A Dialogue On Special Drawing Rights

THE INTERNATIONAL MONETARY MECHANISM has been subjected to a series of shocks in the last year; the devaluation of the British pound in November 1967, the ensuing massive speculative purchases of gold, the suspension of gold sales in the London market by the Gold Pool Countries,[1] and the establishment of the two-price system for gold.[2]

The possibility of an international financial crisis revolves around the fear that the international value of the dollar and the pound sterling may be changed in the future. As these currencies, along with gold, are the present major sources of international reserve assets, speculation on their devaluation would lead some foreigners, both governmental and private, to convert their dollar and sterling assets into gold or some other commodity.

Such a shift in preferences against reserve currencies could lead to a decline in the overall level of international reserves. If this happened, it could result in a decline in international trade and capital movements, as various countries attempt to rebuild their international reserve positions by taking restrictive domestic actions or imposing exchange controls.

Given the apparently large private demand for gold, and the firm intention of the United States Government not to increase the price of gold, it is clear that the future growth in international reserves will not come from increased holdings of monetary gold stocks. Increased foreign official holdings of dollars, sterling, and automatic drawing rights on the International Monetary Fund could fill some of the world's need for increased international reserves. However, the use of sterling as a reserve asset is expected to decline substantially in the future. In addition, the process of foreign acquisition of liquid dollar balances, of necessity, implies continuation of the United States international payments deficit. These deficits have reduced foreign confidence in the value of the dollar.

A mechanism, which in the process of generating international reserves simultaneously reduces confidence in the value of the reserve asset, is clearly in need of some modification. It has been apparent for some time that a supplemental form of reserve asset, not subject to the limitations implicit in the use of a national currency, is needed. SDR's (Special Drawing Rights of the International Monetary Fund) or paper gold, as they are sometimes referred to, are the proposed solution. After four years of discussion and inquiry among interested governments, the general outline of the SDR plan was approved by the International Monetary Fund at its annual meeting at Rio de Janeiro, Brazil, in September 1967. During the subsequent six months the staff of the IMF converted this proposal into detailed language in the form of an Amendment to the IMF Articles of Agreement. This detailed plan was accepted on the weekend of March 30-31, 1968, by monetary officials of the major IMF member countries, ie, the Group of Ten,[3] at a meeting in Stockholm, Sweden.

This meeting was of critical importance because it showed that there is strong agreement on the need to create a supplemental form of international reserve.

[1]The Gold Pool countries were the United States, Switzerland, the United Kingdom, Germany, Italy, Belgium, and The Netherlands. France was a member of the Pool earlier but has not participated actively since June, 1967.

[2]The United States will continue to buy and sell gold to foreign official institutions at a price of $35 an ounce; however, the private market price has been allowed to float.

[3]The Group of Ten are: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States.

Only France reserved its position with respect to participating in the SDR plan. Ratification of the SDR Amendments to the Articles of Agreement requires the approval of 60 per cent of the member countries with at least 80 per cent of the weighted voting power. The United States was the first Government to approve on June 24, 1968. However, because of the legislative procedures involved in ratification by the other member countries, it seems doubtful that the new reserve facility will be activated before 1969.

Technical Issues

Question: What are Special Drawing Rights?

Answer: Special Drawing Rights (SDR's) are account entries on the books of the International Monetary Fund quite separate and distinct from the other accounts of the IMF, which will be divided among the Fund's participating member countries in accordance with their present IMF quotas. The member countries will receive the initial allotment of SDR's without incurring a corresponding debit. A contingent liability exists in case the SDR arrangement should ever be terminated, or in case of the withdrawal of one or more countries.

Question: What are the benefits to those countries which participate?

Answer: Any country with SDR balances can use them to meet balance-of-payments deficits with other countries. A country with a balance-of-payments deficit usually has financed it by sales from its gold or convertible currency holdings. With SDR's, a country can also finance part of its deficit by instructing the IMF to draw down the balance in its SDR account in exchange for an equivalent amount of convertible currency. The IMF then designates one or more member countries to transfer convertible currency to the deficit country in exchange for an equivalent increase in SDR balances.

