Toward a World Reserve System: Meeting Summary

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Joseph Stiglitz opened the meeting with a few remarks outlining the importance of the historical moment. Noting the parallels with Bretton Woods, he stated that Keynes saw the global reserve system as a key to growth and stability in the wake of the Depression. Citing the report of the UN's Commission of Experts [of the President of the UN General Assembly on Reforms of the International Monetary and Financial System], a Commission he chaired, Prof. Stiglitz noted that the issue of reforming the global reserve system had reached the highest levels in China and Russia. Given that reforms could take many forms, especially given differing interests, this meeting would be very important in clearing the outlines of the various proposals.

Chrystia Freeland of the Financial Times moderated **Session 1**, and kicked off the session by congratulating the organizers on holding the meeting. An arcane topic had now begun to hit the front pages, she noted.

Barry Eichengreen was the first speaker. He made the following points on the limitations of the SDR as a global reserve unit:

- The creation of a global reserve currency is not simply an act of political will. The demand for a unit has always flowed from use in private transactions. Many attempts at elevating synthetic units global reserve currency status have failed.
- Since the SDRs can only be used with the IMF and not between market participants, their liquidity will be extremely limited. Thus they cannot be seen as true insurance by central banks as they would not be liquid enough in a crisis.
- Making SDRs more liquid means, ie private market development. An entire restructuring of the forex markets would be involved. It's all possible, but it's not easy. The crisis itself is a reminder that building markets in new novel assets is not something that can be successfully completed overnight.
- For the SDR to be meaningful, the IMF would have to be authorized to be issue SDRs in a crisis much like the Fed. The IMF would have to become more like a true independent central bank. I'm for this, but China, Russia, and Brazil, are they aware that this is the logical implication of their proposals?
- The future will see diverse resources of international reserves. The EU's proportion of reserves is rising. The Chinese have also launched a campaign to make the yuan an international currency. But only when their issuers posses deep and liquid financial markets will the yuan be able to act as a global reserve currency. The time frame for development is measured in decades not years.
- That situation will then resemble the pre-1913 system, and that will be a good thing with greater discipline and fewer less imbalances.

Peter Kenen was the next speaker. He made the following points on the role of the SDR as an international store of value rather than a fully-fledged currency:

- What is the possible role for the SDR as a store of value, not as a reserve currency in the full sense?
- In the late 1970s, a substitution account within the IMF was mooted whereby nations would deposit US dollars and receive SDR claims. How would this work today? [runs through simulation]
- US support would be required, and the US would incur a liability to maintain the dollar value. The simulation showed that even for non-trivial shocks, say when SDRs rise and USD interest rates fall and thus the USD falls, the cost borne by the US is not large. Eventually the account will stand on its own.
- One important thing to note is the role of the US Congress as an obstacle to reform. US participation in the IMF is not governed by treaty, which means that two-thirds of the Senate and agreement by both houses would be required. This is difficult unless the White House provides a good and convincing rationale for any proposal.
- Absent a global market in which SDRs can be traded for national currencies, the IMF cannot perform main functions of intervention. But the SDRs from a substitution account could be transferred to another IMF member. This would bring the SDR close to being a supranational currency without a substantial vesting of power in the IMF.

Jose Antonio Ocampo was the next speaker. He made the following points about the structural properties of the global reserve system and their impact on developing nations in particular:

- There is a deflationary bias to the system as the burden of adjustment falls on deficit nations. This can also be thought of as an anti-Keynesian bias. Nations lose control over their current account deficits. The resulting dynamic instability of the system was Triffin's main point.
- Developing nations demand for reserves reflects their need to manage the instability of capital flows that they face. This can therefore be seen as "self-insurance." Yet there is a fallacy of composition with this insurance: if all developing nations insure themselves at the same time, there is a destabilizing systemic effect. We can call this the instability-inequity link, which leads again to a deflationary bias.
- The rise in the US current account deficit and instability of US dollar have been worse in the post-Bretton Woods period. Capital account volatility in the developing world has resulted. In response, the share of reserves in developing GDP has taken off.
- Developing nations have learned that if they let their exchange-rates rise in the face of capital flows, current account deficits rise and this becomes a certain route to crisis. So they don't do that any more. The system has to solve this problem, which means that developing nations have to use controls and collectively we have to design system better, one or both.
- An SDR system would have two main properties. First, there would be a countercyclical provision of SDRs matching the long-term demand for reserves. Secondly, we could tie IMF lending during crisis to SDRs.

