

## **Eva Srejber: Globalisation and the IMF**

Speech by Ms Eva Srejber, Second Deputy Governor of the Sveriges Riksbank, at The Social-Democratic Student Club, Stockholm, on 19 September 2000.

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Thank you for the opportunity of coming here to Stockholm University and meeting you from the different social-democratic student clubs in Stockholm and others among you who have seen posters here at the University.

In a week's time, the International Monetary Fund, IMF, will have its annual meetings with the World Bank in Prague. We will probably see demonstrations at these meetings - in the same way as we saw at the World Trade Organisation's meeting last winter and at the IMF and World Bank meetings in Washington in April. In a short time, the IMF has increasingly become the subject of debate, not least since it is closely associated with the controversial and often hard-to-interpret economic trend called "globalisation".

The Riksbank has a reason for taking part in this debate. Most of you will be aware that one of our tasks is to maintain stable prices. The other main task of the Riksbank is to promote financial stability and an efficient payment system and to issue banknotes and coins. As part of this task, we participate in various international organisations which work for financial stability, among other things we are the contact authority for the IMF in Sweden. This means that we, together with the Ministry of Finance in the Government Offices, coordinate and conduct Swedish policy in this forum.

This evening, I am intending to talk about globalisation - as an opportunity and a challenge. I am going to discuss what the International Monetary Fund is and the role that it has in an increasingly globalised world. To conclude, I will take up Sweden's participation in the IMF, and what we can expect from the meetings in Prague next week.

### **Globalisation and its benefits**

Before commenting on critical remarks often presented on globalisation, let me first begin by noting that prosperity in the world has improved dramatically during the past decades. Never before in history has the situation of so many people improved so much so quickly. Since the beginning of the 1980s, purchasing power per capita in the world has more than doubled. In the poor developing countries, this has meant that purchasing power correlated GDP per capita has increased by almost 350%. In the rich industrialised countries, the corresponding growth was 220%. In certain cases, developments have been particularly spectacular, not least in Asia. In 1975, six out of ten Asians lived in absolute poverty - under a dollar a day. Today, the figure is two out of ten. In China alone, the number of poor has fallen from 60 to just under 30% in less than twenty years.

There are many factors that explain this development. Major technical advances have taken place enabling manufacturing and other production to be made more efficient. However, a crucial factor has been the increased opportunities for contact between people in different parts of the world, and increased opportunities for making use of each other's abilities. All prosperity is based on people producing goods and engaging in trade to obtain other goods from those who are comparatively better at producing them. This was the case when the Vikings exchanged fur and amber for salt and it still applies today when banks sell foreign exchange derivatives and equity. These greater opportunities for exchange are the foundations of globalisation. It materialises in increased trade, increased capital investment, increased travelling and increased flows of information.

The greater opportunities are often related to political decisions on deregulation and opening of borders. Since 1950, the quantity of tariffs and other trade barriers has drastically reduced. This has meant that the total trade in goods and services in the world is now sixteen times larger than then. The

market for consumers and producers has thus become many times larger than before. This has meant that workers and companies in different parts of the world have been able to concentrate on producing what they are relatively best at. Specialisation and increased competition have pushed down prices. The housekeeping money lasts longer. Moreover, we can buy far more types of goods. It was not so long ago that oranges were a luxury. If you go into a food shop today, you will find Swedish blood pudding as well as Italian salami, Chinese noodles, American peanut butter and coffee from Brazil. The same applies to most other types of goods.

Increased trade also benefits the developing countries, which has been shown in various studies. Jeffrey Sachs and Andrew Warner at Harvard University have found that welfare in developing countries with an open trade policy has increased by 4.7% per year between 1970 and 1990, compared with 0.7% per year for those with closed borders. This means that a country can create more than six times as much welfare each year, just by deregulating its trade. No development assistance project in the world comes anywhere near such figures. The price for shutting oneself off from world trade is very high.

