As we move forward with our mission to make poverty history, we must be prepared to grow as an institution. We must be ready to graduate with our partners and respond to new and emerging challenges.

Today, in Middle Income Countries, more than 1 billion people still live in poverty. We must not forget them. To help the middle income countries grow and prosper, we need to continue to tailor our knowledge and financing to their specific needs.

With time, and with results, the needs of those partners will evolve. Success will bring new challenges that will require new responses. So innovation and adaptation will be critical if the Bank is to remain relevant in this changing world. Sometimes, the problems of success are as daunting as the problems of challenges.

So let us work today to chart our course for the future—a future in which today's poor become tomorrow's entrepreneurs; a future in which today's disease leads to tomorrow's medical breakthrough; and a future in which today's child will be tomorrow's leader.

ADDRESS BY THE CHAIRMAN OF THE EXECUTIVE BOARD AND MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Rodrigo de Rato y Figaredo

Mr. Chairman, Governors, honored guests, it is a pleasure to welcome you to these meetings on behalf of the International Monetary Fund. I would like to extend a special welcome to my new colleague Paul Wolfowitz. Paul's qualifications are strong. His distinguished career as a diplomat and public servant were very well known. What was less well known in some circles when he took office was his deep commitment to development, which was again so evident in his excellent speech today. Welcome, Paul.

The past year has brought news that has saddened us. There have been disasters: the tragedy of the tsunami at the end of last year, severe food shortages in parts of Africa, barbaric acts of terrorism in London and elsewhere, the hurricane in the United States, and too many others.

There have also been troubling economic developments. The accumulation of payments imbalances and the steady drumbeat of rising oil prices continues, and while they have so far had only a muted effect on the confidence of consumers and on asset markets, they should occupy the thoughts of policy makers, that is, of *you*.

Yet there is also cause for hope and for confidence in the future. Global growth has opened up opportunities and improved prospects for people all over the world—and nowhere more so than in the developing world, where growth offers the best hope of liberation from poverty. And the year saw signs of progress in addressing long-standing problems: more exchange rate flexibility in some emerging market economies; growing acceptance of the need to increase saving in some industrial countries and for structural reform in others; and a renewed effort to lift the debt burden from low-income countries.

So there are opportunities for progress and change. But it is up to individuals and governments to grasp them. Can we work together to address the global imbalances which threaten our prosperity, or will we fall separately into recrimination and defensive policies? It is up to *us*. Can the international community work together to achieve the inspiring goals of the Millennium Declaration? It is up to *us*. Can we enhance the legitimacy and relevance of the International Monetary Fund as the central institution of global monetary cooperation, and improve the service it provides to its members? It is up to *us*. We who are gathered here have the opportunity and the obligation to do great good in the world. I'd like to share with you some ideas on what we should do to grasp this opportunity and meet this obligation, and on the contribution that the IMF can make in the year ahead. And in doing so I want to ask you for your *help* and for your *support*.

Current economic situation and outlook

In many ways, the world economy is strong. Growth last year was the highest in three decades, and the prospects for growth this year and next year are also good. Global headline inflation has picked up slightly owing to higher oil prices, but it remains at moderate levels. The global financial system is more robust now than for many years, with long-term interest rates unusually low and markets relatively stable. However, there are risks. These are in part due to continued global imbalances. The world needs to move away from a pattern of growth where investment in most of Asia is too *low*, and high consumption in the U.S. is financed by rapidly increasing *debt*, and where growth of domestic demand in Europe and Japan is too *weak*. New risks—and new imbalances—are caused by higher oil prices. What can be done about these risks?

Let me talk first about oil. Oil-producing countries need to continue with their investment programs to boost production. Oil-consuming countries need to act quickly to increase consumer awareness, strengthen energy conservation, and improve energy efficiency. They should also encourage the development of alternative energy sources and begin to expand refining capacity. Consumer and producer countries alike should consider tax reforms and, especially, reductions in subsidies on oil products. The social inequalities and economic distortions caused by high and indiscriminate subsidies at a time of high oil prices are profound. In many countries the effect is to give money to the people who least need it, often at great cost to the budget. And what is merely bad fiscal policy when oil costs $25 a barrel becomes ruinous fiscal policy when it costs $65 a barrel. The countries that do best will be those that adapt by reducing subsidies and replacing them with targeted social spending.

