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

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I. INTRODUCTION

The global economic crisis of 2008–09 triggered the most intense debate about the international monetary system that the world has seen in the last four decades. As a result, 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 to prevent future crisis.

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 regarding the global monetary system. 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 global monetary imbalances. A second challenge is to reduce currency volatility, with its consequent negative implications for trade flows. The third challenge is to create a mechanism for more symmetric adjustments between surplus and deficit countries, while avoiding recessionary impacts. Finally, as development

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and climate finance needs continue to grow, the potential of the SDRs to provide development finance may no longer be an item that can be sidelined from the debate.

This paper is organized in the following way. The next section introduces the main legal provisions in the IMF Articles of Agreement that set the functioning of the global reserve system. The second section provides a brief survey of the systemic monetary issues raised by the recent Great Recession. The third section outlines a number of reform proposals, where they are being discussed, and the challenges that such reforms may potentially face. The final section assesses the proposals from the standpoint of the four challenges mentioned above and seeks to respond to whether and to what extent existing legal provisions can or cannot accommodate changes that respond to such challenges. In this process, an outline of areas where legal reform may be required will emerge.

II. ISSUES PERTAINING TO 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]

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 policymakers about the need to address its shortfalls.

From a monetary perspective, the main concern raised by the crisis has been the tendency of a system in which 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:

2. *See, e.g.*, R. Baqir et al., *How did emerging Markets Cope in the Crisis?*, INTERNATIONAL MONETARY FUND (IMF) (2010), http://www.imf.org/external/np/pp/eng/2010/061510.pdf (stating that, "[g]rowth of the global economy 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).

> 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 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 of a system

3. *See* Mark Carney, Governor of the Bank of Canada, Remarks to the Foreign Policy Association: The Evolution of the International Monetary System (Nov. 19, 2009). *See also* Ignazio Visco, Deputy Director General of the Bank of Italy, Paper to the Global Economic Symposium: The Global Crisis—the Role of Policy and the International Monetary System (March, 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. JOSEPH E. STIGLITZ ET AL., THE STIGLITZ REPORT: REFORMING THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEMS IN THE WAKE OF THE GLOBAL CRISIS 157 (The New Press 2010).

towards excess demand for the currency of the reserve issuer. This demand makes it easy for the issuing country to finance a trade deficit, which, if left to grow unchecked, eventually undermines confidence in the currency as a store of value. Eventually countries who hold the currency find themselves trapped. Since any attempt to diversify their holdings away from the currency would necessarily force them to first intensify their holdings of it, such a strategy results in further increases in excess demand for the currency, fueling a vicious circle.[5]

An ancillary concern with the use of a domestic currency as an international reserve currency is the way that global monetary decisions end up left to factors related to the reserve issuing country's domestic policy and other idiosyncratic features.[6]

5. *See* Jose Antonio Ocampo, Why Should the Global Reserve System be Reformed? 2 (January 2010) (Friedrich Ebert Stiftung, Dialogue on Globalization Briefing Paper) ("Prior to the current crisis, the most pressing con-cerns 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."); Isabelle Mateos y Lago, Paper Presented at the KDI/IMF Conference on Reconstructing the World Economy: The Debate on the International Monetary System 6 (Feb. 25, 2010), http://www.imf.org/external/np/seminars/eng/2010/kdi/pdf/ims.pdf ("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 Global Institute, An Exorbitant Privilege? Implications of Reserve Currencies for Competitiveness n.17 (Dec. 2009) (Discussion Paper) ("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 Xiaochuan, *Zhou Xiaochuan's Statement on Reforming the International Monetary System*, COUNCIL ON FOREIGN RELATIONS, Mar. 23, 2009, http://www.cfr.org/china/zhou-xiaochuans-statement-reforming-international-monetary-system/p18916 ("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, *Reserve Accumulation and International Monetary Stability*, 10 (Apr. 13, 2010) [hereinafter IMF, *Reserve Accumulation*] ("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* STIGLITZ, *supra* note 4, at 113 ("A

III. LEGAL FRAMEWORK

The legal framework for the international monetary system is established by a number of provisions in the Articles of Agreement of the International Monetary Fund. While this section does not intend to enumerate them exhaustively, it will refer to those that are of interest in light of the analysis and arguments that follow.

Art. I identifies 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.[7]

Article IV refers to general obligations of members regarding exchange arrangements. In this regard, members are required to "to assure orderly exchange arrangements and to

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, *supra* note 5 ("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.").

