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"SDRs" — A *Sui Generis* Concept in International Monetary Law†

A new kind of money, to be used only by Central Banks, has been "activated" by the International Monetary Fund at its meeting in Washington the week of September 29, 1969. The activation was through authorizing an issue in 1970 of $3.5 billion of Special Drawing Rights, SDRs, followed by additional issues of $3 billion in each of 1971 and 1972, making a total of $9.5 billion. If this "paper gold", really serves the same purpose as real gold in providing monetary liquidity sufficient for expanding world commerce, and substitutes for the excess of the spending abroad by the U.S.A. over its foreign income, the Fund may vote further issues. However, it should be kept in mind that as deficits in one country are offset by surpluses in other countries, theoretically only half the allocations, *i.e.*, those made to deficit countries, can be used at one time. Hence the effectiveness of these allocations would ostensibly be cut in half.

The Department of Commerce recently announced that as of June 30, 1969, the United States had reached a surplus of $1.2 billion in its balance of payments computed on the official settlements basis. Dr. Rinaldo Ossola, the Chairman of the Committee of Deputies of the Finance Ministeries and Governors of Central Banks of the group of Ten and Economic Counsellor of the Bank of Italy, says that official settlements would be the basis used for determining whether a deficit exists for the purposes of SDRs. In contrast, on a liquidity basis there was a deficit of $3.8 billion — about the same as past deficits.

These Special Drawing Rights, which are exercised against the surpluses or unused monetary reserves of other members — as contrasted with members' ordinary drawing rights against their own subscriptions in gold or

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†This note summarizes information obtained from Mr. Joseph Gold, General Counsel of the IMF, and other officials of the Fund since the publication of an article by Mr. Carroll entitled *Summit of International Monetary Law* in the INTERNATIONAL LAWYER, January 1969, Vol. 3, No. 2, p. 372-384.

currencies in the Fund itself, were created by amendments adopted at Rio de Janeiro in 1968 to the Bretton Woods agreement of 1944 which established the IMF.

These amendments attribute to a right the gold value of the U. S. dollar envisaged by the 1944 agreement, *i.e.*, each right is a unit of value equivalent to 0.888671 of a grain of pure gold. They are distributed in accordance with agreed quotas ranging from a fraction of 1% (*e.g.*, Luxembourg with 0.1%) up to the U. S. quota of 24.3%. Actually they have no intrinsic value and are represented merely by debits and credits in a "special drawing account" maintained at the head office of the Fund in Washington.

SDRs will be issued to all of the members of the Fund in the agreed percentages, which are the same as those determining their respective subscriptions to the Fund. They are to be exercised, subject to the guidance of the management of the Fund, by a country with a "balance of payments need" through presenting them to the Central Bank of a country with a surplus in its balance of payments, or otherwise with more monetary reserves (in gold, dollars, or possibly pounds, francs or currencies of other countries) than are required to back its own currency.

Countries with surpluses are, for example, Germany, with a quota of 5.7%, and Italy with 2.9%. A central bank, to which a fellow member's SDRs are presented, is committed by the agreement to deliver in exchange its currency or the currency of another country, such as dollars. If it has a sufficient surplus and reserves it may purchase up to three times the amount of its own quota of SDRs. These rights are considered to be worth an amount equal to their face value of the purchasing country's own currency or foreign exchange. The SDRs so purchased are included as an "asset" in its monetary reserves along with gold and dollars or other foreign exchange.

SDRs are called an "asset" despite the fact that they have been exchanged for currency that has been taken out of surplus country's stock of money and transferred to the deficit country.

According to Mr. Joseph Gold,** the General Counsel for the Fund, the country with a "balance of payment need" which has received the dollars or other foreign exchange is not regarded as a debtor or the recipient of a

**Joseph Gold, General Counsel and Director, Legal Department, IMF; *see* THE AMERICAN JOURNAL OF INTERNATIONAL LAW, 1968, Vol. 62, No. 2, p. 365-402, *The Next Stage in the Development of International Monetary Law; The Deliberate Control of Liquidity;* THE CASE WESTERN RESERVE JOURNAL OF INTERNATIONAL LAW, 1969, Vol 1, Issue 2, p. 105-123, *Legal Technique in the Creation of a New International Reserve Asset; Special Drawing Rights and the Amendment of the Articles of Agreement of the International Monetary Fund;* International Monetary Fund, 1969 Pamphlet Series No. 12, THE REFORM OF THE FUND; International Monetary Fund 1969, Pamphlet Series No. 13, SPECIAL DRAWING RIGHTS.

loan. Instead, said country is committed to reconstitute its holdings of SDRs by the end of five years after an allocation, so that its average holdings over the preceding five years will not be less than 30% of its net accumulations of SDRs over the same period. In other words, it can leave 70% of its SDRs in the hands of the Central Bank or Banks whose currency it has bought.

