Updating the International Monetary System to Respond to Current Global Challenges: Can It Happen Within the Existing Legal Framework?[1]

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The global economic crisis 2008-09 triggered the most intense debate about the international monetary system that the world has seen in the last four decades. International policy-makers from both developed and developing countries, intergovernmental organizations as well as business sector 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 such document. In this regard, the principles and provisions surrounding the roles of the US dollar and the Special Drawing Rights (SDRs) in the global reserve system envisioned in the 1960s may prove too limited a framework to allow for reforms that can adequately respond to current and acute 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 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 in a reform of the system a system may no longer be an item that can be sidelined from the debate.

The next section introduces the main legal provisions in the IMF Articles of Agreement that set the functioning of the global reserve system. The following one provides a brief survey of the monetary system issues raised by the recent Great Recession. The sections that follow explains a number of reform proposals that have been made and where they are being discussed and introduce the challenges that the reform may potentially address today. The section that follows will make an assessment of such proposals from the standpoint of the four challenges mentioned above and will seek to respond whether and to what extent existing legal provisions can accommodate (or not) changes that respond to such challenges. In this process, an outline of areas where legal reform may be required will emerge.

I.Issues around the monetary system 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 in the 1930s.[2]

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As a result of the crisis, a debate has emerged on the necessary reforms of the international financial system. The international monetary system has been part of that debate, as the Great Recession has strengthened a sense of urgency among policy-makers about the need to address shortfalls in the international monetary system.

From a monetary system perspective, the main concern raised by the crisis has been the tendency of a system where the US dollar is the dominant reserve and trading currency to generate ever-growing imbalances between countries with trade surpluses and those with deficits.

It is not the place of this paper to analyze in depth the role that global imbalances played in the crisis. Suffice to say, in the words of 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 have come to concur that the use of the domestic currency of a country as 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 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

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[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.")

[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.").

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 excess demand for the currency of the reserve issuer. Such 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 on the capacity of its currency to act as an effective store of value. But the impact that a diversification of reserves away from such currency would have, forces reserve holders to intensify a strategy of building reserves in it, further increasing the excess demand and fueling a vicious circle.[5]

An ancillary concern with the use of a domestic currency as international reserve has also been mentioned in regards to the way that global monetary decisions end up left to factors related to the domestic policy and idiosyncratic features of the reserve-issuer.[6]

II.Legal Framework

[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 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.").

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. While this section does not intend to exhaustively enumerate them, it will refer to some selected ones that are of interest in light of the analysis and arguments to follow.

Art. I sets the purposes for 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."

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**

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

"(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 Right (SDR) "the principal reserve asset in the international monetary system."

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

In Art. VIII, Section 7 the Fund "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."

Also relevant are Articles XV to XXVI that develop 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]

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[8] IMF 2009b.

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

The Special Drawing Right allocations can be made to members that are participants in the Special Drawing Rights department.[10] The Fund can hold SDRs itself 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 participant, institutions that perform as a Central Bank for one or more members and other official entities can also be prescribed holders of SDRs.[12]

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 the SDR. A holder of SDRs simultaneously perceives an interest on them 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]

III.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 imbalances have to do with issues to address in the monetary system, debate on the reform of the international monetary system has gained new vigor. Proposals for

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[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.

reform have come from governments, quasi- and inter-governmental bodies, academics, civil society and the private sector.

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

In an essay released on March 23, 2009, the Governor of the Central Bank of China, Mr. Zhou Xiaochuan asked what kind of international reserve currency is needed.[17] In order to safeguard global economic and financial stability he posits such currency should be "with a stable value, rule-based issuance and manageable supply."[18]

His proposal is for 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 next he recognizes the difficulties to implement such a proposal and calls for giving a greater role to the Special Drawing Right, stating it has "the features and potential to act as a super-sovereign reserve currency."[20]

Then he also calls for a number of reforms to the SDR itself in order to enable the scope of use so it can fully satisfy countries' demand for 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

[17] Zhou 2009.

[18] Zhou 2009.

[19] Zhou 2009.

[20] Zhou 2009.

to a system backed by real assets, such as a reserve pool, to further boost market confidence in its value."[21]

He further says the Fund could set up an open-ended SDR-denominated fund, allowing subscription and redemption in the 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 that was discussed—but failed to be adopted, in the late 1970s.

