REFORMING THE GLOBAL RESERVE SYSTEM

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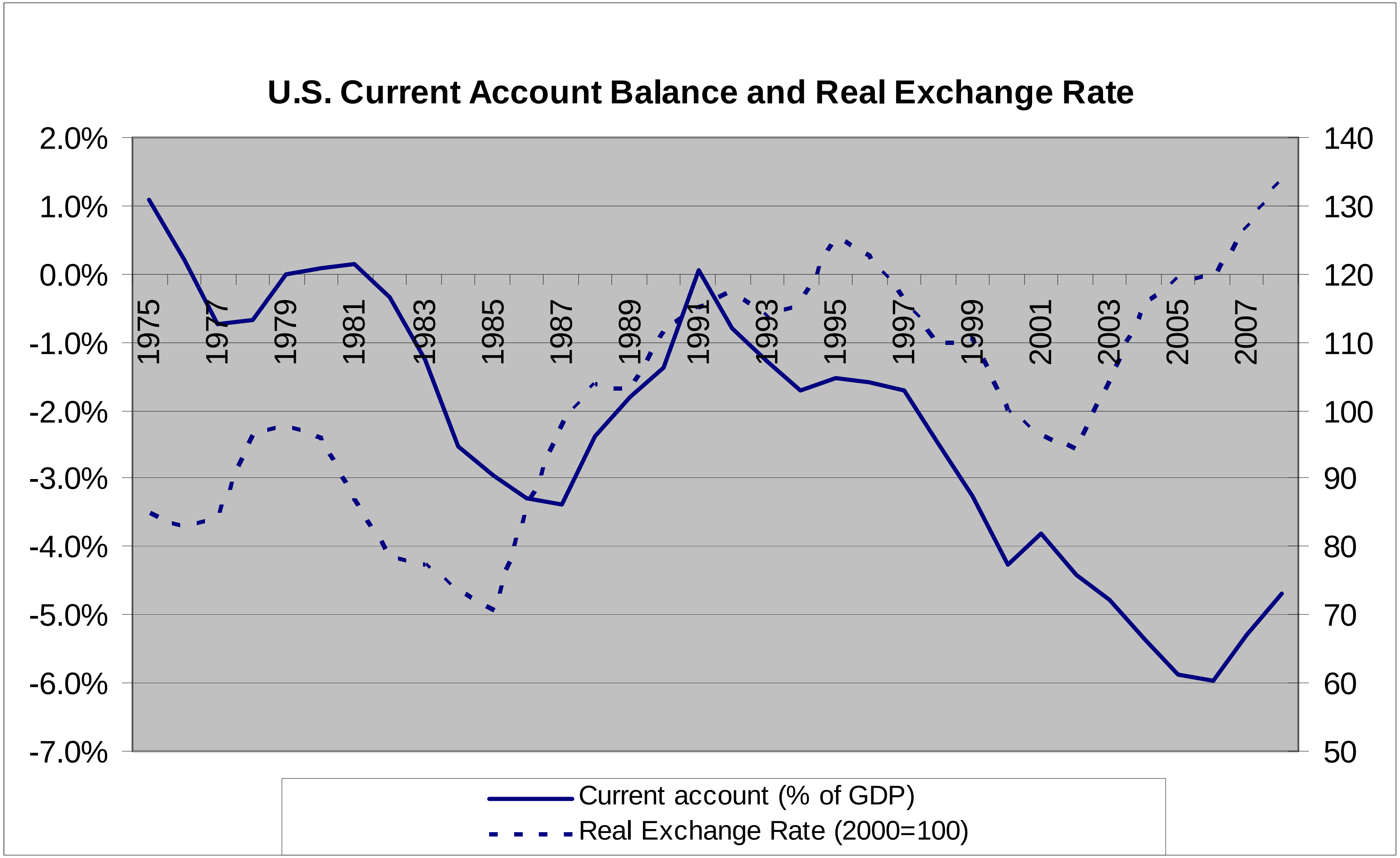
BASIC UNDERLYING ISSUE

Lack of proper adjustment between surplus and deficit countries without affecting world economic activity (or inflationary biases)

