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Global Liquidity Challenges of the International Monetary System

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ABSTRACT: International Monetary System (IMS) has been in the center of the heated debates over 70 years. Severe exchange rate mismatches and global liquidity problems not only led to global crises but also necessitated systemic changes. Notwithstanding several initiatives, setting proper exchange rate mechanisms has not been able to be realized. After the demise of the Bretton Woods system, an amorphous arrangement mechanism of exchange rates was established that led to further severe challenges globally. Moreover, rapid financial globalization and capital liberalization made exchange rates more vulnerable to external shocks. On the other hand, design flaws in global liquidity and reserve system seem hardly to be solved in the absence of the global lender of last resort and sustainable pro-cyclical liquidity provision. In this regard, the increasing scope of various components of the global financial safety nets raises serious concerns in terms of predicting their impact on global economic cycles. Additionally, major challenges associated with the global reserve system reveal that numerous economies still prefer to rely on national and regional-level frameworks rather than multilateral ones. The escalating tendency of such polarization within the global reserve system imposes serious sustainability challenges for the global economy. It should be emphasized that reforming the IMS is a dynamic process in which providing universal and ultimate solutions are far from reality. This study indicates that it would not be a smooth process to eliminate all these challenges that mostly stem from deep contradictions among nation-states' interests and multilateral frameworks.

KEYWORDS: global liquidity, global financial safety nets, exchange rate imbalances, swap arrangements, Special Drawing Rights, political stigma

Introduction

The challenges imposed by the Global Financial Crisis (GFC) erupted in 2008 necessitated cardinal reforms in most important segments of the global economic system including international trade, IMS, and multilateral surveillance frameworks. These challenges encapsulated the adoption and implementation of much more adequate and effective policy packages at local and global levels to smooth the pro-cyclical downturn. In this context, the adaptation of the IMS to the crisis and post-crisis challenges has been one of the major issues of the global policy agenda. However, this process is seriously painful and time-consuming which requires coordinated policy measures taken by sovereign states that have contradictory national interests with each other. Taking into consideration of the experiences of previous periods in which lots of various initiatives were suggested or launched to reshape IMS, it would be unlikely achievable to set a new resilient system in the light of existing trade and currency wars as well as political populism. It is mainly due to that globalization and the expansion of the global economy have boosted the share of international transactions, highlighting the limitations of a monetary system and policies that were designed for a less internationalized global economy (Subacchi 2010). The same approaches can also be applied for other issues such as capital flow management, asymmetric adjustment mechanisms and other ones that are included in the objectives of the IMS. Indeed, evolution stages of the IMS, beginning from bimetallic and gold standards, subsequent dollar and floating exchange rates standards were shaped as reactions to solve these inadequacies. However, despite their initial successes, all of them failed to deliver long-term sustainability in the global economy. Systemic design flaws and shortcomings of the Bretton Woods system seem to preserve their dominance in the modern phase of reform challenges of the IMS. While looking through existing reform approaches toward international monetary architecture, it becomes obvious that some of them focus on the modernizing Bretton Woods' spirit, while others prefer to reshape this format substantially.

Major challenges: do political economic factors matter?

Studies conducted on the problems of the IMS generally identify four main challenges which are listed as below:

- Escalation of exchange rate misalignments and their use for competitive purposes
- Design and functionality problems of global liquidity provision and global reserve system
- Financial globalization and capital flows volatility
- Inadequate multilateral surveillance and governance frameworks

It is worthy to mention that some of these challenges such as exchange rate policies and capital flow management are dominantly shaped by domestic policies while others including international monetary surveillance and governance frameworks are determined by supra-national authorities. Notwithstanding of being "global public goods" in their nature, recent reforming experiences of global liquidity and reserve systems indicate that the scope of attempts initiated by sovereign states and regional financial arrangements exceeds multilateral initiatives in these field. Escalating trends of global reserve accumulation, bilateral currency swaps among central banks and regional financing arrangements (RFAs) capture a lion share in global liquidity while effective regulation of these liquidity providers is still lack.

