23

The International Monetary System and Economic Development

José Antonio Ocampo

1 Introduction

The 2007–2009 North Atlantic financial crisis[1] showed how dysfunctional the current international monetary and financial architecture is for managing today's global economy, and led to calls for reforms. Similar calls were made after the sequence of crises in the emerging economies[2] that sparked in East Asia in 1997 and then spread to Russia and Latin America, but reforms were then marginal at best.[3] The fact that the industrial countries were at the center of the more recent storm led to a broader set of initiatives.

The North Atlantic crisis was unleashed by the collapse of the market for subprime mortgage- backed securities in the United States (US henceforth) in August 2007, followed by that of several investment banks and other financial institutions, notably the bankruptcy of Lehman Brothers and the

[1] Following Mohan and Kapur (2014), I use this term rather than "global financial crisis" because, although the crisis had global effects, its epicenters were the US and Western Europe.

[2] The term "emerging economies" lacks a clear definition, in contrast with "developing countries", to which in a broader sense they belong. Broad access to international private capital markets may be their distinguishing feature. This is why I refer, in the discussion on capital flows and capital account crises, to emerging economies and not to developing countries as a whole.

[3] This was accompanied by extensive academic debates. See, among others, Kenen (2001), Eatwell and Taylor (2002) and Ocampo et al. (2007).

This chapter borrows from my previous work on the subject, particularly from Ocampo (2011 and 2017).

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near collapse of the American Insurance Group (AIG) in September 2008. European banking also suffered major problems generated by investments in US high-risk assets and the real estate euphoria and lending booms in several countries. All this made clear that there was significant deficit in the regulation and supervision of financial activities. The crisis led the Group of 20 (G-20) to re-regulate finance, particularly through the reformed Financial Stability Board (previously Forum) and the Basel Committee on Banking Supervision. These reforms, though positive, were characterized by a low speed of implementation and partial reversals.

In turn, the expansionary monetary policies and initially also the coordinated counter-cyclical fiscal policies helped moderate the recession, though with only gradual effects on economic activity, particularly in Europe. However, monetary expansion in developed countries generated large capital flows toward emerging economies, with major effects on exchange rates and current account balances. In the face of the flood of short-term capital, several emerging and developing countries responded by strengthening or reimposing capital account regulations. These facts, plus the debates during the boom years on the contribution of global payments imbalances to the North Atlantic crisis, as well as old calls for reforms of the role of the US dollar (simply dollar in the rest of this chapter) in the international economy, made clear that the global monetary system also needed deep reforms. Major proposals were made in the early post-crisis years, particularly those by the Chinese Central Bank governor (Zhou 2009) and the UN Commission of Experts on Reforms of the International Monetary and Financial System (United Nations 2009), headed by Joseph E. Stiglitz.

However, global monetary reform has been very limited. Important efforts were made to reform IMF credit lines and increase the resources available to this institution. The G-20 also agreed in 2009 to make the largest issue of IMF's Special Drawing Rights (SDRs) in history. Debates took place in the IMF in 2011–2012 on the role of capital account regulations as a macroprudential policy tool. Some reforms were also undertaken by the IMF in 2014 to improve market-based sovereign debt restructuring, and a debate took place in the United Nations in 2014–2015 to approve some principles in this area.

This chapter analyzes the international monetary system and the reforms it requires, particularly from the perspective of emerging and developing countries. It is divided in seven sections, the first of which is this introduction. Section 2 briefly analyzes the major features of the current international monetary system and sets the major objectives of a reform agenda. Section 3

delves into the global reserve system. Section 4 discusses the interlinked issues of monetary cooperation and the exchange rate system. Section 5 tackles capital account regulations. Section 6 focuses on the interlinked issues of emergency financing and sovereign debt workouts. In Sect. 7, I conclude with a brief analysis of the institutional design of the system.

2 The Need for a Comprehensive Yet Evolutionary Reform

Reforms of the global monetary system should take into account the characteristics of the global monetary system which evolved in an ad hoc way after the collapse of the original Bretton Woods arrangement in the early 1970s (Ocampo 2017). The abandonment of the gold-dollar parity in 1971 gave way to a system in which the fiduciary dollar is the main global currency, though in potential competition with others. The SDRs, although created in 1969 with the aspiration of making them "the principal reserve asset in the international monetary system",[4] play a secondary role. Major currencies float against each other, and IMF members were allowed in 1976 to adopt any exchange rate regime they chose, so long as they avoided "manipulating" their exchange rates—a term that, however, has lacked a clear definition. The attempt, in 1997, to introduce the principle that capital accounts should be liberalized ("capital account convertibility" in IMF terminology) failed, but market pressures and mainstream economic thinking largely imposed this principle in practice. As a result of the scale of capital account crises, the size of IMF financing packages tended to increase. The frequency of financial crises also led to a failed attempt by the IMF in the early 2000s to introduce a formal debt restructuring mechanism.

An additional element is global monetary policy cooperation. However, although this was envisioned as a major role of the IMF, it has been limited to exceptional circumstances and has generally relied on cooperation through ad hoc bodies (Gs) rather than the Fund. The most important efforts at strengthening macroeconomic cooperation were undertaken by the G-20 after the North Atlantic crisis, together with stronger bilateral and multilateral surveillance by the IMF of macroeconomic policies of major economies and their linkages.

So, the major elements of the (ad hoc) global monetary system that evolved out of the breakdown of the Bretton Woods arrangement are:

[4] IMF Articles of Agreement, Article VIII, Section 7, and Article XXII.

- a fiduciary dollar standard, seconded by competition of other currencies and by the irregular issues of SDRs;
- limited macroeconomic policy cooperation, generally under crisis conditions and outside the IMF but may be supported by this institution;
- freedom of countries to choose whatever exchange rate system they prefer, with flexible exchange rates being the dominant mechanism among major currencies;
- largely free capital movements or the market expectation that countries would move in that direction, but with the capacity of countries to control capital flows;
- IMF financing packages that are large relative to quotas but may be small relative to the magnitude of balance of payments crises; and
- debt restructuring limited to market-based mechanisms.

The two major crises of the last decades—that of major emerging economies in the late twentieth century and the North Atlantic financial crisis—have shown that the system must be reformed in a comprehensive way. What makes it viable is that many of the elements of such reform can evolve out of existing arrangements, as have been happening already with the issuance of SDRs, new IMF credit lines, the acceptance of capital account management as a macro-prudential policy tool and so on. The G-20 and its associated bodies have made advances in other areas, including new mechanisms of macroeconomic policy cooperation. So, advances under way create the real possibility of comprehensive yet evolutionary reform.

The major objective of the reform effort should, of course, be global macroeconomic stability. This objective must be consistent with the fact that the system is an *international* one—that is, based on different *national* monetary systems (regional in the case of monetary policy in the euro area and some other cases), which use their own fiduciary currencies, managed by authorities that obviously determine their policies based on their own national (or regional) priorities. The challenge is how to make that system consistent with a reasonable level of *global* macroeconomic stability, thus avoiding both expansionary and recessionary biases, and thus sharp world business cycles, as well as inflationary and deflationary surges. A second objective, and a major one from the point of view of emerging and developing countries, is to make the system more *equitable*. This requires helping to overcome the asymmetries that these countries face in the current system, in particular, the need to accumulate large amounts of foreign exchange reserves to manage the strongly pro-cyclical capital flows they face. In terms of governance, it also means an adequate voice and participation of these countries in global decision-making.

A comprehensive global monetary reform should, therefore, include seven major objectives[5]:

- designing an international reserve system that provides adequate international liquidity through mechanisms that are considered as fair by all parties;
- creating instruments that guarantee the consistency of national economic policies of major countries, thus contributing to the stability of the world economy;
- in close relation to this, and given the central role that it plays in balance of payments adjustments, designing an exchange rate system that promotes stability and avoids negative spillovers on other countries;
- regulating cross-border finance to mitigate the pro-cyclical behavior of capital flows and the risks it generates, particularly for emerging economies;
- offering appropriate emergency balance of payments financing during crises;
- creating adequate sovereign debt workout mechanisms at an international level to manage problems of overindebtedness;
- reforming the governance of the system to make it more inclusive—as we will see, an element of this reform is developing a "dense" architecture, in which the IMF is complemented by regional and interregional institutions.

In the following sections, I deal with these objectives and how they interact with each other.

