

WIDER

Annual  
Lecture

14



UNITED NATIONS  
UNIVERSITY

**UNU-WIDER**

World Institute for Development  
Economics Research

[www.wider.unu.edu](http://www.wider.unu.edu)

9 Dec 2010, 10:00-12:30

ECOSOC Chamber  
TEMPORARY NORTH LAWN BUILDING  
UN HEADQUARTERS, NEW YORK, USA

# Reforming the International Monetary and Financial Architecture

“Amidst still unsettled financial times, international monetary and financial system reforms are at the center of global debates. My lecture looks at the reform agenda from developing countries’ perspective. Global governance must design a system that not only provides the global public goods necessary to guarantee global macroeconomic financial stability and balanced growth, but also corrects asymmetries that developing countries face under the current architecture.”

– José A. Ocampo, Annual Lecturer 14

# **REFORMING THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM**

**WIDER Annual Lecture 14  
December 9<sup>th</sup>, 2010**

**José Antonio Ocampo  
Columbia University**

# THE CONTEXT

# THE CONTEXT

- ❖ The current crisis has shown how dysfunctional the current international monetary and financial architecture is to manage today's global economy.
- ❖ There is, therefore, a need for deep reform.
- ❖ There was a similar perception after the Asian crisis, but little was done.
- ❖ Now, there is an opportunity, as industrial countries are at the center of the storm
- ❖ The current agenda is partial, but it has gradually broadened as new phases of the crisis reveal need for additional reform

# TWO ESSENTIAL OBJECTIVES

- ❖ **Macroeconomic stability**: coherence of policies that are designed at the national level (regional in the case of monetary policy in the euro area), and adequate supply of liquidity at the international level, particularly during crises.
- ❖ **Financial stability**: coherent financial regulation worldwide [an issue that only became important since the 1970s], and debt workout mechanisms [still not fully recognized]

# THE EVOLVING CRISIS AND THE REFORM AGENDA

- ❖ The initial phase: financial meltdown
  - ✓ Macroeconomic policy coordination under the G-20
  - ✓ Re-regulating finance: Financial Stability Board (FSB) and Basel Committee
  - ✓ Issuance of SDRs and additional financing through IMF and development banks.
- ❖ Unbalanced recovery and the “currency wars”:
  - ✓ Need to correct current account imbalances
  - ✓ Growing use of regulation of capital flows
- ❖ Crisis in the European periphery:
  - ✓ Crucial role of regional arrangements
  - ✓ Need for mechanisms to manage over-indebtedness
- ❖ Global monetary reform:
  - ✓ Proposals by China and the Stiglitz Commission
  - ✓ Included in the 2011 G-20 agenda

# THE ORIGINAL ARRANGEMENTS (1)

- ❖ The debate leading to Bretton Woods:
  - John M. Keynes: International clearing union, to rebalance adjustment pressure between surplus and deficit countries
  - Harry Dexter White: this is unacceptable to the major surplus country (the US), as it would imply unlimited financing of European deficits.
  - Consensus: limited IMF lending but agreement to use capital controls, and “scarce currency clause”
- ❖ Basic conception (“embedded liberalism”): “policy space” for each country to pursue full employment through domestic policies.



# THE ORIGINAL ARRANGEMENTS (2)

- ❖ 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 practice
- ❖ Monitoring of member countries’ policies (Article IV consultations), but no real macroeconomic policy coordination.



# THE POST-1971 ARRANGEMENTS

- ❖ Global reserve system essentially based on an inconvertible (fiduciary) dollar.
- ❖ Countries can choose their exchange rate regime, so long as they avoid “manipulation”.
- ❖ A significant degree of capital account liberalization.
- ❖ Official balance of payments: increasingly small relative to magnitude of crises + increasing conditionality
- ❖ Limited macroeconomic policy coordination, but outside the IMF (G-7, now G-20).

# “ELITE MULTILATERALISM” TO MANAGE MACROECONOMIC IMBALANCES

- ❖ “Dollar shortage”: Marshall Plan + European Payments Union. Europe returns to current account convertibility in 1958, but eliminates capital controls only in 1990.
- ❖ Collapse of the dual gold-dollar system: 1971 “Smithsonian Agreement” among G-10 to allow for flexible exchange rates.
- ❖ New global imbalances of the 1980s: Plaza Accord 1985, Louvre 1987.
- ❖ Europe: attempt to maintain some exchange rate flexibility (the “snake”, the European Monetary System, the euro in Dec. 1995 after the 1992 crisis, finally launched in 1999).

