Klaus Liebscher: Global development and stability - the challenge for international institutions

Speech by Dr Klaus Liebscher, Governor of the Austrian National Bank, at the Sozial- und Wirtschaftswissenschaftliche Fakultät der Universität Innsbruck (CSI), Innsbruck, 21 November 2003.

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Ladies and Gentlemen:

The organizers of today's conference have presented me with a formidable challenge. The topic I am to cover is vast, and it is a challenge to delineate the essentials without neglecting the overall picture. As the Governor for the International Monetary Fund (IMF) for the Republic of Austria, let me focus my deliberations on the role especially the IMF plays in fostering global development and stability. This does not imply that other organizations or agencies are less relevant or minor. However, the IMF is tasked with providing the global public good of a stable international financial and monetary system, without which nation states around the world would not enjoy economic growth and rising standards of living.

The main challenge international institutions face today is how to provide the best framework for the governance of globalization such that this process becomes a win-win situation, in which all economies ultimately benefit through productivity and growth effects. This means that a level playing field should govern the international division of labor and the integration of national economies via trade in goods and services to minimize unfair cross-border competition. This also means that there have to be rules which regulate corporate and foreign direct investment as well as financial flows. In the political arena, the United Nations (UN) attempts to deliver global public goods, while the World Bank, the World Trade Organization, the International Labour Organisation, the Bank for International Settlements and the International Monetary Fund are charged with delivering these goods in the economic arena.

I believe that the market is the best coordinating mechanism between free agents. However, there is also no doubt that market forces alone are not sufficient. That is why we need an international regulatory framework for the global community, with recognized and clear rules and with effective institutions. This framework also has to ensure that global public goods such as international financial and monetary stability, a clean environment and free trade are defined and provided, even if this requires nation states to give up part of their sovereignty.

I do not want to imply that international institutions must endeavor to impose a global harmonization of economic and social models. The market economy has many different facets and competition is healthy for the world economy. International institutions help preserve such social and cultural differences by making all countries stakeholders in the global polity. The 1930s have shown that without multilateral cooperation, the lack of national self-responsibility and of international cooperation can have dramatic and devastating effects.

Ladies and Gentlemen:

A recent World Bank[1] study gives clear evidence that opening markets and integrating them into the world economy has contributed to enormous economic progress for many developing countries over the past 20 years. Countries such as Brazil, China, India or Mexico have doubled their ratio of trade to income. Many of these countries have moved up the value chain from mere raw material exports to intermediate and even to finished products and services. The average annual per capita economic growth has increased from 1% in the 1960s to 5% in the 1990s. Real per capita income in China has increased more than fivefold since 1978. Hence on average, the global income distribution has improved rather than deteriorated.[2] Life expectancy, too, has improved: for example in China, it has

[1] Subsequent references to the World Bank refer to "Globalization, Growth and Poverty", A World Bank Policy Research Report, World Bank and Oxford University Press, 2002.

[2] Xavier Sala-i-Martin, The Disturbing "Rise" of Global Income Inequality, NBER Working Paper 8904, April 2002.

increased by nearly 30 years.[3] Hovever, some countries, especially countries in Africa which have not been integrated into the global economy and have not been exposed to globalization, have been left behind.

Dramatic and distressing poverty is still widespread. And I believe that one of the major challenges the international community as well as international institutions face is the eradication of poverty. According to a World Bank classification, nearly 1.2 billion people continue to live in absolute poverty, with incomes of less than USD 1 a day. In many countries, durable economic and social progress remains elusive. In most of these countries, trade has decreased and on average, economic growth has not kept pace with population growth. The situation in Africa is particularly dramatic because it is aggravated by the AIDS pandemic. The fight against global poverty is therefore the greatest challenge for stability and security in the 21st century.

In its fight against poverty the international community is following a strategy based on three interrelated elements:

First, the UN has set a specific objective with the Millennium Development Goals (MDGs) which have identified eight key areas, including for example the halving of absolute poverty or the reduction of child mortality by two thirds by 2015.