Because the substitution account appears on several proposals, it is pertinent to give a brief explanation on what the original proposal entailed. The account would be an off-market mechanism that would have allowed IMF members to exchange foreign currency reserve assets for SDR-denominated claims.[23] The service this mechanism would have done to countries attempting to diversify reserves is that they could shift reserve holdings from dollar to SDRs without a large amount of US dollars entering the market and, thus, triggering a collapse in its value.

The talks on setting 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 as compared to liabilities in SDRs, in a scenario where the latter gain value to the former.[24]

In its report, the UN Commission addressed the issue of reforms of the global 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

[21] Zhou 2009.

[22] Zhou 2009.

[23] IMF 2010, 24.

[24] However, see IMF 2010, 25 (arguing that if there is coordination so reserve holdings are exchanged in the same proportion as the SDR basket, there is no accompanying exchange risk). The IMF states 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, arguable that, which is true from an aggregate perspective, does not necessarily need to be true in the individual cases of countries exchanging their assets, assuming the proper coordination is there.).

[25] UN Commission 2009.

by changing the composition of their international assets, this would feed into exchange rate instability."[26]

So 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, 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 suggest 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" and is what 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 states also 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, in a more sophisticated version, could be adjusted countercyclically.[32]

The move towards a global reserve currency, it suggests, could also happen in more evolutionary ways. For instance, existing regional agreements – either based on swap arrangements among central banks or on foreign exchange reserve pools-- may provide an alternative way of doing this.[33]

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[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.

The World Conference on the Financial and Economic Crisis and Its Impacts on Development, held at the United Nations on June 2009, is also important to highlight as it 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 subregional 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 a process for reviewing its mandate that the Fund’s policy-making body of the Board of Governors requested.[35]

A section of its paper discussed at the Executive Board of the institution and addressing diversification of reserve currencies puts forward several potential reforms.

One of the options the paper develops is that of a multi-polar currency system.[36] While recognizing that the process to get there might be quite long, the IMF states that the emergence of new reserve

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[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.

currencies may add momentum to a more multi-polar reserve system.[37] Whether such a system is an improvement, the Fund admits, may be open to question. It highlights that volatility among reserve currencies, both short and long term, is likely to be high, posing costs for trade and investment. At the same time the hedging opportunities may increase and the Fund considers Central Bank management of their reserve portfolios in a coordinated and transparent way may contribute a great deal to limit such volatility.[38]

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

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

Taking the path of increasing the role of the SDR 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] It recognizes, nonetheless, the challenges to achieve an acceptable burden-sharing mechanism to cover the foreign exchange risk.[44] It also mentions the possibility of issuing more IMF purchasing notes denominated in SDRs, or having other IFIs issue SDR-denominated bonds,[45] and government issuing of debt denominated in SDRs.[46]

[37] IMF 2010, 18.

[38] IMF 2010, 18.

[39] IMF 2010, 19-20.

[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.

Third, the promotion of invoicing of international trade and finance in SDRs, in addition to developing clearance systems in SDR-denominated instruments could 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, taking the path of a sui generis global currency, distinct from the SDR, would have the main advantage of being that, a currency. The SDR is not, which makes it necessary to always go through exchange 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]

It is worth noting that after considering all these proposals the Board of Directors of the Fund submitted a report to the Annual meetings where pledges to take further work on pragmatic steps that the Fund and its 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 monetary system. In general lines, its proposals follow those that had been made by the UN Commission, but

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[47] IMF 2010, 24.

[48] IMF 2010, 26.

[49] IMF 2010, 26.

[50] IMF 2010, 27.

[51] IMF 2010, 27.

[52] IMF 2010, 27.

[53] IMF 2010a, 7.

[54] IMF 2010a, 7.

includes an addition focused on 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] The agency 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 long-lasting 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 its promotion of reforms of the global monetary system, and President Nicolas Sarkozy has more or less explicitly referred to a "new Bretton Woods."[60] As France prepares to exercise the Presidency of the Group of 20 and the Group of 8 in 2011, the adoption of this priority is a significant development. In a recent speech delivered in Washington, DC, French Minister of Finance, Ms. Christine Lagarde, developed further 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 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.

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[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 (stating ""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's statement ""The prosperity of the postwar era owned much to Bretton Woods . . . We need a new Bretton Woods,").

