REFORMING THE INTERNATIONAL MONETARY NON-SYSTEM

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THE BRETTON WOODS AGREEMENT

- Global reserve system based on a dual gold-dollar standard (gold exchange standard).
- Fixed exchange rates, but adjustable under “fundamental disequilibrium”
- Controls on capital flows, to insulate from speculative capital flows.
- Official balance of payments support, financed by quotas and “arrangements to borrow”. Limited in terms of funding, to finance current account deficits.
- Monitoring of member countries’ policies, but weak vis-à-vis major countries, and no mechanism of macroeconomic policy coordination.

THE POST-1971 "NON-SYSTEM"

- Global reserve system essentially based on an inconvertible (fiduciary) dollar. It marginalizes developing countries from reserve creation.
- Countries can choose their exchange rate regime, so long as they avoid "manipulation".
- A significant degree of capital account liberalization. No official debt workout mechanism.
- Official balance of payments financing, but increasingly small relative to magnitude of crises + increasing and later greater focus of conditionality.
- Ineffective surveillance + limited macroeconomic policy coordination, but outside the IMF (G-7, now G-20).

THE FIVE ESSENTIAL ELEMENTS OF A DESIRABLE ARCHITECTURE

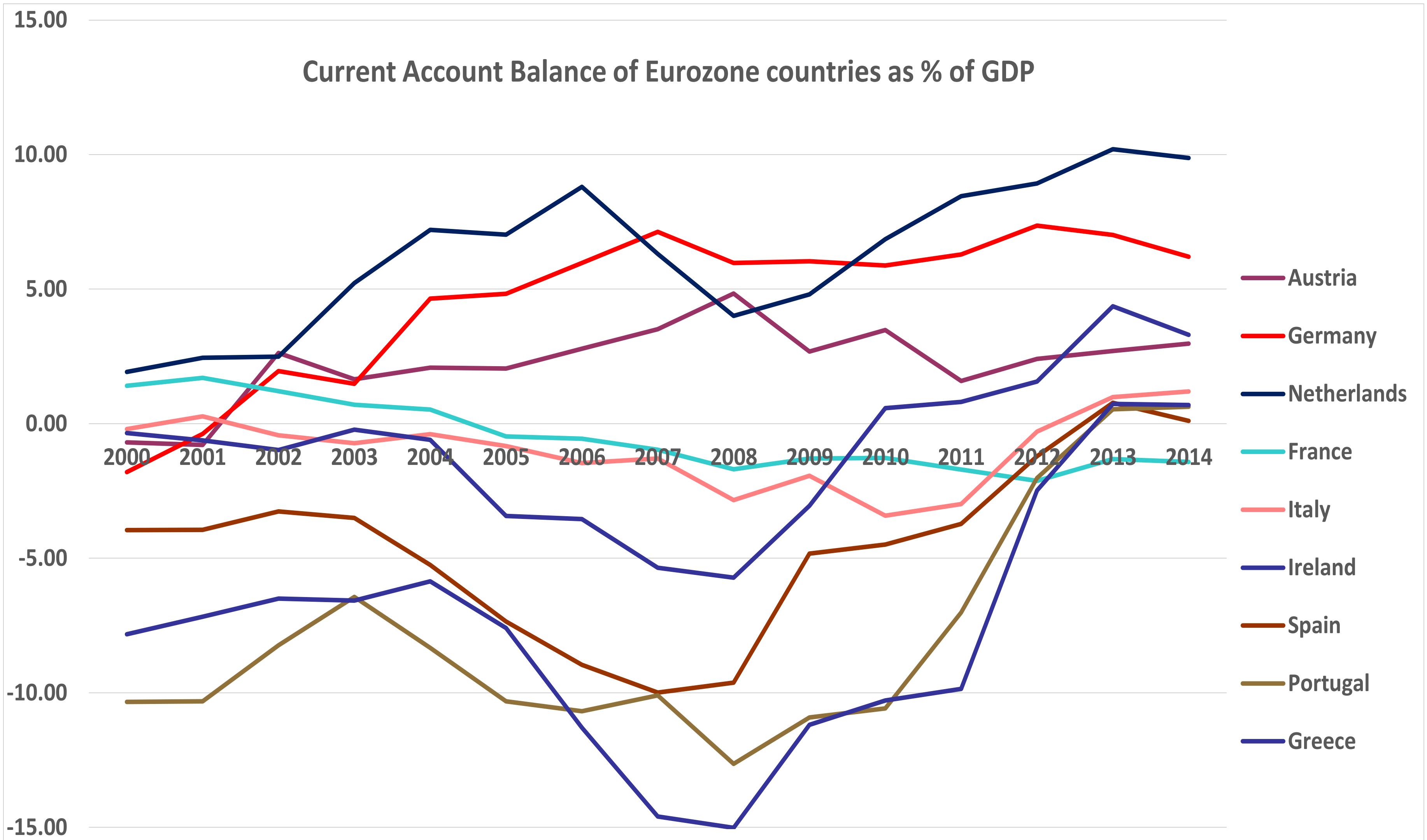
1. An international reserve system that contributes to the stability of the global economy and is considered as fair by all parties.
2. Consistency of national economic policies (particularly of major economies) + avoid negative spillovers on other countries (particularly through exchange rates).
3. Regulation of finance, including of cross-border capital flows to avoid excessive risk accumulation, and moderate the pro-cyclicality of markets.
4. Larger emergency financing during crises.
5. International debt workout mechanisms to manage problems of over-indebtedness.

