STATEMENT BY THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Attached for information for the Members of the Development Committee is a Statement from the Managing Director of the International Monetary Fund, Dominique Strauss-Kahn, for the Committee’s eighty-first meeting to be held in Washington, D.C., on Sunday, April 25, 2010.

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DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR’S WRITTEN STATEMENT

I. Introduction

1. Global economic activity is recovering from a deep recession. Although the upturn is stronger than previously anticipated and self-sustaining growth dynamics appear to be returning, many countries remain dependent on expansionary macroeconomic policy support, underlining the fragility of the recovery.

2. While the worst case scenario has been averted, the negative impact of the crisis on human development will be long lasting. As shown in the 2010 Global Monitoring Report, poverty rates are expected to continue to fall after the crisis, but more slowly. Exceptional efforts from the international community are needed to increase development aid, mitigate the impact of the crisis on the most vulnerable groups and to strengthen the resilience of the global economy to future shocks.

3. In this statement, I will first assess the economic outlook and highlight some of the key policy issues facing emerging and developing countries. I will then report on the IMF’s enhanced support to crisis countries and its engagement with low-income countries, including possible further improvements to our surveillance tools and financial instruments. I will conclude with a review of recent progress on IMF governance.

II. Economic Outlook and Policy Issues

Recent Developments and Outlook

4. Global output growth is projected to increase to 4.2 percent in 2010, following a year of contraction, with GDP growth in emerging and developing countries accelerating to 6.3 percent in 2010, from 2.4 percent in 2009. The recovery is led by emerging economies in Asia, where growth rates now exceed pre-crisis levels. The prospects for developing countries are improving as well, although growth rates have not yet recovered to the levels seen in the years before the crisis. Global inflation has remained low, although some economies, especially in Asia, are seeing the first signs of rising price pressures.

5. The recovery remains vulnerable, however, notably in advanced countries and most economies in Eastern Europe, where elevated sovereign risk, rising public debt, high unemployment and weak household balances are dampening consumption growth and investor confidence. In some groups of countries, including low-income countries, growth rates in the next few years are not expected to reach the high levels recorded before 2008.

6. The impact of the financial crisis differed across emerging and developing countries and the recovery is also proceeding at varying speeds. The general patterns of recovery reflect a broad reversal of negative crisis impacts through three main channels. First, the crisis resulted in a strong decline in external demand and global trade (Figure 1), especially trade in durable goods and other deferrable purchases, magnified by a contraction in global supply chains and, to some extent, declining availability and higher cost of trade finance.
Since the collapse, industrial production in emerging markets has recovered and a global recovery in trade, while fragile, is under way. Regions most integrated in the global supply chain, such as Asia, have also experienced the fastest recovery in trade.

Figure 1. Short-term indicators of production and trade

7. Second, as a result of weaker demand, commodity prices fell during the crisis, resulting in a negative terms of trade shock for most commodity exporters, many of them low-income countries. However, prices for most commodities rebounded in 2009 and are now on an upward trend as the global recovery gains momentum. This reversal has helped to mitigate the impact of the crisis on commodity exporters. Looking forward, both food and commodity prices are projected to remain high by historical standards, given prospects of further demand growth and continuing supply constraints in many sectors.

8. Third, financial markets froze following the collapse of Lehman Brothers in September 2008, interrupting access to markets and increasing volatility. Financial market conditions for emerging and developing countries have improved considerably since then: bond spreads have declined, stock prices have recovered, and exchange rate volatility has subsided. Strong growth, yield differentials and returning appetite for risk have resulted in renewed capital flows to emerging economies. Access to international bank financing remains more limited, however, as banks in advanced economies continue deleveraging.

Macroeconomic Policy Priorities for Emerging and Developing Countries

9. Accommodative macroeconomic policies continue to support the recovery in many emerging and developing countries. Aided by moderate inflation trends most central banks reduced policy interest rates in 2009, and many countries benefited from exchange rate depreciations. Despite falling tax revenues, more than half of the countries have been able to sustain public expenditure plans during the financial crisis and some countries were able
to increase social spending, supporting domestic demand and mitigating the effects on the poorest. This fiscal stance was made possible by the improved fiscal position that most emerging and developing countries had built up during the pre-crisis years. As a result, fiscal deficits in emerging and developing countries expanded by almost 3 percent of GDP in 2009 (Figure 2), and are projected to remain high in 2010 in many countries. While there are wide differences across countries, median growth in real primary expenditure remained positive in 2009, but growth in spending is expected to decline in 2010 as some countries begin to consolidate (Figure 3).¹

Figure 2. Median government balance, 2008-2010

Note: General government balance data is used, except for Zimbabwe, for which central government balance data is used.