- A key question is how to solve the inequality-instability link. Here we have three alternatives:
  - Asymmetric issuance of SDRs to developing nations, de-linked from quotas.
  - Development-link SDR Allocations: allow the IMF to use excess SDRs to buy development bonds not from governments but from development banks.
  - Regional Reserves Funds: make contributions to these reserve funds equivalent to SDRs for IMF allocations.
- Greater multilateral surveillance for macro policy. And a reduction in demand for reserves would also be needed. The latter would entail more unconditional lending by IMF, having it function as lender of last resort, or allowing the broader use of capital account regulation.

John Williamson was the final speaker of the morning session. He made the following points on the benefits of even an unreformed SDR system relative to the status quo:

- Whence the need of world issue right now? The US is unwilling or unable to finance its current account deficit. What is the alternative? We need greater deficits by other nations and less reserve accumulation.
- SDRs already exist, that's an advantage. No lengthy negotiation really needed. The SDR250 billion done by G20 was pretty rapid by international standards.
- The logic behind [Prof. Stiglitz's] SDR proposals is impeccable, but not practical. It does have the advantage of universal participation and it does not rely on regional arraignments.
- As far as objections go, SDRs can't be used to intervene in the market as there are no transactions in SDRs. For precaution to work there has to be the ultimate feeling of use, and in fact there is a mechanism for this.
- IMF conditionality is a good thing for crises that are self-made, but a bad thing for externally-driven crises such as the Asian Crisis. The IMF has a big blot on its record for the latter, but we still need to be able to discriminate between nations. Flexible SDR credit lines from the IMF are really important, and therefore to be welcomed.
- Even an unreformed SDR system dominates the present system. Demand is so far out-sizing the supply at roughly 200 billion USD per year. Countercyclical issuance of SDRs, along the lines of the Polak proposal, is also a good idea.

Eric Helleiner was the discussant for the first session. He made the following points in summary:

- Over all, we have heard no new arguments for SDRs since the 1960s and 1970s, but there have been some new twists. What is new now? The politics. Interest in SDRs is episodic. But this time is different, and a longer-term interest will be sustained. There are three kinds of arguments that we have heard:
  1. Demand for reserves. This is the Triffin argument. If demand continues to grow, SDRs will continue to be talked about. Demand for self-insurance is up, especially after the crisis.

2. Reserve switching, also an episodic argument. The aim is diversification in a way that doesn't provoke a dollar crisis. Concerns about the decline of dollar are persistent, and there is no possibility of another Volcker-type interest rate hike. We also have the Euro. In addition, we lack the glue of military alliances.
3. Equity. There is deep frustration at the US's "exorbitant privilege." Using the reserve system for development purposes goes back to Keynes. This is likely to endure more than in the past. The major reserve-holding nations are those who are suffering from the present system. This is different than the last time.

- We ought to see arguments for new system in historical perspective. Economic arguments are not new, but the political conditions are in fact new.

Discussion

Joseph Stiglitz started the discussion by replying to the points made by Barry Eichengreen. He noted that the medium of exchange function was not a necessary condition for SDR liquidity. This was a matter of government commitment, a political rather than economic issue. Indeed, having the SDRs as a medium of exchange might undermine the system. Noting that, unlike the Bretton Woods era, the debate was now more centered around the capital rather than trade account, Prof. Stiglitz pointed to the need for fair "rules of the game" in the absence of capital controls. Broad reforms might not happen overnight, but we needn't think of an immediate response viz. an emergency issue of SDR and broader reform as an either/or choice.

Barry Eichengreen reasserted that private markets were a big deal. The evidence that all monetary functions [means of exchange, store of value...] come bundled is pretty compelling. Amer Bisat further underlined the critical importance of market liquidity with examples from the financial markets in the recent crisis.

Peter Kenan noted that his substitution account idea was not intended to rescue the US. Rather, he saw it as a feasible medium term to solution to install the SDR as a major reserve asset *before* we enter an era of competing currencies. If the main thrust were development assistance, several opposition consistencies in the US would be tied together. Stephany Griffith-Jones seconded the point, suggesting that SDR issuance be tied to climate change instead.

Jo Marie Griesgraber noted that the need for self-insurance comes from the IMF stigma. "What would be necessary to gain trust back?" she asked. Takatoshi Ito seconded the point, noting that those nations who had accumulated reserves as insurance feel themselves vindicated and will therefore continue to do so, especially given the stigma from IMF borrowing. "It is a very hard sell to substitute self-insurance," he noted.