Global imbalances pose serious risks to prosperity. The question is not whether they will be reduced, but whether their reduction will happen in an orderly or a disorderly way. During the past year some progress has been made. Fiscal revenues in the U.S. have rebounded. The prospects for structural reform in Japan are brighter than for many years. And we have begun to see greater exchange rate flexibility in Asia. But these are just the first steps in a march that needs to speed up.

Many countries need to share the work of reducing global imbalances and sustaining growth.

- In Europe, there is a need to strengthen confidence. Governments need to articulate comprehensive, growth-oriented strategies that address both unemployment and aging, mainly through reducing the rigidities prevailing in labor, product, and service markets. They should also extend the Single Market to the provision of services, including financial services.
- In emerging Asia, there is scope for greater exchange rate flexibility and increased domestic demand. The recent moves in China and Malaysia are welcome, and I hope that the authorities will use the flexibility afforded by their new arrangements. I also hope that other countries in Asia which have been managing their exchange rates more flexibly will continue to do so. In addition, faster domestic demand growth in Asia through a continuation of structural reforms—including to encourage higher investment in some countries and better investment in others—has to be part of an orderly adjustment process.
- For their part, those oil producers whose fiscal and macroeconomic frameworks are strong can help reduce global imbalances by increasing productive spending in priority areas.

- As so often in the recent past, the United States economy has been one of the main engines driving global growth. But as the net external liabilities of the U.S. continue to increase, so the vulnerabilities of the U.S. economy continue to grow. Therefore, the U.S. part of the equation on global imbalances—reducing the fiscal and current account deficits—is particularly urgent. The administration's plan to reduce the fiscal deficit is welcome, but the unprecedented cuts in non-defense discretionary spending that it requires would have been difficult to achieve even before the devastation wrought by Hurricane Katrina. I believe that actions on the revenue side, preferably through reforms to broaden and simplify the tax base, will also be needed. And re-authorization of the Budget Enforcement Act—including pay-as-you-go provisions that cover revenue measures—would also support fiscal discipline.

We all have a pretty good idea what actions are needed to address the global imbalances of today, though knowing what needs to be done and actually doing it are two different things. But global imbalances and global challenges are going to change over time. The emergence of high oil prices as a significant challenge for the global economy in the past couple of years is a case in point. So we need not just solutions to the problems of today but also a *structure* to deal with the global imbalances and other economic problems of the future. The International Monetary Fund, as the institution of global monetary cooperation, *can* and *should* be the forum for collective action. I will come back to this later, but let me first talk about some other issues.

There are also opportunities arising from current benign conditions in international financial markets, and from upcoming discussions on trade. The current exceptionally favorable conditions in financial markets cannot be expected to last forever. So I would encourage emerging market countries to take advantage of them: maintaining sound macroeconomic policies, managing their debt prudently, and further developing domestic capital markets. On trade, we know what we need to do, and I would urge all of you not to squander the opportunity to achieve a substantive and favorable outcome to the Doha Round. The large economies carry a particular responsibility to work for a good agreement, and to head off pressures for protectionism, which would be enormously damaging to the world economy.

Poverty and the MDGs

Last week I attended the UN World Summit, where many world leaders underlined the need for greater momentum in pursuing the

Millennium Development Goals. Each member of the international community has a role to play. Donors need to provide more aid to low-income countries—and in this context the recent pledges of the G-8 countries and others are very welcome. Aid flows should also be more predictable and better aligned with countries' needs. For their part, low-income countries need to promote economic growth, which is the main engine that drives development. This requires policies that ensure economic and financial stability and that help the private sector to flourish.

Low-income countries can also help themselves by eliminating trade-distorting subsidies and reducing trade and administrative barriers. Administrative barriers can be big obstacles to trade. For example, if you take a truck from Lagos to Abidjan, a distance of a thousand kilometers, you need to go through 69 checkpoints. And if you take the same truck on to Burkina Faso, another thousand kilometers, the number rises to over 100.

The Fund can also help low-income countries meet the Millennium Development Goals. We are constantly working to refine and improve the advice we give and the programs we support, and we have developed a wide and flexible set of instruments to help low-income countries deal with problems ranging from the temporary costs of trade liberalization to long-term challenges of poverty reduction. This year we have developed new means to help countries suffering from shocks beyond their control—high oil prices, natural disasters, and others—and also to buttress stability and support reform in countries that do not want or need the Fund's financial assistance.

