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A week ago I returned from the annual Spring Meeting of the IMF in Washington, and I thought that I might discuss with you this evening where we are in our collective international efforts to improve the functioning of the global economy. In particular I will touch upon two broad areas: first, the approach to overall economic management; secondly, the approach to strengthening the international financial system.

But I should like to begin with a few words about the process of international monetary and financial co-operation. Finance Ministers and Central Bank Governors, as well as their Deputies, spend a good deal of time at meetings in various different international fora. I am often asked after one or other of these meetings "what exactly did you decide?" And more often than not, the answer is that we did not actually take any specific decisions. We exchanged opinions, and often agreed that we needed to do more work on this or that issue which we could review and debate at a subsequent meeting. You could be forgiven for thinking that the process of reaching international agreement on anything moves at a snail's pace. To a degree that is true.

But even a snail can make considerable progress provided it keeps going. I am told that the world record for a snail is about 16 cms a minute, or roughly one kilometre in 4 days. On that basis a snail could leave here this evening and be in the BIS in Basel in under a year. It necessarily takes time to build an international consensus to move forward on any significant issue, and you need a broad consensus if whatever it is you agree is to have any meaningful effect. And if you look back over ten, or even five, years, rather than just at the outcome of any particular meeting, then the amount of progress really has been very considerable.

Overall economic management

Let me illustrate this first in relation to the broad consensus that now exists - within the developing, emerging, and transition economies as well as within the industrial world - on the general approach to overall economic management. That consensus can perhaps be summed up essentially as "macro-economic stability and supply-side flexibility", though that characterisation needs elaboration.

On the macro-economic side we have learned - and it has taken some countries longer than others -that you cannot achieve what we are all trying to achieve - sustained growth, high levels of employment and rising living standards - simply by pumping up demand in our economies through expansionary monetary and fiscal policies without proper regard to the underlying supply-side capacity of our economies to meet that demand. Short-term demand management through monetary policy too often led instead to accelerating inflation, and increasing external deficits, which had eventually to be brought under control through recession - an absolute recipe for short-termism in both financial and business behaviour. Equally, excessive public expenditure - which had ultimately to be financed through higher taxation - imposed burdens on the private sector which weakened its capacity to generate employment and income and wealth.

So the emphasis now, more or less everywhere, is on effective price stability as the immediate objective of macro-economic policy - not simply as an end in itself but as a measure of the balance between aggregate demand and underlying supply in the economy as a whole. In effect the aim of monetary policy in particular is to moderate, rather than aggravate, the economic cycle, and so to provide the basis for sustainable growth at around the underlying rate of growth of productive, supply-side, potential. And the emphasis now - again more or less everywhere - in relation to fiscal policy is to limit public sector borrowing, and the outstanding level of public sector debt, to levels that can be sustained into the medium and longer term without the need for increasing tax burdens or the imposition of rising real interest rates on the private sector.

These objectives of macro-economic policy - monetary and overall fiscal policy - will certainly be familiar to you in this country; they are at the heart of the policies being pursued right across Europe; and they are the policies endorsed, too, by all the members of the IMF in the Madrid Declaration adopted at the IMF Annual Meeting in 1994 and expanded and updated two years later. Of course on occasion the flesh proves to be weaker than the spirit - and achieving these macro-economic objectives is not easy in practice even as a technical matter. But the intention - the international commitment to macro-economic stability - is clear.

Acceptance of the aim of macro-economic stability served to bring into sharper focus the structural, supply side, of the economy - that is the whole raft of influences that can affect the underlying growth rate of capacity and thus the growth rate of aggregate demand that can be sustained.

And here, too, there has been a strengthening international presumption in favour of open markets and free competition - both domestically and internationally - with a continuing strong presumption against predatory trade or exchange rate manipulation. The justification is that undistorted competition contributes to potential global economic growth through increased efficiency and the more effective allocation of productive resources. Faster growth in turn provides a more favourable context for addressing social concerns, including the issue of poverty.

