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The SDR

—a blueprint for libra?

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Facebook's libra has reinvigorated the idea of a global currency and use of a currency basket for its valuation. The SDR shared similar ambitions and can serve as useful background to assess possible challenges and difficulties of designing an international currency. The SDR is not the outcome of a singular vision but rather the campaign of competing views among IMF member countries. It is about countries' perspectives on the purposes of the SDR and its evolution from a basket to reflect inclusiveness and diversification reminiscent of the IMF membership to assuming properties to compete with the main reserve assets. Shifting country influences at the IMF may in the near future offer the possibility of a new direction for the SDR. The present paper provides a review, largely based on IMF Executive Board discussions, of the evolution of IMF views about objective and role of the SDR and traces the idea for the valuation basket of the SDR.

Introduction

Facebook's libra coin has reignited interest in the idea of a supra-national currency and currency baskets.[1] The idea is of course not new. The IMF Special Drawing Right (SDR) went furthest at international level.[2] The rationale for an international currency is to minimise transaction costs in international exchanges and not depend on the monetary or exchange rate policy objectives of any single country. At the same time, the formulation of an international currency needs to meet representativeness and usability and may be subject to competing interests. The SDR's history and limited success show how difficult it is to design an international currency. Libra will likely face very similar challenges.

Libra employs features close to the SDR. It is to be issued by a very diverse and large group of entities forming the Libra Association, valued on the basis of a basket of national currencies, is free floating and can be exchanged on demand for national currencies. The underlying motivations are also comparable, to offer a medium of exchange that overcomes the limitations of national currencies. The proliferation of libra would be equivalent to the idea of an IMF substitution account.

The SDR remains a unique undertaking and rare innovation in the international monetary system. Its unparalleled features may henceforth disqualify it as a blueprint

[1] "Libra's mission is to enable a simple global currency" (Libra Association, 2019).

[2] The European Economic and Monetary Union (EMU) represents the most ambitious approach at regional level.

for others. However, the discussions around the SDR are illustrative of the considerations for forming consensus for designing an international currency.

The contribution of the paper is to summarize the discussion about changes to the SDR valuation basket to illustrate the forces that have shaped the SDR. There is an ample literature about the SDR (Boughton, 2001; Coats et al., 1990; McCaulay & Schenk, 2014; Wilkie, 2012). However, the origins of the SDR valuation and different views of IMF member countries leading to the formation and subsequent changes of the SDR have mostly been disregarded.

The debate about the SDR offers a glimpse about countries' different perspectives about the purposes of the SDR and its evolution from a basket to reflect inclusiveness and diversification reminiscent of the IMF membership to assuming properties to compete with the main reserve assets. The valuation of the SDR in terms of a currency basket had been among the most controversial decisions in the IMF history. IMF Managing Director Witteveen commented on the adoption of a new valuation method for the SDR on 3 June 1974:

> "*We are now coming to the concluding phase of agreement on what may be the most important and difficult complex of Decisions that this Board has ever taken under existing powers in the Articles of Agreement. In this connection, I would put before Directors a number of solutions on the issues which are still not fully agreed concerning the valuation of the SDR, its rate of interest, Fund charges and remuneration. It was clear from our last discussion on this subject that full agreement on valuation of the SDR is conditional, not only on a satisfactory set of weights but also on an acceptable view as to what these weights represent. Ideally, they should reflect the relative importance in the world's trading and financial system of the currencies that make up the basket. In practice it is, of course, difficult to establish weights that would convincingly reflect this relative importance.*"[3]

The SDR has seen only limited success in large part amid the interest of dominant advanced economies IMF member countries that have to date frustrated further adoption and development of the SDR. On-going efforts at the IMF to adjust its governance structure and shift more voting power to China and some large emerging markets may eventually tilt the balance of interests and offer in the near future new opportunities for the SDR to evolve further. Today, there are an equivalent of US$291 billion of SDRs outstanding.

The present paper focuses on the IMF deliberations on currency inclusion in the SDR valuation basket. These are traced broadly in chronological order in large part based

[3] IMF (1974e).

on the comments of Executive Directors' and Alternate Executive Directors', referred to as Directors and Alternates, as recorded in the minutes of IMF Executive Board meetings and related statements and documents.[4] Directors are identified by their country of origin and the voting power of their constituency at the IMF at the time a comment was made (Directors, number of member countries, voting power and composition of constituency have changed continuously).

Decisions at the IMF Executive Board are guided by the voting power of Directors. It does not preclude small countries having considerable influence on proceedings but voting power remains decisive for building majorities for a decision.

Decisions on the SDR require qualified majorities of the total voting power at the IMF Executive Board as stipulated in the IMF Articles of Agreement.[5] A 70 percent majority of the total voting power is required for changes in the valuation of the SDR. An 85 percent majority of the total voting power is required for a change in the principle of valuation or a fundamental change in the application of the principle in effect. An SDR allocation requires an 85 percent majority of the total voting power.

