INTERNATIONAL POLICY ANALYSIS

Reforming the International Monetary and Financial Architecture

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August 2014

- The international monetary and financial architecture has experienced important reforms in recent years, yet profound limitations remain. Major gaps in the regulatory framework concern financial cross-border regulation, debt management, macroeconomic coordination, monetary and governance reform.

- The IMF continues to face a stigma for many borrowers and the World Bank's under-capitalization implies that it is unlikely to play the very active role it did during the North-American financial crisis in terms of providing future counter-cyclical financing.

- The present, elaborate system of macroeconomic policy coordination has not avoided the creation of new global imbalances, the most important caused by surplus accumulation in the EU, rising deficits in a large group of emerging and developing countries, insufficient capital account regulations and a lack of sovereign debt workout mechanisms.

- International monetary reform should involve three elements: the design of an apex organization more representative than the G20, advanced participation of developing countries in the Bretton Woods Institutions and on the Financial Stability Board, and the design of a multi-layered financial architecture, with active participation of regional and sub-regional institutions.

Dialogue on Globalization

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This paper will also be published as the author's contribution to the book prepared by the Committee of Development Policy (CDP), a subsidiary body of ECOSOC, on global governance and the United Nations development agenda beyond 2015. It draws from the author's previous work on the subject, which was supported by the Ford Foundation.

Introduction

The recent North-Atlantic[1] financial crisis, once again placed at the center of the global policy agenda the need for an international monetary and financial architecture which is appropriate for the current stage of economic interdependence. The initiatives this crisis unleashed have generated some progress, but should nevertheless be characterized as highly incomplete. The actions identified with these initiatives can be classified in four main groups. The first encompasses those aimed at strengthening prudential financial regulation and supervision; advance in this area contrasts with the inconclusive debate on regulating cross-border capital flows. The second group includes actions to improve counter-cyclical financing through the International Monetary Fund (IMF), but also through multilateral development banks (MDBs) and regional arrangements. The third includes the incomplete measures taken to enhance macroeconomic policy cooperation, and the even more limited steps adopted to strengthen the international monetary system. The fourth group comprises equally insufficient governance reforms.

These actions have repeated a past pattern of speeding up reforms in the face of crises. However, there have been significant differences with the response to the crisis in the emerging economies that erupted in East Asia in 1997 and then spread to Russia, Latin America, and Turkey. The first difference is the larger scale of action, which no doubt reflects the fact that major developed countries have been at the epicenter of the recent turmoil. Second, there have been greater (though still limited) measures in relation to truly global issues, both financial and, to a much lesser extent, monetary. A third difference with the emerging countries' crisis of the late 1990s and early 2000s has been the absence of any actions in relation to the management of debt crises, which contrasts with the attempt by the IMF from 2001 to 2003 to create a sovereign debt workout mechanism, and the spread of collective action clauses in debt contracts after that initiative failed. Finally, greater attention has been given on this occasion to regional mechanisms, which contrasts with the strong negative response by the United States (US) and the then IMF Managing Director, Michel Camdessus, to the Japanese initiative to create an Asian Monetary Fund after the outbreak of the East Asia financial crisis.

This paper analyzes the advance and limitations of the current wave of reforms. The first section analyzes financial regulation and the inconclusive debate on cross-border capital account regulations. The second examines crisis response mechanisms, contrasting the expansion of counter-cyclical financing with the lack of initiatives to manage unsustainable debt burdens. The third section considers macroeconomic coordination and the very limited advance in international monetary reform. The fourth reviews governance reforms. The paper concludes with a short summary of advances and the pending agenda.

1. Financial Regulation

The tendency of financial markets to experience boom-bust cycles is well known (see, for example, Reinhart and Rogoff 2009). Indeed, according to the IMF, financial market volatility has increased over time and has spread to transactions that are generally considered to be less volatile – particularly foreign direct investment (IMF 2011a: ch. 4). This boom-bust pattern is associated with the uncertainties inherent to contracts that are subject to future contingencies, the outcome of which is unknown today, as well as with the information asymmetries that characterize financial transactions. It is enhanced by inadequate prudential regulation and supervision, as the frequent collapse of financial systems following episodes of capital market liberalization indicates.[2] The recent North-Atlantic financial crisis clearly follows past historical patterns: sharp cyclical swings and significant contagion effects of both financial booms and busts, as well as the deficit of financial regulation and supervision in the developed economies – particularly in the US and the European Union (EU). In contrast to that trend, the crisis was less acute in emerging and developing economies, which had strengthened their own frameworks of prudential regulation and supervision, to a large extent as a response to their own previous financial crises.

1. I prefer this term, to that of global financial crisis. Although it had global contagion effects, the crisis was essentially concentrated in the United States and Europe.

2. See, among the extensive literature on the subject, the papers collected in Ocampo and Stiglitz (2008), including the overview of that volume by Ocampo, Spiegel, and Stiglitz (2008).

The North-Atlantic crisis had diverse origins.[3] Several analysts considered capital requirements for banks – including criteria for evaluating risks, which are an essential element of capital requirements in the risk-weighted system in place – provisioning rules for loan losses, and liquidity requirements were inadequate. In addition there was a significant growth of off-balance sheet transactions, which in several countries was a way to avoid regulatory requirements. In the European case, the accumulation of theoretically »risk-free« sovereign debt in the hand of banks, with a clear market segmentation – as banks in specific countries tended to hold a disproportionate share of those countries' debts, a pattern that deepened as a result of the euro crisis – generated a vicious circle between sovereign and bank risk that exploded in the European periphery in 2010 (Pisani-Ferry 2012). Furthermore, banking supervisors inadequately enforced regulations, based on a philosophy that believed that market mechanisms and market agents were better at evaluating risks. This included the adoption of self-evaluation as the major mechanisms to evaluate risks by major financial institutions in the reforms adopted by the Basel Committee in the mid-2000s, which came to be known as Basel II.

Beyond the problems of banking regulation and supervision was the growth of non-banking financial institutions – »hedge« or »alternative investment« funds[4] – which were subject to much more limited (if any) regulation and supervision. Since these institutions often engage in the transformation of maturities, which is the essence of banking activities, they came to be known as the »shadow banking system.« Given the central role of securitized real estate assets during the crisis, an additional problem was the inadequacy of the rules used to evaluate the risks of securitization, associated with insufficient risk evaluation of the underlying assets. Other problems included practices (»slicing« of securitized debts) to create new assets, which were sold as »low-risk« instruments, as well as the incomplete character and poor regulation of markets for derivatives, which tend to become even more incomplete during crises as a result of the underlying information problems that characterize them. This was compounded by the lack of transparency in over-the-counter derivative contracts.

Under the leadership of the Group of 20 (G20) and the Financial Stability Board (FSB),[5] which it created in its April 2009 summit in London, financial regulation and supervision have been strengthened. Nonetheless, this effort is incomplete, and some norms have been weakened under pressure from major financial institutions.[6] Banking regulation was strengthened (see next paragraph) and the »regulatory perimeter« was expanded to include some agents and transactions that were inadequately regulated before the crisis (D'Arista and Griffith-Jones 2010). The principle of counter-cyclical prudential regulations – and, more broadly, of »macroprudential regulations« – was introduced, following proposals that had been made before the crisis (Griffith-Jones and Ocampo 2010). The principle that standardized derivative contracts should be traded in exchanges was established, thus potentially increasing the transparency and reducing the counterparty risks of these transactions – though with significant exceptions for transactions that are still allowed to be undertaken over the counter. Consumer protection was also enhanced, particularly in the US.

The major reforms in banking regulation were those approved by the Basel Committee on Market Supervision in September 2010, which came to be known as Basel III (Basel Committee 2010; Caruana 2010). They increased the minimum common equity and core (Tier 1) capital requirements from 2 to 4.5 percent and from 4 to 6 percent, respectively. They also increased the quality of the remaining assets that can be considered part of the overall risk-weighted capital requirement of 8 percent. A »capital conservation buffer« of 2.5 percent was added, also made up of common equity, as well as a counter-cyclical capital requirement that will fluctuate in a range of 0 to 2.5 percent according to national conditions. These two buffers help absorb the risks that are accumulated during booms and can thus be used during

3. See the papers collected in Griffith-Jones, Ocampo, and Stiglitz (2010). Three well-known commissions also analyzed the source of the crisis and the need for new policy responses: the de Larourière Commission (2009); the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, also known as the Stiglitz Commission (United Nations, 2009); and the Warwick Commission (2009). The Turner Review also provided an insightful analysis (Financial Services Authority 2009).

