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Adapting the international monetary system to face 21st century challenges

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Abstract

Recent calls for more intense debate on and reforms to the international monetary system imply that the current system is unable to respond appropriately and adequately to challenges that have appeared, or become more acute, in recent years. This paper focuses on four such challenges: ensuring an orderly exit from global imbalances, facilitating more complementary adjustments between surplus and deficit countries without recessionary impacts, better supporting international trade by reducing currency volatility and better providing development and climate finance. After describing them, it proposes reforms to enable the international monetary system to better respond to these challenges.

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Adapting the international monetary system to face 21st century challenges[1]

Aldo Caliari

The global economic crisis of 2008-09 has triggered the most intense debate about the international monetary system that the world has seen in the last four decades. Policy-makers from both developed and developing countries, intergovernmental organizations, business leaders and prominent academics have proposed a number of reforms.

It is likely that some of the reforms can be introduced without significant revisions to the IMF Articles of Agreement. However, part of the debate revolves around the adequacy of the existing legal framework in the document. In this regard, the principles and provisions surrounding the roles of the US dollar and Special Drawing Rights (SDRs) in the global reserve system envisioned in the 1960s now seem too limited a framework to allow for reforms that can adequately respond to current and future challenges.

A first challenge is to foster an orderly exit from the global imbalances. A second challenge is to reduce currency volatility, with its consequent negative implications for trade flows. The third challenge is to achieve a mechanism for more symmetric adjustments between surplus and deficit countries, while avoiding recessionary impacts. Finally, as development and climate finance needs grow, the potential of the Special Drawing Rights to provide development finance through reform of the system may no longer be sidelined from the debate.

The next section introduces the main legal provisions in the IMF Articles of Agreement that define the functioning of the global reserve system. The following section provides a brief survey of monetary system issues raised by the recent Great Recession. The sections that follow explain a number of reform proposals that have been made and where they are being discussed, and introduce challenges that the reforms should address. The section that follows assess such proposals in relation to the four challenges mentioned above, and will consider whether and to what extent existing legal provisions can accommodate changes that respond to such challenges. In the process, an outline of areas where legal reforms may be required will emerge.

Monetary System issues raised by the Great Recession

In 2008-09, the world economy experienced what has been characterized as the worst financial crisis since the Great Depression of the 1930s.[2] As a result of the crisis, a debate has emerged on reforming the inter-

1 Paper prepared for ASIL International Economic Law Interest Group Biennial Conference: International Economic Law in a Time of Change: Reassessing Legal Theory, Doctrine, Methodology and Policy Prescriptions, November 18–November 20, 2010, University of Minnesota Law School, Minneapolis.

2 See, for instance, World Bank and IMF 2010 ("Global growth fell 6 percentage points from its pre-crisis peak to its trough in 2009, the biggest shock in the post-war era… These developments marked the end of the boom years of the mid-2000s, with the world economy suddenly thrown into the Great Recession.")

national financial system. The Great Recession has strengthened the sense of urgency among policy-makers about the need to address shortfalls in the international monetary system. The main concern raised by the crisis has been the systemic tendency to generate ever-growing imbalances between countries with trade surpluses and those with deficits, with a national currency (the US dollar) serving the dominant reserve and trading currency while the US economy accounts for a fifth of the world economy, it accounts for about 60 per cent of foreign currency reserves held in the world today.

This paper does not analyze in depth the role that global imbalances played in the crisis. According to Canadian Central Bank Governor, Mark Carney,

"While there were many causes of the crisis, its intensity and scope reflected unprecedented disequilibria. Large and unsustainable current account imbalances across major economic areas were integral to the buildup of vulnerabilities in many asset markets. In recent years, the international monetary system failed to promote timely and orderly economic adjustment."[3]

A number of different analysts concur that the use of the national currency of one country as the principal means of payments in international transactions and as a store of value generates what has been characterized as the "Triffin dilemma". For instance, the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System ("UN Commission"), a commission set up by President of the General Assembly in late 2008 and chaired by Nobel Prize-winner economist Joseph Stiglitz, stated:

"One of the main problems of the Bretton Woods system was identified by Robert Triffin in the 1950s: the use of a *national* currency (the US dollar) as the *international* reserve currency. This generated a difficult dilemma since the dollar deficits necessary to increase global liquidity eroded confidence in the dollar as a reserve currency and created doubt about the ability of the U.S. to maintain dollar-gold parity. Abandonment of dollar convertibility and the acceptance of flexible exchanges rates eliminated some of these problems but at the same time created new ones. Instead of uncertainty over the ability to maintain dollar-gold parity, the "Triffin dilemma" has been reflected in large swings in U.S. current account imbalances and associated volatility of the dollar exchange rate and, in the long-run, with the risk of loss in the value of foreign exchange reserves held in dollars as U.S. external deficits increased."[4]

In brief, the "Triffin dilemma" is the tendency in such a system towards excessive demand for the reserve currency. This demand makes it easy for the issuer of the reserve currency to finance a trade deficit. At the same time, growing amounts of debt issued by the reserve currency issuer and widening deficits undermine confidence in the capacity of the currency to act as an effective store of value. But the impact of diversification of reserves away from such a currency forces reserve currency holders to build reserves in it, further increasing the excessive demand and fueling a vicious circle.[5]

3 Carney 2009. See also Visco 2009 ("Distorted incentives, inadequate risk management and lax supervision encouraged the financial sector to take increasingly large, poorly understood risk exposures, financed through high leverage and a growing reliance on wholesale short-term funding. However, it is unlikely that all this would have developed to the same extent had the macroeconomic environment not been characterized by low interest rates, rising asset prices and large saving-investment imbalances in the United States and, with opposite sign, in Asia and the oil producing countries.").

4 UN Commission 2009, 109.

5 See Ocampo 2010, 2 ("Prior to the current crisis, the most pressing concerns were the weakening of the dollar and escalating U.S. net liabilities with the rest of the world, as part of a broader problem of global payments imbalances."); IMF 2009, 6 ("Key risks are deflationary bias if too few reserves are provided or accumulation of an unsustainable

An ancillary concern with the use of a national currency as the international reserve currency is the way that global monetary decisions become hostage to the policy preferences and other idiosyncratic features of the reserve currency-issuer.[6]

Legal Framework

The legal framework for the international monetary system is framed by a number of provisions in the Articles of Agreement of the International Monetary Fund. This brief section does not exhaustively enumerate them, but will refer to some selected aspects relevant to the analysis and arguments that follow.

