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 instiution, a multi-layered architecture.

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

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

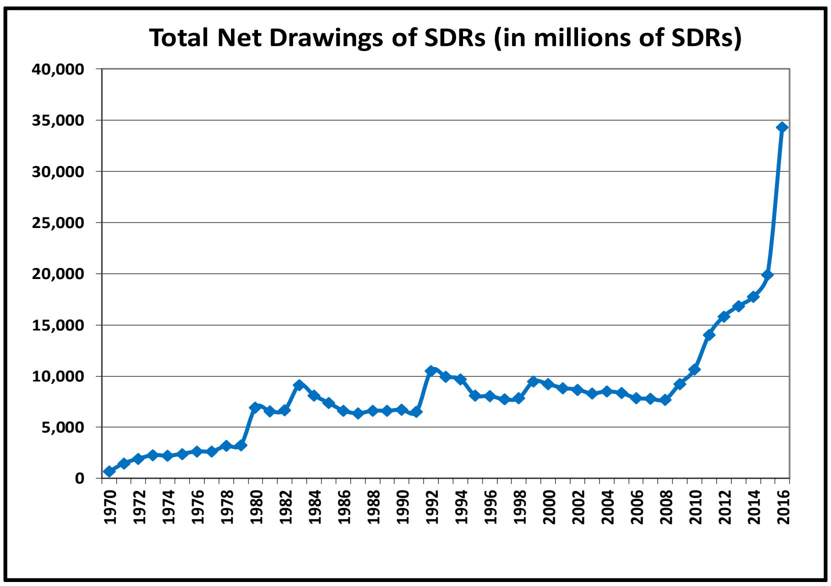
- ❖ Both an asset and a liability. It effectively works as an unconditional overdraft facility.
- ❖ Criteria for allocations: *long*-term need, of a *global* character, to *supplement* existing reserve assets.
- ❖ Most estimates (Bergsten, Kenen, Ocampo, Stiglitz, Williamson, 2011 IMF staff document) 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