Origins of the SDR

The SDR emerged during the 1960s to counter perceived impending shortages of international reserves. Official reserve holdings were critical for payments and settlements of international transactions. Concerns about the adequate supply of reserves are immediately related to the purpose and origins of the IMF itself. John Maynard Keynes stated as part of the objectives of his 1942 proposal of an international clearing union:[6]

> "We need a *quantum* of international currency, which is neither determined in an unpredictable and irrelevant manner as, for example, by the technical progress of the gold industry, nor subject to large variations depending on the gold reserve policies of individual countries […]."

The 1950-60s were marked by the increasing importance of the dollar to become the principal reserve asset of central banks. Under the Bretton Woods exchange rate system, currencies were pegged to the dollar at fixed but adjustable exchange rates—par values—and the dollar was fixed to gold at US$35 an ounce of fine gold.

[4] There are today 24 IMF Executive Directors being the IMF member countries' representatives at the IMF Executive Board responsible for conducting the day-to-day business of the IMF. The Board usually meets several times a week and carries out work largely on the basis of documents prepared by the IMF staff.
[5] The IMF Articles of Agreement constitute the international treaty on which the IMF was established. The Articles were adopted in 1944 and came into force in 1945. The Articles were subsequently amended in 1969, 1978, 1992, 2009 and 2011.
[6] IMF (1969). Italics as per original.

The system provided, in principle, to determine unequivocally the gold value of any currency via the dollar with gold representing its numeraire.

During the 1960s, the IMF became increasingly concerned about the slowing pace of reserve accumulation.[7] By 1960, the dollar overtook sterling as the largest foreign exchange reserve. At the time, any rise in international reserves was mostly due to increased holdings of foreign exchange mainly dollars and it was feared that the accretion of dollars will soon abate leading eventually to a significant weakening of the structure of international liquidity.[8] In 1965, the IMF included as part of its work programme the need for the creation of additional reserves.[9] In 1967, the IMF began deliberations in earnest about a reserve facility based on "drawing rights in the Fund" and the Board of Governors, the highest decision-making body of the IMF, adopted a resolution for a "supplement to existing reserve assets."[10] In 1968, the IMF Executive Board issued a report recommending modifications of the IMF Articles of Agreement of the IMF to establish a facility for special drawing rights.[11] In 1969, the amendment of the Articles became effective." By 1970, foreign exchange reserves overtook gold as the principal reserve assets with the dollar representing on average three quarters of central banks' foreign exchange reserve holdings.[12] In January 1970, the first SDR allocation was made.[13]

In August 1971, the U.S. unilaterally suspended the convertibility of dollars into gold. It brought the collapse of the Bretton Woods system—a complete disruption of the then existing monetary order—and was accompanied by the adoption of generalised floating of the main currencies.

The end of the Bretton Woods system triggered a rethink about the role of the SDR and advanced the idea of a substitution account. In 1972, at the IMF Annual Meetings, then U.S. Treasury Secretary George Shultz outlined a plan to reform the international monetary system and end the special role of the dollar as a reserve currency. The plan included exchanging the dollar for the SDR to become the formal numeraire of the system, offering an exchange of existing reserve assets (dollars) for SDRs, eliminating the role of gold, transferring sovereignty to international institutions to manage the system.[14]

The exchange of existing reserve assets for SDRs was based on proposals for an SDR substitution account. In 1972-74, the Committee of Twenty analysed the possibility of a substitution account based on a compulsory exchange of foreign exchange assets

[7] IMF (1967a).
[8] IMF (1964).
[9] IMF (1965).
[10] IMF (1967b); IMF (1968b).
[11] IMF (1968c); IMF (1968a).
[12] IMF Annual Reports.
[13] IMF (1970).
[14] New York Times (1972).

for SDRs.[15] In 1975, the IMF debated a substitution account for gold to allow IMF member countries to obtain SDRs in exchange of gold.[16] In 1979 after different iterations, the IMF reconsidered a substitution account to exchange dollars for SDRs. The idea attracted considerable interest and consisted of an account administered by the IMF that accepts deposits on a voluntary basis of eligible dollar-denominated securities in exchange for an equivalent amount of SDR-denominated claims. The account was seen to contribute significantly to promoting the SDR.[17] In 1978, the Second Amendment of the IMF Articles of Agreement entered into effect providing among other for the SDR to become "the principal reserve asset in the international monetary system."[18] The amendment also provided for the demonetisation of gold.

The SDR fell subsequently into disregard and attracted only very limited interest during most of the 1980-2000s amid a perceived lack of need to supplement existing reserve assets and concerns that further SDR allocations would be inflationary. There was no SDR allocation from 1981 through 2008. In 1980, the substitution account ideas were abandoned.[19]

In March 2009, the SDR got a fillip with proposals by the Chinese and Russian authorities to establish greater reserve currency diversification based on the SDR.[20] This was followed by large allocations of SDRs in August 2009 to accommodate additional international liquidity needs following the global financial and economic crisis. In October 2016, the inclusion of the renminbi in the SDR valuation basket promised some scope to sustain the momentum towards a renewed proliferation of the SDR.

SDR allocation

SDRs are created by the IMF normally through general allocations to IMF member countries. SDR allocations have to be based on an assessment by the IMF for a long-term global need to supplement existing reserve assets. Decisions on general allocations are made for successive basic periods of up to five years. There have been only three general allocations.

