United Nations University
World Institute for Development Economics Research
(UNU-WIDER)

WIDER Annual Lecture 14

Reforming the International Monetary System

José Antonio Ocampo

UNU-WIDER gratefully acknowledges the support of the Finnish Ministry for Foreign Affairs to the WIDER Annual Lecture 14 and the financial contributions to the research programme by the governments of Denmark (Royal Ministry of Foreign Affairs), Finland (Ministry for Foreign Affairs), Sweden (Swedish International Development Cooperation Agency—Sida), and the United Kingdom (Department for International Development).

UNU World Institute for Development Economics Research (UNU-WIDER)

A research and training centre of the United Nations University

The Board of UNU-WIDER
Ernest Aryeetey
Anne Case
Roberto Frenkel
Martti Hetemäki
Ravi Kanbur
Elisabeth Sadoulet

Ex officio
Konrad Osterwalder, Rector of UNU
Finn Tarp, Director of UNU-WIDER

The World Institute for Development Economics Research (WIDER) was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

CONTENTS

Foreword

Author's acknowledgements

FOREWORD

The unsettling years since 2007 have shown how unfit for the purpose the current international monetary and financial system is. On 9 December 2010, Professor José Antonio Ocampo delivered the 14th WIDER Annual Lecture at the UN headquarters in New York, formulating global recommendations for a serious overhaul of the struggling international system. During the lecture he approached the reform agenda from the perspective of developing countries—elaborating that global governance must design a system that not only provides the global public goods necessary to guarantee macroeconomic financial stability and balanced growth but, crucially, one that also corrects the many asymmetries that developing countries face under the current dysfunctional architecture.

The WIDER Annual Lecture is delivered by an eminent scholar who has made significant contributions in the field of economics of

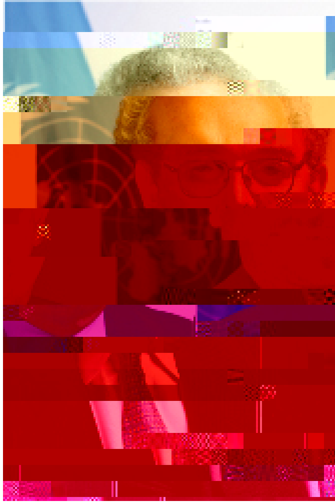
AUTHOR'S ACKNOWLEDGEMENTS

It was an honour to deliver the 14th Annual WIDER Lecture at the United Nations Headquarters in New York on 9th December 2010. I have been associated with UNU-WIDER since its early days, participating initially in projects led by Gerry Helleiner and Lance Taylor, and at a conference in honour of my great professor, Carlos Díaz-Alejandro. I have had since the opportunity to work with UNU-WIDER as both a researcher and a UN official.

This lecture borrows from my work on these issues over many years, both at the UN and at Columbia University. It also benefited greatly by the debates that took place in the 2009 Commission of Experts of the UN General Assembly on Reforms of the International Monetary and Financial System, of which the author was a member. I am grateful to the Ford Foundation for supporting my work on this topic at Columbia University, as well as to many persons with whom I have debated the issues covered in this Lecture in recent years, and from whom I have learnt considerably, including Yilmaz Akyüz, Amar Bhattacharya, Kemal Dervi , Barry Eichengreen, Roberto Frenkel, Kevin Gallagher, Stephany Griffith-Jones, Eric Helleiner, Jomo K.S, Peter Kenen, Jan Kregel, Isabelle Mateos y Lagos, Joseph E. Stiglitz, Lance Taylor, and John Williamson. Some of them also provided comments to previous drafts of this lectures but do not necessarily agree with my points of view. For reasons of space, some topics are, unfortunately, only dealt with in passing.

José Antonio Ocampo
Columbia University, New York

ABOUT THE AUTHOR



José Antonio Ocampo is Professor and Director of the Economic and Political Development Program at the School of International and Public Affairs and Fellow of the Committee on Global Thought at Columbia University. He holds a BA in Economics and Sociology from the University of Notre Dame (1972), and a PhD in Economics from Yale University (1976). He has received a number of personal honours and distinctions, including the 2008 Leontief Prize for Advancing the Frontiers of Economic Thought and the 1988 Alejandro Angel Escobar National Science Award of Colombia. In 2009, he was a Member of the Commission of Experts of the UN General Assembly on Reforms of the International Monetary and Financial System. In 2008-2010, he was co-director of the UNDP/OAS Project on 'Agenda for a Citizens' Democracy in Latin America'.

From 2003 to 2007 he served as the United Nations Under-Secretary-General for Economic and Social Affairs and, prior to that, as Executive Secretary of the UN C

1 The context

The recent global financial crisis showed how dysfunctional the current international monetary and financial architecture is for managing today's global economy. Calls for and steps taken to reform such architecture are, therefore, welcome. Similar calls for reform were made after the Asian, Russian, and Latin American crises of the late twentieth century,[1] but they led to at best marginal reforms. The fact that this time industrial countries have been at the centre of the storm has led to a broader set of initiatives.

The financial meltdown unleashed by the crisis in the market for subprime mortgage-backed securities in the USA in August 2007 and, particularly, by the collapse of Lehman Brothers in September 2008, made clear that there was significant deficit in the regulation and supervision of financial activities. European banking also suffered major problems associated with investments in high-risk assets issued in the USA, real estate euphoria in a number of countries, and the lending booms in several Central and Eastern European countries, among other factors.

These developments indicate that four central elements of global monetary system—the global reserve and exchange rate systems, capital account regulations, and emergency balance of payments financing—are closely interlinked. This is reflected, first of all, in the fact that countries can adjust to variations in external shocks, particularly those coming through the capital accounts, through a mix of four mechanisms: (first) absorbing such shocks through changes in foreign exchange reserves, (second) letting their exchange rates move, (third) controlling capital inflows or outflows, and (fourth) receiving IMF financing. The linkages between the four elements were also reflected in the way the post-war monetary system was designed at Bretton Woods, which included a dual gold-dollar standard, together with the principle that exchange rates would be fixed but could be adjusted in the face of fundamental balance of payments disequilibria, the capacity of countries to resort at any time to regulate capital flows, and limited IMF balance of payments financing.

during the current crisis. The second gap is the lack of a regular institutional framework to manage debt overhangs at the international level.