4. »Hedge« is the term generally used in the US. »Alternative investment« is used in some European countries and is more appropriate, as these institutions undertake much more than »hedging« operations.

5. This was a transformation of the former Financial Stability Forum, which had been created by the Ministerial G7, which was launched after the East Asian crisis.

6. For example, liquidity requirements were significantly reduced and their implementation delayed in early 2013.

crises to absorb the associated losses. The regulations also increased the capital requirements for operations of banks in capital markets (the trading book). Due to the potential weakness of risk evaluation of specific assets, an overall unweighted capital requirement of 3 percent was added, which thus determines the maximum leverage ratio of financial institutions; this requirement was raised to 5 percent in the US in April 2014 for large bank holding companies, and 6 percent for their subsidiary banks benefitting from deposit insurance.

Liquidity requirements were also put in place, with provisioning requirements and associated accounting standards still subject to debate. The principle was established that risk evaluation would depend less on those of credit rating agencies. Systemically important agents (»too-big-to-fail«) were subject to stricter rules, including more stringent capital requirements, and the obligation to simplify the structure of financial conglomerates and draft »living wills« to manage their potential bankruptcy. To better supervise global financial conglomerates, the principle that they should be under a system of »supervisory colleges« was established.

Reforms would be gradually introduced between 2013 and 2019. Several analysts consider the transition period too long and the Basel III leverage still allowed too high. The regular evaluations of the state of implementation indicate that rulemaking has generally gone faster than implementation at the national level, and that major gaps remain. The major challenges that persist include: how to reduce dependence on credit rating agencies, resolution mechanisms for »too-big-to-fail« institutions, still inadequate regulation of shadow banking, the insufficient expansion of derivatives exchanges, the limited advance of supervisory colleges, and the lack of agreement on unique accounting standards (FSB 2013).

Domestic and regional regulations have been adopted in a parallel way, especially in the US and Europe, the two epicenters of the crisis. In the US, the 2010 Frank-Dodd Act strengthened prudential regulation but did so following national principles. It also introduced the »Volcker« rule – finally implemented in late 2013 – which limits the core capital that can be placed in investment funds to 3 percent; this was an alternative to the sharp division between commercial and investment banking that had been introduced during the Great Depression and dismantled in 1999.[7] The EU has also strengthened its own regulations and has determined that supervision of most agents will continue to be the responsibility of national authorities, with the European Central Bank (ECB) in charge of supervising the largest institutions. However, inconclusive steps have been adopted in two areas, which are central to the Eurozone's proposed »banking union«: deposit insurance and banking resolution, two areas in which the fiscal risks involved have led to the reluctance of Germany and some other members to agree on truly collective mechanisms. Both the US and Europe have also put in place macroprudential frameworks, by creating the Financial Stability Oversight Council and the European Systemic Risk Board, respectively. The first of these institutions is also responsible for coordinating the multiple agencies that characterize the US regulatory structure. In any case, the parallel development of the US and European frameworks may lead to important differences in the regulatory frameworks. Notably, regulations have already led to US banks having stronger capital bases than European counterparts.

The FSB initiatives completely ignored the risks associated with cross-border capital flows – almost as if cross-border finance was not part of finance! This includes limited attention to regulations on transactions in foreign currencies in domestic markets, as well as regulations on capital flows proper – generally called »capital controls,« but which should more appropriately be called capital account regulations. Oversight of this issue was a major gap in the efforts to strengthen financial regulation overall, and was particularly critical for emerging and developing countries, because capital account volatility plays a major role in determining boom-bust financial cycles, and therefore macroeconomic risks and fluctuations. However, the IMF addressed this issue in 2011 and 2012 as part of the broader debate on macroprudential regulations.

The official IMF documents on this topic underscore the positive role regulations on capital inflows can have, but take a more critical view of regulations on outflows (IMF 2011b and 2012). In the first case, they consider that regulations are effective in changing the composition of capital inflows toward less volatile sources of finance, which have macro-stability effects. In terms of their

7. The separation was introduced by the Glass-Steagall Act of 1933 but was eliminated by the Gramm-Leach-Billey Act of 1999. The latter was an initiative of the Clinton Administration, but some analysts considered that separation had de facto disappeared prior to the new legislation.

macroeconomic effects, they argue that there is stronger evidence on the capacity of regulations to increase the room of maneuver for restrictive monetary policies but limited evidence that they reduce the total amount of inflows or that they affect the exchange rate. In the case of regulations of outflows, the IMF considers them generally ineffective. They recommend that authorities should favor regulations that do not discriminate based on the residence of the agents, but rather on the currency they use. The official documents have been backed by significant technical work in the institution, with some officials being skeptical of capital account regulations (see, for example, Habermeier et al. 2011), but others more favorable to them (Ostry et al. 2010 and 2011). The latter have argued that they were effective in reducing the vulnerability of emerging economies to the North-Atlantic financial crisis.

On the basis of this analysis, the IMF proposed some guidelines (IMF 2011b) and later an »institutional view« on the use of these regulations (IMF 2012). Both accept that capital account regulations should be part of the toolkit of macroprudential instruments, and underscore, correctly, that these regulations should be a complement and not a substitute for adequate macroeconomic policy. However, the initial guidelines tended to visualize them as sort of »interventions of last resort,« once countries have exhausted all other alternatives to manage booms: letting exchange rates appreciate, accumulating foreign exchange reserves, and adopting contractionary fiscal and monetary policies. The final »institutional view« has a more favorable opinion of capital account regulations, but did not entirely dispel the conception of them as interventions of last resort (Gallagher and Ocampo 2013).

Other analysts have argued that capital account interventions should be used simultaneously with other macroeconomic policy interventions to avoid the potential overheating of the domestic economy and overvaluation of the exchange rate generated by excessive capital inflows (see, for example, the contributions to Gallagher, Griffith-Jones and Ocampo 2012a). In fact, they should be conceived as part of a continuum that goes from regulations of domestic finance in domestic currency, to domestic financial transactions in foreign currencies and cross-border flows, which should be regulated in a manner consistent with the characteristics of different financial systems and the policy objectives of macroeconomic authorities (Ocampo 2011, Ostry et al. 2011).

Under Brazil's initiative, the G20 approved in 2011 an alternative set of guidelines that have a more pragmatic view of the use of these regulations, although also underscoring that they should not be used as a substitute for appropriate macroeconomic policies (G20 2011c). Gallagher, Griffith-Jones, and Ocampo (2012b Box 2) have proposed, in turn, an alternative set of guidelines, which also emphasize that they are a complement and not a substitute for other macroeconomic policies, and that they should be adjusted dynamically to avoid their elusion. Nevertheless, they emphasize that there is no reason to discriminate against regulations on outflows or to favor price-based (taxes or unremunerated reserve requirements) over quantitative or administrative regulations (limits or prohibition of certain transactions), which may be more effective in practice. Furthermore, these alternative sets of regulations respond to the fact that the IMF Articles of Agreement recognize that countries are free to regulate capital flows; a debate that was settled in 1997 when the then Managing Director, Michel Camdessus, proposed the introduction of capital account convertibility as an obligation under the IMF Agreement, but the initiative did not raise the required consensus in the midst of the East Asian crisis then under way.

