Development Policy Review, 2010, 28 (1): 63-74

The SDR Aid Link: It's Now or Never

Graham Bird*

The international community, in the form of the United Nations and, more recently, the G20, has committed itself to the Millennium Development Goals. The global financial crisis of 2008/9 served to increase the economic problems faced by low-income countries, making it much less likely that the goals will be attained. At the same time, the decision has been made to reactivate the SDR scheme by making a new allocation of SDRs in order to create additional international liquidity. This article explores the idea of linking SDR creation with the provision of development assistance. Although the idea of a link is not original, contemporary global economic and political circumstances may generate an environment particularly conducive to the acceptance of the proposal.

Key words: Special Drawing Rights, SDRs, International Monetary Fund, aid

1 Introduction

In its immediate aftermath, the global financial crisis of 2008/9 attracted attention to its effects on advanced and emerging economies. It was these economies that were perceived as being affected by the banking crises which were themselves associated with the use of 'sophisticated' financial instruments. Low-income countries (LICs) were seen as being largely exempt from such problems. But it gradually became recognised that poor countries would be adversely affected by the crisis in other ways.

In March 2009, the International Monetary Fund (IMF, 2009) produced a comprehensive report examining the effects of the crisis on low-income countries and attempting to quantify the implications for their financing needs. It went on to articulate the policies that might be pursued in order to try to mitigate the impact of the crisis, concentrating on domestic fiscal, monetary and exchange-rate policy, as well as donor aid policies and IMF support.

In April 2009, the G20 leaders, at their London summit, restated their commitment to achieving the Millennium Development Goals (MDGs). They also committed themselves to the aid targets set at the G8 meeting in Gleneagles in 2005, as well as to additional support for LICs from multilateral development institutions and from the IMF, with the latter to be financed by additional sales of IMF gold. Furthermore, the leaders endorsed an additional allocation of Special Drawing Rights (SDRs) to members of the scheme, including LICs. In July, 2009, the IMF announced a range of reforms aimed at increasing the flow of finance from the Fund to LICs, making IMF loans more concessionary and limiting their conditionality (*IMF Survey*, 29 July 2009).

* Surrey Centre for International Economic Studies, University of Surrey, Guildford, GU2 7XH (g.bird@surrey.ac.uk).

Published by Blackwell Publishing, Oxford OX4 2DQ, UK and 350 Main Street, Malden, MA 02148, USA.

Although it was seriously debated when SDRs were established in 1970 (see Park, 1973 and Bird, 1978, for reviews of this early literature), and has been occasionally examined since then (Bird, 1994), the current discussions of global economic policy, as represented by the IMF report, the G20 communiqué and the IMF reforms, have had nothing to say about setting up a 'link' between the allocation of SDRs and the provision of development assistance. This article attempts to fill the vacuum by revisiting the idea.

The main theoretical issues raised by the link proposal have been identified in the existing literature, but it is important to assess them in the context of the contemporary global economic and political environment. The strength of the economic arguments on either side of the debate is influenced by contingent factors such as the global rate of inflation. The appeal of the proposal will therefore change over time, depending on other circumstances. Moreover, the politics of policy reform also change over time, with the implication that a proposal that proves politically unacceptable at one time may become acceptable at another. This article examines whether current conditions are particularly conducive to the introduction of an SDR aid link.

The article is organised as follows. Section 2 briefly explores the implications of the global financial crisis for low-income countries. It goes on to summarise estimations of their financing needs and assesses the effects of the crisis on the likelihood of achieving the Millennium Development Goals. Section 3 provides a succinct summary of the SDR and the history of the SDR aid link in order to provide a background to what follows. Section 4 analyses, in slightly more detail, the benefits of SDRs for LICs. Section 5 examines the potential arguments against an SDR aid link and assesses their relevance in the context of the contemporary global economic environment. Section 6 describes how the link might work and offers some simple calculations to estimate its effects. Section 7 explores the political economy of the link to assess whether the proposal has any realistic chance of being adopted. In doing this, it compares the link to other more traditional ways of providing financial assistance to poor countries in the form of bilateral aid. Finally, Section 8 offers a few concluding remarks which attempt to place the SDR aid link in the context of global financial reform.

