

Composition and allocation of SDRs

Abstract

This paper makes the case that the political and technical obstacles to adopting SDRs for development may be surmounted. This calls for a reserve system based on SDRs and an IMF financed entirely with SDRs. The IMF would distribute SDRs in a countercyclical manner and treat them as country deposits that might be utilized for lending them to. For a smooth transition from major reserve currencies to SDRs, a substitution account is required. A counterpart account, which would be credited when the substitute account is in surplus and debited when it is in deficit, is necessary to avoid the deficiency payments. As an alternative, cost-sharing arrangements that are politically feasible could be created. The SDR has recently received more attention in the context of discussions about global monetary reform. Of course, there are three separate ideas that have been referred to by the word "SDR": (i) a composite reserve asset established in 1969 known as the "official SDR" as defined in the Fund's Articles; (ii) a potential new class of reserve assets: tradable SDR-denominated securities issued by the Fund or an investment vehicle backed by a portion of the membership of the Fund; and (iii) a unit of account that may be used to value internationally traded securities (such as sovereign bonds) and products (such as commodities), to peg currencies, and to report balance of payments information.

Keywords: Special drawing rights, international reserve system, and innovative development finance.

Literature Review

The financial structure of the special drawing right (SDR) is intricate. It is neither a currency nor a liability, but it is a

global reserve asset. It is surrounded by rules that limit how it can be created and used in the global financial system.

This paper focuses on the SDR's first historical function as a tool for the process of global adjustment, as well as strategies for advancing that function going forward. Other SDR qualities could be beneficial byproducts, but without the SDR performing its original function it is challenging to make a compelling case that it could perform any other duty save its original one.

Outside of a tiny group of enthusiasts and a little larger group of politicians and their cronies, who typically only have a rudimentary and inaccurate understanding of the asset, the SDR remains unknown. In essence, the International Monetary Fund (IMF) distributes SDR to its members proportionately to their quota subscriptions.

As a result, SDR allocations have developed into a crucial instrument for collaboration during global financial crises. The total SDRs that will be outstanding at the end of December 2021 will be 660.7 billion SDRs, or \$922.1 billion in US dollars.

Following the 2021 allocation, the SDR's share of foreign exchange reserves plus SDR holdings was 7.1 percent, which is a third more than the share of the Japanese yen but much less than the shares of the US dollar and the euro (54.6 percent and 19.6 percent, respectively).

The lack of sufficient gold reserves in the world's monetary system resulted in the creation of additional paper gold in the form of Special Drawing Rights (SDRs). The IMF's member

countries use SDRs for a variety of purposes, including transactions on the Administered Accounts and Operations Division of the IMF in accordance with their quotas. A lot of criticism has recently been leveled at the IMF about recent SDR allocations and the associated weighted voting rights. Currently, the SDR measurement is based on a weighted average, and developed countries are given a sizable portion of the SDR quota due to their greater weight ratio. Due to their low weight ratio, the SDR allotment allotted to developing and least developed nations is insufficient.

SDR ALLOCATION:

The allocation of about \$650 billion in SDRs has been approved by the IMF Board of Governors. A supermajority of 85 percent of the voting power is necessary for an SDR allocation. 16 percent of votes are cast in favor of the United States power. As a result, no proposal could be started unless it received support from the US and the majority of other IMF members.

According to each member's quota or ownership stake in the IMF, the IMF distributes SDRs to them. Due to their greater quotas, advanced economies will collectively receive the majority of the SDRs, with the United States receiving the greatest part. (The US would receive SDRs worth more than \$110 billion.)

The International Monetary Fund (IMF) issues Special Drawing Rights (SDRs), which are then distributed to IMF member nations in accordance with their ownership quotas.

The SDR holdings of a nation are a component of that nation's foreign exchange reserves, which are typically held by the central bank or reserve asset manager of that nation.

As part of the Exchange Stabilization Fund, the Treasury Department of the United States controls them (ESF). The SDR holdings of each IMF member are disclosed on the IMF website once a month.

Only transactions with the IMF or with other members carried out via the IMF are permitted to use SDRs.

A nation that sells SDRs receives one of the five currencies that make up the SDR, the US dollar (which is overvalued compared to the other four), in exchange.

SDR allocation estimates and their potential for financing development:

Initial definitions of the SDR stated that it was equal to 0.888671 grammes of pure gold, which was also the same weight as one US dollar at the time. The SDR was redefined as a basket of currencies when the Bretton Woods system failed. The export requirement and the freely usable requirement must both be satisfied for a currency to be included in the SDR basket. A currency is considered to meet the export requirement if both its issuer and one of the top five exporters in the world is an IMF member or a monetary union that includes IMF members. The IMF defines a currency as "freely usable" if it is frequently used to settle foreign trades and is actively traded on the major exchange markets. Freely transferable money can.

A SDR basket composition that makes it as representative of global economic and financial weights as possible, liquid, and straightforward to use and hedge maximizes the SDR's attractiveness in all the functions listed above. Unfortunately, there are compromises made in order to achieve these goals. There will at the very least be a trade-off between the predictability of the SDR's future value and the necessary evolution of its composition (if it is to stay representational); nevertheless, a rules-based valuation procedure could greatly help to solve this issue. In 2011, a work programme to revise the SDR valuation technique and take into

account increasing the basket is anticipated. The remainder of this section outlines a few factors to take into consideration without assuming its findings.

Method of Valuation:

Currency from developing nations as a emerging market currencies' roles in international trade and finance grow, including them in the basket might make the SDR more alluring by broadening its diversity and representativeness. Additionally, such a method promote the inclusion of emerging markets in the IMS to a larger extent and aid in their financial development. Going beyond a small number of additional currencies, however, might mean including low weight currencies, which would add complexity and transaction costs for those that follow the SDR basket or seek to hedge their exposure. As a result of such modifications, certain central banks would not be eager to raise their SDR exposure. Their willingness to take part in the voluntary trading agreements that sustain SDR would be affected by this.

The calculation of SDRs was rationalized from the value of gold to 16 baskets of currencies to the value that is presently streamlined to 5 baskets of currencies. Euro, Japanese yen, U.K. pound, and four more currencies make up the SDR basket at the moment. British pound, Chinese yuan, and the dollar. The executive board conducts a review of the SDR value every five years, during which decisions are made on the choice of a currency basket, calculating the relative weights of these currencies, and selecting financial instruments to determine the SDR interest rate. The SDR allocation was periodically increased in accordance with the demands of the international political economy. As an illustration, the initial SDR allocation gave 9.3 billion SDR to member nations in 1970–1972.

The GDP, openness, variability, and reserves are the four quota variables. These are shown as percentages of the overall sums, with

the variables' weights added together to equal 1. A compression factor is also used in the formula. Lessens the variability of the calculated quota shares.

The equation is $CQS = (0.5*Y + 0.3*O + 0.15*V + 0.05*R) k$, where CQS stands for calculated quota share; Y for a combination of GDP converted at market rates and purchasing-power-parity (PPP) exchange rates averaged over a 3-year period (the weights of market-based and PPP GDP are, respectively, 0.60 and 0.40); O for the annual average of the sum of current payments and current receipts.

Problems and difficulties with the status quo: SDRs mechanism:

As the world becomes more unequal, there are more quota rises, but less quotas overall, showing a beneficial influence of inequality on quota. Increases in the new SDR allotment also take into account similar facts. The metrics of GDP, openness, variability, and reserves, which have weights of 50%, 30%, 15%, and 5%, respectively, do not take into account the potential abundance of natural resources or the prospective capability of SDR holders. Here, the issue is how the weighted average was determined and why foreign exchange reserves were only granted a 5% weighted average and not more. Although SDRs were created in the 1960s to supplement gold stockpiles, subsequent allocation quotas should be based on vertical equity rather than on criteria. Freely traded currencies (such as the US dollar, the euro, the Chinese yuan, and the British pound sterling) do not accurately represent market size. For instance, if we include about 8 to 10 key trading currencies, the interest rate on SDRs will naturally settle. If one currency is losing value, the other might be gaining value, and the overall result might be that the interest rate on SDRs stays the same. SDRs will stabilize as a result in the long run. As a supplemental international reserve asset within the framework of the Bretton Woods fixed exchange rate system, SDRs were developed by the IMF. The Bretton Woods system came to an end a

few years after the SDR6 was established. The world was informed by President Nixon that the United States was "closing the gold window."

