the Special Drawing Rights Department, in accordance with the Articles of Agreement, as follows:

1. An allocation of special drawing rights shall be made to participants in the Special Drawing Rights Department that are eligible, in accordance with the Articles of Agreement, to receive allocations during the ninth basic period.

2. The allocation shall be made on the twenty-first day following the date on which the proposed Board of Governors' resolution approving the allocation becomes effective.

3. The rate for each participant receiving an allocation shall be 74.1309799813 percent of the quota of each participant on the date on which the proposed Board of Governors' resolution approving the allocation becomes effective.

I further recommend that in accordance with the foregoing proposal, which has been concurred in by the Executive Board on July 17, 2009, the Board of Governors adopt the following draft resolution:

Draft Resolution

Allocation of Special Drawing Rights for the Ninth Basic Period

Whereas the Managing Director has submitted a proposal for the allocation of special drawing rights pursuant to Article XVIII, Section 4(c), of the Articles of Agreement of the International Monetary Fund;

Whereas in the Report containing his proposal, the Managing Director has declared that, before making the proposal, he had satisfied himself that the proposal would be consistent with the provisions of Article XVIII, Section 1(a), and that, after consultation, he has ascertained that there is broad support among participants for the proposal; and

Whereas the Executive Board, in accordance with Article XVIII, Section 4(a) has concurred in the proposal of the Managing Director;

Now, therefore, the Board of Governors, being satisfied that the proposal of the Managing Director meets the principles governing the allocation of special drawing rights set forth in Article XVIII, Section 1(a), hereby resolves that:

1. The Fund shall make an allocation of special drawing rights to participants in the Special Drawing Rights Department that are eligible, in accordance with the Articles of Agreement, to receive allocations during the ninth basic period.

2. The allocation shall be made on the twenty-first day following the date on which this resolution becomes effective.

3. The rate for the allocation shall be 74.1309799813 percent of the quota of each eligible participant on the date on which this resolution becomes effective.