Moreover, it seems that IMS challenges do not stem only from functional shortcomings of its elements. Political economic factors heavily affect all of these challenges which roots can be found in the political trilemma of the global economy (Rodrik 2012). Lack of effective collaborative action towards the challenges listed above coincides with escalating contradictions among key economic powers who conduct pro-active expansionary economic policies. On the other side, notably for the emerging and developing countries, political and economic pressures imposed by trade and financial liberalization beget to some constraints for the independence of domestic economic policies as well as political environment.

Additionally, rising importance and scope of global financial safety nets (GFSN) is also heavily influenced by political economic factors. While looking through its components, particularly central banks' swap arrangements, domestic and external political economic environment changes impose cardinal influence. Duran (2015a) explains the current expansion of swap agreements among central banks with rising independence of monetary authorities in some leading economies. Political stigma towards international financial institutions (notably, International Monetary Fund (IMF)) has also significantly contributed to widening the autonomy of central banks to implement various counter-cyclical measures in case of permanent or temporary global imbalances.

Financial globalization and booming of the implementation of financial technologies also evoke serious challenges for policymakers and extremely complicate attaining financial stability. Rapid financial and capital liberalization beginning from the 1970s under "spiritual leadership" of neoliberal ideology and subsequent technocrat policy transmission channels such as Washington (1989) and post-Washington Consensuses (1998) did not entail to benign consequences for most countries that experienced them. On the other hand, there have been several countries which achieved to get better positioning in the global economic system through expanding their trade relations and financial systems. However, during the 1980-1990s, coupling with floating exchange rates, financial globalization led to systemic currency, debt and banking crises in many leading emerging market economies (EMEs) including Latin American and Asian countries. Global economy and these countries have partly adjusted themselves to the new realities of international monetary relations nonetheless substantial cyclical downturns still occur in these economies and make them highly vulnerable to external factors. On the other hand, gradual changing attitudes by policymakers and IMF (IMF 2011, 2013b, 2015, 2016b) concerning capital flow management in recent years can be welcoming news.

Intensifying debates relating to improving existing multilateral surveillance frameworks also involve some political economic challenges that require enormous efforts to be eradicated. Evolving multilateral formats including the transformation from G7 to G20, some management reforms within IMF and the appearance of new regional multilateral arrangements are considered as reactions to these challenges. However, in the background of rising currency and trade wars and the absence of imperative enforcements by global multilateral institutions, it is unlikely that current reform proposals regarding with modernization of the IMF and other institutions would be able to tackle political stigmas.

Global liquidity and reserve system: design shortcomings and implications for the future

Global liquidity has been one of the instability sources for the effective functioning of the international monetary architecture since its onset. During gold standard and subsequent dollar-gold standard, its constraints appeared in various forms and entailed to serious liquidity provision problems. The problems imposed by global liquidity system stemmed from widening the conceptual framework of the “global liquidity” term (Sousa & Zaghini 2004; Rüffer & Stracca 2006; Domanski, Fender & McGuire 2011; Bruno & Shin 2012; Hasanli 2018) and also negative implications of the cyclical policy measures taken by sovereign countries (e.g. foreign exchange reserve accumulation) on the global liquidity provision. Furthermore, the absence of the global lender of last resort contributed to increasing unsustainable and pro-cyclical liquidity provision. It is also worthy to mention that the notion of a “sustainable level of global liquidity” involves highly debatable issues in terms of academic and policymaking aspects. In other words, depending on global economic growth dynamics, it has been problematic to define such level without compromising the sustainability of the growth cycles.

Systemic design flaws of the global liquidity can be referred to as the main sources of the global downturns during the last decades. In the light of national currency-based IMS, the global liquidity system served to bring “exorbitant privilege” and also serious external instability risks for the main currency issuer country (Eichengreen & Sussman 2000). On the other hand, the rest of the world, in particular, EMEs responded to external imbalances that stemming from systemic liquidity inadequacies and asymmetric adjustment burdens by accelerating foreign exchange reserve accumulation. In economic terms, increasing the tendency of reserve accumulation means the transfer of resources from these countries to the USA as well as other reserve-issuing countries (Ocampo 2014). Due to the “fiduciary dollar” regime of the Bretton Woods system and subsequent period in which the US dollar preserved its de-facto dominance, the USA has been a “supreme” destination for most of these resource transfers. Notwithstanding various efforts to mitigate US dollar hegemony, this process requires more time as well as serious structural and financial reforms both on sovereign state and global economic system levels. Given the risk of catching either Thucydides or Kindleberger traps, this process ought to be completed gradually without completely endangering systemic equilibrium. As seen in the cases of the 1997 Asian crisis and then in the GFC, global liquidity provision problems were serious determinants of recessions. Their 'destructive' roles could be substantiated with high pro-cyclicality of international liquidity provision and its surging inclination to avoid sovereign surveillance frameworks.