It is therefore not astonishing that Mr. Gold describes the way SDRs are used as *sui generis* financial transactions between central banks which cannot be compared with any ordinary banking practice. The same thing, he declares, may be said about the use of ordinary drawing rights against the Fund itself, namely, a member's right to "purchase from the IMF foreign exchange with its own currency subject to reversing the transaction by repurchasing from the Fund its own currency with gold or convertible foreign exchange". The same is true of the Fund's sale of said member's currency to other members. In certain circumstances, a member must repurchase from the Fund its own currency which it has sold to the Fund, in any event within three to five years, in accordance with policies evolved by the Fund.

SDRs Evidenced by Debits and Credits

As has been stated, SDRs are represented by the entry of debits and credits in a special drawing account maintained at the office of the IMF in Washington, but are given by the amendments the gold value of the U.S. dollar recognized in the Bretton Woods Agreement of 1944. They are intended to be a substitute for the dollars that will cease to flow into the world economy when the United States obviates a deficit by limiting the amount of its spending of dollars abroad to the amount of dollars it takes in.

Value is given to the new drawing rights, which are described as "special," because they are exchanged directly for the surplus cash of a member instead of for gold or currencies contributed to the Fund. The amendments not only attribute to an SDR the gold value of the dollar, but they envisage that SDRs will be limited in number to the amount considered necessary, at the time of the issue, to assure the liquidity required for the growth of world commerce. In this regard they are reminiscent of the money of Sparta several centuries BC which consisted of iron coins. They had no intrinsic value but were accepted at their face value because they were listed in number.

The SDRs are limited—$3.5 billion in 1970 and $3 billion in each of 1971 and 1972—and the gold value of the dollar is ascribed to them. However, what actually gives them value is the fact that a country with a

surplus or reserves that are higher than needed must exchange for the SDRs presented to it by another member an equivalent amount of currency, which in turn is backed by gold and foreign exchange, including dollars. Hence, though merely a new concept represented by three words "special drawing rights" and entries in a special account at the IMF, they acquire in effect the real value of the gold and dollars or other foreign exchange, perhaps pounds or francs, which make up the reserves backing the currency for which they are exchanged.

After After World War II, the destroyed factories of Europe could not produce enough goods to sell to the U.S.A. to acquire the dollars which they needed to buy urgently needed supplies from the United States. This "dollar gap" led to the Marshall Plan and the outpouring of dollars that could not be covered by receipts from the sale of goods and returns from investments abroad and capital invested by foreigners in the United States.

Can SDRs Prevent a "Dollar Gap"?

Regardless of how much foreign monetary authorities may have chided the United States for not balancing its international accounts, the world economy benefited from the infusion of dollars. Apprehension over what might happen if the restrictions on capital outflow imposed in 1968 were successful in balancing the U.S. international payments caused the Finance Ministers and Central Bank Governors of the Group of Ten—the strongest countries financially—to seek an "asset" which could be added to monetary reserves of central banks and provide the liquidity that would otherwise diminish progressively with the curtailment of the U.S. deficit.

It is manifest that SDRs are merely a device whereby a country that is short of cash can obtain it from another with a surplus. They do not add to the total supply of currencies, nor to the approximately $40 billion of gold in monetary reserves or the amount of dollars or of foreign exchange that back the currencies of members.

A member must maintain over a five-year period an average of only 30% of the SDRs that have been allocated to it. It can leave 70% outstanding in the hands of other central banks. However, these merely reflect the transactions in currencies that have been bought by holders of SDRs and used for their respective purposes. They have not added to the total supply of money but have provided a means for transferring money, that might otherwise lie idle as reserves, to another country where it can be used.

Dr. Ossola describes this as being "expansionary" rather than inflationary. The use of money is increased without augmenting its quantity.

Operations in SDRs Not Loans

SDRs may be used by a participating government (*e.g.*, the U.S.A.) to meet the "needs of its balance of payments or reserves". Mr. Gold states that operations in SDRs are not loans, legally speaking, but are the exchange of one reserve asset, *i.e.*, SDRs, for another reserve asset, *i.e.*, foreign exchange.