[15] The Committee of Twenty was an ad hoc committee in 1972-74 made of representatives of the IMF Executive Board to review options for reforming the international monetary system; see e.g. Boughton (2001).
[16] IMF (1975).
[17] IMF (1980d).
[18] IMF (1978a), Article VIII section 7.
[19] Boughton (2001).
[20] Xiaochuan Zhou (2009), "Reform of the international monetary system," People's Bank of China website http://www.pbc.gov.cn/english/detail.asp?col=6500&id=178, 23 March 2009; President of Russia (2009), "Russian proposals to the London Summit (April 2009)," President of Russia website http://eng.kremlin.ru/text/docs/2009/03/213995.shtml, 16 March 2009.

SDRs are allocated to IMF member countries receiving an asset (SDR holdings) and a liability (SDR allocation) in SDRs at the same time in proportion to their IMF quotas.[21] SDRs represent a claim on the foreign exchange holdings of other IMF member countries that have the obligation to accept SDRs in exchange of foreign exchange.[22] The SDR mechanism is self-financing and levies charges on allocations which are used to pay interest on SDR holdings. If a country's SDR holdings rise above its allocation, it effectively earns interest on the excess. If it holds fewer SDRs than allocated, it pays interest on the shortfall.

SDRs are held predominately by central banks in their accounts at the IMF and used almost exclusively in transactions within the IMF. The SDR is also a unit of account and all transactions of the IMF are accounted for in SDRs.

The 1970 SDR allocation was part of the first general allocation in 1970-72 of SDR9.3 billion. In 1979-81, the second general allocation was of SDR 12.1 billion. In 2009, a third general allocation of SDR162.2 billion was distributed together with a special one-time allocation of SDR21.5 billion. There are SDR204.1 billion (US$291 billion) outstanding today.

SDR valuation

The SDR was originally valued as an equivalent weight in gold consistent with the par-value system. In 1969, its valuation was set equal to 0.888671 grams of fine gold equivalent to the value of 1 dollar, being the par value of the dollar, so that 1 SDR equalled 1 dollar. The collapse of the Bretton Woods System and devaluations of the dollar led to an appreciation of the SDR against the dollar to US$1.21. The latter value was maintained by the IMF through July 1974 even though the new par value of the dollar ceased to be observed amid the adoption of generalised floating. Since July 1974, the value of the SDR has been based on the market value of a basket of currencies.[23]

The maintenance of the gold value of currencies constituted an essential element for the operation of the IMF. IMF transactions involved the exchange of currencies for assets of a fixed gold value comprising claims on the Fund and SDRs requiring a price link between these assets and currencies. The suspension of convertibility of the dollar into gold severed that link. The IMF had to establish a new basis for the valuation of its assets. In 1971, the IMF Executive Board advanced deliberations on the wider use of

[21] Quotas represent the subscription to the IMF. Each IMF member country is assigned a quota based broadly on its relative position in the world economy. The quota determines the maximum financial commitment of a country to the IMF, its voting power and guides its access to IMF financing.
[22] The SDR designation mechanism provides that in the event there is insufficient capacity under the voluntary trading arrangement, the IMF can ask member countries with sufficiently strong external positions to buy SDRs with freely usable currencies up to a certain amounts from member countries with weak external positions.
[23] IMF (1979a).

SDRs eventually to substitute gold with the SDR as the new numeraire of the international monetary system.[24]

The search for a stable numeraire led to the idea of valuing the SDR in terms of a currency basket. In October 1971, Director Lieftinck (Netherlands, 3.82 percent) submitted a proposal to tie the value of the SDR to a weighted average of currency values.[25] The objective was for the basket to be relatively stable in purchasing power terms and that no single currency should have an undue influence on the value of the basket.[26] The decision to base the SDR on a basket of currencies was taken at a meeting of the Committee of Twenty in January 1974.[27]

The valuation of the SDR was based on the transaction value and yield. The former is defined in terms of average exchange rates vis-à-vis the U.S. dollar and the latter by the SDR interest rate. The IMF staff advanced proposals on possible valuation methods for the SDR based on the principle that "*to value the SDR for transactions purposes by equating it to a specified package of currencies, in which a number of currencies are combined with given weights; and to relate the interest rate on the SDR to a weighted average of the interest rate on the same currencies, combining them with the same weights […].There are difficult questions to be decided as to the currencies to be included in the package and the weights to be selected. Insofar as possible, a rather large number of currencies should be included so as to minimize the impact of unusual movements in the money market of an individual country. However, since one of the major purposes of the calculation would be to determine the rate of interest, one could only include currencies for which a suitable market rate of interest, in addition to a market exchange rate, could readily be determined*."[28] The valuation approach defined the framework and remained an important reference in subsequent deliberations on SDR valuations. Decisions to change the basket and interest rate are taken by the Executive Board with a qualified majority. [29]

The SDR interest rate eventually provides the basis for calculating the interest charged to countries on IMF loans, the interest paid to IMF member countries on their remunerated creditor positions in the IMF and the interest paid on their SDR holdings and charges on their SDR allocation.

