Floor Discussion of the Kenen Paper

A too timid agenda of reform?

Peter Kenen's reform agenda did not arouse much enthusiasm. Various participants, from developing as well as industrial countries, felt it was "too thin". They were disappointed that Kenen, who has gained worldwide reputation as a thinker on international monetary issues, had not presented a more challenging set of proposals.

Bernard Snoy elaborated on this critique by arguing that the discussion should return to the fundamental point made many years ago by his fellow countryman Robert Triffin of placing the Special Drawing Right (SDR) in the centre of the international monetary system and not in the periphery. He also thought Kenen had not done justice to the compelling arguments for a new SDR allocation made by the Managing Director of the IMF, Mr. Camdessus, since April 1993.

According to Snoy there are three fundamental reasons for a new SDR allocation. First, most developing countries and countries in transition to a market economy will not be able to acquire the additional reserves that they need in the coming years, except at high costs to both the countries concerned and the world economic community at large. "These costs," he said, "in terms of total interest costs, but also in terms of compression of domestic demand and compression of imports, exceed the true economic opportunity costs to the world of creating additional reserves through an SDR allocation."

A second reason is that if one fails to relieve the reserve stringencies of the many countries that are currently engaged in stabilisation and transition efforts, the risk of widespread setbacks or failures will be increased. "It is the argument of the underfinancing of Fund programmes, of adjustment fatigue, which in turn leads to aid fatigue in a very vicious circle." The failure to meet the reserve requirements of countries that are assisted by the IMF would have highly adverse effects on the global economy, Snoy warned.

A third reason is that one should implement the provisions of Article 22 of the IMF, "which is the objective of making the SDR the principal asset in the international monetary system, or, at least, to stop its rapid decline."

Illustrating these three arguments for the case of two categories of countries, the low-income developing countries and the transition economies of Eastern Europe and the former Soviet Union, Snoy observed that various urgent problems will have to be solved in the near future.

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"For the low-income countries – who are faced with very serious structural and financial problems – we have more or less a consensus that we will need a successor arrangement when the current ESAF arrangement expires later this year. But we don't know how this ESAF successor will be financed, and solutions may be harder to find when nearly all the industrial countries have serious budget problems. We may find a way through an SDR allocation. Alternatively, an SDR allocation properly rechannelled could also help to strengthen the reserve position and adjustment prospects of the low-income developing countries," Snoy suggested.

With respect to the transition economies Snoy pointed out that among the Group of Ten countries there is a similar consensus that these economies need a strengthening of their reserve position.

"These economies have to cope with systemic shocks which hamper them in building a market economy and they have much to gain from an increase in reserves. They have very limited access to international capital markets, so they can only compress their imports, or increase their access to industrial countries' import markets. In the present circumstances, however, it is very hard to imagine that these countries could acquire a sufficient amount of reserves through either import compression or market borrowing."

Snoy reminded the meeting that the Group of Ten ministers and governors had agreed last September that the reserve stringencies in the transition economies were such that they presented a threat to the stability of the international monetary system. This recognition of a systemic problem, he believed, could be the basis for a new SDR allocation.

Finally, Snoy observed that the debate about an SDR allocation continued to be clouded by two misunderstandings, which, to his regret, had not been dispelled by Peter Kenen's paper.

"The first is that an SDR allocation needs to be large to have any effect on the reserves of the non-industrial countries, i.e. the developing countries and the transition economies. The second is that by delivering unconditional liquidity and by providing it to countries that do not need it, an SDR allocation contains an inherent inflationary risk. Both these arguments can be tackled by deciding to link the SDR allocation to the acceptance by the industrial countries of a retransferring mechanism which redistributes the SDRs allocated to them. Rechannelling these SDRs through the Fund, while attaching conditionality to their use, would ensure a much more effective use of the SDRs allocated. This is the so-called Belgian proposition of rechannelling the new SDR allocation. It has been made repeatedly by the ministers of finance of Belgium since it was first formulated by Minister De Clercq in 1984."

By means of such a redistribution mechanism, Snoy noted, one would ensure that all of the allocated SDRs would be directly and exclusively used to

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meet systemic needs. They would thus supplement the conditional financing already provided by the Fund through ESAF to the low-income countries, and through the Systemic Transformation Facility to the transition economies. Moreover, new allocations of SDRs would remain available in the system for addressing other systemic problems such as the intervention needs of reserve currency countries under a system of more stable exchange rates.

Mahbub ul Haq said he was surprised "that Peter Kenen had limited his intellectual genius, because he is the leading light in international monetary analysis and we would have greatly benefitted from his analysis of what is wrong with the international monetary system." According to him the IMF has become so marginal to global monetary management, "that it is a cripple now". Most of all, he argued, because it does not have much of a role to play vis-à-vis the major part of the monetary system.

"They always played a role vis-à-vis the developing countries, which had to accept IMF-imposed monetary receipts. But that is less than 10 per cent of global liquidity. The really money management is done by Bundesbank and Federal Reserve Board of the U.S., by Japan, by the Group of Seven, and by the private capital markets. A trillion dollars is flowing across international frontiers every 24 hours at the push of computer buttons. The IMF is being made irrelevant by the policies of the industrial countries," ul Haq observed.

Subsequently, he raised the question of whether a global monetary institution would still be needed, and, if so, what reforms would have to be made in the IMF to play that role. His own answer was that one has to keep a sustained intellectual pressure for change. "I think it would be very sad if in a forum like this we are throwing in the towel and saying that realpolitik is such that we cannot expect any major changes in the international monetary institutions."