Another important trend in recent years has been the deregulation of the international capital markets and the new information technology enabling savings capital to move in a second between different parts of the world, at almost zero cost. Capital is not really different from any other type of good. Some people need capital, and are willing to pay to borrow it. Others have savings and can sell the opportunity to use these for a period of time. Deregulation has meant that savings can to an increasing extent be channelled to where they will be most useful. The medium income countries today finance their growing industries and their infrastructure with the aid of the savings capital from us in the rich part of the world. At the same time, those who save money - not least all those saving for pensions - can benefit from the growth potential that exists outside of their own country's borders. Free capital movements have also made it possible to diversify savings capital and thus reduce risks. This gives greater financial security both among those who invest and those who use borrowed capital.

Globalisation brings many benefits that are not only economic. Contacts with the surrounding world have increased and developments in IT make it increasingly difficult to isolate a country. Openness is increasing in all areas, facilitating the exchange of knowledge and information and receives further nourishment from growing economic prosperity. In addition, since it has become less costly to travel and easier to undergo education in other countries, more and more people have had personal experience of everyday life in other countries.

### **Criticism of globalisation**

Nevertheless - despite the very positive development in many respects - there are many that regard globalisation as a threat rather than an opportunity. There are a lot of organisations with many different views in this area. However, they seem to share some of the concerns about trends in the world economy. This may concern the following:

- Trade and new technology increase competition and the requirement to change. The changeover to new types of production makes demands for great, and often swift, adaptation. Some companies become unprofitable and employees both in industrialised countries and developing countries are forced to leave their jobs and look for new.
- Although the situation of more and more people is improving, the gap between the poor and the rich is increasing. Countries, which due to deficient infrastructure and incapable political leadership, etc. are not equipped to take advantage of the benefits of globalisation, risk falling further and further behind.
- The global environmental problems are aggravated.
- Free capital movements make countries more vulnerable if they carry out less credible policies. As quickly as investments flow in when economic prospects are good, they flow out just as quickly when financiers suspect that growing problems threaten the savings they have the task of managing.

These are some of the problems that we cannot ignore. They are among the great challenges for world politics today, and I understand those who feel concern. Many of these issues require coordination between countries, and it is therefore an ambitious agenda that we have to tackle energetically. A lot of work is already in progress, nationally and in various multilateral organisations.

However, despite these issues being important, the conclusion is not that we should endeavour to reduce trade or have fewer contacts between countries. A number of the problems I mentioned are rather related to growth and economic development in general entailing change. All societies, whether open or closed, must find ways of ensuring that people are not excluded when technological progress makes old industries unprofitable. All societies also have a responsibility for production and consumption not having too great an impact on the environment since the welfare and health of future generations will otherwise be imperilled.

We must be clear that development and collaboration are good. Almost everyone, including many of the poor in the world, has experienced great improvements in the past decades. In many respects, it is exactly the increased contacts and trade between countries that has contributed to it being possible to solve the problems that I have just mentioned. Growth in the industrialised countries has led to us being able to afford to conserve our environment, which most poor countries cannot afford to do. To reverse the trend - to attempt to isolate countries from one another - is not the way forward.

### **Globalisation makes new demands**

I will now make some remarks on challenges specifically related to globalisation. Like all other development, globalisation is not without problems. These were clearly expressed in the severe economic crises that we have seen in recent years - in Mexico in 1994-95, in South-East Asia in 1997-98, in Russia in 1998 and in Brazil in 1999. These crises illustrate that increased trade and financial flows makes new demands public policy.

Firstly, requirements increase on the national institutional settings - on laws, authorities and practices. These systems must be solid enough to cope with increased flows of trade and capital. Some countries are not sufficiently well prepared to handle the new conditions of the world economy. Sometimes, countries have deregulated their economies too quickly or in the wrong way. Industrialised countries have deficiencies too.

Secondly, requirements increase on coordination of policy among countries. The countries of the world are increasingly dependent on one another. A financial crisis in South-East Asia has effects in Sweden as well. For this reason, we also benefit from other countries on the other side of the world acquiring better systems for, for instance, bank supervision and bankruptcies. This means that we have greater reason to become involved in global issues. We also have reasons to show lenience on issues that are important for Sweden sometimes, in order to create common rules of play and agreements that will benefit everyone. The old slogan "international solidarity" is national self-interest in a very concrete way.