2 The need for a comprehensive yet evolutionary reform

The dynamics of the crisis has thus brought into the debate an increasing number of ingredients of global monetary and financial reform, most of which had been off the agenda during previous periods of turbulence. This represents an opportunity to undertake the difficult task of negotiating a comprehensive reform. What makes it viable is that many of the elements of reform can evolve out of some existing arrangements, as has been happening already with the issuance of SDRs, new IMF credit lines, new Basel Committee guidelines, etc. The G-20 and its associated bodies have made advances in other areas, including new mechanisms of macroeconomic policy co-ordination upon which the international community can build. So, advances underway create the real possibility of comprehensive yet evolutionary reform.

Reform should have two major objectives: global macroeconomic and financial stability. The first must respond to the fact that the system is fundamentally an *international* one, formed therefore on the basis of different *national* monetary systems (regional in the euro area and some other cases), using their own national fiduciary currencies, and under authorities that obviously determine their policies based on their own national (or regional) priorities. The challenge is how to make that system consistent with a reasonable level of *global* macroeconomic stability, thus avoiding both expansionary and recessionary biases and thus shanonal co,lc9(e other erlusThe s cyclBase otece. Th)6(ee,-186[h3.00

function that central banks perform at the national levels as lenders of last resort. Since emergency financing is only a good alternative when payment difficulties are associated with liquidity problems, the latter objective closely interacts with a sixth, which, as noticed, may be seen more as either a financial or monetary tool; (vi) creating adequate debt workout mechanisms at an international level to manage problems of over-indebtedness.[2]

In the following sections, we will briefly deal with these objectives and how they interact with each other. Section 3 will analyse the global reserve system. Section 4 will discuss the interlinked issues of monetary co-operation and the exchange rate system. Section 5 will then tackle capital account regulation. Section 6 will focus the interlinked issues of emergency financing and debt workouts. This will be followed by a discussion of the institutional design. The study ends with some short conclusions.

3 The global reserve system

As already noticed, the current global reserve system evolved out of the unilateral 1971 decision of the USA to abandon the gold-dollar parity and convertibility of dollars for gold for governments and central banks established at Bretton Woods, thus evolving into a system characterized as essentially based on a fiduciary US dollars. Although other currencies can compete with the US dollar as international means of payments and potential foreign exchange reserve assets, this competition has been weak due to the 'network externalities' in the use of currencies and the fact that the USA has by far the largest market for liquid treasury securities. Over the last decade, more than 80 per cent of foreign exchange transactions have been made in US dollars and about two-thirds of foreign exchange reserves have been held in that currency. The other feature is that alternative reserve currencies float against each other—an issue that links to the debate on the exchange rate system.

This system can be characterized as facing three distinct problems, which in fact may be said to have arisen in a historical sequence (Ocampo 2010a, 2010b). The first is the problem that Keynes (1942-43) emphasized in his proposals for a global monetary system in the years leading to the Bretton Woods agreement, and that, as he pointed out, was also a feature of all international monetary systems that we have known: the asymmetric adjustment pressures that it imposes on deficit versus surplus countries. As the former are forced to adjust, whereas the latter are not, this creates a clear recessionary pressure on the world economy. This problem is, of course, felt with particular severity during global recessions, when deficit financing dries out. This problem may be called the 'anti-Keynesian bias' of the system.

The second problem is that generated by use of a national currency, the US dollar, as the major international currency. It was formulated in the 1960s by the Belgian economist Robert Triffin (1961, 1968) and thus came to be known as the 'Triffin dilemma'. The essential issue is that provision of international liquidity requires the reserve issuing

[2] This agenda coincides in part with that suggested by the IMF (2011b), which includes strengthening of macroeconomic policy collaboration, monitoring and management of capital flows, improving the global financial safety net, and strengthening the system through financial deepening and reserve and asset diversification.

country (or countries) to run a balance of payments deficit(s), either in the current or the capital account. In the

This implies, of course, that efforts to reform quota allocations must continue. These inequities can also be partially corrected with either one or a mix of three types of reforms

The reform could also include more currencies into the SDR basket (notably the renminbi) and could allow the broader use of SDRs in private transactions, as some

agreement of April 2009 to undertake common efforts at fiscal expansion is another case, but it soon broke down leading rather to diverging fiscal policies. Indeed, common action among major economies to adopt expansionary fiscal and monetary policies at the beginning of the global financial crisis is perhaps the best example in history of macroeconomic co-operation, but even in this case it failed to deal with exchange rate issues and lasted only a short time period.

In turn, the best case of a global macroeconomic issue that was dealt with within a multilateral institution (the IMF) was the creation of the SDRs in the 1960s. The multilateral consultations on global imbalances launched by the Fund in 2006, with the participation of the USA, the euro area, Japan, China, and Saudi Arabia, was an interesting initiative, but it lacked binding commitment by the parties and a clear accountability mechanism, and thus soon turned insubstantial. The IMF more recently created a new mechanism of surveillance that can have multilateral implications, under the name of 'spillover reports'. In a different context, the Monterrey Consensus, approved by the United Nations International Conference on Financing for Development, held in 2002 (United Nations 2002), constitutes perhaps the best agreed document on global financial co-operation, but it has lacked clear follow-up and accountability mechanisms. The same can be said about the outcome document at the 2009 United Nations on the World Financial and Economic Crisis (United Nations 2009a).

Macroeconomic policy co-operation has to deal with major spillovers that national decisions have on other countries. An optimal framework should involve all major macroeconomic policies, but there is no example of this type of co-operation so far in history. As we have seen, several agreements have dealt in the past with exchange rates and co-ordinated monetary expansion, typically during financial crises or critical conjunctures. The rarest has been fiscal co-operation. Furthermore, in a system that continues to be essentially international (only partly supranational in the case of the European Union), it is unclear how much international rules should limit national democratic decision making processes which are at the centre of fiscal policies. This fact, together with different perspectives on monetary policies—particularly, the tendency of the US Federal Reserve to have a clearer counter-cyclical focus in its actions relative to the European Central Bank—is why some level of exchange rate flexibility is essential to adjust for different national (regional) decisions.

