International Monetary and Financial Committee

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Statement by Obaid Humaid Al Tayer
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On behalf of United Arab Emirates, Bahrain, Egypt, Iraq , Jordan, Kuwait, Lebanon, Libya, Maldives, Oman, Qatar , Syria, Yemen

Statement by His Excellency
Obaid Humaid Al Tayer
Minister of State for Financial Affairs of the United Arab Emirates

On behalf of Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Maldives, Oman, Qatar, Syria, United Arab Emirates, and Yemen

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I. The Global Economy and Financial Markets—Outlook and Policy Responses

1. Boosted by massive financial and policy support, the world economy is emerging from the worst financial and economic crisis in the post-war period. In recent months, financial markets were showing signs of stability and a revival in market confidence is taking place. It appears that public intervention has paid off.

2. Global economic prospects are brighter but uncertainties remain. Although downside tail risks have receded from earlier peaks, the recovery is still fragile and the overarching concern now is that the recovery could stall. So far, policy actions, rather than restored consumer and investor confidence, are driving the rebound. The pace of the recovery will be constrained as the impact of the fiscal stimulus recedes while private demand may not fully take up the slack due to rising unemployment, higher savings and tighter credit conditions. These considerations call for maintaining **supportive policies** until a durable recovery is attained.

3. Meanwhile, **inflation** concerns appear subdued, and deflation vulnerabilities have emerged in some advanced economies. With policy rates close to zero, national authorities will need to rely on unconventional monetary policies to counter sliding activity or deflation tendencies. However, inflation risks could possibly reemerge if commodity prices pick up or credit surges, especially if central banks misjudge output gaps.

4. **In the United States,** growth has turned positive in the second half of 2009, aided by fiscal stimulus and turnaround in the inventory and housing cycles. Sustaining the recovery will not be easy as consumer confidence remains low and the personal savings rate are likely remain high. Meanwhile, a number of temporary factors are supporting investor confidence—the positive results of bank stress tests, a temporary surge in second quarter bank profits, and the ability of banks to repay some public support and raise private capital—but these temporary factors may ware off. Bank recapitalization and repairing balance sheets are critical prerequisites to restoring confidence in the short-term, while regulatory reforms will be critical to avoiding a repeat of prior excessive risk-taking. The outlook for **Europe** is more

muted as tight credit conditions will likely constrain private investment and unemployment will remain high. Coordinated policy action remains key to regaining growth momentum in the region, while the unwinding of public support needs to be carefully timed. In **Japan**, output began to expand on the back of a strong rebound in exports and aggressive fiscal stimulus. However, the underlying momentum remains weak. A strong performance in the rest of Asia could provide further support in the coming quarters. **Emerging and developing countries** (EMDCs) have shown remarkable resilience in weathering financial strains compared to previous crises. The swift turnaround in economic fortunes in Asia is indeed remarkable, where the resurgence has pushed global growth into positive territory in the second quarter of 2009.

5. Like other EMDCs, countries in the **Middle East region** have experienced varying repercussions. Growth decelerated across the board, but more sharply in oil producing countries, due to the collapse in oil prices and cutbacks in production. Other countries faced sharp contractions in worker remittances, tourism, and foreign direct investment. Interlinkages with global financial markets were limited for the most part, but real estate and equity market corrections have exacerbated the downturn in some countries. After slowing to about 2¼ percent in 2009, growth is expected to pick up in 2010 but will depend on the pace of the global recovery. Inflation has subsided, returning to single digits for the region as a whole. Public policies were directed to supporting demand, in many countries using the financial surpluses accumulated during the boom years. The strategy provided support to nonoil activity with spillovers to non-oil producer countries in the region. Financial institutions have broadly proven their resilience to external stresses but supervisors should remain alert to further spillovers.

6. The Fund's critical role in mitigating crises has been reaffirmed in recent months. Significant achievements since the Spring meetings attest to the Fund's vital role. The trebling of loanable resources, reform of its GRA and LIC facilities, and further streamlining of conditionality have enhanced its crisis response. **Fund programs to EMDCs** have helped avert a major collapse in a number of countries or greatly diminished potential distress in others. Notwithstanding strengthened macroeconomic management and reduced debt burdens of LICs, many countries continue to have fragile debt situations. Concessional financing therefore remains critical, and careful consideration is needed when applying the proposed **new debt sustainability guidelines** that introduce some flexibility to allow for new forms of financing. In this regard, the recent agreement on use of resources linked to gold sales would contribute to the Fund's concessional lending capacity. The Fund should continue to review and enhance its engagement with emerging market and developing countries, and to carry out its surveillance and deliver financial support in an even handed way.

7. As the stress in financial markets appears to have abated, the longer-term implications of the crisis-related measures for debt-sustainability and public balance sheets deserve greater attention as these will contribute to promoting a lasting recovery. The Fund's **revised surveillance priorities** appropriately reflect this change of emphasis. We look forward to the contribution of **early warning methodologies** which will feed into surveillance activities and welcome the recent effort to combine qualitative inputs with the quantitative tools. The Fund remains well-positioned to elicit concerted policy responses aimed at restoring health of the financial system, averting future crises, and promoting sustainable balanced growth. Efforts to intensify the assessment of financial stability of systemically important and emerging markets through the **FSAP** should not be at the expense of reducing the Fund's work on developing countries or of neglecting the assessment of development needs. Emphasis in the period ahead should focus on two parallel aspects (i) further strengthening surveillance with emphasis on coordinating the timely implementation of exit strategies and return to sustainable fiscal positions and balanced growth; (ii) reforms aimed at restoring financial sector health, upgrading regulation, and strengthening supervision.

