The 2021 IMF Allocation of Special Drawing Rights: Too Little, Too Late and Too Unequal

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Since the onset of the Covid-19 pandemic, the International Monetary Fund (IMF) has provided financial assistance to 87 countries for a total of around 117 billion USD[1]. In addition, on the 2nd of August 2021, the IMF Board of Governors approved an historical allocation of Special Drawing Rights (SDRs) equivalent to 650 billion USD.

The SDRs are an international reserve asset which can be issued by the IMF whenever a long-term global need so requires, and which is backed by the members' obligations under the Articles of Agreement[2].

The decision to create SDRs is taken by the IMF Board of Governors with a qualified majority of 85% of the total voting power. SDRs are then allocated to members participating in the SDR Department (currently, all the 190 IMF members), in proportion to their quotas[3].

As a quick reminder, quotas are at the center of the IMF governance structure and reflect each member's relative position in the world economy. Quotas determine each member's voting power, contribution to the IMF resources, access to financing and share in a general allocation of SDRs. Once credited, IMF members can either 1) hold their share of SDRs to strengthen their international reserves and improve market access or 2) exchange them for freely usable currencies to diversify the composition of their international reserves, ease liquidity constraints and create room for additional spending[4].

On top of that, SDRs can be used in a set of authorized transactions between IMF members (e.g., to extend bilateral loans and to settle financial obligations) and to discharge obligations to the Fund (like the repayment of loans and the payment for quota increases).

The IMF Executive Board can also empower international organizations (for instance, multilateral development banks) or supranational institutions performing the functions of central bank for more than one IMF member (like the European Central Bank) to hold SDRs[5]. Pursuant to Art. XVII, Section 3, this decision requires an 85%

[1] Data from www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker.

[2] The power to issue SDRs was attributed to the IMF with the 1969 First Amendment to the Articles of Agreement. Pursuant to Art. XVIII, Section 1 of the IMF Articles, the issuance of SDRs should meet a «long-term global need to supplement existing reserve assets in a manner that will promote the attainment of the IMF's purposes and avoid economic stagnation and deflation, as well as excess demand and inflation in the world».

[3] See IMF Art. XV, Section 1, and Art. XVIII.

[4] The value of the SDR is calculated by the IMF on the basis of a weighted basket of currencies. Currently, the currencies in the SDR basket are the US dollar (with a weight of 41.73%), the euro (30.93%), the Chinese renminbi (10.92%), the Japanese yen (8.33%) and the British pound sterling (8.09%). The next review of the SDR valuation basket will be undertaken in 2022. See www.imf.org/external/np/fin/data/rms_sdrv.aspx.

[5] Currently there are 15 prescribed holders: four supranational central banks (European Central Bank, Bank of Central African States, Central Bank of West African States, and Eastern Caribbean Central Bank); three intergovernmental monetary organizations (Bank for International Settlements, Latin American Reserve Fund, and

majority of the total voting power. Designated 'prescribed holders' can acquire and receive SDRs (e.g., as loan repayments)[6], but they are not entitled to receive direct allocations from the Fund. Additional uses of SDRs can be authorized by the Executive Board with a 70% qualified majority (Art. XIX, Section 2, let. c)[7]. Worthless to say, SDRs are not currency: they cannot be used as a means of payments by private entities or individuals.

IMF members can convert their SDRs in hard currencies in two different ways: a) through a designation mechanism provided for by the IMF Articles or b) through exchanges directly arranged between members and/or prescribed holders.

According to IMF Art. XIX, Section 5, it is the Fund that designates the member (with a strong external position) that will be obliged to provide freely usable currencies. However, no transaction under the designation mechanism has occurred since 1987.

Nowadays, exchanges are conducted through Voluntary Trading Agreements (VTAs)[8]. VTAs are bilateral arrangements between the Fund and a member country (or prescribed holder) under which the latter volunteer to buy or sell SDRs within certain limits in exchange for specific currencies. In this case, the IMF acts as an intermediary, assigning purchase and sale requests among VTAs with a view to ensure their equitable distribution on the basis of a number of factors.

At present, 33 countries and only 1 prescribed holder – the European Central Bank (ECB) – have a VTA in place. This group includes the majority of the G20 countries, with the exception of Argentina, Brazil, India, Indonesia, Russia, South Africa and Turkey. None of the African or South American countries stands ready to participate in SDR transactions and, among BRICS, only China does[9].

Notably, member countries do not have to meet any requirement to initially receive from the IMF their share of SDRs; SDR swaps can be undertaken even in the absence of a balance of payment need and without entering an IMF macroeconomic adjustment program; furthermore, they are not subject to any kind of conditionality or reimbursement obligation. In fact, SDRs do not have to be repaid, do not have a maturity date, and do not have a scheduled amortization table.

