# Address to the
# Board of Governors

# Horst Köhler

**Managing Director**
**International Monetary Fund**

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WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
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Chairman of the Executive Board and
Managing Director of the International Monetary Fund,
to the Board of Governors of the Fund

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Mr. Chairman, Governors, ladies and gentlemen: it is with great pleasure that I join in welcoming you, on behalf of the IMF, to the 2000 Annual Meetings. We are privileged today to have President Havel with us. I would like to express my gratitude to him, to the government and people of the Czech Republic, and to the citizens of the beautiful and historic city of Prague, for their warm hospitality as hosts of these meetings.

This Annual Meeting takes place at the end of a decade of transition and at the turn of the millennium. As we heard from President Havel, Prague has always been a center of creative encounters and spiritual development. Even in the darkest hours of its history, this city never lost its dignity. It was here, too, that—inspired by Václav Havel—freedom and democracy threw off their chains. This is a place from which hope and new perspective originate. I could not have wished for a better location for an Annual Meeting at the beginning of the new millennium, and for my first Annual Meeting.

Governors, I am deeply honored by your trust and support in appointing me as Managing Director of the IMF. Your words of encouragement during these meetings have been overwhelming and I thank you for that. Since joining the IMF five months ago, I have come to appreciate its great strengths—the professionalism and dedication of the staff and my management colleagues; the depth and quality of discussions in the Executive Board; and the trust that is placed in the IMF by its membership. And I greatly appreciate the spirit of close partnership I have experienced during these past months in working with Jim Wolfensohn and his colleagues at the World Bank.

I pay tribute to my predecessor Michel Camdessus who led the Fund with skill and compassion over a long and often difficult time. Throughout his tenure Michel Camdessus adapted the Fund to new developments, and I want to build on his accomplishments. I would also like to thank Stan Fischer for his outstanding job in leading the Fund as Acting Managing Director during the interregnum period.

Mr. Chairman, I see two major challenges to which the membership of the IMF must respond:

First: international private capital flows have become a major source of growth, productivity and job creation. But they can also be a source of volatility and crisis. The crises of 1997/98 have heightened the awareness that the stability of the international financial system is an important international public good.

Second: ten years after the end of the Cold War, there are more opportunities than ever to promote a better world. Ideological divides have faded, and new technologies and the expansion of the market place have opened new horizons for shared prosperity. But at the beginning of the new millennium we are also aware of huge unsolved problems. The most pressing of these is poverty which is becoming a major threat for political stability in the world.

In search of answers to these challenges, I would like to begin with a reflection by the philosopher Karl Popper, who wrote in 1991: "The open future contains unforeseeable and morally quite different possibilities. So our basic attitude should not be 'What will happen?' but 'What should we do to make the world a little better?'." Karl Popper also said: "All life is problem solving." This, if I may say so, is also my approach and how I see my role as Managing Director of the IMF.

In my vision the IMF should:

- strive to promote sustained non-inflationary economic growth that benefits all people of the world;
- be the center of competence for the stability of the international financial system;
- work in a complementary fashion with other institutions established to safeguard global public goods; and
- be an open institution, learning from experience and dialogue, and adapting continuously to changing circumstances.

In this vision, I see the IMF as an active part of the workforce to make globalization work for the benefit of all. This vision builds on an enhanced partnership with the World Bank, based on a clear sense of the complementarities of our two institutions which Jim Wolfensohn and I have outlined in a recent statement to our Boards and staffs.

And it is with humility that I welcome President Havel's reminder to us to reflect about the broader dimension of the task to make globalization work for the benefit of all: to search for new sources of a sense of responsibility for the world. I fully share his appeal that we need universally shared moral standards. Indeed, a global economy needs a global ethic (Hans Küng).

I am aware of the critical debate about globalization, and many questions raised have to be of concern to all of us. But I also want to be clear: if the IMF did not exist already, this would be the time to invent it. More than ever, globalization requires cooperation, and it requires institutions which organize this cooperation. Its 182 members make the IMF a truly global institution and the cooperative nature of this institution is an invaluable asset. We should all seek to preserve and strengthen this asset. Strengthening it requires trust in cooperation. That means:

- trust that the interests of all members are taken into account and, equally,

- trust that each member lives up to its own responsibilities.

This means that members need to listen to each other, and that the Fund should see itself as a partner to its members and as a provider of help for self-help. And it means that the Fund's mandate is directed to promoting the international common good.