Technical Challenges:

The construction of a "substitution account," which enables nations to exchange their dollar reserves and those denominated in other currencies for the SDRs and SDR-denominated assets issued by the Fund, is one of the technical challenges the IMF has in the transition to an SDR-based reserve system. By doing so, if significant holders of dollar reserves attempt to sell them on the foreign exchange market, it will have the advantage of averting a sudden decline in the value of the dollar. The substitution account would be crucial in this regard to maintain the stability of exchange rate fluctuations, and it would also be very helpful in a multi-currency setup to avoid excessive volatility. The expenses of a substitute account that concentrates on the key subject should be compared to these advantages.

A Substitution Account's advantages:

There are numerous advantages to establishing a substitute account at the IMF that enables nations with US dollar (or other currency) reserves to diversify into SDRs. Even if they are hard to measure, these two advantages are crucial for demonstrating why it was a good idea to create it:

Changing Reserve Composition Without Disruption:

Foreign currency reserves held by developing and emerging nations total US\$6.1 trillion, of which US\$5 trillion is held in US dollars. China has the greatest need to diversify its reserves that have been amassed in US dollars and invested in US government assets, with a total reserve buildup of nearly US\$3 trillion. Zhou Xiaochuan, the governor of the People's Bank of China, made the suggestion that surplus nations should be able to convert their stocks of dollar

reserves into SDR-denominated assets in order to indicate this intention unambiguously (Zhou, 2009). The dollar would lose value and experience a crisis if China sold these reserves on the foreign exchange market. The substitution account would avert this issue by enabling the exchange of dollar reserves for SDRs.

Serving as the beginning of the transition to an SDR-based reserve system:

The introduction of a substitution account is a first step toward a significant overhaul of the global reserve system by enabling countries to convert their foreign exchange reserves, whether they are in the form of dollar reserves or reserves denominated in other currencies, into SDR-denominated assets in an off-market reserve pool. The steadiness would be the biggest benefit. It would be essential to manage the exchange rate volatility created by a multi-currency system in addition to the benefits that it gives to the system. One can imagine three times in which the functions of the substitution account alter to eventually transform the SDR into the three-stage transition that Kenen (2010b) describes.

A reserve asset with complete development. The potential costs associated with maintaining the value of the reserves deposited in the account in the initial period following the establishment of the substitution account can be split between the reserve issuers (the United States and the Eurozone countries) and the reserve holders (the majority of which are developing and emerging countries). The IMF would proceed with its routine SDR payments at this time. Allocations to its members, with the money going into the replacement account. Each country that wants to interfere in the foreign exchange market in the ensuing period would be free to transfer some of its SDR claims on the substitution account to the nation issuing the currency it needs to access.

A Substitution Account's expenses:

The creation of a substitution account within the IMF was previously discussed in the late 1970s, but negotiations fell through for two reasons: (i) the US dollar started to appreciate in the early 1980s, allaying concerns about the value of dollar reserves, and (ii) the US refused to accept responsibility as the only nation to implement the substitution account. Maintain the SDR-denominated assets' dollar value in the replacement account.

These two elements are still present in the globe today. Recent developments in the Eurozone financial crisis and the dollar's role as a safe haven caused the US dollar to start strengthening. Many rising nations (including Brazil, Turkey, and India) had to act to stop the depreciation due to the dollar's extreme strength. For instance, the first factor has a wide range in cost projections. The average yearly deficiency payment, or the cost of maintaining the account solvent, would be US\$22.6 billion if the year 1980 is chosen as the first year for the creation of the account starting with a deposit of US\$500 billion, or if it is stretched out over a longer period of time. The average yearly cost would be \$16.4 billion over the course of the 29-year period, which could be covered by a cost-sharing arrangement between the United States and the nations depositing their reserves. However, historical simulation findings reveal that the overall cost comes out to be zero, i.e., there would be no cost if the first year were 1995 and the original deposit was considered to be US\$1000 billion. In the absence of a counterpart account, splitting the overall deficiency payments in half between the United States and the IMF would be one approach to share these expenses. To contribute to the expense of keeping the replacement, the IMF can utilize its own dollar assets or sell part of its gold holdings. Insolvent account

Another cost-sharing option would be to identify the nations that would gain the most by having a substitution account in the IMF (i.e., the nations with the biggest surpluses, like China, Japan, and Germany), and then ask them to contribute more to the overall cost.

Effects of SDRs on Inflation versus Deflation:

Whether or not the introduction of additional central bank money in the form of SDRs would cause inflation is a crucial question to answer. Two strategies would stop fresh SDR allocations from having an inflationary effect: countercyclical finance and IMF allocations. The IMF can move to a totally SDR-funded system, financing the needy nations with newly produced SDRs during crises and eradicating these SDRs when they repay the loans, as suggested by IMF economist Jacques (Polak 1979). A countercyclical finance structure like this would contribute to stabilizing global liquidity levels, improving macroeconomic stability all throughout the world. This might be supplemented by the IMF allocating new SDRs countercyclically, focusing on their issuance during times of financial unrest and economic weakness, and partially allocating them to.

Defense and defence of the Link:

Arguments about the connection can be broadly divided into two categories: those supported by economic and theoretical justifications and those supported by procedural and political justifications. The first addresses the issue of neutrality in the global wealth distribution and the sharing of the social savings from the production of SDRs among the participating nations. The latter is concerned with issues such the impact of a link on how the SDR system functions, the "additionality" of aid flows, and if parliamentary limits on development aid are necessary.

Theoretical and Economic Issues:

The Group of Ten first based its justification for opposing the link on the need for neutrality: Deliberate reserve formation is not meant to result in long-term transfers of actual resources between nations (Group of Ten). A link would go against the initial goal of purposeful costless reserve formation because it would allow emerging countries to buy actual resources from wealthy nations. There are

two different costs that developed countries must bear: the direct national cost of real resources given to developing nations and the indirect worldwide cost of inflation brought on by LDCs' financing of irrational spending without a rise in global output. The key idea here is that genuine resource transfers from one nation to another are not only unnecessary, but also not necessary in order to build the international reserves needed for the global economy (Johnson, 1972). This claim is supported by the following argument: Since reserves enable nations.

A comparison to a group of thirsty hikers who finally come across a large spring and quench their thirst by drinking its cool water is appropriate for this idealistic depiction of SDR distribution. Larger or more thirsty hikers will need more water to quench their thirst than smaller or less thirsty hikers, but no hiker's thirst will be quenched at the expense of another hiker's water supply. There is enough water at the spring to completely satiate every hiker. The question of whether IMF quotas adequately reflect member nations' thirst—their equilibrium needs for extra reserves—is legitimate, of course, but it is absurd to brandish the SDR distribution formula as "unjust" because wealthy countries receive more SDRs than poor ones. According to several professionals (Grubel, 1971). Therefore, creating SDRs for member nations to "keep" rather than "spend" should be the primary goal (Bergsten, 1973). The SDR system enables the IMF to boost global reserves to encourage. To prevent them from enacting extensive controls over international transactions in an effort to increase their reserves by aggressively running balance-of-payments surpluses, national monetary authorities need to feel secure. However, it would be quite challenging to ensure complete neutrality in the actual distribution of SDRs.

Even if the IMF could produce the ideal number of SDRs annually, the mechanism for SDR allocation may still be unfavourable to the neutrality.