# GLOBAL FINANCIAL STABILITY

- ❖ Reconstruction of the global financial system: euro-dollar (euro-currency) market in the 1960s.
- ❖ Basel Committee created in 1974 by G-10.
- ❖ Basic issue: leveling the playing field in financial regulation.
  - 1988 capital adequacy requirements: 8% of risk-weighted assets + supervision + disclosure.
  - 1997: Core principles of banking supervision.
  - Basel II: self-regulation at the center, strongly criticized.
- ❖ Asian crisis: stronger regulation in the periphery + Financial Stability Forum created by G-7.
- ❖ Current crisis: Financial Stability Board + Basel III

**THE AGENDA:  
COMPREHENSIVE YET  
EVOLUTIONARY REFORM**

# THE FIVE ESSENTIAL ELEMENTS OF A DESIRABLE ARCHITECTURE

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

# THE IMF SHOULD BE AT THE CENTER OF GLOBAL MACROECONOMIC POLICY

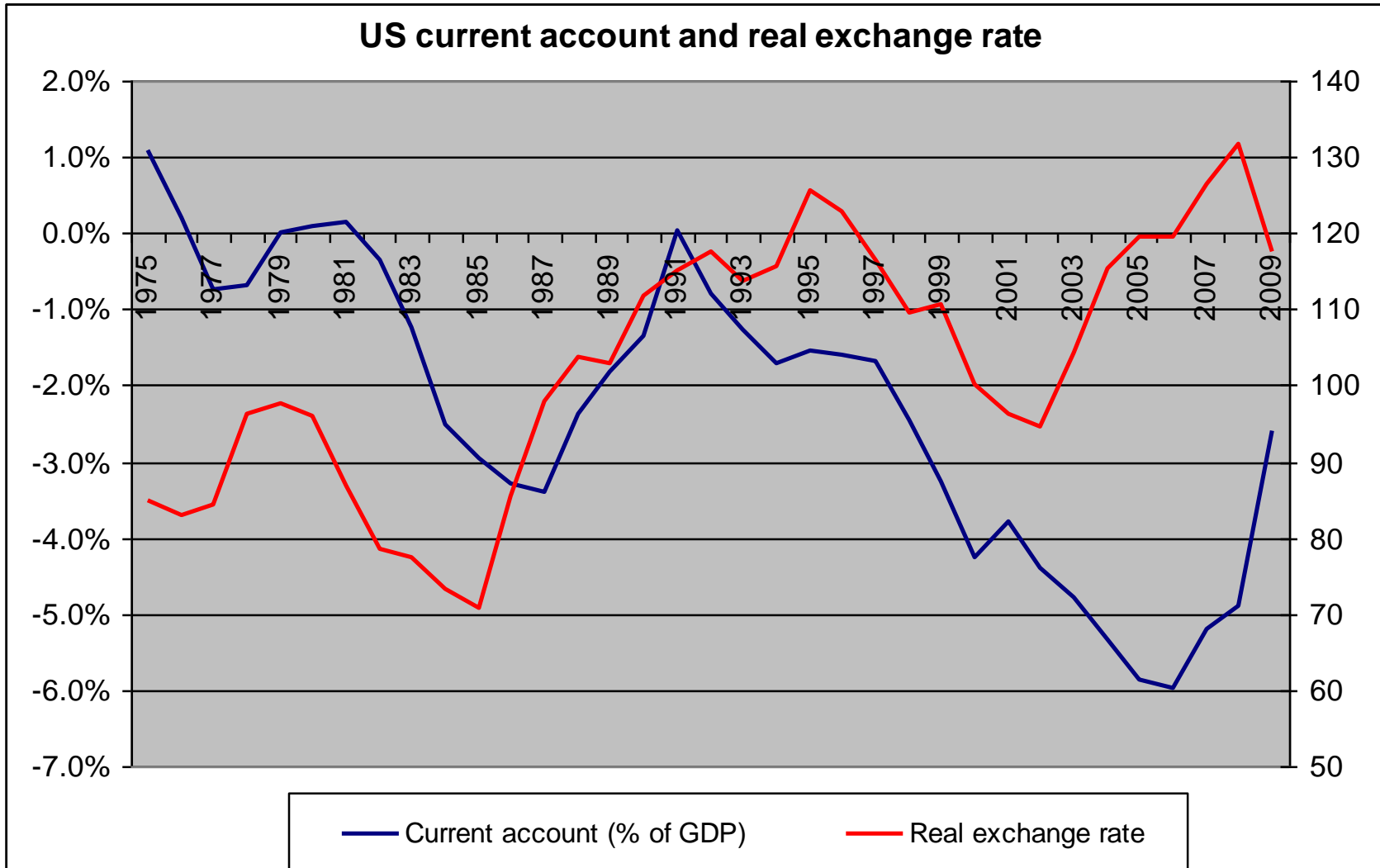
- ❖ The best precedent: the debate and adoption of SDRs in the 1960s.
- ❖ 2006: Multilateral surveillance of global imbalances.
- ❖ 2009: IMF assists the country-led, consultative Mutual Assessment Process of the G-20...
- ❖ ... and broader revival of the IMF:
  - ✓ Return of industrial country borrowing and less conditionality.
  - ✓ 2009 issuance of SDRs for \$283b and bilateral lines.
  - ✓ 2010: doubling of quotas.
- ❖ “Elite multilateralism” must be replaced by IMF-centered macroeconomic policy consultation.