Stephany Griffith-Jones moderated **Session 2**. The first speaker was Bruce Greenwald. He made the following points regarding the nature of our historical conjuncture:

- The postwar meeting had a sense of urgency that seems to be missing now. The main concern was the return of the prewar Depression. The Bretton Woods institutions were meant to be part of the international preventative mechanism. Yet the focus was the GATT more than the IMF.

- The IMF was not as central as was thought. The largely agrarian-driven business cycle in big agricultural producers like the US, Canada, Argentina, Germany and France meant that industrial policy had to be the driver in a context of an agrarian sector that was in terminal decline.

- The main industrial policy that came online to remove redundant labour from the farms was the direct result of World War II. With high savings, there was now demand for manufacturing.
- In the 1990s, we saw the collapse of manufacturing while China opted for a policy for export-led growth. Two things make this worse today. First, export-led growth. Manufacturing may be in real trouble but a command economy is its own version of war. Second, energy exporters are natural sources of surpluses.
- There may be a deflationary problem during this shift from manufacturing to services. In 1944-6, this was solved thanks to War. This time we might be not so lucky. I think 2013 is the US drop-dead date. The government can't stabilize demand.
- There are economic and political balances, and all are committed to keeping their manufacturing balance. But we must manage the transition.

Joseph Stiglitz was the next speaker. He made the following points about the design of the global reserve system:

- Reserves are a mechanism from precautionary demand: the form in which they are held has implications for risks. Export-led growth is based on competitive devaluations which has been advertised as the most efficient way to grow.
- We have an adjustment problem. Equilibrium ought to be 20 percent higher, but this would entail a USD300 billion capital loss. Hence there is no willingness to adjust.
- Apart from the supply side of reserves, trade deficits reduce aggregate demand domestically. So to maintain full employment, we needed loose monetary and fiscal policy. We are now hitting the limits on both of these facilities. We can no longer be the deficit of last resort.
- There are five points here regarding the structure of a new system: size, rules, allocation, institutions, and transition.

    1. We must start with SDRs being a complement to other reserves and begin with a comfortable number. Then we can begin to have a intelligent discussion.
    2. We should relate the issuance to global unemployment and global growth. Rule-based emissions have advantages. The more rule-based the system, the more comfortable nations will be with using existing institutions. Greater discretion leads to greater anxieties.
    3. Emissions should be linked to effective demand, so stability and equity should be the main drivers. We should have an allocation that would pay more attention to development and climate change.
    4. If we're just talking about issuance of SDRs, a rule-based IMF would be fine. Rules would not create a big bureaucracy.
    5. On transition, regional funds will eventually link to a global system in an evolutionary way.

Liqing Zhang was the final speaker of the second session. He presentation was structured around the questions, Why reform?, How are we to reform?, and What is China's role, especially in transition? He made the following points:

- The beginning of the 1970s and collapse of Bretton Woods and rise of dollar standard saw a system with three flaws: the Triffen dilemma, an "exorbitant privilege" that led to easy monetary policy and current account deficit indulgence, and a dollar reserve system that saw resources go from poor to rich nations.
- A super-sovereign currency can overcome the Triffin Dilemma. If the IMF becomes more democratic, representative, efficient, and fair, the SDR will have a bright future, but there would still be major liquidity problems.
- The yuan will take time to be an international currency; this is not realistic in the short to medium term. So for several decades, we will still be multicurrency system, which is potentially unstable. Thus global financial stability is China's main concern viz. the SDR proposal.

Deepak Nayar was the discussant for the first session. He made the following points in summary:

- The analysis is simple: the Dollar Standard is asymmetrical. It is unstable with huge current account deficits and inequitable from transfers of wealth. And there is a nexus between inequity and instability.
- The prescription comes in many forms, all of which are variations on the SDR, a new global greenback, and so on. I'm not convinced. Barry Eichengreen has pointed to an inconvenient truth. For better or worse, the dollar is the only game in town: it is the unit of account, the medium of exchange (most liquidity), and store of value.
- What is the transition path? Evolution, learning by doing? Checks and balances? "Plurilateralism" seems to be the path forward. The UN Commission called for the creation of a unit that nations will join, or regional solutions as building blocks.
- What would the institutional mechanism be? There are serious concerns with the IMF because it is there, it has SDRs. We would be parading the problem as the solution.

