Message for the G-20: SDR Are Your Best Answer

Edwin M. Truman
Senior Fellow
Peterson Institute for International Economics

When the leaders of the G-20 countries gather in London on April 2, they will have one policy instrument immediately available to address the global economic and financial crisis cooperatively, concretely and credibly. To adopt it, however, they will need to overcome a certain amount of complacency and thinking rooted in the past. But the world will not benefit from more fine words and vague promises in London. Instead it needs a commitment to an immediate, one-time allocation of $250 billion in special drawing rights (SDR) by the International Monetary Fund (IMF) to its 185 member countries.

The London leaders' statement will of course contain many well-intentioned pledges to adopt expansionary policies, avoid protectionism, stabilize and reform the financial system, mobilize the IMF and multilateral development banks to help the weakest countries, and combat poverty. A large, one-time allocation of SDR would mobilize than words to address these issues.

Special drawing rights, which in the late 1960s the IMF was authorized to issue, are assets and liabilities of the Fund provided to each member in proportion to its quota share in the institution. A member receiving SDR can transfer some or all of its allocation to another member country—for example, the United States or Germany—and receive credit in a convertible currency to spend on its domestic or international economic or financial needs. The interest rate on this credit is currently about 0.60 percent—a pretty good deal for most countries.

Approval of an SDR allocation requires an 85 percent majority vote of the IMF membership. The US secretary of the treasury can vote for an SDR allocation of up to $250 billion, or somewhat larger, as long as he consults with key members of the US Congress 90-days before he casts his vote. Thus, the actual allocation could occur by mid-summer, much sooner than the most other crisis-mitigation measures would begin to take effect.

A one-time SDR allocation of $250 billion would dramatically build confidence in cooperative solutions to the economic recession and financial meltdown that is affecting all countries. The SDR mechanism in effect leverages the low current borrowing costs of the major industrial countries to finance the immediate, financial needs of developing countries experiencing a sudden disruption of their normal international financial inflows.

An allocation of $250 billion would provide immediate assistance, about $17 billion, to the poorest countries—substantially more than their total, annual disbursements from the International Development Association, the World Bank's soft loan window.

More than $80 billion would flow to other developing countries. These countries have besieged the multilateral development banks for large amounts of quick disbursing credits with little or no economic policy conditions, threatening to distort the banks' normal mode of operations.

Industrial countries would benefit by receiving—in return for their intermediation of a flow of credit to countries that choose to use their SDR allocations—an asset backed by the full membership of the Fund.

Equally important, a large SDR allocation would help allay a systemic danger posed by countries that conclude from this crisis is that their holdings of international reserves were too small. The risk is that their likely response will be to try to manage their exchange rates to generate large trade surpluses and build up their reserves. Such policies of competitive exchange rate depreciation, or non-appreciation, cannot be successfully followed by all countries at the same time. However, in the attempt, they can set off trade wars. Some countries may be successful and promote a new build-up of global imbalances, which many people point to as one of the principal causes of this crisis. A large, SDR allocation can help meet this demand for reserves.

In the lead up to the London summit, proponents of an SDR allocation are likely to hear some tired, out-of-date arguments. First is that the potential credit would be extended without conditions on recipient countries' economic policies. But that is in fact a plus today. The international system should help support income growth around the world. Some countries are not in a position to provide such support through their monetary and fiscal policies. They would be able to use their SDR allocations to do so. In the process, the recent record of economic reforms in many countries would continue because countries would have less incentive to roll them back.

Second, the traditional argument against SDR allocations is that they are inflationary. That is not today's problem. The more likely problem is deflation.

A third argument will be that a substantial amount of the SDR allocation may go to countries that do not need and would not use their allocations. This is an empty argument. If a country did not need to do so, it would not mobilize the SDR-based credit. There would be no benefit, but also zero cost. Furthermore, under current uncertain circumstances, no country can be sure it will not have a need to access official international credit, witness Iceland.

Finally, countries are free to lend their SDR to other countries or use them to support the policies of neighboring countries, as is currently being contemplated in Western Europe with respect to their partners and neighbors in Central and Eastern Europe.

A large, one-time allocation of SDR will not solve all problems. But it would serve as a significant down-payment on the G-20's commitment to further actions.