2 The global financial crisis and LICs

There are many channels through which low-income countries have been and will continue to be affected by the global financial crisis of 2008/9. These include exports, foreign direct investment, workers' remittances and foreign aid. Not all channels will, of course, be equally important in every poor country, and not all aspects of the crisis will necessarily be deleterious for each LIC. For example, a fall in commodity prices will have a negative effect on primary-product producers but will be beneficial for commodity importers. But, having said this, it is possible to reach a general conclusion about the implications of the crisis for LICs as a group; this is far from sanguine. The crisis will have a negative effect on economic growth, development and poverty reduction in LICs. It will put pressure on fiscal balances and will also tend to widen current account balance-of-payments deficits. As a consequence, the international reserve holdings of LICs are likely to fall. By the end of the first quarter of 2009, reserve cover for many poor countries had already declined to less than three months' imports – a conventional 'rule of thumb' guide to reserve adequacy.

Even though banks in LICs do not in general exhibit the high levels of leverage observed in the wholesale banks in advanced economies, poor countries have not been protected from the indirect impact of banking crises elsewhere in the world on their real economies. And the deterioration in their overall economic performance may be expected to exert a negative impact on their own financial sectors. The banking and corporate sectors in LICs could also be adversely affected by the indigenous policy responses to deteriorating economic performance. Thus, exchange-rate devaluation could bring with it adverse balance-sheet effects where borrowers have not hedged against exchange-rate risk. The economic difficulties faced by LICs will be further exacerbated by falling access to international capital markets, increasing spreads on foreign borrowing and the erosion of debt sustainability.

In addition to attempting to quantify many of the individual channels through which LICs will be affected by the global financial crisis, the IMF (2009) estimates and predicts the overall effects of the continuing crisis and identifies the LICs that are most vulnerable to the trends discussed above. Of course, such simulations are surrounded by considerable uncertainty and should only be taken as broadly indicative. Across the 71 LICs that are eligible for concessionary Poverty Reduction and Growth Facility loans, the IMF study classifies them into those that have high, medium and low vulnerability to trade and capital account shocks, according to the impact of the crisis on their holdings of international reserves. Over 20% of LICs, most of them in Africa, are estimated to be highly vulnerable to trade shocks, ten appear to be highly vulnerable to a decline in workers' remittances and about half the sample are moderately vulnerable to sudden declines in Foreign Direct Investment, with this being particularly the case for Latin American LICs. Almost half the LICs that received aid in excess of 10% of GDP are found to be highly vulnerable to reductions in aid.

The IMF study then goes on to estimate very tentatively the additional financing needs of LICs resulting from the crisis that would avoid excessive import contraction or depletion of their international reserves. For 2009, it suggests that the balance-of-payments shock for the 38 worst affected LICs could amount to somewhere between $165 billion and $216 bn.

The 'bottom line' is that, taken as a group, LICs will experience large and significant adverse implications from the global financial crisis which can do little other than to arrest or reverse the achievements of the early to mid-2000s. Even then, prior to the crisis, studies were showing that progress towards achieving the Millennium Development Goals was at best patchy. For 'fragile states', there was evidence of negative rather than positive progress. Since many of the LICs where progress has been least satisfactory are also those that will be particularly adversely affected by the global financial crisis, the unhappy conclusion must be that, as things stand, their chances of achieving the MDGs are exceedingly small.

Might an SDR aid link help?

3 The SDR facility and initial proposals for a link

The Special Drawing Right was introduced in 1970 in order to gain greater control over the amount of liquidity in the international monetary system (a useful and succinct summary of the history of and operations involving SDRs may be found in Williamson, 2009). In particular, it had been believed in the 1960s that shortages of international liquidity could lead to a global economic slowdown. Moreover, the way in which international reserves were created under the Bretton Woods system relied heavily on the state of the US balance of payments and the role of the dollar. It was intended that the SDR would eventually take over as the world's principal reserve asset and overcome many of the problems associated with using the dollar in this role – problems aptly reflected by the Triffin dilemma which argued that there were fundamental contradictions in generating international liquidity by creating US dollar liabilities that would eventually lead to a loss of confidence in the dollar and the collapse of the Bretton Woods system.

