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Promoting the Special Drawing Right

Edwin M. Truman*
Senior Fellow
Mossavar-Rahmani Center for Business and Government
Harvard Kennedy School

The special drawing right (SDR) has a complex financial structure. It is an international reserve asset as well as a liability but is not a currency. It is surrounded by provisions that constrain its creation and use in the international monetary system. Robert McCauley once quipped to me that the SDR is a Rorschach blot test: a mechanism to augment international reserves to aid the global adjustment process, a source of aid for poor countries, a potential and preferable rival to the US dollar as a reserve asset and a currency, a unit of account to increase the liquidity of sovereign bonds, or all the above and more. The focus of this paper is on the first, historic role of the SDR as an aid to the global adjustment process and how to promote that role in the future. Other features of the SDR may be useful by-products, but without the SDR playing its original role, it is difficult to argue convincingly that it would be able to play any other role.

The SDR is unknown outside of a small circle of aficionados and a slightly larger group of politicians and their hangers-on who generally have only a superficial and inaccurate understanding about the asset. In brief, SDR are allocated by the International Monetary Fund (IMF) to its members in proportion to their quota subscriptions. Members receiving SDRs can

* I have benefitted from comments on an earlier drafts of this paper by Jeffrey Frankel, Robert Lawrence, and participants in research meetings of senior fellows at the Mossavar-Rahmani Center for Business and Government. ADD MORE

transfer them to other members in exchange for convertible, or hard, currencies to meet their external financial needs.[1]

The SDR was established as a department of the IMF in 1969 as the first amendment of the IMF Articles of Agreement to support the Bretton Woods system of fixed exchange rates. See Annex I for a brief history of the SDR.

The major initial provisions were:

(1) An 85 weighted majority vote was necessary to allocate SDR based on the Managing Director's assessment that there was broad support for an allocation,
(2) The decision had to satisfy the criterion of a long-term global need to supplement existing reserve assets,
(3) The SDR's value was set equal to one US dollar, which was in turn tied to gold,
(4) A member's use of SDR was subject to a requirement that holdings be reconstituted to average 30 percent of allocations over each five-year basic period, and
(5) The SDR bore no interest as with gold.

In October 1969, the first two hurdles were cleared and SDR 9.3 billion were allocated over the next three years. After the United States in August 1971 suspended the redemption of official holdings of US dollars for gold, the monetary system evolved into one with flexible exchange rates among the major currencies, and the global economy was subjected to several oil-price shocks, slow growth and recessions. In 1978, IMF members decided to allocate an

[1] The SDR's value tracks a basket of currencies comprising the US dollar, Japanese yen, euro, pound sterling, and Chinese renminbi. Each member pays or receives interest on the difference between its cumulative allocation and its current holdings of SDRs. The interest rate is set weekly as the weighted average of the short-term government interest rates on the amounts of national currencies in the SDR basket. On April 17, 2022, the rate was 0.441 percent per annum.

additional SDR 9.3 billion, raising the total to SDR 21.4 billion. Meanwhile, the SDR's value had been set in terms of a basket of 16 currencies with the US dollar's share at one-third, the interest rate on the SDR was raised to 60 percent of the average of the short-term interest rates on debt of governments issuing the five major currencies, [2] and the reconstitution requirement was reduced to 15 percent from 30 percent.

Despite pressure from some IMF members and initiatives by the management of the IMF, no SDR were allocated until 2009 when SDR 161.2 billion were allocated in response to the global financial crisis and a special allocation of SDR 21.5 billion came into effect.[3] In 2021, in response to the COVID pandemic, SDR 456.5 billion more were allocated.

Thus, the SDR allocations have become an important tool of cooperation in international financial crises. Total SDR outstanding are SDR 660.7 billion, or $922.1 billion at the US dollar value of the SDR at the end of December 2021.[4] In the wake of the 2021 allocation, the SDR's share of foreign currency reserves plus SDR holdings was 7.1 percent, significantly less than the shares of the US dollar and euro (54.6 percent and 19.6 percent respectively) but a third more than the Japanese yen's share.

Should the SDR's share of international reserves be roughly maintained in the years ahead? My answer is yes. And the best way to do so is through regular annual SDR allocations. This was the intended role for the SDR when the instrument was established and would be

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[2] The US dollar, the German mark, the British pound sterling, the French franc, and the Japanese yen.

[3] The special allocation had been agreed in 1997 but the United States did not official approve it until 2009. The allocation was designed to provide SDR to countries that were not members of the IMF in 1969 or 1978 and bring the level of SDR holdings for each member up to the same level of its IMF quota.

[4] SDR = $1.399593

consistent with the role envisioned for the SDR in the IMF Articles of Agreement, "the special drawing right [should be] the principal reserve asset in the international monetary system" IMF Article VIII, section 7.

To make regular annual (and ad hoc) SDR allocations more palatable to some critics, I propose four reforms:

(1) Raise the SDR interest rate,

(2) Expand the list of freely usable currencies and their use in voluntary trading arrangements (VTAs) to mobilize SDR holdings.

(3) Re-assess the reserve asset theology applied to the SDR, and

(4) Double the quota share for low-income members of IMF in the 2023 quota negotiations.

Below, I first describe and evaluate the objections raised to SDR allocations. Next, in the context of these objections, I make the case for these four reforms and summarize some data on the use of SDR following the 2009 and 2021 to illustrate the SDR's potential contribution to the adjustment process and, thereby, to international economic and financial stability.

ARGUMENTS AGAINST SDR ALLOCATIONS

The arguments against the SDR and its allocation have not changed substantially since the debates of the 1960s prior to the establish the SDR.

(1) The SDR should meet a long-term global need which may never have existed but cannot exist in today's international monetary system.

(2) SDR distribution using the IMF quota key leads to a maldistribution.

(3) Use of SDR is unconditional contributing to moral hazard in countries' policy choices.

(4) SDR allocations add to global inflation.

(5) The SDR is inconsistent with the philosophical orientation of its major members.

Long-term Global Need

Opponents of SDR allocations cite the criterion embedded in the IMF Articles of Agreement that an SDR allocation must meet an identified long-term global need to supplement international reserves.[5] The IMF "originalists" argue that the SDR was established in the context of the Bretton Woods fixed-exchange-rate system and since the advent of floating exchange rates, countries can borrow international reserves and/or allow their exchange rates to adjust. If they cannot borrow, they are not credit-worthy and, therefore, they should not have access to unconditional liquidity supplied by other countries.

This argument was undercut by the second decision to allocate SDR in 1978 after the IMF Articles of Agreement had been amended to permit floating exchange rates. In other words, an SDR allocation provided benefits in the reformed international monetary system.

