REFORMING THE GLOBAL RESERVE SYSTEM

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BASIC UNDERLYING ISSUE

Lack of proper adjustment between surplus and deficit countries without affecting world economic activity (or inflationary biases)
THE THREE BASIC PROBLEMS OF THE SYSTEM

1. Keynesian bias: burden of adjustment falls on deficit countries.

2. Triffin dilemma: problems associated with the use of national currency as international currency (can generate inflationary bias under the fiduciary dollar standard)

3. Growing inequities associated with demand for reserves by developing countries (self-protection) + fallacy of composition effect (instability-inequity link)
GROWING DEFICITS AND INSTABILITY OF THE VALUE OF THE DOLLAR

U.S. Current Account Balance and Real Exchange Rate

- Current account (% of GDP)
- Real Exchange Rate (2000=100)
GROWING DEMAND FOR FOREIGN EXCHANGE RESERVES BY DEVELOPING COUNTRIES

Reserves Minus Gold as % of GDP
(Left Hand Scale, except China)
## THE WORLD DEMAND FOR RESERVES

SKYROCKETED AFTER THE ASIAN CRISIS

### Accumulation of Foreign Exchange Reserves

<table>
<thead>
<tr>
<th></th>
<th>Million dollars</th>
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</thead>
<tbody>
<tr>
<td>High income: OECD</td>
<td>42,805</td>
<td>30,889</td>
<td>59,358</td>
<td>140,715</td>
</tr>
<tr>
<td>Japan</td>
<td>5,588</td>
<td>20,164</td>
<td>48,307</td>
<td>98,320</td>
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<tr>
<td>Others</td>
<td>37,217</td>
<td>10,725</td>
<td>11,051</td>
<td>42,395</td>
</tr>
<tr>
<td>High income: non OECD</td>
<td>21,833</td>
<td>21,833</td>
<td>28,554</td>
<td>69,822</td>
</tr>
<tr>
<td>Middle income</td>
<td>6,734</td>
<td>56,950</td>
<td>63,739</td>
<td>548,444</td>
</tr>
<tr>
<td>China</td>
<td>2,725</td>
<td>16,168</td>
<td>29,673</td>
<td>247,831</td>
</tr>
<tr>
<td>Excluding China</td>
<td>4,009</td>
<td>40,782</td>
<td>34,066</td>
<td>300,613</td>
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<tr>
<td>Low income</td>
<td>212</td>
<td>1,952</td>
<td>3,654</td>
<td>17,938</td>
</tr>
<tr>
<td>World</td>
<td>59,946</td>
<td>111,624</td>
<td>155,305</td>
<td>776,919</td>
</tr>
<tr>
<td>Excluding China and Japan</td>
<td>51,633</td>
<td>75,292</td>
<td>77,325</td>
<td>430,768</td>
</tr>
</tbody>
</table>
IN THE DEVELOPING WORLD, THE DEMAND FOR RESERVES IS CLOSELY ASSOCIATED WITH CAPITAL ACCOUNT VOLATILITY

Balance of Payments of Developing Countries, Excluding China and the Middle East (% of GDP)
GOING FORWARD: TWO ALTERNATIVE WAYS

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

- An SDR-based system
  - Counter-cyclical provision or SDRs equivalent in long-term to demand for reserves.
  - IMF lending in SDRs: either keeping unused SDRs as deposits, or Polak alternative
NEED TO MANAGE THE INEQUITIES AND INEQUITY-INSTABILITY LINK

Three alternatives

- Asymmetric issue of SDRs (according to demand for reserves)
- “Development link” in SDR allocation
- Encourage regional reserve funds, making contribution to the funds equivalent to IMF quotas for SDR allocations.
The US would be able to maintain its current expansionary policy without need to take into account global repercussions

Less leakages from its stimulus.

The US dollar would still be used as the main world currency for transaction purposes …

… though the system can also evolve into a broader use of the SDRs.
COMPLEMENTARY POLICIES

- Greater macroeconomic policy coordination (particularly between surplus and deficit countries)
- Greater capital-account regulation, to reduce demand for self-insurance
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