IMF quotas were not meant to be the foundation for allocating globally produced reserve assets like SDRs. Originally, they were intended to serve three purposes: They decided each member's commitment to the Fund's resources, assigned voting rights inside the IMF, and set maximum withdrawal limits from the Fund in the event of a necessity for balance of payments. Since this gave the IMF access to "drawable" resources, the degree of currency convertibility of the countries had an impact on the setting of IMF quotas. Furthermore, the quotas represented an implied cap on the quantity of dollars—the "scarce" currency of 1945—that might be demanded from the United States. Pre-war national incomes and were two of the key elements of the quota system that brought.

Procedural and Political Grounds:

Political and procedural justifications are both contentious issues. The link's opponents are not against development aid in general. Simply expressed, their argument is that the creation and development of liquidity Aid and relief are two distinct goals that shouldn't be combined. They see clear drawbacks when attempting to balance the requirements of the present with the goals of long-term development finance of the global financial system. In terms of decisions to generate SDRs, flexibility is necessary from the perspective of international monetary management. On the other hand, from the perspective of development, planning by both donors and receivers needs concrete commitments over a long period of time. This could only be accomplished by incorporating an inflexibility into the SDR facility, degrading the SDRs' monetary quality. However, the time of the aid delivery will not always match with that of the SDR formation, which slightly lessens the power of this criticism.

SDR BASKET COMPOSITION:

Objective: an SDR basket arrangement that maximizes the SDR's all-around attractiveness. As much as is feasible, it is representative because of the responsibilities stated above of weights in the global financial and economic spheres, liquid, and easy to use and hedge. Unfortunately, there are compromises made in order to achieve these goals. There will at least be a trade-off between the required SDR composition evolution (assuming it is to remain) and despite a rules-based appraisal procedure, its future worth is predictable and representative could significantly help in solving this issue.

Emerging market currencies: As emerging market currencies' roles in international trade and finance grow, including them in the basket might make the SDR more alluring by broadening its diversity and representativeness. Additionally, such a method promote the inclusion of emerging markets in the IMS to a larger extent and aid in their financial development. Going beyond a small number of additional currencies, however, might mean including low weight currencies, which would add complexity and transaction costs for those that follow the SDR basket or seek to hedge their exposure. As a result of such modifications, certain central banks would not be eager to raise their SDR exposure. Their readiness to take part in the voluntary trading arrangements that underpin SDR liquidity would be impacted by this.

Not-fully convertible currencies:

All the currencies in the SDR basket must be "freely usable currencies," as determined by the Fund (currently the Dollar, Euro, Pound, and SDR) under the Executive Board-approved SDR valuation system in force since 2000. Yen). The SDR basket included a number of currencies from the Second Amendment's implementation, when the idea of freely usable currency was established, until 1982. These currencies not only weren't on the list of freely usable currencies, but also had limitations on both current and capital account transactions. The private sector may actually demand more SDR-denominated assets if a partially convertible currency is added to the basket because it would be

simpler to obtain exposure to this currency than it is currently possible (although this benefit would disappear as the currency becomes fully convertible).

The RMB dilemma:

Despite China's significant export share, the RMB should not be included in the SDR basket since it does not meet the requirements to be deemed a freely usable currency, according to a recent evaluation of the SDR valuation. The retention of this criterion as part of the SDR valuation process is debatable, though. Recent changes that let nonresidents, including central banks, to hold RMB-denominated deposits and Hong Kong's steady development of RMB futures may eventually help to alleviate some of the technical challenges associated with hedging RMB exposure. Additional convertibility agreements between the PBC and other SDR designated holders might be used to supplement these.

Political Difficulties

Political challenges and solutions must be taken into account while reforming the global reserve system using SDRs. It is generally known that the United States refused to guarantee the solvency of the substitution account as it would have done in order for the SDR to play a significant role in the late 1970s impose the entire burden of interest rate and less expensive exchange rate risk on this nation. It is crucial to create a cost-sharing system that divides the possible costs among the countries taking part in the substitution account in order to prevent the same kind of failure to reach an agreement. In the section before, various cost-sharing schemes are assessed.

United States Interests

It is widely believed that the United States has a significant national interest in opposing the SDR's expanded role since doing so could limit the dollar's use abroad. However, the situation is more of a compromise between two conflicting forces:

- 1) The United States benefits from the dollar's role as a reserve currency and from its international recognition by having lower borrowing costs, more affordable foreign debt financing, and the capacity to implement effective countercyclical macroeconomic policies as a result. This indicates that the benefits of seigniorage accrue to the United States,

which make it better off. It is able to accomplish this benefit thanks to the "exorbitant" as holders of other currencies want the dollar, the "privilege" of issuing.

- 2) As a result of the dollar's status as a reserve currency and its global recognition, the United States benefits from lower borrowing costs, more cheap foreign debt financing, and the ability to adopt successful countercyclical macroeconomic policies. This shows that the United States benefits from seigniorage, which improves its situation. It can achieve this gain because of the "exorbitant".

The seigniorage advantages of the dollar's acceptability abroad come at the expense of larger foreign deficits and higher debt levels that encourage capital flight and have a negative impact on the American economy. Risk of monetary loss is another another drawback of using the dollar as the reserve currency.

policy autonomy if the United States must comply with the requests of significant holders of dollar reserves in U.S. government debt by refraining from doing actions that might cause the dollar to weaken. Therefore, the switch to an SDR-based reserve system that supports global financial and economic stability is necessary if the United States wants to maintain its independence from international financial institutions while also reducing its twin deficits and overall debt.

During the transition, it will be crucial to strengthen the function of SDRs first as a reserve asset by restricting their ownership to central banks and a few other international organizations and refraining from pursuing their use as an international payment method. Demands for the dollar rise as a result of its use as a form of payment. Financial services in the US. The US Congress is likely to oppose giving up this position since it would be costly for the US economy. Given the gradual decline in confidence, it is therefore more politically viable to seek changes in the reserve asset role of the dollar, which are also in the long-term interests of the United States as a reserve currency, in dollars.

Developing Countries Interest

If developing nations with sizable dollar reserves converted a sizable portion of their reserves into SDRs through a substitution account, they

would be less affected by the decline of the dollar. It will be crucial to decide who would pay the price if the dollar declines in the next years. A cost-sharing arrangement. However, as previously demonstrated, the establishment of a counterpart account could actually balance the substitution account without incurring any costs to any parties involved. Under this mechanism, depositors of substantial dollar reserves would equally share the potential costs with the United States. But without this parallel account, the burden of keeping the replacement account solvent would be borne in part by the developing nations with sizable dollar reserves.

In the medium term, the developing nations would gain from sharing in the seigniorage that results from reserve generation thanks to the IMF's periodic SDR grants. The seigniorage advantages would be taken by the issuers of these currencies, i.e. the United States, if they continue to rely on other reserve currencies and nations in the Eurozone. Therefore, the only method for poor countries to share in the benefits of seigniorage is through the policy of SDR allocations. The benefits of switching to an SDR-centered system for developing countries are clear, especially when considering the potential costs of rising instability from switching to a multi-currency system and the costs of a persistent global imbalance from relying on the dollar as the primary reserve currency. It should be highlighted as well.

For developing nations whose currencies don't have the capacity to become reserve currencies, these advantages would last over the long term in the medium term. Some have suggested that the long-term benefit of the ability to fund a greater current account deficit and greatly increase domestic consumption due to the obvious candidate whose currency is a candidate to become a major reserve currency in the future, i.e. China. The benefits of an SDR-based system might not outweigh the desire for renminbi as a reserve currency (Subramanian, 2009). However, there are valid arguments against acting as the reserve currency: Due to the potential instability this scenario could cause, there are two drawbacks to being a significant short-term debtor.

A reserve system reform based on SDRs would also provide developing nations with the added benefit of funding international public goods like the dissemination of green technology and health programmes. The expanded funding options could aid poor nations in achieving the MDGs.

ARGUMENTS AGAINST SDR ALLOCATIONS:

Since the discussions in the 1960s before the SDR was established, the arguments against the SDR and its allocation have not altered:

(1) The SDR should fill a long-term global need that might not have existed in the past but that is incompatible with the current international monetary system.

