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**Statement by Mr. Ján Kubiš
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Executive Secretary of the United Nations
Economic Commission for Europe**

at

at the 4th Astana Economic Forum

***“New Decade: Challenges and Perspectives”
Astana, Kazakhstan, 3 May, 2011***

Mr. President,
Mr. Chairperson,
Distinguished Participants,
Ladies and Gentlemen,

It is a pleasure to be here today in order to speak to such a distinguished audience and to be part of such a truly distinguished panel for the opening ceremony. As the recent economic crisis has made clear, the performance of the global economy can definitely benefit from increased inter-governmental cooperation. This forum, with inputs from leaders in government, international organizations, business and academic institutions provides a valuable opportunity to explore how specifically this can be accomplished.

One of the central themes of the Forum this year concerns the design of the international monetary system, and there are several panels devoted to that topic both today and tomorrow. Although this has been a recurrent if not continuous topic for discussion amongst economists, the issue has recently moved to the center of practical policy debate with the ongoing discussions within the G-20 framework.

In North America, Europe and some parts of the CIS, the effects of the recent financial and economic crisis are still very much present in terms of sub-par growth, high unemployment and soaring sovereign debt. It is easy to be critical of the functioning of the current international monetary system, since it bears some responsibility for the severity and geographical reach of the crisis. Some view that the global imbalances produced by the current system were the fundamental underlying cause of the crisis. In addition there are some legitimate

concerns regarding the US dollar as the main international reserve currency of this system, given the increasing debt level of the US and the very large increase in the balance sheet of the US Federal Reserve.

However, at the same time we should appreciate the fact that under the current system that evolved after the breakdown of the Bretton Woods system, the world has experienced 35 years of relative prosperity and unprecedented integration and globalization. Therefore, improving what is not working well makes perfect sense, but at the same time we do not want to inadvertently change what has been working reasonably well. Nevertheless, the current dollar-based system is not sustainable in the medium-to-long run and thus reform will be needed, the only questions are how and when. However, it is unlikely that there will be any important new reform in the short-to-medium run, as there is neither economic nor political consensus on what needs to be done. It is at meetings such as the Astana Economic Forum, where world-class experts can come and debate these issues, that such an economic consensus can begin to emerge.

There are a number of problems with the current international monetary system including the boom-bust cycles of international capital flows, global imbalances, and misaligned exchange rates. However, I would like to focus on the current ongoing discussions surrounding international currency reserves and the use of the US dollar as the principal asset. Currently, best estimates are that the US dollar accounts for about two-thirds of international currency reserves as it has for the last 35 years.¹ There is a certain logic in having one main reserve asset which can act as both the basic numéraire or yardstick for valuing everything while at the same time also being the major transaction currency. It is for this reason that the current system has survived as long as it has, and why in the half century before World War I only one currency dominated reserve holdings, that being the British pound.

However, there is a major problem with this dollar-based system which will only get worse over time. The problem is that official reserve holdings of US dollars are growing significantly faster than US GDP. As a result the ratio of US official foreign liabilities to US GDP has been increasing rapidly. This ratio more than quadrupled between 1990 and 2010, and is now over a third of US GDP. This trend is due to the fact that as countries grow they want their international reserve assets to grow accordingly; and since the late 1990s the world has been growing much faster than the US and this trend is expected to continue. In addition, a country's need for reserves is related closely to its growth of trade and capital flows and for most countries these are growing even faster than their GDPs; as a result countries increasingly want their reserves to grow even faster than their GDPs.

Given these trends, in time the foreign holdings of US dollars will become so large that questions will arise about the ability of the US to service its debt. Thus the current arrangement is unsustainable. The problem is similar in many ways to the dilemma with the international monetary system created in Bretton Woods

¹ Several major countries do not report the currency breakdown of their reserve assets so there is some uncertainty as to precise levels of dollar holdings.

after the Second World War. In the early 1960s it was recognized that official reserve holdings of dollars were increasing faster than the US gold stock and that it was only a matter of time before the viability of the dollar would come into question. Today the issue is not the ability of the US to back the dollar with gold, but to service its debt more generally; nevertheless the fundamental issue is the same – the world wants more official reserves than the US can afford to create.