2. Crisis Resolution

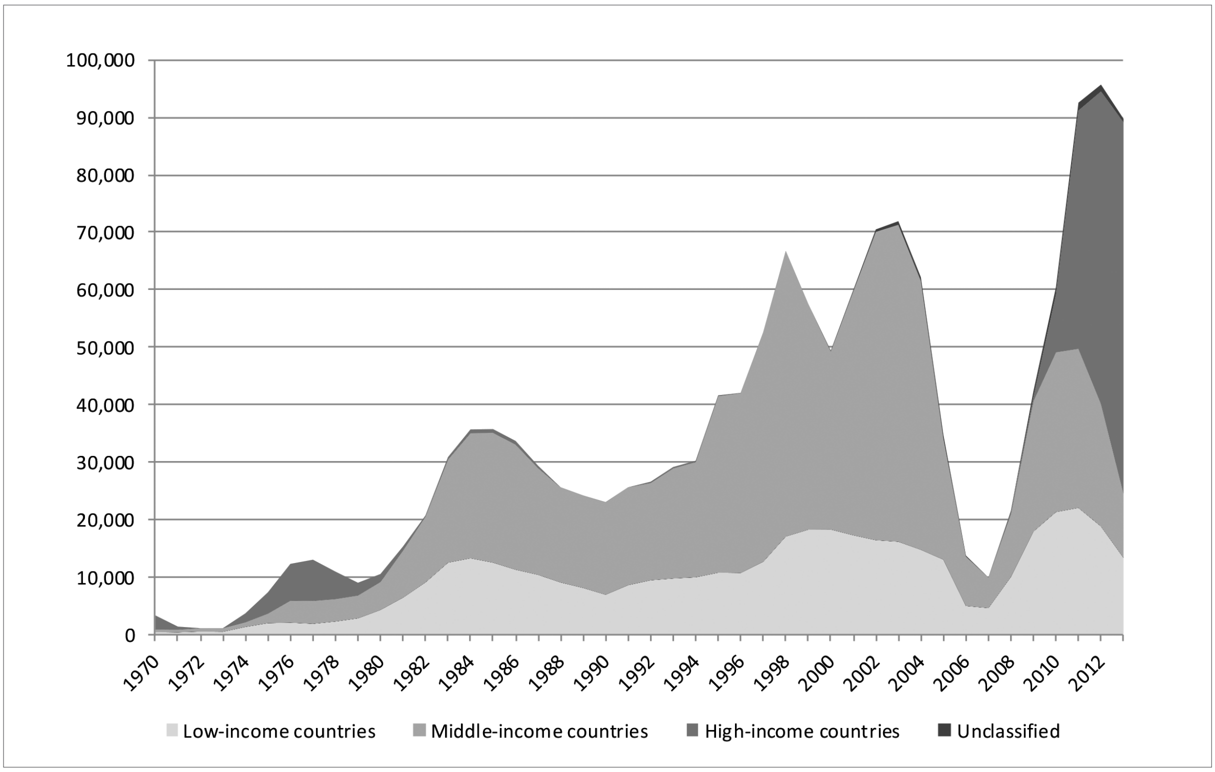
The North-Atlantic financial crisis generated the most ambitious response of official counter-cyclical financing in history. This response included a rapid expansion of IMF financing, as well as that of multilateral development banks (MDBs). Both benefitted developing countries, but IMF financing also helped some developed countries. This was accompanied by the largest issuance of Special Drawing Rights (SDRs) in history, an issue that will be considered in the next section.

At the regional level, this was reinforced by old and new mechanisms in Europe and by the Chiang Mai Initiative of ASEAN + 3 (China, Republic of Korea, and Japan). In the first case, it involved both financing mechanisms for EU members (the Balance of Payments Assistance Facility, a preexisting mechanism, and the new European Financial Stabilization Mechanism), but particularly for euro members (the temporary European Financial Stability Facility put in place in 2010, and the permanent European Stability Mechanism inaugurated in October 2012). In turn, the Chiang Mai mechanism was expanded to 240 billion US dollars and multilateralized, and a monitoring unit to support it was put in place in Singapore, but it has not been used thus far. A small, preexisting, and very successful institution of its kind is the Latin American Reserve Fund (FLAR, according to its Spanish acronym), made up of the Andean countries, Costa Rica, Uruguay, and Paraguay. Other mechanisms are in place or have been created in other parts of the world (IMF 2013).

There was also an expansion of financing by the major central banks and the increase, again without precedent, of swap lines among central banks. Those from the US Federal Reserve benefitted central banks from developed countries but also – though only temporarily – some emerging economies (Brazil, Republic of Korea, Mexico, and Singapore). China has also created swap facilities for some other emerging countries and its development bank has facilitated financing on a relatively large scale to other emerging and developing countries. In any case, this expansion of official financing was smaller than the initial contraction of private sector financing. Also, notoriously, the weakest response was that of official development assistance – which only modestly increased during the early phase of the crisis and has declined after peaking in 2010 (United Nations 2013) – a victim of austerity programs in place in developed countries. The net result of this is that, to a large extent, the crisis response benefitted high- and middle-income, rather than low-income countries (Griffith-Jones and Ocampo 2012).

As Figure 1 shows, the IMF has provided counter-cyclical financing, which significantly increased from the early 1980s to the early 2000s as a response to the series of crises in the emerging and developing world: the debt crisis (primarily in Latin America) in the 1980s, the shorter Mexican turmoil in December 1994, and the succession of crises in the emerging economies that began in East Asia in 1997. With the exuberance that characterized private capital markets in the mid-2000s, IMF financing fell sharply and in fact forced a reduction in the size of its staff. The direct and contagion effects of the

Figure 1: IMF Loans by Level of Development (Million SDRs)



Source: International Monetary Fund database. The classification of countries according to 2000 World Bank criteria; this year is considered more representative of countries' levels of development for the whole period covered in this graph.

North-Atlantic financial crisis led to the sharpest increase in financing, soon surpassing the previous 2003 peak. Equally interesting is that for the first time since the 1970s, several high-income Western European countries used those facilities: Iceland in 2009, Greece and Ireland in 2010, Portugal in 2011, Greece again in 2012, and Cyprus in 2013. Several Central and Eastern European countries also did, with Hungary, Romania and Ukraine – all classified as middle-income countries – as the largest borrowers among them. In addition to the financing recorded in Figure 1, which refers to disbursements, precautionary credit facilities were created during the crisis, but have not been disbursed.

This process was the result of a major redesign of credit facilities, particularly in 2009 and 2010. Facilities had already expanded during the emerging economies' crises of the late twentieth and early twenty-first century, primarily to respond to the extensive financial needs created by the sudden stop of private sector financing during crises. The major novelty was the 1997 Supplementary Reserve Facility. There was also an attempt to create a contingency credit line, but it was eliminated in 2003 because no country made use of it. An early attempt in 2008 to create a new line of this type also failed to attract borrowers.

The reform adopted in March 2009 was probably the most ambitious in history, and was adjusted later to improve its novel features (IMF 2009b). They included the creation of a new preventive facility – the Flexible Credit Line (FCL) – for countries with solid fundamentals but with risk of contagion, which was soon demanded by three emerging economies (Colombia, Mexico, and Poland). It was improved in August 2010, both in terms of its size as well as the period for which it can be utilized (from one to two years). In turn, the size of the other credit lines was doubled, and it was agreed that the stand-by facilities could also be used with preventive purposes. The reforms also included the elimination of some preexisting lines.[8]

This was followed in December 2009 by a reform of the concessional facilities for low-income countries, which moved from a single design to a menu of options, based on two factors: the level of indebtedness and their macroeconomic and public finance management capacity. Within this framework, countries where debt vulnerabilities are high will always have concessionary loans, but those with limited debt vulnerability and high capacity can eventually access non-concessionary facilities.

Continuing with the task of improving the precautionary facilities, a new facility – the Precautionary Credit Line – was created in August 2010 for countries with sound policies, but which do not meet the requirements of the FCL. This facility was transformed into the Precautionary and Liquidity Line, to allow countries to use it to obtain rapid disbursement funds for six months.

It should be noted that as a result of the strong criticism of the IMF programs during the Asian crisis, there has been a long-term effort to reform the conditionality associated with such programs. Conditionality had been subject to a heated debate as a result of its enhancement during the 1980s and 1990s. In 2002, the IMF Board approved the principle that structural conditions had to be »macro-relevant.« This implied that they had to be necessary to achieve the objectives of the macroeconomic adjustment program, and that the IMF had to be flexible and sensible to the adoption of alternative policies proposed by countries. This was followed by the creation of preventive credit lines with no ex-post conditionality (though with ex-ante conditions) and the elimination, in 2009, of the link between disbursement and fulfillment of structural conditions.

A major evaluation of the implementation of this policy was undertaken in 2008 by the IMF's Independent Evaluation Office (IEO), based on lending from 1995 to 2004 (IMF-IEO 2007). This evaluation concluded that there had not been a significant reduction in the number of structural conditions after the 2002 reform, but that conditionality had moved from the areas subject to heated controversy (privatization of state-owned enterprises and trade reforms), to macro-relevant areas (tax policy and administration, public expenditure management and financial sector reform). A later analysis of 2008–09 stand-by programs indicated that the number of conditions had fallen significantly in relation to those estimated in the IMF-IEO's study (from 19 to 12, on average) and had continued to concentrate in macro-relevant areas, but that these advances were less typical in programs for low-income countries (Griffith-Jones and Ocampo 2012).

