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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The global economic outlook

1. The world economy is gaining strength boosted mostly by growth momentum in emerging markets and developing countries. Yet the root causes of the crisis – oversized financial sectors, excessive financial risk-taking, destabilizing cross-border capital flows and the lack of adequate supervision and regulation in major financial centers – have not been fully addressed. Not surprisingly, the recovery remains fragile. This fragility manifests itself in a buildup of new tensions and vulnerabilities. Large surges in capital flows, currency misalignments, and commodity and asset price inflation could signal a rerun of boom and bust cycles.

2. The major short-term risks to the global economy today are to be found in the uncertainties and unresolved problems in Europe, particularly those affecting the periphery of the euro area. So far, IMF/European Union programs for countries in Europe have involved draconian fiscal adjustment, but have often failed to reduce public debts and underlying economic and financial weaknesses. It remains to be seen whether current efforts to avoid contagion beyond the euro periphery will be successful. In the meantime, European citizens, especially the most vulnerable segments of society, are being forced to bear the burden of a crisis that is largely due to financial sector mismanagement. Efforts to avoid debt restructuring have led to an unfair distribution of the costs of adjustment.

3. Equally worrisome are the risks associated with policies adopted by advanced countries that attempt to export their way out of difficult economic situations. Major reserve currency issuing countries continue to resort to ultra-expansionary monetary policies, the primary trigger of many of today’s economic woes. Excessive liquidity contributes to rapid credit expansion and asset price booms, as well as oil and other commodity price bubbles. Rises in oil and commodity prices increase the cost of living, especially for the poorest.

4. The resurgence of inflation, associated with high demand for commodities in fast-growing emerging market and developing countries and supply disturbances for some important products (oil in particular), is another relevant risk to the medium-term outlook.

Price increases reflect a mixture of cyclical and financial factors. Demand and supply influences are exacerbated by abundant liquidity, dollar depreciation and lack of regulation of derivatives and futures markets.

5. As a result, capital recipient countries are experiencing both commodity inflation and currency overvaluation related to capital inflows. Faced with these combined challenges, they have to resort to capital controls and other policy measures to contain excessive inflows. These measures of self-defense are a legitimate response to the effects of the monetary policies adopted by reserve currency issuing countries.

6. Domestic political constraints have been too easily invoked by reserve currency issuing countries as a reason for adopting ultra-expansionary monetary policies, but this does not change the fact that these policies generate spillovers that have made life difficult for other countries. Those with floating exchange rate regimes, like Brazil and Colombia in our constituency, are facing the adverse impact of currency overvaluation on their external competitiveness and current account balances. These countries are already bearing more than their share of so-called global rebalancing, as recognized in the latest edition of the IMF's World Economic Outlook. They cannot accept further overshooting of their exchange rates.

7. The same domestic constraints are also invoked to explain the delay in financial sector reforms. Efforts to regulate the financial sector appear to have lost steam, as lobbies retain the upper hand in the political circles of advanced countries, particularly of the largest systemic financial centers.

Managing capital flows

8. We welcomed last year's recognition by the IMF that capital controls may be useful and necessary. However, we consider some recent proposals for a possible policy framework on managing capital inflows unnecessary and lacking in evenhandedness. Insufficient consideration is given to "push" factors or to the policies in major advanced economies that have produced large and often disruptive financial flows.

9. We are concerned with recent calls by some advanced countries to establish codes of conduct or policy frameworks for the management of capital flows. Ironically, some of the countries that are responsible for the deepest crisis since the Great Depression, and have yet to solve their own problems, are eager to prescribe codes of conduct to the rest of the world, including to countries that are overburdened by the spillover effects of the policies adopted by them.

10. We oppose any guidelines, frameworks or "codes of conduct" that attempt to constrain, directly or indirectly, policy responses of countries facing surges in volatile capital

inflows. Governments must have flexibility and discretion to adopt policies that they consider appropriate, including macroeconomic, prudential measures and capital controls.

