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Address by **RODRIGO DE RATO Y FIGAREDO**,
Chairman of the Executive Board and
Managing Director of the International Monetary Fund,
to the Board of Governors of the Fund,
at the Joint Annual Discussion

Remarks by Rodrigo de Rato, Chairman of the Executive Board and Managing Director of the International Monetary Fund, to the Board of Governors of the IMF at the Joint Annual Discussion, September 19, 2006

1. Mr. Chairman, Governors, honored guests, it is a pleasure to welcome you to these Annual Meetings. Before beginning my speech, I would like to make an announcement. Last night, the Board of Governors completed its vote on reform of quotas and voice in the International Monetary Fund. This morning, I am delighted to tell you that Governors have voted overwhelmingly in support of the reforms.

2. These reforms are the first step in a process that will increase the representation of many emerging market countries to reflect their increased weight in the global economy. Right away, they will increase the voting power of four countries—China, Korea, Mexico, and Turkey—that are most clearly underrepresented. Equally important, Governors have agreed that we must strengthen the voice and representation of low-income countries that continue to borrow from the Fund but have only a limited share in Fund voting.

3. These governance reforms are tremendously important for the future of our institution. They will enhance our effectiveness and add legitimacy to all of

the other reforms that we are implementing. Their passage is a tribute to the hard work of the staff and the Board, and to your vision in recognizing that preparing the Fund for the future is in every country's interests. We will implement the agreed package over the next two years. There is much work to do, but this vote is a great start. It shows that the spirit of international cooperation is alive and well at the Fund. Governors, thank you very much.

4. Having given you this good news, let me now thank Prime Minister Lee Hsien Loong and the authorities of Singapore for hosting the meetings this year. Thank you also to the people of Singapore for welcoming us to their exciting city. Singapore's achievements show the benefits that can flow from sound economic policies, openness to trade, and private sector development. They are symbolic of Asia's achievements over the past thirty years.

5. When we last held the Annual Meetings in Asia, in 1997, an economic crisis loomed over the region. International confidence in Asia was shaken, and there was great loss to economies—and to people. The Fund stood shoulder to shoulder with the countries of this region as they strove to overcome the crisis. They were successful, and Asia emerged from it stronger. Today, Asia is the most dynamic region in the world. The Fund will continue its engagement in Asia. It will support Asia's efforts to achieve continued sustained growth,

through further integration into the global economy and more integrated financial markets. Challenges remain, of course, especially to raise the living standards of the poor. We cannot forget that 20 percent of Asia's people still live in extreme poverty. But there is no question that Asia's recovery has been impressive and its prospects are bright. International confidence in the region has risen again—last year, foreign direct investment into Southeast Asia reached US\$38 billion, surpassing pre-crisis levels.

Global Economic Prospects and Challenges

6. Mr. Chairman, this is a time of opportunity, for both Asia and the world. We are enjoying a period of rapid global growth and low inflation that has not been seen since the 1960s. This year, global growth, fueled by continuing worldwide productivity improvements, remains high—despite rising interest rates and continued high oil prices. We expect 2007 to be another year of solid and broad-based growth. In the United States, the speed of the expansion appears to have moderated. But expansions in Europe and Japan will support global demand. China and India will continue to grow rapidly. And prospects are good in many other countries, including some of the poorest.

7. However, the global growth cycle may be close to its peak. Educated and skilled labor is in tight supply, and the scope for continuing productivity improvements may be diminishing. The best hope for continued high growth lies in further increases to international trade. If this does not happen, the outlook is less encouraging. In fact, I see three clear risks to global economic prospects. First, high oil prices could still lead to higher inflation. Second, there is the continued risk that global current account imbalances will unwind in a disorderly way. Third, there is a growing risk that protectionist sentiment will overwhelm good sense. If it does, all other risks loom larger.

8. The first risk is continued high oil prices. Up to now, the world has lived with high oil prices without serious problems. But these may emerge if supply remains tight. Oil-producing and oil-consuming countries have generally reacted sensibly so far. For example, the Gulf Cooperation Council countries have increased planned investment to expand oil and gas output and refining capacity. And countries such as Indonesia and Egypt have reduced subsidies to consumers and replaced them with targeted social spending. But we are not out of the woods yet. We still need more investment and energy conservation. And it is important to avoid mistakes. Attempts by producer-country governments to make short-run gains by taking a larger share of oil and gas revenues will backfire if they result in reduced efficiency and lower investment. So I would

urge governments to consider carefully how to get the most benefits from oil and gas resources for their citizens in the medium-term.

9. The second risk to economic prospects is a disorderly unwinding of global imbalances. The current account imbalances between the United States and other large economies are not sustainable. And they are creating further imbalances, both economic and social. There is broad agreement on what should be done to reduce these imbalances in an orderly way. For the sake of its own economy, as well as the wider world, the United States should take advantage of its good growth performance to make sustainable reductions in its structural fiscal deficit. For the sake of their own growth, as well as the growth of the wider world, Europe and Japan should implement further structural reforms—especially product market reform—and prepare for the impact of aging populations on their budgets. And for the sake of its own economic stability, as well as the stability of the wider world, China should strengthen its financial sector, boost domestic demand, and use the exchange rate flexibility it gave itself a year ago.

10. The third risk I want to talk to you about is protectionism. The suspension of the Doha Round talks is deeply disappointing and damaging. It delays an agreement that would raise prosperity and support growth around the

world. And it feeds a growing inclination towards at best bilateralism, and at worst protectionism. The stakes are far too high to accept failure. Let me take this opportunity to call on the G-7 countries and the major emerging market economies to intervene quickly to conserve the gains made in negotiations so far, and to put the Doha Round back on track. On trade, the world will either go forward to greater growth and broader opportunities, or backward, to narrow nationalism. We should not fool ourselves that there is a comfortable middle ground.

