4th ICRIER G20 CONFERENCE – GLOBAL ECONOMIC COOPERATION: VIEWS FROM G20 COUNTRIES

Session 4 – Reforming the International Monetary System: The Need for a New Framework[1]

The International Monetary System does not require a complete "reboot" or overhaul. Rather, like any system, regular "upgrades" in the spirit of its ongoing evolution are necessary for it to remain "fit for purpose". A big problem is a lack of political consensus which has prevented its smooth evolution. The current global economic environment —difficult as it is —serves as an opportunity to examine existing arrangements and, ideally, would be harnessed to provide the impetus and political will to implement change. Reform of the International Monetary System is vital to ensuring economic stability and reducing future vulnerability to economic and financial crises. Drawing on Australia's experience in co-chairing the G20 Working Group on International Financial Architecture (Turkey and Australia are co-chairs), this presentation will provide some insights on the G20's recent efforts in support of IMS reform.

The International Monetary System (IMS) consists of the rules, institutions, political environment and collaborative frameworks that facilitate the exchange of goods and services, and flows of capital among countries. The current system originated in the aftermath of the Second World War with the memory of the Great Depression fresh in policymakers' minds. But 'the system' has evolved much since, and would be barely recognisable to its original designers. Key changes include the break in the gold-dollar link in 1971 and the widespread adoption of flexible exchange rate regimes, as well as the role played by the G7 advanced economies as an informal 'steering committee' for the system, a role more recently taken up by the G20. Also importantly, the system has grown, firstly to become a truly global system with near universal membership, and now as it further evolves to accommodate the rapidly growing emerging economies within the leadership circle.

The system, as it has evolved, has facilitated a substantial increase in global trade and cross-border capital flows in the past decades, contributing to the growth of the global economy and the re-emergence of dynamic emerging markets.

Interconnectedness and Spillovers

As the global economy has grown, it has also become more complex and interconnected. There are ever-increasing international linkages between national markets through trade, finance, and investment. A highly liquid IMS has facilitated these cross border linkages. For much of the past few decades, these linkages have facilitated positive spillovers between national economies, as the increased flows of goods, services, capital, people and ideas have helped lift millions out of poverty.

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[1] Paper delivered by Matt Crooke, Minister-Counsellor (Economic), Australian High Commission, New Delhi. The author gratefully acknowledges the support provided by the Australian Treasury's International Monetary System Unit in preparing the paper. Responsibility for any errors or omissions rests with the author.

However, greater economic interconnectedness also brings the potential for significant negative spillovers, with increased sharing of financial and economic risks.

The global financial crisis provides a stark example of such negative spillovers. What started as a problem in the US housing market was transmitted through international financial system to the global real economy. Once Lehman Brothers collapsed, first the global financial system experienced severe disruptions, and then the real economy was hit hard by an unprecedented synchronised fall in world trade and production. Millions of jobs were lost around the world. Even as policymakers sought to contain the crisis, the financial systems of the crisis-affected countries exacerbated the situation through various channels, including by exposing existing vulnerabilities in European sovereign debt markets.

The crisis pushed us into unchartered territory, as our guiding policy frameworks came up against their natural limits. Nonetheless, there were important markers that helped us to navigate in that territory and chart a way through —we were able to fall back on key institutions and cooperative processes that form the IMS.

Evolving IMS I – the IMF responds to the GFC

The IMS evolved in two key ways in response to the crisis. The central institution of the IMS, the International Monetary Fund (IMF), acted in a timely and decisive manner to support its members, while at the same time, undertaking reforms whose importance should not be understated; even if they were overdue. Key among these reforms is the response to what Alok Sheel has called the IMF's 'crisis of legitimacy' – that is, the failure of the Fund's governance and ownership structure to adjust to fundamental changes in the global economy.[2]

From its inception in 1944, the IMF's primary purpose has been to ensure the stability of the IMS—essential for promoting sustainable economic growth, increasing living standards, and reducing poverty. This is achieved through preventative tools, namely the IMF's bilateral and multilateral surveillance activities including key publications such as the World Economic Outlook and Global Financial Stability Report; and crisis resolution through financial support to countries undergoing necessary balance of payments adjustments. Since the onset of the global financial crisis in 2007, the IMF has provided over US$300 billion in loans to its member countries.[3] IMF members have significantly bolstered its lending capacity to support this rapid ramping up in lending activities, beginning with the 2008 increase in the New Arrangements to Borrow and the 2010 doubling of quotas, which is still to take effect, and more recently with pledges of around US$456 billion to increase the Fund's available resources even further. These actions are a powerful symbol that the global community is committed to ensure the stability of the IMS.

The IMF's increased lending to members has been accompanied by changes to its lending and surveillance policies, including notably reforms to its multilateral and financial sector surveillance, as well as revisiting the legal framework underpinning its surveillance activities. There has also been significant reform to the support it gives to low income members. These reforms have been made in close consultation with, and with significant cajoling by, the Fund's membership.

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[2] Sheel, Alok, Challenges on IMS Reforms: A global and emerging markets' perspective, ICRIER Policy Series, December 2011

[3] http://www.imf.org/external/np/exr/facts/changing.htm

Looking to IMF institutional reforms, an important recent milestone was the 2010 IMF Governance and Quota Reform. The IMF has recognised that "these reforms represent a major realignment in the ranking of quota shares that better reflects global economic realities, and a strengthening in the Fund's legitimacy and effectiveness."[4] Greater voice and representation for emerging markets and developing countries in recognition of their growing role in the global economy is also likely to enhance the IMF's ability to coordinate collective efforts towards bolstering global financial and economic stability as a number of these countries are now key drivers of global growth.

