and relevant to the world's needs. The IMF will still be of value to developing economies but will have much less influence when it comes to helping the global economy adapt.

If quotas do shift to reflect economic strength without any other change in governance, China may eventually have the largest quota. Then, under the IMF's Articles of Agreement, IMF headquarters would have to move to Beijing. The politicization Keynes feared would continue, but potentially with a new set of political players and rules and a new set of dissatisfied and disengaged countries.

If, however, members reform quotas and governance simultaneously, an independent IMF could bring a fragmenting world together on key issues. To be palatable to the rest, such comprehensive reforms should happen soon, else the rest could well believe this is an attempt by the Western alliance to hold on to some influence just when power is finally shifting.

A reformed IMF could help determine new rules for international exchange, for instance by setting out a preliminary list of issues to be negotiated, taking the changes in the world economy into account. Given the complexity of the issues, it could bring together a small set of countries to do the initial negotiations under its *multilateral consultations* framework. If the IMF gains sufficient broad trust, it could shape these new rules and enforce their implementation. And it could sharpen its analysis and better advise countries on macroeconomic and external sustainability while lending more effectively to set countries back on track.

Eighty years after Bretton Woods, the world must decide whether to reform the IMF to better engage with members and address their challenges—or fail to act and let the Fund fade away. F&D

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Special Drawing Rights Reconsidered

Edwin M. Truman

Countries could better address the world's economic challenges with help from the IMF's global reserve asset

Congratulations to members, staff, and leadership on the 80th anniversary of the IMF's foundation at Bretton Woods, New Hampshire. The Fund is the crown jewel of the post–World War II international architecture. It was designed by idealists determined to construct a set of institutions to deter aggression among the major powers and prevent resumption of the interwar economic and financial unilateralism.

The IMF's principal purpose, according to its Articles of Agreement, is to promote international monetary cooperation by providing "the machinery for consultation and collaboration on international monetary problems." In the turbulent period following the end of US dollar convertibility to gold in August 1971, members demonstrated that principle and quickly completed the Smithsonian Agreement by December. The agreement's new par values for fixing currencies to the US dollar did not hold, though, and within two years, the Bretton Woods exchange rate regime dissolved into a system of managed floating exchange rates.

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Illustration by Joan Wong

However, members cooperated in making the transition to this system and maintained the principle of exchange rate policies as a focus of mutual concern, which underlies IMF surveillance today.

In addition to monitoring members' exchange rates and other policies, the IMF plays a central role in crisis management, drawing on the experience and expertise of its staff. The IMF's prepositioned stockpile of financial resources is crucial to this role. When a member country needs financial assistance, help can be available without having to pass the hat.

The key to the IMF's success in its first 80 years is its continued evolution. Harry Dexter White and John Maynard Keynes would not recognize the institution today. The Fund's leaders and members have supported innovation in response to new challenges. The IMF and its members must not tread water; continued evolution is essential to continued success. The most critical challenge is governance. The most enticing opportunity is the IMF's global reserve asset, special drawing rights (SDRs).

Governance challenge

The United States and Europe have gradually relaxed the convention that the managing director of the IMF should be a European male, the first deputy managing director a US male, and the president of the World Bank a US male. However, that transformation is incomplete. A more critical challenge is the persistent ability of certain countries (the United States) or groups of countries (the Europeans) to block crucial decisions of the IMF and the desire of other countries (China) to join in.

For more than a decade, I argued within the US government against the use of US veto power over major IMF decisions as our principal talking point when we requested that the US Congress approve an increase in our IMF quota or commitment to the New Arrangements to Borrow. The global economy has expanded more rapidly than the US economy, so the technical and policy rationale for US dominance has grown increasingly tenuous. I also reminded my colleagues at the US Treasury that if we cannot persuade a few other countries to support it, our position is probably wrong. Charles Dallara, US IMF executive director in the 1980s, expresses a similar view: "I learned quickly that building a consensus among like-minded directors is the key to being effective in representing US interests."

The answer to this thorny problem is a grand bargain involving the United States, Europe, China, and Japan. Today's leaders of the IMF and its key members must marshal the ambition and imagination to shape such a bargain.

SDR opportunity

More than 50 years ago, members approved the first amendment to the Articles of Agreement authorizing the IMF to allocate special drawing rights. The negotiations lasted the better part of the 1960s. The result was a complex compromise of strongly held views about how best to sustain the Bretton Woods system.

SDRs are allocated in proportion to IMF members' quotas. Each member receives an interest-bearing reserve asset and corresponding long-term liability on which it pays the same rate. The SDR's value is based on a basket of currencies with weights adjusted periodically by the IMF board. Its interest rate is a weighted average of the short-term government interest rates for the constituent currencies. An SDR allocation adds to a member's unconditional liquidity. Unlike unconditional liquidity derived from borrowing or current account surpluses, the liquidity is costless until the SDRs are transferred to another holder.