SDRs were allocated to participants in relation to their IMF quotas, the assumption being that the pattern of supply would match the pattern of long-term demand for reserves, with participants over the long term holding the SDRs they were allocated. No permanent unrequited resource transfers were envisaged, and the idea was that participants would benefit simply from the liquidity yield associated with an increase in owned reserves. There was a debate about whether this was the best way of distributing the seigniorage from SDR creation (Hawkins and Rangarajan, 1970: Grubel, 1972). Developing countries advocated an alternative, suggesting that SDRs could be allocated to them disproportionately. To the extent that they then held them, they would indeed derive a liquidity yield. But by spending them on imports from advanced economies they could also engineer an inward transfer of real resources. Advanced economies would in effect have to earn their extra reserves by sacrificing goods and services. The creation of reserves would thereby be linked to the provision of development assistance.

The link proposal came in various forms and the details differed across the individual schemes. One version, the 'inorganic' link, involved advanced economies making voluntary contributions of the SDRs they received directly to developing countries or to international development agencies. Another, 'organic', version involved changing the formula used for distributing SDRs, so that more of them would go to developing countries, either directly or indirectly through the intermediation of multilateral development agencies. The organic link would have meant changing the Articles of Agreement of the IMF. There were variations on these general themes involving different degrees of concessionality and conditionality.

Opponents of the link argued that it would be inflationary because it would lead to an increase in world aggregate monetary demand with no matching increase in real aggregate supply. This appeared to be a particularly relevant concern in the 1970s when global inflation was reaching a post-war peak. There was also the argument that the link would undermine the integrity of the SDR and frustrate aspirations to make it the principal international reserve asset. Furthermore, there was a concern that allocations of SDRs would create a source of friction between the developing and developed world, since developing countries would always be requesting new allocations while developed countries would tend to turn down such requests because of fears of inflation and the real resource cost. The link proposal was not adopted and was effectively dropped from the reform agenda.

However, inasmuch as developing countries were net users of SDRs, which initially carried only a nominal charge and had only limited reconstitution provisions, they took advantage of an 'informal'link (Bird, 1976, 1978). While the abrogation of the reconstitution requirement in 1981, that required recipients to hold over the long run a minimum proportion of the SDRs they had been allocated, would have increased the value of this informal link, the simultaneous increase in the charge for using SDRs to a market equivalent rate reduced it. However, calculations made at the time continued to suggest that developing countries would still have derived significant benefit from a more formal link (Bird, 1981, 1982). After all, developing countries often had impaired access to international capital markets even at commercial rates, and often continued to face an availability constraint. Moreover, the market equivalent rate of charge on using SDRs could have been subsidised by richer countries if they had so desired.

To many observers the whole question of SDR allocations appeared to become redundant in a world with high degrees of capital mobility and exchange-rate flexibility (but see Williamson, 1984), and it was not until the early 1990s that the topic came once again to the centre of the international monetary stage, with the Managing Director of the IMF arguing that there should be a new allocation. In part he sought to justify this by arguing that new members of the IMF had missed out on the earlier allocations. But he also pointed out that 'for small low-income countries the situation is one of true catastrophe', going on to claim that 'the case for the SDR allocation is very strong'. Not strong enough as it turned out, since even by 2009 the proposed allocation had yet to be approved by the required super majority in the IMF, largely as a consequence of the reluctance of the US Administration to seek congressional support.

4 The benefits of SDRs for LICs

A number of early studies attempted to analyse in detail, both theoretically and empirically, the benefits of SDRs for low-income countries, and there is little point in replicating the analysis here (see Bird, 1976, 1978, 1979, 1981, 1982, 1994). However, it may still be useful to reinforce a few of the salient points. In simple terms, an allocation of SDRs to low-income countries would help to meet the financing needs discussed in Section 2. It would contribute to replenishing the international reserves that would otherwise be depleted as a consequence of the global financial crisis. The benefit could then be seen as allowing LICs to avoid the opportunity cost of equivalent reserve reconstitution brought about in other ways, and, in particular, by forgoing imports. More broadly, this opportunity cost could be calculated to include the negative growth and employment effects of the policies designed to reduce aggregate demand as a means of contracting imports. It might also be suggested that the benefit of reserve replenishment would be higher where the global crisis had had the effect of reducing reserves below a threshold that would be seen conventionally as demarcating reserve adequacy. In such circumstances, there might be a premium on the additional reserves associated with SDR allocation.

The longer-term welfare benefits from SDR allocations depend on the nature of the imports that are in effect financed through SDRs. In the case of capital goods that contribute to raising the rate of economic growth, the welfare benefit will exceed the straightforward liquidity yield associated with the windfall gain of additional international reserves. Calculations in the extant literature suggest that there may be a significant welfare multiplier for low-income countries associated with SDRs.

