



**Edited Transcript of
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The contagion shaking world financial markets has raised fundamental questions about the stability of the global economy, and the system put in place after World War II to ensure that stability. With those questions, has come criticism of the multilateral institutions charged with overseeing the world economy. Of course, the IMF has felt the brunt of that criticism, some of which is justified, but a great deal of which has been wide of the mark. There is even serious discussion in some quarters about shutting down the IMF altogether and letting the world fend for itself. So what I would like to do today is to address all of these closely related issues--the global system, the multilateral institutions, and the questions about the role and future of the IMF.

First, I would like to make the case that the IMF has a charter, which it has stuck to, and it is a charter that justifies an organization like the IMF continuing. Second, I want to talk a little bit about reform of the system and the IMF. And third, I'd like to comment on a few very important points that go to the heart of the Fund's purpose, and its goals.

The purposes of the IMF were set out in its Articles of Agreement. These were drawn up in 1944 and 1945, and the core purposes have not changed despite the many changes the global economy has experienced.

What is the IMF supposed to do? Let me go through our main purposes as set out in the Articles of Agreement.

Purpose Number One: "To promote international monetary cooperation, through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems." That the IMF does. It is the organization through which its member countries--and there are now 182 of them--get things done related to the international economy. This is true whether it was introducing the Brady Plan to deal with the developing country debt problem in the late 1980s; whether it is trying to improve banking standards internationally; whether it is coordinating the international assistance to Bosnia and Herzegovina; whether it is overseeing the effort by the rest of the world to assist Russia. All those things get done through the IMF.

As the current discussion on reforming the international system proceeds, it too will end up in the IMF to do the analysis and to implement many of the changes.

Purpose Number Two: "To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income." Since the beginning, the IMF has encouraged trade liberalization in its lending operations to countries, in its annual consultations with them. It has pushed constantly for trade liberalization and for the removal of restrictions on currency transactions. That has been successful. It is in large part the reason why the world economy in the last fifty years has done better than in any previous half century of history. And it is a function that it is critical for us to maintain. We face risks now of reversals, with regard to international trade and with regard to capital flows. We must maintain this institution that has the mandate and the mission and the means to help countries maintain open trade.

Purpose Number Three: "To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciations." This purpose is included because of the disasters of the 1930s, where all those things were absent. This is a purpose we have pursued--sometimes more successfully, sometimes less successfully--as when there have been major depreciations and collapses of currencies in Russia and Indonesia recently.

Purpose Number Four: "To assist in the establishment of a multilateral system of payments in respect of current transactions... and in the elimination of foreign exchange restrictions which hamper the growth of world trade." This is the other side of the coin of the promotion of trade in the world economy since the end of World War II. It has been done. Article VIII of the IMF charter refers to countries that have removed restrictions on current transactions, and 142 of our 182 members have accepted Article VIII. That is one of the other vital reasons that the world economy has behaved so much better in this period than before. It is also remarkable that the transition economies which started reform in 1989, went very quickly to current account convertibility. Unlike the Europeans after World War II, there has been a general acceptance of the virtues of this convertibility on the current account, and that is something we have promoted and will continue to promote.

From the public's point of view, the most prominent function of the IMF is Purpose Number Five of the IMF. The language is very interesting: "To give confidence to members by making the general resources of the fund temporarily available to them under adequate safeguards, thus providing them with opportunities to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." That is the lending function of the IMF. Why is it needed? It is needed because from time to time, for whatever reason, countries get into trouble, frequently because of mistakes in their own policies. But the tendency in those situations is to take measures that would be destructive of their own prosperity or of their neighbors. What measures would be destructive of their own prosperity? It would be to close down the system, to increase tariffs, to impose capital controls. It is something we see unfortunately in one or two countries amid the current crisis. And what is it that would be destructive of their neighbors' prosperity? It is excessive devaluation. It is the contagion that has been seen as countries get into trouble. And it is the reason why we all have an interest in helping countries that by and large play by the rules, receive financial support to help get them out of trouble. We all have an interest in minimizing the costs on countries as we seek to resolve these crises.

