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International Moneys: Official and Private

There is a nice twist of fate in the fact that at about the time in history that gold, the metal, lost important characteristics that had made it so long a critically important international monetary medium, Sir Joseph Gold, a leading expert on international monetary law and then General Counsel at the International Monetary Fund, was closely associated with the creation of a new fiduciary instrument that may yet become the most important of the world's international moneys. At the time in the 1960s when the continued convertibility of the U.S. dollar into gold (and hence the monetary system's link to the metal) was brought into question, Sir Joseph was the chief draftsman and leading explicator of the First Amendment to the charter of the Fund, composing words that brought into being and clarified the Fund's Special Drawing Right (SDR). While the Second Amendment to the charter of the Fund, also chiefly Gold's words, significantly altered the Fund's constitutional basis for operations and the position of the SDR, and while the future evolution of the system is of course uncertain, there is good reason to believe that the SDR has an important future and that Sir Joseph's work will prove to have been a turning point in financial history. It is not inappropriate, therefore, in a *festschrift* honoring Gold, the man, to appraise the progress of the SDR and the outlook for its future, along with prospects for other forms of international money.

The SDR's early history did not satisfy the intent of its designers. Intended, at least by U.S. officials, to be a source of liquidity for the major reserve center countries that would enable them to maintain currency convertibility at existing exchange rates, the SDR was too little and too late. Allocated to IMF member countries for the first time in 1970, the SDR arrived on the scene when the days of dollar convertibility into gold and the convertibility of other currencies into dollars at fixed exchange rates already were numbered. Furthermore, the SDR 851 million U.S. share of the 1970 SDR 3.4 billion allocation was inadequate to delay for long the demise of the Bretton Woods system of fixed exchange rates.

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Subsequent SDR distributions, in 1971 and 1972 and again in the three-year allocation period 1979–1981, have brought the cumulative total of SDRs created to SDR 21.4 billion. This amount is still less than 3.7 percent of total world official monetary reserves in 1988, with the U.S. 1988 holdings comprising about a third of the total. Between 1981 and 1989 policy makers' concerns with the problem of inflation precluded further creation of the international fiduciary asset.

While the SDR has not yet become a major component of world international reserve money, it has nonetheless played a role in the economic history of the period of its existence. Countries have, of course, used it as a reserve asset in the Fund. For some countries, its exchange market value has been made the target for exchange rate interventions. The SDR is the currency for price quotations in a few markets and the denominator of the interest and maturity values of a limited number of bond issues. It is the currency of denomination of some bank deposits and other short-term claims, and it is the unit of account in IMF bookkeeping.

The creation of Special Drawing Rights in the IMF completed a chapter of monetary evolution that had been in progress since the period between the World Wars and that has increasingly distinguished *official* international money from *private* sector money. In the 1930s the recall of gold from private circulation in the United States and some other countries had begun to distinguish moneys that governments could use for international settlements from moneys that were usable in the private sector. After 1934, gold became a medium available to the United States Government for making international settlements but not available to domestic residents for making payments. The design of the IMF, in which drawing rights on the Fund could be used to obtain foreign exchange by governments but not by private firms or individuals, completed the distinction. In the SDR, authorized in 1969, the distinction between official and private money was made, for that asset, universal and complete. Whereas gold, before 1934, along with other monetary assets that were held for official uses, had been available for official purposes *because* it had value in private uses, SDRs had value in official uses only by virtue of agreement among a limited number of participating governments. SDRs are allocated only to governments and are held only by governments, the IMF, and a few other designated international institutions. Further, SDRs take the form of claims on the IMF that are transferrable, with some limitations, only among the participating governments, the designated institutions, and the IMF. Before the 1920s, the idea of official money distinct from money used in open, private sector markets, had probably not been considered a realistic possibility. By the 1960s the change was profound and the concept of such money was taken for granted.

