THE BRETTON WOODS COMMITTEE

AUGUST 2021

Special Drawing Rights: A Primer

The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. In August 2021 the IMF Board of Governors approved a general allocation of SDRs equivalent to about $650 billion, adding to the almost $300 billion in SDRs previously allocated to IMF member countries. The value of the SDR is based on a basket of five currencies—the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling.

BRIEF EXPLANATION

Special Drawing Rights or SDRs are created by the International Monetary Fund (IMF) and allocated to IMF member countries in proportion to their quotas or ownership shares.

A country's holdings of its SDRs are part of its foreign exchange reserves, usually held by the central bank or by that country's reserve asset manager. In the United States, the Treasury Department holds them as part of the Exchange Stabilization Fund (ESF). Each IMF member's SDR holdings are published monthly on the IMF website.

SDRs can only be utilized in transactions with the IMF or with other members arranged through the IMF.[1] When a country sells SDRs, it receives foreign currency in return, one of the five currencies comprising the SDR—the US dollar (which is over 40% of the SDR "basket"), UK pound, Euro, Japanese Yen, and Chinese yuan.

Countries are free to sell their SDRs to a willing buyer in order to obtain a useable currency. (If no willing buyer is available, the IMF can designate a buyer. This has not happened since 1987.) There are no restrictions on how countries may use the foreign exchange they receive in return. These transactions have allowed countries to use the proceeds (i.e., the useable currency) to purchase critical imports, repay debts, or cover other expenses.

1 A small number of non-members are also allowed to hold, buy and sell SDRs, such as the World Bank, the Bank for International Settlements, and the European Central Bank.

SDR Process

APPROVAL
SDR allocation approved by the IMF Board of Governors

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ALLOCATION
SDRs allocated to IMF member countries in proportion to their quota shares at the Fund

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TRADING
Participating countries can buy/sell SDRs in a voluntary marketplace in exchange for hard currency

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EXPENDITURE
Hard currency received in exchange for SDRs can be used by governments to purchase vaccines, boost domestic spending, reduce borrowing, and more

Countries earn interest on their SDR holding and pay interest on their SDR allocations. When a country's SDR holdings fall below the amount of its cumulative IMF allocations, that country must pay interest on the difference. The interest is paid to the IMF which in turn pays interest to those countries whose SDR holdings are greater than their allocations. The interest rate is an average of short term interest rates in the five countries with currencies in the SDR basket. For example:

- The US holds more SDRs than it has been allocated, reflecting US purchases of SDRs from other countries in the past. The United States earns interest on the difference, paid by the IMF to the ESF at Treasury.
- Chile has sold some of its SDRs. It pays interest to the IMF on the difference, reflecting past sales of SDRs.

SDR ALLOCATION

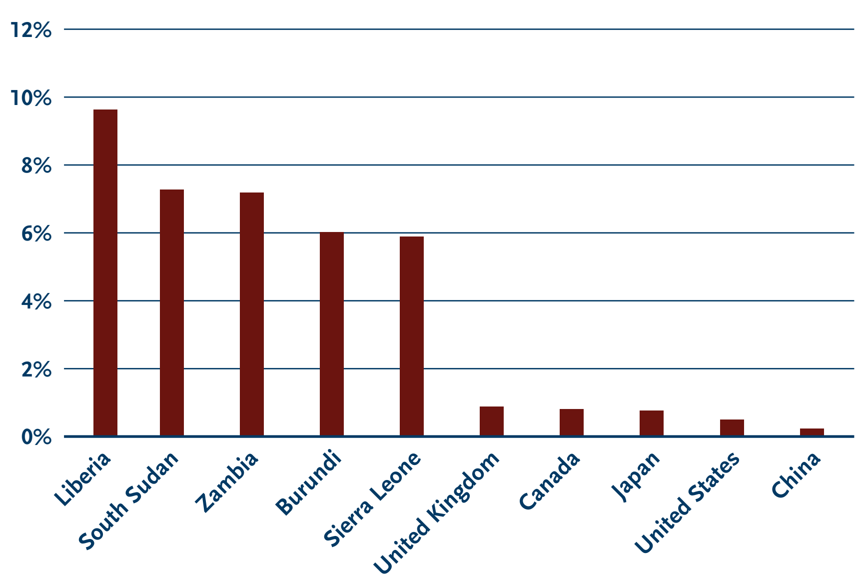
The IMF Board of Governors has approved an allocation of approximately $650 billion in SDRs. An SDR allocation requires a supermajority of the voting power, 85 percent. The United States holds 16 percent of the voting power. Therefore, work on a proposal could not begin until the United States and most other IMF members indicated they would support it.

The IMF allocates SDRs to members according to their quota or ownership share in the IMF. The United States will receive the largest share, and collectively, advanced economies will receive most of the SDRs due to their higher quotas. (The US would receive over $110 billion in SDRs.) Many members of the G20 are likely to retain their SDRs in foreign exchange reserves and will be purchasers of SDRs from low and middle income countries.

