Reflections on the Global Financial System*

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The world is poised to enter a new era of human history as it sets forth into the twenty-first century. The new times promise unparalleled hope and breathtaking advances in every facet of life, but at the same time it can exact stiff penalties and suffering for those who fail to comprehend the unpredictable and volatile nature of today's interwoven global economy. For the International Monetary Fund (IMF), whose main duties include safeguarding the global economic and financial system, the current situation in Asia is especially alarming since most of the countries afflicted by this downturn, have broadly enjoyed growth unrivalled by the rest of the world for the past few decades. Since the crash, however, the IMF has begun to examine and analyze the woes and deficiencies that have caused this disaster to unfold. The result of the preliminary studies indicate that the region as a whole suffers from several weaknesses that were not readily apparent during the heydays of rapid development, which includes, the fragile public and private banking and financial structures; an unsustainable accumulation of short-term financing; and the problems associated with governance. Fortunately, for the world, the emergency funds and measures endorsed by the IMF were effective in curtailing the precipitous downward spiral of the Asian economies. However, it is not enough to just limit the damage, and the IMF has been called upon to devise means to prevent a recurrence of such eventualities in the future. To this goal, the IMF is in the process of strengthening the global economic architecture by enhancing surveillance, and developing "tiered responses," that would protect and bolster financial and banking systems around the world from dubious investments and loans, while continuing to liberalize international capital flows. The era of globalization is at hand. It could be said that it is an irrevocable trend. What is important for the world at this juncture is that stable growth accompanies this ongoing process so that all of mankind can experience its rewards.

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Toward a New Financial Architecture for a Globalized World*

CHANGE IS NEEDED

As in the days of the Industrial Revolution, we are now at a defining moment of human history. The question before us is straightforward: how to utilize the full potential of globalization to improve the living standards of all—particularly the poorest—while containing the risks it entails, such as those we have seen materialize so brutally in Asia, and those at least equally pernicious, even if less spectacular, of the continuous marginalization of the poorest countries. What kind of new architecture of the global system could achieve this? The response must be deduced from a proper analysis of the most recent crises.

Contrary to what we saw during the debt crisis of the 1980s, the problems in Asia were not almost exclusively macroeconomic in nature; even if these countries suffered, all of them, from some deficiencies in this respect, by and large they had long track records of successful economic management. Rather, in a context dramatically changed by a major realignment between the dollar and the yen, and important differences in short-term yields, three other factors helped trigger the crisis:

- the weakness of their public and private banking and financial structures;
- higher spending on primary health care and education; and adequate social protection for the poor, the unemployed, and other vulnerable groups;
- the creation of a more level playing field for private sector activity, by increasing openness, stepping up privatization, dismantling monopolies, and setting up simpler, more transparent regulatory systems.

Together with the macroeconomic problems, these three major factors had to be addressed for our response to the crisis to be pertinent. If you examine our programs with Thailand, Korea, and Indonesia, you will see that we have tried to deal with these factors, and they will have to be taken into consideration in the future in whatever efforts are undertaken to avoid the recurrence of crises. But even that will not suffice. In view of the enormous human and economic cost of the Asian crisis, no wonder we hear many radical suggestions as to how to avoid such losses in the future. There are calls for us to do a better job of predicting and preventing crises, addressing their social impact more effectively, stopping speculators and properly regulating this “casino economy,”

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seeing to it that investors bear the full costs of their mistakes, stabilizing the international monetary system, providing for more political accountability of our institution, etc., etc.

We cannot deny the basic justification of these, at times, vociferous calls for change. No doubt there are at least some elements of validity in each of them. Taken together they tell us that, at this stage, world public opinion expects its leaders to design and build a new, common house with an audaciously modern architecture, and not limit themselves to some plumbing and interior decorating of the old mansion.

But, as responsible architects, let us start by recognizing the building blocks at hand. Indeed, they are substantial.

SEVEN BUILDING BLOCKS

The first of these building blocks is the tremendous potential for growth and prosperity globalization provides countries fully integrating into the global economy. Formidable sources of dynamism are there, engendered by new information technologies and unifying financial markets. The question, then, is how to discipline and channel these forces so that growth will be sustainable and more broadly shared and the fundamental desire for greater equity will be more fully satisfied.

The second building block is integration. By integrating themselves into the mainstream of the globalizing world economy, the poorest countries will avail themselves of a most powerful instrument of acceleration of development, while, if they preferred to do it alone, they would expose themselves to the risks of marginalization, abandoning several generations to economic stagnation and poverty.

The third building block is the universal consensus on the importance of an increasingly open and liberal system of capital flows in order for globalization to deliver on its promises.

The fourth building block is what we could call the "golden rule" of transparency, now truly seen as the key for modern management, economic success, and rational behavior of global markets.

The fifth is good governance, which is equally essential for strong economics and properly functioning democracies. No doubt, competing for excellence in governance is the modern face of statesmanlike responsibility.

The sixth building block could be a set of standards and codes of best practices; this could require a few words of elaboration. More and more we observe an emerging recognition that the global markets still suffer from the kind of anarchy that afflicted our domestic financial markets here in Europe during the nineteenth and the beginning of the twentieth centuries that is, until various scandals and crises led to the creation of such institutions and rules as securities and exchange commissions, banking supervision, accounting standards, disclosure and prudential rules, and so forth. Our challenge today is to disseminate these good practices in emerging markets and to establish similar checks and balances in global markets. This could appear an impossible task, as many will pre-

tend that the absence of rules or regulations of any kind has been at the very origin of the developments of these markets. The world community is now coming to a different view, and looks forward for the definition of international standards and codes of good practices, which would be progressively disseminated by the IMF through its surveillance, and could help limit the excesses of an international "casino economy."

Last, but not least, the seventh building block is the option for the multilateral approach to handle problems which are now more and more global in nature. And the key instruments of such an approach will have to be the Bretton Woods institutions themselves. Let me be immodest for a moment. The experience they have accumulated, the quality of their staff, their demonstrated ability to address new economic challenges promptly and efficiently make them a major asset of the world community and a central pillar of a new architecture, provided they continue adapting themselves, reforming themselves, to this new world. And suggestions for self-reform are in abundant supply.

