Conference on "Reforming the Global Monetary System"

Organized by:
Initiative for Policy Dialogue (IPD) at Columbia University and
The School of Finance at Central University of Finance and Economics (CUFE)

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Summary prepared by Mildred Behm

Discussion surrounding reform of the global monetary system is a theme as cyclical as the market itself. Some participants at the day and a half long conference organized by the Initiative for Policy Dialogue (IPD) and The School of Finance at Central University of Finance and Economics (CUFE) even commented that these questions were ones that they had been attending meetings on for decades. However, although the questions may be the same, today's world financial context is very different. Given the current state of the global monetary system the need for discussion is clear. The system in place is simply not working, and since the occurrence of the recent global crisis, the global financial system of even five or ten years ago needs to be rethought. In our highly interconnected world, situations that once would have been relegated to the category of domestic crisis are now that much more easily transmitted,via contagion, translating into serious issues for the world financial community.

The joint conference entitled "Reforming the Global Monetary System" was held at the Central University of Finance and Economics in Beijing, China and is part of a series of conferences by IPD's Financial Markets Task Force whose mission is to promote research and debate on the international financial architecture. Conference events included a private high-level meeting attended by 30 academics, policy makers and private sector finance members as well as a public panel discussion open to the university community.[1] It preceded a G20 meeting held in China on the same subject a week later; the meeting produced a Statement of the Beijing Group, (signed by most participants at the conference) which was sent to the most senior G20 policy-makers and published in the press.

Due to the meeting's location and China's large stake in these issues, the attendance of many participants from Asia was able to be capitalized on and one important focus was given to the possible internationalization of their currency and the development of an Asian Monetary Fund.

This report serves to summarize the most relevant points of the conference's presentations and discussions[2]. The report is divided into eight sections comprised of opening remarks from the organizers, the opening address by speaker Yi Gang, the "Overall Architecture of the International Monetary System" panel, the "Special Drawing Rights" panel, Joseph Stiglitz'

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[1] This report will only center on the discussion which took place in the private meeting

[2] The names of the presenters are always indicated next to their arguments. The report largely follows the chronological order of presentations and discussion, although post-presentation commentary and question-and-answer sessions may be summarized.

lunchtime speech, the “Multi-Currency System Including Internationalization of the Renminbi” panel, the “Regional Schemes” panel and concluding remarks.

<u>Introductory Remarks</u>

During the organizers’ welcome Joseph Stiglitz began the day’s discussion by taking a comprehensive look at the events that have led up to the current global financial situation as well as making recommendations of what reform measures need to be taken in order to ensure history does not repeat itself. Stiglitz contends that economic theory itself needs to be rethought, most notably standard macro economic policy stances which inform views on monetary policies. An increase in American liquidity should logically lead to more investment and spending in the US, but problems in the US banking system have prevented that from occurring effectively. Money is being funneled to the largest of the rapidly growing emerging markets, where the highest returns are obtained, but under this system money is not going to where it is most needed. Despite the end of the global financial crisis, problems with global monetary policy have persisted. The US’ policy of quantitative easing, which has spread difficulties to the rest of the world, is just one example of the global consequences of national monetary policies.

Professor Stiglitz argued that a financial system in which the currency of one country plays such a critical role is an anachronism in the 21st century. The global system is not self-adjusting or stable and thus these problems must be addressed from a global perspective. He urged that the focus of the conference not be just about creating the ideal global monetary system, but to also keep in mind that any reform achieved will only come about as a result of a political process and will be a gradual movement. The process of unanimity that the G20 works through makes change difficult, a concern Stiglitz’ UN Commission was sensitive to in their work. How will reforms pass if there are always one or two countries opposed to them? People must be persuaded that it is in their interest to *not* act in their narrowly-defined self-interest. Cooperative action is of value to everybody and there can be successful reforms which don’t have unanimity. The Kyoto Protocol, for example, did not have the largest polluter as a signatory but was still considered an important step in dealing with global warming. Ways should be found to achieve collective action without unanimity, the latter a policy which will only lead to deadlocks on decision making. Methods to stimulate collective action include mobilizing regional initiatives, of which Asia’s own Chiang Mai Initiative (CMI) is a good example.

In order for a multi-currency system to exist between the polar extremes of fixed and flexible exchange rates, a strong SDR system is needed to stabilize it (Jose Antonio Ocampo). Ocampo’s ideal vision for the global monetary system would be to rebuild it from the bottom-up, with a global International Monetary Fund at the center and regional and sub-regional funds at the following levels to give clearer structure and grant greater support. As a regional fund, the CMI illustrates the possibility of building a stronger set of regional institutions for global monetary cooperation.

