

## The SDR: Ten Years of Experience

1. Within the uncharted course which has been followed by the international payments system in recent years, the new exchange rate arrangements administered by the International Monetary Fund under the Second Amendment appear to have had a limited effectiveness. Positive action has been taken, however, with respect to the Special Drawing Rights (SDR), and further action is being contemplated. Since ten years have elapsed from the decision to activate the SDR, it appears appropriate, at this time, to take a distant fresh look at this reserve asset and at its prospects, and to present suggestions.

On the whole, the picture is a mixed one. There have been various positive developments in the forms of measures taken by the IMF to enhance the use of the asset. There have also been developments, mostly in the public sector, that imply acceptance of the SDR as a unit of account. Other factual developments, however, can be viewed as having a negative reflection on the SDR, particularly the emergence of alternative units of account, the difficulties encountered so far by the SDR in gaining acceptance outside the public sector, and in some instances within it, as a standard of value, and the increase in importance of competing international reserve assets. Finally, in the economic literature some negative critical writings have appeared of late.<sup>1</sup>

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<sup>1</sup> During the ten-year period under review there has been a considerable number of publications concerning the SDR. The vast majority has been of a vulgarizing nature, prompted by the novelty of this international asset and by changes in arrangements regulating its use from time to time. To the best of our knowledge there have been very few critical evaluations of the merits and shortcomings of the asset; and, if anything, most of the writings, including pamphlets and articles issued by the IMF itself, explicitly or implicitly were in support of the SDR. Negative criticisms have been relatively few. Mostly they came from gold supporters; but some sober appraisals started appearing recently. A fairly comprehensive study was made in 1978 by K. Alec Chrystal ('International Money and the Use of the SDR', *Essay in International Finance*, No. 128, June 1978, Princeton University, Princeton, N.J.) Noting the failure of the SDR to make

2. On the positive side it can be recorded that most of those countries which had initially declined to be participants in the SDR arrangements, such as Ethiopia, Lebanon, Libya, Saudi Arabia, and others, have joined the system. Not all the IMF member countries have, however, done so.

Moreover, institutional changes have been introduced to increase the attractiveness of the SDR vis-à-vis other reserve assets. Of major importance are the steps taken to increase the rate of return on SDR holdings in excess of allocations. The rate of interest was fixed initially at 1.5 per cent, and this rate prevailed until July 1st, 1974. At the latter time new arrangements were introduced under which the interest rate was to be determined quarterly on the basis of the yields of a basket of public securities quoted in major financial markets. This gives rise to rates that vary in line with the combined trends in the securities included in the basket, although the US securities have a dominant position as their respective yields have been assigned a 50 per cent weight for the purpose of the calculation of the weighted average. On the basis of this arrangement the interest rate as of July 1st, 1974 was set at 5 per cent. Subsequently, and until December 31st, 1978 it fluctuated between 3.5 and 4.0 per cent. On January 1st, 1979, a revised formula went into effect, according to which the rate is set at 80 per cent of the above mentioned average, instead of 60 per cent under the formula applied up to that time.

The enactment of the Second Amendment in April 1978 permitted a "freer" and potentially broader "market" for the SDR. The major changes were those that eliminated the requirement of the "need" to use reserve assets in order to carry out transactions in SDR between participating members, and that enabled participants to enter into such transactions without the necessity of a decision by the IMF. Moreover, a provision for enlarging the category of so-called "other holders", permits a potential broadening of the "market" for SDR through decisions that would include in that category official entities other than central banks. More recently a decision of great potential importance was taken. At the meeting of the Interim Committee in March 1979 it was decided that the IMF

significant progress towards becoming the principal reserve asset, he subsumed that this was probably due to the nature of the SDR itself. He concluded, *inter alia*, that the SDR provides «neither a suitable way of storing wealth, nor a possible instrument for central-bank market intervention».

Executive Directors should study the feasibility of establishing a "substitution account" on a voluntary basis and to make recommendations to the Committee. Should positive action be taken under this proposal, it could be an important step towards making the SDR the principal reserve asset of the international monetary system.

