

INTERNATIONAL FINANCIAL REFORM: CAN WE AVERT THE NEXT BUST?

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THE ROOTS OF THE CRISIS

- ❖ Regulatory deficit, more severe in industrial countries + Inadequate implementation of existing regulations.
- ❖ Loose monetary policies + no action against asset price bubbles.
- ❖ Worsening income distribution may have compounded the problems
- ❖ Global imbalances, with different interpretations: Asian “mercantilism” vs. “self-insurance”.

ISSUES IN THE AGENDA (1)

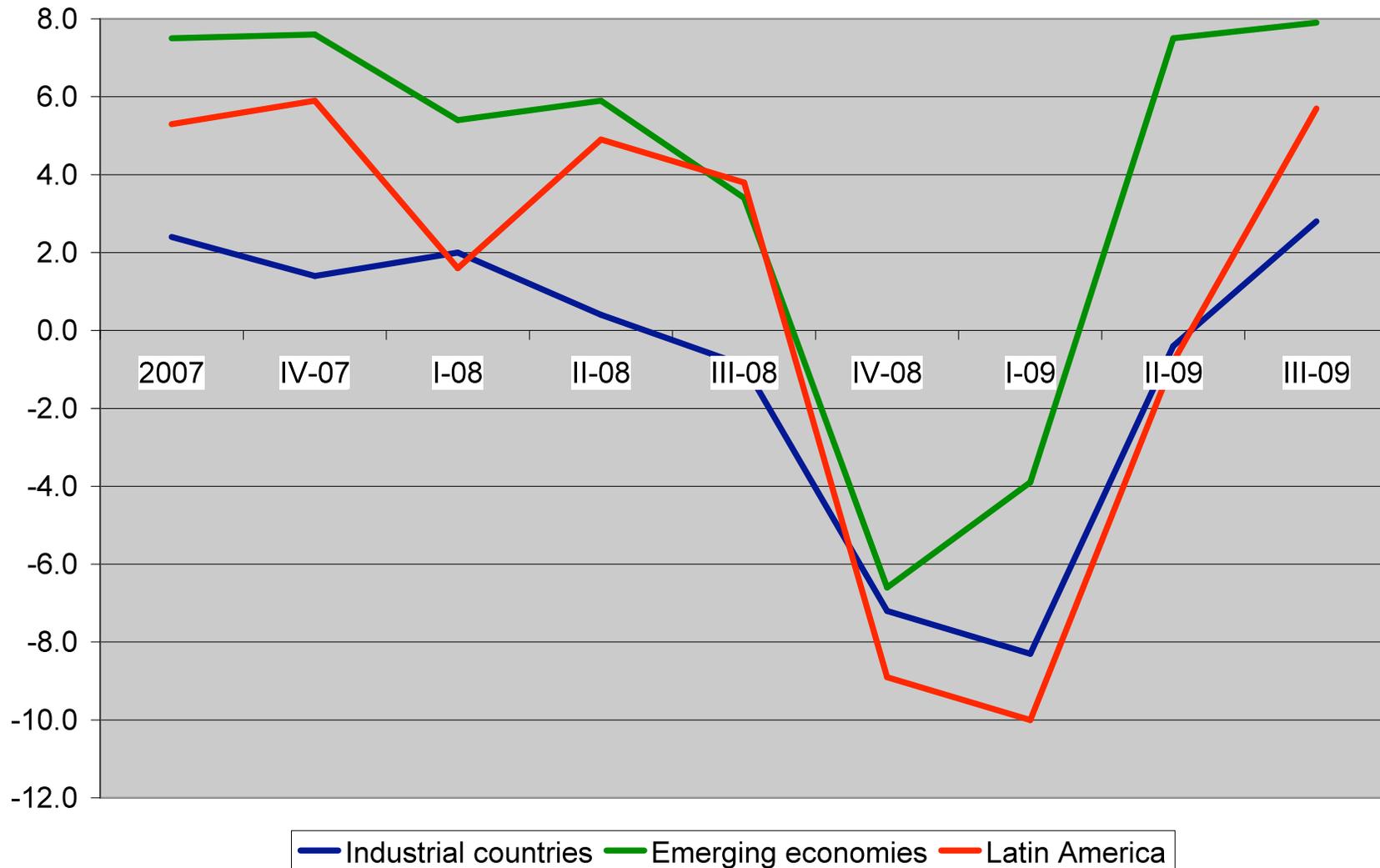
- ❖ Coordination of macroeconomic stimulus packages, both monetary (better coordination) and fiscal (less so). Financial bailouts were more chaotic.
- ❖ Support for developing countries to share in the recovery:
 - ✓ Issuance of SDRs for \$283 billion
 - ✓ \$750 billion in credit to IMF
 - ✓ Capitalization of multilateral development banks (largely pending)

