International Monetary System: Strengthening Key Fault Lines

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What is the IMS?
- A brief description

Issues with the current IMS
- Symptoms of instability
- Root causes of instability

Avenues for reform
- Strengthen policy collaboration
- Monitoring and management of global capital flows
- Creation of global safety nets

Conclusions
- Current IMS underpinned strong growth but prone to instability
- Several efforts are underway to address the problems
The International Monetary System (IMS)

- This is the rules and institutions guiding the international payments and foreign exchange systems

There have been various systems historically

- Several forms of the gold standard
- Bretton Woods arrangements (after World War II)
- Current floating and fixed but adjustable rates (since 1971 when the gold standard was abandoned)

Key feature of the current IMS

- It needs a liquid international asset of stable value (i.e., a reserve asset, which since the demise of gold standard, has been the U.S. dollar)
Symptoms of Instability (1)

Crisis a recurrent event in the post-Bretton Woods period

Persistent current account imbalances

Current Account Balance 1/
(percent of world GDP)

Sources: G-20 authorities and IMF staff estimates.
1/ 2000-2010 reflects WEO data; 2011-2016 reflects MAP estimates and projections for G-20 countries and WEO projections for ROW.
Symptoms of Instability (2)

Volatile capital flows and currencies

Exchange Rates vs Dollar

Annual Change in Gross Capital Flows

<table>
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<th>Advanced and Emerging Countries</th>
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<td>2001</td>
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-50% 0 +50%
Symptoms of Instability (3)

Sizable build-up of international reserves in key emerging economies

Stock of International Reserves (billions dollars, 3 year ma)

International Reserves (in percent of GDP, 3 year ma)

- Advanced economies
- Emerging markets 1/
- Low income
Inadequate global adjustment mechanisms

• No mechanisms for burden sharing across countries
• The system is prone to inconsistencies and externalities

No global oversight framework for cross-border capital flows

• Complex interdependencies due to higher volume of cross-border capital flows
• However, universal framework that addresses cross-border capital flows is lacking
No systemic liquidity provision mechanism

- Inadequate size of collective safety net
- Lack of mechanism to provide liquidity at the global level

Structural challenges

- Concerns about a dominant national currency based reserve currency system
  - Exorbitant privilege to reserve currency issuer
  - The world’s dependence on center’s policies
  - Asymmetric adjustment to imbalances
- Need to accommodate the changing core
- Need to generate the necessary supply of safe assets
Avenues for Reform

Strengthen policy collaboration

• G-20 MAP
• Spillover reports
• Review of the IMF surveillance policies and Integrated Surveillance Decision

Monitoring and management of global capital flows

• IMF work on dealing with large inflows recently considered by the Board
• Further work will need to focus on macroprudential and capital flow management measures

Creation of global safety net
Conclusions

Current IMS underpinned strong growth and increasing integration but has shown symptoms of instability

Several efforts are underway to address the problem

• Stronger policies in the core and periphery (G-20 MAP)
• Strengthening IMF surveillance
• Strengthening global safety nets

Important to ensure orderly and gradual transmission to stronger system