7. Articles of Agreement of the IMF, art. I, Jul. 22, 1944 (entered into force Dec. 27, 1945).

promote a stable system of exchange rates."[8]

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;[9]

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.[10]

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."[11]

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 IMF's reserve currencies.[12]

In Article 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

8. *Id.* art. IV(1).
9. *Id.*
10. *Id.* sec. 3.
11. *Id.* art. VIII(7).
12. IMF, *Special Drawing Rights: A Factsheet* (Feb. 2009).

> and making the special drawing right the principal reserve asset in the international monetary system."[13]

According to Article 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."[14]

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

In Article XV it is determined that the Fund has the authority to allocate Special Drawing Rights "To meet the need, as and when it arises, for a supplement to existing reserve assets . . . ."[15]

The Special Drawing Right allocations can be made to members that are participants in the Special Drawing Rights department.[16] The Fund itself can hold SDRs in the General Resources Account and "accept and use them in operations and transactions conducted through the General Resources Account."[17] 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, as well as other official entities can also be prescribed holders of SDRs.[18] These provisions restrict the universe of holders of SDRs.

In Article 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.[19]

Article XX prescribes the interest and service charges on

13. Articles of Agreement of the IMF, *supra* note 7, art. VIII(7).
14. *Id.* art. XXII.
15. *Id.* art. XVII(1).
16. *Id.* Nowadays all members of the IMF area also members of the SDR Department.
17. *Id.* art. XVII(2).
18. *Id.* art. XVII(3).
19. *See* Articles of Agreement of the IMF, *supra* note 7, art. VIII(7), sec. 1.

the SDR. A holder of SDRs simultaneously receives and pays interest on them.[20] Both rates[21] are set at the weighted average of the interest rates on the short-term instruments in the markets of the currencies included in the SDR valuation basket.[22]

IV. REFORM PROPOSALS

Since the onset of the crisis, debate on the reform of the international monetary system has gained new vigor. This is consistent with the perception that global imbalances played a role in the crisis and that the persistence of imbalances has to do with issues which need to be addressed in the monetary system. Proposals for 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.

A. ZHOU XIAOCHUAN'S PROPOSALS

In an essay released on March 23, 2009, the Governor of the Central Bank of China, Mr. Zhou Xiaochuan, examined what kind of international reserve currency is needed.[23] He posits that in order to safeguard global economic and financial stability a successful reserve currency should have "a stable value, rule-based issuance and manageable supply."[24]

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

20. *Id.* art. XX(1) and(2).

21. *Id.* sec. 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 though they no longer rerceive the interest, on their net allocation.

22. Press Release, IMF, *IMF Completes Review of SDR Valuation*, Press Release No. 05/265 (Dec. 2, 2005).

23. Zhou, *supra* note 5.

24. *Id.*

liquidity."[25] However, he also recognizes the difficulties in implementing such a proposal and therefore calls for giving a greater role to the Special Drawing Right, because it has "the features and potential to act as a super-sovereign reserve currency."[26]

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 to a system backed by real assets, such as a reserve pool, to further boost market confidence in its value."[27]

He further states that 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."[28] This last part of his proposal closely resembles the Substitution account proposal discussed, but ultimately rejected, in the late 1970s.

Because the substitution account appears in several proposals, it is pertinent to give a brief explanation of what the original proposal entailed. The account would have been an off-market mechanism that allowed IMF members to exchange

25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.*

foreign currency reserve assets for SDR-denominated claims.[29] 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.

Talks concerning the institution of such an account dissolved as countries were unable to agree on how to limit the risk borne by the IMF as a result of the exchange rate mismatch created, e.g., scenarios in which the liabilities in SDRs outweighed the value of the accumulated assets denominated in US dollars.[30]

B. UN COMMISSION PROPOSALS

In a recent report on the global monetary system, the UN Commission addressed the issue of reform.[31] In the report, 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."[32]

Instead, the report proposes a "truly global reserve currency."[33] Pursuant to the proposal, the IMF, currently the only issuer of a global currency, Special Drawing Rights (SDRs), would receive responsibility for managing the global reserve

29. IMF, *Reserve Accumulation*, *supra* note 6, at 24.

30. However, see *id.* at 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 the purpose of the account would not be diversification but an increase in the proportion of SDR-denominated claims held as reserves. However, while this is true from an aggregate perspective, it is not necessarily true in the context of countries exchanging their assets, assuming the proper coordination is there.

