

INCREASING THE ROLE OF THE SPECIAL DRAWING RIGHTS (SDR)

Ph.D. Lucian C. Ionescu²⁶

Abstract:

The present stage of the development of the international and financial system requires a substantial and significant increase of the Special Drawing Rights (SDR) functions both for resolving or at least mitigating crisis phenomena and for strengthening the stability and functioning of international monetary & financial relations. Although the `second amendment` of the Articles of the Agreement (IMF Statutes), since 1978, offered a large basis for developing the SDR role, in practice, the SDR's role and functions have been quite limited. The inclusion of the Chinese yuan (renminbi) in defining SDR (2016) gave a kick-start to the debate regarding the important role that the SDR could play.

Keywords: *Special Drawing Rights (SDR/XDR); monetary, financial and economic indicators; substitution account; international monetary standard.*

JEL classification: *E4, E5, F3.*

According to «IMF Financial Operations – 2018 », the creation of the SDR was meant to improve the way the international liquidity is managed, based on “international consultation and decision.” Notwithstanding this `good intention`, in our view, the main brake for increasing the role of the SDR resides in a formula constantly repeated in the IMF documents and declarations: “The SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on freely usable currencies of IMF members. SDRs can be exchanged for these currencies. (...) SDR can only be held by IMF countries and not by individuals, investment companies or corporations.”²⁷ However, at the same time, it is mentioned that SDR “play a crucial role in maintaining macroeconomic stability and global growth by providing emergency liquidity and credit when traditional methods fall short.”(Idem) It is evident that due to quite different – if not directly opposing – interests, IMF attitude is hesitant and, sometimes, even duplicitous. In our view, the main cause lies in the ambivalent position of the USA as regards the SDR's role. On the one hand, there is an obvious interest in avoiding a high responsibility of US dollar (USD) in settling the IMFS's problems, but, on the other hand, there is a permanent tendency to prolong as much as possible the advantages arising from the USD *de facto* dominant position as the main component of the international monetary & financial reserves. Since 1978, there has been an increasing scission between *de jure* and *de facto* functioning of the IMFS. The relation between the effective roles of SDR and USD has been in the centre of this intricate puzzle.

In the aftermath of the Global Financial Crisis (GFC), there has been a new impetus to debate the SDR's role and to propose measures for strengthening the international monetary and financial system (IMFS). China and the emerging economies group have proved to be quite active, especially since Renminbi (CHY) has entered the SDR basket (2016). In this context, Danyi Zhao²⁸(Jinan University) has summarised that “the SDR have three main functions: first, as the national reserve assets, the total amount of SDR in the world remains unchanged. When the balance of payments occurs, the IMF negotiates to regulate countries to carry out SDRs and a basket of currencies to keep the balance of payments; second, IMF member countries can directly use SDR to repay their loans, interest and other expenses in the IMF; third, IMF member countries can use

²⁶ Professor, Institute for studies on finance and banking (ISFB)

²⁷ IMF Factsheet, March 8, 2019.

SDR loans as gifts or conduct various financial businesses.(...) After the inclusion of RMB in the SDR currency basket, the GDP of the economies of all countries in the SDR basket accounted for a larger proportion of global GDP, which was 71% in 2016, ... compared to 56% in 2015. (...) Including China's official currency into the SDR basket shows the determination to reform of SDR and IMF..."²⁹ Another beneficial effect of co-opting Chinese yuan (renminbi) in the SDR basket has consisted in a remarkable decrease of SDR's interest rate.

Since SDR evolution became the core of the `second amendment` of the articles of the IMF Agreement, important decisions have been taken only under the pressure of crisis phenomena or grave disequilibria in the world economy (1967-73; 1978/79; 2009; 2015/16). One should remember that between end-1980s and beginning of 2000s, the amount of loans granted by IMF to member countries dramatically decreased until the GFC, putting a question mark on the future role of the main international monetary institution. In a way, one could say that GFC `saved` the importance of IMF. Gradually this reality has begun to be recognized by the IMF itself: "... Episodes of stress point to some weaknesses, including external adjustment mechanism; limitations of official liquidity provisions; and large-scale reserve accumulation – with systemic side effects. Those weaknesses, together with the expansion of the SDR basket, have renewed interest in the SDR..."³⁰ After more than a decade since GFC burst, in a difficult international climate, new debates and disputes have been initiated concerning the way the IMFS should be renovated. Consequently three concepts have been introduced in defining SDR: the official SDR, as the reserve asset administrated by IMF (O – SDR); SDR as a unit of account (U – SDR); and the SDR – denominated financial instruments in the market (M – SDR).