Stemming from credit expansion before the GFC, unsustainable development patterns has led to increments in commodity prices as well as “asset bubbles” in financial markets. Along with the cardinal expansion of financial capital flows, global liquidity has surged significantly during the last decades. However, because of the GFC and subsequent stagnation process, a substantial drop in international capital flows and credits offered by banks (particularly in the Eurozone) was experienced. In the background of these cyclical processes, various fragmentation trends are observed through the formulation of regional or bilateral liquidity arrangements between sovereign states and their policymaking institutions. Additionally, rising difficulties regarding maintaining appropriate levels of liquidity provision on a global scale, recent development trends of non-bank financial intermediation, expansion of shadow banking all over the world have increased pro-cyclical features of the global liquidity system. Inadequate multilateral surveillance regarding the implementation of much more broad-based prudential frameworks at national levels has also led to increased vulnerability of global liquidity provision.

As aforementioned, it seems that fragmentation tendencies in the provision of global liquidity will increase its significance in medium and long-term perspective IMS reform agenda. In this regard, GFSN requires special attention due to its rapidly increasing scope. Focusing on the GFSN is also necessary due to the rising importance of international macroeconomic policy coordination. Particularly, in the context of rising monetary cooperation challenges, the absence of the institutions which can serve as a global lender of last resort endangers sustainable levels of liquidity provision. Adjusting to the scale of the global economic system, a global lender of last resort can be described as an institution which (i) provides liquidity to cope with (or avoid) balance of payment imbalances; (ii) allows to smooth adjustments on currency values and finally (iii) precludes those changes not consistent with the countries' economic fundamentals. In other words, a global lender of last resort should act as a monetary stabilizer when the global economy faces with sharp imbalances. However, during the evolution stages of the IMS, it was impossible to establish an institution that covered all these areas emphasized above due to several reasons such as contradictions among major economies and the design of the global reserve system. In various episodes of global imbalances, as observed in the GFC, the US Fed took this responsibility. Indeed, the Fed's role as a lender of last resort has stemmed from the US dollar's main global reserve currency status.

At the onset of the Bretton Woods stage, GFSN involved much more centralized feature, however, in the subsequent decades, decentralization trends on various levels began to be observed. This decentralization involved establishing various components of GFSN which were perceived as policy reactions to different imbalances. Because of the IMF's inability to fulfill its mandate as a lender of last resort, various countries, particularly EMEs have to formulate their policy buffers to tackle these imbalances. The nature of these policy measures taken by EMEs has also exposed to significant changes. For instance, during the 1990s, the biggest EMEs relied on the IMF as well as other multilateral and regional mechanisms to smooth liquidity shortages and cope with their currency crises. However, beginning from the 2000s, these economies exponentially focused on reserve accumulation which served as a precautionary and economic policy tool (aiming to manage exchange rates and external sector). When the GFC erupted, not only EMEs but also advanced economies (AEs) relied on ad hoc bilateral monetary cooperation among central banks rather than multilateral arrangements.

Approaches regarding the conceptual essence of the GFSN differ due to its scope. Some assess GSFN as financial arrangements that can provide foreign exchange to official borrowers in the event of a crisis (Di Mauro & Zettelmeyer 2017). According to the IMF, GFSN is a loose-knit connection of insurance, liquidity and financing instruments and comprise arrangement both on individual economies, regional and global scales (IMF 2013c; 2016). Based on experiences during recent decades, the main objectives of the GFSN include providing precautionary insurance against a crisis, supplying liquidity when crises hit and incentivizing sound macroeconomic policies (IMF 2016a; 2017a). In recent years, there is exponential widening in the institutional structure of the GFSN and this process is significantly shaped under the influence of financial globalization. As aforementioned, GFSN encompasses four broad categories (IMF 2013a):