Flawed Distribution of SDR

Already in the 1960s, representatives of some countries argued that SDR should be allocated to countries where there was the greatest need for additional international reserves – to emerging market and developing countries or to low-income countries. This topic was revisited in the 1970s during the deliberations of the Committee of Twenty (C-20) on Reform of the

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

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

International Monetary System and Related Issues in the form of discussions of establishing a link between a portion of an SDR allocation and aid to low-income countries—an SDR/Aid link[6]. Today, this argument has been turned on its head. Opponents of the 2021 SDR allocation argue that the allocation goes to countries that do not need additional international reserves and only a small portion of an allocation goes to and is used by low-income countries.

The first part of this argument is correct, the combined quota share of low-income countries is constrained to be at least 3.2 percent of total quotas. The second part of this argument is incorrect as shown by the analysis presented in Annex II on the use of SDR following the 2009 and 2021 allocations. The predominant use of these allocations has been by higher income emerging market and developing countries.

Opponents of SDR allocations also argue that the high-income countries do not need the SDR. However, the do not explain what damage is done to the international economy and financial system by increasing these countries' SDR holdings. These countries are free to lend their SDR to other countries or to "recycle" their SDR through loans to the IMF, for example, to the IMF's new Resilience and Sustainability Trust (RST) (IMF 2022). Moreover, higher income countries are substantial users of the SDR. As of the end of July 2021 before the SDR allocation in August, the high-income countries had used 5 percent of their previous allocations. In US dollar terms, their combined use of $10 billion was equal to the combined use of the upper-middle-income countries and only slightly less than the $12 billion used by lower-middle-income countries.[7]

[6] See IMF 1974.

[7] These SDR are valued at their US dollar value on August 31, 2021 at $1.42426 per SDR.

Lack of Conditionality

Countries borrowing from the IMF must satisfy or pledge to satisfy conditions on their economic policies. The strength of those conditions depends on the country's current policies, its economic circumstances, and the facility or window from which it is borrowing. A member country's use of its SDR allocation is essentially without conditions.[8]

It is correct that a country's use of its SDR is not subject to conditions on its economic policies such as with most other borrowing from the IMF. However, the use of SDR is not borrowing from the IMF. It is borrowing directly from other member countries and the country using its SDR must pay interest to those countries. This argument is not about policy conditionality, it is about whether the IMF should be in the business of allocating SDR, which the amended Articles of Agreement have sanctioned. Moreover, the IMF does not place conditions on member countries' use of the owned reserves. Why should it place conditions on its use a member's SDR holdings?

SDR Allocations Contribute to Inflation

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

But the inflation argument is essentially specious. The argument is that SDR allocations will be inflationary through direct effects on monetary aggregates or by stimulating global aggregate demand. The argument is unsupported by the historical evidence as well as the

[8] Technically, the country must have a "need" to use its SDR should not use its SDR merely to diversify its reserve holdings, but these are not binding conditions.

analysis of Ricard Cooper (2002) [add reference and check date] and others. In summary, not all SDR transactions flow through the accounts of central banks; any SDR allocation would be small relative to the stock of banks' reserves at those central banks accepting the SDR; they do not increase banks' reserves if the central bank supplies a currency other than its own, or if it pursues its basic policy objective of limiting inflation. If many countries use their SDR in the same time period after an allocation in support of expansionary economic policies, the aggregate size would be trivial; half the current stock of SDR is less than $500 billion less than one half of one percent of global GDP, which is in excess of $100 trillion. This is an argument about the stock of reserves not a flow increase in reserves in the context of deficient global aggregate demand and applies to countries stocks of reserves in any form, of which more than 90 percent is in national currency holdings.

The SDR Is Against Our Philosophy

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

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

Second, at a technical level, opposition is grounded on the cost to the United States of doing its part to facilitate use of the SDR. However, for the United States these costs are minuscule. For 20 years, the US Congress has required the US Treasury to report on the cost to the United States of participation in the SDR regime. In its latest report [ADD REFERENCE], the total net interest cost to the United States – the difference between the interest the United

States receives on its holdings of SDR in excess of its allocations and the average cost of US Treasury borrowing to supply those dollars – has been $52 million (not billion) over the past 20 years, $2.6 million a year on average.

In a world in which many problems are not confined within national borders, political pressures to put the perceived short-term interests of a country first and under-value the longer-term benefits of cooperation are substantial in some countries. With respect to SDR allocations, this attitude takes the form of opposition to the SDR on the grounds that some countries that will receive shares of an allocation do not share the values of most of the IMF membership or currently have pariah status, such as Belarus, China, Iran, Russia, Syria, and Venezuela. As is reported below, most of these countries have not used their SDR allocations. In some cases, this is because they find it difficult to do so in environment where transactions involving in exchange for national currencies are voluntary. Moreover, these countries' combined share of IMF quotas is only 10.8 percent. Should the benefits of an SDR allocation to the other 89.2 percent be denied because some countries will benefit do not, in the view, of some deserve to benefit.

REFORMING THE SDR

IMF members should reform the SDR in order to meet the arguments against the instrument sketched out in the previous section of this paper.

Raise the SDR Interest Rate

The SDR interest rate provides a perpetual subsidy to almost all net users of SDR. It also imposes a fiscal or opportunity cost on any net holder. The net holder either must borrow its own currency in the market to provide its currency to the SDR user or forego earnings on its

reserve assets held in one of the other currencies that may be provided to the user (currently the five currencies in the SDR basket: euro, Renminbi, sterling, US dollar, and yen).

Table 1 illustrates two alternative approaches to reducing the size of this subsidy by SDR holders of SDR users: either set the SDR interest rate as the weighted average of the long-term interest rates for issuers of the currencies in the SDR basket or as a blend of that average with the current SDR interest rate based on their short-term interest rates. For the period 2000 to 2008, the average long-term interest rate for four of the five issuers of currency in the basket exceeded the SDR interest rate by an average of about 130 basis points. [9] For the period 2009 to 2019, the difference was about 175 basis points. A 50 percent blend of the two rates would have cut these differences in half.

The external borrowing rate for emerging market and developing countries on average is substantially above either figure. On December 31, 2020, the average yield on the EMBIG index was 4.55 percent.[10] For the full year 2020, the SDR interest rates averaged 20 basis points and the SDR weighted average long-term rates on the sovereign debt of four of the five currencies in the basket was 53 basis points.[11] For the period, 2016 to 2019, the average yield of only one of 55 constituent countries in the EMBIG index was less than 3 percent—Poland with an average yield of 2.73 percent—compared with an average SDR rate of 63.5 basis points and the SDR weighted average long-term rates on the sovereign debt of four of the five

[9] The source does not provide a comparable average long-term interest rate for China.

[10] Source: State Street Global Advisors.

[11] Source: Organization for Economic Cooperation and Development, Monthly Monetary and Financial Statistics.

currencies in the basket of 1.53 percent.[12] Thus, under this proposal, the subsidy element for use of SDR would remain albeit reduced.