Between the periods of the first three-year allocation of SDRs to participating IMF member countries and the second, the Bretton Woods system of fixed exchange rates broke down. Many governments opted to allow the exchange

values of their currencies to float. As floating among currencies of the major industrial countries was recognized to be a permanent arrangement, many observers argued that demand for official international money would decline. For exchange rates to be more market determined implied that governments would intervene little to influence the course of the rates, and the exchange rates would vary to equate, over short periods of time, the private sector demands and supplies for various currencies. With the private markets clearing promptly, there would be few official settlements to make.

But nearly free floating did not emerge, as indeed it probably should not have been expected to do. Every government, except the United States, intervened in the exchange markets soon after the day that each in turn had announced it had abandoned fixed and preannounced intervention levels. And in the managed floating system that has emerged it is clear that money has all of its traditional roles to play on the international level, both for private and official purposes.

The traditional role of money is to provide services of three sorts: one is to serve as a standard, or unit of measure, for value; a second is to serve as a medium of exchange obviating barter; and the third is to function as a medium for storing value through time. Various international moneys provide some or all of these services both on official account and on private account. To illustrate the international roles of money, consideration is given to the ways in which some currently used instruments are employed.

At the *official* level, the *measure of value* function of international money may be thought of as the use of one or more instruments as the numeraire or numeraires of the values of other moneys. The dollar was, at the end of the Second World War, the currency of the world's biggest trading country and of the world's chief source of investment capital. In addition, to some degree that currency became the alternate (with gold) numeraire of the par value system of exchange rates under the unamended charter of the IMF. Hence, the U.S. dollar came to serve, and survives today, as the most widely cited unit of common measurement of the values of national currencies. Before the Second World War, gold, and to some extent sterling, French francs and a few other currencies, served this function. With the ending of the par value system of exchange rates in the 1970s, gold ceased to be widely used for this purpose. The SDR now serves in its place in some circumstances, and, within the European Monetary System and beyond, the European Currency Unit (ECU) serves as a numeraire.

Identification of the moneys that serve the international *medium of exchange* function at the official level is more involved. Often it is the national currency that a government has chosen for exchange market intervention actions, and that is acquired or held for that purpose, that serves as the official medium of exchange. In these circumstances, the intervention currency is the means by which a government insures the settlement of imbalances in payments between holders of its currency and holders of other currencies at exchange rates in which it has some choice. Of course, thanks to intercurrency arbitrage, a government

need intervene in only a single currency in order to affect the exchange rates of its currency against all other currencies. The dollar and a few other national moneys are widely used as intervention currencies at the present time. But the strictly official moneys, the SDR, and reserve positions in the International Monetary Fund, may be presented for national currencies usable for exchange market interventions. Hence, these currencies are also very close to being official media of exchange even though they can only rarely be used directly for that purpose—when international settlements happen to involve government to government payments. Gold is in a special circumstance in that, while its use was for a time circumscribed, there is now nothing to prevent governments from selling it either to other governments or on the open market for currencies usable for intervention purposes.

The *store of value* function of money at the official international level is seen in the amount and composition of the official reserves of countries and international institutions. Reserves are a tool for buffering changes in the flow of foreign funds into and out of national economies; they are a means by which governments store claims on the world obtained at one period of time until another. At the end of 1987, total official reserves of IMF countries (with gold valued at the London market price) were SDR 823.3 billion, composed 56.2 percent of national moneys (foreign exchange), 3.7 percent of reserve positions in the Fund, 2.5 percent of SDRs, and 37.6 percent of gold. Of the foreign exchange component, dollar holdings were 67.1 percent, but that share was down from 73.2 percent at the end of 1979.[1]

At the *private* level certain national moneys play an international, as well as a domestic, role, and some moneys that are no nation's money have come into use. Among national currencies, the dollar has been extensively used as an international money since the Second World War, and sterling, the French franc, the deutschemark, the Swiss franc, the yen, the Netherlands guilder, and a few others have been variously used outside the countries of their issue. Since the mid-1970s the SDR, the ECU, and some privately composed units valued as indexes of national moneys have been utilized.