The international presumption in favour of free markets in itself is somewhat remarkable, given that, at the micro-economic level, increased competition invariably constitutes a threat to established producers - and their employees - who might well be tempted to urge protection in one form or another on their national governments. Consumers, who benefit from such competition, tend to be less vocal or well organised. The threat of protectionism is never, therefore, far away. But in fact the presumption in favour of competition has proved encouragingly robust. And that is not just in relation to international trade. There is a parallel presumption in favour of freedom of capital movements, and much greater openness around the world to foreign investment.

Among other things on the supply-side, there is a shared emphasis on the need to direct public spending to developing human resources through education and training, to effective health care, and affordable social safety nets. There has been a global trend to privatisation through which governments have increasingly returned essentially commercial activities, in which they have no necessary comparative advantage, to market disciplines. And there is a common recognition of the need for reforms in labour and product markets designed to reduce distortions which impede the efficient allocation of resources.

Now I do not pretend to you, Mr Chairman, that the international policy consensus in favour of macro-economic stability and supply-side reform is fully articulated, particularly on the supply side; nor do I claim that it is subscribed to in its detail equally in every IMF member country. But it does represent a substantial evolution in our collective thinking over the past decade or so towards a much more common approach to economic management, which serves as a valuable framework within which countries' performance can be assessed. The snail may have moved slowly but it has in fact travelled a considerable distance!

But broad agreement on the principles, does not make them any easier to apply in practice. This is evident from the imbalances which have built up within and between the major industrial countries in recent years. It is uncertainty as to how those imbalances are likely to be corrected that underlies much of the current concern about the prospects for the global economy.

The major uncertainty relates to the situation in the United States which has experienced a period of exceptionally strong economic growth with relatively low inflation until quite recently. Briefly - and no doubt oversimply - this very strong performance is widely seen as driven largely by exceptional productivity gains, as the application of new information and communications technologies spread through the economy. This development promised a higher sustainable rate of growth in the US economy and higher corporate earnings growth. That expectation contributed to a rapid rise in equity prices, especially in the "high tech" sectors, which in turn helped stimulate both business investment in the US and consumer demand causing the private sector to move into financial deficit. It also attracted massive direct and portfolio investment inflows from abroad which over-financed an increasing current account deficit in the US and caused the dollar to strengthen against other currencies. By the first half of last year the US economy was expanding at a rate of over 5%, which even on the most optimistic view of underlying productivity growth was clearly unsustainable. The pace of demand growth in the US needed to slowdown - as of course it has.

The big questions now are about the extent of the slowdown and how long it will last. And the reality is that no one can be confident that they know the answers.

What we do know is that the US data on the whole have not so far been as weak as many commentators predicted. Consumer spending in particular has held up reasonably well, though there has been a fall-off in investment growth, as well as a sharp downwards stocks adjustment and an associated decline in US imports. On an optimistic view, if consumption continues to hold up, and assuming that the recent underlying productivity gains can be maintained, investment spending will recover as the spread of ICT through the economy resumes, and the downward stock adjustment will come to an end. On this view we can look forward to a pick up in US activity as we move, say, into next year. But the pessimist is inclined to point to the weakness of private sector saving, which could induce more cautious consumer behaviour especially if unemployment continues to rise; he points to a possible overhang of past investment excesses; and he points to the US external deficit which will at some point need to be corrected. These adjustments might take place gradually over time, in which case the US might face a more protracted period of relatively slow growth; or, if you are really pessimistic, the adjustments might be more abrupt implying a possible period of negative growth and global financial instability. The recent somewhat erratic recovery of US stock markets from their earlier gloom suggests that they are beginning to side with the optimists; some of the survey evidence of consumer and business confidence on the other hand still supports a rather more pessimistic view. For what it is worth, and given the strong policy response in the US, I am modestly optimistic, but I recognise the downside risks. The outcome is obviously the major uncertainty surrounding the global economic prospect, and policymakers elsewhere can only monitor, continuously and very closely, the emerging evidence and react to that in the light of its likely impact on their own situation.

