THE BROOKINGS INSTITUTION

RODRIGO DE RATO, MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

Tuesday, September 5, 2006

11:00 a.m. - 12:00 p.m.

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CONTENTS:

FEATURED SPEAKER:

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INTRODUCTION:

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P R O C E E D I N G S

MR. TALBOTT: Good morning, everybody. I am Strobe Talbott, and I want to welcome you here on a rainy back-to-school Tuesday for what we are very proud to think will be an extremely good opening to the fall season here at Brookings.

We are delighted to welcome here to the Institution, Rodrigo de Rato, the Managing Director of the IMF. He has been kind enough to be with us today as part of our 90th Anniversary Leadership Forum.

Today's event, I should say, is a result of a collaboration between two of our research departments here at Brookings.

(PA system feedback interruption.)

That was more of a build-up than I even intended.

The two research programs that have put their heads together to put our program together are our newest, the research program devoted to Global Economy and Development, and one of our oldest research programs which is Economic Studies. We have set up the Global Economy and Development program under the leadership of Lael Brainard, Vice President and Director of that program, who is here with us today, in order to build on the traditional strengths of the Brookings Institution but with new emphasis on issues related to globalization, and particularly, that means global macroeconomic policies, trade, the rise of new powers like China and India, and very prominently, poverty elimination and poverty reduction.

I might say that one of our friends and colleagues here at Brookings, our Trustee and the Chairman of our new Wolfensohn Center on Development, Jim Wolfensohn, asked me particularly, Mr. de Rato, to extend to you, his greetings. He has great admiration for you. He is making his way back from Wyoming to Washington, and he looks forward to seeing you in Singapore in a little over a week.

Our Economic Studies program is represented by its new Vice President and Director, Bill Gale — this is his first working day on the job — and also by one of our very distinguished Senior Fellows, Susan Collins, who, by the way, spent some months, about nine months, at the IMF as a visiting scholar several years ago, and Susan will be moderating the Q and A that we will have as soon as Mr. de Rato completes his remarks.

Just a word more about our guest of honor: Mr. de Rato is going to be addressing, I am sure, the reform agenda of the Fund in advance of the joint meetings of the Fund and the Bank that will be taking place in Singapore. The issue of IMF reform, especially with regard to governance and quotas, is very much back in the forefront of discussion, and that is in particular in the context of how we can ensure the financial stability of the new global economy. As Managing Director of the Fund, Mr. de Rato is working to retool the Fund to make it more effective for the 21st Century and modernize its core functions. He personally epitomizes the Fund's commitment to working boldly to build a broad consensus for change in Singapore, which is an important task and no easy one, and we appreciate very much his willingness to come here and preview some of the issues and, with Susan's help, to discuss it with all of you.

Mr. de Rato, the podium is yours.

(Applause.)

MR. DE RATO: Good morning. First of all, I want to thank the Brookings Institution for giving me this opportunity and to Strobe Talbott for his very kind introduction and in advance to Susan Collins for moderating the discussion that will follow.

This is the first day after Labor Day, and we don't have to tell our children what that means, but for us also, I think it is a good moment to take stock for a fresh start and to look at our work and the agenda that each of us has set for the next future.

Regarding the Institution I have the honor of leading, the International Monetary Fund is also going through a very exciting time, and we will be hosting the Annual Meetings in Singapore in around a week from now. This will be the first time since 1997 in Hong Kong that the Annual Meetings of the International Monetary Fund and the World Bank will be held in Asia, and I believe this is a very good opportunity. Asian countries' commitment to openness, trade, and private sector development has made the region the most dynamic in the world. The two principle items on our agenda in Singapore are discussions of the developments in the global economy and also a stock-taking and some decisions on implementation of our Medium-Term Strategy, which is the plan that we lay out for the Institution to adapt to what our members need in the 21st Century and what globalization is demanding.

Today, here in the Brookings Institution, I want to focus mostly on two aspects of the Medium-Term Strategy: proposals for reform of the Fund's governance structure and the changes we are making in the way we conduct surveillance. But before doing so, let me say a few words about the global economy.

