

Feuerlein, W. J.

Article — Digitized Version

The dollar and special drawing rights

Intereconomics

Suggested Citation: Feuerlein, W. J. (1979) : The dollar and special drawing rights, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 14, Iss. 3, pp. 111-115, <https://doi.org/10.1007/BF02924550>

This Version is available at:

<https://hdl.handle.net/10419/139608>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

The Dollar and Special Drawing Rights

by W. J. Feuerlein, Boca Raton *

The IMF's Interim Committee recently for the first time discussed the creation of a "Substitution Account" to convert certain amounts of excess reserve currencies into SDRs. This issue is likely to be on the agenda of the next annual meeting of the IMF in the fall of this year. Prof. Feuerlein discusses the problems of such an account.

At the annual meeting of the International Monetary Fund in Washington, D.C., in September 1978, two key actions were taken. In the first place, agreement was reached on an increase in the quotas in the fund which would bring the IMF's general resources to SDR 58.6 bn (about \$ 73 bn). The second agreement was to allocate SDRs in a quantity that would just double the amount now in existence; in this connection, it was also agreed to make the SDRs more attractive by easing many of the requirements concerning their use. Subsequent to these actions, the US Government has agreed to let the IMF study a proposal to create a "Substitution Account". Such account was suggested many times in the past and again by the previous managing director early in 1978. The purpose was to convert certain amounts of excess reserve currencies into SDRs. Until recently, the US Government did not agree to have this proposal considered. Now it seems that the US's attitude has changed and thus serious consideration could be given to such an action. The IMF's Interim Committee recently for the first time discussed this suggestion and will make a more detailed report prior to the next annual meeting of the IMF in the fall of this year. In order to give a perspective to this problem, a brief review of the evolution and developments of the SDRs since 1969 is presented herewith.

The Original Concept of the SDR Creation

In the 1960s, the world's liquidity problem, or the potential lack of international reserves, led to an agreement at the IMF meeting in 1967 to create a new international reserve, namely, "Special Drawing Rights" (SDRs). Subsequent to the ratification of the agreement a total of somewhat more than 9 bn dollars of SDRs were issued in three tranches; it was also agreed to consider additional issues if needed. The SDRs issued in 1969/71 were defined

in terms of gold, thus indirectly in dollars, but due to the problems with the US dollar in 1974, this was changed and the value of the SDRs from then was fixed in terms of a basket of 16 of the world's major currencies. Since the SDRs were expected to play a role somewhat similar to the limited role of gold they were also popularly called "paper gold". As constituted in 1969, SDRs could only be used for transactions between central banks and international government institutions.

Although the general reason for creating the SDRs was to create more international liquidity, or in other words to provide additional international reserves to members of the IMF, there are four specific more detailed concepts involved, namely:

□ To provide fairly substantial amounts of international reserves to member countries, especially the industrialized countries of the world, because the volume of international transactions had been skyrocketing; in order to have a smoothly functioning international system, larger reserves than available in the 1960s were believed necessary. Although there was no excess inflation in the industrialized countries during that period, the moderate but general price increases also required larger and larger amounts of international reserves.

□ It was deemed unsound economically to rely on US balance of payments deficits as the major vehicle for liquidity creation. Furthermore, the US balance of payments in some years, as shown below, had no deficit and had some surplus years which lead to liquidity destruction. Relying on a single currency as the vehicle for liquidity was deemed to be unsound. Other currencies could not be relied upon to provide it and gold also had become an uncertain element in the monetary system.

□ The creation of liquidity through US balance of payments deficits proved to be very uneven. Some countries gained reserves while others did

* Florida Atlantic University

not. It all depended on the flow of transactions in countries' balances of payments.

□ The creation of SDRs as an additional international reserve was deemed to be the first step in a series of future steps leading towards a new world monetary system. Although this was far in the future, it was deemed to be important to get started.

The two tabulations below show in figures some of the developments in the sixties. The first table shows the growth of international reserves, namely, gold, dollars and other foreign exchange and resources in the IMF. These resources increased considerably until 1968 and also 1969, which are the years when SDR creation was under consideration. The second table shows, however, that the US balance of payments had a deficit only in the early sixties and later was in balance; a slight surplus in 1968 and 1969, thus leading to liquidity destruction. Naturally, this was offset probably by some increase in gold holdings and also in the holdings of other foreign exchange. It seems clear, however, that the world could not rely on deficits in the US's balance of payments to create the liquidity necessary for smooth operations.