Second, the International Conference on Financing for Development held in Monterrey, Mexico in 2002 called for a partnership for development. Industrialized countries offered more comprehensive support while developing countries agreed to greater efforts with respect to good governance and ensuring a better investment climate.

Third, the World Bank and the IMF have formulated the HIPC (Highly Indebted Poor Countries) and PRSP (Poverty Reduction and Strategy Papers) processes as operational vehicles to achieve the MDGs. Both initiatives are encouraging developing countries to develop their own long-term poverty reduction plans in the form of Poverty Reduction Strategy Papers.

Experience[4] over the past decades has shown that especially IMF programs are more successful if these programs are owned by the government and if the support is based on a broad consultation process including government and civil society, who set the priorities for development.

Almost simultaneously with the genesis of the enhanced HIPC, a further basic change in the Fund's approach to low-income countries occurred. A review of the Enhanced Structural Adjustment Facility, ESAF, led the Fund to substantially reframe its role in the low-income countries by launching the PRSP and PRGF (Poverty Reduction and Growth Facility) approaches, making poverty reduction, growth, and a participatory process that enhances ownership the key objectives and modalities for program supported by the Fund's concessional lending. While the PRGF relates strictly to the Fund's role, the HIPC and the PRSP are initiatives that guide all cooperation with developing countries, not only that of the Fund, but also that of the World Bank and increasingly the entire community of donors.

The Fund's role in the developing countries is increasingly becoming an essential and integral part of the efforts of the whole international community to advance development. The HIPC and PRSP are clear examples of such integration and of the coordination of development efforts. They are also novel, given that heavily indebted poor countries must design poverty-reducing strategies in collaboration with their parliaments, subnational entities, business and trade union organizations, and civil organizations representing the poorest members of society.

I also think that much more progress is needed in coordinating multilateral and bilateral support more closely with the poverty reduction strategies and in reducing the administrative burden linked to aid.

Better governance in the poorest countries, and the pursuit of best practices by donor countries under the guidance of the OECD's Development Aid Committee (DAC) could help to reduce these administrative burdens.

Finally, patience and perseverance are needed. Effective poverty reduction requires that the recipient countries receive consistent support from donor countries, international financial institutions (IFIs), and UN organizations to help them pursue the right policies unswervingly for very long periods.

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[3] Angus Maddison, The World Economy: A Millennial Perspective, OECD 2001.

[4] James Boughton, Who's in Charge? Ownership and Conditionality in IMF-Supported Programs, IMF Working Paper WP/03/191.

I believe that if we follow through with the elements I have outlined, developing countries stand a reasonable chance to eradicate poverty. Therefore, I do not think it is productive to constantly start new initiatives to fight poverty, which I also judge to be a sign that the involved parties are not willing to live up to their responsibilities.

Poverty will only be eradicated by economic growth, which also depends on integrating in particular African countries into the world economy and offering them fair and equitable access to markets in developed countries. Trade is one of the best forms of self-help. Therefore, it was very disappointing that the multilateral trade talks in Cancún failed a few weeks ago. However, at the Annual Meetings of the IMF and the World Bank in Dubai, there was a general consensus that the parties have to return to the negotiation table as soon as possible.

Ladies and Gentlemen:

Next to the fight against poverty, I perceive the strengthening of the international financial architecture as a major challenge.

Since the Asian crisis, the international financial system has undergone significant reform. An important outcome of these reforms has been the relative resilience of international financial markets to a series of shocks over the past three years: Owing to the decisive intervention and cooperation of the Federal Reserve System and the Eurosystem, September 11 did not produce a major financial crisis, the synchronised economic slowdown of major industrial countries has not led to any major stress in the financial system, and the financial meltdown in Argentina did not entail any significant contagion except on Uruguay, which proves that financial market agents may be pricing risk better and have become more discriminating without falling into irrational herding behavior.

