OPENING REMARKS BY JAIME CARUANA, GOVERNOR OF THE BANCO DE ESPAÑA, FOR THE CONFERENCE "DOLLARS, DEBT AND DEFICITS: 60 YEARS AFTER BRETTON WOODS"

Mr Managing Director of the IMF, Mr Second Vice-President of the Government and Minister of Economy and Finance, ladies and gentlemen:

It is a pleasure for me to welcome you all to the Banco de España and to the inauguration of this conference, which is jointly organised by the International Monetary Fund and the Banco de España in commemoration of the 60th Anniversary of the Bretton Woods Agreements. For our country, which previously hosted the annual meetings of the Fund and the World Bank on the occasion of the 50th anniversary of these agreements, in autumn 1994, it is a source of satisfaction that this meeting should be held ten years later in Spain. I am also particularly pleased to welcome our distinguished audience –both from Spain and abroad-- of representatives from official institutions, from academia and the private sector, who are going to participate in the busy sessions scheduled over the next two days.

The Banco de España and the International Monetary Fund are tied by long-standing and deep-rooted links. Not only have we worked hand-in-hand for many years on various matters; we also share a similar mission and vocation, as well as similar concerns in many respects.

The world has changed in the past 60 years, and the transformations both institutions have undergone bear witness to this. We have moved from a system of fixed but adjustable exchange rate parities to one where floating is the norm. Economic integration has made enormous headway during these years, both multilaterally and through regional agreements, the European Union being perhaps the most advanced. From a world of widespread capital controls and multiple exchange rates, we have moved to a very different one in which enormous cross-border flows take place daily in the form of a wide array of financial instruments, among which derivatives, which were virtually non-existent at the end of the Second World War.

Undoubtedly, free capital movements have contributed to a significant improvement in the allocation of global saving to more profitable uses, although they have also entailed a swifter transmission of financial shocks across highly integrated markets, a phenomenon behind some of the recent crises. Economic policies --fiscal, monetary and structural-- have been increasingly geared to providing a framework of stability and appropriate incentives for decision-making by agents. In addition to contributing to smoothing cyclical fluctuations, these policies help set in place the right conditions to achieve sustained economic growth based on flexible, competitive and efficient markets where comparative advantages are tailored to the changing circumstances of international markets.

The International Monetary Fund has adapted to these changes, seeking to respond in its capacity as the guardian of international monetary stability to the new problems that have arisen. It has evolved from focusing essentially on monetary stability and on countries' external transactions and the management of their exchange rates, to areas more related to the overall quality of macroeconomic policies and to the design of structural policies and sound institutions. More recently, the Fund has devoted particular attention to financial stability.

To a certain extent, central banks have also undergone changes similar to those at the Fund. Developments in macroeconomic theory and the experience built up over the years have forged an increasingly broad consensus on the need to apply stability-oriented macroeconomic policies and, in particular, to conduct an independent monetary policy with the primary objective of achieving and maintaining price stability, which is vital for sustained economic growth. Central banks have also focused increasingly on financial stability issues, both in countries where the central bank is the supervisor of the banking system and in those where such functions are entrusted to a different supervisory agency. In the case of the Banco de España, these transformations have also been induced by far-reaching changes in our environment and in the role of the central bank, including most notably the adoption of the euro as the single currency for an ample group of European Union countries.

Spain's relationship - and that of the Banco de España - to the International Monetary Fund is certainly today very different from what it was in 1958, when our country joined the Bretton Woods institutions. In the early years of its participation in the Fund, Spain received financial and, most importantly, technical assistance from this institution, as part of the process of external openness and liberalisation that allowed its economic take-off in that period. The Fund’s excellent technical guidance in this process supported those economic sectors in favor of liberalization, who nevertheless met notable resistance in pushing through their programme of reforms. I believe that Spain, since then, has a considerable debt of gratitude with the International Monetary Fund.

Currently, the framework for our relationship to the Fund is very different. As part of the euro area, monetary policy discussions take place in a broader context spanning the whole of the euro area. As a member of the Eurosystem however, the Banco de España remains deeply involved in such discussions. In other realms, relations with the Spanish authorities remain on a bilateral footing, as is notably the case with the close contact each year on the occasion of the analysis of the Spanish economy via the Article IV report. That said, the European dimension is becoming increasingly important. Beyond the single monetary policy, there are various areas of European co-ordination in IMF-related matters although, as is well known, the different European states are represented on an individual basis in the Bretton Woods institutions.