¹ For a more detailed description of developments in emerging economies, see Creating Policy Space: Responsive Design and Streamlined Conditionality in Recent Low-Income Country Programs (EBS/09/244) and Review of Recent Crisis Programs (SM/09/246).
10. As the crisis and its immediate impact recedes, the focus for macroeconomic policies shifts to new challenges: how to exit from extraordinary stimulus and to address medium term sustainability, while ensuring a return to robust and balanced growth. The appropriate timing and nature of exit policies depends on individual country circumstances. In many countries, where private demand components are still cyclically weak and sufficient policy space is available, monetary and fiscal policy can remain geared toward supporting activity. In these circumstances, monetary and fiscal support should be gradually removed only when private demand is sufficiently strong to sustain growth.

11. A number of countries, however, are not in a position to leave these expansionary policies in place. Financing constraints are likely to compel some developing countries, which for the most part financed widening budget deficits in 2009 through increased reliance on domestic sources to start moving to more prudent policies. If there are no signs of rising inflation, accommodating monetary policies in these countries can be maintained for some time to support domestic demand, unless strong pressures on the exchange rate or reserves emerge. Countries that have already returned to strong growth also need to withdraw stimulus.

12. While fiscal stimulus in many emerging and developing countries continues to support the recovery, risks to debt sustainability and crowding-out through higher interest

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rates may be rising. Recent Bank-Fund debt sustainability analyses for low-income countries suggest that debt ratios, while negatively affected in the short term, are expected to return to a downward trend in the medium term. However, these projections crucially assume that the crisis has no permanent impact on long-term growth and that fiscal space is restored through consolidation. In addition, recent IMF research shows significant effects of fiscal deficits on interest rates, which could dampen private investment and force governments to spend more on debt service payments and less on social programs. These effects will be stronger when initial deficits or debts are high.

13. Credible medium-term fiscal adjustment plans are important to maintain confidence in macroeconomic stability—a priority for all emerging and developing countries. In addition to phasing out temporary stimulus measures, for several countries this will require improvements in their structural primary balance. To enhance confidence and to create space for longer-term development oriented expenditure, the medium-term adjustment plans could emphasize structural cuts in non-priority expenditure and measures to improve revenue performance, while strengthening well-targeted social safety nets. In particular, many emerging and developing countries have room for further improvements in tax systems and revenue administration, including measures aimed at widening the tax base.

14. Emerging and developing countries are faced with a number of other medium-term challenges. First, a return to sustained growth in the medium-term requires mobilizing new sources of growth. These include measures to strengthen the role of the private sector, structural reforms to boost productivity, and fostering growth from the “green” economy. Second, as global integration advances, global efforts to strengthen financial sector regulation and supervision are becoming increasingly relevant also in emerging and developing countries. Policies should focus on strengthening the soundness of individual institutions, solidifying contingency planning and crisis management frameworks, mitigating risks from cross-border exposure and spillover effects and adopting a broader macroeconomic orientation for financial surveillance.4

Stronger International Policy Coordination

15. The prospects of sustaining the current economic recovery will be enhanced if advanced, emerging, and developing countries continue to cooperate in the implementation

3 See The State of Public Finances Cross Country Fiscal Monitor, IMF Staff Position Note, SPN/09/25, November 2009, and Emanuele Baldacci and Manmohan Kumar, Deficits, Debt, and Interest Rates, forthcoming IMF working paper. An increase in fiscal deficits of 1 percent of GDP is found to increase 10-year nominal bond yields by about 20 basis points in the medium term, and an increase in the debt-to-GDP ratio of 1 percent increases rates by approximately 5 basis points. Although the econometric analysis is based on a sample of advanced and emerging economies, recent analysis for a larger sample of emerging economies show similar relations between deficits, debt, and interest rates.