ISSUES IN THE AGENDA (2)

- ❖ Strengthening financial regulation.
Broadened Financial Stability Board as the relevant forum.
- ❖ G-20 as the premier mechanism for policy coordination.
- ❖ [Fighting tax havens]
- ❖ [Working for a successful climate change deal in Copenhagen]

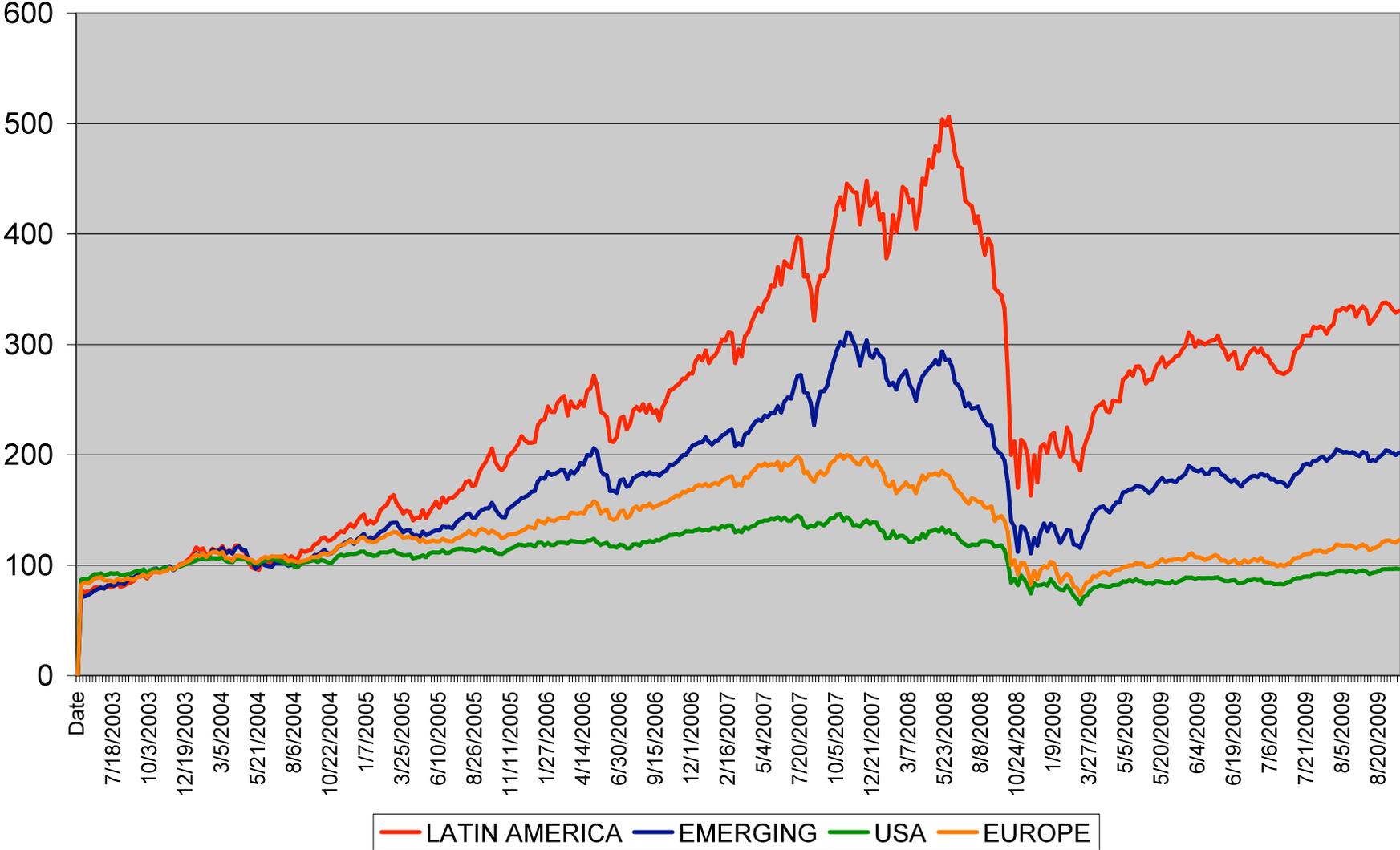
OVERALL: SPECTACULAR SUCCESS OF KEYNESIAN POLICIES...

