

# **The IMF and the new world economic order**

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It is a great pleasure to be here today, and would like to thank the organizers of the conference for inviting me. I always enjoy coming to Tsaghkadzor, and especially today, as the venue of the conference is fitting in order for us to elevate ourselves from local political events and be able to achieve a better vision on some critical issues the world is facing.

The global crisis that started in 2008 has shaken economies, industries and households across the world, but it has also shaken the intellectual foundations of the prevailing world order and national policy frameworks. A new, more solid, sounder intellectual basis is taking shape, with initiative such as Kazakhstan's of creating an open forum for global cooperation being welcome and important to contribute to its construction.

Closer integration and interconnectedness in the world economy has had tremendous benefits. It created unprecedented prosperity for countries of different sizes and different regions, lifting millions out of poverty. It helped citizens enjoying access to a wider variety of goods and services, lower prices, more and better-paying jobs.

However, it has come with important downsides, including higher instability. To draw a useful parallelism, let's remember what happened when people originally migrated from the countryside to live in cities. This process enabled brand new job opportunities and more access to goods and services. But at the same time it also allowed diseases to be spread much more quickly than in the past. The current crisis was a disease that originated in the households' balance sheets of some countries including the US, was quickly transmitted into global banks' balance sheets, and then transmitted again to some vulnerable sovereign balance sheets, especially in Europe. These sick sovereign balance sheets have now

affected some other global banks again, creating new negative vicious cycles which can bring new unexpected victims.

But the solution to a series of health epidemics that occurred when we started to live in cities was not to send everyone back to the primitive modes of living in the countryside. The solution was to improve preventive health, improve health care, and other measures. There is no way back to the global village, but we need to do better to address the downsides.

Given the problems we face are global in nature, the response to these problems has to be global. A defining feature of the new economic order ought to be more and better cooperation. The period immediately after the crisis showed there is room for hope. The G-20 emerged as a key forum for the world's major economies to discuss policy priorities, a marked improvement with respect to the past in which emerging markets did not participate in important decisions concerning the global economy. G-20 priorities were taken to the IMF, where they have become global in nature. April 2009 was the climax of commonality of focus and purpose, with an unprecedented multilateral effort taking place. Were it not for the bold action of G20 after the crisis, we would have probably seen a second great depression.

Unfortunately after the worst moments of the crisis the effort quickly lost momentum, and maybe not coincidentally the economic recovery has entered a dangerous phase, with financial sectors struggling and sovereigns besieged. The lack of progress could derive into the process being set into reverse motion, with a fast proliferation of ill-conceived policies with a narrow geographical and temporal focus. We are already witnessing more bilateral payment agreements, and currency tensions are evident. Regionalism is already in some cases going from a means (a stepping stone to multilateralism) to an end in itself (a replacement).

We now need to rebuild momentum of the effectiveness of cooperation, and not just to handle a possible new crisis, but also to fix the infrastructure. Global platforms should be informing and influencing the design and implementation of the globally consistent and reinforcing national policies. The issues are too

important to passively wait for the G-20 to come up with solutions. We all need to do more to address the multidimensional failures that lay behind the crisis. Global conferences of academics are taking place, and other global forums like G-Global can also be very important to develop new ideas, and to have a multiplicity of voices heard.

At the IMF we have also been working in this direction. Let me highlight some of it in three key areas:

- The crisis showed that **financial systems** need to reform. First, they need to be made safer. In this context, we have proposed to:
  - Broaden the perimeter of regulation to encompass institutions and markets that were outside the scope of regulation
  - Better regulate banks' capital, provide incentives to encourage firms to accumulate additional capital buffers during upturns and let them run down during downturns,
  - Improve data disclosures for supervisors and investors to better understand where risk is located
  - Address inconsistencies of legal frameworks to ensure a smoother international banks' resolution
  - Improve liquidity provision frameworks

Second, the functioning of financial systems has to be made fairer: we need to move away from a system that privatizes the gains and socializes the losses. In this context, we have proposed a new tax on financial activity that would go a long way for the financial sector financing the costs of expensive government bailouts.

- Also, the crisis has shown with renewed vigor that the **international monetary system** is too unstable. Work has progressed on the following issues:
  - Better monitoring and handling of volatile capital flows could help contain risks. Work has been done to formulate a framework to help countries cope better with those flows.

- A stronger global financial safety net will limit contagion. IMF has augmented its resources and is seeking further augmentation. The lending toolkit was revamped and further work is under way on developing mechanisms for meeting short-term liquidity needs during systemic crises, ensuring the Fund's resources remain adequate and moral hazard is limited.
  - Over time, there may also be a role for the SDR to contribute to a more stable international monetary system. But the global reserve asset system is likely to evolve only gradually, along with changes in the global economy. There is general support for expanding the SDR basket and, in that context; Fund staff are currently working toward clarifying the circumstances under which a currency could enter the SDR basket.
- The crisis led to very high levels of unemployment, especially among those most vulnerable, and inequality had been growing even in the pre-crisis era. High inequality has strained social cohesion and created unrest. These developments have brought into clear focus the fact that globalization needs a more human face. The benefits of growth must be broadly shared, not just captured by few. We have undertaken research that shines a clear light on the inadequacy of notions that growth can come at the expense of inequality.

The new world order also needed a better IMF, as an institution uniquely placed thanks to its nearly universal membership and a clearly defined set of objectives and institutional arrangements. And the IMF has been changing. As expressed, we have reformed our lending instruments to better tailor them to our members' needs. We have also streamlined conditionality, and are working with a renewed sense of partnership and flexibility. We have improved governance, with two reforms in 2008 and 2010 that will involve a quite considerable increase of around 9 percent in voting shares towards developing countries, with all BRICS now among our top ten shareholders. Our lending programs have put a clear emphasis on the protection of social spending.

We live in an age of uncertainty, in which the world economy faces daunting challenges and serious risks. Responding to those is a tall order, but it is the responsibility of people in various circles, here today and across the world, to support policy makers raise up to those challenges.

Crises bring opportunities to change, and there is now a general recognition of the need for action. As soon as a favorable economic cycle gathers steam, complacency can set in, laying the seeds for another crisis down the road. There is now a window of opportunity, and we should not let the opportunity go by to secure a more prosperous, stronger and safer world economy for the next generations.