31. U.N. Conference on the World Financial and Economic Crisis and its Impact on Development, June 24–26, 2009, *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System* [hereinafter *Report of the Comm'n of Experts*].

32. *Id.* at 97.

33. *Id.*

system, or such authority may be given to a new institution such as a "Global Reserve Bank."[34]

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 that they could be SDRs—and vice-versa, just as IMF quotas work today.[35]

The other is that the international agency that creates the global reserves also issue the currency, allocating the "ICCs" to member countries in the same way Special Drawing Rights are currently issued. 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 the currency "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 the domestic money."[36]

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."[37]

Issuances could be fixed—a certain amount every year—or, in a more sophisticated version, could be adjusted countercyclically.[38]

Finally, the Commission points out that the move towards a global reserve currency, 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 a feasible alternative.[39]

C. WORLD CONFERENCE PROPOSALS

Another important set of discussions on reforms to the global reserve system took place at The World Conference on the Financial and Economic Crisis and Its Impacts on Development, held at the United Nations in June 2009. This conference is

34. *Id.* at 98.
35. *Id.*
36. *Id.* at 99.
37. *Report of the Comm'n of Experts* at 99.
38. *Id.*
39. *Id.* at 120–21.

important to highlight because it generated the first global consensus on post-crisis reforms of the international financial system. In its Outcome Document, the Conference addressed the issue of global monetary reform 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.[40]

D. IMF PROPOSALS

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 policymaking body of the Board of Governors requested.[41] A section of a paper discussed at the Executive Board of the institution and that addresses diversification of reserve currencies puts forward several

40. Conference on the World Financial and Economic Crisis and Its Impact on Development, June 24–26, 2009, *Outcome Document of the Conference*, ¶¶ 35–36, U.N. Doc. A/CONF.214/3 (June 22, 2009).

41. *See* Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund (Oct. 4, 2009) (". . . 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."), *available at h*ttp://www.imf.org/external/np /sec/pr/2009/pr09347.h tm.

potential reforms.

One of the options the paper develops is that of a multi-polar currency system.[42] While recognizing that the process of getting there might be quite long, the IMF states that the emergence of new reserve currencies may add momentum to a more multi-polar reserve system.[43] 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 that Central Bank management of their reserve portfolios in a coordinated and transparent way may contribute a great deal to limit such volatility.[44]

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, and require information from them on the composition of their reserves, among other things.[45] 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.[46]

Taking the path of increasing the role of the SDR would require several steps. First, it requires increasing the stock of SDRs significantly, which calls for allocations of substantial new amounts.[47] Second, it would require the official sector to issue SDR-denominated instruments that could be traded "within the official sector or in some cases issued to the private sector."[48] 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."[49] It recognizes, nonetheless, the challenges to achieving an acceptable burden-sharing mechanism to cover the foreign exchange risk.[50] It also

42. Baqir, *supra* note 2, at 18.
43. *Id.* at 18.
44. *Id.* at 18.
45. *Id.* at 19–20.
46. *Id.* at 20.
47. *Id.* at 23.
48. Baqir, *supra* note 2, at 24.
49. *Id.* at 25.
50. *Id.* at 24.

mentions the possibility of issuing more IMF purchasing notes denominated in SDRs, or having other international financial institutions issue SDR-denominated bonds,[51] and government issuing of debt denominated in SDRs.[52] The third step would be the promotion of invoicing of international trade and finance in SDRs, in addition to developing clearance systems in SDR-denominated instruments, which could further enhance its role as a reserve asset. [53] Fourth, the basket composition of the SDR might require revision to render it transparent, simple, and automatic, so that changes are predictable.[54]

On the other hand, taking the path of a *sui generis* global currency, distinct from the SDR, has as its main advantage, creation of actual currency. The SDR is not a currency, which makes conversion into a currency for any payments or foreign exchange interventions necessary.[55] This currency could be adopted by fiat as a common currency or, in a less ambitious version, circulate alongside national currencies.[56] 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."[57]

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."[58]

It is worth noting that after considering all these proposals the Board of Directors of the Fund submitted a report to the Annual Meetings. In this report, the Board 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.[59] The same document says, "The scope for a greater role for the SDR (both in the official and private sector)

51. *Id.*
52. *Id.*
53. *Id.*
54. Baqir, *supra* note 2, at 26.
55. *Id.*
56. *Id.* at 27.
57. *Id.*
58. *Id.*
59. International Monetary Fund, *Executive Board Progress Report to the IMFC on the Fund's Mandate*, at 7 (Oct. 6, 2006).

