Mr Stark elucidates the future of official international organizations

Remarks by Mr Jürgen Stark, Vice President of the Deutsche Bundesbank, at the Conference "Lessons from Recent Global Financial Crises", held in Chicago on 30 September – 2 October 1999.

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Ladies and gentlemen,

My following remarks about the future of official international organizations are divided into two parts.

Firstly, I want to say something about the *rationale* and, secondly, I want to deal with the *past and future role* of official international organizations.

But let me start with a summary:

1. There is *a need and a future for well designed official international organizations*. In the political setting of sovereign nation states and the increasing economic and financial integration and globalization, they perform important tasks. Many of these tasks can hardly be taken over by other organizations, national or private. Furthermore, due to their establishment by agreement between governments of many countries, official international organizations have a high degree of legitimacy.

2. Effective international organizations must have a *clear mandate and clear-cut responsibilities* for their work, reflecting the benefits of specialization and the division of labor. *Overlapping mandates and activities tend to waste resources due to double work and – which is even more important – blur responsibilities*.

3. Within these clear and non-overlapping mandates the different international organizations should develop *appropriate cooperation procedures* to make their work consistent and to arrive at highly efficient results.

4. Existing official international organizations in general have so far shown a *broadly satisfactory performance*. They have acquired a strong expertise and valuable experience in their respective fields which provide a special capital for future work. However, they must also be prepared to *adapt to significant and systemic changes* in the international environment but should refrain from adapting their strategies to volatile topics of the day. There is a need for *leaner agendas* for international organizations.

5. Official international organizations are public institutions and consume and manage taxpayers' money – or central bank money in the case of the IMF. Thus, they are responsible to their official "shareholders" and their work must be *transparent, accountable and efficient*.

Rationale for official international organizations

Given the general superiority of the market mechanism for coordination of individual action, *public intervention requires justification*. *Economists* usually refer to *welfare factors*, in the form of market failures such as externalities or a shortage in the supply of public goods, or to *transaction costs*. Such factors, however large or small, can play a role in an integrated world economy. Many economic and financial linkages between countries – such as international trade, capital flows or transportation as well as spill-over effects from national policy decisions – may call for some official regulation to prevent or limit adverse effects or to allow for scale effects. However, the question whether official intervention would be beneficial, and if so, what kind of intervention would be most adequate, has to be decided for the *single case*.

There are also *political considerations* that support official international treaties and organizations. Such considerations include benefits from the international *exchange of information and consultations* on a regular basis or from cooperation and dispute settlements within an existing and accepted framework. The existence of official international organizations, especially with a broad international membership, also facilitates and promotes the search for *multilateral solutions* to problems in areas such as trade policy, and limits the scope for bilateral or unilateral policies. Such multilateral solutions which are developed and implemented within a rule-based framework might be more acceptable to the parties involved than other solutions, e.g. unilateral sanctions.

„International economic and financial stability" is often referred to as an international public good, as a means to broadly shared global prosperity.

Evidence seems to support the view that adding *rules for international transactions* such as through the WTO to ensure fair international trade or the BIS to develop capital adequacy ratios for financial institutions have the potential effect of reducing the likelihood of severe international economic and financial instability. In this regard such rules and organizations limit the non-sanctioned room for manoeuvre of the single nation states to such measures which are supposed to be in line with international stability. This applies also to international organizations which have a mandate to promote *sound domestic economic policies* – such as the IMF with its surveillance mandate. Promoting sound policies aiming at internal and external stability in a country helps to avoid externalities or negative spillover effects to other countries, such as through beggar-thy-neighbor policies or inappropriate exchange rate policies.

International economic and financial stability is dependent on economic stability at the national level and to the stability of international transactions. Both factors can be and are being addressed through specific *codes, rules and procedures,* which are *set by official international organizations,* such as the IMF, the WTO or the BIS.

Crucial is the *implementation of all these codes, rules and procedures* by individual countries. The *implementation then has to be monitored* very closely by the respective official international organizations.

I would like to mention here especially the IMF surveillance procedure in the context of its Article IV consultations. This exercise should disclose macro-economic as well as micro-economic weaknesses and imbalances – in the latter case I am thinking specifically about national banking systems – and recommend appropriate policies to achieve internal stability and external viability. Thus, it could serve as a prominent tool for preventing externalities and international crises.