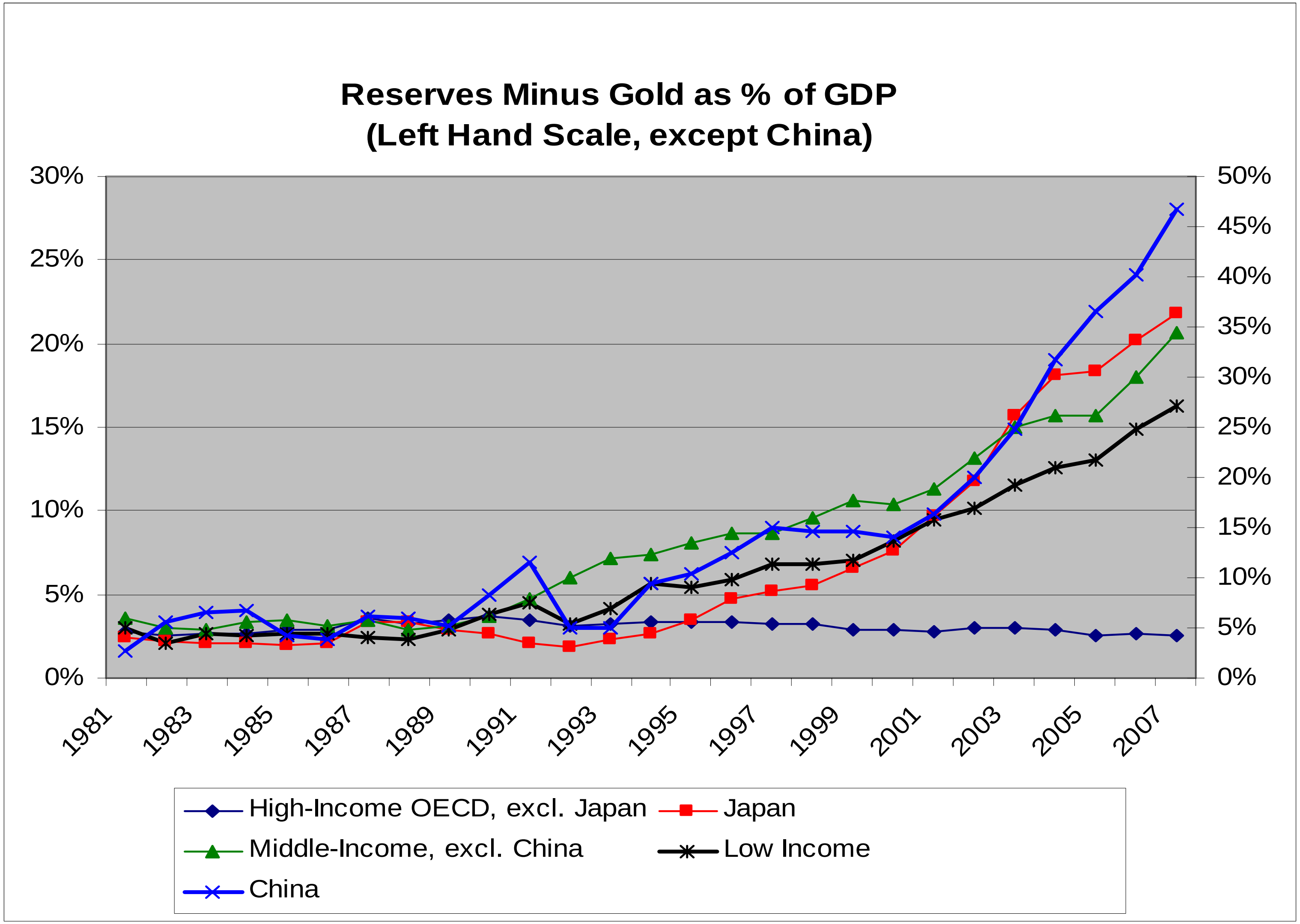
THE THREE BASIC PROBLEMS OF THE SYSTEM

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



GROWING DEMAND FOR FOREIGN EXCHANGE RESERVES BY DEVELOPING COUNTRIES

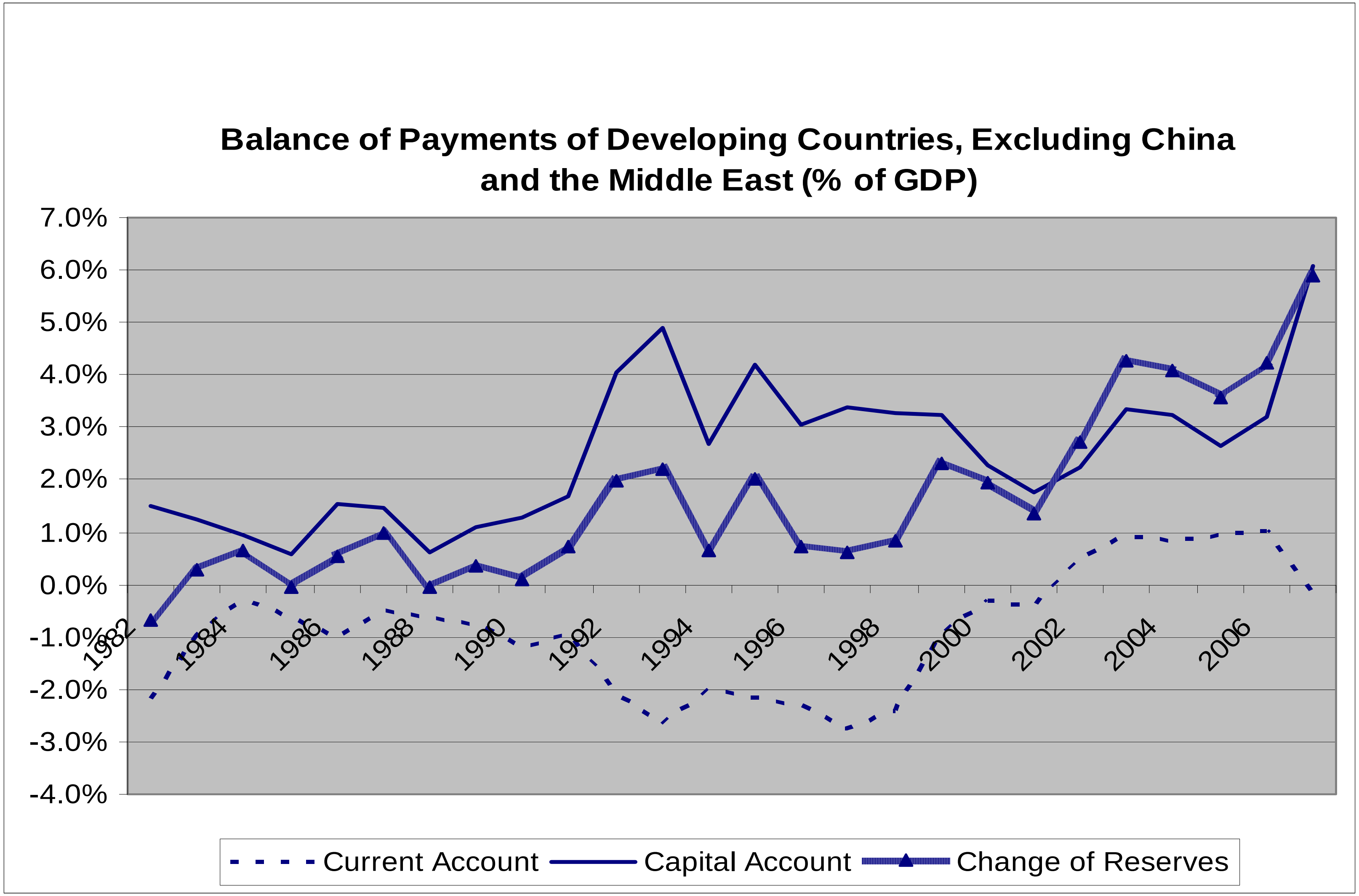


THE WORLD DEMAND FOR RESERVES SKYROCKETED AFTER THE ASIAN CRISIS

Accumulation of Foreign Exchange Reserves
Million dollars

	1982-90	1991-97	1998-02	2003-07
High income: OECD	42,805	30,889	59,358	140,715
Japan	5,588	20,164	48,307	98,320
Others	37,217	10,725	11,051	42,395
High income: non OECD		21,833	28,554	69,822
Middle income	6,734	56,950	63,739	548,444
China	2,725	16,168	29,673	247,831
Excluding China	4,009	40,782	34,066	300,613
Low income	212	1,952	3,654	17,938
World	59,946	111,624	155,305	776,919
Excluding China and Japan	51,633	75,292	77,325	430,768

IN THE DEVELOPING WORLD, THE DEMAND FOR RESERVES IS CLOSELY ASSOCIATED WITH CAPITAL ACCOUNT VOLATILITY



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.

ATTRACTIVENESS OF THE PROPOSAL FOR THE US

- 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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