3 The Global Reserve System

The basic characteristics—and associated deficiencies—of the current global reserve system have been identified in a sequential way in the global policy debate (Ocampo 2017, ch. 2). The first, underscored by Keynes (1942–43), is the *asymmetric adjustment* to payments imbalances that deficit versus surplus countries face: the former must adjust, particularly during crises, when financing dries out, but surplus countries do not face similar pressures to correct their imbalances. As Keynes underscored, this has been a characteristic of *all* international monetary systems—and, indeed, it was even more severe during the gold standard era. The major implication of this feature of the system is the global recessionary bias[6] it generates, particularly during crises.

[5] See parallel consideration on pending reform issues in Obstfeld and Taylor (2017).

[6] I prefer this term to "deflationary"—generally used in the literature—as this pressure is more likely to be reflected today in economic activity rather than in price deflation.

The second feature is the *Triffin dilemma* that characterizes a system in which a *national* currency is used as the major *international* currency. The essential problem, as formulated by Triffin (1961, 1968) in the 1960s, is that the provision of international liquidity requires that the country supplying the reserve currency run balance of payments deficits, but this tends, in turn, to erode the confidence in that currency. The collapse of the original Bretton Woods arrangement in the early 1970s was associated with this problem, as the increased supply of dollars in the international economy led to the collapse of the gold-dollar parity. Under the fiduciary dollar standard that has prevailed since then, the basic manifestation of the Triffin dilemma has been the alternation of periods in which the US runs current account deficits with others in which such deficits tend to be corrected; this cycle is accompanied by significant variations in the real exchange rate of the dollar (Fig. 23.1).

This indicates that the currency at the center of the current global reserve system has an unstable value and that the world economy is hostage to the monetary policy of the main reserve-issuing country, which is generally adopted with no regard to its international spillovers. This may have global implications, as the stability of the system may be inconsistent with the monetary policy objectives of the major reserve-issuing country (Padoa-Schioppa 2011). Also, the confidence in the dollar may be undermined by the fact that

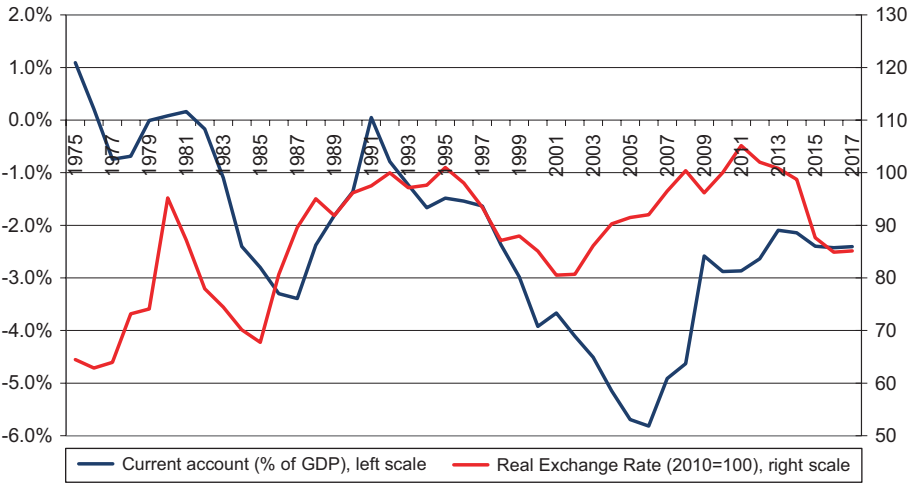

Fig. 23.1 US current account balance and real exchange rate. The real exchange rate is depicted here to show an increase when there is a real depreciation (the opposite convention to that used by the IMF). It is thus the inverse of the real exchange rate estimated by the Fund. For 1975–1980, it is estimated on the basis of the Fund series with base 2000
Source: IMF, *International Financial Statistics*

the net US investment position has been consistently negative since the early 1980s and has tended to deteriorate since then (see Mateos y Lagos et al. 2011, among others). However, although this is a potential problem, the dollar has continued to be the dominant global currency—and, indeed, somewhat paradoxically, that role was enhanced by the North Atlantic crisis, despite the fact that the US was at the center of the crisis.

The third characteristic of the system is the *inequity bias* generated by the need of emerging and developing countries to "self-insure" against strong volatility of capital flows through the accumulation of large amounts of foreign exchange reserves and, particularly, to defend themselves against "sudden stops" in external financing. Figure 23.2 shows that, starting in the early 1990s, and particularly after the crises faced by many emerging economies in the late twentieth century, the demand for reserves by all categories of low- and middle-income countries increased substantially, whereas that by OECD countries remained low, with the notable exception of Japan. This pattern has changed little since the North Atlantic financial crisis, but OECD countries have increased somewhat their demand for reserves, those of low-income countries have fallen somewhat, the upward trend of reserve accumulation by middle-income countries has moderated and that by China has fallen to levels similar to other those of middle-income countries.

Since reserves are invested in safe industrial countries' assets, the reserve accumulation is nothing else than lending to rich countries (particularly to the US) at low interest rates. This is what generates the inequity of the system.

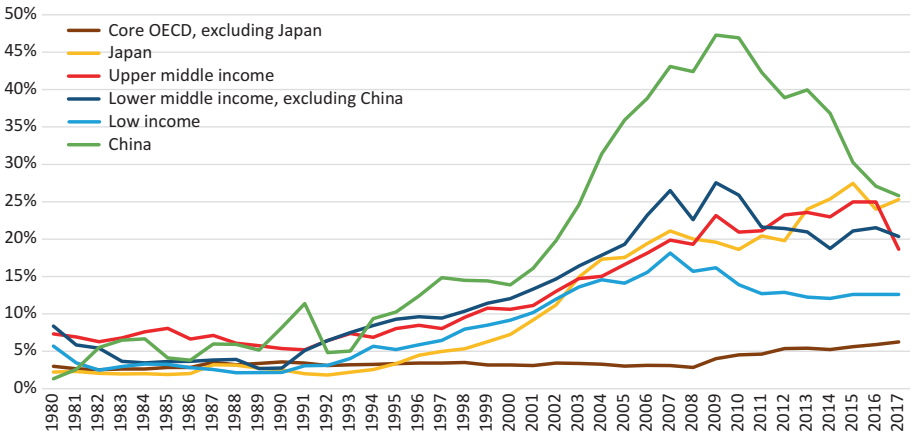

Fig. 23.2 Foreign exchange reserves by level of development (% of GDP). Countries are categorized by income levels according to the 2000 World Bank classification
Source: IMF, *International Financial Statistics*

Furthermore, if the majority or, at least, a large group of emerging and developing countries accumulate reserves by running current account surpluses or moderating their deficits, it will contribute to the generation of global imbalances. Reserve accumulation will also contribute to changing the composition of the demand for international financial assets, tending to increase the prices and reduce the interest rate of safe assets.

There are two alternative ways to reform this system.[7] The first is to effectively make it a multicurrency arrangement, something that it already potentially is. The second would be to fully exploit the role of the only truly global reserve asset that the world has created: the SDRs. In practice, these two alternatives can be combined, and this may be the only way to make the wider use of SDRs acceptable to the issuers of reserve currencies, particularly to the US.

On the first alternative, it should be underscored that, although the current system allows any currency to compete with the dollar as international means of payments and reserve assets, such competition has been weak. This means that the dollar enjoys stronger "network externalities", largely because there is no alternative to the market for US Treasury bonds in terms of liquidity and depth. The dollar is followed by a large margin by the euro, which showed a remarkable resilience as a reserve currency during the Eurozone crisis of 2011–2012. The British pound, together with the Swiss franc, the Australian and Canadian dollars, and more recently the Renminbi, plays a tertiary role.

The basic advantage of a multicurrency arrangement is that it allows reserve holders to diversify the composition of their foreign exchange reserve assets and thus manage the risks associated with fluctuations in the value of individual currencies. Although it may be convenient, as I argue later, to manage the exchange rate flexibility among major currencies, such flexibility is essential for the stability of the system, to avoid the problems that the original Bretton Woods arrangement faced due to the fixed gold-dollar parity as well as the collapse of bimetallism in the late nineteenth century. However, to manage the risks associated with possible reduction in the demand for a specific reserve currency, an IMF "substitution account" should be created, allowing countries to exchange for SDRs the reserves currencies they do not want to hold. This is one of the potential complementarities between the two reform paths. The creation of such an account was proposed by the US in the 1970s to manage the instability of the dollar, and it has come back periodically into the debate, but it was not adopted because of the lack of agreement on who would bear the potential losses that it could generate.

[7] Of course, more ambitious alternatives would be to return to Keynes' proposal for an International Clearing Union or to create a truly global reserve bank (see, e.g., on the latter, Stiglitz 2006, ch. 9), but none of these alternatives would be viable. A more active use of SDRs in the way suggested in this chapter has, in a sense, some elements of a global central bank.

