29. Can special drawing rights replace the dollar and other national currencies as a reserve asset?

The Bretton Woods international monetary system began to unravel when European currencies and the Japanese yen became convertible in the late 1950s and early 1960s. Marshall Plan grants and the growth of their exports to the United States (US) made it possible for these countries to acquire sufficient reserves of gold and dollars to be able to exchange their currencies for those of other countries and begin to expand their contacts with trading partners. The positive effect of this development was a substantial increase in growth in industrial countries in the 1960s, largely due to the expansion of trade. Throughout the decade, however, there was an increase in private speculative sales of dollars for other currencies and some official demand for gold in expectation of dollar devaluation (Dam, 1982).

As discussed in Chapters 2 and 12, the external (Eurodollar) market was seen as a way to absorb excess dollars without changing the US international balance sheet after the first dollar crisis in 1960. But the second run on the dollar in 1967 demonstrated that offshore transactions would affect the exchange rate for the dollar; change the demand for dollars as effectively as transactions involving capital flows into and out of the national market; and expand foreign holdings of dollars if other currencies were not used in cross-border transactions with countries other than the US. The continued "dollar glut" resulted from an ongoing preference for using dollars in international payments, but a waning preference for using the dollar as a store of value. Demands on the US to convert dollars for gold contributed to the unraveling of the dollar/gold exchange standard and forced President Nixon to end the dollar's convertibility into gold in August 1971, and end the monetary system established under the Bretton Woods Agreement (D'Arista, 2009a).

As the unsustainability of the dollar/gold exchange standard became increasingly obvious in the 1960s, the noted international economist Robert Triffin led the way in calling attention to the need for a post-Bretton Woods system. His proposals were an integral part of the

discussions that led to the Rio Agreement in 1967 that authorized the International Monetary Fund (IMF) to create and issue special drawing rights (SDRs) to be used as reserve assets. Since then, other crises—in the 1980s, in 1997, and in 2008—prompted a re-emergence of interest in international monetary reform. Most of the discussion has continued to focus on expanding the role of SDRs; the amended IMF Articles of Agreement state the intention of making the SDR the principal reserve asset in the international system. But a total of only 21.4 SDRs ($33 billion) were issued after their creation in 1969 and the IMF's approval of a new issuing of $250 billion in 2009 reveals how minor the SDRs' role remains, compared with trillions of dollars of outstanding dollar-denominated reserves (D'Arista, 2009a).

Nevertheless, SDRs have played an important role in providing reserves to developing countries. In the absence of the ability or willingness of any country or group of countries to fund grants on a scale comparable to the US Marshall Plan, the SDR is the only debt-free source of liquidity at the international level for economies in crisis. Loans from the IMF are not a desirable solution for crisis countries. Since they are no different than debt owed to the private sector and, since debt to the IMF has priority status and must be serviced before other obligations, these loans tend to compound the pressure on countries to export their way out of additional IMF loans. On the other hand, new SDR allocations provide a uniquely benign alternative to bailout loans that compound the underlying inequities in the system. Given these benefits and the fact that the SDR is an established component of the current international monetary system, we begin this section by examining the potential benefits and limitations of relying on SDRs as a vehicle for monetary reform.

Robert Triffin believed that the central achievement of the 1967 Rio Agreement—the creation of new reserve assets to strengthen the balance of payments adjustment mechanism—was a first step in the right direction. But he warned that it would not constitute a viable reform effort if it failed to take a more comprehensive approach in assigning roles to all three components of reserves—gold, foreign exchange, and collectively created assets—especially since he predicted that gold would be demonetized internationally as it had been nationally since the 1930s (Triffin, 1968).

Triffin's created reserve assets were similar to the reserve asset that Keynes called "bancor" in his 1940s proposal for an international clearing union to hold international reserves. Unlike Keynes, however, Triffin proposed that the distribution of reserves created by the IMF be linked to development finance. But the major industrial countries with the majority of votes in the IMF linked the distribution of SDRs to the size of existing quotas. Triffin complained that their decision to link issuance to quotas was "as indefensible economically as it [was] morally," especially since two of the richest countries in the world (the US and the United Kingdom (UK)) were assigned about one-third of the total (Triffin, 1968, p. 194).

One outcome of the decision to allocate so large a share of SDRs to the US was that it effectively destroyed the ability of the SDR to assume an important role in the system, since it made the US, the holder of the largest share of SDRs, reluctant to exchange dollars for SDRs offered by other countries. As a result, it undermined the potential to forge the needed link between the reserve asset and the medium of exchange. Moreover, continuation of the system of allocating SDRs in proportion to quotas has perpetuated the inequity in the system. The new issuing of $250 billion approved in 2009 allocated less than $100 billion to developing countries and only about $20 billion to low-income countries (United Nations, 2009).