The US slowdown comes at a particularly bad time for Japan which is already suffering from a combination of weak domestic demand - particularly consumer demand - and supply-side constraints reflecting pressures on the banking system, heavily burdened with non-performing loans, and an acknowledged need for restructuring parts of the nonfinancial sector. Japan has pretty well exhausted the scope for macro-economic stimulus. Successive fiscal packages focused on public works, and a sustained period of attempted monetary expansion, at near-zero interest rates in the face of deflation, have failed to overcome a high rate of precautionary saving by an ageing population facing an uncertain economic future. The policy emphasis of the new Japanese administration appears to be shifting towards firmer action to bring about supply-side reform in the belief that this will help to engender greater confidence. The danger is that, to the extent that more aggressive restructuring results in bankruptcies and higher unemployment in the short term, that in itself might tend to weaken consumer demand for a time before the benefits of the restructuring come through.

Closer to home, the Euro area economy is a good deal better placed to withstand the US slowdown although we are all bound to be affected to some degree. For most of last year the Euro area economy performed relatively strongly, with overall output growth well above trend, and unemployment in the area as a whole continuing to fall from its earlier chronically high level.

A problem, of course, was the persistent weakness of the Euro in foreign exchange markets, despite strong "fundamentals" in terms of conventional analysis. This was largely the result of an outflow of capital, much of it drawn into the US by the magnetic attraction of prospective corporate earnings growth - and apparently continuing despite the US slowdown.

The euro's weakness gave rise to widespread - but in my view unjustified - criticism of the ECB. The task of a central bank operating an independent monetary policy is necessarily a limited task, not least because it effectively has only one instrument - its control over short-term interest rates. Its role - as I said earlier - is essentially, to use that instrument to influence aggregate demand in the economy, with the aim of keeping demand broadly in line with the supply-side capacity of the economy. The measure of its success is consistently low inflation. Against that criterion the ECB has been relatively successful. The Euro area economy has grown, above trend, with core inflation nevertheless remaining within the tolerance range of 0-2%, even though on the headline measure, influenced by rising oil prices and the weaker exchange rate, inflation has for the time being moved above the top of that range. The ECB would have put that internal stability of the Euro area as a whole at risk if it had attempted at the same time to use monetary policy to target the euro's exchange rate.

The more recent criticism has been that the ECB has been slow to respond to the weakening of the US economy. Implicit in that criticism is no doubt a judgement about the extent and duration of the US slowdown and its likely impact on the euro area. As I have said there is a great deal of uncertainty about that. But the ECB has to take account, too, of domestic demand pressures in the euro area, and of the fact that even on the core measure Euro area inflation has been moving up gradually towards the top of the ECB's 0-2% range. Frankly I don't see how anyone can be confident whether the ECB has it precisely right or wrong - it is perfectly normal for even the best-informed people to disagree on these judgements, as anyone who reads our own Monetary Policy Committee meeting minutes will tell you. But I am wholly confident that the ECB is sensitive to the issues surrounding those judgements, including the downside risks in the US.

So, too, are we in the United Kingdom. In our case, we again enjoyed relatively steady overall economic growth last year combined with a further fall in unemployment to its lowest rate for 25 years. Inflation meanwhile continued to run somewhat below the Government's 2½% target, partly at least as a result of the dampening effect of sterling's surprisingly persistent strength against the euro. The problem that has been with us for some time now is the sectoral (and associated regional) imbalance within our overall economy. The domestically - oriented sectors have, for the most part, been doing relatively well, whereas those sectors that are exposed to competition within or from the Euro area have been under considerable pressure.

Domestic demand growth has remained relatively robust into this year, but we too are affected by the US slowdown and by the associated weakening of equity prices. And we have had a new problem of our own in the form of Foot and Mouth Disease, the effects of which have gone a good deal wider than just the agricultural sector. These new developments were likely to have a dampening effect on demand pressure within the overall economy, both through their direct impact and through possible damaging effects on confidence. Given the fact that we started from a position in which inflation was below target (and expected to remain so for some period ahead); and given only modest upward pressure - at least so far - on wages and earnings growth, despite the continuing tightness in the labour market; we judged that we needed to reduce interest rates - by ½% - earlier this year in order to meet the inflation target further ahead. And we have made it clear that we will continue to monitor the downside risks very closely, in the context of course of all the other developments affecting our economy.