Discussion

Barry Eichengreen started the discussion by noting that reserve nations do not have to run deficits: UK, US, and EU did not do so at different times. He further questioned whether a multiple currency could be stable. John Williamson answered that a multiple currency system, unless it has fixed parities, would be unstable as central Banks would try to jump on bandwagons. Prof. Eichengreen clarified that if one eliminated one-way bets and had fully flexible exchange rates, such a system would not be unstable. Gerald Epstein pointed out that a degree of stability was achieved in properly-regulated international system. If we don't change that, the system will be unstable. Peter Kenen stated that a multi-currency system is intrinsically unstable. Cooperation helps, but speculation has to have its stake. Cooperation cannot be guaranteed. The substitution account does not rule out a multi-currency system. It has nothing to do with currency trading.

Jane D'Arista opined that the proposals on the table had short-changed the transactions functions of the reserve currencies. The reserve accumulations have never been based on transactions. How would we move back to a public system in SDRs and link it to transactions? Rather than a substitution account, it would be much better to have swap arrangements. The IMF's purchasing government securities in SDRs would make it useful to national economies.

Joseph Stiglitz noted that the capital account can be used as a basis for draining reserves in an open account world. Russia found this out. The trade account can adjust, but not as fast as the capital account, so the danger from trade openness is less. On the liquidity of Global Greenbacks or SDRs, it all depends on the rules of the game. The system will not work unless governments agree to do it.

Liqing Zhang asked if international usage were a precondition for China to make the RMB convertible? A more open capital account is important but not necessary, he observed.

The first presenter for **Session 3** was Peter Bofinger. He made the following points regarding the broad configuration of the reserve and exchange rate system:

- There are two dimensions of the international reserve situation. First, there is a stock issue viz. the huge dollar hang-over and the related risk of exit. Secondly, there is also a flow issue that we were discussing this morning. Thanks to increased demand for reserves, our problem is to decrease the stock of reserves even while increasing the flow.
- It is not ideal to discuss the reserve system in isolation from the more broad topic of the exchange-rate system. We now have an anarchic system that is totally unregulated. Exchange-rate policy in mainly unilateral; there is no multilateral or bilateral approach.
- In 1973, no one regarded this as a problem: flexible rates were thought to adjust to fundamental a disequilibrium. No reserves were thought necessary as there would be no manipulation. There is no need to say that the reality was and is different.
- Is an SDR-based system a substitute for this configuration? SDRs cannot substitute other reserves viz. the precautionary demand as they have no liquidity. Some increase in SDRs will be okay, but the current increment is not that much.
- Can we get away from unilateralism and at least have bilateralism? If we start with mutually-agreed currency supports, including crisis supports, then perhaps a system of bilateral deals would be a transitional stage to a genuinely multilateral arrangement.
- The main constraint is the stock problem. We all have to bear the cost of mercantilism. The dollar is a good peg at this point. Regional plans are a good idea but difficult to implement.

Ricardo Ffrench-Davis was the next speaker. He made the following points about the role of Latin America in the current conjuncture:

- Latin American nations are doing okay: there is price stability and they have good ratings. But volatility has allocative implications. Money does not go into real investment when it is volatile; it flows to financial assets. Savings leads to capital formation, but instability of flows is bad for aggregate demand.
- There needs to be an improvement of domestic policies in a countercyclical direction. Compensatory finance can help here. Reserves might indeed be costly but recessions are even more costly. But there is a danger with certain kinds of countercyclical measures.

- On regional institutions, they are basically a pooling mechanism for reserves and capital. They get good grades from the ratings agencies, better than the individual developing nations. But they ought to have a countercyclical component. And they will not alter the need for IMF reform.