Table 1
Total International Reserves

End of Year	in bn SDRs
1960	59.8
1962	62.6
1965	70.9
1968	77.7
1969	78.7

Source: IMF 1978 Supplement.

Table 2
US Balance of Payments
Surplus or Deficit (-)
in bn \$

1960-64 average	-2.2
1965-69 average	in balance
1968	+1.6
1969	+2.7

Source: Federal Reserve Bulletins.

When in 1967 and 1968 the original issuance of Special Drawing Rights was considered for the first time, nobody foresaw the developments of the US balance of payments and the coming excess liquidity situation in the 70s. Nobody foresaw that

the whole Bretton Woods System was near collapse. The emphasis at that time was to improve the international monetary system and to create more liquidity as a substitute for gold without, however, requiring the US dollar to perform the world's key currency function in the long run.

The US balance of payments changed from a surplus of 2.7 bn dollars in 1969 to a deficit of 9.8 bn in 1970, and further large deficits almost in all subsequent years. No end is in sight yet. This paper does not intend to analyze the cause for these deficits or the remedies. These figures are cited only to show that the world's dollar liquidity increased tremendously since 1969.

The years 1971 to 1973 were crucial in the evolution of the international monetary system. Technically, the Bretton Woods system began to fall apart in 1971, when it was realized that the US dollar was heavily overvalued. The dollar subsequently was devalued twice and then permitted to fluctuate freely. Notwithstanding this development, the international financial changes did not result in an international financial collapse, and in fact the US dollar continued as the major world trading and financial currency.

As a result of the exchange rate adjustments after 1971, it would have been expected that the US balance of payments would slowly return to an equilibrium position. This did not occur, partly at least because the US dollar was not floating freely but was supported at one time or another through the intervention of foreign central banks which did not want their currencies to appreciate too much against the dollar, and thus bring about export problems and possible unemployment and economic difficulties. Thus, the world's international liquidity continued concentrated mostly in United States dollars. The following short table shows this:

Table 3
Total International Reserves
(in bn SDRs)

1970	93.3
1972	146.7
1974	180.2
1976	222.3
1977	262.2
1978 (est.)	280.0

Source: IMF 1978 Supplement.

The excess liquidity in US dollars was not evenly distributed; in fact it was heavily concentrated in a few countries such as Germany, Switzerland, Japan. Other countries participated in a minor

degree. As the dollar overhang problem emerged in the early 70s there was some discussion of the possibility of converting some dollars into SDRs. No adequate method for this was found at that time and no measures were taken until recently as noted below. The world was occupied with other problems, particularly how to achieve equilibrium in the US balance of payments without causing serious worldwide repercussions, especially without imposing restrictions on the free flow of goods, services and finances.

New Issuance of SDRs

The Board of Governors of the International Monetary Fund at the annual meeting of the IMF September 25–28, 1978 agreed to a new issue of SDRs. Provided all nations agreed to this upon ratification during the following two months, it was agreed that the IMF should allocate 4 bn SDRs each year during the next 3 years, namely, 1979 to 1981. Together with the original issue of SDRs in 1969 to 1971 of 9.3 bn SDRs, the total SDRs outstanding after the third annual installment would be 21.3 bn SDRs. In order to strengthen the SDR system, and to make them more attractive as international reserve assets, two other measures were approved, namely:

- to establish a new formula for increasing the interest rate on SDRs;
- to reduce the minimum average balance of SDRs which participating members were required to maintain.

The Interim Committee which had worked out the various proposals before increasing and strengthening SDRs, also has other measures under review for possible action at a later time. They include facilitating the operations of the SDR accounts, making SDR loan or loans with SDRs as security. At the meeting in Washington in September, 1978, no official mention was made of the "Substitution Account", probably because of US opposition.

