

G24 developing countries call for international monetary system reforms, a greater role for SDRs in capital controls

15 April, Washington, D.C. (Bhumika Muchhala) - The Group of 24 (G24) grouping of developing countries at the International Monetary Fund (IMF) and World Bank issued a communiqué on 14 April that emphasized reform of the international monetary system, a greater role for special drawing rights (SDRs), and cautioned against the IMF's recently proposed framework for managing capital flows.

The G24 statement, that came at the end of the Group's 85th ministerial meeting in Washington D.C., expressed concern over the various adverse spillover effects that developed country policies have recently had on developing countries. The communiqué states that the "reliance by advanced economies on overly expansionary monetary policy as the primary instrument to support recovery has contributed to a surge in capital flows, increased risks to financial stability, promoted speculative movements in commodity prices, and led to overheating and exchange rate pressures in many emerging markets."

G24 Ministers stated their disagreement with the IMF's proposed framework for capital controls, which would be used as staff advice to member countries on managing capital flows and get included in IMF surveillance reports. Instead, the G24 stressed that the IMF must adopt an "open-minded and even-handed approach to the management of capital flows and take into account policies in capital-originating countries," in particular the systemic financial centers in the US and the Eurozone.

In the recently released IMF paper on a capital controls framework, the Fund tries to formulate the "global rules of the game" on "macroprudential policies, capital account liberalization, and reserve adequacy." The paper stipulates that because capital controls can potentially be used to avoid the necessary macroeconomic policy adjustments, they warrant greater scrutiny and should be used only when appropriate macroeconomic conditions are already in place as a "first line of defense."

The three central macroeconomic conditions are an exchange rate that is not undervalued ("allowing the currency to strengthen"); reserves that are more than adequate ("accumulating reserves"); and, resistance to lowering interest rates any further when the economy is overheating ("rebalancing the monetary and fiscal policy mix"). These macroeconomic pre-conditions are some of the contentious areas to which G24 Ministers referred when stating that policymakers of capital recipient countries "must have the flexibility and discretion to adopt policies that they consider appropriate and effective..."

The IMF paper also states that "the onus of policy adjustment from inflow surges rests solely on the recipient countries." The G24 again parted ways with the IMF, stating that the IMF must "take into account policies in capital-originating countries, especially systemically important financial

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centers, as well as specific circumstances of capital-receiving countries.” Academics such as Kevin Gallagher and Stephanie Griffith-Jones have also argued that capital controls could be “coordinated on a global level – indeed, as a part of the global process to re-regulate finance.” They remind the international community that “in the meetings that led up to the establishment of the IMF, both Harry Dexter White and John Maynard Keynes agreed that capital controls be targeted at ‘both ends’ of a capital flow.”

Reserve adequacy, international monetary system, and SDRs

The G24 Ministers did not support the adoption of the IMF’s recent policy proposal on “reserve adequacy metrics,” nor the inclusion of such a framework that defines reserve adequacy in IMF surveillance. Instead, the Ministers emphasized the important role that reserves have played in cushioning the impact of the financial crisis on developing countries. Since the Asian financial crisis of 1997-98, many developing countries, particularly in Asia and Latin America, have avoided going to the IMF by employing a ‘self-insurance’ strategy of accumulating foreign exchange reserves. This has enabled many developing countries to sustain their economies in the wake of the current financial crisis by protecting their domestic economies from balance of payment problems.

G24 Ministers asked the IMF to continue exploring options to improve the international monetary system, including through a “greater role for SDRs and expansion of the SDR basket to include emerging markets currencies.” This statement echoes recent calls by China, and other countries such as France, for the inclusion of the yuan and other emerging market currencies in the SDR currency basket, so that the international currency better reflects current changes in the world economic geography. (The SDR is currently comprised of the US dollar, the euro, the yen and the sterling pound).