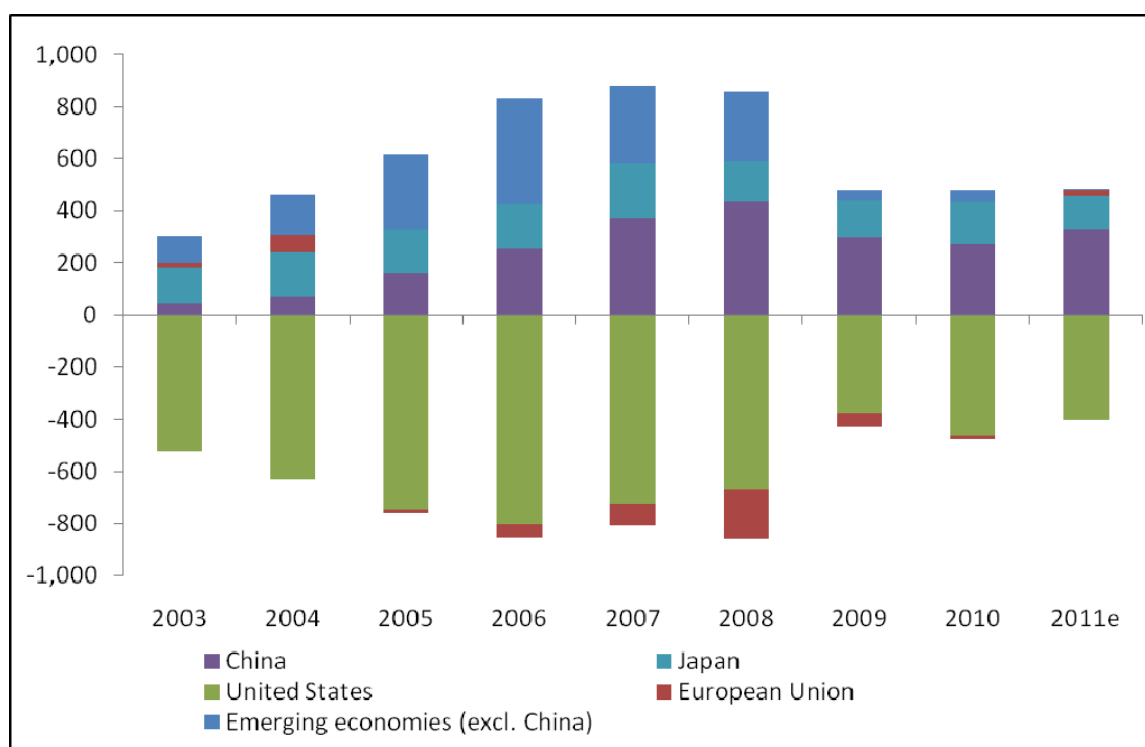
Because of this, and the fact that since its creation it was agreed that the IMF should focus its attention on exchange rates,[9] this is perhaps the area in which the international community should look for better forms of co-operation. This is important not only for exchange rates as such, which of course can generate major externalities, but more importantly because exchange rate movements reflect divergence in other macroeconomic policies, as pointed out in the previous paragraph. The 2010 debate on the 'currency wars' was, for example, associated with the effects that monetary expansion in the USA was having on capital flows towards emerging economies.

The major problem in this regard is, as already noticed, that the system that evolved since the breakdown of the original Bretton Woods arrangement is in fact a non-system, as all

[9] It is interesting to remember in this regard that in its original design this included the principle that modifications of the exchange rate parities should be subject to consultation, a principle that, nonetheless, never worked in practice.

countries are essentially free to choose any exchange rate regime. The only constraint is that, as Article IV of the IMF Agreement reads, countries should ‘avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members’. This is also stated in the June 2007 decision on bilateral surveillance. However, both the IMF and the G-20 have failed to determine so far what ‘manipulation’ means. Beyond that, it can be said that an even more important problem of the exchange rate (non)system is that it may distort trade flows and is dysfunctional in terms of correcting global payments imbalances. Thus, it can be said that it has failed to meet the objective set in the first IMF Article of Agreement: ‘to facilitate the expansion and balanced growth of international trade’. A major paradox of the current system is, indeed, that there is no mechanism linking world trade and exchange rate rules. Countries spend years negotiating trade rules, but exchange rate variations can have within days (or even hours) more effects on trade than those painstaking deals.[10] On top of that, exchange rate movements are essentially determined by financial flows, which may also have strong effects on trade patterns, as the long literature on the ‘Dutch disease’ indicates.

FIGURE 3
CURRENT ACCOUNT DEFICIT (BILLION DOLLARS)



Source: International Monetary Fund, World Economic Outlook Database, 2010-12.

It can be said that the current exchange rate (non)system has also failed to meet two additional objectives set in the first IMF Article of Agreement: to ‘lessen the degree of disequilibrium in the international balance of payments’, and ‘to promote exchange stability’. The issue of global payments imbalances is illustrated in Figure 3. These

10 This does not mean, however, that exchange rate issues should be brought into WTO dispute settlement, as suggested by Matoo and Subramanian (2008), as this may end up weakening one of the few effective mechanisms of the sort at the international level.

collapse; a new depreciation of the dollar during the normalization of financial markets since March 2009 followed by an appreciation during the first semester of 2010 as a result of the series of crises in peripheral Europe; and a new cycle that started in mid 2010 and has probably not finished. It is unclear what purpose the high level of volatility between the world's two most important currencies serves.

The system could therefore be improved by introducing elements that provide some level of stability to exchange rates. Returning to fixed exchange rates among major currencies is, of course, impossible, given the level of capital account flows that characterize today's world economy, and inconvenient, given that different priorities of macroeconomic policies among major countries. The world should rather evolve into a system of reference rates among major currencies, as has been suggested by Williamson (2007), among others. This implies that major countries would follow some form of managed floating—the system which most emerging economies have actually chosen, more as a result of empirical learning than theoretical arguments. Multilaterally agreed parities or bands would be the cornerstone of such a system, and would help give some level of stability to the way markets operate, which in the past have been characterized by extended periods of deviation from equilibrium. Guidelines would indicate that interventions in foreign exchange markets and policies with strong effects on exchange rates would have to support the movement of exchange rates towards the agreed parities or bands (i.e., reinforce depreciation if the currency is perceived to be overvalued and appreciation if it is undervalued). Such rules would also imply an implicit definition of what 'manipulating' the exchange rate means. A country (or region, in the case of the euro) may choose not to intervene, but this would only increase the level of interventions required by other countries to reach equilibrium and may reduce the effectiveness of interventions.

