reserve asset created by the IMF in 1969 and allocated to its members to supplement existing reserve assets. The IMF has allocated a total of SDR 21.4 billion since 1970. IMF member countries—all of which are participants in the SDR Department—are the largest holders of SDRs. They may use SDRs in operations and transactions among themselves, with 15 “prescribed institutional holders,” and with the IMF itself. The balance of SDRs is held in the IMF’s General Resources Account and by the prescribed holders, which do not receive SDR allocations but can acquire and use SDRs in operations and transactions under the same terms and conditions as participants.

The SDR is the unit of account for IMF operations and transactions. It is also used as a unit of account, or the basis for a unit of account, by a number of other international and regional organizations and international conventions and has been used to denominate private financial instruments. As of April 30, 1999, the currencies of four member countries were pegged to the SDR.

The value of the SDR—determined daily on the basis of a basket of currencies—tends to be more stable than that of any single currency in the basket. Movements in the exchange rate of any one component currency will tend to be partly or fully offset by movements in the exchange rates of the other currencies.

The composition of the basket is reviewed every five years to ensure that the currencies included in it are representative of those used in international transactions and that the weights assigned to the currencies reflect their relative importance in the world’s trading and financial systems. Since 1981, the currencies of five countries—France, Germany, Japan, the United Kingdom, and the United States—have been included in the basket because successive reviews have determined that these are the five countries with the largest exports of goods and services. The reviews also specify the initial weights of the currencies in the basket, reflecting their relative importance in international trade and reserves as measured by the value of exports of goods and services of the countries issuing them and the balances of the currencies held as reserves by members of the IMF.

With the introduction of the euro on January 1, 1999, the currency amounts of the deutsche mark and the French franc in the SDR basket were replaced with equivalent amounts of euros, based on the fixed conversion rates between the euro and the deutsche mark and the French franc announced by the European Council on December 31, 1998.

The SDR interest rate, which is adjusted weekly, is a weighted average of interest rates on selected short-term instruments in the five countries whose currencies are included in the valuation basket. Since January 1, 1991, these rates and instruments have been the market yield on three-month treasury bills for France, the United Kingdom, and the United States; the three-month interbank deposit rate for Germany; and the

Developments

Total overdue financial obligations to the IMF increased slightly in 1998/99, to SDR 2.30 billion from SDR 2.26 billion in 1997/98, with the number of countries in protracted arrears remaining at seven. As of August 31, 1999, four countries were subject to declarations of ineligibility to use the IMF’s general resources; declarations of noncooperation remained in effect for two of them; two had their voting and related rights in the IMF suspended; and for one, there was an outstanding complaint with respect to compulsory withdrawal from the IMF. Following its annual review of the arrears strategy in March 1999, the Board decided to extend again the deadline for entry into a rights-accumulation program until the spring 2000 meeting of the Interim Committee.
three-month rate on certificates of deposit for Japan. These rates and instruments were not changed with the introduction of the euro on January 1, 1999, but the French and German instruments have since been expressed in euros.

The next revision of the SDR valuation and interest rate baskets will take place no later than 2000, with any changes to take effect on January 1, 2001.

**SDR allocations**

One of the IMF’s principal goals is to facilitate the expansion and balanced growth of international trade, which requires adequate levels of reserves. If the IMF identifies a long-term global need for reserves, it can supplement existing assets through an SDR allocation, whose size and timing are determined by the Board of Governors. The IMF has the authority to create unconditional liquidity by allocating SDRs to all member countries in proportion to their quotas. The most recent allocation was on January 1, 1981, when SDR 4.1 billion was allocated to the IMF’s then 141 member countries.

More than one-fifth of the IMF’s 182 member countries have never received an SDR allocation because they joined the IMF after 1981. In addition, other members have not participated in every allocation. To ensure that all participants in the SDR Department receive an equitable share of cumulative SDR allocations and following a broad review of the role and functions of the SDR in the light of changes in the world financial system, the Board of Governors adopted a resolution in September 1997 proposing a Fourth Amendment to the IMF’s Articles of Agreement.

If approved by the membership, the amendment would provide for a special onetime allocation of SDR 21.4 billion, which would double the current level of cumulative SDR allocations and raise all participants’ ratios of cumulative SDR allocations to quota under the Ninth General Review of Quotas to a common benchmark ratio of about 29.32 percent. The proposed amendment, which will become effective when approved by three-fifths of the members having 85 percent of the total voting power, also provides for future participants to receive a special allocation following the date of their participation or the effective date of the Fourth Amendment, whichever is later. It will not affect the IMF’s existing power to allocate SDRs based on a finding of a long-term global need to supplement reserves as and when that need arises.

**SDR operations and transactions**

IMF members may use SDRs in a variety of voluntary transfers, including in transactions “by agreement,” in which SDRs are exchanged for currencies. Transactions by agreement increased to SDR 13.8 billion in 1998/99 from SDR 8.6 billion in 1997/98. In addition, SDRs may be used in certain other operations: in forward purchases and sales and in swaps, to settle financial obligations, to make loans and donations, and as security for the performance of financial obligations.

Transactions in SDRs are facilitated by arrangements between the IMF and 12 members that are prepared to buy or sell SDRs for one or more freely usable currencies as long as their SDR holdings remain within certain limits. These “two-way” arrangements have helped ensure the liquidity of the SDR system. The volume of SDR transactions rose to a record SDR 49 billion in 1998/99, boosted primarily by flows associated with the quota increase under the Eleventh General Review.

Members also use SDRs in discharging their financial obligations to the IMF in the General Resources Account. These obligations mainly take the form of charges levied on members’ use of IMF resources, repurchases (repayments), and quota subscriptions. The IMF transfers SDRs from the General Resources Account to members, primarily for purchases (drawings); remuneration on members’ creditor positions; and repayments of, and interest payments on, IMF borrowing. In addition, SDRs may be used in operations under the Enhanced Structural Adjustment Facility; these operations require the intermediation of prescribed holders because the IMF’s Special Disbursement Account and administered accounts may not hold SDRs directly.

The IMF’s Articles of Agreement provide for a designation mechanism, under which the IMF designates members with strong balance of payments and gross reserve positions to provide freely usable currencies to members with a balance of payments need in exchange for SDRs. No transactions with designation have taken place since September 1987 because it has been possible to accommodate all desired exchanges of SDRs for currencies through transactions by agreement.

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**SDR valuation on August 31, 1999**

<table>
<thead>
<tr>
<th>Currency</th>
<th>Currency amount</th>
<th>Exchange rate on August 31</th>
<th>U.S. dollar equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro (Germany)</td>
<td>0.2280</td>
<td>1.05450</td>
<td>0.240426</td>
</tr>
<tr>
<td>Euro (France)</td>
<td>0.1239</td>
<td>1.05450</td>
<td>0.130653</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>27.2000</td>
<td>109.55000</td>
<td>0.248288</td>
</tr>
<tr>
<td>Pound sterling</td>
<td>0.1050</td>
<td>1.60370</td>
<td>0.168389</td>
</tr>
<tr>
<td>U.S. dollar</td>
<td>0.5821</td>
<td>1.00000</td>
<td>0.582100</td>
</tr>
</tbody>
</table>

Total 1.369856

1The currency components of the SDR basket.
2Exchange rates in terms of currency units per U.S. dollar, except for the euro and the pound sterling, which are expressed in U.S. dollars per currency unit.
3The U.S. dollar equivalents of the currency amounts.
4The official SDR value of the U.S. dollar, which is the reciprocal of the total of the U.S. dollar equivalents—that is, 1÷1.36986, rounded to six significant digits.

Data: IMF Treasurer’s Department