With this in mind I felt it very important to use a good part of my first months in office to visit a wide range of member countries, especially in Latin America, Asia, and Africa. My impression from these visits is:

- First: private initiative and democracy are spreading throughout the world. A fair judgement of the IMF should acknowledge that the Fund has contributed to this positive fundamental trend in the world.

- Second: overall, there is broad recognition within developing and emerging market countries that there are often serious homemade problems, including poor governance, corruption, and armed conflicts. And that the main responsibility for tackling these problems lies with the countries themselves.

- Third: I heard a lot of critical comments about the IMF. There is obviously a need for further change. But, on the whole, I was left in no doubt that the emerging market and developing countries value the Fund and that they strongly wish to continue working with it.

Economic growth is not everything, but without growth we get nowhere. Growth requires innovation, adaptation, and reform as permanent features of societies. To a remarkable extent—and notwithstanding severe strains and hardships—developing countries and transition countries have embraced this challenge. But this process cannot be understood as a one-way street. Many industrial countries have not yet developed enough of a sense of urgency to deliver their part of structural change to make globalization work for all. This includes, crucially, that industrial countries recognize that it is both in their own interest and in the interest of the global economy to take a strong lead in opening their markets. It also includes the necessary awareness of the importance of balanced exchange rate relations between the major currencies. I welcome the action taken by the European Central Bank (ECB), together with other major central banks, to bring the Euro better in line with the fundamentals of the European economy. This action also demonstrates the institutional maturity of the ECB.

I do think that the mandate of the IMF demands that the Fund speaks up on both exchange rate and trade issues, which are relevant for stability and growth in the global economy. Estimates of the potential welfare gains for developing countries from a 50 percent worldwide reduction in barriers to trade generally exceed US$100 billion per year! This drives home the point that greater access to industrialized country markets is key in the fight against poverty. A few months ago, the United States expanded duty-free access to its markets for more than 70 countries in Africa, Central America, and the Caribbean Basin. Just recently the European Commission made a proposal to fully open Europe's markets to the 48 poorest countries for "all but arms". I welcome these initiatives and urge further bold steps, particularly in the area of agriculture.

I am convinced: if the willingness of the developing and emerging market countries to tackle energetically their homemade problems would be combined with more determination in the industrial countries to reform and open their markets, we will create a win-win situation for all and thus make the objective of the United Nations of halving the share of people living in poverty by 2015 achievable.

To strengthen its efficiency and legitimacy, the Fund needs to refocus. The Fund's focus must clearly be to promote macroeconomic stability as an essential condition for sustained growth. To pursue this objective, the Fund has to concentrate on fostering sound monetary, fiscal, and exchange rate policies, along with their institutional underpinnings and closely related structural reforms. And more important than ever in the modern economy is the IMF's mandate to oversee the international monetary system and to ensure its effective operation. This virtually obliges the Fund to give particular attention to systemic issues of financial markets, both domestic and international.

To fulfill this task effectively requires the Fund to gain a better understanding and judgment of the dynamics of international capital markets and the operations of private financial intermediaries. In this context I have established a Capital Markets Consultative Group in the IMF to foster a regular dialogue with the private sector. The dialogue in this group will also be an important element of our efforts to avoid crises. With the buildup of further expertise, the Fund should quite naturally assume a coordinating role among the various agencies and fora dealing with financial markets issues.

My ambition is not to have more and more lending programs but to place crisis prevention and thus surveillance at the center of the Fund's activities. For this, we must develop a culture in the Fund where member countries are eager to seek the Fund's advice early and voluntarily. In our bilateral surveillance we need to place particular emphasis on identifying sources of external and financial sector vulnerability and on helping our member countries cope with volatility in international capital flows. The Fund should further develop its multilateral surveillance with a focus on the early identification of systemic issues and risks, particularly in global financial markets. We should also pay increased attention in our policy advice to issues of regional integration, including through regional surveillance. In its advice the Fund should show respect for the cultural and historical traditions of its member countries, and should not lecture. But, at the same time, it must be candid in conveying its professional analysis and judgement to member countries.

The International Monetary and Financial Committee (IMFC) has launched a wide range of measures to strengthen the global financial architecture, particularly through improved data transparency, standards and codes, vulnerability assessments, and the Financial Sector Assessment Program (FSAP), a joint initiative of the IMF and the World Bank. Taking stock today, we can state that the international financial system is stronger now than before the outbreak of the Asian crisis. But we should beware of complacency. Financial sectors in many countries are not yet as robust as they need to be, and there is a risk that the high growth rates could weaken the momentum of reform. All members have to ask themselves how they can accelerate the implementation of these reforms. I think it is in the interest of all that the entire membership be fully involved and take full ownership of the initiatives in this area.