The benefits of an SDR allocation as perceived by LIC recipients would, however, depend on the conditionality that was involved. Conventional assistance from the IMF under the Poverty Reduction and Growth Facility has, in the past, involved a relatively high degree of conditionality spanning both macroeconomic and structural conditions, although changes in early 2009 will eliminate structural performance criteria, and further reforms announced in July 2009 will generally tend to reduce the degree of conditionality.

As currently constituted, SDR use is unconditional and LIC recipients will no doubt regard SDRs as providing high-quality assistance, giving them a greater value than other forms of IMF assistance. However, as is discussed later, the lack of conditionality may make a linked allocation of SDRs less appealing to the Fund's major shareholders, and this is an area where low-income countries may have to concede to compromises if they want the idea of a link to be politically acceptable. The trend towards lower conditionality, however, suggests that the extent of the compromise may be rather less than it would have been prior to the summer of 2009.

As well as conditionality, there is the issue of additionality. The benefits of a linked allocation of SDRs to LICs would clearly diminish if it was to result in reductions in conventional aid, except to the extent that SDRs are seen as providing higher-quality assistance. We return to this later.

The long and short of it is that LICs would benefit from a linked allocation of SDRs. The benefit would be bigger, the greater the extent to which their financing needs are met by the allocation. The form in which individual LICs might choose to enjoy the benefits would almost certainly vary. Some might opt not to alter other policies and simply add the SDRs to their reserves, deriving the liquidity yield associated with extra reserves. Others might opt to substitute the reserves associated with an allocation of SDRs for those that would have been generated by policy changes designed to contract imports. In this case reserves would not be any higher, but imports would be. Or, of course, they might opt for something between the two. If LICs were to benefit, would other countries lose? Is an SDR link a zero-sum policy proposal? Would it be efficient as well as being effective?

5 Assessing potential arguments against the link

It is relatively easy to anticipate the arguments that will be assembled against the proposal for an SDR aid link, since they were well rehearsed when the idea was previously floated. The principal argument has been that the link will be inflationary because low-income countries will spend a high proportion of the SDRs that they are allocated. This argument can be countered in two ways. The first is a quantitative one. At the levels of allocation that are likely to be involved (see more on this later), it is very doubtful that the impact on global aggregate demand would be sufficient to generate a significant increase in global inflation. The global trend in inflation has, in any case, been in a downward direction and there have indeed been fears of deflation in some advanced economies. Even in circumstances where fiscal stimuli and monetary easing in advanced economies lead to some increase in the future rate of inflation, it remains extremely unlikely that the link would have any significant inflationary impact.

The inflationary concerns might be more justified if, as was envisaged in the initial proposals for it in the 1970s, the link was intended to be a permanent feature of the international monetary system, with ongoing SDR allocations year upon year associated with the SDR becoming the principal international reserve asset. But with a one-off allocation, or even limited allocations spread over a discrete number of years to coincide with the effects of the global financial crisis, the justification dissipates. (The details of a more precise proposal are discussed below.) In short, the contingent factors relating to inflation are very different in 2009 from what they were in the middle of the 1970s. In the 1970s, inflation was one of the major problems facing the world economy. In 2009 it is not.

This leads on to the second counter-argument to the criticism of the link based on inflation. The major global problem in the late 2000s is economic recession. The concern is with deficient global aggregate demand. In these circumstances, the link works in a way that helps to alleviate the problem rather than to make it worse. Although the quantitative impact is again likely to be very modest, the impact will be in a generally desirable direction. Individual economies are responding to the legacy of the global financial crisis by a quantitative easing of monetary policy. A linked allocation of SDRs is essentially a multilateral application of a similar policy.

The world economy in 2009 is also different from the one that existed in the 1970s in other important ways as well; and ways that have a bearing on criticisms of the link. As noted above, in the 1970s there was still the formal intention of establishing the SDR as the principal reserve asset in the international monetary system, ousting the US dollar – an objective that was incorporated into an Amendment to the Fund's Articles of Agreement. In current circumstances there is no equivalent clear-cut international commitment to move in this direction, although China has taken the lead, along with other BRIC countries (Brazil, Russia, India, China), in suggesting that the world would benefit from establishing an international reserve asset such as the SDR to replace the dollar.