The global economy has been resilient in the past year, even with high oil prices and some other macroeconomic disturbances and a change in monetary policy in most of the main areas of the world. At the same time, we have to say that growth prospects are still good, not only for 2006 but also for 2007.

Starting here at home in the United States, the speed of expansion is moderating but certainly to a more sustainable path that largely reflects the change in the monetary policy that has been taking place and also some slowdown in the housing market. Elsewhere in the world, growth prospects are encouraging. We see Japan appears to have put deflation behind it; China and India continue to be engines of growth; and many other countries, including Sub-Saharan Africa, are enjoying a continuation of the strong growth that we saw in 2004 and 2005. At the same time, we also see a stronger recovery than expected in Europe. In that respect, we expect next year to be another solid year of growth in the world with expansion in Europe and Japan supporting global demand even as the U.S. moves to a more moderated situation.

Nonetheless, there are more clouds on the horizon than there were a year ago. Inflation risks are a concern as output gaps narrow; high oil prices could adversely affect both inflation and growth; and there has been a major setback in the Doha Round. Of course, global imbalances continue to grow and could be exacerbated by the previous risks that I just mentioned. So, in this respect, one of the messages I want to give to policymakers a week from now in Singapore is that the world is facing an increasingly challenging environment and that policymakers in different countries with different agenda should be proactive in addressing the risks.

Let me now move to the central theme which is the progress in implementing two very important aspects of our Medium-Term Strategy, relating to our own governance and also to surveillance. Our Medium-Term Strategy, approved by the member countries last September and with some proposals implemented last spring, was motivated by the central insight that the world is changing very fast and that the Fund needs to adapt to reflect the changes that we are seeing today and that those changes are posing new challenges to our membership. New economic powers are rising, especially among the emerging market economies. Financial globalization creates tremendous economic opportunities but has also changed the nature of risk.

How should the Fund react to these new realities? I believe that the changed distribution of the economic weight in the world demands that we reform our governance structure. The distribution of quotas which largely determine voting power in our Institution and, at the same time, influence the amount that members can borrow from us, has changed only gradually over time. We know, if we look at the numbers, that it has not kept up with the changes in the relative position of countries in the global economy. So, in that respect, I see a clear need for rebalancing of quotas to reflect changed economic realities, especially the increased economic weight of major emerging economies but also of other economies in the world.

I also see, at the same level of importance, the need to protect the voice and representation of low income countries. Their voting power has been eroded over time, in part because other countries' relative importance in the global economy has increased and in part because basic votes — an equal allocation of votes based on the principle of equality of states that was made when the Fund was founded — has become relatively less significant with each new increase in quotas. This gives rise to concerns about the adequacy of voice and representation for a number of countries that continue to borrow from the Fund but that have only a limited share in Fund voting.

Why are these issues important? The Fund has a global membership and a global scope of responsibilities. It is the most important and sometimes the only forum for collective action on complex macroeconomic problems. Increasingly, the Fund is also a vehicle for promoting cooperation between groups of members, most recently through the initiative on multilateral consultations to which I will refer a little later.

The Fund has legitimacy and a record of effectiveness, but if it is to retain its legitimacy and maintain its effectives and be a useful vehicle for promoting international cooperation, all of the Fund's members must be confident that they have a fair share in its decision-making and that their voice will be heard. This is certainly a challenging process for the structure of a multilateral institution. There are many interests at stake and also as many principles that can be invoked to defend those interests.

I want to say that I am thankful for the attitude of many, many countries governments. I have to say I have witnessed that they have taken a broad view of the Institution's interest and not just looked at their own narrow, legitimate but narrow, interests. As a result, I can report that the members of our Executive Board have risen to the challenge and have agreed on a package of measures that will be recommended to the Fund's Governors in Singapore.

