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Exchange rate misalignments and the present international monetary system

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1. Introduction

The most recent crisis was not primarily a crisis of the international monetary system, as such, but demands for reforms have reached such a high point that some reforms are in the process of being implemented and more are being proposed, now that the general direction of the international monetary system has shifted from the G-7 to the G-20 countries. Reforms are required in order to solve the most serious problem facing the present international monetary system. This is the large and persistent misalignment among the world's leading currencies (dollar, euro, and renminbi). Currency misalignments disrupt the pattern of specialization and trade based on comparative advantage and can lead to dangerous trade disputes and protectionism. Correcting currency misalignments and asymmetries in the system requires the elimination of the deep structural imbalances that exist among the major economic areas, especially between the United States and China. They also require the leading nations allowing their currencies to move toward their equilibrium level.

Section 2 of the paper briefly reviews the characteristics and functioning of the present international monetary system. Section 3 identifies the major shortcomings of the present system – the most important of which being currency misalignments. Section 4 examines the structural imbalances in the world's major economic areas that are the fundamental causes of currency misalignments and the serious trading problem facing the world economy today. Section 5 examines

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Table 1
Exchange rate arrangements of IMF members as of April 30, 2011.

Exchange rate regime	Number of countries	
Number of exchange rate arrangements	Countries	Percent
Hard pegs	25	13.2
No separate legal tender	13	6.8
Currency board	12	6.3
Soft pegs	82	43.2
Conventional peg	43	22.6
Stabilized arrangement	23	12.1
Crawling peg	3	1.6
Crawl-like arrangement	12	6.3
Pegged exchange rate within horizontal bands	1	0.5
Floating	66	34.7
Floating	36	18.9
Free floating	30	15.8
Residual		
Other managed arrangements	17	8.9
Total	190	100.0

Source: IMF (2011).

the reforms required to have a better-functioning international monetary system and what that future system is likely to look like.

2. Characteristics and operation of the present international monetary system

The present international monetary system has four main characteristics:

(1) There is a wide variety of exchange rate arrangements. Table 1 gives the distribution of actual (de facto) exchange rate arrangements of the 187 member countries of the International Monetary Fund and three territories: Aruba (Netherlands), Curacao and Saint Maarten (Netherlands), and Hong Kong SAR (China) as of April 30, 2011. The table shows 107 countries (56.4 percent of the total of 190 countries and territories) operated under hard or soft pegged (i.e., some kind of fixed exchange rate system) and 83 countries (43.6 percent of the total) operated with floating or other managed arrangements.

Among the 13 countries with no separate legal tender (hard peg) were Ecuador, El Salvador, and Panama (all three using the dollar); among the 12 countries that have a currency board (also a hard peg) are Bulgaria, Hong Kong SAR, and Lithuania; the 43 countries that have a conventional (soft) peg include Denmark, Jordan, Kuwait, Libya, Morocco, Saudi Arabia, and Venezuela; the 23 countries that have stabilized arrangements (also a soft peg) include Iran, Pakistan, Syria, and the Ukraine; among the 12 countries with a crawl-like arrangement (also a soft peg) are Argentina, Bangladesh, China, Dominican Republic, and Egypt.

Among the 36 countries that operate under floating are Brazil, Hungary, India, Indonesia, Korea, Mexico, Philippines, Romania, South Africa, Thailand and Turkey; the 30 countries that operate under free floating include the United States, the 17 members of the European Monetary Union (EMU) or Euro Zone, Japan, the United Kingdom, Australia, Canada,