Round Table on International Cooperation in Times of Global Crisis: The Way Ahead

Conference on International Cooperation in Times of Global Crisis: Views from G20 Countries

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It was a great pleasure to participate in this conference. I came to learn more about views from other G20 countries. I have not been disappointed. I have been asked to provide some thoughts on international financial institutions, aside from the G20 itself. I will also include some points about the related issue of the role of the dollar in the international monetary system.

International Financial Institutions

Dealing with the global economic and financial crisis of 2007-09 has required a re-energizing of global institutions, in particular the IMF on which I will focus. (Of course the G20 itself was super-energized.) The Fund has stepped up the crisis, in particular after September 2008, and also has been pushed forward by its members. The issue for the IMF and its members is whether after the crisis it will go back to the status quo. There are plenty of forces pushing for a return to the past, which would be a mistake.

However, before the Fund can move forward, more needs to be accomplished with respect to both its legitimacy and its relevance. Some argue that we must re-define the IMF's mission before addressing issues of legitimacy. My view is that if the IMF's mission is redefined while there are still doubts about its legitimacy will be addressed, the exercise will be flawed.

With respect to legitimacy, the IMF has an agenda agreed by the G20 to reach agreement on a set of governance issues by January 2011.[1] I would like to see five elements in that agreement:

1. A doubling of the size of IMF quotas;
2. A shift of about 7 percentage points in voting power from the traditional industrial countries to emerging market and developing countries;[2]
3. A reduction in the number of European chairs on the executive board, preferably in the context of a reduction of its overall size;
4. A reform of the selection process of the heads and senior officials of the IMF and World Bank, as well as other international financial organizations, in which that process picks the best people without regard to nationality; and
5. A reduction of the current 85 percent majority votes, which gives the United States and other small groups of countries the ability to block major IMF (and World Bank) decisions, to 80 percent.

With respect to relevance, I see many of the desirable elements as part of a quid pro quo, or grand bargain, on governance and legitimacy. What is required, in my view, is three major elements:

1. The members of the IMF, starting with the major emerging market economies, must buy into a new global growth framework in which they accept self-imposed limits on their use of export-led growth strategies;

[1] I was delighted to see that in Pittsburgh, after our meeting in New Delhi, the G20 delivered a down payment on that commitment.
[2] It would appear that the G20 in Pittsburgh did not quite meet my test. The G20 agreed on only a 5 percentage point shift from the over-represented to the under-represented members of the IMF.

2. All members of the IMF, including the advanced countries but also a larger group of systemically important countries than just those in the G20, must accept and support an enhanced role of the IMF in surveillance; and
3. As part of this process, the Fund management and staff must be allowed to exercise a more forceful role as the umpire of the system applying symmetric pressures on countries in surplus and in deficit. Consideration might be given to reviving the proposal that was discussed by the Committee of Twenty in the 1970s to use reserve indicators in which the accumulation of excess reserves might force a change in exchange rate policy, a tax on those reserves, or trade measures.

Role of the US Dollar

This issue of accumulations of excess reserves is relevant to the issue of the role of the dollar in the international monetary system.

First, a great deal of uniformed nonsense has been written and spoken on this topic. Commentators often confuse the reserve role of the dollar with its more important role in private international transactions, which is at least five times as large. Both roles came about via the evolution of the international financial system since the early 1970s rather than by fiat or as a matter of US policy. Moreover, we are already in a multi-polar reserve system: the dollar accounts for only about two thirds of all reserve currencies, based on information reported to the IMF. In today's system, there is no hard-wired link between the US dollar's reserve role and US current account deficits. International investors today purchase assets denominated in the domestic currencies of a wide range of countries including countries such as India and Brazil. The accumulation of reserves denominated in euro over the past decade has been about $1.5 trillion and the Euro area has had a cumulative current account surplus. Therefore, officials and commentators should stop making "cheap shot" comments about the exorbitant privileg that the United States enjoys today.

Instead, we should focus on the important issue: the risk that the lesson that many countries will learn from this crisis is that they should increase their self-insurance in foreign exchange reserves and indulge in the competitive non-appreciation of their currencies in order to run current account surpluses. Additional SDR allocations in size may help in this regard, but only if they are linked with increased discipline in the international adjustment process as I mentioned under the heading of IMF relevance. (See my earlier reference to reserve indicators.)

At the same time, it is naïve to think about the SDR as the center of the international monetary and financial system without contemplating huge changes in the system in the direction of a rules-based system. This is not going to happen.

Talk about revival of the 1970s proposals for a substitution account for dollars (and possibly other currencies) is equally naïve. Only two countries are at all constrained in the currency composition of their reserves at present: China and Japan. All other countries can change the composition and do so without creating even the whiff of a ripple in foreign exchange markets – just a few days of headlines in the *Financial Times*. It is beyond me to understand why the rest of the countries in the international financial system would be willing to bribe Japan and China via offering them a type of foreign-exchange-risk insurance after those countries have distorted the global adjustment process for several decades on the part of Japan and half a decade on the part of China.