Art. I sets out the purposes for establishing the International Monetary Fund:

- "To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- "To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- "To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- "To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
- "To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members."

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debt overhang if too many are (the "Triffin dilemma," which was originally developed in a world with few cross-border capital flows, but still lives today, albeit in a different form"); McKinsey 2009, fn. 17 ("This is analogous, in some ways, to Triffin's dilemma… the intuition that because the reserve currency issuer has to provide liquidity to the global system by issuing debt denominated in its currency, eventually the pressure to provide additional debt will undermine the sustainability of the reserve currency issuer. This may place the system under significant pressure and perhaps even cause it to break down."); Zhou 2009 ("The Triffin Dilemma, i.e., the issuing countries of reserve currencies cannot maintain the value of the reserve currencies while providing liquidity to the world, still exists.").

6 IMF 2010, 10 ("Reserves concentration in the government debt of one country introduces idiosyncratic risks to the IMS stemming from conditions and policy in that country. Policies designed to meet domestic concerns typically do not consider effects on the wider world (e.g., a loose monetary policy may be warranted for domestic stability purposes, and yet induce unwanted demand at the global level). Moreover, the system is left vulnerable to policy mistakes, or private sector excesses, in the core economies."). See also UN Commission 2009, 113 ("A global reserve currency whose creation is not linked to the external position of any particular national economy could provide a better system to manage the instability analyzed above."); Zhou 2009 ("Issuing countries of reserve currencies are constantly confronted with the dilemma between achieving their domestic monetary policy goals and meeting other countries' demand for reserve currencies. On the one hand, the monetary authorities cannot simply focus on domestic goals without carrying out their international responsibilities; on the other hand, they cannot pursue different domestic and international objectives at the same time.").

Art. IV refers to general obligations of members regarding exchange arrangements. In this regard, members are required to "to assure orderly exchange arrangements and to promote a stable system of exchange rates."[7]

In particular, each member is required to:

- "ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions; and
- "iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members;"

In Section 3, the same clause addresses surveillance by the Fund over *exchange arrangements:*

- "*(a)* The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.
- "*(b)* In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members."

The Articles of Agreement also refer to the objective of making the Special Drawing Rights (SDR) "the principal reserve asset in the international monetary system."

The Special Drawing Right is a reserve asset issued by the IMF that confers to holders "a potential claim on the freely usable currencies of IMF members"— that is, they can be exchanged for any of the reserve currencies.[8]

In Art. VIII, Section 7, "Each member undertakes to collaborate with the Fund and with other members in order to ensure that the policies of the member with respect to reserve assets shall be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system."

According to Art. XXII, in addition to the obligations assumed with respect to Special Drawing Rights under other articles, "each participant undertakes to collaborate with the Fund and with other participants in order to facilitate …the proper use of special drawing rights in accordance with this Agreement and with the objective of making the special drawing right the principal reserve asset in the international monetary system."

7 Articles of Agreement of the IMF, Art. IV, Section 1.

8 IMF 2009b.

Also relevant are Articles XV to XXVI that develop the understanding of the Special Drawing Rights.

In Art. XV, it is determined that the Fund is authorized to allocate Special Drawing Rights "To meet the need, as and when it arises, for a supplement to existing reserve assets…"[9]

The Special Drawing Rights allocations can be made to members who participate in the Special Drawing Rights department.[10] The Fund can itself hold SDRs in the General Resources Account and "accept and use them in operations and transactions conducted through the General Resources Account."[11] It can also prescribe, by 85% majority vote, that non-members, members that are not participants, institutions that function as central banks for one or more members and other official entities can also be prescribed holders of SDRs.[12] Hence, these provisions restrict the universe of holders of SDRs.

In Art. XVIII, the conditions under which SDRs can be issued are established:

"In all its decisions with respect to the allocation and cancellation of special drawing rights the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world."[13]

Art. XX prescribes the interest and service charges on SDRs. A holder of SDRs simultaneously perceives an interest on SDRs and pays an interest on them.[14] Both are to be set at the same rate.[15] The interest rate is set at the weighted average of interest rates on short-term instruments in the markets of the currencies included in the SDR valuation basket.[16]

Reform proposals

Since the onset of the crisis, and consistent with the perception that global imbalances did play a role in the crisis and that the persistence of the imbalances has to do with issues to be addressed in the monetary system, the debate on the reform of the international monetary system has gained new vigor. Proposals for reform have come from governments, inter-governmental and quasi-bodies, academics, the private sector and civil society.

This section briefly summarizes some of the proposals made since 2009. Although an exhaustive survey of all proposals made in the period exceeds the scope of this section, it attempts to capture the main representative approaches.

9 Articles of Agreement of the IMF, Art. XVII, Section 1.

10 Ib. Nowadays all members of the IMF area also members of the SDR Department.

11 Art. XVII(2).

12 Art. XVII(3).

13 See Section 1.

14 XX, Sections 1 and 2.

15 Section 3. This is why the SDR cannot be compared to a claim on the Fund. This is also why SDR holders incur, as long as they do not use them and hold them as reserves, no net charge. However, should they exchange or transfer their SDRs, they continue to pay the charge, even it no longer perceive the interest, on their net allocation.

