International Monetary and Financial Committee

Seventeenth Meeting
April 12, 2008

Statement by Mr. 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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Global Economy

The turbulence in the U.S. and Western European financial markets is undeniably serious.

It is debatable whether there was a delay in recognizing the seriousness of the crisis. The authorities may have been slow to respond, but it seems clear that governments and central banks in the advanced countries have responded appropriately to the challenge by combining the reduction of basic interest rates with liquidity injections and by flexibilizing the instruments available to central banks. The monetary authorities have been taking steps to assist systemically important financial institutions to keep the crisis from spreading and causing panic. In some countries, especially here in the United States, fiscal policy was eased in tandem with the monetary stimulus.

We therefore welcome, as a sign of the reform of the Fund—and at the same time as a symptom of the seriousness of the crisis—the statements of the Managing Director, Dominique Strauss-Kahn, in favor of a global fiscal stimulus. As he has said repeatedly, monetary policy alone may not be sufficient. And countries which have space to do so, should not hesitate to implement anticyclical fiscal policies.

Treasury Secretary Paulson's plan to strengthen the regulatory structure in the United States is an important step. Increasing the authority to regulate and supervise the financial system is essential in the United States and in other countries as well. Our only regret is that measures of this type, which are so important for the reorganization and soundness of the financial system, were not taken earlier.

The current crisis revealed remarkable weaknesses and deficiencies in the financial systems and regulatory structures of countries that were previously considered to be examples the rest of the world should follow. The model in place until now was based largely on the assumption that financial markets could self-protect and self-regulate. It was thought that financial agents would basically be able to take care of themselves.

What is important now is to establish new systems to regulate and supervise financial systems, as well as new codes of conduct for rating agencies. It is also necessary to deal with the abuses and distortions in the pay and in the rather perverse system of incentives faced by financial executives. Naturally, a balanced approach is needed. On the one hand, we do not want to stifle creativity and innovations in the financial system. On the other hand, we cannot allow the rest of the economy and society to remain at the mercy of recurrent bouts of instability caused by unregulated or insufficiently regulated financial markets.

A few comments concerning the emerging and developing countries. One truly remarkable aspect of the current crisis—at least so far—is the resilience of these economies. The turbulence in the major financial markets began about nine months ago and, so far, they have escaped virtually unscathed. This is a very different scenario from the one we were used to. The number of IMF clients, incidentally, did not increase—or increased only very slightly. Of course, this is a good sign for our countries. But for the Fund, which was used to covering its expenses with the interest we paid on the loans it granted us, the situation is quite problematic. As a result, for the first time, the Fund is being forced to practice the austerity it preached to countries.

The macroeconomic performance of the countries in our constituency has been quite positive. Some of them are even experiencing an excess of capital inflows. This is in large part attributable to the strengthening of the external position of our economies in recent years—trade surpluses, current account adjustments, and increasing international reserves. Our external vulnerability was not completely eliminated, but it was considerably reduced.

The international economy is undergoing a substantial change. The emerging economies are, to all appearances, becoming the new dynamic center. This is especially true of China, India and other Asian economies. More recently, however, this dynamism has spread to other parts of the developing world, including Latin America and much of sub-Saharan Africa. Until now, the leading emerging economies have played an offsetting and stabilizing role in the face of the difficulties the advanced economies are experiencing. If I may be allowed to make a historical comparison, I would venture to say that the current situation could be similar to that of the 19th century, when the dynamic center of the world economy gradually shifted from old Europe to the United States.

Finally, a word about the Fund's role in this crisis. The IMF produces analyses and documents that are unquestionably useful for governments, businesses, and researchers of the international economy. We know that the Fund has to be cautious in its communication with the public. The reason is that financial markets in particular take their decisions based on expectations of the future. It thus becomes important to be very careful in disseminating information that, even if incorrect, may produce market turbulences or even lead to crises.

However, I am not entirely convinced that the Fund diagnosed in due time the escalating problems in the U.S. and European financial systems. In any case, those who follow more closely the Fund's analyses have noticed that the staff was, shall we say, rather tolerant in its assessment of the advanced countries' financial systems during Article IV consultations.

This brings up a fundamental issue, which we are only beginning to tackle with the quota and voice reform currently before the governors of the Fund: the imbalance in the representation and decision-making power in this institution. The Fund does not display, in relation to its major shareholders, the same boldness it shows in the case of developing countries.