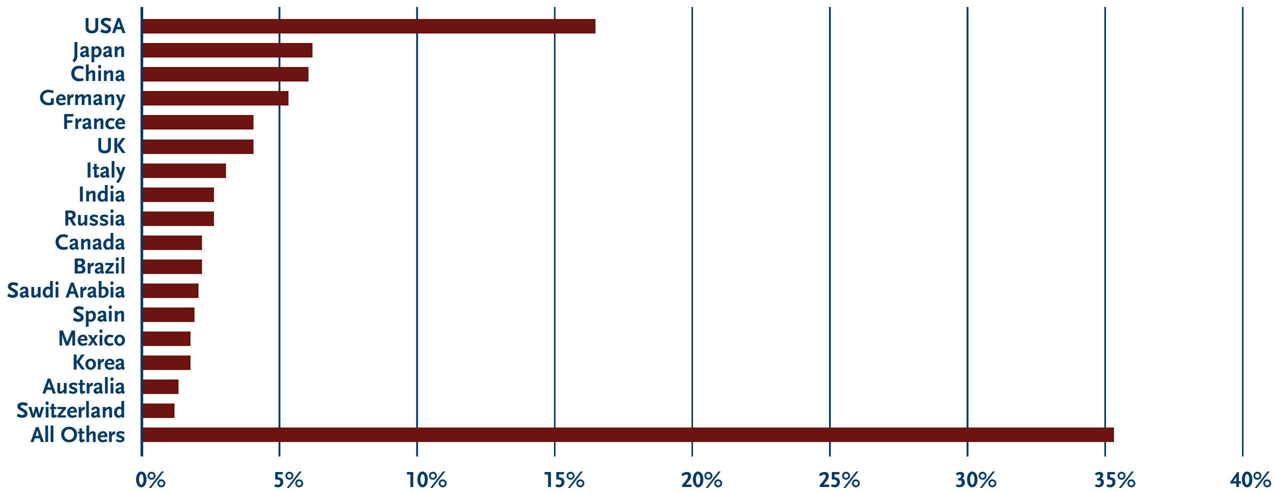
Low income countries, which have very small ownership shares in the IMF, will collectively receive over $20 billion in SDRs, while middle income countries will collectively receive over $200 billion in SDRs. These resources can be exchanged for useable currency (see above) and then used to purchase imports, bolster domestic spending, and reduce the need for borrowing.

A key component of the current discussions surrounding SDRs is an apparent agreement by the G20 and other members to be more transparent about SDR transactions and how the proceeds of SDR sales are used. As noted

SDR Allocation as % of GDP for Select Countries



IMF Voting Shares



Source: https://www.imf.org/external/np/sec/memdir/eds.aspx

above, country holdings are published monthly, but individual transactions among IMF members are not and countries have generally not announced SDR sales or purchases. More transparency in this regard would be welcome but may not go so far as to include individual transactions.

Not every member of the IMF will have access to its SDR allocation. An IMF member must not be in arrears to the IMF and must have a government recognized as the legitimate government by IMF members. Thus, Venezuela does not have a government in power that is recognized by the IMF and will not be able to access its SDR allocation. Due to the coup, Myanmar will also not be able to access its SDR allocation.

SDR REALLOCATION

Now that the SDR allocation has been approved by the IMF membership, the Executive Board will turn to considering how countries may voluntarily lend or donate SDRs to help other IMF members. Currently, a number of IMF members have lent SDRs to the Poverty Reduction and Growth Trust (PRGT), which is the vehicle for IMF lending to low income countries. The PRGT provides below market rate loans to poorer countries. These loans are conditioned on policy reforms and on countries having sustainable debt.

While on-lending SDRs to the PRGT is probably the simplest form of re-allocation, there are proposals for new IMF trust funds focused on lending for specific purposes including financing for climate change adaptation, pandemic preparedness, or debt distress alleviation. These new trust funds would be financed by countries lending or donating SDRs.

US ADMINISTRATION POSITION

US Treasury Secretary Yellen notified Congress of her intent to support an SDR allocation in late March, as required under US law. (If the US share of an allocation remains below an amount equal to its IMF quota, Congressional notification and consultations are required, *not* Congressional approval.) She has also strongly advocated for more transparency in SDR transactions.[2]

In its FY 2022 budget request recently sent to Congress, the Administration seeks an appropriation of $102 million. These funds would be used to provide a grant to the PRGT or other IMF facility to subsidize the interest rate charged low income borrowers and to cover the US budgetary cost of loans of up to SDR 15 billion (roughly $22 billion) from Treasury's Exchange Stabilization Fund to the PRGT or other IMF trust funds.

2 The Trump Administration decided against approving an SDR allocation, because it thought SDRs (i) are largely allocated to countries that do not need them, (ii) are an inefficient mechanism to provide financing to lower income countries, and (iii) could provide a source of financing—even if small—to problematic countries, such as Iran (to date, Iran has not sold any of its SDRs).