It certainly is an interesting development that additional amounts of SDRs were allocated during a period when the world is "flooded" with US dollars and when international reserves of member countries are very high. The reason, however, is not hard to find, namely that the increase in liquidity through the large increases in dollar holdings was restricted to half a dozen or a dozen countries which maintained favorable balances of payments with the US. Other countries who were not in this position did not benefit. It was also pointed out during a press conference that existing international reserve assets must be supple-

mented in a "desirable manner". This really means that it is the intention of the members of the Fund to increase liquidity, not through deficits in the US balance of payments, but through an allocation system of SDRs, thus hopefully bringing about a new world international reserve system. International liquidity is now particularly important because of the persistent rather large inflation existing in most countries of the world. Larger international reserves will be necessary merely to handle the inflated volume of international transactions. The failure to create these additional international reserves might have brought about a stagnation of the international monetary system and maybe even a more general breakdown than so far experienced through the collapse of the Bretton Woods system.

This broadening of the SDR system also reflects the idea that gold should not resume an international monetary function. There has been considerable agitation in favor of returning, partly at least, to a gold standard through a heavy revaluation of gold world-wide. There doesn't seem to be much support for this idea since gold in recent months and years has become highly speculative, and any re-emergence as a monetary metal could have unforeseen consequences. Similarly many countries felt that in due course the IMF members should generally reduce as international reserve assets all currencies, including the US dollar. Should the US balance of payments problem be straightened out and no further liquidity created through deficits in this balance, it would not be deemed desirable to rely on other countries such as Germany or Switzerland to provide the desired increase in international liquidity through deficits in their balances of payments. In other words, it is felt that the world should move towards a system not relying on balance of payments deficits or surpluses as a basis for international reserve. Finally there may have been some concern in connection with the creation in Europe of the European Monetary System (EMS) and the creation of a European unit of account, the ECU. If the development of the IMF system had stagnated, then there would have been a possibility of using the European unit of account as a possible vehicle for international reserves. This again would not suit certain members of the IMF, and it was felt that a more general world-wide system would be preferable.

In general, it would appear that as a result of last year's IMF conference and the work of the Interim Committee, the world's monetary system is starting on a new track. Since it proved difficult, if not impossible, to bring about a reform of the Bretton Woods system and to establish guidelines for bringing about balance of payments equilibrium

and stability in exchange rates, it seems that the powers behind the IMF are really thinking about restructuring the whole international monetary system. This will be discussed in the next paragraph in connection with the possible creation of the "Substitution Account".

Substitution Account Problems

A creation of a "Substitution Account" system by the IMF was informally mentioned several times during the 70s. No action has been taken so far because the creation of such an account was not deemed appropriate for solving the existing international monetary problems. At the last meeting of the International Monetary Fund in 1978, again the subject was not officially mentioned. However, subsequent to that meeting it was decided that the problem should be looked into, especially since the US Government had no longer an objection to such an investigation.

Basically a substitution account would permit a conversion of dollars or other excess currencies in the international reserves of central banks to be converted into SDRs. The US or other debtors would then owe the IMF substitution account the dollars or other currencies, and in turn the creditor countries would obtain SDRs which could be used to finance or balance international transactions.

In analyzing the idea, the first question is whether there should be limits in the amounts that excess currencies may be converted into SDRs. And then there is the question whether these SDRs would in fact be real SDRs or merely deposits in the IMF "denominated" SDRs. In the long run such a distinction should probably not exist because there are already many SDR denominated accounts in world finance with the IMF making this more complicated¹. The magnitude of the actual substitution possibility is undoubtedly one question that must be solved at the very beginning before any more technical problems can be considered. At the outset, the creation of a substitution account may well call for a fixed maximum amount to be substituted under specific rules. Should this work out satisfactorily, there is no doubt that more substitution activities will occur in the future. It could then become an open ended operation leading towards a world monetary system being based upon SDRs. Thus a thorough analysis of the consequences of creating a "Substitution Account" may be the most far-reaching element in the potential restructuring of the international mon-

etary system. In the last Interim Committee of the Board of Governors of the IMF, it was stated that this new account should be a possible "reinforcement" for the SDR system. It was also noted that it should not be considered at this time an action which would assist international monetary stability or assist currencies that have come under pressure. It is not quite clear what the distinction between the two parts of this statement is. It is certainly a purpose of the creation of the SDR, to strengthen the international monetary system and also to help bringing about equilibrium conditions. If this is not the case and if the substitution account would not help in this, then the question is, what the main purpose of all the proposed arrangements is.

