



Concept of Special Drawing Rights (SDR's)

What Are Special Drawing Rights (SDRs)?

Special Drawing Rights (SDRs) were a part of the monetary system that was created post World War-2 in the Bretton Woods arrangement. Since the United States had almost all of the gold reserves of the world at that time, the Special Drawing Rights (SDRs) were intended as a supra-national currency that could be used instead of gold, thereby reducing dependence on gold.

However, the idea of an abstract currency replacing gold has not caught up with the world till date. The Special Drawing Rights (SDRs) were virtually unheard of till the year 1968 and are still not very popular. The average person who is not connected to the Forex markets is not even aware of the existence of Special Drawing Rights (SDRs)!

The **Special Drawing Rights (SDRs) are basically a combination (weighted average) of multiple currencies**. This means that the International Monetary Fund (IMF) has its own reserve which has multiple currencies. Based on the value of these reserves, the IMF creates and distributes Special Drawing Rights (SDRs).

Each unit of Special Drawing Rights (SDRs) consists of 4 major currencies. The Special Drawing Rights (SDRs) derives 44% of its value from the United States Dollar, 34% from the Euro, 11% from the Japanese Yen and 11% from the Pound Sterling.

Since the Special Drawing Rights (SDRs) is nothing but a weighted average of multiple currencies, the interest rate due on the Special Drawing Rights (SDRs) is also nothing but a weighted average of all the currencies.

Why are Special Drawing Rights (SDR's) Required?

In the recent past, there have been rumours that countries like China and Russia are urging the International Monetary Fund to move away from the United States dollar based system. These rumours suggest that these countries propose that Special Drawing Rights (SDRs) become the de-facto reserve currency of the world.

One possible reason could be the fact that countries like China are fully aware of the fragile economic condition on which the United States economy stands. Also, China is forced to buy more and more United States treasury debt if it wants to keep its own economy afloat.

Hence, if a Special Drawing Rights (SDRs) based system was implemented, China and many other countries could exchange the excess dollars that they have with a basket of currencies. True, they would still end up with 44% dollars again! However, that would still be a better scenario than being 100% dependent on the United States economy as being a store of value.

Benefits of the Special Drawing Rights (SDR's) System

Whether a Special Drawing Rights (SDRs) based system will replace the current dollar based system is yet to be known. However, there are some benefits if such a system does get implemented. The benefits are as follows:

- **Reduced United States Dependence:** First and foremost, the entire world will no longer have to depend on the currency of United States to trade with each other. This would eliminate what the French have nicknamed as “exorbitant privilege” given to the United States government wherein they have been placed at the centre of the financial universe.
- **More Stable System:** Since essential commodities such as gold, oil and food grains will no longer be exclusively traded in dollars, the United States government will not be able to exert an undue influence on their prices by increasing and decreasing the money supply of dollars. A weighted average of multiple currencies would make the system more stable.
- **Balance of Payment Issues:** If the world were to go off a dollar based system it would resolve a lot of balance of payment issues that are being faced. The United States is running a perpetual trade deficit with countries like China. They can sustain such a budget deficit because the world depends on the dollar for its day to day functioning. However, if the world goes off the dollar standard, the United States would lose this privilege.

Disadvantages of the Special Drawing Rights (SDR's) System

The implementation of Special Drawing Rights (SDRs) in place of dollar based system will also lead to certain issues. Some of them have been mentioned below:

- **Money Supply Becomes an Administrative Decision:** If Special Drawing Rights (SDRs) become the reserve currency of the world, then the IMF would be in charge of regulating the money supply. Given the fact that Special Drawing Rights (SDRs) would not have an open market of their own, the decision regarding whether the money supply should be expanded or contracted would end up becoming an administrative decision.

The fact that all other economic parameters are extremely sensitive to changes in money supply, this is a dangerous situation to be in.

- **Abstract Nature:** The Special Drawing Rights (SDRs) are an abstract weighted average. They are not an actual currency that can be used by people. As such, Special Drawing Rights (SDRs) will be extremely difficult to implement and manage, if they are ever introduced at the micro-economic level.
- **No Gold Backing:** Lastly, only backing by a tangible commodity like gold makes a currency stable. Hence, replacing dollars with Special Drawing Rights (SDRs) would be like replacing one unstable system with another slightly less unstable system.

Critics are of the opinion that it is highly unlikely that the Special Drawing Rights (SDRs) may ever replace the dollar. However, as a student of Foreign Exchange, it is essential that one knows that such a concept exists!