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]

McKinsey Global Institute released in 2009 a Discussion paper that is clearly more focused on diagnosing and making predictions on the issues of the monetary system, particularly highlighting the problems that the imbalances and volatility carry for business executives. But in a final chapter it hints at some proposals. Assessing the IMF proposals for reforms based on the Special Drawing Rights, the study acknowledges that SDRs have "clear drawbacks" and mention in particular that they constitute a very small portion of total reserves.[62] But it goes on to state these issues can be addressed, including 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] Likewise the paper signals the attention paid to proposals to see a greater degree of policy coordination in the exchange rate system, saying this may resemble the "negotiated exchange rate arrangements in the 1980s."[65]

An important insight of the study is its finding that, given the limited benefits that the status of reserve currency issuers carries nowadays for the United States, or the European Union, there will be support for some important changes in the exchange rate system in the coming years.[66] Therefore the uncertainty in the reserve system is greater than "today's dollar dominance and the lack of a near-term challenger might suggest."[67]

IV.Current challenges a reform of the monetary system would have to address

The reform of the monetary system has to be seen, today, against the backdrop of four acute and current challenges that it could potentially be geared to address.

The first, perhaps most obvious challenge, is how to foster an orderly exit from the global imbalances.

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[61] Lagarde, Christine 2010.

[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.

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.

This would be of great importance for trade flows. It is no coincidence that facilitating "the expansion and balanced growth of international trade" is chief among the Fund's purposes.[68]

In fact, the positive influence of a stable monetary system on the evolution of world trade was clear in writings by the ideologues of the system. John Maynard Keynes has been famously quoted 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 Prize-winner economist Robert Mundell replied "The whole idea 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 have a strong impact on trade performance through channels such as the levels of domestic investment, the variations of relative prices of export products (which, in turn, affect competitiveness of the economies), the price 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 challenge and this one. The large imbalances in a world of free capital flows have contributed to the increased volatility of currency prices. It is expected that fluctuations among reserve currencies would also be eased if the imbalances were smaller.

However, on what basis imbalances are reduced is an important variable in determining how stable the system can be. For instance, it is to be expected that trying to adjust imbalances—which is possible—in a US dollar-based system will have different implications than those in a multi-polar system and, yet, different from those in a system centered around a strengthened role for the SDR.

Third, preventing adjustment mechanisms from having negative impacts on full employment, by ensuring the preservation of adequate levels of aggregate demand and symmetric adjustment mechanisms for both deficit and surplus nations. The current system fails not only in closing the

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

[69] Quoted in UNCTAD 2004.

[70] Shelton 2010.

imbalances, but also in regards to the available mechanism for adjustment which is, by definition, recessionary.

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 recessionary or deflationary bias stems directly from the asymmetry in adjustment pressure faced by surplus versus that faced by deficit nations.[72] While, thus, deficit nations have to adjust by reducing their level of imports and consumption, surplus nations have no symmetric obligation to raise theirs.[73]

This conspires against adequate aggregate demand and employment levels, and in the aggregate results in the global economy consistently working below full employment levels.

Fourth, generating innovative sources of development and climate finance.

Estimates in the lead up to the recent Millennium Summit put the need of resources to fulfill the international development goals and climate change in the range of USD 324-336 bn per year between 2012 and 2017.[74] The recent Copenhagen Accord pledged USD 30 billion a year of additional financing in the period 2010-2012 for adaptation and mitigation, and to reach the figure of USD 100 billion a year by 2020.[75]

In a time where donors are struggling to, in some cases, merely maintain aid levels either in absolute terms or as a share of GDP, because of budget gaps generated by 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 the fact that some of the reform proposals involve reform of the SDRs or, alternatively, a global reserve currency, revives the relevance, in the current context, of questions about the link between SDRs in development --and, by extension, climate-- finance.

V.Analysis of reforms and legal framework

[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.

In the 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 intends to outline the areas where legal reform may be required.

a. The challenge of reducing global imbalances

Some proposals for reducing global imbalances, definitely those that are most actively being debated by decision-makers at present, attempt to fix the imbalances within the framework of the dollar-based system.

In these scenarios, the solution would have to do with strengthening coordination mechanisms so surplus and deficit countries take measures to ultimately reduce the imbalances.