Outside the official sphere of the Fund, there has been a spreading in the use of the SDR as a unit of account. To a large extent this is confined to international conventions, and to statutes of international and regional organizations. In some cases this was probably the result both of the fact that gold lost its official status, and of the formal elimination of the official price of gold after the enactment of the Second Amendment. In other cases it may have resulted from the non-availability of other units of accounts commonly recognized and adopted by the majority of the countries in the world. With respect to private transactions and contracts, the use of the SDR is, however, still very limited.<sup>2</sup> Some cases have been reported of bank deposits and loans so denominated, as well as of private bond issue; but for the time being these must be considered as exceptions to the rule rather than an indication of a beginning of a trend.<sup>3</sup> Doubts in this respect may derive from the considerations developed in a subsequent paragraph concerning the loss over time of SDR's purchasing power in terms of goods and services, and in some cases in terms of national currencies. Also some monetary authorities reportedly bought gold.

3. A number of factual developments during the period under examination can be considered as reflecting negatively on the SDR. Despite the repeated official statements that this asset should replace gold as the basis of the international monetary system, with the exception of some gold sales by the US Treasury, no other government or central bank has taken a decision to divest itself of its gold holdings. In addition, in recent years some official monetary authorities have changed the valuation of their gold holdings

<sup>2</sup> The reader interested in detailed aspects of this matter is referred to three publications by JOSEPH GOLD in the International Monetary Fund Pamphlet Series under the titles: "Floating Currencies, Gold and SDRs: Some Recent Legal Developments" (No. 19); "Floating Currencies, SDRs and Gold: Further Legal Developments" (No. 22); and "SDRs, Gold and Currencies; Third Survey of New Legal Developments" (No. 26).

<sup>3</sup> Bond issues denominated in SDR took place mostly in 1975; but the practice apparently died thereafter.

by adopting a market-related price for gold.<sup>4</sup> A similar step was recently taken by the Bank for International Settlements; and financial arrangements under the European Monetary System entail the use of market-related gold prices for gold deposits with the European Monetary Cooperation Fund.<sup>5</sup>

With respect to the exchange rate system of the various countries that are members of the IMF the SDR has not fared well. After ten years of existence only 13 countries, out of a total of 137 listed in IFS, had pegged, as of April 30, 1979, their currencies to the SDR.<sup>6</sup> Forty countries maintained their currencies pegged to the US dollar and 20 to other currencies. Moreover, another group of 20 countries, while pegging their currencies to baskets of other currencies, found it appropriate to adopt baskets different from that on which the SDR valuation is based.

One of the conclusions that can be drawn is that on the whole the SDR has had a limited genuine spontaneous appeal. To attempt to explain the divergences between the tendencies in the "official" international sphere, where the SDR has registered considerable gains and the relatively scanty spontaneous reception elsewhere, coupled with the preference given to other units over the SDR, even in international matters as reported above, one has to rely on two sets of considerations. On the one hand, the void resulting from the banning of gold from the IMF system and the elimination of fixed par values have created a need to introduce a new unit in various covenants, and the SDR was the only one around. This should be considered jointly with the active role played so far by the Fund in trying to promote the widespread use of this unit as a standard of international value.<sup>7</sup> On the other hand, one should focus on the inadequacies of the asset unit as such, which derive from its poor characteristic as a standard or store

<sup>4</sup> For a brief account of the countries that took this decision and of the specific arrangements adopted by them, see: JOSEPH GOLD, "SDRs, Gold and Currencies. Third Survey of New Legal Developments", *International Monetary Fund, Pamphlet Series*, No. 26, pp. 33-34 and footnotes 97, 98 and 99.

<sup>5</sup> A summary of the details of these arrangements is included in *International Financial Statistics*, June 1979, p. 7.

<sup>6</sup> *International Financial Statistics*, June 1979, p. 11.

