Rodrigo de Rato: The IMF in a changing world (keynote address)

Keynote address by Mr Rodrigo de Rato, Managing Director of the International Monetary Fund, at the Joint IMF-Bundesbank Symposium "The IMF in a changing world", Frankfurt, 8 June 2005.

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Thank you, Mr. Stark, for that opening and introduction. Good morning – It is a great pleasure to be here today among this impressive gathering of experts from many countries. Let me first thank the German authorities for graciously hosting this conference. Their organization of this event is much appreciated.

As you know, the IMF was established about 60 years ago. The world economy has witnessed dramatic changes since that time. For instance, our membership has grown four-fold, from around 40 to 184. The world's financial landscape has also been dramatically altered by the rise of private international capital flows. Throughout the changes of the last six decades, the IMF has continually evolved to meet the needs of its members and the international economic system. It is in that spirit of evolution and renewal that we meet today to discuss issues related to the international monetary system, financial stability and, more broadly, the IMF's role in the world economy.

My remarks this morning may be conveniently divided into three sections:

- The origins of the IMF, addressing its purposes, objectives, and mandates.
- Main changes to the IMF since its establishment, and the reasons for those changes.
- Some thoughts on the future role of the IMF in the international monetary system.

In going through these subjects, it is my hope that the developments and ideas in each section will provide useful context for your panel discussions later today.

The IMF and its origins

We live today in a highly globalized and integrated world. However, some analysts may suggest that the global economy was actually more integrated at the end of the 19th century than it is now. In the first half of the 20th century, nationalism and protectionism disrupted this integration, setting off the Great Depression and contributing to World War II. The IMF – and the World Bank, its sister institution – were established to restore an open system of trade and finance, help countries rebuild from the war and, in the process, hopefully build a new era of world peace and prosperity.

Against that background, a key part of the IMF's mandate today is the promotion and maintenance of monetary and financial stability, both in individual countries and at the international level. Stability is the foundation for sustained economic growth, and crisis prevention and resolution is an integral part of our work. The IMF discharges this mandate in a variety of ways, including the following. First, it provides the framework and mechanisms for international economic cooperation. With increasing integration in the world economy, the importance of this aspect cannot be overstated. Second, it helps countries design macroeconomic policies that achieve and maintain high levels of employment and income. The promotion of open economies and trade is a key element of these policies. Third, the IMF helps in the orderly correction of a country's balance of payments problems by providing temporary financing.

The ways in which we carry out our operations are also unique in several respects. Broadly-speaking, these may be divided into three categories of activities:

- **Surveillance** – This involves the monitoring of economic and financial conditions, both at the global level and in individual countries. For the IMF, surveillance is a central instrument for maintaining monetary and financial stability. By obliging each IMF member to engage in a regular consultation with us on its economic policies, the surveillance process also explicitly recognizes the role that all countries play in maintaining global stability.
- **Lending** – Our financing role is focused in assisting members with balance of payments adjustments. Through the temporary provision of funds, IMF lending gives members breathing room to implement policy measures to overcome underlying economic problems.

For the poorest countries, financing may be provided on concessional terms, and with longer maturities. The availability of IMF funds to assist in economic adjustment gives confidence to members and the international system as a whole, since it lowers the incentive for countries to take adjustment measures which are damaging to the national and international economies.

- **Technical Assistance** – Technical advice and assistance is provided to member countries in areas of the IMF's expertise, primarily in macroeconomic and financial policymaking. By helping to build institutional and human capacity for the making of sound economic policies, IMF technical assistance contributes to the building of strong economies and stable growth.

The IMF's purposes, and its operational activities, were therefore designed with a key objective in mind – that is, the fostering of healthy national economies, linked by finance and trade, as the foundation for a robust global economic system. I think it correct to say that this vision for international peace and stability has produced remarkable results, for the past fifty years have been a period of growing economic prosperity and freedom. Global per capita income has more than tripled, and most of the world has experienced major improvements in literacy and life expectancy. Among the biggest gainers have been the developing nations, home to half of the world's population. Many of them have been quick to take advantage of the opportunities afforded by the global economy, especially during the last two decades. These countries – whose ranks include Brazil, Chile, China, India, Korea, and Mexico – were able to double their share in world trade, raise per capita incomes, and lift millions out of poverty. Their experience demonstrates that integration into the global economy can bring major benefits.

The IMF's evolution

The world has witnessed many changes and developments – in technology, politics, culture, as well as economics – over the years, and the IMF has adapted itself accordingly. At the time of IMF's establishment, our economic policy advice focused mainly on helping members to shape sound macroeconomic and financial policies, within the disciplines of the Bretton Woods system of fixed exchange rates. The breakdown of that system in the early 1970s, and the resultant Second Amendment of the IMF's Articles of Agreement, led to a re-orientation of the IMF's functions. In particular, the revision of Article IV, and the introduction of the surveillance process, explicitly recognized the close relationship between domestic economic policies and international stability. To this day, this forms the basis for our systematic and comprehensive review of economic conditions and policies in each member country.

