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Bretton Woods Committee

THE INTERNATIONAL MONETARY FUND's EVOLUTION AND CHALLENGES AHEAD

Intervention de Monsieur Jacques de Larosière

I have been asked to provide some comments on the subject : "The Fund's evolution and challenges ahead". I will try to save as much of your time as possible and to focus on what is, in my view, essential.

I. SURVEILLANCE :

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 that all market participants should do a better job in analyzing emerging economies. The performance of banks (see the 1996 unjustifiable tightening of spreads), 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 also embraces 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 side) that would reduce major global imbalances and contribute to more stability in the financial system ?

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II. THE IMF AND 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[1] (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.

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

First, the IMF should be seen has 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 are not dissociable from IMF

[1] Actually, the multilateral financial institutions flows to emerging markets have become negative (- 11 billion dollars) as well as bilateral official flows (- 9 billion), whilst private net flows amount to 226 billion.

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 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 efforts of the private sector to put together a market-based "code of principles" are more promising, in my view, than a formalized regulatory mechanism. I very much hope that the "code of principles" on which both issuers and investors are working under the aegis of the Institute of International Finance will be soon finalized. It could contribute to stabilizing the system and fostering capital flows.

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III. GOVERNANCE :

In defining policies and carrying out their execution, 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. During my years as Managing Director, I don't remember that we ever counted votes (except, of course, and rightly so, for quota increases). 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".**

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