On Soros: Are Special Drawing Rights the Deus ex Machina of the World Economy?

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This is less a review of George Soros's new book than an answer to it and a call for further reform. The author believes Soros has some good ideas about how to expand the West's giving to poorer nations. He would like to see a more dramatic change in the international financial system to reduce its natural instability, however.

IN HIS BOOK *SOROS ON GLOBALIZATION*, GEORGE SOROS PROPOSES A RAFT OF CHANGES in national-level and international-level public policy that he contends would improve the performance of the world economy.[1] He gives pride of place to a proposal to expand the existing system of International Monetary Fund (IMF) special drawing rights (SDRs)—not only to

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expand but to change the way SDRs are used. In this article I describe Soros's proposal and then assess its strengths and weaknesses. At the end, I make some remarks about some of Soros's other suggestions for reform of the multilateral development banks.

First a word about SDRs.

What Are Special Drawing Rights (SDRs)?

SDRs are a form of special-purpose money that the IMF's board of governors can create by crediting accounts of IMF member states (at an exchange rate set by a basket of major currencies). The allocation goes strictly proportionally to the countries' quotas. (Hence economist Robert Triffin wrote at the time of their introduction that the automatic allocation of SDRs according to quotas was "as indefensible economically as it is morally," since at that time, allocation by quota meant that the two biggest economies got one-third of the total. The SDR designers, he said, had created an asset that made the rich even richer.)[2] SDRs are special purpose in that they are not a transactions currency. They can be used only for repaying debts to the IMF, for repaying Paris Club debt, and to augment foreign-exchange reserves by freeing up hard currency that would otherwise have to be held against the IMF and Paris Club debt for use on other things. But anything that is an expenditure, that involves debt service to *private* agents, must be paid for in hard currency.

They have not been created on a significant scale since being instituted in 1969 because the United States and other rich countries have not been keen on them. Rich countries get most of the SDRs, but they cannot spend them—they do not need them for boosting foreign exchange reserves since they already have hard currency, and they neither borrow from the IMF nor carry Paris Club debt.

What Is the Soros Proposal?

Soros proposes to make SDRs into a somewhat more general-purpose currency, though the uses would remain very restricted compared to hard currencies. He concentrates on what the *rich* countries would do with their newly created, broader-purpose SDRs—that is, they would use them for the purpose of raising the supply of "global public goods." What would be their incentive to do so? Pressure from their electorates generated by public campaigns. The Jubilee 2000 campaign for debt cancellation for very poor countries is a model of the campaign that should be mounted in favor of a new, broader-purpose SDR issue, says Soros.

The rich countries would *donate* their SDRs to a trust fund managed by a board or jury of "eminent persons" (not state representatives). The board would draw up a menu of worthy projects with a high quotient of global public good-ness (for example, a TB-eradication program in Africa). The donors (the rich-country governments) would then select from the menu some projects that they individually wish to support. At the point when the SDR allocation was made to each project, the sponsoring rich country would have to pay the recipient (or the trust fund) in U.S. dollars or the equivalent amount in its own (hard) currency (at the going SDR exchange rate determined by the basket of major currencies). So the new scheme does not alter the economic character of SDRs: The rich countries have to pay for them with their own currency once the SDRs are put to use (and at that point they become a charge on the national budget). The SDRs are not "freebies" for the rich countries.[3]

Merits of the Soros Proposal

Soros's proposal focuses public attention on apparently arcane monetary issues that have a huge impact on the performance of the world economy yet receive rather little public attention.

Changes in the world monetary system could indeed, as the proposal implies, produce better performance from the world economy as a whole. The fact that the proposal is very modest (only $27 billion SDR equivalent for the first issue) means it is doable.

Also, the proposal makes a creative link between these monetary/payments issues and the supply of global public goods. I need no convincing that the world could do with a more reliable supply of global public goods. And the Soros mechanism of choosing which goods will be supplied, by whom, and financed by whom, is an interesting one when put alongside the present arrangements.

At present, the World Bank is one of the main suppliers of global public goods. Its agenda is being set largely by the representatives of the rich states (specifically by the finance ministers who constitute "the International Development Association deputies"), with emissaries from poor countries having little or no say. There is little substantive analysis underpinning the IDA deputies' choice of four items to head the Bank's global public-goods priorities: "fighting infectious diseases, promoting environmental improvement, facilitating trade, and promoting financial stability." In practice, the G7 countries, the IDA deputies, and the senior management of the Bank have great discretion as to how they prioritize global public goods. The worry is that the choice may reflect private interests—which use the income of an international organization to provide themselves with narrow private goods—or may reflect whatever has the most slogan appeal to northern governments. The Soros mechanism may help to ease these difficulties with the World Bank's mechanism, and it may also provide a model that can be deployed internationally for other purposes.