These seven building blocks have been neglected or unevenly utilized for too long. Assembled in the right way, they could offer a rock-solid foundation for a new financial system. Assembling them, nevertheless, will be hard work, each of them implying that vested interests or perverse practices be challenged. Thus, notwithstanding our sense of urgency, we are heading here for an evolutionary change: Athena in her helmet will not spring full-grown from the head of Zeus! And, as with all transitions from one era to another, we can expect risks and uncertainties to persist for some years to come. This makes it all the more urgent to get to work on this new architecture right away.

INITIAL STEPS FOR A NEW ARCHITECTURE

In fact, a number of significant steps are already under way. At its April meeting, our governing body, the Interim Committee (of Ministers and Central Bank Governors of IMF member countries), set the broad agenda for the IMF's own work—and its work with others—for the near future. Five areas have been given priority by member governments:

- The central role to be played by the IMF in crisis prevention through its surveillance and its role in encouraging members to strengthen their macroeconomic policies and financial sectors.¹ The Interim Committee suggests that the Fund intensify its work in surveillance of financial sector issues and capital flows, and focus on the risks posed by potentially abrupt reversals of capital flows, especially those of a short-term nature. The Fund is also asked to examine ways to strengthen the monitoring of capital flows, a major and difficult undertaking indeed!

¹ Of course, it is clear that for IMF surveillance to be effective, member countries must provide timely, accurate, and comprehensive data to the Fund. The Interim Committee underscored members' obligation in this regard and suggested delaying the Fund's reviews of member economies when deficiencies in disclosing relevant information to the IMF seriously impede our surveillance. Indeed, the G-7 countries have the opportunity this week to establish leadership by pledging to convey to the IMF and to publish comprehensive and timely data on both gross and net reserves, including reserve-related liabilities and central bank derivative transactions and positions, as well as external debt and data on banking and financial sector health.

- Drawing on the lessons from the Asian crisis, and the frustration that confidential warnings from the Fund were not always heeded, the Fund has been asked to develop a "tiered response," whereby countries that are believed to be seriously off course in their policies are given increasingly strong warnings. Addressing an audience in this country, where football is a way of life, or in my own country in advance of the World Cup, I do not need to emphasize how important it is to know exactly when the referee has shown a yellow card and how many yellow cards are permitted! We also have the red card in our Articles of Agreement, but using this card could precipitate the crisis we seek to avoid. So we prefer to use the yellow card.
- The Interim Committee also called upon the IMF to help members strengthen their domestic financial systems by encouraging them to develop supervisory and regulatory frameworks that are consistent with internationally accepted best practices, as well as strengthened standards for bank and non-bank institutions. Here you will recognize, of course, the "standards and good practices" building block. Work in this area is already in progress in various fora. A notable example is the Basle Committee's Core Principles for strengthening banking regulation and supervision, which the IMF is now helping to disseminate to member countries. We will now work with other relevant institutions that could be responsible for developing similar standards in areas such as accounting, auditing, disclosure, asset valuation, bankruptcy, and corporate governance. We will also consider how to disseminate such standards to member countries through our surveillance and encourage their adoption. Working with so many institutions, public and private, in addition to our 182 member countries, will be an ambitious undertaking, but we are ready - and enthusiastic - to play our full part in this new chapter in international cooperation.

In the meantime, the IMF has been applying this standards approach to one of its traditional domains of expertise: fiscal policy. Last winter, following the suggestion of the Chancellor of Exchequer, the IMF developed a code of good practices on fiscal transparency to which members will be encouraged to adhere. Looking ahead, we plan to develop a similar code with respect to financial and monetary policies in cooperation with the appropriate institutions.

- But despite these efforts at crisis prevention, crises may continue to arise from time to time. In this regard, the Interim Committee also reaffirmed both the central role of the Fund in crisis management and the need to develop more effective procedures to involve the private sector in forestalling or resolving financial crises.²

² Regarding the latter, some follow-up actions are needed, including measures to discourage excessive reliance on short-term financing and strengthen countries' capacity to withstand sudden shifts in market sentiment. In addition, the Interim Committee has requested the Fund to consider other ways to strengthen incentives for creditors to use available information to analyze risks appropriately and avoid excessive risk-taking. Possibilities include introducing provisions in bond contracts regarding bondholder representation and voting in case of negotiations on bond restructuring; extending the Fund's policy of providing financing to member countries in arrears to private creditors; encouraging strong bankruptcy systems for both domestic and international capital markets; and advising member countries to exercise greater caution in granting public guarantees. We also need to examine the possibility of closer contacts with creditors in order to explain Fund arrangements and, if needed, catalyze private sector financing so as to achieve more equitable burden sharing vis à vis the official sector and limit moral hazard.

Establishing closer contacts with private creditors, particularly at an early stage of a crisis, raises difficult issues; thus, it is not surprising that the Interim Committee has not pronounced on this point. Among the various options, I would suggest that consideration be given to asking the appropriate authorities in each creditor country to arrange for the selection of a representative of its financial community, who could be contacted in a crisis and who could provide a channel for communicating with a wide spectrum of financial institutions.

- Finally, as I have already alluded, the Committee reaffirmed its view that the time has come to add a new chapter to the Bretton Woods Agreement by making the liberalization of capital movements one of the purposes of the Fund and extending, as needed, the Fund's jurisdiction for this purpose. It requested the Executive Board to pursue its work on this issue with determination, with the aim of submitting an appropriate amendment of our Articles of Agreement as soon as possible.

Greater transparency and availability of economic information, adoption of standards and dissemination of best practices, a continuous strengthening of IMF surveillance, the orderly liberalization of capital movements, and better private sector involvement in crisis prevention and resolution—taken together and utilized to their full potentials these first five pillars could be a very significant contribution to a new financial architecture much more attune to dramatically modernized and globalized markets. I have no doubt the G-7/G-8 leaders in Birmingham will invite us to build on this basis. One can even imagine that they want to point out some additional avenues, which, as we have been absorbed by more immediately pressing aspects of our work— we have not, as yet, been able to explore sufficiently.