International collaboration is thus of great value. Therefore, we have reason to take a great interest in the multilateral organisations for collaboration that exists. The "Bretton Woods institutions" - the IMF, the World Bank and WTO/GATT - were established fifty years ago during a period when the countries in the world economy drew the lesson that the trade wars of the 1930s, payment obstacles and competitive devaluations contributed to unemployment, lower prosperity and war. Among other things, it is the collaboration in these organisations that opened the road for the economic development we are seeing today. It is also in the first place within these organisations that the countries of the world discuss how the gains from globalisation shall benefit everyone.

The World Bank is a development organisation, whose main purpose is to reduce poverty in the world. Every year, the World Bank lends the equivalent of roughly 200 billion Swedish crowns (25 billion US dollars), to finance several thousand projects in water sanitation, combating AIDS, vaccination, etc. The World Trade Organisation, WTO, that has replaced GATT, is working to remove tariffs, import quotas and other trade barriers. The increased world trade that I recently mentioned is largely a product of the work that has taken place in this forum.

## **The organisation and purpose of the IMF**

The IMF can be characterised as a financial “club”. It is an association of countries that share their experiences and help one another during crises, among other ways by lending one another money from a common fund. Influence in this club - in the form of voting rights on the IMF board - is quota-based and reflects among other things the amount of capital the member countries have provided. The background to this is that the creditors in the IMF wish to have a reasonable control of how their money is used. Not least to be able to justify this to taxpayers in their home countries. Voting power in the IMF is a balance of creditors’ interests, borrowers’ needs and that all members should be able to exercise influence.

Membership of the IMF is open for all countries that meet certain criteria. Today, 182 countries are members, which means that very few countries do not take part in the IMF. This broad membership is one of the organisation’s strengths. The IMF’s head office is in Washington DC in the USA. Around 3,000 people work there. The major part are economists specialising in macroeconomics and international finance. The IMF board which decides on the day-to-day policy in the organisation is also located in Washington DC. The board meets at least three times per week. It has 24 seats, where all countries are represented, most of them in geographical groupings.

The IMF’s purpose is to work for financial stability. In simple terms, this means ensuring that the various macroeconomic variables in a country – the exchange rate, inflation, the budget deficit, for instance - are dealt with in such a way that the economy can run smoothly and efficiently. A stable economy allows people to think in a long-term way when they invest and consume. Without stability, it is not possible to create sustainable growth. In Sweden, we have recent experiences of the opposite. The financial crisis here at the beginning of the 1990s increased unemployment and reduced production at the same time as government finances were dramatically weakened and Sweden entered the deepest recession since the 1930s. Bear in mind then that Sweden is an industrialised country. Many of the member states of the IMF are poor and have even in calm periods unemployment of around 30%, a very strained government budget and limited opportunities to obtain foreign finance. Financial stability is even more important in these countries.

## **Activities to prevent crises**

A large part of the IMF’s activity centres around preventing crises arising. Globalisation has meant that this work has become increasingly important. Few people want to trade with a country that is insecure, and even fewer to lend money there. Since the flow of information is increasing and capital can swiftly be moved between countries, economic crises can arise more quickly in the event of indications of problems in a country. They can also become deeper and spread to regions farther away than previously. The value of a stable, long-term economic policy has therefore been reinforced.

Briefly, the IMF’s preventive work involves spreading knowledge, giving advice and creating norms. Spreading knowledge means that the IMF continually monitors trends in the world economy, conducts research and spreads knowledge to national governments and the general public. Knowledge about where the economic risks are has a stabilising effect on markets and also allows countries to tackle their problems. The IMF continuously surveys economic trends in each member country and also gives regular advice on economic policy on issues concerning, for instance, exchange rates, inflation and the financial market. Most countries receive a visit from the IMF every year. In Sweden this usually takes place in the early summer and the delegation stays for a week and visits during this period the Riksbank, the Ministry of Finance, Finansinspektionen [the Swedish financial supervisory authority], the social partners and other central economic participants to obtain a picture of the economic state of the country. This leads to a report that is discussed in the IMF board.