8. This included the Compensatory Finance Facility. It had been created in 1963 as a low-conditionality facility to finance countries facing deterioration in their terms of trade. It was a very important instrument in the 1970s, but then languished due to increased conditionality, and ceased to be used since 2000.

The issue of conditionality is central to the »stigma« associated with IMF financing. Hence, the importance of lending by MDBs, which has no stigma associated with it, as well as the importance of the design of the particular mix of regional with IMF financing. In the latter case, support by the European funds has been done largely together with the IMF, in the hope of building on its experience with emergency balance of payments lending. However, this has generated friction between the European institutions and the IMF, notably in the treatment of unsustainable debts. There is also a general perception that the unwillingness to use the Chiang Mai facilities is associated with the IMF stigma in East Asia, because beyond a certain level (30 percent of available swap facilities), the use of these facilities requires an IMF program.

In relation to MDBs, the crisis placed their counter-cyclical role at the center of the global agenda – an issue that most of them had not recognized prior to the crisis – to-

Table 1: Lending by Multilateral Development Banks, 2004-2012 (Million dollars)

COMMITMENTS	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
World Bank/IBRD	11.045	13.611	14.135	12.829	13.468	32.911	44.197	26.737	20.582
World Bank/IDA	9.035	8.696	9.506	11.867	11.235	14.041	14.550	16.269	14.753
International Finance Corporation (IFC)	4.753	5.373	6.703	8.220	11.399	10.547	12.664	12.186	15.462
Subtotal World Bank Group	24.833	27.680	30.344	32.915	36.101	57.499	71.411	55.192	50.797
African Development Bank	4.326	3.277	3.904	4.895	5.435	12.643	6.314	8.782	6.536
Asian Development Bank	5.039	5.761	7.389	10.770	12.174	20.389	18.935	21.717	21.571
European Bank for Reconstruction and Development	5.093	5.346	6.149	7.664	7.464	10.987	11.924	12.659	11.437
Inter-American Development Bank	5.468	6.738	5.774	8.812	11.085	15.278	12.136	10.400	10.799
Subtotal regional banks	19.926	21.122	23.216	32.141	36.158	59.296	49.309	53.558	50.344
TOTAL	**44.759**	**48.802**	**53.560**	**65.056**	**72.259**	**116.795**	**120.720**	**108.750**	**101.140**

DISBURSEMENTS	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
World Bank/IBRD	10.109	9.722	11.833	11.055	10.490	18.564	28.855	21.879	19.777
World Bank/IDA	6.936	8.950	8.910	8.579	9.160	9.219	11.460	10.282	11.061
International Finance Corporation (IFC)	3.152	3.456	4.428	5.841	7.539	5.640	6.793	6.715	7.981
Subtotal World Bank Group	20.197	22.128	25.171	25.475	27.189	33.423	47.108	38.876	38.819
African Development Bank	2.042	1.842	1.863	2.553	2.866	6.402	3.867	4.873	5.193
Asian Development Bank	3.559	4.745	5.758	6.852	8.515	10.581	7.976	8.266	8.592
European Bank for Reconstruction and Development	4.596	2.859	4.768	5.611	7.317	7.649	7.950	9.320	7.711
Inter-American Development Bank	3.768	4.899	6.088	6.725	7.149	11.424	10.341	7.898	6.883
Subtotal regional banks	13.965	14.345	18.477	21.741	25.848	36.056	30.133	30.357	28.379
TOTAL	**34.162**	**36.473**	**43.648**	**47.216**	**53.037**	**69.479**	**77.241**	**69.233**	**67.198**

Source: Reports of the different banks. IBRD, IDA, and IFC data refer to the fiscal years ending in June.

gether, of course, with poverty reduction and the provision of international public goods. Increased financing by the MDBs during crises should not be considered liquidity financing, but mainly financing for counter-cyclical fiscal programs and for programs aimed at facilitating the recovery of private sector investment during crises, but their disbursement obviously increases the foreign exchange available to countries. Interestingly, the recognition of the counter-cyclical functions of MDBs has also been highlighted in relation to the European Investment Bank, as well as to national development banks, which played a crucial role in generating a strong early recovery of several emerging economies (including Brazil, China, and India) during the North-Atlantic crisis. The Obama Administration has even proposed the creation of a development bank for infrastructure for the US.

As Table 1 indicates, the MDBs serving emerging and developing countries increased their commitments by 124 percent in 2009–10 compared to their average level of lending in 2004–07. Increased disbursements came with a lag, which occurred despite the use or creation of fast-track facilities in all of them. All of the major institutions played an important role, and remarkably so the World Bank's International Bank for Reconstruction and Development (IBRD). Regional development banks also rapidly expanded their lending, notably the Asian and African Development Banks. The least dynamic was the World Bank's International Development Authority (IDA), confirming again the lesser priority given to low-income countries in the counter-cyclical financial support. Among regional development banks, the least dynamic was the European Bank for Reconstruction and Development, which serves the transition economies.

One of the most interesting responses by MDBs to the crisis was also the rapid way in which they addressed the paralysis of trade financing. The resources that they committed for that purpose were 9.1 billion US dollars, on top of the 3.2 billion US dollars that they were already providing. Due to the high rotation of trade credits, these resources provided much larger amounts of financing. An evaluation by the International Chamber of Commerce (ICC) in the midst of the crisis indicated that 55 percent of the banks they analyzed were using the resources of MDBs in the summer of 2009 (ICC 2009).

Increased lending required a capitalization of all major institutions. The G20 agreed in April 2009 to support the capitalization of MDBs. The Asian and African Development Banks agreed in 2009 to a 200 percent increase in their capital. Although the expectations of the Latin American and Caribbean countries were not fulfilled, the Inter-American Development Bank also agreed to a capitalization of 70 billion US dollars in March 2010, which represented close to a 70 percent rise in callable capital. This was followed by a 50 percent increase in capital of the European Bank for Reconstruction and Development, which was agreed in May 2010. The President of the World Bank initially argued that due to the institution's capital cushions, the IBRD did not require additional capital. However, in April 2010, it agreed on a capital increase of 86.2 billion US dollars, which included a general increase of 58.4 billion US dollars and a selective one for 27.5 billion US dollars to allow emerging and developing countries to enlarge their share in the institution's capital. This capitalization was clearly insufficient and implies that in the future, the World Bank would be unable to respond to a new sudden halt in external financing for developing countries the way it did during the North-Atlantic financial crisis. In fact, as Table 1 indicates, IBRD financing has declined sharply from its peak, though it has remained above pre-crisis levels. This is not true of IDA and IFC, which have been more resilient; in fact, the IFC has continued to expand quite dynamically. Regional development banks have also been resilient, but some –notably the Inter-American Development Bank – have reduced financing in recent years.

Nonetheless, the amount of financing provided by the MDBs was much smaller than the initial contraction of private external financing, and this is also true of the IMF.[9] Since private capital markets recovered relatively quickly (starting in mid-2009), this implies that their role in mitigating the sudden stop in external financing was moderate at best. This also implies that official financing can only moderately smooth out boom-bust cycles in private financing, and that the main instrument to reduce the volatility of external financing is the regulation of capital accounts, particularly regulation on inflows during the boom phase of the cycle.

9. Based on World Bank data, it can be estimated that the contraction of private external financial flows (i.e., excluding foreign direct investment) toward emerging and developing countries was 534 billion dollars between 2007 and 2008, or 249 billion US dollars if compared with 2006, to eliminate the peak 2007 levels. This compares to a peak increase in disbursements of MDBs of about 30 billion US dollars. IMF financing increased by SDR 90 billion or close to 140 billion US dollars, but a large amount was directed toward peripheral Europe.

Moreover, the crisis response cannot rely exclusively on emergency financing, as the availability of such financing could raise moral hazard issues for private sector lenders and/or public sector borrowers. Emergency financing serves to correct the problems of access to liquidity during crises from turning into insolvency, but is not adequate to manage problems of over-indebtedness. This is why a regular institutional framework to manage debt overhangs at the international level must be created: a debt workout mechanism for sovereign debts similar to those that help manage bankruptcies in national economies.

