INTERNATIONAL MONETARY FUND

The Fund's Mandate—An Overview

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- The latest IMFC communiqué asks the Fund to review its "mandate to cover the full range of macroeconomic and financial sector policies that bear on global stability, and to report back to the Committee by the time of the next Annual Meetings."
- This paper, and a companion piece on legal aspects ("The Fund's Mandate—The Legal Framework"), is the first in a series of reflections on the Fund's mandate—on what it should be doing to promote global stability and how the membership might support that process. At this stage, the aim is not to put forward concrete proposals but to float ideas with a view to stimulating a broader debate. Follow up papers, based on feedback from the Executive Board and public outreach, are planned ahead of the final report to the IMFC in September.
- A mere updating of a mandate cannot rectify all institutional shortcomings. But it can usher in processes that impel change of the kind that has revived the Fund's standing. Needless to say, the broader push for reform now in train, especially in governance, will be central to the legitimacy and effectiveness of any mandate, new or old.
- As a guardian of economic stability, the Fund has tended to emphasize surveillance and lending at the *country level*. Yet, a lesson of the crisis is that the larger risks in a globalized world are *systemic* in nature, requiring the Fund to adopt a more systemic perspective and for members to support this with requisite data and dialogue.
- Such a shift, however, would benefit from clarifying ambiguities in the current mandate and rethinking modalities—most of which can be achieved without the politically taxing process of amending the Articles of Agreement—in key areas:
  - *Surveillance*. Consideration should be given to a Board decision on multilateral surveillance that lays out, for the first time, the nature of the Fund's responsibility to oversee the international monetary system and the engagement of members. Clarifying the remit over the financial sector is important, and the institution can also do more to monitor capital flows and provide guidance on their regulation. New procedures are needed to consider the systemic effects of country policies beyond the coverage possible in bilateral surveillance.
  - *Lending*. The crisis has shown the value of actual and contingent financing, and of more flexible instruments. The Fund can build on recent initiatives, but must also be ready to handle *systemic* crises, rethinking its size and ability to deliver short-term liquidity quickly to several countries simultaneously.
  - *Reserves*. The Fund can support systemic stability, providing alternatives to reserve buildup and helping to avoid abrupt shifts between reserve assets.

I. INTRODUCTION

1. ***Mandate***. The term encompasses at least two ideas. One has to do with *expectations* regarding the role of an institution. The other, more formal, refers to the *legal framework*, the purposes and powers, which in the Fund's case are anchored in the Articles of Agreement. The greater the clarity in—and consonance between—the two notions, the more effective an institution can be. Unfortunately, clarity and consonance are often lacking in the Fund's mandate to promote economic stability and collaboration, reflecting the seemingly narrow cast of the Articles, with purposes that speak to the issues of a bygone era (e.g., trade and payments restrictions) and powers that do not even reference today's most compelling issues (e.g., the systemic risk in a globalized financial sector).

2. ***Why is a review needed?*** Outdatedness, per se, is not a reason for rethinking the Fund's mandate. Few would assert that shortcomings in the mandate prevented the Fund from anticipating the crisis—as discussed in *Initial Lessons of the Crisis*, the causes of the crisis were far more complex. Nevertheless, a central lesson of the crisis has been that surveillance for crisis prevention needs to be much more rigorous, with greater coverage of financial sector and regulatory issues, and better appreciation of systemic risks and spillovers. Equally, lending for crisis response has to be of a speed, coverage and size far beyond previous assumptions—otherwise, it will be left to country and regional entities, not the Fund, to serve that function (as indeed it was at the outset of this crisis). The argument here is that a clearer and stronger mandate can put in place the processes that impel the institution, and its members, to better confront and respond to the risk of instability. An updated mandate can carry forward the pro-active role of the institution in stabilizing the global economy evident since early 2008, which reflects not merely a revival in Fund lending, but also in the range of new Fund products and analyses that must be built on.

3. ***Approach to the Articles of Agreement***. It is important to bear in mind that the Fund's mandate originates in its Articles—i.e., in an international treaty that balances the differing views of members on the goals and powers of a supra-national entity and differing views on associated obligations. While updating the Articles is certainly an option, albeit a difficult one, the Articles are sufficiently flexible to accommodate major reforms. Moreover, a number of powers in the Articles have yet to be fully exploited. What is needed is a shared understanding on key points, which could be set out in a vision statement endorsed by the membership, and Board decisions to give those force.