[24] IMF (1971a). See also IMF (1972).
[25] Director for Cyprus, Israel, Netherlands, Romania and Yugoslavia. IMF (1971b).
[26] IMF (1974b).
[27] IMF (1979b).
[28] IMF (1973b).
[29] The IMF Articles of Agreement prescribe the conditions for changing the valuation (Article XV): The method of valuation of the special drawing right shall be determined by the Fund by a seventy percent majority of the total voting power, provided, however, that an eighty-five percent majority of the total voting power shall be required for a change in the principle of valuation or a fundamental change in the application of the principle in effect.

16 currencies

The SDR interest rate was a central focus of the initial IMF SDR valuation debates. The notion that the SDR has to offer an attractive interest rate to be adopted as a reserve asset dominated discussions. Directors debated whether the SDR interest rate should be determined on the basis of market interest rates or set discretely by the IMF. Director Brand (Australia, 4.29 percent), representing the dominant view proposed, that the SDR "*should have an interest rate that is competitive with, or is broadly based on, or moves in sympathy with, those of alternative reserve assets*."[30]

The debate about the transaction value of the SDR centred mostly on the number of currencies and choice of weights. Director Schleiminger (Germany, 5.27 percent) reflected on the dimension of the debate noting "*it might be appropriate to include [in the SDR valuation basket] only those trading currencies the value of which was supported through active intervention in the market. However, that formula might have to be revised to take account of the interest of countries whose currency would not qualify for inclusion according to the formula but which had a legitimate interest in maintaining a stable store of value for their foreign reserves. […] A question of prestige might be at issue but otherwise [there was] no merit in that proposal*."[31] Director Massad (Chile, 2.94 percent) retorted "*[t]he larger the sample of currencies included in the basket for the purposes of SDR valuation, the more stable would be the value of SDRs in terms of currencies in general. The size of the basket was not, therefore, a question of prestige, but involved the desire to have a formula that reflected the movement of currencies in general rather than just one particular group of currencies.*"[32] Director Prasad (India, 4.02 percent) echoed concerns about the distributional consequence of the SDR valuation stating that an "*upward bias in the valuation of the SDR [could sharply affect] the relationship between debtors and creditors*."[33] Director Rawlinson (U.K., 9.16 percent) indicated that he "*would favour inclusion in the basket of the currencies most widely used in international trade and contemplated a somewhat larger number of currencies [than 5]*.[34]" Director Bryce (Canada, 4.50 percent) stressed his "*preference for a basket of currencies approach involving about 15 or 20 of the currencies most used in trade as suggested by Mr Rawlinson. The currencies in the basket should be weighted by trade, a formula which would reduce the weights of existing reserve currencies and provide a fairly objective measure*."[35]

The IMF staff advanced different SDR valuation approaches and basket sizes. Approaches included varying cut-off levels in terms of international trade share of 6,

[30] Director for Australia, New Zealand, South Africa, Swaziland and Western Samoa. IMF (1974d).
[31] Director for Germany. IMF (1973a).
[32] IMF (1973a).
[33] Director for Bangladesh, India and Sri Lanka. IMF (1973a).
[34] Director for United Kingdom. IMF (1973a).
[35] Director for Barbados, Canada, Ireland and Jamaica. IMF (1973a).

5, 3 and 1 percent resulting in inclusion of 5, 7, 9 and 16 countries.[36] Different basket approaches were reviewed comprising a standard basket and an asymmetrical basket. The standard basket involved setting the value of the SDR equal to a basket of currencies where the amounts of each currency in the basket would be specified for a long period; the value of the SDR in terms of any one currency would be the value of the amounts of each of the currencies in the basket expressed in terms of this one currency at the prevailing spot exchange rate. The asymmetrical basket was based on the principle that the value of the SDR was set equal to a group of currencies except that exchange rate devaluations were not allowed to influence the value of the SDR to be achieved by modifying sufficiently the weight of the currency subject to a devaluation implying an appreciation bias of the basket. Another alternative to balance between revaluation and devaluation based on the system of par values was rejected. Agreement was reached to adopt a standard basket.

Consensus emerged around a basket including 16 currencies. However, different views on the number of currencies and weights remained. Alternate Harley (U.S., 21.81 percent) stated that "*the size of the basket could be considered from two different approaches […]. The first was that the SDR should be stable against the average of those currencies most likely to be regarded as alternative reserve assets and used most widely in international transactions. Such a basket should be constructed so as to minimize the effects of basket variations on the valuation of countries' reserve holdings. Those considerations would tend to argue for a small basket on the order of the […] five currencies […]. The second approach […] would be that the SDR should be stable against the average of currencies in general, and that the impact of any single exchange rate change on the purchasing power of the SDR should be minimized. That approach would argue for the broadest practical coverage. Ready availability of market rates might limit the number of currencies and […] that operational considerations might limit the size of a large basket to around 16 currencies*."[37] Director Lieftinck (Netherlands, 3.77 percent) indicated "*the Netherlands strongly favoured a basket that would comprise countries with a share in world trade, measured by exports of goods and services, of 3 per cent. A smaller basket would give disproportionate weight to a few major currencies. Although they would not object to a somewhat larger group, their preference was for a 9-currency basket*."[38] Director Bueso (Honduras, 3.34 percent) outlined that "*[h]is preference was for a basket including the five major currencies […], although he would consider adding two other countries, one of which might be an oil producing member. The logic of that position might argue in favour of a system of weights that reflected the relative share of currencies in reserve portfolios.*"[39]

[36] IMF (1974c).
[37] Alternate Director for United States. IMF (1974d).
[38] Director for Cyprus, Israel, Netherlands and Yugoslavia. IMF (1974d).
[39] Director for Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Venezuela. IMF (1974d).