The only regular institutional mechanism of this type is the Paris Club, which deals exclusively with official financing. To this we should add two ad-hoc initiatives: the Heavily Indebted Poor Countries (HIPC) Initiative launched in the mid-1990s and its successor, the 2005 Multilateral Debt Relief Initiative. For private obligations, the system has relied in the past on ad-hoc mechanisms, such as the 1989 Brady Plan, but has essentially depended on traumatic individual debt renegotiations, including those with banks under the so-called London Club(s). The problem with all of these mechanisms is that solutions come generally (or even always) too late, after over-indebtedness has had devastating effects on countries. They are also horizontally inequitable, because they do not treat all debtors or all creditors with uniform rules.[10]

This issue was a subject of significant attention by the IMF after the emerging countries' crisis of the late twentieth century, leading to the proposal to create a Sovereign Debt Restructuring Mechanism (SDRM), which was subject to heated debates from 2001 to 2003. However, the negotiations failed due to the opposition of both major developed and emerging economies. So, the only initiative that was put in place by the Finance Ministers' G20 was the spread of collective action clauses (CACs) in bond contracts. During the current crisis, it is generally accepted that the only debt reduction agreed in the European periphery – that of Greece – came too late, after many private creditors had already been bailed out by EU members; the IMF has also argued that the exception given to Greece regarding the criteria for debt sustainability required for IMF loans was an inadequate response.

10. See in this regard, the contributions to Herman, Ocampo, and Spiegel (2010).

A debt workout mechanism should include a mediation mechanism and, if it fails, an arbitration process, which should encompass both public and private sector liabilities (United Nations 2009: ch. 5). Market-based restructuring mechanisms – based on London Club negotiations – or the active use of CACs are clearly insufficient, because: (i) debtors may delay using the mechanism to avoid antagonizing creditors; (ii) they may provide insufficient debt reductions to guarantee a »fresh start«; and (iii) they do not generate a uniform treatment of creditors and fail to treat official and private lending with a unique set of rules, thus maintaining the horizontal inequities of the current non-system. In the case of CACs, they also face aggregation problems. Individual debt renegotiations, even successful ones, continue to generate significant legal uncertainties as the disputes between holdouts and Argentina in US courts in 2013–14 indicate.

3. Macroeconomic Policy Cooperation and International Monetary Reform

There is probably no area with greater tensions between the globalization process and the persistence of policies that continue to be national – or, in the case of the euro area, partly regional[11] – than in the macroeconomic field. The net result is the world lacks a mechanism that guarantees the consistency of the macroeconomic policies of the major economies, including the one that issues the main global currency.

The IMF constitutes the major multilateral instrument of macroeconomic policy dialogue and cooperation. Article I of the IMF's Agreement defines as its first purpose: »To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems«. However, most forms of macroeconomic cooperation have tended to take place in ad-hoc arrangements outside the IMF.

The original Bretton Woods international monetary arrangement collapsed in the early 1970s and was not replaced by a coherent system – or, rather, it can be

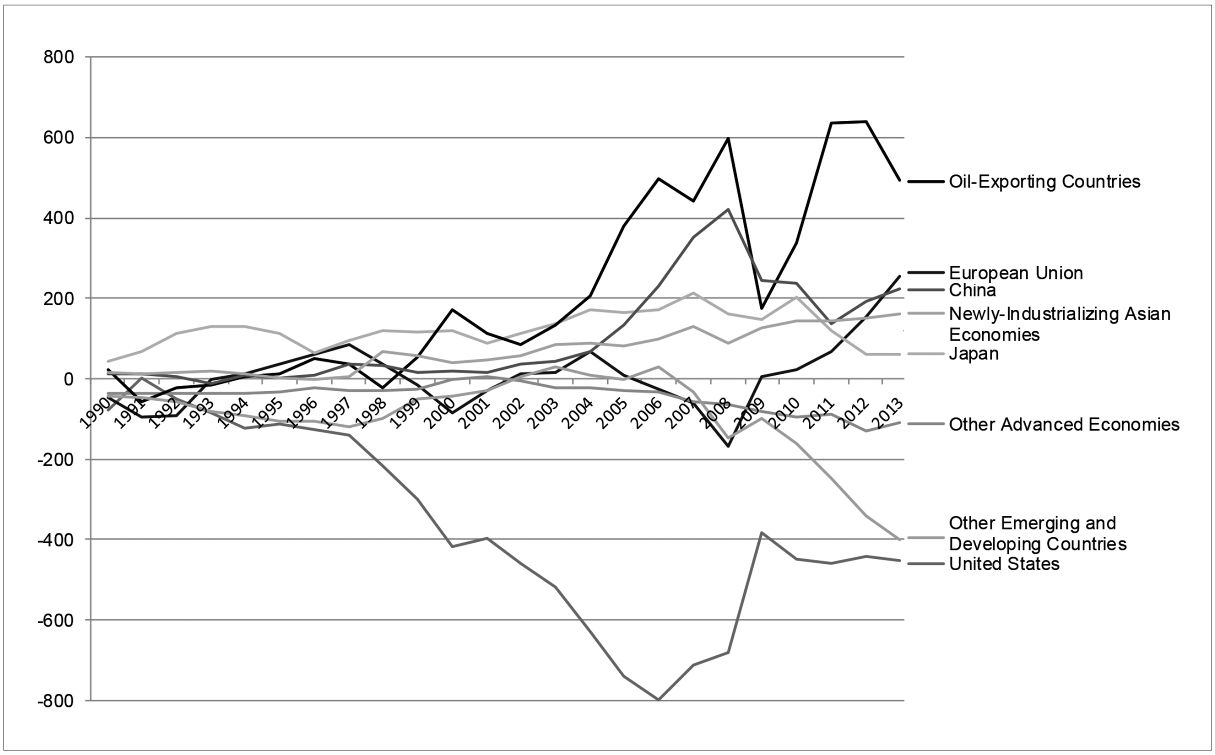
11. This is true of monetary policy, as fiscal policy continues to be essentially national, though subject to regional rules and supervision. Financial policy is in a transition to a regional framework, based on the proposals for a »banking union« – an incomplete one, as we saw in section I.

said that it was replaced by a »non-system.« The major reform efforts were the creation of the IMF's SDRs in 1969 and the attempt to agree on a new international monetary system, possibly based on the SDRs, after the unilateral abandonment by the US of the convertibility of dollars for gold in August 1971. The discussions took place in the so-called Committee of 20, but were unable to lead to any fundamental agreement (Williamson 1977). The non-system that evolved is characterized by the central role played by domestic fiduciary currency, with countries being able to adopt any exchange rate system they choose, so long as they guarantee a stable system (rather than stable exchange rates), and avoid »manipulating« the exchange rates – with no agreement, however, on what manipulation means.

This system has faced several problems. First of all, the monetary policy of the major reserve-issuing country is adopted without taking into account its spillover effects on the rest of the world. Second, since most advanced countries chose a flexible exchange rate, there was an implicit decision to let flexible rates adjust the discrepancies in the policies of these economies (Padoa-Schioppa 2011). However, it can be argued that exchange rate flexibility does not operate as an effective mechanism to reduce global imbalances; the volatility that characterizes major bilateral exchange rates also tends to increase during crises with no effect in terms of correcting these imbalances. Third, the major emerging economy, China, continues to have limited flexibility, and most major oil exporting countries continue to peg to the dollar. European countries also chose to have limited exchange rate flexibility among themselves, and most of them eventually converged into a monetary union. For all of these reasons, it can be said that, even more than the Bretton Woods arrangement, the system lacks sufficient adjustment mechanisms.

This is reflected in the generation of major global imbalances, which became massive before the 2007–08 North-Atlantic financial crisis. The major US deficit had as counterparts the surpluses of oil-exporting countries,

Figure 2: Current Account Balances (Billion dollars)



Current Account Balances (Billion dollars)
Oil-exporting countries: Angola, Bahrein, Iran, Irak, Jordan, Kwait, Lybia, Omar, Qatar, Russia, Saudi Arabia, United Arab Emirates, and Venezuela
Newly Industrializing Asian Economies: Hong Kong, Republic of Korea, Singapore, and Taiwan POC

China, Japan, and the East Asian Newly Industrializing Economies (NIEs) (Figure 2). The US went from a relative equilibrium position in its current account to a deficit of around 6 percent in 2005–06. The depreciation of the US dollar since 2003 helped reduce such imbalance, but only in a moderate way and with a significant lag. The major correction took place during the North-Atlantic crisis and helped to spread the US recession to the rest of the world, as indeed it has been true of previous reductions in US imbalances around 1980 and 1990, which were also accompanied by major global slowdowns.

