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Press briefing

Köhler, Fischer discuss work of new department, IMF response to financial crises, including Turkey

On March 1, IMF Managing Director Horst Köhler announced the establishment of the International Capital Markets Department in the IMF. Below are edited excerpts from a March 2 press briefing by Köhler and First Deputy Managing Director Stanley Fischer on that decision and on the IMF's response to financial crises, including Turkey.

IMF Managing Director Horst Köhler (right) with First Deputy Managing Director Stanley Fischer.

KÖHLER: In Prague, I outlined a vision of the IMF's future role that was unanimously endorsed by the members of the IMF. A central element of that vision was that the IMF should become a center of excellence for the stability of the international financial system. In the process of making this vision operational, I asked a panel of outside experts in October 2000 to provide an independent perspective on how the IMF should organize its financial sector and capital markets work. That group, headed by John Lipsky, Chief Economist of J. P. Morgan Chase, presented its report in January 2001.

Broadly, the report observed that although important improvements had been made in the past few years, the IMF's work in capital markets needed to be considerably (Please turn to the following page)

Workshop on financial abuse

Panelists stress role of international community in tackling money laundering

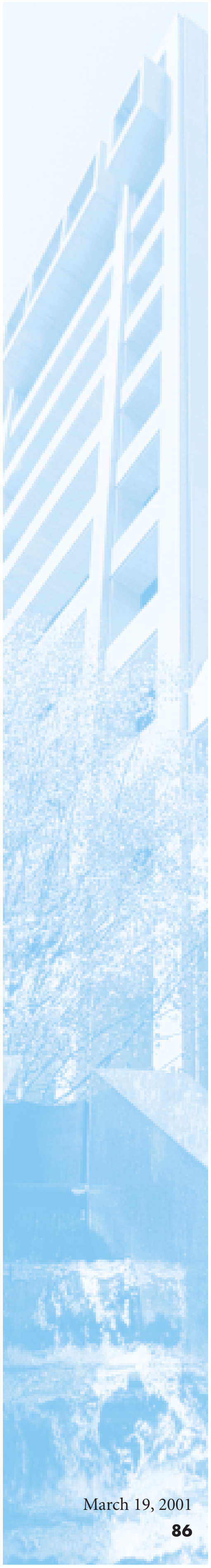
Fighting money laundering makes it more difficult for criminals to retain the proceeds of their crimes. On February 19, panelists participating in a joint IMF–World Bank workshop on financial abuse stressed this point and gave special attention to multinational efforts to combat money laundering.

Impact of crimes

The workshop was divided into three panels. The first, introduced and moderated by IMF General Counsel François Gianviti, included Rick McDonell of the Asia/Pacific Group on Money Laundering; Judge Jean-François Thony of the Court of Appeals of Versailles, France; and Jack Blum of the Washington, DC, law firm of Lobel, Novins & Lamont. The panel members drew particular attention to underlying crimes that had potentially adverse economic effects on countries, such as corruption by public officials. This form of financial abuse, they noted, can seriously retard economic development by raising costs to business, inhibiting foreign investment, and reducing government resources. The panelists also discussed organized crime, whose effects are similar to those of public corruption. Both activities can be severely destabilizing politically, they observed, and both activities often have their proceeds laundered offshore, including through major financial centers like New York and London. (Continued on page 88)

Rick McDonell

IMF to set up capital markets department



(Continued from front page) enhanced. Among its recommendations was the creation of a new department that would consolidate and develop further the capital markets–related functions now carried out in several of the IMF's functional departments.

After intensive deliberations among management and senior staff over the past few weeks, I concluded that the creation of a new department was appropriate. I see this decision as a critical element of ongoing efforts to strengthen the international financial architecture and ensure the necessary support for the IMF's work on crisis prevention and crisis management.

More specifically, the consolidation of the work on capital market issues in the new department is expected to deepen the IMF's understanding of financial market operations and of the factors influencing the supply of capital to member countries; provide enhanced support to the IMF's surveillance and lending operations in member countries through strengthened links between information gathering, analysis, and judgment regarding capital market developments; and enhance the IMF's conceptual capacities in addressing systemic issues stemming from developments in international capital markets.

I am confident this decision is in the interest of all IMF members. It will enhance the IMF's early-warning capabilities and, more fundamentally, strengthen its ability to help member countries in their efforts to gain access to, as well as deal with and benefit from interactions with, the international capital markets and their potential for income and job creation.

To make the new department operational as soon as possible, I have launched a search for a department director with the appropriate professional background and experience to lead this important task.

QUESTION: What would you expect this department to do in a crisis situation?

KÖHLER: I would like to stress that crisis prevention is in the foreground. This means a variety of activities and actions, particularly dialogue with the private sector and communication with investors. Last year, we set up the Capital Markets Consultative Group, which was an important first step. A crucial task of the new department will be to help strengthen our early-warning capacities. I don't think it will be possible to keep crises from happening again, but it is important to strengthen our ability to read developments in the markets and interpret and draw conclusions at an early stage. This is one of the main purposes of the new department.

QUESTION: The banks, working through the Institute of International Finance, have frequently asked the IMF to be a lot more forthcoming with inside information. To what degree will this new department be responsible for providing early warnings to investors, and vice versa?

KÖHLER: I'm sure you will understand the IMF is not an extension of the risk-management capacity of private institutions. They have to do their own assessments, but we have a common interest in the stability of the system, and we need to strengthen the dialogue between ourselves and the private sector. We can help countries build up relations with investors so that the authorities and the private sector gain a better understanding of each other and of their respective motivations and constraints so that there is less scope for surprise.

