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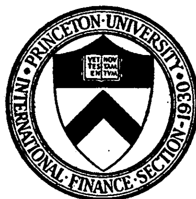
FRED HIRSCH



INTERNATIONAL FINANCE SECTION
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An SDR Standard: Impetus, Elements, and Impediments

Special Drawing Rights, in the specific form established in 1969, were designed to supplement existing reserve assets—official holdings of gold, dollars, and sterling. Their wider purpose was to provide a secure and controlled base for world monetary reserves. As is now generally recognized in both academic and official circles, SDRs in their present form are inadequate to this wider task. In order to achieve the desired degree of administrative regulation over global reserves, and to contribute to a satisfactory working of the international monetary system as a whole, changes in the rules now governing the creation and use of SDRs would be required as part of an ambitious and comprehensive reform relating, in addition, to such matters as exchange-rate adjustment.

The necessary extent and "depth" of such a reform will be governed by the wider economic and political context. Thus, in a world of fixed or only occasionally adjusted exchange rates, involving a high degree of economic integration, a more comprehensive SDR system would represent a substantial step toward a world central bank. In some of the early discussions, notably those of Triffin (1959), the development was expected to be along this line; to some extent, indeed, increased international integration at the institutional, economic, and political levels was regarded as an objective in itself. At present, however, the integrationist objective is not generally regarded as feasible on a global basis (and some, including myself, would not regard it as desirable). This is one reason why the "institutional integrationists" have turned their attention to the European front. Globally, the pressure for an increased degree of flexibility in exchange rates represents in part the felt need to "disintegrate" the international economy somewhat at the financial level, to loosen the links between domestic economies and create more leeway for pursuit of differing domestic economic policies. If this pressure is regarded as a continuing constraint on the extent of international financial integration, as I believe it realistically must be, it sets important limits on the character of a reformed SDR system. The system must not involve additional substantive inroads into national economic sov-

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ereignty, in the sense of removing or reducing the scope for choice among economic policies that have a significant impact on national economic conditions. This essay deals with the central question posed by these circumstances: Can a technically adequate SDR system be constructed within a political constraint of this kind?

I suggest that it probably can be, and that the required changes in the present system are essentially institutional in character, affecting various professional and sectional interests rather than national sovereignty in the sense used above. I suggest that the roles of these institutional influences and of the range of interest groups involved have been insufficiently explored, and that these roles may help to explain the halting nature of recent progress in international monetary arrangements.

Another important impediment arises from the nature of these arrangements. They constitute an international collective good that has to be "paid for" in voluntary cooperation. The absence of an international authority with police and tax powers means that the necessary sanctions must be built into the collective scheme itself, by denying its specific benefits to nonmembers and transgressors; the effectiveness of such sanctions as deterrents, however, is limited by the fact that the exclusion they involve will to some extent damage the interests of the law-abiding members as well as those of the excluded transgressors. This is the basis of a private club or voluntary association. Because any indirect benefits can be captured by "free riders," the chances of securing agreement on provision of a private collective good will be the greater, the more its benefits can be internalized to participating members.[1] By implication, an SDR standard subject to the political constraint set in this essay must tie the benefits and obligations of the international reserve standard more closely together. These issues are discussed further in section 4.

1. The Go-Stop Drive to an SDR Standard

Discussions of the task to be performed by an international reserve unit have retained a common central thread from Keynes's first treatment of the subject in his *Treatise on Money* (1930, Chap. 38) to current preparations for a remodeled SDR system. This task is to surmount the inherent instability of a reserve standard based on gold while avoiding the bias in the international system that would emerge in any system based on the inconvertible paper money of a particular country acting as the world reserve center.

[1] A private collective good is customarily distinguished from a public good by the absence of compulsion in participation and/or financing; thus a private collective good may be provided by a public authority, or between independent public authorities, such as occurs internationally in international organizations and agreements.

A system based on gold has a natural tendency to instability because endogenous forces carry the system to and through the cycle of the gold-exchange standard. The inherent properties of gold as a non–interest-bearing asset and as a cumbersome means of payment induce monetary authorities to supplement or replace gold holdings by currency balances. For reasons of efficiency, these balances become concentrated in one or two dominant reserve centers. The progressive accumulation of these currency liabilities gradually weakens the balance-sheet position of the reserve-center country and at the same time inhibits its recourse to payments adjustment through devaluation. Meanwhile, in an expanding world economy with an upward trend to the price level, accruals of gold to monetary reserves tend to diminish, leaving the system increasingly dependent for incremental liquidity on the further expansion of reserve-currency balances. Since such expansion involves a further deterioration of the reserves-to-liabilities ratio of the reserve center, the process cannot be sustained and must eventuate in suspension of convertibility. [The cycle of the gold-exchange standard, and the view of this standard as a natural outgrowth of the gold standard, is described more fully in Hirsch (1971, pp. 224–232), drawing on the work of Triffin, Kenen, Johnson, Gilbert, and Willett, as there cited.] In the recent case of the U.S. dollar, this outcome was delayed for years by a series of expedients which partly anticipated the formal break made on August 15, 1971.