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 SMALL BUT ACTIVE

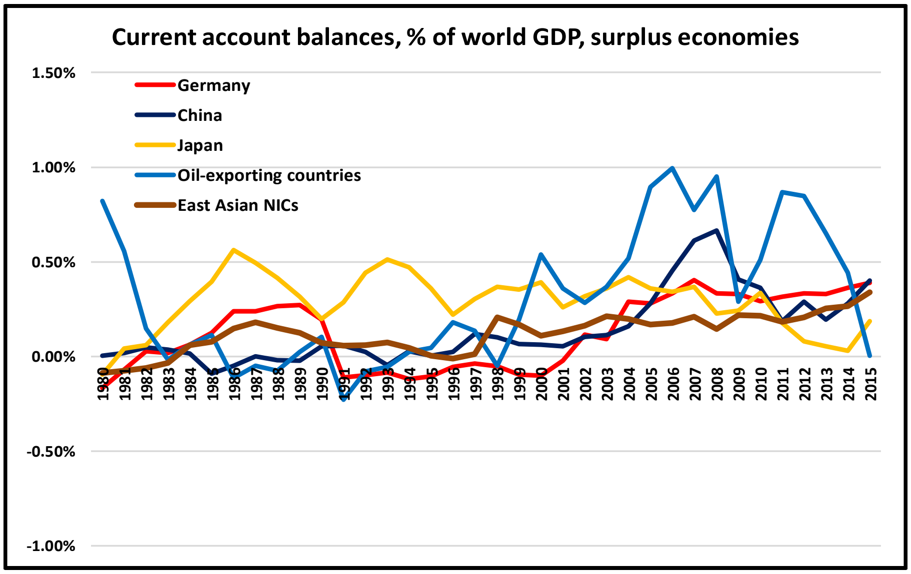


INTERNATIONAL MACROECONOMIC COOPERATION AND THE EXCHANGE RATE NON-SYSTEM

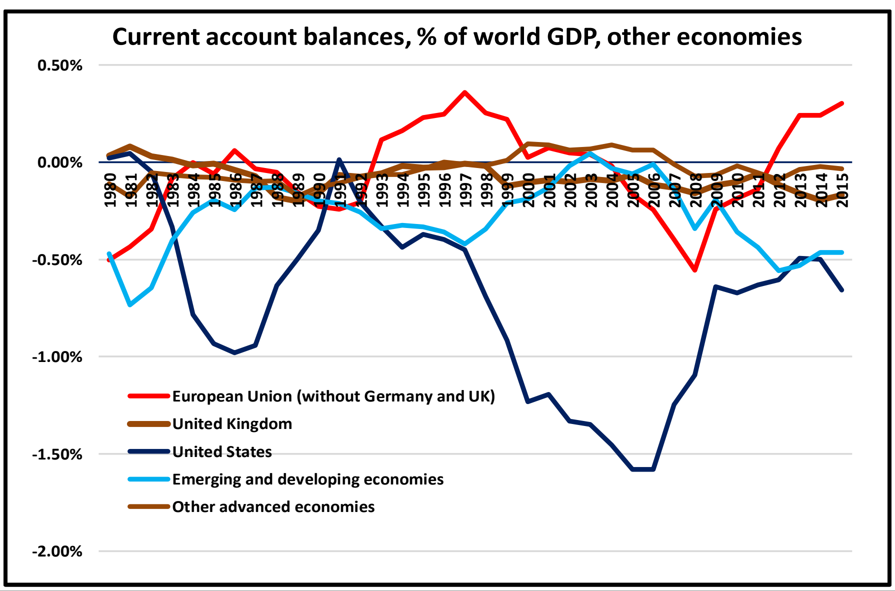
MACROECONOMIC POLICY COOPERATION

- IMF was created to “promote international monetary cooperation”, but most cooperation takes places 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.

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” –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

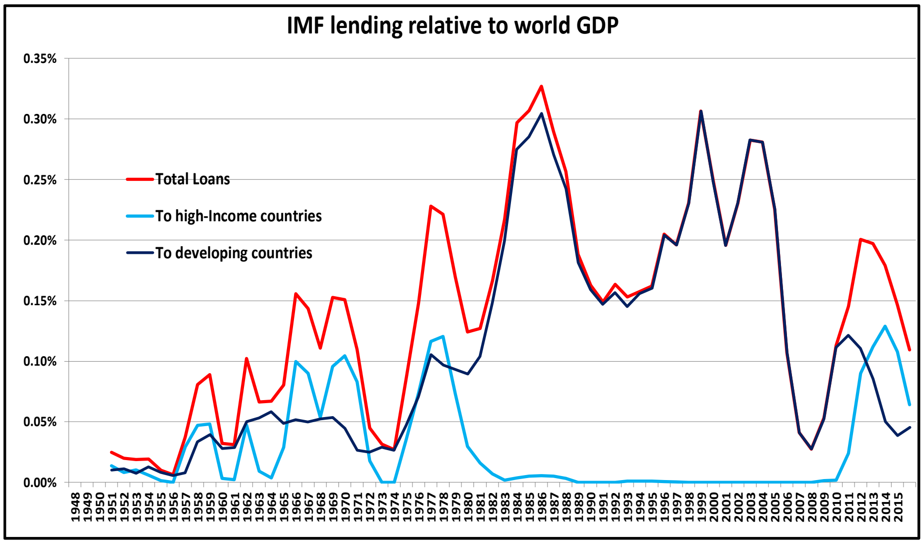
AN UNSETTLED ISSUE IN CRISIS PREVENTION: THE ROLE OF CAPITAL ACCOUNT REGULATIONS

- 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.

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). 2015: principles on debt restructuring agreed in the UN General Assembly.
- ❖ 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