16 IMF 2005.

On March 23, 2009, Governor of the People's (Central) Bank of China Zhou Xiaochuan asked what kind of international reserve currency is needed.[17] To safeguard global economic and financial stability, he posits that such a currency should be characterized by "a stable value, rule-based issuance and manageable supply."[18]

He proposed a super-sovereign reserve currency which "not only eliminates the inherent risks of credit-based sovereign currency, but also makes it possible to manage global liquidity. A super-sovereign reserve currency managed by a global institution could be used to both create and control the global liquidity."[19] But he also recognizes the difficulties of implementing such a proposal and calls for giving a greater role to Special Drawing Rights, stating that it has "the features and potential to act as a super-sovereign reserve currency."[20]

Then, he called for a number of reforms to use so that SDRs can fully satisfy countries' need for a reserve currency:

- "Set up a settlement system between the SDR and other currencies. Therefore, the SDR, which is now only used between governments and international institutions, could become a widely accepted means of payment in international trade and financial transactions.
- "Actively promote the use of the SDR in international trade, commodities pricing, investment and corporate book-keeping. This will help enhance the role of the SDR, and will effectively reduce the fluctuation of prices of assets denominated in national currencies and related risks.
- "Create financial assets denominated in the SDR to increase its appeal. The introduction of SDR-denominated securities, which is being studied by the IMF, will be a good start.
- "Further improve the valuation and allocation of the SDR. The basket of currencies forming the basis for SDR valuation should be expanded to include currencies of all major economies, and the GDP may also be included as a weight. The allocation of the SDR can be shifted from a purely calculation-based system to a system backed by real assets, such as a reserve pool, to further boost market confidence in its value."[21]
- He further notes that the Fund could set up an open-ended SDR-denominated fund, allowing subscription and redemption in existing reserve currencies by various investors as desired. This arrangement "can even lay a foundation for increasing SDR allocation to gradually replace existing reserve currencies with the SDR."[22]

This last part of his proposal closely resembles the Substitution Account proposal discussed, but not adopted in the late 1970s.

Because the Substitution Account appears in several proposals, it is pertinent to briefly review what the original proposal entailed. The account would be an off-market mechanism that would allow IMF members to exchange foreign currency reserve assets for SDR-denominated claims.[23] This mechanism would enable

17 Zhou 2009.
18 Zhou 2009.
19 Zhou 2009.
20 Zhou 2009.
21 Zhou 2009.
22 Zhou 2009.
23 IMF 2010, 24.

countries attempting to diversify their reserves, to shift their reserve holdings from dollar to SDRs without a large amount of US dollars entering the market and thus triggering a downward pressure on its value.

Talks on setting up such an account broke up as countries were unable to agree on the way to cover the risk that would be borne by the IMF as a result of the ensuing exchange rate mismatch—e.g., accumulation of assets denominated in US dollars compared to liabilities in SDRs in a scenario where the latter gain value against the former.[24] In its report, the UN Commission addressed the issue of reforming the monetary system.[25] The Commission dismisses the option of a multi-currency reserve system: "The basic advantage of a multi-polar reserve world is, of course, that it provides room for diversification. However, it would come at the cost of adding an additional element of instability: the exchange rate volatility among currencies used as reserve assets. If central banks and private agents were to respond to exchange rate fluctuations by changing the composition of their international assets, this would feed into exchange rate instability."[26]

Instead, its proposal is for a "truly global reserve currency"[27]. In the proposal, responsibility for managing the global reserve system could be given to the IMF, which currently issues the only global currency, the Special Drawing Rights (SDRs), on which the system could be built. But it could also be given to a new institution, such as a "Global Reserve Bank."[28]

The Commission suggests two possible approaches. One is that countries agree to exchange their own currencies for the new currency—the Commission calls them "International Currency Certificates (ICCs)", but clarifies they could be SDRs - and vice-versa, just as IMF quotas are made up today.[29]

The other is that the international agency that creates global reserves issues the currency, allocating the "ICCs" to member countries, the same way Special Drawing Rights are issued today. In this case, the "backing" for the global currency would be "the commitment of central banks to accept it in exchange for their own currencies". This would give it "the character of an international reserve currency, the same way that acceptance by citizens of payments in a national currency gives it the character of domestic money."[30]

The Commission also states that "The allocation can and should have built into it incentives and/or penalties to discourage maintaining large surpluses. Countries that maintain excessive surpluses could lose all or part of their quota allocations if they are not utilized in a timely manner to increase global demand."[31]

Issuances could be fixed—a certain amount every year—or adjusted counter-cyclically.[32] The move towards a global reserve currency, it suggests, could also happen in more evolutionary ways. For instance,

24 However, see IMF 2010, 25, arguing that if there is coordination so that reserve holdings are exchanged in the same proportion as the SDR basket, there is no accompanying exchange risk. The IMF states that, in this case, the purpose of the account would not be diversification, but an increase in the proportion of SDR-denominated claims held as reserves. However, while true from an aggregate perspective, it is not necessarily true for all individual cases of countries exchanging their assets, assuming the proper coordination is there.

25 UN Commission 2009.

26 UN Commission 2009, 114.

27 UN Commission 2009, 115.

28 UN Commission 2009, 115.

29 UN Commission 2009, 116.

30 UN Commission 2009, 116.

31 UN Commission 2009, 117.

32 UN Commission 2009, 117.

existing regional agreements—either based on swap arrangements among central banks or on foreign exchange reserve pools—may provide alternative ways of doing this.[33]

The World Conference on the Financial and Economic Crisis and Its Impacts on Development, held at the United Nations in June 2009, also generated the first global consensus on post-crisis reforms of the international financial system. In its Outcome Document, the issue of global monetary reform was addressed in the following terms:

- "35. We recognize that increases in global liquidity play a useful role in overcoming the financial crisis. Therefore, we strongly support and call for early implementation of the new general special drawing right (SDR) allocation of $250 billion. We also call for the urgent ratification of the fourth amendment to the IMF Articles of Agreement of for a special one-time allocation of SDRs, as approved by the IMF Board of Governors in September 1997. We recognize the need for keeping under review the allocation of SDRs for development purposes. We also recognize the potential of expanded SDRs to help increase global liquidity in response to the urgent financial shortfalls caused by this crisis and to help prevent future crises. This potential should be further studied.
- "36. The crisis has intensified calls by some States for reform of the current global reserve system to overcome its insufficiencies. We acknowledge the calls by many States for further study of the feasibility and advisability of a more efficient reserve system, including the possible function of SDRs in any such system and the complementary roles that could be played by various regional arrangements. We also acknowledge the importance of seeking consensus on the parameters of such a study and its implementation. We recognize the existence of new and existing regional and sub-regional economic and financial cooperation initiatives to address, inter alia, the liquidity shortfalls and the short-term balance of payment difficulties among its members."[34]