From this point of breakdown, three alternative courses are open in principle:

a. Reestablishment of a favorable position of the reserve currency and other currencies relative to gold through an increase in the currency price of gold sufficient to ensure, at this stage, an adequate flow of monetary gold from new production (and to discourage private speculative purchases and perhaps induce sales): such action will in effect set off a new cycle of the gold-exchange standard.

b. Suspension indefinitely of convertibility at a fixed price between the reserve currency and other assets, thereby avoiding the dynamic instability implicit in the first course and establishing an unencumbered reserve-currency standard available to such countries as choose to fix their own currencies to it.

c. Substitution of an international paper standard for gold in order to achieve the stability of (b) by collective inconvertibility of currencies into any "outside" asset such as gold, while establishing a nationally neutral basis for the world reserve system through convertibility of national currencies into the unit, issued under collective administrative control.

The checkered progress of the international monetary system since about 1960 can be interpreted as a reluctant recognition of the dead-end character of (a) combined with a strong unwillingness to travel deliberately down (b), in turn leaving no alternative but (c). For national policy makers, the pull of the SDR standard is essentially negative, in the unattractiveness of the apparent alternatives.

The negative character of this evolution impedes progress to a solution and postpones definitive choice in a number of ways. Enthusiasm for the deliberative task of establishing a viable SDR standard can be brought to the necessary pitch only by the imminent threat of a breakdown or the prospect of an unavoidable choice between the two disfavored alternatives. Once this threat wanes or is obscured by the natural evolution of the system toward some new hybrid variant, there will be a tendency to judge the issues involved in constructing an SDR standard not on a comprehensive basis that compares the whole package with the one offered by an alternative "system" (i.e. a sustainable set of arrangements), but rather on a piecemeal level in which particular new arrangements and procedures of the SDR scheme are implicitly compared with the status quo or some minor modification of it. This kind of partial, sequential comparison is inherently unfavorable to a scheme that involves, as does a full-blown SDR standard, substitution of a set of codified present and future commitments for a set of loose and mainly evolutionary arrangements. A comparison on this piecemeal basis is "producer-oriented," giving more attention to objections or resistances to change expressed by existing agencies or private operating interests than to the impact of the new arrangements on the national and international economies as a whole—as the "consumers" of the system. In effect, the former elements comprise costs of the collective good and the latter its net benefits; considered separately, the costs naturally attract little enthusiasm. The interaction of the various interests and decision-making influences involved is discussed further in section 5.

2. The Role of SDRs Mark I

The form of the embryo SDR system that emerged from the official discussions and negotiations of 1963–68, in the existing facility, reflects the influence of the organizational bias discussed above. The key feature of the present SDR facility is its incrementalism. SDRs are provided as increments to existing forms of liquidity—as supplements and not as substitutes. This feature embodied in more permanent form a long-standing tendency of official responses to pressures on the international reserve system, a tendency best encapsuled by Robert Mundell as the principle of "Add, never take away," producing the "living bouillabaisse"

of reserves of ever-more-variegated form. This reflected the fact that, in the conditions of the 1960's, the consensus that could be reached in long and intensive negotiations was just wide enough to support the single major institutional innovation involved in the introduction of SDRs, but only with the proviso that the innovation entailed no specific (i.e. identifiable) costs to participants and no serious limitations on their freedom of action.

Limitation of the facility to an "add-on" role also permitted varying interpretations of the future evolution of the reserve system. While there was general agreement that further expansion of reserve currencies in the system ought to be limited, no specific provisions were made to this end. This left a fundamental ambiguity: Did SDRs replace a dollar standard or underwrite it? Some ambiguity also remained on the future role of gold and on the significance in this context of the unequivocal expression of the value of SDRs in weight of gold.

The SDR Mark I was at once a continuation of the earlier expedients designed to shore up the gold-exchange standard and to paper over the payments disequilibrium between the United States and other countries, which the structural features of the gold-exchange standard helped to perpetuate; and, at the same time, an innovation whose own objective would tend to bring these inconsistencies to a head. This objective is in effect to help regulate the supply of global reserves in line with long-term needs. This is implicit in Article XXIV, Section 1(a), of the International Monetary Fund setting out the principles that are to govern decisions on allocations and cancellations of SDRs by the IMF: "the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such a manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world."