One element of this package will be implemented very quickly. This is an increase in quotas for four countries that are clearly under-represented by any standard you want to use: China, South Korea, Mexico, and Turkey. This increase would be designed in part to rectify the most extreme distortions in the representation. It will correct about one-third of the actual under-representation, but its greater significance is an initial action in a broader process of reform. This will take place over the next two years with discussions beginning very soon on a new quota formula designed to capture more accurately members' positions in the global economy, so that — if possible by next year in 2007 at the Annual Meetings here in Washington or at the latest, in 2008 — the Board will agree on a new formula and recommend further ad hoc increases in quotas for a broader range of members, based on this new formula.

There is also agreement that we should ensure that quota shares continue to evolve in line with the changes in members' positions in the global economy, while continuing to ensure that the Fund has enough liquidity to achieve its purposes.

The Board will also ask Governors in Singapore to agree in principle to an amendment of the Fund Articles to at least double basic votes, so that the existing voting share of low-income countries as a group is protected, and to add a provision in the Articles of Agreement that the share of basic votes in total voting power should remain constant in the event of any future changes in total voting power. It takes time to amend the Articles of Agreement of an institution with 184 country members — in many countries, we need legislative approval — but the plan is that these changes be made at the same time as the second round of quota increases.

In addition, right away, I will ask the board to increase the staff in the offices of Executive Directors who represent a very large number of countries, like is the case for Africa, to help them continue to make their voices heard effectively.

This is a package that I have taken some detail to explain to you, and I apologize if some elements I have described seem arcane. The principles behind the package are not arcane. They are based on fairness, and their impact will be large. They will allow the Fund to remain an effective and credible participant in the global economic discussion. They underpin all of the other elements of the Fund reform.

Now, let me turn to the second issue. One of the most important functions of the Fund is surveillance of the international monetary system and of the global economy. By surveillance, I mean both monitoring of the global economy and the Fund's discussions, called consultations, with individual members on their economies, which are done usually once a year. In proposing changes in this area, we are building on reforms that have been underway for many years, especially the increased emphasis that we have placed since the late nineties on promoting internationally agreed standards and codes and on a greater transparency in our operations and assessments. But the Medium-Term Strategy goes further with the aim of adapting the Fund's surveillance to a new world of financial globalization with all of its attendant opportunities and risks.

One change that we have already begun to implement is the introduction of a new tool to which I have referred before, multilateral consultations, in which particular issues of global or regional significance will be taken up collectively with some members and, where relevant, with entities formed by groups of members. Multilateral consultations are an example of the Fund's increasingly important role as a vehicle for international cooperation. The aim is to provide a vehicle for analysis and consensus-building and a framework that helps our members overcome some of the hurdles to individual action by emphasizing the benefits of joint action for all.

Our first initiative on multilateral consultations has already begun, and it was agreed last spring here in Washington and focuses on narrowing global current account imbalances while maintaining robust global growth. Fund staff have already held bilateral discussions with the participants in these multilateral consultations on global imbalances — there is China, the Euro Area, Japan, Saudi Arabia, and the United States — and over the coming months, we will hold roundtable meetings with all of the participants together. The consultation in this case is focusing on the spillovers and linkages among these and other economies and on actions that could sustain growth and promote an orderly unwinding of the imbalances.

I don’t want to go into much detail of these discussions as these consultations are still at an early stage. It will also take time both to complete the consultations and for actions taken to produce effects on the global imbalances. Global imbalances have been built over a number of years and will not be reduced to sustainable levels quickly unless we have a crisis. However, I hope that the consultations will produce (a) a shared analysis of the nature and consequences of global imbalances, (b) a common understanding of policies designed to make things happen in several countries together, and (c) understandings of the role the Fund can play as a forum for implementing the common approach, a forum in which all of the international community is represented.

Another part of the reform of the Fund’s surveillance is a review of the foundations of our surveillance, embodied in past Executive Board decisions, to ensure that they are clear and relevant. We are sharpening our focus on exchange rates. A recent study we made of our staff reports on 30 large economies revealed that most provided assessments on the adequacy of exchange rate regimes and exchange rate levels, but we can improve our analysis further. We are in the process of extending to the currencies of the major emerging economies, the analysis the Fund currently does to assess whether the exchange rates are broadly in line with fundamentals, as we do regularly with developing economies. This is something that needs to be handled with caution, given the methodological difficulties and sensitivities, but I think it is a very important step on global surveillance.