However, aside from diversification, this reform path would not address any of the other deficiencies of the current system: the benefits from the reserve currency status would still be mainly captured by industrial countries, it would not solve the asymmetric adjustment problem and it would not reduce the demand of emerging and developing countries for self-insurance. Also, in the light of the growing world demand for foreign exchange reserves, it could further worsen the net investment position of the US and thus the Triffin dilemma.

The alternative reform path would be to enhance the role of the SDRs. The basic advantage of this reform path is that all countries would share in the creation of international liquidity (and the associated seignorage), and would make the system less dependent on the US dollar, making it less hostage to the macroeconomic policies and the potential risks of the deterioration in the US's net investment position. Of course, to make such benefits more equitable, IMF quota shares must be reformed. Furthermore, given the inequities associated with the differential demand for reserves by developed versus developing countries, it might be convenient to include a "development link" in SDR allocations.

Under current rules, the IMF makes SDR allocations proportionally to country quotas. The share of high-income countries has gradually declined, but it was still over 60% in the most recent allocation (see Table 23.1). Three allocations have been made since the creation of the SDRs: in 1970–1972, 1979–1981 and 2009; the latter included an allocation that had been agreed to in 1997 but had not been effective until the Fourth Amendment of the IMF Articles of Agreement of which a part was approved by the US Congress in 2009.

Table 23.1 SDR allocations by level of development (in millions of SDRs)

	Allocations (million SDRs)			Share in total allocations (%)		
	1970–1972	1979–1981	2009	1970–1972	1979–1981	2009
High income: OECD	6796	7906	1,08,879	73.6	65.8	59.6
United States	2294	2606	30,416	24.8	21.7	16.6
Japan	377	514	11,393	4.1	4.3	6.2
Others	4,125	4,786	67,070	44.7	39.8	36.7
High income: non-OECD	17	127	3588	0.2	1.1	2.0
Gulf countries	0	78	2057	0.0	0.7	1.1
Excluding Gulf countries	17	49	1531	0.2	0.4	0.8
Middle income	1488	2730	54,173	16.1	22.7	29.6
China	0	237	6753	0.0	2.0	3.7
Excluding China	1488	2493	47,420	16.1	20.7	26.0
Low income	933	1254	16,095	10.1	10.4	8.8
Total allocations	9234	12,016	1,82,734	100.0	100.0	100.0

Source: Author estimates based on IMF data and on World Bank classifications by level of development in 2000

As Fig. 23.3 indicates, the use of SDRs tends to increase after each allocation. From the mid-1980s to 2008, the use of SDRs fluctuated between 30% and 50% of total allocations. This proportion fell substantially after the large 2009 allocation, but it has tended to increase since then. Many countries tend to use their allocations, including high-income ones, but developing countries make a more frequent use of them (Erten and Ocampo 2013, and Ocampo 2017, ch. 2). Since countries that use them have to make interest payments to the IMF, they are not a pure reserve asset and should perhaps be considered as an unconditional overdraft facility.[8]

A more active use of this instrument should preferably make SDR allocations in a counter-cyclical way (Camdessus 2000; Ocampo 2002). Indeed, all allocations have been made during periods of turbulence in global markets; this includes the initial one, which coincided with the crisis of the US dollar. An alternative, of course, is to make regular annual allocations but with the capacity of the IMF Board to keep them on hold until global economic conditions make them necessary. Of course, issuance must take into account the global demand for reserves. Most estimates indicate that average allocations for the equivalent of US$200–300 billion a year (or slightly more) would be reasonable, but even this size of allocation would only increase the share of SDRs in non-gold reserves to just over one-tenth in the 2020s (Ocampo 2017, ch. 2). This indicates that SDR allocations would still largely complement other reserve assets.

Even a moderate reform along these lines would help mitigate the three major problems of the current system. First, as indicated, it would allow developing countries to partly benefit from the seignorage associated with the creation of international money. Second, if SDRs are allocated in a counter-cyclical way, they would constitute a global macroeconomic instrument to manage crises and would reduce the recessionary bias associated with the asymmetric adjustment problem. Third, they could help reduce the need for "self-insurance" by developing countries.

To enhance the first and third of these benefits, SDR allocations could include a "development link", an idea that has been on the table since the discussions of the 1960s. The best rule would be to include the demand for reserves as a criterion in SDR allocations. A simple rule could be that suggested by Williamson (2010), according to which 80% of allocations would

[8] Formally, they are both an asset and a liability. Countries receive interest for their net holdings and have to pay interest for their net use. This peculiar structure is a legacy of the debates of the 1960s, when France, against the view of most countries, opposed the idea of creating a pure reserve asset. See a review of this debate and the contemporary developments in the international monetary system in works by Solomon (1982, ch. 8) and Eichengreen (2008).

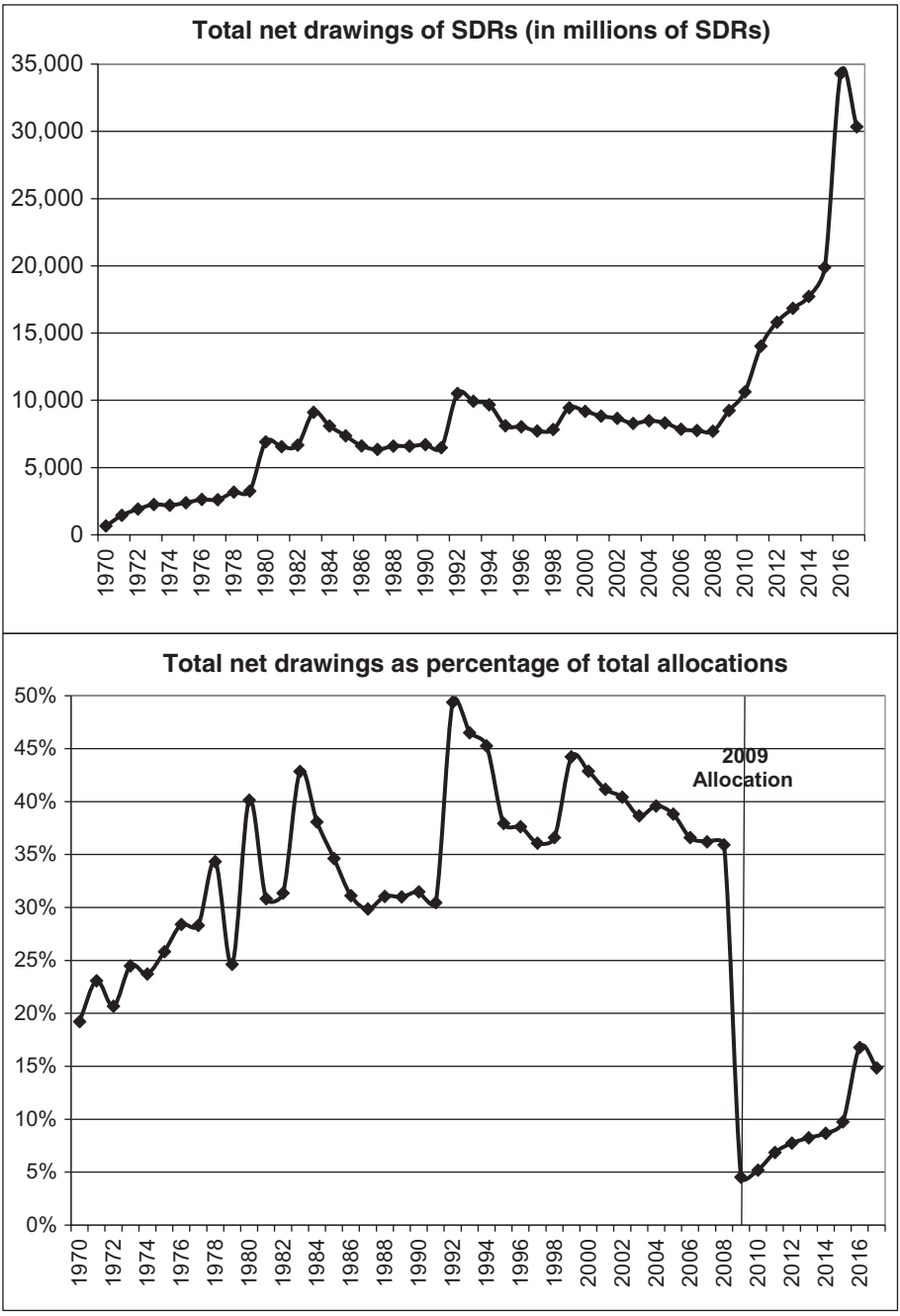

Fig. 23.3
Source: Author estimates based on IMF data

go to developing countries, with allocation among the groups of developed and developing countries made according to IMF quotas. A complementary solution that has been suggested by several authors is to allow unutilized SDRs to be used to provide or leverage financing for development (e.g., buying bonds from multilateral development banks) or support institutions that provide global public goods (such as climate mitigation and adaptation) (United Nations 2009).