The International Monetary Fund has also recently addressed the issue of reform in the context of reviewing its mandate that the Fund's policy-making Board of Governors requested.[35] A section of the paper discussed by the Executive Board of the institution, addressing the diversification of reserve currencies, puts forward several potential reforms. One option the paper develops is that of a multi-polar currency system.[36] While recognizing that the process of getting there may be quite long, the IMF states that the emergence of new reserve currencies may add momentum towards a more multi-polar reserve system.[37] Whether such a system is an improvement, the Fund admits, may be open to question. Volatility among reserve currencies, both in the short and long term, is likely to be high, posing costs for trade and investment. At the same time, hedging opportunities may increase; the Fund considers central bank management of their reserve portfolios in a coordinated and transparent way may help limit such volatility.[38]

The paper states that such a scenario may require the Fund to play a role in encouraging reserve holders to gradually manage the currency composition of reserves and to require information from them on the composition of their reserves, among other things.[39]

33 UN Commission 2009, 121.

34 World Conference on the Financial and Economic Crisis and Its Impact on Development 2009.

35 See IMFC, para. 7 ("the crisis has shown that a further reassessment of the Fund's mandate is in order. We call on the Fund to review its mandate to cover the full range of macroeconomic and financial sector policies that bear on global stability, and to report back to the Committee by the time of the next Annual Meetings.").

36 IMF 2010, 18.

37 IMF 2010, 18.

38 IMF 2010, 18.

39 IMF 2010, 19-20.

The paper also develops the option–either as a complement or as the logical end point of a multipolar system—of supranational reserve currencies: both a greater role for the SDR as well as a globally-issued currency distinct from the SDR.[40]

Increasing the role of SDRs would require some steps. First, increasing the stock of SDRs significantly, which calls for allocations of substantial new amounts.[41]

Second, the official sector issuing SDR-denominated instruments that could be traded "within the official sector or in some cases issued to the private sector."[42] In this vein, the IMF mentions the "substitution account" idea: "Operated by the IMF, the account would be an off-market mechanism for IMF members to exchange foreign currency reserve assets for SDR-denominated claims."[43] Nonetheless, it recognizes the challenges to achieve an acceptable burden-sharing mechanism to cover foreign exchange risk.[44] It also mentions the possibility of issuing more IMF purchasing notes denominated in SDRs, having other IFIs issue SDR-denominated bonds,[45] and governments issue debt denominated in SDRs.[46]

Third, the promotion of invoicing international trade and finance in SDRs, in addition to developing clearance systems in SDR-denominated instruments would further enhance its role as a reserve asset.[47]

Fourth, the basket composition of the SDR might need to be revised, to be made transparent, simple, and automatic, so that changes are predictable.[48]

On the other hand, developing a sui generis global currency, distinct from the SDR, would have the main advantage of clearly being a currency. The SDR is not a currency, which makes it necessary to exchange it into a currency for any payments or foreign exchange interventions.[49] This currency could be adopted by fiat as a common currency or, in a less ambitious version, circulate alongside national currencies.[50] Even in this latter case, the IMF says, "it would need to be adopted by fiat by at least some (not necessarily systemic) countries in order for an exchange market to develop."[51]

The IMF recognizes the presence of major obstacles to implementing this idea: "Absent significant monetary instability or an injunction for use of bancor for the making of an important set of payments (e.g. payment of taxes), surmounting the barriers to wide acceptance would be a key and perhaps prohibitive challenge."[52]

After considering all these proposals, the Board of Directors of the Fund submitted a report to the Annual meetings which pledged to undertake further work on pragmatic steps that the Fund and its

40 IMF 2010, 20.
41 IMF 2010, 23.
42 IMF 2010, 24.
43 IMF 2010, 24.
44 IMF 2010, 24.
45 IMF 2010, 24.
46 IMF 2010, 24.
47 IMF 2010, 24.
48 IMF 2010, 26.
49 IMF 2010, 26.
50 IMF 2010, 27.
51 IMF 2010, 27.
52 IMF 2010, 27.

members can take to strengthen the stability of the international monetary system.[53] The same document says "The scope for a greater role for the SDR (both in the official and private sector) to strengthen the resilience and effectiveness of the IMS will be considered further, with due regard for the realism, implications and potential costs of fostering demand for an alternative reserve asset."[54]

In its *2009 Trade and Development Report*, UNCTAD makes proposals for the reform of the international monetary system. In general, its proposals parallel those made by the UN Commission, but include a multilateral framework for real exchange rates management.[55] This becomes necessary, UNCTAD says, because the exchange rate is a variable that involves more than one currency.[56] It argues "An internationally agreed exchange–rate system based on the principle of constant and sustainable real exchange rates ("RER") of all countries would go a long way towards reducing the scope for speculative capital flows, which generate volatility in the international financial system and distort the pattern of exchange rates."[57] In UNCTAD's view, this system would also, among other things, prevent fundamental and persistent global imbalances and reduce the need to hold international reserves because these would no longer be necessary to defend an exchange rate level.[58] The proposed constant RER would result from nominal exchange rates strictly following inflation differentials.[59]

The Government of France has become increasingly vocal in promoting reform of the global monetary system, and President Nicolas Sarkozy has more or less explicitly referred to a "new Bretton Woods".[60] As France assumes the Presidency of the Group of 20 and the Group of 8 in 2011, its adoption of this priority gains added significance. In a recent speech delivered in Washington, DC, French Minister of Finance, Christine Lagarde, further developed what the French vision might entail: "we want to tackle three essential proposals.

"One is we want to try to explore ways to protect particularly those least developed countries, and sometimes emerging countries, from which there have been capital flows—as I said—in and out, depending on expectations and currency variations. So protecting will be one avenue to explore.

"The second one will be to diversify, because as it stands today, there is clearly a lack of diversification, which induces, in and of itself, a level of risk that is associated with the currency variation.

"And third, there is really a need to actually coordinate and coordinate better—because decisions that are made unilaterally are not going to be as efficient as if they were made as it happened in the past—on a much more concerted basis."[61]

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53 IMF 2010a, 7.

54 IMF 2010a, 7.

55 UNCTAD 2009, 128. See also UNCTAD 2007, 50, more specifically referring to a "multilateral approach in the form of a code of conduct".

56 UNCTAD 2009, 127. See also UNCTAD 2007, 50, "The exchange rate of any country is, by definition, a multilateral phenomenon".