Quarterly GDP growth annualized



... THOUGH PERHAPS WITH EMERGING MARKETS EXHUBERANCE

Stock Market Dollar Indices, (July 2003/June 2004=100)



ISSUES MISSING FROM THE AGENDA

- ❖ Increased aid for the poorest countries. Mechanisms in place are debt creating.
- ❖ International debt court, particularly for sovereign debt.
- ❖ Reforming the global monetary system: Proposals by China and the Stiglitz Commission.
- ❖ Role of the UN, despite the June UN Conference.

FOCUS ON THREE ISSUES

- ❖ Reforming financial regulation
- ❖ Global monetary reform
- ❖ Institutional mechanism

FINANCIAL REGULATION: The G-20 Consensus (1)

- ❖ **More comprehensive regulation:**
 - ✓ By instrument: securitization and derivatives.
 - ✓ By agent: hedge (alternative investment) funds, security dealers, retail stores' financial agents.
 - ✓ Strong preference for securities and derivatives markets vs. over-the-counter negotiations.
 - ✓ Credit rating agencies.

- ❖ **Counter-cyclical regulation:**
 - ✓ Capital cushions (or non-distributable reserves)
 - ✓ Counter-cyclical provisions
 - ✓ Stronger liquidity requirements

FINANCIAL REGULATION: The G-20 Consensus (2)

❖ Consumer protection:

- ✓ Financial Safety Commission (in US)
- ✓ Simpler products (even “plain vanilla”) to fight complexity. [Complex products are also more difficult to value].

❖ Cross-border issues: stronger supervision of international banks (college of supervisors).

❖ Dealing with “too big to fail” institutions:

- ✓ Breaking them up?
- ✓ New mechanisms (including “living wills”) to avoid use of taxpayer money in bailouts.