Imbalances initially fell with the outbreak of the crisis. As a counterpart of the sharp initial reduction in the US deficit, the surpluses of the oil-exporting countries and China also fell. However, this was soon followed by new imbalances. The most important of these included the renewal of the surpluses of the oil-exporting countries, and the change in the EU from a moderate current account deficit to a major surplus. The most important counterpart was the change in the position of non-oil, non-East Asian emerging and developing countries (»other emerging and developing countries« in Figure 2) from a moderate to a massive deficit. In a significant sense, and since the Chinese surplus has fallen, this means that adjustment in the EU has been made at the cost of emerging and developing countries. In any case, these »beggar-thy-neighbor« policies have been relatively ineffective in supporting a strong European recovery, as export-led strategies can be effective to support the recovery of small but not of large economies.

In turn, within the European Union, this reflects the massive adjustment in the countries of the periphery – in order of magnitude, Spain, Greece, Portugal, and Ireland – while maintaining the surpluses of other countries, particularly that of Germany. This is in fact one of the best examples of Keynes' assertion that the major problem of the international monetary system is the asymmetry between the need for deficit countries to adjust during crises and the lack of any pressure for surplus countries to do so, which generates a deflationary (or, more properly, recessionary) bias (Keynes 1943). This has also called attention to the problems associated with the relations between the international monetary systems and payments imbalances, and more generally between the former and global macroeconomic stability.

For decades, mechanisms of macroeconomic policy coordination have tended to work outside the IMF and have not been particularly effective. In the 1980s, they included the ad-hoc agreements among major economies – the 1985 Plaza and 1987 Louvre Accords – mainly aimed at reducing the Japanese surplus. In fact, it may be argued that these agreements are part of the explanation for the massive appreciation of the Yen and the Japanese asset price bubble of the second half of the 1980s, which eventually generated a financial crisis and a lost decade in Japan. Cooperation then shifted to the G7, and since the outbreak of the North-American financial crisis, to the G20.

G20 macroeconomic cooperation worked relatively well in the early stages of the crisis, when it assumed the form of a »Keynesian consensus.« The peak level of cooperation was reached at the London April 2009 meeting and continued in the September 2009 Pittsburgh meeting, when the Group self-designating itself as »the premier forum for our international economic co-operation« (G20 2009). The launch of the counter-cyclical financing mechanisms mentioned in the previous section was matched by a temporary agreement to adopt expansionary monetary and, to a lesser extent, fiscal policies. Informal coordination among leading developed countries' central banks had already been in place, and was particularly critical during the outbreak of the subprime crisis in the US in mid-2007, and the major global contagion associated with the bankruptcy of Lehman Brothers in September 2008. Pittsburgh also marked the launch of the Mutual Assessment Process (MAP) as the instrument of cooperation among major economies. The June 2010 G20 summit in Toronto represented the end of the »Keynesian consensus,« because several developed countries decided to prioritize public sector debt sustainability over their support to recovery. Even the European Central Bank made the wrong decision to start moving in the direction of less expansionary policies in 2011, before shifting again into the expansionary path at the end of the year.

In February and April 2011, the G20 Finance Ministers and Central Bank Governors agreed that the macroeconomic cooperation would focus on »the persistently large imbalances that require policy action«, which they defined as: »(i) public debt and fiscal deficits; and private savings and private debt (ii) and the external imbalances composed of the trade balance and net investment income flows and transfers, taking due consideration of exchange rate, fiscal, monetary, and other policies« (G20 2011a). This was followed by the agreement on the indicative guidelines against which each of the indicators would be assessed, based both on economic models and countries' historical trends (G20 2011b). The main technical support is provided by the IMF, which has been asked »to assess the coherence, consistency, and mutual compatibility of G20 members' policy frameworks« (IMF 2011c). This activity, which is defined as »technical assistance to G20 members,« generates an obvious tension between the truly multilateral character of the IMF and the specific ownership of the MAP by the G20 – or perhaps even by a subgroup of G20 members.

This has been combined with a proper IMF activity: the strengthening of surveillance, both multilateral and bilateral. At the multilateral level, this includes the regular IMF biannual analyses of the global economy, global financial stability, and a new fiscal monitor. It also includes a »Consolidated Multilateral Surveillance Report,« launched in 2009; the »spillover reports« for the »systemic 5« (US, Eurozone, UK, Japan, and China); and, most recently, the »External Sector Reports« assessing global imbalances, the first of which was issued in July 2012. In turn, the most important instrument of bilateral surveillance continues to be the Article IV Consultations. Its major changes are the more in-depth consideration of financial issues, and the commitment to more »candid« assessments of major economies. In 2010, it was also decided that all jurisdictions with systemically important financial sectors must be subject to Financial Sector Assessments Programs (FSAP).

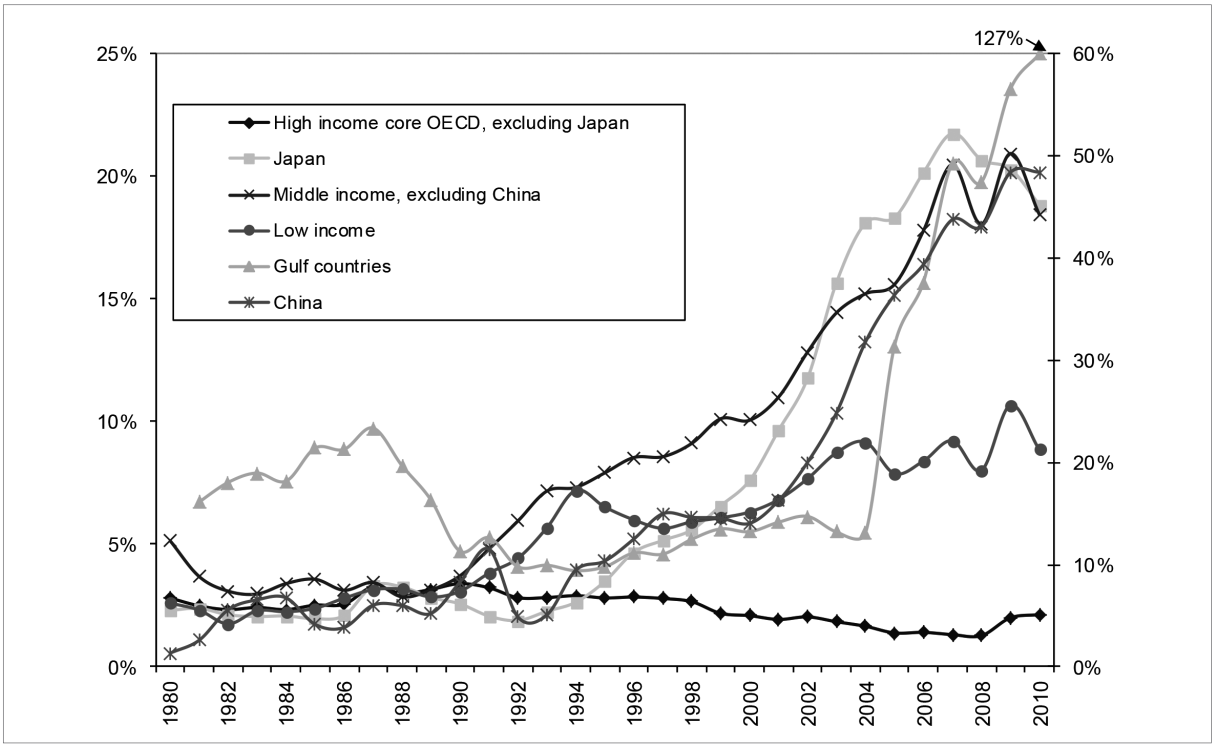
The world had never such an elaborate system of surveillance and macroeconomic policy cooperation; but it continues to rely essentially on a mix of stronger surveillance and peer pressure, which have proven to be weak forces. This is reflected, in particular, in the limited attention to the spillovers generated by expansionary monetary policies of developed countries on emerging markets and associated »currency wars« – to use the term coined by the Brazilian finance minister – and, as we have seen, the incapacity to avoid austerity in the Eurozone from generating new global imbalances. As also indicated, this implies that, following Keynes' diagnosis, asymmetric European adjustment has also generated a global recessionary bias.

It is important to note that, aside from the recessionary bias of asymmetric adjustment, the international monetary system has two additional deficiencies (Ocampo 2010 and 2011). One is what the literature has come to call the »Triffin dilemma«: the problems generated by the dependence of the international reserve system on a national currency – or, more generally, on a limited number of national or regional currencies (Triffin 1961 and 1968, Padoa-Schioppa 2011). Given the fiduciary character of the currency at the center of the system since the early 1970s, the most important manifestations of this problem in recent decades have been the strong cycles in the value of the dollar and the US current account, which are transmitted to the global economy.