WHAT NEXT?

Trying to answer the question of “what next” is a risky endeavor. No doubt with globalization unfolding its opportunities and risks, new priorities will promptly capture our attention and overtake our pre-established agendas. But it is always better to try to anticipate them, particularly when they reflect problems that should already have been addressed, be it:

- the integration of the poorest countries in the globalized economy; Asia should not distract us from the pressing problems of the poorest economies;
- the stabilization of the international monetary system; or
- the issue of the democratic accountability of international financial institutions, as far as the IMF is concerned.

The issue of the integration of the poorest countries is, of course, already on our agenda. But, true, the attention of the world has been so focused on the Asian crisis and the need to avoid its recurrence that the immense problem of development and alleviation of poverty, particularly in Africa, seems to have been put temporarily on a back-burner. This is no longer acceptable.

In this context, I was particularly happy that, in drawing the lessons of an external evaluation of ESAF (Enhanced Structural Adjustment Facility), the Interim Committee encouraged us to “strengthen the ability of the Fund to foster sustained growth and external viability in poor countries.” There is more than conventional rhetoric in these words. This mention, in a document essentially devoted to the handling of financial crisis, surely

testifies to the recognition by the world's financial leaders that the success or failure of poor countries in finding their own way toward integration and development in an interdependent world will have a major influence on what the twenty-first century will be. This means that the solidity of our new architecture will crucially depend on the way in which, for the poorest countries, monetary and financial strategies, on the one hand, and poverty alleviation strategies, on the other hand, are made mutually reinforcing.

Poverty alleviation is chiefly, of course, the task of the World Bank, the regional development banks, and bilateral donors. Among the latter, it is quite encouraging, indeed, to see the energy and enthusiasm with which the British Minister for Development—an MP from Birmingham, as a matter of fact!—Ms. Clare Short, is promoting the DAC (Development Assistance Committee) Target of reducing by one half the proportion of the world's population living in extreme poverty by 2015.³

These objectives are ambitious, but they remain realistic, provided industrial countries join forces in stopping the present decline of development assistance and implement their agreed commitment to support, as needed, countries that truly own their national strategies for sustainable development. Among the latter, I would agree that particular priority be given to post-conflict countries where we must join forces to give new chances to reconciliation, peace and development. Obeying this same imperative of serving together peace and development, I would also suggest that the G-7/G-8 warmly endorse Mr. Koffi Annan's recommendation to the African Governments to reduce purchases of arms and munitions to 1.5 percent of GDP and maintain zero growth on defense budgets for the next decade. Industrial countries must play their full part in these efforts, and, here, I must share with you my anxiety.

Today's silence on the crisis in official development assistance is profound and distressing. It means that Africa, in particular, must rely chiefly for its economic progress on humanitarian compassion or the benefits of trade. This cannot suffice if human development is to be intensified and accelerated. Yet, at the present juncture, the macroeconomic and structural successes of recent years, precisely in the context of IMF-World Bank supported programs, are creating an opportunity that is too good to miss. Africa has found a way to advance from two decades of negative per capita growth to positive growth in more than forty of its countries. In many African countries, a new generation of leaders is seriously concerned about the need for democratization, protection of human rights, promotion of "good governance," and human development. Their efforts are in danger of falling short, however, because their domestic savings rates are still too low to finance the volume of investments needed to boost their rate of growth from approximately 5 percent to over 7 percent, which is not an unrealistic objective; it could be attained and sustained for a long time if local savings were supplemented by an appropriate mix of public and private foreign support and if a few key conditions were met, notably :

- continued modernization of the framework for private investment; and
- improvement in public governance through the total commitment of new governing teams.

³ I hope I am not revealing a state secret in telling you that she inscribed this on her Christmas card!

Together with the World Bank and bilateral donors, we can make a difference. But a strong political impulsion by the world's leaders and the example of their countries' cooperation to development will be of the essence. May their communique demonstrate their vision and leadership in this domain also.

The stability of the international monetary system has been on the agenda for more than 20 years of annual summits. The Asian crisis has highlighted how disruptive developments in exchange markets can help trigger a crisis. It is in this domain that efforts to strengthen multilateral surveillance over the international monetary system could be particularly fruitful. Moreover, the development of the euro into a key international currency could make a major contribution to stability of the overall architecture, provided that close cooperation is established among the monetary authorities of the tripolar system that might take shape. Even if it would be premature at this stage to try to elaborate further on how to maximize the positive effects of this major innovation, no doubt the new international monetary equilibrium will have to be kept under review as a key element of the new architecture. From the outset, effective means of coordination will have to be found to avoid excessive misalignments and disruptive corrections. The world is fully justified in expecting a responsible leadership from these major currencies blocs, which should be actively mindful of their global responsibility and resist the temptation of "benign neglect." Each of them.

Lastly, at a time when *de facto* more and more responsibilities are being given to the international financial institutions, and particularly to the IMF, the question of their political accountability will probably be raised with increasing insistence. Indeed, this question already arises from time to time, although not always with full awareness of the nature of our institutions and of the powerful checks and balances already enshrined in their Articles of Agreement. In this context, and as far as the IMF is concerned, is there anything that could be done to strengthen what one might call the political accountability or legitimacy of our institutions? At this stage, this would require at least a few organizational changes, which would make more explicit the tie that binds us to the governments we depend on. The IMF could, for instance, encourage its Governors, in general the Ministers of Finance, to become more actively involved in its work, in terms of decision-making and not merely in a consultative capacity in the Interim Committee. A similar question faces the G-7, which feels the need to embrace emerging market countries, but is unclear about how to go about it, and finds it difficult to come up with acceptable ways of choosing its partners. The design of a new architecture provides, perhaps, a good occasion to address these long-avoided questions. Two avenues could be explored.