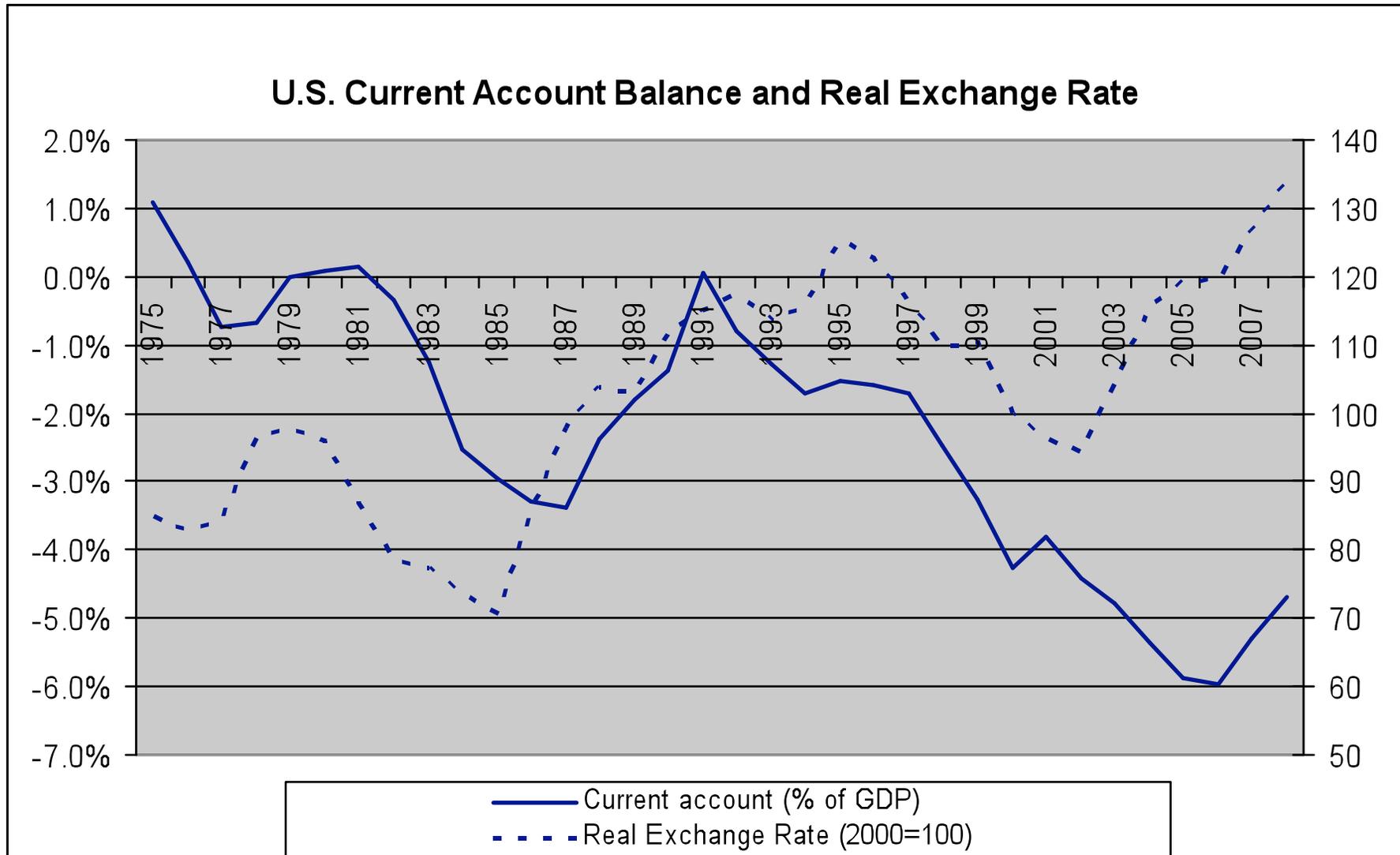
FINANCIAL REGULATION: The debate

- ❖ Regulating cross-border flows?
 - ✓ Tax or reserve requirements?
 - ✓ Minimum stay periods?
 - ✓ Regulating currency mismatches.
- ❖ Competence of different authorities:
 - ✓ Central vs. non-central bank regulation.
 - ✓ Coordination mechanism in systems with multiple agents (national/regional en EU, multiple agencies in US).
 - ✓ What role for global institutions (FSB): standards or norms?
- ❖ Will stronger regulation stifle innovation?

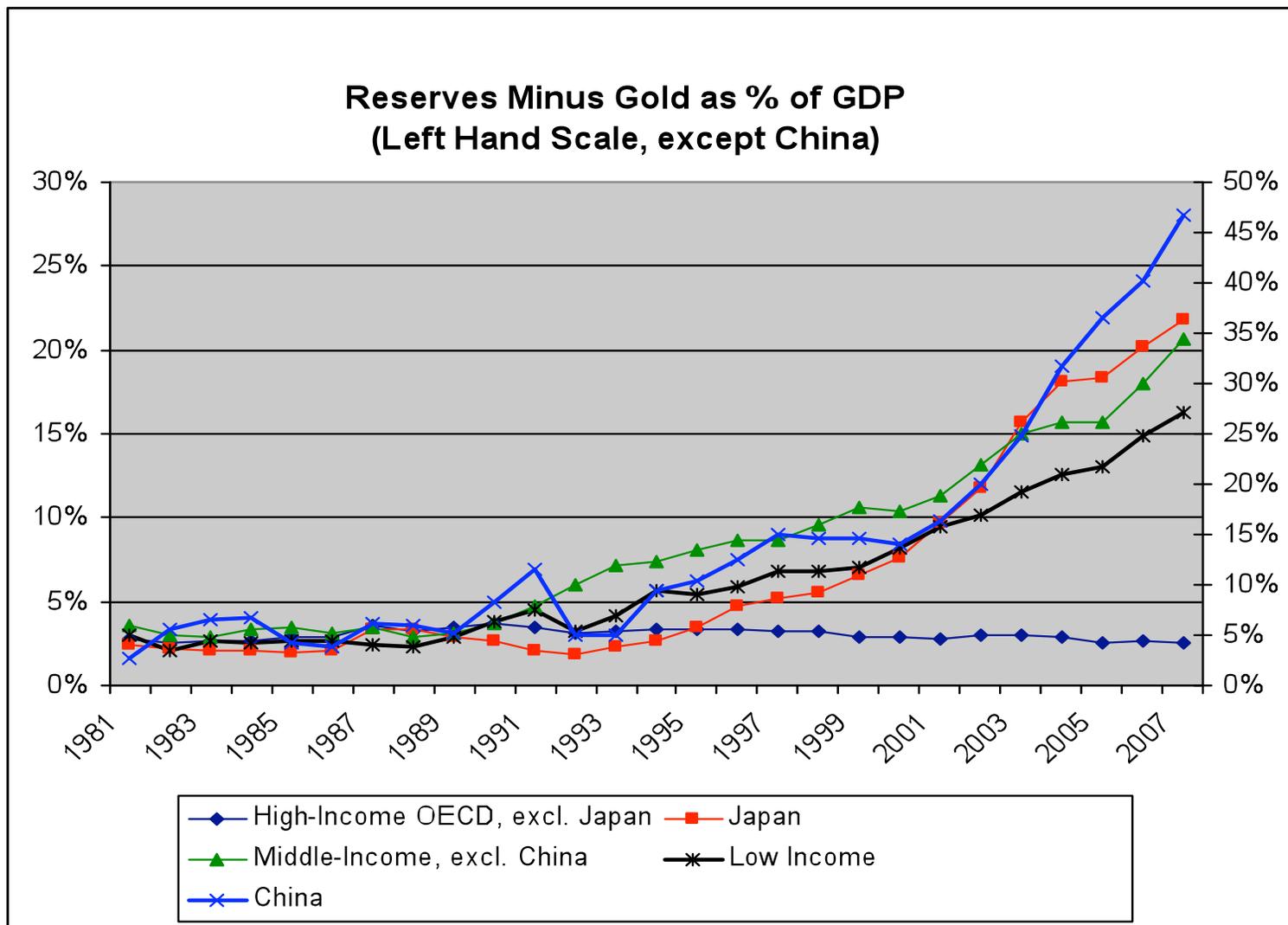
THE GLOBAL MONETARY SYSTEM: The problems