The proposal, though modest in scale, could in principle be readily scaled up to the point where it made a significant contribution to solving the chronic tendency in the world economy at large toward excess capacity reflecting insufficient demand. Allocations of SDRs in favor of less-developed countries (LDCs) could significantly raise LDC consumption, especially if the possible uses of SDRs were broadened. The allocations would function to raise demand in low-income countries for the products of northern industry, similar to the way the Marshall Plan served to raise demand in war-damaged Europe and create a market for the products of American industry.

However, we should not kid ourselves that the SDR proposal itself will make much of a difference even if implemented in full. It is "small potatoes." It is basically a way to arrange for the rich countries to cough up more grants to poor countries. All the fancy talk is really just a fig leaf on this—very familiar—idea. That being said, the trust fund, the independent jury, the shopping for recipient programs, and the addition of SDRs to the reserves of the poorer member countries—these ideas deserve to be treated seriously.

Limitations of Soros's Proposal

Soros is not clear on a key question: What is in the proposal for the U.S. government, which has always resisted further SDR allocations? Congress has been refusing for several years to sign on to a (conventional) SDR expansion, which most of the IMF's members have signed. Will the bells and whistles on the central idea of more grants from rich countries to poor countries make it more palatable to Congress? If Congress does not trust the IMF, why would it trust a board of "eminent persons"? Presumably, the United States could use its SDRs to buy back its government securities from other countries and thus retire some U.S. foreign debt. But would this, together with pressure from a public campaign, be sufficient to obtain congressional approval? Is there any way the U.S. government, now in a determinedly unilateralist frame of mind, could get more *direct* benefits from some of its SDRs?

Soros says little about what the poorer countries would do with their SDR allocations—what benefits *they* would get (apart from the benefits of the global public goods projects). Presumably, the direct benefits are those they could have had all along from conventional SDRs, and the Soros proposal does not contain anything new in this respect. LDCs could use the SDRs (a) to repay the IMF, (b) to repay Paris Club debt, (c) to help countries in foreign-exchange crisis get hard currency from the IMF (they could go to the Fund with their SDRs and ask for U.S. dollars in return, and the IMF has to match them up with a source of dollars), and (d) to release hard currency reserves for use in transactions (importing, servicing foreign private debt), now that the reserves needed to be held against IMF and Paris Club debt and against the possibility of financial crisis are partly constituted of SDRs.

How attractive are these (direct) benefits to developing countries? Should not a public campaign give more attention to them than Soros gives?

Then there is the governance question. Beyond the idea of putting the governance in the hands of a board or jury of eminent persons, Soros says little. And closely related is the question of how the global public goods would be prioritized. Soros suggests infectious diseases, judicial reform, education, and bridging the digital divide. The G7 countries and the IDA deputies identify as priorities for the World Bank infectious diseases, environmental improvement, trade promotion, and greater financial stability. This is a game anyone can play. My candidate is "generating more social-science knowledge in developing countries." The existing polarization along the social-science dimension can be seen from the location of affiliation of authors and discussants at the World Bank's Annual Bank Conference on Development Economics (ABCDE). In 1995–2000, seventy-six authors of papers took part. Three-quarters were affiliated with a U.S. center, 20 percent with a center elsewhere in the North, only 5 percent with a center in the South—yet the papers were virtually all about the South. Of the eighty-three discussants, 20 percent came from the South. The disproportions in the IMF research conferences are similar.[4] The upshot is that after half a century of "development" as a directed endeavor, developing countries as a group seem to have little capacity to think for themselves on issues critical to their future—and the Bretton Woods institutions are implicated in this failure, reflecting their lack of priority given to improving the supply of this particular global public good.

SDR Proposal Ignores Core Problems of the Post–Bretton Woods System

Soros's proposal does not touch the root cause of financial fragility and slow growth in the world economy at large, especially in "emerging market economies" (LDCs of interest to international investors).

The post–Bretton Woods international monetary system generates financial instability and slow growth in the world economy "endogenously" and particularly handicaps developing countries. Four features combine to produce this result:

1. The "original sin" of not allowing economic actors to engage in international payments in their own national currency, requiring them to obtain hard currency, generally U.S. dollars, for paying for imports or for repaying foreign loans.
2. *Private* foreign exchange markets and settlement systems—via private banks, not via central banks.