11. Capital account liberalization was not part of the Fund's original objectives. Article VI of the Articles of Agreement states that "members may exercise such controls as are necessary to regulate international capital movements". Fortunately, the attempt to suppress or amend this Article in the late 1990s was not successful.

12. It is not by accident that the Articles of Agreement included such a provision since the beginning. John Maynard Keynes, as well as Harry White, learned from the experience of the interwar period that laissez-faire with respect to capital movements had been a major cause of instability. Thus, the Fund was conceived with the explicit aim of allowing member countries "full liberty of action to control such movements", as Keynes explained at the time. From the beginnings of this institution, each country was given the choice to enforce controls or leave all transactions free. And, as Keynes also observed, if a country were to decide in favor of capital controls, it was left "to discover its own technique".

13. This is as it should be. Brazil, for one, is doing and will continue to do whatever it thinks is necessary and adequate to its circumstances to face the challenges arising from large and volatile capital flows.

Governance of the Fund

14. The attempts to repair the Fund's longstanding legitimacy deficit have been slow and insufficient. A few advanced countries continue to have a disproportionate weight in the Fund's governance. The agreement on quota and governance reform adopted by the IMF Board of Governors last year is a positive step. However, roughly four months after the adoption of this reform, only ten countries – three of them from our constituency – have accepted the proposed amendment on the reform of the Executive Board. The IMF and member countries should deploy efforts to ensure that the 2010 reform comes into effect no later than the 2012 Annual Meetings, as we committed to do at the end of last year. The Executive Board should monitor on a quarterly basis the progress made in this regard, as established by the Board of Governors of the IMF in December 2010.

15. Also, it is high time that we make a political breakthrough in departing from the outdated practice of reserving the position of Managing Director of the IMF 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.

16. Equally important is that we make decisive progress in promoting greater staff diversity in the Fund, particularly in fostering national diversity. The most important

positions in the Management and staff are held by nationals of advanced countries. There are still invisible glass ceilings that hamper the careers of staff members on the basis of their nationalities.

Role of the Fund in the Crisis

17. In 2009, the IMF helped avoid what would have been a sharp downward spiral with unpredictable economic consequences. The substantial financial resources that were made available to the Fund through bilateral credit arrangements played an important role. So did the fact that the institution was able to reform its lending facilities and conditionality, a process that culminated in the creation of the Flexible Credit Line in 2009 and its enhancement last year.

18. However, the Fund had its share of responsibility in bringing about the crisis. The Independent Evaluation Office report on *IMF Performance in the Run-Up to the Financial and Economic Crisis* provided a dismaying picture of how the Fund not only failed to see the crisis coming or to identify the buildup of risks, but also encouraged policies that were at the origin of the crisis. The Fund's sins were not only of omission, but also of active dissemination of a policy framework that led to disaster. The Fund's analytical blind spots may have been enhanced by a lack of diversity in the academic background of staff members. Uniformity in institutions is arguably necessary to ensure a minimum of coherence. However, we have a recipe for insuccess when cognitive biases become articles of faith. Even today those in the Fund who dare to present challenging views and proposals are often met with indifference if not outright hostility.

19. Although progress was achieved on many important issues, including reforming the Fund's lending instruments and agreeing on quota and governance reforms, there is still a long way to go before we can truly speak of a new IMF.

Reform of the International Monetary System

20. We welcome the discussion on reforming the International Monetary System. While there are no simple solutions, the current system, heavily reliant on a single reserve currency, does not reflect the reality of an increasingly multi-polar world. A gradual approach to this issue could allow us to circumvent resistance to change in this area. We favor the issuance of a significant volume of SDRs by the Fund in the next few years. A more extensive use of the SDR, in parallel with that of existing international reserve currencies, would be a good start, as well as the enlargement of the SDR basket with the inclusion of emerging market currencies.