4 For a more detailed discussion, see Global Monitoring Report 2009.
of exit strategies and policies aimed at increasing growth. The agreement among G20 leaders at Pittsburgh to create a new process for mutual policy assessments is an important step in this direction.

16. The enhanced spirit of international collaboration should be extended to increase aid to developing countries, avoid protectionism, and conclude the Doha Round as soon as possible. Aid levels still fall well short of the 2005 Gleneagles commitments, in particular for Africa. In addition, many donor countries have reduced their aid budgets, while others face pressures to reduce aid in light of tighter domestic fiscal constraints. A scaling up of aid is essential to allow developing countries to maintain growth-supporting public expenditure and social protection. A strong and concerted effort by the international community is also needed to help developing countries finance their responses to climate change. This will require long-term commitments to mobilize new resources on a large scale. While protectionist measures have been limited thus far in the crisis, political pressures to take more far-reaching measures could rise, especially in light of high unemployment, posing a threat to the recovery. Such pressures should be firmly resisted. In addition, further opening up international trade has the potential to strengthen sustainable economic growth. Governments should therefore make strong efforts to reinvigorate and successfully conclude the Doha Round.

III. Enhanced Support to Crisis Countries and Our Engagement with Low-Income Countries

17. Thanks to several recent initiatives the IMF is well-positioned to assist countries during the recovery. Scaled-up and more flexible financial support to countries most affected by the global downturn has been the centerpiece of the IMF’s efforts to respond to the crisis. Since September 2008, the IMF’s new lending commitments under the GRA reached a record high total of US$169 billion. The IMF’s concessional lending commitments more than tripled in 2009, compared to 2008, to nearly US$4 billion. Close to one third of the membership had an arrangement with the IMF at the end of March 2010. The IMF’s approach to financial support has been made more effective by higher access limits, the streamlined conditionality framework introduced in 2009 and the use of the new Flexible Credit Line (FCL) and the High Access Precautionary Stand-by Arrangements (HAPA). Both the FCL and the HAPA have proven successful in helping to stabilize economies affected by the crisis and mitigating potential contagion effects. The IMF’s new conditionality framework encourages greater focus on the achievement of reform objectives in critical areas, while providing more flexibility on the timing and content of policy measures.5

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5 Recent IMF studies found that crisis programs in emerging market countries were succeeding in avoiding the worst disruptions of previous crises, including currency overshooting, and that the design of recent low-income programs has shown considerable flexibility and emphasis on strengthening social protection. These results reflect a mix of timely, higher and more frontloaded financing and supportive macroeconomic (continued)
18. At the same time, the new concessional lending framework, which was revamped in 2009, puts us in a better position to help low-income countries weather the crisis. The IMF has waived all interest due on lending to low-income countries until 2012, and has doubled its medium-term concessional lending capacity. To meet the expected new financing commitments, US$14 billion in additional loan resources are being mobilized from member countries, and US$2.3 billion in new subsidy resources secured from a combination of bilateral contributions and the IMF’s internal resources, including those from agreed gold sales.

19. The global financial safety net was further strengthened with the general allocation of Special Drawing Rights (SDRs) totaling US$250 billion, with about US$100 billion going to emerging and developing countries, including about US$18 billion to low-income countries. This allocation has allowed many countries to build up their depleted reserves without having to divert resources from essential public expenditure programs in 2009, including social spending. This has been an important factor in mitigating the effects of the crisis on the poorest. In response to a call by the leaders of the Group of 20, the Executive Board of the IMF also recently approved a ten-fold expansion of the Fund’s New Arrangements to Borrow (NAB) and the transformation of this credit arrangement into a more flexible and effective tool of crisis management. The NAB will be increased by about US$500 billion, representing a major strengthening of our lending resources.

