International Monetary and Financial Committee

Eighteenth Meeting
October 11, 2008

Statement by Guido Mantega
Minister of Finance, Brazil

On behalf of Brazil, Colombia, Dominican Republic, Ecuador, Guyana, Haiti, Panama, Suriname, Trinidad and Tobago

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The International Financial Crisis

The world economy has been brought to a critical situation. Our generation has never seen such a deep crisis. Intense speculation in financial markets, lack of adequate regulation and supervision, and weak crisis resolution mechanisms in important countries have led to what seems to be by far the worst financial debacle since World War II. To quote Franklin Delano Roosevelt's words in 1936: "We are all suffering from individualism run wild".

The United States and Europe are at the center of the financial storm. The world watches in disbelief as the unfolding crisis reveals serious systemic weaknesses and policy blunders in what used to be regarded as model countries, countries that were presented as references of good governance, as examples to be imitated. The IMF itself used to take these countries' financial systems as the basis for devising so-called best practices in terms of financial management. After the current turbulence is controlled, we will have to establish a new set of practices to strengthen and protect the financial system, but without a bias towards the practices of the advanced countries.

The depth and seriousness of the crisis have made large-scale State intervention indispensable, as currently observed in the United States, in the United Kingdom and in several other developed countries. With the exception of doctrinaire "market fundamentalists", everyone seems to recognize that these interventions are unavoidable. Even governments deeply committed to *laissez-faire* now accept the inevitability of wide-ranging public sector involvement not only in the resolution of the crisis but also in the establishment of a new model of tighter regulation and supervision of financial institutions in the post-crisis period. The financial system that will emerge from the current crisis will probably be smaller and more regulated.

Government involvement, including partial and temporary nationalization of a large part of the financial system in the United States and Europe, will be required to restore the functioning of credit markets. It will also be necessary to restore trust, something that has been shattered by the failure of several major financial institutions. This may require not only measures directed at financial institutions but also debt relief to homeowners in the United States and in other countries hit by housing crises.

Once the hemorrhage is stopped and the acute phase of the crisis is past, it will be necessary to correct past errors in the organization of the financial sector. I hope that the mistaken belief that markets can be largely left to themselves will be buried for a long time to come. I would not say forever, though. As John Kenneth Galbraith once wrote: "For all practical purposes, the financial memory should be assumed to last, at a maximum, no more than 20 years". Be as it may, the pre-crisis model, which was based on the assumption that a host of financial intermediaries were somehow able to practice self-regulation, should be replaced by a carefully designed system of controls and supervision. In many cases, given the globalization of finance, this will require close international cooperation.

Emerging Market and Developing Countries

Developing countries are being increasingly affected by the financial crisis in the advanced economies. The linkages, commercial and financial, between the developing and the developed world are much too extensive to allow us to escape unscathed from the current crisis in the United States and Europe.

Nevertheless, it remains true that economic growth is still holding up reasonably well in emerging market and developing countries. We are all aware that economic projections, even for the very short term, are always precarious. This is especially true in highly unstable circumstances. That said, the IMF's projections for GDP growth, though revised downwards, still indicate relatively high rates for the developing world in 2008 and 2009. According to the Fund's estimates, in recent years, developing countries accounted for 75% of world GDP growth, measured on a purchasing power parity basis. Brazil, China, India and Russia continue to contribute with about 40% of global growth. In 2009, the Fund's numbers suggest that our contribution to world growth may be even higher, given the severity of the downturn in developed countries.

It can be said that the responsibility for avoiding a world recession has passed into the hands of developing countries. I believe that these countries will have to partially offset the recessionary forces originating from the developed world. Of course, there are limits to what we can do in that respect. The resolution of the crisis depends on the success of the policies that have been and will be implemented by the advanced countries. However, we may well have to play a countercyclical role in the present world economic situation.

The Food and Fuel Price Shock

In 2007-08, the world faced the largest commodity shock since the 1970s. The impact on developing countries and especially on the most vulnerable members of the IMF's membership has been considerable, with second-round effects yet to be revealed in some cases. Because of the volatility that accompanied the rise in fuel and food prices and of the considerable size of the shock, both net importers and net exporters of commodities saw their economies' stability threatened. The fuel and food price shock is having a disproportionate effect on the poor and, in some countries, has led to political and social crises.

We commend the IMF for intensifying its technical advice to member countries on policy responses to the food and fuel price shock. We think that the sharing of information on different countries' experiences is a good initiative. Nonetheless, we call on the Board and Management of the IMF to ensure that policy advice is tailored to individual countries' needs and particularities. Moreover, we urge the Fund to make sure that policy advice is delivered in an even-handed manner. Case in point, we would not support the inclusion of subsidy reforms in the Article IV surveillance mandate if it only targets middle income and low-income countries. We all know that fuel and food prices are significantly influenced by the advanced countries' agricultural subsidies and energy policies. The IMF has a duty to be comprehensive in its approach.