<sup>7</sup> STEPHEN SILARD, "The General Standard of International Value in Public International Law". (Manuscript kindly supplied by Mr. Silard, to be published in the *Proceedings of the 1979 Annual Meeting of American Society of International Law*.)

of value, from it not being an intervention currency, and, indirectly, from the limitations resulting from its management features. We shall develop these aspects in the remainder of this article.

The matter of the SDR's inadequacy as a store or standard of value should be analyzed under two different configurations: the SDR held as a reserve asset; and the SDR used as a reference for value maintenance or indexation purposes. In the former case, the interest yielding feature has particular relevance, so that a comparison with other assets requires consideration not only of "capital gains or losses" but also of the income produced. This will be discussed in a later paragraph. The characteristics of the SDR with respect to the requirements to maintain the value of capital assets or of income is of great potential importance for international and national public bodies and for individuals and private institutions entering into contracts that provide for payments to be made over periods of time.

The inflationary developments of the seventies have produced a spreading of practices which aim at maintaining the real value of contractual payments, such as wages, salaries and pensions, over time. Moreover, values of shares in securities market have remained depressed in the United States despite increasing profits in monetary terms; and this is attributed in part to inadequacies of depreciation allowances to maintain the real value of capital assets. A similar concern exists in the case of public financial institutions which are subjected to a process of gradual decapitalization as the paid-in portion of their capital loses value in real terms. In the distant past, a remedy to these problems was sought through the use of the so-called "gold-clause". This clause was, however, made illegal in the United States in 1934; and in subsequent years the anti-gold intellectual movement doomed that technique — at least to this day — even though the legal impediments were recently removed. A role was therefore left to be filled; but unfortunately the SDR, *as it is presently valued*, does not have the intrinsic qualities to be a legitimate successor<sup>8</sup>; even though someone may believe that from a purely formal point of view the SDR has replaced gold. A few years ago, this point was discussed, in some

<sup>8</sup> See: *Reshaping the International Monetary and Financial Arrangements*, in this *Review*, No. 121, June 1977, pp. 163-4.

details, and a solution was offered, by this writer, with respect to international development institutions.<sup>9</sup>

There has been of late additional public acknowledgment of the above mentioned inadequacy of the SDR. As recalled earlier, this was one of Chrystal's conclusions<sup>10</sup>; and, perhaps more significantly, remarks to the same effect were made at the closing of an article that otherwise extolled the qualities and the acceptability of the asset<sup>11</sup>. While the notion that the real value of the SDR slides with inflation is a fairly easy one to grasp, under the present valuation arrangements, what is probably not fully appreciated is the extent of the phenomenon. The following Table 1 shows the trend of the purchasing power of the SDR for the ten-year period 1969-1978 in terms of domestic goods and services in ten countries. The country sample includes 3 industrialized countries, one oil producing country, three advanced developing countries and three lower income developing countries. In each of these groups one country experienced a markedly different inflation rate than the other two. The different continents are represented in the sample. The consumer's price index has been used to determine changes in the purchasing power. All the data were derived from various issues of *International Financial Statistics*.

The calculations reproduced in Table 1 show that the decline in the SDR's purchasing power over the ten-year period ranged between 79 per cent (Zaire) and 24 per cent (India).<sup>12</sup> With respect to Belgian and German goods and services the decline in purchasing power was about 60 per cent; whereas it ranged between 30 and 38 per cent for such diverse countries as Argentina, Korea, Tunisia and the United States.

The results obtained from our calculations require several comments. A general comment is that regardless of the stage of development, size, intensity of inflationary developments, economic and export diversification of the countries, the SDR lost considerable purchasing power over the ten-year period. Within this

<sup>9</sup> *Op. cit.*

<sup>10</sup> *Op. cit.*, p. 28.

<sup>11</sup> STEPHEN A. SILARD, *op. cit.* For a summary of this article see *IMF Survey*, May 21, 1979.

<sup>12</sup> The calculations are not totally accurate. Besides the usual shortcomings of index numbers, the data are not coterminous, in that the consumer price indices are yearly averages, as given by IFS, whereas the exchange rates are those at year end. The errors, however, cannot materially affect the results.