IMF Executive Board organised a seminal debate on the role of the SDR (in April 2018). It is important that it has been finally acknowledged that despite the aim of the Second Amendment of the Articles of Agreement to transform the SDR into `the principal reserve asset in the international monetary system`, the SDR's role as an international reserve asset has remained very limited: actions/initiatives "in both the U – SDR as the unit of account to price international trade..., and M – SDR as the denomination for financial instruments such as bank deposits, loans, or securities, has been sporadic..."³¹ Here is a little bit of hypocrisy: it is well known that the USA (together with some western developed states) have not been interested to favour a too rapid and/or substantial takeover from US dollar to SDR's effective role in the IMFS. This `forward/backward play` and `stop & go` tactics seem to continue to be the preferred game by the IMF Executive Board as regards the role and functions of SDR: "Many Directors noted that the 2009 SDR allocation played an important role in mitigating the impact of the GFC. Nevertheless, many Directors also considered that such allocations could raise moral hazard concerns."(idem) It is at least strange to refer to `moral hazard concerns` after a decade of *quantitative easing* programmes launched by the central banks (in close cooperation with treasuries/ministries of finance) of the most developed states and which amplified the risk of *moral hazard*, being contrary to the basic principles and functioning of a – more or less - `free market` economy. Positioned closer to the true cause of this contradictory attitude, `other Directors` mentioned that a more important role allotted to SDR allocations "would blur the distinction between conditionality-based Fund lending and the role of the SDR as reserves." Nevertheless, during GFC, IMF representatives recognised that, especially in the 1980 - 2000 period, under the neoliberal doctrine pressures, imposed excessive constraints mainly on developing and emergent economies which had borrowed loans from the IMF (often jointly with the World Bank). Such an example has been the obsessive insistence for `absolute` freedom for international capital flows (an important part of which was of a speculative origin and nature).

Another way of postponing effective decisions for increasing the SDR's role, despite the provisions of the Second Amendment, is, in a perverted way, to consider that empowering and enlarging the SDR's role and functions "would require amending the Articles of Agreement and resolving a number of operational considerations..." (idem). In reality more provisions of the Second Amendment still wait to be implemented and others have been only partially observed. However it

²⁹ D. Zhao, *Study on the Influence of RMB's Entry into SDR*, in American Journal of Industry and Business Management, 2019, no.9.

³⁰ IMF, *Policy Papers*, April 11, 2018.

³¹ IMF, *Press Release*, No. 18/126

is possible to witness a rather surprising speeding up of the decision making process regarding the SDR's role due to the alarming signals, that seems to multiply since mid-2019, enhancing the probability of an international recession in the near future: "...Economic growth has fallen back across the developed world. Some blame this on a slowing of innovation and productivity...I see the issue differently – the struggle to revive the world economy is the result of the disequilibrium that led to the crisis itself."³²

`Normalising` monetary policy has already been forgotten or at least downgraded. Here follows the reference interest rates (in %) of the main central banks in 2019 (Q III) – source *Trading Economics*: USA: 1.75/2; Canada: 1.75; UK: 0.75; Euro Area: 0.00; Japan: -0.10. China is an exception: 4.25 (Aug.). In this context, President Trump's virulent attack addressed to The Federal Reserve Board for `keeping too high the interest rate` level has been in a certain conflict with the rather bombastic appraisal of the `force and efficiency` of the American economy. Therefore, at the end of October, Fed reduced the interest rate to 1.50/1.75%. China also cut the interest rate to 4.15 in November (2019). As regards the Euro Area and Japan, the 0.0% and a negative interest rate clearly show a stagnant evolution.