For Liqing Zhang, the American financial crisis highlights many of the old reasons why the global reserve system needs to be reformed. Forefront on his reform agenda are whether special drawing rights (SDR’s) or other forms of global currency will replace the US Dollar (USD) and play a more important role in global markets, how to make a more stable and equal monetary system, and whether China should push for RMB internationalization or consider it a process to let evolve as it will.

Opening Address by Yi Gang

Yi Gang's opening address focused on the seven pillars of design crucial for a sound international monetary system. These pillars are: (i) A mechanism to adjust trade balances (ii) Price adjustment mechanisms- channels through which relative price can be effectively adjusted (iii) Method for a country to efficiently deal with the accumulation of wealth inherent in holding reserve currency (iv) Providing proper incentives to act in a beneficial manner (ie energy efficiency, environmental protection, high quality innovation) (v) Mechanism to maintain stability (vi) Inclusion of a safety net for times of crisis. (vii) Regional arrangements. Tasks at hand for the global economy include expanding the role of SDR, improving SDR allocation and valuation and making the SDR basket more reflective of the current world economy. In the post-discussion commentary Jacob Frenkel agreed with Yi Gang on the need for incentives, stating that they are necessary in order to provide the best service to the market. A built-in disciplinary impact should also be included for those who issue reserve currency and debase the value of their own currency for inflation to ensure that they do not go too far.

All global monetary systems enacted, including the gold standard, have attempted to solve all seven questions above, albeit not completely. At the time Bretton Woods was put into place global GDP was dominated by developed countries. One of the largest changes that must be accounted for since the end of the Bretton Woods system is the dramatic increase in GDP growth by the emerging markets. The largest of these emerging markets is China, where today the topic of greatest interest is their progress towards capital account convertibility (Yi Gang). Although the recent allowance of RMB usage in the financial transactions of trade settlements has been an important step in demonstrating market demand for the currency, Yi Gang, in response to a question posed by Stephany Griffith-Jones, answered that he did not believe RMB internationalization was currently being pushed in the way that other convertible currencies, such as the yen and dollar had been in the past. Roadblocks particular to RMB internationalization include that it remains a domestically controversial policy issue, having no official convertibility timetable in place and the presence of a Chinese policy environment which only allows this issue to be pushed along in a gradual manner. Despite this, consensus is growing, and there is enough positive progress to indicate that the convertibility process will continue to advance.

To conclude the question and answer period Jose Antonio Ocampo noted that it was surprising that for being a country with many capital controls, China's informal exchange rates are actually quite close to the official exchange rate and that therefore there must be a connection between China and offshore markets. Yi Gang answered that the offshore market is very close to the onshore exchange rate. There are people who contend that RMB is undervalued but in fact it is very close to the equilibrium level in terms of asset and stock price interims of the equity bond and real estate market. Given the property price boom and what happened to labor costs it can be seen that the RMB is much closer to its equilibrium level than ever in its history.

Panel on Overall Architecture of the International Monetary System: Options and Elements, Benefits and Costs for Different Countries

As the first speaker on the "Overall Architecture" panel Joseph Stiglitz stressed the importance of efficiency and stability in the new system. Stiglitz began by referencing Triffin's dilemma[3] and agreeing with it, acknowledging that the conditions of a static economy are largely untrue in the real world, so that the system may not be stable solely due to its own nature. The nation of reserve currency builds up indebtedness which undermines the viability of the system itself. Building off Yi Gang's "seven pillars", Stiglitz' recommendations for features of a new global financial system include: (i) Remembering that regulation is not alone at the center of global financial system, with global monetary system also key (ii) Not separating domestic from global policy. All global policies are reflective of national priorities in some way and in a globalized economy they have global consequences (iii) Systems for restructuring debts must be in place and safety nets must be there in case of a crisis. There is currently no good system of debt restructuring and it should be viewed as an important part of the new global financial system (iv) Exchange rate surveillance.

Financial systems are a means to an end and should be judged on how they enable the real economy to perform in terms of growth and stability. In addition to Yi's seven pillars, equity is a top priority, one undermined by the current system's deflationary bias.

