The Future of the International Financial Architecture

Remarks by

Roger W. Ferguson, Jr.

Vice Chairman

Board of Governors of the Federal Reserve System

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Ten years ago in Madrid, economists and policymakers commemorated the 50th Anniversary of the Bretton Woods agreement at the IMF-World Bank annual meetings. Those meetings marked a chance to acknowledge the achievements of the institutions created at Bretton Woods and to examine the challenges facing these institutions and, indeed, challenges involving the international financial architecture more broadly. Today we have a similar opportunity.

The previous conference came just a few years after the Brady Plan helped resolve the Latin American debt crises of the 1980s. At the time of the conference, many emerging market and developing economies were struggling with high inflation, and fixed exchange rates were viewed as a viable – perhaps even preferred – way of containing inflation pressures. Moreover, world trade and capital flows were significantly lower than they are now.

Soon after the 50th anniversary commemoration, the world was confronted with the Mexican crisis of 1994-95, the first in a sequence of balance of payments crises that would span the next several years and severely test the existing international financial institutions. These crises revealed several things. First, the growing size of international capital flows and the greater use of bond financing had vastly increased the speed at which crises could develop and spread across countries. Second, the crises reinforced the importance of sound fiscal and monetary policies regardless of exchange rate regime but also highlighted the critical role that domestic financial, legal, and supervisory institutions play in exposing a country to economic risk. Third, the crises clearly demonstrated the need for investors and international policymakers to have better, more complete, and more timely economic and financial information. Finally, the crises highlighted the new types of challenges facing the international financial institutions (IFIs) as they worked to manage these crises.

With these lessons in mind, the distinguished panel before us today will discuss the future of the international financial architecture. I anticipate that they will also note the work already taking place on this issue by the international official community. The Group of Seven has for a number of years focused on reform of the IFIs; its most recent effort, spearheaded by the U.S. Treasury, is the Strategic Review of the International Financial Institutions. Two other groups, the Group of Twenty and the Financial Stability Forum, were formed in the late 1990s specifically to reduce the frequency and severity of financial crises and to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance. And we should not overlook the self-initiated examination and reforms undertaken by the IFIs.

Partially as a result of the efforts of these groups, we have made notable strides in reducing vulnerabilities and improving crisis management and prevention. As examples, these gains include better surveillance of economies through the Financial Sector Assessment Program and the establishment of a wide array of standards and codes and the development and encouragement of the use of collective action clauses in sovereign bonds.

Much of the heavy lifting, however, has been done by the emerging-market economies themselves. The lower and far more stable inflationary environment across the developing world reflects the achievements of policymakers and electorates who recognized the benefits of sound monetary, fiscal, and exchange rate policies. The continuing financial and structural improvements in many countries can be credited to domestic reformers. And the now almost-standard use of collective action clauses in sovereign issuances is due in large part to the leadership role of Mexico, followed by other emerging economies, in adopting these clauses.

Recognizing past progress and acknowledging that the Bretton Woods institutions and the international financial architecture more generally have been far from static, I would like to ask a number of questions that may be useful in framing future discussion.

- Examination and improvement of the IFIs has been a priority for some time. In the pursuit of reform are we in danger of undervaluing and perhaps undermining the successful aspects of these institutions?

- Or are we overly cautious and unwilling to step outside the box to make major changes, including cutbacks as well as additions to mission statements?

- Recent experience has led to calls for increased accountability, transparency, and consistency in the lending practices of the IFIs, but at the same time, global financial market developments have necessitated faster and more flexible responses. How do we balance the tensions inherent in responding to both these concerns?

- Are we sending mixed signals to the IFIs, criticizing them for overstepping their mandate while relying on them to cope with an increasingly broad set of issues?

- What are the most critical gaps in the international financial architecture? And how can we address them?

This conference comes at an ideal time for us to assess progress over the past decade and to strengthen the international financial architecture. International financial markets are relatively calm; global growth is projected to be strong; and the IMF has just welcomed a new and energetic managing director from Spain, Rodrigo Rato. It is obviously hubris to think that we can eliminate financial crises entirely, but I have no doubt that with better communication, stronger institution building, and improved macroeconomic policies, we can go a long way toward reducing their frequency and severity. As Michel Camdessus, then managing director of the IMF, remarked in the opening session of the annual meetings ten years ago, the purposes of the Fund “remain equally valid today.... But for the fulfillment of these purposes, the Fund (and I

would add the international financial architecture more broadly) must adapt its operations to a changing world economy and in light of lessons we have learned about economic policy."