For example, if Japan had a $100 million deficit, it could finance all or part of it from its SDR balances. If the Japanese wish to utilize the equivalent of $50 million of their SDR account, the IMF would debit Japan's account for $50 million and credit the SDR account of, for example, Germany, with a like amount. Germany would transfer the equivalent of $50 million in convertible currencies to Japan.

A country without a current balance-of-payments deficit, or a declining level of international reserves, may engage in voluntary transfers of SDR's with another country in order to restore a better balance in the components of its international reserves. Such action requires the mutual agreement of both participating countries, and the approval of the International Monetary Fund. This provision is of special importance to a reserve currency country like the United States which has a substantial volume of outstanding dollar liabilities to foreign central banks. A member country holding more dollars than is considered appropriate can exchange them for SDR's with the United States, or with another country holding fewer dollars than it desires.

Countries which hold SDR's will receive interest on these balances at a rate to be decided by the Board of Governors of the IMF, presently anticipated to be 1½ per cent per year.

Question: What are the obligations of SDR participation?

Answer: There are basically two obligations to participation in the SDR arrangement and they are converse to the benefits. Just as countries with a deficit can finance part of it by drawing down their SDR holdings, countries with surpluses must be prepared to accept part of the surplus in the form of SDR's. There is, however, a limit to the amount of SDR's which any one country must accept, equal to three times the net cumulative allocation of SDR's which that country has received from the IMF inclusive of these allocations. For example, if Italy's share of the net cumulative allocations is the equivalent of $10 million, it must be prepared to accept at least $20 million in additional SDR's from other countries. A country may, at its discretion, agree to accept a larger amount of SDR's.

Each country must pay a charge to the IMF on its net cumulative allocations of SDR's. The charge will be equal to the interest rate paid on SDR's. Thus, those countries which hold only their net cumulative issuance of SDR's will have interest income and charges which are equal to each other. Countries whose SDR balance exceeds their net cumulative allocations (Germany in the example) will have interest income which exceeds their charges. Countries with SDR balances which are less than their net accumulative allocations (Japan in the example) will have charges which exceed their interest income. Consequently, there will be a small incentive for surplus countries to acquire SDR balances and a small cost for deficit countries to draw down their SDR balances.

Question: Must SDR balances be reconstituted?

Answer: This was one of the key questions in the negotiation of the SDR arrangement. Some countries wanted SDR's to be fully repayable within a specified number of years, which would have made them equivalent to intermediate-term financing much like conventional type IMF financing. Other countries wanted SDR's to be permanently outstanding, which would have made them, in effect, a net addition to the stock of international reserves to the full extent of the amount allocated. The final result was a compromise. Participating countries will be required to maintain an average daily balance of SDR's equal to 30 per cent of their net cumulative allocation during each "basic" period, which will be five years in length. A country may reduce its SDR balance below 30 per cent at any time, but should have it rebuilt by the end of the "basic" period in such a way that the average daily balance is 30 per cent for the "basic" period as a whole.

Question: What will prevent the issuance of SDR's from causing an international inflation?

Answer: The proposed amendment to the Articles of Agreement of the International Monetary Fund, to determine the amount of SDR's to be issued, specifies such restrictive procedures that the major fear is that too few, and not too many, SDR's will be issued. An 85 per cent weighted vote of the members of the IMF is required to initiate any issuance of SDR's – a minority group holding a fraction more than 15 per cent of the votes can block any issuance.

Typically, those countries with balance-of-payments surpluses are enjoying an increase in their holdings of international reserves, and will probably require substantial evidence of international deflation to convince them that there is a world-wide shortage of reserves. If surplus countries with a weighted voting power of only 15.1 per cent are not convinced of the need to increase international reserves, they could veto any growth in SDR's.

Question: What is the significance of the SDR plan?

Answer: With gold no longer expected to contribute to the growth in world monetary reserves, and with the United States determined to correct its chronic balance-of-payments problem in the near future, it is essential that a supplementary reserve asset be developed. The implementation of the SDR plan will provide the means for regulating the stock of international reserves through conscious decision-making, according to the needs of world trade and capital movements.

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