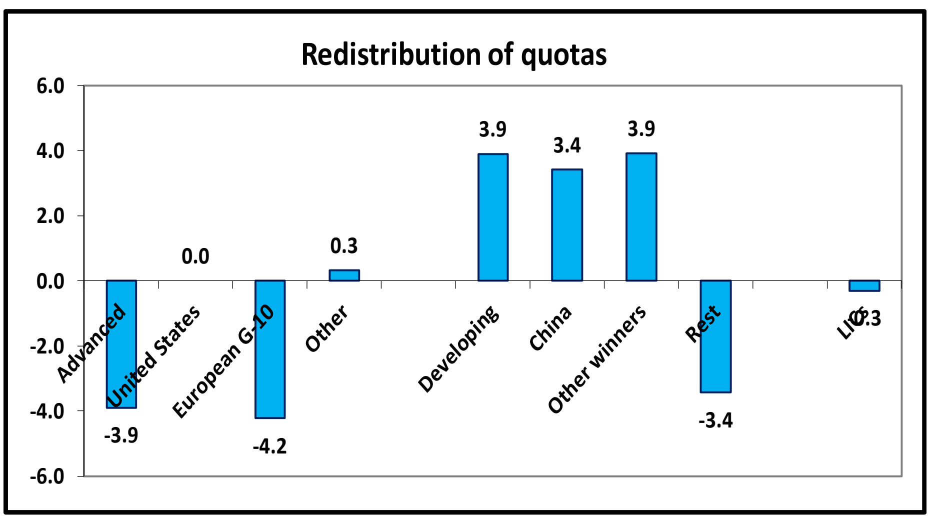
GOVERNANCE: THREE COMPLEMENTARY REFORMS

- “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

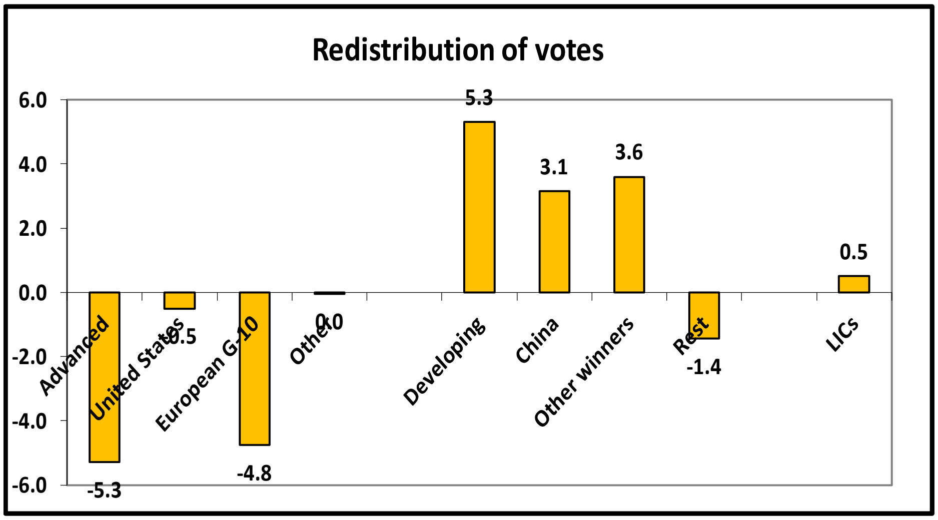
REFORMING THE BRETTON WOODS INSTITUTIONS

- 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



THE IMF VOICE REFORM: SLIGHTLY MORE AMBITIOUS



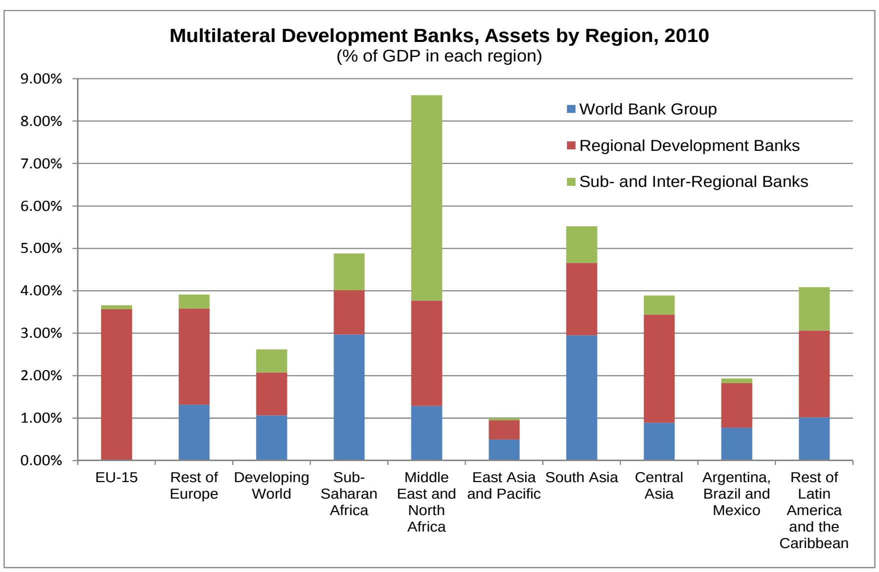
THE APEX INSTITUTION

- "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).

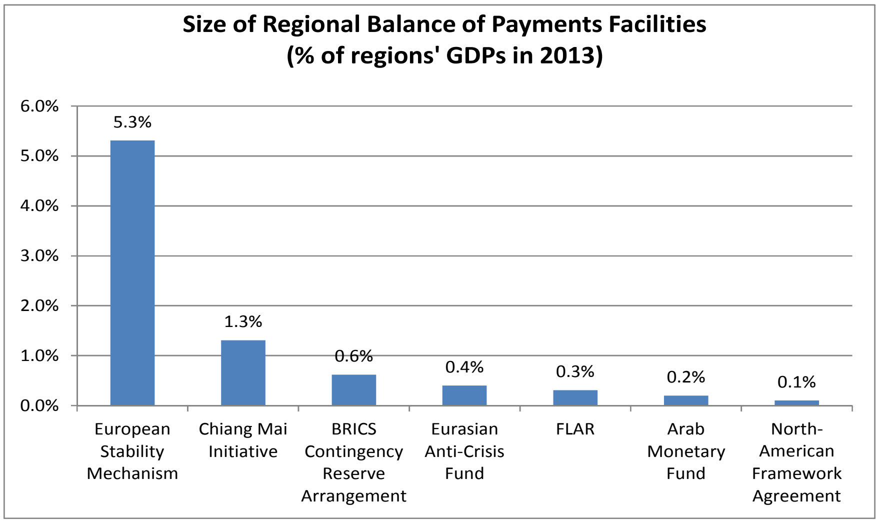
A MULTI-LAYERED ARCHITECTURE

- 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



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