Alexander Dynkin was the final speaker of the day. He made the following points on Russia's global role:

- Exchange-rate volatility and cross-border financial flows create a lot of problems for nations, especially for Russia. The stock exchange and commodity prices see bubbles. With global uncertainty, there is a spread of possibilities as reserve assets, including the dollar and crude oil.
- On the use of the ruble in international settlements, it is realistic, but can we use a bottom up approach? Yes, but there is a dark side to this: financial debts are still lower than in industrial nations, and 75 percent of our exports are in hydrocarbons, which are dollar-denominated.
- Making the ruble a regional currency for CIS countries was intensively discussed. There was strong support from parts, but CIS nations have large deficits with Russia. The broad basis of trade might not be in place for a common currency. The Sterling zone, Franc zone, and Ruble zone are all gone, so we need to ensure conditions for gradual transitions for a new multi-zone system.
- The politics of leading nations might, in the distant future, lead to a soft Maastricht agreement at the global level or even a world government that allocates international reserves, governs nuclear war heads, and makes hydrocarbon allocations.
- But the new requirements of the present global economy see the existing exchange-rate system as critical. Floating rates saved us in the early 1970s, but now financial bubbles are the main dangers. Floating rates create conditions for bubbles. We need cross-border coordination of financial policy and predictable exchange-rates

Aleksei Mozhin was the discussant. He made the following points in summary:

- The G20 agreement to increase resources lent to the IMF was significant. The BRIC nations were able to impose this solution on the IMF, which does not happen too frequently. Although BRIC nations had less than 10 percent of the voting power, the rest wanted their financial contribution and so ceded power to them on this occasion
- The Chinese then had it in mind that this could develop into an SDR system. But these are not tradable instruments. Are there geopolitical considerations in play? Yes, to some extent: they see the currency with the same geopolitical vision as the rest of international politics.
- That's a shame. Behind this "noise" there is the fact that we don't like the present system. What kind of system is it when oil price goes all over the place in a couple of months? The Federal Reserve just printed money for many years and we were at the receiving end of massive inflows of speculative capital. The whole system forced us to specialize in commodity exports.

- Talking with Chinese colleagues once a week, I get the sense that exchange-rate policy in China focuses on safety and stability. ASEAN believes that Chinese policy is the pillar of stability in the region. They are very happy about it and target the RMB implicitly or explicitly.

- Is global money possible? Yes. The whole history of mankind, save the last forty years, was that global money was gold. The last forty years was an experiment. Do we need it? After twenty years of chaos, the Snake, the ECU (akin to the SDR), ERM I and II, nothing worked. In the 1990s, the EU faced a choice to abandon the project or take the plunge.

Discussion

Jane D'Arista pointed out that there will be some difficulties in a transitional moment. Capital flows are excessive and the carry trade is ongoing. The reality is that the status quo benefits the financial sector: they are in control. There are profits from the uncertainty by continuing, for those who can, the proprietary trading, carry trading that goes on. Another crisis might be an issue that will drive the US into more reasonable positions.

Stephany Griffith-Jones raised a discussion on the fact that regulating finance and currency issues were intertwined. Jose Antonio Ocampo concurred: the exchange-rate system was indeed very important. Indirectly, we talked about it when we talked about the stability of a multicurrency system. Looking at the volatility of Euro-Dollar exchange-rate, what was the value of that flexibility, he questioned?

Joseph Stiglitz, in his closing remarks, agreed that these discussions were indeed part of a broader debate. The problems were with the global system, but we are talking about just one part. Grand design would be different, we might begin with something else. There is no global coordination adequate to a single currency either, so we would have instability. But global systems would be needed in the long term, and the more stable the system is the less insurance will be needed. The more the IMF does a good job, the less self insurance will be required.

On what is in the US's interest, he noted that in any society there are different groups of winners and losers. There is an awareness of the two sides of this debate. The big advantage of seigniorage, of borrowing infinitely, is mirrored by a trade deficit that is bad for aggregate demand. They are aware of that. Yet there is still a conservatism: what we are talking about is a big change, even when you run on a platform of change. Greater discussion makes it more acceptable.

Liqing Zhang stated that "manipulation," a term used by Peter Bofinger, was a misleading concept, political rather than economic, a point raised earlier by Stephany Griffith-Jones. In economics, we only have intervention. Global imbalances are not in China's interest, particularly in the long-run. Even a 100 appreciation appreciation is not going to dent this comparative advantage. Peter Bofinger replied that there is potential for manipulation when there is no rule at all, and countries will use that flaw. Instability will result. What is the exchange-rate system of the future, he asked? The efficiency of markets has never been in question viz. foreign exchange markets. We should target exchange-rate purchasing power parity along an uncovered interest parity path, he suggested.

Aleksei Mozhin, in conclusion, noted that we were already back to the pre-crisis world. The Moscow stock exchange up 100 percent since the beginning of the year. Bubbles and the carry trade are back. It's like Groundhog Day.

Joseph Stiglitz closed the meeting with thanks to all.