Countries have agreed to play by the rules of a particular system. It is a system that the United States rightly took a lead role in setting up after World War II. It is a system that occasionally produces crises, and it is therefore a system that justifies lending to countries that get into trouble--under adequate safeguards. What are the safeguards? The safeguards are to make sure that those countries adopt policies that will prevent the recurrence of those crises.

So much for the purposes. The IMF is not perfect, as you may have noticed. And there is good reason to want to reform aspects of the system and aspects of the organization. Let me review the main areas in which reform is needed.

First and foremost is the reform of banking and financial systems. Around the world, every major crisis we have seen in the last five years has been either caused by or accentuated by massive banking sector weaknesses. We do not have in the international system the ability to require countries to strengthen their banking systems. You can only do it definitively when they get into crises. We need mechanisms--international cooperative mechanisms--to make that happen before the onset of a crisis.

The IMF did not anticipate the depth of the crisis in Korea, or the depth of the crisis in Indonesia. But we were on record with the Indonesians, and the Koreans and the Thais, warning them about the weakness of their financial systems and the risks they posed. Unfortunately these warnings did not generate action by the countries at risk.

The second concern in reforming the system is one of contagion. We have seen recently as a result of the Russian devaluation a spread of the crisis from one country to others in ways that are caused by the financial leverage that was present in the Russian case. I have no doubt that the markets, relatively speaking, get the order of priorities right. I'm sure that countries that are more under attack from the markets are weaker, and have less strong fundamentals than those that are less under attack. But I am far from convinced that the aggregate level of pressure is right. How do I know? First, spreads on emerging market debt before this crisis were absurdly low. The markets didn't get that right. And now, the spreads on Latin American debt are absurdly high. Why should we care, given that market performance does balance out after a while? We care because these things can become self-fulfilling prophecies. If nobody lends to Latin America, it will be very difficult for Latin America to come through, at least without significant financial assistance. We need to find ways to deal with that.

We also have an ongoing debate on capital controls, which is very very dangerous, which we need to resolve very quickly in favor of maintenance of orderly capital account liberalization. That is an item high on the agenda. It is an item in which many influential voices are arrayed on the other side--some even among my academic colleagues.

Fourth, there is the issue of moral hazard. There is great concern about the difficulties the international system has in lending to countries without bailing out private sector participants. This is very difficult, because as you try to bail in the private sector, you frequently will spread contagion. And if you want to know why we did not on Day One ask countries to close down and tell the private sector they had to maintain their positions, it was because of a fundamental fear: If you tell the private sector in one country, for example

Thailand, "Your money is here, you cannot take it out," then it would be taken out of other countries. With that, you would be producing contagion. We need a system, and we are developing it, for making sure that an appropriate contribution is made by the private sector to the resolution of crises in a way that does not exacerbate contagion.

A fifth issue is exchange rate systems. We are in an in-between world in which floating rates sometimes fluctuate excessively and fixed rates are too vulnerable to attack. Probably in the long run we will move toward a system in which rates either float or currency blocs are formed. And I expect that the probable success of the European Monetary Union will lead to much greater interest in the creation of currency blocs, of many countries using one currency.

Finally on reform, the IMF itself needs reform. We need reform in two main areas, transparency and accountability.

I believe fully that the IMF needs a great deal more transparency. We have done a lot in the past four years. There is far more openness, there is far more that you can read on the IMF website about what we do, about what countries do when they agree to programs with the IMF. If you are interested, the Internet address is www.imf.org. Visit it and you will see an enormous increase in transparency. But we need to do more. Some of our members are little behind the United States, and the United Kingdom and other industrialized countries on this issue. They have good reasons. But I expect that greater transparency is a trend that will continue, and I am thoroughly in favor of it. It is the way to get an informed debate on the measures that the IMF is taking, measures contained in IMF programs.

