# International Monetary and Financial Committee

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Statement by Guido Mantega, Minister of Finance, Ministerio da Fazenda, Brazil

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

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**Minister of Finance of Brazil**

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

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## The Global Economy and Financial Markets

1. As the post-crisis economy takes shape, emerging market and developing countries (EMDCs) and advanced economies are moving at different speeds and adopting divergent policies. This trend brings new challenges both at the domestic and international level.

2. EMDCs have increasingly become the main pillar of economic growth. In these economies, growth continues to gain momentum. Exit policies from crisis response have been implemented smoothly and have not disrupted growth.

3. In contrast, the recovery of advanced countries remains weak. Despite positive surprises in the first half of 2010, more recent economic data suggest a less favorable outlook, notably in the US, Japan and some European countries.

4. Advanced countries are adopting aggressively expansionary monetary policies as a means to spur growth. They are expected to continue to follow these policies, and may even decide to intensify them, in response to the weak recovery, the persistence of high unemployment and, in some cases, risks of deflation. The reliance on monetary policy is perceived as a the only option to increasing constraints on the fiscal side. Many advanced countries are reluctant to continue to rely on fiscal expansion due both to financial limitations (large public debts coupled with market pressures) and political constraints (increasing domestic resistance to further increases in public expenditure). In some of them, fiscal tightening is already underway, in our opinion, often prematurely and at an excessively rapid pace. For those advanced countries that still have fiscal space, cuts in public expenditure or tax increases should be delayed until the recovery takes hold. Indeed, some important countries still have room for fiscal expansion. This would allow them to resort less to loose monetary policies.

5. Unsynchronized monetary stances between advanced and emerging market countries are leading to a massive shift of capital resources to the latter. These capital movements are stimulated by the growth potential of emerging market countries, large interest rate differentials, and open capital accounts. Some recipient countries struggle with rapid growth

in credit, asset prices and demand. Faced with excessive currency appreciation, governments and central banks have intervened in the foreign exchange market and adopted capital controls and other prudential measures.

6. The IMF is aware of the difficulties faced by EMDCs in managing sizable and potentially volatile capital flows. This Fall's "Global Financial Stability Report" acknowledges that capital movements generated by asset reallocation to emerging markets could be overwhelming. The staff of the IMF estimate that a one percentage point shift of global equity and debt securities held by G-4 investors (US, euro area, Japan and the UK) would lead to additional portfolio flows to emerging markets of as much as US$ 485 billion, an amount considerably larger than the record annual flows registered in 2007.

7. Despite this acknowledgement, the Fund is still reluctant to draw practical conclusions from its analysis. Experience seems to have shown that the free flow of capital is not necessarily a preferable option for EMDCs and that fully open capital accounts can be problematic. Pragmatic policy recommendations on how to limit excessive short-term flows should have more prominence in our deliberations and in the Fund's agenda.

8. EMDCs are contributing to global rebalancing. The current account balance of EMDCs in all regions, with the exception of Europe, has declined in recent years. Many EMDCs that are suffering upward pressures on their currencies are already deficit countries, as is the case in most of Latin America and the Caribbean. In our constituency, for instance, Brazil and Colombia are contributing to this process by strong growth and exchange rate appreciation. Looking ahead, the rise in current account deficits of EMDCs can become a source of concern and it is unrealistic to expect that this trend can continue indefinitely.

9. The constant calls for global rebalancing have to be taken "cum grano salis". Advanced economies, facing the prospect of a painful period of many years of weak growth and high unemployment, are eager to export their way out of the crisis. Near-zero interest rates and rapid monetary expansion are geared at stimulating domestic demand but also tend to produce a weakening of their currencies and an increase in their net exports of goods and services. All reserve currency issuing central banks are engaged in this policy to a greater or lesser degree. Meanwhile, emerging market countries are being encouraged to allow their currencies to appreciate and to accumulate current account deficits. Some advanced countries are even intervening directly in the foreign exchange market to weaken their currencies. This is why I recently spoke of an ongoing currency war. Ideally, we should be able to cooperate and avoid beggar-thy-neighbor policies like competitive devaluations.

