

Willem F Duisenberg: The role of the ECB at the international level

Speech by Dr Willem F Duisenberg, President of the European Central Bank, at the Annual Meeting of the Institute of International Finance, Inc (IIF), held in Prague, on 23 September 2000.

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Introduction

First of all, I should like to thank you for giving me the opportunity to address such a distinguished audience. The Institute of International Finance (IIF) is the leading professional association of private sector financial institutions acting at the global level. As such, the IIF serves as a prominent forum for fostering a dialogue between the private financial community and policymakers on key issues, such as the prevention of financial crises and the architecture of the international monetary system. This explains why the European Central Bank (ECB) follows the IIF's initiatives with great interest and why, this evening, I am pleased to be able to share some thoughts with you. Given the global nature of the IIF's activities and the concomitance of its Annual Meeting with the Annual Meetings of the IMF and the World Bank, I shall focus on the *international* dimension of the ECB's activities.

Let me start by recalling that, on 1 January 1999, the 11 Member States of what is now the euro area transferred their monetary sovereignty to a new supranational institution, the ECB. Since then, the Governing Council of the ECB has been solely responsible for deciding the euro area's monetary policy. The Executive Board of the ECB has been implementing the Council's decisions mainly through the national central banks (NCBs) of the countries which have adopted the euro. The ECB and the NCBs together form the "Eurosystem". Accordingly, the Eurosystem is the central bank of the euro area, although it does not have a legal personality; this is only conferred upon the ECB and the NCBs. On 1 January 2001 the euro area will welcome a new Member State, Greece. Moreover, in five days - on 28 September 2000 - the Danish citizens will decide in a referendum whether their country shall also adopt the euro.

The Eurosystem enjoys full independence in pursuing its statutory mandate to ensure and maintain price stability. "Independence", however, does not mean "isolation". The Eurosystem, in other words, cannot perform its tasks without establishing appropriate *external* relations with both market participants and other policymakers.

This evening I shall focus on the *multilateral* relations which the ECB - and more generally, the Eurosystem - maintains with other policymakers at the *international* (ie neither euro area nor European Union) level. These relations are promoted within organisations such as the IMF, the OECD and the BIS, as well as in fora such as the G7 and the G20. I shall first provide a brief overview of the current relations of the ECB and the Eurosystem, both from an institutional angle and from the point of view of their rationale. Without wanting to be exhaustive, I shall then highlight a few challenges which the ECB - and, more generally, the international official community - may be confronted with. In this context, I shall outline the ECB's assessment of a more specific issue, namely the issue of private sector involvement in the resolution of financial crises.

1. The ECB and the process of international cooperation

Institutional framework

The Treaty establishing the European Community (the "Treaty") stipulates which European institutions are allowed either to speak or to act on behalf of the euro area at the international level. The euro area, like the Eurosystem, has no legal personality. This implies that the euro area cannot negotiate and conclude public international law agreements or become a member of international organisations. This also implies that the euro area has to be represented externally by Community institutions or bodies which have a legal personality; this means: (1) the Council of the Ministers of

Finance and Economy of the EU (“ECOFIN Council”); and (2) the ECB and, in accordance with an ECB decision, one or more NCBs. While the Treaty provides for interaction between the ECOFIN Council and the ECB in a number of cases, these entities have well-defined responsibilities.

This legal framework provides guidelines to give the euro area a voice at the international level. In particular, when the external representation of the euro area in the field of international cooperation involves the tasks entrusted to the Eurosystem, decisions are centralised in the hands of the Governing Council of the ECB. This facilitates the decision-making process with regard to external representation. While NCBs may participate in international fora depending on their respective memberships (eg G7, G10, G20), the participation of the ECB in *all* relevant fora gives continuity and visibility to the external representation of the euro area.