Under the system created in 1969, SDRs are valued in relation to a basket of currencies and serve as the unit of account in which all IMF transactions are denominated. Member countries' obligations to and claims on the fund are also denominated in SDRs. SDRs may be used as reserve assets by a member country in exchange for another country's currency in cases where the former needs to finance a balance of payments deficit and the latter has a strong balance of payments position. Such transactions can take place at the direction of the IMF or through the mutual consent of the two countries, but only if both countries agree. In addition, SDRs can be used in loans, swap arrangements, and the settlement of other financial obligations among member countries, and between a member country and the IMF (IMF, 1987).

Like past proposals for new issues of SDRs, the objective of the 2009 allocation was to move beyond the key currency system by creating an international reserve unit under multilateral governance. While new issues of SDRs have been used as a mechanism for expanding reserves, they have the potential to contribute to global stability by removing the credit-generating attribute of foreign exchange reserves that, as discussed in Chapter 13, introduced a pro-cyclical aspect to reserve holdings and exacerbated booms and busts. Using the SDR as a reserve currency could accomplish that objective without the loss of national sovereignty because national central banks would continue to issue national currencies. But while the SDR could be used in transactions among central banks and with the IMF—and like the European Currency Unit created by the European Monetary System before the adoption of the euro, could

serve as a unit of account in private transactions—it could not be used to finance transactions in the private sector. In other words, the SDR as currently structured cannot be used as a means of payment.

In an effort to overcome this problem, economist Joseph Stiglitz proposed creating a "global greenbacks" system in which new reserves could be created every year and would not be given largely to the wealthiest countries. His proposed system would include a trust fund of conventional hard currencies to enable countries in crisis to exchange their global greenbacks for currencies that can be used to pay private creditors and for imports. A more ambitious version of the system, he noted, "would allow global greenbacks to be held by individuals, in which case there would be a market price for them and they would be treated like any other hard currency" (Stiglitz, 2006, p. 263).

Unlike other proponents of SDR issuings, Stiglitz acknowledges the need to forge a link between a reserve asset not based on national currencies and the currencies used in private international transactions. His proposal improves on the current system for exchanging SDRs for hard currencies in that the pool of hard currencies that would be created would be used at the direction of the IMF rather than the national central banks that issue those currencies. Nevertheless, the trust fund would necessarily rely on contributions from those countries; he does not suggest how the IMF would ensure that their contributions would be sufficient to create a pool large enough to be effective in managing crises.

As for the more ambitious proposal to allow the global greenback to evolve into a transaction currency, Stiglitz is vague on the institutional arrangements that would be required. One assumes that global greenbacks would not be issued directly to individuals or private institutions, but might leak into the system through sales to private institutions by central banks. Or, again, like the European Currency Unit, they could be used to denominate private transactions without being exchanged at settlement.

After the 2008 crisis, the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System published a report calling for a global reserve currency issued by a public international institution to replace the dollar. The report offered several alternative arrangements for this core proposal, including the following:

> One institutional way of establishing a new global reserve system is simply a broadening of existing SDR arrangements, making their issuance automatic and regular. Doing so could be viewed simply as completing the process begun in the 1960s when SDRs were created. The simplest version, as noted, is an annual issuance equivalent to the estimated additional demand for foreign exchange reserves due to the growth of the world economy. But they could be issued in a countercyclical fashion, thereby concentrating issuances during crisis periods. One advantage of using SDRs in such a countercyclical fashion is that it would provide a mechanism for the IMF to play a more active role during crises. (United Nations, 2009, p. 117)

Forging institutional means to use a more plentiful supply of SDRs in trade and debt-servicing transactions might constitute an effective incremental path toward substituting an international unit of account for national currencies as both the primary reserve asset and as a means of payment in the international system. As noted, the SDR is already part of the international monetary system; additional creative proposals on how it could be used in managing crises appear to be the most fruitful path toward reform. As these proposals are developed, however, they must place restraints on the role of the private financial sector in pricing or distributing SDRs or similar reserve assets. Failure to do so would likely expose the reserve asset once again to the perils of speculation. Given the damage done by the process of privatizing the international monetary system since the 1970s, the debate on reform must include discussions of the appropriate criteria for determining changes in exchange rates and how those determinations should be made.