

WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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INTERNATIONAL MONETARY FUND

Press Release No. 3

September 23–24, 2003

Address by **HORST KÖHLER**,
Chairman of the Executive Board and
Managing Director of the International Monetary Fund,
to the Board of Governors of the Fund

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To the Board of Governors of the Fund
Dubai, September 23, 2003

1. Your Highnesses, Mr. Chairman, Governors, honored guests, it is a pleasure to welcome you to these Annual Meetings. I would like to join Chairman Kaspar Villiger and Jim Wolfensohn in thanking the authorities of the United Arab Emirates, and Dubai in particular, for their splendid organization while hosting these Meetings. Holding our Annual Meetings in the Middle East has been long overdue. Throughout history, the people in this region have made significant contributions to human civilization. Our presence here – at this time in particular – underscores the importance that we attach to our relations with the region.

2. Mr. Chairman, allow me to join you and Jim Wolfensohn in remembering the United Nations, World Bank, and IMF staff who were killed or injured in last month's attack in Baghdad. It is tragedy – but it is also a reminder of the dedication of our staff, who work hard, under often difficult circumstances, in many different countries.

The Challenges Facing the Global Economy

3. We meet at a time of rising optimism about the global economy. We know that uncertainties remain. But the increasing signs of a recovery in a number of regions are a welcome indication that the world economy may have turned the corner. Global financial markets are also supportive of the recovery.

4. But I caution us against complacency. The setback in the world trade discussions in Cancún has certainly not strengthened global confidence. Nurturing the recovery will require vigilance and decisive economic policy management. And achieving a balanced recovery and a return to sound and sustained global growth, in particular requires broadening our focus from the short-term requirements to the serious underlying problems that many of our economies continue to face.

5. We must understand that we are all in the same boat. Tackling our common problems means that we must fight together against inertia, and must embrace change in all our societies. For change is the life-blood of human progress. Innovation, competition, and expanding markets are the key to job creation and raising living standards everywhere. The way forward lies in redoubling efforts to implement structural reforms in all our members. We all know what the priorities are: reforms to place public finances on a sound medium term footing in the face of aging societies; reforms to make our economies more flexible, in

particular by strengthening education and improving incentives to work; and reforms to strengthen the institutions supporting a well-functioning market economy and social equity. And these reforms will pay off not only for individual countries – but by building stronger world-wide growth, they are a win-win solution for the global economy.

Restoring global balance

6. In our quest for sustained global growth and international financial stability, the large global current account imbalances and the persistent high levels of public debt in many countries represent significant risks. Ensuring an orderly resolution of these imbalances is in all our interest. The way forward is through multilateral dialogue and cooperation. In my view, such cooperation now needs to include strengthening the foundations of domestic growth where they have been weak and allowing more flexibility in exchange rates where appropriate. I am also concerned about rising levels of public debt across the world in the face of the serious demographic challenges in advanced economies and the vulnerability to financial crises that high debt levels imply for emerging market economies. It is imperative that all countries use the opportunity of an economic recovery well to make public finances – and our children’s future – more secure.

7. In addressing these challenges, I see the following priorities:

- In the United States, the sharp swing in public finances has provided economic stimulus to the global economy during this period of economic weakness. We now look to the United States to establish a credible framework for a return to a balanced fiscal position over the cycle as an essential contribution to sustaining global growth and resolving global imbalances.
- In Europe and Japan, the ambitious implementation of structural reforms to raise productive capacity must take center stage. In Japan, reforms in the corporate and financial sectors must continue. In Europe, labor market reforms aimed at raising employment rates – as outlined in the Lisbon Agenda – are a critical priority. And in both Japan and Europe, looming demographic pressures require urgent steps to place public finances on a sound medium-term footing.
- In many emerging market economies, bold structural reforms and sound macroeconomic policies are bearing fruit. But in too many countries vulnerabilities remain. The current favorable conditions in financial markets must be used to further strengthen the foundations of these economies and improve their resilience to shocks. And in several emerging market economies, where reserve accumulation has been rapid and current account surpluses are large, allowing greater exchange rate flexibility would be helpful, both domestically and globally.

8. My vision for the IMF is to work for a better globalization. And this requires more than financial stability. It requires long-term social and political balance. The burst of the financial bubble of the 1990s should give us all pause for thought. I see four lessons to guide us in restoring balance to the world economy:

- First, sound and sustained global growth requires a better balance between foreign and domestic sources of growth. Outward-looking policies aimed at integration in the global economy remain key to seizing the benefits of globalization. But at the same time, countries need to develop and nurture domestic sources of growth through the establishment of strong institutions, sound and diversified financial sectors, and an investment climate that attracts domestic as well as foreign investors. Vibrant local economies and small and medium-sized enterprises are crucial for job creation and social stability.
- Second, over the long term, social equity and an acceptable income distribution are essential pillars of political stability, and hence of economic development. Social contracts differ across countries and there is no single model of an equitable society. But without a durable social consensus there can be no long-term prosperity.
- Third, globalization and interdependence must reinforce, not weaken diversity. Without respecting diversity, globalization will not succeed. But also: we must see diversity as a valuable asset for learning from all human experience. It is very important, therefore, that global governance structures, including at the Fund, promote a broad inclusive dialogue that ensures that the views of all countries are adequately taken into account.
- And finally, sustained global growth requires both the public and private sectors to contribute to restoring public confidence in markets world-wide. The public sector needs to continue to strengthen institutional frameworks, with predictable, well-enforced rules. And in the private sector, it requires a new awareness of the need to observe ethical principles and foster long-term value creation.