Of course national authorities have to be prepared to adopt *corrective policies* in a timely manner – if called for.

The future of official international organizations

To what extent the efforts of international organizations to produce stability have been successful in the past is open to debate. Unfortunately, financial crises have occurred in recent years in several countries. All elements – the setting of codes, rules and procedures, their implementation and monitoring – have to be respected to safeguard international economic and financial stability. Some initiatives are already under way in this respect. In general, it seems crucial that the international organizations concentrate – not least under conditions of scarce resources – on their *core mandates*.

As concerns the *IMF*, the *surveillance* function must play a dominant role on the basis of professional diagnosis and frank and open discussion of therapy. Not completely new though is the problem of non-complying countries that refuse corrective policies suggested by the IMF and supported by its membership. At some point in time, when non-compliance heightens the risk of a crisis, the IMF must go beyond confidential channels of communication with the respective country. While we do not want the IMF to become a kind of rating agency, the IMF should under appropriate circumstances issue data information to encourage the respective authorities to correct some "dangerous policies".

Another element of the Fund's preventive role is the design and monitoring of *data publication standards* like the SDDS to enhance transparency of the national economic situation and policies as a means to facilitate solid judgements by markets participants that allocate financial flows.

I mention the *financing role* of the IMF at this late stage, since it generally comes into play when preventive efforts of all players have not succeeded. It is certainly a more visible and glamorous role, especially in crises situations, than the day to day business of surveillance, but it is a sign of failure of the preventive role.

A rising need for IMF financing reflects a poor grade for the Fund's surveillance efforts. Generally speaking, the more successful the surveillance, the less IMF financing is required. Of course, conditionality under Fund supported programs should be subject to the same test to demonstrate its effectiveness. This implies that successful work of the IMF should be reflected in a declining trend of the overall number of Fund supported programs over time, i.e. fewer new and follow-up arrangements.

To be clear, we do not object that there are legitimate cases which require access to the Fund's resources. However, the Fund's *financing role* should and can only be *catalytic*. In that respect we also have to enhance our efforts to involve the private sector in crises prevention and solution. The prolonged use of Fund resources is hardly in line with the Fund's mandate, that speaks of "making the general resources of the Fund temporarily available" (IMF Articles of Agreement, Article I (v)). Countries that run IMF supported programs over many years or even decades are probably not a demonstration of success. Thus, the major role of the IMF should be to prevent that IMF financing becomes necessary and to make it redundant over time for countries.

When performing the financing role, however, negative feedbacks on the intended international public good in the future must be avoided. There has been a controversial discussion to what extent large IMF financing packages have caused *moral hazard* and thus undermined the functioning of the market mechanisms, i.e. whether the crisis solution in one case has actually prepared the ground for the next crises.

To conclude:

1. Official international organizations may play a *well founded and systematically meaningful role*, supplying public services, that are not profit-oriented and therefore would not be attractive to, or performed by, the Private Sector. Thus, the IMF and the World Bank are also justified and have to be streamlined on this basis.
2. This does not mean, however, that international institutions should not be *viewed very critically*. They work with public money, and thus have to operate very efficiently – in the short-run as well as in the long-run. International organizations are responsible to the public, and thus are always part of an open and changing world.
3. International organizations – particularly the IMF and the World Bank – should *refocus their respective mandates*. Otherwise we run the risk that while there is double work on some tasks, other crucial tasks for safeguarding international economic and financial stability are neglected. Responsibilities would be blurred with yet unknown consequences for long-run international stability.

I fully agree with the findings of an Independent Task Force – sponsored by the Council on Foreign Relations – on the future international architecture: the IMF and the World Bank have tried to do too much in recent years or were driven by their shareholders to do more.

1. The *IMF* should lend less and concentrate more on crisis prevention.
2. It should focus on a leaner agenda of monetary, fiscal and exchange rate policies, and on banking and financial sector surveillance and reform.
3. The *World Bank* should focus on longer term structural and social aspects of economic development and help to reduce poverty.

4. It should not be involved in crisis lending or crisis management and should refrain from publicly second-guessing the Fund's macro-economic policy advice.

5. Finally, the World Bank should do more in the design of social safety nets.

To refocus the IMF and the World Bank does not mean that other areas of economic policy should be ignored. Those areas fall to other institutions or agencies within their respective mandates and expertise.