In some cases, the IMF has a very practical involvement in countries. Many central banks in developing countries have been established with the assistance of the IMF. An example that is close to hand is the establishment of a central bank in Kosovo. The same applies to introductions of new currencies, or the introduction of new exchange rate regimes. The IMF also trains officials from national central banks and ministries of finance as part of the work of spreading knowledge.

An increasingly important part of its activity concerns creating common rules of play within different areas that affect financial stability. Many of these are in the form of general minimum standards and recommendations, for instance, in bank supervision, financial statistics, transparency and foreign exchange reserve management. By encouraging countries to meet these, countries reinforce their institutional framework, at the same time as increased standardisation makes it easier for everyone to be cognisant of systems in different countries. Not least, this assists investors to make risk assessments.

### **Fund lending**

The areas of activity that I have just mentioned involve in the first place the long-term prevention of crises and the promotion of trade and growth. They account for the major part of the IMF's work. However, the IMF also has the role of fire brigade in the international financial system. Roughly, financial problems occur in four or five countries each year. This often includes difficulties for these countries to handle their foreign payments - their foreign exchange reserve runs low since imports are greater than exports, and there is insufficient foreign capital inflow to bridge the gap. In such a situation, the country can apply to the IMF for a loan. A team of economists is then quickly put together and sent to the country to assess how severe the crisis is and what has to be done to regain control over the situation. Together with the country's government, the IMF staff rapidly creates an economic reform programme that runs over a couple of years. The purpose of this programme is to establish confidence in the country's economy and in this way turn the outflow of capital to an inflow, so that the country can regain balance in its payments. During the period that the country is undergoing the programme, it can also borrow limited amounts from the IMF to assist in covering parts of its deficit.

The IMF's lending is thus relatively short-term. It is often sufficient with loans with a three to five year term to restore balance in the foreign payments. In the case of developing countries, however, it has increasingly been seen that short-term instability often depends on deep-seated structural problems. Examples of this type of problem are inability to collect taxes, inefficient bankruptcy legislation, widespread corruption and weaknesses in the banking sector. These types of issues are in the borderland between the mandate of the IMF and the World Bank and the two organisations collaborate in initiatives in this area. Among other things, the IMF and the World Bank have certain types of loans which, in combination with economic reform programmes, are focused on building long-term, strong structures in poor countries.

Another type of structural problem is the unsustainable foreign debts burden that some of the most poor developing countries have to contend with. For a couple of years, the IMF and the World Bank have been working together in debt relief projects for these countries. In practice, this implies writing off parts of the debts. The debt relief goes hand-in-hand with economic reforms in the countries, aimed at decreasing poverty. In the longer term it is only through a responsible economic policy, focused on growth, stability and sound government finances, that these countries can avoid debts building up again. An important part of the IMF's work with debt management in the poor countries is therefore to strive for the resources that are released in the country are invested long-term and in a way that benefits all the population.

Research shows that IMF lending and programs are successful. In the years a program is implemented, and the countries save to finance their deficits, growth is normally decreased a bit. After a few years, the countries can however reap the fruits of a more stable economy, in terms of lower inflation and higher growth. Successful programs also have a positive effect on social policy in the countries. Expenditure on education and healthcare in the poorest program countries increased by four per cent per capita between 1985 and 1998, and these areas now account for a larger share of the government budgets. Countries with IMF programs have seen more children in schools, increased literacy and access to clean water, and lower child mortality.