The issues involved are somewhat tangential to the main theme of this article and have been discussed as part of the contemporary debate about international monetary reform (Bergsten, 2009). However, it might be anticipated that the BRIC countries would not be opposed to a link that assisted the economic development of poor countries, or could be persuaded to support the idea. Concerns about damaging the integrity of the SDR by establishing a link would therefore seem to be less significant at the end of 2009 than they were in the early 1970s.

The basic conclusion of this section is that the conventional arguments against the link have relatively little relevance in the global economic circumstances found in 2009, and probably for a few years beyond. Indeed, with global economic recession, rising unemployment and deficient aggregate demand, what was previously seen as a potential disadvantage of SDR allocations in general, and a link in particular, has undergone a metamorphosis and emerged as an additional argument in its favour.

6 Further considerations

Of course, the devil with any reform proposal is often to be found in the detail. But in this section it may be sensible to consider a few more general issues that would need to be addressed if the idea of establishing a link between the allocation of SDRs and the provision of development assistance were to be taken forward.

First, administrative ease and the desire to make speedy progress would seem to dictate that the link should be inorganic. Altering the Articles of Agreement to change the IMF's formula for allocating SDRs would be time-consuming and may be unnecessary.

Second, although the inorganic link would imply that individual advanced economies could determine which countries they wanted to support by their voluntary reallocation of SDRs, in the same way that each decides on the pattern of their conventional aid, there might be some advantage in having an agreed general approach. This would involve determining the identity of the LICs that would benefit. Various approaches could be adopted. One would be to build on the IMF's analysis of which LICs are most vulnerable to the implications of the global financial crisis. But it might be more straightforward to use an existing classification such as eligibility for the PRGF or, perhaps better than this, for concessionary assistance from the International Development Association. This would imply a degree of consistency with existing views about the distribution of concessionary assistance through international financial institutions.

Third, donor countries making voluntary SDR contributions would need to decide whether they wanted to make them directly to the LICs identified as receiving assistance or to an international financial institution that would act as an intermediary. Institutional economies of scale might be derived from the latter approach and, in addition to this, if a degree of conditionality were to be included this would favour the intermediation of the IFIs. If PRGF eligibility (or its equivalent) were to be used to identify the recipients of the SDR linked aid, there would be a logic in using the IMF as the most appropriate intermediary – an argument further supported by the fact that SDRs are created by the IMF in the first place.

Fourth, and as noted already, the market equivalent rate of charge on the net use of SDRs reduces the extent to which they are concessionary. Rather than formally altering the rate of charge on SDRs, which would again involve bureaucratic costs, a simpler solution would be for 'donor' countries to pay the rate of charge on behalf of the recipients. This would increase the benefit of the inorganic link for LICs, but it would also have the effect of encouraging the recipients to spend the linked SDRs rather than add them to their reserves. This might not always be appropriate; reserves might have fallen significantly below the levels deemed to be adequate. However, LICs would be receiving SDRs already as part of the regular unlinked allocation. The charge on the net use of these regular SDRs could be left at the market equivalent rate, especially if some degree of reserve accumulation was perceived as desirable.

Fifth, concerns about the ways in which LICs would use the linked SDRs that they received and the dangers of potential moral hazard, with countries substituting out of economic adjustment, might mean that linked SDRs should be conditional on the pursuit of policies approved by the IMF. Poor countries have often been critical of the conditionality embedded in PRGF arrangements with the IMF, and it has sometimes been claimed that excessive conditionality may adversely affect ownership and the implementation of policy reform (Bird, 2001). However, it appears that the Fund is embarking on what it refers to as a 'major overhaul' of conditionality, and this seems likely to bring with it a reduction in the number of conditions and a movement away from structural conditionality which is frequently the source of most tensions. Just as the Fund is moving towards pre-qualification for its support in the context of emerging economies, it seems to be following a similar path with regard to low-income countries. The conditionality attached to linked SDRs could be of the 'light-touch' variety. Alternatively, LIC recipients could be offered a choice between the degree of concessionality and the degree of conditionality. An incentive to comply with IMF conditionality could be created by making access to subsequent linked SDRs itself conditional to some degree on the implementation of previous programmes. Once more, of course, it may be noted that the SDRs that LICs would receive as part of their regular allocation (i.e. the unlinked part) would be unconditional, so that SDR allocations would in practice involve a mixture of unconditional and conditional financial assistance.