(2) An improper distribution of SDRs results from utilizing the IMF quota key.

(3) The use of SDR always increases the moral hazard in a country's policymaking.

(4) Allocations of SDRs increase global inflation.

(5) The major members of the SDR do not share the philosophical outlook of the SDR.

Global Long-Term Need

IMF Articles of Agreement criterion that an SDR allocation must address an identified long-term global need to augment international reserves is cited by opponents of SDR allocations as evidence reserves. The SDR was created within the framework of the Bretton Woods fixed-exchange-rate system, according to IMF "originalists," but since the emergence of floating exchange rates, countries can borrow foreign reserves or permit their exchange rates to fluctuate. They are not creditworthy if they are unable to borrow, hence they shouldn't have access to unconditional liquidity provided by other nations. This claim was refuted by the second allocation of SDR in 1978, which came about after the IMF Articles of Agreement were changed to allow for floating currency rates.

Inaccurate SDR Distribution:

Representatives of several nations proposed that SDR should be distributed to nations with the greatest need for additional international reserves, such as emerging market and developing nations or low-income nations, as early as the 1960s. It was brought up once more. When the Committee of Twenty (C-20) on Reform of the United Nations (ERC) was in session in the 1970s.

Without Conditions:

Countries that borrow money from the IMF must meet or promise to meet requirements on their economic policy. The severity of those conditions is determined by the nation's current policies, its economic situation, and the lending facility or window it is using. a person. The country's use of its SDR allotment is practically unrestricted. It is true that, unlike the majority of other IMF loans, a country's use of its SDR is not subject to limitations on its economic policy. However, using SDR does not constitute IMF borrowing. The nation using its SDR must pay interest to the other member countries it is borrowing directly from. This debate is about whether or not the IMF should, not about policy conditionality.

SDR Allotments Increase Inflation:

Inflation was a major issue for the IMF and many countries' economic leaders throughout the 1960s and 1970s. Up until recently, fears about inflation were dormant, and it is unknown whether the current concerns will persist for longer than two or three years. The inflation argument, however, is essentially false. The claim is that SDR allotments will cause inflation either directly by impacting monetary aggregates or indirectly by increasing global aggregate demand. Both the historical data and the current evidence refute the argument. Analysis of Ricard Cooper, et al., 2002 [add citation and confirm date]. In conclusion, not all SDR transactions go through central banks' accounts; any SDR allocation would be negligible compared to the amount of bank reserves held by those central banks who accept the SDR; they do not raise banks' reserves when the central bank provides a different currency or when it pursues its primary policy goal of containing inflation. The aggregate amount would be minor if several countries used their SDR in the same time period after an allocation to support expansionary economic policies; half the present stock of SDR is less than \$500 billion, or less than 0.5 percent of the world's GDP.

The SDR Goes Against What We Believe:

The widest criticism of the SDR is based on how nations view international institutions in general and international cooperation in particular. There are various ways to criticize this. The first is hostility to all forms of foreign aid. Participation in the SDR mechanism or the IMF, for that matter, is not the only thing that attracts this kind of criticism. Technically speaking, opposition is based on the cost to the United States of helping to make use of the SDR possible. However, these expenses are negligible for the US. Political pressures

to prioritize a country's perceived short-term interests and undervalue the long-term benefits of collaboration are significant in some countries in a world where many problems transcend national boundaries. In relation to SDR. This attitude manifests itself in resistance to SDR allocations on the basis that some of the nations that would receive SDR shares do not share the values of the majority of IMF members or are now considered pariah states, such as Belarus, China, Iran, Russia, Syria, and Venezuela. The majority of these nations have not utilized their SDR allotments, as is stated below. In some circumstances, this is because they find it challenging to do so in a setting where exchanges for things are common

Complementary Reforms for the SDR-Based System:

The SDR-based reserve system must undergo a number of additional reforms in order to perform better than the current system. These include the Keynes-originally suggested International Clearance Unit and the regional financial arrangements, including reserve pools like the Chiang Mai Initiative, the Latin American Reserve both the Arab Monetary Fund and the American Reserve Fund.

International Clearance Unit and the IMF's Role:

In order to prevent any inflationary bias that additional SDR allocations might cause, countercyclical IMF SDR allocations and IMF lending to SDR-holding nations are crucial. However, it should be acknowledged that the existing restrictions on IMF loan lines and the resulting unfavourable public perception requires an additional change. It is time to establish "an overdraft facility that can be used unconditionally by all IMF members up to a specified limit and for a pre-established time period," as Ocampo suggested (2010b, p. 15). Keynes' initial concept included an international clearance unit as an overdraft facility, but it was never implemented because of conflicts among major powers. This facility is significant because it would help mitigate the unbalanced adjustment between surplus and deficit.

Regional Arrangements:

According to the Stiglitz Commission's (2009) recommendation, the new global reserve system ought to be constructed from the ground up, with the agreements reached among regional monetary arrangements playing a key role. In line with the World Bank's coexistence with numerous regional

development banks and other sub-regional organizations, this plan envisions the IMF's future as a network of regional reserve funds. Regional through a variety of means, arrangements would be crucial in enhancing global macroeconomic stability.

- 1) By improving collective insurance through new credit lines and swaps.
- 2) By creating a forum for the coordination and discussion of macroeconomic policy, and 3) by giving smaller countries a stronger voice, to which they can quickly respond (Ocampo, 2006).

In addition to swap lines, common central banks, and payments agreements, reserve pools have been significant entities that have offered different forms of collective insurance to their members. The reserve pools with the greatest success are:

The Chiang Mai Initiative (CMI):

The CMI was established in May 2000 in Chiang Mai, Thailand, and is made up of the 10 ASEAN member nations as well as China, Japan, and South Korea. Its main goal was to provide short-term financial assistance to the neighbouring nations experiencing balance of payments issues.

The CMI has been multilateralized since May 2009 and consists solely of swap agreements between ASEAN+3 nations. In other words, a single regional pooling agreement was created from the bilateral currency exchange arrangements (Volz et al., 2011). Following the 2009 financial crisis, the CMI's funds were increased to US\$120 billion. Potential borrowers have access to only a limited amount of finance as compared to the region's foreign exchange reserves. It is still a multiple of, though.

The Latin American Reserve Fund (FLAR):

The FLAR, which was established in 1978 by the Andean nations of Bolivia, Colombia, Ecuador, Peru, and Venezuela, expanded in 1989 with the addition of Costa Rica and in 2008 with the addition of Uruguay. The initial goal was to provide short-term financial support for its members' balance of payments. It currently pursues further objectives of "increasing the liquidity of foreign reserve investments, facilitating the restructuring of public debt, and aiding in the harmonization of the monetary, exchange, and financial policies of the member countries" (Volz, 2011). The Fund offers favourable access to smaller and less developed nations like Bolivia

and Ecuador despite its lesser size compared to CMI (US\$1.77 billion). These nations can borrow up to 350% of their capital contribution while others can only borrow up to 250%. The variety of the member nations guarantees.

The Arab Monetary Fund (AMF):

The AMF, which is similar to the CMI and the FLAR in that it offers balance of payments support, was established in 1976 by 22 Middle Eastern nations. Additionally, it fosters Arab monetary cooperation through aiding the growth of Arab financial markets and the regulatory frameworks necessary to ensure their efficient operation markets. Additionally, it advises member governments on how to spend financial resources in international markets and promotes intra-regional commerce. In 2009, the Fund received capital contributions totaling US\$2.8 billion. The Fund can be viewed as providing short-term lending from the largest gas and oil producers in the world.

Overall, these regional reserve funds offer a collective mechanism to protect individual nations from any speculative attacks on their currencies, notwithstanding their limits as primarily being a supplement to IMF loans. They should be viewed as complementary loan options with essential stabilizing activities.

REFORMING THE SDR:

To address the criticisms of the instrument outlined in the previous section of this paper, IMF members should reform the SDR.

