IMS Reform: Broader, Incentive-based Approach

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Why a new framework?

IMS reforms so far: Asymmetric, unbalanced, incomplete

- Asymmetry in the G20's IMS reform agenda:
  - Stronger international policy collaboration at G20 focused on near-term actions to lift global growth, related short-term macro-policies.
  - Medium-term policy imperatives devoted to growth, unemployment and social issues.
  - Long-term reforms on backburner.

- Global liquidity issues:
  - Outcomes versus Causes: Balance tilted towards monitoring and management of capital flows.
  - Recipients versus Sources. On capital account policies.

- Strengthening macroeconomic surveillance for stricter oversight and remedial action: Individual to Multilateral; External Balance Approach

Structural reforms lagging, stagnant by contrast

- Structural reforms to address the 'non-system' nature of IMS lagging, stagnant:
  - Role of SDR [Notwithstanding that the SDR has been very useful in "a rapidly decided exceptional allocation" (Palais Royal Initiative, 2011) to boost the IMF's resources.
  - Governance structure: far from reflects the core shift of the world, or its multipolarity. Seoul G20 meeting in November 2010 made a beginning, but only slightly.
- While focus on global recovery welcome, necessary, but danger of perpetuating the flawed structure of the current IMS.
- Failure to provide stable, systemic underpinnings to growth keeps it vulnerable to instability from an IMS susceptible to idiosyncratic shocks, policy risks.
- Legitimacy deficit weakens incentives for members' cooperation, especially those with poor representation but substantial global economic weight.
- So how to move forward?

The starting point: What reforms considered necessary to begin with?

IMS Reform: Broad dimensions (IMF)

- Stronger international policy collaboration
- Monitoring and management of capital flows
- Global financial safety net
- Structural strengthening of the system through financial deepening and reserve asset diversification.

Palais Royal Initiative identifies specific elements

- Policy Spillovers and need for Stronger Surveillance
- Exchange Rate Policies, Benchmarks and Members' Obligations
- Global Liquidity
- SDR's role
- Governance issues

Palais Royal Initiative: provides cooperative reform approach

- Modifications to IMF's Articles of Agreements IV and VI to give more teeth to surveillance and peer-review.
- Shared analytical understanding of global liquidity between IMF-BIS-FSB
- Ideas to encourage the use of SDR: as reserve asset & international unit of account; modify composition of SDR basket to reflect relative importance of economies in international trade and financial transactions; using SDR as an incentive to improve the workings of the adjustment process;
- Address and improve IMS governance to ensure universal representation, build an "effective advocate of global interest"

Narrow, asymmetric approach to IMS reform feeds back into G20's efforts at multilateral cooperation on current reforms too

- Legitimacy deficit weakens individual country incentives, especially those with poor representation but substantial global economic weight, to commit, cooperate to improve functioning of current IMS.

- Strengthening IMF surveillance to take it the next level may be difficult. Members' Obligations under current Articles of Agreements, especially exchange rate policies, benchmarks and remedial action may be ineffective.

- Global Liquidity issues could be hard to address and extend to capital account policies, if reform is examined solely from recipients' standpoint without attempt to address cause/source, viz. monetary policy of reserve issuer and related structural reform.

Reform framework: greater balance, more incentives

- Incentives for enhanced multilateral cooperation: Formalize the idea of the G20 fairly and squarely at multilateral institutions, notably at the IMF.

- *PRI* provides a cooperative approach to address legitimacy deficit
  - Three tier structure embodying universal representation:
    - *1)* Heads of Government or State, who meet sparingly (e.g., once a year) except in times of crisis;
    - 2) Finance Ministers and Central Bank Governors, to take strategic decisions related to the functioning of the IMS in the framework of a "Council" as envisaged in the Fund's Articles of Agreement. This Council could be activated to take over and merge the functions of the IMFC and the G20 ministers and governors, as far as the latter's role in the global economic, monetary and financial domains is concerned. Requires an amendment to ensure a representation of Central Banks in the Council, as it is the case in the current G20 structure;
    - 3) Executive Directors overseeing the work of the IMF, and its managing director.

  - A Global Advisory Committee (GAC) of eminent independent personalities to provide independent advice to the key organs of the IMF (e.g., the IMF Council, Executive Board, Managing Director) in the fields of surveillance, management of international liquidity and reserves, whether at its own initiative or at their request.. Advice would not be binding but would be made public in principle.

- Start with a role for the SDR at the G20

Conclusion

- Governance reforms suggested by PRI can be instituted quickly, little difficulty.

- Risks from the ‘nonsystem’ IMS too large to ignore

- Positive gains from global economic integration post Bretton-Woods now under threat: increased risks of instability; retreat into protectionism; competitive depreciations and so on.

- Absence of progress on fundamental overhaul of the current IMS leading affected countries to find other solutions: strengthening regional reserve pools and other arrangements; recycle global surpluses, e.g. BRICS development bank, etc.

Thank You