- Individual countries' foreign exchange reserves
- Bilateral currency swap arrangements
- Regional financing arrangements
- Multilateral financing arrangements

In each of these components, significant increases have been observed in recent years. Rise of bilateral currency swaps and RFAs are generally explained by their successes in delivering urgent counter-crisis measures in recent decades. On the other hand, these measures accelerate fragmentation inclinations and constraint space for policy cooperation among countries. In general, recently booming components of the GFSN reflect intensifying competition among major economies and lead to the unsustainable provision of global liquidity. In addition to the chaotic correlation among these components, the level of political risk in accessing some of them is significantly high (IMF 2016a; 2017a; 2017b).

The expansion of foreign exchange reserves accumulation has begun to thrive since the 1960s and partly stemmed from the global reserve system design of the Bretton Woods stage. As the U.S. was main reserve-issuer country, reserve accumulation by the rest of world entailed to large current account deficit and substantial rise of financial liabilities of the U.S. (Eichengreen & Frankel 1996). In the subsequent periods, due to the surging trade deficit problem in the USA which was 'importer of last resort' for major emerging Asian economies, reserve accumulation preserved its significance in terms of precautionary and counter-cyclical policy tool. Beginning from 2000s, a new wave towards reserve accumulation appeared under the influence of the global economic growth dynamics.

Reserve accumulation can be stemmed from a broad range of motives depending on economies' development levels. In general, it is perceived that these reserves offer a broad maneuver space for central banks to achieve financial and price stability and act as a lender of last resort when they offset external sector imbalances. Increasingly faced tradeoffs between financial stability and currency flexibility in the economies with flexible exchange rates necessitate central banks' intervention in these countries. Especially in those economies which possess high levels of cross-border liabilities, central banks' active participation through implementation of their lender of last resort functionalities makes a significant sense during frequent market imbalances and capital flow volatilities (Obstfeld 2013; Borio, James & Shin 2014).

Reserve accumulation has not been a widespread experience in AEs; nonetheless, some of these countries (e.g. Australia and Sweden) with floating exchange rate regimes used these reserves when the GFC started. The reasons behind why AEs do not need a high level of reserves are not only related to the implementation of floating exchange rates in these countries but also their free access to international financial markets. Furthermore, institutional and structural maturity of banking and financial sectors, as well as the overall economic system in these economies allows them to respond to crises and mitigate market dysfunctions through a mix of economic policies. Experience in recent decades also suggests that AEs are typically seemed more resilient, and are less likely to suffer periods of market dysfunction, with these economies maintaining lower and less volatile spreads even during periods of heightened stress (IMF 2013d). However, the rationale of reserve accumulation in some of these economies can be substantiated by those central banks in these countries would have to provide domestic banks with foreign exchange in case of liquidity shortages.

On the other hand, reserve accumulation by EMEs largely involves precautionary (Ocampo 2014; IMF 2018) and counter-cyclical motives (Farhi, Gourinchas & Rey 2011; Ocampo 2014). These reserves are also used as a financial stability (Ocampo 2014) and trade policy tool (Duran 2015a; Henning 2015). Even though foreign reserves are generally interpreted as resource flows from these economies to AEs, recent experience indicates that EMEs with substantial reserves can have more monetary autonomy and more capacity to respond to immediate liquidity shortages. It is worthy to mention that most of these economies lack free and adequate access to international financial markets.

Despite foreign reserves are associated with lower risks of a currency crisis, their marginal benefits decline at high levels. Empirical studies indicate that global reserves are also highly costly policy measures and lead to additional costs such as quasi-fiscal (Obstfeld 2013) or sterilization costs, balance sheet risks, exposure to potentially large capital losses in case of strengthening of the domestic currency against reserve currencies (IMF 2018). Foreign reserves are also vulnerable in terms of the spreading of imbalances from reserve-issuer countries to reserve holders. Moreover, some authors consider that countries' reserve growth on a global scale is associated with fiscal deficits in reserve-issuing economies rather than current account deficits (Obstfeld 2013). This approach is substantiated by the fact that central banks and sovereign wealth funds gravitate toward the government liabilities of highly creditworthy economies and assets of major financial institutions in these countries. In this case, EMEs' inclination towards acquiring these assets and reserves begets to rising fiscal burden in AEs either through shrinking of current account surplus or increasing public and private debt.