The regulation of reserve supply is impossible as long as SDR allocations can be dwarfed by uncontrolled expansion of foreign-exchange holdings, as they were in 1970–72. Attainment of control over the foreign-exchange component requires both (i) a usable instrument of adjustment for reserve centers, so that they are *able* to avoid an excessive expansion of their currency liabilities to foreign monetary authorities, and (ii) regulations applying to issuers and recipients of reserve currencies requiring the conversion of new accruals, so that reserve centers *do* avoid such increases in their reserve liabilities. The SDR system, in its careful ambiguity, included neither of these requirements; it could nonetheless be considered to set the stage for a second operation in which these requirements could be imposed without excessive risk.

More directly, the creation of the SDR facility affected at two key

points the outcome of the pressures on the U.S. dollar and on the gold-exchange standard of the 1960's. These points can be related to particular historical episodes. Following the devaluation of sterling in 1967, intensive speculative pressures arose in the form of massive purchases of gold. On this first occasion, the imminent availability of the SDR facility enabled governments to postpone the choice between an official revaluation of gold and a move to a pure dollar standard—alternatives (a) and (b) above. It offered the possibility that the SDR facility, then at an advanced stage of negotiation, would somehow provide a third alternative. The Ministerial Meeting of the Group of Ten, which was to deal with the remaining outstanding issues in the SDR negotiation, had been scheduled to meet in Stockholm in late March 1968; this turned out to be two weeks after the culmination of the gold crisis, and the crisis atmosphere undoubtedly contributed to the necessary agreement. The prospect of SDR allocation also helped to tilt the balance against gold by allowing the major central banks at the Washington meeting which broke up the earlier gold pool to renounce gold purchases from the private market, as well as gold sales to the market (Hirsch, 1971, fn. 15).

The second occasion on which SDRs Mark I influenced "system choice" occurred when the U.S. balance-of-payments deficit resurfaced in unprecedented magnitude in 1970. The existence of SDRs, and the fact that they had been allocated on the predication that increases in dollar reserves would be minimal, permitted and encouraged the exertion of international pressure for the financing of the U.S. deficit through use of its reserve assets. Thus, in a widely quoted portion of his opening address at the September 1970 meeting of the IMF in Copenhagen, the Managing Director of the Fund stated: "Until the payments position of the United States is brought into balance, it is important that the deficit should be financed by the use of U.S. reserve assets to the extent necessary to avoid an excessive expansion of official holdings of dollars by other countries. A policy of this kind is indeed necessary if control over the issuance of special drawing rights is also to provide the means of regulating the aggregate volume of world reserves" (IMF, 1971, p. 18). Obviously, this pressure was in practice likely to increase the probability of a suspension of convertibility and an exchange adjustment, such as eventually occurred in August to December 1971. This is not to say that these actions were deliberately forced or directly contemplated. But the existence of the SDR facility meant that such actions could be risked and, in a sense, had to be risked. They could be risked because SDR allocations could now make good any eventual undue tightening in reserve positions that might result from an adequate ex-

change adjustment by the United States. And they had to be risked because if the United States had not undertaken adjustment in the face of a huge deficit, a dollar standard would have been enshrined, removing an ambiguity of the SDR scheme in a way fatal to its continuance and to its underlying internationalist rationale.

3. Elements of a Viable SDR Standard

On this reading, then, the historical role of SDRs Mark I was to introduce and keep open alternative course (c), a viable international paper standard, while stopping short of a definitive commitment to that course. The issue underlying current official investigations is what provisions would be needed for such a definitive commitment to a full-fledged SDR system and what implications these provisions would have for institutional arrangements and for the pursuit of national policy objectives. The characteristics of a reformed SDR system are examined briefly in this section, within the general constraint that the system avoids substantive reduction in effective national economic sovereignty in the sense indicated in the introduction to this essay.