QUESTION: The IMF has been trying to strengthen its early-warning capacity for some time. Is it attempting to do more than just bring together staff who had previously been in different departments?

KÖHLER: The objective is certainly not just to reorganize. The purpose is to define a clear focus and have the professional capacity to respond to changes in the global economy—changes that are strongly driven by capital markets. But the crucial issue is to have a working unit and a management information system that allow us to draw conclusions on market developments, such as spreads, the development of interbank lines, and so on. We could then sort out whether an early warning is needed or not.

FISCHER: The IMF has had units dealing with capital markets in several departments. The idea is to put them together and rely on synergies to strengthen the analysis we provide. But the overriding reason why the management wants to do this is the belief that interactions between the IMF's operations and its intelligence gathering have been inadequate in some respects. We want to integrate that work completely into our surveillance work. What the Managing Director continues to emphasize is that the capital markets staff have to talk daily with the area departments about what is going on in their countries, as well as gather information from the markets.

KÖHLER: That is a very important point. For the area departments, as you know, all business is local. We need to have the area departments fully equipped and attentive to capital market developments relating to the country they work on, but the new functional department brings specialized expertise and can support the area departments better in their job.

QUESTION: How would this have helped in Turkey?

FISCHER: Turkey is an unusually difficult case because the precipitating event was hardly to be expected. But as you go forward, what you would be looking for is absolutely full knowledge of what the people in the capital markets are saying are the critical factors involved in Turkey. You want to make sure that the area department dealing

with this issue is aware of that information and attentive to it. You have both to be aware of what is happening and to have the analytic insight to decide precisely what the real issues are in these cases.

This is happening to a considerable extent in Turkey. The IMF has moved a long way since 1994, when we just didn't see the Mexican crisis coming in the capital markets. I don't think we are in that position now, but we could strengthen our efforts considerably by having a dedicated group working on these issues every day and reporting to management and the area departments.

QUESTION: Would this have made a difference in 1994?

FISCHER: I think, yes. The problem is that not every crisis is unforeseen. Sometimes crises come because the people who have to take action—usually the governments—are not going to take action. You can foresee, and you can warn. That doesn't mean that we will ultimately have the power in every case to persuade governments to do what needs doing. But we should certainly be in the position to give them the necessary information, which in some cases in the past we were not.

QUESTION: Did you consult with the U.S. Treasury on this new reorganization?

KÖHLER: We consulted with the U.S. Treasury, also with the Japanese Finance Ministry, and informed and discussed it with the Executive Directors. This process was launched even before the new U.S. administration took office. The U.S. Treasury is supporting this decision. It is in line with their thinking.

QUESTION: Do you plan to station someone on Wall Street or in London?

KÖHLER: The idea of the Capital Markets Consultative Group was also to reach out to regions. We are close to New York, but we are reaching out to Asia and Latin America. In January, I met with Asian financial institutions in Singapore. I will be traveling to Latin America in June or July and will invite Latin American financial institutions. I will probably also do this in Madrid during the second half of this year.

This demonstrates our systematic attempt to reach out to the private sector. For instance, we are working on standards and codes and want to know what they think about standards and codes. We are also working to make the Contingent Credit Lines operational, and I will ask private sector people how they feel this facility should be used, and we will draw our conclusions.

FISCHER: The IMF does have people in Tokyo and London attached to the current Capital Markets Group in the Research Department. We haven't made any decisions as to whether to station people in other cities.

QUESTION: Critics have said that the IMF should have foreseen that Turkey's pegged currency wasn't going to hold. Was there a surveillance failure or a problem of a completely different nature?

KÖHLER: What happened at the political level was not foreseeable. That is decisive. In November, when we supported Turkey after intensive discussions, there was a credible program that had good chances to be successful.

FISCHER: I think I can say, without fear of contradiction, that we knew exactly what the markets were saying about Turkey. We analyzed all of those issues and we knew about those concerns. This was not a failure of knowing what the risks were. This was a series of political difficulties that took a program that had a very good chance of succeeding and made it less likely to succeed. And then, when there was still a good chance of making it succeed, those political problems just did it in.

QUESTION: Will this new department have the capability to send out red flags in situations like Turkey's, where the situation does seem precarious?

KÖHLER: This new group will not and should not have the capability or the objective of replacing private sector risk assessment and management. We want to be clear that private sector creditors have to bear the risk of their decisions. This new initiative does not replace their own judgment. But there is a common interest—via transparency, via judgment of indicators—in having early warnings.

QUESTION: Mr. Fischer years earlier cited the underlying tension between open information and possibly provoking a crisis. How do you resolve that issue?

FISCHER: There are circumstances when you can make information public, and it is helpful to make it public. There are also circumstances when you could precipitate a crisis. We have to judge in each case. We never have information that we withhold from governments about the dangers of what they are doing or the underlying difficulties we see. We consult with the capital markets, and we advise countries on how to react and what needs to be done to improve the situation.

I can still see circumstances in which it will not be appropriate for us to send a message to the market. For instance, if we discover a major bank in a country is exceptionally weak, publishing that information will precipitate a run on the bank. Giving that information to the government is a responsible action.

There could be other cases when we think fiscal policy is going off track. Issuing a public warning is helpful in getting the problem corrected. I don't think we would have the capacity to say, whenever we find a problem we are going to tell everybody. We will have to make a judgment as to whether going public helps or doesn't help in a particular case. ■

The full text of the press briefing is available on the IMF's website (www.imf.org).