John Williamson, who at a previous FONDAD conference had presented his own agenda of monetary reform, made another suggestion for broadening the agenda. According to him, one of the main points should be to do something in the monetary field to support open trade policies.

"We are living in a world where more and more people are worrying about the export of jobs to – depending on where you are – Eastern Europe, Mexico or East Asia, and, as a consequence, are favouring protectionism. If the concern is the export of jobs, then we ought to be able to think of a way to ensure that this will not happen. What I have in mind is to use some type of arrangement for balance of payments targeting, with sanctions for countries that have excessive surpluses, because as long as Malaysia is increasing its exports, but at the same time is increasing its imports, there is no danger of jobs being lost in the West.

This leads me to think that there is another argument for the sort of balance of payments targets that I proposed in the blueprint for policy

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coordination, which was in the paper I presented at the FONDAD conference last year. I have always thought of these targets as something that is useful to prevent misalignments in the exchange rate system. But this may be an even more important rationale for going down that road: providing the assurance to the public in the industrial countries that their jobs are not going to be exported to developing countries."

Kenen's proposals

Peter Kenen's three proposals – SDR creation, freer access to CCFF, extra reserve credit – excited some critical comments as well.

Delphin Rwegasira disagreed with Kenen's conclusion that most developing countries now have a fairly adequate level of reserves. "These reserves may look quite good, but have partly been the result of very serious import compression," he contended. Given the source of this reserve accumulation he also questioned the sustainability of the current level of reserves.

Rwegasira felt that the international monetary authorities should do much more to meet the needs of, in particular, the low-income countries because, he argued, these countries are highly vulnerable to shocks in the prices of their export commodities and climatic factors like droughts.

"I happened to work in a central bank of a low-income country," Rwegasira explained, "and there I have learned that things like droughts, not to mention the usual deterioration of the terms of trade, can turn a reserve level that looks quite reasonable into a big shortage. Then you can try to juggle with the exchange rate, but there is a very limited range within which the government, or indeed the economy as a whole, can adjust to these kinds of shocks. Given the vulnerability of these countries, and given the opportunity costs of reserves, I would therefore hope that the international monetary system would not only provide adequate levels of liquidity, but also liquidity at low costs."

Helen Junz objected to Kenen's suggestion that the IMF should give developing countries a freer access to its Compensatory and Contingency Financing Facility (CCFF).

"I think that fixing and re-fixing the CCFF is not really even a partial answer," she said. According to Junz the CCFF was instituted to provide financing for problems that were reversible in the short term, but since the short term very easily becomes the medium or the long term, she argued, it was quite reasonable to attach conditionality to the CCFF or other bridge financing mechanisms. Moreover, she stressed, CCFF conditionality was not as strict as Kenen suggested. "There are gradations," she said.

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Kenen's reply

Kenen explained, first of all, why he had substantially restricted his reform agenda.

"I have been asked to write a paper on the most urgent reforms of the international monetary system and ways to improve the access of developing countries to international liquidity, and that's what I have done. I wrote a paper on what I thought to be the most urgent and immediate steps and I did not intend to present a long-term agenda. But yet, even what I am proposing as feasible in the short run may turn out not to be feasible."

Kenen agreed with Bernard Snoy on the need for a new SDR allocation. He had tried very hard, he said, to get his hands on some of the documents of the Fund concerning this matter, but had met with a flat refusal. Nonetheless, he believed that the case made in those documents was strong and he fully endorsed it.

Kenen accepted the criticism that the ratio of reserves to imports is not a good measure of reserve adequacy, and is less relevant today than in the past. "May I say in self-defence," he added, "that already in 1965 I wrote a paper on the demand for international reserves which began with an assault on that measure and went on to say that the appropriate measure was the variability of the balance of payments. And I got some pretty good empirical results in support of that proposition."

He also accepted the criticism that, after having made the case for owned reserves, he had focused much more on reserve credit. Kenen said that in revising his paper he would give more attention to the importance of an SDR allocation.

Though agreeing with Gerald Helleiner's complaint that the interest rates on the SDR were too high for the low-income countries, Kenen strongly disagreed with Helleiner's proposal to lower these rates. "We worked very hard to make the SDR a more attractive reserve asset and one of the reasons why the interest rate was raised was precisely that," he said. Kenen would prefer a different method of reducing the SDR interest rate.

"I would take a more general position and argue that some portion of the development assistance programmes of the industrial countries should be devoted to interest subsidies across the board, not tied to the SDR or any other specific asset. Using ODA for interest subsidies on various sorts of obligations, including the SDR, would be a very effective leverage, but I would not touch the SDR scheme itself. That would be a retrograde step. Just as the restoration of a reconstitution requirement would be a retrograde step."

Finally, Kenen took up the challenge to provide "a very short version" of his long-term reform agenda.

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"First, I have always argued that we must move to a Fund fully based on the SDR. The financing of the Fund should be done by SDR creation, not by quota subscriptions, for both economic and political reasons.

Second, I strongly endorse the notion that the process of G-7 coordination ought to be integrated in some way into the work of the Fund. The instrumentalities and techniques may not be easy to work out, but I fully agree with those who say that present arrangements under which the Managing Director of the Fund comes and goes are utterly inappropriate. The G-7 process must become integrated thoroughly into the work of the IMF.

Third, I have from time to time argued that the whole approach to conditionality needs to be reviewed.

Fourth, I of all people have argued that we should move to a more structured exchange rate system among the major industrial countries, not necessarily moving back to fixed rates, but moving in the direction of a much more explicit system of targetting.

That would be my agenda. These measures are not directed specifically at the developing countries, but I think that the developing countries would benefit from them."

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