3. A fiduciary currency, the U.S. dollar, as the main international currency, meaning a currency whose issuance is unconstrained by any supply-side factor (such as a dollar-gold link).
4. Largely unrestricted capital flows.

This post–Bretton Woods (PBW) system gives hard-currency governments—above all, the U.S. government—a much freer hand than before to print money and incur fiscal and current account deficits. The amount of U.S. currency in circulation and the size of total international reserves have grown almost exponentially since the early 1970s, in association with rapidly rising trade imbalances and cross-border flows of short-term capital. These trade imbalances and short-term capital flows have become major sources of instability and slow growth in the world economy at large. In particular:

1. The U.S. current account deficit is a "facilitating condition" of the economic overheating and asset price booms in Japan, the East Asian crisis countries, China, and the United States. The deficits have caused an explosion of international liquidity (credit), because as the "U.S. government securities" (issued to finance the deficit) accumulate in surplus countries' banking systems, they have the same impact as high-powered money injected by the central bank into the banking system: They are deposited, lent, redeposited, and re-lent many times over. They can easily blow out asset price bubbles and industrial overinvestment, ending in recessions or depressions. This was the story of the Japanese bubble and crash in the second half of the 1980s and 1990s—also the story of the East Asian bubble and crash in the 1990s, and China is currently well along this path. The continuing credit expansion being created by record

U.S. external deficits ensures that credit bubbles will continue to blow out around the "emerging market" world with much higher frequency than in the Bretton Woods era, and their bursting will cause bigger economic and social costs. As crisis-affected countries devalue their currencies in order to increase their current-account surpluses (a practice sanctioned by the IMF and the World Bank), they make the systemic instability worse.[5]

2. The PBW system makes foreign exchange markets prone to volatility, reflecting essentially speculative movements of funds unrelated to changes in demand for goods and services or costs of production, movements that are *procyclical*, that amplify rather than dampen swings in economic activity.
3. The PBW system makes debtor countries (other than hard-currency ones) vulnerable to exchange-rate volatility, because when the domestic currency falls in value, the burden of debt service denominated in dollars rises, tipping more firms into insolvency.
4. The PBW system forces debtor countries (all except the United States) to restructure their economies toward exports with which to earn the hard currency needed to pay for imports and to service debt, which can *shortchange* domestic demand and national economic articulation (rising density of national, perhaps regional, input-output linkages) as sources of growth.

The PBW system liberates the U.S. government from concerns about what other governments do, while constraining other governments more tightly by what the United States does. This is the great paradox of globalization: Debtor countries are generally not masters of their fate, but globalization and the PBW monetary system allow the biggest debtor of all to harness the rest of the world to its rhythms. The system forces all countries to lend to the United States at cheap rates, because they hold their reserves mainly in "U.S. government securities." Other countries' willingness to accumulate "U.S. government securities" (without redeeming them in the form of U.S.-made goods and services) allows the United States to continue living far beyond its means. The fact that the world's savings are flowing disproportionately to the United States, the richest country, impoverishes everyone else, including the Europeans. European investment levels are held down because European savings flow to the United States. On the other hand, the platinum credit card of the United States, on which it need pay only (low) interest, not principal, allows the United States to invest heavily, to accumulate military armaments, and generally to accelerate the density of its hegemony.

The fact that the world's skilled people are also flowing disproportionately to the United States—and not just capital—compounds the U.S. hegemonic advantage.

To tackle these root problems of the world economy, we need to design an architecture that allows countries to make cross-border payments in their own currency and that gives the central management role in international payments to public institutions (central banks and a new international clearing agency).[6]

The key point in this new architecture is that banks receiving payments in foreign currency would be required to exchange them for domestic currency deposits at their national central banks. The national central banks in turn would be required to present the foreign currency payments to the international agency for clearing. Net payments through the international agency would be debited or credited against a member country's reserve account (held in the country's own currency). Exchange-rate changes would be made in-house in accordance with changes in reserves, at regular intervals. The exchange rates would reflect costs of production and demand for goods and services, not speculation against future movements. They would become an order of magnitude more stable than under the PBW system.