In this framework, the process leading to d

sustainability issues as well as the policy space for expansionary macroeconomic policies. The 'indicative guidelines' chosen by the G-20 for its Mutual Assessment Process include public debts and fiscal deficits, private savings rates and private debt, and current account imbalances debts, also 'taking due consideration of exchange rate, fiscal, monetary, and other policies' (G-20 2011: par. 3). In any case, complexity may not be a good starting point for an incipient process. For that reason, a simple set of indicators may be better. This is why the reference exchange rate proposal is a good idea, or alternatively a focus on current account deficits and global output gaps.

There are also major institutional challenges to building these forms of co-operation. One is the continuity of the co-operation framework. History informs us that there is strong demand for co-operation only during crises, but it is equally essential to have co-operation during periods of prosperity, which many times incubate crises. An additional issue is representativeness, the central topic dealt with in Section 7. For both reasons, it would be better to fulfil the expectation that the IMF should be 'the machinery for consultation and collaboration on international monetary problems'. A basic advantage of the G-7 is, nonetheless, that small groups help build up confidence and thus broader exchange among a small set of relevant policy actors (Dervi 2010a). But this is not in contradiction with the objective of representativeness if the regular and intensive dialogue among the countries that are systemically important is embedded into a global institution. This is precisely what 2006 multilateral consultations on global imbalances launched by the Fund aimed at. This was indeed a better framework, both because it was embedded into the IMF and because it involved in fact a smaller number of relevant actors. This is perhaps why the G-20's MAP should be done within the IMF framework, possibly involving a smaller number of countries.

5 Capital account regulation

'Excessive' exchange rate volatility associated with capital flows points towards an additional leg of international monetary reform: capital account regulations. It is useful in this regard to recall that a major agreement during the recent crisis was that deregulated financial activities can be a source of major macroeconomic disruptions. The G-20 thus led a major effort to re-regulate finance, mainly at national level. However, *cross-border* finance was left almost entirely out of the agenda, as if it did not require any regulation—or indeed as if it was not part of finance. A particular twist of terminology is also involved in discussing this issue: domestic financial regulations are called by that name, but if they involve cross-border flows, they are called 'controls'. We would refer to them by their appropriate name: capital account *regulations*.

The essential problem here is that capital flows, like finance in general, is pro-cyclical. Agents that are perceived to be risky borrowers are subject to the strongest swings in the availability and costs of financing. These riskier agents include small firms and poor households in all domestic markets and emerging markets and, more generally, developing country borrowers in global markets. There is overwhelming evidence that capital flows to developing countries are pro-cyclical and have become one of the major determinants (and perhaps *the* major determinant) of business cycles in emerging economies (Prasad et al. 2003; Ocampo et al. 2008). Furthermore, the cyclical supply of finance is increasingly driven by portfolio decisions in industrial countries which may be entirely delinked from demand for capital by emerging and developing countries. These

countries face further problems: their domestic financial markets are significantly more ‘incomplete’ and are plagued by variable mixes of currency and maturity mismatches, and their capital markets are shallower and small relative to the magnitude of the speculative pressures they face.

It is important to emphasize that the cyclical behaviour that characterizes capital flows goes beyond volatility of short-term flows. Even more important are the *medium-term* cycles in the availability and costs of financing. Since the mid 1970s, we have experienced three full medium-term cycles—from the mid 1970s to the end of the 1980s, from 1990 to 2002, and from 2003 to 2009—and we ar

policies. During booms, they increase the policy space to undertake contractionary monetary policy while reducing exchange rate appreciation pressures. In turn, during crises, they can create some room for expansionary monetary policies. Viewed as a liability policy, capital account regulations recognize the fact that pro-cyclical behaviour and, particularly, reversibility varies significantly according to the nature of capital flows: foreign direct investment is more stable than portfolio and debt flows and, among the latter, short-term debt flows are particularly volatile.

‘speed bumps’[18] rather than permanent restrictions; this implies that further reinforcement may be required to maintain their effectiveness. Third, capital account regulations on inflows help improve debt profiles and thus act as an effective liability policy that reduces external vulnerability. Finally, and perhaps most importantly, regulations are a complement to sound macroeconomic policies, not a substitute for them.

Overall, the evidence is therefore that capital account regulations are a useful and effective complementary instrument of counter-cyclical policy management (IMF 2011a). There is also evidence that countries using regulations on capital inflows fared better during the recent global financial crisis (Ostry et al. 2010), and that the new regulations put in place by some countries since 2010 have been at least partly effective (Gallagher 2011; IMF 2011a).

Debates on this issue since 2010 have emphasized some *global* dimensions of these regulations that must be at the center of attention. The first and essential problem is the asymmetry generated between the strength of several emerging economies and the continuing weakness of most industrial countries. This situation, which is likely to continue, implies that the latter have to maintain expansionary policies, but the former are gradually moving towards more restrictive policies, though partially constrained for doing so by massive capital inflows. In short, the ‘multi-speed’ character of the recovery creates a need for a mirror asymmetry in monetary policies, which would be very difficult to manage without some restrictions on capital flows.

A second problem is that monetary expansion may be largely ineffective in industrial countries but can generate large externalities on emerging markets. This is particularly problematic when it involves the country issuing the major global reserve currency. Indeed, expansionary monetary policies in the USA, including now quantitative easing, has had at best mixed effects in generating a reactivation of credit, the major transmission mechanism of monetary expansion to domestic economic activity, but the low dollar interest rates associated with that policy are inducing massive capital flows to emerging markets, where they are generating appreciation pressures and risks of asset price bubbles. They may also be contributing to the weakening of the dollar, with negative effects on trading partners.