## **Swedish participation in the IMF**

Sweden is one of the creditor countries in the IMF. In the board we share a seat together with the seven other Nordic and Baltic countries. As well as other country groups, we have an office in Washington with representatives who work full time on pursuing our interests on the board. I worked at this office myself for over four years as Nordic-Baltic representative in the board. Our board representatives receive guidance from their home countries on important issues and statements in the board are coordinated among our countries in advance. In Sweden, the Riksbank has the main responsibility for contacts with Washington, but all issues are coordinated with the Government Offices where the Ministry of Finance is our contact. In certain cases, there is also consultation with the Ministry for Foreign Affairs.

The Nordic and Baltic countries are small on the board - our combined voting power is just over 3.5% of that of the IMF as a whole. Our opportunities to pursue policies on the board are in having sensible points of view on the proposals that are on the agenda and, together with other countries, trying to influence proposals so that they move in the direction we want them to. To some extent, we have an advantage in appearing independent on the board, since we represent neither the most influential creditors within G7 nor the large group of debtor countries. This means that our statements sometimes have more weight than our voting powers indicate.

Let me give three examples of issues where our countries have been actively involved in the IMF. The first concerns the transparency of the IMF. In Sweden, we are accustomed to authorities publishing their decisions and their way of dealing with items. Many international organisations on the other hand operate behind closed doors. However, the IMF has become considerably more open in recent years, and today material on almost all activities is available, not least on the IMF's website ([www.imf.org](http://www.imf.org)). A second example is the issue of capital account liberalisation. Besides working for opening up the capital account in many countries, we strive for the long-term goal of giving the IMF a clearer mandate to regulate issues relating to the international capital market. A third issue where we have been active is developing a body of rules for how private creditors are to contribute to the financing of countries' finance requirements in crisis situations.

The increased attention in the media about the IMF and the World Bank has arisen during a period when the functioning of these organisations and their mandate have been discussed intensively internally as well. The growth of private capital markets has resulted in many countries no longer requiring financing from the IMF. At the same time, the need to build institutions, regulation and coordination is increasing, not least in the financial sphere. Some radical groups have argued that the IMF should be abolished, or considerably reduced in size. Others believe that the organisation should take on more responsibilities, such as within areas concerning the labour market, the environment and money laundering. Sweden is among those who believe that the IMF can only be an efficient organisation if its mandate is kept relatively narrow. The IMF shall work with financial stability, and in particular macroeconomic issues. Within this area, the IMF has its main competence and can contribute most. At the same time, the world has changed a lot since the IMF was set up at Bretton Woods in the forties, and it is natural for the organisation to expand its involvement in financial issues and, in particular, with respect to how private flows of capital are to operate within a good regulatory framework.

## **The annual meetings in Prague**

The coming annual meetings in Prague are to some extent a continuation of this discussion. In Prague, the ministers of finance and governors of central banks from the member countries will meet to discuss the IMF's future agenda and share views on the work that has been done since the meetings in Washington in the spring. Most of the issues that I have mentioned will be taken up at these meetings. They will discuss trends in the world economy and future risks and opportunities. They will discuss the increased role of private flows of capital and how they affect the IMF's provision of advice and loans. They will also discuss how the IMF can obtain a more constructive collaboration with private financiers. The experiences of standards within different areas will be analysed as well as the poorest countries' debt situation, and not least how the debt relief is to be financed.

The IMF has accordingly a key role in what we somewhat carelessly call globalisation. I hope that the trend towards increasing economic and cultural openness will continue. People continually seek new opportunities to trade and communicate with one another, and find new ways to benefit from one another's knowledge and possibilities. It is fundamentally a very positive development which gives poor and rich people enormous opportunities for greater wealth and reduced suffering. In order to make use of this potential, intensive international collaboration is required, and energetic national efforts. Sweden and all other countries must adapt their national systems so that they can cope with the increased contacts with the outside world and so that other countries can benefit from increased contacts with us.

Issues of financial stability and macroeconomics are intimately related to this. The IMF therefore has an increasingly important function to fill. Economic developments, not least in the financial sphere, take place quickly, however. In order to be able to make an active contribution, the IMF and other financial organisations must continually be reformed and keep in step with this development. The meetings in Prague are a part of this reform process.