ESSENTIAL REFORMS
FOR A SOUND 21ST CENTURY
INTERNATIONAL MONETARY SYSTEM

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FOUR MAJOR AREAS OF REFORM

1. A global reserve system that contributes to the stability of the global economy and is considered as fair by all parties.

2. Better macroeconomic policy cooperation (among major economies) + an exchange rate system that contributes to global balances.

3. Improved crisis prevention and resolution: regulation of cross-border capital flows, larger emergency financing, and creation of an international debt workout mechanisms.

4. Improved governance: voice and representation in the IMF, representative apex institution, a multi-layered architecture.
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.
THE GLOBAL RESERVE SYSTEM: Two alternative reform 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 it can generate 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 $400b.

- Best “development link” would be an asymmetric issue of SDRs, taking into account the demand for reserves.
DEVELOPING COUNTRIES GET LESS THAN 40% OF SDR ALLOCATIONS

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

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

THE “MARKET” FOR SDRs IS SMALL BUT ACTIVE

Total Net Drawings of SDRs (in millions of SDRs)
INTERNATIONAL MACROECONOMIC COOPERATION AND THE EXCHANGE RATE NON-SYSTEM

MACROECONOMIC POLICY COOPERATION

- IMF was created to “promote international monetary cooperation”, but most cooperation takes place in ad-hoc arrangements (Gs) = “elite multilateralism”.
- Cooperation takes place through the G-20’s Mutual Assessment Process (MAP), with “indicative guidelines” on both domestic and external imbalances.
- Increased IMF multilateral surveillance:
- This is, in a sense, the most elaborate system of cooperation ever designed, but it has done little to avoid 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.
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” – a concept that has never been defined.
- 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.
  - Climbing conditionality in 1980s and 1990s.
  - 2002 reform: it should be *macro relevant*.
  - Reducing conditionality is essential to eliminate stigma associated with borrowing form the IMF.
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 treat different debtors, and different creditors with uniform rules.
- Best try: IMF proposal for an SDRM (Sovereign Debt Restructuring). 2015: principles on debt restructuring agreed in the UN General Assembly.
- 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 REFORMS

- “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: INSUFFICIENT REDISTRIBUTION

Redistribution of quotas

- United States: -3.9
- European G10: -4.2
- Other: 0.3
- Developing: 3.9
- China: 3.4
- Other winners: 3.9
- Rest: -3.4
- Left: 3.4

Redistribution chart showing current quotas and the proposed 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”.
- 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

Size of Regional Balance of Payments Facilities (% of regions' GDPs in 2013)

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