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INTERVIEW

Special Drawing Rights — The Result of Rio

Interview with Dr Otmar Emminger, Deutsche Bundesbank, Frankfurt/M.

To overcome the lack of international liquidity, those who attended the Rio de Janeiro monetary conference agreed to introduce special drawing rights. This measure stemmed from an initiative taken by the Group of Ten. It is considered a milestone in international monetary policy. INTERECONOMICS* was able to interview Dr Otmar Emminger, member of the Board of Governors of the Deutsche Bundesbank and Chairman of the working party of the Group of Ten, about the reasons for introducing this new instrument and its probable effects.

QUESTION: Dr Emminger, the meeting of IMF Governors in Rio has decided upon a new instrument to be used together with the existing monetary reserves in gold, currency and claims upon the IMF; this instrument is to be known as 'special drawing rights'. When may we expect the activation of this new plan?

ANSWER: To be precise, the decision taken by the meeting of IMF Governors does not mean that members are immediately granted special drawing rights; the IMF Executive Board was instructed to work out by March 1968 what amendments and additions to the Articles of Agreement of the IMF will be necessary to put the proposed plan into proper legal form

and to submit them to the Governors for their final decision. These amendments would then have to be submitted to the parliaments of the 107 member states for ratification. After completion of this procedure the plan would be formally put into force — if we permit ourselves a certain amount of optimism this could be by spring of 1969 — and we could then start allocating the special drawing rights. It is, however, only a "contingency plan", i.e. a plan in anticipation of a later contingency. Once it has come into force it will require a proposal by the Managing Director of the IMF and a decision by the members — with an 85% majority — that there is a real need for additional reserves

and that the other conditions for allocation of new special drawing rights have been met.

QUESTION: Why did it become necessary to replenish international monetary reserves?

ANSWER: The Group of Ten based itself upon historical experience, judging that—as it said in its first Report in 1964—"the continuing growth of world trade and payments is likely to entail a need for larger international liquidity". Certainly the need for world monetary reserves does not necessarily grow in line with the growth of world trade; for example, over the 17 years from 1960 to 1966 world trade increased at the unprecedented rate of almost 8 per cent p.a., whereas the monetary reserves of all western countries rose, on an average, by only 2.7 per cent. This persistent discrepancy was, however, very much alleviated by the redistribution of reserves from the United States to the rest of the world. It is not necessary for monetary reserves to rise each year, but in case of prolonged stagnation, or even diminution of reserves, we should probably, in the longer run, be faced with distortions in the world economy: In order to prevent their reserves from falling, an increasing number of countries would adopt unsound practices in

OTMAR EMMINGER

Dr oec. publ., Member of the Board of Governors of the Deutsche Bundesbank, as Chairman of the working party of the Group of Ten has taken a decisive part in the creation of special drawing rights within the IMF. Emminger was born in Augsburg in 1911. From 1928 to 1933 he studied economics and law at the Universities of Berlin, Munich, Edinburgh, and London. After the war he first belonged to the Bavarian Ministry for Economic Affairs and the Federal Republic's Representation at the OEEC in Paris, where he was in charge of the economic department. Then, in 1950, he joined the Bank deutscher Länder, the predecessor of the Deutsche Bundesbank. Since that time Emminger as German representative attended at all important international negotiations on monetary problems.

* The interview was arranged by Wolfgang Reilsener and Dietrich Kebschull

trade, payments and capital movements; the exchange rate structure would disintegrate and, in extreme cases, as in the early thirties, there would be the danger of a deflationary recession in world trade.

QUESTION: And the special drawing rights were introduced to prevent this?

ANSWER: The Group of Ten, in its 1964 and 1966 Reports, decided unanimously—i.e. the French also agreed—that “it is unlikely that the existing sources of reserves will provide an adequate basis for world trade and payments in the longer run”. The Group of Ten estimated that in future the flow of new gold into world monetary reserves would dry up. It also was of the opinion (Group of Ten Report, July 1966) “that for a variety of reasons, further substantial increases of dollar reserves are unlikely to occur and in our view it would indeed be undesirable that the increase in the external short-term indebtedness of the US should continue as in the recent past”. Consequently, “it was agreed that, at some point in the future, existing types of reserves may have to be supplemented by the deliberate creation of additional reserve assets” and that this should not be “left to the outcome of individual countries’ balance-of-payments deficits”. That such a contingency will one day arise is reasonably certain; but when is still an open question. Naturally opinions are divided on this issue. Some people—including, for instance, the economic adviser to the Bank for International Settlements (BIS)—think there is already a shortage of world monetary reserves. Others, including some representatives of EEC countries, are of the opinion that at present we still have a sufficient degree of international liquidity.