20. In light of the increasing ability of some low-income countries to support non-concessional debt, the IMF has moved from a single design for concessionality requirements toward a menu of options linked to country circumstances. The revised policy allows more flexibility for external borrowing for most countries and provides a clear path towards graduation from concessionality requirements. In the same spirit, the Debt Sustainability Framework for low-income countries has been made more flexible, through closer attention to the impact of public investment on growth, the role of remittances, and the treatment of external debt of state-owned enterprises. Modifications in these areas could result in a more favorable assessment of low-income countries’ capacity to borrow.6

21. The IMF’s analysis and policy advice have provided critical support to countries during the crisis. We are working on further strengthening the analytical underpinnings of our analysis, including bolstering the assessment of systemic risks, potential shocks and cross-border spillovers. IMF advice and technical assistance continue to contribute to the

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6 The Debt Sustainability Framework represents joint work between World Bank and IMF staff. Close collaboration between the two institutions is vital, given their distinct but closely linked mandates. A recent report found that Bank-Fund collaboration has improved in recent years and describes actions to be taken by both institutions to move collaboration forward. See Implementation of the Joint Management Action Plan on Bank-Fund Collaboration (SM/10/54).
effectiveness of surveillance and lending programs and help build capacity in countries for effective policy-making. A new regional assistance center was opened in Central America in 2009 and the IMF is planning to open three more centers in 2010. An Anti-Money Laundering trust fund was launched in 2009 and fund-raising is ongoing for similar funds on managing natural resources wealth and tax and revenue administration.

IV. New Initiatives to Strengthen Support to Emerging and Developing Countries

22. The IMF responded to the global economic downturn on many fronts, adapting support to its members in response to their evolving needs. The overarching aim of the IMF -- promoting economic stability and prosperity -- remains crucial also in the post-crisis era. However, the downturn has highlighted the need for the IMF to be even better equipped to safeguard global stability. To address this need the International Monetary and Financial Committee (IMFC), at its October 2009 meeting, called on the IMF to review its mandate and to report back by the next Annual Meetings.

23. On-going discussions focus on clarifying ambiguities in the current mandate and rethinking modalities in three key areas: surveillance, lending, and the functioning of the international monetary system. First, a central lesson of the crisis has been that localized risks can spread quickly. Rigorous surveillance therefore needs to include greater attention to multilateral surveillance, spillovers and risks stemming from the financial sector. Second, risks of systemic crises in today’s integrated world require a reassessment of the speed, coverage and size of IMF’s lending for crisis prevention and response, especially in emerging economies. The IMF is exploring enhanced means of providing support, including strengthening the FCL, multi-country credit lines and financial backstopping of regional reserve pools. Third, there is a need to do more to strengthen the long-term stability of the international monetary system. Tension between high demand for international reserves and limited supply can be mitigated by strengthening alternatives to self-insurance and diversifying the supply of reserve assets.

24. The crisis has reminded us of the very high cost—in terms of lost income and increased poverty—of economic shocks and volatility in low-income countries. Increased resilience through improved domestic policies and institutions, combined with IMF financing where appropriate, should be the first line of defense against volatility. There may be a case, however, for a closer look at how the IMF and others could help low-income countries address volatilities with the help of targeted financing instruments. This could be complemented by support from the international community, among other things, in fostering private insurance markets and promoting hedging instruments.

25. The recent earthquake in Haiti demonstrated the need for the IMF to be able to join international efforts to provide debt relief when low-income countries suffer truly catastrophic disasters. A proposal for a Post-Catastrophe Debt Relief Trust Fund has been developed for this purpose, for consideration by the IMF’s Executive Board after the Spring Meetings.
V. IMF Governance

26. IMF governance reforms are essential for enhancing its legitimacy and effectiveness. A rebalancing of quota shares is a key element of such reforms: it is therefore critical that all members secure the needed acceptances of the 2008 Quota and Voice Reform. With a view to completing the 14th General review of Quotas by January 2011, initial discussions have focused on two issues. First, discussions have commenced on a realignment of quota shares, based on a shift to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries, while protecting the voting share of the poorest members. Second, discussions have also begun on the overall adequacy of IMF resources and the potential need for increasing quotas.

27. Work is also ongoing on broader reforms that, together with quotas, could form a comprehensive reform package of the IMF’s corporate governance. In particular, initial discussions have begun on ways to increase ministerial engagement and oversight of the IMF; to enhance the role and effectiveness of the Executive Board, including possible reforms to composition, size and voting rules; and to establish an open process of management selection.