This reform would help to blunt the criticism of the unconditional nature of SDR credit by raising its cost. It would also help to blunt the criticism that providers of usable currencies to those countries transferring their SDR bear an interest cost.

Expand the List of Freely Usable Currencies and their Use in VTAs

The number of currencies classified as freely usable by the IMF should be expanded from the current five in the SDR basket. This would facilitate the mobilization of SDR.

The current combined quota share of IMF members issuing the currencies in the SDR basket is 56 percent. If the Australian and Canadian dollars and the Swiss franc were classified as freely usable currencies the quota share of such currencies would increase to 61 percent. These three currencies have long been included in the IMF's survey of the currency composition of foreign exchange reserves. They account for more than 4 percent of the allocated total. The New Zealand dollar, Swedish krona, and Korean won should also be classified as freely usable currencies. Each of these currencies as well as the eight others accounts for more than 2 percent of over-the-counter foreign exchange turnover in the most recent BIS (2019) survey. Including these currencies on the list of freely exchangeable currencies would further boost the quota share of countries issuing them to 64 percent. I have long advocated this reform not only to facilitate the mobilization of SDR but also to enhance the multicurrency feature of the Fund and the international monetary system while reducing reliance on the US dollar (Truman 2021).

[12] I thank the Institute of International Finance for the EMBIG constituent yields. The four excluded countries are China whose currency is in the SDR basket and Latvia, Lithuania, and the Slovak Republic, advanced countries in the euro area. However, their EMBIG yields exceed the SDR rate and the four-currency average of long-term rates.

IMF members should also agree to a presumption that all members that issue freely usable currencies should provide their own currencies in exchange for SDR. This would also benefit the evolution of the multicurrency system and take some burden off the dollar. Current IMF procedures governing valuation in transactions converting SDR into national currencies are outdated. The depth and breadth of foreign exchange markets ensures that IMF members will receive fair value when converting from one freely usable currency to another after receiving the first currency in exchange for their SDR. The case for the IMF or member countries to internalize the transactions costs is weak.

These reforms would help to promote the SDR in enhancing the international adjustment process by spreading the burden of adjustment away from the US dollar.

Re-Assess the Reserve Asset Theology of the SDR

Deeply embedded in IMF practices and procedures with respect to the use of SDR is the view that they are liquid assets, and their liquidity always should be maintained. One can understand and appreciate why in the early days of the SDR supporters of the SDR and the IMF staff were determined that the SDR would be as "reserve-like" as any other reserve assets. At that time, the emphasis was on their ready availability reserves to meet external and financial needs.

Today, in contrast, many countries hold very large amounts of reserves, and they are invested in a range of assets some of which such as corporate bonds or the bonds of developing finance institutions are not very liquid. Indeed, many countries segment their reserve

portfolios into liquid assets and investments. The IMF theology is that the SDR should be in the former category.[13]

To facilitate the more flexible use by members of their SDR holdings, the "reserve asset" provisions governing their use should be relaxed if not eliminated. A country should be free to lend its SDR to another country, to the IMF, to a multi-lateral development bank, or to some other approved holder without strings attached to preserve the "reserve asset" character of the SDR. Credit risks and provisions governing the repayment of loans of SDR via set-asides are another matter. In other words, member countries should be free to treat SDR holdings the same way they treat their other holdings of reserves and to decide for themselves whether the SDR should be at the top of the pile, the bottom of the pile, or the middle of the pile.

This reform would help to address the criticism that SDR are misallocated relative to the needs of lower income members of the IMF. It would facilitate the transfer of SDR to other countries and institutions to benefit lower income countries. This type of recycling operation is second or third best because the financial resources could be transferred directly by the higher-income countries and because of the technical complexities of mobilizing SDR via their conversion into national currencies. On the other hand, third best is better than nothing.

Increase the Quota Share of Low-Income Members

The distribution of quotas and, therefore, SDR allocations should be tilted more toward the low-income countries and other emerging market and developing countries and away from the

[13] See Lazard (2022) for an elaboration of this argument.

advanced countries, most of whom are not expected to borrow from the Fund and do not have as much need to augment their reserves.[14]

The 16th review of IMF quotas is to be completed by December 15, 2023. The outcome of this Rubik's-cube exercise is uncertain. The number of proposed variations of the formula for calculated quotas and ad hoc adjustments is substantial. Given that the most recent adjustment in quota shares was agreed more than a decade ago (2010), pressures to make further adjustments in the current review are large. Considering the increased potential for SDR allocations in the future, the implications of the 16th review will not only involve traditional considerations of the distribution of votes and scale of potential commitments and drawings on the IMF resources but also impact shares of future SDR allocations.

The 16th review could end in a stalemate and a decision not to increase or adjust quota shares at this time. Such an outcome would be unfortunate. If the review is successful at increasing the total size of quotas, it will almost certainly boost the combined quota share of emerging market and developing countries as group and, therefore, also their share of any SDR allocation. In 1970-1972, the 22 advanced countries, as then classified, received 73 percent of the first SDR allocation. In 2021, the same group of countries received 62 percent of the allocation. In other words, the evolution of IMF quotas has led to a larger share of any SDR allocation going to emerging market and developing countries.

[14] That generalization does not hold for all 56 countries currently classified by the IMF's *World Economic Outlook* and by the World Bank as high income. The allocation of $650 billion SDR increases the international reserves of six of these countries by more than percent. The six include Cyprus, Greece, Ireland, and Portugal, countries that borrowed from the IMF during the European debt crisis and ran down their international reserve holdings.

The classification of countries by income per capita is revised annually. However, the country classifications used in the quota negotiations are immutable. In this abstract statistical world, the advanced countries' combined quota share is now 57.6 percent and would be 50.2 percent under the current quota formula using data through 2018 (IMF 2020, 6). The combined quota share of the low-income countries is protected at 3.2 percent. To enhance the attractiveness of SDR allocations to these countries and their supporters, the protected combined LIC share of quotas should be doubled to 6.4 percent. This change, along with the likely boost in the combined quota share of other emerging market and developing countries, would help to ensure what some would consider a more equitable distribution of an SDR allocation and help to obviate some of the need to go through the contortions of SDR recycling that have been associated with the 2021 SDR allocation.

Adding a constrained LIC share of quotas at 6.4 percent to calculated share of quota of the other emerging market and developing countries would, based on 2018 data [UPDATE], raise their combined share to 53.8 percent compared with their current share of 42.4 percent. If IMF quotas were doubled and the addition were allocated on using the current quota formula, their combined share would increase by about 7 percentage points [CHECK].