QUESTION: The Group of Ten’s negotiations for the creation of new monetary reserves have already lasted for four years...

ANSWER: That is not quite correct! The first two years of the discussions in the Group of Ten were filled with a general investi-

gation of the functioning of the present international monetary system and of possibilities for further development. Negotiations on the creation of new monetary reserves began in November 1965 among the Deputies’ Group of the Ten after it had received instructions to that effect by the Ministers and Central Bank Governors of the ‘Ten’. On a worldwide basis the negotiations only began with the joint meetings of the Group of Ten Deputies and the IMF Executive Directors, which lasted from November 1966 until June 1967. These negotiations were terminated by the Group of Ten meetings held in London in July and August of 1967. Thus the actual negotiation period can be put at 18-20 months.

QUESTION: Various plans have been discussed during this period for improving international liquidity. Why were special drawing rights finally decided upon?

ANSWER: Naturally, in the course of these negotiations widely differing plans were put forward for discussion by various countries and individuals; plans on a worldwide basis as well as plans limited to a smaller group of countries, plans tied more or less closely to gold, and finally plans for either reserve units or drawing rights. The reasons why the final decision was in favour of special drawing rights within the IMF rather than so-called ‘reserve units’ were the following: first, special drawing rights were a concession to conservative views, particularly to those held by certain European central banks, which felt that reserve units might lead to money being created internationally in a revolutionary way with the risk of inflation, whereas they are familiar with the technique of drawing rights within the Fund; there are also precedents for the allocation of drawing rights among a group of countries such as for example the credit lines within the European Payments Union from 1950 to 1958 or the reciprocally granted central bank swaps. Secondly, the technique of drawing rights satisfied the French demand that any new supplement to re-

serves must under all circumstances be a type of credit with a repayment obligation. Automatically available credit lines, even if tied to certain repayment obligations, can supplement reserves just as well as reserve units; the use of EPU credit lines as substitute reserves is an obvious example of this.

QUESTION: Thus there is no essential difference between reserve units and special drawing rights?

ANSWER: Not even reserve units would be directly transferable new money, since they could not directly be used to cover a country’s deficits in the foreign exchange markets. Like special drawing rights, reserve units could only be used to obtain currencies convertible into dollars—or dollars themselves—from other member countries. Incidentally, reserve units would have to be provided, just like drawing rights, with certain rules governing their acceptance, transferability and to guard against misuse, at least in the initial stages. Thus one might as well say: a reserve unit would have been, at least initially, only a ‘drawing right in disguise’, as one could say: the new special drawing rights are reserve units in disguise. In brief, the special drawing rights for reserve purposes can meet the demand for a supplement to existing reserve assets as well as the—essentially French—demand for a credit-type instrument. Special drawing rights are both; as a French commentator put it, they have the two faces of Janus—or, as I use to put it: they are like a zebra.

QUESTION: What are the main characteristics and functions of these special drawing rights?

ANSWER: The function of the new special drawing rights is described, as follows, in the first sentence of the plan adopted by the Group of Ten and the IMF: they are “intended to meet the need, as and when it arises, for a supplement to existing reserve assets”. Their essential characteristics are the following: They will be allocated to all IMF

member countries participating in the plan, on the basis of the IMF quotas. Participating countries thus gain the right to obtain from certain other countries, on the basis of certain transfer regulations, a corresponding sum in a de facto convertible currency. The latter country thus acquires special drawing rights, but it is obliged to do so only within certain limits. The special drawing rights thus represent a claim on all the other participating countries as a group. They will be provided with an irrevocable gold value guarantee and a moderate interest rate. This means that they are a sort of interest-bearing gold certificate.