Transforming SDR in a major component of international reserves has become a priority which requires a series of prerequisites, but, at the same time, offers a historic chance of profoundly improving the stability and the functioning of IMFS. In our view, first of all it is needed a gradual removal of the `umbilical connection` between IMF and SDR. Undoubtedly it was necessary that the SDR to be created under the auspices of the main institution of the international monetary and financial community. Now it is high time to let SDR to fly/circulate according to the laws and mechanisms specific to the world economy. Certainly the coordination and guiding by the IMF will preserve its role. There are yet a lot of lessons to be learnt and many a mistake to avoid if we are referring only to the last 2 – 3 decades: "...Because SDRs are merely claims on hard-currency reserves..., their emission has no further value once the outstanding SDR claims is sufficient to purchase the outstanding stock of gross currency reserves."³³ Substantially increasing the SDR role would represent a rare opportunity to stimulate productive investment and drastically diminish pure speculative capital flows which, as it is well known, were a main cause of GFC and of the prolonged stagnation afterwards – an eloquent expression of the rift between nominal and real dimensions of the economy: "Notwithstanding the practical obstacles to a substitution account, a reserves system largely based on the SDR would have some advantages. Through allocating new SDRs..., the IMF could influence aggregate world reserve growth and... make it less erratic."³⁴ Increasing the role of the SDR would also counteract the temptation of issuing all sorts of `cryptocurrencies` which imply the major risk of volatility, instability and voracious monetary speculation.

As the gold exchange standard (*de jure*) functioned under the form of the US dollar exchange standard (*de facto*) after the World War II until 1971/73, since 1978 `second amendment` to the Articles of the IMF Agreement there has been a *de jure* commitment toward a SDR standard which, until nowadays, functions as a *de facto* USD exchange supplemented by SDR allocations. In this perspective, there may be conceived several stages of `liberalising` the international SDR circuit: (i) payments or loans effectuated inter – central banks of the IMF member states, informing IMF but without a special need for approval; (ii) issuing new tranches of SDR especially meant for the real sector of the economies, being strictly *discouraged speculative financial operations*; (iii) the possibility of issuing bonds by Treasuries/Ministries of finance denominated in SDR (speculative operations being forbidden). Certainly a specific market infrastructure should be set up, preferably under the guidance of IMF experts. The phases suggested also prepare the road for the SDR to becoming a currency. In this vision, the issue of a so-called `substitution account` would be easier to perform, avoiding to lay `the burden` only on IMF. In this context, it would not be too difficult to structure a segment of the monetary and financial market for SDR transactions under a strict regulation.

The utility of such an organised initiative is confirmed by the `invasion` of the so-called cryptocurrencies which appear and evolve in a `grey zone` (somehow alike *shadow banking*). The

³² M. King, *The end of Alchemy*, ed. Little, Brown, London, 2016, p.291.

³³ *The viability of the Special Drawing rights as an international asset*, IGC – International Growth Centre.

³⁴ M. Obstfeld (Univ. of California, Berkeley/International Growth Centre – London School of Economics), *The SDR as an International Reserve Asset: What Future?*, March 2011, p.13.

`tolerance` of the monetary and banking authorities toward such `experiments` is, in fact, not encouraging `free enterprise`, but is a form in disguise of the greed for new ways of speculative operations, which is an old virus affecting the real qualities of an economy based on capital accumulation.

Although the main role of SDR would be to contribute to the equilibrium of international liquidity, especially in the periods of troubled economic and financial relations, SDR should confirm one of its original meanings – alleviating the gaps between the levels of development among different groups of countries (mainly industrialised states and underdeveloped countries). It is evident that, beyond economic and financial factors, solving the intricate problem of the huge development gaps vitally depends on *political will* of the most powerful and developed states. Despite some steps in the direction of democratising the institutional infrastructure of the present role, the road to a real democracy has always been bumpy. The first years after the World War II were the most prolific as regards the international institutions and organizations meant to assure a peaceful world, favouring negotiations instead of military conflicts. Certainly IMF, the World Bank and the World Trade Organization are only some pillars of the post-war international order. Unfortunately their progress was frequently impeded by the main political forces acting worldwide. Thus between the end of 1940s to the end of 1980s, there was a bipolar division of the world (USA and USSR). The dissolution of the state socialism system and, finally, of the USSR seemed, for more than a decade, to bring the world to a one polar position.