In my view, the compensating adjustment in the shares of the advance countries should be accomplished by putting greater weight on the GDP component of the formula (either in its current form or with a more substantial shift toward GDP on a purchasing-power-parity basis) and adjusting the trade openness variable by excluding intra-currency union trade, which is one option under consideration. These adjustments would allow the United States to maintain its

voting share of more than 15 percent for one more round of quota adjustments while reducing the oversized combined quota and voting share of European members.[15]

This reform would help to address the criticism that the use of the quota key for SDR allocation of SDR fails to provide as large a financial safety net to low income countries as is appropriate.

CONCLUSION

These reforms would add to the attractiveness of initiating regular annual SDR allocations during the thirteenth basic period (2026 to 2031) if not before by addressing at the margin some of the criticisms of the current system. If one assumes that the global need for international liquidity leads to about a 13 percent increase over the next five years – the midpoint of the projection of $1.1 to $1.9 trillion in IMF (2021b) – a similar percentage increase over the next five years implies a midpoint increase in the estimated global need of $1.7 trillion. If half of that amount were covered by annual SDR allocations over five years, the allocations would be about $170 billion per year.

I have focused in this paper on the role of the SDR as an official asset rather than as market instrument or a unit of account becoming more like a currency.[16] In my view, a necessary condition for an expansion of the role for SDR in these other areas is that the SDR first become more than a crisis management tool. My four reform proposals, none of which

[15] To resolve the "veto problem" of one country or a coherent group of countries like the European Union being able to block decisions because they have more than 15 percent of IMF votes, I favor reducing the US and EU shares below 15 percent at the same time.

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

require an amendment to the IMF Articles, focus on expanding the originally intended role for the SDR.

If there were an appetite among IMF members large as well as small for more substantial reforms affecting the SDR such as establishing a different key for allocation of SDR, that could be done via an amendment of the Articles of Agreement.

Another reform that would require an amendment of the Articles would be to pre-position an SDR allocation to be triggered by a greater-than-fifty, but less than 85, percent majority vote of the IMF executive board on the recommendation of the Managing Director. This reform could also be introduced under the current system. The governors could approve by the required 85 percent majority an allocation of SDR up to a specified amount to be triggered by the recommendation of the Managing Director that was approved by an agreed majority of the executive board.

ANNEX I – A BRIEF HISTORY OF THE SDR

The SDR has had a controversial 60-year history. The SDR's birth was the outgrowth of intense discussions during the 1960. Two allocations were agreed during the first decade of its existence. During the following two decades, the SDR struggled to remain relevant. During the global financial crisis SDR allocations were revived and again during the Covid pandemic. This annex sketches this history of the SDR.

Birth of the SDR[17]

A fundamental reform of the international monetary system has long been overdue. Its necessity and urgency are further highlighted today by the imminent threat to the once mighty U.S. dollar.
Robert Triffin, December 8,1960[18]

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

Although the United States ran current account surpluses throughout the 1950s, US net private capital outflows exceeded those surpluses. Under the Bretton Woods international monetary system of pegged exchange rates, other countries were forced to buy dollars to prevent their currencies from appreciating. The result was a buildup of official claims on the United States. Some countries used those dollars to buy gold from the United States. Others just let their holdings accumulate. Triffin (1959a, 1959b, 1959c, 1960s, and 1960b) foresaw a

[17] For more detail on this and the following section, see Solomon (1981) and De Vries (1976, 1986).

[18] Triffin (1960b). Triffin's initial analysis appeared in (1959a and 1959c) and were reprinted in Triffin (1960). He also appeared before the Joint Economic Committee the year before (Triffin 1959b). Triffin (1978) provides a nice history of the evolution of his thinking.

dilemma for the United States and the system: either official dollar holdings would soon exceed the remaining US gold stock, precipitating a run, or US policy would act preemptively and tighten its macroeconomic policies to increase its current account surpluses and stem the outflow of dollars, precipitating an unwelcome contraction of the global economy.

Beginning shortly after Triffin sounded his warning private and official groups met and issued reports about the future of the international monetary system and what to do to undergird it. In 1965, the United States became more open to considering proposals for a supplementary reserve asset. Representatives of the finance ministries and central banks of the G-10 countries began a series of meetings. The SDR negotiations concluded in March 1968. In early 1969, the SDR amendment to the IMF Articles of Agreement came into force.

The First Decade of the SDR

> *In my judgment, the experience up to now with the operation of the special drawing rights facility has been highly successful, and it can be stated that the SDR has become established as a reserve asset.*
> Pierre-Paul Schweitzer, September 21, 1970[19]

IMF members acted quickly and agreed in 1969 to allocate SDR. They agreed to another allocation in 1978 in the wake of the collapse of the Bretton Woods system, agreement on a partial reform of the international monetary system in 1976, and a succession of economic shocks.

The First SDR Allocation

[19] De Vries (1976, 207).

The first SDR allocation was approved in October 1969: an allocation of SDR 9.5 billion over the next three years.[20] Over the four-year period ending in 1968, international reserves had declined by $4.4 billion. During the same period the US gold stock had declined by a further $4.6 billion, and $2 billion in total official gold holdings was used to support the London gold pool until that support was terminated in March 1968.

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

The SDR and International Monetary Reform

After the United States closed its gold window, the international monetary system entered a transitional period. The US dollar was devalued against gold as part of the Smithsonian Agreement in December 1971 and was devalued again in February 1973. A month later the widespread managed floating of the major currencies was accepted as a temporary measure that became permanent. From 1972 to 1974, the Committee on Reform of the International Monetary System and Related Issues (Committee of Twenty or C-20) unsuccessfully sought to agree on a comprehensive reform of the system. It reached agreement an Outline of Reform (IMF 1974). The Outline contained many elements that were subsequently implemented.

[20] The plan was to allocate SDR 3.5 billion in 1970s and SDR 3.0 billion in 1971 and 1972, but China (Taiwan) declined to receive its allocation even though it had joined the facility with the result that only SDR 9.3 billion were allocated. These figures were in the middle of the range of SDR 2.5 to 4.0 billion per year providing for an increase in international reserves of about 4 percent per year, about 70 percent of the annual demand for reserves of 5-6 percent per year as projected by the IMF staff.

However, the third amendment of the IMF Articles of Agreement was not agreed until January 1976 and only became effective on April 1, 1978.

The SDR and the Outline of Reform

The C-20's efforts to agree on a comprehensive reform of the international monetary system were unsuccessful. However, agreement was reached on several points concerning the SDR that were included in the second amendment to the Articles of Agreement approved in 1978.

The most prominent point or agreement was not only to retain the SDR mechanism but also to promote its role in the reformed system. Margaret de Vries (1985, 262) characterized the resulting system in the amended Articles as one based on an "SDR standard" that replaced the gold, gold-exchange, and dollar standards of the past. Today, most analysts (some with regret) would say that the international monetary system is firmly based on the dollar standard. However, the amended Articles obligated members to collaborate with the Fund and other members with the objective of "making the special drawing right the principal reserve asset in the international monetary system."[21]

In addition to endorsing an SDR standard, the C-20 also revisited the question of linking SDR allocations to international financial assistance. The C-20 deputies established a Technical Group on the SDR/Aid Link and Related Proposals (IMF 1974).[22] In 2020 and 2021, echoes of

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[21] IMF Articles of Agreement: Article VIII, section 7

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

This obligation is repeated in Article XXII.