But we know we can do more. The growing consensus that aid must be increased and debt must be reduced gives us a great opportunity to make a difference to the lives of billions of people. To make the most of this opportunity, we need to improve the focus of the Fund's work on low-income countries. Part of this will involve a discussion over the coming months with our colleagues in the World Bank on the best allocation of work between the two institutions. But we also need to deepen the Fund's involvement in advising countries on how macroeconomic policies can complement higher aid, and counter any adverse effects on external competitiveness. Increased aid flows also should go hand-in-hand with incentives to develop the domestic revenue base and strengthen the tax system. And public expenditure management must be strengthened so that low-income countries can use resources more efficiently—for example for well-targeted spending on education and health. These are all areas where the Fund can make an important contribution, through policy advice and technical assistance.

The Fund's financial assistance will continue to be vital for our role in low-income countries. There is a strong consensus that the Poverty Reduction and Growth Facility should remain the primary vehicle for Fund support, and that the shocks facility will be an important additional instrument. We now also have the G-8's important proposal on debt relief. Let me repeat my personal support for the proposal. Of course, debt relief can be only one element of the Fund's support, and it must not be financed in a way that causes other poor countries to lose out, or that would cripple the Fund's ability to provide support to low-income countries that need our help in the future. The commitments already made by the G-8 are encouraging, and I hope that all of our members will show their support for the principle that the Fund's ability to help low-income countries must not be impaired, and do so, if necessary, by adding to the resources available to support them. I am confident that we will reach a favorable conclusion on this very soon.

Making the Fund More Effective

In my report on the strategic direction of the Fund I have suggested priorities and actions to improve the effectiveness of our institution. I do appreciate members' expressions of support for much of what I have proposed, and I look forward to continuing to hear Governors' views, both at these Meetings and as we carry implementation forward in the months ahead. I would also like to thank my Management colleagues, Anne Krueger, Agustin Carstens, and Takatoshi Kato, and the staff of the Fund for their contributions to the strategic review and also for their magnificent work throughout the year. This institution runs on the extraordinary quality and dedication of its staff. I *thank* them, and I *salute* them.

The review of the Fund's strategy builds on the work and accomplishments of recent years, and looks forward to the work we need to do over the next few years. Let me talk briefly about some of the highest priorities.

I believe that the Fund must intensify its focus on helping countries come to grips with globalization. It is not only emerging market economies that face challenges from the increasing integration of countries into the world economy. Advanced economies also face challenges in macroeconomic policy, challenges in financial sector policy, challenges of international economic integration and migration. Sometimes these problems are not recognized, and sometimes they are misjudged. The Fund needs to be able to advise *all* our members on dealing effectively with the consequences of increasing integration.

A prerequisite for giving good advice is that we understand all the issues fully ourselves. So I would also like the Fund to focus more on the effects of globalization in our research, and perhaps to distill that research into an annual report on macroeconomic and financial issues in globalization. To do this, we will need to reorganize our work, sharpening our understanding of financial sector issues and capital markets. We also need to enhance our monitoring of members' vulnerability to crises and consider again the possible role of Fund financing commitments in crisis prevention. And we need robust mechanisms in place to help countries deal with crises when they happen.

Another area where we need to act is on reform of IMF quotas and representation. The Fund's ability to persuade our members to adopt wise policies depends not only on the quality of our analysis but also on the Fund's perceived *legitimacy*. And our legitimacy suffers if we do not adequately represent countries of growing economic importance. This means, in particular, increases in voting power for some of the emerging-market economies, especially in Asia. We must also ensure that our members in Africa, where the Fund is very actively engaged, are adequately represented. It is usually taken as axiomatic that if some countries "win" from a re-allocation of quotas, others must "lose." I do not agree. This is not a zero-sum game. If there is broad acceptance of the IMF's legitimacy, the institution and *all* of its members will benefit.

Conclusion

We meet at a time of opportunity. There are many challenges—global imbalances, turbulent oil markets, the needs of low-income countries—but together we can meet these challenges. Some members of the Fund must act to reduce global imbalances, and all of you must act to promote growth and to preserve stability in their economies. And acting will be easier if we work together. We can work together in the Fund, which remains the central forum—the only *global* forum—for discussion and resolution of global economic problems. We can work together in the coming year. We can start *now*. I ask for your *support*, and I ask for your *action*, so that we can take the opportunities we have today, and meet the challenges of tomorrow. With these thoughts, I once again welcome you to the Annual Meetings.