Emerging markets are lending at close to a 0% interest rate and borrowing at very high interest rates. This practice ultimately results in a flow of money from poor to rich countries. The current practice of setting aside reserves and not spending them in order to have a safety net is a real problem. Money that could be spent is being untouched and the result is a great cost to the global system. Smaller countries are forced to make judgments on whether to put money in Euros or USD and their reserves will bear the consequences of any problems with the currency chosen. Creating a global reserve system can address those issues in a way that reserve currency diversification doesn't. Diversification doesn't solve the problem of stability either. In the past, exchange rate systems were either fixed or perfectly flexible. Since the economic collapse in Argentina, very few support those extremes. Unfettered capital flows can be very destabilizing and can induce high volatility. Unregulated finance and securities markets were very unstable, with cross-country capital movements being a prime source of instability. Often pro-cyclical capital flows are a source of instability in developing and emerging countries. Moving to a global reserve system is feasible and could be a very big improvement for global equity, stability and growth (Joseph Stiglitz).

As the next panelist on the SDR panel, Yongding Yu spoke about China's monetary policy options. At the moment China is pursuing three policy positions- promoting regional bilateral cooperation, reform of the international monetary system, and promoting internationalization of the RMB. Yu does not believe China needs to intervene in the foreign exchange market. As Yi Gang did, he contends that China's exchange rate is not undervalued as evidenced from the fact that it is not far from the equilibrium exchange rate. Even if it rises dramatically the exchange rate will not have a large effect on Chinese trade and import. Capital controls management should be improved however, and increased efforts should be made to spur RMB convertibility.

[3] A theory that states that when a national currency also serves as an international reserve currency, there could be conflicts of interest between short-term domestic and long-term international economic objectives.

The ultimate objective of reform is sustainable economic growth and prosperity. If a system cannot provide that then the system is not optimal. In the past, in order to have a sustainable impact on the exchange rate there was a need for complete macro policy coordination, which at that time meant fiscal policy. As time passed the debate became whether an outsider could effectively design another country's fiscal policy. The resulting consensus was that each country should design their own fiscal policy but recognize while doing so that they were part of a larger system. Thus, there is incentive to design rules that have an impact on everyone. On the topic of SDR's, Frenkel believes that a new name should be invented for them. SDR's have a legacy of being controversial and have never been seen as the solution to the problem at hand. A new name that would better address the issue would provide a good launching point for moving forward with a fresh perspective.

During the post-panel discussion John Williamson made the widely agreed-with point that it is not likely for reform to be achieved when "things are going beautifully". Policymakers could never be persuaded to change fiscal policy for the betterment of another country, but perhaps it was possible to ask them to change the system of formulating fiscal policy so that although there may be a short term loss, there is the possibility of long term gain. However, Frenkel cautions that one of the dangers of implementing an overhaul in times of emergency is the tendency to operate with a short term perspective in mind, and it is important that any system designed must be robust enough to stand the test of time.

Panel on Special Drawing Rights

Yiping Huang began the panel on Special Drawing Rights by calling for a currency basket reflective of the world economy in order to improve and enhance SDR. Some emerging market currencies should be included in this basket, of which RMB is a strong candidate. This inclusion would be helpful for China's reform, who is hoping that a liberalization of the capital account would improve their image internationally.

While at its creation SDR may be artificial, upon receipt it becomes real money due to the fact that it is able to be spent, which is why SDR allocations are so attractive to developing countries. Liquidity consideration was the main impetus behind SDR creation and it is still important but in other respects SDR is still needed in order to improve the system and provide assistance to developing countries. Many developing countries maintain high levels of imports just to feed their people. Therefore how can they hope to create a surplus with their current trade account? China itself has only just seen improvement this century (Benhua Wei). Returning to his initial point about the importance of inclusion of emerging market currencies in the currency basket, Wei inquires into the wisdom of the continual heavy investment into USD and treasury bonds, instead of promoting investment in the emerging market countries.

In the system's current design, SDR's are made irrelevant by the distinction of a general account and SDR account (Ocampo). In order for IMF lending to move to a system exclusively based on SDR's, SDR allocations should be considered as deposits of central banks in the IMF. The IMF can then lend in a way similar to central banks rather than using the now-obsolete quota system or arrangements to borrow, both of which make the IMF more dependent on national decisions. Counter-cyclical issues of SDR's should be the focus, concentrating allocations to crisis periods to solve Keynesian deflationary problems. All countries would be allocated international reserves, but those who don't have sufficient would have the option to borrow from countries that aren't using their SDR allocations for any other purpose. Developing countries are ones who need more reserves, thus an asymmetrical lending system is needed whereby 80% is lent to developing countries and 20% to industrial countries. If allocation according to quotas is to continue then another method will need to be designed for countries that need more reserves to receive them (Jose Antonio Ocampo). Other recommendations Ocampo had included using IMF deposits to buy bonds from multilateral development banks in order to finance developing banks by recycling dollars through them, and possibly encouraging broader use of SDR's through private markets. Obviously, the latter option is less attractive to the US because a broader use of SDR's would mean the substitution of the USD. However, a substitution account would function as a stabilizing force and an essential instrument to manage the multicurrency system that would naturally evolve, as a move to a multicurrency system would need a stronger SDR system. Other ways to increase stability in the system are to create regional institutions (for which incentives to form must be provided) which developing countries could contribute to. Another alternative is to create a system similar to what Keynes proposed- an overdraft account, with no conditionality, that could be used by all countries in the IMF. It is essential to give confidence to the SDR as a substitute to foreign exchange reserves. This system would create greater equivalence between SDRs and foreign exchange reserves.

