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Revoking the United States' Exorbitant Privilege

By Jose Antonio Ocampo

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The ongoing political stalemate in the U.S. holds two major implications for the international monetary system. The better-known consequence has been deepening uncertainty about the U.S. dollar, the main global reserve currency, and U.S. Treasury securities, supposedly the world's "safest" financial asset. Not surprisingly, the major investors in U.S. Treasuries, China and Japan, have expressed alarm. Simply put, the global economy has at its center a dysfunctional political regime that generates recurrent threats of default on the world's major reserve asset.

The second implication is further postponement of the International Monetary Fund's, or IMF's, 2010 quota and governance reforms, which would double member countries' contributions and modestly increase major emerging economies' voting power. Prior to its approval by the IMF board in December 2010, the reform, agreed at the Group of 20 Seoul summit, had been hailed as a "historic" breakthrough. But history has stalled without approval by the U.S., which has an effective veto over major IMF decisions.

The latest drama over the partial U.S. government shutdown and debt ceiling makes it abundantly clear that our globalized world deserves a better international monetary system than the current "nonsystem" that evolved in an ad hoc manner after the collapse in the early 1970s of the initial Bretton Woods arrangements.

The need to overhaul the international monetary and financial system was one of the basic lessons of the global financial crisis. While there have been major, albeit incomplete, reforms of international finance, efforts in 2009 and 2010 to reform the international monetary system — including the proposed changes at the IMF — have led to no significant action.

The reform proposals came from diverse quarters: the governor of the People's Bank of China; a commission convened by the United Nations General Assembly on reform of the international monetary and financial system, headed by the Nobel laureate Joseph Stiglitz; and the French Palais Royal Initiative, led by former IMF Managing Director Michel Camdessus. There have been myriad academic contributions to the debate as well.

The first element of reform should be to give a greater role to the only true international money that the world now has: the IMF's special drawing rights, or SDRs, created in 1969 as the result of another dollar crisis. The establishment of SDRs was accompanied by a commitment, included in the IMF Articles of Agreement, to "making the special drawing right the principal reserve asset in the international monetary system." But this commitment has remained a dead letter, except for periodic emissions of SDRs during crises, including the equivalent of $250 billion in 2009.

The IMF Articles of Agreement should be amended to allow more flexible use of SDRs, replicating the way central banks operate. That is, SDRs could be created during global recessions and withdrawn during booms. They should be the major source of IMF financing as well, replacing quota subscriptions or lending to the fund by member countries, potentially making the IMF a purely SDR-based institution, as proposed decades ago by the late IMF economist Jacques Polak. The simplest approach would be for countries to "deposit" the SDRs that they receive at the IMF, which could then lend them to countries and invest the remainder in sovereign bonds.

This should be combined with a more active role for the IMF, rather than the G-20, as the true instrument of global macroeconomic policy coordination. One essential and generally agreed goal of such coordination should be to reduce global imbalances like those caused in recent years by the European Union's rising external surplus, which has forced many emerging economies to run growing deficits.

Because other global currencies — the dollar, the euro and increasingly the yuan — would continue to coexist with the SDRs as global reserve assets, another essential element of global macroeconomic cooperation should be defining the particular obligations of countries or regions issuing reserve currencies.

Still another element of international monetary reform is better management of the global exchange rate system, which should aim at avoiding currency "manipulation" — but only after defining precisely what that means. It should also reduce the high levels of exchange rate volatility — "a tax on international specialization," as U.S. economist Charles Kindleberger once put it — that we have seen in recent years, including among major currencies.

Long-term discussions about global finance have also made clear that under certain conditions, regulation of capital flows are warranted on "macro-prudential" grounds — an understanding accepted by the G-20 at its 2011 Cannes meeting and by the IMF last year.

Last but not least, the international monetary system requires governance reform, which includes giving a stronger voice to emerging and developing countries. Aside from the final adoption of the 2010 reforms and the forthcoming 2014 quota debates, the changes should include those recommended by the Stiglitz Commission, the Palais Royal Initiative, and the 2009 Committee on IMF Governance Reform headed by former South African Finance Minister Trevor Manuel, among others.

One central element of these proposals is to eliminate, once and for all, the veto power of any individual country. With the world waiting anxiously for some of the U.S. political leaders to behave like adults, the cost of maintaining the current nonsystem has become all too obvious.

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