Forum for American Leadership

How the U.S. Should Respond to the Proposed IMF Special Drawing Rights Allocation

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The International Monetary Fund (IMF) is currently moving towards a Special Drawing Rights (SDR) allocation equivalent to $650 billion U.S. dollars. According to the IMF, "by addressing the long-term global need for reserve assets, a new SDR allocation would benefit our member countries and support the global recovery from the Covid-19 crisis." Yet an SDR allocation would primarily subsidize rich and middle-income countries while providing rogue regimes access to hard currency. As the United States holds a veto over an SDR allocation, the Biden Administration and Congress should consider and address the significant issues that would arise from such a large allocation. While the United States should oppose an SDR allocation, at a minimum it should (i) insist on improvements to the SDR process to ensure greater transparency, accountability, and oversight, and (ii) ensure that a substantial portion of SDRs are actually used in a targeted manner to aid the poorest, most vulnerable countries.

Background: What are SDRs and what does it mean to allocate them?

SDRs are an international reserve asset created and administered by the IMF. The value of the SDR is based on a basket of the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling. SDRs are "allocated" by the IMF to its members. Once an IMF member is allocated an SDR, it can trade the SDR with another IMF member in exchange for freely usable currencies like the U.S. dollar. If a member trades an SDR for currency, it must pay interest, and the member exchanging currency for the SDR will receive interest. However, unlike a traditional loan, the country that receives currency will never have to pay the principal back.

If the United States exchanges SDRs for U.S. dollars, the interest rate the United States receives is close to its current cost of debt. As a result, proponents of an SDR allocation argue that it would not impose a material financial burden on the United States. However, the cost of debt can rise, and in any event the United States must exchange SDRs for *real dollars*. These dollars must be borrowed in the Treasury market, where unlike SDRs, the United States must ultimately pay back the principal.

An SDR allocation requires the approval of 85 percent of the IMF's shares. As the United States holds a voting share of roughly 17 percent, it has an effective veto over an SDR allocation. Under the Special Drawing Rights Act (as amended in 1983), Congress authorized the Secretary of the Treasury to support an SDR allocation without additional legislation as long as the allocation falls below a certain threshold. The threshold is currently equivalent to slightly more than $680 billion U.S. dollars. The proposed SDR allocation is sized at $650 billion U.S. dollars to avoid requiring Congressional approval.

The IMF must allocate SDRs according to its members on the basis of their shareholding, or "quota." IMF quota generally relates to the size and importance of each member's economy to the global system. Therefore, advanced economies will receive the vast majority of any SDR allocation. The below table provides expected allocations for select countries. The G7 countries alone would receive more than 45% of the proposed allocation. China would receive more than all of Africa. Rogue regimes subject to U.S. sanctions such as Iran and Syria are IMF shareholders; those two countries receive approximately $5 billion and $1.5 billion in SDRs, respectively.

Country	Quota Percentage	Share of SDR Allocation in U.S. dollar Terms
United States	17.4%	$113.1 billion
G7 (excluding U.S.)	26.0%	$168.8 billion
China	6.4%	$41.5 billion
Russia	2.7%	$17.6 billion
Iran	0.7%	$4.86 billion
Syria	0.2%	$1.51 billion
African Continent	4.7%	$30.2 billion
All Others	41.9%	$272.4 billion
Total	**100.0%**	**$650 billion**

Is the proposed SDR allocation in the United States' interest?

An SDR allocation is an inefficient and poorly targeted way to provide assistance to needy countries. Because SDRs must be allocated according to the IMF quota, an allocation would disproportionately benefit rich and middle-income countries. The pandemic, on the other hand, has disproportionately harmed low-income countries that generally lack access to capital required to support needed fiscal expansion. The IMF has justified its proposal in part on the basis that rich countries will reallocate their SDRs to low-income countries (*Note: this is equivalent to on-lending the newly created SDRs)*, and it is on this basis that advocates have pushed for an allocation. Yet the IMF is moving toward an allocation with no agreement or political commitment for such a reallocation. The recent G7 Communiqué provided some detail on how G7 members might reallocate their SDRs, but it lacked any agreement on a plan to do so. Other major recipients of an allocation, such as China and Russia, are even less likely than G7 members to be willing to reallocate. The IMF's continued push to move forward in the absence of a definitive reallocation proposal suggests that the real motivation is to create the appearance that wealthy and middle-income members are doing *something* to aid poor countries, though in making this gesture they incur no present financial burden and provide little real assistance.

The IMF should focus on its core mission rather than supplanting economic functions properly undertaken by sovereign governments. It is laudable that the IMF is seeking to support the worthy goal of providing additional support to low-income countries. However, the asymmetry between the proposed SDR allocation and the provision of actual relief indicates the proposal is best seen as an attempt for the IMF to remain relevant. The IMF was initially created to help ensure the stability of the international system of exchange by relieving balance of payments issues inherent to the gold standard. Over time, the IMF's mission has gradually expanded to economic and financial stability monitoring, lending, capacity building, and wide-ranging economic research on everything from digital assets to climate change. However, SDR allocations present perhaps the most dramatic extension of the IMF's role from its original mission. An SDR allocation is, at its core, money creation. Money creation should be properly in the hands of sovereign governments rather than an international financial institution straying beyond its original mission.