Similarly, the wave of de-colonization that swept the world from the 1950s onwards placed new and complex responsibilities on the Fund. The IMF quickly found that countries looked to it for advice and assistance beyond the traditional macroeconomic areas of fiscal policy, monetary policy, and exchange rate systems. In addition to these subjects, IMF advice and assistance were also sought on establishing the institutions of monetary and fiscal policy, and on supply-side structural policies to help promote sustained growth. In the last fifteen years, following the end of the Cold War, new challenges were created in this regard by the transition of former centrally-planned economies to market-based systems. Through our work in these areas, it also became increasingly clear that structural and institutional issues were important for stability and growth in other member countries too, including the major industrial economies.

The area of IMF financing has also seen great transformation. For example, although IMF lending continues to be targeted at short-term balance of payments needs, our financing instruments have, for nearly two decades, included concessional lending for low-income countries. In response to the rapid development of international capital markets as a major source of financing for countries, special IMF financing policies have also been put in place to assist countries facing capitalaccount driven crises. Related to these capital market developments, the Fund also began to play an unanticipated role in facilitating the resolution of sovereign debt problems. This function became critically important following the emergence of the debt crisis in 1982, and it remains so today.

All of these changes – ranging from de-colonization and transition, to the rapid development of private international capital flows and new instruments, to the emergence of capital-account driven crises – posed new challenges for the IMF. In many cases, these developments touched upon issues which lay at the frontiers of economic knowledge and research. Addressing them has led to a significant transformation of the Fund, including a broadening of the skills mix of Fund staff, greater dialogue with private financial sectors, and more involvement in institutional development in member countries. In the process, the IMF has also become a more open and transparent institution.

Meeting the needs of the future

To continue to serve the interests of our member countries and the international community at large, the IMF has to be in a position to deal with the influences that are expected to shape the global economy in the coming years. We must not remain static, nor must we change only in a reactive manner when forced to. For that reason, I have initiated an examination of the Fund's medium-term strategic direction. We hope to use this opportunity to explore a variety of issues and their implications for the work of the IMF. These include matters like global financial flows, regional integration, efforts to reduce poverty, and questions concerning global governance, transparency, and accountability.

We are still in the early stages of the review, and there have been many preliminary ideas floated and discussed. At this juncture, it is important for all of us to remain flexible and open-minded, particularly to views and opinions from outside the IMF. However, there is a sense that the continuing evolution of the Fund must remain grounded in the institution's key areas of responsibility, as specified in our Articles of Agreement – that is, to facilitate international monetary cooperation, to foster a liberal system of international trade and payments, and to promote macroeconomic and financial stability, as a condition for sustained growth. As we ponder how best to meet the challenges of the future, there appears a strong case that the IMF should remain anchored to its core macroeconomic and financial areas of mandate and expertise.

The Fund's governing organs – including our Executive Board and the International Monetary and Financial Committee (IMFC) – are already actively engaged in this review. They have had various occasions to consider this matter, and I would like to use this opportunity to present some of the key ideas that have emerged in discussion, in the following five areas: surveillance, financial sector and capital markets work, Fund financing and lending, our assistance to low-income countries, and internal management and governance.

First, on surveillance, both the IMF's Executive Board and the IMFC share my vision that a central task of the Fund lies in a stronger and better-focused surveillance process. IMF surveillance provides the foundation for cooperation among our members in the promotion of stability and growth in the global economy. With increased trade and financial linkages among nations, and strong connections between economic performance, poverty, and security issues, such cooperation to address shared problems is now more important than ever. For instance, the IMF has repeatedly pointed to the need to address current global imbalances, so as to reinforce the basis for more balanced and sustainable global growth. The existing relatively benign global outlook provides an excellent window of opportunity to do that, and the IMF serves as a ready vehicle through which to cooperate on the necessary actions.

With respect to individual countries, we should continue working to strengthen the bilateral surveillance process. While focused on the country at hand, it would be important that bilateral surveillance be fully-informed by regional and global perspectives as well. Systemically important countries will clearly continue to deserve special attention. Operationally, our respective country teams will remain the focal points for our activities in individual members. At the same time, country teams will continue to draw upon specialized expertise where necessary, from both inside and outside of the Fund. To maintain overall coherence, it would be important for efforts to continue in the integration and sharing of information among country teams and specialized experts.

Second, our work in financial sectors and capital markets. The IMF is the one international organization capable of carrying out financial sector surveillance universally and comprehensively. Further efforts will be needed to realize this potential, not least by deepening the IMF's role in anticipating sources of instability in national and global financial markets, and in generating timely action to address them. The IMF will continue to help countries strengthen their financial sectors, including in following up on the findings of the Financial Sector Assessment Program (FSAP) exercises. One important aspect of this will be to help members adapt their prudential and administrative frameworks to benefit more from private capital flows.