We are also intensifying our efforts to integrate our financial sector framework, including on capital and financial markets, in our regular surveillance activities. The increased importance of financial markets for growth and development for all countries is a major feature of the new world globalization. It is of particular importance for emerging market countries which have a lot to gain from financial integration, but many also become more vulnerable in integrated global markets. The Fund has been placing increased emphasis on identifying the strengths and vulnerabilities in the financial sector for many years, including through the launch of the Financial Sector Assessment Program in the late nineties.

Where we are now advancing, it goes a little further. In our surveillance of the global economy, we have already begun to devote more attention to the linkages between the financial sector and the real economy. The linkages work both ways. We are examining the implications of financial sector changes for countries' economies, including in a chapter of the World Economic Outlook that will be released tomorrow. Risks to financial stability are addressed in the Global Financial Stability Report that will be released on September 12th.

In our surveillance of individual countries' economies, we are enhancing the analysis of financial sector vulnerabilities and ensuring that this is reflected in our macroeconomic analysis and policy advice. In Article IV consultations reports, we will increasingly cover the implications of such vulnerabilities for macroeconomic aggregates and capital flows and for domestic and external spillovers. The bottom line is that in the past, nasty surprises in the financial sector have had even nastier effects on the real economy. To avoid such surprises, we are devoting increased resources to financial sector surveillance.

I have focused particularly on surveillance work today because it benefits all of our members and it is at the heart of our responsibilities, but the Medium-Term Strategy covers many other aspects of our work besides surveillance, and let me mention very briefly two areas where I expect some changes over the coming months.

I think we need to improve the usefulness of our support for emerging market economies. After very heavy borrowing for a period of years, not many of our emerging market country members borrow today. This is partly a reflection of the good conditions in financial markets but also of improved economic management in those economies. But I want to make sure that if financial market conditions worsen, the serves we offer to our members are sufficiently useful that they will come to us for support if they need it. For this reason, I have proposed that we develop a new instrument to provide liquidity for emerging market countries that have strong fundamental but remain vulnerable to shocks. The aim would be to provide assurances that substantial financing will be available in time of need, a framework for policy commitment and monitoring, and a signal to the markets.

Our Executive Board discussed this instrument for the first time last week. I look forward to further discussions on this issue in Singapore and after Singapore. Given members' support, we would work on these issues in the coming period, and I hope that we will be able to make concrete proposals in the next six months by the Spring Meetings here in Washington in 2007.

Let me now turn to low income countries. Over the past year, the Fund has moved quickly to implement the Multilateral Debt Relief Initiative, wiping out the debt owed to us by some 19 poor countries, and other international organizations have followed us. We have put in place a new subsidized lending facility for low income countries hit by shocks and a new instrument to support policies in those countries that do not need Fund financing, but it is clear that the challenges are very big and we need to do more.

Mahatma Gandhi is reported to have advised "Think of the poorest person you have ever seen and ask if your next act will be of any use to that person." This is certainly a very high standard to meet, but it gives us the standard we must try to meet.

I have proposed a Medium-Term Strategy that the Fund renew its commitment and improve its effectiveness in helping low income countries meet their Millennium Development Goals, by focusing on what we do best and on tasks where we can make the greatest contribution. These includes helping countries reap the benefits of higher aid and debt relief and avoid a new buildup of unsustainable debt, promoting macroeconomic stability which is the prerequisite for sustainable growth, and providing support in policy areas where the Fund has expertise and that are critical to growth; for example, trade policy and financial sector issues. In all of these areas, we also need to work closely with others, such as the World Bank but also the donors and most importantly, with the country governments and civil society of those countries.

To sum up, we have, as I said, a very exciting and important agenda before us in Singapore and beyond. The International Monetary Fund has made good progress in the past year on measures to improve surveillance, measures to help low income countries, and others aspects of our Medium-Term Strategy. We have a more clear picture than we did a year ago of the direction that those reforms should take, and we have taken steps along the way.