57 UNCTAD 2009, 128.

58 UNCTAD 2009, 128.

59 UNCTAD 2009, 128.

60 Interview with President Sarkozy 2010 ("I have three major objectives: first, a new international monetary order. Bretton Woods is 65 years old. There was only a single currency, the dollar. We cannot continue with the monetary disorders we face now."). See also Tett 2010 (quoting Sarkozy)"The prosperity of the postwar era owed much to Bretton Woods . . . We need a new Bretton Woods").

61 Lagarde, C. 2010.

In 2009, McKinsey Global Institute released a discussion paper clearly more focused on diagnosing and making predictions on the monetary system, particularly highlighting the problems that the imbalances and volatility pose for businesses. In the final chapter, it hints at some proposals. Assessing the IMF proposals for reforms based on Special Drawing Rights, the study notes that SDRs have "clear drawbacks" mentioning in particular that they constitute a very small portion of total reserves.[62] But it goes on to suggest that these issues can be addressed, e.g. through the private sector issuing its own synthetic SDR instruments.[63] It concludes "There is no fundamental reason why SDRs cannot become a more significant part of the global exchange rate system in the future".[64] The paper signals the attention being paid to proposals to see a greater degree of policy coordination in the exchange rate system, saying that this may resemble the "negotiated exchange rate arrangements in the 1980s."[65]

The study also suggests that, given the limited benefits that the status of reserve currency issuer carries nowadays for the United States, or the European Union, there should be broad support for some important changes in the exchange rate system in the coming years.[66] The paper concludes that the uncertainty in the reserve system is greater than "today's dollar dominance and the lack of a near-term challenger might suggest".[67]

Current challenges monetary system reform should address

Reform of the monetary system has to be seen, today, against the backdrop of four acute current challenges that it should address.

The first, and perhaps most obvious challenge, is how to foster orderly exit from existing global imbalances. As mentioned earlier, the inability of the system to carry out automatic adjustments of imbalances is, in the eyes of several analysts, at the heart of the recent crisis. There is a fear that, without fixing that problem, future crises are just a matter of time.

Second, reducing currency volatility and its consequent negative implications for trade flows.

Facilitating "the expansion and balanced growth of international trade" is chief among the Fund's purposes.[68]

The positive influence of a stable monetary system for world trade was clear in the writings of the advocates of the system. John Maynard Keynes has been famously quoted as saying, "It is extraordinarily difficult to frame any proposals about tariffs if countries are free to alter the value of their currencies without agreement at short notice. Tariffs and currency depreciations are in many cases alternatives. Without currency agreements you have no firm ground on which to discuss tariffs."[69] Recently asked whether a stable exchange rate is more favorable to trade, Nobel laureate economist Robert Mundell replied, "The whole idea

62 McKinsey 2009, 38.

63 McKinsey 2009, 38.

64 McKinsey 2009, 38-39.

65 McKinsey 2009, 39.

66 McKinsey 2009, 39.

67 McKinsey 2009, 39.

68 Articles of Agreement, Art. I(ii).

69 Quoted in UNCTAD 2004.

of having a free trade area when you have gyrating exchange rates doesn't make sense at all. It just spoils the effect of any kind of free trade agreement."[70]

Increased levels of exchange rate volatility strongly impact trade performance through channels such as the levels of domestic investment, variations in the relative prices of exports (which, in turn, affect the competitiveness of economies), and the cost of access to finance for production. The value of market access concessions and price-based trade liberalization measures—that receive so much attention in trade negotiations—are significantly affected by such variations.

There is obviously a connection between addressing the first and second challenges. Large imbalances in a world of free capital flows have contributed to the increased volatility of currency prices. Fluctuations among reserve currencies will also be eased if the imbalances were smaller.

However, the basis for reducing imbalances is an important determinant of how stable the system can be. For instance, trying to adjust imbalances in a US dollar-based system will have different implications than in a multi-polar system or in a system with a strengthened role for the SDR.

Third, preventing adjustment mechanisms from having negative impacts on full employment, by preserving adequate aggregate demand and symmetric adjustment mechanisms for both deficit and surplus nations. The current system fails, not only in reducing imbalances, but also because the available adjustment mechanism is, by definition, contractionary. As put by Ocampo, the present system's 'recessionary' bias "is particularly noticeable during crises, when the threat of capital flight and/or the lack of adequate financing forces deficit nations to adjust, a dilemma not faced by surplus nations."[71]

The contractionary, recessionary or deflationary bias stems directly from the asymmetry in adjustment pressures faced by surplus in contrast to deficit nations.[72] While, deficit nations have to adjust by reducing their imports and consumption, surplus nations face no corresponding pressures to raise theirs.[73]

This conspires against adequate aggregate demand and employment levels, and in the aggregate, results in the global economy consistently at less than full employment levels.

Fourth, generating innovative sources of development and climate finance.

The lead up to the September 2010 MDG Summit estimated the need for resources to fulfill the international development goals and to meet climate change finance needs in the range of USD 324-336 bn per year between 2012 and 2017.[74] The 2009 Copenhagen Accord pledged USD30 billion a year of additional financing in the period 2010-2012 for adaptation and mitigation, rising to USD100 billion a year by 2020.[75]

70 Shelton 2010.

71 Ocampo 2010, 2.

72 Carney 2009 ("it is generally much less costly, economically as well as politically, for countries with a balance of payments surplus to run persistent surpluses and accumulate reserves than it is for deficit countries to sustain deficits").

73 UNCTAD 2009, 122. See also IMF 2010, 9, "If the counterpart of reserve accumulation is that many countries pursue current account surpluses, an aggregate deflationary impact may emerge to the extent that the rest of the world is no longer willing to incur balance of payments deficits".

74 Report of the Committee of Experts to the Task Force on International Financial Transactions and Development 2010, 2.

75 Copenhagen Accord 2009.

As donors struggle to maintain aid levels, either in absolute terms or as a share of GDP, because of fiscal constraints associated with the crisis, it is unclear where the financing to meet these commitments will come from.

It would seem, at first sight, that the reform of the monetary system has nothing to do with how to obtain financing for development or climate purposes. But some reform proposals involving reform of the SDRs or, alternatively, a global reserve currency, revive the relevance, in the current context, of questions about the link between SDRs in development— and, by extension, climate—finance.

Reforms and legal framework

In light of the preceding analysis, this section asks whether and to what extent reforms of the international monetary system needed to respond to such challenges can be undertaken within the existing legal framework. In this process, it also identifies the areas where legal reforms may be required.