As a *unit of account* the dollar is often the denominator of exchange rate quotations in the private sector. More importantly, it is often also the currency of account in private merchandise and service trade, even trade in which U.S. residents are not participants. The dollar is the most important currency of denomination of international loans and the flows of service payments on them. It is a common reference pricing medium for many relatively homogeneous commodities, such as petroleum, gold, bananas, bauxite, coffee, and copper, that are bought and sold in many parts of the world. It serves as well for services where the homogeneity requirement suffices, as in the pricing of airline and other

1. Data on international reserves and their composition are from 1988 IMF ANN. REP. 66, 68, (app. tables 1.1, 1.2).

travel services. It is the use of the dollar by non-U.S. residents in transactions with, or in conveying information to, other nonresidents that constitutes what is here considered the international use of the dollar.

Nevertheless, the dollar is not alone in serving as a standard of value in transactions where the unit of account is the currency of neither the buyer nor the seller. Sterling presumably still has a place in some trade transactions involving residents of former British colonies or Commonwealth countries, as does the French franc in the francophone part of the world, and the yen in Asia. The SDR and the ECU have had limited use as denominators of value in private current account transactions but have been more widely used as denominators of both short- and long-term loans. The currencies of all of the larger industrialized countries have served, at one time or another, as denominators of Eurocurrency loans.

The private markets have been less innovative in devising international moneys for use as *media of exchange* than they have in devising units of account. Where the national currency of one of the transactors has not been specified as the currency of settlement, use of the dollar is apparently common in trade transactions. Common as well in their respective areas are the French franc and the Japanese yen. As is discussed below, there is no reason that SDR units and ECUs might not be used as private means of settlement, but evidence of their widespread employment in this way has not yet appeared. Of course, the service of Eurocurrency denominated securities involves the passage of the appropriate Eurocurrencies between the lenders and borrowers at prescribed times, and SDR and ECU denominated loans are usually serviced with the currencies of one or more industrialized countries.

For the *store of value* function of money at an international level, the private markets employ a range of assets almost as wide as that used by their official counterparts. The function is served, of course, by any durable asset that is highly liquid in terms of the foreign moneys that the holder may require. Private firms in many parts of the world hold dollar deposits to buffer their international receipts and payments. They also hold deposits in currencies of other industrialized countries, and in gold, SDRs, and ECUs.

Private SDRs and ECUs must be carefully distinguished from official ones. The official SDR, a credit in the IMF balance sheet accounts, is held only by governments, the designated international institutions, and the IMF. Similarly, the official ECU is a claim that is holdable only by governments participating in the European Monetary Cooperation Fund. Private SDRs and ECUs potentially usable as media of exchange arise nonetheless when banks accept deposits denominated in those units of account and promise to make payment in them. A number of U.S. and European banks now engage in such business, and the IMF publishes in *International Financial Statistics* a series of the London Interbank Offer Rates on SDR deposits that goes back to 1982. In 1987 the authorities of the Federal Republic of Germany ended their ban on the acceptance by German

banks of ECU denominated deposits. The SDR and ECU are, of course, composite moneys, with dollar values defined by their issuing authorities as weighted averages of the daily dollar exchange rates of the included currencies. Official SDRs and ECUs bear interest rates, for official uses, equivalent to weighted average short-term interest rates on the currencies included in the composites. Arbitrage theory suggests that private SDRs and ECUs will necessarily also bear rates of interest that approximate averages of the interest rates in the composite currencies due to the opportunity private traders have of arbitraging between interest rates on the composites and those on bundles of the currencies that make up the composites. In the case of the ECU, however, the interest rate on the private unit will not be the same as that on the official unit since interest on the latter is defined in terms of the central bank discount rates of the included currencies, and these rates are not generally available to the market for arbitraging purposes. Short-term interest rates on the private SDR and ECU may be expected to approximate closely the weighted averages of the several short-term, low-risk interest rates available to institutional investors.