The first would be to "revitalize" the IMF Interim Committee. It could become an essential structure, because no other can match the scope of its responsibility and the legitimacy of its members, who are collectively responsible for key developments in the world economy. At present, however, it is hampered by the ritualism of its meetings and an insufficient awareness of its uniqueness and potential. This is why I think that the suggestion of the French Minister of Finance, M. Strauss-Kahn, to consider its transformation into a "Council" with decision-making, rather than merely consultative, powers, is

particularly important. This is not a new idea. This transformation, pursuant to Article XII, Section 1 of the Fund's Articles of Agreement, could give it a new start. This approach was envisaged under the Jamaica accords, but deferred at the time because of the experimental nature of the Interim Committee. But given the daunting changes that have occurred recently in the world economy, and the fact that the IMF has achieved truly universal status with the accession of the transition countries, perhaps the time has come to consider it. Without greatly altering the operation of the institution and the pivotal role of its Executive Board, such a transformation would give the IMF renewed and very valuable legitimacy for the increasingly difficult tasks it is called upon to perform.⁴

The second avenue, in the same spirit, would consist of making provisions every two years for the G-7/G-8 — on the occasion of their meetings — to join the heads of state and government of the 16 countries holding seats on the IMF and World Bank Executive Boards to discuss with them and with the heads of those two institutions and the WTO the major economic and financial questions of the day. This new G-24 would have the significant merit of its basic legitimacy, as it would strictly reflect the system of international representation established for monetary and financial affairs in Bretton Woods. This would clearly represent a step forward not only in terms of dispelling the current malaise, but also in terms of hastening the adoption of integrated policy responses to the challenges of the globalized economy. The Secretary General of the United Nations should also be invited to participate to take into account the work of the entire family of UN agencies, which could become a fourth humanitarian and social pillar of the world system.

Such ideas could, of course, be met with skepticism and run up against logistical problems that may seem insurmountable. Nevertheless, they need to be discussed, as they could provide a concrete way of recognizing that each medium-sized or developing country must have a more equitable share of responsibility for the future of the world economy, a share that they believe is unjustly denied them in the present institutional arrangements of the international financial system.

Now, at the end of this analysis of a number of key issues confronting the world economy, it is perhaps appropriate to come back for one minute to the central messages of our eminent predecessors of the Lunar Society two hundred years ago. I am told that they included:

- the value of drawing lessons and inspiration from various disciplines and from the experience in different countries;
- the need to establish and disseminate standards so quality would be upheld and trade would flourish; and
- a deep concern for the social implications of economic change and a keen desire to improve education;
- and, of course, a strong sense of purpose and confidence in the promises of their new world.

No doubt these messages could strike a chord with many people today, including —

⁴ This decision must be taken by an 85 percent majority and thus requires the active support of all G-7 members.

why not? -- the stellar group that will assemble in Birmingham. May they share these approaches and concerns. Their confidence in the lasting benefits of globalization will be fully justified as a new world, born from the opening of economies, the unification of markets, and the universal availability of information and knowledge, has an immense potential for high-quality growth. May they also validate their own message of confidence by a clear demonstration of their sense of universal responsibility and solidarity.

From the Asian Crisis Toward a New Global Architecture*

What went wrong in Asia?

We have all admired the “Asian miracle” based on saving, prudent fiscal policies, investment in physical and human capital, and the liberalization and opening up—albeit in unequal measure—of economies. The results are there to see, particularly in terms of a reduction in extreme poverty. But there was a dark side, and the lesson from this crisis is that in a globalized economy a few macroeconomic virtues are not enough. Constant vigilance must be maintained over all the socioeconomic parameters: yet in each of these countries, there were lapses. The soundness of the banking system in particular must be monitored at all times; yet, here too, these countries failed, and, what is more, their unsustainable accumulation of short-term financing made them vulnerable to swift changes in market sentiment. Finally, countries must take great care to ensure that their affairs are conducted in an irreproachable and transparent manner and that all forms of corruption, nepotism, and favoritism are shunned: yet, over time in Asia, these afflictions took hold and overpowered systems that were otherwise remarkably successful.

But let us not single out the Asian countries alone. These blemishes exist to a degree everywhere, and these countries’ problems would not have reached such proportions if certain financial institutions in major industrial countries had not taken excessive risks. There are, however, lessons to be learned here, so I shall return to this point.

What is the IMF doing to contain the crisis?

As soon as it was called upon—unfortunately, typically, too late—the IMF helped Korea, Indonesia, and Thailand formulate, and adapt as necessary, reform programs aimed at restoring investor confidence, re-establishing access to international capital markets, and reversing excessive currency depreciation. These programs—I would like to emphasize—go far beyond restoring the major fiscal, monetary, or external balances. Their aim is to strengthen financial systems, improve governance and transparency, and restore economic competitiveness through, for example, the elimination of monopolies and the modernization of the legal and regulatory environment. To ensure the success of these efforts, we have marshaled an unprecedented volume of financial support. And in varied ways, we have helped all the countries throughout the world that were being

* Paper presented at the Parliamentary Assembly of the Council of Europe, Strasbourg, France, June 23, 1998. The original was given in French.

threatened with contagion to strengthen their equilibria and their structures.

But now, in recent weeks, a new crisis—a crisis within the crisis—has emerged with the dramatic fall of the yen. This new development reflects a serious lack of confidence, provoked by Japan's sluggish reaction to an economic slowdown that is turning into recession and the crisis in its financial institutions. Clearly, the fall of the Japanese yen is not unrelated to the Asian crisis, but it could also seriously jeopardize the ongoing recovery of the economies that were hit first. And it adds to the market instability that is again affecting Russia and some emerging economies.

Faced with these developments, an immediate, forceful reaction was required. The joint interventions of the United States and Japan on the foreign exchange market to help the yen regain lost ground were justified, but the effect will be lasting only if Japan promptly adopts energetic measures for the rehabilitation of its banking sector, tax relief, public investment, and the opening up and deregulation of its economy. The world cannot stand by, however, and simply wait for the good health of the U.S. economy and the strength of the recovery in continental Europe to dispel the crisis and restore harmonious, broad-based growth. So I would like to list, if I may, several other urgent tasks facing the international community.