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."[60]

E. UNCTAD TRADE AND DEVELOPMENT REPORT PROPOSALS

Another set of reform proposals comes from UNCTAD's 2009 Trade and Development Report. In general, its proposals follow those that had been made by the UN Commission, but they include an additional focus on a multilateral framework for real exchange rates management.[61] This becomes necessary, UNCTAD says, because the exchange rate is a variable that involves more than one currency.[62] The agency argues that "[a]n 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."[63] 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.[64] The proposed constant RER would result from nominal exchange rates strictly following inflation differentials.[65]

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."[66] As France prepares to exercise the

60. *Id.*

61. U.N. CTAD, *Trade and Development Report Responding to the Global Crisis: Climate Change Mitigation and Development*, 127 UNCTAD/TDR/2009 (2009); *see also* U.N. CTAD, *Global and Regional Approaches to Trade and Finance*, 50, NCTAD/GDS/2007/1 (Dec. 2007) (more specifically referring to a "multilateral approach in the form of a code of conduct.").

62. UNCTAD Report 2009, *supra* note 61, at 127. *See also* UNCTAD Report 2007, *supra* note 61 ("The exchange rate of any country is, by definition, a multilateral phenomenon . . .").

63. UNCTAD Report 2009, *supra* note 61, at 128.

64. *Id.*

65. *Id.*

66. Interview with President Nicolas 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

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, further developed what the French vision might entail:

> [W]e 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.
>
> 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.[67]

F. MCKINSEY PROPOSALS

Finally, in 2009, the McKinsey Global Institute released a discussion paper that is clearly 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. However, in the 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 mentions in particular that they constitute a very small portion of total reserves.[68] However, it goes on to state that these issues can be addressed, in part through the private sector issuing its own synthetic SDR instruments.[69] It concludes that "[t]here is no fundamental reason why SDRs cannot become a more significant part of the global exchange rate system in the

with the monetary disorders we face now." *See also* Gillian Tett, *Do not dismiss Sarkozy's back to the future currency plan*, FINANCIAL TIMES, Jan. 29, 2010 (quoting Sarkozy's statement "The prosperity of the postwar era owned much to Bretton Woods . . . We need a new Bretton Woods.").

67. Lagarde, Christine, Minister for Economy, Industry and Employment of France, Address at Carnegie Endowment for International Peace (Oct. 7, 2010) (transcript by Federal News Service).

68. McKinsey Global Institute, *supra* note 5, at 38.

69. *Id.* at 38.

future."[70] Likewise, the paper pinpoints the renewed attention paid to proposals to achieve a greater degree of policy coordination in the exchange rate system, saying this may resemble the "negotiated exchange rate arrangements in the 1980s."[71]

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.[72] Therefore, the uncertainty in the reserve system is greater than "today's dollar dominance and the lack of a near-term challenger might suggest."[73]

V. CURRENT CHALLENGES A REFORM OF THE MONETARY SYSTEM MUST ADDRESS

Current proposals to reform the monetary system should be assessed against the backdrop of four acute and current challenges that may require action. The first, perhaps most obvious challenge, is how to foster an orderly exit from the 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.

The second challenge is reducing currency volatility and its consequent negative implications for trade flows. Achieving this reduction is of great importance to trade flows. It is no coincidence that facilitating "the expansion and balanced growth of international trade" is chief among the Fund's enumerated purposes.[74] In fact, the positive influence of a stable monetary system on the evolution of world trade was clear to the intellectual founders of the system. John Maynard Keynes has been famously quoted for saying that "[i]t is extraordinarily difficult to frame any proposals about tariffs if countries are free to alter the value of their currencies without agreement at short

70. *Id.* at 38–39.
71. *Id.* at 39.
72. *Id.*
73. *Id.*
74. Articles of Agreement of the IMF, art. I(ii).

notice. Tariffs and currency depreciations are in many cases alternatives. Without currency agreements you have no firm ground on which to discuss tariffs."[75] Recently asked whether a stable exchange rate is more favorable to trade, renowned economist Robert Mundell replied that "[t]he 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."[76]

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), and the price of access to finance for production. Such variations significantly affect the value of market access concessions and price-based trade liberalization measures that receive so much attention in trade negotiations.