A third problem is that unilateral actions by countries also have negative externalities on other countries; that is, regulations by some countries may generate even stronger flows towards those not doing so. This is also true, of course, of interventions in foreign exchange markets.

So, cross-border capital account regulations are an essential part of global monetary reform. Actually, the basic principle that should guide actions in this field is the ‘embedded liberalism’ under which the IMF was built: that it is in the best interest of all members to allow countries to pursue their own full employment macroeconomic policies, even if this requires blocking free capital movements. It is therefore positive that the Fund has recognized that capital account regulations can play a positive role, as part of the broader family of macroprudential regulations, and has taken the step to openly discuss this issue and has suggested a possible ‘policy framework’ for discussion (IMF

2011a). Furthermore, this is the first step taken to include cross-border capital flows within ongoing efforts at strengthening prudential regulation worldwide.

Such policy framework should start, however, by designing mechanism to co-operate with countries using these policies, helping in particular make those regulations effective. In fact this may require eliminating provisions in several free trade agreements (particularly those signed by the USA) that restrict the use of such regulations. This type of co-operation is excluded from the IMF guidelines even while recognizing that capital account volatility is a negative externality inflicted upon recipient countries.

The guidelines try to identify 'best practices' in this area. As indicated, such best practices include the recognition that they are a complement and not a substitute for counter-cyclical macroeconomic policies. However, the guidelines tend to view them as interventions of 'last resort' (or a second, third or fourth line of defence), to be used once other macroeconomic policies have been exhausted: exchange rate adjustments, reserve accumulation and restrictive macroeconomic policies. This is a limited view of their role, as they should actually be part of the counter-cyclical package, which should include avoiding excessive exchange rate appreciation and reserve accumulation in the first place.

Also, the guidelines tend to view them as temporary measures. This goes against another IMF recommendation, which calls for 'strengthening the institutional framework on an ongoing basis'. This implies that regulations should be part of the permanent toolkit of countries, which are strengthened or weakened in a counter-cyclical way. Also, and again against the guidelines, almost by necessity they require some discrimination between residents and non-residents, which reflects the segmentation that characterizes financial markets in an international system: as different moneys are used in different territories, residents and non-residents have asymmetric demands for assets denominated in those currencies.

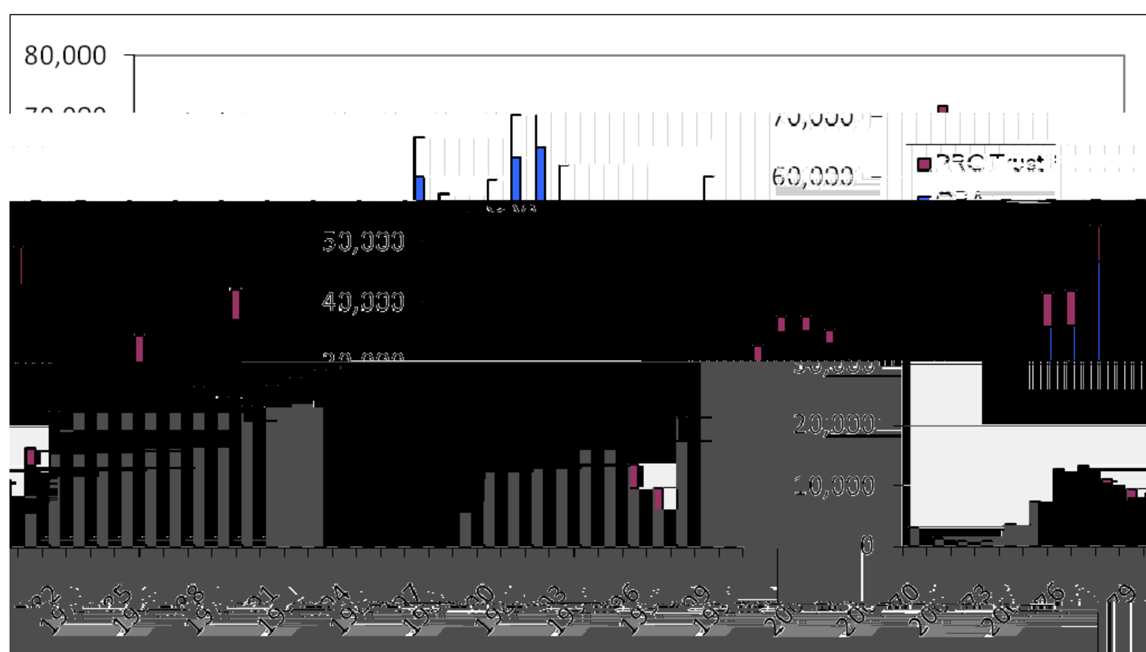
In any case, any guidelines in this area should recognize the fact that there is no obligation to capital account convertibility under the IMF Articles of Agreement—an issue that was settled in the 1997 debates—and therefore countries have full freedom to manage their capital account. In the words of the Group of Twenty-Four (G-24 2011: par. 8): 'Policy makers of countries facing large and volatile capital flows must have the flexibility and discretion to adopt policies that they consider appropriate and effective to mitigate risks'. So, although the IMF has made a positive contribution by bringing the issue of capital account regulations into the global debate, it can only be taken as a first step in the necessary task of including this issue in the efforts to re-regulate finance and avoid global macroeconomic imbalances.

6 Emergency balance of payments financing and debt workouts

Since the Second World War, the international community has been able to count on emergency financing from the IMF during balance of payment crises. As Figure 5 indicates, this mechanism provided increasing counter-cyclical financing until the start of this decade, especially during the debt crisis of the 1980s and the succession of crises that began in 1994: Mexico, East

After the Mexican crisis, the need to create new credit lines to mitigate the effects of capital account volatility and, more generally, to expand the magnitude of programmes for individual countries began to be recognized. So, in the face of the Asian crisis, the IMF created two new credit facilities: the Supplemental Reserve Facility, which served as a framework for the large loans made during the crises of the late twentieth and early twenty-first centuries, and the Contingent Credit Line, which had a more preventive aim. The latter was never tapped, possibly because using it was perceived as an indicator of vulnerability, and it was suspended in 2003. In 2006 the IMF proposed an alternative facility, the Reserve Augmentation Line, but it was never approved. For the poorest countries, the structural adjustment lines created in the mid 1980s were transformed in 1999 into the Poverty Reduction and Growth Facility (PRGF). In January 2006, a credit line was added for those countries aimed at facilitating recovery after negative shocks—from trade and natural disasters—and conflicts with neighbouring countries.