Fundamental Conditions

One of the key fundamental conditions of the expanded SDR system and the potential creation of the substitution account should be the restructuring of the international monetary system and recreation of international monetary stability. Any deviation from this principle would mean that the revised SDR system might be used as an excuse for not putting pressure on deficit countries to equilibrate their balances of payments, or to take measures at least to bring their current accounts into equilibrium. This will be difficult to achieve because according to all information, the US balance of payments will not be in equilibrium for some time to come. The countries which have a major surplus in their balance of payments vis-a-vis the US, namely Japan, the oil producing countries, and to some extent Europe, however, should not consider these new arrangements an excuse for not taking adequate measures to assist the US in bringing about equilibrium in its balance of payments. Without this international liquidity would continue to rise year by year and the SDR system would merely cover up the imbalances or the distortions created thereby; it could lead to serious future breakdowns.

Another important condition when creating a substitution account is that it will not be inflationary. In the narrow sense, the substitution of SDRs for dollars would not be inflationary *per se*. However, if this substitution account together with other SDR issuance would be used to create a new international lending system similar in character or type as the Eurodollar market, then it could become very inflationary. The question of using SDRs, including those created by a substitution account, should be fully explored. Any potential lending activities, presumably through the Central Banks should become subject to close scrutiny, so that the uncontrolled growth as occurred with the Eurocurrency markets would not be repeated.

¹ A good description of SDR valued accounts is given by Walter O. Habermeier (The SDR as an international unit of account) in the March 1979 issue of "Finance and Development" issued by the International Monetary Fund and the World Bank.

The framers of the new account may actually have in mind the adoption in the long run of a system similar to the Triffin Plan of 1960 which was partly based on the Keynes Plan of 1944. Triffin's proposal was to expand the IMF into a world central bank, endowing it with the right of reserve creation, expanding demand deposits, granting of loans and participating in open-market operations. If a substitution account proposal is seriously considered for adoption, many aspects of the earlier plans would actually be implemented.

There are many technical questions to be considered. One of them would be the structure of interest rates maintained by the IMF. Its income from the international reserves, e.g. dollar deposits, should cover interest payments to SDR holders. In no case could the IMF run a "loss" operation, and yet interest received from different sources at different times may vary considerably.

The interest question may also have to be seriously considered when other modalities for the substitution account are reviewed. It has been suggested that bonds with different maturities and different interest rates be issued. Other proposals for acceptance and/or use of substitution account funds may have to be analyzed. Thus the interest and many other operational problems have to be worked out, and different models may have to be

prepared. At this time it is too early to discuss such hypothetical schemes.

Conclusion

The recently authorized issuance of additional SDRs totalling SDR 12 bn together with the subsequent agreement to consider the establishment of a "Substitution Account" may signal a new phase in the search of a new or an improved international monetary system. Many aspects and many problems will have to be explored, which will require a lot of time. Furthermore, the efforts may in no case detract attention from the need to reestablish equilibrium conditions; otherwise any new system would have little chance for success.

Finally a fundamental question has to be raised, namely, has the world reached a point at which it is possible to endorse an international institution with sovereign power? Or in other words, should the International Monetary Fund receive the right of making decisions, or will it as in the past have to rely on affirmative action by the Board of Governors? In the long run certain rules, either concerning SDRs or other matters may have to be made and then enforced. In any case an interesting phase in the world's monetary relationships may open up.

PUBLICATIONS OF THE HWWA-INSTITUT FÜR WIRTSCHAFTSFORSCHUNG-HAMBURG

NEW PUBLICATION

Hajo Hasenpflug (Ed.)

DIE EG-AUSSENBEZIEHUNGEN – Stand und Perspektiven

(The EC-External Relations – State and Perspectives)

In view of the increasingly external trade and foreign policy oriented Community policies, the manifold EC-external relations in their entirety are to be analysed in this volume. It is to show the present state of relations with the individual countries or regions, respectively. Conurrences and complexes of problems are presented and an attempt is made to assess possible developments or shifts, respectively, vis-à-vis other industrial nations, the developing countries as well as the Eastern-bloc states and China. (In German.)

Large octavo, 618 pages, 1979, price paperbound DM 44,-

ISBN 3-87895-177-9

V E R L A G W E L T A R C H I V G M B H - H A M B U R G