TABLE 1

	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978
<b>ARGENTINA</b>										
Cons. Pr. Index .....	7.34	8.33	11.23	17.79	28.69	35.42	100	543	1500	4131
\$s per SDR .....	3.5	4.0	5.4	5.4	6.0	6.1	71.3	319	726	1307
SDR purch. power.....	1.00	1.00	1.00	0.636	0.438	0.361	1.49	1.23	1.01	0.663
1969 = 1										
<b>BELGIUM</b>										
Cons. Pr. Index .....	64.4	66.9	69.8	73.6	78.7	88.7	100	109.2	116.9	122.2
BF.s per SDR .....	49.7	49.7	48.6	47.8	49.8	44.2	46.3	41.8	40.	37.52
SDR purch. power.....	1.	0.961	0.902	0.842	0.82	0.646	0.60	0.496	0.443	0.398
1969 = 1										
<b>GERMANY</b>										
Cons. Pr. Index .....	71.8	74.2	78.2	82.5	88.2	94.4	100	104.5	108.6	111.4
DM.s per SDR .....	3.69	3.65	3.55	3.48	3.26	2.95	3.07	274	2.56	2.38
SDR purch. power.....	1.	0.957	0.883	0.821	0.719	0.608	0.597	0.51	0.459	0.416
1969 = 1										
<b>INDIA</b>										
Cons. Pr. Index .....	55.1	57.9	59.8	62.9	74.1	94.7	100	92.2	100	102.5
R.s per SDR .....	7.49	7.51	7.83	8.69	9.80	9.89	10.46	10.31	9.97	10.66
SDR purch. power.....	1.	0.954	0.963	1.02	0.973	0.768	0.769	0.823	0.733	0.765
1969 = 1										
<b>KOREA</b>										
Cons. Pr. Index .....	43.9	49.5	55.5	62.1	64.	79.2	100	115.4	127.3	145.5
W.s per SDR .....	304.4	316.6	405.2	433.1	479.5	592.6	566.6	562.3	587.9	630.5
SDR purch. power.....	1.	0.921	1.051	1.004	1.079	1.078	0.816	0.702	0.665	0.624
1969 = 1										
<b>SAUDI ARABIA</b>										
Cons. Pr. Index .....	48.1	48.2	50.3	52.5	61.2	74.3	100	131.6	146.9	144.2
SR1.s per SDR .....	4.50	4.50	4.51	4.51	4.28	4.35	4.13	4.10	4.26	4.32
SDR purch. power.....	1.	0.998	0.958	0.918	0.748	0.626	0.441	0.333	0.31	0.32
1969 = 1										
<b>SPAIN</b>										
Cons. Pr. Index .....	53.6	56.7	61.3	66.4	74	85.6	100	115.1	143.3	171.6
Ptas. per SDR .....	69.9	69.6	71.5	68.9	68.6	68.7	70.	79.3	98.3	91.34
SDR purch. power.....	1.	0.926	0.894	0.796	0.711	0.615	0.537	0.528	0.526	0.408
1969 = 1										
<b>TUNISIA</b>										
Cons. Pr. Index .....	76.7	77.6	82.0	83.7	87.6	91.3	100	105.4	112.4	119.4
D.s per SDR .....	0.521	0.521	0.522	0.537	0.498	0.498	0.5	0.5	0.5	0.525
SDR purch. power.....	1.	0.988	0.937	0.944	0.837	0.803	0.736	0.698	0.655	0.647
1969 = 1										
<b>UNITED STATES</b>										
Cons. Pr. Index .....	65.2	67.2	69.0	71.3	78.9	92.8	100	103.3	109.4	121.2
US\$ per SDR .....	1.0	1.0	1.09	1.09	1.21	1.22	1.17	1.16	1.21	1.30
SDR purch. power.....	1.	0.97	1.03	0.997	1.	0.857	0.762	0.732	0.721	0.699
1969 = 1										
<b>ZAIRE</b>										
Cons. Pr. Index .....	39.2	42.4	44.8	51.9	60	76.5	100	186	30.3	480
Z.s per SDR .....	0.50	0.50	0.50	0.54	0.60	0.61	0.58	1.00	1.00	1.31
SDR purch. power.....	1.	0.924	0.875	0.816	0.784	0.625	0.455	0.421	0.259	0.214
1969 = 1										