4. ***The role of the Fund***. Three priorities stand out in the post-crisis world:

- *Crisis prevention*. Just as national regulatory oversight after the crisis is shifting from the risks in individual institutions to the risks in financial systems as a whole, the Fund's oversight too must shift from a sum of its parts (bilateral surveillance of countries) to the system as a whole (multilateral surveillance). However, as discussed in the next section, the nature of bilateral surveillance (with its emphasis on members' obligations relating to their own domestic and balance of payments stability) and

multilateral surveillance (with its emphasis on systemic stability) are different. As such, new modalities and outputs may be needed to tackle the systemic implications and interactions of country policies, along with a new conception of cooperation, data provision and peer review. The coverage of financial sector policies is particularly important if the Fund is to be ahead of the curve in crises.

- *Crisis response*. The crisis has highlighted the risk of sudden runs on liquidity in advanced, emerging, and developing economies alike. The Fund can help by offering more flexible insurance facilities that build on recent reforms and expanding its lending capacity to be more effective in systemic crises.

- *Stability of reserves*. The crisis has also cast a spotlight on the tension between the high demand for reserves by emerging market economies and, on the other hand, dependence on the stability of just a few suppliers of reserve assets. While strengthening both crisis prevention and response should help alleviate the perceived need for reserve accumulation, there may be a role for the Fund in promoting systemically preferable approaches, including the use of a global reserve asset.

5. ***Plan***. This paper sets out the main issues with regard to the Fund's mandate, alongside a companion paper that elaborates on the legal background. Section II is devoted to multilateral and bilateral surveillance, including the coverage of financial sector issues and capital flows. Section III discusses the Fund's lending role. The paper then turns to a long-term issue that has lain dormant until this crisis struck at the heart of the global system: the role of the Fund in resolving the tension between the growing demand for, and narrow supply of, reserve assets. Section V offers some concluding thoughts.

II. SURVEILLANCE

6. ***Gaps***. In principle, the Fund's surveillance covers both the analysis of economic policies in member countries (bilateral surveillance) and developments relating to the system as a whole (multilateral surveillance, mainly in the form of the World Economic Outlook (WEO), the Global Financial Stability Report (GFSR), and now the Early Warning Exercise (EWE)). In practice, the great bulk of the Fund's surveillance output has been bilateral, focused on the impact of macroeconomic and exchange rate policies on a country's domestic and balance of payments stability. Although there have been major strides in the quality and coverage of these two strands of work, including expanded treatment of financial sector and cross-country issues, there remains a significant gap between the two. The gap stems from the fact that bilateral surveillance is based on a detailed dialogue with policymakers but rarely touches on the systemic effects of country policies; meanwhile, multilateral surveillance looks at systemic outcomes, but is not based on a detailed dialogue with all relevant policymakers. The multilateral consultation on global imbalances tried to bridge this gap in 2006, with only mixed results. But the crisis has changed attitudes about coming to grips with the systemic effects of country policies. The new G-20 Mutual Assessment

Process, with its mechanisms of data provision and policy dialogue, is a manifestation of that demand. The challenge for the Fund is to build on such initiatives.

7. ***The mandate for systemic surveillance***. What is termed multilateral surveillance originates in Article IV, Section 3 (a)'s requirement that the Fund "oversee the international monetary system in order to ensure its effective operation." This mandate, set out in a mere half sentence, poses several challenges.

- From an expectations perspective, the tone of the provision is sweeping, suggesting a very broad mandate and power to deliver stability.
- From a legal perspective, however, no substantive obligations of members are identified, and the Fund's responsibility is narrowly cast over the international *monetary* system. This concept is limited to official arrangements relating to the balance of payments—exchange rates, reserves, and regulation of current payments and capital flows—and is different from the international *financial* system. While the financial sector is a valid subject of scrutiny, it is a second order activity, derived from the potential impact on the stability of the international monetary system.
- From a practical perspective, the Fund has never spelled out what its systemic oversight under Article IV Section 3 (a) entails by way of process, substance, and data—either for itself or for members. The result has been a multilateral surveillance mostly analytical in character, with little formal debate of specific policy responses to systemic risks, spillovers, and tensions emanating from country-level developments.

