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WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
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Chairman of the Executive Board and
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to the Board of Governors of the Fund

Address to the Board of Governors of the IMF
by
Rodrigo de Rato y Figaredo
Managing Director and Chairman of the Executive Board
October 3, 2004

1. Mr. Chairman, Governors, Distinguished Guests: it is a pleasure to welcome you to these Annual Meetings on behalf of the International Monetary Fund. Let me first express the IMF's gratitude to Horst Köhler -- now President Köhler -- for his leadership of the institution these past four years, and also to Anne Krueger for assuming the role of Acting Managing Director in the transition period. My personal thanks also to the Deputy Managing Directors for their help and counsel in the months since my appointment and to Jim Wolfensohn for extending a warm welcome and a hand of collaboration.
2. Governors: I am deeply honored to have been chosen to lead an institution with such vital responsibilities and a 60-year history of promoting global welfare. The role and mandate of this institution were well thought out by its founders and have stood the test of time. Of course, there have been dramatic changes in the world economy since 1944 to which the Fund has constantly adapted. The last decade has been a particularly challenging time for the Fund. But it has emerged as a stronger institution from that experience, one that has adapted its instruments—surveillance, lending and technical assistance—in response to the lessons learned. So there is a tradition of adapting our methods to changes in the world economy to serve the needs of our members. It is a tradition I certainly intend to uphold.

3. My first few months at the Fund have been a time of listening. Visits to Africa, Asia and Latin America have informed me about the policy priorities of governments. I have also learnt from discussions on the strategic direction of the Fund which have been energized by the 60th anniversary of the Bretton Woods Agreement. These discussions, along with the excellent work of our Independent Evaluation Office, are essential to maintain the Fund's effectiveness. And you will have noted their influence in my report to the IMFC.

Sustaining the Recovery

4. Let me begin with some thoughts on the global recovery and how to sustain it. Over the last year, the recovery has become increasingly well-established. Global GDP growth this year is expected to be the highest in nearly three decades. In financial markets, the start of the transition to higher interest rates has been successfully managed by most countries. In short, the world economy has mounted a vigorous recovery from the slowdown of 2001. This is a remarkable performance in the face of the shocks experienced in the past few years. Some of this resilience is due to the improvements in policy frameworks and in the international financial architecture put in place after the crises of the 1990s. These are improvements for which you and your countries deserve credit, and we should be proud that the IMF and the World Bank have played a role in fostering these improvements. Looking ahead, there is much for our members to do to sustain the global recovery, and, therefore, there is much for the Fund to do to nudge them in the right direction.

5. Let me mention three areas. First, policymakers need to monitor carefully—and be prepared to address—the near-term effects of higher oil prices on their economies. To date, in many of our member countries, the impact of higher oil prices on output and inflation appears moderate. But a high oil bill places an especially heavy burden on the poorest countries, in part by reducing their ability to finance other much-needed imports; the Fund stands ready to help countries cope with this problem.
6. Second, the challenge of maintaining an orderly transition to higher interest rates has not ended. The move to a neutral monetary policy stance should be continued through timely actions by central banks. They should also communicate their intentions clearly as this will help financial markets adjust better to these policy actions. Of course, the desirable pace and timing of monetary tightening vary among countries, depending on their cyclical situations and the extent to which oil prices are contributing to inflationary pressures.

Addressing Global Imbalances

7. Third, we also need to continue policy actions to have an orderly adjustment of current account imbalances. This is a global problem and the solution requires efforts by many countries.
   - In the United States, the Federal Reserve earlier this year started to take welcome steps in response to the signs that the expansion had regained momentum. What is now needed is for U.S. fiscal policy to follow suit and carry out a more ambitious deficit reduction over the medium term.

