

# Special Drawing Rights

[UPSC Notes]

## What is Special Drawing Rights(SDR)?

Special Drawing Rights or SDR is an arrangement of the International Monetary Fund, which is the currency of the International Monetary Fund too. It was introduced in 1969 to increase the global liquid.

SDR Currency is also known as paper gold, synthetic currency, International reserve currency, and Quasi-currency. When a country joins International Monetary Fund, it is assigned an initial quota that depends on the following quota formula of weighted average-

- GDP- 50%
- Openness-30%
- Economic Variability-15%
- International Reserve -5%

## What is an International Monetary Fund?

The International Monetary Fund was established on 27 December 1945 under the Bretton Woods Agreement, with headquarters in Washington, DC.

- The International Monetary Fund works to foster global monetary cooperation, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.
- Some objectives of the International Monetary Fund are:
- To stabilize the exchange rate in the world.
- To suggest member nations take corrective steps for economic development.
- Providing financial assistance to the member nation to make the Balance of Trade and Balance of Payment favorable.
- There are 189 members of the IMF and the last member was Nauru- an African country.

## Purpose of Special Drawing Rights

The purpose of Special Drawing Rights is to utilize the Special Drawing Rights as a supplementary foreign currency reserve is the primary objective of introducing the SDRs.

- To fix the exchange rate regime under Bretton Woods, the SDR was created.
- The SDR was replaced by a basket of major currencies after the collapse of this system in 1973.

- As a complement to foreign currency reserves, SDRs (Special Drawing Rights) have continued to serve their initial role, albeit to a lesser extent, since 1973.
- To Serve as a unit of account for the International Monetary Fund(IMFs), internal accounting is one of the primary functions of the Special Drawing Rights.
- By holding this basket of currencies, the IMF can regulate the exchange rate volatility of any particular currency.
- In order to improve transparency, countries have also linked their currencies to the Special Drawing Rights.

## Special Drawing Rights Value

To determine Special Drawing Rights, a basket of currencies is used by the International Monetary Fund, and as per its prominence in International trade and the respective nation's foreign exchange reserves- the weightage given to those basket of currencies varies.

The weightage of currencies is as follows:

1. British Pound – 8.09%
2. Japanese Yen – 8.33%
3. Chinese Yuan – Around 11%
4. Euro – Around 31%
5. US Dollar – Around 41.73%

## Quotas in SDR

Quotas are denominated in Special Drawing Rights(SDR). The quota of the International Monetary Fund is revised every five years. Although it may constitute a claim on IMF member, freely usable currencies, it is neither a currency nor a claim on the IMF.

- India is the eighth largest quota holder in the International Monetary Fund. India has a 2.80 percent quota in the International Monetary Fund(IMF).
- To calculate the Special Drawing Rights, 5 currencies are used by the International Monetary Fund- the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling.

## SDR used by the International Organizations

As a unit of account, some major International Organizations use XDR (currency code of the Special Drawing Rights) as follows:

1. International Fund for Agricultural Development
2. Asian Development Bank (ADB)
3. Bank of International Settlements –by replacing Franc, started using XDR in 2003.
4. Islamic Development Bank

5. African Development Bank
6. Japan External Trade Organization (JETRO)

## Special Drawing Rights During COVID-19

The general allocation of new Special Drawing Rights by the International Monetary Fund is not supported by the Finance Minister of India because, due to the Covid 19, it might not be effective in easing the financial pressure.

- A new foreign exchange reserve without any conditions will be provided to all 189 members by the new Special Drawing Rights allocation.
- The finance minister was concerned that if the countries used the funds for irrelevant purposes then such a major liquidity injection could produce potentially costly side effects.

By ignoring India's resistance may be the fresh Special Drawing Rights to member countries issued by the International Monetary Fund, which further will help poor countries to fight the economic fallout due to the outbreak of Coronavirus.

In a potential boost for lending to poor countries recently, G20 major economies have agreed to raise the International Monetary Fund reserve with a new allocation of funds for their own SDR Currency.

## Significance of the General SDR Allocation 2021

To complement current reserve assets to assist in meeting a long-term global requirement is a clear benefit of a broader allocation of Special Drawing Rights which further increases buffers and strengthens the international economic resilience.

- Assisting in the stabilization of weak nations through the Special Drawing Rights allocation will help in improving the International Monetary system's stability and alleviate the risks of economic and social fragility.
- To foster trust and promote a sustained and economically resilient global recovery, the long-term global demand for reserves is satisfied by the gender allocation of Special Drawing Rights enacted on August 23, 2021.
- All the member nations benefited from this as it assisted developing markets and low-income countries after the crisis of Covid-Pandemic.
- Accelerate worldwide cooperation in the face of the Covid 19 pandemic.

## Use of Special Drawing Rights

The Special Drawing Rights (SDR) department serves as the conduit for all Special Drawing Rights (SDR) transactions and activities and also keeps track of the allocations of a Special Drawing Right to members.

- As a part of their Foreign Exchange Reserves, members can keep their SDR allocations, or they can also sell or utilize it.
- To activate the designation plan, the Special Drawing Rights market has been operated voluntarily with no obligation since 1987.

- Special Drawing Rights can also be used in loan interest payment and repayment or payment for quota increases by the members of the International Monetary Fund.

## Challenges of Reallocating Special Drawing Rights

Some challenges associated with reallocating Special Drawing Rights are as follows:

- They can't be used to buy anything as they aren't money in the usual sense
- To the strategy proposed by the International Monetary Fund and high-income economies for the Special Drawing Rights (SDR) channeling, there has been widespread and outspoken opposition.
- Minimize the exchange rate volatility among the major reserve currencies due to the more global reserves denominated in Special Drawing Rights.