IMF Reforms

The ongoing crisis makes a fundamental reform in the way the IMF operates all the more urgent. Until recently, the IMF had been focusing on problems in emerging market and developing countries. It seems to have devoted insufficient attention to major financial centers, where boom-bust credit cycles have been observed with alarming frequency and intensity in recent decades. There is a clear need to strengthen the monitoring of these markets.

There is also a need to strengthen prudential safeguards related specifically to cross-border capital transactions. Many distortions can arise in times of ample liquidity in international markets. For instance, the build-up of highly leveraged currency mismatches may lead to disruptive unwinding, as currently observed in many countries. I take note that both concerns, the need to improve surveillance of major financial centers and of cross-border transactions, are included in the Statement of Surveillance Priorities of the International Monetary Fund, recently approved by the Executive Board. Because of their criticality, I hope that the Fund will make substantial progress in these areas. The way advanced economies are dealing with the financial crisis has to be carefully analyzed in order to address potential spillovers and to distill lessons for emerging market and developing countries.

The current crisis has highlighted one important difference between developing countries and advanced countries. The latter issue reserve currencies or can rely on currency swap arrangements. The U.S. Federal Reserve has provided swap lines to other developed countries' central banks on a very large scale – amounting currently to as much as US$ 620 billion – to allow them to supply U.S. dollars to their currency markets. These swaps have helped central banks in the recipient countries manage liquidity shortages in dollars in their markets.

Swaps in reserve currencies are rarely available to emerging market and developing countries. Therefore, they have to accumulate international reserves in good times, i.e., in periods of liquidity expansion in international capital markets, in order to use them when there is an unwinding of domestic currency positions by foreigners. The Fund should include reserve accumulation in the set of prudential measures for emerging market and developing countries. In the absence of swap arrangements, or of a new liquidity instrument provided by the Fund, these countries have to rely on the protection provided by their own international reserves or on regional reserve-pooling arrangements.

A New Liquidity Instrument

The severity and widespread effects of the financial crisis make it critical for the Fund to introduce a new liquidity instrument directed at emerging market and developing countries facing capital account shocks. I proposed in the last IMFC meeting, in April, the creation within the Fund of instruments capable of quickly providing liquidity to countries hit by the financial turbulence. Since then, the Executive Board has discussed this topic as part of the general revision of the Fund's lending role. However, the discussion seems to be proceeding too slowly. I hope that the creation of a new liquidity instrument will be further examined after the Annual Meetings and approved by the Board as soon as possible. I am glad to see that Japan has now presented a similar proposal for the creation of a new liquidity instrument in the Fund.

A new liquidity instrument would be directed to countries integrated in international financial markets that follow basically sound economic policies. It would be a new credit line in the toolkit through which the Fund provides liquidity to countries facing crises of a regional or global nature, like the present one. The line would provide large access, calculated according to countries' needs.

This would be an important step in adapting the Fund to the financial needs of its membership in an environment of very large cross-border financial flows and highly leveraged operations. The Fund needs to move beyond its traditional stance of offering rigid instruments, with low access levels compared to countries' needs and overburdened with conditionality.

I recognize that the Fund has been relatively flexible in recent years, especially in exceptional circumstances. However, if we do not make further substantial progress on this issue, members will approach the Fund only in advanced stages of a crisis – or not at all.

I welcome the ongoing streamlining of conditionality and urge the Fund to quickly evolve to a framework of higher access limits for its lending. In this way, we may be able to restore the Fund's role as key player in the international financial architecture, capable of providing financing to its members that do not issue reserve currencies or do not belong to the network of special swap arrangements for liquidity provision in foreign currency.

The international financial landscape is undergoing enormous changes. Our chair will continue to support the Managing Director in his efforts to build a modern IMF, with an appropriate set of instruments and policies.

The Exogenous Shock Facility

The Executive Board has recently taken a first step in the revision of its financing instruments by modifying the Exogenous Shock Facility (ESF), which is available exclusively for low-income countries. The modified ESF is an improvement relative to the one that existed since 2005 and that had remained unused. The new design provides for the existence of two components: the Rapid Access Component (RAC) and the Higher Access Component (HAC), with the former requiring less stringent conditions. The RAC reaches up to 25% of quota, while the HAC has a ceiling of 75% of quota (including any disbursement made under the RAC for the same shock).

However, the changes do not go far enough in terms of access and streamlining conditionality. Our chair in the Executive Board argued for a larger increase in level of access for both components of the new ESF. Unfortunately, the Board was only willing to approve a modest increase in access, from 50% in the old ESF to 75% of quota.

Nevertheless, I hope there will be political willingness to further adjust the ESF, if experience shows again that there are few takers or none at all.