The beginning of the 21st century has marked a clear advancement to a multi-polar political world and a strong move toward a multipolar global economy. This situation has created an ambivalent political environment: on the one hand, this may be a prerequisite to enhance the level of the democratic approach of the most important world problems to solve. But, on the other hand, there is a dangerous possibility to assist to a multiplying of international conflicts (economic, financial, commercial and even military). A weak point of the present world order is that the UNO has been in a shade of grey for some time. Probably UNO itself needs some functional improvements.

The 2010 IMF reform represented a power shift in favour of the emerging and developing economy Fund's members, but which became effective in 2016, mainly because the US Congress did not ratify the reform in due course. After the above-mentioned reform, China's voting share rose from 3.8 to 6.1%, consequently becoming the third important member, after the US and Japan. However that was more of a `diplomatic` manoeuvre, because the minor decline in the US voting power share – from 16.7 to 16.5 – did not affect the US *de facto* veto right. As it is known, the issues considered of `major importance` – as it is the increasing role of the SDR – could be approved only with a majority of at least 85% of the total voting power. A new role and quality of the SDR depends on the type of international order dominant in the world economy. As long as the major powers of the world are obsessed by reshaping their spheres of influence, the international relations would be poisoned by real or provoked conflicts, generating the so-called `regional wars` which, unfortunately, could degenerate in a world military disaster. In such tensed environment, mined by threats and force demonstrations, a fully developed role for SDR, based on democratic and generous principles, could offer a unique opportunity for solving present world grave problems, paving the way for a better future.

After a complex improvement in the organizing and functioning of the IMF, SDR should, in the near future, become the IMF's currency. To avoid difficult and lengthy procedure, a certain amount of SDR should be at the disposal of IMF executive Board yearly (e.g., SDR 200 billion), deposited in a `substitution account`, in a transparent and well managed way, under a periodical auditing procedure: "Until now, the Fund has relied mainly on quota (capital) increases and borrowing from member countries. But quotas have tended to lag behind global economic growth; the last increase was approved in 2010, but the US Congress agreed to it only in 2015. And loans from member countries, the IMF's main source of new funds (particularly during crises), are not true multilateral instruments."³⁵ SDR could accomplish the basic functions of money: unit of account (already accomplished), a store of value (partly and weakly accomplished so far) and – most important for its evolution – means of exchange. In our view, this proposal should not be considered a position in

³⁵ J. A. Ocampo (Columbia University), *Is it time for a `true global currency`? World Economic Forum / Project Syndicate, April 2019.*

favour of establishing `a unique world currency`. National and regional currencies should preserve their role and their natural evolution, according to every nation's will.

The SDR as a currency should valorise `the principle of communicating vessels`, for smoothing the functioning of the global monetary and financial system, aiding to reduce the gaps in development of different groups of countries, avoiding lack of international liquidity, financing productive, socially useful real investments and discouraging speculative and disruptive operations (more or less `sophisticated`). Undoubtedly, it is useful to analyse the composition of the foreign exchange reserve. It is worth mentioning that the percentage of the reserves officially identified increased remarkably, from almost 78.5% in 2016 to about 94% in 2019.

Table 1

World currency composition (in %)

	2016	2019 (Q I)
USD	65.36	61.82
Euro	19.14	20.82
CHY	1.04	1.95
JPY	3.96	5.25
GBP	4.34	4.54
AUD	1.69	1.67
CAD	1.94	1.92
CHF	0.17	0.5
Other currencies	2.34	2.45
Unallocated reserves	21.35	5.95

Source: Currency composition - Official Statistics (IFS)

At the beginning of 2019, the total `allocated` exchange reserves have represented almost USD 11 trillion. It is interesting to remark that, in the wake of the GFC, central banks allotted to the `markets`, by their `nonstandard` monetary policies about USD 10 trillion. Taking into account that USD represents over 60% of the `official` reserves, it is obvious that, beyond the `exorbitant` privilege, USD is the `messenger` of the American economy, with its strong and weak characteristics during its evolution. Regrettably, after the GFC, the western advanced economies have proved an increased *financial fragility* (see Minsky's terminology). This complex stimulating concept has been researched and developed furthermore: "The current international monetary system is fragile because the dollar standard is rapidly deteriorating. The dual role of the US dollar as the dominant international money *and* national money cannot easily be reconciled because the US monetary authorities face a conflict between pursuing domestic objectives of employment and inflation *and* maintain the international public good of stable money."³⁶ To avoid this `dilemma`, the authors of the quoted study, taking "inspiration from the principles underlying Keynes's old plan for *bancor* and an international clearing union", have proposed "the creation of a supernational bank money (SBM) within the institutional setting of a clearing union."