However global reserves can yield only temporary and limited positive outcomes when these are not supported by other sets of economic policies. In the light of market imbalances, using these reserves reaps the only limited benefit in terms of mitigating speculations in currency markets if appropriate revisions are not made in other economic fundamentals. As seen during the GFC, in terms of addressing financial stability concerns, prudential tools are better and can go much farther to constraint risks imposed by systemic vulnerabilities. Moreover, using reserves to intervene in currency markets can give birth to new waves of speculative exchange rate pressures. Particularly in the countries where pegged or “sticky” exchange rates are used, the extent of intervention by central banks is becoming more aggressive and proactive.

Besides the limited impact on market imbalances, intensive usage of reserves, after some time leads to deterioration of economic policy discipline and also avoidance from rule-based policymaking. Increasing trend toward rule-less policymaking at macro-levels entails to unsustainable global liquidity provision. In other words, as some countries accumulate substantial levels of reserves, they experience current account surplus while other ones are exposed to current account deficits. As aforementioned, the absence of adequate adjustment systems among surplus and deficit economies has several times led to systemic crises and even the demise of previous international monetary formats. Besides, to attract more resources from EMEs, AEs are obliged to implement a lower level of interest rates which as observed in the pre-GFC period, led to speculative bubbles in financial markets.

Studies also emphasize that the global rush for reserve accumulation seriously limits macroeconomic policy coordination opportunities. In recent years some positive changes are observed in EMEs in terms of changing their traditional attitudes toward reserve accumulation. For instance, during the GFC, nine of the largest EMEs chose not to use reserves (IMF 2016a). This fact can also be explained by the loosening of global financial conditions as was associated with counter-crisis policy packages in AEs after the GFC erupted. Low-interest rate environments in AEs and hereby changes in the international capital flows destinations allowed EMEs to get access to necessary funding without deploying their reserves. Furthermore, temporary and permanent standing bilateral currency swap lines were mostly preferred by monetary authorities to offset macroeconomic menaces.

Currency swap lines have attracted special attention due to preferred by numerous central banks as a measure to cope with liquidity shortages in the aftermath of the GFC. Excluding unlimited currency swap lines among advanced economies' central banks, the overall size of other swap arrangements accounted for $1 trln during 2010-2014, the rapid proliferation of swap agreements encompassed more than 50 countries and 70 new arrangements (Duran 2015a) while according to the recent estimations, nearly 160 bilateral swap lines exist among central banks around the world (Reis & Bahaj 2018). In the aftermath of the GFC, currency swap lines were also widespread among EMEs’ central banks which formulated these arrangements as the first line of defense. In addition to the Fed’s swap lines with central banks of Mexico, Brazil, Singapore, and South Korea, central banks from China, South Korea, Indonesia, and Malaysia formulated swap lines in local currencies with their counterparts.

Bilateral swap agreements generally address to meet short-term foreign currency liabilities notwithstanding their use for other purposes in recent years (e.g. China’s enormous efforts to internationalize RMB and expand foreign trade opportunities). However, these arrangements possess some institutional shortcomings because of their dependence on the committed resources provided by stakeholders of these agreements. In other words, resources in the framework of currency swaps are kept at national hands until their activation which begets to some uncertainties during crisis episodes. Main initiator of any currency swap prefers to conduct these operations with those economies which have significant trade or financial relations and even dependencies. Therefore, currency swaps do not completely substitute foreign exchange reserves in terms of liquidity provision. Moreover, currency swaps involve exchange rate risks between stakeholders of these arrangements. In practice, the nature of currency swaps involves a significant asymmetry in the form of various roles of currencies in global liquidity provision. It is generally perceived that the role of swap lines is to increase the global supply of liquidity in foreign currency reserves. However, as experiences indicate not all currency swaps are effective in terms of increasing global liquidity. In most swap arrangements during the GFC, the final result was the provision of the US dollar liquidity on a global scale and exorbitant central bank balance sheet surges all over the world, including particularly Fed's balance sheet. Therefore it is sounded much effective to systematize and sustain currency swap lines by setting up an institutionalized network of established and codified agreements in advance in order to them much more credible alternatives of reserve accumulation (Farhi, Gourichas & Rey 2011). This approach can also be used to mitigate domestic political restrictions during crisis stages while avoid from lags in the implementation of urgent policy decisions. The latter issue should also be taken into consideration in terms of broadening autonomy of monetary authorities.