First, we must strengthen the adjustment programs of the countries most severely affected by the crisis in southeast Asia and support their economic recovery. The multilateral institutions—the IMF, World Bank, and Asian Development Bank—have taken on this task. But there is also a need for countries that have been accumulating balance of payments surpluses for some time now, including certain European Union countries, to recycle those surpluses in the form of untied loans to countries in the process of adjustment. I appeal to the European countries—particularly those with surpluses—to increase their humanitarian aid. As creditors, they should stand ready to grant generous terms for the restructuring of their claims, support the recovery in Asia through new loans—and, above all, keep their markets open. This will be a good investment in their own future.

Second, we must strengthen policies to improve fiscal management, in order to guard against further economic downturns. This message applies to all countries, including those now taking the historic step of adopting the euro. It applies in particular to the transition countries and certain emerging countries, particularly those in Latin America, which are more vulnerable than others. It applies most especially to Russia, which has also been severely shaken by the crisis and which knows that additional external assistance would provide only scant relief unless accompanied by far-reaching financial adjustment measures that are long overdue.

Third, we must help preserve the stability of exchange rates in countries whose actions may be crucial to market stability, such as China and Hong Kong, despite the short-term negative impact of the crisis on their exports and growth. In these countries, as in Singapore and Taiwan Province of China, there is a certain margin for fiscal stimulus, which should be used without delay if it becomes necessary.

Lastly, the attention focused on the problems of Asia should be coupled with an equally determined effort to help Africa escape marginalization and accelerate its growth, which is finally positive again after two lost decades. I would like to mention just two

IMF initiatives in this regard:

- The effort to put the ESAF (Enhanced Structural Adjustment Facility) - our facility for loans at an interest rate of 0.5 percent - on a permanent footing and increase its effectiveness in terms of growth and social priorities. The ESAF is the instrument we use to provide financing to the poorest countries. Again, I appeal to the European countries. This facility is one of the cornerstones of international cooperation. You cannot allow it to be underfinanced.
- Rapid implementation of our joint initiative with the World Bank for the heavily indebted poor countries. Just 18 months since the launching of this initiative, commitments of about \$6 billion have been made to six countries, and I hope that a good number of others will follow.

I am convinced that if such a package of measures is promptly adopted, the crisis will be averted and those who have suffered the most will soon emerge stronger than ever. I trust, however, that no one will want to stop there. We have lessons to learn and an international financial system in need of rebuilding. These are the requirements for stable world growth in the era of globalization. How can this be achieved?

STABLE GROWTH IN AN ERA OF GLOBALIZATION

Let us begin by focusing our attention on the lessons of the Asian crisis. These lessons hold a message for us all and should be put into practice especially in the most vulnerable countries, such as the countries in transition. Allow me to digress briefly on this subject. Undoubtedly, 1997 brought good news for these countries: positive growth was recorded for the first time in eight years, and the overall expansion is expected to strengthen this year and next. Regrettably, a number of these countries have been feeling the after shocks of the turmoil in Asia: their export prices have weakened, conditions in international capital markets have become less favorable, Asian investors have scaled back investments, and their currencies have come under attack.

The challenge for us, therefore, is to assist these countries in safeguarding and extending their progress through sound macroeconomic policies and structural reforms aimed at the strengthening of bank regulation and supervision; further privatization and enterprise reform; the minimization of monopoly power; legal and institutional modernization; improvements in tax systems; health and education reforms; pension reforms; and above all, good governance. The IMF will naturally continue to support such programs. I should emphasize, however, that these types of measures are vital throughout the world, and particularly in the emerging countries wishing to obtain financing from global capital markets.

So how can we make the world less prone to financial crises?

What kind of new architecture of the global system could achieve this? Let me describe for you four areas of reform on which the IMF has been asked to work.

First, we must continue our efforts to *make Fund surveillance more effective and to enhance transparency* in international finance. Indeed, transparency is the golden rule for a globalized economy. If the IMF receives the necessary resources, it can play a central role in crisis prevention by encouraging members to strengthen their macroeconomic policies and financial sectors. The IMF must now step up its efforts on surveillance of the financial sector, capital flows, and the risks posed by a sudden reversal of capital flows. Work is also underway to develop a "tiered response," whereby countries that are believed to be seriously off course in their policies would be given increasingly strong warnings.

In order for our surveillance to be effective, however, data provision needs to be timely, accurate, and comprehensive. Thus, the IMF has decided to be more demanding about the coverage and quality of the data provided to us and communicated to the markets.

Second, *financial and banking systems, as well as their supervision, must be strengthened*. For some time now, the Fund has been working to help disseminate a set of "best practices" in the banking areas developed by the Basle Committee so that standards and practices that have worked well in some countries can be adapted and applied in others. These efforts will now be stepped up.

Third, we need to *establish more effective procedures to involve the private sector in preventing and resolving debt crises*. Clearly, better ways must be found to involve private creditors at an early stage, in order to achieve equitable burden sharing vis-à-vis the official sector and to limit moral hazard.

Fourth, we must *continue to liberalize international capital flows*. This does not mean a mad rush to liberalization, regardless of the risks. What it does mean is liberalizing these flows in an orderly manner that takes account of the specific circumstances prevailing within each individual country, without forgetting that the countries that take appropriate steps to achieve liberalization, while strengthening their economic equilibria and structures, will reap the rewards of global competition.

In the months and years ahead, we look forward to working with the international community, including all the countries represented at the Council of Europe, on shaping this new global architecture. In the ultimate analysis, our goal is to ensure that the world – and each country at its own particular stage of development – is afforded adequate protection against the risks entailed by globalization and is helped to embrace the opportunities that globalization provides. This is the challenge that the countries in this forum have instructed the Fund to address, and I thank them profoundly for their wholehearted support.