Accountability is a much more difficult concept in the following sense: The IMF is now fully accountable to its members. The membership consists of 182 member governments. We have an executive board that agrees to everything that gets done—otherwise it doesn't get done. The Board consists of 24 members. The eight largest countries have individual executive directors, and they vote their share of the capital of the IMF. That means the United States votes about 18%, Germany and Japan about 5.5% each; Britain and France about 5%, etc. The management and staff are responsible and accountable to that board.

When critics in the United States suggest the IMF is not accountable, what they really are singling out is the accountability of the executive branch to the legislative branch, of the White House to the Congress. The representative of the United States in the IMF is a Treasury official. That's who gets to make the vote. The question of to which branch of government the Fund should be responsible is a very complicated one, but I am not sure how an international organization could be responsible to 182 legislatures, as opposed to executive branches. Still, the accountability is there.

There is an element of accountability in transparency. And that is important: accountability to the academic community and the public opinion world outside. Those communities should have an opportunity to comment more on the programs that the IMF supports around the world, and some details of which are not yet available. I think if we could get more of that, the accountability to informed public opinion at large would increase. That would be wholly to the good, and that is something the management of the IMF is promoting.

Finally, there are some broader notions that are central to the purpose of the IMF, notions that George Schultz mentioned in his speech but that sometimes get lost in the heat of the debate over the institution: ownership and community. Ownership is the ideal. We know in the IMF that when a country owns a program it will get done. That has never been a question. And I could go through a list of 40 programs that have been successful in this decade--Argentina, the Czech Republic, Hungary, Poland, the Mexican program of 1995, and many others. You don't know about most of these programs. Why? Because the governments took responsibility for what they were doing. They accepted our financial assistance. We discussed the structure of the program. We agreed on it, and they did it. That's the ideal.

The problem is what do you do when you don't have that ideal. Do you sit back and say: "Let us know when you have a government that's ready to do what needs doing"? Or do you try to help with a government that says, "Yes, we will do this"-- even if you have fears that they won't. It is a fact that the three programs that are most controversial--Indonesia, Thailand, Korea--all took hold within a week of a change of government. Korea's currency and Thailand's currency stabilized as soon as the governments changed. The new governments came in committed to taking responsibility for the programs and implementing them. And since the change of government in Indonesia, the program is working much better. That is obvious; that is true.

What were we supposed to do when a member of the IMF turned to us for assistance? And when the international community, the 182 members of the IMF, thought it was important, for example, that Korea not collapse? The answer is you negotiate the strongest program you can. You have to make a critical judgment as to whether it has a good chance of being carried out, knowing it may not be perfect. And then you go with it, and you do everything you can to make it work. You cannot stand back. That is because these events have an impact on other countries.

Similarly in Russia, that was a judgment that was very, very difficult. We all had an interest in helping Russia make the transition to capitalism and to a market system. The members of the IMF gave that responsibility to the IMF. It is possible that it would have been better for the members to make grants to Russia and tell them to get on with it. But that is not what they chose to do. The job was given to us. And for seven years Russia made progress with reform. Russia stabilized its inflation. Russia began to grow in 1997. It was always a battle, every single year. But it was not a question--and this is where the ownership issue becomes so hard--of the country taking responsibility for the program. It is a country in which a large number of people want to go back to the old system. And it is a country in which many people want a different way of doing things. And the outside world, through the IMF, decided to weigh in on one side of that debate, recognizing that it was not clear what the outcome would be. It would have been inexcusable for the international community, the United States and the other members of the IMF, to step back and say, "Sort it out, we'll show up when you know what to do." That's not what we did. There are no apologies owed for what was attempted in Russia.

And finally community. Community is what we try to do. Community is what is being expressed through the fact that all the members of the international economy who have agreed to a certain set of rules are in one organization that is organized to help them when

they get into trouble, and to make the system operate more efficiently on a day to day basis
- the IMF.

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