SDR Interest Rate Increase:

Nearly all net SDR consumers receive a constant subsidy from the SDR interest rate. Any net holder is likewise subject to a financial or opportunity cost. To transfer its currency to the SDR user, the net holder must either borrow it from the market or forfeit earnings on its own currency.

The five currencies now included in the SDR basket are the yen, euro, renminbi, pound, and US dollar. Reserve assets are held in one of the other currencies that may be offered to the user.

By increasing the cost of the SDR credit, this adjustment would serve to mitigate the criticism of its unconditional character. Additionally, it would lessen the accusation that those who contribute usable currency to those nations in exchange for their SDR must pay interest.

Increase the Number of Freely Usable Currency Types and Their Application in VTAs:

There should be more currencies in the SDR basket than the existing five that the IMF now classifies as freely useable. The SDR's mobilization would be aided by this. The current combined percentage of IMF members issuing SDR-denominated currencies 56 percent of the basket. The quota proportion of such currencies would rise to 61 percent if the Australian, Canadian, and Swiss francs were designated as freely usable currencies. The IMF has historically included these three currencies in its analysis of the currency breakdown of foreign exchange reserves. They make up more than 4% of the overall budgeted amount. As freely usable currencies, the New Zealand dollar, Swedish krona, and Korean won should also be included.

A presumption that all IMF members who issue freely useable currencies should contribute their own currencies in exchange for SDR should be accepted by all IMF members. Additionally, this would ease some of the pressure on the dollar and help the multicurrency system develop. The IMF's value guidelines for SDR to national currency exchange operations are dated. IMF members will receive fair value when converting from one freely usable currency to another after receiving the first currency in return for their SDR due to the depth and breadth of foreign exchange markets. There isn't much justification for the IMF or its member nations to internalize the costs of transactions.

By distributing the cost of these changes, these reforms would serve to support the SDR in boosting the international adjustment process.

Reevaluate the SDR's Reserve Asset Theology:

The idea that SDRs are liquid assets whose liquidity should always be maintained is deeply ingrained in IMF norms and procedures regarding their use. One may comprehend and appreciate the reasons why early SDR and IMF proponents did so. The SDR would be as "reserve-like" as any other reserve asset, according to officials. The emphasis at the time was on their readily available reserves to address financial and external needs. The idea that SDRs

are liquid assets whose liquidity should always be maintained is deeply ingrained in IMF norms and procedures regarding their use. One may comprehend and appreciate the reasons why early SDR and IMF proponents did so. The SDR would be as "reserve-like" as any other reserve asset, according to officials. The emphasis at the time was on their readily available reserves to address financial and external needs.

There is a compelling argument against continuing to utilize the axiomatic reserve asset definition as a means of opposing or limiting the rechanneling of SDRs by some governmental institutions, primarily those in Europe.

First, the idea of a "reserve asset," which is defined as a high credit quality and liquid asset, is not absolute. Credit quality is largely a relative concept, and central banks around the world purchase a wide range of rated debt in the context of managing their foreign exchange reserves, including, for instance, the public debt of Italy, Japan, the UK, or the US.

Contrarily, many nations keep sizable reserves now, and they are invested in a variety of assets, some of which are less liquid than others, such as corporate bonds or the bonds of growing finance institutions.

The allegation that SDR are misallocated in relation to the needs of IMF members with lower incomes would be addressed in part by this revision. It would make it easier to transfer SDR to other nations and organizations in order to help low-income nations. This particular recycling endeavour is second or third best due to both the technical difficulties of mobilizing SDR via their conversion into national currencies and the fact that the financial resources may be transferred directly by the higher-income countries. However, third place is still preferable to nothing.

Boost the percentage of low-income members:

As a result, the distribution of quotas and SDR allotments should be skewed more in favour of low-income nations and other emerging market and developing nations, and away from the developed nations. Advanced nations, the majority of which do not have as much need to increase their reserves and are not likely to borrow from the Fund. 14

By December 15, 2023, the 16th review of IMF quotas must be completed. The result the outcome of this Rubik's cube practise is unknown. The algorithm for computed quotas and ad hoc adjustments has a significant number of

recommended modifications. The demand to make additional adjustments in the current assessment is great given that the most recent adjustment to quota shares was agreed upon more than ten years ago (2010). The ramifications of the 16th review will not only include customary concerns of the distribution of votes and scale of prospective commitments and drawings given the enhanced possibility for SDR allocations in the future.

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.

Every year, the list of nations according to their per-capita income is updated. The nation groups utilized in the quota negotiations, however, cannot be changed. The aggregate quota share of the advanced countries is currently 57.6 percent in this hypothetical statistical universe, and would be 50.2 % using data up to 2018 and the existing quota formula (IMF 2020, 6). Low-income nations are guaranteed a combined quota allocation of 3.2%. The protected combined LIC share of quotas should be raised to 6.4 percent in order to increase the appeal of SDR allocations to these nations and those who support them. This adjustment would contribute to what some could consider a more equitable distribution of quotas, together with the probable increase in the total quota share of other emerging market and developing nations.

Based on 2018 data, increasing the limited LIC share of quotas from 6.4 percent to the calculated share of quotas of the other emerging market and developing nations would increase their combined contribution from 42.4 percent to 53.8 percent. The combined share of the IMF would rise by almost 7 percentage points if its quotas were doubled and the additional quotas were distributed according to the current quota methodology. My opinion is that the formula's GDP component should be given more weight (either in its current form or with a more significant movement toward GDP calculated using purchasing power parity) and that the trade openness variable should be adjusted by removing intra-currency unions.

This reform would assist in addressing the complaint that low-income countries are not adequately protected financially due to the use of the quota key for SDR allocation.

Inclusion of Chinese currency in SDR basket and why not any other emerging countries currency?

After 2013, US Fed taper tantrum, India's forex reserves went up 2X till September 2021, and have been falling since then.

In 2013, the Rupee depreciated by almost 29% between April and September from ₹53 a dollar to ₹68. Forex reserves fell to \$275B by August-end 2013 from

\$293B in March-end 2013. Between May and August 2013, the Nifty 50 fell around 18% whereas the Nifty's fall between the October 2021 peak and the June 2022 bottom has also been around 18%.

As the Reserves improved, Nifty 50 went up 80% between August 2013 and February 2015. India's External Debt-to-GDP ratio strengthened to 20% in Dec'21 against 22.4% in Mar'13. Reserves-to-External debt Ratio has improved from 71.3% to 103% during the same period. Import cover has strengthened from 7 months to 13.1 months in this period. Despite falling reserves, these ratios indicate strong and improving macroeconomic conditions.

Global acceptance of a currency depends as much on political factors as on purely economic factors. And the former is harder to predict.

The first aspect to consider when looking at the renminbi's path towards the SDR basket was the China's extraordinary economic growth over the last 30 years. No other country in modern history has achieved such high rates of growth for so long. From 1980 to 2010, China grew at an average rate of 10% every year. In terms of rankings, China is today the world's second largest economy (using GDP at market exchange rates), and when measured at purchasing power parity, it accounts for 17.1% of global GDP, surpassing the United States (15.8%), in 2015.

This rapid growth was prompted by market-oriented reforms that

opened the Chinese economy to the world. Two drivers are often cited as main factors behind this growth, namely exports and investment.

Some 13.8% of global trade originated in China in 2015, making it the largest exporter in the world (way ahead of the United States with 9.1% and Germany with 8.1%⁴). The strong growth in investment and infrastructure was often cited as another of the main engines of China's growth during the 2000s. It is estimated that, during these years, capital accumulation accounted for more than half of average real growth. The second aspect that pushed the renminbi towards the SDR was its the active role played by the Chinese government and central bank to promote the internationalization of its currency.

Historically, no other currency has been pushed so actively by its authorities as a means of global exchange.

In pursuit of more open financial markets, the Chinese authorities had taken several steps to encourage greater participation in the country's foreign exchange bond, and equity markets.