# THE GLOBAL RESERVE SYSTEM: The problems

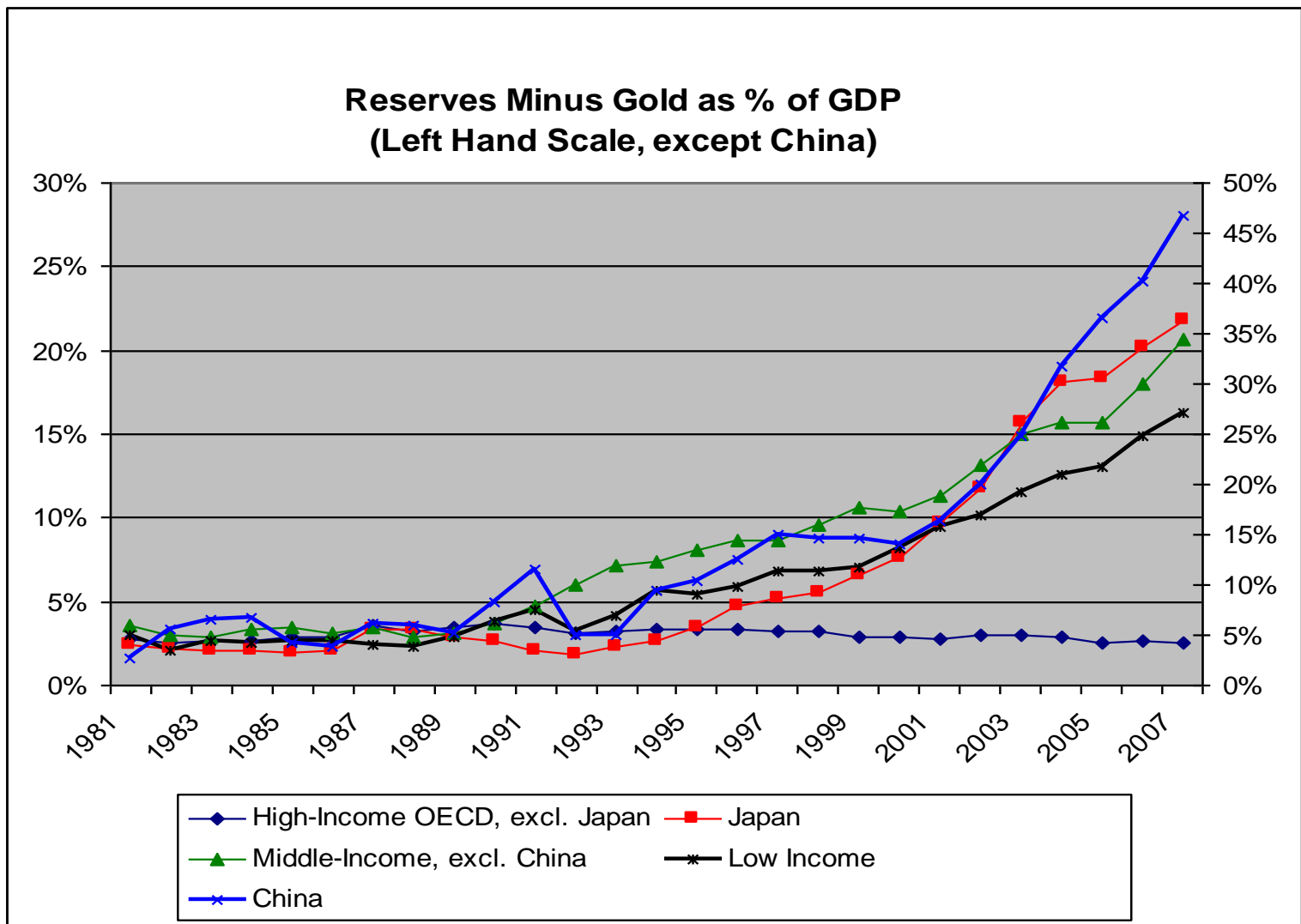
1. **Anti-Keynesian bias**: burden of adjustment falls on deficit countries.
2. **Triffin dilemma**: problems associated with the use of national currency as international currency (can generate inflationary and deflationary biases).
3. **Growing inequities** associated with demand for reserves by developing countries (self-protection) + fallacy of composition effect (**instability-inequity link**)