I hope that in Singapore, our Governors will support the planned changes in Fund quotas and endorse our plans for continued reform of surveillance. I also hope that they will indicate their support for the future work, including that on crisis prevention and Fund income that we are planning in the coming months.

We have a long journey ahead of us. I am sure it will be exciting and sometimes may be difficult, but we approaching it with the determination and with the conviction that the Fund can help our members meet the challenges of globalization, so that the people of the countries can enjoy the benefits.

With that, I certainly thank you for your attention. I invite your comments and questions. Thank you very much.

(Applause.)

MS. COLLINS: Thank you very much, Mr. de Rato. We very much appreciate your comments this morning on two of the very important issues that the Fund faces going forward.

Your remarks this morning focused on the issues of surveillance and on the issues of Fund governance. I think everyone in this room would agree that surveillance, in particular the issues that face the Fund in being perceived as being democratic, as being representative are critical for it playing a very positive continuing role going forward. The issues of surveillance, in particular, in terms of financial markets and global imbalances are difficult challenges that face the Fund as well as other countries in the global market. Improving our understanding of those and our ability to work together will be critical for addressing those kinds of concerns.

I would like to shift the session this morning to a question and answer period, addressing the issues that Mr. de Rato has put on the table. Perhaps, before opening the floor to questions from all of you, I would like to begin the discussion by asking about some of the governance issues, in particular.

As you mentioned in your comments, there have been a number of changes in the global economy and the importance of different countries over the period since the initial voting shares and quota representations were established. You mentioned that the initial phase that you are proposing would include increasing the quota shares somewhat for four countries that have really certainly increased their prominence in the global economy. I wonder if you could share with us a little bit about why those four in particular. I mean there are certainly other countries as well. India comes to mind as a country that has certainly become more important in the global economy. It would be of interest to hear a little bit more discussion about why China, South Korea, Mexico, and Turkey are the four that appear to be initially on the table for those increases.

MR. DE RATO: Thank you, certainly.

First of all, I want to say that those four countries were not handpicked by any reason. We just applied all the possible variables, all the possible formulas, and decided that the countries that will be under-represented of any of those will be the ones that will center the first movement.

Why? Well, first of all, because the way we measure economic weight — there is the formula we use right now to measure economic weight — is very contested in the Fund. A lot of countries find that the formula is difficult to understand — I certainly agree with them — and that the formula is not at all transparent — I would also agree with them. So we needed to take a first movement on very clear cases that, by any type of measurement, would be under-represented. That was a clear consensus position on the countries, so that by doing that, we would not preempt the need to change the formula and then address a much wider ad hoc increase for those countries that would come under-represented.

By applying different types of measurements, we came out with those four countries, and I think there won't be any contest in that respect. I want to thank other countries who are under-represented in Asia, in Europe, in the Arab countries, who have understood that we needed a better formula and who have put the interest of the Institution before their own particular interest. I think that has shown clearly that we live in a world which, in some occasions, international cooperation is positive. This is a very good accomplishment.

But, of course, the correction, if you want to call it that, that we have implemented, or that will be implemented if the Governors accept the proposal, will only represent about one-third of the actual under-representation of those four countries and will leave a very important agenda for all the countries to be corrected.

In that correction, in the future one after a new formula is accepted and approved by the Board, I will ask the most advanced economies, some of them under-represented too because they have grown much faster than the maneuverability of the world economy, not to use or at least not to use completely their room of maneuver. That means that if the most advanced and developed economies, who already have an important capacity of decision on the Board, do get a movement for under-representation, so that they are entitled to get some ad hoc increase, that they will not use that, at least they will not use that fully, so that we have more room of maneuver to address other economies who are not so well represented by any standard on the Board.

At the same time, I think that the inclusion of provisions to protect basic votes is a very important step in the governance of the Institution and shows clearly the Institution is responding to what is today a more defined way to define legitimacy.

MS. COLLINS: Thank you.