Arab Monetary Fund); and eight intergovernmental development organizations (African Development Bank, African Development Fund, Asian Development Bank, International Bank for Reconstruction and Development and the International Development Association, Islamic Development Bank, Nordic Investment Bank, and International Fund for Agricultural Development).

[6] See IMF, Executive Board Decision n. 6467-(80/71) S, 14 April 1980. This decision was adopted to give borrowing countries the possibility to use SDRs instead of hard currencies to reimburse MDBs loans, and therefore at their convenience.

[7] On the additional uses of SDRs, see IMF, *Selected Decisions and Selected Documents of the IMF*, 2020, in particular those based on Art. XIX, Section 2 (www.imf.org/en/Publications/Selected-Decisions/selected-decisions-list).

[8] See IMF, *Annual Update on SDR Trading Operations*, October 2021, p. 13, available at www.imf.org/en/Publications/Policy-Papers/Issues/2021/10/26/Annual-Update-on-SDR-Trading-Operations-498096.

[9] On 30 September 2021, the purchasing capacity under VTAs was of 234.1 billion SDRs. Some participants are however likely to increase their maximum purchasing capacity in the near future. Also, the IMF is encouraging other members to join the voluntary trading market.

SDR allocations therefore provide each member with a supplementary, unconditional and almost costless reserve asset.

Actually, the only cost that receiving countries may incur is associated with their use. When an IMF member exchanges part of its SDR allocation for hard currency, it will have to pay interest on the difference between its cumulative SDR allocation and its SDR holding to the IMF (that is, on the shortfall). Conversely, when a member's SDR holdings rise above its allocation, it will earn interest on the excess[10]. As a result, SDRs do not add to a country sovereign debt if not in a negligible way.

Despite their prominent features, the IMF has seldom exercised the power to issue SDRs and their role to date has been moderate.

SDRs have been distributed to IMF members only four times before 2021.

The first two allocations were respectively made in the period 1970-1972 (while the par value system was still in operation) and in the period 1979-1981 (after the entry into force of the 1978 Second Amendment to the IMF Articles).

The third (special) and fourth (general) SDR allocations were approved in 2009 after being debated since the mid-1990s.

Already at the 1994 IMF-WB annual meeting, the IMF Managing Director Michel Camdessus put forward a proposal about a new general allocation of 36 billion SDRs to be jointly approved with a special allocation that would have been distributed only among the 40 developing countries and economies in transition that had joined the Fund after 1981. The IMF Articles, however, do not allow for selective allocations and the issuance of SDRs needs to be justified by a long-term 'global' need. The only way to overcome the legal requirement that SDRs be distributed in proportion to quotas is to amend the Articles of Agreement. Such a proposal was eventually put forward in 1997[11] but the required approval by three fifths of the IMF members representing 85% of the total voting power could not be met at that time.

In the aftermath of the global financial crisis, the Fund reconsidered the need for a general allocation of SDRs. However, since membership in the Fund had grown further, a simultaneous selective and corrective allocation of SDRs to the benefit of those members that had never received SDRs was needed. This time the 1997 Amendment proposal obtained the required qualified majority. The Fourth Amendment entered into force in August 2009, allowing for a 'Special One-Time Allocation' of 21.5 billion SDRs (about 33 billion USD). Soon afterwards, the IMF Board of Governors approved a new issuance of 161.2 billion SDRs, equivalent to 250 billion USD. Together, the 2009 general and special allocations raised the total of cumulative SDRs to 204.1 billion.

[10] The SDR interest rate is currently very low: 0.05%. See www.imf.org/external/np/fin/data/sdr_ir.aspx.

[11] IMF, Proposed Fourth Amendment of the Articles of Agreement 'Special One-Time Allocation of SDRs', Board of Governors Resolution No. 52-4, adopted 23 September 1997, available at www.imf.org/external/pubs/ft/history/2012/pdf/15a.pdf.

Since the outbreak of the Covid-19 pandemic in March 2020, civil society organizations started advocating the necessity of a new allocation of SDRs equivalent to 3 trillion USD to help developing countries counter the crisis[12]. On April 2021, however, the International Monetary and Financial Committee (IMFC) recommended a general SDR allocation of only 456.5 billion SDRs, equivalent to 650 billion USD.

This amount was determined mainly by political reasons. The US government is in fact authorized by the 1968 Special Drawing Rights Act[13] to vote in favor of SDR allocations up to a certain amount, which is currently set at 680 billion USD (at the current SDR/USD exchange rate)[14]. Beyond that threshold, the US Congress is called to authorize such a vote by law. However, under the Trump administration, Congress approval was considered impossible. Besides, a new Bill had been introduced before the House of Representatives to further strengthen congressional oversight with respect to allocations of SDRs, and to prohibit such allocations for States perpetrators of genocide and sponsors of terrorism without congressional authorization[15].

Eventually, thanks to the support of the Biden administration, on the 2nd of August 2021, the IMF Board of Governors approved the new issuance. Such a decision requires in fact a qualified majority of 85% of the total voting power, with the United States having 16.50%.