SDR Frequently Asked Questions

The SDR allocation is much bigger than any previous allocation. Why so big?

- Under the IMF Articles of Agreement, SDR allocations are linked to an assessment of the adequacy of global foreign exchange reserves. The IMF staff and its Executive Board have been evaluating the global reserves situation and recommended a substantial allocation, with some even calling for a larger allocation.
- Any global assessment obscures the very uneven distribution of reserves among countries. Some countries have high reserves and several countries issue reserve currencies and therefore do not themselves face a shortage of reserves.
- Many other countries have low levels of reserves, which limits their ability to purchase imports of goods and services and slows global economic recovery.

The largest recipient of SDRs will be the United States. The US does not need them so why does the US support this allocation?

- The Administration supported this allocation in order to address the uneven distribution of global reserves, which could make low and middle income countries more financially vulnerable. This limits the global economic recovery and could lead to balance of payments crises in the countries hit hard by the pandemic and its aftermath.
- G20 member countries support the allocation and economically stronger countries will be expected to purchase SDRs from low and middle income countries who may need access to hard currency (dollar, yen, euro, yuan, or pound).
- Secretary Yellen has notified Congress of her intent to support this allocation, as required under US law. Congress does not need to approve an SDR allocation of this size.
- The 90 day notification period ended in early July and Secretary Yellen voted in favor of the allocation this summer.
- To assist the lower income countries even more, there is also a proposal to re-allocate SDRs (most likely via concessional IMF loans) to poorer countries, which would require Congressional authorization and appropriation.

Does this allocation expose the US taxpayer to any risks? And what does it cost?

- The allocation is equivalent to the IMF creating a form of money. In the case of the United States, it consists of increases in US official reserve assets which are held by the Exchange Stabilization Fund at the Treasury Department.
- The allocation would have a minimal—if any—cost to the US Treasury.
- Countries may sell their SDRs for other currencies through a market managed by the IMF. If the US agrees to purchase SDRs from another country, the US provides dollars in exchange.
- The US currently holds about SDR 1.5 billion more than its allocations. This indicates earlier purchases of SDRs for dollars from other IMF member countries. This amount is very small in relation to US dollar funding markets.
- The US earns net interest on holdings of SDRs above US allocations. Countries holding fewer SDRs than their allocations pay net interest on the difference to the IMF.

The US Treasury is asking for $102 million to subsidize an SDR loan in the FY22 budget. I thought this doesn't cost anything?

- While the US vote in favor of an allocation does not require Congressional approval, an SDR loan by the US to the IMF does require Congressional authorization and appropriation.
- The request for $102 million is partially to enable Treasury to lend up to approximately $22 billion to an IMF facility—the Poverty Reduction and Growth Trust (PRGT) or a similar facility.
- The PRGT is the IMF facility that allows it to lend to poor countries at subsidized rates.
- A US loan to the IMF is scored with an appropriation to cover credit risk.
- The risk of lending to the IMF is extremely low, given the protections the IMF has in place: the PRGT holds a reserve, conditions its lending on policy reforms, and has a long track record of receiving repayments.
- Some portion of the $102 million may be in the form of a grant to the PRGT to subsidize the interest rate that borrowing countries (the poorest countries) would pay on any borrowing from the facility.

The G7 Carbis Bay Summit called for IMF members to channel SDR 100 billion to the IMF Poverty Reduction and Growth Trust or other facility which supports low income countries. Have countries pledged specific amounts?

- The US budget request indicates that the Treasury is seeking authorization and appropriations to lend up to SDR 15 billion to the IMF PRGT or another IMF facility. The G7 will be working with the broader IMF membership to secure commitments to provide the total amount to the PRGT.

What is the impact of this SDR allocation on the dollar?

- SDRs can be exchanged for the currencies comprising the SDR basket: the US dollar, Euro, Japanese yen, UK pound, and Chinese yuan.
- While the SDR allocation of this size will increase total global reserves and therefore diminish slightly the share of US dollars as reserve assets, the size does not appear sufficient to impact foreign exchange values of any of these currencies, including the dollar.

Can the US prevent SDRs from going to China, Russia, Myanmar, Venezuela, or Iran?

- China, Russia and Iran will receive their allocations. China and Russia are expected to buy SDRs from low income and other struggling IMF members. China currently holds more SDRs than it has received in allocations, indicating past purchases of SDRs.
- Iran has not engaged in any SDR transactions and would have difficulty exchanging their SDRs for dollars given many international sanctions, although it may be possible for Iran to exchange its SDRs for other hard currencies.
- The governments of Venezuela and Myanmar are not currently recognized by the IMF membership and will not be able to access any SDR allocation.

This paper was prepared by the Bretton Woods Committee's Legislative Working Group, which provides policymakers in Congress and the Administration with non-partisan expertise on the International Financial Institutions. The Working Group is co-chaired by Whitney Debevoise and Meg Lundsager and includes Sara Aviel, Tony Fratto, Bill Frymoyer, Jim Kolbe, Clay Lowery, and Scott Morris.

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