THE GLOBAL RESERVE SYSTEM

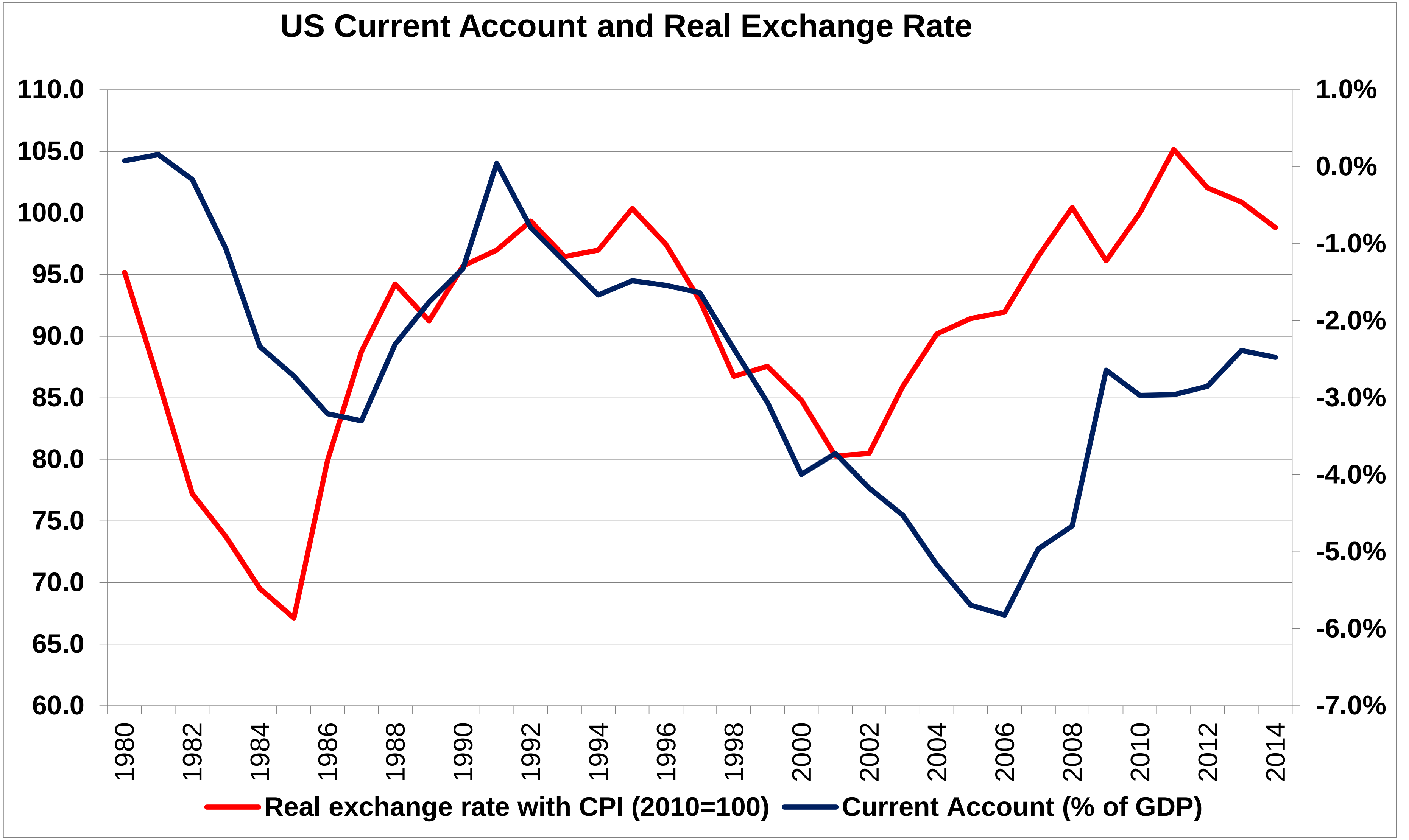
THE GLOBAL RESERVE SYSTEM: The problems

1. *Asymmetric burden of adjustment*, as it falls on deficit countries during crises.
2. *Triffin dilemma*: problems associated with the use of national currency as international currency (can generate inflationary and deflationary biases).
3. *Inequities* associated with demand for reserves by developing countries as self-protection. It can generate fallacy of composition effects

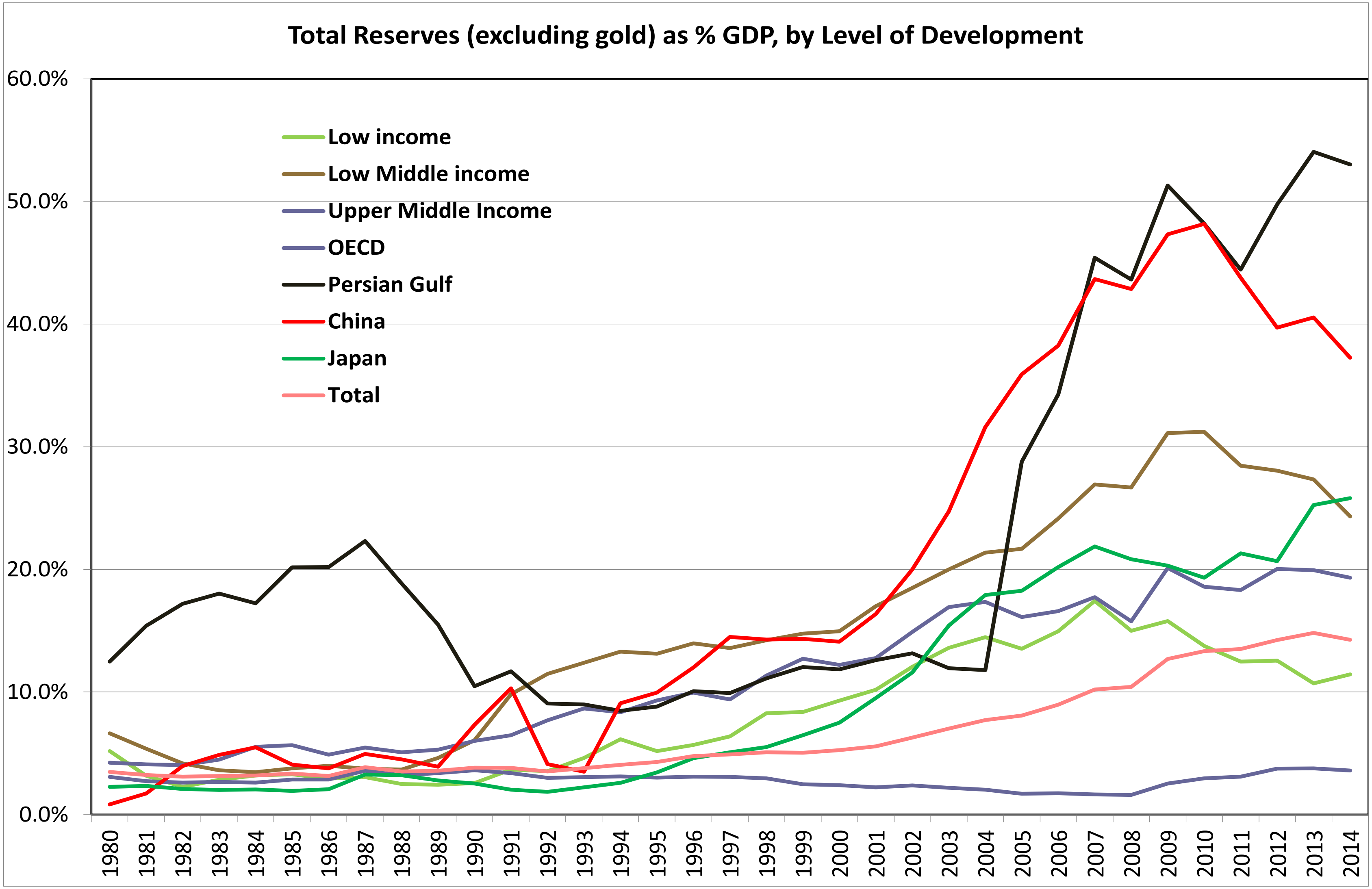
ASYMMETRIC BURDEN OF ADJUSTMENT: THE EUROZONE CASE



