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## **Do We Still Need the IMF in an Era of Massive Private Capital Flows?**

Remarks by Michel Camdessus  
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at the Economic Club of New York  
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Mr. Chairman, it is an honor to join you here at the Economic Club of New York and a pleasure to share the podium with my young colleague and old friend, Jim Wolfensohn.

The IMF and the World Bank were founded to help restore economic stability and growth in the aftermath of World War II. Half a century later, the two institutions are still working together to promote these goals, but in a world that has changed. In particular, the international economy is now dominated by massive private capital flows—available on a scale undreamed of, not only at Bretton Woods, but even ten years ago—flows that are opening new opportunities for investment, trade, and growth to an ever larger number of countries. Last year was another record year. Net private capital flows to emerging market economies reached \$235 billion—five times the level in 1990—while maturities lengthened and spreads declined. So, one may well ask: in this day and age of the Chile Fund, the China Fund, the Czech Fund, and so forth, do we still need the International Monetary Fund?

I raise the question only because in my view, the answer is very clear. Yes, the world does need the IMF, and more so today than ever before. It is true that global economic opportunities are increasing, but many countries are not yet able to take advantage of them. Moreover, for countries that do tap private capital markets, the risks have increased. As we have seen on countless occasions, the market rewards what it sees as sound economic policy and punishes—sometimes resoundingly—what it perceives as policy weakness. Hence, the upside potential for good economic performers is substantial, but the latitude for policy mistakes remains, and the cost of mistakes can be much greater. This is why, with a remarkable unanimity, our 181 member countries are increasingly looking to the Fund to help enhance the stability of the global economic and financial system and increase the prospects for

high-quality growth in ways that individual countries are not as well equipped to do. This is why more than ever they expect us:

- one, to encourage countries to pursue the sound economic and financial policies required to attract private capital and thereby expand opportunities for investment, trade, and growth worldwide; we do this through our policy advice, our technical assistance, and, when appropriate, our financial support.
- two, through this emphasis on appropriate policies, to reduce the risk of a sudden reversal of capital flows and their potentially destabilizing spillover effects;
- three, when crises do occur—as undoubtedly they will—to ensure that they are dealt with in ways that are not detrimental to international prosperity; and
- four, to provide a forum in which members can discuss and learn from each other's policy successes and failures, assess developments in the global economy and, to the extent possible, diffuse emerging problems before they become major crises.

Admittedly, these are ambitious goals. Indeed, the IMF can hardly expect to forestall every crisis or inspire every member to economic and financial rectitude. However, we do believe that prevention is better than cure and that the opportunities in the global economy should not be squandered. Thus, we have taken a number of steps both to strengthen the IMF's traditional surveillance over member country policies and to broaden its scope. Against this background, let me highlight four issues on which we are working hard this very moment in order to help the world maximize the opportunities and reduce the risks in this new era of global capital markets.

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The first point concerns capital account liberalization. The agreement at Bretton Woods gave the IMF the mandate to help eliminate "foreign exchange restrictions that hamper the growth of world trade." It has taken more than fifty years, but we are well on our way to finishing the job: as of today, more than three quarters of our members (139 countries) have eliminated restrictions on current transactions.

But this is not enough. The benefits of an open and liberal system of capital movements—for individual countries and investors, and for the world economy at large—are widely recognized. But in order to have full access to private capital, countries have to open their capital accounts. Up until now, the IMF's mandate was practically limited to the current transactions, not capital transactions. Now, there is agreement among the membership that another chapter should be added to the unfinished opus of Bretton Woods—that is, an amendment to our charter specifically

calling upon the IMF to promote capital account liberalization and giving the Fund appropriate oversight over restrictions on capital movements. We hope that the provisions of this amendment will be worked out over the next few months. And I dare say, this is history!

Needless to say, the point is not to encourage countries to remove capital controls prematurely, or to enjoin them from using capital controls on a temporary basis in emergencies. Rather, the emphasis will be on fostering the smooth operation of international capital markets, and encouraging countries to remove capital controls in a way that is consistent with sustainable macroeconomic policies, strong monetary and financial sectors, and lasting liberalization. This is good for recipient countries, good for investors, and good for the world economy.

This brings me to a second point, which is even more relevant in light of the first: the soundness of domestic financial systems in general, and of banking systems, in particular. As you may suspect, I am often asked where I think the next "Mexico" will occur. I do not know, but of this much, I am sure: the next Mexico will almost certainly start with a banking crisis or be intensified by one. In many countries, poor bank management, weak supervision, and unfavorable macroeconomic conditions have left the banking system in a perilous state. Moreover, when the banking system is weak, countries are often reluctant to tighten macroeconomic policies when they should, for fear of provoking a banking sector crisis. In these circumstances, a banking crisis is an accident waiting to happen. What can be done?

