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Statement by the Hon. **HANS TIETMEYER**,
Governor of the Fund for **GERMANY**,
at the Joint Annual Discussion

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Governor of the Fund for Germany
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I

The situation in the world economy, without doubt, has turned out to be more difficult than we expected a year ago in Hong Kong. In some regions, growth has slowed down and global financial markets have become more volatile. It must be recognized, however, that the existing international economic and monetary system has brought advantages to all of us in the past. Particularly those countries that are at present undergoing temporary setbacks have benefited from the inflow of foreign investment. This has been reflected by impressive and - until last year - sustained economic growth in the emerging markets.

It is true that globalization is bringing several new challenges but, overall, the advantages for people throughout the world are clearly prevailing. The response to today's problems should, therefore, not be to question international integration, which would jeopardize the progress in development that has been achieved so far. Rather, the international economic and monetary system should be developed further in such a way that it will be ready for the challenges of the 21st century.

II

There is certainly no panacea for overcoming the present problems. We know today that the problems in the countries currently undergoing crises are different in some respects from those of the eighties. Therefore, the prescriptions must in some respects be different, too, being no longer solely an issue of macroeconomic stabilization following periods of lax fiscal and monetary policies, but also one of good governance, a reliable legal framework, stable financial markets, efficient banking supervision and the phenomenon of an excessive and ill-structured private debt. Market economies in particular, require a reliable legal framework and well-functioning institutions. It has become evident that restoring confidence also requires social and political reforms.

Especially at this juncture, we need a strong IMF, both in crisis prevention and in crisis management. Regrettably some responses to the crises in recent years and months may have contributed to the distortion of the incentive structures for financial market players, and lulled investors into a false sense of security. Excessively large financial assistance by the IMF can undermine the proper working of the markets. Consequently, market players may easily underestimate the risks, trusting in government guarantees or a bail-out by the international community. This moral-hazard problem has to be taken seriously. In future, therefore, the private sector must be integrated better and earlier into crisis management and bear full responsibility for its actions.

IMF programs up to now, regrettably, have not always produced convincing results. Not in all cases did the Fund's conditionality address the underlying causes sufficiently. In particular, its financial support was not sufficiently effective whenever the country concerned did not clearly subscribe to radical corrective measures. Ultimately, it is the countries themselves, which are responsible for the success of their programs. Shortcomings in their own efforts cannot be offset by providing international liquidity.

III

The free movement of capital is a key element in the efficient allocation of resources and therefore a precondition for increasing prosperity worldwide. For this reason, it continues to be appropriate to give the IMF a mandate for the liberalization of capital movements.

Experience in many industrial countries and emerging markets clearly shows, however, that liberalization must be accompanied by the establishment of stable financial markets and efficient prudential structures. The World Bank and the IMF can and must play a major role in that respect. Capital controls, however, are normally not an effective instrument of monetary policy.

IV

I am concerned that the present difficulties might trigger pressure for protectionism, not only in crisis regions but also in other countries. To give in to these pressures would be highly detrimental to the prospects for a worldwide recovery. Therefore, it is crucial to keep markets open, even if competition intensifies.

Similarly, it is also crucial to avoid a renewed round of competitive depreciation. In the long run, nobody would benefit, but everyone would suffer. The exchange rate policy has to be credible and in line with the development of the fundamentals.

V

On January 1, 1999, for eleven countries of the European Union, the single European currency will become a reality. This will create a currency area with a population of almost 300 million. The euro, the future European currency, will start on an - all in all - positive economic basis, notwithstanding that unemployment is still too high. The commitment of the EU-countries to a stability-oriented fiscal policy and continuing structural reform is a key to the long-term success of the European Monetary Union and also for continued improvement of prospects for growth and employment.

Also, the incoming euro must inherit the stability of the D-Mark. For this purpose, it is important that the European Central Bank is committed to the primary objective of price stability and enjoys genuine independence, secured under international law. A stable and strong euro is a major contribution by Europe to the stability of the global monetary system and to ongoing economic prosperity.

VI

The involvement of the World Bank in overcoming the financial crises in South-East Asia and in Russia is of great importance. The World Bank has unique expertise in addressing the underlying structural problems. At the same time, its main task, to fight poverty, should not be neglected.

We should not forget that many countries, including the poorest ones, have been implementing structural measures with great effort and commitment for a number of years. IDA is the largest concessionary aid fund in the world. Countries trust its advice and welcome its financial support which lays the foundation for sustained growth and fighting poverty.

It will be very difficult to fully integrate these countries into the world economy without efficient institutions in the financial sector, without a coherent development-oriented government strategy and without a reliable legal framework. This has been demonstrated again by recent crises.

IDA's development policy mandate and its success in implementing reform programs encourage us to successfully conclude the current negotiations for the 12th replenishment by the end of the year. Also against the backdrop of the current negotiations, we note with great concern that armed conflicts jeopardize the first fruits of structural reforms and arduous reconstruction measures.

In the wake of the financial crises, structural shortcomings have also surfaced in the World Bank's income development. The negative trend in the World Bank's profitability must be tackled quickly so that it can regain its former scope for action. The recently adopted measures for improving the profitability of the Bank are a major step in the right direction.

VII

For the IMF to play its key role in the international monetary system, the increase in quotas agreed in Hong Kong must be speedily implemented. This must have absolute priority. Germany has already notified the IMF of its consent to the quota increase. We hope that others will follow without further delay so that the IMF will again have sufficient quota resources as soon as possible. The IMF's key role in overcoming the crises should encourage all members to fulfill their obligations speedily. The New Arrangements to Borrow (NAB) should also come into force as

soon as possible. This “reserve tank”, however, can only be a supplement to raising the quotas, and by no means a substitute. Germany is prepared to notify its consent to the NAB. Similarly, we are prepared to ratify the special one-time allocation of SDR.

VIII

The activities of the IMF and the World Bank complement each other. They are not competing organizations. Close cooperation between the IMF and the World Bank is particularly important when responding to crisis situations in order to avoid conflicting signals. We therefore welcome the ongoing efforts to improve cooperation between the two institutions.

I would like to take this opportunity to thank management and staff of the IMF and the World Bank for their sometimes extremely difficult work during the past months. You may rest assured that Germany will continue to attach great importance to the work of the IMF and the World Bank.

Finally, I am pleased to join my fellow governors in welcoming the Republic of Palau as a new member.