U.S. DEFICITS AND INSTABILITY OF THE VALUE OF THE DOLLAR



GROWING DEMAND FOR FOREIGN EXCHANGE RESERVES BY DEVELOPING COUNTRIES



THE GLOBAL RESERVE SYSTEM: Two alternative routes (which may be complementary)

- Multi-currency standard
  - ✓ Would not be unstable as past systems of its kind (thanks to flexible exchange rates)
  - ✓ Provides diversification
  - ✓ But new instabilities and equally inequitable
- An SDR-based system
  - ✓ Counter-cyclical provision or SDRs equivalent in long-term to demand for reserves.
  - ✓ IMF lending in SDRs: either keeping unused SDRs as deposits, or Polak alternative

SOME FEATURES OF THE SDRs

- Both an asset and a liability. It effectively works as an unconditional overdraft facility.
- Criteria for allocations: *long*-term need, of a *global* character, to *supplement* existing reserve assets.
- Most estimates (Bergsten, Kenen, Ocampo, Stiglitz, Williamson, 2011 IMF staff document) talk of at least $200b annually, some of up to $400 vs. about $500b in annual demand for reserves.
- Basket should be based on use of currencies in trade and foreign exchange reserves. Full convertibility was originally not, and should not be the basic criterion.

THE GLOBAL RESERVE SYSTEM: Development issues

Three alternatives

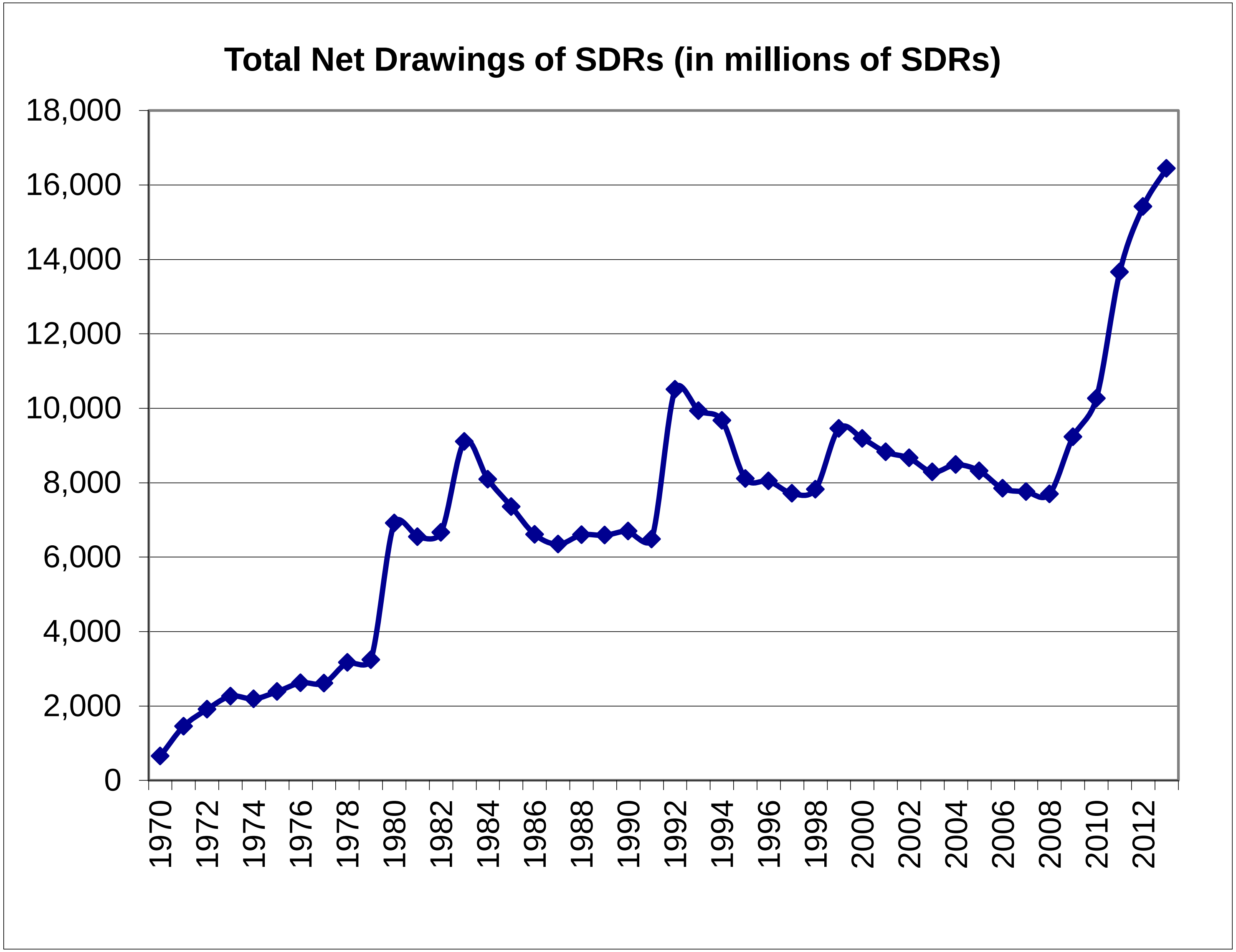
- Asymmetric issue of SDRs (taking into account the demand for reserves)
- “Development link” in SDR allocation (allow the utilization of unused SDRs to buy bonds from MDBs or climate fund)
- Use SDR allocations to finance development aid or the provision of global public goods.

DEVELOPING COUNTRIES GET LESS THAN 40% OF SDR ALLOCATIONS

SDR allocations by level of develoment			
	1970-72	**1979-81**	**2009**
High income: OECD	73.6%	65.8%	59.7%
United States	24.8%	21.7%	16.7%
Japan	4.1%	4.3%	6.2%
Others	44.7%	39.8%	36.8%
High income: non-OECD	0.2%	1.1%	1.8%
Gulf countries	0.0%	0.7%	1.1%
Excluding Gulf countries	0.2%	0.4%	0.7%
Middle income	16.3%	22.9%	30.1%
China	0.0%	2.0%	3.7%
Excluding China	16.3%	21.0%	26.4%
Low income	9.9%	10.2%	8.3%
Total allocations	100.0%	100.0%	100.0%

Note: using 2000 World Bank classification by level of development.