Perhaps the Fund is not accustomed to thinking of solutions and recommendations for its major shareholders. It may be that those countries are not inclined to listen to them. The contrast with the developing countries is striking. In our case, when a crisis erupts, the Fund staff invariably shows up with more or less ready-made adjustment formulas, to be applied promptly and decisively. Experience has shown—one need only remember the crisis in East Asia in 1997-98 and the extremely serious crisis in Argentina—that those formulas were not always the best ones.

But I have no interest in pursuing these criticisms. We trust that under the leadership of Dominique Strauss-Kahn, the process of updating the Fund, which has already begun, will move forward successfully and make the developing countries more active members of this organization.

Quota and Voice Reform

Regarding the quota and voice reform, I would like to express our sincere appreciation to the Managing Director for his personal efforts to bring it to a rapid and satisfactory conclusion. I would also like to thank other chairs who supported the reform approved by the Executive Board, especially those who, although losing relative voting power in this institution, agreed to go ahead with the process. It was a magnificent gesture on the part of those countries, which are thus beginning to make room for new partners.

Indeed, the reform now before the Governors is an important first step in the necessary modernization of the IMF. I have publicly stressed the significance of the reform and acknowledged the collective effort of the advanced, emerging, and developing countries.

An important new feature was the inclusion of GDP calculated in terms of purchasing power parity (PPP) in the new quota formula. This criterion favors the developing countries in particular.

A compression factor of 0.95 was introduced with a view to reducing dispersion of quotas between those economies and larger ones, which is another feature that benefits developing countries. The tripling of basic votes favors small countries.

As a result of the reform, there will be increases in voting shares for 135 countries. There will be a transfer of voting power from industrial countries to emerging and developing countries of 2.7 percentage points. Over time, as the new formula is applied, countries that display higher economic growth and are better integrated into the world economy will see their voting power in the IMF increase. Since the current trend indicates that emerging and developing countries have greater potential to meet those requirements, they are likely to have a larger role in the IMF's decision-making process.

I would like to highlight two commitments for the future which were included in the Report of the Executive Board to the Governors.

First, **two variables in the formula – openness and variability – need to be improved** so that they can properly fulfill their economic role in quota calculations.

Second, the current reform is part of a dynamic process. **Member quotas should be adjusted periodically, every five years, in the context of future general reviews** so that they reflect the relative position of the member countries in the world economy.

Another issue is the level of access to Fund resources. The reform fulfills the objective of increasing the quotas of several emerging and developing countries. This was a positive outcome. However, even in the case of those countries, and even more so of those which did not obtain an increase, the IMF quotas do not satisfy their financing requirements in the event of balance of payments crises.

It is essential that the Fund modernize its instruments in order to adapt to the needs of its member countries in the new environment of a large and volatile volume of international transactions. The current turmoil in the major financial centers has shown that advanced economy central banks on both sides of the Atlantic use extraordinary instruments to inject massive amounts of liquidity, in an effort to stabilize the markets.

In the advanced economies, central banks— which issue reserve currencies—are able to provide liquidity on two fronts, acting both internally and externally, sometimes in a coordinated manner. This is not the case of emerging and developing countries.

The problem has not spread to those countries yet. But that possibility cannot be ruled out. In a systemic crisis, developing countries may have to rely on IMF loans to cope—in most cases only partially—with the liquidity problem, implying economic adjustments and conditionalities.

The Fund can play a key role as a liquidity provider, but it will only be able to do so if the levels of access are increased and facilities more suited to a context of sudden international liquidity crunches are created.

Therefore, **we support the proposal, which we consider very important, to increase normal access to Fund resources.** This would represent a concrete response to the current crisis. It would compensate those countries that did not receive a quota increase in this round, or that received very small increases. Moreover, it would be a way to restore, even if only partially, the ratio of quotas to trade and financial flows.

We also support the creation of a new crisis prevention instrument, such as the Rapid Access Line (RAL) currently being developed by the Fund.

An idea that is still not on the agenda but is worth exploring is **the creation within the Fund of instruments for the quick provision of liquidity similar to those used by the central banks of advanced economies to cope with the current turbulence.** It would be necessary to examine the possibility of providing the Fund with mechanisms for short- or very short-term loans, to be granted rapidly to member countries experiencing liquidity problems.

New Income Model

Finally, I would like to mention that we are pleased with the progress made since last October toward the definition of a new income model, in which the Fund no longer relies primarily on income from its lending to finance its current and capital expenditures.

Our constituency has supported the effort to redefine the financing model from the outset. We hope that the remaining stages will be completed quickly. We also support the process of downsizing this institution. We consider cutting expenses essential for the long-term sustainability of the IMF.