Before 1971 the international monetary system had become increasingly dollar centered. After 1958 and until the mid-1970s, for example, a growing share of official international monetary reserves was held in dollar denomination. Most governments used the dollar as the currency of intervention for fulfilling their exchange rate stability obligations, and the dollar played the other roles, official and private, that have been mentioned above. The dollar's convertibility to gold at $35 per ounce was the monetary system's link to the traditional money metal. With the severance of the dollar's link to gold and the disappearance of the par value system of exchange rates, many observers characterized the new arrangements as an international dollar standard, pure and simple. Such a characterization, however, was not to be valid for long. Among factors contributing to an erosion in the uniqueness of the dollar as an international monetary instrument were (a) the giant fluctuations in the value of the dollar through the 1970s and 1980s; (b) the expansion of financial centers in London, on the continent, and in Tokyo; (c) the emergence of the diversified Eurocurrency and Eurobond markets; (d) the success of the European Monetary System; and (e) the shift of the availability of exportable savings from the U.S. to Japan, Europe, and, for a time, the petroleum exporting nations. Between 1979 and 1987 the dollar's share in the foreign exchange component of the world's total official monetary reserves declined from 73.2 to 67.1 percent,[2] and between 1984 and 1987 the dollar denominated share of total international bond issues fell from 63.5 to 35.8 percent.[3] Whereas in the mid-1960s the dollar was almost alone among

2. The value of ECUs issued against dollars to members of the European Monetary Cooperation Fund are counted as dollars in this tabulation, and all percentages are calculated when reserves have been converted into SDR amounts. *See id.* at 68 (app. table 1.2).

3. 58 BANK FOR INT'L SETTLEMENTS ANN. REP. 126 (1988).

Eurocurrencies, at the end of 1987 other currencies constituted 42 percent of the Eurocurrency liabilities of banks reporting to the Bank for International Settlements.[4] At the end of the 1980s the monetary system must be characterized as one in which blocs of currencies float in value against each other and in which there are multiple major financial centers and multiple moneys available for international use, both at the official and the private levels.

In these circumstances, what can be predicted for the future international monetary roles of the dollar, other national currencies, the SDR, and the ECU? The dollar's usefulness for this purpose has been somewhat impaired by mistakes in the U.S. management of its value, but the currency continues to be used internationally because monetary practices change very slowly and a satisfactory substitute has not emerged. Protracted inflation in the United States from 1964 to 1981, and the dollar's associated volatility on the exchange markets in that and in subsequent periods, have been cited as part of the rationale for the creation of the European Monetary System and, with that system, the ECU. High demand levels and incipient inflation in the United States in the 1960s led to the external liquidity crisis of the United States that gave birth to the SDR and eventually to the end of the par value exchange rate system. Price ceilings on bank deposits in the United States in the early part of the great inflation of the mid-1960s and 1970s, augmented by inflation-induced U.S. and British capital export controls, accelerated the appearance of Eurodollar banking that was followed by more diversified Eurocurrency banking. The dollar's extended depreciation between 1971 and 1979 finally induced some diversification in the denomination of official reserve assets by countries outside the United States even though that diversification was offset by dollar acquisitions by some governments in order to limit dollar depreciation.

Official holdings of foreign exchange and the use of particular currencies for official international settlement purposes is, in the present context, a function of the foreign exchange intervention decisions of governments. These, in turn, depend upon the exchange rate policies those countries find attractive in connection with their other micro- and macroeconomic policy strategies. It is useful to think of the level and composition of governments' foreign exchange reserve holdings as a residual after other policy decisions have been made in the context of noncontrollable economic disturbances. The system, therefore, is not very vulnerable to shifts of monetary reserves among currencies for capital gain or interest earning possibilities, and financial authorities are not in search of replacements for the international monetary media now in official use. Governments of countries that are inflation prone or heavily indebted of course seek an increase in access to monetary reserves of some sort, but this is different from dissatisfaction with the range of instruments that is available for performing

4. The figures for 1987 are from *id.* at 119.

monetary functions. It is in the private markets that monetary evolution toward the use of new instruments now seems most likely.