THE “MARKET” FOR SDRs IS ACTIVE BUT SMALL



INTERNATIONAL MACROECONOMIC COOPERATION AND THE EXCHANGE RATE NON-SYSTEM

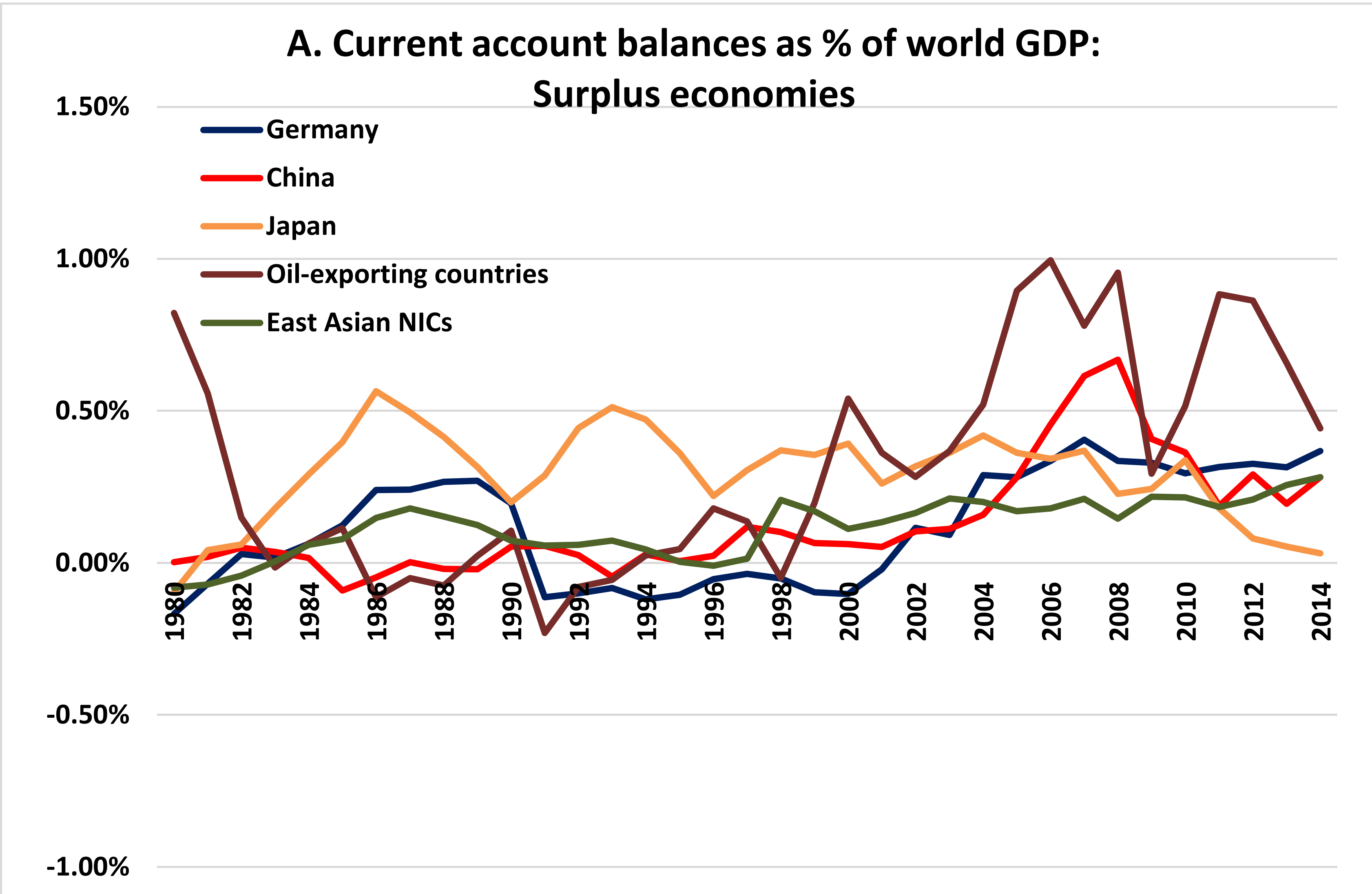
MACROECONOMIC POLICY COOPERATION (1)

- IMF was created to “promote international monetary cooperation”
- But most cooperation takes places outside the IMF in ad-hoc arrangements (Gs) = “elite multilateralism”.
- Best attempt at intra-IMF cooperation: the 2006 multilateral consultation on global imbalances.
- Cooperation takes place through the G-20’s Mutual Assessment Process (MAP) with “technical assistance” from the IMF.
- The MAP focuses on both domestic and external imbalances based on “indicative guidelines”
- Failure of the G-20: from the 2009 “London/Keynesian consensus” to the 2010 “Toronto divergence”.

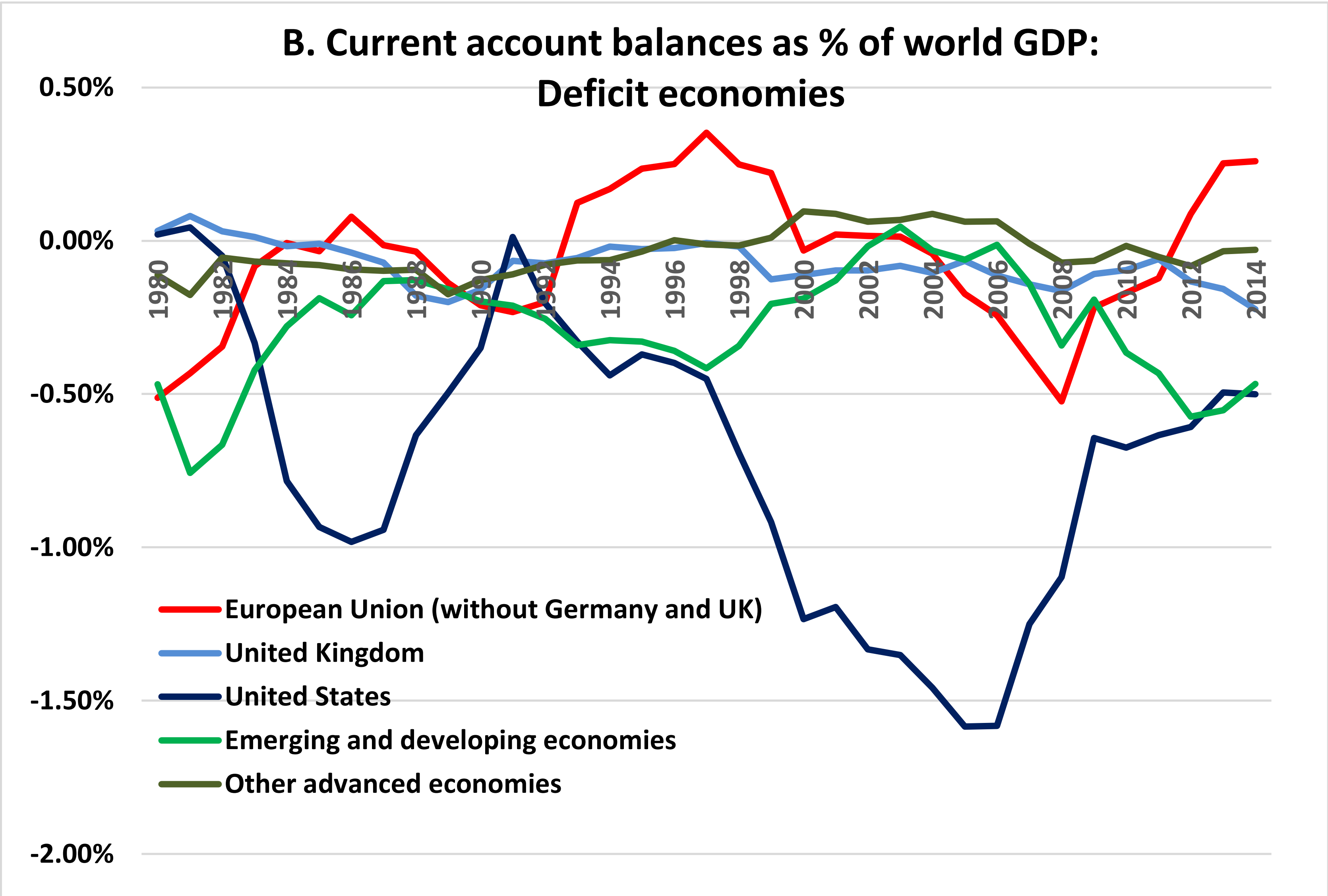
MACROECONOMIC POLICY COOPERATION (2)