The last presenter on the panel, John Williamson, put forth his reform proposals as a counter to the well-known proposal put forward by Barry Eichengreen. Williamson's proposal includes a more widespread allocation of SDR so that it could become a more important reserve asset over time. He notes that there would only be a point in this though if important countries are accumulating reserves for precautionary measures. Williamson also believes that the IMF should be authorized in times of crisis to issue new SDR's sufficient to finance its own lending. The reason there is so much reluctance to allocate SDR's is because developing countries see them not as precautionary measures and something to hold but as something to get rid of to developed countries. If the SDR interest rate were calculated in another way then this aspect would be overcome. It is only if SDR were to remain a public asset that this would be avoided. Williamson contends that RMB should only be introduced into the basket in the case that SDR remains a public asset.

The post-panel discussion centered on the financial realities of increasing the role of SDR in the system. Benhua Wei held that if you want to convert SDR into hard currency you have to be prepared to pay for it. If other emerging markets want to join the basket they have to be prepared to be lenders in times of crisis. In John Williamson's opinion if one is going to have an objective of increasing the role of SDR in the system then there needs to be a sizeable allocation made. Jose Antonio Ocampo believes that it would not be in the US's interest to follow the Eichengreen proposal of expanding private use of SDRs, since the threat to the US to the extent that SDRs are central bank money is much less than if it becomes a private asset.

<u>Joseph Stiglitz Keynote Lunch Speech</u>

Before the crisis there was much talk about the presence of a savings glut. This could be interpreted as the US saying there was too much savings going on in rest of the world, and shifting blame for their role in the crisis.

There are multiple schemes being proposed ranging from trying to provide greater reserves, to trying to manage the macro economy better but the creation of reserves cannot be used as a way of addressing multiple objectives. SDR's should remain public money. In order to maintain demand and minimize instability a multi-track approach is needed. SDR's do not address the full range of objectives we should be aiming to achieve. Discussions should be begun immediately to lead to the creation of a really effective global reserve system. In fact there are many reforms that could be recommend to the G20 immediately, including Ocampo's single SDR account proposal. An issuance of 250 billion dollars would not be inflationary and would create significant reserves. Additionally, more of the SDR's should be allocated along the lines Williamson proposed (e.g. development aid) with the addition of climate change to his list (Joseph Stiglitz).

During the post-speech question and answer session, Stephany Griffith-Jones noted that QE2 may be too blunt an instrument because it does not allow channeling of credit to those sectors that need it within the US. Griffith-Jones also believes there needs to be a rethinking of increasing policy instruments to channel credit to sectors that need it rather than just printing money to lower interest rates. In answer to those who believe that the basket should be expanded to all emerging market currencies deemed strong enough Ocampo counters that he doubts there would be enough demand for 12 separate currencies to sustain their inclusion. Only a few are strong enough to generate substantial demand.

Stiglitz attempted to answer all questions and comments posed during the discussion through the form of a large block reply. He urged that monetary authorities have to be sensitive to blocking credit channels, which typically happens in crisis. In this global economy the easiest channels for money to flow to are the emerging markets, with everywhere else largely neglected. The danger of precautionary savings is that if everyone is saving, aggregate demand goes down. Thus that problem will not be solved by going to two or three currencies. If everyone chooses one currency as the "safe"one, it no longer becomes safe. Fixing the real interest rate is virtually impossible due to the fact that the interest rate arbitrage equation doesn't hold and the equilibrium condition is often not satisfied. In general, the notion that you could stabilize real interest rates in all countries means you would have to totally control capital inflows. Stabilization is not possible because there are no full contracts to assure you of what will happen to exchange rates. Quantitative controls can be used to dampen lending through the banking system but recently a large shadow banking system has developed which we must more greatly regulate. As a whole the system has a deflationary bias which arises from asymmetry from surplus and deficit countries. Deficit countries have to restrain spending in crisis, those with a surplus don't. Thus, when you have a shock to the system, those who gain spend more than those who lose.