broad observation, the following specific comments are in order. It can be seen that in the case of Belgium and Germany the decline has been steady throughout the period, whereas marked fluctua-

tions are observable in the case of Argentina and to a less degree in the case of India. These results, as well as those relative to other developing countries are influenced by the interrelation between the exchange rate policy, the rate of inflation and the particular factors affecting the balance of payments. The latter consideration is particularly applicable to Saudi Arabia which has appreciated its currency in terms of SDR despite the rapid domestic inflation which probably reflects to a large extent the rise of prices in the countries where Saudi Arabian imports originate. The authorities have been under no compulsion to depreciate the currency — in fact they could have appreciated it even more — due to the heavy balance of payment surpluses after 1973. Had this been done, the calculated loss in SDR purchasing power would have been correspondingly greater.

The influence of the exchange rate policy is also evident, for different reasons, in the cases of Argentina and Zaire. In the former country the official exchange rate was maintained at unrealistically low levels until 1974 and part of 1975, which is reflected in the abnormally rapid appreciation of the peso vis-à-vis the SDR in terms of goods and services in the period 1971-74. In 1975, the abrupt dramatic change in the exchange rate produced a perhaps equally abnormal level of the SDR value vis-à-vis the peso. The more consistent policies, although under heavy inflationary conditions, of the period after 1975 and the favorable balance of payments out-turn in 1978 brought the SDR valuation to a level closer to the real economic and financial situation of the country. In the case of Zaire the exchange rate was maintained at a level that considerably appreciated the currency throughout the period with the assistance of restrictions on international transactions, of the accumulation of medium and short term indebtedness, and of the inflow of foreign financial capital which largely offset the current account balance of payments deficits. Incidentally, the persistence of these various factors are also an explanation of the implausibly low level of the SDR purchasing power in Zaire in 1978.

What is the possible future course of the SDR under the present valuation arrangements? Unfortunately, one is forced to state that the trend observed over the past ten years will continue, except under highly unlikely circumstances; i.e., under pervasive deflationary conditions with prices actually declining at least in the major countries. Should, on the contrary, the more likely opposite

course of events materialize and should a convergence of inflation rates in industrialized countries develop, a further erosion of the SDR purchasing power is bound to ensue over the years. Short term fluctuations around this trend are likely to take place. For instance, from the end of 1978 and May 16, 1979, the SDR depreciated against Spanish and U.S. goods and services, as it lost ground vis-à-vis the peseta and the US dollar, while prices were rising in these countries. On the other hand, the SDR may have remained stable vis-à-vis Belgian and German goods and services, as it appreciated vis-à-vis the DM and the Belgian Franc in that period.

Before discussing the SDR as a reserve asset actually held by the monetary authorities, some clarifications are perhaps appropriate on the conclusions reached above. The fact that the SDR lost purchasing power in varying degrees vis-à-vis domestic goods and services of the countries included in Table 1, *simply means that had recipients of payments in local currency hypothetically indexed them on the consumer price index, they would have done better than if those payments had been indexed on the SDR*. It does not mean that the SDR necessarily performed worse than each of the domestic currencies of those countries. This may or may not have happened. To illustrate by an example, a person who starting in 1969 were to receive annually 100 units of domestic currency, *without indexation*, in Belgium, Germany and Saudi Arabia, would have done *better* than having a contract under which the 100 units had been indexed on the SDR. He would have been at the point of indifference in Tunisia; and *worse off* in all other countries (and of course immensely worse off in Argentina). To give an order of magnitude, in Germany a contract paying DM 100 annually from 1969 to 1978 would have given the beneficiary in 1978 a purchasing power in German goods and services of 89.8 versus 139.3 in 1969. A similar contract indexed on the SDR would have given in 1978 a purchasing power of 57.9 versus 139.3 in 1969.