China's Initiatives to be part in the SDR Basket:

Initiatives for public sector investors:

China entered into several swap agreements before the internationalization of the renminbi was put on the agenda. In

November 2000, after the Asian crisis, the ASEAN central banks agreed to set up bilateral swap agreements under the Chiang Mai Initiative, with the main aim of providing liquidity for short-term

payment needs. Since 2009, the PBoC has actively pursued an expansion of bilateral swap agreements with central banks overseas (not only in the ASEAN region) with a view to increasing the use of the renminbi internationally. These investments have several restrictions, but there is no minimum holding period.

On 2015, the PBoC announced that foreign central banks, sovereign wealth funds and international financial institutions could access the onshore interbank markets for bond, repo, IRS, and other permitted products after registering with the PBoC. Investors were also free to decide how much they want to invest. This would likely help broaden market access and improve participation onshore, marking another step toward capital account convertibility.

This means that public sector investors can access the interbank FX market through three channels, namely (i) using the PBoC itself as their agent, or (ii) by using interbank FX market members as their agent(s), or (iii) directly participating in the interbank FX market as foreign members.

Initiatives for private sector investors:

The PBoC was announced the opening of the onshore interbank bond market to foreign institutional investors. Qualified institutional investors were defined as financial institutions such as commercial banks, insurance companies, securities companies, fund and asset

managers (and investment products issued by them), as well as pension funds and charity funds that:

- (i) are incorporated outside China and in compliance with relevant regional laws;
- (ii) have not been subject to major penalties related to bond investments in the past three years; and
- (iii) have appropriate risk management controls.

These medium- and long-term investors on the interbank bond market will no longer be subject to quota limits, and the PBoC will supervise investment activity via macroprudential measures. Based on the foregoing, it is clear that the Chinese authorities had chosen to open their financial markets gradually, initially encouraging public sector investors to gain access and then letting the private sector in.

The greater number of measures undertaken during the last two years is likely to be related to the renminbi's imminent entry into the SDR and more such steps can be expected.

USE OF THE SDR FOLLOWING THE 2021 AND 2009 ALLOCATIONS:

The main grounds made by the US Congress to oppose the 2021

allocation were that:

(a) many countries would receive allocations that they didn't need and wouldn't use because of both it would advance those nations' degree of development and

(b) it would help those that the US dislikes, like Belarus, China, Iran, Russia, Syria, and Venezuela. In other words, SDR would be distributed to nations that deserved them or did not need them. Even if their governments gave the proposed allotment its approval before the United States, some of these worries were also voiced in other nations.

Only 13% of low-income IMF members' new allocations had been used as of December 31, 2021. Among those nations, only four have utilized more than half of their fresh holdings. 24 other members, including 10 more, had done the same at the same time. 13 upper-middle-income nations, one high-income nation, and 12 lower-middle-income nations. Upper-middle-income countries have accessed a bigger portion of their newly acquired SDRs collectively than did lower-middle-income countries. On the other hand, compared to the two groupings of middle-income nations, low-income countries as a whole utilized more of their combined

additional allocation.

Focusing on the nations that might be qualified for IDA grants or mixed loans does not change the narrative.

HOW CAN INDIA BE THE PART OF THE BASKET OF CURRENCY:

There are two criteria for country to be part of the SDR Basket of currencies:

- 1.) Export
- 2.) Freely usable currency.

Currencies included in the SDRs basket must meet above criterion. A currency fulfills the export criterion if its issuer is a member of the IMF or it represents a monetary union including members of IMF (example: Eurozone) & it is also one of top five global exporters. A freely usable currency must be widely used in international transactions and widely traded on major exchange markets.

India is one of the leading emerging markets in the world and has built up huge reserves more than that of countries currently in the SDR Basket, namely, Germany, France, and the UK.

India's record of its exchange rate management has been quite clean and its reserves and exports have been quite well.

India has also been moving in the direction of full capital convertibility since the last ten years.

India appears to be on the path of de-internationalization of the

Indian rupee (INR). Of the two countries which had adopted the INR as

legal tender, Nepal and Bhutan, one had to ban the use of notes above Rs 100 as legal tender. Considering the demand from people engaged in the trade and tourism links between the two countries, Nepal has now requested the Reserve Bank of India (RBI) to allow the use of higher denomination rupee notes in Nepal.

Eighty per cent of the world's trade takes place in dollars. The dollar as the currency of trade, store of value and central bank reserves all over the world offers many advantages to the US. The US does not have to worry about current account deficits. It does not need to worry about foreign currency exposure, or the change in the exchange rate hitting trade and debt. The US even threatens to use its power from use of the dollar internationally to impose sanctions on currencies such as Iran.

Countries like those in Europe, which have a lot of active trade in the region, saw the advantages of having a common currency with their trading partners and created the Euro.

India should focus more on increasing its exports and decreasing the inflation rate to be the part of SDR basket. According to the data released by the Ministry of Commerce, India's merchandise exports rose by 2.14% in July 2022. The export in July 2022 stood at \$36.27

billion as compared to the exports of \$35.51 billion in July 2021. India can achieve this amid continuous supply disruptions due to COVID-19 and Russia-Ukraine war.

Industries like tobacco, petroleum products, leather, electronic goods, coffee, etc. witnessed growth.

FUTURE OF INDIA'S EXPORTS

Government is aiming to enhance its domestic competitiveness to nurture exports initiatives. Various are taken by the Government like PLI, RoDTEP, PM GatiShakti, etc. to boost our domestic manufacturing of products.

To gain greater access to international markets India is negotiating various trade deals with economies like UK, UAE, Canada, Australia, etc.

The future of India's exports looks bright with the continuous efforts of the Government to develop the overall trade ecosystem and to be the part of SDR basket of currency.

Among forex reserves:

- ◆ Foreign-currency assets, at \$508.22B, are the largest component,
- ◆ Followed by the gold holding of \$39.64B.
- ◆ Special drawing rights (SDR) of \$17.98B, and
- ◆ The Reserve tranche position with the IMF of \$4.9B comprises the rest.

How to make Indian Currency Freely Usable Currency:

On 11th of July 2022, Reserve Bank Of India made a very-very bold announcement whereby domestic traders could settle their imports

and exports with Indian rupees and this move of taking INR global is a very-very big deal because it is said well help India to do trade directly with Russia without depending on the American Banks so on one side this could push up into new horizons of world trade with Russian-Iran and Venezuela on the other this move would actually destroy with both US and Europe. So, this not just the major move from the economic standpoint but also geo-political standpoint.

The following will occur if INR becomes SDR:

- 1.) Prices for imports will decrease.
- 2.) A decrease in transactional expenses. (As of today, in order to trade, we must get our money translated into any SDR.)
- 3.) A significant quantity of confidence will be gained, making India more tradable with other countries (easily).
- 4.) We can settle international debts using your home currency (again interests will be lower).
- 5.) Bonds in INR.
- 6.) The value of the national currency will increase globally.

The 2021 SDR Allocation:

In response to the epidemic, the IMF granted to its members in August 2021 the equivalent of USD 650 billion in SDRs in order to "address the long-term global requirement... [and] enhance current reserve assets," in accordance with Article XVIII of the IMF's charter. The fact that this allocation surpassed all prior allocations and was more than twice as many SDRs as were previously in circulation was a sign that the international community needed to give weaker nations a "shot in the arm" (Mrs. Georgieva).