In turn, to enhance the second of these benefits, allocation rules could make countries with large surpluses and/or excessive reserves ineligible to receive SDR allocations. This would help mitigate the asymmetric adjustment problem.

Following the proposals made by Polak (1979), the most important reform would be to finance *all* IMF lending with SDRs, as part of a broader reform to make the IMF operate exclusively in SDRs. This would make global monetary creation similar to how central banks create domestic money. The way he suggested would be to finance IMF lending during crises with new SDRs, which would be automatically destroyed once such loans are paid for. The alternative I have suggested is to treat the SDRs not used by countries as deposits in (or lending to) the IMF, which could then use them to lend to countries in need (Ocampo 2017, ch. 2). Either of these proposals would involve eliminating the division in the IMF between what are called the general resources and the SDR accounts (Polak 2005, Part II).

The use of SDRs to finance IMF programs would eliminate the need for the IMF to get financing from its members in the form of "arrangements to borrow" or bilateral credit lines. In fact, it would also eliminate the need to make additional contribution to the IMF through quota increases as well as the need of the IMF to manage multiple currencies, most of which are useless for its operations.

Several analysts have suggested that the private sector should also be allowed to use SDRs, making it a truly global currency (Cooper 2010; Eichengreen 2007; Padoa-Schioppa 2011). However, such private use of SDRs could generate problems of its own, particularly speculative changes in the demand for this global reserve asset. Such reforms could also face strong opposition by the US. For these reasons, it may be better to think of a mixed system in which the SDRs continue to be used mainly as reserve assets and medium of exchange in transactions among central banks (i.e., as "central bank money"), and national or regional currencies continue to play the major role in private transactions. Of course, countries or firms could issue bonds denominated in SDRs (China is actually doing so) or use this instrument as a unit of account for certain transactions, but these alternatives are less interesting than the pos-

sibilities of a broader official use of SDRs as a reserve currency and the financing of IMF programs.[9]

As pointed out, under a system that mixes SDRs with a multicurrency arrangement, a substitution account could be created, allowing central banks to substitute for SDRs other reserve assets they do not want to hold. Kenen (2010) has also suggested that it could be used in a transition mechanism to a more ambitious reform effort.

In any case, the most important reform would involve counter-cyclical *allocations* of SDRs that would increase international liquidity during crises and help fund counter-cyclical IMF *financing*. It would also involve designing criteria for SDR allocations that take into account the very different demand for reserves by developing versus developed countries. The introduction of a substitution account would make this system complementary to a multicurrency system. The mix between the two alternative paths of reform is the best practical option for moving forward.

4 Macroeconomic Cooperation and the Exchange Rate System

The main challenge of macroeconomic policy cooperation is managing global imbalances, which reflect structural, cyclical and short-term phenomena. The main structural factor is the tendency of the US to run persistent deficits under the current "fiduciary dollar standard", which has, of course, important implications for the Triffin dilemma. The surplus of oil-exporting countries is strongly cyclical, but has also structural dimensions. High savings rates may be seen as the source of the structural surpluses in East Asian countries, including Japan, the newly industrializing economies (NIEs) (though only in a consistent way since the 1997 crisis) and China. In the latter case (and perhaps of some NIEs in the past), it may have been associated in part with the undervaluation of the Renminbi, but this situation has been fully corrected.[10] Normally, as a group, other emerging and developing countries tend to run a deficit, whereas European other developed countries have a mixed pattern. In the case of Europe, an important example is the contrast between Germany and the United Kingdom (UK henceforth), normally surplus and deficit economies, respectively (see Fig. 23.4).

[9] See, for instance, the recent analysis and proposals presented by the IMF (2018).

[10] This is partly due to nominal appreciation but even more to relative wage movements, which are not captured in traditional estimations of real exchange rates. Indeed, in recent years, China has rather been making efforts to avoid a depreciation of the Renminbi, sacrificing a large amount of reserves.

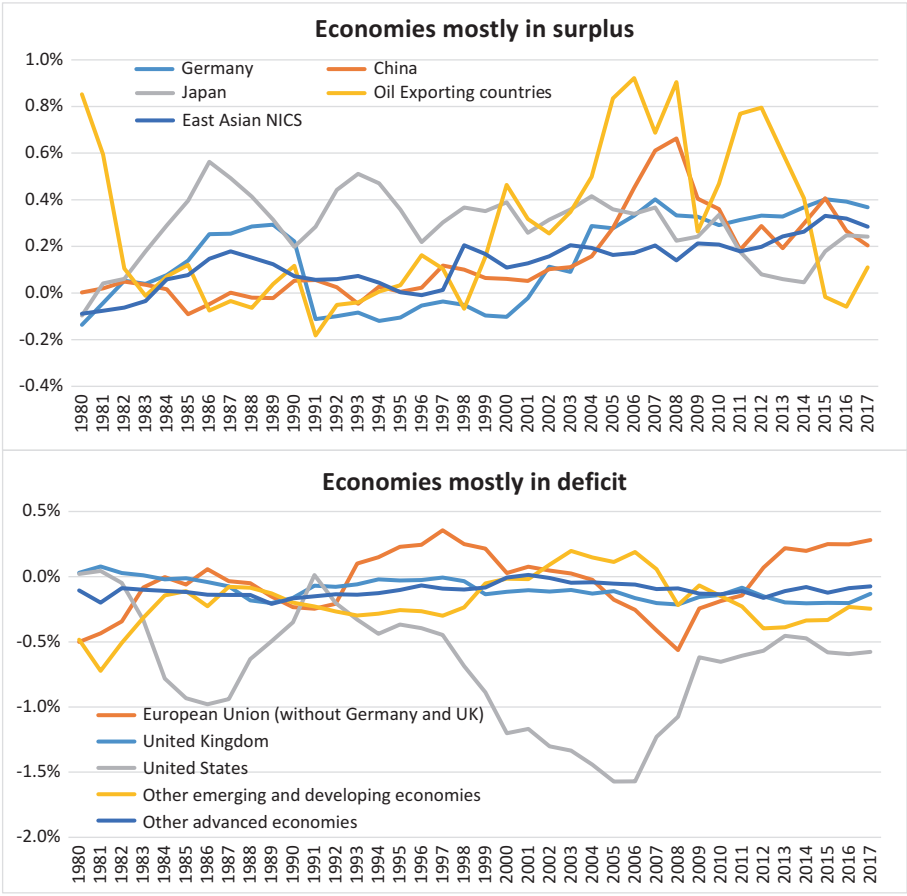

Fig. 23.4 Current account balances as a percentage of world GDP. (Notes: Oil-exporting countries: Algeria, Angola, Iran, Iraq, Kuwait, Libya, Nigeria, Norway Qatar, Russia, Saudi Arabia, United Arab Emirates and Venezuela. East Asian NICs (newly industrializing economies): Hong Kong, Republic of Korea, Singapore and Taiwan POC)
Source: Author estimates based on statistics from the IMF International Financial Statistics and updates in the World Economic Outlook. World GDP according to World Bank

One of the best cases of asymmetric adjustments of deficit versus surplus economies, but also of the global linkages associated with balance of payments adjustment, is that of the European Union, and particularly the Eurozone, after the outbreak of the North Atlantic financial crisis. There was a massive adjustment of the deficit economies (Greece, Portugal, Spain and Ireland, ordered by the magnitude of their 2007 deficit) and to a lesser extent of Italy. In contrast, the major surplus economy, Germany, but also others (the Netherlands, in particular) continued to run sizable surpluses. The net effect

was that the European Union moved from running a large deficit in 2008 to a large surplus by 2015. The change, which was equivalent to about 1% of world GDP, was similar to the reduction of the US deficit between 2006 and 2009. The mix of the two changes forced other economies to either reduce their surpluses (China and Japan), which may be seen as a positive phenomenon, or run deficits. The major case of larger deficits was that of other developing countries, which as a group moved from running a small surplus before the North Atlantic crisis to running a sizable deficit, a change equivalent to 0.6% of world GDP. The major mechanisms leading to this result was reduced import demand by the North Atlantic economies and the appreciation generated by massive capital inflows into emerging economies. Viewed overall, emerging and developing countries were thus negatively affected in terms of external balances by the adjustment of the European Union and of the US.