The Multi-Currency System, Including Internationalization of the Renmimbi

Since the international monetary system is defined as the monetary and exchange rate system of countries, proponents of new systems must be able to resolve some of the problems arising from the current exchange rate arrangement. The new global monetary system should be able to resolve global imbalances. The current multicurrency system spoken of is three or four currencies at most, however, there are other currencies such as the Australian dollar that are internationalized in the sense that they can borrow in their own currency even though they are not a reserve currency. If emerging market economies are able to internationalize their currencies enough to borrow in their own currency then they can denominate their financial liabilities and invoice their trade. If this system is going to be complimented by the reform of the international financial system, the introduction of global public goods could reduce the volatility of capital flows (YC Park).

Problems with the current financial system include its volatility and that it does not satisfy the needs of the productive sector in the economy. As Yongding Yu raised, in the matter of exchange rate stability, the problem is that any sort of appreciation becomes default on global lending. If China were to satisfy the reserve needs of the global currency community they would be running deficits of 10-12% of GDP. Under the gold standard central banks were required to stabilize the currencies by holding gold reserves. Is there a private market mechanism to replace the current government mandated system we have under Bretton Woods? (Jan Kregel)

The chief benefits of currency diversification and the internationalization of RMB would be manifest in its impact on efficiency, in other words, lowering the transaction cost of the foreign exchange markets. In order to make Shanghai a significant financial center RMB internationalization is needed, but internationalization does not necessary equate with it becoming a significant reserve currency. Chinese GDP will equal US GDP around 2027. The amount of export that China would be engaged in would be twice that of the US. Given the fragmentation of international production what we will see is the incentive within a supply chain to adopt a common currency in order to keep costs predictable. It is likely that RMB would be considered for this given how much production China engages in. The ability to deal with transactions in multiple currencies has increased due to the internet and the increased computation power we now have. The Kinderberger Rule states that if there is to be one hegemon then there will be one international reserve currency. Whether a truly significant diversification would occur or not would depend on the future state of political relations between the US and China (Wing Thye Woo). During his presentation Wing Thye Woo put forth three aspects in which global economic governance should change: (i) The IMF- The IMF has not done a stellar management job with only one reserve currency; by adding more currencies, their administrative functions and supervisory responsibilities also multiply. Given the difficulties of reforming the IMF, Woo foresees the world circumventing the IMF's role by setting up the equivalent of a European Monetary fund. Since Asia is in a prime financial position it would be a logical step to see the setup of an Asian Monetary Fund. The "new" IMF could be known as a system of regional monetary funds for those regions able to afford it. The timeline of the creation of an Asian Monetary Fund would depend largely on the relationship between China and Japan. (ii) Bilateral currency links should be developed between new reserve currencies such as the RMB and Euro. This is something which could be jumpstarted by policy. (iii) The identification of foreign exchange manipulation- This is not a practice that is a thing of the past. Speculators are not only found in the private sector but also in the form of central banks of countries who feel they can free ride on the system.

Liqing Zhang agrees with the Stiglitz Commission report's assertion that today's instability is due to a failure of policy coordination. The system is inherently unfair, money clearly flows from the developing to the developed countries as evidenced by the fact that so much capital flows to the US from China. Reform will need to be planned for in both the short and long run. Zhang's long run plan is to have a global currency. SDR's are one option but whether it can be a realistic choice depends on its supply and demand. On the supply side the IMF must regulate annually, rather than just once after summits. From the demand side, the two most important questions to answer are how to encourage SDR denominated bonds and how to use SDR in the private sector? In the short run a multicurrency system is more realistic but unstable, and better policy coordination would be needed to make it effective. The G20 framework should be used more fruitfully. Owing to the fact that a global currency is only realistic in the long run, and multicurrency in the short run, RMB internationalization should be realized in the short or mid run. The internationalization of RMB is beneficial to global financial stability because if RMB eventually becomes a reserve currency it would be subject to competition, making banks of each reserve currency country more careful with their monetary policy. Additional benefits include the satisfaction of the Triffin dilemma and the creation of a new vehicle of financial monetary policy and an ongoing part of reform. Internationalization would push forward China's international reform, particularly financial market reform because greater openness would be created. Since it would be dangerous to internationalize all at once, Zhang agrees with those who believe that it should be a gradual process.