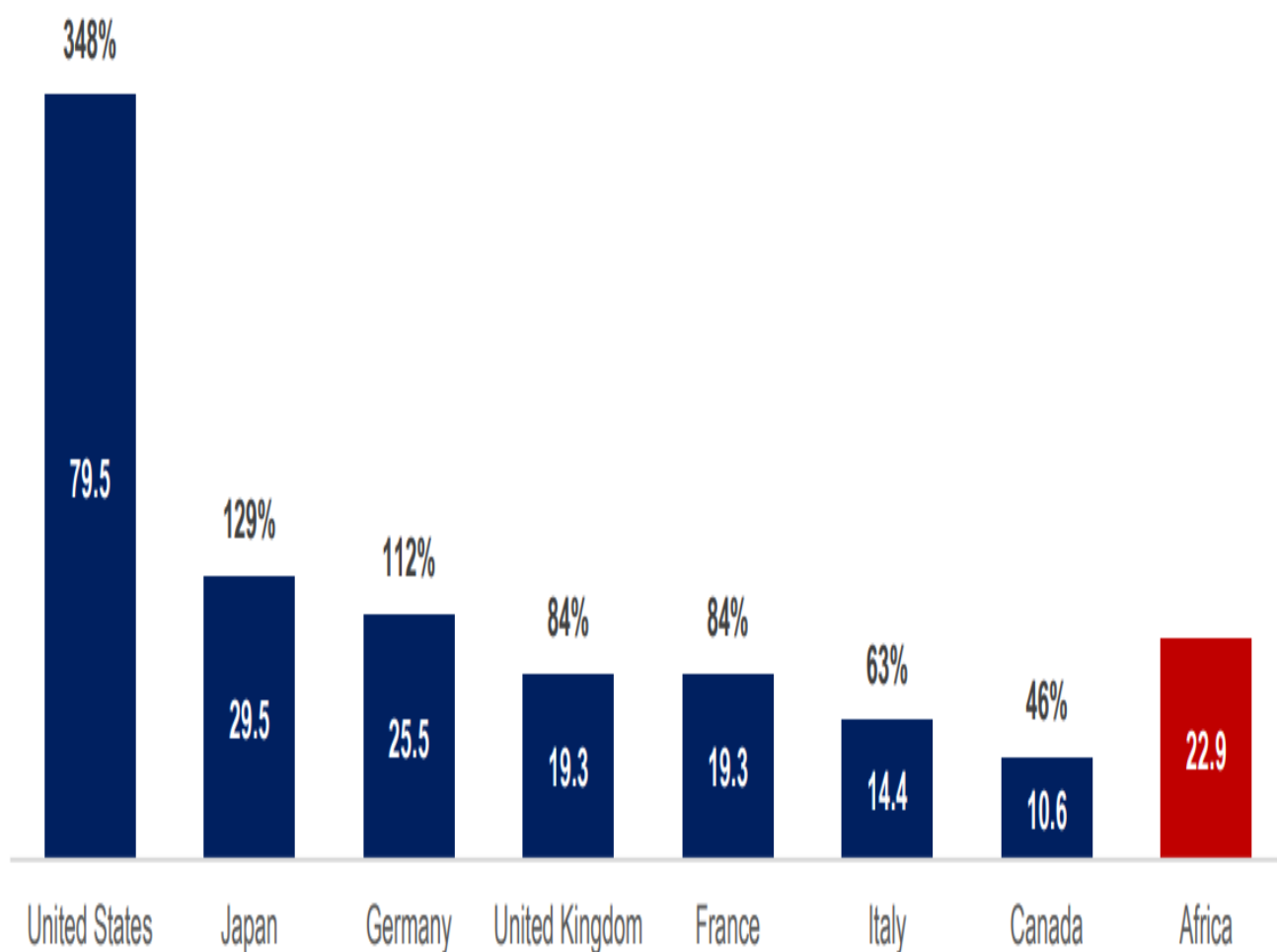
SDRs are distributed using a mechanism based on the Member quota formula that prioritises GDP when the case is made to issue them (at an 85% majority of the membership).

SDRs are distributed using a mechanism based on the Member quota formula that prioritises GDP when the case is made to issue them (at an 85% majority of the membership). As a result, those nations who don't require SDRs for balance of payments reasons get a lot of

money, while those nations that frequently need them don't.

SDRs are not given nearly enough. The allocation for 2021 was no exception: for example, the G7 countries received over nine times as much as all of Africa combined.

Chart 1 – General allocation received in August 2021 (in SDR bn and in % of Africa's total allocation)



Source: authors, IMF

In a global economy where there is more international liquidity than ever before, the need to "supplement existing reserve assets" is less

pressing. Levels of high-quality debts denominated in USD or EUR, for example, have never been higher, thanks to a rise in total government debt. Consequently, FX reserves.

The central banks of a number of emerging market economies as well as advanced market economies oversee assets worth several US trillions.

In light of the elevated inflation risks, it follows that the August SDR allocation was motivated by both more specialized and localized needs as well as a global need to augment reserve assets and generate liquidity. Such demands are frequently present in low-income economies live with severe balance of payments restrictions and require substantial investment to address economic, social, and environmental issues. The revised allocation has two additional goals in this regard, in addition to providing more reserve assets to nations with a precarious balance of payments:

- 1.) Assist nations in easing financial restrictions during COVID outbreaks, such as when buying vaccines; the IMF administration has been very clear that this would be a proper use of SDRs.
- 2.) Assist nations with the digital transition and climate concerns,

which are potentially longer-term goals than meeting the needs of the balance of payments.

The goal 1- raises a number of relevant practical concerns. As mentioned above, SDRs are typically recorded at the central bank in most nations. The government must therefore get an advance from its central bank in order to use SDRs (or rather, USD or EUR acquired in exchange for SDRs) for budgetary purposes rises in the national public debt. This reflects the fact that SDRs are not distributed by the IMF and that the SDR Department is consequently liable.

Goal 2- calls for a certain amount of maturity transformation, or the conversion of a liquid asset into a longer-term investment. SDRs must be permitted to be utilized in ways other than being kept in the balance.

IMF's on-lending mechanisms:

1. The existing Poverty Reduction and Growth Trust (PRGT): The Poverty Reduction and Growth Trust is the on-lending mechanism used by the IMF through which SDRs have already been redirected (PRGT). Despite how appealing it may seem from a practical standpoint (the PRGT already exists, therefore no new institutional arrangements are required), this alternative is not the best. The PRGT-recycling has two limitations: first, PRGT funding is contingent upon negotiated IMF programmes mixed with conditions. The orders of

magnitude also don't match. PRGT payments were made in the unusual sum of SDR 4 billion in 2020 and 2021. Rapid credit financing (RCF), an IMF emergency assistance line that is widely accessible during times of financial crisis, was quickly and effectively deployed, which is what caused the increase. The IMF anticipates a stabilization of the payout level at SDR in 2022 and future years.

2. The forthcoming Resilience and Sustainability Trust (RST):

The Resilience and Sustainability Trust was the alternative mechanism that the IMF proposed be established to serve nations who were ineligible for PRGT finance (RST). The RST's announced final fundraising goal is over \$50 billion, with an initial target of around \$30 billion. Compared to conventional IMF macroeconomic support, the RST is anticipated to offer longer-term financing. The RST would support specific policy goals like the battle against climate change, and RST funds would be used to purchase vaccines, the IMF Managing Director repeatedly stated. Other voices (Eichengreen, 2021) have proposed for the creation of a special fund that would be operationalized around conditions that are simple to monitor and defined around explicit uses of proceeds (such as health, ESG3, green).

**Table 1 - 2021 SDR General allocation breakdown by income level and exchange rate regime
(in USDm)⁴**

	High-income	Upper middle- income	Lower middle- income	Low-income
Floating	391,161.9	71,607.2	31,393.0	1,328.6
%	62%	11%	5%	0%
Non-floating	33,590.1	61,868.2	32,177.4	7,234.9
%	5%	10%	5%	1%

Source: authors, IMF

For those nations (or monetary zones) that issue an international reserve currency—a currency that is used by others as a unit of account, a means of payment, and a store of value—the position is particularly peculiar.

These nations don't need to amass additional reserves to deal with balance of payments difficulties either because they have little trouble issuing debt in their own currency, or because boosting interest rates has much more of an impact on market pressure than

purchasing one's own currency on the FX market.

