Comment on "Reforming the International Monetary System," by Peter B. Kenen

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Peter Kenen's paper is very good – as far as it goes. It has very modest aspirations.

Kenen suggests some ways of meeting the liquidity needs of the developing countries: two of these ways are old; one is new. Subject to some caveats, that I will offer below, his suggestions are sensible, and I agree with them.

I particularly welcome Kenen's clarity as to the distinction between "owned reserves" and reserve credit – and, implicitly, between such "reserve credit", which provides liquidity, and upper credit tranche IMF credit which, however useful, because of its transactions costs and delays, does not.

I would have preferred more explicit recognition on his part of the typically greater "needs" of developing countries for liquidity – both on traditionally agreed grounds and on the new capital-flow related ones. Whether reserves are held or not, and whether they rise or fall over any particular period, there are likely to be very high returns from the provision of increased liquidity for the developing countries. But the cost of acquiring this liquidity, in the particular form of owned reserves, is also very high in terms of opportunity costs. That reserves have risen over time does not indicate anything about the cost of the acquisition of these increased reserves. That cost has frequently been very high – in terms of severe and unsustainable degrees of demand restraint and import compression.

Low-income countries are closer to the "survival margin" than are richer countries. Insurance is a luxury good. It has never been useful to recommend to the poor that, buffeted as they are by severe shocks, they should buy insurance policies! Low-income countries are subject to export shocks that are typically larger than those of other countries – both price and volume shocks, and these two do not offset one another at the country level. These countries also incur higher costs when they borrow and/or have limited access to credit. Moreover, they typically can enjoy fewer scale economies in reserve management. In short, there is no reason to believe that the low-income countries in Sub-Saharan Africa that, on Kenen's evidence, have increased their reserves are in an acceptable state of macroeconomic balance, or are "on their appropriate demand functions". Such demand functions are

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the product of an international income and wealth distribution with which these countries are certainly not content.

The utilisation of savings for the purpose of building foreign exchange reserves in the 1980s has been at the expense of investment and levels of welfare among extremely poor members of the global community. These low-income countries have always been and remain particularly vulnerable to turbulence, disorder and uncertainty of the kind that has characterised the global economy during the last two decades. The most glaring shortcoming of the global liquidity system in the 1970s and 1980s has been its failure to deliver expanding access to low conditionality credit for those countries with limited access to commercial credit in the face of growing trade and international payments, and growing international economic turbulence.

Let me first address those recommendations with which I agree. Let me offer wholehearted support for Kenen's proposed reform of the CCFF, that which Sidney Dell called – in its current "silly" version – the "fifth credit tranche". There should certainly be a return to greater automaticity of access to this facility, as Kenen suggests. But Kenen's reforms do not go far enough – for three reasons:

1. Access to the CCFF is IMF quota-related. CCFF drawing rights have therefore typically fallen far short of shortfalls. The oil facility in the 1970s provided a temporary and ad hoc substitute for a more satisfactory CCFF; but it has long since vanished from the scene. Access rights should more closely approach actual shortfalls and are probably best expressed in terms of a pre-stipulated percentage of shortfall rather than as a percentage of quota.
2. Access rights should also be related to forecast errors, i.e., shocks that are not simply the product of one-year shortfalls. More automatic, and therefore faster, access on a contingency basis is required. Provided that these access rights are still formula-based, neither such contingency financing arrangements nor shortfall-related rights will generate any moral hazard.
3. The CCFF still charges the same interest rate to all IMF borrowers. Low-income countries (those that benefit from the SAF and ESAF) should receive concessional interest rates on CCFF finance in the same way as they do for other IMF finance.

This third point raises the more general issue of the special needs of the very low-income countries. The concessional interest rates they have been receiving through the Trust Fund, the SAF and the ESAF have not been fully institutionalised and are subject to periodic renegotiation every two or three years. It is surely time that, as in the case of IDA lending, very low-income countries should be able to count on concessional interest rates in whatever borrowing they undertake from the IMF under whatever facility. Moreover,

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the financing of interest subsidies in the IMF should be more equitable than at present. The U.S. and some other countries are at present "free-riding" on the generosity of other donors. One promising option for such financing is the sale of some of the IMF's vast stock of gold. More fundamentally, low-income countries most require more IDA programme lending together with contingency clauses therein. The World Bank would then "lead" financing efforts for these countries, as they certainly should; and, with adequate contingency finance through IDA programmes, the IMF could retreat to a technical assistance role.

Kenen's suggestions concerning an SDR allocation also win my support. Again, however, they do not take into account the peculiar needs of the very low-income countries. These countries will be unable to use SDRs that are issued on the present basis because of the commercial interest rate that must be paid on them. A way must be found to ensure that the very low-income countries can acquire increased liquidity, that they can afford, as their needs expand. There are many institutional devices through which a concessional interest rate on future SDR allocations can be financed, again including IMF gold sales.

I have no quarrel with Kenen's new suggestion for additional rights. It seems to me, however, that symmetry would require that some form of "supplementary finance" for countries with problems other than those created by private capital flow would also be appropriate. It might also be appropriate to "target" reserves for primary producing countries that experience large export shocks, with further IMF credit offered once certain target levels are achieved. "Shadow conditions" and provisional letters of intent could assist primary producing countries as well as those vulnerable to private capital surges. Incentives can always be expected to help countries to meet liquidity targets. Why should they not be provided to those with "old" problems as well as those with new ones?

Kenen's approach has been to tinker with the system as it is. I would have preferred a paper that dealt with the potential for more fundamental reform and the rethinking of first principles. Kenen opts for tinkering because "there is almost no interest today in any reform of the monetary system". I find this a breathtaking observation. It appears to offer a possible new element, although it is actually quite old, within the Washington consensus: arguments should be weighted by the income of those making them. With apologies to another author, let me offer some comment.

"The poor complain. They always do. But that's just idle chatter.
Our system brings rewards to all, at least to all who matter."

I reject Kenen's premise that no one is interested. I accept a related, more accurate, proposition: that the G-7 powers are not at present very interested in more fundamental reform and therefore that such reform is not in

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prospect. I cannot accept his view that, because for developing countries the trade issues may be more important, they should not be interested in these international monetary issues. Why must they choose? Does the U.S. do so? This conference was intended to discuss the need for reform in the interest of all members of the global community. Personally, I have always preferred population weights to income weights.

I therefore regret that Kenen did not address a number of deeper issues.

First, the "global need" for liquidity needs to be redefined and its provision automaticised. There should be a formula base for IMF quota expansion and/or SDR issues, rather than continuing to debate on the basis of political negotiation of what is an appropriate degree of expansion.

Second, like Percy Mistry, I think in the financial sphere there is an overconcentration in Washington. We do need a global system, but we may want to decentralise responsibilities. What about the potential for regional funds and/or the regional development banks; and the pros and cons of a deconcentration of the international monetary and financial system? If we were to begin again, would we construct the centralised system as it now exists?

Third, there is also a clear need for more "bridge finance" – not simply for "systemic transition" in Eastern Europe and the former Soviet Union, but for a variety of other purposes as well.

Fourth, what about the developing countries' interest in problems emphasised elsewhere in this conference, those created by international private capital flows, and their possible support for the Tobin proposals for putting more "sand in the wheels".

And, fifth, is anyone content with the current macroeconomic governance of the global economy? Must there not be better provision for the representation in such governance of countries other than the members of the G-7?

There is much that Kenen, with his income-weighted "realism" has left out.

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