Table 1. EMEs' central banks preferences for monetary cooperation

Relevant national actor	**Immediate responses to crisis**		**Aftermath of a crisis: process of global lender of last resort institutionalization**
	Low political stigma towards the IMF	**High political stigma towards the IMF**	
Powerful central banks	Bilateral currency swaps	Bilateral currency swaps	Bilateral swaps and/or regional arrangements based on bilateral swaps
Less powerful central banks	Multilateral responses	Regional arrangements based on international organization	Regional arrangements based on international organization

Source: Duran (2015a)

Expansion of currency swap lines in the aftermath of the GFC is also related to the revisions in central banks' mandate (identification of maintaining financial stability as a primary objective together with price stability) and changing sovereignty boundaries of their independence in terms of political economic aspects. The latter element in its turn is associated with the broadening of monetary policy objectives and responsibilities as well as overhauls in international monetary cooperation formats since 2008. Increasing political and economic influence of central banks on global scale has led to more intensive use of currency swap lines. However, this process has resulted in the formulation of such arrangements on regional rather than global levels hereby accelerating fragmentation tendencies in the IMS. Indeed organizing bilateral swap lines between IMF and central banks was offered during the Seoul Summit of G20 in 2010; however, it was rejected by advanced economies. The main rationales behind advanced economies' approach were exchange rate imbalances and the risks of losing control over these funds by main issuer countries.

Notwithstanding of proliferation in recent years, various RFAs demonstrate significant differences in terms of liquidity provision and functionalities. For instance, BRICS Contingent Reserve Arrangement focuses on precautionary purposes while European Stabilization Mechanism created in the EU is designed to provide funding during severe financial distresses as well as maintaining financial stability in the currency union. On the other hand, the Arab Monetary Fund and Latin American Reserve Fund are designed to address macroeconomic policy cooperation and harmonization as well as facilitating regional integration. The former is also formulated to bolster the implementation of structural reforms in the financial and banking as well as the public finance sector. Such a broad range of objectives of the AMF indicates that it was intended to be designed as a regional supranational institution rather than solely RFA.

However, as several experiences reveal, there are also some shortcomings in the functionality of RFAs that encompass limited funding opportunities, as well as conditionality demanded to get funding from these arrangements. Most RFAs possess limited lending capacity in comparison to their potential resources—as demonstrated by the substantial reserves held across their member states. Moreover, most such regional initiatives still urgently need better institutionalization patterns to improve their roles in the provision of liquidity during normal and crisis periods. Their mutual relations with the IMF also matters in terms of shaping of future international monetary architecture. It should also be taken into account that RFAs are not completely free from political stigma (IMF, 2016a). They have also confronted with more or fewer confidence problems during the crisis resolution process as the IMF experienced several times. Claims which state that RFAs can substitute IMF soon, seem highly ambitious particularly when aforementioned institutional constraints of RFAs and expansion trends in other components of GFSN are taken into consideration

Final component of the GFSN is multilateral financing arrangements that have exhibited significant imbalances in the recent decades which are associated with the inadequacy of IMF resources, bureaucratic impediments within IMF governance mechanism. In other words, emerging of other components of the GFSN is strongly correlated with the fact that IMF, as a multilateral institution created with the charge of implementing global surveillance and providing financial stability is partly able to deliver its responsibilities during crises.

In 2010, IMF quota resources were doubled aiming to meet exponentially increasing liquidity demands by member states. Furthermore, the introduction of new financing instruments such as the Flexible Credit Line and the Precautionary Liquidity Line which were principally designed as contingent liquidity support for crisis prevention happened in the same period. Another financing instrument - Global Stabilization Mechanism (GSM) was created intending to address the identification of systemic risks and the implementation of appropriate financing arrangements to cope with them. However, in the subsequent period, the proposal for GSM was refused to claim by the IMF Board of Directors (Duran 2015a).