The first SDR basket included 16 currencies and came into effect in July 1974 (Table). The currencies in the basket were chosen on the basis of an international transaction criterion approximated by the issuing countries' shares in international trade of goods and services of equal or greater than 1 percent in the period 1968 to 1972. A modified weight was assigned to the dollar of about one third of the total to reflect its special role and importance. The value of the SDR was calculated as the weighted average of the exchanger rates of the SDR basket currencies vis-a-vis the dollar. The SDR interest rate was initially set at 5 percent by the Fund in July 1974.[40]

Table. SDR basket composition

Initial weights

	Jul 1969-Jun 1974	Jul 1974-Jun 1978	Jul 1978-Dec 1980	1981-85	1986-98	1999-2016	from Oct 2016
Gold (grams)	0.8887						
U.S. dollars		0.330	0.330	0.420	0.420	0.419	0.417
Deutsche marks		0.125	0.125	0.190	0.190		
Pound sterling		0.090	0.075	0.130	0.120	0.113	0.081
Japanese yen		0.075	0.075	0.130	0.150	0.094	0.083
French francs		0.075	0.075	0.130	0.120		
Canadian dollars		0.060	0.050				
Italian lire		0.060	0.050				
Netherland guilders		0.045	0.050				
Belgian francs		0.035	0.040				
Swedish krona		0.025	0.020				
Australian dollars		0.015	0.015				
Danish krone		0.015					
Norwegian krone		0.015	0.015				
Spanish peseta		0.015	0.015				
Austrian shillings		0.010	0.015				
South African rand		0.010					
Saudi Arabia riyals			0.030				
Iranian rials			0.020				
Euro						0.374	0.309
Chinese renminbi							0.109

Source: Boughton, J. (2001), Silent Revolution: The IMF 1979-1989, IMF (corrected); IMF. *In January 1999, the Deutsche Mark and French franc were replaced by equivalent amounts of euro; weights with effect from January 2011.

The SDR valuation remained contested. Emphasis shifted away from the objective of the SDR being representative of the international transactions of IMF member countries towards strengthening and simplifying the SDR as a financial asset. Overarching concerns about the SDR interest rate gave way to consideration about the composition of the currency basket. In July 1976, the Fund modified the rate of interest to be determined by the weighted market rates of the daily interest rates of short-dated treasury bills of the U.S., Germany, France and the U.K and the call money rate of Japan.[41] The hitherto different reference baskets for the SDR transaction value and interest rate became a critical issue.

[40] IMF (1974a).
[41] IMF (1976a).

The review of the SDR in 1976 reflected broad-based satisfaction with the valuation of the SDR. However, the number of currencies remained a concern: "*Many Directors commented on the desirability of keeping the present basket of currencies unchanged in order to foster general confidence in the continuity of the valuation procedure and thereby to promote the establishment of the SDR as an asset at the centre of the international monetary system. Even though several Directors would in principle favour a smaller number of currencies than the present 16, and a few Directors would prefer expanding the number by using the criterion of a minimum share of 1 per cent in exports of goods and services, many of these Directors indicated an inclination to subordinate these preferences for the time being to the desideratum of constancy of the valuation procedure*."[42]

The adoption of the Second Amendment of the IMF Articles of Agreement brought about a reassessment of the criteria guiding the currency inclusion criteria. In April 1977, the Interim Committee of the Board of Governors requested the Directors to review the characteristics and uses of the SDR to assess whether it remains consistent with the purposes of the IMF and in particular with making the SDR the principal reserve assets as stipulated in the Second Amendment.

The review of the SDR was largely defined by issues concerning the composition of the basket. Four issues had been shaping the discussion: continuity, stability, representativeness and logical consistency.[43] Continuity was based on the retention of the original 16-currency basket largely given the unit of account and standard of value function of the SDR also in view of the increasing adoption of the SDR in international treaties. The stability argument referred to the robustness of currency selection to minimise significant changes in the composition of currencies. The criterion of representativeness remained ambiguous between strict criteria on the usability of currencies to reflecting exchange rate movements among IMF members in general pointing towards a more inclusive basket. The logical consistency presumed that selection should be rules-based to reject any arbitrary selection of currencies.