The IMF's Role in Today's Globalized World*

What is the IMF? Contrary to what I thought when I joined the institution, this is not a question on which educated people and policymakers have an immediate and accurate response. In fact, according to popular opinion and indeed, the makings of newspaper headlines – the Fund is simply a source of financing or a mechanism for crisis management. But this is wrong, as by far one of our most important functions is what we call “surveillance” – a mechanism that offers the prospect of addressing economic difficulties before they reach crisis proportions. Surveillance is the process through which the IMF continually exchanges views with national authorities and thereby evaluates the policies, performance, and prospects of each member, and provides a candid assessment to the membership at large at least once a year. Of course, the crises that are thereby prevented generally go unnoticed, but the importance of this surveillance in promoting economic growth and financial stability cannot be overstated.

What kind of policy advice do we give? Throughout our history, we have urged countries to pursue sound economic policies and by that I mean policies that promote growth through low inflation, sound money, prudent fiscal policies, and a sustainable current account position. Advice that should sound familiar to a German audience! Yet, as the economic landscape has changed, we have broadened the scope of our advice to include other elements – what we call second generation reforms – that are also vital for economic growth and financial stability. These include:

- reductions in unproductive government spending;
- higher spending on primary health care and education; and adequate social protection for the poor, the unemployed, and other vulnerable groups;
- the creation of a more level playing field for private sector activity, by increasing openness, stepping up privatization, dismantling monopolies, and setting up simpler, more transparent regulatory systems;
- stronger banking systems that protect depositors, especially small savers, and reduce risks for shareholders and creditors by enforcing strict prudential standards and information disclosure requirements;
- tax systems that are effective, efficient, equitable, and as simple as possible; and
- greater transparency and accountability in government and corporate affairs. The challenge for us is to give these issues the proper attention – which can be critical for the sustainability of macroeconomic policies – while keeping strongly focused, as part of our permanent task of surveillance, on the paramount objective of stability in its internal and external aspects.

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Beyond that, of course, there is our responsibility for helping member countries adapt to changing circumstances. And if this had not been our reading of our mandate, our membership would have been prompt – and has been prompt – in asking us to take on this responsibility: in the 1970s, for helping oil exporters recycle their surpluses and helping others finance their oil-related deficits; in the 1980s, for helping Latin America overcome its debt crisis; in 1989 and the early 1990s, for helping the transition countries of eastern Europe and the former Soviet Union overcome the legacy of central planning; and in late 1994 and early 1995, for helping Mexico, and with it probably Latin America, avert financial collapse.

HELPING COUNTRIES TO ADJUST

These days, we remain quite active in Russia and in many economies in transition, where we are trying to bolster reform efforts; in Africa, where we are helping to secure a renaissance after two lost decades; and in Asia, where we are trying to contain the current financial crisis. Let me take these areas of the world one at a time.

From the earliest days of the transition, the IMF has been helping to underpin reform efforts in the transition economies with policy advice, technical assistance, and financial support – and to mobilize financing from other sources. From 1990 to early 1998, IMF commitments to these economies totaled about \$41.3 billion. And the transition economies' share of IMF technical assistance rose from a little over a quarter in 1992 to nearly 40 percent in 1995, and is now still almost one third. Moreover, by the end of last month, the JVI (Joint Vienna Institute) – which was set up in 1992 by the IMF and several other multilateral institutions – had provided training to over 9,300 participants from 33 transition countries.

How are these countries faring? Undoubtedly, 1997 brought good news: positive growth was recorded for the first time in eight years, and the overall expansion is expected to strengthen this year and next. But regrettably, a number of these countries have been feeling the aftershocks of the recent turmoil in East Asia: their export prices have weakened, conditions in international capital markets have become less favorable, Asian investors have scaled back investments, and their currencies have come under attack.

The challenge for us, therefore, is to assist the transition economies in safeguarding and extending their progress through sound macroeconomic policies and – with the support of EBRD (European Bank for Reconstruction and Development) and the World Bank – the second generation reforms that I have already mentioned. The IMF will naturally continue to support such programs. Indeed, these types of measures are vital throughout the world, especially for emerging countries wishing to access global capital markets. It is interesting to recall that at the beginning of the 1990s – a passionate debate developed: weren't we too tough pressing too much for low inflation and speedy reform? Now the response is clear: the fastest countries in adjusting and reforming are now the strongest in growing and in withstanding the crisis. A lesson worth remembering.

As for Africa, we are stepping up our efforts to help this continent avoid marginaliza-

tion and accelerate growth in four key ways:

- First, we are taking steps to put the ESAF (Enhanced Structural Adjustment Facility) – our concessional lending window – on a self-sustained footing so that we can continue to support reform efforts in Africa, and indeed, in other low-income countries, over the long term. We are also exploring ways that the ESAF can serve the developing world better, drawing on findings of recent internal and external evaluations. Working closely with the World Bank, we shall be taking a fresh look at ways to accelerate public enterprise and financial sector reforms; improve the assessment of medium-term investment needs and capacity to absorb external financing; and identify potential adverse social consequences of reforms, to be in a position to coordinate with national authorities the appropriate, rapid, effective responses. And we shall certainly be looking at approaches that can help governments take ownership of programs, and truly call them their own.
- Second, we have been moving swiftly to *implement our joint HIPC (Heavily Indebted Poor Countries) initiative with the World Bank for the heavily indebted poor countries*. Just in the 18 months since its launching, commitments of about \$6 billion have been made to six countries; and work with a number of other countries is in the pipeline.
- Third, over the years, the IMF has provided assistance to countries that have experienced political turmoil, civil unrest, or international armed conflict – and since 1995, we have had a special policy to *provide emergency post-conflict assistance*. Bosnia-Herzegovina was the first country to benefit from this new policy in late 1995, and Rwanda, Albania, and Tajikistan have also received such assistance. The Republic of Congo may be next in line.
- Fourth, the IMF stands ready to *continue to provide – and intensify – our training and technical assistance for capacity building and institutional reform* in Africa and low-income countries elsewhere. Perhaps one of the most encouraging signs is the recent Initiative of the African Governors of the Bank and the Fund to ensure that capacity building is henceforth an integral part of Africa's development agenda. In this context, the IMF Institute has been expanding its training activities for African officials and supporting regional training and research institutions. It is our intention to extend the reach of our training by the establishment of an IMF regional institute in Africa, jointly with training partners in the region, just as we have done for the transition economies by establishing the JVI and by putting in place the IMF - Singapore Regional Training Institute.