An additional deficiency, which affects emerging and developing countries in particular, is the need to accumulate large amounts of foreign exchange reserves as »self-insurance« in the absence of proper global regulation of, and insurance against capital account volatility. Indeed, the strong pro-cyclical pattern of capital flows and the lack of an appropriate international architecture to manage balance of payments crises, which originate in the capital account, have led these countries to accumulate massive reserves – particularly after the emerging economies' crisis of the late twentieth century. Figure 3 shows that until the end of the 1980s, the level of reserves of developing countries, with the exception of China and oil-exporting countries, was similar to that of developed countries: around 3 percent of GDP. Trends started to diverge in the 1990s, but especially in the early twenty-first century. By 2007, middle-income countries, excluding China, had reserves equivalent to 20 percent, and low-income countries to 9 percent of GDP. China's reserves had reached 40 percent, and an even higher proportion was reached in the Persian Gulf countries. In contrast to this, reserves of high-income countries, with the exception of Japan, continued to be around 2–3 percent of GDP. After a short interruption during the North-Atlantic crisis, reserve accumulation resumed, as capital flows toward emerging economies experienced an early recovery.

Reserve accumulation provided emerging and developing countries an exceptional level of insurance, as well as equally unprecedented policy space to adopt expansionary monetary policies during the North-Atlantic financial crisis, in open contrast with previous crises. However, it has also generated inequities – because reserve accumu-

Figure 3: Foreign Exchange Reserves by Level of Development (% of GDP)
(Left-hand scale, except China and the Gulf Countries)



Source: Total reserves minus gold series, World Bank, World Development Indicators, based on information from the IMF

lation has costs – and it may have contributed to global imbalances. Notably, the demand for »safe assets« increased their prices and reduced their yield, possibly contributing to the asset bubbles that characterized the boom years. To the extent that reserve accumulation reflects strong current accounts, it also contributes to the generation of a global recessionary bias, which was attenuated prior to the crisis by US and the European periphery's deficits. In broader terms, though reserve accumulation obviously has positive effects on countries, they also generate »fallacy of composition« effects that feed into global imbalances.

The three deficiencies of the global monetary system – the recessionary bias associated with asymmetric adjustments, the Triffin dilemma, and the need for massive »self-insurance« by emerging and developing countries – are, in variable ways, at the center of the reform proposals formulated at the beginning of the crisis. They included the proposal by China's central bank governor to gradually eliminate the role that the dollar plays at the center of the system (Zhou 2009). In turn, the Commission of Experts convened of the President of the UN General Assembly on Reforms of the International Monetary and Financial System (Stiglitz Commission) proposed that reforms of the global reserve system should be at the center of the global reform agenda (United Nations 2009). The Palais Royal Initiative, convened by Michel Camdessus, Alexandre Lamfalussy, and Tommaso Padoa-Schioppa also presented a series of reform proposals on February 2011 (Boorman and Icard 2011). However, actions have been limited and the reforms of the international monetary system did not fully enter into either G20 or IMF debates.

The most important action was the largest issuance of SDRs in history, agreed to in 2009 for the equivalent of 250 billion US dollars. It should be remembered that since the initial SDRs were issued in 1970–72, new allocations have been associated with crises: 1979–81, 1997, and 2009. The allocation of 1997 only became effective in mid-2009 when the US Congress approved the

Table 2: SDR Allocations by Level of Development (in millions of SDRs)

	Allocations (million SDRs)			Allocation to each group by percent of total allocations		
	1970-72	1979-81	2009	1970-72	1979-81	2009
High income: OECD	6.796	7.906	109.095	73,6%	65,8%	59,7%
United States	2.294	2.606	30.416	24,8%	21,7%	16,7%
Japan	377	514	11.393	4,1%	4,3%	6,2%
Others	4.125	4.786	67.286	44,7%	39,8%	36,8%
High income: non-OECD	17	127	3.372	0,2%	1,1%	1,8%
Gulf countries	0	78	2.057	0,0%	0,7%	1,1%
Excluding Gulf countries	17	49	1.315	0,2%	0,4%	0,7%
Middle income	1.507	2.758	55.062	16,3%	22,9%	30,1%
China	0	237	6.753	0,0%	2,0%	3,7%
Excluding China	1.507	2.521	48.309	16,3%	21,0%	26,4%
Low income	913	1.226	15.125	9,9%	10,2%	8,3%
Total allocations	9.234	12.016	182.653	100,0%	100,0%	100,0%

Source: International Monetary Fund database.

amendments of the IMF Articles of Agreement, of which it was part (as it involved allocation to members who had joined in the 1990s). However, this instrument of cooperation still has limited effects. This is due primarily to the limited share – less than a third (see Table 2) – going to developing countries, which are the most active users of this instrument. Their use is also limited, because they essentially operate as an unconditional overdraft facility rather than a full reserve asset (Erten and Ocampo 2014).

In any case, the emission of SDRs gave way to a debate on the need to make regular and large allocations. Existing proposals include a variable mix of several recommendations: (i) the transformation of SDRs into a full reserve asset; (ii) a more active use of this instrument, by using it in particular to finance IMF lending; (iii) the inclusion of a »development dimension« in the allocation, by increasing the share of emerging and developing countries, recognizing that they have the largest demand for reserves; (iv) using SDRs for development programs, or to help finance the provision of global public goods, particularly to combat climate change; (v) the creation of a »substitution account« to manage shifts in the currency composition of reserves, to avoid their effects on foreign exchange market, following proposals that go back to the 1970s and that become increasingly relevant in a world of diversified reserve composition; and (vi) allowing the private use of this instrument to transform it into a true global currency. Most of these reforms would require a change in the IMF Articles of Agreement.[12]

After its 2009 proposal to reduce the role of the dollar, China focused on the internationalization of the Renminbi. This included the growing role of its central bank in swap arrangements, lending by its development bank (largely associated, in turn, to financing of Chinese exports), allowing Hong Kong to gradually create a market for Renminbi-denominated financial transactions and assets, and more recently London as a center for foreign exchange transactions undertaken in that currency. These moves will position the Chinese currency in a system that allows different currencies to compete among themselves. However, it is likely to succeed only partially, due to the advantages that the dollar will continue to have in the system – including providing the most liquid

12. For a more extensive analysis, see Erten and Ocampo (2014) and the contributions to the debate on the reforms of the global reserve system published by the Journal of Globalization and Development, Vol. 1, No. 2. 2010. Some of the most interesting proposals go back to that of the late IMF economist Jacques Polak (1979) and the Committee of 20 of the 1970s (Williamson 1977). Ocampo (2011) provides a recent positive perspective on the role of SDRs, whereas Eichengreen (2011) presents a skeptical view.

market in the world for dollar-denominated securities, an advantage that China is unlikely to enjoy for a long time. The Chinese Renminbi would require much larger financial liberalization in China, a step that it would have to carefully gauge on the basis of its domestic policy goals, particularly the financial instabilities that are associated with a more open capital market.[13]

4. Governance

Governance reforms in the international monetary and financial architecture should involve three interrelated issues. The first one is the design of a more representative international institution at the apex of the system, which would replace but could also evolve out of the G20. The second is to broaden and strengthen the participation of emerging and developing countries in »international economic decision-making and norms-setting,« as called forth by the Monterrey Consensus (United Nations 2002, par. 62). The third is to design a »dense,« multilayered architecture, in which global, regional, and sub-regional institutions interact in a constructive way.

In the first area, as mentioned earlier, the G20 designated itself in 2009 as the premier forum for macroeconomic and financial cooperation of major economies. In terms of developing countries' representation in economic decision-making, the G20 has been, of course, a step forward compared to the G7. The preference for »Gs« over representative international institutions – »elite multilateralism,« as I have called it (Ocampo 2011) – has been a historical bias of major developed countries, which prefer institutional mechanisms over which they can exercise direct control. Yet, this creates major problems, because ad-hoc, self-appointed bodies cannot replace representative institutions in a well-structured international institutional architecture.