1. **Keynesian bias**: burden of adjustment falls on deficit countries.
2. **Triffin dilemma**: problems associated with the use of national currency as international currency (can generate inflationary bias under the fiduciary dollar standard)
3. **Growing inequities** associated with demand for reserves by developing countries (self-protection) + fallacy of composition effect (**instability-inequity link**)

GROWING DEFICITS AND INSTABILITY OF THE VALUE OF THE DOLLAR



GROWING DEMAND FOR FOREIGN EXCHANGE RESERVES BY DEVELOPING COUNTRIES



THE WORLD DEMAND FOR RESERVES SKYROCKETED AFTER THE ASIAN CRISIS

Accumulation of Foreign Exchange Reserves				
Million dollars				
	1982-90	1991-97	1998-02	2003-07
High income: OECD	42,805	30,889	59,358	140,715
Japan	5,588	20,164	48,307	98,320
Others	37,217	10,725	11,051	42,395
High income: non OECD		21,833	28,554	69,822
Middle income	6,734	56,950	63,739	548,444
China	2,725	16,168	29,673	247,831
Excluding China	4,009	40,782	34,066	300,613
Low income	212	1,952	3,654	17,938
World	59,946	111,624	155,305	776,919
Excluding China and Japan	51,633	75,292	77,325	430,768

THE GLOBAL MONETARY SYSTEM: Two alternative routes

❖ Multi-currency standard

- ✓ Would not be unstable as past systems of its kind
- ✓ Provides diversification
- ✓ But new instabilities and equally inequitable

❖ An SDR-based system

- ✓ Counter-cyclical provision or SDRs equivalent in long-term to demand for reserves.
- ✓ IMF lending in SDRs: either keeping unused SDRs as deposits, or Polak alternative

THE GLOBAL MONETARY SYSTEM: Development issues

Three alternatives

- Asymmetric issue of SDRs (according to demand for reserves)
- “Development link” in SDR allocation
- Encourage regional reserve funds, making contribution to the funds equivalent to IMF quotas for SDR allocations.

ATTRACTIVENESS OF THE SDRs SYSTEM FOR THE US

- The US would be able to maintain its current expansionary policy without need to take into account global repercussions
- Less leakages from its stimulus.
- The US dollar would still be used as the main world currency for transaction purposes ...
- ... though the system can also evolve into a broader use of the SDRs

THE INSTITUTIONAL QUESTIONS (1)

- ❖ Redistribute voting power in the Bretton Woods Institution.
 - ✓ Over-representation of Europe
 - ✓ Under-representation of Asia.

- ❖ The G-20: advantages and concerns:
 - ✓ Advance over the G-7/8
 - ✓ But it is a self-appointed, ad-hoc body, with problems of representation and legitimacy.
 - ✓ Awkward relation with existing institutions.
 - ✓ Similar problem with the Financial Stability Board.

THE INSTITUTIONAL QUESTIONS (2)

- ❖ Has the time come for a UN Global Economic Council?
 - ✓ Is the UN the appropriate house for global economic policy coordination?
 - ✓ It would have to be at the apex of the UN System, not the UN Organization
 - ✓ In any case, weighted vote, not “one country, one vote”

- ❖ A more limited issue: the UN as a forum for dialogue: Follow-up of the June UN Conference, and the Monterrey Consensus.

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