This will clearly be a complicated but important discussion. At this stage, I would like to open the floor up.

As you know, this session is being broadcast. There will also be a transcript available on the Brookings web page, probably by tomorrow. And so, I would ask that as I call on individuals, if they could state their name and affiliation and wait for the microphone before they raise their questions.

QUESTIONER: Thank you. Jo Marie Griesgraber, New Rules for Global Finance Coalition.

Thank you, Mr. de Rato, and I want to congratulate you and the Board for the decision last week on ensuring that the African countries would not lose any votes as the four countries gain in quota and votes.

I do have two questions. One is a concern about the quota formula that is being described, mainly that openness would be a particular criteria. My understanding is that would certainly benefit the smaller European countries and might reduce the possibility of a redistribution of votes that many people think would be appropriate.

The second is a factual question on the facility that was put in place recently for the low income countries, the facility for crisis, particularly commodity price collapses. How does that function?

MR. DE RATO: Okay.

Openness is already part of our way to measure economic weight in the world, and I think it makes sense because it shows that countries with dynamic external sectors are represented in an international institution. It is clear that weight or size is also another very clear measure. But I don't think that the Institution should become only a big country institution. So, in that respect, certainly GDP is a very important component. It is clear and I am convinced — although, of course, it depends on the discussion — but it make all sense that it will be probably a more important component than it is today, but openness is a clear element of the integration and the role of a country in the world economy.

To perceive that openness is only a small European country characteristic is a little narrow. If you go to Southeast Asia, you will find very open economies, and if you go to Latin America, you see more and more open economies, and we all would like to see more openness in Latin America. It would be in the interest of Latin America. In a world of global markets, openness is not at all a characteristic only of European economies, at all, and today, it is becoming very clear perhaps, for instance, with Asia economies and all the economies that are really benefiting from integration.

A formula is, of course, formed by many things, not one. So openness will be part of it probably. I cannot anticipate the discussion, but it is clear that many countries believe that openness shows part of the role of an economy in the world economy. Size and GDP will be part of it certainly. Also, many countries believe that the economic size, the systemic size, if you want to call it, plays a role in the global economy. But other variables have been put on the table, like variability and others, the perceived need for financial resources or for international financial resources. That will be a very important discussion.

Every time one of these issues wants to be characterized geographically, I think we make a mistake because the world is very varied and you have many different cases in Europe; you have also many different cases in Asia; you have many different cases in Latin America. So it is very difficult to say this is only good or bad for this side of the world. Every time we try to do that, reality shows us that that is not exactly true.

Then, on our shock facility, we approved a shock facility last year at the end of 2005 to try to come up with financial resources, if needed, for countries who were facing external shocks related to commodity price changes. We already have some facilities related to trade changes. We have also special programs for countries coming out of conflict. So this was another instrument that was helping us to cope with the needs of countries. Right now, given the very benign financial circumstances of the world and the fact that not only oil but also other commodity prices that many emerging and low income countries' economies produce, the demand for that type of facility has still not matured yet, but I think it is an important element of our toolkit to respond to the different possible challenges that emerging and especially low income countries can face in a less benign financial scenario, whether it is trade shocks or commodity shocks.

MS. COLLINS: Just a follow-up quickly: Is this a facility that countries have begun to use?

MR. DE RATO: Not yet.

MS. COLLINS: Not yet?

MR. DE RATO: Well, part of them are using it already through a pre-existing facility which is the poverty reduction facility. So you could say that some of the possible cases were already being addressed.

This new facility is designed for countries that could be eligible for poverty reduction, but they are not right now using it and could be facing a shock. So it is a very, if you want to say, specific window for a very specific case but has not yet been used up until now.

MS. COLLINS: I see.

There is a question over here. Jon, if you would wait for the microphone, please.

QUESTIONER: I am Jon Starrels, Fund retiree who is now with Brookings.

Mr. Managing Director, this strikes me as a terribly consequential step. How long do you think it is going to take to complete?