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 also 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, would 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.

The third challenge monetary reform should address is preventing adjustment mechanisms from having negative impacts on full employment. This could be done by ensuring the preservation of adequate levels of aggregate demand and symmetric adjustment mechanisms for both deficit and surplus nations. The current system not only fails in closing the imbalances but also in regards to the available mechanism for adjustment, which is, by definition, recessionary.

As put by Jose Antonio Ocampo, the present system's

75. Communication from U.N. Conference on Trade and Development to Working Group on Trade, Debt and Finance, *Economic Policy Challenges in an Open Economy: Coherence between Trade and Finance* ¶ 1, WT/WGTDF/W/27 (Nov. 7, 2004).

76. Judy Shelton, *Currency Chaos: Where Do We Go From Here?*, THE WALL STREET JOURNAL, Oct. 16, 2010.

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."[77]

The recessionary or deflationary bias stems directly from the asymmetry in adjustment pressure faced by surplus versus that faced by deficit nations.[78] Thus, while deficit nations have to adjust by reducing their level of imports and consumption, surplus nations have no symmetric obligation to raise theirs.[79] This asymmetry conspires against adequate aggregate demand and employment levels, and taken together, results in the global economy consistently working below full employment levels.

The final challenge, to which monetary reform is a backdrop, is the need for 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 billion per year between 2012 and 2017.[80] 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.[81] 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, questions about the link

77. Ocampo, *supra* note 5, at 2.

78. Carney, *supra* note 3, at 2 "[I]t is generally much less costly, economically as well as politically, f.or countries with a balance of payments surplus to run persistent surpluses and accumulate reserves than it is for deficit countries to sustain deficits." *Id.*

79. UNCTAD Report 2009, *supra* note 61, at 122. *See also* IMF, *Reserve Accumulation*, *supra* note 6, at 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.").

80. *Globalizing Solidarity: The Case for Financial Levies* 2, (Task Force on International Financial Transactions and Development, Report of the Committee of Experts, Oct. 22, 2010).

81. Report of the Conference of the Parties on its fifteen session, held in Copenhagen from 7 to 19 December 2009 7, FCCC/CP/2009/11/Add.1 (Mar. 30, 2010). The document is generally known as the Copenhagen Accord.

between SDRs in development—and, by extension, climate—finance gain relevancy since some of the reform proposals involve reform of the SDRs or, alternatively, a global reserve currency.

VI. ANALYSIS OF REFORMS AND LEGAL FRAMEWORK

In light of the preceding analysis, this section asks whether and to what extent the reforms to 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 that surplus and deficit countries take measures to reduce the imbalances. In fact, there is a track record of more than ten years of failed 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 Article IV consultations and, since 2006, with the initiation of the "Multilateral Consultations on Surveillance."[82]

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 in September 2009, the G20 agreed on a "Framework for Strong, Sustainable, and Balanced Growth."[83] The declared intention of this framework was to lead to a correction and to prevent the future recreation of imbalances between countries with high

82. *Contra* IMF, *The Fund's Mandate – The Legal Framework* 9, Prepared by the Legal Department In Consultation with the Strategy, Policy and Review Department Approved by Sean Hagan (Feb. 22, 2010). 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."

83. Group of 20, Leader's Statement: The Pittsburgh Summit ¶ 15 (Sep. 24–25, 2009).

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 that the forecasts "will not add up" and that "[e]xports from one region to another region have to equal imports and it won't be the case."[84]

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 intervened 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 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 discussion paper observe,[85] the fact that these mechanisms attempt 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 as 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.[86] Similarly, the Fund has an obligation to exert "firm surveillance" over exchange rate policies - as opposed to the general responsibility given by the Articles of Agreement - on all of members' obligations that emanated from Article IV.[87]

But the Fund lacks any teeth to ensure that "firm

84. Chris Giles, *IMF chief warns of reliance on exports,* FINANCIAL TIMES, Jan. 30 2010.

85. *See generally* Section III of this paper.

86. *See* IMF, *The Fund's Mandate*, *supra* note 82, at 4. This is the Fund's own interpretation.

87. *Id.* at 6.

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 members will reach consensus regarding legal changes necessary to grant the IMF more enforcement power. If changes were adopted, it is unlikely such revisions would actually affect practice in a significant way.[88]

A number of proposals for reform suggest moving to a multi-currency system.[89] One important advantage of this system is that more than one country acts as reserve issuer, which introduces some diversity in the macroeconomic factors likely to influence the supply of reserve currencies.