The general objectives of the reserve standard are assumed to be as follows:

- Consistency with chosen domestic economic policies
- Consistency with the absence of restrictions on current trade and payments
- Promotion of adjustment of international payments in smooth and gradual ways, together with reasonable assurance of stability for the reserve standard itself

To attain these objectives, three main attributes appear to be required of the reserve standard:

a. Association with a smooth and effective system of exchange-rate adjustment
b. Provision of a regular source of reserve growth under administrative control
c. Avoidance of accumulation and decumulation of holdings of national currencies in official reserves

The elements are interlinked in various ways:

a. A smooth system of *exchange-rate adjustment* is necessary for all three objectives. For reasons I have detailed elsewhere (Hirsch, 1972a), I believe this requires not merely a more flexible attitude toward the use of "existing" provisions, but a specific reform of institutional arrange-

ments governing exchange adjustment. This could be achieved, in a context of wider exchange margins, by some blend of international agreement on "equilibrium parity zones" and national decision on establishment of parities within these zones (Hirsch, 1972a), or by some variant on this theme. Such a variant could include a formal abandonment of parities, in a system of "managed floating" in which intervention in exchange markets by national exchange authorities was constrained and coordinated in some way by international agreement. The actions taken in response to exchange-market speculation in February and March of this year could be interpreted as a development along this line. All major currencies are now floating against the dollar. Arrangements to limit the range of fluctuation in market rates among their own currencies are now formalized by an inner core of European countries. (These fluctuations are limited within set margins of 2¼ per cent on either side of the effective cross-parities, but the significance of this is diluted by the continuing possibility of changes in the effective cross-parities whenever pressure builds up.) The position of other exchange rates, as influenced by market forces tempered by official intervention, is generally accepted as a matter of legitimate mutual concern. All this is a step toward a more positive collective influence over exchange rates, such as is probably necessary to attain a smooth system of exchange-rate adjustment. At the same time, the partial insulation from speculative influences provided by floating rates may well reduce the pressure on governments to negotiate a comprehensive reform of the system.

b. Provision for *reserve growth* is the essence of the existing SDR facility. It is accomplished by annual allocations of SDRs in an amount determined in advance by collective decision, distributed among countries in proportion to their quotas in the IMF. This is an efficient mechanism that could be carried over to the full-fledged SDR system, subject to two desirable amendments: (i) upward adjustment of the interest rate on net use or net acquisition (ex-allocation) of SDRs, to avoid arbitrary transfers of resources to net users or net spenders of these reserves, and (ii) assignment of some portion, such as one-half, of the annual SDR allocation to the World Bank group to furnish additional development aid.

The rationale for a link with development aid is that the SDR scheme as a whole confers a collective global benefit as compared with the alternatives. Unlike the gold standard, it allows for the creation of reserve assets without absorbing real resources. Unlike the dollar standard, it allows for general "participation" in decision making and, therefore, an international distribution of influence. For some or all of this benefit to be distributed for a collective purpose—such as the provision

of additional development aid—is then as rational as for it to be distributed pro rata to individual participants to use for individual or collective purposes as they wish.

Johnson's criticism (1972) of the former course, on the ground that it involves resource transfer, begs the question of whether it may be legitimate for the international community to take a deliberate distributional decision to effect such a transfer in the process of harvesting the resource or participation "yield" of the SDR system. This seems as legitimate an exercise of collective choice as a decision by a national government to devote the fruits of an increase in productivity to increased welfare payments, rather than distribute it pro rata in rebates to all citizens and leave them to decide individually whether they wish to devote these windfalls to the needy in private charity. Development aid can be regarded as in part an international collective good, as an analogue to national redistribution that is in part a national collective good. There may indeed be a stronger case for such a categorization in the international context, to the extent that an increase in aid given by one industrial country in isolation will worsen its terms of trade in a way that the same transfer accompanied by matching transfers by other industrial countries may not. There is an ancillary danger that when reserves created by collective decision of the rich countries no longer accrue proportionately to them, they will create too few. But this can be neutralized by suitable manipulation of the fraction of the SDR allocation that is still distributed proportionately to countries; this aspect of the allocation gives rich countries with their eyes on their own take an incentive to *increase* the total allocation.

If a link with development aid were introduced for the allocation of SDRs bearing equilibrium interest rates (i.e. based on rates in major money markets adjusted for expectations of exchange-rate movements vis-à-vis SDRs), and if SDRs disbursed as aid by the development agency were to be on concessional terms, special devices would be required. One possibility would be to exempt the agency from the obligation to pay interest on its own use of these SDRs, and to square the books by paying no interest to the developed countries receiving the SDRs in settlement of aid contracts; these countries would thereafter be counted as the allocatees for purposes of charging interest on subsequent use, and the regular interest provisions would then apply. An arrangement of this kind, involving payment for exports in what amounted to an assured overdraft facility, might induce a few countries with comfortable reserve positions to bow out of tendering for such aid contracts. For the most part, however, this would have the effect of curbing excessive surpluses, so that the arrangement would merely introduce a