5. When the SDR is held as a reserve asset, the interest paid on it becomes, of course, of considerable importance. In order to compare this asset with alternative holdings both the relative rates of interest and the depreciation rates have to be taken into account. It should be understood, to begin with, that the interest is paid only on excesses over allocations and not on the balances corresponding to the allocations themselves. Nevertheless, under appropriate circumstances it could be profitable to dispose a portion of

these balances if the interest to be paid on it is more than compensated by the yield of the assets acquired with it, taking into account the relative appreciation and depreciation.

In accordance with the brief summary contained in paragraph 2, the interest rate on the SDR has been set at different times during the period 1974-1979 on the basis of a pre-established formula. Until December 31, 1978 the rates were set at 60 per cent of the weighted average of the yield of Treasury bills and other short term instruments in the money markets of the U.S., U.K., France, Germany and Japan. Effective January 1st, 1979, the percentage was raised to 80 per cent. The different interest rates and the corresponding dates at which they have been set are reproduced in Table 2. For the purpose of determining the attractiveness, in pure financial terms, of the SDR holdings it would be necessary to consider a number of alternatives. Since central banks usually hold foreign exchange reserves in large proportions in US securities, a comparative calculation was performed using these securities in hypothetical cases. Let us assume that in 1974 the central banks of two countries, A and B, had 100 interest producing SDRs in their reserves and that one of them (country A) had decided to convert the SDRs into US dollars for the purchase of US Government securities. If it had chosen to purchase 3 to 5 years securities, their average yield in 1974 was about 7.8 per cent. One dollar invested for, say, three years would have yielded 1.263. This sum, reinvested in the same type of securities in 1977, would have yielded 6.85 per cent; and the accumulated sum in 1978 would have been 1.449. Since in the meantime the US dollar had, however, depreciated in terms of SDR, the value of this sum in terms of SDR was 1.353. This should be compared with the accumulated

INTEREST RATES ON SDR HOLDINGS\*  
(in %)

1970.....	1.5	1977, April 1.....	3.75
1974, July 1.....	5.0	July 1.....	3.5
1975, July 7.....	3.75	1978, April 1.....	3.75
1976, Jan. 1.....	3.5	October 1.....	4.0
July 1.....	3.75	1979, Jan. 1*.....	6.—
Oct. 1.....	4.0	April 1.....	6.5

\* Calculated as 60% of the weighted average of a basket (US with 50% weight) of market rates. The percentage was raised to 80% on January 1, 1979.

balance that would have accrued to central bank of country B under the interest rates reproduced in Table 2. Such a balance would have been 1.22, i.e. about 90 per cent of country A's balance.

The figures used in the preceding example<sup>13</sup> must be considered as approximative. While the yields of US securities are averages of different types of securities and yearly averages, they have been used in our calculations as if they were actual yields of a specific type of securities at a given date. This being said, those data are much more realistic for a meaningful comparison than purely hypothetical data. For additional illustrative purposes we have calculated the minimum yield of US securities that in the period 1974-78 would have produced, when applied throughout the period, a result equivalent to that given by equivalent SDR holdings (including the US dollar depreciation). The yield is 5.5 per cent; which means that any investment in securities giving yields higher than 5.5 per cent would have been financially superior to SDR holdings in that period. In order to assess the overall relative attractiveness of SDR holdings one should take into account, in addition, both the ease with which the different assets can be marketed and the cost of the transactions.