FIGURE 5
USE OF IMF RESOURCES (MILLION SDRS)



Notes: PRG Trust: Facilities for low-income countries. GRA: General Resource Account.

Source: International Monetary Fund (http://www.imf.org/external/np/fin/tad/extcred1.aspx).

The global financial crisis led to further reforms in all of these areas. In October 2008, the IMF created a new precautionary facility for countries with 'sound macroeconomic policies', a short-term liquidity facility (SLF), which could be disbursed without the traditional IMF ex-post conditionality. Yet, as the global crisis deepened and spread through the developing world, no country called upon it. Interestingly, the same day that

preventive facility, the Flexible Credit Line (FCL), again for countries with solid fundamentals but a risk of facing problems in their capital account.[19] Its terms were improved in August 2010, by increasing the scale of the resources and extending the period for which it can be used. Second, the March 2009 package doubled the other credit lines and allowed a wider use of Stand-by agreements for preventive purposes (termed 'high-access precautionary arrangements'). In August 2010, an additional step was taken, with the creation of the new Precautionary Credit Line (PCL) for countries which the IMF deems have good policies, but that do not meet the criteria of the FCL. The other significant reform introduced in March 2009 was to eliminate the relationship between IMF disbursements and structural conditionality. These reforms were accompanied by the elimination of several existing credit lines.

In terms of low-income countries, the IMF increased the global capacity of the IMF loans to these countries to US$17 billion until 2014, which is done through either the Extended Credit Facility, which replaced the PRGF, or through faster disbursing and lower conditionality emergency facilities. The IMF also decided that all low-income countries would receive an exceptional cancellation of all owed interest payments on concessional loans until the end of 2011, as well as lower rates of interest on future loans. In December 2009, it reformed its concessional loan lines from a single design to a menu of options, which aimed to be more flexible to different situations facing countries in relation to their vulnerability to debt and their macroeconomic and public finance management capacity ('capacity'). Within this framework, countries where debt vulnerabilities is high will always have concessionary loans, but those with limited vulnerability and high capacity can eventually access non-concessionary facilities.

Aside from continuing to improve this menu, the major pending issue relates to how IMF lending is financed. The typical mechanisms used in the past are quotas and 'arrangements to borrow'. The disadvantages of the first are that quotathe f2ᴬMCID itiine f2ᴬMre that q

There are two alternative ways to design fully SDR-funded IMF lending. The first is that suggested by the late IMF economist Jacques Polak three decades ago: IMF lending during crises would create new SDRs (similar to the way lending by central banks creates domestic money), but such SDRs would be automatically destroyed once such loans are paid for (Polak 1979). This would be an entirely counter-cyclical financing mechanism. A corollary of that is that the Fund should be allowed, in any case, to create SDRs in almost unlimited amount in the face of a major global disturbance (Stiglitz et al. 2011). The other mechanism would be to treat the SDRs not used by countries as deposits in (or lending to) the IMF that could then be used by the institution to lend to countries in need (Ocampo 2010a, 2010c). Either of these proposals would involve eliminating the division between what are called the 'general resources' and the SDR accounts, which severely limits the usefulness of SDR allocations. It would also imply a change in the meaning of the 'quotas' of member states, which would not involve actual transfers of resources to the IMF, but would in any case be essential to determine borrowing limits and SDR allocations (Polak 2005: part II).

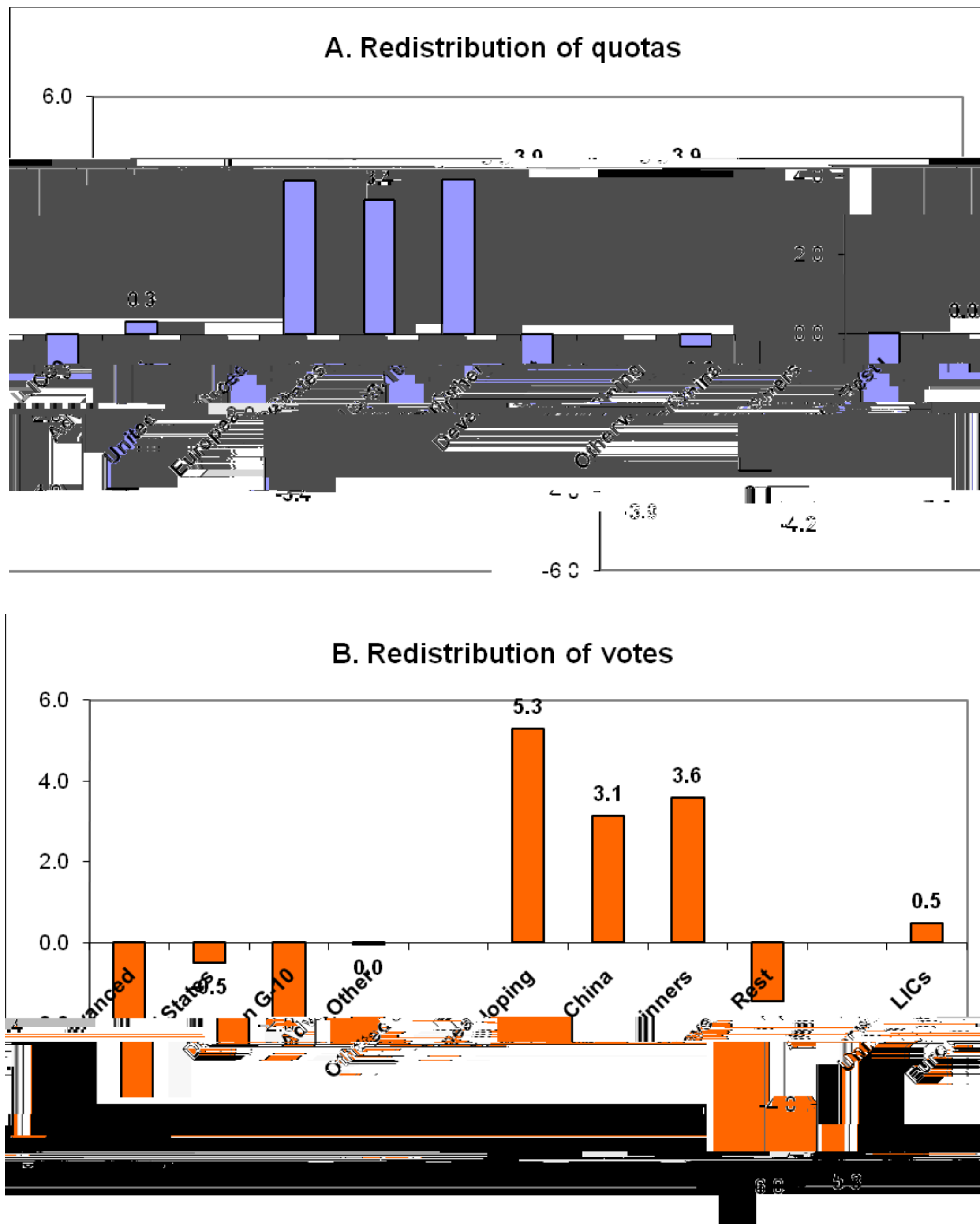
For any of these solutions to work, it is, of course, essential that IMF credit lines should continue to improve in terms of their size, timeliness and conditionality. However, recent reforms seem to have been unable to overcome the stigma associated with borrowing from this institution, and thus have not corrected the demand for 'self-insurance'. This is why a more ambitious reform is required, pe