The initial allocation of SDRs annually over a three-year period starting in 1969 proved to be too little too late to save the Bretton Woods exchange rate regime, but nevertheless it was a pathbreaking and historic example of international monetary cooperation. The second amendment to the articles, in 1978, not only preserved the IMF's authority to allocate SDRs but also established a two-part obligation for members to collaborate on "better international surveillance of international liquidity" and "making the special drawing right the principal reserve asset of the international monetary system." Both elements of the obligation have proved to be more aspirational than operational.

A second allocation of SDRs was authorized for the three-year period 1979–81 after the amendment of the IMF articles and the start of the floating exchange rate regime. The SDR then remained in the IMF's closet for 30 years until 2009, when the Fund allocated $250 billion in SDRs during the global financial crisis. The most recent allocation occurred in 2021, when the IMF issued $650 billion in SDRs to help members manage the economic and financial consequences of the COVID pandemic.

The SDR has demonstrated its value as a crisis management tool. Now the IMF should build on that success and further enhance the SDR's role in the international monetary system.

First, the IMF should resume annual allocations to maintain and gradually increase the share of SDRs in members' holdings of SDR reserves and currencies, which is now roughly 7 percent. Based on recent trends, an annual allocation of $100 billion to $200 billion in SDRs should achieve this objective. Regular annual SDR allocations would ensure steady growth in global liquidity, as envisioned when the instrument was established and in the amended Articles of Agreement, without dramatic effects on the international monetary system. SDRs are an efficient, low-cost, and nondistortionary way of boosting countries' international reserves and have the added advantage that they remain permanently in the global stock of international reserves.

Second, the interest rate on SDRs should be raised by incorporating a blend of long-term as well as short-term interest rates on government securities denominated in the currencies in the SDR basket. This reform would slightly reduce the subsidy on what are in effect perpetual loans to countries that mobilize their SDRs. It would also offer some compensation to countries that facilitate mobilization, by reducing their

currency reserves and increasing their SDR holdings.

Third, the IMF should actively encourage members with excess SDR holdings to use them to help meet global challenges such as climate change and pandemics—for example, by lending them to the IMF's Poverty Reduction and Growth or Resilience and Sustainability Trusts, multilateral development banks, or other prescribed holders of SDRs; by purchasing SDR-denominated securities issued by those entities; and through similar mechanisms. Member countries should not restrict their policies on the use of SDRs by requiring SDR-denominated claims to remain liquid. Excess reserves need not be liquid if they indeed exceed requirements. Moreover, these SDRs remain in the system, adding permanently to global liquidity.

Regular annual allocations of SDRs would support IMF members in pursuing national and global economic objectives such as climate change mitigation and adaptation. In addition, by lowering the risk and cost of financial crises, SDRs lower the cost of market borrowing, giving policymakers confidence and relaxing external constraints on economic growth policies.

SDRs are not a magic bullet that alone will solve today's pressing global economic and financial challenges, but they are one of many instruments that can contribute. Reform of the IMF's governance is not the only structural challenge facing the institution today. Continued reform and institutional evolution are essential if the Fund is to maintain its central role in the promotion of international monetary cooperation.

When the IMF celebrates its 100th anniversary 20 years from now, may commentators commend the mid-2020s leaders for their vision and imagination in sustaining the institution in the role assigned to it at Bretton Woods. F&D

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No Time for Half Measures

CHARLIE BIBBY/FT

Martin Wolf

The agenda for making the IMF work better has four vital elements

The decision to launch the International Monetary Fund, made eight decades ago at Bretton Woods, New Hampshire, signaled determination more than optimism. The countries represented at this seminal conference wanted to make the postwar world they envisioned altogether different from the one preceding the catastrophe.

This differed starkly from aspirations back in 1918, when the main aim, as John Maynard Keynes noted in a letter written in 1942, was to get back to 1914. In 1944 no one wanted to go back to 1939. The next era, everyone agreed, had to be quite different—and it has been. The world has enjoyed remarkable progress over the past 80 years, with the IMF playing a valuable part.

Yet the world in which the IMF operates now is arguably more challenging than at any time since its founding. In a piece published in *Finance & Development* in 2019, in celebration of the IMF's 75th anniversary, I noted eight crucial features of this changing world: a huge shift in relative economic and political power from long-established high-income countries toward emerging market economies, especially China; growing rivalry between the US and a rising China; an increase in populist politics, including within established democracies; a backlash against the notion of globalization; new transformative technologies, especially the internet and, more recently, artificial intelligence; pervasive financial fragility, notably including rising public debt to GDP across much of the world; a lengthy period of secular stagnation, characterized by ultra-easy monetary policies and low inflation; and, finally, the rising salience of climate change.

> "Cracks in the edifice of global cooperation are deeper, pressure on global institutions is greater, and long-term economic performance has deteriorated."

In the five years since that article the world has endured a series of shocks, notably the pandemic, Russia's war in Ukraine, and the Israel-Hamas war. Secular stagnation is the only trend that seems to have improved—in part thanks to those shocks. But sudden jumps in inflation and higher interest rates have taken its place. Cracks in the edifice of global cooperation are