In the post-panel discussion Ousmene Mandeng also came forward with his support for a multicurrency system and advocated the creation of a pragmatic proposal to move towards this goal. Mandeng thinks a multicurrency system is both desirable and feasible because diluting dependence on one currency mitigates risk. Central bank reserves could provide the defining vehicle to bring forward such a proposal. Recognizing current limitations of the system should be a motivating factor to think about a new system. Today, even if central banks wanted to use their reserves for crisis situations they probably couldn't because it would lead to their collapse. Intervention of currencies could be done through a commonly agreed fund (similar to a substitution account or Asian bond fund) with a minimum of $500 billion which would lead to more effective coordination.

Chalongphob Sussangkarn urged the importance of the RMB to begin to be developed offshore. In order for money to go out, capital outflows are needed which means foreigners must be allowed to issue bonds. In Sussangkarn's opinion the problem today is that in many East Asian transactions although it is not necessary to denominate in USD, it is done anyway. RMB or the Thai Baht should be used instead. The reason USD is so widely used is because it has most liquid currency market, thus the cost of using it is very low. If the development of alternative currency markets between other countries is not created then there is little hope of East Asia moving away from primarily using USD.

Regional Schemes: The Role of Regional Arrangements and Their Interactions with Global Ones

Making regional arrangements more attractive is an extremely important issue since lending capacity is crucial to conducting crisis response. East Asia has had recent experience with sudden liquidity and systematic shocks. During its problems in 2008, Korea obtained $62 billion dollars from three bilateral arrangements. Past examples such as this suggest that no single resource is enough to cover a country's time of need. As far as crisis response is concerned, having adequate lending capacity is crucial. When countries face capital flows, there are 3 official mechanisms they can turn to: country specific resources (macro-economic policy, prudential, capital controls), bilateral (between central banks) and multilateral. However there are drawbacks to these solutions. Macro policy and related policies have limitations which make them insufficient on their own in times of crisis and bilateral has the flaw of distorting the allocation of resources. A global arrangement does provide much more funding and wider risk sharing but carries a stigma. A layered option for crisis response would be workable but shouldn't minimize the role of regional arrangements.

Surveillance is the key element to an efficient Asian regional arrangement and a step forward to institutionalize the Chiang Mai Initiative (CMI). The ASEAN+3 Macroeconomic Research Office (AMRO) should be tasked with monitoring financial sectors, facilitating exchange of experiences, regulating and giving policy advice. At this initial stage AMRO can only conduct very limited functions given its own limitations and personnel supply. The relationship with the IMF is a very crucial one and an indicator of success will be satisfaction with the role they ultimately play. Even now the IMF is like a distant relative to East Asia. Many countries believe that, as with cases involving Latin America and Eastern Europe, the IMF is less than likely to provide timely support. There is currently an 80% IMF linkage to conditionality, which is against the original intention of Chiang Mai and prevents it from becoming a fully fledged regional fund since it is not allowed to have its own conditionality. The IMF link program needs to be redefined. The IMF should be incorporated and its technical support assistance utilized, which links with the AMRO lending process. Healthy competition between regional and global arrangements is beneficial to all partners. The question remains whether exchange rate coordination is needed. Each country has its own policy in dealing with excessive capital flows but coordinating exchange rate policies regionally could make a positive difference. ASEAN+3 countries should see which areas need further work and what sort of timeline is needed to carry out a deep investigation of how to integrate the region. One such area receiving closer scrutiny is trade flows. If one were to solely analyze them it could be seen as proof that the region isn't integrated enough. For policy coordination to move forward it must be put on the global agenda (Haihong Gao).

