Reforming the International Monetary System
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Towards a multicurrency reserve system
Positive aspects

• A multicurrency reserve environment means more countries have a stake in global stability and aim to play an active role in international monetary cooperation.

• More equitable sharing of the « exorbitant privilege »

• The change in reserve composition is likely to be gradual

• For central banks, reserve currency diversification can be good

• The desire to internationalize their currencies drives emerging market economies to implement economic reforms and strengthen institutions

• The international use of major creditor countries’ currencies is likely to result in an appreciation of their currencies, thereby facilitating adjustment of their external balance of payments.

• IMF’s encouragements to improve communication and coordination of policy action in view of addressing spillovers are welcome.
But complacency would be dangerous

• No guarantee that the system will be more stable.
• No satisfactory solution to the Triffin dilemma; i.e. the use of a national currency as an international currency
• Needs of the national economy overriding the needs of the global economy
• Weakening of the external constraint, exacerbating macro-economic imbalances
• Huge and volatile private capital flows and undesirable liquidity spillovers
• Downside risk to monetary and financial stability; loss of control of monetary aggregates, generating global monetary waves fostering vicious circles of boom and bust episodes.
Need to move to a multilateral reserve currency

• Importance of managing global liquidity as a global public good, calibrating global liquidity to the needs of the global economy.

• Rational solution is to move to multilateral currency reserve system, with multilateral drawing rights (MDRs) issued by an IMF transformed into a global central bank, endowed with the necessary legal and financial instruments to regulate global liquidity.

• This requires fundamental reform of the IMF, enhancing its surveillance role and strengthening its legitimacy and governance (see recommendations of Palais-Royal Initiative).

• If Bretton Woods II negotiations are not possible in the short run, the second best would be to enhance the use of the SDR.

• Danger of current situation but reasons for hope: ideas on the table, China’s attitude.
Broadening SDR use as a lever for gradual IMS reform

• Change anachronic name
• Use SDR more actively in the official sector life
• Reform allocation regime: general and targeted allocations
• Enable IMF to issue SDRs as International Lender of Last Resort
• Revival of Substitution Account idea for orderly diversification of reserves
• Make the SDR more attractive and user-friendly
• Promote private SDR market: clearing arrangements, legal and administrative rules, develop private SDR operations by public sector (e.g. World Bank and China SDR bond issues)