As we continue to address the challenges facing the world economy, we need to take these orientations into account in the formulation of our policy advice.

Strengthening the fabric of the international financial system

9. Over the past several years, the Fund has been engaged with the international community in an intensive process of reform. My report to the IMFC demonstrates that our member countries, Executive Board, staff, and management have continued to work hard and have made progress. We are reinforcing our surveillance, focusing more on vulnerabilities in financial sectors and international capital markets, and sharpening the candor of our judgments. We are strengthening the framework of rules for the global economy, in

collaboration with public and private sector institutions, by developing and implementing international standards and codes. We are continuing to examine ways to improve crisis management and resolution when crises do occur. And the quantum leap in transparency, both at the IMF and in our members, is providing more information to help markets function better. Overall, I believe our work has contributed to the remarkable resilience of the international financial system in the face of unprecedented shocks during the past three years. And in this, we have benefited from the establishment of the Independent Evaluation Office (IEO) at the IMF to strengthen a culture of listening and learning. In particular, the IEO has stressed the importance of ownership and a better understanding of countries' differing capacity to implement economic policies. This has reinforced us in the changes we are making in our lending practices, including the streamlining of conditionality.

10. The increasing interdependence of the world's economies poses new challenges for member countries and for the IMF. Therefore, in our surveillance, we must pay even more attention to the linkages between countries and regions and exercise evenhandedness, because crises can originate in mature markets as well as in emerging markets. The overriding objective must be to give our surveillance more impact in all our members. Improving our ability to identify risks and vulnerabilities at an early stage, and our intensified work on financial systems and international capital markets, must play a central role in this process. I also look forward to continued cooperation with other fora, including the Financial Stability Forum, in identifying gaps and potential soft spots in the international financial system. I believe such a broad dialogue, including with regional institutions, is essential in fostering global stability.

11. But we should always be mindful that it is unrealistic to think that a dynamic market economy can be fully sheltered from periods of turbulence and adjustment. Not all crises can be prevented. And in my view, the objective of the IMF's Contingent Credit Line remains valid: we must strive to find ways to assure members with sound policy frameworks that they can rely on proactive support from the IMF to help them resist contagion from crises elsewhere.

Fighting poverty

12. I am happy that Ministers and Governors of the IMFC urged the IMF to stay engaged with our low-income members. And there is progress in the fight against poverty. With the Millennium Development Goals and the two-pillar approach of mutual responsibility agreed at Monterrey last year – reflected also in Africa's own NEPAD initiative – we have a common policy framework. And with the PRSP and HIPC processes, we have the operational vehicles to take us to the agreed goals. Now is the time for steadfast implementation, rather than reembarking on a search for new development strategies. I look forward to further close cooperation with Jim Wolfensohn and the World Bank, which must have the lead role in our joint work on low-income countries.

13. I also see progress on the ground. In a growing number of developing countries, sound policies are beginning to bear fruit. Good governance and strong institutions are indispensable to fostering investment, job creation, and growth. The Fund's work will continue to focus on macroeconomic stability as a precondition for sustained growth. And technical assistance, including through our newly-established regional AFRITAC centers in Tanzania and Mali, is a central element in our strategy to help countries build domestic capacity and strengthen institutions. We are also working on ways to assist developing countries to deal better with exogenous shocks. I look forward to continuing the broad and inclusive discussion on the long-term role of the Fund in low-income countries that we started here in Dubai. I am confident that the forthcoming review by the IEO of the PRGF-PRSP process will provide valuable input to this work.

14. I agree with Jim Wolfensohn that more financing for development is needed to reach the MDGs. And I will not tire to remind the advanced economies that they need to live up to their commitments. Moreover, current aid flows are not only insufficient, they are also unpredictable, and often insufficiently coordinated among donors. Better aid coordination and multi-year commitments are key steps in making development assistance more effective, and the IMF is fully committed to participate in the donor harmonization process defined in Rome earlier this year. And in my view, Gordon Brown's proposal for an International Financing Facility deserves serious consideration.

15. We must also make further progress in reducing the debt burden of our poorest members. The enhanced HIPC initiative has succeeded in providing deeper and earlier relief to heavily indebted poor countries, but we have not yet reached our goal. And I believe we should fully use the existing flexibility to top up the available assistance in exceptional cases.

Expanding trade

16. The breakdown of the trade talks in Cancún must be a wake-up call for the international community. We all know that trade is the most powerful force for global growth and poverty alleviation. And this force works best when applied in a multilateral, rules-based context. What is needed now is political will on all sides to overcome the impasse and return to the negotiating table as soon as possible. More than ever, success will depend on the leadership of the major industrial countries – and agriculture remains the key to unlocking decisive progress. And I reiterate the IMF's commitment to work on ways to provide targeted financial support to countries to cushion possible temporary adverse effects from implementing their commitments under the Doha Round.

Better globalization through more cooperation

17. The increase in the IMF's membership from 38 at the inaugural meeting of the Board of Governors in Savannah to 184 today is a reflection of the process of accelerated globalization, as economies and peoples of this planet become ever more closely intertwined. And with this integration has come more interdependence. More than ever, our quest for global solutions to global problems requires cooperation for the global common good. By working together, multilaterally, we can ensure that all voices are heard and respected, and that the benefits of globalization are more widely spread. This is the true spirit and mandate of the Fund: to promote international financial stability and economic prosperity in all our members – through cooperation and trust.