The general allocation of 456.5 billion SDRs (650 billion USD) is the fourth and the largest one in history. Yet, it gives rise to strong criticisms: the 2021 allocation is too late, too little and too unequal.

Too late. The veto power of the United States and other political considerations led to a regrettable delay, despite the fact that the urgency and gravity of the situation were already apparent in the first months of 2020.

Too little. Even if in 2020 Official Development Assistance (ODA) by member countries of the Development Assistance Committee (DAC) reached an all-time high of 161.2 billion USD[16], UNCTAD estimates that, to avoid a new lost decade, developing countries need between 2 and 3 trillion USD[17]. Therefore, only a much larger allocation of SDRs would have provided enough support to developing countries to contrast the

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[12] See the Open Letter to G20 Finance Ministers and the IMF for a quick special SDR allocation signed by more than 250 civil society organizations available at www.latindadd.org/2021/02/12/civil-society-organizations-call-for-quick-special-drawing-rights-allocation. See also, among others, K. GALLAGHER, J.A. OCAMPO, U. VOLZ, *Special Drawing Rights: International Monetary Support for Developing Countries in Times of the COVID-19 Crisis*, in *The Economists' Voice*, December 2020.

[13] US Special Drawing Rights Act, 22 C.F.R. §§ 286n -286u, 19 June 1968.

[14] This amount is calculated on the basis of the requirement established by the US Special Drawing Rights Act, Section 6, that cumulative allocations to the United States cannot «exceed an amount equal to the US quota in the Fund».

[15] 117th Congress (2021-2022), H.R.1568 - Special Drawing Rights Oversight Act of 2021, referred to the House Committee on Financial Services on 3 March 2021. Currently on hold.

[16] OECD, *COVID-19 Spending Helped to Lift Foreign Aid to an All-time High in 2020*, 13 April 2021, available at www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2020-detailed-summary.pdf.

[17] UNCTAD, *Trade and Development Report 2021, From Recovery to Resilience: The Development Dimension*, July 2021.

worst peace-time recession after the Great Depression and the health, environmental and debt crisis[18].

Too unequal. The approved amount of 456.5 billion SDRs is insufficient to compensate for the inequalities deriving from the fact that a member's share in a general allocation of SDRs is determined by its IMF quota. In fact, as a result of the SDR distribution mechanism, the issuance will benefit mostly the richest countries.

High-income countries will receive an amount of SDRs equivalent to 438 billion USD (or about 67% of the allocation), more than half of which will go to G7 countries (283 billion USD). These countries do not need SDRs, as demonstrated by the fact that the SDR amount received by euro area countries and by the United States is only a fraction of the additional liquidity their central banks have issued since 2020 deploying exceptional and extraordinary monetary measures[19].

Moreover, while middle-income countries will receive an amount of SDRs equivalent to 203 billion USD (or 31.2% of the allocation), low-income countries will obtain only the equivalent of 8.5 billion USD (or about 1.3%)[20].

To provide a telling comparison, in 2020 the debt burden of low-income countries increased by 12% to a record level of 860 billion USD and the combined debt stock of middle- and low-income countries reached 8.7 trillion USD[21].

To redress this situation, high income countries declared to be ready to redirect SDRs to the most vulnerable countries. Different options are on the table, among which a) replenishing the resources of the IMF Poverty Reduction and Growth Trust (PRGT) under which concessional lending is provided to low-income countries and b) creating a second IMF instrument – the Resilience and Sustainability Trust (RST) – to provide longer-term lending, with low interest rates, to vulnerable middle-income countries and fragile island economies and to support their transition to a green economy.

Unfortunately, whilst the G20 welcomed both initiatives[22], concrete action is lagging behind, as demonstrated by the fact that the features of the new RST are expected to be finalized only by the IMF/World Bank Spring Meetings of 2022.

Novembre 2021

[18] See P. Steele, S. Patel, *Tackling the Triple Crisis: Using Debt Swaps to Address Debt, Climate and Nature Loss post-COVID-19*, IIED Issue Paper, September 2020.

[19] We are referring here to the European Central Bank Pandemic Emergency Purchase Program (PEPP) and to the US Federal Reserve pandemic quantitative easing operations.

[20] Data from L. Jensen, *An Unprecedented Opportunity to Boost Finance for Development*, UNDP Global Policy Network Brief, June 2021, p. 4, available at www.undp.org/sites/g/files/zskgke326/files/2021-06/UNDP-DFS-An-Unprecedented-Opportunity-to-Boost-Finance-for-Development_0.pdf.

[21] Data from World Bank, *International Debt Statistics 2022*, 11 October 2021, available at openknowledge.worldbank.org/handle/10986/36289.

[22] See G20 Rome Leaders' Declaration, 30-31 October 2021, available at www.g20.org/wp-content/uploads/2021/10/G20-ROME-LEADERS-DECLARATION.pdf.