Private usage of dollars for transactions and store of value purposes is affected by transactions needs, the utilities of various national moneys for transactions purposes, and relative holding costs for the various currencies, where the holding costs are composed of interest rates and expected exchange rate changes. World cross-border bank deposits of nonbank agencies in all currencies, expressed in dollar terms, have increased 75.6 percent, from 1982 to 1988, while total dollar value of world exports, a crude measure of the demand for international money for transactions purposes, increased by only a little over 50 percent. The share of the cross-border holdings that is on deposit in the United States has increased slightly, from 7.2 percent to 7.5 percent,[5] in spite of strong appreciation in the dollar value of the nondollar components of those balances. This demand for dollars must be assumed to reflect the conflicting effects of changing ideas about the utility of dollars as a monetary medium, relatively high U.S. interest rates, and fears of further dollar depreciation in view of the sustained U.S. balance of payments current account deficits. The dollar component of European cross-border bank liabilities has, however, fallen between 1984 and 1987, when the effects of changing exchange rates on the composition are excluded, being 57.0 percent in 1984 and only 40.9 percent at the end of 1987.[6]

The dollar share of issues in international bond markets has been declining for several years, and the use of dollars to denominate the value of trade transactions may be waning. Certainly private traders and investors in international markets will not choose to employ as an international money a currency that is more unstable in value against other major currencies than the other currencies are among themselves, as the dollar has tended to be since 1971. If wide swings in the dollar's value continue, the currency will be used less and less as a measure of value and as a medium of exchange. Furthermore, private economic agents will not hold liquid assets in dollars unless interest differentials in favor of the dollar swing to offset recurring market fears of dollar depreciation. Whether or not the United States and other governments can so manage their macroeconomic policies to reduce and contain pressures on dollar exchange rates while still satisfying domestic demand management needs is to be seen. But in view of the intractability of fiscal policy in the United States, and in some degree abroad, and in view of persistently low private sector saving rates in the United States, the country seems destined in the near future to remain a major importer of capital. In these circumstances, stabilization of dollar exchange rates around 1988 levels without intolerably high interest rates in the United States does not

5. Calculated from IMF, INT'L FIN. STATISTICS 62 (1988).

6. Calculated from *The Currency Composition of Reporting Banks' Cross-Border Positions*, 58 BANK FOR INT'L SETTLEMENTS ANN. REP. 119 (1988).

appear sustainable. Greater stability for the dollar in the near future than in the decade past cannot be taken for granted.

Can another national currency displace the dollar in its international usage? The enormous expansion, at home and abroad, of Japanese financial institutions suggests the yen as the leading dollar competitor. But variability of the yen in the triangle of Asian, North American, and European currencies has been only somewhat less than the variability of the dollar, and international usage of the yen has long been inhibited by regulations consciously retained for that purpose by Japan's Government. While international usage of the yen is growing, the currency's place as more than a regionally important unit of account, medium of exchange, and store of value seems doubtful.