Nevertheless, it is doubtful that a multi-currency-based proposal 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 a move 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 unsatisfactory results. The proponents have not been able to explain how to avoid this result in the future.

These proposals have been dismissed by others on the grounds that they would generate greater instability.[90] Those who believe the instability in this scenario could be dealt with, do so on the assumption, again, of strong measures for coordination among currency issuers and central banks.[91] A

88. 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.

89. *See* CHATHAM HOUSE REPORT, BEYOND THE DOLLAR: RETHINKING THE INTERNATIONAL MONETARY SYSTEM , at ix (Paola Subacchi & John Driffill eds., 2010) (recommending that 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, *Reserve Accumulation*, *supra* note 6, at 18.

90. *See* Report of the Comm'n of Experts, *supra* note 31, at 113; Ocampo, *supra* note 5, at 3–4 (Briefing Paper #1, FES New York, January 2010) (acknowledging it—even if more optimistic about possibilities to manage it); IMF, *Reserve Accumulation*, *supra* note 6, at 18.

91. *See* IMF, *Reserve Accumulation*, *supra* note 6, at 18–19 ("[t]hat a multi-

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 does not follow that merely shifting 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 existing global imbalances. Such a change would certainly be a helpful—and for some analysts even necessary—condition. And 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's economy.

However, it does not solve the underlying problem of surplus countries accumulating excessive amounts of currency or resolving the problems inherent to the erosion of value of the asset in question.[92] 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,[93] 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 commitment to symmetric adjustments of international

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 . . . .").

92. *See* Jan Kregel, *Some Simple Observations on the Reform of the International Monetary System*, 3–5 (Levy Econ. Inst. of Bard Coll., Policy Note, 2009/8).

93. *See* Carney, *supra* note 3, at 6 ("Indeed, by providing instant diversification, SDR reserves could entrench some of the existing strategies of surplus countries."); *id.* ("A substitution account would create considerable moral hazard, since reserve holders would be tempted to engage in further accumulation."); *id.* at 7, (pointing to a problem of moral hazard with the substitution account).

imbalances."[94] 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 will 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. Keynes proposed a reserve asset termed "bancor," which, if held in excessive quantities, would be reduced. As such, it was useless to try to engage in excessive accumulation of it. The UN Commission seems to have had this proposal in mind when, speaking of the proposed global currency, it said that it's 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."[95]

A subset of the proposals presented earlier focus on the establishment of a supranational currency a-la-bancor. The following 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 are unattainable 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 reform of the SDR in such a way that

94. Kregel, *supra* note 92, at 5.
95. *See* Report of the Comm'n of Experts, *supra* note 31, at 117.

places 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."[96] However, as the remainder of this section shows, the achievement of this goal is far from feasible were it to remain solely within the limits of the Articles of Agreement. The required changes to the SDR necessary to enable it to 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.[97] Nonetheless, SDRs merely made up a total of only 4% of the total stock of reserves.[98] Increasing the stock of SDRs to the extent necessary to make them a significant portion of total reserves in the world may be difficult in the context of the current strict legal requirements pertaining to new issuances of SDRs. Thus, a relaxation of the requirements to issue SDRs is one of the legal reforms that needs 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 sustaining 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 will 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 SDRs. 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

96. Articles of Agreement of the International Monetary Fund art. VIII(7).

97. 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 1979–81, for a total of USD 33 billion altogether. *See* UN Commission 2009, *supra* note 95, at 119.

98. *See* IMF, *Reserve Accumulation*, *supra* note 6, at 22.

necessary to address this liquidity issue in looking at the technical aspects of its most recent allocation.[99]

Third, in order to increase the appeal of the SDR, some of its features require modification in ways that cannot take place within the current legal framework, as mentioned in some of the examined proposals.[100] One part of such reform 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 solution may be to encourage greater use of the SDR in invoicing international transactions. Otherwise, since there will always be 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.

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

A third area that may need addressing is the fact that some public sector actions that would be useful to prop up the role of the SDR in the system are 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, some suggest that the IMF could foster SDR-denominated settlement systems, something that, due to its current structure, is a far-fetched request.[101]

99. *See* Int'l Monetary Fund, Proposal for a General Allocation of SDRs § IV (C), (E) (June 9, 2009) (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).

