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Statement by the Hon. GORDON BROWN ,
Governor of the Fund and Alternate Governor of the Bank for the UNITED KINGDOM ,
at the Joint Annual Discussion

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GOVERNOR OF THE FUND FOR THE UNITED KINGDOM
AT THE JOINT ANNUAL DISCUSSION

STEERING A COURSE FOR STABILITY

Introduction

Mr Chairman, at this time of great challenge for the global economy, I am grateful to have the opportunity to address this most distinguished gathering of world financial leaders.

I would like to start by thanking the staff of the IMF and the World Bank for the excellent organization of these meetings--and I would also like to pass on the thanks of Clare Short, UK Governor of the World Bank.

Our challenge is compelling. Never in our economic history have so many depended so much on economic cooperation among the nations of the world. And the leadership of the world's economic powers has not been so important or potentially decisive since the post World-War period of international economic transformation--a time when the IMF and World Bank were born and Dean Acheson spoke of being "present at the creation".

We, too, present at the creation of a new interdependent and integrated global economy, must now shape that economy and, through stability and growth, ensure prosperity and opportunity for all.

We must never forget that the path of open trade and open capital markets that we have travelled in the last 30 or 40 years has brought unprecedented growth, greater opportunity and the prospect of better lives for millions across the world. But there is still massive poverty in a world where millions are denied opportunity, and the new economy has brought greater risks of insecurity as well as new opportunities.

No sensible policy-maker wants to turn the clock back to protectionism and insularity. But to move forward we need vigilant and active governments, acting together through reformed international institutions, to ensure that the prosperity that has been achieved by some can be extended to all. And so we must not weaken support for the IMF and World Bank when the need for surveillance and coordination is pressing, but strengthen them by building the operational rules and institutional architecture for the new global financial system.

The statements from the G7, the Interim Committee and the Development Committee over the past few days have all demonstrated our shared determination to turn words and analysis into action. The proposals for action that I will outline are rooted in an understanding of what has gone wrong and what we must now do together to get the world economy back on track.

The key challenge now is to devise procedures and institutions--nothing less than new international rules of the game--that help deliver greater stability, and prosperity for all our citizens in industrialized and industrializing economies alike.

The Causes of the Current Crisis

Fifty years ago, that earlier generation began by honestly facing conditions in the world of their day. That must be our beginning as well.

The current financial crisis originated in national economic policy mistakes in Asia and a destabilising lack of transparency. It grew because of their poorly regulated and often distorted financial sectors. It became global because of insufficient supervision and ineffective risk management in the developed country financial markets. It became a crisis because the initial policy responses were more appropriate to over-extended public sectors whereas the problem was over-exposed private investors. And it has become a human tragedy affecting millions because our social policy approach is still deficient.

Five weaknesses--in economic and financial policies, under-developed financial sectors in emerging markets, ineffective supervision, poor crisis management, unacceptably poor social protection. But together they expose an even more fundamental common problem.

For the last fifty years our policies for regulation, supervision and crisis management have been devised for what were essentially independent relatively sheltered national economies with discrete national capital markets and limited and slow-moving international capital flows.

Now that we are in an era of interdependent and instantaneous capital markets, individual economies can no longer shelter themselves from massive fast-moving and sometimes destabilising global financial flows, and it is obvious that if we are to respond to this, we need urgent action now both to sustain domestic demand and make urgent progress for reform at both national and global levels.

Restoring Stability and Growth

First the current situation.

What began last year as a local and regional crisis centred in a handful of Asian countries, with its effects most sharply felt in Asia, has spread from Asia to Europe and South and North America becoming what is now a global problem affecting us all.

Better risk management in future will lead to more stable capital flows. But it is a matter of concern that many emerging market economies are being caught up in the turmoil, regardless of the strength of their macro-economic fundamentals.

Which is why, as last weekend's G7 statement has made clear, the G7 countries--North America, Europe and Japan--as well as the IMF and the World Bank, stand ready to support all emerging market countries which are prepared to embark on strong sound policies which will involve structural reform.

But when the balance of risks in the world economy has shifted from inflation to slower growth, the G7 countries must now assume greater responsibility.

The necessary improvement in trade balances in affected countries could either come from domestic stagnation or export-led growth. It is in our shared interests to achieve this export led growth , but this will only be possible if, by sustaining world demand, the industrialized world is the driving force for that growth.

As I said in Japan recently, all industrialized countries must now bear their fair share of the burden of adjustment. No one country can either escape its responsibility or be required to bear the whole burden with all the risks of protectionist sentiment that this would entail. Burden-sharing rather than burden-shifting is the way forward.