10. In practice, given the uncertainties in the world economy, the EMDCs will continue to accumulate reserves as a means of containing currency volatility and appreciation, and also of building buffers for self-protection. In many cases, reserve accumulation has to be

supplemented by prudential measures and direct controls aimed at stemming large inflows of short-term and volatile capital.

**IMF Quotas and other Governance Reforms**

11. Before the 2008-2009 crisis the Fund was on a path of diminishing relevance. The crisis opened a window of opportunity for the institution to address one of its longstanding fragilities: the legitimacy deficit. Yet, two years after the outbreak of the worst phase of the crisis, the prospects of reforming a profoundly imbalanced institution remain unclear. We are concerned that resistance to change may undermine attempts to transform the IMF into a truly multilateral and representative organization.

12. The realignment of quota shares remains the centerpiece of IMF reform. The main focus should remain the shift in quotas and voting power from advanced countries to EMDCs. The outside world will judge the significance of the ongoing reform primarily by the size of this shift.

13. Economic realities no longer justify that EMDCs hold only 39.5 percent of the quotas of the IMF. Their share in the global economy, in purchasing power terms, is projected by the Fund to exceed 50 percent in 2010, up from 40 percent in 2000. This share will continue to increase in the coming years, and is projected to reach 55 percent by 2014. In contrast, their aggregate quota share in the IMF has increased by less than 2 percentage points in the last 10 years.

14. The G-20 and the IMFC have agreed that quota shares should reflect the relative weights of the Fund's members in the world economy, which have changed substantially in the last decade in light of the strong growth in dynamic EMDCs. We expect the current quota review to result in a 5 to 6 percentage point net shift in quota shares from advanced countries to EMDCs, while protecting the voting power of the poorest members. This shift is a relatively modest goal, given the present and prospective share of EMDCs in the world economy. With this shift, the Fund would still lag behind the World Bank where developing countries have 47.2 percent of shares.

15. Equally important is that the ranking of members' quota shares be aligned with their relative weights in the world economy. Considering 2009 data, Brazil ranks among the top ten economies in the world at both market exchange rates and PPP. At market exchange rates, Brazil's GDP ranks eight. In PPP terms, it ranks ninth. By contrast, Brazil will only reach the 14th position in the ranking of quota shares in the Fund after the 2008 quota and voice reform enters into force. Colombia, currently among the 30 largest economies in the world in PPP terms, will be the 53rd in terms of quota shares in the Fund.

16. The issue of the size and composition of the Board has been brought to the forefront in the context of the failure of the proposed Board of Governors' resolution on the 2010 regular election of the Executive Directors. We favor an enhancement of the relative representation of EMDCs in the Board, while preserving its current size. However, changes in Board composition would have little effect if it were not accompanied by an increase in the voting power of chairs held by EMDCs. This can only be achieved by the afore-mentioned shift in quotas and votes in favor of EMDCs.

17. The presence of ministers and governors at this meeting confirms that the IMFC continues to play an important role in the discussion of international economic issues and providing strategic guidance to the Fund. We welcome ongoing efforts to promote greater engagement of governors in the institution through improvements in the IMFC. In our view, proposals to replace the consensus-based IMFC by a Council or a similar entity that would take decisions on the basis of weighted voting are not constructive and should be abandoned once and for all.

18. Finally, we should not further delay a political decision to depart from the obsolete practice of reserving the position of Managing Director to a European national and that of the President of the World Bank to a US national. The heads of the Bretton Woods institutions should be chosen solely on the basis of an open and merit-based process without regard to nationality. While we recognize that the issue cannot be dissociated from the problem of the skewed distribution of voting power in the Fund and the Bank, we believe that clear statements from the IMFC and the Development Committee against informal understandings on nationality among major shareholders would be an important step forward.

**Other issues**

19. We welcome the changes in the Flexible Credit Line (FCL) including the removal of the implicit access cap and the lengthening of arrangements under this facility, as well as the establishment of the Precautionary Credit Line (PCL). To our satisfaction, the recent changes to the FCL bring it even closer to our original proposal, which we called Rapid Liquidity Line, and that was presented by our chair in mid- 2008.

20. We wish to express our appreciation for the establishment of the Post-Catastrophe Debt Relief (PCDR) Trust and the cancellation of Haiti's entire outstanding debt to the IMF. We believe that the PCDR constitutes a useful framework for low-income countries that may face similar circumstances in the future.