SDRs are not subject to the Fund's ordinary requirements and policies which apply in the case of a member's purchase, and repurchase after a sale, of foreign exchange from the Fund. Instead, members which have sold their allocations of SDRs to other members under the guidance of the Fund must "reconstitute" their holdings of said rights by the end of five years after the first allocation. At the end of each calendar quarter thereafter, the participant's average holdings over the preceding five-year period must not be less than 30% of its net cumulative allocations of SDRs during the same period.

If, for example, the U.S.A. sells its SDRs to Germany in exchange for Dmarks, this does not give rise to a loan of Dmarks by Germany to the U.S.A. This country would not have to repay Germany for the Dmarks so obtained as would occur if it borrowed them under a loan agreement. Instead, Germany may use the SDRs received from the U.S.A. in transactions with other participants when it needs foreign exchange, or effects certain transactions with the Fund. The U.S. must reconstitute or buy back only 30% of its SDRs, as has been described *supra*.

SDRs Considered to be Assets in Monetary Reserves

The amendments to the Bretton Woods Agreement of 1944 on SDRs are being activated by the vote of the IMF Assembly at the meeting at Washington at the end of September, 1969. Each allocation of SDRs is apportioned among the 112 members in accordance with their respective quotas, for example, the U.S. 24.3%, the U.K. 11.5%, France 4.6%, Germany 5.7%, Italy 2.9%, Netherlands 2.4%, Belgium 2%, Luxembourg 0.1%.

Central banks maintain their monetary reserves in gold, dollars and foreign exchange, SDRs are considered to be a reserve asset guaranteed as to gold value, *i.e.*, each is a unit of value equivalent to 0.888671 of a grain of fine gold. This was the gold content of the U.S. dollar of the weight and fineness in effect on July 1, 1944, and is still in effect, under the Bretton Woods Agreement, which entered into force on December 27, 1945, and is being amended by the provisions on SDRs. The United States buys and sells gold at $35 an ounce, and this determines the value of the dollar for

the purposes of the international monetary system and SDRs.

The monetary gold held by central banks amounts to around $40 billion and this is supplemented by holdings of U.S. dollars, U.K. pounds, French francs or other foreign exchange. The 112 members of the IMF have, through adopting the new amendments, accepted the SDRs as a means of payment to be used only by central banks. Thus by collective action they have provided a new "asset" to supplement monetary reserves.

Obviously they do not add anything quantitatively to existing monetary reserves in gold and foreign exchange. However, they do provide a facility for taking away from countries which have a surplus in their balance of payments, or reserves that are stronger than necessary, and for transferring this amount to countries which have a deficit or depleted reserves.

An official of the Fund has explained that a participating country with a "balance of payments need" such as that of financing a deficit, may ask the Fund to designate another participating country with a sufficiently strong balance of payments and reserve position to accept the former's SDRs in exchange for its currency or dollars or the currency of a third country. Before allocating a new issue of SDRs in accordance with agreed percentages to the 112 members, the Fund must be satisfied that the addition to the existing reserve assets in this fashion will promote the attainment of the purposes of the Fund and will avoid economic stagnation and deflation or, on the other hand, excess demand and inflation in the world. Mr. Gold asserts that the deliberate control of international liquidity on the basis of collective international judgment holds out the best hope for avoiding a repetition of the recession of the 1930s.

Conclusion

SDRs have been given by treaty a gold value. They are to be exchanged for currencies backed by monetary reserves consisting of gold, and also dollars and other foreign monies, which in turn are to varying degrees based on gold, an ounce of which is valued at $35.

SDRs have been devised as a substitute for the infusion of dollars that results from the deficitary spending abroad by the United States. Will they add enough to provide the money needed to carry on international trade?

Countries short of cash because of a deficit in their balance of payments can obtain unconditionally currency from more prosperous nations up to the face value of the SDRs, to use in financing imports or otherwise to apply against their deficit. They can spend 100% of their respective allocation of SDRs, but have to "reconstitute," or buy back, only a prescribed 30%. Countries with a surplus may buy SDRs from other countries with balance of payments needs and pay out currencies up to three times the

face value of their own quota. The crucial question is whether this method of mobilizing otherwise idle funds will provide the liquidity needed to develop the full potential of world commerce. This question is pertinent when consideration is given to the fact that apparently France would be entitled to SDRs with a face value of only $158 million out of the first issue of $3.5 billion, yet its government has recently had to obtain from the IMF credits amounting to $2 billion to meet its needs after the recent devaluation.