The roles the ECB plays in the international community differ depending on the Eurosystem tasks involved in international relations. In particular, the ECB can play three different roles. *First*, the ECB is a primary and autonomous counterpart whenever the Eurosystem’s exclusive competencies - ie monetary policy and related central banking tasks - are involved in international relations. *Second*, with regard to issues related to the exchange rate of the euro, the ECB shares with the ECOFIN Council the responsibility for both consultations with third parties - for example at G7 level - and communication to the general public. However, the ECB is solely responsible for deciding foreign exchange operations. *Third*, within the limits of the Eurosystem’s field of competence, the ECB can advise other euro area policymakers on international issues. In specific circumstances the ECB may also act as a “catalyst for cooperation”. This may happen when the Eurosystem develops common views on issues which fall within the competence of other euro area authorities (mainly national governments), but in which the Eurosystem has a strong institutional interest, in accordance with its statute. This applies, for instance, to issues related to the stability of the global financial markets and the architecture of the international monetary system. In dealing with these issues, the ECB may provide value added to the development of common euro area positions to be taken at the international level.

Rationale for cooperation

The relations of the ECB with other policymakers at the international level involve a number of *cooperation activities* designed to increase the “joint welfare” resulting from their policies.

Generally speaking, “international cooperation” takes place within the relevant organisations (eg IMF) and fora (eg G7), between the competent authorities of different countries for either a given policy (eg monetary policy) or a set of policies (eg macroeconomic policies). In this context, the term “country” should be understood to include monetary unions such as the euro area. In principle, cooperation can include a wide spectrum of activities, namely:

- *Consultation*, which simply consists of a mutual exchange of information and views;
- *Surveillance*, ie the systematic monitoring and assessment, by an independent organisation, of the economic policies of its members. Within this context, the international community may also develop “standards” and “codes”, which constitute a form of multilateral rule-making to be implemented on a voluntary basis; and
- *Coordination*, ie the agreement between separate policymakers to take and implement joint decisions.

As I shall discuss, the Eurosystem is directly involved in most, although *not all*, of these activities.

The economic rationale for the ECB’s involvement in international cooperation activities rests on the international externalities of domestic policies, ie spillover effects which policies in one economy can produce on other economies via, for instance, interest rates, exchange rates and equity prices. The euro area, however, is a large and relatively closed economy. The degree of trade openness of the euro area is much smaller than that of its constituent countries. Measured by the average of exports and imports as a share of euro area GDP, the degree of openness is 16% in the euro area. By contrast, prior to Monetary Union, the average export ratio of individual Member States stood at around 35% in 1997.

This helps to understand both why the euro area is not affected by spillover effects to the same extent as small open economies, and why the Eurosystem is in a position to pursue its primary objective - maintaining domestic price stability - in the most effective way.

This does not mean, however, that the ECB neglects *external* economic developments when establishing the euro area monetary policy. On the contrary, the ECB takes these developments into due account as they may have an impact on *domestic* economic developments, and thus on price stability.

The ECB's approach to external economic developments has three implications for the participation of the Eurosystem in the process of international cooperation in the area of *macroeconomic* policies.

First, a substantial component of the ECB's cooperation is the reciprocal exchange of information and views within international organisations and fora. Regular consultation on external economic developments enhances the ECB's ability to analyse the outlook for price developments in the euro area. By taking into account possible spillover effects from third countries' policy actions, consultation plays a part in reducing the likelihood of misinterpreting the impact of external developments on domestic variables. Given its voluntary nature, consultation does not impinge on the ECB's independence.

Second, consultation is supplemented by international *surveillance*. In this case, a third and independent party, such as the IMF or OECD, regularly monitors and assesses the economic policies of its members. In this regard, whenever the euro area monetary policy is under surveillance, the ECB is solely responsible for interaction with the IMF and OECD. International surveillance adds to the ECB's transparency as both the IMF and the OECD make their assessments of euro area economic policies available to the public. In the context of surveillance, the international community is also developing common understandings on a number of "rules of the game" to be implemented in each individual country on a voluntary basis. An example is given by the IMF Code of Good Practices on Transparency in Monetary and Financial Policies. The selection of best practices and rules enhances competition and transparency among policymakers, thus making the idea of good public governance a central component of international cooperation.