8. ***A multilateral surveillance decision***. An alternative to amending the Articles' narrowing reference to the "international monetary system" would be a Board decision that makes clear that the financial sector is an integral, even if derived, part of the Fund's systemic oversight mandate. The case for a multilateral surveillance decision, however, is more about clarity than convenience. At a very practical level, and despite important innovations such as the EWE and G-20 surveillance notes, the membership continues to call for making something more of systemic oversight. A multilateral surveillance decision would set out what is expected of the Fund, including with regard to the financial sector, what is expected of members in terms of data provision and dialogue, and what new procedures might be followed in engaging members, singly or jointly or even with relevant nonmembers (e.g., the European Central Bank, to which members have delegated some responsibilities). The goal must be to build analysis and discussion of the *systemic* effects of country policies and developments, whether produced by one or the interaction of several.

9. ***Could multilateral issues not simply be covered in bilateral surveillance?*** To some extent they could, and recent staff reports have done more of this. However, there are limitations as to what bilateral surveillance can deliver:

- *Legal tensions*. There are two constraints. First, bilateral surveillance focuses on whether a member's domestic and external policies are promoting its balance of

payments stability—there must be a balance of payments channel of transmission for the policy to be discussed in this context. Second, even if this constraint were removed by amending the *2007 Decision*, a more basic problem remains: members' obligations regarding *domestic* policies under the Articles are limited to the adoption of policies that promote domestic stability. This renders bilateral surveillance, a procedure designed to verify observance of these obligations, a poor vehicle for discussing the global effects of country policies. These are serious constraints. Financial sector shocks can transmit without balance of payment effects and without adverse implications for domestic stability (e.g., US banks may respond to policies by delevering abroad, with less borrowing in Western Europe and less lending in Eastern Europe); monetary shocks too often transmit to foreign bond rates without currency effects. Domestic policies that have no negative effects on a member's domestic stability or impact on its balance of payments are best taken up in a multilateral procedure, which does not involve oversight of substantive member obligations.

- *Organizational challenges*. Bilateral surveillance is an area department centered process. Although they are well placed to go into country details and make regional comparisons, and functional department staff broaden the perspective, country teams are not fundamentally geared to assessing systemic effects and risks. The capacity is there, but the logistical challenge of delivering a fully multilateral analysis of a major country's policies, joining the scope of the WEO/GFSR with the detail and engagement of bilateral surveillance, should not be underestimated.

10. ***A multilateral procedure***. A new procedure would enable the Fund to take up the broader and systemic effects of country-level policies (e.g., the effect of US interest rates on Asian asset prices), and the associated risks, in a fundamentally different way than in the WEO, GFSR, EWE or Article IV reports. Most importantly, the analysis would key off a dialogue with country authorities, thus holding out the prospect of accessing richer data and inputs, and occupying a space between the aggregative nature of the WEO/GFSR and the country-level detail of bilateral surveillance reports. Unlike the confidential EWE, a detailed report would be presented for discussion by the entire membership. The procedure could cover issues such as global imbalances (in which case the Fund could also facilitate a prior dialogue between members) or the effects of a single economy's monetary, fiscal, financial sector or exchange rate policies on the rest of the world (in which case the Fund would be the one interacting with individual members). Reports on the systemic effects of a country's policies could be taken up by the Board alongside its Article IV, although precise modalities are perhaps best left open at this stage. The profile and traction of such a process might be raised by also taking up the debate, in addition to the Board, at the IMFC.

11. ***Financial system oversight***. An issue that has attracted much attention since the onset of the crisis is whether there should be an overarching agency to bring together the scatter of international bodies charged with different aspects of financial oversight. Should the Fund be that overarching entity? The answer depends on what is meant by "overarching." The Fund

cannot realistically cover all financial sector issues, nor should it try to become a global regulator. Nevertheless, it must cover all that bears on macroeconomic and financial system stability, the two being intertwined. One option would be for the Fund to take the lead in identifying and prioritizing *macro-systemic* risks through its macroeconomic, early warning, and macro-financial analyses. This task would still require substantial collaboration with expert bodies such as the FSB and BIS, with which it already collaborates on the EWE. The Fund thus could play at the global level the role envisaged for country and regional systemic risk boards, working with national authorities, the FSB and BIS to assess and respond to systemic risks and vulnerabilities. By contrast, the FSB and BIS are better situated to take the lead on the more specialized work of *micro-prudential* and regulatory oversight.