In looking at the global system, the IMF is the clear key global agency. Having the monopoly of power on rule setting and assistance to countries at the level that they do it makes it paramount that they maintain the highest level of integrity. However, they lost credibility in the eyes of many countries after their poor handling of the 1997 East Asian crisis. The US and IMF insisted that Thailand give full guarantees to creditors before agreeing to the Thai program. However, foreign creditors should have been equally to blame because they lent without careful analysis. There remain strong doubts that the IMF has changed much since the East Asian crisis and it is because of those doubts that East Asia will embark on their own monetary cooperation. When Japan originally introduced the idea of an Asian Monetary Fund it was bad timing. Japan was also not helped by the fact that they had not conducted prior consultations with other countries in the region before putting forth their proposal. After that initial unsuccessful attempt, there was a meeting among several Finance Ministers that produced a framework that stated that the primary importance of a global facility still remained. The CMI essentially operated as a network of bilateral swaps that are closely tied to the IMF. A major blow to CMI came when Korea faced a liquidity crisis and needed dollars but didn't use CMI because of its strong IMF linkages. After the experience Korea had had with the IMF during the East Asian crisis, they were loath to enter into another IMF program. It is important to distinguish however that despite its linkages the CMI is a 60-day swap agreement, and not an IMF lending program. If a member country feels they need more liquidity they can go to CMI and draw on their swap based on their original contribution and level of development. The IMF link is present in the rule that if a country would like to withdraw more than 20% of their access limit, they are subject to IMF supervision (Chalongphob Sussangkarn). To Chalongphob Sussangkarn this rule does not make any sense because by definition a swap is meant to tide you over in the short term. The IMF linkage should be to be changed to become more sensible at the very least, although he would prefer removal. Instead of a link based on percent withdrawn, the IMF linkage should be based on numbers of rollovers requested, with, for example, the fourth rollover request signaling the introduction of the IMF. The reasoning being that by the time a fourth rollover has been requested there would be valid reason to suspect that the problem is structural rather than one of liquidity.

As previously referenced by Sussangkarn, Yungong Wang noted that the Japanese attempted to establish an Asian Monetary Fund but the proposal was rejected by both the IMF and US. Another roadblock to its creation was the reluctance of the Chinese to establish an independent Asian arrangement. It was not until the Asian Development Bank (ADB) Institute was established with the cooperation of many Asian economists that they agreed to participate in the Chiang Mai Initiative (CMI). Unfortunately, in the ten years since its creations there has been little progress. Looking into the future, Wang's hopes for an Asian regional financial arrangement are very low.

On the topic of SDR's, Wang believes that they are only symbolically meaningful and not widely used in the market. Non-convertible currencies such as RMB could be included in the basket but are still useless to many emerging markets such as Korea. As yet, there exists no concrete implementation method to use SDR's in financial transactions and no tangible benefits to emerging markets countries to do so have been presented. The reality is that nobody wants to lose their gains. The internationalization of the RMB is still in a primitive stage but in order for it to have infrastructure it must able to be used in trade and financial transactions. One large benefit to Chinese importers would be that they would no longer be exposed to exchange rate risk on payment of imported goods. It is equally crucial that exporters to Chinese markets must also accept RMB. Korean parent companies *could* use RMB for future transactions, but the RMB interest rate is higher than the USD interest rate. Most trade settlements are done through bilateral credit, thus Korean exporters must pay a higher discount rate for RMB transactions because the RMB discount rate is higher than the USD discount rate. An RMB denominated bond is now being issued in Hong Kong and US companies like McDonalds are issuing bonds in the Hong Kong market with China's approval. This is only approved on a case by case basis however and approval is rarely granted for Korean companies. The infrastructure is now under construction but in about 2-3 years, it is estimated that 10% of trade settlements between China and Korea will be done in RMB. In 10 years that figure could be more than 30% if infrastructure continues to build well. Still, a huge gap remains between the ideas and reality of the global monetary system (Yunjong Wang).

In his presentation to the panel Ulrich Volz spoke of the need for both a strong IMF and strong regional financing arrangements (RFA's). They should not be viewed as an either/or arrangement, but rather compliments to each other. Ways need to be found for them to work together. One important part of this package would include making RFA's an integral part of the global financial architecture and governance reform. The IMF underwent a huge crisis and although it is back in business, still carries a huge stigma as evidenced by the fact that European countries were not eager to get the IMF involved in their bailout. Thus, IMF governance reform is a crucial point, with general reform of quota shares and questions of European representation, particularly the selection of the managing director. The IMF has launched new facilities which will improve cooperation with RFA's but there is still a lot of work to do. RFA's exist in many forms, each with different limitations and different stages of progress. Volz hopes CMI will develop further and believes it is important to develop AMRO into a strong institution. IMF reform needs to include it being more independent of political pressure. According to a report by the ILO, interactions with large member countries provide an undue influence. Linkages between RFA's and the IMF need to be increased, a network created with the IMF at the center and RFA's around it would be ideal. Additionally, there are various other ways linkages between RFA's and the IMF can be established such as having the IMF invite RFA's to take part in consultations, staff exchanges, joint training programs and RFA representation in the Fund. In turn RFA's should disclose what is happening in regional arrangements to the IMF .. When new SDR allocations are discussed, allocations to RFA's should be taken into account.