Australia recognises that the role of dynamic emerging markets such as India and other economies in Asia and more broadly around the globe in driving global efforts to strengthen the IMS should reflect their growing weight in the global economy. When the 2010 quota and governance reforms are taken together with the earlier round of reforms agreed in 2008, it is clear that the changes made in recent times are much more significant than any previous changes to the way in which the IMF is governed.

At the same time, that significant 'catch up' has occurred does not mean that the job is near complete – it only serves to remind us how far behind the quota system was and how far there is still to go. If Alok's 'legitimacy crisis' is to be put fully behind us, then it is important to maintain the momentum to deliver on the forward-looking elements of the 2010 reforms, the review of the quota formula and the bringing forward of the Sixteenth General Review of Quotas to January 2014.

Evolving IMS II – a new role for the G20

The second response by the IMS to the global crisis has been the rise of the G20 as the premier body for international economic cooperation. As a forum that brings together the world's major advanced and emerging economies, the G20 is well placed to drive towards international consensus on key issues.[5]

Getting broad agreement on the reforms required by the IMF has been greatly aided by the G20 taking on a supporting role that in times past had been filled, with varying degrees of success, by the G7. But the new role of the G20, which is the second response of the IMS in response to the global crisis, is also broader and more ambitious than that of a steering committee for resolving differences of view within the IMF.

The G20 had of course already been established in the wake of the 1997-98 Asian financial crisis, when it was recognised that the existing structures for cooperation in response to a global or major regional crisis were either too slow moving (i.e. the IMF) or nowhere near representative of current global weightings (such at the G7).

Designated by G20 Leaders at their September 2009 Pittsburgh Summit as now the premier forum for their international economic cooperation , the G20 works to promote strong, sustainable and balanced growth by, among other things, working to build a stronger and more stable IMS that includes legitimate and effective international financial institutions and robust financial regulation.

Through the most virulent phase of the global crisis in 2008-09, the decisive and coordinated actions of G20 members boosted consumer and business confidence and supported the first signs of economic recovery.

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[4] http://www.imf.org/external/np/fin/quotas/pubs/index.htm
[5] Sheel, 2011

The G20 agenda continues to push for improved macro policy coordination, IMF governance reform, and international financial regulation (through the Financial Stability Board), along with important work in other areas. These are the mutually reinforcing streams of the G20 finance agenda that serve to underpin global macro and financial stability, creating important breathing space in which the IMS can to continue to evolve. And evolve it must.

The ongoing reform agenda

Although restoring the stability of the IMS was essential during the height of the crisis, ongoing developments make adapting to the new challenges all the more important. That said, given the evolution that is already taking place, reforming the IMS should not necessitate a complete system overhaul or creation of a new framework. Reform should be an ongoing process and one that involves the continued evolution of key institutions, including the IMF, World Bank and others.

Given the interconnectedness of the global economy and the lived experience of the global financial crisis which has seen significant spillovers spread across regions, effective multilateral cooperation and coordination will remain essential. Enhanced cooperation amongst the member countries of the IMF, as well as between the IMF and other global and regional institutions, will be an important part of the IMS going forward.

This year, the Mexican G20 Presidency established a Working Group on International Financial Architecture (IFA) to drive IMS reform by focusing on one of its key global institutions, the IMF. In the lead up to the G20 Leaders' Summit in June 2012, the IFA Working Group played a key role in efforts to boost the IMF's lending capacity, culminating in announced commitments in Los Cabos of around US$456 billion to boost Fund resources, mentioned above.

It has also helped drive a modernisation of the IMF's surveillance framework and supported (and is continuing to support) IMF governance reform so that members' quotas better reflect their relative weights in the global economy, an outcome which is expected to result in increased shares for dynamic emerging economies and developing countries.[6]

As co-chair of the IFA Working Group, Australia has played an active role in this work, and in doing so, has developed some unique insights into the G20's current efforts to build a stronger and more stable IMS.

Australian policymakers seek to bring a sense of realism about the reform process of the IMS. There is no immediate alternative framework; the IMS' evolution will be gradual. The Australian Government believes that reform should be an ongoing process that is built around engagement and is delivered in a responsible way. The IMS, as outlined above, proved to be sufficiently flexible and resilient in response to the global crisis. Reforms to the system should be pragmatic and implementable.

Traction and trajectory are important. Reform should build on existing strengths, including, for the IMF: enhanced surveillance; adequately resourced institutions; and well-designed lending packages with appropriate conditionality. The system is not broken; it could, however, be improved. Ongoing governance reform to better reflect global economic realities will be vital to fostering new leadership within the system.

[6] http://www.g20.org/en/working-groups

The most important element for reform will be political will, ongoing collaboration and fair representation. In a recent speech Mike Callaghan, until very recently Australia's G20 Finance Deputy, and who joins us at this conference as a guest of ICRIER, recognised the importance of better multilateral organisations as much as a sense of realism about what they can and cannot achieve.[7] The speech also recognised the importance of countries meeting commitments in terms of their own actions and policies and that political will is a vital element to the domestic and global reforms required to underpin the stability of the IMS.

Looking at how the G20 can make a meaningful contribution to further strengthening the IMS will be something Australia will be considering when it hosts the G20 in 2014. This will be a unique opportunity for Australia to influence the global economic agenda, as well as an opportunity to strengthen engagement with the leaders of the world's major economies on the issues that matter. Maintaining political leadership and continuing reform will be vital to the ongoing stability and success of the international monetary system, the global economy and the fate of all our countries.

[7] Callaghan, Michael, Multilateralism on the wane: Can the world economy become one again? 14 July 2012, http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2012/Multilateralism-on-the-Vane-Can-the-World-Economy-Become-One-Again