As already underlined, the revival of an international interest for increasing the role of the SDR was stimulated by the inclusion of the Chinese Yuan (renminbi) as a component for defining SDR value (in 2015/16). However, so far China's efforts has had modest effects, mainly due to the position of the USA which still have a de facto veto in the IMF voting procedure. Therefore a "top – down reform of the international monetary system appears infeasible. ... Any reform will have to be *de facto* and bottom –up, the initiative of a state or group of states, and promulgated by the market

³⁶ P. Alessandrini, M. Fratianni, *Dominant currencies, Special Drawing Rights and Supernational Bank Money*, in *World Economics*, Vol. 10, No. 4, Oct. – Dec., 2009 (updated in January 2019).

process.”³⁷ As the IMF documents underline, nowadays “IMF members regularly need to buy SDRs to discharge their obligations to the IMF or to replenish their SDR holdings. They may also wish sell SDRs in order to adjust the composition of their reserves.”³⁸ Despite these needs, “the major limitation on the use of SDRs is the division between the IMF’s general resources and SDR accounts, which limits the use of SDR to payments among central banks.”³⁹ Therefore the normal evolution of the SDR is mainly blocked by the US restrictive position, despite an obvious necessity for increasing the SDR’s role. The rather shocking project of Facebook to `create` *Libra* as a virtual/digital currency indirectly confirms the utility of developing the SDR as an effective international currency, avoiding risky `private` initiatives, which usually reflect narrow speculative interests (one should pay attention to the tribulations of the *bitcoin* experiment).

As aforementioned, the threat of a serious recession could favour an increase of the SDR’s role. Since mid-2019, there have been more signals of a worsening international economic climate. Recently (September 2019), Ron Paul – founder of the *Institute for Peace and Prosperity* - declared (at CNBC) that bonds of about 17 billion USD are already in the zone of negative interests which would be a clear sign of a new huge financial bubble: “We are in the biggest bond bubble in history and it’s going to burst.” Under these circumstances, it is quite possible the SDR to be seen as a mitigating factor so that their role and functions to be substantially increased. Certainly it would be wiser to act according to a well-balanced plan beneficial for all the parties involved. Unfortunately the present world is marked by numerous contradictions and conflicts which make solutions of the *force majeure* type more probable.

Bibliography

P. Alessandrini, M. Fatianni, “*Dominant currencies, SDR and Supernational Bank Money*”, in *World Economics*, Vol. 10, No.4.

M. Harrison, Geng Xao, “*China and Special Drawing Rights – towards a better International monetary System*”, in *Risk Financial Management*, April 2019.

“IMF Financial Operations – 2018”, IMF, 2018

M. King, *The End of Alchemy*, ed. Little, Brown, 2016

M. Obstfeld (University of California, Berkeley), *The SDR as an International Reserve Asset. What Future?*, March 2011

J. A. Ocampo (Columbia University), *Is it time for a `true global currency`?* , in *World Economics Forum/Project Syndicate* (April 2019) and *The SDR’s time has come*, in *Finance & Development*, Dec. 2019

D. Zhao, *Study on the influence of RMB’s Entry into SDR*, in *American Journal of Industry and Business Management*, 2019, no.9.

³⁷ M. Harrison and Geng Xao, “*China and Special Drawing Rights – towards a better International Monetary System*”, *Risk Financial Management*, April 2019.

³⁸ “*IMF Financial Operations 2018*”, IMF, April 2018.

³⁹ J. A. Ocampo, “*The SDR’s Time Has Come*”, in *Finance & Development*, December 2019, vol. 56, No.4.