In fact, there is a failed track record of, now, more than 10 years of IMF attempts to exercise this function. Since the late 1990s, countries have attempted to place the locus of this coordination at the International Monetary Fund, first with the utilization of Art. IV consultations and, since 2006, with the "Multilateral Consultations on Surveillance."[76]

As an informal forum that brings together leaders of systemically important countries, the Group of 20 has tried to give a political response to this challenge and become a forum for coordination. But its own record—admittedly a short one-- is not much better. At their Summit held in Pittsburgh, September 2009, the G20 agreed on a "Framework for Strong, Sustainable, and Balanced Growth."[77] The declared intention of this framework was to lead to a correction, and prevent the future recreation, of imbalances between countries with high current account surpluses and those with high current account deficits. The exercise has yielded so far limited progress. Earlier this year, the Managing Director of the International Monetary Fund, in relation to the reports on growth prospects that the institution was gathering from countries, said that it was clear the forecasts "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, held in Gyeongju, Korea, on October 23, 2010, currency tensions became so intense that the Finance Minister of Brazil, Mr. Guido Mantega, spoke of a "currency war." Indeed, Japan's foreign exchange intervention for the first time since 2004 to weaken the value of the yen and the prospect of the US expanding its quantitative easing program in order to boost ailing growth, evoked, for many, ghosts from the inter-war period's race of competitive

[76] See, however, IMF 2010b, 9 (according to the Fund, the prerogative for exercising this function has a different source in Art. IV, 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.

devaluations. US Secretary of Treasury, Mr. Geithner, made a proposal to cap current account surpluses as a share of GDP. However, Mr. Geithner's proposal that implementation is to be policed by the IMF is, given the aforementioned appraisal of the Fund's performance, akin to a return to square one.

As analysts quoted earlier in this paper discuss,[79] the fact that these mechanisms would try to operate within a system where the currency of one country is the dominant reserve and trading asset conspires against their success.

However, should one choose to follow this path, there are reasons to hold the existing legal framework for the international monetary system is inadequate. One can agree that the IMF Articles of Agreement put members under specific obligations with regards to the conduct of exchange rate policy and also domestic policies that affect the exchange rate.[80] Similarly, the Fund has an obligation to exert "firm surveillance" over exchange rate policies - -as opposed to the general responsibility the Articles of Agreement give it on all of members' obligations that emanate from Art. IV.[81]

But the Fund lacks any teeth to ensure that "firm surveillance" translates into policy change in the members. Given the power held at the Board by the members where such decisions would matter, it is unlikely that legal changes necessary to grant the IMF more enforcement power would be agreed and, if they were, that they would actually affect practice in a significant way.[82]

A number of proposals for reform suggest moving to a multi-currency system.[83]

One important advantage of this system would be that it would spread the burden of acting as reserve issuer among more than one country and, thus, introduce some diversity in the macroeconomic factors that are likely to influence the supply of reserve currencies.

But it is doubtful that a multi-currency-based proposals would adequately respond to the challenge of global imbalances. For one, it is unclear in multi-currency system proposals how such multiplicity is maintained over time, without moving to a particular currency becoming paramount. Moreover, a system where several domestic currencies can operate as reserves is what we have today. But the system has, nonetheless, inexorably moved to US dollar's pre-eminence, with quite visible, and

[79] See section III.

[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 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 into such category, leaving the Fund to wield any potential power upon countries that are 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.

unsatisfactory results. The proponents have not been able to explain how this result would be avoided in the future.

These proposals have been dismissed by others on the grounds that they would generate greater instability.[84] Those who believe the instability in this scenario could be dealt with, do so on the assumption of, again, strong measures for coordination among currency issuers and central banks.[85] A multi-currency system can work, therefore, in scenarios that are highly optimistic on the feasibility for such cooperation, optimism that experience hardly warrants.

Several of the proposals suggest that in order to solve the problem of global imbalances there is a need to establish a supranational reserve currency or anchor the system in the SDRs.

However, it is not straightforward that 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 deal with the global imbalances.

It would certainly be a helpful – and for some analysts even necessary—condition. It would certainly reduce the need for reserve currency issuers to have to run deficits and free the reserve asset from the vagaries of a single country economy.

But that the reserve asset at the center of the system changes does not automatically suppress the tendency of surplus countries to accumulate excessive amounts of it or the problems inherent to the erosion of value of the asset in question.[86] As noted by the Governor of the Central Bank of Canada, there is no guarantee that the more prominent use of the SDR –or the substitution account-- would not simply entrench and encourage existing strategies of surplus countries,[87] rather than contribute to greater balance.

It seems, therefore, that even under this scenario, the system would not succeed in the absence of an effective mechanism for the orderly adjustment between deficit and surplus countries.

The UN Commission has offered a solution, in the form of a new body, within the aegis of the United Nations. This body, a Global Economic Coordination Council, would be the "seat of the political

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[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 …").

[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.

commitment to symmetric adjustments of international imbalances."[88] While the new body would avoid some of the governance imbalances of the IMF, and would arguably be born with some fresh political capital, the UN Commission's proposal is unclear about how the new body is expected to have the teeth to enforce its decisions that the IMF lacks.