# GROWING DEFICITS AND INSTABILITY OF THE VALUE OF THE DOLLAR



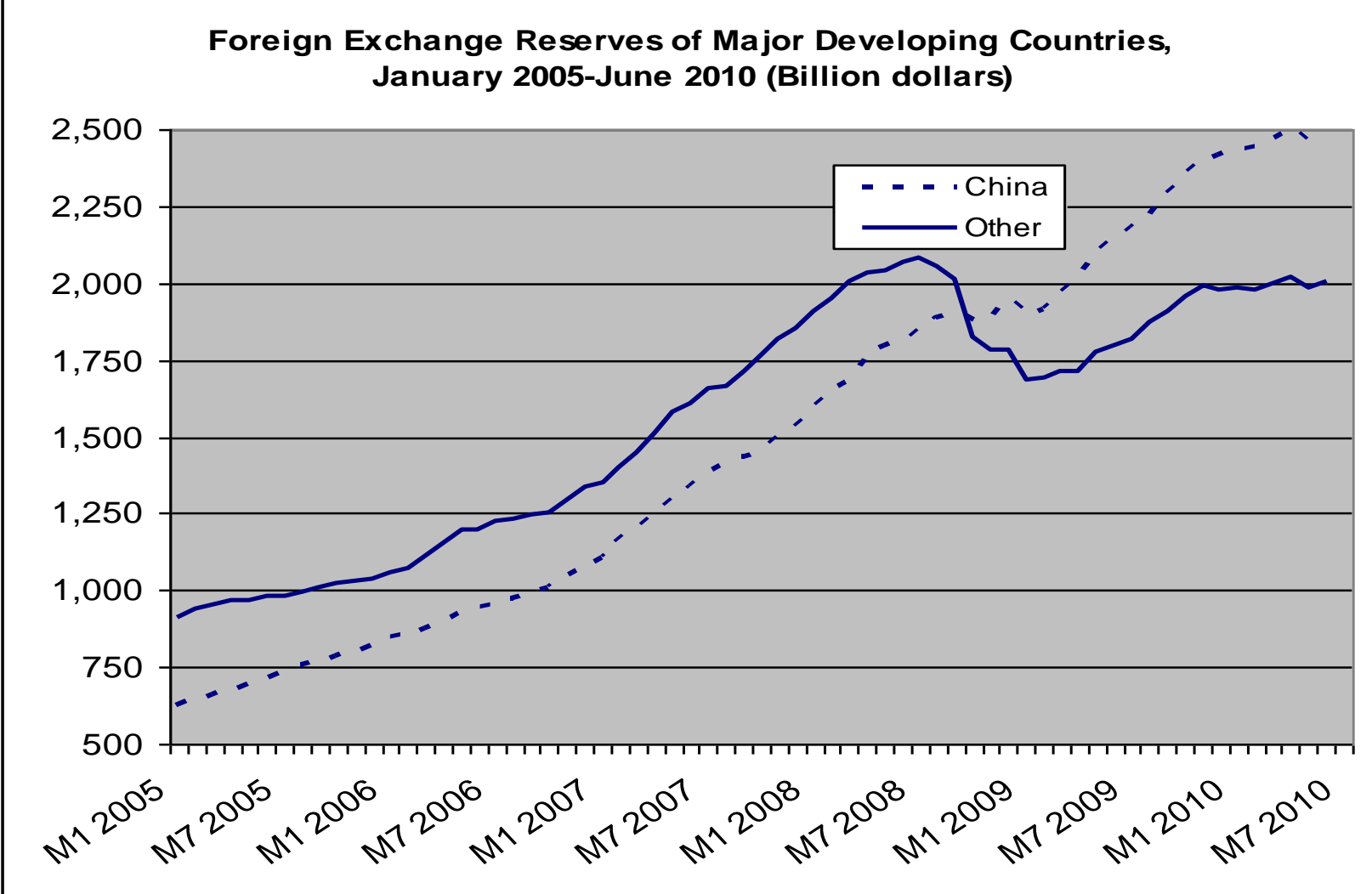
# GROWING DEMAND FOR FOREIGN EXCHANGE RESERVES BY DEVELOPING COUNTRIES



# THE WORLD DEMAND FOR RESERVES SKYROCKETED AFTER THE ASIAN CRISIS

Accumulation of Foreign Exchange Reserves				
Million dollars				
	1982-90	1991-97	1998-02	2003-07
High income: OECD	42,805	30,889	59,358	140,715
Japan	5,588	20,164	48,307	98,320
Others	37,217	10,725	11,051	42,395
High income: non OECD		21,833	28,554	69,822
Middle income	6,734	56,950	63,739	548,444
China	2,725	16,168	29,673	247,831
Excluding China	4,009	40,782	34,066	300,613
Low income	212	1,952	3,654	17,938
World	59,946	111,624	155,305	776,919
Excluding China and Japan	51,633	75,292	77,325	430,768

# THE RECENT RETURN OF RESERVE ACCUMULATION



# THE GLOBAL RESERVE SYSTEM:

## Two alternative routes

### ❖ Multi-currency standard

- ✓ Would not be unstable as past systems of its kind
- ✓ 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

# THE GLOBAL RESERVE SYSTEM: Development issues

## Three alternatives

- Asymmetric issue of SDRs (taking into account the demand for reserves)
- “Development link” in SDR allocation
- Encourage regional reserve funds, making contribution to the funds equivalent to IMF quotas for SDR allocations.

# ATTRACTIVENESS OF THE SDRs SYSTEM FOR THE US

- The US would be able to maintain its current expansionary policy with reduced need to take into account global repercussions
- Less leakages from its stimulus.
- The US dollar would still be used as the main world currency for transaction purposes ...
- ... though the system can also evolve into a broader use of the SDRs