Third, consultation and surveillance are the forms of international cooperation which are relevant to the ECB in the area of macroeconomic policies. Any form of *ex ante* international *coordination* of monetary policy with other macroeconomic policies could easily be incompatible with the Eurosystem's mandate and independence. Attempts to coordinate *ex ante* would not only blur the specific responsibilities of individual policymakers, but also reduce their accountability. In determining its monetary policy stance, the ECB should and does take into account all relevant information. It cannot let its policy be determined solely by the current and future course of other policies. This could easily compromise the maintenance of price stability. The inappropriateness of *ex ante* policy coordination also applies to the more specific option of exchange rate coordination between large economic areas, for instance by setting ranges for the fluctuation of the major currencies. In this regard, I should like to take the opportunity to reaffirm that the ECB does not pursue any exchange rate target. Our objective is to maintain stable prices in the euro area and not a specific level of the euro's exchange rate.

Last but not least, the Eurosystem takes part in the process of international cooperation not only in its role as a "primary player" - ie when euro area monetary and exchange rate policies are involved - but also in its roles as *advisor* to other euro area authorities on international issues and "*catalyst for cooperation*". In this case, international cooperation is mainly designed to ensure global financial stability and enhance the architecture of the international monetary system. The economic rationale for this kind of cooperation can be summarised as follows. *First*, financial instability can materialise even with sound macroeconomic policies, as a result of factors such as inadequate supervision in emerging market economies and so-called "contagion", ie the international transmission of instability. *Second*, a world divided into sovereign states has inevitably moved more rapidly towards full capital mobility than towards common rules. The asymmetry between the free movement of capital, which takes place on a global scale, and policymaking, which remains mainly in the national domain, can have implications for financial stability and calls for enhanced international cooperation.

2. The challenges ahead

Let me now turn to the challenges ahead. I shall distinguish between challenges related to the institutional framework for international cooperation and challenges pertaining to the specific contents of international cooperation.

Institutional challenges

Over the past two years, the representation of the euro area in international organisations and fora has been decided in accordance with the aforementioned guidelines laid down in the Treaty. These guidelines and decisions, however, have no direct legal bearing on the statutes and/or internal rules governing international organisations and fora. This implies a need for the gradual adaptation of the traditional institutional framework for international relations. That framework was not tailored to the involvement of monetary unions as such, nor to the advent of the Eurosystem - and, more generally, the euro area - as a new actor in international relations. Until now, this process of adaptation has been conducted to a large extent on the basis of ad hoc solutions. In the longer run, however, a more fundamental approach may be needed.

A first challenge arises from the fact that the international intergovernmental organisations - the IMF and the OECD - were created at a time when only national states were responsible for domestic policymaking. As a result, only individual countries - and not the ECB and other representatives of the euro area as such - are members of the IMF and the OECD, even if these organisations deal, among other things, with the euro area monetary and exchange rate policy. Both the IMF and the OECD have adjusted their internal rules to reflect the new context. In particular, the Executive Board of the IMF has granted permanent observer status to the ECB, and the OECD has allowed the ECB to participate in the work of its relevant committees and working groups as a separate member of the European Community delegation alongside the Commission.

A second challenge is the definition of an adequate representation of the euro area in those international fora where both ministers and central bank governors are represented (eg G7 and G20). Here the problem raised by the creation of the euro area was its capability to speak - if and when appropriate - "with one voice". Specific arrangements between the euro area and its counterparts in the various fora have dealt with this problem. These arrangements, however, may still call for some improvement. For instance, it is true that issues such as the architecture of the international monetary system fall primarily under the competence of individual euro area countries. The ECOFIN Council, however, needs to gain an increasingly higher profile when these issues are discussed in the competent fora (eg G7). This would strengthen the European stance and simplify the process for decision-making at the international level. In this respect, the Eurosystem may provide - as I will discuss afterwards - significant value added to euro area governments. More generally speaking, the ECB would welcome any initiative of euro area governments designed to enhance - in compliance with the respective competencies of the ECOFIN Council and the Eurosystem - the credibility and clout of the euro area in the international community.