In the Fund's work program it is now time to prioritize and concentrate on implementation. We need to concentrate in particular on expanding the Financial

Sector Assessment Program. This program is a systematic and comprehensive approach to fostering a sound and integrated international financial system. It will benefit countries seeking access to capital markets and professional advice in this process. I especially urge countries that are already integrated into global capital markets and therefore more subject to market volatilities to volunteer their participation.

I am very much aware of objective difficulties emerging market and developing countries can have in their capacity to implement the various standards and codes developed by the international community. We need to prioritize our work, taking better account of the stage of development of domestic financial sectors. And, we need to establish clearer priorities for our technical assistance and help make sure that technical assistance is better coordinated amongst the various providers.

A Fund focused on promoting the stability of the international financial system has to be pointed and rigorous in its assessment of the appropriateness of exchange rate arrangements in member countries. We also need to be able to reach clear conclusions about the right balance and sequencing between capital account liberalization and financial sector development. And I do think that the Fund has to be more proactive in the discussion about the issue of the appropriate regulation and supervision of international financial markets. Here, I also see a particular need for further research and analysis in the Fund.

My discussions with private sector participants, including in the Capital Markets Consultative Group, have confirmed that the crisis-prevention work of the IMF and the efforts to strengthen the global financial architecture will bear fruit. However, we have to be aware that crises can occur again in an open and dynamic global economy. Our work should make crises less frequent and less severe. And we should promote financial sectors that are able to absorb shocks. This means we should work to foster competition in the financial sector and diversity among financial intermediaries. It also means that private financial institutions acting in the global market place have to continuously strengthen their capacity to assess and manage risk.

For crisis resolution, the Fund needs to have efficient lending instruments and adequate resources to mount a credible response to crises. But its resources are limited and thus the Fund cannot be seen as a lender of last resort. Therefore, it was important to conduct a comprehensive review of IMF facilities. The outcome clearly strengthens the catalytic role of the Fund and the revolving character of its resources. It demonstrates that the cooperative nature of the Fund is solidly rooted in its membership. With the set of differentiated, but streamlined and sharpened, facilities the IMF is now better equipped to deal with crises and prevent contagion.

There has been considerable progress in developing a framework for involving the private sector in the resolution of crises. The rapid return of private capital to a number of crisis countries underscores that it makes sense to engage constructively with the private sector, both in the prevention and resolution of crises. Private investors know that they must assume full responsibility for the risks they take. There is broad agreement that the operational framework for private sector involvement should rely as much as possible on market-oriented solutions and on voluntary approaches. It is also undisputed that there may be exceptionally difficult cases that call for more concerted approaches to involve the private sector, including the possibility of standstills as a truly last resort. Judgement will always be a crucial element. Thus a rules-based approach needs flexibility and the use of discretion in a case-by-case approach certainly needs to be constrained. We need to explore the middle ground between these approaches further, to make the framework operational. This requires further research and analysis, to enable us better to assess the risks of possible spillover effects on other countries and gain a clearer understanding of the factors that determine how fast a country regains market access.

We need to stick to conditionality in our lending operations but at the same time work to enhance real ownership of programs. We have learned that the effectiveness of members in confronting their economic difficulties depends critically on the vigorous implementation of appropriate stabilization and reform measures. This comes only when the country's authorities are seeking to implement measures that they see as responsive to their needs and capable of securing domestic support. Therefore, I trust that ownership is promoted when the Fund's conditionality focuses in content and timing predominantly on what is crucial for the achievement of macroeconomic stability and growth. Less can be more if it helps to break the ground for a sustained process of adjustment and reform. Moreover, program design must take into account the social dimensions of adjustment programs and the unique characteristics of each country. To foster ownership, the Fund should also explore alternative policy options in program discussions with member countries. This approach to strengthen ownership and streamline IMF conditionality will have to be well coordinated with the World Bank. In this context, I welcome and support the Poverty Reduction and Support Credit which the Bank is planning to introduce, and see it as holding promise for increasing the effectiveness of our joint work in the poorer member countries.

I consider the Poverty Reduction and Growth Facility (PRGF) to be an innovative instrument in the Fund's efforts to make globalization work for the benefit of all. First, because it aims at tackling poverty from its root causes; and second, because its concessional character demonstrates practical solidarity with the poor.