- European countries should use the recovery to implement structural reforms. This opportunity to boost medium-term growth was missed during the last upswing.
- I hope Japan's continuing progress in dealing with its financial and corporate sector weaknesses will give a sustained boost to its growth, and thus contribute to the reduction in global current account imbalances.
- Greater exchange rate flexibility in emerging Asia will serve both multilateral and national needs. In addition to reducing global imbalances, it would help countries in the region to better withstand external shocks.

Strengthening Medium-Term Growth

8. We should also use this time of cyclical recovery to address structural challenges to continued global growth. We try to push these to the back of our minds by calling them *medium-term* issues, but they are now staring us in the face. The medium-term has come sooner than we thought.
9. First, there is a need to strengthen fiscal positions over the medium term. Public debt-to-GDP ratios need to be brought back to tolerable levels in a number of countries, including many in Latin America. Strengthening fiscal positions will help developed and developing countries deal with the pressures from aging populations. There is much to be learned from the examples of countries like Australia, Canada, Chile and Sweden, which have taken pre-emptive actions to bolster their fiscal positions, including through pension reform.

10. Second, we need energy policies that can bring about a better balance between energy supplies and demands. This balance can be achieved through changes in the structure of taxation, other policies to boost energy efficiency, and polices to encourage more innovation in alternative sources of energy. While efforts of oil-producing countries to stabilize the market through increased output are welcome, the medium-term solution will require investment in capacity expansion.

11. In many oil-producing countries in the Middle East—and in some in Africa, Latin America and the CIS as well—there is a need to save windfall revenues. This is particularly the case in countries with high public debt levels. Increased transparency about the use of revenues from natural resource sectors is much needed too.
I commend the governments that have shown a commitment to transparency through their participation in the Extractive Industries Transparency Initiative (EITI).

12. Third, Doha Round negotiations are central to sustained growth. While recent framework agreements contain welcome commitments to reduce agricultural subsidies as part of an eventual settlement, they also leave many loose ends to be tied in other areas. A stepped-up political commitment is needed so that all countries can continue to benefit from a multilateral trading system.

13. Our new Trade Integration Mechanism can help countries facing short-term balance of payments difficulties in the transition to a more open global trade environment. In July, Bangladesh became the first country to benefit from this mechanism.

Keeping the IMF Effective

14. The introduction of the Trade Integration Mechanism is only the latest example of a Fund that is responsive to the needs of its members. As I mentioned, the history of the Fund is one of constant adaptation of instruments to maintain the institution's effectiveness. That is why I have launched a strategic review to discuss what changes are needed in the years ahead.

Promoting Global Financial Stability

15. Surveillance of course remains at the heart of the IMF's work. The biennial review of surveillance, and my report on the policy agenda, show how surveillance is being sharpened to help countries adopt polices that will deliver sustained economic growth. A number of initiatives are also underway so that surveillance can provide early warnings of problems and hence serve as a better tool for crisis prevention. But to be effective, IMF surveillance cannot rely on early warning alone; it must also prompt early action. There is room for improvement here.

16. First, a prerequisite for effective surveillance is that our analysis and arguments should be convincing and expressed candidly. Where countries are following good policies, the findings of our surveillance help spread the word about best practices to other countries. But, by the same token, we should not shy away from pointing out problems with countries' economic policies to their policymakers and to the international community. The overwhelming endorsement of transparency by our member countries—the publication rate for country staff reports is now above 75

percent—is welcome. Making markets and the public aware of problems can prompt early action and strengthen the incentives for the adoption of good policies.

17. Second, country surveillance must be based upon a clear understanding of the specific circumstances of each country as well as the linkages across economies implied by financial integration. Even if a country is not itself at risk, its policies may have an impact on other countries and on the stability of the system as a whole. This requires that we intensify our firm surveillance of systemically important countries and of global capital markets.

18. Third, we must continue with the intensive health check-ups of financial sectors conducted through the Financial Sector Assessment Program. Over ninety countries have thus far taken advantage of the program. In a world of contagion, a clean bill of health for a country's financial sector is good news not only for the country itself but for its trading and financial partners too.

