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-third meeting to be held in Washington, D.C., on Saturday, April 16, 2011.

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I. Introduction

1. Even as global economic recovery takes hold, it is proceeding along two tracks. Advanced economies are experiencing subdued growth with high unemployment, while many fast-growing emerging economies are seeing signs of overheating, with inflation pressures building and, in some cases, credit expanding rapidly. Sustaining the global recovery demands divergent policy responses: in the advanced economies, redressing fiscal imbalances and repairing and reforming financial systems; and in the emerging economies, checking overheating pressures and facilitating external rebalancing, which in many cases requires further monetary and fiscal tightening and, in those with large external surpluses, more ambitious exchange rate appreciation.

2. In the low-income countries (LICs), policy buffers established before the crisis allowed for active countercyclical policies that softened the impact of the crisis and—aided by a robust recovery in emerging market trading partners—helped to drive a relatively rapid return to strong growth. To substantially reduce poverty and to meet the Millennium Development Goals, low-income and other developing countries need to grow faster, expand employment opportunities, and rebuild buffers so as to guard against future shocks. In addition to strong, well-designed policies in the countries themselves, international cooperation is required to restore a global economic environment conducive to poverty reduction and development, and to provide adequate assistance to countries in need.

II. Economic Outlook and Policy Issues

The Recovery is Gaining Traction, but Downside Risks Persist

3. Signs are increasing that the recovery has become more self-sustained. In advanced economies, the shift from public to private demand is progressing and financial conditions—although they remain unusually fragile—have continued to improve. In emerging and developing economies, robust growth is being supported by private demand that in many cases is being boosted by still-accommodative macroeconomic policies, easy financial conditions and high commodity prices. Global output is projected to expand by 4½ percent in both 2011 and 2012, with advanced economies growing by 2½ percent and emerging and developing economies growing by 6½ percent.

4. Downside risks continue to dominate. In advanced economies, weak sovereign balance sheets (especially in certain euro area economies) and vulnerable real estate markets present major concerns, while high funding requirements of banks and sovereigns present financial risks. New risks are building, on account of high prices for oil and, in many low and lower-middle income countries, for food. Overheating and booming asset markets in some emerging market economies also pose risks.
Macroeconomic Policy Priorities

5. Addressing the many existing and emerging policy challenges is the key to sustained growth and to better job opportunities, particularly among young adults hit hard by crisis-related layoffs. Most advanced economies require continued monetary accommodation; structural reforms to boost productivity and job creation; the implementation of fiscal adjustment plans; and the repair and reform of financial systems.

6. In many emerging economies, the policy priority is to ensure that present conditions do not develop into overheating or financial vulnerabilities. Inflation pressure is likely to build further as capacity constraints begin to bind. Moreover, as policy rates in advanced economies rise from their unusually low levels, volatile capital flows may again exit the emerging market economies. Depending on country-specific circumstances, and assuming appropriate macroeconomic and prudential policies are in place, measures to curb capital inflows can play a role in dampening the impact of their excessive volatility on the real economy. However, such measures are not a substitute for needed macroeconomic adjustments.

7. In LICs, the remarkable resilience demonstrated during the Great Recession owed much to improved policy frameworks and the availability of larger policy buffers. LICs now need to confront the challenges of higher food and energy prices, while also undertaking the structural reforms and investments needed to reach a higher growth path. Looking ahead, these countries also need to rebuild the policy room to prepare for new risks and possible new shocks.

8. Other medium term challenges for emerging and developing economies after the crisis include mobilizing new sources of growth and, in view of increasing global integration, strengthening financial sector regulation and supervision. Moreover, recent developments in Middle East/North Africa underscore the inextricable links between economic and political stability, and hence the vital importance of policies that foster economic opportunity and job creation.

