Critical Issues for the Bretton Woods Institutions

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Good evening and thank you Larry[1] for your efforts in making this conference happen.

I also helped organize a conference here at this hotel to help celebrate the then 50th Anniversary of Bretton Woods 20 years ago in 1994. The keynote speaker was former President George Bush Sr. and I introduced him and took him back and forth to his home in Kennebunkport and then flew with his wife, Barbara and Jeb Bush Jr. to the world cup soccer final in Los Angeles. It was quite a wonderful experience.

His remarks at the conference were optimistic about the future of what seemed to be a new world order in the making.

The Soviet Union had recently collapsed and we were in a unipolar world with the US dominant economically strategically and militarily.

In China, Deng Zhou Peng had two years earlier given his historic speech in Shenzhen when he said, "It doesn't matter whether a cat is white or black, as long as it catches mice." This set off China on its tremendous economic drive in investments, exports and growth the like of which the world had never seen before.

In the rest of Asia Japan had yet to face its banking crises and the future decade and half of deflation had not yet begun.

Also, the Asian Financial Crisis was still several years away.

In the Middle East, the first Gulf War had recently been fought and it appeared that the political crisis was settling down in that area. We found out differently a few years later.

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[1] Lawrence Goodman, President of the Center for Financial Stability.

In South America the Brady Plan was taking the area out of its lost decade of economic problems and returning most of the countries back to sustained growth.

In Mexico, President Ernesto Zedillo and his finance minister, Guillermo Ortiz, who are here tonight, were facing a financial crisis which they courageously managed and resolved.

The Euro was not yet a reality even though Bob Mundell and some others were already talking about its creation.

And lastly, since this is my topic tonight the IMF and World Bank were playing major roles in the international economy.

At many times over the last 65 years the IMF and the World Bank have played vital and constructive roles in the global economy. Both institutions have been blessed with a number of outstanding leaders who developed the roles of the institutions to meet the needs of a changing world, and to be most effective in challenging circumstances.

My role tonight is to provide some thoughts and to stimulate discussion about the challenges and the opportunities for the two institutions as we look to the future. My expectation is that at tomorrow's sessions you will provide some of the answers to the questions that I will raise with you this evening.

We need to consider if changes in the roles of the IMF and the World Bank are needed and, should we believe that they are, then what changes should be made?

Starting in the early 1980s, the World Bank developed program lending, which promoted structural adjustment, as distinct from purely project, lending. These programs were closely synchronized with IMF programs and this brought the two institutions far closer together than had previously been the case. There was even talk at one time of merging the two institutions, an idea resisted by the staffs of both organizations.

Today, neither institution is as paramount in the global economic system as it once was. Most people, including many in the institutions themselves, feel that neither institution has adequately adapted to a changing global economic and development landscape. Let me provide some examples:

- Most countries have far greater access to capital markets than before and so most have a lower need for funds from official sources than before.

- Where once the IMF Interim Committee played the leading role in global economic and financial policy coordination area, now in many ways the Group of 20 has superseded it. Moreover, financial regulation has become the coordinating role of the Financial Stability Board, which in some respects weakens some of the IMF's actual and potential influence.

- There are now a range of regional development banks and more in the making, which reduces the World Bank's monopolistic position. The World Bank group in its 2013 fiscal year made a significant total of commitments of $52.6 billion in the form of loans, grants, equity investments, and guarantees to its members and private businesses.

  Today, however the emerging market countries have their own powerful development agencies, the BNDES in Brazil disbursed more than $84 billion in 2013; the Chinese Development Bank is an enormous organization, and other emerging market countries are also finding ways to be less dependent on World Bank and other finance from multilateral institutions.

- In addition, there is a fundamental challenge to the Bank and to the Fund as they are perceived by many developing countries and emerging market countries as being dominated by the governments of the major industrial economies. For example, a BRICs Bank was launched at a summit in Brazil in July that involves Brazil, China, India, Russia and South Africa. It starts with $50 billion of capital, which may rise soon to $100 billion and grow from there in coming years.

  Then, just last week *The Wall Street Journal* reported that India may join a planned China-backed Asian Infrastructure Investment Bank, which will have a starting capital of $50 billion. It would be an interesting breakthrough if the Modi government actually agreed to participate. This institution is seen as both a challenge to the World Bank and to the Asian Development Bank.

- The IFC, the private sector arm of the World Bank has been a major success story. But, we need to consider at our meetings here whether it is now too competitive with private international sources of capital: is it using its official status to edge out meaningful private competition?

- And, we should also note recent challenges to the IMF's leadership. For example, the IMF has been forced in the Eurozone crisis to share its influence with the Brussels Commission and with the ECB. Its leverage has been weakened.

- In Asia, the IMF has been challenged ever since the financial crisis of 1997/98. The Fund's role, especially with regard to the crisis in Indonesia, and to some degree with regard to South Korea, was widely perceived in Asia as too domineering. There were perceptions in some quarters that Washington was, in fact, dictating to Asia. One result was the decision 14 years ago by the finance ministers of ASEAN+3 to announce the Chiang Mai Initiative in Thailand. At a meeting on the side of the May 2000 annual meeting of the Asian Development Bank, the ministers announced their intention to cooperate in four principal areas: monitoring capital flows, regional surveillance, swap networks, and training personnel.