Sixth and finally, decisions would need to be made about how many SDRs were to be redistributed to LICs and over what period. Simply for illustrative purposes, advanced economies could redistribute about $75 bn of the almost $150 bn that they are to receive as part of the agreement reached by the G20 in April 2009. This redistribution could be phased over the period 2010-15 and could therefore run up to the target date for achieving the MDGs. Thus LICs would be receiving about $15 bn annually. According to the IMF's calculations cited earlier, this would make a modest contribution to meeting the financing needs of LICs associated with the global financial crisis, but it would represent a significant contribution when compared with other financial flows to LICs.

7 The political economy of the link

In the earlier literature on the link a number of conditions were identified as having to be met in order to make it a practicable possibility (Bird, 1994). These were that there has to be an awareness of the problem to be solved, a recognised need for action, a means through which action can be taken, and a willingness to act. As of 2009 these conditions seem to be met. The commitment to the MDGs shows an awareness of the problem of international poverty and all its attendant features. Similarly, the G20 communiqué emerging from the London summit in April 2009 clearly articulates an awareness of the problems associated with fostering development. In addition, the IMF (2009) study already referred to clearly expresses the problems that LICs will encounter as a consequence of the global financial crisis.

Moreover, it is also recognised universally that action is needed and that the problems facing LICs will not solve themselves. In the same vein, the leaders of the world's largest economies have shown a willingness to act by advocating a series of policies to alleviate hardship in poor countries.

Beyond these general observations, a number of additional factors make it a particularly propitious time to be introducing an SDR aid link. Conventional bilateral aid will be put under threat by the ramifications of the global financial crisis and its fiscal fall-out in advanced economies. Providing assistance by redistributing SDRs does not carry the same budgetary implications as conventional aid, and, for this reason, SDR linked aid appears superior to conventional aid. To this it may be added that SDR linked aid is multilateral. There is a growing consensus that favours a shift in this direction.

The resource cost of the link that undoubtedly exists for advanced economies may appear less important where there is spare productive capacity. The real resources may not have been produced without the linked expenditures from LICs, so the sacrifice seems less. Indeed, rather than advanced economies having to contemplate the inflationary consequences of the link that would make it appear less attractive, it offers a way of helping to stimulate global aggregate demand at a time of recession and unemployment without requiring an increase in domestic government expenditure. It can encourage export-led growth. As a mechanism for raising demand it has many attractions over the alternative of increasing national domestic government expenditure.

Whereas in the 1970s the idea of a link ran counter to the shifting macroeconomic paradigm which involved a switch from Keynesianism to monetarism, at the end of the 2000s Keynesianism has come back into fashion and the link is a global Keynesian policy. Both LICs and donor countries would gain from it. There would be a 'mutuality of interests'. This was a theme that the Brandt Report strongly canvassed in favour of foreign aid, but at the time of the Brandt Report's publication in the 1980s it carried little support from the governments of advanced donor countries. At the end of the 2000s, the mutuality is more pronounced. LICs would benefit from the additional resources and from the help in meeting their financing needs. Advanced economies would benefit from the additional demand for their goods and services, and the positive effects on employment and economic growth, as well as from the impact on their balance-of-payments current accounts. In the global economic circumstances of 2009 the link represents efficient global economic policy.

The link would not only have economic attractions for donor countries. Politically it would enable them to be seen to be doing something to address problems for which LICs are hardly responsible, and to do it in a multilateral fashion. The IMF might welcome it as a way of reasserting its institutional relevance, making a contribution to alleviating the problems faced by a large proportion of its member countries when it is sometimes accused of ignoring their interests, and reactivating the role of its own reserve asset in a way that does not significantly threaten any long-term role for the SDR.

Indeed, it is difficult to imagine a set of circumstances that would provide a more favourable environment for the SDR aid link. The greatest obstacle in the way of achieving it may be its past record and the animosities that it generated. There may be a degree of institutional 'baggage' associated with the proposal. This is reflected by the fact that, when similar ideas were raised in the 1990s, some supporters chose carefully to avoid using the phrase 'the link'.

There may also be the possibility that policy fatigue sets in. With the proliferation of policy initiatives, it may be that there is an upper limit on what can be achieved. It would be unfortunate, however, if the scheme were to be rejected in the late 2000s because it reminded previous adversaries of old battles, or in circumstances where it represents a superior alternative to other policies.