12. ***Financial data***. Major crises often prompt major data initiatives—e.g., national accounts after the Great Depression and the Special Data Dissemination Standard (SDDS) after the Asian Crisis. Given the role played by opacity in the shadow banking system and in derivatives markets, this crisis should not be different. The process has begun with the G-20 data gaps initiative, where the Fund is cooperating closely with the FSB, but the institution faces two further challenges. First, it has only limited and episodic access to supervisory data (e.g., in the context of FSAPs), and members often decline to provide systemically relevant information on grounds of confidentiality. Second, the Fund has no authority to require confidential data on entities such as large complex financial institutions (LCFIs), a few dozen of which make up the basic plumbing of global finance. The reason is that Article VIII, Section 5 provides that members are under no obligation to furnish information that exposes individual corporations. Yet understanding the linkages between LCFIs, and changing patterns and concentrations in exposure, is crucial to any institution claiming to be a guardian of global stability. As amendment of the Articles to require such disclosure is unlikely to find broad support, alternative arrangements will be needed. These could include voluntary agreements with national and regional regulators/systemic risk boards, and with the FSB and BIS, which might suitably repackage data. Consideration might also be given to a "Financial Data Dissemination Standard" for countries with systemically important financial sectors.

13. ***Bilateral surveillance***. Bilateral surveillance, focusing on domestic and exchange rate policies, has long been the foundation of Fund analysis, and has underpinned much of its multilateral outputs. What members value most from bilateral surveillance is an international perspective with regard to their domestic policies. A new multilateral procedure to cover the systemic effects of large countries' domestic policies would certainly bring such a perspective to the surveillance of large countries. At the same time, it will be important to continue shifting the content of bilateral surveillance to emphasize cross-country comparison (of greater interest to the growing number of countries that have built up the capacity to analyze their own policies) and more analysis of regional spillovers. One way of promoting this would be to permit thematic Article IVs, where staff undertake joint discussions with several members facing common issues—e.g., commodity exporting inflation targeters or structurally similar low income countries—and the Board concludes all the Article IV on the basis of a single report and a single meeting. Clearly, such an approach, will not work for all

countries at all times, and should not be the norm. But, used judiciously, it can increase the traction and effectiveness of surveillance, while retaining the Fund's obligation to assess the consistency of members' policies with domestic and external stability. The bilateral surveillance mandate could also be strengthened by further elevating expectations regarding financial sector policies—e.g., by making FSAPs mandatory for countries with regionally or systemically important financial sectors. Finally, the *process* of bilateral surveillance should also be rendered more effective, including with rules on the timeliness of consultations.

14. ***Capital flows***. Given the integration of global capital markets, and the Fund's role in stepping in when sudden stops and reversals in capital flows threaten the international monetary system, it seems appropriate that Fund surveillance cover more effectively capital flows and related policies. Granting the Fund the authority to approve—or not—capital controls would require amending the Articles, which is never an easy process, especially on an issue on which the membership is highly divided. Instead, the Board could clarify that capital flows indeed are an integral part of the remit of surveillance and that the Fund may advise members on related policies in this context. It would be open for the Fund to provide guidance to members as to: (a) what conditions should be in place before a member liberalizes its capital account; and (b) when the imposition of controls on inflows or outflows may be an appropriate response to balance of payments or macroeconomic pressures. The Fund could also foster collaboration among members in the design and implementation of capital controls when they become necessary, ensuring that negative spillovers are avoided (imagine discriminatory provisions) and that broader goals are taken into account (imagine if concerted action were needed to slow down the withdrawal of foreign bank lines in a regional crisis). The Fund could also promote the collection of more detailed cross-border capital account data, allowing for better informed surveillance.

III. LENDING

15. ***Issues***. It is revealing that the Fund was not the first responder to the major emerging market countries in this crisis: the US Federal Reserve, with its swap lines, was. This, and the broader realization that the world was facing an unprecedented shock, prompted a major reform of the Fund's lending instruments and an increase in its lending capacity. The new Flexible Credit Line (FCL), in particular, demonstrated that the Articles' requirement to attach conditionality to Fund resources—to ensure that underlying balance of payments problems would be resolved and resources safeguarded—could be achieved ex-ante through robust qualification criteria rather than via traditional performance criteria and reviews. But even if the Articles, and underlying concepts such as balance of payments need, allow for a great deal of flexibility in lending, the institution can do more to provide countries with requisite insurance, and in ways that tackle the stigma still associated with Fund lending, especially in Asia. The options below, in ascending ambition, build on recent initiatives.