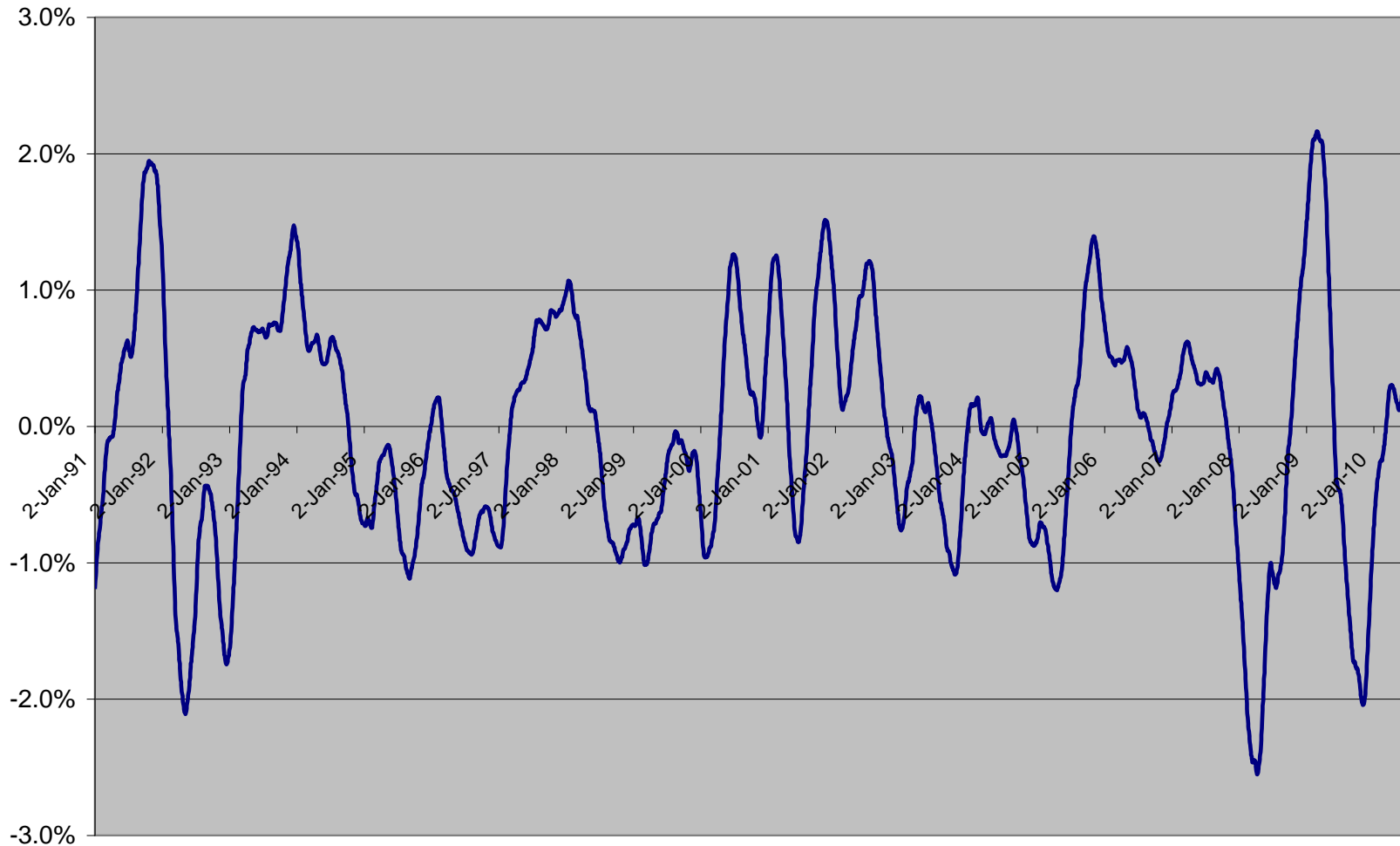


# THE EXCHANGE RATE SYSTEM

- 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
  - ✓ “Target zones” or “reference rates” to avoid excessive exchange rate volatility.

# EXCHANGE RATE INSTABILITY: THE DOLLAR-EURO EXCHANGE RATE

Average deviation of euro/dollar exchange rate from 12 months average



# CAPITAL ACCOUNT REGULATIONS

- Regulation of cross-border capital flows is an essential ingredient of global financial regulation, but has been missing so far.
- A possibly approach: build on “good practices”
  - ✓ Reserve requirements on capital inflows.
  - ✓ Minimum stay periods.
  - ✓ Eliminating or regulating currency mismatches.
- Possible spillovers: a global approach may be preferable...
- ... and may be essential to manage the asymmetric monetary policies that the world requires today

# EMERGENCY BALANCE OF PAYMENTS FINANCING

- Supplemental Reserve Facility in 1997.
- Contingency credit line in 1999, eliminated in 2003.
- Major reforms of 2009 and 2010:
  - ✓ Doubling existing facilities.
  - ✓ Contingency credit lines: Flexible Credit Line and Precautionary Credit Line.
  - ✓ Flexible framework of lending to low-income countries
  - ✓ No structural benchmarks.
- Major problems that remain:
  - ✓ Stigma associated with IMF borrowing: need for a totally unconditional credit line.
  - ✓ Using SDRs as the major mechanism of financing.

# THE UNSETTLED ISSUE OF DEBT RESOLUTION MECHANISMS

- 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.
- Need for comprehensive debt mediation and arbitration.
- Best try: IMF proposal for an SDRM (Sovereign Debt Restructuring). New proposals for Europe.
- Possible use of a WTO-type panel system in the framework of the IMF.

