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IMF's

Special Drawing Rights

Definition and relation to foreign exchange reserves

INFOPRO

IMF's Special Drawing Rights

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The International Monetary Fund (IMF) has approved the distribution of a new package of Special Drawing Rights (SDRs) amounting to SDR458 billion to all its member countries. Each country willing to participate has been allocated approximately its relative share in the quota system. The local media published the good news, and how the amount allocated to Lebanon, (estimated at SDR 605 million (equivalent to approximately $860 million), would be spent. It neglected to mention previous cumulative distributions in favor of Lebanon, which amounted to SDR196 million, to bring the total to SDR 801 million ($1.137 billion). It is premature to speculate how these sums will be spent. It is necessary to explain the modus operandi of the IMF and the role of Lebanon as an IMF member, in order to clarify the picture and the impact of this distribution.

The IMF was established in 1944 by 44 countries. Lebanon joined in 1947. It currently includes 190 member countries. The main objective of its establishment was to create an institution that fosters international economic cooperation, develops international trade and growth, and maintains the stability of the global financial system. To achieve this, the Fund monitors economic and financial developments and the balance of payments of member countries. It provides the necessary advice to countries facing economic troubles and shortage of hard currency reserves. It also provides foreign currency reserve financing to central banks that face repeated balance of payments deficits and a severe and critical decline in their reserves that could hamper its trade in goods and services.

The IMF consists of two main departments: the General Resources Department and the Special Drawing Rights Department. The fund is managed by a Board of Governors representing all member states. The operational management, one of the tasks of the Executive Board, consists of 24 executive directors. In addition to that, all the IMF's accounts are calculated on the Special Drawing Right (the IMF's unit of account). It consists of a basket of five major currencies ($0.58, €0.387, £0.0859, ¥11.9 and 1.017Chinese renminbi), the currency shares reflect the quota of each of these countries and the European Union. A distinction must be made between the Special Drawing Rights Department, and the SDR unit as a unit of account only.

The Special Drawing Rights Department is independent of the General Resources Department. It was established in 1969 with the aim of providing additional voluntary reserves for member states. The Fund distributes Special Drawing Rights as needed, free of charge, to stimulate international trade, and it is entitled to cancel these rights. Each country receives a share of each distribution as a percentage of its quota in the Fund. The total distributions of special drawing rights carried out in several stages amounted to SDR662 billion, including the last distribution of SDR458 billion. The distribution is recorded in each country’s account at the IMF as both credit and debit entries. So on a net basis, the distribution does not provide additional reserves.

The country must pay interest cost on the quantities of SDRs it uses, and abide by Article 19 of the IMF Agreement, which clarifies the terms and conditions of swapping the SDRs with reserve currencies. The most important of these is the third clause, which requires the country to show the need to use the special drawing rights to finance the balance of payments, and not to subsidize goods that are within the scope of the Ministry of Finance. Holding SDRs is considered as a potential reserve and not as an actual foreign currency reserve, as the SDRs are not used directly in external financing until they are exchanged for reserve currencies according to the country’s ability to comply with all the terms of the Voluntary Exchange Arrangement, set up by the IMF as a platform to facilitate exchange of SDRs with other currencies.. Also, members participating in the Special Drawing Rights Department are not obligated to respond to any transaction related to the use of SDRs. Most SDR transactions in the Special Drawing Rights Department are currently, conducted under the supervision of the IMF as an intermediary through the platform of Voluntary Exchange Arrangement.

Since the Central Bank of Lebanon (BDL) had not previously resorted to using the SDR department, it may investigate the details of its modus operandi to determine its ability to replace SDRs with currency reserves. We must be reminded that resorting to this department depletes the country's holdings of special drawing rights and requires its service according to the prevailing interest rate on SDRs. Use of SDRs have a cost, and in no way it should be perceived as a grant.

On the hand, the IMF obtains its resources in the General Resources Department, which was established at its inception to help countries facing shortages in their reserves, from subscriptions of member country to the IMF capital, which is based on a quota system that reflects the size of each member country such as the size of its GDP, foreign trade, and reserves. The quota is managed by the General Resources Department. Therefore, each country was allocated a specific quota in the IMF's capital. Lebanon's share in the General Resources Department is only 633.5 million SDR units (0.1%) out of the total quota of 477 billion SDR units.

The quotas consist of the reserve quota, which is 25 percent of the quota paid in hard reserve currency, while the remainder is paid in a countrys' local currency. Therefore, Lebanon's share of unconditional ready-to-use reserves in the IMF is only SDR158 million ($224 million) , with the exception of expressing the need to finance its balance of payments. The country can use other IMF facilities as needed and during a specified period within a maximum withdrawal limit ranging between 50 percent and 145 percent of the quota annually, taking into account the country's ability to serve its debt obligation resulting from such borrowing and ability to adhere to a reform program. As a maximum, a country could access about 400 percent of the quota if it undertakes a serious reform, while continually meeting the performance indicators of the reform programs agreed upon with the IMF. The repayment of these facilities would usually start within a few years. The crucial issue is to determine the need for these funds and the capacity of the country to service such debt which will become due within a short period of time.

Resorting to the General Resources Department in excess of the reserve quota requires several reforms, the most important of which, in the case of Lebanon, is seeking to achieve sustainable fiscal and balance of payments balance. What contributes to achieving these two goals includes: liberalizing the exchange rate, implementing fiscal reforms to reduce the deficit, and targeting the reduction of the deficit in the current account of the balance of payments, with the exception of private transfers, which should not exceed those transfers. Borrowing from abroad without reform may once again lead to a potential default on its foreign currency debt service , which has been the main cause of the current crisis.