16. ***Credit lines***. The FCL has been instrumental in tackling the current crisis by casting a safety net over key emerging market countries that otherwise would have delayed

approaching the Fund on account of the associated stigma. Even so, the FCL has been used sparingly, in part because of competition from central bank swap lines but also because members continue to have reservations about it; similar considerations apply to High Access Precautionary Arrangements (HAPAs). To alleviate the stigma problem, FCLs could be made more attractive by increasing their flexibility with regard to access and duration, and the ex-post conditionality in HAPAs could be streamlined for countries that are near FCL qualifiers. To reduce the uncertainty surrounding qualifiers, transparent Maastricht-like criteria or Article IV assessments could be used. Finally, a number of observers have proposed broadening qualification, with graduated hard caps on access or varying charges based on the strength of policies and fundamentals (although charges differentiated on this basis entail amending the Articles). As always, there will be trade-offs to resolve: broadening qualification may expand coverage but undermine safeguards and reduce the appeal of the FCL to "platinum" countries with strong fundamentals and policy frameworks; and too rigid Maastricht-like qualification criteria may excessively restrict the Fund's flexibility.

17. ***Regional reserve pools***. Such arrangements, exemplified by the Chiang Mai Initiative, have grown in prominence. This partly reflects dissatisfaction with the governance arrangements and conditions attached to multilateral pools such as the Fund. However, regional pools also are a symbol of regional solidarity and integration. If one views a regional component to international financing as a positive and stabilizing force (as, for instance, EU lending in parallel with Fund programs has been), instead of as a rival to the Fund (a "universal" pool), one can consider ways to collaborate. At one end is the option of low level Fund engagement—technical support to regional pools to assess financing needs, pre-qualify members, and monitor policies. At the other end, one could backstop regional pools, with Fund resources made available to the pool's constituent members.

18. ***Multi-country credit lines***. If the intensity of the systemic crisis of October 2008 were to be repeated tomorrow, could the Fund put in place the kind of overnight responses across a broad spectrum of emerging markets that the Fed did? Possibly, but the challenge should not be underestimated of getting major players to put aside their qualms about stigma and for the Fund to respond in a simple easily understood way. Among other things, the Fund would be hard pressed to justify common access, it being important to not signal unintended differences. Thus, in the face of a global shock, the Fund may need a new modality to boost confidence in the overall financial system, as opposed to just in the borrowing member. This could be achieved by the Fund unilaterally offering, on grounds of systemic stability, a short-term credit line to a group of members who satisfy qualification criteria. While it would be for the member to accept this offer (and at that point pay a commitment fee), the mere fact of a firm—and credibly large—offer by the Fund to a critical set of members could quell an emerging crisis. A more radical option would be to amend the Articles to allow the Fund, in the systemic interest, to issue SDRs on a temporary basis to specific members in a flexible manner, not uniformly based on quota and long-term global need.

19. ***Lender of last resort***. This term has led to some confusion since the Fund already is a "lender of last resort" insofar as it comes to the aid of countries with impaired or no market access. However, as used here, it is intended to convey the scope to lend the way central banks do—i.e., a swap of liquidity against eligible collateral, with recourse to the solvent borrower's assets. (The collateral itself would need to go beyond liquid foreign assets (there would be little point in offering that) or domestic government bonds (the government in any event is the borrowing entity), thus potentially consisting of temporarily illiquid foreign assets or domestic private assets.) The benefits are significant, since a switch from conditionality to collateral-based lending would reduce the stigma attached to Fund lending while still safeguarding its resources. However, the obstacles should not be underestimated. As noted in the companion paper, collateral is not a substitute for conditionality under the current Articles: some form of pre-qualification or ex-post conditionality would still be required to demonstrate that the underlying balance of payments problem is being resolved. Moreover, given that other creditors rely on the Fund's assessment and conditionality when deciding to disburse, collateral-based lending may undermine the Fund's catalytic role.