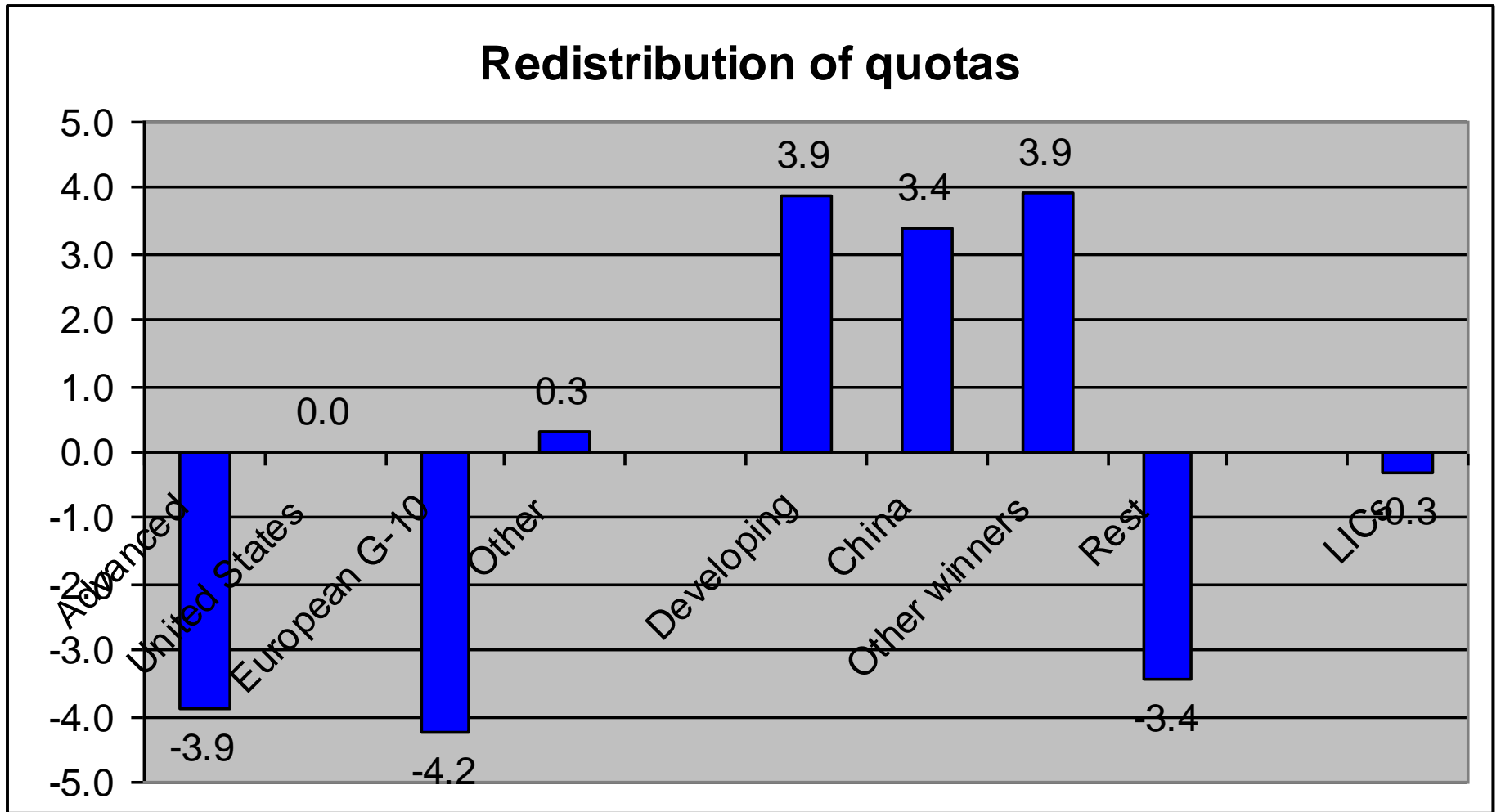
**GOVERNANCE STRUCTURES:  
BUILDING AN INCLUSIVE  
ARCHITECTURE**