HELPING COUNTRIES IN CRISIS

Turning to East Asia, the first question here is what went wrong? How could events unfold as they did after several decades of such outstanding performance, in terms of growth and poverty reduction? The answer is that there was another side to the so-called miracle. In a globalized economy, as I suggested when talking about the scope for surveillance, a few macroeconomic virtues are not enough. Constant vigilance by all countries

must be maintained over all the socioeconomic parameters. The soundness of the banking system, in particular, must be monitored at all times. The unsustainable accumulation of short-term financing must be avoided. And great care must be taken to ensure that governments conduct their affairs in an irreproachable and transparent manner and that all forms of corruption, favoritism, nepotism, and, if I may use the expression, "cronyism" are shunned.

But let us not single out the Asian countries alone. These missing elements exist to a degree everywhere. And Asia's problems would not have reached such proportions if financial institutions operating in the international markets had not taken excessive risks.

What is the IMF doing to contain the crisis? As soon as it was called upon, the IMF moved quickly to help Thailand, then Indonesia, and then Korea formulate reform programs aimed at tackling the roots of their problems and restoring investor confidence. In view of the nature of the crisis, these programs had to go far beyond addressing the major fiscal, monetary, or external balances. Their aim is to strengthen financial systems, improve governance and transparency, restore economic competitiveness, and modernize the legal and regulatory environment.

To provide the breathing space in which these efforts could go forward – as, of course, it takes time to turn around a situation where major structural transformations are called for – we had to marshal catalytic, but alas, sizable financial support, and convince public and private creditors to take their share in the burden of rebuilding the creditworthiness of these countries. I must also mention a much less spectacular, but equally important, effort, which is to help other countries that were being threatened with contagion to strengthen their macroeconomic fundamentals and their economic structures. This explains why, at the present time, 55 countries around the world are applying IMF programs and 28 more – for a total of 83 countries – are having more or less advanced negotiations with us: the effort at strengthening economic structures with IMF support is truly widespread in the world!

But in recent weeks, a new crisis – a crisis within the crisis – has emerged with the weakness of the yen. This new development reflects a serious lack of confidence, provoked in part by recessionary conditions in Japan, as well as the crisis facing its financial institutions. Clearly, the fall of the yen is not unrelated to the Asian crisis, but it could also seriously jeopardize the ongoing recovery of the economies that were hit first. And it adds to the market instability that is again affecting other countries within the region, as well as some countries, including Russia, outside it. Thus, Japan must now move aggressively and quickly to rehabilitate its banking sector, to adopt policies – including reforms that would provide significant tax relief – that ensure that fiscal stimulus is not withdrawn too quickly next year, and to open up and deregulate its economy. Here, too, I should add that the Fund is closely involved through its surveillance process.

Are we creating a moral hazard for borrowers and investors? As for borrowers, there is agreement, I believe, that no country would deliberately pursue reckless policies because it thought the IMF would bail it out in the event of a crisis. The political cost would simply be too great. As for investors, the debate is going on, and it is a healthy one. But even if I frequently play devil's advocate for myself and my colleagues in the Fund, I always

end up concluding that these programs are hardly bailouts. Many private investors are taking heavy losses. With stock markets and exchange rates plunging, foreign equity investors have lost nearly three quarters – if not more – of the value of their equity holdings in some markets. Many firms and financial institutions will go bankrupt, and their lenders will not be repaid. Moreover, earnings reports indicate that, overall, the Asian crisis has been very costly for many foreign commercial banks.

That being said, it is true that some short-term private creditors are being at least partly protected. Efforts should now be made to involve the private sector in resolving both sovereign and private debt problems, not just sovereign ones. But please remember that, in any case, surely the global interest lies in containing and overcoming this crisis as quickly as possible.

This is, Mr. Chairman, what keeps us busy at this very moment. But that is not all. There is another feature of the half-century long life of the Fund, which today keeps us even busier: namely, the fact that we are never allowed to wait for the end of a crisis to start thinking about how to reinforce the system to avoid the next. This is what we now call, rather pompously, strengthening the architecture.

STRENGTHENING THE ARCHITECTURE

In view of the enormous human and economic cost of the Asia crisis, no wonder we hear many radical suggestions as to how to avoid such losses in the future. There are calls for the international financial system to do a better job of predicting and preventing crises, addressing their social impact more effectively, stopping speculators and properly regulating this "casino economy," seeing to it that investors bear the full costs of their mistakes, stabilizing the international monetary system, providing for more political accountability of our institution, etc., etc.

We cannot deny the basic justification of these – at times vociferous – calls for change. No doubt there are at least some elements of validity in each of them. Taken together, they tell us that world public opinion expects its leaders not necessarily to redesign everything from scratch, as if we were back to Bretton Woods; but neither should we limit ourselves to some plumbing and interior decorating of the old mansion.

As responsible architects, what can we come up with? I would like to suggest five areas where we should concentrate our efforts. And in our discussions today, I look forward to hearing the views of participants on these and any other areas they consider important.

- First, we must continue our efforts to make Fund surveillance more effective, as Fund surveillance will continue to play a crucial role in future crisis prevention. We must intensify our monitoring of financial sector and capital account developments, including the risks posed by a sudden reversal of capital flows, the rapid accumulation of short-term external debt, and unhedged exposure to currency fluctuations. We must also monitor more closely market views and perspectives, and give greater attention to policy interdependence and risks of contagion.