The defense of such a structure is based on the idea that inclusiveness is sacrificed for the sake of effectiveness (Bradford and Lim 2011). However, the G20 is an unclear success story in this regard. Following the analysis in previous sections, it can be argued that it exercised leadership in the area of financial regulation and created new forms of macroeconomic cooperation. However, after a good start, its effectiveness has declined and, in general, it has failed to deliver on its commitment to generate »strong, sustainable and balanced global growth« (G20 2009, par. 13). Performance has also been weak in terms of representation, contribution to the coherence of the global system of governance, and the lack of an effective secretariat supporting the continuity of its actions (Ocampo and Stiglitz 2011).

Accordingly, a better option would be to transition toward a more representative, and thus legitimate, mechanism of international cooperation. In this regard, the best recent proposal was that made by the Stiglitz Commission to create a Global Economic Co-ordination Council (United Nations 2009: ch. 4). This Council would direct, coordinate and enhance cooperation among all institutions that are part of the UN system, including the BWIs and the WTO, which would become part of the system. It would identify and fill gaps in the current system of cooperation (e.g., the absence of a restructuring mechanism for sovereign debt), and strengthen synergies of different organizations in areas that need common attention – for example, environmental effects of trade policies, and effects of conflict on development, among many others. According to this proposal, the Council would be organized on the basis of constituencies, using a weighted voting system that would mix the economic weight of countries with basic votes. This voting structure would thus be akin to that of the BWIs, but it would correct the problems that the weighted votes of these organizations face today. The Palais Royal Initiative has also proposed the creation of a constituency-based organization as the apex of the international monetary system, which would replace the G20 (Boorman and Icard 2011: 24).

As mentioned earlier, the second of these reforms – enhancing the voice and participation of developing countries in economic decision-making – was launched at the UN Conference on Financing for Development that took place in Monterrey in 2002. Although this proposal predates the creation of the leaders' level G20, the endorsement of the latter was critical for the reforms adopted in 2010, which in turn built upon the modest agreements reached in 2006 and 2007.[14] The reforms included the doubling of quotas, increasing basic votes, revising the allocation of quotas, reducing by two the

13. See an analysis of the internationalization of the Renminbi in Yu (2012).

14. These governance reforms were matched by those of the World Bank, which I will not cover in this paper.

European representatives in the IMF Board, and electing all of its members. Relative to the situation prevailing before the Singapore 2006 annual meetings, where the first reforms were adopted, developing and transition economies increased their quota share by 3.9 percentage points and voting power by 5.3 points. The increase in quotas was largely concentrated in a few emerging economies – China, Republic of Korea, Brazil, India, Mexico, and Turkey, in that order – which gained in part at the expense of other emerging and developing countries. This was not the case of voting power, thanks to the increase in basic votes (Ocampo 2011). In any case, this reform should be considered as part of an ongoing process, because it failed to correct the over-representation of Western Europe in the IMF and the under-representation of some emerging economies, particularly those of Asia. Furthermore, the reform is still not effective as of May 2014 because the US Congress has not approved the additional capital contributions, and that country has veto power on the implementation of major IMF decisions.

Other governance issues have been raised by the 2009 Commission for IMF Governance Reform headed by Trevor Manuel (IMF 2009a) and the IMF's Independent Evaluation Office (IMF-IEO 2008). A crucial issue is the selection of the head and senior management on the basis of transparent and open processes and the merit of the candidates, and regardless of nationality. Although these principles were endorsed by the G20, the election of the IMF Managing Director in 2011 did not change preexisting practices, leading to the selection of another European candidate; the selection of the World Bank President in 2012 was similarly deficient, and once again led again to the choice of a US citizen.

The third element of governance reforms indicates that in a heterogeneous international community the creation of networks of global, regional, and national institutions can provide a better system of governance, because they give a stronger voice and a sense of ownership to smaller countries.[15] The best case in this regard is the system of multilateral development banks (MDBs), where the World Bank coexists with several regional and subregional banks, and an interregional one (the Islamic Development Bank). What this means in the case of the international monetary system is that the IMF of the future should be conceived as the apex of a network of regional reserve funds. A similar structure should be adopted for global financial regulation and supervision.

15. See the contributions to Ocampo (2006).

Regional arrangements in the monetary area have taken different forms – payment agreements, swap credit lines, reserve pools, common central banks – but today exhibit a rather hollow architecture.[16] As we saw in section II, the creation of a European Financial Stability Facility and the later European Stability Mechanism were the major developments in this area during the recent crisis. The Chiang Mai Initiative is the most ambitious involving emerging economies, but has not been used so far. The Latin American Reserve Fund is a smaller very successful institution made up of eight small and medium-sized Latin American countries. The BRICS members have also announced the creation of a Contingent Reserve Arrangement to provide liquidity through currency swaps.

The links between the IMF and regional arrangements should be subject to a »variable geometry.« In this regard, during the recent crisis, Europeans chose rescue packages in which the IMF was a partner (perhaps a junior partner) of the European institutions and involved programs with heavy conditionality. In contrast, as mentioned earlier, the strong »stigma« associated with IMF programs in East Asia explains why Chiang Mai has not been used, because beyond a certain limit, the use of its facilities requires an IMF program. As a result, countries that may have used the initiative during the recent crisis (possibly Indonesia and the Republic of Korea) did not do so. Eliminating the link with IMF programs is thus essential in this case. In turn, the use of the Latin American Reserve Fund has traditionally been delinked from any IMF program, and in fact has no conditionality attached to it.

5. Conclusions

The international monetary and financial architecture has experienced important reforms in recent years. They include: the strengthening of prudential regulation and supervision under the aegis of the Financial Stability Board, including the recognition of the role of macroprudential regulation; larger and better-structured counter-cyclical financing from a revitalized IMF; the creation of new re-

16. See, in this regard, the contributions to Volz and Caliari (2010) and the evaluation of the IMF of its relations with regional financial institutions (IMF 2013).

gional financial arrangements; the capitalization of MDBs and the recognition of the role they play as counter-cyclical policy instrument; the largest issuance of SDRs in history; and the creation of an elaborate system of macroeconomic policy cooperation among major economies.

These actions have been limited in many ways. The regulatory framework still faces major gaps, including the regulation of shadow banking and the expansion of derivative exchanges. The IMF continues to face a »stigma« for many borrowers, and the Chiang Mai Initiative – the most elaborate system of balance of payments cooperation involving emerging and developing countries – has not been used thus far. The under-capitalization of the World Bank implies that in the future, it is unlikely to play the very active role it did during the North-American financial crisis in terms of providing counter-cyclical financing. And, perhaps most importantly, the elaborate system of macroeconomic policy coordination has not avoided the creation of new global imbalances, the most important of which are the rising surplus of the EU and the rising deficits of a large group of emerging and developing countries. This implies that European adjustment has had »beggar-thy-neighbor« features as well as global recessionary effects, which have particularly affected emerging and developing countries.

Other elements of the architecture continue to be weak or absent. The first is the unsettled discussion as to the role of capital account regulations, a critical issue to provide policy space to emerging and developing countries in the face of capital account volatility. International monetary reform has not advanced beyond the large issuance of SDRs in 2009 and, particularly, has not taken steps to strengthen the role of SDRs in the global monetary system. This implies that the system continues to marginalize emerging and developing countries from reserve creation, except through the minority participation in SDRs allocations and the possibility of the Renminbi gradually becoming one of the secondary reserve currencies. And the world continues to lack a sovereign debt workout mechanism, which is essential for handling problems of over-indebtedness in an orderly way.

Improvements in the policy space that emerging and developing countries have enjoyed have depended mainly on the »self-insurance« provided by the accumulation of foreign exchange reserves. But this is costly, implies a transfer of resources to reserve-issuing countries, and may contribute to the creation of global imbalances and the recessionary bias of the system. Thus, policy space would be enhanced by a fuller use of capital account regulations, even with some global features, further improvement in unconditional counter-cyclical financing mechanisms – including through the expansion of regional financing networks – a better system of macroeconomic policy cooperation that avoids beggar-thy-neighbor policies, and the creation of an effective international debt workout mechanism.

Finally, ongoing reforms have not been matched by changes in the governance of the system. Reforms in this area should involve three elements: the design of a more representative apex organization than the G20; advancing further in the reform of »voice and participation« of developing countries in the Bretton Woods Institutions and the Financial Stability Board; and the design of a multilayered architecture, with active participation of regional and subregional institutions. Reforms have only been made in the second of these areas, and have had so far limited effects.

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Imprint

Friedrich-Ebert-Stiftung | Global Policy and Development
Hiroshimastr. 28 | 10785 Berlin | Germany

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This publication is printed on paper from sustainable forestry.

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ISBN
978-3-86498-933-9