# REFORMING THE BRETTON WOODS INSTITUTIONS

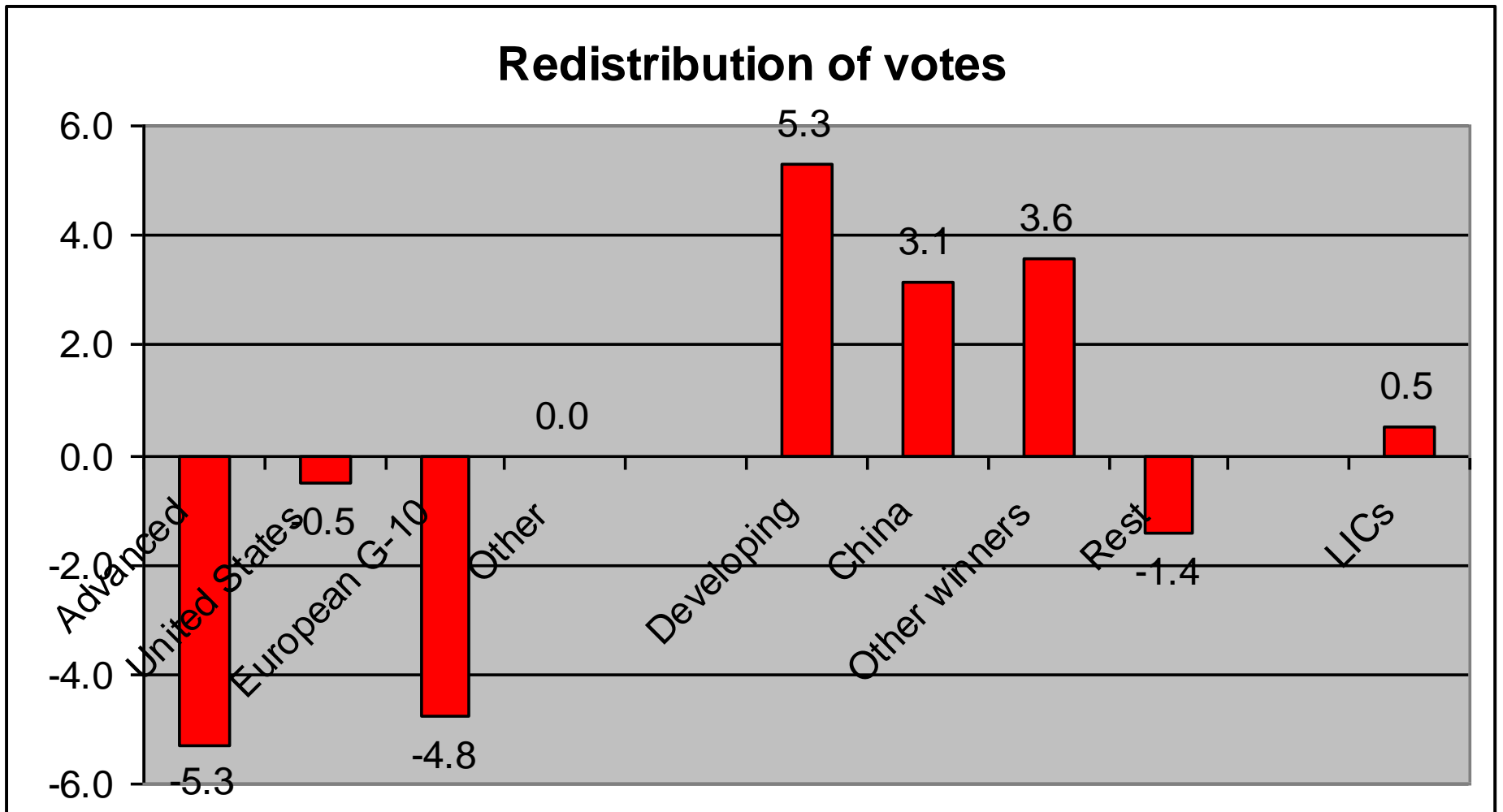
- ❖ The basic issue raised by the Monterrey Consensus: voice and participation of developing countries in international economic decision making.
- ❖ Quotas and voting power:
  - ✓ Over-representation of Europe, under-representation of Asia.
  - ✓ All seats must be elected.
- ❖ Other institutional issues:
  - ✓ 85% majority rule in the IMF.
  - ✓ 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 BASIC INSTITUTIONAL ISSUE

- ❖ “Elite multilateralism” (the G-20): advantages and concerns:
  - ✓ Advance over the G-7/8
  - ✓ But it is a self-appointed, ad-hoc body, with problems of representation and legitimacy.
  - ✓ Awkward relation with existing broad-based multilateral institutions.
  - ✓ Totally “elite” in Financial Stability Board.
- ❖ Desirable evolution towards a decision making body of the UN *system*, based on constituencies.
- ❖ The UN as a center of analysis, and as a forum for dialogue and consensus: the 2002 Monterrey Consensus, the June 2009 Conference on the crisis, but raise the profile of these processes.

# 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 provision 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.

# CONCLUSIONS

# CONCLUSIONS

- ❖ Comprehensive yet evolutionary reform:
  - ✓ An IMF-centered macroeconomic policy consultation/coordination.
  - ✓ An SDR-based global reserve system.