And I was reassured that, in the recent G7 statement, members from each respective continent have resolved to play our rightful role and take action to ensure that our economies can both sustain growth and remain open to trade:

- the recent action of the US Federal Reserve in cutting interest rates was designed to sustain domestic demand growth. I was pleased to hear President Clinton say this morning that maintaining free trade, free from protectionism, is an important element of the US response. I know also that the administration is working very hard to ensure ratification of the NAB and the IMF quota increase. We should support and encourage them to step up their efforts in these areas;

- I know too from my recent visit to Japan that my Japanese colleagues are focussed on their efforts to stimulate domestic demand through fiscal and monetary policy. And, to help restore market and consumer confidence, the Japanese government must make available public funds and lay out a clear timetable for action to restore health to the banks and the financial sector.

- and in Europe too, including the UK, we will be working to ensure that the Euro promotes stability and growth. And the European contribution will include a commitment to employment creation within a policy of structural reform.

Last year I told this meeting that I was determined to get the British economy back on track for sustained growth with low inflation. That required a necessary slowing in economic growth.

The UK economy grew last year by 3.5 per cent. At the time of our March budget we expected growth to slow to 2 to 2.5 per cent in 1998 and 1.75 to 2.25 per cent in 1999 before returning to trend. So far this year, the latest indications are that we will meet our growth forecast for this year.

Six months ago the IMF was forecasting world growth at 3.7 per cent in 1999. The turmoil in emerging markets together with the deteriorating economic situation in industrialized countries has led the Fund to revise down expected world growth to 2.5 per cent next year.

So with Japan and one quarter of the world in recession, every country will be affected by the instability that is currently affecting the world economy.

With the IMF forecasting that growth in world trade will fall by two thirds this year, Britain's export markets are set to grow much more slowly. UK exports to Indonesia and Malaysia are already down 50 per cent this year, they are down 55 per cent to South Korea and down 60 per cent to Thailand and the Philippines.

Slower world growth makes it inevitable that growth in Britain next year will be more moderate. But as a result of the tough and decisive action this government has taken, Britain is better placed to steer a course of stability in an uncertain and unstable world as we get the British economy back on track for sustained growth.

Our first task when we came into government was to set in place a long-term and credible platform to achieve the stability that is an essential pre-condition for long-term investment, growth and jobs.

It is in pursuit of our long-term goals--high and stable levels of growth and employment--and the rejection of the short-termism and stop-go polices that have undermined the UK economy in the past--that we have taken tough decisions.

In the face of rising inflationary pressure and the large structural deficit we inherited, we made the Bank of England independent, raised interest rates and tightened fiscal policy by 20 billion pounds over the past year, amounting to 3.5 per cent of GDP from financial year 1996/97 to financial year 1999/2000.

Our Pre-Budget Report will set out the next steps, building on this platform of stability, that we must take over the coming year to equip the British economy so that it is more than equal to the challenges that the new global economy brings.

Britain cannot be properly equipped while we have productivity levels 40 per cent below America, and 20 per cent below France and Germany, so over the next year, in partnership with industry, we intend to examine and begin the task of dismantling every barrier to productivity, prosperity and employment creation.

That will require policies to promote entrepreneurship and small business development, to invest in science and innovation, to encourage industrial investment to modernize our infrastructure and to open all sectors of our economy to greater competition.

In the modern economy, the economies that succeed will be those that get the most out of their people. So we will continue our reforms to promote greater employability of the British workforce through our New Deals for the unemployed and to make work pay by combining our new Working Families Tax Credit and national insurance reform with the minimum wage.

By building upon a platform of stability with our continuing commitment to a stable monetary framework and sound public finances, and united in our determination to promote and sustain domestic demand growth, I can assure you that, at this time of world economic instability, the British Government will continue to pursue policies for open trade, investment in productivity and employment opportunity for all.

Reforming the Financial Architecture

Vigilance in national economic policies today must be matched by a willingness to reform the international financial system to secure greater stability tomorrow.

As British Prime Minister Tony Blair said in New York two weeks ago, we must create a new global framework which will have to mirror, at a global level, national regimes for transparency, supervision, crisis management and stability.

For too long, the financial architecture has been defined in terms of the roles and responsibilities of the international institutions. In fact, the new financial architecture we propose--codes of conduct, the new global regulator and an international memorandum of understanding--is not about new institutions, but about how, in an interdependent world, we monitor and discipline ourselves and reach decisions in a more coordinated way.

The key challenge is to devise new international rules of the game that, by boosting credibility and investor confidence, help deliver stability and prosperity. Our task is not to weaken support for the IMF and World Bank at a time when the need for surveillance and coordination across the world is more pressing, but to strengthen them by building the operational rules and architecture for the new global financial system.

So what are the new “rules of the game” and what are the institutional changes we need?

We need to promote greater openness and transparency in national policy-making. In this new world, national governments must set clear, long-term policy objectives that build confidence and commit to openness in policy making that keeps markets properly informed and ensure that objectives and institutions are seen to be credible.

The way for them to do this is to agree to abide by well-understood, and internationally-endorsed, codes of conduct: for fiscal policy, monetary and financial policy, corporate standards and social policy. The IMF has already drawn up a code of good conduct for fiscal policy and is now drawing up a code for monetary and financial policy. The OECD is drawing up the corporate code, and the World Bank is considering a social code.