20. ***Guarantees***. When financial markets are strained, it may be useful for the Fund to consider guaranteeing new debt issuances of governments or of government-sponsored vehicles (for bank recapitalization, purchase of troubled assets). To the extent the backing for such guarantees is less than the value of the guarantees, such an approach leverages official resources. However, as an amendment of the Articles would be needed to use the Fund's general resources for such purposes, it may be preferable to deploy Trust Fund or Special Disbursement Account resources to back up these guarantees.

21. ***Role in Low Income Countries***. The overall lending framework for LICs—conditionality, instruments, and financing—was revamped last year. However, there is considerable scope to build on the Fund's engagement in LICs. In particular, the Fund may need to expand its role as a provider of insurance against global volatility and other shocks, including from the effects of climate change. This could include more flexible access under existing instruments, facilitation of commodity price hedging, and new insurance tools without ex-post conditionality. More can also be done to address the needs of countries facing fragilities and security issues. In these countries, the new facilities provide a flexible toolkit for safeguarding macroeconomic stability, but the Fund may need to expand its hands-on technical support and explore ways to boost financial resources.

22. ***Implications for the size of the Fund***. The envisaged role of Fund lending in maintaining international stability obviously is key to the overall size of Fund resources and its structure (quotas versus borrowed resources). As discussed in the forthcoming paper *The Size of the Fund*, under the current mandate and lending facilities, a scenario broadly centered on a doubling of quotas would ensure that quota resources are adequate in most circumstances, taking the total size of usable Fund resources, including via the NAB, to almost US$1 trillion. If the next time around some of the more expansive instruments discussed above need to be used, the Fund's lending capacity would need to be larger.

IV. Reserves

23. ***Issues***. The build-up of international reserves as a buffer against shocks is widely expected to resume as the crisis fades and to some extent already has. While such accumulation can be costly for surplus and reserve-issuing countries alike, there are three underlying problems. First, there are concerns about the availability of international liquidity in times of crisis, prompting a precautionary reserve buildup, especially when heavy capital inflows threaten to overwhelm emerging markets. Second, there is no automatic adjustment of current account imbalances, neither surplus countries nor reserve-issuing deficit countries facing pressure to adjust. Third, the concentration of reserves in US dollars reflects the absence of close substitutes as a global store of value and anchor for asset and price stability. The Fund's overarching responsibility to promote the effective operation of the international monetary system requires that it seek solutions to the above problems. While it may draw on all its powers for this purpose, a rarely discussed one is to be found in Article VIII, Section 7, which calls on members to collaborate on reserve policies with the objective of "better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system." Consideration may need to be given to reviving this forgotten provision as a basis for action, not least because official reserves have become large enough relative to private flows as to have significant—and potentially destabilizing—market impact from a sudden portfolio reallocation.

24. ***Reducing precautionary demand***. The most promising avenue for reducing reserve demand from precautionary motives would be for the Fund to offer more reliable and less politically onerous lending facilities as an alternative to self insurance. Stronger multilateral surveillance and, possibly, regulation of capital flows also would go to the root of the problem by helping reduce the volatility that reserves aim to insure against. That said, there are limits to such approaches. Not only are precautionary motives only a part of the story, but the convenience and flexibility of reserves are hard to match and better surveillance and regulation of capital flows will not eradicate volatility.

25. ***Reducing currency intervention in surplus countries***. Consideration may need to be given to a broader political agreement on limiting currency intervention in the interest of systemic stability. This could be manifested in a voluntary and gradual move to floating exchange rates by the next set of large advancing economies, similar to the adoption of floating by the major economies in the 1970s.

26. ***Preserving the global store of value***. A key problem with using a national currency as the main global reserve asset is that instability in its value translates to the entire system. The problem can be ameliorated by the presence of several suppliers of reserve assets—the euro has emerged as an alternative to the dollar and at some point in the future the yen and, further out, the renminbi might also—or by globally-issued reserves. Given the network externalities associated with a single reserve asset, neither solution is likely to emerge *spontaneously* any time soon. Thus, it may be necessary to consider giving content to

members' obligation, under Article VIII, Section 7, "to collaborate with the Fund and with one another with regard to policies on reserve assets" so as to facilitate a smooth transition to a more stable system.

27. ***A truly multi-polar reserve system***. Ultimately, what makes a currency viable as a global reserve asset is the size and health of the financial markets and economies backing it. But whether a currency with the potential to be a major global reserve currency actually becomes one also depends on *official* preferences—of reserve issuers and reserve managers. The Fund could play a role by encouraging reserve holders to aim for a less skewed distribution. Against this, due regard must be given to the risk that a system of as co-equal reserves currencies could make for very volatile exchange rates in the absence of close collaboration, which the Fund could facilitate.