[22] I served on this Technical Group. For more on the C-20 see Truman (2017).

the deliberations of the Technical Group have been heard in proposals to recycle some part of the $650 billion allocation of SDR on a voluntary basis from advanced to low-income countries.

The Technical Group met in June and July 1973. Participants' ex ante positions divided into three groups: representatives of developing countries favored the position that a portion of an SDR allocation received by developed countries be channeled first to the developing countries (the "Link"). Their fallback position was to channel a portion of the allocation directly or indirectly from the advanced countries to the development finance institutions such as the World Bank or regional development banks. The Technical Group considered illustrative shares of 15, 30, and 50 percent of any SDR allocation that might be dedicated to link-treatment.[23]

The C20's Outline of Reform addressed the fundamental question of whether the SDR should also be an aid instrument, "It is generally agreed that if a link were established the amount of SDR allocations and the principal characteristics of the SDR should continue to be determined solely on the basis of global monetary requirements" (IMF 1974, 47).

The Second Allocation of SDR

The 1970s was a decade of economic and financial turbulence. Following the collapse of the Bretton Woods system, wide swings in bilateral and effective exchange rates were common, petroleum prices soared, inflation rose, the global economy experienced a near recession in 1975, current account imbalances widened, and external financial crises became more common (most prominently crises for systemically important countries like Italy, Mexico, and the United

[23] It is probably a coincidence, but the G-7 leaders' communiqué (G7 2021) on June 13, 2021, called for contributions, including from rechanneling SDR to the IMF's Poverty Reduction and Growth Trust of $100 billion, 15 percent of the $650 billion allocation of SDR.

Kingdom). The IMF was in the center of cooperative efforts to address countries' external financing problems throughout this period.

Multiple initiatives to augment IMF resources for program lending to members pushed aside consideration of another SDR allocation. There was no allocation in the second five-year basic period (1973-1977). However, in 1976 IMF Managing Director Johannes Witteveen began consultations on an allocation in the third basic period (1978-1982).

Meanwhile, two key aspects of the SDR had been further changed. In June 1976, the interest rate on the SDR was raised from 50 percent to 60 percent of the short-term market interest rates of the five major currencies. In August 1978, the rate was raised to 80 percent.[24] At the same time, the reconstitution requirement was reduced to 15 percent from 30 percent. These steps helped to lay the groundwork for a grand bargain in September 1978 on the seventh quota review and the allocation of SDR 9.3 billion in 1979, 1980, and 1981, raising the total outstanding to SDR 21.4 billion.[25]

As the 1970s came to an end and the US dollar continued its prolonged period of weakness dating back to 1971, proposals to substitute some or all outstanding official holdings of US dollar or other currency assets with SDR issued by an account in the IMF resurfaced. In 1980, the United States and principal creditor countries failed to reach agreement on how to

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

[25] In the staff report on the proposal, the demand for reserves over the next five years was estimated at SDR 20 billion a year, and SDR 9.3 billion in the first three years could substitute for part of this demand, but only a small part, that otherwise would be satisfied by increased holdings of reserve currencies, limiting any inflationary effects. In fact, from December 1978 to December 1983, international liquidity increased by SDR 98 billion, or $43 billion. During this period, the dollar depreciated, and the global debt crisis led to an absolute decline in the stock of reserves in US dollar terms in 1982 and 1983.

share possible financial losses of the account. Holders of US dollar assets in the emerging market and developing countries also were unenthusiastic about receiving a lower return on their reserves in the form of SDR-denominated claims on the account than on their reserves in US dollar balances.[26]

The second allocation of SDR in 1979-1981 solidified the SDR as a component of the post-Bretton Woods international monetary system. The SDR's survival inspired Margaret de Vries (1985) to title part eleven of her history of the IMF from 1972 to 1978, "Resurgence of the SDR in 1978."

Struggles of the SDR

Evolution of the SDR: Paper Gold or Paper Tiger?
James Boughton[27]

The SDR struggled for support and relevance throughout most of the 1980s and the 1990s. Representatives of developing countries continued to press for a resumption of SDR allocations, but the advanced countries expressed little interest until late in the second decade. IMF management and staff did succeed in convincing the executive board to increase the attractiveness of the SDR. In 1980, they raised the interest rate on the SDR to 100 percent of the average of the weighted short-term interest rates of the countries with currencies in the SDR basket, whose number was reduced to five. The rate still did not track market rates closely, because it was reset quarterly, and even today the rate is reset only weekly. In April 1981 the reconstitution requirement was abrogated. In 1987, the Fund implemented a

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

[27] Boughton (2001, chapter 18 title). Boughton (2012) further demoted the IMF discussions of the SDR to a few pages in a chapter on IMF financing.

voluntary exchange market for the SDR in which users of SDR did not have to assert a balance-of-payments need to exchange SDRs for currencies. All members of the IMF became members of the SDR department and use of SDR increased somewhat even though its stock remained small.

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

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

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

In advance of the IMF/World Bank annual meetings in Madrid in September 1994, Camdessus proposed to combine a new general allocation of SDR with an amendment of the Articles to permit a special allocation to members that had joined the Fund after January 1981,

principally Russia, other parts of the former Soviet Union, and Eastern European countries.[28] He misread the position of the United States, which favored the second part of his proposal but not the first, as well as the positions of several other G-7 countries. The result was an embarrassing stalemate that stretched into the wee hours of the morning.

The Madrid "debacle" (to use Karin Lissakers' (2005) description) led the IMF's Interim Committee, the predecessor of the International Monetary and Financial Committee (IMFC) to request the Fund conduct a clarification of the issues and differences that contributed to the failure to agree when many thought agreement was in sight. In response, the IMF held a conference to consider the future of the SDR. Authors presented 22 papers on topics ranging from the origins of the SDR to proposals for reform of the SDR mechanism and its role in the international monetary and financial system. The conference and resulting publication (Mussa, Boughton, and Isard 1996) did not move the needle on the SDR's evolution.