The immediate result of the change in the formula for the setting of the interest rate on the SDR was a 6 per cent rate fixed effective January 1st, 1979, and a 6.5 per cent rate fixed effective April 1, 1979. There is no doubt that this new formula will enhance the absolute attractiveness of the SDR holdings. Whether they will become more attractive than US securities holdings is a highly speculative question. The answer depends on a number of factors, including the future rate of depreciation or appreciation of the US dollar vis-à-vis the SDR; the performance of other securities markets; and the perception of this and other future developments by the monetary authorities of the countries concerned. In the extreme hypothetical case where inflation rates in various countries

<sup>13</sup> The example is based on the assumption that the alternative to the SDR holdings consists of US securities; and this was done to reflect the actual practice largely followed so far by the central banks. The results would have been without any doubt against SDR holdings if the comparison had been made for the same period of time with securities of countries vis-à-vis whose currency the SDR had actually depreciated, even if such securities gave a minimal yield. This case, which has relatively small quantitative relevance at this time, may have to be borne in mind when considering a possible evolution towards a multiple currency reserve system which is being currently discussed in international fora.

should become uniform, *and* should produce unchanging exchange rates between various currencies, *as well as* equal securities yields in the five countries concerned; then the SDR would not appreciate against any of the currencies of the basket and the yield on the SDR holdings would be 20 per cent below that of the securities of individual countries.

6. Mention was made in paragraph 4 of effects on the SDR's appeal resulting from its management features. We shall touch briefly on this point, although it deserves much more extensive consideration. By changing the role of the SDR from a "supplement to existing reserve assets" to becoming ultimately the "principal reserve asset", the Second Amendment has, at least intentionally, moved the IMF an additional step toward the position of an issue bank on a world-wide basis. Should this situation materialize it would parallel that of the national banks of issue. We are, of course, a long way from that situation; but the process leading to it should be characterized by actions that gradually build confidence in the currency. Unfortunately, some of the main features of the present SDR management system are not conducive, in our opinion, to that objective.

When currency management is discussed one is inevitably inclined to think of the model represented by national systems where: (i) institutionally the issue bank is fairly independent of the political process, and disposes of an array of tools that permit it to regulate the supply of the currency in a speedy and flexible manner; and (ii) the institution is responsible for the maintenance of a stable purchasing power of the currency — a mandate to be achieved through the use of those tools. Neither of these features are present in the actual SDR system. The decision taking process concerning the issue of the SDR appears to be appreciably influenced by political factors; while the rules governing SDR allocations and cancellations are too rigid and cumbersome for an effective management. Moreover, there is no direct association between the value of the SDR and the supply management. As is known, the value is determined on the basis of a mechanical formula, and it responds to events that take place in national systems, particularly inflationary developments.

In these cursory remarks about SDR management, brief mention should be made of two other aspects. The valuation formula recalled above is at the entire discretion of the IMF which can

change it over time, and this is a possible deterrent to a spontaneous increasing acceptance of the SDR. There is, in addition, a possibility that a supply management responsive to political pressures may indirectly affect the value of the SDR and this too could be a deterrent. The process that is envisaged here — by no means inevitable — relates to the connection between an addition of SDRs to the total liquidity of the system and a possible relaxation of fiscal discipline in those countries that would otherwise be forced to take measures to conserve dwindling reserves. Admittedly, under the present circumstances, with the SDR representing a fraction of total international reserves, the danger mentioned above can be considered as being rather remote. Nevertheless, there has been some criticism of the recent decision to allocate 12 billion SDRs in the face of a generally recognized ample international liquidity; and, at any rate, the point made here refers to the management arrangements *per se*. In any long run plan, changes are necessary in those arrangements in a manner designed to enhance the attractiveness of the SDR outside the IMF system.

*Conclusions.* Since its *de facto* inauguration in 1969 there has been a progressive and considerable enlargement of the sphere of application of the SDR, particularly within the IMF system and in the case of international or regional conventions and statutes of a public or semi-public nature. The IMF has considerably contributed to this process, both by improving the arrangements for the transfer and use of the SDR by its members, and by actively promoting its adoption outside the IMF system proper. The objective sanctioned by the Second Amendment to make the SDR the "principal reserve asset" of the international monetary system appears, however, to be frustrated by events in the world economy at large. Not only have US dollar assets held as reserve increased very rapidly, particularly during the last five years, but the price of gold, which the SDR has displaced, has registered (*July 1979*) an eight-fold increase in terms of the US dollar and a six-fold increase in terms of the SDR. This denotes the great and increased attraction of this commodity as a store of value, not only in the private sector, but also in official quarters since no central monetary authority (with some exception in the United States) has decided to divest itself of its gold reserves. The appetite for the SDR in the private sector has also been extremely limited. Admittedly, this unit could not be held so far by private parties (or even public entities outside the monetary

authorities), but we have no record of private contracts indexed on the SDR. A few bond issues denominated in SDR were made in 1975, but this had no further following.