Director Kafka (Brazil, 3.45 percent) highlighted the divisions regarding the choice of basket. "*If the SDR was to become an important reserve asset it would need to be based on a credible principle of valuation. He had never been convinced that the use of a basket of 16 currencies was the optimum method of valuation. And his reservations had increased with consideration of the criterion upon which entry into the basket had been judged, namely, representation of more than 1 per cent of world trade in goods and services. Under that criterion, one currency in the basket was no longer qualified to remain and three other currencies, not included in the basket, had*

[42] IMF (1976b).
[43] See e.g. IMF (1977b).

qualified for admission. A smaller basket of five currencies would avoid that instability because the differences between the currencies representing the least share of world trade in the basket and the next most important currency would be relatively large."[44]

Director de Groote (Belgium, 3.80 percent) recalled the original purpose of the valuation approach: "*We also have to remember what our intentions were in deciding on a basket definition for the SDR, and on a 16-currency basket. Following an initial proposal by Mr. Lieftinck, the intention was to provide monetary authorities with a reserve asset, the composition of which would reflect, as accurately as possible, the distribution of a country's reserves among the different money markets where reserves are normally invested, taking into account the relative magnitude of those markets. It is, however, impossible to measure directly the relative importance of money markets; the size of payments made in each currency could be a first approximation, but there also statistics are unavailable. As a second proxy, the decision was taken to use shares in world trade, but, at no point was it implied that these figures had in themselves, for this purpose, any other than an approximate value. The reason for including all currencies from countries having more than 1 per cent of world trade was, similarly, not that any sacrosanct importance was attached to the 1 per cent benchmark, but that the basket, defined on this basis, happened to include all currencies in which members normally invest, or could invest, their reserves*."[45]

Director Ruding (Netherlands, 4.49 percent) argued that a basket of 9 or less currencies would be less acceptable because the share of world trade represented would become too low and stability would be impaired.[46] Others pressed for greater simplicity of the basket. Director Simone (Argentina, 2.75 percent) argued that a smaller basket of 5 currencies would facilitate forecasting the value of each underlying currency and hence the SDR.[47] Director Al-Atrash (Syria, 2.49 percent) stressed that the retention of South Africa while excluding major OPEC countries could not be justified.[48]

Apprehension that the SDR should not be dominated by the large economies remained prominent. Director Pieske (Germany, 5.35 percent) favoured to increase the trade threshold to 5 percent to insure greater stability in the basket composition based on international trade though he would lower the threshold to 3 percent to allow for a broader basket including Saudi Arabia to ensure the basket is not only confined to industrial countries.[49] Director Cross (U.S., 20.66 percent) remarked that

[44] Director for Brazil, Colombia, Dominican Republic, Guyana, Haiti, Panama, Peru and Trinidad and Tobago. IMF (1977a).
[45] Director for Austria, Belgium, Luxembourg and Turkey. IMF (1977a)
[46] Director for Cyprus, Israel, Netherlands, Romania and Yugoslavia. IMF (1977a).
[47] Director for Argentina, Bolivia, Chile, Ecuador, Paraguay and Uruguay. IMF (1977a).
[48] Director for Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Pakistan, Qatar, Saudi Arabia, Somalia, Syria, United Arab Emirates, Yemen Arab Republic. IMF (1977a).
[49] Director for Germany. IMF (1977a).

"*the whole purpose of a basket had been to make the SDR an international reserve asset whose value would not depend primarily on the economic policy decisions of only one member government. The same logic called for a basket of more than five, seven, or nine currencies. The 16-currency basket originally adopted had been based on a sound idea […] [to be] representative of a number of economies in different parts of the world, rather than one composed of the currencies of five large economies*."[50] Director Whitelaw (Australia, 3.10 percent) echoed similar concerns arguing that the SDR should convey an average experience of currencies and that the "*best way to get to a representative sample was to make it as large as practicable. In theory, the optimum basket would be one of 130 currencies, but by the same token, 16 was probably more representative than 5*."[51]

The Executive Board decided on 31 March 1978 to maintain the 16-currency basket. The original basket saw a change with the substitution of the Danish krone and South African rand for the Saudi riyal and Iranian rial (Table). The IMF also decided that the basket was due for revision on the basis of a quinquennial review with effect on 1 July 1983 and that from 1 July 1983, the share of each currency in the basket will be based on the sum of components representing exports of goods and services and the share of a currency in other countries' international reserve holdings.

Notwithstanding, discomfort with the 16-currency basket remained. The objective now shifted towards making the SDR gain greater acceptance among private sector participants with the possibility to develop deposits or other liabilities denominated in SDRs. The arguments included the lack of replicability and the difficulty for private market participants to hedge the 16 currencies amid the lack of well-developed local capital markets.[52]

From 16 to 5 currencies

The Interim Committee at its meeting in Hamburg in April 1980 endorsed the objective of simplifying the SDR basket to enhance the attractiveness of the SDR and expressed the view that it would be desirable for the interest rate and valuation basket to be identical.[53] The focus was on a proposal to reduce the SDR currency basket to 5 currencies.