As national financial sectors become increasingly integrated and interdependent, another top priority for us must be to strengthen our understanding of the factors that drive global capital asset allocation, and the reasons for capital flows across sectors and national borders. Early identification and assessment of capital flows will help us evaluate vulnerabilities in a timely manner, as well as enhance countries' ability to address them. The effectiveness of our bilateral and multilateral surveillance activities will also be strengthened as a result. For members who wish to access international capital markets and integrate their economies more fully into the global financial system, we can provide advice on the appropriate sequencing of measures, such as how to strengthen their financial sectors and reduce their vulnerability to shocks as preparatory steps.

Third, IMF financing and lending. The Fund's traditional role of providing financing to help smooth the adjustment of temporary current-account imbalances remains vital for many countries. For others, our main task is to help prevent, or mitigate, capital account crises and their cross-border contagion effects. To succeed in these roles, the IMF must be able to exercise selectivity in supporting only those adjustment programs that will put the relevant members firmly on the path to external viability. The existence of robust domestic institutional frameworks, and strong national ownership of programs, would be key. Building on these principles, we will continue working towards a clearer consensus on the appropriate circumstances and scale for IMF lending, the possible need for additional financial instruments, and the adequacy of the present framework for the orderly resolution of sovereign debt problems.

Fourth, the Fund's role in low-income countries. Low-income countries present the international community with some profound challenges. Over a billion people live on less than a dollar a day, and hundreds of millions are affected by disease. Addressing the HIV/AIDS pandemic, in particular, will be critical for growth and poverty reduction in many developing countries. Achieving durable economic growth in these countries – which is essential for lasting poverty reduction and reaching the Millennium Development Goals – will therefore require a strong social framework as well as sound economic policies. On our part, the IMF can help countries put in place policies and systems to effectively manage the increased and large inflows of aid that could be forthcoming in response to the HIV/AIDs crisis.

Importantly, lasting poverty reduction can only be achieved with stable and sustained growth. The IMF, with our mandate in promoting economic stability, can help countries to put in place strong macroeconomic frameworks that will lead to economic expansion and debt sustainability. As in everything else that we do, we must ensure that our assistance to low-income countries continues to fit their particular needs and circumstances. Some issues which may warrant closer examination include:

- Ensuring that resources in the Poverty Reduction and Growth Facility – our main lending instrument for developing countries – remain adequate to meet future demands;
- New ways to help low-income countries deal with economic shocks;
- In the case of low-income countries which do not need or want IMF lending, how to enhance the IMF's role in signaling to others the strength of these countries' policies;
- The role of the Fund in supporting low-income countries' poverty reduction strategies; and
- Our relationship with donors and aid agencies.

As a partner of the 2002 Monterrey Consensus, the IMF is committed to supporting countries in their efforts to reduce poverty and reach the Millennium Development Goals. Our unique position gives us the potential to contribute to building both pillars of the Monterrey Consensus. On one side, we can work with countries to design policies and build institutions that will help them grow out of poverty. On the other, we can advocate for more and better international support, and help with its coordination. Nevertheless, examining the issues highlighted earlier will help frame a better understanding of the areas of low-income country work for which the IMF can take responsibility, and those that will fall to other institutions and actors. It would be helpful to have greater definition in this area as we approach the U.N. Millennium Summit in September.

Fifth, the IMF's internal governance and management. To maintain the IMF's effectiveness, it is essential for our membership to resolve the difficult issues that have been raised about our own governance – notably, the voice and participation of emerging market economies and developing countries in our institution. All members countries should have adequate voice and participation in the IMF's decision-making, and the distribution of our quotas should reflect developments in the global economy. In this connection, the ongoing 13th general review of IMF quotas provides an opportunity to make progress on this front.

Further, given the demands placed on the IMF by its members, it is clear that the institution's resources must be commensurate with the tasks it is asked to perform. This ongoing strategic review will help us to identify needs, define priorities, and consider possibilities to redeploy resources from lower-priority areas. Regardless of the outcome, IMF management, and our Executive Board, are committed to making the most effective use of resources entrusted to them by our membership. Efforts must therefore continue in the search for greater efficiency gains. One important aspect of this concerns the cooperation and division of labor between the IMF, the World Bank, and other international organizations. This is an issue which may bear revisiting, and I am very much looking forward to working with President Wolfowitz, and to learning his views and vision for the Bank.

Conclusion

This conference's organizers have put together an excellent program that addresses many of the points I have touched upon – from international financial stability, to capital market integration, to financial crisis resolution, to IMF governance. In these and other areas, work is underway on a medium-term strategy that will guide the IMF's priorities and decision-making over the next few years. Your discussions will therefore provide valuable insights for that medium-term strategy, which we hope to finalize by the time of the 2005 Annual Meetings in September. Subsequently, I anticipate that the debate on longer-term issues, relating for instance to global governance and the future structure of the international monetary system, will continue, both within and outside the Fund. I look forward to your contributions to that debate as well.

Thank you once again for your presence and participation in this symposium. As we consider how the IMF can best serve its membership and the world, it is indeed a great privilege to be able to tap into your wealth of experience and knowledge on some of the issues that lie at the heart of our institution's mandate.