Soros's Proposals for Multilateral Development Banks Go in Wrong Direction

The SDR proposal aside, there are further questions about the wider Soros agenda on managing globalization, such as the role of the World Bank and the other multilateral development banks. Soros wants more grants and fewer loans, because loans create debts, and he wants the World Bank to accelerate its present move out of infrastructure projects and into building human and social capital. Social initiatives—such as microcredit, distance learning, fighting AIDs, using nongovernmental organizations (NGOs) and the private sector as the agents rather than just governments—these are the right way forward financed by grants. The Bank should refuse to make loans or grants to "repressive and corrupt regimes."

As for switching to more grant finance, the danger is that this direction reduces still further, even more than foreign loans, the pressure on LDC governments to establish effective tax-raising and service-providing bureaucracies—to establish, more broadly, a social compact with their populations whereby the state and its incumbents can plausibly claim to be working for the "public" service and can plausibly claim the right to levy taxes in order to do so. Such a social compact seems to be a necessary condition of economic development. Grants make it all too easy for a government to sustain itself in power without having to build up the social sinews of power.

Is it good for the world that the World Bank exits from sectors where projects are inevitably socially and environmentally sensitive, like water supply and sanitation, irrigation, transport, forestry, and mining? The short answer is no, because the Bank's involvement is *likely* to cause more attention to damage mitigation than if the financing and design are left to private companies.

Should the *World Bank* be operating close to the "grass roots," as the Soros agenda implies? We should remember that just because X is important for development does not mean that the World Bank should do X. This is a point that the IDA deputies (representing the IDA *donors* only), who set the conditions to be attached to World Bank loans (*both* the highly concessional IDA loans and the close-to-commercial IBRD loans), seem unwilling to learn. In the recent IDA-13 negotiations over the next round of contributions, the IDA deputies placed fifty-three conditions or recommendations on their contributions—one of which was that the Bank should seek to "increase selectivity"!

It is worth considering a radical proposal, a grand accord, whereby LDC governments (all except the poorest) would renounce aid and concessional finance—would agree to give up the modest increase in "positive freedoms" (freedom *to*) that aid and concessional finance give them. And the rich countries would agree to expand the LDCs' "negative freedoms" (freedom *from*) by lowering barriers to their exports, weakening intellectual property rights and patents as they cover items of LDC origin, not imposing environmental and labor standards as invisible trade barriers, and so on.

Why would this grand accord be good for development? First, it would make it more difficult for "corrupt and repressive" governments to avoid establishing a social compact with their populations. Second, expanded negative freedoms of this kind would be worth much more than the present modest expansion of positive freedoms that comes from aid and concessional finance. The problem is, of course, worth more to whom? Aid finance benefits the government in the short term. The expansion of negative freedoms confers more diffuse and longer-term benefits. Likewise, on the "donor" side: Rich country governments that shrink LDCs' negative freedoms (by raising protection against LDC exports, toughening intellectual property rights, and so on) confer benefits on or avoid harm to quite specific interest groups in their populations, while still being able to claim the magnanimity of being "donors" even as they shrink their aid budgets. It goes without saying that—absent a lot of public pressure—this expansion of LDCs' negative freedoms will not happen. Perhaps something as modest as Soros's SDR proposal is the best we can hope for at present.

Notes

1. George Soros, *Soros on Globalization* (New York: Public Affairs, 2002).

2. Robert Triffin, *Our International Monetary System: Yesterday, Today, and Tomorrow* (New York: Random House, 1968), 194.

3. I would like to know what lay behind Triffin's complaint about SDRs, which on the face of it seems to assume that SDRs cost the rich countries nothing. Perhaps the early SDR champions assumed that SDRs would displace the U.S. dollar for some significant category of international transactions and would constitute claims over goods and services that really were created de nuovo. If so, the rule of SDR allocation proportional to quotas really would amount to the rich countries' awarding themselves the biggest shares of the new claims. But SDRs have not evolved in this way.

4. Devesh Kapur, "Do as I Say, Not as I Do: A Critique of G-7 Proposals on Reforming the MDBs," UNDP, International Monetary and Financial Issues, New York, forthcoming 2002. I would not contest the argument that generation of social-science knowledge in LDCs is a lower priority than generating science and technology knowledge.

5. Richard Duncan, "Disequilibrium and Denial," February 10, 2002.

6. Jane D'Arista, "Reforming the Privatized International Monetary and Financial Architecture" (Philomont, VA: Financial Markets Center, 1999) (www.fmcenter.org); reprinted as "Reforming International Financial Architecture" in *Challenge* 43, no. 3 (May–June 2000): 44–82.