The SDR discussion highlighted mounting tensions between the large advanced economies and other IMF member countries. Director Drabble (Canada, 4.27 percent) encapsulated the debate shift by stating: "[A] *a five currency basket could*'

[50] IMF (1978b).
[51] Director for Australia, New Zealand, Papua New Guinea, Philippines and Western Samoa.
[52] See e.g. IMF (1980b).
[53] IMF (1980c).

be perceived as further institutionalizing the special role of the Fund's five largest members—the only countries which at all times have a right to appoint Directors and whose currencies are the only ones to have been designated so far as 'freely usable' currencies.[54] Alternate Schneider (Austria, 3.61 percent) favoured a basket of 9 currencies indicating that it would "*have flexibility to include eventually developing countries*" upon meeting the inclusion criteria.[55] Director Amuzegar (Iran, 2.91 percent) stressed that a "*drastic reduction of the basket size [is] not warranted*" and highlighted that "*the international character of the Fund would be damaged if the currencies in the valuation basket were limited to those of the five most highly industrialised countries*."[56] Director Muns (Spain, 4.96 percent) indicted that the reduction of the basket to 5 currencies "*would be a departure from the initial objective of making the SDR a reserve asset with as wide an economic and political base as possible [and that the] concentration of monetary power would be inconsistent [with that]*."[57]

The objective to increase the SDR in private markets dominated the discussion. Director Cross (U.S., 20.01 percent) stated that a small basket would "*make the SDR a true financial instrument rather than a political statement*."[58] Alternate Price (U.K., 6.99 percent) argued that a "*combined basket should increase attractiveness of the SDR as reserve asset and as unit of account for public and private transactions.*"[59] Director Hirao (Japan, 3.98 percent) stressed preference for a 5-currency basket "*because of simplicity and acceptability to the market*."[60] Director Laske (Germany, 5.16 percent) stated preference for a 5-currency basket "*to increase attractiveness of SDR in the international monetary system and private markets*."[61]

The decision to reduce the basket to 5 currencies was taken on 9 September 1980 to become effective on 1 January 1981 (Table). The new SDR basket comprised the U.S. dollar, German mark, French franc, Japanese yen and British pound. The international transaction criterion for selecting the currencies for inclusion in the basket was modified to contain the currencies of the five IMF member countries whose exports of goods and services during the five-year period ending 12 months before the effective date of the SDR revision had the largest value.[62]

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[54] Director for Bahamas, Barbados, Canada, Grenada, Ireland and Jamaica. See IMF (1980f). The statement refers to the fact that the 5 largest IMF member countries all have the right to appoint their Directors. The adoption of an all-elected IMF Executive Board now became effective in December 2015 with the 2010 quota reform package.
[55] Alternate Director for Austria, Belgium, Luxembourg and Turkey. IMF (1980b).
[56] Director for Afghanistan, Algeria, Ghana, Iran, Morocco, Oman and Tunisia. IMF (1980a).
[57] Director for Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Spain and Venezuela. IMF (1980a).
[58] IMF (1980a).
[59] Alternate Director for United Kingdom. IMF (1980a).
[60] Director for Japan. IMF (1980a).
[61] Director for Germany. IMF (1980a).
[62] IMF (1980e).

IMF Managing Director de Larosière remarked in his summing-up of the Executive Board Meeting: "*First of all, I think we can say that there has been an overwhelming sentiment that a five-currency basket is an acceptable solution; those whose first preference is for a five-currency basket account for more than 75 per cent of the total voting power in the Fund. Thus, in drawing the sense of the meeting, I am in a position to state that the Board has accepted as a matter of principle a five currency basket and the identity of the two baskets*."

The 1985 review of the SDR basket focused mostly on technical matters. The controversy regarding the current basket had abated. The debate about the SDR during the 1980s came to a standstill. The lack of further SDR allocations and progress on the substitution account reduced further interest in the SDR.

From 5 to 4 currencies

The reduction from 5 currencies to 4 was based entirely on the introduction of the euro (Table). The euro replaced the mark and franc at their combined weight at the prevailing valuation method. For the interest rate calculation, the proposed continued use of government securities for Germany and France received some criticism. In December 1998, the IMF incorporated the euro into the SDR valuation basket effective 1 January 1999. The basket comprised the dollar, euro, yen and sterling.

The October 2000, the IMF amended the method for the inclusion of currencies. The international transaction criterion for the SDR basket was changed to comprise a second criterion stipulating that the currencies in the SDR valuation basket are among the most widely used in international transactions. The relevant benchmark would be based on an assessment by the IMF that a currency is "freely usable" meaning widely used to make payments for international transactions and is widely traded in the principal foreign exchange markets.[63]

The IMF remained reluctant to support greater SDR allocations which damped interest for the SDR more generally. For the conclusion of the eighth basic period in 2011, Director Wei (China, 2.95 percent) stated: "*The Fund should make efforts to make the SDR a principal reserve asset. However, the continuous decline of the ratio of SDR volume in global aggregate reserves from nearly 9 percent to 2 percent over the past two decades […] will weaken the ability of the Fund to safeguard the stability of the international monetary system. Therefore, we advocate the increase in the SDR allocation and the enlargement of the use of the SDR in the international financial system, which we believe will be of great significance to the stability of the*

[63] IMF (2000).

international financial system and the promotion of international trade."[64] Director Zoccali (Argentina, 2.00 percent) expressed considerable frustration that was echoed by several Directors: "*In any event, the arguments in favour of a general SDR allocation are of little value if the political will to keep the SDR alive is not there*."[65] The dominant attitude among the IMF membership towards SDR allocations was expressed by Alternate von Kleist (Germany, 6.02 percent): "*We cannot support the finding of a 'long-term global need.' The current slowdown of the world economy can be attributed to many factors—the lack of availability of SDRs is surely not one of them*."[66]