It is suggested in this article that these developments — i.e., the preference given to other assets and the non-adoption of the SDR as a standard of value — can be attributed to the perception by the business community of the continued and considerable loss of purchasing power of the SDR in terms of goods and services practically all over the world, and particularly in countries with relatively stable currencies. In a few countries a contract hypothetically indexed on the SDR would have fared even worse than a non-indexed contract. This appears to have resulted from the valuation arrangements basically adopted in 1974, and, of course, from the inflationary developments experienced particularly during the last five years. In view of the prospects for continued inflation on a world-wide basis in the foreseeable future, it is to be expected that the erosion of the SDR purchasing power will continue. This must be viewed against the background of increasing widespread concern for maintenance of real values. Therefore, considerable improvements in the SDR valuation arrangements appear essential in order to arrest the trends mentioned above.

No detailed suggestion is made here to bring about such improvements in the immediate future. To the extent, however, that there is agreement that the absence of genuine appeal of the SDR is due to its proneness to lose purchasing power vis-à-vis goods and services, the inescapable conclusions appear to be that any new valuation arrangement should aim at avoiding such purchasing power losses. The payments of interest on SDR actually *held* in excess of allocations has, of course, improved the absolute attractiveness of the asset for its holders; but until the end of 1978 this was not sufficient to place it in a preferred position vis-à-vis other income producing assets. It is premature to state what will be the effect of the improvements introduced in this respect on January 1st 1979. At any rate such improvement will not enhance the attractiveness of the SDR for non-holders.

Looking far ahead, considerable improvements are necessary in other aspects of the SDR management system. Ideally the value of the unit would have to result ultimately from supply management which would, thus, supplant the valuation formula. For this to happen, however, it would be necessary not only to make it in-

stitutionally possible for a broad segment of the international monetary and financial system to use the SDR; but also to introduce in the interim changes of the type mentioned above in the valuation arrangements, so as to generate an increasing demand for the unit. To steer this infant asset towards that distant goal is, of course, a very delicate undertaking, and under normal circumstances would entail a long drawn out process. Unfortunately, however, initial steps are needed promptly. The international monetary system in a broad sense has been experiencing in recent times what the latest BIS Report described a "natural drift towards a multiple reserve-currency system".<sup>14</sup> This is to be viewed as a rival course to an approach to expand the use of the SDR as a reserve asset; even though it is only grudgingly accepted by the countries whose currencies are used as reserves. Thus, to reduce sufficiently the momentum of the current trend towards a multiple reserve-currency system, the features of the "substitution account" now under study acquire great importance.<sup>15</sup> For the longer run, management decisions should always bear the ultimate goal in mind. Should there be a continued relative decline, in quantitative terms, of the SDR as a component of total international liquidity, the temptation may arise to decide upon additional SDR allocations in the future. Political pressures may push the IMF in the same direction, to alleviate the tight reserve position of groups of countries. Actions of this type would, however, go counter the ultimate objective under discussion. Once again, part of the answer to the present and future dilemma resides in actions that generate a genuine attraction of the SDR on a broad spectrum based on the performance of its real value through time.

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<sup>14</sup> Bank for International Settlements, Forty-Ninth Annual Report, 1978-79, p. 182.

<sup>15</sup> Mr. Henry C. Wallich, Member of the Board of Governors of the Federal Reserve System, discussing this alternative in a recent address, stated: "I suspect the SDR system is preferable to a multi-currency system, provided the SDR is sufficiently attractive and inspires sufficient confidence." ("The International Monetary and Cyclical Situation", remarks by Henry C. Wallich at a Meeting sponsored by the Landeszentralbank in Berlin, Germany, June 18, 1979 - Mimeographed).