  - ✓ Rebuilding the exchange rate system.
  - ✓ Broader use of capital account regulations.
  - ✓ An international debt workout mechanism
- ❖ An inclusive architecture:
  - ✓ Reform of the Bretton Woods institutions
  - ✓ From “elite multilateralism” to a UN-system organization.
  - ✓ A multilayered architecture with active participation of regional institutions

# **REFORMING THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM**

**WIDER Annual Lecture 14  
December 9<sup>th</sup>, 2010**

**José Antonio Ocampo  
Columbia University**

WIDER

Annual  
Lecture

14



UNITED NATIONS  
UNIVERSITY

**UNU-WIDER**

World Institute for Development  
Economics Research

[www.wider.unu.edu](http://www.wider.unu.edu)

9 Dec 2010, 10:00-12:30

ECOSOC Chamber  
TEMPORARY NORTH LAWN BUILDING  
UN HEADQUARTERS, NEW YORK, USA

# Reforming the International Monetary and Financial Architecture

“Amidst still unsettled financial times, international monetary and financial system reforms are at the center of global debates. My lecture looks at the reform agenda from developing countries’ perspective. Global governance must design a system that not only provides the global public goods necessary to guarantee global macroeconomic financial stability and balanced growth, but also corrects asymmetries that developing countries face under the current architecture.”

– José A. Ocampo, Annual Lecturer 14