Reducing global imbalances

Some proposals for reducing global imbalances, especially those most actively debated by decision-makers at present, attempt to address the imbalances within the framework of the dollar-based system. In these scenarios, the solution involves strengthening coordination mechanisms so that surplus and deficit countries take measures to reduce the imbalances. In fact, there is now a track record of, more than 10 years of the failure IMF attempts to do so. Since the late 1990s, countries have attempted to place the IMF at the G7 locus of such coordination, at first through Art. IV consultations and, since 2006, with the "Multilateral Consultations on Surveillance."[76]

Following the crisis, and since its first leaders' summit, as a broader informal forum also involving other of systemically important countries, the G20 has tried to become the new forum for such coordination. But after its own record—initial success during 2008-2009 has not been much better. At their Summit held in Pittsburgh in September 2009, the G20 agreed on a "Framework for Strong, Sustainable, and Balanced Growth."[77] One declared intention of this framework was to correct, and limit future imbalances between countries with large current account surpluses and those with large current account deficits. While, the crisis initially reduced some imbalances, G20 efforts have yielded limited progress so far. Earlier in 2010, the IMF Managing Director that the forecasts that the institution was gathering from countries "will not add up" and that "Exports from one region to another region have to equal imports and it won't be the case."[78]

In the lead up to the G20 Finance Ministers meeting in Gyeongju, Korea, on October 23, 2010, currency tensions became so intense that Brazil Finance Minister, Guido Mantega, warned of a "currency war". Indeed, Japan's first foreign exchange intervention since 2004 to weaken the value of the yen and the new US quantitative easing program (QE2), evoked, for many, the inter-war period's competitive devaluations. US Treasury Secretary, Tim Geithner made a proposal to cap the current account surplus as a share of GDP to be policed by the IMF is almost a return to square one. But, as noted earlier,[79] a system where

76 See, however, IMF 2010b, 9 (according to the Fund, the prerogative for exercising this function has a different source in Art. IV, i.e. in the prescription that the Fund "Shall oversee the international monetary system in order to ensure its effective operation.")

77 Group of 20, 2009.

78 Giles 2010.

79 See section III.

the currency of one country is the dominant reserve and trading asset conspires against the success of such efforts.

Furthermore, the existing legal framework for the international monetary system is inadequate. The IMF's Articles of Agreement impose specific obligations on members with regards to the conduct of exchange rate policy and of domestic policies that affect the exchange rate.[80] Similarly, the Fund has an obligation to exert "firm surveillance" over exchange rate policies—in contrast to the general member obligations that emanate from Art. IV of the Articles of Agreement.[81] But the Fund lacks the teeth to ensure that "firm surveillance" translates into policy changes by members. Given the power of key Board members, it is unlikely that the legal changes necessary to grant the IMF more enforcement powers would be agreed to and would actually significantly affect policy.[82]

A number of reform proposals propose moving to a multi-currency system.[83] It is unclear how multiplicity is maintained over time in multi-currency system proposals, without a particular currency becoming paramount. A system where several currencies can operate as reserves is what we have today. But the system has not undermined US dollar pre-eminence. The proponents have not been able to explain how this result would be avoided in the future. If successful, however, this would further diversify the reserve currencies used and, thus, diversify the macroeconomic factors likely to influence the supply of reserve currencies.

But it is doubtful that a multi-currency proposal would adequately address the challenge of global imbalances.

These proposals have been dismissed by some on the grounds that they would generate greater instability.[84] Those who believe that instability in this scenario can be dealt with, do so on the assumption of strong measures for coordination among currency issuers and central banks.[85] A multi-currency system requires considerable cooperation, a scenario that experience suggests is most unlikely.

Some proposals suggest that a supranational reserve currency or a system anchored in expanded SDRs are needed to address the global imbalances.

However, the mere shift from the US dollar to a supranational currency (or reserve asset, as in the case of the SDR) as the main reserve currency would not automatically resolve the global imbalances. It

80 This is the Fund's own interpretation, see IMF 2010b, 4.

81 IMF 2010b, 6.

82 One obstacle has to do with the inevitable fact that the Fund wields more power and influence with member countries that somehow depend on it for balance of payments' support. Neither the countries that have large surpluses, nor those that issue reserve currencies, belong in such a category, leaving the Fund to wield power and influence on countries generally irrelevant to the problem at hand.

83 Subacchi, Paola, and John Driffil 2010, ix. (Recommendation to "Develop a multicurrency reserve system that is appropriate for a world of regional trading blocs—Europe, Asia, the Americas—alongside a still preeminent dollar. The disadvantage of losing network externalities would be compensated by gaining stability. Historical experience has shown that two or more reserve currencies can operate simultaneously."); IMF 2010, 18.

84 UN Commission 2009, 114; Ocampo 2010, 3-4. Acknowledging it, even if more optimistic about possibilities to manage it—see IMF 2010, 18.

85 IMF 2010, 18-19. ("that a multi-currency system might exhibit greater, if not continued high, long-run volatility…. is not a foregone conclusion: to the extent that central banks manage their international reserves portfolio to maintain constant shares of the different reserve currencies, they could play a stabilizing role such that volatility would be lower in the end in the steady state. . . . In any event, the volatility issue will likely remain in any IMS—new or current—in the absence of greater policy coordination between reserve issuers").

would certainly be a helpful—and for some analysts, even a necessary—condition, and would certainly reduce the need for reserve currency issuers to have to run deficits and thus free the reserve asset from the vagaries of the economy issuing the currency. But a supranational reserve currency would not automatically discourage surplus countries from accumulating excessive amounts or prevent the erosion of its value.[86] As noted by the Governor of the (central) Bank of Canada, there is no guarantee that greater use of the SDR—or the Substitution Account—would not simply entrench or even encourage existing reserve accumulation by surplus countries,[87] rather than achieve greater balance. Therefore, even in this scenario, imbalances would not decline in the absence of an effective mechanism for orderly adjustment between deficit and surplus countries.

The UN Commission suggested a solution, in the form of a new body under the aegis of the United Nations. This Global Economic Coordination Council (GECC) would be the "seat of the political commitment to symmetric adjustments of international imbalances."[88] While this new body would avoid some of the governance inequalities of the IMF, and would arguably enjoy some fresh political capital, the UN Commission's proposal is unclear about how the new body is expected to enforce its decisions when the IMF cannot do so.