Iran, Syria, and other rogue regimes would be aided by the proposed SDR allocation. Despotic regimes do not lose their status as IMF shareholders as a result of engaging in terrorism, weapons proliferation, human rights abuses, and other dangerous behavior. As a result, countries properly subject to U.S. sanctions would receive significant financial and economic relief as a result of the proposed allocation, undercutting U.S. national security objectives. The United States does retain the right to refuse to purchase SDRs from sanctioned countries. However, other IMF members may provide hard currency to rogue actors in exchange for these SDRs. Additionally, though SDRs can only be exchanged with IMF members, sanctioned countries may be able to avail themselves of additional financial mechanisms with private lenders as a result of their SDR holdings.

An SDR allocation will modestly decrease the U.S. dollar's share of global reserves. The proposed SDR allocation will more than triple the SDR's share of global reserves from 2% to 7%, in turn diminishing the dollar's share. Though SDRs are not a like-for-like substitute for the dollar, the U.S. government should proceed cautiously with any policy initiative that will diminish the dollar's hegemony in the international monetary system.

How should the United States handle the SDR proposal?

The United States should oppose a new SDR allocation, and instead pursue other policy solutions to address the underlying goals articulated by proponents of the allocation. Providing aid to very poor countries struggling with the public health and economic consequences of Covid-19 is in the interests of the American people. The IMF has policy tools available that will prove significantly more precise and effective in targeting relief towards poor countries than the proposed SDR allocation. The United States should push the IMF to use these tools, such as the Catastrophe Containment and Relief Trust (CCRT) and the Poverty Reduction and Growth Trust (PRGT), to properly target aid. Congress should focus attention on the Biden Administration's request for roughly $100 million for the PRGT to ensure that this money is used in an appropriate and leveraged manner.

Additionally, the United States should accelerate its efforts to vaccinate developing countries. The Biden Administration's announcement that it would donate 500 million vaccines over the next year is a positive development, but it is not sufficiently ambitious to meet the current need. Pharmaceutical companies have demonstrated private industry's unique capacity to dramatically increase output at a breathtaking pace, enabling the U.S. government to take bold action rather than engage in expectation management. Additionally, the United States should seek to maximize the effectiveness of its vaccine donations, including by pursuing bilateral distributions if multilateral efforts fall short.

If an SDR allocation does occur, what measures should the United States take to protect American interests?

- *Demand that IMF members reallocate SDRs to countries in need.* If the United States is going to support an SDR allocation, it should do so only on the express condition that advanced economies' new SDRs be reallocated to countries in need. If no reallocation proposal is agreed before the allocation, at a minimum, the G7, China, and other developed economies should agree to lend their full allocation to low-income countries. Given the magnitude of SDRs that should be reallocated in relation to the size of low-income economies, the United States should also lead in the development of a framework for utilizing SDR allocations to ensure that hard currency obtained through SDR exchanges are used by low-income countries in a productive manner that benefits its citizens.

- *Forge international consensus that pariah regimes should not be able to exchange SDRs for freely tradable currencies.* Iran, Syria, and other countries subject to significant U.S. sanctions should not be able to leverage their SDR allocations as a means to receive economic relief. The United States should work to establish consensus that IMF members should not exchange SDRs from countries subject to sanctions by the United States or other significant economies.

- *Promote the highest degree of transparency on SDR exchanges and use of proceeds.* The IMF reports SDR holdings of its members on a monthly basis. As a result, the existing SDR framework provides some insight into SDR exchanges but falls short of disclosing actual SDR transactions and provides no visibility into use of proceeds. The IMF has stated that it intends to improve transparency in SDR trading, but has not yet put forward a specific proposal. Enhanced transparency on SDR exchanges and use of proceeds would support sound macroeconomic policies and good governance, and enhance the IMF's ability to respond to future economic crises.

- *Congress should review the Special Drawing Rights Act and consider whether to require Congressional approval for all SDR allocations.* SDR allocations incur little to no budgetary cost, but they obligate U.S. taxpayers to hand over real dollars. Congress should consider whether it should exercise its traditional power of the purse in the context of the evolution of SDR allocations over the last forty years. When the SDR Act was last amended in 1983, an SDR allocation was not considered to be a tool to respond to international economic crises. In 1983, there were approximately $22 billion dollars worth of SDRs allocated (in 1983 dollars), compared to roughly $300 billion today. In 2021 U.S. dollar terms, the approximate threshold for Congressional approval has risen from $240 billion in 1983 to $680 billion today. In light of the evolving use of SDR allocations, Congress should consider whether the current legal framework reflects legislative intent.