The conference did not settle any issues. Nevertheless, Camdessus successfully revived the second part of his original proposal. In 1997, members agreed to double the amount of SDR outstanding to SDR 42.8 billion via an amendment of the Articles that authorized a special allocation that would be distributed to bring holdings of each member up to 29.3 percent of its quota. However, soon thereafter Russia turned away from economic reform and the United States lost interest in the proposal and did not act to approve the amendment. Other countries were slow to approve the amendment as well. Consequently, the amendment did not come

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

into effect until September 2009 when the United States approved it in the context of the global financial crisis.[29]

Revival of the SDR

Is the SDR a Monetary Dodo?
Karin Lissakers, September 2005[30]

At the turn of the 20th century, an objective observer might have reasonably concluded that the SDR's future was dim. The official sector demonstrated no interest in the instrument. No SDR had been allocated for 20 years. The most recent serious proposal to allocate SDR in 1996 had been firmly opposed by several major industrial countries led by the United States. And the equity amendment to the IMF articles to bring holdings of all members up to a benchmark of 29.32 percent of quotas appeared to be in permanent limbo.[31]

Camdessus was succeeded as IMF managing director by Horst Köhler of Germany. Under his leadership, the analysis in the background paper prepared by the IMF staff (IMF 2001) for the executive board's consideration of an SDR allocation in the eighth basic period (2002-2006) was similar to that outlined by Mussa in Mussa, Boughton, and Isard (1996). Although a careful reader of the paper would conclude that the staff's case for an SDR allocation was on balance positive, the paper contained no conclusion or allocation proposal in contrast with similar papers produced under Camdessus.

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

[30] Lissakers (2006, 483).

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

On the other hand, outside advocates for the SDR continued to make proposals. A Council on Foreign Relations (1999) task force proposed special SDR allocations to fund a "contingency facility" in the IMF. Richard Cooper (2002) envisaged a temporary SDR allocation to deal with crises and creditor panic. His proposal was echoed by Camdessus in Camdessus, de Larosière, and Köhler (2004). In United Nations (2002), the Zedillo Report advocated a resumption of SDR regular SDR allocations. George Soros (2002) advocated the use of SDR allocations not only to promote development but also to help fund global public goods.[32]

In 2005, at a conference on the future of the IMF, former US IMF executive director Karin Lissakers answered her question about whether the SDR was a monetary dodo bird. She concluded that the SDR bird might still fly either in the form of regular SDR allocations or in response a global financial crisis, "SDR provide a low-cost financial cushion and can help lower-income IMF members maintain higher growth, to the benefit of the global economy as well as themselves" (Lissakers 2006, 492). In my introductory paper for the conference, I argued that SDR should have a place in the international monetary system of the 21st century, but my best guess was that "nothing will happen with respect to the SDR in the next decade or so" (Truman 2006, 119).

In 2006, IMF managing director Rodrigo de Rato reported to the IMFC "that there is no proposal for a general SDR allocation for the ninth basic period [2007 to 2011] consistent with the provisions of the Articles of Agreement that has the necessary broad support of participants in the SDR department, and [he had] issued a report to this effect to the Executive Board" (IMF

[32] In 2021, the SDR is again being linked to this role.

2006).[33] However, he noted that the IMF Articles provide for an SDR allocation proposal during a basic period. Dominique Strauss-Kahn replaced de Rato as managing director in July 2007.

When the global financial crisis entered its virulent phase in the fall of 2008, support for an SDR allocation revived. Representatives of emerging market and developing countries, participating in one of the working groups formed at the Washington G-20 meeting in November 2008 to prepare for the London meeting in April 2009, expressed strong interest. Agitation also came from the think tank community which lobbied the British authorities to support an allocation of $250 billion in SDR.[34] The proposal was adopted to the surprise of many advanced countries and the IMF staff. [35] However, the IMF staff subsequently assembled a comprehensive report to the executive board that was discussed on June 26 (IMF 2009b). The paper emphasized that the allocation would strengthen the global financial safety net, set an example of a cooperative response to the global crisis, and build confidence. The paper argued that the allocation met the criteria in the IMF Articles. The staff estimated that emerging market and developing countries, excluding China and fuel exporters, would need $400 to $900 billion additional reserves over the next five years and $1.3 to $2 trillion over the next 10 years.[36] The governors promptly approved the proposal and on August 28, SDR 161.2 billion

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[33] I have been unable to find the report to the Executive Board, but IMF (2009a, 3) provides a summary:

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

[34] See Truman (2019) for more detail.

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

[36] In fact, the international liquidity of those 129 countries increased by $446 billion between 2009 and 2014 and $935 billon between 2009 and 2019.

were allocated. On August 5, the United States finally completed its approval of the fourth amendment of the Articles, allowing the Fund to implement the special allocation of SDR 21.5 billion on September 9. These allocations raised cumulative SDR allocations to SDR 204 billion, about 85 percent of total IMF quotas.[37]

Although the 2009 estimates of increases in reserves over the subsequent five and ten years were remarkably accurate, estimates of possible use of SDRs following the 2009 allocation were substantially higher than actual use. Sales of SDR to other members totaled SDR 3.4 billion through the end of 2010 and SDR 8.8 billion through the end of 2020, compared with a pre-allocation estimate of SDR 10 to 30 billion (IMF 2021a, 27).[38] The reasons for this limited use of SDR are obscure, but one factor may have been that the holders were uninformed or inexperienced in their use and the IMF staff may have been less than systematically proactive about informing members.

In the wake of the 2009 allocations, collective interest in the SDR and its possibilities increased in 2010 and 2011 prior to the start of the tenth basic period on January 1, 2012. A contributing factor was renewed interest in the reform of the international monetary system after the global financial crisis and the agenda of the French presidency of the G-20.[39] In 2011,

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

[38] Transactions with the IMF itself are excluded from these figures. IMF (2009b and 2021) do not indicate the time period for which the estimates were prepared.

[39] The international monetary system has been a traditional preoccupation of French authorities for generations. In December 2010 they launched a series of conferences on the subject. Michel Camdessus, Alexandre Lamfalussy, and Tommaso Padoa-Schioppa launched the Palais Royal Initiative in the fall of 2010. The group produced a set of reform suggestions in February 2011 and subsequently published a set of background papers (Boorman and Icard

the IMF staff produced a series of papers on various aspects of the SDR and the international monetary system. In January the staff circulated (IMF 2011a) a broad-ranging paper on the potential role for the SDR in enhancing international monetary stability.[40]

The paper identified three concepts of the SDR:

(1) The official SDR as defined in the Articles.

(2) A tradeable SDR in the form of SDR bonds or securities.

(3) The SDR as a unit of account. [41]

In June 2011, the executive board formally considered the case for a general allocation of SDR during the tenth basic period of January 1, 2012, through December 31, 2016 (IMF 2011c). The staff proposed an allocation of $350 -- $400 billion to all members over three years starting in 2014 to meet part of an estimated demand for additional reserves of $800 -- $1,600 billion over the five-year period from 118 emerging market and developing countries.[42] The staff argued that SDRs are “inherently superior” to endogenously generate reserves in that they are costless, continuously available and liquid, can be accumulated without contributing to global imbalances, and are a better store of value than holdings of individual currencies. The

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2011). In the end, the G20 meeting in Cannes was preoccupied with the European debt crises and the communiqué contained a scant four paragraphs on the international monetary system.