One way out of the conundrum –that we owe to Keynes– would be to design the reserve currency in a way that ensures automatic or semi-automatic adjustment between surplus and deficit countries. Indeed, not other was the nature of Keynes' "bancor" became useless when held in excessive quantities.[89] The UN Commission seems to have had this in mind when it said that new allocations of the proposed global currency "can and should have built into it incentives and/or penalties to discourage maintaining large surpluses. Countries that maintain excessive surpluses could lose all or part of their quota allocations if they are not utilized in a timely manner to increase global demand."[90]

Some of the proposals presented earlier focus on the establishment of a supranational currency a la bancor. The rest of this section focuses on the conditions for and potential legal changes to enable the SDR—rather than an altogether new, supranational currency—to play such role. While some proponents of a new supranational currency acknowledge daunting challenges— undoubtedly an important consideration—establishing a new currency calls for its own new set of rules, including a possible "global central bank." Clearly, these reforms cannot be done within the current legal framework or the monetary system.

In contrast, increasing the prominence of SDR only requires tweaking and modifying a legal framework that already exists. Additionally, even for writing completely new rules, investigating the potential and limitations of an SDR-based system can be very useful. Also, many would argue that SDR reform is no more than a logical extension of provisions in the IMF Articles of Agreement obliging members to make the SDR "the principal reserve asset in the international monetary system."[91] However, as this section shows, achieve-

86 Kregel 2009.

87 Carney 2009. ("Indeed, by providing instant diversification, SDR reserves could entrench some of the existing strategies of surplus countries." and "A substitution account would create considerable moral hazard, since reserve holders would be tempted to engage in further accumulation."). Additionally, he also points to a problem of moral hazard with the substitution account.

88 Kregel 2009.

89 Under Keynes' proposal, states would be better off holding their balances of the supranational reserve currency, the "bancor," as close to zero as possible.

90 UN Commission 2009, 117.

91 Art. VIII(7) and XXII.

ment of this goal is far from feasible within the limits of the Articles of Agreement. The changes necessary for SDR to adequately perform this function are not possible within the current legal framework.

First, large increases in available SDRs stock would be needed to transform the SDR into a preferred asset. A historically large SDR allocation of USD250 billion was made in 2009 following the April G20 initiative.[92] Nonetheless, SDRs merely total nearly four percent of the total stock of currency reserves.[93] Increasing the stock of SDRs to the extent necessary to make them a significant portion of total reserves in the world may be difficult with the strict requirements currently part of the legal requirements for new SDR issuances.[94] Thus, relaxation of the requirements for SDR issuance is a necessary legal reform.

Second, the SDR would need to become a means of payment, not just a reserve asset. In its current form, SDR are not useful for keeping balance. Should countries choose not to hold SDR as a reserve asset, but to purchase imports instead, they will have to swap them for a hard currency - probably US dollars. Hence, demand for USD will either remain unchanged, or even grow, but certainly not decrease.

The fact that SDR need to be swapped for a hard currency to serve as a means of payment may, at some point, begin to entail some liquidity risks, which would also harm its capacity to serve as a reserve asset. Liquidity risk here involves the prospect that there may not be enough of the desired hard currency (usually US dollars) available to exchange for. This risk is not great with the amount of SDRs in circulation today, but cannot be ruled out in the not too distant future. It is indicative that the IMF has already found it necessary to address this liquidity issue by looking at some technical aspects of its most recent allocation.[95]

Third, in order to increase the appeal of the SDR some of its features will need to be modified in ways that cannot take place within the current legal framework, as mentioned in some of the proposals that have been examined.[96]

One aspect of such reforms could be to broaden the universe of holders, currently restricted by the Articles of Agreement to the Fund to members and a limited number of official entities.

Another suggestion is for greater use of SDR in invoicing international transactions. Since there will be always a certain exchange rate risk between the value of the actual currency that a country uses in international transactions and SDR, countries will then have an incentive to keep their reserves in the currency used for settlement.

Owing to the currently limited transferability of SDRs, they are rarely used in foreign exchange transactions. This diminishes the SDR's effectiveness as a reserve asset. A reserve asset that cannot be used by a government holding it, to intervene in its forex market to influence the value of its currency, would be of limited use.

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92 Adding this to an allocation of USD33 billion that had been pending US ratification since the 1990s, and was also approved at the same time, bringing the total amount up to USD283 billion. Previous allocations had taken place in 1970-72 and 1979-1981, for a total of USD33 billion altogether. UN Commission 2009, 119.

93 IMF 2010, 22.

94 Conf. IMF 2010, 23.

95 IMF 2009a. See Sections III C and E focusing on the "absorption capacity" of existing voluntary arrangements and the possible need to resort to "designation", that is, the mechanism by which members with sufficiently strong external positions are required to purchase a determined amount of SDRs.

96 See, for instance, Zhou 2009.

Fourth, some public sector actions that would be useful to enhance the role of SDRs in the system are also limited by the current legal framework. For instance, the issuance of SDR-denominated instruments, which the Fund has done in relatively limited fashion, could not be greatly scaled up by the Fund without coming up against the requirement that borrowing is only supposed to complement quota resources. Likewise, it has been suggested that the IMF could facilitate SDR-denominated settlement systems, something rather far-fetched on account of its present structure.[97]

Exchange rate volatility

As explained, reducing global imbalances would ensure greater stability in the system. If this is done through a combination of SDR enhancement and some additional coordination, what is the potential of SDR to anchor stability.

Placing the SDR at the center of the system could lower volatility as its basket comprises most major trading currencies.[98] However, since the currencies that compose the basket today have had quite a high degree of volatility, not least the US dollar which represents 44 percent of its weight, the composition of the basket should be improved to further reduce volatility; what would be the legal implications of doing so?