- Increased IMF multilateral surveillance:
  - ✓ Consolidated Multilateral Surveillance Report (2009).
  - ✓ “Spillover reports” for the “systemic 5”
  - ✓ “External Sector Reports” assessing global imbalances (2012).
- This is, in a sense, the most elaborate system of cooperation ever designed…
- … but it has done little to reduce global imbalances. In fact, it has not avoided the creation of new imbalances.
- The best scheme: strong dialogue of systemically-important economies (e.g., the “systemic-5”) but accountable to the full IMF membership.

CHANGING COMPOSITION OF GLOBAL IMBALANCES (1)



CHANGING COMPOSITION OF GLOBAL IMBALANCES (2)



THE EXCHANGE RATE NON-SYSTEM

- The collapse of the original Bretton Woods arrangements led to a “non-system” of exchange arrangements: freedom to choose regime so long as countries avoid exchange rate “manipulation” and large misalignment.
- This system does not contribute to correcting global imbalances…
- … and is dysfunctional for orderly international trade.
- So, need for major reforms:
  - ✓ “Indicative” current account objectives and/or
  - ✓ “Target zones” or “reference rates” to avoid excessive exchange rate volatility.
  - ✓ The “indicative guidelines” of MAP provide a model.

FINANCIAL CRISIS PREVENTION AND RESOLUTION

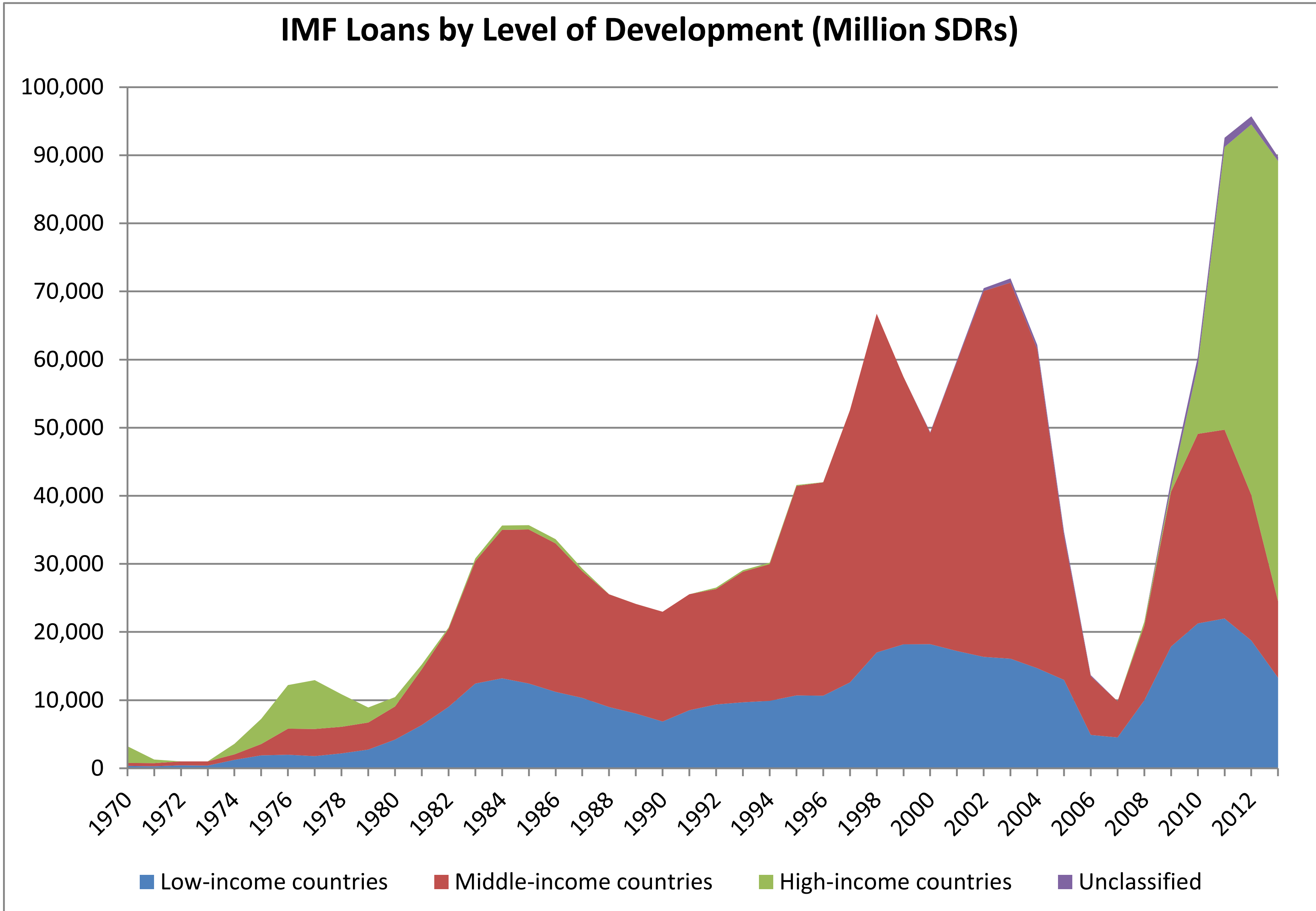
AN UNSETTLED ISSUE IN CRISIS PREVENTION: THE ROLE OF CAPITAL ACCOUNT REGULATIONS

- Regulation of cross-border capital flows is an essential ingredient of global financial regulation has not been recognized by G-20/FSB, partly so by IMF.
- It should be seen as an essential element of macroeconomic management in emerging economies, not as a “last instance intervention”
- The major problem today is the management of the asymmetric monetary policies that the world requires today.
- So long as source countries are not active participants, the issue will remain unsettled.