One way out of the conundrum –and one that we owe to Keynes-- would be to design the reserve asset in a way that provides an incentive to generate automatic or semi-automatic adjustment between surplus and deficit countries. Indeed, not other was the nature of Keynes' "bancor" which, held in excessive quantities, became useless.[89] The UN Commission seems to have had this in mind when it said, speaking of the proposed global currency, that its new 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."[90]

A subset of the proposals presented earlier focus on the establishment of a supranational currency a-la-bancor. In what follows, the section deliberately chooses to focus on the conditions and potential legal changes to enable the SDR—rather than an altogether new, supranational currency-- to play such role.

The reason for this choice is not that, as some of the proponents of the latter, say, implementing the idea faces daunting challenges—though this is doubtlessly an important consideration. It is rather because establishing a new currency likely calls for its own new set of rules, including possibly a "Global Central Bank." It is rather obvious that these reforms cannot be done in the current legal framework for the monetary system and demand a complete re-writing of it.

On the contrary, increasing the prominence of the SDR is a more interesting line of inquiry as it calls for tweaking and changing a legal framework that already exists. Additionally, even for the hypothetical purpose of totally tearing apart the old rules and writing new ones, it is imaginable that exploring where an SDR-based system is or is not a good model is a profitable enterprise.

Some might say that reforms of the SDR to place it at the center of the system is no more than a logical extension of the provisions in the IMF Articles of Agreement alluding to the obligation of members to make the SDR "the principal reserve asset in the international monetary system."[91]

However, as the rest of the section shows, the achievement of this goal is far from feasible were it to remain within the limits of the Articles of Agreement. The changes that it would be necessary to

[88] Kregel 2009.

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

[90] UN Commission 2009, 117.

[91] Art. VIII(7) and XXII.

introduce in the SDR so it can adequately perform this function are not possible within the current legal framework.

First, large increases in the available stock of SDRs would be needed to turn the SDR into a preferred asset. A historically large allocation of SDR in the amount of USD 250 billion was made in 2009.[92] Nonetheless, SDRs merely total nearly a 4 percent of the total stock of reserves.[93] Increasing the stock of SDRs to the extent it is necessary to make them a significant portion of total reserves in the world may be difficult in the context of strict requirements that are currently part of legal requirements to new issuances of SDRs.[94] Thus, a relaxation of the requirements to issue them is one aspect of legal reforms that need to happen.

Second, the SDR would need to become, in itself, a means of payment, not just a reserve asset. In the current form, SDRs are not a useful devise for keeping balance. Should countries choose not to use the SDRs as a reserve asset, but rather to purchase imports, they will have to swap them for a hard currency - most likely US dollars. To the extent that this is the case, the demand for USD will either remain unchanged, or grow, but certainly not decrease.

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

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[92] Adding this to an allocation in the amount of USD 33 billion that had been pending US ratification since the 1990s, and was approved also at the same time, brings the total amount up to USD 283 billion. Previous allocations had taken place in 1970-72 and 1979-1981, for a total of USD 33 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 a sufficiently strong external position are required to purchase a determined amount of SDRs.

[96] See, for instance, Zhou 2009.

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

Another aspect is greater use of the SDR in invoicing international transactions. Otherwise, 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 the SDR, countries have an incentive to keep their reserves in the actual currency that needs to be used for the settlement.

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

Fourth, some public sector actions that would be useful to prop the role of the SDR 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 reach a higher scale –at least as done by the Fund --without bumping against the requirement that borrowing is supposed to only complement quota resources. Likewise, it has been suggested the IMF could foster SDR-denominated settlement systems, something that on account of its current structure it would be far-fetched to ask it to do.[97]

b. <u>The challenge of exchange rate volatility</u>

As explained, the success in achieving adjustments of global imbalances would already introduce a greater level of stability in the system.

Assuming this is done through a combination of SDRs enhancement and some additional coordination, there is still the question of what is the potential of the SDR to anchor stability.

Placing the SDR at the center of the system could contribute to lower volatility—by the mere fact that its basket comprises several currencies.[98] However, since the currencies that compose the basket today have exhibited quite a high degree of volatility, not least the US dollar which represents a 44 % of the weight, it is worth asking the question of whether the composition of the basket could be improved in order to further reduce volatility, and what would be the legal implications.