Would more effective regional surveillance help? Certainly, Europe has shown us that

regional surveillance and peer pressure can produce an impressive degree of macroeconomic convergence. And while the instruments of regional cooperation are not as well developed in other regions, as in Europe, their combined experiences suggest that there is considerable scope for improving policies when neighboring countries get together on a regular basis to encourage one another-- and, at times, to exert some peer pressure on one another-- to pursue sound policies. For that reason, it is very encouraging to see such initiatives under way in Asia, and the Fund stands ready to contribute its technical expertise to these efforts, as it already does in the G-7 and other fora.

We also need to *develop a "tiered response,"* whereby countries that are believed to be seriously off course in their policies would be given increasingly strong warnings. Here, we want to draw on the lessons from the Asian crisis, and the experience that confidential warnings from the Fund are not always heeded. Addressing an audience in this country, where football is a favorite pastime, I do not need to emphasize how important it is to know exactly when the referee has shown a yellow card and how many yellow cards are permitted! We also have in our Articles of Agreement the red card of going public with our assessments, but using this card could precipitate the crisis we seek to avoid. So as good referees, we would try to keep the red card for truly unacceptable persistence in wrongdoing.

- Second, in order for our surveillance to be effective, we must *improve the availability and transparency of information.* In recent years, the IMF has taken numerous steps to enhance transparency and openness, including the establishment of standards to guide countries in publishing a regular and timely flow of comprehensive economic and financial data. Already, 47 countries have subscribed to the Special Data Dissemination Standard, which provides guidance to countries participating in international markets, or aspiring to do so. We are now in the process of developing proposals for strengthening the standard, especially in the areas of international reserves, by including reserve-related liabilities and central bank derivative transactions, and private external debt, particularly short-term debt. We have also recently adopted a code of good practices on fiscal transparency, and looking ahead, we plan to develop a similar code with respect to financial and monetary policies.

Let me add that the Fund tries to practice the transparency it preaches: our Website on the Internet tries to answer just about any questions one may have on the Fund. It allows access, for example, to the conclusion of the Article IV consultations by the Executive Board in the form of Press Information Notices, and the letters of intent of a growing number of countries. And we will continue to post a wealth of data and other information. But to all those with an "unbearable lightness" who continue to complain about the so-called culture of secrecy of the Fund, I would like to ask: how could we do our job without preserving a sufficient confidentiality so as not to jeopardize the candor and comprehensiveness of policy discussions or to contribute to market scares?

- Third, we must *strengthen financial and banking systems, as well as their supervision.* For some time now, the Fund has been working to help disseminate the set of "best practices" in the banking supervision area-- as developed by the Basle Committee-- so that standards and practices that have worked well in some countries can be adapted and

applied in others. In accord now with the wishes of the Fund's Interim Committee, these efforts will be stepped up and broadened to cover other important areas, such as accounting, auditing, disclosure, asset valuation, bankruptcy, and corporate governance - domains, of course, where the definition of standards will have to be the responsibility of other relevant international agencies.

- Fourth, we need to establish more effective procedures to involve the private sector in preventing and resolving debt crises. Clearly, better ways must be found to involve private creditors at an early stage, in order to achieve equitable burden sharing vis-a-vis the official sector and to limit moral hazard. This is a difficult issue, but one that must now be tackled.

- Fifth, as countries open their economies to foreign capital, we must encourage them to *liberalize capital account flows in a prudent and properly sequenced way* that will maximize the benefits and minimize the risks of freer capital movements. To this end, work is under way on an amendment to the IMF's charter that would make the orderly liberalization of capital movements one of the purposes of the Fund and extend its jurisdiction to capital movements.

As I wouldn't like to conclude on an exceedingly parochial note, I will only mention in passing the need to *enhance the effectiveness of multilateral institutions*, which includes ensuring that they have sufficient resources to do their jobs. On this score, I welcome the positive example Germany has set by consenting already to its share of the IMF quota increase being proposed by the international community. With our usable resources now at a precariously low level, I hope Germany's example will inspire the other members to quickly follow suit.

Before concluding, I would like to suggest how the membership, and particularly our leading members, could best help us at this difficult juncture. Of course, for me, this is a familiar task, as not that long ago, when I served as a central bank governor, I was on the other side of the table sending instructions to my representative at the board of the IMF. So let me see if I can find seven pillars of wisdom.

First, as Mr. Jeske suggested, Europe must show more of a presence in the IMF and take heed on its responsibility as the IMF's biggest group of shareholders, resisting the temptation to abandon itself to a benign neglect of our institution.

Second, again, recalling my former role, in recommending toughness to the IMF, Europe must stick also with this message even when protégé are on the spot, and act with the even-handedness that you recommend to us.

Third, be helpful and avoid holding back at financing consortia, or creditor groups. And indeed, avoid telling us that we are late in calling creditors' groups when you are not that interested in joining them.

Fourth, avoid undercutting us, even if it's done with the best possible intentions, by designing new schemes or new institutions - the last avatar of that being, for instance, the so-called Asian Fund, which had to be gentler and kinder than the IMF. This kind of idea too often gives countries in difficulty the feeling that they can escape the hard, but indispensable, discipline that the IMF is there to promote.

Fifth, the main shareholders of the IMF should help us as much as they can in our key

task of surveillance: in helping us, in warning us when they see things we possibly don't perceive sufficiently, in emphasizing our message to the rest of the world, and in not doing the opposite — namely saying yes, yes, the IMF says that, but don't worry, we will help you find a solution.

Sixth, and by far the most important, you must compete for excellence in your economic policymaking, not just for the sake of your people but also for the sake of the world. We need this example!

And seventh — as you are so frequently giving the IMF the impossible task of squaring circles — please give us also generously, as the President of the Bundesbank did this morning, the benefit of the doubt and the benefit of your friendly support, in spite of our well-known flaws and lack of infallibility.

Well, together, these seven pillars and the IMF's five points (plus one!) sum up to a rather ambitious agenda. But it is an agenda that needs pursuing in these turbulent times. For without a more stable economic and financial system, we will be left adrift, unable to take on the challenges of the twenty-first century. But, Mr. Chairman, if this were to materialize, I am sure we could count on you to call a new seminar, this time for reinventing the true IMF, which Germany has so faithfully supported for so many years.