CRISIS RESOLUTION: EMERGENCY LENDING

- Better credit lines:
  - Supplemental Reserve Facility in 1997.
  - Contingency credit line in 1999, eliminated in 2003.
  - Major reforms of 2009 and 2010: larger facilities, flexible credit line and other contingency facilities + no structural benchmarks.
- Conditionality:
  - Since the beginnings of the IMF, of a macro character.
  - Debate on “external” vs. “internal” origin, and rise of fairly unconditional contingency credit lines in 1970s.
  - Climbing conditionality in 1980s and 1990s.
  - 2002 reform: it should be *macro relevant*.
- Lending to industrial countries comes back in 2009

LARGE INCRESE IN IMF FINANCING



THE UNSETTLED ISSUE OF SOVEREIGN DEBT CRISIS RESOLUTION

- Lack of regular institutional mechanisms to manage debt overhangs: only Paris Club + case-by-case negotiations.
- The system does not produce adequate and timely debt relief, and does not treats different debtors, and different creditors with uniform rules.
- Best try: IMF proposal for an SDRM (Sovereign Debt Restructuring). September 2014: UN General Assembly proposes negotiations for a sovereign debt framework.
- Contractual arrangements: collective action clauses (2003 in US) + aggregation clauses (EU in 2013) + meaning of pari passu clause. Improved in 2014 by ICMA and IMF.
- Possible use of a WTO-type panel system in the framework of the IMF: successive negotiation, mediation and arbitration.

THE GOVERNANCE OF THE SYSTEM

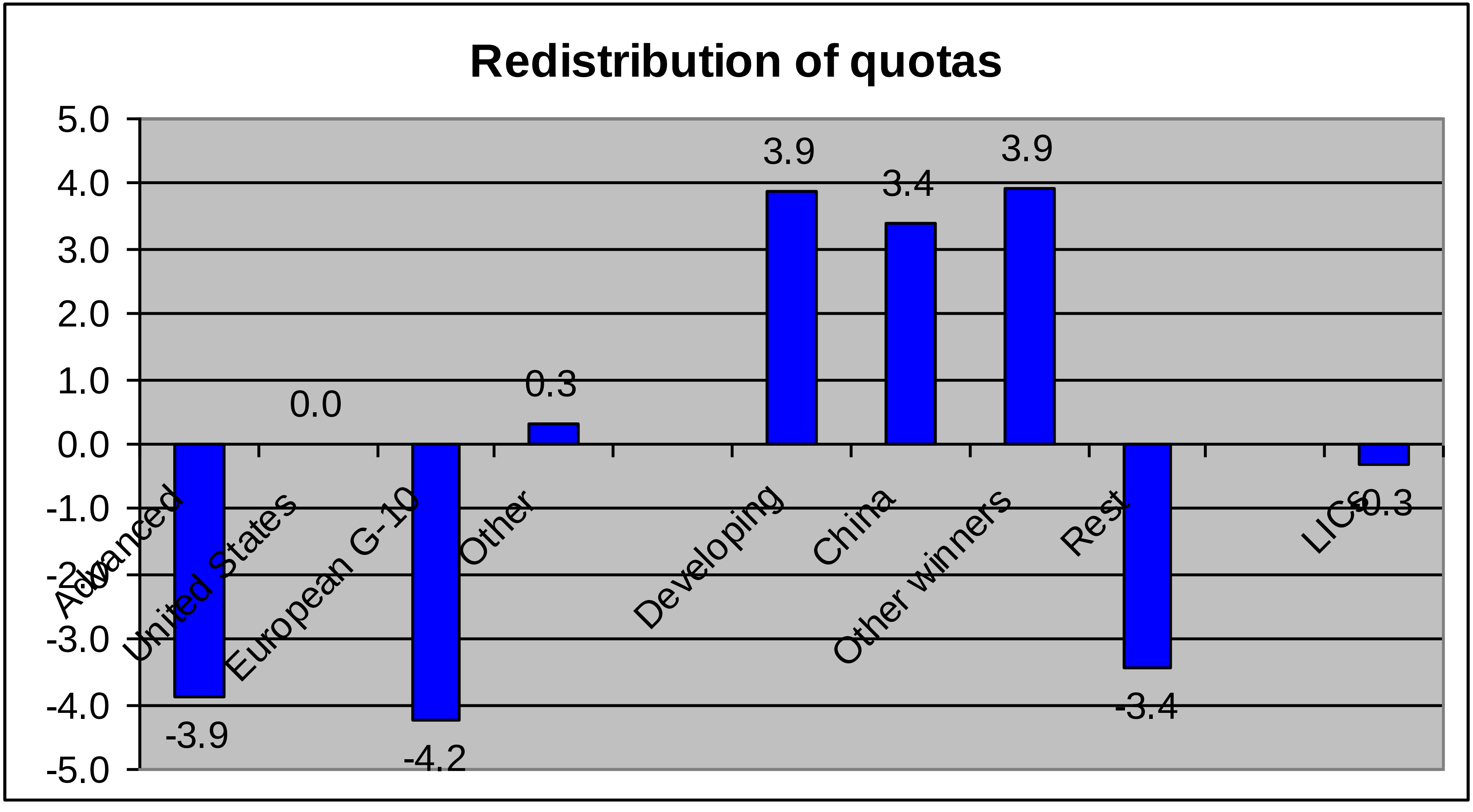
GOVERNANCE:
THREE COMPLEMENTARY ISSUES

- ❖ "Voice and representation" of developing countries in the Bretton Woods Institutions
- ❖ A representative organization at the apex of the system
- ❖ A denser, multi-layered architecture