I see that particular progress has been made on three fronts:

First, the international dialogue has been broadened and has been made more inclusive. The committees of the BIS as well as the creation of the G-20 have enabled emerging market countries (EMCs) as well as developing countries to get involved in the discussion on how to strengthen the international financial system.

Second, the establishment of the Financial Stability Forum in 1999, which brings together high-ranking G-7 officials and market participants, has been an important step to identify gaps and weaknesses in the international financial system.

Third, the IMF with its near universal membership is devoting an increasing amount of resources on crisis prevention. The main element that the IMF has at its disposal is bilateral and multilateral surveillance work, with which it regularly examines the economic developments and policies at the national and international level.

Ladies and Gentlemen:

One can also identify a shift in the crisis prevention strategy the IMF employs. Indeed, mistakes were made in assessing vulnerabilities up to the Asian crises. But now the IMF is concentrating on identifying vulnerabilities such as excessive sovereign debt or balance sheet mismatches. Also, its stance on capital account liberalization has changed. Now the IMF advocates that member countries should first have the institutional capacity and a relatively strong financial sector with a good supervision before taking this major step of liberalization. IMF members are advised to move to flexible exchange rates as a shock absorber as well as to implement fiscal policies that permit cyclical behavior in the case of a crisis. One important initiative is the Financial Sector Assessment Programs (FSAP) which are conducted together with the World Bank. An FSAP draws up profiles of the strengths and weaknesses of a financial sector of a country. This initiative is not only geared towards EMCs or developing countries, but also towards industrial countries. Austria, for example, is currently conducting an FSAP.

Another key area is economic and financial standards and codes, which are formulated in collaboration with public and private sector institutions. The aim of such standards is to promote meaningful comparable statistics, transparency rules for fiscal and monetary policies and supervisory standards for the banking, securities and insurance sectors. The idea behind this is to facilitate the integration of countries into the global economy.

Will all of these initiatives prevent financial crises from occurring? Overshooting and correction will always be part of financial markets. This means that in an open and dynamic market economy there are limits to our capacity to anticipate and prevent crises. With skillful and prudent economic, monetary and financial policies, however, crises should be rarer and less severe.

An important initiative which the IMF started to discuss in 2001 proposed the establishment of an international bankruptcy procedure for unsustainable sovereign debt. However, the time may not have been right yet to establish such a comprehensive framework for the restructuring of sovereign debt. Nevertheless, public and academic awareness has been raised; the debate has helped prompt many EMCs to introduce Collective Action Clauses (CACs) in their sovereign bond contracts, as the EU, Canada and Switzerland have. Also, this awareness has induced the Paris Club to change its debt restructuring procedures for insolvent countries. Nevertheless, I am still firmly convinced that we need an international treaty which would facilitate the orderly resolution of sovereign debt crises.

Ladies and Gentlemen:

I have the impression that very often, the strong track record the IMF as well as the World Bank have established in transition countries is overlooked. At the beginning of the 1990s, all of those countries, apart from Slovenia, had some form of IMF involvement via a fully fledged IMF program or technical assistance. The IMF together with the World Bank and the country authorities concerned have worked hard to stabilize the economies of those countries, devise economic policies and build up modern institutions. The Bretton Woods Institutions have thus successfully contributed to transforming these economies into today’s very successful market economies. We have also contributed to this effort by setting up the Joint Vienna Institute together with the IMF, which has trained many officials from these countries.

Their successful work in that area has also helped pave the way for the inclusion of many of these countries into the European Union, while for other transition economies the EU represents an anchor of stability. The Bretton Woods Institutions supported by the EU will help them to successfully graduate from the status of transition economies to that of modern market economies.

Ladies and Gentlemen:

With my remarks, I have only been able to scratch the surface of the problems involved. At the moment, I see a certain tendency in some parts of the world to turn back the hands of time. I believe that instead, we must look ahead and work to find global solutions to global problems, solutions that are both practical and that garner sufficient support. While they are not without flaws, international institutions contribute to making the global economy more stable and to promoting economic growth.