MR. DE RATO: Well, it has a calendar. Governance issues are, of course, very broad, and this agenda doesn't pretend to address them all. We have been, I don't know if humbled, but we have decided that there were some issues that we should address. Of course, that doesn't mean that all of the governance issues have been addressed in this agenda. This is a very specific agenda that refers to making the Fund more receptive to changes in the global economy and to increase the capacity of low income countries. Those are the two main items of the agenda, and the agenda is very well specified.

The agenda is a two-year agenda. So by the Annual Meetings of 2008, the agenda should be completed, but the Board has clearly made 2007 as a possible target for some of these decisions. We have a very, I would say, tight schedule, but at the same time, I think it is a feasible schedule, in two years to be able to face these questions. Given that calendar, much of the work will have to start immediately, for instance, the discussion on the formula.

MS. COLLINS: Yes, in the back, again, if you could introduce yourself, please.

QUESTIONER: Jeffrey Hancuff, I am an independent research.

In the Managing Director's report, the Fund expresses a desire to focus and collaborate with developing countries to develop their priorities and create a poverty reduction strategy, a very laudable goal. Given that loans inevitably strengthen governments, how does it plan to interact with countries, post-conflict or not, with low levels of legitimacy, with limited or no democracy, or that systematically ignore ethnic minorities within their country?

MR. DE RATO: We deal with a lot of different political regimes and political establishments. This is a financial institution. So, in that respect, we deal with the governments of the countries. Some of the issues you address are certainly very important and essential but are not ones in which we have an expertise or a mandate.

On governance issues, we do have a policy. When the governance problems are really an impediment to macroeconomic development and you have some cases where that is the case, it certainly becomes part of our program's mandate to address immediately governance issues.

But there is indirect work that enhances good governance in a broader sense in societies, which is the build-up of institutions. When you have independent central banks, when you have independent and efficient tax authorities, when you have independent custom authorities, when you have a transparent use of public resources, when you have a good management of public expenditures, well, you are advancing toward a more transparent society. Maybe in a very narrow sense, you have other very important issues — political freedom, political expression, rights of minorities, many important issues — but the ones we work on, I think they are a good base for freer societies. Experience shows clearly that to have a sustainable society, some of these basic macroeconomic and financial institutions do a play a very important role in terms of making societies more stable. But of course, those are very important political issues that you have mentioned should be on the agenda but not certainly on ours.

MS. COLLINS: Thank you.

Let me take a question over here, yes, the gentleman in the back.

QUESTIONER: Hi, Donald Hoskins, Professor at American University. I want to thank Brookings once again for hosting my class here. Thanks again for the donuts, especially.

I was wondering, Mr. de Rato, whether you are concerned about the huge build-up in reserves from many of your former clients and whether this is sort of an implication that IMF assistance may not be easily assessed or easily accessed and may not be that helpful.

In my past life, I was an investment fund manager in emerging markets, and large reserves were a big positive, going to the IMF was a big negative. So, in that light, is the IMF — and you may be addressing this somewhat with your liquidity facility — looking at ways for countries to have easier access? Let us say the surveillance is ongoing and they have to be up to par to have access, but instead of emergency loans, having resources available to the central bank so they don't have to build up these huge reserves that may not be that efficient.

MR. DE RATO: First of all, let me tell you we believe that financial crises are not a good thing. So my colleagues have gone through very long experiences of dealing with financial crises, and I don't think they long for anything in that respect.

When you have to go to a country that has 30 percent of non-performing loans, that means their whole banking industry is bankrupt; that means that people's savings have evaporate; that means that probably their wage system, private and public, has to have a huge cut. I mean it is not something that you like to see. So, financial crises, we don't miss them at all. Although we live today in a world of very benign financial circumstances, we should all remember that in 2003, which is not that far away, we had the biggest amount of programs that we had in history. So financial crises are not today an immediate danger, but they are a risk, and I think that the Fund should try to use as much as crisis prevention as possible to diminish that risk.