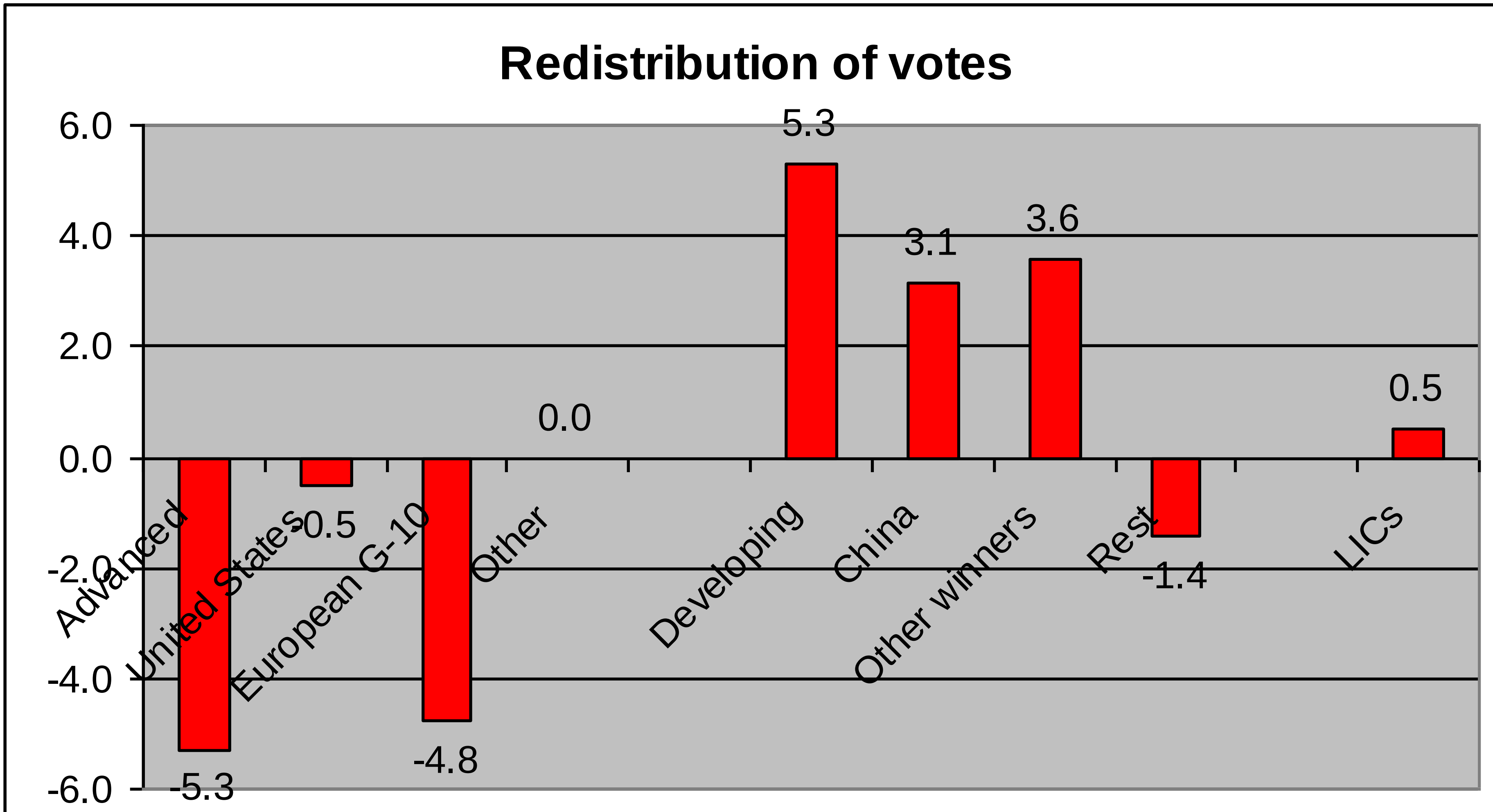
REFORMING THE BRETTON WOODS INSTITUTIONS

- ❖ Quotas and voting power:
  - ✓ Over-representation of Europe, under-representation of Asia.
  - ✓ All seats must be elected.
- ❖ Other institutional issues:
  - ✓ Reform the 85% majority rule.
  - ✓ Proper functioning of the constituency system.
  - ✓ Competitive, merit-based election of the IMF Managing Director and the World Bank President.
  - ✓ Clear division of labor between Ministerial meeting, Boards and Administration.