The most likely candidates for increased international monetary usage in private markets appear to be the moneys that are no nation's currency. The one of these that has a deep monetary tradition and that inspires confidence for many is gold. Gold, however, is coined in usable money sizes by only a few governments, and those issues are purposefully kept small to enhance the numismatic collectors' value of the coinage. Furthermore, gold has conditions of demand and supply that are significantly independent of its monetary functions. Monetary disturbances arising from these nonmoney related causes have historically been a source of criticism of the metal's use as a base for currency. In particular, gold discoveries and changes in mining and refining technology have periodically cheapened the metal while technologically revealed new industrial uses have enhanced or reduced the demand. Observers throughout the nineteenth and twentieth centuries have used these unpredictable variations in gold's scarcity as the basis for criticism of gold's use as money. As a medium that cannot be reproduced by government recourse to the printing press, gold remains a widely used store of liquid value against reproducible national currencies whose supplies are persistently inflated. It is not much used any more as a medium of exchange or unit of account, however, and only in a situation in which a number of countries would experience hyperinflation does its international use for these purposes seem likely to reappear.

The other non-national moneys that are employed to any extent in private markets in the 1980s are the ECU and the SDR. Whereas the official ECU has limited liquidity, being transferrable only among governments participating in the European Monetary Cooperation Fund, the private ECU's use is not so limited. The unit is, however, by its definition a composite of *European* money. Should the ECU and the yen stabilize in value relative to each other while the North American currencies vary widely against these other two legs of the world's financial triangle, the ECU and the yen would undoubtedly gain in international usage as units of account and media of exchange relative to the dollar. Without another dramatic experience along those lines, however, both the ECU and the yen seem likely to see their growth as international moneys limited

to the regions where the trade of the countries issuing the underlying currencies is dominant.

The SDR is in a different situation. As a unit of account averaging the moneys of the five largest trading countries in the world, which are also countries that include all of the world's leading financial centers, the SDR is uniquely a globally important unit of account. Its definition as an average ensures that when any change occurs in the exchange rate between two currencies that are included in the composite, the SDR changes value less against each of those two currencies than they change against each other. As a measure of central tendency, it tends to move in value against each of its elements over time by less than the constituent currencies move against each other. It has, therefore, particular attractiveness as a unit of account and a store of value due to its relative value stability.

Furthermore, that property of the SDR that makes it desirable as a unit of account and liquid store of value is not lost, as might appear to be the case, if the SDR gains usage as a medium of exchange. While as a medium that can be freely traded against goods and services and other moneys, the SDR will take on a life of its own and have its value influenced by its own supply and demand conditions, its definition in terms of a fixed weighted average of other moneys provides arbitrage possibilities that will sustain the parity of the SDR with its defined currency bundle.

Whether or not national central banks will undertake to regulate SDR banking and limit, in their respective areas, SDR credit creation, seems likely to depend on whether or not SDRs come into usage for purely domestic transactions. If SDRs become an important unit for pricing or for settlements within a country, one must expect that the process of credit creation in the unit will become a matter of interest to that country's central bank and government. On the other hand, so long as the composite currency is used primarily for international pricing and settlements, it is reasonable to believe that bank assets and liabilities in SDRs will be left free of national regulations, much as Eurocurrency banking has been left free during the past thirty years.

Increased banking in SDRs that is relatively free of governmental regulation, therefore, seems a development that is quite possible and one that will be accelerated by continued large variability in the exchange rates between the currencies of the leading industrial countries. Success among the industrialized countries in "harmonizing" their macroeconomic policies while stabilizing their exchange rates will postpone growth in usage of the SDR. Governments, however, are still beholden to the perceived wants of the national constituencies that elect them, and this constraint, together with substantial ignorance about how the market systems function, make the international coordination of policies toward the end of greater global stability very difficult. It will therefore be surprising if significant variability in the exchange rates of the industrialized countries can be long suppressed.

Should use of the SDR for private purposes grow in the next few decades, new questions would be precipitated, such as whether there should be international regulation of the unofficial markets in this international asset. If international regulation of SDR banking should be thought necessary, the IMF would be the natural regulatory agency. Consideration of the assignment of such important monetary authority to this international institution would then surely be accompanied by calls for reform of the IMF's governance. That is another story and would provide another cause for cooperation between lawyers and economists. If this point in history should be reached, Sir Joseph Gold's text giving birth to the SDR will long since have added much to human welfare.