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

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

[41] A later IMF Policy Paper (IMF 2018) labeled these three concepts as the O-SDR, M-SDR, and U-SDR.

[42] The staff paper did not identify the 118 emerging market and developing countries. However, for the 129 countries specified in the previous footnote, international liquidity increased by only $70 billion.

acting managing director subsequently reported to the IMF board of governors that there was not the required broad support among executive directors for an allocation.

This caution and uncertainty about the role of the SDR and the case for further allocations prevailed in official circles until the outbreak of the Coronavirus pandemic in 2020. Most governments, including several of the traditional European skeptics, joined representatives of non-governmental organizations and think tanks to embrace proposals for another large one-time SDR allocation to help address the economic and financial strains of the pandemic.[43] The US administration did not share this judgment. US treasury secretary Steven Mnuchin stated the US position at the April 16, 2020, meeting of the IMFC:

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

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

[43] For two examples, see Collins and Truman (2020) and Main, Jacobs, and Weisbrot (2020).

On February 25, 2021, US Treasury Secretary Janet Yellen (2021) announced a reversal of the US position. The IMF allocated SDR 456.5 billion ($650 billion) in August 2021.[44] The IMF staff paper (IMF 2021) on the proposed allocation stressed the global economic context, noted that aggregate reserve accumulation had decelerated sharply since 2011, noted that in 2020 the reserves of non-Asian emerging market an developing countries declined by SDR 95 billion, estimated a demand for increased reserves of $1.1--1.9 billion over the next five years (of which the allocation would cover 30 to 60 percent), emphasized that SDR allocations are less costly than acquisition of reserves by borrowing or current account surpluses, do not contribute to excess global imbalances, involve no immediate rollover risks, benefit all members of the Fund, and provide rapid unconditional liquidity,[45] and observed that the allocation would contribute to fulfilling the general purposes of the Fund.

The paper also sought to blunt the criticism that SDR allocations provide no benefits to countries that do not use their allocations. It presented estimates of the impact of increases in reserves on credit-default-swap spreads. It estimated the impact of the proposed SDR allocation on the spreads of countries with very low reserves could be as large as 240 basis points (IMF 2021, 14).

[44] The $650 billion amount is less than the constraint in US legislation that the Treasury secretary cannot vote for an SDR allocation in any basic period in which the United States receives more SDR than its quota in SDR (SDR 83 billion) with approval of the US Congress. The 2021 SDR allocation amounts to 95.6 percent of each members' quota. As required by US law, Secretary Yellen notified the Congress on April 2 that she intended to vote in favor of the allocation. Congressional opposition to the allocation focuses primarily on concerns that it will benefit countries that are in US disfavor such as China, Iran, and Venezuela. On the other hand, some lawmakers favor an even larger allocation to provide more direct benefit to low-income countries.

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

On implementation, the paper put forward plans to upgrade the transparency of SDR operations, responding to some of the criticism of SDR allocations based on geopolitical considerations that, for example, countries would use them for the "wrong" payments to the "wrong" countries, e.g., debt payments to China. The paper also provided assurance that the existing framework of voluntary trading arrangements (VTAs) would be adequate to meet the demand for SDR transfers while outlining an effort to expand the number of participants in the VAT system and to encourage the relaxing of the limits in the existing VTAs on how many SDR they would accept.[46] The paper also stated that the managing director did not at this time plan to submit a proposal for an SDR allocation in the twelfth basic period that starts on January 1, 2022.

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

[46] Thirty-two IMF members with 70 percent of IMF quotas now have VATs.

Whatever the motivation, one or more mechanisms will be established. They could take various forms: lending SDR to the IMF to add to the resources of an existing or new facility; lending SDR to one of currently prescribed institutions that can hold SDR such as the World Bank; lending SDR to another lending facility to be prescribed; and/or distributing SDR through donations to specific entities.[47] On April 13, 2022 the IMF executive board approved the establishment of the Resilience and Sustainability Trust (RST) through which members can channel SDRs for lending to low-income and vulnerable middle-income members (a total of 143 countries) for 20 years with a 10-1/2 year grace period. The initial projected size of the RST is a modest $45 billion. Members may also and have lent SDR to the IMF's Poverty Reduction and Growth Trust (PRGT) which first established in the 1970s.

These mechanisms de facto link the allocation of SDR with additional financial assistance to developing countries as has been advocated from the start of discussions of mechanisms to augment international reserves in the 1960s.

[47] This is not an exhaustive list. For an analysis of these four models see Mark Plant (2021) and CGD (2021).

ANNEX II – USE OF THE SDR FOLLOWING THE 2021 AND 2009 ALLOCATIONS

US Congressional opposition to the 2021 allocation focused primarily on arguments that (a) many countries would receive allocations that they did not need and would not use because of their level of development and (b) it would benefit countries that are in US disfavor such as Belarus, China, Iran, Russia, Syria, and Venezuela. In other words, SDR would go to those countries that did not need them or to countries that deserve them. Some of these concerns were shared in other countries although their governments endorsed the proposed allocation before the United States.

ANALYSIS OF 2021 SDR ALLOCATION

As of **December 31, 2021**, low-income members of the IMF had accessed only 13 percent of their new allocations. (See table 1.) Only four of those countries had used more than 50 percent of their new holdings. At the same time, 24 other members had done so, including 10 lower-middle-income countries, 13 upper-middle-income countries, and one high-income country.

Lower-middle-income countries collectively accessed a larger percentage of their newly acquired SDR, and upper-middle-income countries had done so on an even larger scale. On the other hand, low-income countries as a group used more of their collective new allocation, than the two groups of middle-income countries.

Focusing on the countries potentially eligible for IDA grants or blended loans does not tell a different story. Thirteen of these countries used 50 percent or more of their new allocations or only 18 percent of this group of countries. Their use of SDR accounted for only 10.4 percent of total use of SDR following the allocation. Although their share of such use

exceeded their share of the allocation, it was in line with the three sub-groups of countries other than the high-income countries.[48]

As of March 2022 . . .

The apparent low use of their new SDR allocation by lower-income countries or IDA eligible countries should be qualified in two respects. First, table 1 focuses on the direct use of SDR through reductions in holdings via transfers to other countries for hard currency. Anecdotal reports suggest that some countries have used some of the allocations for fiscal purposes while maintaining their actual holdings unchanged.[49] Second, lower income countries are also eligible to for support from the IMF's Poverty Reduction and Growth Trust (PRGT) on highly conditional terms with relatively light conditions on the country's economic policies. From the March 2020 and the start of the pandemic through December 2021, 54 members have received $13,563 million in support from various programs financed out of the PRGT. In the absence of that support, more of the countries eligible for PRGT support might have directly used more of their SDR allocation over the last four months of 2021.