International Policy Coordination

9. Together with partners, the IMF has been active in helping to strengthen international collaboration in response to the crisis. We continue to provide critical support to the G20 mutual assessment process (MAP) exercise, which is helping G20 members to assess the global consistency of their policies and to achieve shared growth objectives. The G20 took an important step in agreeing on a set of indicators to identify global economic imbalances. We also work closely with the Financial Stability Board (FSB), which monitors progress on the consistent international implementation of financial reforms, while fostering financial stability through close cooperation among G20 finance ministers, central bank governors, and other international institutions.

10. Much remains to be done in the areas of trade and aid to foster economic development. New impetus is needed to conclude the WTO Doha Round negotiations, which would provide a more open and secure global trading environment. The development
benefits of the Doha Round could be complemented by the provision, by advanced and major emerging market economies, of more effective trade preferences for the poorest countries. I also underscore the importance of individual countries meeting their commitments on aid, together with further reforms to improve aid effectiveness. These steps are critical to help developing countries finance needed infrastructure investments and respond to the challenges of climate change.

III. Enhanced Support During the Crisis and Beyond

11. Thanks to significant reforms undertaken since the onset of the crisis, the IMF is well-positioned to support its members during the recovery. IMF financial support is helping to ease liquidity constraints among members and to catalyze additional donor support. Our reformed concessional lending framework has proved effective in making Fund financial support more flexible and tailored to the diversity of low-income countries. In addition, generous donor support to the Fund’s capacity building initiatives has facilitated delivery of critically-needed technical assistance to LICs and other countries affected by the crisis.

12. A key innovation has been the establishment of new insurance instruments to forestall crises. The Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL) provide large and upfront financing subject to no or limited traditional policy conditionality. Because they target members with relatively strong policies and fundamentals, these instruments convey positive signals about their users. The FCL and PCL have allowed the Fund to respond more flexibly to financing requests.

13. Further progress has been made in relieving unsustainable debt burdens in low-income countries under the HIPC Initiative and MDRI. Since the Annual Meetings, two countries (Guinea Bissau and Togo) reached the completion point and received irrevocable debt relief. Implementation of the HIPC Initiative is now well-advanced, with 90 percent of HIPC countries having reached the decision point and 80 percent the completion point.

14. Continued Fund financial support and policy advice for LICs is vital as they exit the crisis. Having drawn down their macroeconomic policy buffers during the crisis, LICs must now consolidate their positions to prepare for future adverse shocks. The LICs also need to build the capacity to finance the great infrastructure investments essential to reaching a higher and more inclusive growth path. In many LICs, this will require continued efforts to improve domestic revenue mobilization. Together with supporting policies in key social areas, higher and more stable rates of growth would help greatly to meet poverty reduction objectives.

IV. Directions for Further Reform

15. Looking ahead, we will continue to pursue initiatives and reforms in several areas, aimed at strengthening the IMF’s role in global economic stability and preparing to respond to future systemic stresses.

- **Enhancing surveillance.** We are building on the recent review of the Fund’s mandate to strengthen our surveillance both at the country and global levels. In this
context, work is underway to examine the impact of the economic and financial policies of the most systemic economies on the rest of the world, including developing countries, through “spillover reports” to be discussed by the Executive Board in mid-2011. Work on addressing data gaps revealed by the crisis is also ongoing, in collaboration with the FSB and other international institutions. The forthcoming triennial review of surveillance will take stock of the broader range of recent initiatives, including steps to strengthen risk assessments and financial sector surveillance, assess experience with surveillance since the beginning of the crisis, and recommend further steps for improvement.

- **A possible framework for managing large capital inflows.** Work toward developing such a framework was partly motivated by the number of countries grappling with capital inflow surges, and by the need for a clear organizing framework to weigh the effects of alternative policy responses. The recent broad endorsement of the framework by the IMF’s Executive Board constitutes an initial articulation of the Fund’s institutional views and—by recognizing that capital flow management measures, including capital controls, are part of the policy toolkit—signals that the Fund has become more pragmatic and flexible. This key step will be complemented in coming months by further work on the multilateral aspects of policies affecting financial flows in both recipient and source countries, including macroprudential policies, as well as work on capital account liberalization and dealing with outflows. Our goal is to ensure consistency and evenhandedness in Fund policy advice in this area.