Together, these codes will help produce an environment in which financial markets can operate better. They should reduce the risk of future failures, and mean that when failures do occur the financial system is robust enough to withstand them. By improving public understanding of why and how decisions are made, and making sure the right long-term policies are in place, they will help build public understanding and support for the policies that deliver economic growth and prosperity.

Proper implementation of the codes of conduct should be a condition of IMF and World Bank support. Immediate action to promote transparency in policy making, financial sector reform and corporate governance should be key components in any reform programme which the IMF and World Bank agree in coming months.

Of course, in this new role the IMF must be more publicly accountable. We need a systematic approach to internal and external evaluation of the Fund's own activities, including a new full-time evaluation unit inside the IMF, but reporting directly to the Fund's shareholders, and in public, on its performance. And the Fund and Bank must also work much more closely together, particularly in providing advice on financial policy to emerging markets countries. That is why the joint department of the IMF and World Bank we have proposed is essential to carry out this work.

The four codes of good conduct for policy-making, codes agreed by the international institutions, but accepted by national governments and the radical institutional changes--a merged World Bank/IMF financial regulation department--are key building blocks in the new financial architecture.

But I believe we must now go further and develop new global structures for the global age. The events of recent months have pointed out inadequacies in our understanding of the interrelationships between financial markets and between countries, particularly between developed and emerging market economies, inadequacies in the quality of risk assessment and gaps in the international regulatory system. The Basle Committee has published a comprehensive set of core principles for banking supervision and set-up a liaison group and consultation group to monitor their implementation. I also welcome the Basle Committee's work on improving transparency and risk assessment.

But we now need a new co-ordinating mechanism to ensure proper standards and provide regular and timely international surveillance of all countries' financial systems and of international capital flows, not just to point out weaknesses, but to ensure these weaknesses are addressed and to identify systemic risks to the global financial structure.

That is why we must examine the scope for a new permanent Standing Committee for Global Financial Regulation, bringing together not only the Fund and Bank, but also the Basle Committee and other regulatory groupings on a regular--perhaps monthly--basis. This global regulator would be charged with developing and implementing a mechanism to ensure that the necessary international standards for financial regulation and supervision are put in place and properly coordinated.

This Standing Committee could also play an important role in strengthening the incentives to the private sector to improve its risk assessment. Recent events have shown that it is particularly important that we have greater transparency of hedge funds which, wherever they are formally registered, can have an impact on global financial markets. We also need to consider strengthening prudential regulation in both emerging and industrialized countries and particularly for cross-border activities.

Third, the Standing Committee could also help to find better ways to identify systemic risk. In the UK, we published last year a Memorandum of Understanding, setting clear divisions of responsibilities and establishing a regular system of meetings and surveillance to ensure cooperation between our national financial institutions to identify and address systemic risk at an early stage. Systemic risk is not confined to national boundaries. What we need is an international memorandum of understanding which would establish the proper division of responsibility at the international level, to reduce the chance of crises occurring.

The IMF should remain at the centre of this framework, as part of the new Standing Committee, to coordinate the identification of systemic risk. We need to have clearly defined procedures for deciding when and how to provide liquidity support, without offering a guarantee to private investors which would compound moral hazard. I would like to see the IMF indicate that in the event of a crisis, and where a country adopts good policies, it may be prepared to sanction temporary debt standstills, by lending into arrears, in order to enable countries to reach agreements with creditors on debt rescheduling. By making this clear in advance, private lenders would know that in future crises, they would be expected to contribute to the solution as part of an IMF-led rescue. There also needs to be a better mechanism for the international authorities to liaise with private sector creditors and national authorities to discuss the handling of debt problems at times of potential crisis.

The UK is also determined to ensure that action is taken at an international level to promote fairness and relieve poverty. We should not allow our discussion of the lessons to be learnt from developments in Asia to obscure the important work that is still needed in the poorer countries.

I am pleased that we have agreed this week new procedures for advancing debt reduction to post conflict countries. And to meet our Mauritius Mandate targets, we need to aim for 22 countries to reach the decision point in the HIPC process by the end of 1999. All countries should insist export credits are used only for productive expenditure. And all countries must stand ready to provide the resources to make progress by 2000.

Conclusion

The responsibility of all of us who lead in the era of globalization is to meet the authentic problems of our times with a vision, an intelligence, and an energy which will make the world economy stronger, more stable, and more prosperous. A world more open, not just to the free flow of goods, but to the rising tide of people's aspirations everywhere. Globalization has happened--we must now make it work in hard times as well as in good.

The challenges that arise from our ever greater interdependence in an integrated global economy are challenges that summon forth new solutions. So let us resolve from here in Washington today to do whatever is necessary to create the conditions for stability and growth and to put in place the financial architecture that can achieve the ambitions of 1945 in a new world: to encourage investment flows from private and public sources in even the poorest areas of the world, so that all countries--from the richest to the poorest, most indebted countries--have the chance that they deserve to achieve stability, economic growth and opportunity for all their citizens.