One high-income country (Antigua and Barbuda) transferred most of its new allocation of SDR to obtain foreign currency. And high-income countries as a group added to their net holdings of SDR on balance. They were on balance the collective counterparty for about 60 percent of the net sales by other groups countries. The remainder was transferred to other eligible holders of SDR, primarily to the general resources account of the IMF itself, but also to

[48] All low-income countries, two-thirds of the lower-middle-income countries, and 11 of the upper-middle-income countries can potentially benefit from IDA financial assistance.
[49] I am unsure of the mechanism employed to provide this support and am seeking more information.

the European Central Bank. Both the Bank for International Settlements and the Arab Monetary Fund disposed of some of their holding between August and December 2021.

These data demonstrate that many countries other than lower-income countries or IDA-eligible countries benefitted from the 2021 SDR allocation during the first four months after it was implemented. Those who argued that allocation would only benefit lower income countries and only on a small scale have been proved wrong.

With respect to countries that the United States and other Western countries did not want to benefit from the SDR allocation for geopolitical reasons (Belarus, China, Iran, Russia, Syria, and Venezuela), none of them transferred more than a trivial amount of their share of the 2021 SDR allocation to obtain hard currency or for other reasons. China increased its holdings of SDR either through direct transfers or the operation of the Voluntary Transfer Arrangements (VTAs) designed to make an SDR market for official holders. The geopolitical objections to the SDR allocation on the grounds that certain countries should not benefit have proved to be unfounded so far. Moreover, as of December 2021, five of these countries held more SDR than they had received in all allocations. The exception was Venezuela, which used a substantial amount of its earlier allocations, but not any of its 2021 additional allocation.

COMPARISON WITH THE 2009 SDR ALLOCATION

It is useful to consider whether the pattern of immediate, crisis usage of the 2021 SDR allocation was like the pattern following the SDR allocation in response to the global financial crisis of 2007-2009.

In August and September 2009, the IMF allocated SDR 182.7 billion in two pieces: a general allocation of SDR 161.2 billion based on quota shares in the IMF at the time and a

special allocation of SDR 21.5 billion that went primarily to countries that had not been members of the IMF when SDR were first issued in 1970-72 and 1979-1981. Because the SDR had depreciated against the dollar by 10 percent between end-September 2009 and end-August 2021, an SDR was worth more US dollars at the time of the earlier allocations, and the 2009 allocations amounted to $289.2 billion. [50]

Table 2 summarizes the use of SDR by members of the IMF in the first four months after the September 2009 allocation. Recall that these allocations occurred only 12 months after the start of the virulent stage of the 2007-2009 allocation, compared with 18 months in the case of the 2021 allocation.

We can see from table 2 that a smaller number of countries (15 compared with 28) made substantial immediate use of their additional SDR holdings, as indicated by countries mobilizing at least 50 percent of their new allocations. Low-income members of the IMF and lower-middle-income members used about the same percentages of the allocations to those groups of countries in 2009 as in 2021. On the other hand, they accounted for about 65 percent of total use of SDR compared with only 39 percent in 2021. Use by countries potentially eligible to borrow from IDA also accounted for a somewhat larger share of total use of SDR, but that share was only 20.5 percent. The IDA eligible countries are essentials the same countries can access the PRGT for loans with low conditionality on more concessional terms. The amount of such lending in the 22 months from March 2020 to December 2021 was $13.8 billion, 4 times the amount of such lending from September 2008 to June 2010, which was $3.5 billion. In US dollar terms the 2021 SDR allocation as only 2.25 times the allocations in 2009.

[50] The dollar value of one SDR was $1.5837 at the end of September 2009.

CONTINUE THROUGH APRIL 2009 AND PRIOR TO 2021 ALLOCATION

However, a substantial proportion of the immediate use of SDR after both allocations was by other than the poorest countries. In other words, both allocations provided an important degree of immediate financial support to a broad swath of IMF membership, contrary to the implicit prediction by some critics of both SDR allocations that only the poorest members of the IMF would benefit.

ADD MATERIAL ON TOTAL USE OF SDR RELATIVE TO GLOBAL GDP??? OR SOME OTHER SUBSET OF COUNTRIES

TO BE COMPLETED

I will extend the analysis of the 2009 allocation in two steps: first, until February 2020 before the outbreak of the pandemic and, second, between February 2020 and July 2021 before the most recent allocation.

I also hope to track down more information about how SDR have been used to support, for example, the budget of countries suffering from the pandemic without reducing the aggregate holdings of those countries.

I may also look at the ex ante circumstances of countries in advance of each allocation, for example, looking at the allocations relative to countries' reserves or relative to their current account positions. RESERVES AND CURRENT ACCOUNTS (THREE YEAR AVERAGE?)

BENEFITS NEED NOT ONLY FLOW FROM USE

Table 1 – Summary of use of new SDR allocation, August 2021 to December 2021

			Holdings declined by more than 50 percent of new allocation		Amount used by group (reduction in holdings)		Share of group in (percent)	
Country group	Number of countries	Change in holdings (USD million)	Number of countries	Percent of group	USD millions	Percent of new allocation	New allocation	Total use of SDR
Low income	26	-1,078	4	15.4	1,135	12.95	1.3	6.2
Lower middle income	54	-5,989	10	18.5	5,991	9.21	10.0	32.7
Upper middle income	54	-9,525	13	24.1	11,140	7.86	21.8	60.8
High income	56	10,229	1	1.8	62	0.01	66.9	0.3
All countries	190	-6,363	28	14.7	18,329	2.82	100.0	100.0
MEMO:								
Potential IDA eligible	73	-1,357	13	17.8	2,838	10.40	4.2	15.5

Note: SDR values converted to US dollars at $1.42426 per SDR the rate on August 31, 2021.

Table 2 – Summary of use of new SDR allocation, September 2009 to January 2010

			Holdings declined by more than 50 percent of new allocation		Amount used by group (reduction in holdings)		Share of group in (percent)	
Coun*try group	Number of countries	Change in holdings (USD million)	Number of countries	Percent of group	USD millions	Percent of new allocation	New allocation	Total use of SDR
Low income	25	-414	5	20.0	501	12.92	1.3	9.3
Lower middle income	54	-2,897	5	9.3	1,012	10.43	10.0	55.6
Upper middle income	53	-912	5	9.4	1,653	2.98	19.2	30.6
High income	54	3,554	0	0	243	0.12	69.5	4.5
All countries	186	-729	15	8.1	5,410	1.87	100.0	100.0
MEMO:								
Potential IDA eligible*	71	-1.083	9	12.7	1,110	8.14	4.7	20.5

Note: SDR values converted to US dollars at $1.58437 per SDR the rate on September 30, 2009.

* Based on 2021 eligibility not including two countries who were not yet members of the IMF.

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