QUESTION: What is the relationship of the special drawing rights to the US Dollar, the pound sterling and to gold?

ANSWER: Special drawing rights are intended to supplement existing types of reserve in case of need. Initially, of course, they will play only a very modest role in terms of value, compared with current holdings of world monetary reserves, which amount to over \$70 billion—\$41 billion in gold, \$24 billion in foreign currency holdings, and over \$5 billion of so-called reserve positions in the IMF. Whether they may one day take the place of traditional reserves—for instance, to liquidate sterling reserve holdings, which are no longer wanted—will depend upon future developments.

QUESTION: Are special drawing rights intended to substitute for gold in the long run?

ANSWER: As "interest-bearing gold certificates", special drawing rights are intended to complement gold reserves which, in the long run, will prove insufficient. This will mean that the world will become less dependent upon gold alone, future supplies of which are very uncertain. It is not likely, however, that the new reserve drawing rights will replace the existing gold reserves of more than \$40 billion in the near future. It is more probable that at some future time gold, foreign currency claims, reserve positions

within the IMF and special drawing rights will co-exist. In the course of time, special drawing rights will gain in importance.

QUESTION: Special drawing rights aim at the controlled introduction of additional monetary reserves. Is there any chance of the system functioning as long as a permanent balance-of-payments deficit in the USA produces uncontrolled liquidity?

ANSWER: The Group of Ten is in agreement that the special drawing rights should only be activated when a worldwide shortage of monetary reserves arises and the American balance of payments is nearer equilibrium. Over the last two years, American deficits have no longer been financed by increasing American short-term indebtedness to other countries, but mainly by the US selling gold and drawing on IMF credits. It can certainly no longer be said that there is an uncontrolled expansion of international liquidity due to American balance-of-payments deficits. Should further substantial increases occur in American short-term foreign indebtedness, this would certainly impede the activation of the new reserve plan. Furthermore, the Group of Ten has envisaged that not only the creation of reserves under the new plan, but also the creation of liquidity by other means—American deficits, central bank swaps, drawing on the Euro-Dollar markets—should be subject to multilateral surveillance by the Group of Ten.

QUESTION: Is the proportionate use of the various reserve components necessary and secured?

ANSWER: At the beginning of the Group of Ten negotiations, a formula was discussed whereby the new special drawing rights should be used in proportion to a country's own reserves—as was done under the former EPU—. As happened under EPU, this would have led to an almost automatic renewal of the special drawing rights in connection with an improvement in the balance-of-payments position. Subsequently, for various reasons, agreement was reached on a different formula for the re-

constitution (repayment) of drawing rights. However, the proportionate use of special drawing rights, together with countries' own reserves, was then included in the plan as a general rule without specific sanctions; in cases of long-term non-compliance the IMF might make representations.

QUESTION: What rights and obligations does an IMF member have with regard to the use of special drawing rights?

ANSWER: I have explained already before what are the rights of a participant country in respect of special drawing rights. Under certain circumstances, which are outlined in detail in the plan, a participant country is obliged, when so requested by the IMF, to make available for drawings by other countries sums in a de facto convertible currency up to twice the amount of special drawing rights which have been allocated to it to date. Any participant country may voluntarily exceed this limit; this means, for instance, that if a country has dollar or sterling reserves it does not want any more, it can, by accepting drawing rights from other countries, convert these into gold-guaranteed claims upon the IMF.

QUESTION: What were the basic considerations in favour of introducing a reconstitution obligation for a proportion of the special drawing rights?

ANSWER: The so-called 'reconstitution' of special drawing rights after use over a longer period is nothing else but the repayment of the credit lines used. The reconstitution obligation emphasises the credit character of the new facilities. It is aimed at preventing the freezing of individual deficit positions in the scheme; it thus serves simultaneously to ensure the system's liquidity and the credibility of the special drawing rights as a reserve instrument. The repayment obligation is based on the formula that the net use of drawing rights allocated over a period of 5 years should not exceed an average of 70 per cent. For instance, if a country has used all the special drawing rights allocated

to it for 3½ years, it is then obliged to repay the entire sum, and for one and a half years thereafter it may make no further use of special drawing rights. So it is not quite correct to say that repayment applies to only a part of the amount. This depends entirely upon the way in which the rights have been used.