Overall, the evolution of payment imbalances over the past decades thus reflects the deficiencies of the international monetary system: the Triffin dilemma, the asymmetric pressures on deficit versus surplus countries to adjust, and pro-cyclical capital flows to emerging/developing countries. A fourth phenomenon has also been at work: the strong cyclical pattern of the balances of oil-exporting countries, which generates a strong demand for recycling their surpluses during periods of high oil prices, but also reduces the supply of financing during periods of low prices.

To manage these imbalances, the world counts with a limited set of mechanisms of macroeconomic policy dialogue and cooperation. The IMF was, of course, created to serve as the major multilateral institution for this purpose, but most macroeconomic cooperation over decades has taken place outside the IMF, through support among major central banks and ad hoc groupings of major economies—G-10, G-7 and, more recently, the G-20, which self-designated itself, at the peak of the North Atlantic financial crisis, as "the premier forum for our international economic cooperation" (G-20 2009). In short, macroeconomic cooperation has taken place predominantly through mechanisms of "elite multilateralism"—a term I have proposed (Ocampo 2011)—rather than through the formal multilateral organization that the world has created for that purpose.

G-20 cooperation was successful in the initial phase of the crisis, when the major economies adopted complementary expansionary monetary and fiscal policies. However, in relation to fiscal policies, the consensus broke down in the June 2010 Toronto meeting, when some major economies moved to place their priority on public sector debt sustainability. The European Central Bank also temporarily reversed its monetary stimulus in 2011. The need for continued monetary stimulus in the advanced economies was a major source of capital

flows toward emerging economies, which in turn generated the strong exchange rate pressures that these economies faced—that is, a "currency war", the term then coined by the Brazilian finance minister Guido Mantega.

The G-20 launched in Pittsburgh in 2009 its major instrument of macroeconomic policy cooperation: the Mutual Assessment Process (MAP). In 2011, it agreed that "the persistently large imbalances that require policy action" under the MAP are public sector deficits and debts, private savings and private debt and external current account imbalances, taking into consideration the macroeconomic policies of different countries that may generate these imbalances (G-20 2011a). The G-20 countries later defined the indicative guidelines for each indicator, which were explicitly defined as "reference values" and not as targets (G-20 2011b).

In practice, the IMF provides the main technical support to the MAP and makes its own policy recommendations to guarantee the consistency of the macroeconomic policies of major economies (IMF 2011). In turn, aside from strengthening their own bilateral surveillance of major economies through Article IV consultations,[11] it created a myriad of new multilateral surveillance reports: the Consolidated Multilateral Surveillance Report, the Spillover Reports for the "systemic 5" (the US, the UK, Eurozone, Japan and China) and the external sector reports assessing global imbalances. In 2010, it was also decided that all systemically important financial economies (25 jurisdictions) must be subject to financial sector assessment programs (FSAPs).

This is, no doubt, the most elaborate system of surveillance and macroeconomic policy dialogue that has been ever put in place. It also places particular attention to the economies of systemic importance. But whether this mix of stronger surveillance and peer pressure is effective in terms of inducing changes in the macroeconomic policies of major economies continues to be the major question. Its incapacity to avoid the asymmetric adjustment in the Eurozone and the spillovers generated by the expansionary monetary policies of developed countries on emerging markets since the North Atlantic crisis are two clear manifestations of its, at best, limited "traction"—to use a typical IMF term. So, it may be essential in the future to move to specific macroeconomic *targets*, particularly the current account and foreign exchange reserves levels, following recommendations that go back to the debate of the 1970s.[12]

[11] The more "candid" assessment of major economies in Article IV consultations was a response to the views, held by the IMF's Independent Evaluation Office (IMF-IEO 2011), among others, that the Fund had lacked strong assessments of major developed countries in the run-up to the North Atlantic financial crisis.

[12] The US backed at the time a "reserve indicator" system, under which each IMF member would have been assigned a target level of reserves and forced to adjust to keep reserves around that target.

This may be particularly important in relation to exchange rates. The importance of this issue is its relation not only to the correction of global imbalances, but also to another major purpose of the IMF, which, as stated in the Article of Agreement, is "to facilitate the expansion and balanced growth of international trade" (Article I). The major problem is that with the breakdown of the original system of fixed but adjustable pegs, the world moved into what can be clearly characterized as a "non-system", as all countries are essentially free to choose their exchange rate regime, subject only to the condition that they avoid manipulating their exchange rates to gain competitive advantages, as stated in the revised Article IV approved in 1976. This was also the focus of both the 1977 and 2007 decisions on bilateral surveillance of exchange rate policies. The basic problem is that none of these decisions provided a clear definition or criteria to determine when a specific country is "manipulating" its exchange rate. The complexity of this issue is, of course, that "manipulation" could take place, not only in a direct way (fixing a specific exchange rate or band or intervening in foreign exchange markets) but also indirectly through other macroeconomic policies that may affect this variable.

An alternative would be to allow countries to use the World Trade Organization's (WTO) dispute settlement mechanism to argue that other partners are manipulating the exchange rate, as Matoo and Subramanian (2008) have proposed. But this is not a good idea, as it could end up weakening one of the few successful mechanisms for enforcing international agreements. It would also ignore that exchange rates may respond to other elements of macroeconomic policies or to financial flows and associated boom-bust cycles. These are basic reasons why exchange rate policies should continue to be under IMF jurisdiction, as part of broader mechanisms of macroeconomic policy cooperation.

The system should, therefore, be improved by introducing elements that enhance the capacity of exchange rates to contribute to correcting global imbalances and providing a reasonable level of exchange rate stability among major currencies, which is crucial for international trade. The best system may be one of *reference rates* among major currencies, which was initially suggested by Ethier and Bloomfield (1975), and later by Williamson (1983, 2007), among others. This would imply that currencies would be subject to some form of managed floating around multilaterally agreed parities or bands, particularly in the case of major currencies. Interventions in foreign exchange markets and other macroeconomic policies would support the movement of exchange rates toward the agreed bands. In turn, if interventions and policies help exchange rates move in the opposite direction, it may be argued that countries are "manipulating" the exchange rate. An additional advantage of this system is that it would also give some guidance to markets.

This system should, of course, take into account all macroeconomic determinants of the exchange rate and payment imbalances—for example, the broader set of indicators chosen by the G-20 for its MAP. It could also take into consideration global output (employment) gaps and inflationary or deflationary pressures. But a simple set of indicators should be preferred, mixing reference exchange rate with information about current account deficits, reserve levels and global output gaps.

In the case of emerging and developing countries, it should be noticed that they moved to more flexible exchange rate regimes in the 1970s, following the collapse of the original Bretton Woods arrangement and the adoption of flexible rates by developed countries.[13] The move was less sharp in middle-income countries, which had been using a broader set of exchange rate flexibilities (such as the crawling peg) since the 1960s. The popularity of greater flexibility increased among emerging and developing countries in the 1990s[14] only to give way to more cases of managed flexibility after the crises they experienced in the late twentieth century. This implied a pragmatic rejection by authorities of what came to be known as the bipolar view defended by Fischer (2001), according to which only freely floating exchange rates or hard pegs are stable exchange rate regimes.

5 Capital Account Regulations

The central role that capital flows play in determining exchange rates and macroeconomic activity brings into focus an additional leg of international monetary reform: the management of the capital account. International capital flows are also a major determinant of financial stability, again particularly in the case of emerging economies. Paradoxically, however, *cross-border* finance was entirely left out of the financial stability agenda of the G-20 and Financial Stability Board. It was, nonetheless, taken up by the IMF as part of global monetary reform. In this regard, the IMF adopted in 2012 an "institutional view", which implies that regulating (or managing)[15] cross-border capital

[13] For a discussion of the evolution of exchange rate regimes, see Reinhart and Rogoff (2004), Ghosh et al. (2015) and Ocampo (2017, ch. 3).

[14] There was also the spread of what Reinhart and Rogoff (2004) call "free falling" exchange rates, which were the results of high levels of inflation. The group of countries in this situation increased in the 1970s and 1980s, peaking in the early 1990s before falling sharply, as part of the worldwide reduction in inflation rates.