Emerging economies are increasingly trying to diversify their reserve assets from the traditional reserve composition that has been dominated by the US dollar Treasury bills. Diversification of the composition of assets in country reserves would on the one hand decrease the privilege of the US dollar as the sole global reserve currency, and on the other hand lower the foreign exchange risk associated with the low-value US dollar for countries.

Ministers also called for regular allocations of SDRs to complement the reserves of member countries. So far, there has been only one SDR allocation of \$283 billion, which occurred in August 2009, in direct response to the urgent liquidity needs of member countries in response to the many adverse impacts of the financial and economic crisis. However, the SDR allocations were made according to the IMF’s skewed quota-based voting power system. Consequently, the vast majority of the SDR allocation was received by developed countries, which, ironically, needed them the least.

Commodity price spikes

The G24 Ministers call for “urgent and concerted actions to deal with the immediate consequences of food and energy price increases and to address the long-standing impediments to food and energy security.” Their communiqué highlighted the surge in commodity prices relative to their previous peak in mid-2008 and agreed that “structural, cyclical and financial

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factors, as well as supply disruptions, all appear to play a role in explaining recent trends and increased volatility.”

While commodity price increases have been a positive development for developing countries that are commodity exporters, the sharp price spikes of fuel and food are a serious concern for many developing countries. A key cause of concern is the high share of consumption that food and fuel account for in the household budgets of the most vulnerable sections of society in developing countries. Other concerns are inflation pressures, the exacerbation of social tension, and fiscal and import cost burdens that endanger growth prospects, especially of low-income countries.

The G24 called on the IMF to adapt its lending tool kit, particularly with respect to conditionality and interest rates, to better help countries cope with the adverse effects of the food and energy crisis. Concern was expressed about the adequacy of resources available for food and energy from the World Bank’s Global Food Crisis Response Program as well as other international financial institutions. However, the G24 Ministers agreed with the World Bank’s Agriculture Action Plan which scales up agriculture, improves resilience to climate change and addresses binding land and water constraints toward the goal of decreasing the supply shocks associated with commodity price volatility.

Surveillance and global imbalances

The G24 Ministers highlighted the lessons from the recent report by the Independent Evaluation Office (IEO) on IMF performance in the run-up to the 2008 crisis, calling for “even-handed surveillance” and more effective traction in systemically important advanced economies. One of the key conclusions of the IEO report was the lack of impartiality and objectivity in IMF surveillance, as advanced economies, particularly the US, were assessed favorably despite the economic evidence at hand, whereas developing countries were assessed rigorously with a bias toward requiring structural reforms.

On the hotly debated issue of global imbalances, the G24 acknowledged the role of developing countries in supporting global demand. While this reflects the persistent argument from the US that China must boost its domestic demand and consumption partly by increasing its imports, the G24 also stressed that policies must “take into account differing country circumstances and continued uncertainties in the global economy.”

G24 Ministers noted that while fiscal consolidation in many advanced economies is imperative, the “pace and synchronization of fiscal adjustment” must be supportive to maintaining private demand as well as to “strong structural reforms.” Upon the advent of interest rate increases (monetary tightening) in the US, many developing countries that have experienced high volumes of capital inflows may face the prospect of a sudden reversal of capital outflows, which would instigate financial instability and the threat of currency depreciation in those countries.

Downside risks were identified by the G24 to range from the still weak financial systems in advanced economies, debt sustainability problems in the Eurozone area, recent commodity price spikes, “disruptions to growth stemming from the disruptions in oil supply”, and threats to food security from “aggravated demand-supply imbalances.”

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The communiqué made note of the recent events in Middle East and North African countries which may have “spillover effects” to other regions in social and economic areas. The importance of IMF and World Bank responses to the “developmental needs” of Middle Eastern countries was emphasized, particularly through “job creation, especially for women and the youth, social safety nets, and other critical areas” which include a scaling up of resources.

