Veterans of the System

Ideas for strengthening the international monetary system

A GROUP of former senior policymakers and global luminaries were intent on seeing something good rise from the ashes of the global financial crisis. The crisis was an opportunity to advance the reform agenda and, according to former IMF Managing Director Michel Camdessus, secure the international monetary system against similar future crises and distribute the potential benefits of globalization more equitably.

Together with Alexandre Lamfalussy and Tommaso Padoa-Schioppa (who passed away in late 2010), Camdessus convened the high-level group behind the Palais-Royal Initiative. Camdessus spoke to F&D *about the group's report on reform of the international monetary system, which was released in February.*

***F&D:* What is the idea of the Palais-Royal Initiative?**

Camdessus: The global financial crisis led those with some experience of international cooperation to think twice about what's going on and, in particular, to ask if and to what degree the international monetary system—or non-system—was the origin of the crisis. If so, the crisis could be an opportunity to put in place a system that is able to avoid a similar event in the future and ensure that the potential benefits of globalization become durable and more equitably distributed.

All these questions were in our minds. And, when I say "we," I speak about many of the veterans of the system. We were excited to see that the Group of Twenty (G-20) had put reform of the system back on its agenda this year, after having concentrated in the previous years on other aspects of the crisis.

The idea came to a few of us that we should put our experience of previous crises at the disposal of those who are now in charge. We decided to see if, together, we could come to a common understanding of the problem—the key weaknesses of the system and that it allows formidable imbalances to continue developing—and what could be done to establish more solidity, discipline in the system.

We established a group of 18 persons and distributed among ourselves the task of producing papers. We asked for informal support from the IMF, Bank for International Settlements (BIS), central banks, and others. We put all these papers on the table on the occasion of our meetings in the Palais Royal in Paris—for which the initiative is named—and we put in writing a set of proposals. I had the honor of bringing our initial report to the president of the G-20, [French] President Nicolas Sarkozy, on January 21.

The origin of this initiative is totally private. It does not commit any country: our credibility as individuals is the only thing at stake. We hope our report will be a source of inspiration and show that when you sit together—and here we have 15 countries represented in the group—in a real spirit of cooperation, then you can create the basis for more cooperative coordination of economic policies.

***F&D:* Why are the reforms already initiated—including by the G-20—not enough to address risks in the international monetary system?**

Camdessus: We value very much the work that has been developed so far, but we must go several extra miles if we want to be sure the system is made safer. There are still many risks that are not answered sufficiently by what has been done so far, and several ideas have been considered and, for the time being, rejected. As private individuals, we thought it would be worth revisiting a few of those ideas that have so far been left aside.

Box 1

Members of the Palais-Royal Initiative

The group was convened by Michel Camdessus, former IMF Managing Director; Alexandre Lamfalussy, former General Manager, Bank for International Settlements (BIS); and the late Tommaso Padoa-Schioppa, former Minister of Finance, Italy. Other members include Sergey Aleksashenko, former Deputy Governor, Central Bank of Russia; Hamad Al Sayari, former Governor, Saudi Arabian Monetary Agency; Jack T. Boorman, former senior IMF official; Andrew Crockett, former BIS General Manager; Guillermo de la Dehesa, former State Secretary of Economy and Finance, Spain; Arminio Fraga, former Governor, Central Bank of Brazil; Toyoo Gyohten, former Vice Finance Minister, Japan; Xiaolian Hu, Vice President of China Society of Finance and Banking; André Icard, former BIS Deputy General Manager; Horst Köhler, former IMF Managing Director; Guillermo Ortiz, former Governor, Banco de México; Maria Ramos, former Treasury Director General, South Africa; Y. Venugopal Reddy, former Governor, Reserve Bank of India; Edwin M. Truman, former Assistant Secretary, U.S. Treasury; and Paul A. Volcker, former U.S. Federal Reserve Board Chairman.

We don't want to see the world economy retreating into a fragmented economic system, vulnerable to protectionist pressures. We don't want the move toward an open and competitive global market to be at risk as it is now. We also know that the years immediately following a crisis are fraught with dangers. The comprehensive measures adopted by the G-20 will deliver positive effects only after several years due to the inevitable delays in implementation.