[15] The terms "regulation" or "management" of the capital account should be clearly preferred to the most common use of "controls", as they have significant similarities with other financial prudential regulations and can include price-based mechanisms. Indeed, the common use of the word "controls" carries an implicit stigma. For a broader discussion on this issue, see Gallagher (2014) and Ocampo (2017, ch. 4).

flows is a useful instrument of macroeconomic adjustment under certain conditions (IMF 2012). Managing capital flows had, of course, been an area of consensus in the Breton Woods discussion, except when they affected international trade. "Current account convertibility" was, therefore, introduced as a basic principle in the IMF Articles of Agreement, but there was no commitment to "capital account convertibility". The attempt in 1997 to introduce the latter into the Article of Agreement—that is, the liberalization of cross-border capital flows—was defeated, mainly by the opposition of developing countries.

The essential problem is that finance in general, and capital flows in particular, are highly volatile and pro-cyclical. Furthermore, capital account volatility tends to be stronger in emerging market economies than in advanced economies. Low-income countries are less affected by this problem due to their greater dependence on official flows, but some of them have been dragged into a similar volatility phenomenon as private capital flows started to taper the so-called "frontier markets" after the North Atlantic crisis. Swings in sovereign risk spreads, net flows and availability of long-term financing are some of the determinants (and, under certain conditions, *the* major determinants) of business cycles in emerging economies (Prasad et al. 2003; Ocampo et al. 2008). The fact that domestic financial markets are more incomplete and characterized by variable mixes of currency and maturity mismatches in portfolios is the basic source of vulnerability. This also implies that room for maneuver of macroeconomic policy is more limited, indeed forcing authorities on many occasions to adopt pro-cyclical policies, particularly during balance of payments crises, but also during capital account booms.

One of the major determinants of capital flows to emerging economies is monetary and financial conditions in advanced economies, which operate as "push" or "pull" factors, positive or negative. A major case of a push was, as already pointed out, the massive capital flows toward emerging economies and some frontier markets generated by expansionary monetary policies in developed countries after the North Atlantic crisis. The major problems in this regard are that such flows are entirely delinked from the demand for capital by emerging countries and that, due to the relative size of advanced countries' financial systems, a small change in their portfolios can have major effects on emerging economies.[16]

[16] According to Bank for International Settlements data, the peak of emerging and developing countries in the issuance of bonds and notes in the international market was before the East Asian crisis and was less than 15%. Before the North Atlantic crisis, it had fallen to just 7%. See Ocampo (2017, Table 4.2).

The 2011–2012 IMF debate on this issue recognized that capital account regulations ("capital flow management measures", CFMs in IMF terminology) may have an important role in supporting macroeconomic and financial stability, as part of the broader family of "macro-prudential" regulations and as a complement and not a substitute for appropriate macroeconomic policy. This implies, in turn, that there is no presumption that full liberalization of capital flows is an appropriate goal for all countries at all times, an idea that had already spread in emerging and developing countries since the series of crises of the late twentieth century. These ideas were incorporated into what came to be known as the IMF's *institutional view* on liberalization and management of capital flows (IMF 2012).

The IMF view has a preference for regulations of inflows over outflows, for price-based over-administrative ones (quantity based, in the terminology of the debate) and for those that do not discriminate according to the resident of the agents involved. It also tended to regard these regulations as a sort of "interventions of last resort"—that is, as policies to be adopted once other macroeconomic options had been exhausted. However, this view is too narrow. They should be seen as part of the *normal* toolkit of macroeconomic interventions that should be used *simultaneously* with other macroeconomic policies to limit excessive capital inflows or outflows, avoid strong business cycles and excessive exchange rate instability and, more generally, increase the policy space for counter-cyclical macroeconomic policies.[17]

In turn, capital account regulations should be seen as a continuum, which go from prudential regulations on assets and liabilities in the domestic currency, through those that relate to the use of assets and liabilities denominated in foreign currencies in the domestic financial system, to regulations on cross-border capital flows as such. The particular mix would depend on the characteristics of the domestic financial system of the countries involved and of course on the policy objectives of their authorities (Ocampo 2011; Ostry et al. 2010, 2011). There should be no presumption that regulation of inflows should be preferred over those on outflows—in fact, the latter may be more effective—and administrative regulations may be more effective than price-based mechanisms. Avoiding discriminating between domestic and foreign residents may also be impossible in practice, given their very different demands for domestic assets. More broadly, regulations should be used pragmatically and modified dynamically to avoid their elusion. Interestingly, this more pragmatic view is implicit in the only framework on this issue adopted by the G-20 (2011c).

[17] For a critique of the IMF view along these lines, see Gallagher and Ocampo (2013).

Overall, there is significant evidence that capital account regulations improve the composition of capital flows toward less volatile flows and increase monetary independence by partly weakening the trade-off that authorities face between monetary policy autonomy and exchange rate stability, particularly in emerging economies. There have been strong debates on other effects, particularly on those on exchange rates, where several authors have found that they are temporary or statistically insignificant. Studies also indicate that all these effects are stronger for emerging and developing countries. If impacts are temporary, this could be interpreted as the need for authorities to dynamically adjust regulations to take into account the response of the private sector, including "innovations" to circumvent them.[18]

The IMF institutional view also recognized that source countries should "better internalize the spillovers from their monetary and prudential policies" (IMF 2012, par. 36). This implies, in particular, that there should be "a more consistent approach to the design of policy space for CFMs under bilateral and regional agreements" (IMF 2012, par. 33). This is the principle that should apply to rules that limit the use of capital account regulations in free trade agreements (particularly those with the US) and on the liberalization of capital flows of the Organization for Economic Cooperation and Development (OECD). So far, however, there has been no significant action to apply these principles in those agreements.

6 Crisis Resolution: Balance of Payments Financing and Sovereign Debt Workouts

6.1 Balance of Payments Financing

The creation of credit lines to counteract or at least mitigate the contractionary effects of balance of payments crises was one of the major innovations that came with the creation of the IMF. The initial framework aimed at financing current account imbalances, as those associated with capital outflows were supposed to be managed by interventions in the capital account. However, with the reconstruction of private international capital markets, crises came to be increasingly associated with capital flows. Since the 1960s, a major issue was, therefore, how to provide support in the face of capital account crises. The importance of this issue was further raised by the balance of payments

[18] For reviews on this debate, see Magud et al. (2011), Erten and Ocampo (2017) and Ocampo (2017, ch. 4), among others.

crises in emerging and developing countries during the last decades of the twentieth century. This required a much larger scale of financing relative to quotas—"exceptional access" in IMF terminology. The contagion associated with international financial crises came also with the call for preventive or precautionary facilities to mitigate and hopefully avoid this problem. The swap facilities that central banks from developed countries had been creating since the early postwar period[19] also responded to these demands. These elements were also present in the major reforms adopted after the North Atlantic financial crisis, which was one of the major reforms in IMF history (IMF 2009b). The design of new facilities has been accompanied with debates about IMF conditionality, which are as old as the Fund but were particularly heated after the crises of emerging economies of the late twentieth century.

Figure 23.5 indicates that Fund lending has clearly met its counter-cyclical objective through history. The peaks of financing have followed major crises: those generated by the return of volatile capital flows in the 1960s, the 1973 oil shock, the Latin American debt crisis, that of a broader set of emerging markets in the late twentieth century, and the North Atlantic financial crisis. Lending to high-income countries was larger during the first two, but then emerging and developing countries came to dominate IMF financing, with some high-income countries returning to the IMF during the most recent crisis.

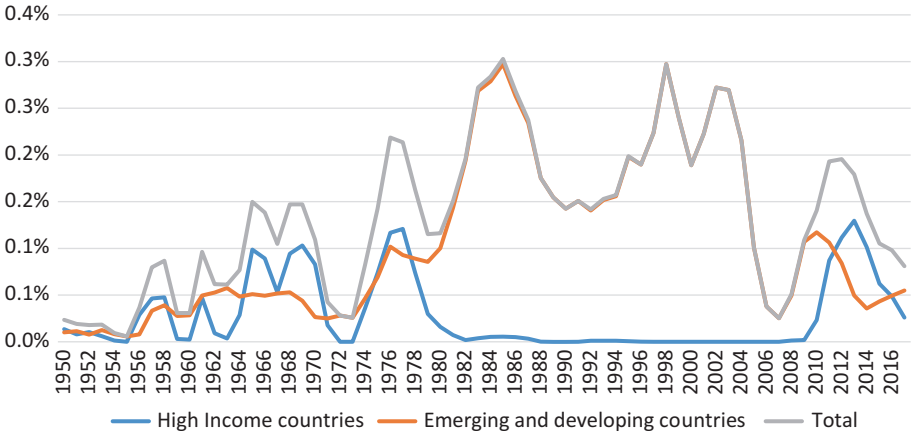

Fig. 23.5 IMF lending relative to world GDP. World GDP according to Ocampo (2017), which coincides with World Bank in recent decades. Countries are categorized by income level according to the 2000 World Bank classification
Source: IMF, *International Financial Statistics*

[19] Some of them were made available under the umbrella of the Bank for International Settlements, which was also active in raising financing packages for the UK, which faced the decline of the sterling as an international currency.