In order to address this problem either countries must significantly reduce the amount of reserves they are accumulating, or they must switch to accumulating some other type of reserve asset. An alternative to each country accumulating all the reserves it needs is for countries to share or pool reserves; as a result fewer total world reserves are needed. This is of course the logic behind the creation of the International Monetary Fund. The tripling of the IMF's lending capacity that was agreed to at the April 2009 G-20 meeting in London was an attempt to promote this alternative. Of course countries have to be comfortable in turning to the IMF, but after the harsh conditionality that was imposed during the Asian Crisis of 1997-98 many countries decided to reduce their dependence on the IMF and accumulate their own reserves. However, the relaxation of IMF conditionality during the recent crisis was significant and has restored to some degree the acceptability of borrowing from the IMF. Thus the increase in IMF resources and the easing of conditionality over the last several years are significant developments that may reduce the need or desire of countries to accumulate excessive international reserves.

However, in this regard one major problem remains, and that involves the situation that arises when a country increases its reserves not because it really needs reserves but as an unintended consequence of some other economic policy such as maintaining a trade surplus or an exchange rate. It has long been recognized that more pressure needs to be placed on surplus countries but so far there has been little progress. The first step, however, is to agree on an indicator for measuring imbalances, and this was agreed to at the recent G-20 ministerial meeting in Paris in February 2011.

The alternative to reducing reserve accumulation is to diversify the type of reserves countries hold. This could include other currencies, gold or an international reserve asset such as special drawing rights (SDR). It may seem natural that in an increasingly multi-polar world there should be multiple currency assets, but that is not necessarily the case. There are significant advantages to having only one major reserve currency, and so diversification will reduce those advantages. Historically, periods in which there have been multiple reserve assets have been periods characterized by economic instability; to some degree this instability was due to countries attempting to shift their composition of reserve assets. Thus, diversifying reserve assets may solve one problem but create a whole new set of problems. As a result, with a system of multiple reserve assets it may be necessary to have an international agreement on how these reserve assets can be used.

There is currently nothing to stop countries from diversifying their current reserve holdings. The complication is that there are problems with the two most

obvious alternatives, the euro and the renminbi. The euro, which currently accounts for about a fourth of reserve holdings, is in the midst of an existential crisis as its members try to agree on the basic rules governing the eurozone and deal with fairly serious sovereign debt crises in its periphery. In addition, there is no Eurobond for central banks to hold, just a multitude of national bonds. The renminbi remains essentially non-convertible and as a result is not yet suitable as a reserve currency. In time, however, it is inevitable that the importance of both of these currencies is likely to increase, but they are not ready to assume that role today. The currencies of some other countries such as Japan, the UK and Switzerland will be able to play only a minor role as these countries are simply too small to be major players. There is also much potential for the SDR, and the huge 2009 increase in allocations was a move in this direction. However, that asset will need to become more widely used in financial markets before it can replace national currencies as a major reserve asset.

In conclusion there are numerous alternatives to the US dollar, including other national currencies, the SDR, and IMF borrowing. In time all of the options are likely to be further developed, but for now each of these options have their own problems and there are many details to work out which will take time to resolve.

It is generally acknowledged that much of the economic chaos during the 1930s resulted from an absence of leadership of international monetary affairs during a period of rapid economic transition. The United Kingdom was in relative economic decline while the US was rising. The UK which had been the trustee of the global monetary system no longer had the economic resources to govern and the US lacked the political will to lead. To some degree we are in a similar transition period today. The relative economic importance of the US and Europe is declining while China and some of the other emerging economies are growing rapidly but appear hesitant to assume the responsibilities of global leadership. It is therefore critically important during this period that the international monetary system be designed rationally and cooperatively. However, what shape that design will take has yet to be clearly articulated; but hopefully the discussions we will have here in Astana will move us one small step closer.

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