One possible option, perhaps the most simple one, would be to expand the number of currencies, while preserving the same criteria for choosing them, from four to eight, or ten. Another would be to change the basket to the currencies of the major economies.[99]

To understand the context of the reforms being analyzed here, it is important to acknowledge that while the SDR functions as both a unit of account and a reserve asset, there are trade-offs between improving a currency basket as a unit of account and as a reserve asset.[100] For the former, what matters is the correlation structure of exchange rate changes of the component currencies. For the latter, what matters is high liquidity of the component currencies. [101] One principle adopted in the current valuation method is that the currencies have to be freely usable currencies, as defined in Art. XXX.[102] This means that the current system leans towards an asset that has better characteristics as a reserve rather in the basket than as a unit of account. In fact, an extra dimension of volatility comes from the freely usable currencies as these currencies are most subject to speculation in international financial markets. Therefore, in order to improve the stability of the currency basket, one could conceive a range of solutions that involve the exact opposite—where all SDR components are not-freely usable currencies—to some broadly acceptable mix between convertible and non-convertible currencies.

There is no substantive principle for the valuation of SDRs embedded in the IMF Articles of Agreement, so any change in the SDR valuation method is possible within the current legal framework, as long as it is approved by an 85 percent majority vote.[103]

97 See Julius 2010, arguing for this and even for the IMF to act as a market-maker for SDR-denominated bonds.

98 According to current rules, the valuation of the SDRs is reviewed every five years. Since 2006, the four currencies that make up the SDR basket (with their relative weights) are: U.S. dollar (44 percent), euro (34 percent), Japanese yen (11 percent), and pound sterling (11 percent). IMF 2005.

99 As suggested by Zhou 2009.

100 See Wolf 2005, 312.

101 See Wolf 2005, 312.

102 Art XXX(f) defines “freely usable currencies” as a “member’s currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets.”

103 Article XV(2) of the Articles of Agreement.

Aggregate demand and full employment

Basing the international monetary system on a reserve asset that can stimulate the correction of imbalances will greatly contribute to ensuring higher levels of aggregate demand than is presently the case. But can the system perform better in terms of raising aggregate demand and full employment levels?

First, it may be desirable to explore linking the principles determining the issuance of new SDRs—and conversely, the principles for SDR cancellation—with global aggregate demand needs.[104]

Second, the criteria for allocation to members should also be reconsidered. Under the current legal framework, SDRs are automatically allocated to IMF members on the basis of their quotas. The quota system is grossly problematic, as consensus has been growing in the last decade on its biases, even as a mechanism for determining voting weights.

The focus here is on examining its consistency with attempts to ensure that SDR allocations boost aggregate demand. From this perspective, it is relevant to note that the logical outcome of using the quotas to allocate SDRs is that countries with the largest IMF quotas—many with no need to increase reserve holdings—receive the most SDRs.

A mechanism to bolster aggregate demand would need to emphasize the needs of receiving countries in light of the shocks or spending challenges they face. In any case, it is clear that the current mechanism is inadequate and suboptimal, and can be improved. Such changes would require reform of the principles for allocation currently established in the Articles of Agreement.

Development and climate finance

The use of SDRs to support development and climate finance needs, mentioned in some proposals, would also require legal reforms.

In principle, the fact that SDRs are supposed to be issued for liquidity considerations should not pose an obstacle to developing countries allocated SDRs for any specific development or climate change mitigation or adaptation spending. It should also be possible for the IMF to prescribe other international institutions as SDR holders, as allowed in Art. XVII, Section 3. Thus, it is perfectly possible that multilateral or regional development banks can back new lending with SDRs.[105]

However, difficulties may be posed by the Articles of Agreement requirement that new allocations "shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets, in such a manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world."[106]

104 For instance, Ocampo has proposed: "SDR allocations could follow two different approaches. The best would be issuing them in a countercyclical way, which would mean that they would be issued during crises rather than booms." See Ocampo 2010, 4.

105 Conf. UN Commission 2009, 118 ("A simple way to further the use of SDR allocations to advance developmental objectives (which might require changing the Articles of Agreement) would be for the International Monetary and Finance Committee and the IMF Board to allow the IMF to invest some of the funds made available through issuance of SDRs in bonds issued by multilateral development banks.").

106 Art. XVIII Section 1 (a).

Were one to make a favorable interpretation, expressions such as “long term,” “global need” and “supplement existing reserve assets” are ambiguous, but can justify SDR allocations to finance development or climate action.[107] Certainly, the same could be said of “the attainment of [the Fund]’s purposes”, giving extraordinary leeway for interpretation. If, as argued above, international monetary stability calls for circulation of SDRs in much larger amounts than has been the case so far, then there is a case for large new allocations.

The limited issuance of SDRs since their creation suggests that past interpretations have not been favorable. But no reform of language is actually necessary to enable the issuance and use of SDRs for development or climate action purposes. The Fund’s governing bodies can be masters of creative interpretation of these provisions in ways that may affect their original intent in some eyes—a common phenomenon in many international organizations.[108]

A legal reform to allow issuing SDRs for development or climate finance could subject such issuances to different rules with regards to interest and service charges. As noted earlier, members attempting to exchange SDRs face net charges.[109] While small compared to the cost of borrowing hard currencies in international markets, such charges can be quite significant for very poor countries. In such cases, a subsidization of interest charges—for instance, through grants or slightly higher interest rates paid by other members - may be an acceptable solution. This would ensure that SDRs for development or climate finance purposes are not undermined by excessive charges.

Conclusion

The global economic crisis of 2008-09 has triggered the most intense debate over the international monetary system the world has seen in the last four decades.

This paper has argued that four global challenges should be addressed by monetary system reform proposals. The first is enabling orderly resolution of global imbalances. A second challenge is to reduce currency volatility, with its negative implications for trade flows. The third challenge is to achieve more symmetric adjustments between surplus and deficit countries, while avoiding recessionary effects and preserving aggregate demand. Finally, the growing need for additional development and climate finance needs to be addressed.

Some reform proposals can be introduced without revising the existing legal framework—embodied in the IMF Articles of Agreement. But, other required reforms for the framework is no longer adequate to adequately respond to such challenges. This is particularly true for some principles and provisions surrounding the role of the US dollar and Special Drawing Rights (SDRs) in the global reserve system envisioned in the 1960s.

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107 Ahluwalia 1996 contains a detailed analysis of the ambiguities in the language (even if not going as far as the argument contained in this paragraph).

108 Alvarez 2005 has an in-depth account of this trend (saying, at 600, “International Organizations have also blurred the distinctions between making law, interpreting it and adjudicating it.”).

109 See endnote 15 above.

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