8 Concluding remarks

When SDRs were introduced in 1970 some analysts argued that there was an opportunity to 'kill two birds with one stone' (although it has to be said that killing birds is not something of which I approve). The first bird was the need to design a superior way of meeting the world's liquidity needs, and the second was to provide poor countries with development assistance. They argued in favour of linking the allocation of SDRs with the provision of foreign aid. The link was not accepted, largely because of fears that it would be inflationary at a time when inflation was perceived as a major problem facing the world economy.

At the end of the 2000s, the major problem facing the world economy is no longer inflation but the recession associated with the global financial crisis of 2008/9. However, it is low-income countries that probably stand to be worst affected by it, such that the probability of achieving the Millennium Development Goals has been severely reduced. Conventional ways of assisting poor countries to deal with the implications of the crisis encounter problems, so a new initiative is needed.

Some commentators – this author included – had been canvassing for an additional allocation of SDRs well before the G20 endorsed the idea in April, 2009 (Bird, 2007). Although somewhat 'unfashionable', the claim was that allocations of SDRs could contribute to reducing global economic imbalances by allowing emerging economies to accumulate international reserves without having to run large current-account balance-of-payments surpluses, could help alleviate international poverty, and might even help to un-jam multilateral trade talks. The SDR aid link goes further in terms of pursuing the objective of international poverty reduction.

The link would be a globally effective and efficient policy conferring benefits on both poor and rich countries. It would help reduce international poverty and meet the financing needs of poor countries. It would increase (albeit modestly) global aggregate demand and moderate the recessionary effects of the financial crisis of 2008/9. Indeed, it is difficult to imagine a set of circumstances that would be more favourable to the link. Not only are the economic conditions conducive to it but so are the international political conditions. If the SDR aid link is not activated in the circumstances that currently exist, it is difficult to imagine any circumstances in which it would be. From the link's point of view, it is now or never.

first submitted May 2009
final revision accepted September 2009

References

Bergsten, C. Fred (2009) 'We Should Listen to Beijing's Currency Idea', *Financial Times*, 8 April.

Bird, Graham (2007) 'On Solving the World's Economic Problems by Doing Something Unfashionable', *World Economics* 8 (2): 119-31.

Bird, Graham (2001) 'IMF Programmes: Is There a Conditionality Laffer Curve?', *World Economics* 2 (2): 29-49.

Bird, Graham (1994) *Economic Assistance to Low-Income Countries: Should the Link Be Resurrected?* Essays in International Finance No. 193. Princeton, NJ: Princeton University Press.

Bird, Graham (1988) 'An Analysis of the Welfare Gains from Special Drawing Rights', *Economia Internazionale*, August-November: 177-85.

Bird, Graham (1982) 'Developing Country Interests in Proposals for International Monetary Reform' in Tony Killick (ed.), *Adjustment and Financing in the Developing World*, Washington, DC: International Monetary Fund and London: Overseas Development Institute.

Bird, Graham (1981) 'SDR Distribution, Interest Rates and Aid Flows', *The World Economy* 4: 419-27.

Bird, Graham (1979) 'The Benefits of Special Drawing Rights for Less Developed Countries', *World Development* 7: 281-90.

Bird, Graham (1978) *The International Monetary System and the Less Developed Countries.* London: Macmillan.

Bird, Graham (1976) 'The Informal Link Between SDR Allocation and Aid: A Note', *Journal of Development Studies* 12: 268-73.

Grubel, Herbert G. (1972) 'Basic Methods for Distributing Special Drawing Rights and the Problem of International Aid', *Journal of Finance* 27: 1009-22.

Hawkins, Robert G. and Rangarajan, C. (1970) 'On the Distribution of New International Reserves', *Journal of Finance* 25: 881-91.

International Monetary Fund (2009) *The Implications of the Global Financial Crisis for Low-Income Countries.* Washington, DC: IMF, March.

Park, Yoon S. (1973) *The Link Between Special Drawing Rights and Development Finance.* Essays in International Finance No. 100. Princeton, NJ: Princeton University Press.

Williamson, John (2009) *Understanding Special Drawing Rights*. Policy Brief, PB09-11. Washington, DC: Peterson Institute for International Economics.

Williamson, John (1984) *A New SDR Allocation?* Washington, DC: Institute for International Economics, March.