Exceptional financing to manage capital account crises came with stronger procedures for decision-making and program evaluation, a rigorous analysis of debt sustainability and considerations of whether countries have good prospects of regaining access to private capital markets. A major constraint has been all along the lack of institutional debt workout mechanisms that countries could use to manage unsustainable debt burdens.

The creation of a successful precautionary facility in 2009, the Flexible Credit Line (FCL), which lacks ex ante conditionality and is aimed at countries with "solid fundamentals" but a risk of facing contagion, came after several failed attempts—the 2003 Contingent Credit Line, the 2006 proposed Reserve Augmentation Line and the 2008 Short-Term Liquidity Facility. However, its use has been quite limited, indicating that it still carries the stigma associated with borrowing from the IMF. Swaps facilities are much better in this regard; as indicated, they are the major mechanisms for liquidity financing among developed countries' central banks.

The 2009 reforms also included the doubling of the size of other credit lines, the wider use of traditional stand-by agreements for preventive purposes, to which a new Precautionary Credit Line (later called Precautionary and Liquidity Line) was added in 2010 for countries that do not meet the criteria of the FCL. For the poorest countries, the Poverty Reduction and Growth Facility created in 1999 was transformed into the Extended Credit Facility in 2009. Other facilities were made available to these countries for shorter-term difficulties associated with temporary external shocks and natural disasters. The most important reform for these countries was, however, the decision to move from a single design to a menu of options, which allows low-income countries with stronger management capacity and limited debt vulnerabilities to eventually access non-concessionary facilities (IMF 2009c).

The 2009–2010 reforms have been insufficient in two ways. The first is that the resources available for IMF lending have lagged behind other global aggregates. This is despite the increasing demand for financing, particularly to manage capital account shocks. Hence the importance of quota increases but, even more, as argued above, of using SDRs as a source of resources for IMF lending. The second is the need to continue making progress in designing financing facilities that either are automatic or have simpler prequalification processes to overcome the stigma associated with borrowing from the IMF, which is associated with conditionality.

The focus of debates on conditionality has changed over time. One of the older debates relates to whether countries should be subject to strict conditionality when crises originate in adverse external shocks rather than as a result of expansionary domestic policies and when deficits are expected to be temporary

and self-reversing. The low-conditionality compensatory financing facility created in the 1960s as well as the oil facilities of the 1970s were designed to face external shocks, but the low-conditionality features of the compensatory facility were gradually dismantled later on. As indicated above, an additional reason for low or no conditionality is financing to avoid contagion.

However, the most important criticisms of conditionality came with its extension beyond the strict macroeconomic realm, to include structural adjustment. This became a typical pattern in the 1980s and 1990s with the balance of payments crises of emerging economies and reinforced with the major economic reforms of the transition economies in the 1990s. Criticisms of the structural adjustment go back to the 1980s but became frontal after the East Asian crisis.[20] The major criticism was that such conditionality was too rigid and uniform, reflected controversial orthodox views on economic reforms and was excessively intrusive on domestic decision-making processes. Furthermore, in some cases, they reflected pressures from influential countries on what they wanted specific borrowing countries to do.

The guidelines on conditionality approved in 2002 (IMF 2002) were steps in the right direction. They introduced three basic principles: (i) member countries' *ownership* of policies; (ii) the requirement that structural conditions should be *macro-relevant* and focus on the core competencies of the IMF (monetary, fiscal and exchange rate policies, as well as financial system issues); and (iii) the need to streamline conditions to those that are *critical* to achieve program goals. These reforms were complemented in 2009 with the elimination of the relationship between IMF disbursements and structural conditionality (the structural performance criteria) and the elimination of ex ante conditionality for the FCL. Overall, existing evaluations, particularly by the IMF's Independent Evaluation Office, indicate that the volume of structural conditions has decreased since the mid-2000s and that conditionality has focused on the macro-relevant areas but that there is limited evidence that these advances have been reflected in increased ownership and reduced stigma of IMF programs (IMF-IEO 2007, 2018). This indicates again that much more has to be done to design automatic credit facilities with no conditionality, making them available to a larger set of countries.

The counter-cyclical role of IMF lending should be complemented by other mechanisms, as part of what has come to be called the "global financial safety net". Notable among them is counter-cyclical lending by multilateral development banks. As indicated, swap facilities are already the major mechanism among

[20] For early criticism of structural adjustment, see Cornia et al. (1987). The best-known criticism after the East Asian crisis is the work by Stiglitz (2002).

developed countries; in the case of the FED, they were temporarily extended to a few emerging economies (Brazil, Mexico, the Republic of Korea and Singapore) during the peak of the North Atlantic crisis. There is also a growing use of swap facilities by China and other countries, which will undoubtedly grow in the future. There is also an incomplete set of regional arrangements, the most important of which are the small but well-functioning Latin American Reserve Fund (FLAR, for its Spanish acronym), the Chiang Mai Initiative of ASEAN+3 (Association of Southeast Asian Nations, China, Japan and the Republic of Korea) and the European Union mechanisms, notably the permanent European Stability Mechanism for Eurozone members inaugurated in October 2012. The BRICS Contingency Reserve Arrangement, launched in 2015, is a new addition to the safety net. The association with IMF programs beyond a certain level of lending has been a basic constraint to the use of the Chiang Mai Initiative—due to the stigma associated with IMF programs—and this rule has (paradoxically) been adopted by the BRICS arrangement. Since the North Atlantic crisis, most European programs have been jointly done with the IMF.

6.2 Sovereign Debt Workouts

The second element of a well-structured crisis response architecture is a system to manage debt overhangs. One basic reason for this is that the dividing line between "illiquidity" and "insolvency" is not easy to draw, as an inadequate management of the former may lead to the latter. Another is that the absence of an effective mechanism of this sort forces debtors to adopt excessively contractionary adjustment policies during crises, which may have negative long-term effects for both debtors and creditors.

Advances made in improving emergency financing have not been matched by the development of an institutional framework to manage debt overhangs. The only regular mechanism in place is the Paris Club, which deals exclusively with official creditors; its reach has been limited by the rise of the official lenders that are not members (notably China). There have also been a few ad hoc debt relief initiatives: the Brady Plan after the Latin American debt crisis, the 1996 Heavily Indebted Poor Countries Initiative, and its successor, the 2005 Multilateral Debt Relief Initiative. However, most debt restructurings with private creditors must be done through individual voluntary negotiations, generating solutions that come "too little and too late", according to the IMF's own evaluation (IMF 2013); they also lack a uniform treatment of both debtors and creditors.[21]

[21] See also the considerations on debt issues in low-income countries, in the context of the aid-debt-growth debate in the chapter by Nissanke (Chap. 15, in this volume).

Several proposals to create a multilateral framework for dealing with international debt crises involving private creditors have been on the table since the 1994 Mexican crisis. They have followed two different approaches, which have been called "contractual" and "statutory". The major attempt to create a statutory regime was the 2001–2003 IMF proposals for a Sovereign Debt Restructuring Mechanism. Although it failed, due to the joint opposition of the US (which had originally launched the initiative) and some emerging countries, it helped improve the contractual approach by leading to agreement that collective action clauses should be introduced in all debt contracts in the US market (they were already in place in the UK). The contractual approach has been further improved in recent years after the difficulties faced by Argentina in US courts in 2013 in the confrontation with "holdout" creditors that had not participated in the 2005 and 2010 debt restructurings. In 2015, the International Capital Market Association (ICMA 2014) and the IMF (2014) agreed to include aggregation clauses and a new *pari passu* clause that avoids the problems faced by Argentina. Eurozone bonds also require aggregation clauses since 2013. The United Nations also adopted in 2015 basic principles on sovereign debt restructuring (United Nations 2015).

Therefore, the basic framework continues to be the contractual one: voluntary negotiations with private creditors. As indicated above, the first problem with this mechanism is that it generates incentives for both debtors and creditors to delay restructurings, which may have long-term effects on debtor countries and may result in renegotiations, thereby also affecting creditors. A second problem is that the effects of the new clauses introduced in debt contracts will only be gradual, as a significant part of the debt stock lacks collective action clauses and only a small part has aggregation clauses. In any case, aggregation does not exclude the possibility of blocking majorities in individual issues, and excludes other creditors aside from bondholders, particularly syndicated bank lending and bonds bought by international investors in the domestic markets of emerging economies. A third problem is that credit default swaps may reduce the incentive to participate in debt renegotiations and introduce a whole new set of actors into the process.