8. Policy-makers are beginning to turn their attention to designing **exit strategies** and plans for correcting government and financial sector imbalances. A key challenge for advanced economies will be to achieve a correction in their fiscal primary balance by 4-9 percent of GDP in line with the debt-stabilizing levels. Improved market conditions have encouraged financial institutions to shed state support and motivated some governments to begin unwinding interventions. Calibrating the timing of unwinding support policies is particularly difficult because of uncertainties about the structural shift in potential output and size of the output gap. Therefore extreme caution regarding the timing and modalities of exit strategies are extremely critical to the maintenance of sustainable growth without inflation.

9. A **rapid healing of financial systems** is an indispensable prerequisite to **restoring potential output**, which has typically experienced a large permanent loss following previous banking crises. While more rapid progress in this area could raise world GDP somewhat, slower progress in this area could depress world output significantly by reducing credit supply. Staff analysis points to a sizeable 'financing or credit gap" in advanced economies as sovereign debt issuance more than offsets the decline in private sector credit demand. Restoring potential output will also require focusing demand support policies on measures that have a more durable impact on employment creation and capital build-up. **Rebalancing of growth** toward domestic demand in Asia depends on reforming social safety nets to foster lower precautionary savings.

10. The crisis revealed weaknesses in **financial supervision**, particularly a failure to recognize the build-up of systemic risk in important institutions. The global

financial crisis has cast doubt on the wisdom of relying on markets to self-correct their activities. In recent months, however, banks' risk appetites are growing again and some financial firms are assuming large trading risks. This underscores the urgency of establishing new rules to address excessive and undisclosed off-balance sheet risks and risk-concentration in large interconnected financial firms before a surge in investor confidence leads to a re-escalation of risk-taking. A range of domestic and international institutions are involved in shaping regulatory reforms and we welcome the Fund's continued contribution to shaping this endeavor. Going forward, central banks should consider reacting more strongly to variables other than inflation and output gaps by taking into account signs of growing macrofinancial risks, such as asset price bubbles, high rates of investment, and excessive credit expansion.

II. Governance Issues, Increasing Fund Legitimacy and IMFC Process

11. Governance is an important subject, in particular for an institution like the Fund, which is mandated to maintain international financial stability and cooperation in an increasingly complex environment. Key to governance at the Fund is quota reform. Those who believe that the Fund lacks legitimacy and effectiveness believe the Fund lacks those two aspects because the quotas are so skewed. Legitimacy and effectiveness demand an immediate **quota and voice reform** which is key to opening the door for other reforms.

12. Little progress has been achieved in **realigning quota shares**, even after the yet-to-be-effective quota and voice reform that was agreed in April 2008. The aggregate share of EMDCs increased by 5 percentage points only over the past 30 years even with the 2008 reform. The difficulties surrounding a meaningful realignment of quota shares reflect political considerations that seem to outweigh methodological and data concerns. A mere updating of data, or tinkering with the variables and formula, will do little to reform quota shares without a political commitment that departs from past practices. A sizeable shift in EMDCs' share by 5-10 percentage points should be implemented in this round if we are to advance the reform agenda in a meaningful manner. A smaller shift in actual quota shares would be disappointing. With respect to the size of the quota increase, if the Fund is to remain a quota-based institution, **a much larger quota increase** would be warranted, larger than the proposed doubling of quotas, consistent with the magnitude of the recent 10-fold increase in the Fund's borrowing capacity and 8-fold increase in SDR allocations. Moreover, a shift in quota shares can be more easily implemented through a larger quota increase without diminishing any individual member's quota.

13. On **political engagement and accountability**, the key concern should be to strengthen the Fund's effectiveness and legitimacy. A systematic ministerial involvement in all operational and strategic decisions, oversight, and coordination could jeopardize this objective. It could be construed as a drawback to governance in the Fund if it centralizes power. We agree with others who noted that you cannot delegate the functions of the Executive Board to ministers because they just do not have the time, institutional knowledge, or inclination to carry out those functions. With respect to **Board responsibility**, the aim should be to strengthen the Board mandate regarding strategic issues rather than lessening its role in surveillance or in other core activities. Limiting Board responsibilities would weaken the checks and balances on management and staff. It could also weaken the role of smaller countries in the governance of the Fund. The Board is a hands-on entity, and we welcome ongoing efforts to improve its effectiveness.

14. Similarly, **shifting the forum of multilateral surveillance to G20 Ministers** would weaken the voice of smaller countries and go against the spirit of universal economic cooperation that the Fund was entrusted with. On the other hand, a number of worthwhile suggestions have been proposed to strengthen ministerial engagement through the reform of IMFC processes. The merits of each proposal should be measured by its ability to improve the effectiveness of delivering the Fund's mandate and to increase legitimacy through better representation.

15. On the **size and composition of the Executive Board**, the desired shape of the Executive Board depends to a large extent on the distribution of quotas and voting power. It is difficult to arrive to a credible conclusion on this issue as well the elimination of appointed chairs and reformulation of constituencies, before a quota realignment. On **double majority rules**, these should apply for example to the selection of the Managing Director as well as any other major strategic issue. There is broad agreement on the process for the **selection of the Managing Director** and the principles have been set forth over the years.