asborrorule trea2 Tw -17.03 -1.15 02d[whatin3e t could theould also)Tj0y the i34 T n teri beTc 0035 w -

The only regular institutional mechanism of

of Korea, Brazil, India, Mexico, and Turkey, in that order), which adds up 7.3 and 6.7 percentage points in terms of quota and voting power, respectively, came partly at the expense of other developing countries (Figure 6). Furthermore, although the quota and voting power of European countries was reduced, its over-representation continued to be a fundamental problem, as is the under-representation of some emerging economies relative to their actual share in the world economy. Given current dynamics, this problem is likely to worsen over time.

FIGURE 6
REDISTRIBUTION OF QUOTAS AND VOTES IN THE IMF
(VERSUS PRE-2006 SITUATION)



Notes: European G-10: Belgium, France, Germany, Italy, Netherlands, Sweden, Switzerland. Developing countries, other winners: Brazil, India, Mexico, Turkey and Republic of Korea .LICs: Low-income countries.

To these we must add other important proposals made on various occasions, including that by the 2009 Commission for IMF Governance Reform headed by Trevor Manuel (IMF 2009): a reduction in the threshold of votes needed to approve important IMF reforms from the current 85 per cent to, for example, 70-75 per cent; the creation of a Council of Ministers with effective powers to adopt the most important political decisions, thus replacing the International Monetary and Financial Committee; and a clear redefinition of the relations between this Council, the Board, and the administration.

For its part, in the spring 2010 meetings, the World Bank approved a transfer of 3.13 per cent of voting power from the developed economies to the developing and transition economies, which will now hold 47.19 per cent of voting power and have received a promise that they will reach parity in the near future. The increases were mainly concentrated in middle-income countries, especially from Asia, which were heavily under-represented, while low-income countries saw limited change. This change was achieved through an ad hoc capital increase, not through a formula based on clear principles, including the Bank's development mission. There was agreement that this would be done by 2015.

The G-20 has also agreed that the senior management of these organizations should be chosen on the basis of transparent and open processes, based on the merit of the candidates, and regardless of nationality. We still have to see how this principle will work in practice when the majority of voting power in both institutions is still concentrated in the hands of the USA and EU members, who currently head the two major organizations. It would also be useful for the staff of these institutions to be more diverse, not just in terms of nationality but also in terms of education and professional experience, as well as gender.

The broader issues on global financial governance relate, however, to elite multilateralism; i.e., to the G-20 itself. The creation of this G at a leaders' level was, of course, a step forward compared to the G-7, in terms of representation of developing countries. But this solution also created problems because of the ad hoc nature of the co-operation mechanism adopted, including the way in which the membership was defined, which implies the exclusion of some large countries (Nigeria is the most prominent case) and (once again) the over-representation of Western Europe.

This preference for 'Gs' over representative international institutions has deep historical roots in the case of major industrial countries, and reflects a revealed predilection of these countries for mechanisms over which they can exercise greater influence, but such bias may now be affecting other members of the G-20. The basic problem is the challenge of overcoming the tension between representativeness and the legi

Therefore, although Gs can play an important role in placing new issues on the agenda and facilitating consensus among major powers, and in general in steering changes that generate a consensus among the most influential countries, no structure of governance can generate legitimacy as long as decision-making processes are not inclusive. For this reason, the G-20 should be seen as a transition to a more representative, and thereby legitimate, mechanism of international economic co-operation.

One such mechanism would be the Global Economic Co-ordination Council proposed by the previously mentioned UN Commission of Experts on Reforms of the International Monetary and Financial System (United Nations 2009b: ch. 4), which is in turn part of a long history of proposals to create a UN ‘Ec

The creation of such an institutional network is particularly urgent in the monetary arena, where the IMF should make more active use of regional institutions, such as the Chiang Mai Initiative and the Latin American Reserve Fund, and support their creation in other parts of the developing world. The creation of a European Financial Stability Facility and the future European Stability Mechanism are also major steps in that direction. Indeed, the IMF of the future should be designed as the apex of a network of regional reserve funds rather than a mere global fund (Ocampo 2002, 2006). Aside from its benefits in terms of participation by all countries, th

References

Akyüz, Yilmaz (2005). 'Reforming the IMF: Back to the Drawing Board'. Third World Network, *Global Economy Series*, No. 7.

Ariyoshi, Akira, Karl Habermeier, Bernard Laurens, Inci Ötker-Robe, Jorge Iván Canales-Kriljenko, and Andrei Kirilenko (2000). 'Capital Controls: Country Experiences with Their Use and Liberalization'. *Occasional Paper,* No. 190, Washington, DC: International Monetary Fund.