QUESTION: Would it not be possible for several creditor countries to destroy the new system by refusing to accept further drawing rights in excess of an initial amount?

ANSWER: The rules on what is called 'opting out'—i.e. non-participation in the allocation of special drawing rights over and above an established minimum—have not yet been worked out in detail. However, countries may only opt out if they have voted against the respective allocation of special drawing rights. If several important creditor countries have voted against an allocation and are threatening to opt out, that allocation will in all probability not come about. It is therefore correct to say that every new allocation requires the participation of a sufficient number of countries in a potentially strong monetary position. The same, of course, has always applied to any decision to increase members' quotas inside the present IMF—i.e. to the creation of 'conditional liquidity'.

QUESTION: Might not the accumulation of special drawing rights—either allocated or transferred—with the main creditor countries lead to a constant, worldwide inflationary movement?

ANSWER: The mere allocation of special drawing rights on the basis of a joint decision has no inflationary effects, since this is merely a book-keeping transaction to establish credit lines. On the other hand, any increase in gold or dollar reserves because of balance-of-payments surpluses does normally have an expansive effect since this means that the cash liquidity of the banking system and of the entire economy is raised proportionally. Nor do special drawing rights acquired by a

country have any primary expansive effects, provided it has no balance-of-payments surpluses of its own; such a country has to give dollars in return for the drawing rights accepted by it, so that only the composition of its monetary reserves is altered, not the overall amount. If, on the other hand, a country accumulates special drawing rights because it has balance-of-payments surpluses and thus increases its overall reserves, this would have precisely the same expansive effect as if an equivalent amount were acquired in gold or dollars. That is to say: the expansive and potential inflationary effects come from the balance-of-payments surpluses regardless of the way they are financed, whether in gold, dollars or special drawing rights.

QUESTION: In your view, should the IMF exercise a greater influence upon the economic policies of its members—primarily in respect of their monetary policies?

ANSWER: Naturally the IMF should exercise as great an influence as possible on the financial policies of its member countries—on the condition, of course, that this influence is always exerted in favour of stability and not—as was demanded in Rio, for instance, by certain countries and groups of countries—in order to attain greater expansion in surplus countries. Some member countries—particularly deficit countries—think that the IMF already now exercises too much pressure upon the economic policy of member countries. If the bow is drawn too taut, this could, in certain circumstances, backfire and diminish the influence of the IMF.

QUESTION: Hitherto, the EEC has not been able to exercise, within the IMF, an economic influence in accordance with its strength. Do you think the voting requirements should be reformed in favour of EEC?

ANSWER: It is not true that EEC countries have not been able to exert an influence in accordance with their economic strength within the IMF. Over the last

10 years there has been no single decision of importance passed in the IMF over and against the votes of the EEC countries, or even only 3 or 4 of them, even if, formally, such decisions could have been passed by simple majority. Thus the EEC countries have in fact exercised an influence in accordance with their monetary strength. However, it seems justified that this de facto position should be formalised for certain important types of decisions—particularly where such decisions directly or indirectly affect the creation of liquidity within the IMF—by requiring for such decisions a qualified majority of 85 per cent and thus giving in due form a blocking minority to the EEC countries. Formal recognition of the existing de facto situation would not really mean a great concession on the part of the others.

QUESTION: What opportunities does the new system offer to improve the economic position in developing countries?

ANSWER: The proposed special drawing rights offer only a relatively slight direct advantage to developing countries. The share of 81 developing countries in the IMF membership quotas, and thus in the future allocation of special drawing rights, totals only 27 per cent. On the hypothesis of an annual allocation of \$1 billion new drawing rights to all participant countries, only \$270 million would be allocated to the 81 developing countries, and only a minimal amount to most of these countries individually. Consequently, the main importance of the new plan to developing countries lies elsewhere, namely that in the long run it will assist the large industrialised countries which have a major influence upon world economic trends, to maintain a better balance in the world economy. It was definitely recognised by certain speakers from the less developed countries at the last annual conference of the IMF in Rio that, indirectly, this is very important for developing countries, since they will always be the main sufferers from any distortions or set-backs in the world economy.