Beyond 4 currencies

The SDR gained renewed momentum with the global financial and economic crisis. While in the past, the SDR debate was dominated by the advanced economies, China and emerging markets increasingly assumed leadership. In March 2009, proposals were advanced by the Chinese and Russian authorities to establish greater reserve currency diversification based on the SDR.[67] In August 2009, a large SDR allocation of US$250 billion was made following a request by the International Monetary and Financial Committee (IMFC), successor of the Interim Committee, to strengthen the global financial safety net in the face of the severe crisis. In preparation of France's Group of Twenty (G20) Presidency in 2010, further momentum built amid emphasis on the need to reform the international monetary system including a special role for the renminbi.[68] The IMFC and the Ministers from the G20 countries instructed the IMF in 2010 to develop a criteria-based path to broaden the composition of the SDR basket.

Past debates on the SDR revealed mounting divergence between large advanced economies and other countries. While the initial discussions to establish the 16-currency basket had not shown marked divisions by country size or income, the adoption of the 5-currency basket caused a schism amid strong preferences for a smaller basket among the large advanced economies. This divide underscored fundamentally different perspectives on the purposes of the SDR. The need for near consensus on SDR allocations and the large majorities required for changes in the SDR valuation, make it necessary to reach broad-based support among IMF member countries for any meaningful change. As in the past, this will be determined by essential alliances among key countries.

[64] Director for China. IMF (2001).
[65] Director for Argentina, Bolivia, Chile, Paraguay, Peru and Uruguay. IMF (2001).
[66] Alternate Director for Germany. IMF (2001).
[67] See footnote 20.
[68] Reuters (2015): "One official said a key area of discussion was how to encourage greater use of China's yuan as a reserve currency in the future, including talks on a possible timetable for its inclusion in the basket of currencies which underpin the IMF's Special Drawing Rights. Other ideas include encouraging a greater role for the SDR itself as a reserve currency, in an effort to move away from reliance on the U.S. dollar, officials say."

The inclusion of the renminbi with the 2015 SDR valuation review marked the first net addition of a currency to the SDR basket. However, the IMF maintained prevailing valuation criteria affirming the bias towards the SDR as a financial instrument adopted in 1980. The amendment of the SDR valuation criteria in 2000 further tilted the SDR towards continuity rather than innovation.[69] The significant accumulation of central bank foreign exchange reserves especially in 2002-2014 also remains inconsistent with the notion of a lack of global need to supplement existing reserve assets.

Conclusion

The SDR has failed as a reserve asset. The hoped success of the SDR and greater acceptance by private markets has never materialised. Alternate Ahmad (Malaysia, 2.88 percent) noted in 1985 "*that the method of valuation, based on a basket of five currencies, had not achieved all the aims of the 1980 decision. The attractiveness of the SDR either as a reserve asset, or as a unit of account in the private market, had not significantly improved*."[70] The lack of success of the SDR has not to date led to retrospection whether the valuation framework and purpose of the SDR, in particular the assumption that attractiveness of the SDR rests in its simplicity and replicability, remain valid and adapted to current circumstances. The fundamental failure to make the SDR the principal reserve asset as prescribed by the Articles of Agreement for more than 40 years since the Second Amendment reflects a profound weakness to rally IMF member countries to reform the international monetary system.

The inclusion of the renminbi in the SDR basket had the potential to mark a new beginning. In 1980, at the time of the decision to reduce the basket from 16 to 5 currencies, Director Kharmawan (Indonesia, 3.19 percent) emphasised that "*[i]f countries could change their reserves that were at present composed of 100 per cent or 90 per cent U.S. dollars into an asset composed of only 44 per cent U.S. dollars, they would have made a move in the right direction.*"[71] If diversification in the international monetary system remains an important objective, IMF member countries may consider simply finding their way back to the original purpose of the SDR currency basket by basing currency inclusion on the representativeness of IMF member countries. Similarly, complementarity to rather than substitutability of existing reserves may be the more relevant concept to increase attractiveness of the SDR. While as before the inclusion of 140 currencies may not be feasible, a basket bigger than 5 would be.[72]

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[69] See e.g. Ousmène Mandeng, SDR valuation review: A test nobody can pass, 9 August 2015, http://www.ousmenemandeng.com/comments/15-8-9-IMF-SDR-valuation-review.html.

[70] Alternate Director for Burma, Fiji, Indonesia, Lao, Malaysia, Nepal, Singapore, Thailand and Vietnam. IMF (1985).

[71] Director for Burma, Fiji, Indonesia, Lao, Malaysia, Nepal, Singapore, Thailand and Vietnam. IMF (1980b).

[72] The IMF has 189 member countries of which 13 do not maintain their own currencies and 39 are in 4 different currencies unions.

The relevance of the SDR for libra rests in the considerations of forming the SDR. To identify an optimum valuation basket is highly complicated. The objective of what libra would like to constitute as a substitute of or complement to existing national currencies remains to be seen. The number of members and diversity of the Libra Association may raise similar problems of competing interests as among the IMF membership. Forming a global currency is a complex undertaking. The SDR may offer some unusual through unique lessons that are likely to define success for libra too.

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