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

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

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

In addition, to understand the context to 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] From the standpoint of the former, what matters is the correlation structure of exchange rate changes of the component currencies. From the standpoint of the latter, what matters is high liquidity of the component currencies.[101] One of the principles 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 has made a choice that, in such trade-off, leans towards an asset that has better characteristics as reserve than as unit of account. In fact, the fact that freely usable currencies are part of the basket brings almost by definition an extra dimension of volatility as it is these currencies that are most subject to the forces of speculation in international financial markets.

Therefore, in order to improve the stability of the currency basket one could conceive a range of solutions that go from the exact opposite – say, one where all SDR components are non-freely usable currencies – to some acceptable mix between convertible and non-convertible currencies.

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

c. The challenge of aggregate demand and full employment

Centering the international monetary system around a reserve asset that can stimulate the correction of imbalances will make a great contribution to ensuring higher levels of aggregate demand than it is presently the case. So the respective reflections on legal reform are also relevant to this purpose.

But the question is worth asking: can the system perform better in terms of reaching aggregate demand and full employment levels?

[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.

First, it may be desirable to explore establishing a connection between the principles determining the issuance of new SDRs –and symmetrically, also the principles for cancellation-- and linking them to global aggregate demand needs.[104]

Second, the issue of the criteria for allocation to members may also need to be revisited. Under the current legal framework, SDRs are automatically allocated to members on the basis of their quota in the IMF. The quota system suffers of severe limitations, as consensus has been growing in the last decade on its inadequacy and obsolescence even as a mechanism for the determination of voting weights.

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

A mechanism geared to bolster aggregate demand would need, conceivably, to place much more emphasis on what are the needs of receiving countries in the light of the shocks or spending challenges they face, as opposed to any mechanistic assessment. In any case, it is clear that the current mechanism is inadequate and suboptimal and could be improved. Such changes would require reforms of the principle for allocation as currently established in the Articles of Agreement.

<u>d. The challenge of development and climate finance</u>

The use of SDRs to support development and climate finance needs, as mentioned in some of the proposals, might 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 that are allocated SDRs to use them for any specific development or climate 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 back their lending with SDRs.[105]

However, difficulties might be posed by the Articles of Agreement requisite that new allocations “shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets, in

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[104] For instance, Ocampo’s proposal: “ SDR allocations could follow two different ap-proaches. 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.”).

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]

Were one to make a favorable interpretation, the definitions of expressions such as "long term," "global need" and "supplement existing reserve assets" are not exempt of ambiguities that could be used to justify allocations of SDRs to be directed to finance development or climate.[107] Certainly the same could be said of "the attainment of [the Fund]'s purposes" that such clause refers to, giving extraordinary leeway to the interpreters. If, as argued above, the stability of the international monetary system calls for a circulation of SDRs in much larger amounts than has so far been the case, then there is a solid case for large new allocations.

The limited issuances of SDRs since their creation attest to the fact that interpretation of such clauses have tended to not be so favorable. But it does not appear that a reform of the language is actually necessary to enable the issuance and use of SDRs for development or climate purposes. After all, acknowledging that the Fund's governing bodies are masters of the interpretations of these provisions in ways that may, in some eyes, disturbingly affect their substance, is today a common phenomenon across many international organizations.[108]

There is one reason that may justify a legal reform to establish the possibility of issuing SDRs for development or climate finance: in order to enable subjecting such issuances to differentiated rules with regards to interest and service charges. As explained, members attempting to exchange SDRs face a net charge.[109] As small as it may be for some holders, compared to their cost of borrowing hard currency in international markets, can become significant for very poor countries. In these cases, a subsidization of the interest charges – for instance through grants or through a slightly higher interest paid by other members- may be an acceptable solution. This would make sure that SDRs directed to development or climate finance purposes do not have their ends frustrated.

VI. Conclusion

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

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[106] Art. XVIII Section 1 (a).

[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 for an in-depth account of this trend (also saying, at 600, "International Organizations have also blurred the distinctions between making law, interpreting it and adjudicating it.").

[109] See endnote 15 above.

This paper argued that there are four acute challenges in the current world that reform proposals for the monetary system should be able to address. The first one 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 mechanism for more symmetric adjustments between surplus and deficit countries, while avoiding recessionary impacts and preserving aggregate demand. Finally, the growing needs for development and climate finance in a post-crisis world.

It was argued that some of the reform proposals could be introduced without revising the existing legal framework –as embodied in the IMF Articles of Agreement. But, for adopting a number of reforms that are required to adequately respond to such challenges, such framework is no longer adequate. This is particularly the case for the principles and provisions surrounding the roles of the US dollar and the Special Drawing Rights (SDRs) in the global reserve system envisioned in the 1960s.

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