Disengagement from the poor countries would be inconsistent with the mandate of the Fund and it would also deepen the division of the world. It would run counter to the ambitions of the people in the poor countries and neglect their talents and potential. The contrary is necessary: namely, encouragement and empowerment.

The PRGF is also a key vehicle to help make the HIPC initiative a success. In no area is cooperation between the Bank and the Fund in the coming months more critical than here. Jim Wolfensohn and I are determined to bring the benefits of debt relief under the HIPC initiative to as many countries as possible as rapidly as possible. The ultimate test of the success of this initiative is how effectively debt relief contributes toward poverty reduction. I trust that the leaders of the poor countries themselves fully recognize the importance of sound policies and good governance.

Especially during my visit to Africa, I sensed a lot of bitterness about unfulfilled promises regarding official development assistance (ODA). And, indeed, the promise by OECD member countries was to provide ODA equivalent to 0.7 percent of their GDP. Today the average ratio is 0.24 percent. The difference between promise and delivery in U.S. dollar terms is US$100 billion a year. I do think that governments in the rich countries must seek more actively to galvanize public opinion in support of ODA. No doubt they will be helped in this regard if there is clear evidence from the aid-receiving countries that aid is used effectively to reduce poverty.

A real breakthrough in poverty reduction will be possible only if private saving and investment take firm roots in these countries and if a much larger part of the savings generated in the world becomes available to them. In this context, credit is and will remain an important financing instrument for investment and is thus also crucial in any longer-term strategy to fight poverty. Therefore, we must not lose sight of the need to preserve and build a sound credit culture. Credit is derived from the Latin word *credere*. *Credere* means trust. And trust in creditor/debtor relations is indispensable for a sustained flow of investment capital to the developing countries and—in a wider context—for the long-term stability of an integrated international financial system. This highlights even more the need for steady work on the ground to strengthen the institutional underpinnings for a productive private sector in the developing countries. Every day that passes unused for this work is a lost day in the fight against poverty.

Here lies for me the main logic in the joint work of the IMF and the World Bank to promote the formulation of poverty reduction and growth strategies in a broad-based participatory process. For me globalization requires, not least, building problem-solving capacity at the local and regional level and to give people <u>there</u> help for self-help. A very practical measure for this could be to bring more systematically together private investors, officials, and international financial institutions (IFIs) to discuss practical issues of the local investment climate. Help for self-help could be further enhanced by fostering regional integration and business cooperation in developing countries. Jim Wolfensohn and I intend to demonstrate our commitment to Africa in a joint visit in the near future.

The oil price hike is a particular setback for the poorest countries. In our multilateral surveillance discussion there was a clear common understanding that the current, excessively high oil price is neither in the interest of oil-consuming countries nor in that of the oil-producing countries. I trust that the dialogue between oil producers and consumers will bear fruit. On the whole, I remain optimistic about the prospects for the world economy. We know that there are significant risks. We discussed these in the IMFC and agreed that, with the appropriate policy management, these risks should not materialize.

Mr. Chairman, the IMF of the future should be a strong advocate of improved governance in all member countries. It is, therefore, only logical that the Fund itself has to be receptive to calls for increased transparency and accountability. There has already been a sea change in opening up to the public. And we have just decided to expand further our program of voluntary publication of country reports and staff assessments. Moreover, the Executive Board has now paved the way for making an Independent Evaluation Office in the IMF operational. However, we also have to recognize that there are areas where a frank and candid discussion would be hampered if it had to take place in public. The Fund has to strike a balance between openness and the member's desire for candid and confidential advice. And the Fund must explain itself better—what it is and what it does—particularly in program countries. Thus, the IMF has to expand its dialogue with the public and reach out, not least to civil society at the regional and local level. However, this must not lead to a blurring of responsibilities. Ultimately, the Fund is accountable to the governments of its member countries.

Let me conclude by saying: I sincerely hope that you can join me in the future work of the IMF based on the vision I have just outlined. The IMF can make a difference for long-term growth to benefit all people of the world. For this we have to be focused and concentrate, above all, on the stability of the international financial system. We will benefit from the enhanced partnership with the World Bank and cooperate closely with other institutions.

I see the discussion on changes in the IMF as a permanent process and consider it very important that these further discussions have their center within the Fund itself. I know that staff, management and the Executive Board are deeply committed to the Fund's mandate and want to give their best. I call on the membership of the IMF to make good use of this dedication and work with the Fund in a new spirit of global partnership.