Mr Chairman, I have discussed the current international conjuncture at some length to illustrate that even though we all have broadly common economic objectives, that does not make them easy to achieve. We all face our own domestic uncertainties and are exposed to the international repercussions of developments elsewhere.

Financial stability

One of the greatest difficulties we face is the problem of how to cope with movements in financial asset prices, including exchange rates. That problem has become an increasing preoccupation with increasing financial wealth in our economies and with global financial integration.

In the context of macro-economic stabilisation we can, and of course do, take account of asset prices as best we can in both our projections and our policy decisions. The strength and subsequent weakening of stock markets in all our economies, for example, will have been one of the factors influencing both investment and consumer demand to varying degrees for all of us; and the behaviour of exchange rates is clearly a factor influencing inflationary pressures in our respective economies, both through its direct effect on prices and indirectly through its impact on net external demand. But while we can try to make allowance for these effects we cannot predict future asset price movements and we certainly cannot seek to control them. They remain a major source of uncertainty.

They also, of course, represent a major potential threat to financial stability which is a necessary concomitant to monetary stability. In the rest of my remarks I should like to comment briefly on the evolving international consensus on the approach to maintaining financial stability.

The 1994 Madrid Declaration, to which I referred earlier, had already welcomed "the growing trend towards currency convertibility and encouraged IMF member countries to remove impediments to the free flow of capital." One might have supposed that the subsequent eruption of the Asian financial crisis - which was certainly aggravated, if not provoked, by volatile international capital flows - might have resulted in something of a reaction to further evolution in that direction. In fact, in the midst of the turmoil, in September 1997, the IMF's Interim Committee confirmed the consensus view that: "Private capital flows have become much more important to the international monetary system, and an increasingly open and liberal system has proved to be highly beneficial to the world economy. By facilitating the flow of savings to their most productive uses, capital movements increase investment, growth, and prosperity." In other words, while markets may not be perfect, they are in general the best means we have of allocating financial resources efficiently. The impact of the crisis was instead to give fresh impetus to defining and establishing the conditions that are necessary for financial markets to function more efficiently, and that would help to reduce the risks of and limit the damage from, volatile shifts in market sentiment, with their potentially disruptive effect on both economic and financial stability.

It goes without saying that macro-economic stability is our first line of defence. But, beyond that, a huge amount of work has been undertaken in a variety of international fora to develop codes and standards of best practice in a whole range of more specific areas relevant to improving the functioning of the international financial system. The IMF has produced codes of good practice on data dissemination, on transparency of monetary, financial and fiscal policies, and guidelines for public debt and reserves management. The main Basel Committee has put forward proposals for revising its capital accord designed to align regulatory capital requirements more closely with economic capital and has drawn up core principles for effective banking supervision. The Basel Committee on Payments and Settlement Systems has developed core principles for systemically important payments systems. The International Organisation of Securities Commissions has developed objectives and principles for securities regulation; the International Association of Insurance Supervisors have developed insurance core principles; and the OECD a set of principles on corporate governance. The International Accounting Standards Committee has developed international accounting standards; and the International Federation of Accountants international standards on auditing and audit practice and so the list goes on.

The emphasis now has to be on implementation by national authorities with the help where necessary of the international community. And there needs to be increasing emphasis, too, on transparency and validation of progress towards implementation in individual countries in the context of IMF surveillance.