At the same time, I don't think there is anything bad to the countries. There is everything good. The international community has an instrument through international cooperation to face financial crises once the countries themselves cannot handle them. It has proven useful. It has proven useful because it has made financial crises shorter. Many countries that were facing very huge financial crises, only five, six, eight years ago, are today in a very good situation. Certainly, that is because they have done a lot of important things themselves, but also it is because at some point, the international community was able to provide private-public money when it was impossible to find any other people to finance those countries.

Build-up of reserves; well, build-up of reserves is a consequence, for instances, of imbalances. If you have a huge imbalance, you have a huge surplus in another. So the build-up of reserves has to do much more than anything with the way the world economy has grown in the last five to six years. If you have 7 percent of GDP imbalance in one place, well, that amount of money has to be somewhere else. Of course, it has to do also with an extremely benign financial scenario, not the least because the three major monetary areas of the world were in a very expansionary monetary policy.

Reserves are useful — certainly, they are — but they are not free. At the end of the day, how reasonable is a world in which the emergent side of the world that has the youngest population builds up savings so that it can finance the richer side of the world that has the older population.

Is that the balance we think is sustainable? That balance makes a lot of sense medium-term speaking.

Do we like to see those savings being used in investment in the emerging economies and will that be healthy? I think it will, and I think that is the challenge of the future, for instance, in Asia, but not only in Asia but also in Latin America, to use part of those reserves to build new futures in those societies. To do that, of course, investment in those countries has to be as attractive as investment in other countries. Savings in those countries can be rewarded as it is rewarded in more advanced financial systems. That is, I think, a very important agenda moving forward.

But the fact that today you see that many emerging economies can issue their debt in their own currency in a lower market, I think is a very important step that gives the world a more broad-based stability.

Does that mean that financial crises are a thing of the past and we will never see another financial crisis? Well, I wouldn't go that far.

MS. COLLINS: We are starting to run out of time, but I do want to follow-up on the topic that is most recently on the table.

Clearly, financial crises in countries that look like they were behaving very strongly have proved to be one of the most damaging things that can happen to a country's economic growth. In principle, having a facility or a mechanism that enables countries that seem to have very strong fundamentals to be able to have some kind of a cushion seems like a very good idea. But I am reminded that a few years ago, in fact, during the period I was visiting the IMF, there was something called the Contingency Credit Line which was intended to provide that role and unfortunately, it was not very successful. I wonder if you could say a little bit about whether what is currently beginning to be discussed is different in some ways from that, which would make it more effective?

MR. DE RATO: It is true. The Contingent Credit Line was a first reaction to what I think the international community saw in the crisis of the nineties. The crisis of the nineties was different than the crisis in previous decades because it was more a capital account crisis and maybe we were seeing the type of crisis that globalized financial markets will produce.

But, of course, things have changed a lot since the nineties in terms of the size of the markets, the linkages between the real economy and the financial economy, the balance between different financial markets, the spread of risk much broader than before. That is good but is also different in terms of the household being the last risk holder. All that has given us a new environment in which good things happen. You have more finance to individuals and to countries and to corporations, but also you have a much bigger size of markets and the balance between those linkages and the leverage that you have in those markets is of a size not known before. So that means that we have to respond to those challenges.

The Credit Contingent Line was a first initiative, but it didn't respond to the needs because it has some kind of stigma in it. If you ask for a Credit Contingent Line, well, something was wrong with you, and of course, then nobody asked for it because nobody wanted to be seen as having something wrong. We have to develop something that will be different in the respect that it will not have any stigma, but it will be useful.

We are more in a moment of questions than answers here. The question we are asking ourselves is: Do we have enough instruments, so that the type of crises we will be facing in the future in terms of sudden and in terms of size and in terms of market reception can be addressed quickly enough and effectively enough by the Fund? That is the question, and we are working on the answers. I can't give you the answers yet, but I think the fact that we are asking ourselves that question, I think is something that, given the mandate of the Fund, we should be doing.

MS. COLLINS: Thank you very much.

Unfortunately, we are out of time, but I would like to ask you to join me in thanking Mr. de Rato for sharing the details in his proposal with us.

(Applause.)

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