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SDRs on the International Agenda

Two years have passed since Governor Zhou Xiaochuan of the Peoples Bank of China suggested that it is unwise for the international monetary system to rely on a national currency for its effective functioning. He did not mention the US dollar, or any particular currency, but his comment applied to all national currencies, including the Chinese yuan. He suggested a much larger role for the SDR (= special drawing right), a synthetic money created back in the late 1960s by the International Monetary Fund (IMF) for transactions among monetary authorities and their institutions, such as the IMF and the Bank for International Settlements. The value of the SDR these days is defined in terms of fixed amounts of the US dollar, the euro, the British pound, and the Japanese yen. Governor Zhou did not mention that a greater role for the SDR was officially endorsed by the international community back in 1978, when it amended the Articles of the IMF to the effect that IMF members will conduct their policies with respect to reserve assets consistent with ”the objectives of promoting better international surveillance of international liquidity and making the special drawing right [SDR] the principal reserve asset in the international monetary system.” This objective was largely ignored in subsequent years. Since 1969 only SDR 22 billion (about $35 billion) had been created through 2008, amounting to less than 0.5 percent of international reserves in that year, hardly the “principal reserve asset.”

Much has happened since Governor Zhou’s speech. SDRs are back on the official agenda. About $250 billion worth of SDRs were created in 2009, when the world was in economic recession, with a view both to issuing some SDRs to countries (such as China and Russia) which were not members of the IMF when the last allocation of SDRs was made, and with a view to relieving financial pressure on all countries following the financial crisis of 2008. Apart from the special allocation to relatively new members, SDRs are allocated to countries according to their quotas at the IMF. SDRs still account for only a small fraction of official foreign exchange reserves, but it is much larger than in 2008.

Moreover, reform of the international monetary system is again on the official agenda, starting with the G20 meeting in South Korea last year. President Sarkozy of France has made it a priority during his chairmanship of the G20 during 2011. The last time so much official attention was paid to the international monetary system was 37 years ago, in 1972-74, when the C20 of the IMF took up the issue. That effort was largely unsuccessful, but it did result in amendment of the IMF articles to drop the official role of gold in monetary affairs, to permit flexible exchange rates (thus acknowledging the factual situation at the time), and to emphasize the future importance of the SDR, noted above.

Where do we go from here? A modest reform would be to agree to regular significant annual allocations of SDRs, say $200 billion a year. This would satisfy at least part of the evident demand for growth in official international reserves, and thus on that account would help reduce trade surpluses in countries trying to earn more foreign exchange. It would also permit countries to use a higher share of their national savings for investment at home rather than putting it into low-yielding assets in US dollars, euros, or other foreign currencies. Such an annual allocation would not be inflationary for the world economy so long as countries taken together wished to augment their reserves by at least the amount allocated, and so long as the leading central banks or governments of the world -- most notably the US Federal Reserve and the European Central Bank – remained sensitive to inflation rates higher than they desire and framed their monetary actions accordingly.

A more ambitious reform would empower the IMF – with approval from governments – to create SDRs to deal urgently with financial crises such as occurred in the fall of 2008, when financial markets ceased to function effectively and demand for secure, liquid assets rose sharply. Any such creation would be unwound as normal financial conditions returned. But this would enlarge the potential role for the SDR. Unlike the more modest reform, it would require a treaty amendment to the IMF Articles.

A still more ambitious reform would permit private use of SDRs, something that is not now possible (although the SDR could be used as a private unit of account), and actively encourage their adoption for private international transactions. Several formidable changes would have to be made, and such use is beyond reach for many years. In the end may not be possible or even desirable. But it is a reform that should be carefully explored. Governor Zhou's suggestion has opened a new international dialogue.

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