The G24 communiqué highlighted the shift towards “multi-polar sources of growth” through the contrast between advanced economies, where risks of a “double-dip” recession continue and where high unemployment and sluggish growth persist, and developing regions, which continue to maintain “strong growth momentum reflecting robust macroeconomic frameworks.”

World Bank lending and boosting multilateral development finance

The G24 ministers welcomed ongoing reforms that streamline World Bank lending through “due flexibility in the policies and instruments of the Bank, including its financial policies, and cautioned against increases in the costs associated with its lending.” Ministers also welcomed the proposed introduction of a new instrument for “results-based lending,” the program for results (P4R), that focuses on scaling up successful country programs, while stressing that “the efficacy of this instrument should not be undermined by conditions and restrictions.”

In a major break with the past, governments using the P4R instrument will not be required to comply with the World Bank’s environmental and social safeguards even for operations classified as Category B, or in other words, programs with “substantial risk.” Category A operations, such as large infrastructure projects, would be subject to a revised set of safeguards.

Ministers agreed that a “priority area for collective action is the reinvigoration of multilateral development finance.” To achieve this they committed to work together on financing proposals, “including through enhanced South-South cooperation.” They also underscored the critical importance of upgrading infrastructure and raising investment in developing countries, as well as financing to meet the Millennium Development Goals (MDGs), agricultural revitalization, and climate change adaptation and mitigation.

Climate finance

On climate finance, the G24 Ministers took note of the agreement reached at Cancun to establish a Green Fund to function under the UNFCCC (UN Framework Convention on Climate Change) that would channel concessional and other resources of \$100 billion a year by 2020 from a mix of public, private and innovative sources. The communiqué stresses the need for scaled-up financing to be in place as expeditiously as possible, given that the cost of delays would be borne primarily by climate vulnerable countries, and called on developed countries to fully meet their commitments starting with the Fast Track Initiative.

Ministers asked the G24 to assist member countries in drafting proposals that can serve as an input to the deliberations in the Transitional Committee and related discussions in the G20 to ensure that low-carbon growth is pro-poor, to provide input on the design of the Green Fund, and to advise economies on adaptation and its development linkages.

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Governance tenets for the Green Fund were discussed by the Ministers, which range from provision of public funds based on the principles of common but differentiated responsibility in compliance with financing obligations, leveraging public resources, private flows and MDG finance to ensure scaled up, adequate and predictable financing, and having the flexibility to address REDD+ adaptation, mitigation, technology development and transfer and capacity building. The Ministers underscored that the governance arrangements for the Green Fund should operate under the guidance and accountability of the Conference of Parties, and that the Green Fund be anchored in country-focused and country-owned programs.

(REDD refers to Reduction of Emissions from Deforestation and Forest Degradation.)

Governance reform in the Bretton Woods Institutions

Governance reforms in both the World Bank and IMF were taken note of and Ministers repeated their call for an “open, transparent, merit-based process,” without regard to nationality, for the selection of both Bank and Fund chiefs. There are prevailing sentiments that the next chief of the IMF should be selected from a BRICS country (Brazil, Russia, India, China, South Africa), while civil society groups have also put forward a joint advocacy report calling for the fair, open and meritocratic selection of the next IMF Managing Director.

The G24 group is composed of African, Asian and Latin American country clusters. There are 9 African countries (Algeria, Cote d'Ivoire, Democratic republic of Congo, Egypt, Ethiopia, Gabon, Ghana, Nigeria, South Africa), 5 Asian countries (India, Islamic Republic of Iran, Lebanon, Pakistan, Philippines, Sri Lanka) and 8 Latin American countries (Argentina, Brazil, Colombia, Guatemala, Mexico, Peru, Trinidad and Tobago, Venezuela). The chair of the G24 is South Africa, and the First and Second Vice-Chairmen are, respectively, India and Mexico. Observer countries are China, Morocco and Saudi Arabia. The Chair of the Group of 77 developing countries (currently Argentina) is also an observer.

For the full communiqué please see: <http://www.imf.org/external/np/cm/2011/041411.htm>