Spain, which adhered to the New Arrangements to Borrow (NAB) as from their creation in 1998, is today an IMF creditor country. And though we continue to benefit from the Fund's excellent technical advice, we also provide technical assistance, in some cases in collaboration with the Fund, to other countries in the process of implementing systems or procedures in which we have a certain comparative advantage. Moreover, the Spanish authorities and, in particular, the Banco de España, co-operate increasingly closely with the Fund on matters relating to national and international financial stability. As I indicated earlier, this issue is becoming more and more important, and the objectives and the interests of the Fund tend to coincide in this connection with those of the competent national authorities.

The reasons why national and international authorities pay greater attention to financial stability can be found in the crises a significant number of countries have undergone in recent years. These have highlighted the complex linkages between the real sector and the financial sector and the risk that the latter may not only be a source of instability, but also amplify the imbalances or shocks generated in other sectors of the economy. The links between exchange rate crises and banking crises - the so-called twin crises - and the feedback mechanisms between the two are, along with the propagation and contagion channels from one country to another, matters of particular importance here.

National regulators and supervisors, in addition to their initial aim of safeguarding the solvency of individual institutions, have given increasing importance to combining the presence of flexible, efficient financial markets and intermediaries with the absence of excessive volatility on financial markets and to prevent the so-called systemic risks - which affect the whole of the financial system - from materialising. International financial institutions have also become increasingly oriented towards the need to ensure a proper functioning of international financial markets and to limit the transmission of shocks from one country to another in a world of ever deeper and swifter linkages.

The relationship between national and international financial stability is obviously all the more important for countries, such as Spain, whose banking system has a significant presence abroad. The expansion of Spanish banks into Latin America explains why the Banco de España has, in recent years, promoted the monitoring and analysis of financial stability problems in this region in particular, and in the emerging market economies in general, an area in which the role of the International Monetary Fund has become increasingly important.

Key lessons may be drawn from the recent crises that have affected emerging economies --though not only them--, which should be borne in mind when designing mechanisms to reduce their frequency and cost. They include most notably: the need for a sound and well-designed institutional framework that protects property rights, prevents excessive public- or private-sector debt from accumulating and ensures economic stability; the importance of ensuring consistency between the exchange rate regime and the domestic economic policies and institutional framework; the risks entailed by the vulnerability associated with exchange rate instability processes for the balance sheets of different sectors in the economy, especially when there is a high degree of dollarisation; the marked sensitivity of emerging market economies to potentially very volatile capital flows, the direction of which can change suddenly due, at times, to factors that may even be exogenous to the country experiencing them; the importance of an appropriate regulatory and macro-prudential supervisory system to prevent crises generated in the financial system and to alleviate the ensuing costs if such crises finally occur, and to cushion the effects of shocks stemming from the real sector of the economy; and, finally, the importance of distinguishing, as far as possible, between liquidity and solvency crises in countries' external debt and in governments' public debt, as a first step towards applying suitable remedies for resolving each type of crisis.

As a result of these crises, and in collaboration with other international agencies and with national authorities, the Fund conducted a far-reaching review of the so-called “international financial architecture”. Numerous initiatives were adopted over recent years with the aim of lessening the frequency and cost of crises and of improving the stability of the international monetary system. Accordingly, there has been a notable effort to increase the transparency of member countries’ economic policies and to improve the information at the disposal of economic agents and, in particular, international financial markets so that the latter may exert market discipline more effectively. Specific measures have been adopted to reinforce financial systems. And it has also been sought to improve the crisis prevention and crisis resolution mechanisms available to the international financial community, including those particularly difficult cases in which sovereign debt restructuring proves inevitable. Moreover, instead of relying on exhaustive international regulations which, as experience has shown, are difficult to approve and even harder to implement, all these reforms have relied on voluntarily mechanisms, based frequently on the adoption of codes of best practices, international standards and systems that offer incentives for their application.

Over the next two days the Conference will address these and other matters of interest to us all, among them the risks associated with the persistent imbalances between the current account positions of the main economic areas; the consequences of adopting different exchange rate regimes in the current environment of free capital flows; the problems that arise from excessive public debt levels both in the emerging and industrialised countries; and the role of the Fund in the face of the challenges of economic and financial globalisation.

All these issues have interested authorities, the private sector and the academic community for many years, although the way to deal with them has evolved in step with changes in the international economy. In what is an exceedingly dynamic environment, then, it is crucial to identify the root of the problems and possible solutions for them, which is precisely the chief aim of conferences such as this.

We have an intense and fascinating agenda for discussion. It highlights, once more, the need for national authorities, international financial institutions and the academic community to work together in areas of common interest, taking advantage of their experience and comparative advantages and with the degree of technical excellence these matters require. I trust that these sessions will shed light on how to improve the functioning of the global economy and, in particular, the international monetary system.

Thank you.

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