From our perspective, the main emphasis should be on strengthening internal bank management and reinforcing market discipline over banking practices. But there is also a clear need to improve bank regulation and supervision. Our policy dialogue with member countries now places greater emphasis on banking and financial sector problems. At the same time, however, having seen the state of banking systems around the world, the IMF has pointed to the need for a set of "best practices" in the financial area that are internationally recognized and applicable in countries at varying stages of development. We have also indicated our readiness to help disseminate these "best practices" through our policy discussions with member countries. I am happy to say that important steps are now being taken in this direction—such as the Basle Committee's "Core Principles for Effective Banking Supervision." We applaud these steps and hope to see more work in this direction.

The third point concerns transparency. Since market perceptions determine where capital will flow, there is now a much higher premium on accurate information about country economic policies and performance. Besides, better information makes for better investment decisions and fewer market surprises. Thus, the IMF is actively encouraging all countries, but especially those tapping, or hoping to tap, international

capital markets, to improve the economic and financial data they provide to the public. In particular, we have helped develop and disseminate a set of standards regarding the coverage, frequency, and timeliness of data; their quality and integrity; and their availability to the public. Countries subscribing to this Special Data Dissemination Standard agree to abide by its principles and to post information on their own specific data practices on an electronic bulletin board on the Internet maintained by the Fund. I am pleased to report that so far, 42 advanced and emerging market economies have subscribed to this Data Standard, and 7 have established "hyperlinks" to their actual economic data. Nevertheless, I am afraid that progress will still be slow because it is immensely difficult to get countries to devote resources to improving the quality of information and increasing transparency, when frequently their instincts go in the opposite direction.

So far, I have focused mainly on issues confronting countries that have access to global financial markets. What about those that don't? This brings me to the fourth point: in this era of global markets, countries face a rather stark choice: either to integrate themselves into the international economy or to become marginalized from it and thus fall farther and farther behind in terms of growth and development. This marginalization is not only the source of much human misery, but a drag on world growth, and increasingly, a threat to peace. Part of our mission at the Fund is to help countries make the right policy choices so that they can avoid these pitfalls. Traditionally, IMF assistance has focused on helping countries correct macroeconomic imbalances, reduce inflation, and undertake the key trade, labor, and market reforms needed to improve efficiency and expand production. Indeed, this is still our first order of business in all our member countries. But increasingly, we find that a much broader range of institutional reforms is needed if countries are to establish and maintain private sector confidence, and thereby lay the basis for sustained growth—call it the "second generation" of structural reform. These reforms include a simple, transparent regulatory system, an independent and professional judicial system, and a government that makes cost-effective use of public resources.

Every country that hopes to maintain market confidence must come to terms with these issues associated with "good governance." Our approach at the Fund is to focus on those aspects of "good governance" that are most closely related to our surveillance over macroeconomic policies, such as increasing the transparency of government accounts (an excellent means of controlling corruption!) and encouraging countries to reduce unproductive public expenditure in favor of investments in health, education, and basic infrastructure.

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You have heard now where the Fund is heading—toward freer capital movements, sounder financial systems, greater transparency, and a more encompassing view of policy reform—all with the goal of enhancing stability and growth in the global economy. What I have not yet made clear, perhaps, is what it takes to get there: and that is the financial support of its shareholders, especially its largest shareholder, the United States. Let me reassure you: I don't plan to pass the hat, at least not here. But I would like you to understand where the Fund gets the bulk of its resources, so that you will see just what a good deal the IMF is for your country, and indeed, all countries.

As you may know, the Fund is a financial cooperative. On joining the Fund, each member country subscribes a sum of money called its "quota," which it pays partly in national currency and partly out of reserves. When a member encounters a need for temporary balance of payments financing and "borrows" from the Fund, it exchanges a certain amount of its own national currency for an equivalent amount of currency of another Fund member in a strong balance of payments position. The borrowing country pays interest at a floating market rate on the amount of currency it is using, while the country whose currency is being used receives interest. When it comes time to "repay," the country exchanges the hard currency it is using for its own national currency.

For a country—rich or poor—subscribing to a quota increase is like putting your money in the bank—it does not reduce your net worth; it does not increase your budget deficit. The U.S., for example, considers its quota subscription an exchange of assets with the IMF, not as a budgetary outlay. In fact, in many years, the U.S. has actually made money on its position in the Fund through the interest it receives on other countries' use of dollars, and the exchange rate gains it has realized on its SDR-denominated position.

The economic history of the world over the last fifty years is marked by many occasions when the United States exercised its leadership to help strengthen the world economy: in successive rounds of trade liberalization, in the resolution of the debt crisis, and in the economic transformation of Eastern Europe and the former Soviet Union, among other occasions. In doing these things, the United States has served the common good of the world. It has been able to accomplish all of this, and at relatively little cost to the U.S. Treasury, in large part because it could work through the IMF—and because the IMF, itself, has maintained its financial strength. Our membership is now considering an increase in IMF quotas, to ensure that the IMF continues to have the strength and the credibility to fulfill its functions. Americans are well known for their pragmatism. Thus, I am confident that America will continue to recognize the benefits of a strong IMF, see what a miraculously good business it is, and give the IMF its wholehearted support.

