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Global Reserve System, Global Insurance, Risk Mitigation

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1. The political sustainability of any global reserve system depends on the size of the imbalances between the main economic regions of the world and on the financial conditions creditor countries impose on debtor countries.

2. The large imbalances between the US and China were an important part of the dynamics that led up to the current crisis, but they were not its main cause. The unsustainable global financial conditions have more to do with deregulation and inadequate financial supervision in the US than with excess savings from the rest of the world.

3. Theoretically, imbalances are not a problem per se as long as they are stable. The problem lies on explosive imbalances within and across countries. If and when it emerges, a new world reserve system has to have an efficient mechanism, both politically and economically, to cope with explosive imbalances.

4. Imbalances between regions at different stages of economic development have long been a natural feature of economic history. Mainstream economic theory holds that capital should flow from developed to developing countries, but after the East Asian crises the Asian (export-led) development model became more popular in developing economies.

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5. Depreciated exchange-rates and accumulation of international reserves are a rational response of economic policy to an international monetary system that penalizes debtors with pro-cyclical adjustments during a balance-of-payments crisis.

6. The positive link between export and productivity growth also favors a development strategy based on temporary competitive exchange rates, at least for large economies which can build “comparative advantages” in specific sectors and speed up the catching up process.

7. Given the liquidity constraint on developing countries and the export-productivity correlation, the best exchange-rate policy for emerging economies seems to be an asymmetric dirty floating, in which authorities block excessive appreciation by buying foreign exchange, but fight excessive depreciation through traditional recessive macro policy.

8. For a developing or emerging economy, it would be reasonable to abandon such a “strategic” exchange-rate policy only when the catching-up process is almost complete, or when the liquidity constraints on developing countries are alleviated.

9. In theory a new monetary system in which liquidity is generated through “new” SDRs can reduce the liquidity constraints on developing economies and help the world to move to a new reserve system. However, the decision process to issue new SDRs is still too slow to attend to the fluctuations in the world’s demand for liquidity.

10. More important, given the current distribution of IMF quotas, most of the resources generated by new SDRs tend to be allocated to advanced economies before being recycled to the countries in need. So, even with a new unit of account, we still have to face the problems created by the restrictive and pro-cyclical conditionalities associated with liquid assistance by the IMF.