There are two groupings among those nations or zones (the United States, the United Kingdom, Japan, Switzerland, and the Eurozone):

- The United States, which at year's end 2020 had "only" USD equivalent of 134 billion in reserves, received USD.
- the others, who have accumulated Reserve Assets primarily to prevent currency appreciation (Japan at USD 1,344 billion before receiving USD 41 billion more; Switzerland at USD 1,020 billion before receiving USD 8 billion more); and/or merely to provide revenues (UK at USD 161 billion before receiving USD 27 billion; Germany at USD 64 billion before receiving USD 36 billion; France at USD 76 billion before receiving USD 27 billion).

Therefore, the SDR distribution provided many high-income countries' needs while low-income countries received very little.

COMPARISON WITH THE 2009 SDR ALLOCATION:

It is important to think about whether the usage pattern of the SDR allocation for 2021 was similar to the usage trend that followed the SDR allocation in response to the global financial crisis of 2007–2009.

The IMF distributed SDR 182.7 billion in two instalments in August and September 2009: a general allocation of SDR 161.2 billion based on IMF quota shares at the time and a special allocation of SDR 43.2 billion.

Conclusion:

In order to create a more secure and fair international monetary system, this paper makes the case that the political and technical challenges of establishing an SDR-based reserve system and a fully SDR-funded IMF can be solved. In this approach, the IMF would distribute SDRs countercyclically and treat them as country deposits that could be used as collateral for financing. Even though SDRs are limited to acting as a form of payment solely among central banks and not private agents, this would still be true. Changing this system's structure would be beneficial in addressing some of the fundamental flaws in the existing international monetary system. This change would be advantageous for developing nations in particular because they would share in the seigniorage. Although the distribution of SDRs has been a potent symbol of global unity, developing nations

that require more aid and liquidity are now underrepresented in this distribution. Therefore, it is essential to redirect SDRs from nations that do not require them to those that do. To achieve this, it is necessary to enlarge two fundamental aspects of SDRs: the closed system in which they circulate and the historically constrained understanding of their status as reserve assets. The best method to use the extra SDRs is to invest them in MDBs that can: (i) fund long-term projects related to the climate transition and other areas; (ii) leverage their balance sheets (if prudently); and (iii) go through maturity transformation.

The expenses of a substitution account, which are deficiency payments that can result from a drop in US interest rates, an increase in SDR interest rates, or a devaluation of the US currency, are one of the most significant technical challenges in the transition to an SDR-based reserve system. The United States refused to accept responsibility during the 1970s negotiations to retain the dollar value of.

The negotiations came to a halt due to the account's SDR-denominated assets. Two components of the substitution account

should be considered if one wants to avoid a similar outcome in the future. First, historical simulations show that the substitution account alternates between periods of surplus and deficit in terms of dollars, and the deficit payments only occur when the substitution account is in deficit.

Second, in the absence of a counterpart account, various cost-sharing mechanisms could be created, including (i) splitting the cost (the total of deficiency payments) between the United States and the IMF because the latter can use its gold or dollar holdings; and (ii) dividing the costs among depositor countries proportionate to their level of economic development shares of dollar deposits in the account so that larger depositors pay a higher cost; (iii) having the IMF collect an annual fee of 1% of the dollar reserves deposited in the account so that depositors pay for the costs and create a fund to invest these fees in US government securities; and (iv) altering the previous option so that this fund and the US share the cost in some way.

The historical simulations show that, even in the worst-case scenario, when all downside risks materialize, the expenses of preserving the solvency of the substitution account would be insignificant and even

considerably smaller in 2008, at 0.2% of total US foreign assets and 0.3% of US GDP. If there is a cost-sharing system in which, depending on the arrangement, the US pays half or less of the cost.

There were four points that might be used to summarise additional technical inquiries. First off, will the new SDR allotments result in inflation? No, provided they are not created during periods of high global demand and inflationary worries, and provided that the central banks sterilise any unauthorized money production. Second, might should other currencies be incorporated into the SDR basket in order to more accurately reflect the composition of global output and reduce SDR value volatility? The renminbi, which is issued by one of the largest exporters and is freely useable for payments, trade settlement, and some FDI investments as long as the central bank ensures its convertibility in official transactions, is the currency that successfully meets the IMF's criteria.

Third, how would bonds denominated in SDRs fit into this reform agenda? These bonds provide developing nations a number of benefits by serving as both a replacement for other important short-term assets and a tool for advancing IMF quota revisions. The SDR

denominated bonds may substitute for if they attract sufficient market depth and liquidity with the help of private investors, other global assets may follow. Fourth, does the lack of private markets pose a challenge for the use of SDRs as a central bank asset for reserve building or for market intervention? The answer is no since the SDR is a medium of exchange as long as central banks continue to swap SDRs for convertible currencies.

References:

Eichengreen, Barry (2009) "The Dollar Dilemma: The World's Top Currency Faces Competition" *Foreign Affairs*, September/October.

Greenwald, Bruce and Joseph Stiglitz (2008) "A Modest Proposal for International Monetary Reform" presented at the International Economic Association Meeting, Istanbul.

Griffith-Jones, Stephany and José A. Ocampo (2011) "Innovative Sources of Financing" Initiative for Policy Dialogue, Columbia University.

Ikawa, Motomichi (2009) "Reform of the International Monetary System Based on Special Drawing Rights and its Implications for Asia" *Pacific Economic Review*, 14: 5 pp. 668–681.

International Monetary Fund (2010) "Reserve Accumulation and International Monetary Stability" Prepared by the Strategy, Policy and Review Department.

Padoa-Schioppa, Tommaso (2011). The ghost of bancor: The economic crisis and global monetary disorder.

In Jack T. Boorman and André Icard, eds. Reform of the International Monetary System: The Palais Royal Initiative, New Delhi: SAGE Publications, chapter 6. Polak, Jacques J. (1979), "Thoughts on an International Monetary Fund based fully on SDR", Pamphlet Series No. 28, International Monetary Fund, Washington, DC. Prasad, Eswar (2009) "IMF Bonds: Details and Implications" The Brookings Institution.

Rodrik, D. (2006) 'The social cost of foreign exchange reserves', International Economic Journal, Korean International Economic Association, 20(3), pp 253-266

Rodrik, Dani (2007) "The Real Exchange Rate and Economic Growth: Theory and Evidence" John F. Kennedy School of Government Harvard University.

IMF (International Monetary Fund). 2009a. Allocation of Special

Drawing Rights for the Ninth Basic Period: Draft Executive Board Decision and Managing Director Report to the Board of Governors (July 16). Washington: International Monetary Fund.

IMF (International Monetary Fund). 2009b. Proposal for a General Allocation of SDR (June 9). Washington: International Monetary Fund.

IMF (International Monetary Fund). 2011a. Enhancing International Monetary Stability: A Role for the SDR? (January 7). Washington: International Monetary Fund. IMF (International Monetary Fund). 2011b.

IMF Board Concludes the Meeting on Enhancing International Monetary Stability: A Role for the SDR? Public Information Notice February 10. Washington: International Monetary Fund.

IMF (International Monetary Fund). 2011c. Report of the Acting Managing Director to the Board of Governors and to the Executive Board Pursuant to Article XVIII, Section 4(c).

MF (International Monetary Fund). 2018. Considerations on the Role of the SDR (March 6). Washington: International Monetary Fund.

IMF (International Monetary Fund). 2020. 2020 Quota Data Update.

IMF Policy Paper (October 23). Washington: International Monetary Fund.

IMF (International Monetary Fund). 2021a. Proposal for a General Allocation of Special Drawing Rights (May 27). Washington:

International Monetary Fund. IMF (International Monetary Fund).

2021b. World Currency Composition of Official Foreign Exchange

Reserves (June 30). Washington: International Monetary Fund.

IMF (International Monetary Fund). 2021c. World Economic Outlook Update: Fault Lines Widen in the Global Recovery (July).

Washington: International Monetary Fund. Lazard. 2022. Rechanneling SDRs in a Responsible and Efficient Way.