- **Vulnerability Exercise for LICs (VE-LIC).** The LICs remain vulnerable to external developments, including the recent surge in food and fuel prices. The Fund will maintain extensive program engagement with LICs to assist them in addressing these shocks and in rebuilding their policy buffers, while continuing to enhance cross-country analysis to strengthen our policy support to LICs. In this context, we have developed a new annual Vulnerability Exercise for LICs, which will allow the closer monitoring of countries’ vulnerabilities in the face of continuing shocks and help to guide policy responses. The results of the annual exercise will facilitate cross-country comparisons and analyses and bolster IMF surveillance.

- **Lending instruments.** Ongoing work on lending instruments will identify remaining gaps, especially regarding contagious systemic shocks. We are reviewing the experience of past systemic crises to understand how large shocks propagate and what policies are effective in stopping them. This work points to the importance of proactive liquidity provision to shield ‘innocent bystanders’ hit by external shocks. We are also exploring the scope for greater synergies between the Fund and regional financing arrangements.

- **Diversification of the global reserve system.** Work is underway to identify avenues through which greater international use of emerging market currencies and financial development in all developing countries could be encouraged. These would help strengthen the resilience of both the system and these countries’ economies to global volatility. Another way to diversify the global reserve system is to enhance the role of
the SDR, and we have put forward options to that end. Adding some emerging market currencies to the SDR basket would make the latter more representative; however care must be taken not to reduce the attractiveness of the SDR by introducing prematurely currencies that are not widely used and traded. A review of the criteria for joining the SDR basket is on our near term work program.

16. Countries in fragile situations face financial and capacity constraints that lock them into bad equilibria for extended periods of time. The experience of the international community has shown that helping such countries meet their unique challenges requires flexible and well-coordinated approaches. Against this background, many development partners have sought to adapt their approaches to the specific needs of such countries. The Fund, too, will consider ways to increase the effectiveness of its engagement with countries in fragile situations, including through the deployment of its enhanced toolkit of LIC facilities. In addition, the Fund will continue to partner with donors to ensure unfettered access to technical assistance by countries that need to further build capacity for sound macroeconomic management.

17. Ensuring the IMF has the resources to adequately assist LICs in this uncertain global economic environment remains a key challenge. Additional resources are still needed to complete the LIC financing package of SDR 11.3 billion for the period through 2014. So far, members have pledged about SDR 9.8 billion in new loan resources, compared to the target of SDR 10.8 billion. Additional bilateral subsidy pledges have reached SDR 154 million, compared to the agreed target for bilateral subsidy contributions of SDR 200–400 million. In addition to the bilateral contributions, resources linked to the limited gold sales are expected to boost subsidies to the Poverty Reduction and Growth Trust (PRGT) by a further SDR 0.5–0.6 billion through 2014. Looking further ahead, we will also need to consider the longer-term funding needs of the PRGT. Beyond 2014, PRGT lending capacity is projected to be limited to about SDR 0.7 billion annually, compared to expected demand of SDR 1–2 billion a year.

V. Fund Governance

18. The IMF’s Board of Governors concluded the 14th General Review of Quotas in December 2010, agreeing to a doubling of quota resources and a historic shift in quota share of more than 6 percent to dynamic emerging markets and developing countries (EMDCs) and from over-represented to under-represented countries. Once this reform becomes effective, expected by the Annual Meetings 2012, China will become the third largest shareholder, and will be joined by three other emerging market countries—Brazil, India and Russia—among the Fund’s 10 largest members. In addition, the package of reforms preserves the voting power of the poorest members. The reforms will be mirrored in the composition of the Executive Board, with advanced European countries holding two fewer seats. These build on the reforms agreed in 2008 which recently became effective. The alignment of the Fund’s governance structure with global economic realities will continue with a comprehensive review of the quota formula to be completed by January 2013 and the completion of the 15th General Review of Quotas by January 2014. Discussions on other aspects of the IMF’s governance are ongoing.