Why IMF must reform the SDR

Renminbi inclusion would strengthen multilateralism

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The Special Drawing Right has failed as a reserve asset, and never gained ground as a financial instrument. However, it may succeed as a framework for international currency diversification.

In April, the International Monetary and Finance Committee, the IMF's steering body, called for collective efforts to strengthen the international monetary system and facilitate further integration of dynamic emerging markets.

The 2015 quinquennial SDR valuation review offers an important opportunity to assess how the SDR, currently composed of dollars, euros, sterling and yen, may serve emerging markets currency integration. It would signal the IMF's willingness to engage directly in fostering change in the international monetary system.

Renewed interest

The SDR, which is the unit of account of the IMF and some other international organisations, slid into obscurity from the early 1980s. The relatively large increase in the allocation of SDRs in 2009 to $280bn (SDR204bn) reignited interest.

So too did proposals by the Chinese and Russian authorities and in 2011 by the French authorities for a broader role for the SDR. In 2015, China voiced its intention to have the renminbi included in the SDR basket of currencies, following rejection in the 2010 review. SDR valuation reviews have been guided by the objective that the SDR should serve as a substitute for reserve assets. But the unit never took off. SDRs outstanding are very small compared with $12tn in foreign exchange reserves.

They have remained confined to operations within the IMF, are not determined by market forces, have no market impact and have not been adopted by the private sector.

The restrictions on the SDR make it unlikely that it will ever play a major role and previous attempts to increase its appeal have failed. Yet the SDR remains the closest thing to an international currency and it does have certain signalling power.

China's aim to include the renminbi echoes widespread apprehension that the international economy is too dependent on too narrow a set of currencies. While greater emphasis on the SDR would not address this concern directly, it could help raise proliferation of other currencies to advance recognition that the international economy has evolved.

More currencies will soon play an increasing role in promoting more diversified sources of international liquidity.

Changing the rules

The inclusion of the renminbi in the SDR would require a modification of the existing inclusion principles or allowing a rather flexible interpretation of the rules.

Currency inclusion depends on the size of a country's exports, and whether the currency is freely usable, widely used to make payments for international transactions, and widely traded in the principal exchange markets. The latter remains in doubt for the renminbi.

Changing the rules would be the best solution. They address the wrong objectives and reflect the very different concerns of a different era. Squeezing China past the existing rules when there is doubt about its qualification risks undermining the transparency and verifiability of the inclusion principles and would set the wrong precedent.

Rethink

The SDR valuation review offers an important opportunity for the IMF to rethink the role of the SDR. It could serve as a transition framework towards a more diversified international monetary system, echoing earlier concerns among IMF member countries about too great a concentration of international monetary power with the largest IMF members.

The review should therefore not be about whether to include the renminbi but on currency diversification in general. Other currencies such as the won, Brazilian real, Canadian dollar, Mexican peso, Turkish lira and Saudi riyal could equally qualify.

The IMF's prime monetary denominator should be made more representative of the global economy. This seems long overdue. A positive outcome to the SDR review would recognise the increasingly multilateral nature of the world monetary and financial system. ▪

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