The Financial Stability Forum has recommended that in seeking to strengthen their financial systems countries give priority to implementing standards and codes in twelve particular areas, and the IMF and World Bank have developed a framework for assessing the progress countries are making in implementing these key standards and codes. Standards that are particularly relevant to the development of sound financial systems are evaluated under the Financial Sector Assessment Programme (FSAP), while Reports on the Observance of Standards and Codes (ROSC) provide summary assessments of a country's progress in observing standards across a range of areas. Taken together all these initiatives should contribute to greater stability at the national level. But they should also help lenders and investors better to assess the risks of lending to or investing in one country as against another, dampening potential volatility and, at the same time, giving the countries themselves stronger incentives to move toward best practice. As far as crisis prevention goes our snail has come a long way in the past few years, though of course it needs to keep moving forwards.

But while we can hope to reduce the risk of crises we cannot realistically hope that they will not continue to occur. So a great deal of attention has also been paid to improving our capacity for crisis management.

A major step forward was the agreement - at the G7 Summit some two years ago - on a set of principles and tools that could be applied in managing a crisis.

Broadly, having emphasised the importance of not undermining contractual obligations, the principles stress that all private creditors should accept responsibility for their lending and investment decisions - without expecting to be underwritten by the official sector. They encourage co-operative solutions between the debtor country and its creditors, building on effective dialogues established in advance. The tools link official support to efforts by the debtor country to obtain private financing - or maintain existing exposures - on a voluntary basis, and provide for comparability of treatment within the Paris Club, of all categories of creditors other than international financial institutions. They include mechanisms that can be used to limit the use of official financing to fund external deficits or domestic capital outflows or to repay private sector debt. And they provide ultimately for capital controls, as part of payments standstills, in conjunction with IMF programmes.

So we have the principles and we have the tools. What we still need to develop is a better framework of understanding as to how they might normally be applied. I agree of course that we should not adopt hard and fast rules, because to a degree each case is different. But we do need to develop some kind of presumption about the limits within which IMF support might be made available to member countries in different situations, and the conditions, relating both to adjustment action and to private sector financing that would normally be applied. We need to develop a clearer presumptive framework of this kind - no doubt with provision for exceptions where they could be properly justified - before the next crisis hits us, because what debtor countries and their private sector creditors believe they can expect will influence their behaviour in the meantime.

What we all have to recognise is that the exceptional amounts of official funding committed during the Asian crisis are far less likely to be forthcoming in future. And to the extent that official funding is forthcoming, conditions may well be attached to ensure that it is not used simply to re-finance payments of short-term debt to private sector creditors or to fund a resident capital outlflow. Several of the tools which the G7 communiqué identified are designed to have precisely this effect.

The last thing that the official international community wants is to get dragged into the micro-management of relations between debtor countries and their creditors. We would all agree on the desirability of voluntary solutions, which might be easier to achieve if borrowing countries and their major creditors - above all the short-term lenders - were to establish, during the good times but on an on-going basis, arrangements for regular dialogue. Nor would anyone want to insist upon the imposition of constraints on capital outflows.

But where, in more extreme situations, an agreed solution in relation to external debt is not immediately achievable there may be a logical case for the orderly suspension of payments until a better alternative can be put in place. This could have advantages for committed private sector creditors as well as for the debtor country and the official international community if it prevented free riders running for the exit, or seeking to attach assets, and provided time for orderly negotiations on the provision of new finance or for equitable debt rescheduling. Similarly, in some situations, there may be an equivalent case for restraining domestic capital outflows.

I am under no illusion that this area is an extremely sensitive and complex one. There are no simple solutions. But we do need to continue to explore the available options or we will remain in the position of making things up as we go along. The snail in this area certainly still has a long way to go!

Conclusion

Mr Chairman, I hope that I may have been able to persuade you this evening that the continuous round of meetings on international monetary and financial question do indeed serve a useful purpose, even though the outcome from one meeting to another may not be immediately apparent. It may just reflect the increasing patience that comes with advancing years, but I believe we have in fact made very real progress towards defining common objectives, and agreeing upon tangible steps that will help us towards achieving those objectives, in relation both to monetary, and broader macro-economic, stability and to creating a more effective and more robust financial system. It is of course an endless journey, and no doubt we will from time to time run into rough waters. But I'm convinced that our snail will keep moving forwards - and that it will even learn to swim!