To a considerable degree the proliferation of institutions reflect concerns in the governments of a number of emerging markets over the power structures in the IMF and the World Bank. There is a strong feeling that the governance of these institutions, notably the allocation of voting rights, continues to greatly favor the United States and the traditional West European governments, while it fails to recognize the rise of the leading emerging market economies in the global economy.

The difficulties that recent U.S. administrations have had in convincing the U.S. Congress to support new resources for the IMF have added to the sense of grievance on the part of many governments. The tradition that has been maintained that a West European should always be the Managing Director of the Fund and an American should always be the President of the World Bank has compounded this sense of grievance.

Until the governance issues are resolved, both the Bank and the IMF will suffer in their international standing and importance. It will be interesting to learn your views on this political issue in the meetings tomorrow.

Against the background of so many issues, there are the core questions of what are the major roles of both Bretton Woods sisters in the years to come?

On the World Bank first: it continues to lend to many countries that have very substantial reserves and strong access to the capital markets. It does so to ensure its large balance sheet and its powerful AAA status in the markets where it borrows. But, is it not time that this policy be thoroughly reviewed and that many current borrowers be graduated?

In our discussions here we may wish to consider whether the Bank should, and can, find new ways to strengthen its resources, including co-financing with private financial institutions, to significantly expand its structural adjustment lending and its balance of payments support in tandem with IMF programs.

As we discuss this, however, we should note that the Bank's leadership had downplayed this role in recent times. The Bank frequently defines itself these days in terms of two related actions: "(i) ending extreme poverty by reducing the percentage of people living on less than $1.25 a day to 3 percent (*of the global population*) by 2030; and (ii) promoting shared prosperity by fostering income growth for the bottom 40 percent of the population in every country." [2]

In this context the World Bank could be, perhaps, an increasingly powerful engine of technical assistance. It is the supreme leader in knowledge and research among the official development agencies and this is a role which, as it considers specializing its focus more on absolute poverty, could have still greater influence as a very active partner with other multilateral and bilateral aid agencies.

Now, on the IMF: today the Fund is the lender of last resort for countries that have critical balance of payments problems. The influence the IMF has, despite its impressive research, and despite the learned discussions on the value of Article 4 consultations, depends above all on how ill the patient is. Today, governments rarely go to the Fund for assistance unless they felt they had nowhere else to turn. Sometimes, as we have seen with Argentina, even then they have refused to turn to the IMF.

I believe that ways need to be considered to strengthen the resources and the stature of the Fund so that it can play a more effective role as a crisis manager, as lender of last resort, as the critical actor in times of international crisis, and, very importantly, as a leader in preventing crises.

I believe that the Fund should draw a lesson from its past successes in the 1980s, when in the midst of the Latin American debt crisis it moved rapidly to involve private financial institutions as partners in crisis management and crisis resolution situations.

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[2] The World Bank Group Corporate Scorecard In October 2013, the World Bank Group adopted a new Strategy that is grounded in two ambitious goals:

- ending extreme poverty by reducing the percentage of people living on less than $1.25 a day to 3 percent by 2030; and,
- promoting shared prosperity by fostering income growth for the bottom 40 percent of the population in every country.

The Strategy outlines how the World Bank Group will partner with clients to help them achieve these goals through economic growth, inclusion, and sustainability. Implementation of the Strategy is monitored by a newly developed World Bank Group Corporate Scorecard that aggregates the contributions of all the World Bank Group institutions—the World Bank (WB), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).

I would also suggest that the IMF should be playing a larger role in crisis prevention and here too the private sector should be an important partner.

Following the Asian Financial Crisis, the IMF established a Contingency Credit Line to enable countries to obtain resources to augment their reserves and offset possible contagion risk at a time of crisis. There were too many conditions attached to the CCL and it failed. In 2009, at the urging of several of us in the private sector including Jacques de Larosiere, the G20 encouraged the IMF to IIF introduce a new, less conditional version. This became the Flexible Credit Line. It his only been used by Mexico, Poland and Colombia – more countries might have used the FCL but for the fact that there is a perceived stigma attached to going to the Fund.

The fact is that tools like this can be valuable, yet governments attach a stigma to going to the IMF. As the IMF seeks to strengthen its crisis prevention roles, so it has to confront the issue of its public image and the stigma that remains widely seen by governments that could, for example, take advantage of the FCL.

To further strengthen its overall crisis prevention role, the Fund needs to become a far more serious partner with the private financial sector. There have been a range of initiatives about this over many years, but they have fallen far short of what is necessary.

We have a panel tomorrow on sovereign debt restructuring. In the 1980s, the Fund moved swiftly to involve leaders of the banking sector in negotiations with the sovereign debtor. Now, conditions are more complicated with not just banks, but large numbers of other financial institutions and investors highly active in sovereign bond markets. The Fund should view this as a challenge and formulate innovative ways to engage seriously with the private financial sector to develop partnerships that promote effective crisis prevention approaches.

The Fund has the capacity I believe to learn from its past successes and failures, and it needs to do so if it is to restore its former influence in assisting governments to restructure their sovereign debts. This is a crucial area for Fund leadership.

In conclusion, I believe that the Fund and the Bank can play very important roles in the future. The Bank can be the center of development knowledge and the coordinator of international efforts in the drive against global poverty. The Fund can be a vital player in crisis management, crisis resolution and crisis prevention. As we consider such roles, and others that you may advocate, we need to also find a path forward for the governance issues that the lead shareholders of both institutions have inadequately confronted.

Thank you.