100. *See, e.g.*, Zhou, *supra* note 5 (explaining necessary modifications to SDR features to increase appeal).

101. *See* DeAnne Julius, *A Roadmap for SDR Evolution*, *in* BEYOND THE DOLLAR: RETHINKING THE INTERNATIONAL MONETARY SYSTEM 39–40 (Paola Subacchi & John Driffill eds., 2010) (arguing for IMF fostered settlement systems and even for the IMF to act as a market-maker for operations in SDR-

B. THE CHALLENGE OF EXCHANGE RATE VOLATILITY

As explained above, 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 SDR enhancements and some additional coordination, there still remains the question of the ability 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.[102] However, since the currencies that compose the basket today have exhibited quite a high degree of volatility, not the least of which is the US dollar which represents 44 % of the weight, it is worth asking the questions of whether improvement to the composition of the basket is possible in order to reduce volatility further, and what the legal implications would be.

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 option would be to change the basket to the currencies of the major economies.[103] In addition, 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.[104] 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. [105] 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.[106] This means

denominated bonds).

102. 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)." Press Release No. 05/265, Int'l Monetary Fund, IMF Completes Review of SDR Valuation (Dec. 2, 2005).

103. *See* Zhou, *supra* note 5.

104. *See* Holger C. Wolf, *Currency Baskets as International Units of Account*, *in* THE FUTURE OF THE SDR IN THE LIGHT OF CHANGES IN THE INTERNATIONAL FINANCIAL SYSTEM 312 (Michael Mussa et al. eds., 1996).

105. *See id.*

106. *See* IMF Articles art. XXX(f) (defining "freely usable currencies" as a "member's currency that the Fund determines (i) is, in fact, widely used to

that the current system has made a choice that, in such trade-offs, leans towards an asset that has better characteristics as reserve than as unit of account. In 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.[107]

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 is presently the case. As such, the respective reflections on legal reform are also relevant to this purpose. Nevertheless, it is worth asking: can the system perform better in terms of reaching aggregate demand and full employment levels?

First, it may be desirable to explore establishing a connection between the principles determining the issuance of new SDRs—and symmetrically, the principles for cancellation—and linking them to global aggregate demand needs.[108]

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 severe

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make payments for international transactions, and (ii) is widely traded in the principal exchange markets.").

107. *See* IMF Articles art. XV(2).

108. *See, e.g.*, Ocampo, *supra* note 5 ("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.").

limitations, a 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 that 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 the needs of receiving countries are 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.

D. THE CHALLENGE OF DEVELOPMENT AND CLIMATE FINANCE

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 allocate SDRs to use 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.[109]

However, difficulties might arise as a result of 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 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

109. *See* Report of the Comm'n of Experts, *supra* note 31, at 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.").

world."[110]

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.[111] 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 instances, disturbingly affect their substance, is today a common phenomenon across many international organizations.[112]

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.[113] As small as it may be for some holders, compared to their cost of borrowing hard currency in international markets, it 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

110. *See* IMF Articles art. XVIII(1)(a).

111. *See* Montek Singh Ahluwalia, *SDR Allocations and the Present Articles of Agreement*, *in* THE FUTURE OF THE SDR IN THE LIGHT OF CHANGES IN THE INTERNATIONAL FINANCIAL SYSTEM 88–95 (Michael Mussa et al. eds., 1996) (detailing the ambiguities in the language of the IMF Articles of Agreement (even if not going as far as the argument contained in this paragraph)).

112. *See* JOSÉ E. ALVAREZ, INTERNATIONAL ORGANIZATIONS AS LAW-MAKERS, 521–69 (2005) (providing an in-depth account of the trend of interpretations affecting substance); *id.* at 600 ("[International Organizations] have also blurred the distinctions between making law, interpreting it and adjudicating it.").

113. *See supra* note 21 and accompanying text.

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.

VII. CONCLUSION

This paper argued that there are four acute challenges that reform proposals to the monetary system should be able to address. The first challenge is to foster an orderly exit from the global imbalances. The second challenge is to reduce currency volatility, with its consequent negative implications for trade flows. The third is to achieve a mechanism for more symmetric adjustments between surplus and deficit countries, while avoiding recessionary impacts and preserving aggregate demand. Finally, the fourth challenge is to assess 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. However, in order to adopt a number of reforms that are required to adequately respond to such challenges, the current legal 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.