Bergsten, C. Fred (2007). 'How to Solve the Problem of the Dollar'. *Financial Times*, 11 December. Available at: http://www.iie.com/publications/opeds/oped.cfm?ResearchID=854

Camdessus, Michel (2000). 'An Agenda for the IMF at the Start of the 21st Century'. Remarks at the Council on Foreign Relations, New York, February.

Dervi , Kemal (2008). 'Fairness for Emerging Markets'. *Washington Post*, 3 November.

Dervi , Kemal (2010a). 'Keep the Faith: The G20 Can Stop the War'. Financial Times, 8 November.

Dervi , Kemal (2010b). 'The G-20 and Macroeconomic Policy Co-ordination at the Crossroads: A Macroeconomic Agenda for the G-20'. In Colin Bradford et al., *The G-20 Seoul G-20 Summit: Strengthening the Global Recovery*, Washington DC: Brookings Institution, pp. 3-8.

Eatwell, John, and Lance Taylor (eds) (2002). *International Capital Markets: Systems in Transition*. New York: Oxford University Press.

Eichengreen, Barry (1996). *Globalizing Capital: A History of the International Monetary System*. Princeton: Princeton University Press.

Eichengreen, Barry (2007). *Global Imbalances and the Lessons of Bretton Woods*. Cambridge: MIT Press.

Eichengreen, Barry (2011). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*. New York: Oxford University Press.

Epstein, Gerald, Ilene Grabel, and K.S. Jomo (2003). 'Capital Manageme1 122.34039hnique

Greenwald, Bruce, and Joseph E. Stiglitz (2010). 'A Modest Proposal for International Financial Reform'. In Stephany Griffith-Jones, José Antonio Ocampo and Joseph E. Stiglitz (eds), *Time for a Visible Hand: Lessons from the 2008 World Financial Crisis*. New York: Oxford University Press.

Group of 20 (G-20) (2011). 'Communiqué, Meeting of Finance Ministers and Central Bank Governors', Paris, 18-19 February.

Group of Twenty-Four (G-24) (2011). 'Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development: Communiqué', Washington DC, 14 April.

Hart, A.G., Nicholas Kaldor, and Jan Tinbergen (1964). 'The Case for an International Commodity Reserve Currency'. Geneva: UNCTAD. Reproduced in Nicholas Kaldor (1980) *Essays on Economic Policy II: Vol. IV of Collected Economic Essays*. New York: Holmes and Meier, ch. 18.

Herman, Barry, José Antonio Ocampo, and Shari Spiegel (eds) (2010). *Overcoming Developing Country Debt Crises*. New York: Oxford University Press.

International Monetary Fund (IMF) (2009). *Committee on IMF Global Governance Reform: Final Report*. March. Washington, DC.

International Monetary Fund (IMF) (2010). 'Fourteen General Review of Quotas: The Size of the Fund: Initial Considerations', 12 March.

International Monetary Fund (IMF) (2011a). 'Recent Experiences in Managing Capital Inflows: Cross-Cutting Themes and Possible Policy Framework', *IMF Policy Paper*, 14 February.

International Monetary Fund (IMF) (2011b). 'Strengthening the International Monetary System: Taking Stock and Looking Ahead', 23 March.

Kenen, Peter B. (1983). 'Use of SDR to Supplement or Substitute for Other Means of Finance'. In George M. von Furstenberg (ed.), *International Money and Credit: The Policy Roles*. Washington DC: International Monetary Fund, ch. 7.

Kenen, Peter B. (2001). *The International Financial Architecture: What's New? What's Missing?*. Washington DC: Institute for International Economics.

Kenen, Peter B. (2010a). 'Reforming the Global Reserve Regime: The Role of a Substitution Account'. *International Finance*, 13(1).

Kenen, Peter B. (2010b). 'An SDR-based Reserve System', *Journal of Globalization and Development*, 1(2): Article 13.

Kawai, Mashiro, and Mario B. Lamberte (eds) (2010). *4c E-(a)-1(pit221Fl8(i)nflows: The)-6( )]Tj0.*

Ocampo, José Antonio, Shari Spiegel, and Joseph E. Stiglitz (2008). 'Capital Market Liberalization and Development'. In José Antonio Ocampo and Joseph E. Stiglitz (eds), *Capital Market Liberalization and Development*. New York: Oxford University Press.

Ostry, Jonathan D., Atish R. Ghosh, Karl Habermeier, Marcos Chamon, Mahvash S. Qureshi, and Dennis B. S. Reinhardt (2010). 'Capital Inflows: The Role of Controls'. *IMF Staff Position Note,* SPN/10/04, 19 February. Available at www.imf.org

Palma, Gabriel (2002). 'The Three Routes to

United Nations (2002). *Monterrey Consensus on Financing for Development*

WIDER ANNUAL LECTURES

14 *Reforming the International Monetary System*
José Antonio Ocampo

13 *The Trade-Development Nexus in Theory and History*
Ronald Findlay

12 *Developing Countries in the World Economy: The Future in the Past?*
Deepak Nayyar

11 *The Climate Change Challenge*
Kemal Dervi

10 *Global Patterns of Income and Health: Facts, Interpretations, and Policies*
Angus Deaton

9 *The World is Not Flat: Inequality and Injustice in our Global Economy*
Nancy Birdsall

8 *Rethinking Growth Strategies*
Dani Rodrik

7 *Global Labour Standards and Local Freedoms*
Kaushik Basu

6 *Winners and Losers in Two Centuries of Globalization*
Jeffrey G. Williamson

5 *Horizontal Inequality: A Neglected Dimension of Development*
Frances Stewart

4 *Globalization and Appropriate Governance*
Jagdish N. Bhagwati

3 *Is Rising Income Inequality Inevitable? A Critique of the Transatlantic Consensus*
Sir Anthony B. Atkinson

2 *More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus*
Joseph E. Stiglitz

1 *The Contribution of the New Institutional Economics to an Understanding of the Transition Problem*
Douglass C. North

The collection of Annual Lectures 1997–2004 is available as:
Wider Perspectives on Global Development
Published in Studies in Development Economics and Policy, by Palgrave Macmillan (ISBN 9781403996312)