THE IMF QUOTA REFORM: SIGNIFICANT REDISTRIBUTION



THE IMF VOICE REFORM: SLIGHTLY MORE AMBITIOUS



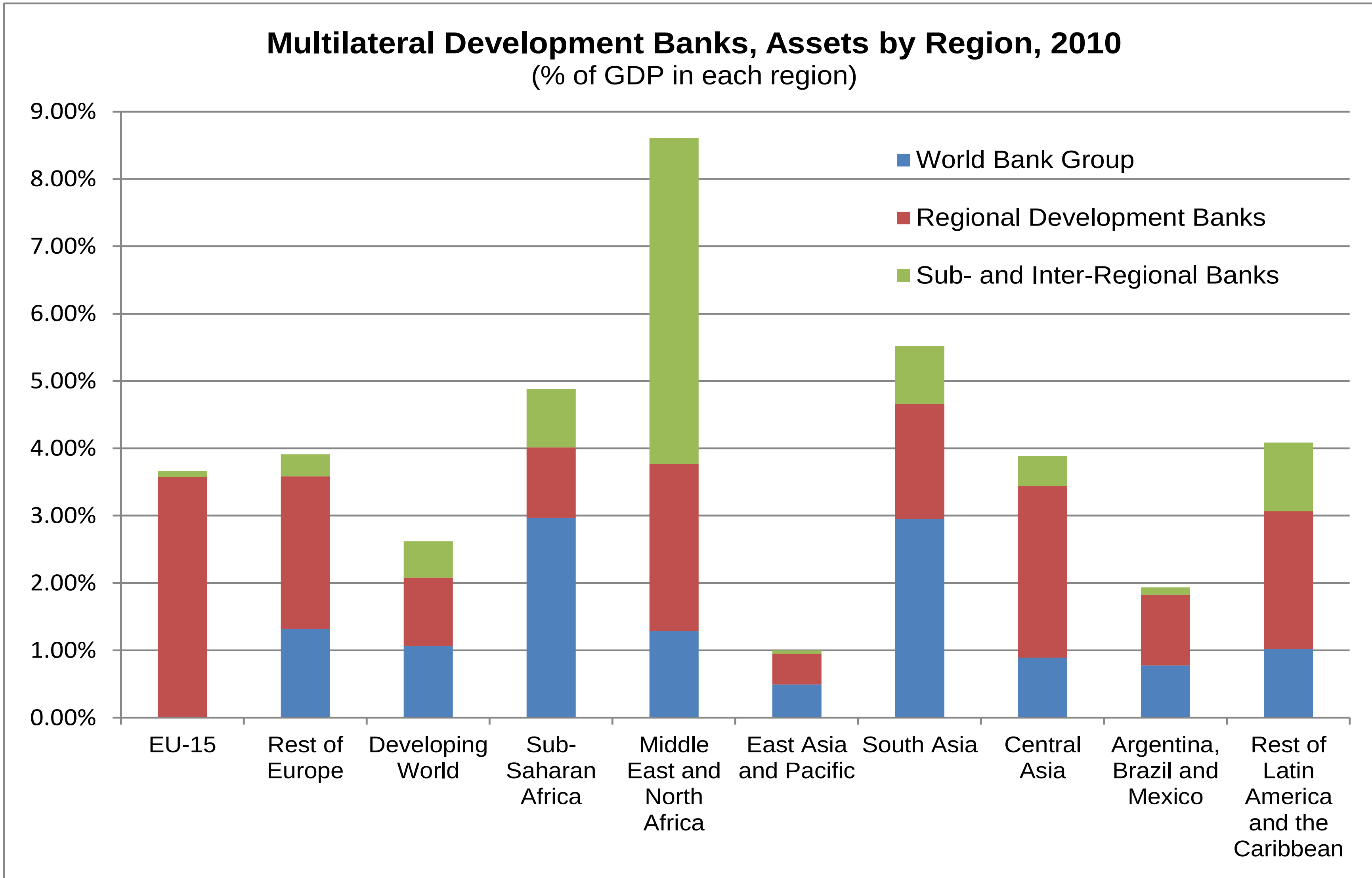
THE APEX INSTITUTION

- “Elite multilateralism” (the G-20): advantages and concerns:
  - ✓ Most positive features: leadership, ownership.
  - ✓ Effectiveness: in financial reform, only initially in macroeconomics, problematic mission creep.
  - ✓ Most negative: it is a self-appointed, ad-hoc body, with problems of representation and legitimacy.
  - ✓ Awkward relation with existing broad-based multilateral institutions.
  - ✓ Lack of a permanent secretariat (which would not make sense to create, anyway).
- Desirable evolution towards a decision making body of the UN *system*, based on constituencies (Global Economic Coordination Council proposed by the Stiglitz Commission).

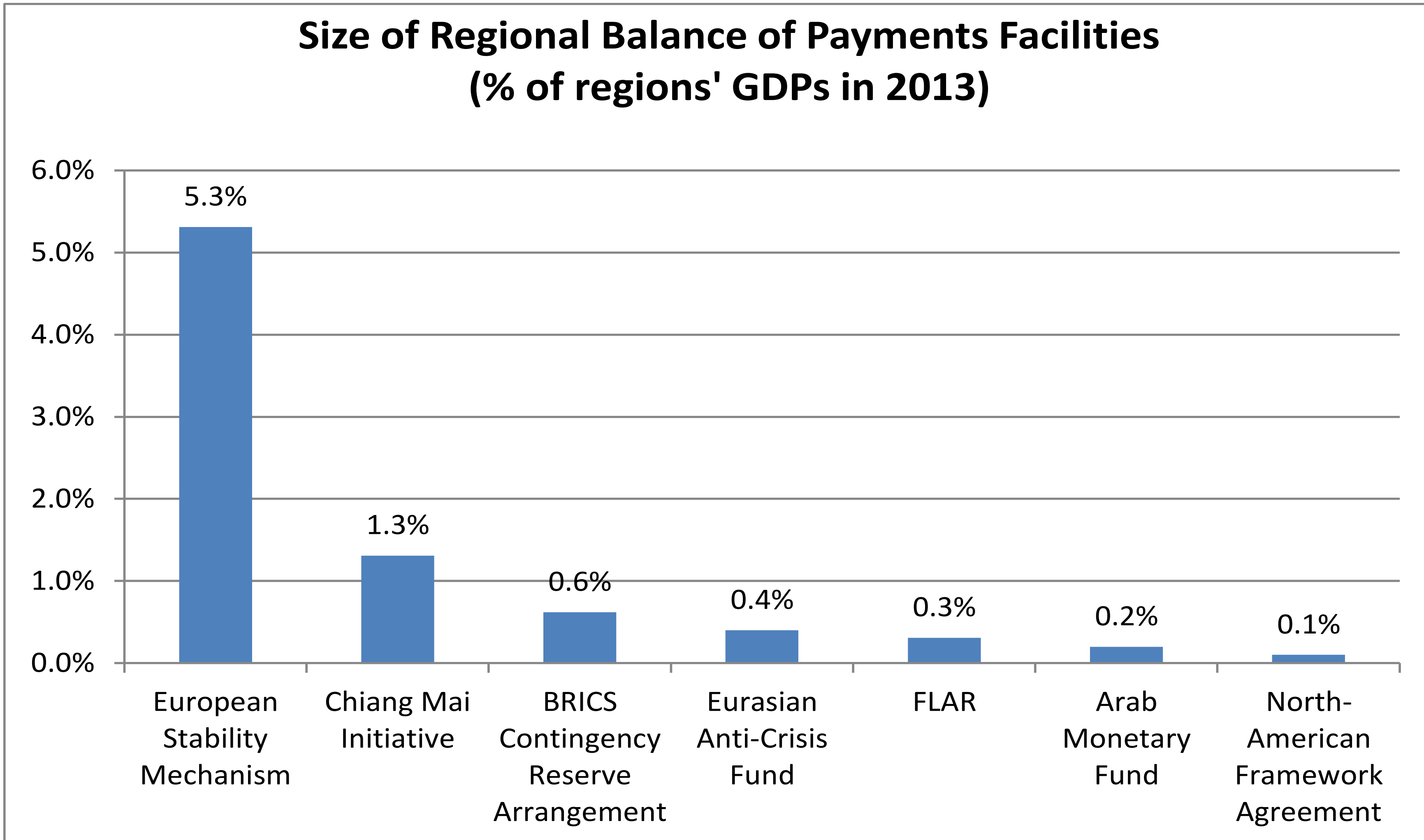
A MULTI-LAYERED ARCHITECTURE

- Globalization is also a world of “open regionalism”: trade, macro linkages, regional public goods.
- Complementary role of regional institutions in a heterogeneous international community.
- Competition in the prevision of services to small and medium-sized countries
- The “federalist” argument: greater sense of ownership of regional institutions.
- So, need for multilayered architecture made up of networks of global and regional institutions, as already recognized in multilateral development banks.
- The IMF of the future as the apex of a network of regional reserve funds.

THE MDBs: A DENSE, MULTI-LAYERED ARCHITECTURE



IN CONTRAST TO MDBs, LIMITED DEVELOPMENT OF REGIONAL MONETARY INSTITUTIONS



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