The content of cooperation: the ECB's assessment of "private sector involvement"

The other major challenge for the ECB and the Eurosystem in the years to come will be to become more directly involved in the process of international cooperation beyond the area of macroeconomic cooperation. This relates, in particular, to current work being done to strengthen the international financial architecture, which is close to the area of traditional competence and expertise of the central banking community. The Eurosystem supports this process for two reasons. *First*, because the achievement of its primary objective of safeguarding price stability in the euro area would be facilitated by a safer and more resilient international financial system. *Second*, because the statute of the Eurosystem establishes that the Eurosystem shall contribute to the smooth conduct of policies relating to the stability of the financial system.

A wide range of topics could be discussed here. However, the interest that the IIF has shown in the recent past in the issue of “private sector involvement” leads me to focus on the ECB’s assessment of ongoing discussions.

Owing to changes in the magnitude and composition of capital flows, the *private sector* is playing an increasingly important role in the financing of emerging market economies. According to recent IIF estimates, in the 1990s 85% of total net inflows of capital to the major borrowing countries came from the private sector. Such inflows averaged USD 170 billion per annum, compared with USD 35 billion per annum in the 1980s. By contrast, net official flows averaged USD 30 billion per annum throughout the 1990s and reached only USD 5 billion in 1999, their lowest level for over 20 years.

Despite these developments, however, in times of financial distress the role of the official sector remains crucial in providing financial assistance to emerging market economies. It is true that informal arrangements are in force in order to facilitate negotiations with the main creditors of the private sector. The so-called “London Club” has become a kind of permanent institution, like the Paris Club for obligations vis-à-vis official creditors. However, the development of new instruments for lending to emerging market economies and the increasing diversification of the creditor base, while facilitating the financing of the countries concerned, render negotiations between debtor countries and their private sector creditors more difficult in the event of a crisis. This explains why, so far, only ad hoc measures have been developed in order to involve private sector creditors - on a case-by-case basis - in the resolution of financial crises.

In addition to enhanced efforts to improve the communication channels between debtor countries and their creditors, which would also enhance crisis prevention, the ECB would support a move to strengthen the existing framework for the management of financial crises. Three fundamental principles may be helpful to this aim.

First, the framework should rely *more on rules and less on discretion* than was the case in the second half of the 1990s. A case-by-case approach, lacking clear “rules of the game” on the respective roles of private and official sectors in times of distress, runs the risk of creating the perception that official resources would provide a “safety net” if need be. Such a perception is likely to distort debt management on the borrowers’ side and risk assessment on the creditors’ side, thus engendering problems of moral hazard on both sides.

Second, the *IMF* cannot - owing to its limited resources which do not match private capital outflows - and should not - owing to moral hazard problems mentioned above - act as an international lender of last resort. IMF financial assistance can neither be unlimited nor cover all the financing needs of a country. The IMF should rather play a catalytic role. IMF conditionality in the form of adjustment programmes should, in conjunction with IMF financing, be instrumental in improving the external position of member countries and quickly restoring market confidence. Actual ceilings on access to IMF financing facilities should also be established.

Third, as a logical consequence of limited official financing, *the private sector should be involved in the resolution of financial crises*. It is a matter of fact that a country running into financial difficulties will need to involve its creditors in one way or another. In this context, the crucial question is how “orderly” such an involvement should be. In their efforts to secure adequate private sector involvement, debtor countries should try to reach market-based and cooperative solutions with all classes of creditors, respecting comparable treatment among and within different classes.

We are convinced that a strengthened framework based on these principles would create the right expectations in both the private sector and the official sector. It would also allow for sufficient flexibility to address specific cases in the course of a crisis.

Conclusions

I shall bring this talk to a close by drawing a few basic conclusions.

In principle, the introduction of the euro should simplify international cooperation by reducing the number of key players in the international arena.

In this new streamlined international setting, the euro area can be expected to play a greater role and to gain a higher profile.

In this respect, the ECB is already a potentially influential participant in the process of international cooperation. At the same time, the ECB is a new player in this process, and its role will therefore evolve over time.