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THE ROLE OF THE BRETTON WOODS INSTITUTIONS

par

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I. In terms of economic development :

I would like to focus on three ideas :

1. Official development aid is dwarfed by the abundance of private capital flows to emerging economies.

The recent IIF tables on capital flows to emerging markets show that, in net terms, official assistance has become negative in the last years. While private net flows are forecast to amount to some 345 billion dollars in 2005 (42 in the form of portfolio investment, 150 of direct investment and 153 of loans), the official net flows are negative (- 50 billion dollars, split in two equal parts for bilateral and multilateral creditors).

This does not mean, of course that official development assistance (ODA) is irrelevant. Indeed, many poor countries (some of them not included in “emerging economies”) still benefit from net official assistance. But it puts things in perspective and **should incite multilateral institutions to adapt to the real new world, to streamline their own organisations and to focus public assistance on what private flows cannot and are not supposed to achieve.**

2. Official aid and particularly multilateral aid should be focused on the least developed and low income countries¹.

Is that the case ? Yes, to a large extent. Indeed, two thirds of ODA go to those countries. But, another third goes to lower middle income countries (like

¹ With gross national income of less than 825 dollars.

Algeria, Brazil, China, Thailand...) with gross national savings of less than 3.255 dollars.

Multilateral aid (its gross annual flows are of the order of 20 Billion dollars) represents a quarter of total gross official flows.

It therefore seems that multilateral flows should concentrate on the poorest and most needy countries, and should correct in a way the “middle income bias” of bilateral aid and of private flows.

3. Where multilateral institutions can make a difference is on aid quality and its development impact.

Research² has shown that :

- besides specific programs in the fields of education and health, **aid aimed more directly to support growth relatively quickly** (infrastructure: roads, irrigation, ports...) **has the most immediate and effective impact on growth ;**
- aid works better in countries with strong institutions. Therefore **there is a need for multilateral organisations to help reducing absorptive capacity constraints ;**
- in this vein, **fostering conditions for the creation of local financial markets** -including corporates- (as the IFC has done with particular success over the last years) can be a significant tool to mobilize domestic savings for development objectives ;
- **aid to very poor countries -with no debt servicing capabilities- should be allocated in the form of grants or on very concessionary terms.** We see today how much past lending policies to these types of countries is constraining present official aid. It is gratifying that ODA has been increasing between 2001 and 2004 (+15 % in real terms). But most (2/3) of that increase has been in the form of non-cash assistance and debt relief. This certainly helps putting the accounts in order but does not provide for new growth oriented aid projects.

² See « Aid and Growth » by Steven Radelet, Michael Clemens and Rikhil Bhavnani, in « Finance and Development », September 2005.

II. As far as the IMF is concerned :

I should like to stress three points :

1. Improving multilateral surveillance is of the essence :

This is the basic role of the IMF. **More than being a lending agency concentrating large resources on a few countries, the Fund should be seen primarily as responsible for the adjustment process.** It has the expertise to perform that task and should never compromise on the quality of its programs. My impression is that over the past ten years, too much emphasis might have been placed on financing and not enough on adjustment.

This implies also that all market participants should do a better job in analyzing emerging economies. The performance of banks (see the 1996 unjustifiable tightening of spreads not to mention the present situation), of rating agencies (they all missed Argentina's fiscal slippage in the mid-1990's) and of the IFIs (the Fund started lending very large amounts to that country in an apparently stable financial situation, but, in fact, precisely at that fatal turning point, which only compounded the problems later...) was far from being adequate.

A preventive approach is, of course, the best course of action, although it is easier said than done because governments are often politically unwilling to act before a crisis, especially if external finance is easily available.

But surveillance is not only a bilateral exercise on needy emerging markets. It should also embrace large industrial economies, major imbalances and exchange rates. One of the challenges of the IMF is to deal with these issues. Multilateral surveillance on the G3 -and in particular on the US imbalances- clearly needs strengthening. I shall add that the international monetary system is, in my view, slipping into a sort of semi-fixed "à la carte" system where some large countries choose their exchange rate peg to take the best advantage of their export capacities. The question is : what should the IMF do about this situation ? Is the membership ready to engage, under the leadership of the IMF, into cooperative policies (including on the fiscal and structural side) that would reduce major global imbalances and contribute to more stability in the financial system ?

2. The IMF should play a more active role in coping with debt crises :

We live in an integrated financial market. Emerging market countries are, in particular, very dependent on private capital flows. Two points can thus be

made. Firstly, the IMF cannot, and should not, provide *all* the financing for balance of payments problems. It has to count on private flows to do the bulk of the financing (heavy lending by the IMF to a few countries has accumulated into a serious issue for the institution and the system). Secondly, the IMF must develop a close and cooperative relationship with the private sector (this notion is not even alluded to in the recent MD's report on the Funds medium term strategy).

If one agrees on those two points, one should be open to a number of ideas.

First, the IMF should be seen as developing a clear and more predictable policy on access limits.

Second, international financial institutions and the private sector should develop relations based on mutual trust on an ongoing basis. The private sector can be called upon (especially if that climate of trust has flourished) to participate voluntarily in preventive actions to lessen the probability of a crisis (take, for example, the case of Brazil a few years ago, when commercial banks agreed on a voluntary standstill). And when a crisis erupts, it is critical that the IMF and the debtor country cooperate with private creditors.

The fact that dispersed bondholders have replaced commercial banks as the main creditors doesn't mean that unilateral exchanges should be imposed on them. Bondholders have shown that they can work together. The IMF should use its influence to encourage debtor countries to negotiate in good faith with creditor committees. Not only this is good common sense but it is also the Fund's stated policy. The IMF should also share with private creditors the intellectual underpinnings of its programs so that they can better assess debt sustainability constraints. This indispensable relationship between the IMF and the private sector can be much improved.

I would add that I don't think the IMF can "isolate" itself from those external developments. Large debt restructuring operations should be based on good IMF programs destined to help a country restore its financial credibility and access to the market. In this respect, **the ability of the IMF to convince the market and the creditors that an adjustment program is sound and strong enough to underpin debt negotiations is of the essence. This is crucial for the Fund's credibility.** It is all the more important when the Fund is itself a major creditor. Nothing should be done (as it has been the case in Argentina) that could give the impression that the IMF is overwhelmingly concerned by its own balance sheet and that it might even be willing to rely overly on private creditors to strengthen the adjustment programs that it has approved.

The move toward generalized collective action clauses in international bonds is a step in the right direction. The successful efforts of the private sector to put together a market-based "code of principles" (adopted a year ago and endorsed by the G20) are more promising, in my view, than a formalized regulatory mechanism.

3. In terms of governance, the IMF should act as a consensus builder :

The question of representation is, to some extent, technical in the sense that one has to give countries appropriate weighting while keeping the confidence of the net "contributors". But it also has to cope with a broader challenge : making members feeling more genuinely involved in the Fund's decision-making process. The G-7 shouldn't be a specific element in the IMF's decision making. It is for the Executive Board, under management's leadership, to make decisions consistent with the Articles of Agreement and the policies of the institution (even if groups of members are free to get together to help formulate their own positions). As Jack Polack stated recently : "**Large members should be willing to consider the IMF in a long term perspective...., which means a willingness to be overruled on certain issues**".



I have always been convinced that the IMF and the World Bank were indispensable. Perhaps even more today than ever in the past. I very much hope that with their experience, with the high quality of their staff and under their new management, the two institutions will live up to these challenges.