28. ***Special Drawing Rights***. The Articles already require the Fund and its members to work toward making the SDR the principal reserve asset—a provision that has lain dormant for decades. Some version of the SDR is a potential long-run solution to a more stable global reserve system. However, there are major hurdles to clear, including: (i) tight conditions imposed by the Articles on the issuance of SDRs (i.e., according to quota, with 85 percent majority of Governors); and (ii) the absence of deep and liquid markets in SDRs, which can be traded only within the official sector. If a greater role for the SDR were to be actively pursued, these limitations would need to be revisited. Active collaboration would also be required to actually establish the SDR as a principal reserve asset.

29. ***A global currency***. The SDR is not a currency but a right to access freely usable currencies in case of balance of payments difficulties; its stability rests on that of its component currencies. A more far reaching approach would be to introduce a new global reserve currency, similar to Keynes' bancor, issued by an institution with an impeccable balance sheet and a governance structure that gives confidence that it can function as a prudent and independent world central bank. A global reserve currency that is not associated with the economic developments of any particular country would remove the vulnerabilities associated with reserve accumulation in national currencies and could remedy the lack of automatic adjustment. The operational and political challenges, however, would be huge. As such, the idea is clearly one for the long term.

30. ***Managing risks***. Whether the current system endures or morphs into a more diversified one or even to one with a globally issued reserve currency, there will be risks and concerns in the interim as to the stability of the world's principal reserve asset. Thus, there is merit in considering mechanisms to mitigate such risks, including the setting up of a global substitution account of the sort envisaged in the 1970s, perhaps in conjunction with a broader move to reduce foreign currency intervention by surplus countries.

V. CONCLUSIONS

31. ***An opportunity***. The Fund now has the chance to build on the positive role it has played in the crisis, addressing shortcomings in its mandate for crisis prevention and crisis response and helping the membership to confront pressing issues—e.g., macro-prudential risk assessments, platforms for collective action, and effective crisis insurance. An updated mandate is not a silver bullet, and its capacity to resolve problems should not be oversold: a wanting mandate was not at the root of the Fund's failure to predict the crisis, and a change does not mean that it will predict the next one. Nor should discussion of mandate distract from the everyday business of supporting its members or become an excuse for mission creep. But a renewed mandate can put in place the legal foundation and public expectation that any international agency needs to get on with its work, adapting to the times and putting in place processes—e.g., new multilateral surveillance products—that impel the institution to take up difficult issues and respond to crises more effectively.

32. ***Multilateral perspective***. The crisis has reminded all that this crucially important term has many connotations. An obvious one stems from the so-called fallacy of composition: the whole is greater than the sum of its parts (e.g., the collective destruction of global wealth can be out of all proportion to one country's exuberance with financial innovation). Hence, a better balance is needed in Fund surveillance and lending between country versus systemic risks. Another connotation has to do with the effectiveness of collective action. Hence, it is vital that the Fund continue to participate in the kind of global coordination seen in this crisis. And yet another concerns engagement with systemically relevant players. Large complex financial institutions now dominate global finance and risk, yet the Fund's focus is still on central banks and finance ministries. Regional institutions, such as the European Commission and European Central Bank are of systemic importance, yet most of the Fund's engagement is still with the capitals of their constituents. Regional reserve pools are growing in stature, yet the Fund cannot lend to them directly. The Fund's mandate to engage with all these entities directly too might be reconsidered. Finally, there is scope for the Fund to collaborate more with multilateral development banks, including co-financing operations.

33. ***Priorities***. The over-arching theme in this paper has been to strengthen the Fund's role as a guardian of systemic stability, as opposed to country level stability, where it goes without saying that the Fund's detailed macroeconomic analysis will continue to be developed. On the surveillance side, this paper has made a case for a Board decision on multilateral surveillance, sharper requirements on surveillance of the financial sector and capital flows, and a stronger peer review process to deliver compliance with obligations. On the lending side, the Fund must build on recent reforms, offering more flexible insurance facilities and developing instruments to handle systemic crises (e.g., via multi-country credit lines). Amendment of the Articles is, for the most part, not necessary. Board decisions and other measures can deliver the desired outcomes just as well.