19. But however good our surveillance is, crises will not disappear, and the Fund will be called upon to help mitigate their impact. As shown by recent programs, the Fund stands ready to assist members facing temporary financial difficulties. Over the last decade, this crisis resolution has sometimes required the commitment of substantial amounts of Fund resources. In most cases, this commitment has paid off: it has supported strong stabilization and reform programs and helped to limit or avoid contagion. The IMF's loans to Mexico in 1995, to Korea in 1997, and the support in recent years to Brazil and Turkey, are some of the examples from the recent past where large-scale support was appropriate. That said, we also need a Fund that can

say "No". The prospect of the Fund declining to provide financial support would strengthen the incentives to implement sound policies, thus avoiding the need for Fund support in the first place.

Assisting in the Global War on Poverty

20. Promoting financial stability through better crisis prevention and resolution is one aspect of the Fund's work. No less important is our work in low-income countries. In the last few years, the poverty reduction strategies drawn up by countries have served as the basis for the Fund's work with them. The Independent Evaluation Office recently concluded that this approach has had a positive impact on economic policy design and implementation in low-income countries. But the review also makes a number of recommendations on how the approach can be improved.

21. National ownership remains the foundation of successful poverty reduction strategies. A home-grown initiative such as the New Partnership for Africa's Development is for me a very positive example. It acknowledges the responsibility of developing countries themselves to implement sound economic policies, and strengthen governance and institutions.

22. The Fund can help in its core area of expertise—provision of macroeconomic policy advice, including on financial sector reform. There can be little hope of sustained poverty reduction without macroeconomic stability. We have seen encouraging results where such stability has been complemented by structural reforms and by targeting public spending to areas of greatest benefits to people. Mozambique,

Tanzania, and Uganda have seen sustained improvements in economic performance. Growth rates have also picked up in other African countries that have made progress in curbing inflation and establishing better control of the public finances.

23. Where such improvements in policymaking are evident, developed nations should fulfill their end of the bargain by liberalizing trade and delivering aid. They should improve access to their markets for developing countries' exports and dismantle trade-distorting subsidies. There must also be increased aid, not just for the countries under the HIPC Initiative but for others as well. In some countries, we are indeed seeing larger inflows of foreign assistance, including to combat HIV / AIDS. Other ideas for increasing aid for low-income members, including deeper debt relief and increased grant financing, are needed and welcome. The Fund is ready to help design polices that would help countries make the most effective use of these increased resources. Better aid coordination among donors, and multi-year commitments, are also needed to make development assistance more effective. But, first and foremost, we need to increase aid levels now.

Managing the IMF

24. Keeping the IMF effective will also require changes in management practices at the Fund. In addition to the work on the strategic direction of the Fund, we are working to ensure that the Fund is managed in a way that meets the highest standards of efficiency and financial integrity. This includes adopting a medium-term budget framework and conducting a review of the Fund's financial structure.

Voice and Participation

25. We must continue to find ways to guarantee that the voices of all our member governments are heard. As you know, some very specific steps, such as providing more support to the African Executive Directors' offices, have already been taken. It is also important that the Executive Board maintain a consensus approach to decision-making, that we ensure representation of all regions and countries on the IMF's staff, and that management and staff listen to—and absorb—the policy priorities of all our member governments.

26. Many members want deeper progress on issues of voice and participation that would take into account changes happening in the world. It is my responsibility, in my first speech to you as Managing Director, to reflect these concerns; addressing them is vital to the viability of this institution. But changes in quota and voting shares will require a political consensus among our members that is not yet evident.

Conclusion

27. Mr. Chairman, Governors: the global outlook is bright, but far from risk-free. Let us seize this opportunity to make progress in tackling *now* difficult issues that will otherwise impose high costs in the future. The Fund stands ready to assist its members in improving the prospects for sustained growth to help them weather the shocks we will face in the future. I would like to thank you again for the confidence you have shown in me, and I am committed to working with all of you to tackle the challenges that lie ahead.