The limitations of the contractual approach are the basic case for a statutory solution or a mixed system. Any mechanism that is put in place must follow three basic principles: a fresh start, comprehensive debt restructurings and impartiality of the mediation and arbitration processes. The first of these principles indicates that the solution should be seen as a permanent one that allows the debtor country to take off and avoid renegotiations. The second may imply that aggregation should encompass *all* obligations, possibly including official creditors and even multilateral lending, with proper seniority rules

and preferences for creditors that provide funding during crises. The third is essential to guarantee a fair solution for debtors and an equitable sharing of haircuts among creditors.

The statutory approach would involve the creation of an international debt court, the decisions of which would be legally enforceable in the main financial markets. A mix between the voluntary and statutory solutions could be a mechanism similar to the WTO dispute settlement, in which there is a sequence of voluntary negotiations, mediation and eventual arbitration that would take place with pre-established deadlines, which are an essential incentive to reach an agreement before arbitration takes place. The mechanism could be created as a new institution in the UN system, but also as *independent* mediation and arbitration processes within the IMF, similar again to the WTO dispute settlement mechanism. This would require that mediation and arbitration would operate independently of the Executive Board and the Board of Governors and with strong provisions to avoid interference from IMF staff, directors and member states.[22] This should be complemented with the creation of an international debt registry and a multi-stakeholder sovereign debt forum. The latter would include governments, international institutions, the private sector and civil society and could be organized under the umbrella of the UN Financing for Development process.

7 The Governance of the System

Substantive reforms of the system must be matched by appropriate governance structures. This involves three interrelated reforms. The first one is the design of an appropriate apex organization. The second is to enhance the "voice and participation" of developing countries in the Bretton Woods Institutions (BWIs)—in the case of the international monetary system, in the IMF. The third is the design of a dense multilayered architecture, with active participation of regional, subregional and interregional institutions.

In the first area, the major step is undoubtedly the reform of the G-20, which self-designated itself as the premier forum for international economic cooperation. The creation of this G-20 at a leaders level was, of course, a step forward in relation to the G-7, but ad hoc self-appointed bodies can never replace representative institutions in a well-structured international institutional architecture. The preference for "Gs" has deep historical roots, reflect-

[22] This is what is implicit in Krueger's (2002) late proposal during negotiations regarding the Sovereign Debt Restructuring Mechanism.

ing the preference of major industrial countries for institutional mechanisms over which they can exercise direct influence—a view that may be shared now by some large emerging economies. But this "elite multilateralism" creates a tension between representativeness and the legitimacy associated with it, on the one hand, and power structures, on the other. Effective decision-making may require small bodies, but this is *not* inconsistent with representation, as those small bodies can be embedded in larger representative institutions that elect their members according to agreed criteria.

As noticed previously, the G-20 played an important role after the outbreak of the North Atlantic crisis by adopting coordinated expansionary policies that allowed the world to avoid another Great Depression, together with a new mechanism of macroeconomic cooperation (the MAP) and a series of financial regulatory reforms in the major industrial economies. It also put in place a new instrument of international tax cooperation (the Base Erosion and Profits Shifting process, led by the OECD) and helped avoid in the initial stages of the crisis the protectionist responses that deepened the Great Depression—though it has been unable (so far) to limit the 2018 US protectionist actions. But its record is terms of effectiveness is mixed: quite good in the early phases of the crisis but weaker since then. Performance is also poor in three other dimensions: representation, contribution to the coherence of the global system of governance and lack of an effective secretariat (Ocampo and Stiglitz 2011; Woods 2011).

The G-20 should, therefore, be transformed into a more representative mechanism of international economic cooperation. The best proposal in this regard is that of the UN Stiglitz Commission to create a Global Economic Coordination Council (United Nations 2009, ch. 4), which in a sense belongs to the series of proposals to create a UN Economic Security Council. The Coordination Council proposed would be UN *system* organization, to include the BWIs and possibly the WTO (the former are part of the UN system but not the latter), and it would be formed on the basis of constituencies elected through weighted votes—a similar mechanism to that of the BWIs, though improving the voting weights of developing countries. The proposals by the Palais Royal Initiative (2011) are similar but it would create an apex organization for the international monetary system, and thus more limited in its functions than the proposed Global Economic Coordination Council.

The debate on voice and representation of developing countries in the BWIs should continue beyond the advances made in 2010, following discussions that had taken place in previous years. In the case of the IMF, they became effective only in 2016, due to the late approval by the US Congress of the quota increase, which was part of the reform process. The reform included

the doubling of IMF quotas, changes in their allocation and in voting power among members, the reduction by two of the European representatives in the Board and the principle that all of its members should be elected. In any case, this reform was still short of what is required. As Table 23.2 indicates, although the quota and voting power of European countries were reduced—particularly of the European members of the G-10, which includes some small countries that are financial centers—the region continued to be overrepresented relative to its current share in the world economy. The representation of emerging and developing countries was increased, but the gain was concentrated in a few large ones (see again Table 23.2) and, as a group, these countries continued to be underrepresented relative to their current size, particularly in the case of the Asian economies. Low-income countries saw their quotas decline, but this was compensated by the increase in basic voting rights (those rights that area allocated equally to all countries). Additional reforms are, therefore, necessary, and indeed a mechanism should be put in place facilitating regular adjustment of the quotas according to the share of different countries in the world economy.

There are other issues of governance that have to be addressed, including those proposed by the 2009 Commission for IMF Governance Reform (IMF 2009a). They include the creation of a Council of Ministers, with effective powers to adopt the most important political decisions, thus replacing the International Monetary and Financial Committee; reorienting the Board toward formulating strategy and monitoring policy implementation rather than overseeing day-to-day functions; and reducing the threshold of votes

Table 23.2 2010 Redistribution of quotas and votes in the IMF (versus pre-2006 situation)

	Quota			Votes		
	Pre-2006	2010	Change	Pre-2006	2010	Change
Advanced countries	61.6	57.7	−3.9	60.6	55.3	−5.3
United States	17.4	17.4	0.0	17.0	16.5	−0.5
European G-10[a]	26.7	22.5	−4.2	26.3	21.5	−4.8
Other	17.5	17.8	0.3	17.3	17.3	0.0
Developing countries	38.4	42.3	3.9	39.4	44.7	5.3
China	3.0	6.4	3.4	2.9	6.1	3.1
Other winners[b]	5.8	9.7	3.9	5.7	9.3	3.6
Rest	29.6	26.2	−3.4	30.7	29.3	−1.4
Low-income countries	3.5	3.2	−0.3	4.0	4.5	0.5

[a]European G-10: Belgium, France, Germany, Italy, Netherlands, Sweden, Switzerland and the UK

[b]Other developing countries winners: Brazil, India, Mexico, Turkey and Republic of Korea

Source: Author's estimates based on IMF data

needed to approve important IMF reforms from the current 85% to, for example, 70–75%. It is also crucial to guarantee a transparent and open process to select the IMF managing director, based on the merit of the candidates and regardless of nationality.

The third line of governance reform is the creation of a multilayered architecture that relies on a dense *network* of global, regional, subregional and interregional institutions rather than on a single global organization. The best example in this regard is the system of multilateral development banks, where the World Bank Group is complemented by a network of regional development banks (including the European Investment Bank) and several subregional and interregional banks (the Islamic Development Bank and now the New Development Bank). The basic advantages of such a system is the stronger voice that smaller and poorer countries would have, which also implies a stronger sense of ownership of regional and subregional institutions, as well as stronger competition in the provision of services to member countries (Ocampo 2006). An important implication is that the IMF of the future should be conceived as the apex of such a network rather than the single global organization it now is.

Regional monetary arrangements can take different forms: payments agreements, swap lines, reserve pools and common central banks. They can also have different degrees of multilateralization. FLAR, the Chiang Mai Initiative and the European Stability Mechanism are three frameworks already in place, the last case complementing the role of the European Central Bank. The new BRICS Contingency Reserve Arrangement is an additional recent mechanism of an interregional character. But large parts of the world lack such arrangements. These arrangements should cooperate with the IMF but in a system of "variable geometry" and with no presumption that the IMF views and programs would prevail.

This tripod of governance reforms is essential for the global monetary system—the global financial safety net, in IMF terminology—to provide better services to the international community along the lines presented in the previous sections of this chapter.

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