In the background of extending global liquidity, the functionality and perspective of the Special Drawing Right (SDR) in the global reserve system have been subjected to continuous concerns particularly due to the fact it failed to fulfill the international reserve asset role since its onset. Its limited capacity to serve as an international reserve asset stems from both internal design flaws of the SDR as well as its limited capacity to react abrupt changes in the global economic system. When it was proposed in the late 1960s, it was intended to address global liquidity shortages through reducing excess demand for the US dollar which was the primary reserve currency. At that time it was thought that introduction of the SDR would mitigate external pressures on the US current account and would be more flexible in terms of meeting escalating liquidity demand of the global economy. However, in subsequent years, SDR exhibited limited functionality despite its broad scope of objectives. The global stock of SDRs has averaged just over 3 percent of global reserves since 1970 (IMF 2018). During 1970-72 when the initial general allocation of the SDR was made, the overall stock of the SDR constituted 9.5% of the global non-gold reserves (Williamson 2009) while in the eve of the GFC, this figure dropped to 0.5% (Obstfeld 2013). After general allocations made in 2009, the stock of SDRs peaked at nearly 5% of global non-dollar reserves (Ocampo 2014).

Many reasons shed light to explain why SDRs fail to become an international reserve asset. Firstly, SDR is designed as a reserve asset; it is not a currency notwithstanding involving a substitution for other reserve currencies. In other words, countries need to convert their SDR holdings into reserve currencies to make payments or intervene in currency markets. Secondly, the IMF does not issue SDRs; it just allocates SDR resources. Thus it can be concluded that SDR holding does not represent a liability against the IMF (Duran 2015b). Furthermore, SDRs take part in both an asset and a liability against the countries hold these resources (Ocampo 2013). Thirdly, because of SDR valuation is determined by a basket of five reserve currencies, it is highly linked to the conditions of major reserve-issuing economies. While SDRs are generally considered as a mutual credit line which can be used by developing economies in unconditional terms, major reserve-issuing countries seem reluctant to meet the increasing demand for their currencies originated by the rest of the world. This reluctance also stems from constraints partly in their domestic monetary policies as well as imposed by the Triffin dilemma. Official SDR is a reserve instrument which does not constitute a debt of any specific economy but rather represents the potential right to obtain freely usable currencies of other member countries. In reality, taking into consideration the dominance of a handful of currencies in the global trade and financial flows, SDR stocks allow EMEs to borrow in key reserve currencies without additional interest burdens. However, contradictions between domestic economic policy objectives in AEs and EMEs, as well as political economic factors behind SDR allocations beget to uncertainties regarding this issue.

Discussion

Reform challenges of the IMS seem to preserve its urgency as the global economy confronts continuous recessions and realignments. This study indicates that it would not be a smooth process to eliminate all these challenges that mostly stem from deep contradictions among nation-states' interests. Political economic factors significantly matter in various fields of the IMS notwithstanding they are frequently neglected by policymakers. These political economic shortcomings are observed both in international and macro-level decision-making mechanisms.

Moreover, the problematic aspects of the reform challenges mentioned in this study also stem from their structural complexity. These challenges will continue to involve more shortcomings under the impact of global economic realignments. On the other hand, there is a significant lack of effective macroeconomic policy coordination on the global level notwithstanding some cooperation initiatives with limited participants particularly during global recessions over the previous decades.

In light of these challenges, GFSN experiences rising decentralization trends on various levels which can be perceived as policy reactions by nation-states to different imbalances. Because of the IMF's inability to fulfill its mandate as a lender of last resort, various countries, particularly EMEs have to formulate their policy buffers to tackle these imbalances. However, such a decentralized structure also involves serious challenges including the unsustainable provision of liquidity, impediments stemming from the low level of macroeconomic coordination as well as underdeveloped institutionalized features of some GFSN layers.

In terms of future of the global reserve system, it is dominantly considered that increasing SDR functionality as a unit of account would contribute to more stable trade and capital flows as well as reducing dependency on the policy stance of the main reserve-issuing countries. Nonetheless, consideration of major challenges associated with SDR reveals that numerous economies still prefer to rely on other resources (e.g. reserves, bilateral swap arrangements) in front of volatilities in global markets. Therefore SDR transformation into a real global currency seems unlikely to be realized in the short-term notably when fragmentation trends in global liquidity are observed.

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