And you have other risks. The strong, but resistible, temptation to return to business as usual. We see it in the banking industry, but also in international institutions. There is also the risk that the changes adopted are too small and too late, leaving the system vulnerable to unexpected crises and not allowing globalization to deliver all its potential and positive contribution to a better world.

Nobody believes that these risks would gently disappear by muddling through. Without completing bold changes, this could leave us with a more unstable world. So we cannot rest on our laurels.

***F&D:* Why might the recommended IMF reforms—including some that have been suggested in the past—have more traction today?**

Camdessus: The question is whether they are necessary or not. Not to have adopted them has contributed at least partly to the mess in which we are. We were wrong in postponing these changes or to water down many suggestions. Now we know what has been the cost of procrastination and hesitations. Now it's time for change. Now or never.

***F&D:* What IMF reforms should have the highest priority?**

Camdessus: It is a package of measures. You cannot say, "Here you have something which is important, let's do that and then we'll see." No. A bold overhaul of the system is needed. We must recognize that the IMF has new and powerful partners emerging who will want full-fledged responsibilities in the system.

We need a much broader scope of surveillance by the IMF, not only the current account and monetary dimensions, but the full monetary and financial sphere. The ultimate goal is to have better surveillance and more efficient prevention of crises, and an IMF with stronger instruments for doing its job. In that regard, we propose new obligations for IMF member countries, and that is described in full detail in the report.

I believe that it's time now—it should have been done earlier—to merge the G-20 ministers of finance and the IMFC [International Monetary and Financial Committee] within the Council as is provided for in the IMF's Articles of Agreement.

All these reforms must go hand in hand and be adopted soon. The next crisis may not be far away if we don't move.

***F&D:* How would the proposed new global governance structure change the system?**

Camdessus: Well, I don't see many changes. First, creation of the Council, as I mentioned earlier, is long overdue. Second, we suggest that the G-20 organize itself with a system of constituencies. This would allow each country to be actively part of the system, to be consulted prior to meetings, and to receive direct reports from members of the G-20 about the decision-taking at the supreme level.

***F&D:* You suggest an expanded role for the IMF's Special Drawing Right (SDR). What was the group's thinking?**

Camdessus: It's interesting to observe that this group, which has taken very diverse positions in the past on the future of the SDR, recognizes that it has demonstrated it could be a useful instrument—even more useful in the next few years and, possibly, even more important in a longer-term perspective. You could see a kind of revival of the SDR if you give the IMF a status akin to lender of last resort.

***F&D:* The report calls for improved measurement and monitoring of changes in global liquidity. How can this be done in a way that will stand the test of time?**

Camdessus: I believe this should have been done earlier, and I regret not taking the initiative when I was in the IMF. The tradition was that there was a distribution of tasks between the BIS and IMF; as the issue has become so central, we only suggest that the IMF and BIS work closely together to this end. We are certain that what these two institutions will do jointly will stand the test of time.

Now, we must have proper surveillance of global liquidity. IMF and BIS staff will have to work together to define properly what we are talking about—which definition of liquidity we must adopt, what kind of data we must collect, and then how to analyze the data. Together they must track much more closely developments in the global economy and be able to play the alert role, which is indispensable. ■

Box 2

Key suggestions in the report

The Palais-Royal Initiative's more detailed February report included 18 suggestions, with several focusing on surveillance and cooperation and governance of the international monetary system.

On ***surveillance and cooperation***, the IMF should develop and adopt "norms" for members' policies, including globally consistent exchange rate norms. Persistent breaches of a norm or norms would trigger a consultation and, if needed, remedial action. For systemically important countries whose policies do not appear to meet the norms, compliance should be assessed by a relevant body within the IMF. Each country would be expected to refrain from policies that push or keep its exchange rate away from its norm. Macroprudential policies in systemically relevant economies should take into account the need for broadly appropriate global liquidity conditions.

Governance of the international monetary system should be based on a single three-level structure, with all countries represented through a system of constituencies. This could include a global advisory committee of eminent independent individuals.