Globalization and International Cooperation

11. Much of the recent strength of the global economy has been due to gains from free trade in goods and services. Market-driven specialization, supported by the global deployment of investment, has boosted productivity, raised living standards around the world, and lifted millions of people out of poverty. As the process has unfolded, the position of many emerging markets, especially here in Asia, has changed dramatically—and for the better. Some have become major sources of demand as well as supply in the world economy. These changes have been made possible not only by new technologies but also by increased reliance on market forces, and by governments and central banks managing their economies with a more medium-term perspective.

12. But if we are to continue to reap these benefits, we must confront the challenges of globalization. We must work together to reduce the risks from large and persistent payments imbalances. We must work together to reduce the risks of capital account crises. And as Chairman Bernanke has stressed, we must work together to make sure that the benefits of global economic integration are more widely shared, especially with the citizens of low-income countries.

The Significance of IMF Reform

13. The Fund is committed to help our members meet these challenges. This is the vision that is at the heart of the Medium-Term Strategy. Over the past year, we have begun a comprehensive process of reform, to better meet the needs of all our members. I have already talked about our progress on reform of quotas and voice. Let me now talk about two other areas: reforms of surveillance, and measures to strengthen crisis prevention, especially in emerging markets.

14. First, surveillance. This work—monitoring the global economy, advising individual members on their economies and assessing their policies—is perhaps

the greatest single service that the Fund provides. To improve this service, we are sharpening our focus on exchange rates and intensifying our work on capital and financial markets. One of the lessons we all learned from the Asian crisis is that nasty surprises in the financial sector can lead to even nastier surprises in the real economy. Effective financial sector surveillance is critical if we are to avoid such surprises in the future.

15. Another important step towards improving surveillance is a new tool: Multilateral Consultations. The first of these focuses on narrowing current account imbalances while maintaining robust global growth. The consultation has begun, and we are making progress. I hope the consultation will produce a common understanding on policies designed to produce actions in several countries together, and also on the role the Fund can play as a forum for implementing the common approach.

16. A second key area of our reform program is centered on crisis prevention, especially for emerging markets. At the moment, times are good in financial markets. But financial crises have not disappeared from the face of the earth. And the time to prepare for them is now. The best defense against financial and economic crisis is good policies at home. Emerging markets all over the world—in Eastern Europe, in Latin America, and here in Asia—know

this very well. Many have acted to reduce their vulnerability. Some could go further—by reducing public debt, strengthening financial systems and enhancing the flexibility of their economies. The international community, through the Fund, should also be prepared. We should ask ourselves whether we need new instruments to make sure that the financial support we provide is sufficiently predictable, flexible and substantial to enable us to meet the challenges our members could face. With your help, we will be working on this important issue over the coming months.

17. Let me now say a few words about the position of low-income countries. Many countries are making progress: growth in Africa over the last two years is the highest it has been in a decade, and average inflation is the lowest in a quarter of a century. But many low-income countries have yet to achieve integration into the global economy. Doing so is critical for their future prosperity. And a look at the conditions in which many people in low-income countries live shows that there is still a very long way to go.

18. The Fund is fully committed to helping low-income countries meet the Millennium Development Goals. We will be most effective if we focus on what

we do best, and on tasks where we can make the greatest contribution. In doing so, we will work in partnership with the World Bank and other development agencies.

19. The Fund and the Bank both took an important step in the past year, in implementing the Multilateral Debt Relief Initiative. In the Fund's case, this wiped out debt owed to us by 22 poor countries. Now we need to help countries reap the benefits of higher debt relief and higher aid. One critical task is to avoid a new buildup of unsustainable debt. I believe that creditors share with debtors not only a responsibility but also an interest in this. The Fund can help both creditors and debtors by assessing debt sustainability. But the Fund's assessments will be most useful if all creditors provide information on lending, and make it available to the Fund and the Bank, and I call on them to do so. This is an area where we must not allow history to repeat itself.

20. For their part, low-income countries must continue to implement good policies and structural reforms. Donors must turn the promise of higher aid into a reality, and make their aid more predictable, and less subject to an array of different conditions.

Conclusion: A Time of Opportunity

21. Before concluding, let me offer a few words of thanks. To the staff of the Fund, for their extraordinary work during this very busy year, for their commitment, and for their support of changes that will make the Fund stronger. To my Management colleagues, John Lipsky, Agustín Carstens, and Takatoshi Kato, for their support and help. Special thanks to Anne Krueger, who retired in August after five years as First Deputy Managing Director. And thanks to Paul Wolfowitz for his leadership of the World Bank, for his friendship and for his wise counsel over the past year. I would also like to thank those who have helped to organize these meetings, including the authorities and especially the people of Singapore.

22. Mr. Chairman, Governors, honored guests, I said earlier that this is a time of opportunity. The door is open for the citizens of the world to benefit from a new round of growth. The question is whether we, the international community, are prepared to work together to grasp this opportunity. We need to renew our commitment to multilateralism: to finding shared solutions to shared problems. The vote to reform quotas and voice that has taken place here in Singapore should inspire us all. It shows your support for the Fund and for the changes we

need to help our members meet the challenges they face. We have a well-defined work program to make these changes. We have the will to change. We have the support of our members. Mr. Chairman, we are ready to take this opportunity.

23. Thank you very much.