A reduction in structural conditionality was only possible because Europeans were pushing for reform in the IMF. Europe would never have accepted the conditions that Asia had to accept during the Asian crisis or Latin America did during theirs. The only reason reform was able to be achieved was because it was Europe who was in crisis (Jose Antonio Ocampo). Ocampo cites The Andean Development Corporation (CAF) as one example of an RAF that is working. Stephany Griffith-Jones agreed with Ocampo's reference of CAF as a success story, especially in light of the fact that some of the CAF member countries have experienced bad crises but still paid back the CAF. However, she does disagree with Volz' assertion that a strong link of the RAF with the IMF is necessary. Sussangkarn believes that the reason progress on an Asian RFA has not moved is because "real money" has not been spent. Right now the pooling of the money is largely theoretical because it is held in each country's central bank. Once a central office it set up with a staff hired, space rented and meetings held it then becomes "real money" being spent.

In his post-panel commentary Jan Kregel highlighted the paradox many developing countries find themselves in. Countries do not want to borrow from the IMF anymore, but no one wants to borrow from RFA's either because of their IMF link. In order to be self-sufficient countries end up holding huge reserves so that they won't have to turn to anyone if they find themselves in need. However, when crisis hits, they do not want to use their reserves and end up turning to the Fed for liquidity. Thus by trying to get out from under the US they run right to them. What good then are reserves? Countries are in a difficult position because as soon as you draw from your reserves you indicate to the market that you are having financial problems. This leads to a lack of worldwide confidence in your economy which results in market movements that create a self-fulfilling prophecy of actual large problems for your economy. Haihong Gao points out that it is difficult for East Asia to have its own conditionality because they lack their own surveillance body. Some countries are reluctant to have that kind of institutionalized format for oversight enter the region.

Concluding Remarks

Through the conference's one and a half days of discussion the topics of a global arrangement, reserve currency system, and RFA's were explored. Out of this exploration, Jose Antonio Ocampo deemed the internationalization of the RMB a clear certainty. The meeting's Chinese participants provided many insights on what internationalization would imply. This is the first time in history in which a developing country could become a hegemon. The question is whether China will be able to manage all that this implies. The country has followed a controversial but successful macroeconomic policy which has involved a significant degree of management of balance of payments, capital account regulations, and accumulations of massive amounts of foreign exchange reserves. From the outside there are many countries which find this attractive and have been following this model in a variety of ways (Jose Antonio Ocampo).

Can internationalization of RMB be done without speedy liberalization of the capital account? The risks of liberalization are very high if improperly managed. There is a real concern of what will happen to the foreign exchange rate when the People's Bank of China stops buying foreign reserves. Becoming a global currency has always implied a strong domestic financial system and the fact that China doesn't have that could be the tragedy of internationalization for them (Jose Antonio Ocampo).

We now approach a worldwide accumulation of $6 trillion in foreign exchange reserves. Where is the supply going to come from for the assets that are acceptable as foreign exchange reserves? US treasury bills are and will be abundant but they are not as risk-free as they used to be. China holds so many already that they are not as attractive as they once were. If this continues it will be a very serious problem. Major interventions are coming to reserves and capital management, and capital account management will be seen as a threat by some countries. All these factors are leading to demand for reform, but the question is where the call for reform will come from that will actually lead to real change (Jose Antonio Ocampo).

Speakers and Quoted Discussants

Joseph Stiglitz, Co-President, IPD

Jose Antonio Ocampo, Co-President, IPD

Liqing Zhang, Dean of the School of Finance, CUFE

Yi Gang, Deputy Governor, PBOC

Jacob Frenkel, Chairman, JP Morgan Chase International

Stephany Griffith-Jones, Director of Financial Markets Research, IPD

Yongding Yu, Director-General of Institute of World Economics and Politics, CASS

John Williamson, Senior Fellow, Peterson Institute

Yiping Huang, Professor of Economics at the China Center for Economic Research, Peking University

Wei Benhua, Former China Director of the IMF and Deputy Governor of SAFE

Jan Kregel, Senior Scholar, Levy Economics Institute, Bard College

Wing Thye Woo, Professor of Economics, UC Davis

Ousmene Mandeng, Head of Public Sector Investment Advisory, Ashmore Investment Management Limited

Chalongphob Sussangkarn, President, Thailand Development Research Institute

Haihong Gao, Director of Research Center for International Finance Studies, CASS

Yungong Wang, Director, SK Institute (Beijing)

Ulrich Volz, Senior Economist, German Development Institute

Marc Uzan, Executive Director, Reinventing Bretton Woods