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World economic situation and prospects

The recent global financial turmoil has heightened the downside prospects of the world economy. We are maintaining our projection for global growth in 2007 at 3.4 per cent, as presented earlier this year in the UN’s World Economic Situation and Prospects 2007 (http://www.un.org/esa/policy/wess/wesp.html). To a large extent, this projection foresaw the serious spillovers from the US housing sector meltdown to the world economy. Meanwhile, we have downgraded our growth projection for 2008 from 3.6 per cent to 3.0 per cent.

As we warned in January, a bursting of the housing bubble in the United States could cascade during 2007, with a collapse of the sub-prime mortgage loans eventually leading to a full-scale credit crisis in major developed markets in the summer.

A continued housing slump in the United States, combined with a reappearance of significant risk aversion on the part of private actors, is expected to keep the US economy at a subdued rate of growth for 2008. For various reasons, Europe and Japan will not be able smoothly to replace the US as engines of growth for the world economy; recent conjectures about decoupling of growth trends among major advanced economies seem unlikely following globalization.

The impact of the recent financial turbulence on most developing countries has been relatively small so far. Because of ample credit availability in the last half-decade, growth has been relatively strong among developing countries and this has underpinned their improved macroeconomic fundamentals. Some Asian and oil-exporting developing countries have built up substantial foreign exchange reserves. Yet, growth in developing countries remains highly dependent on demand from developed countries and on the prices of primary commodities. A U.S. slowdown will likely undermine the external conditions for the growth of most developing economies.

The major downside risks for the growth and stability of the world economy in the short to medium run include: further deterioration of housing loan assets in the United States; a precipitous fall of the US dollar, triggering a disorderly adjustment in the global imbalances; and a continued surge in oil prices driven by supply-side shocks. Any one of these or, worse, any combination of these could slow global growth and seriously jeopardize developing country prospects for achieving the Millennium Development Goals.
To address the deeper roots of the current financial turmoil, policy makers worldwide would need to reassess systemic risks and enhance multilaterally agreed financial regulations to keep pace with financial innovations and maintain systemic stability.

**Multilaterally coordinated action urgently needed**

During the recent financial turmoil, central banks of the major developed countries have adjusted monetary policy and injected new liquidity into the financial system to avoid a credit crunch. While these measures have eased immediate financial strains, they have not addressed the fundamental weakness in the international economy stemming from the buildup in global imbalances of finance and trade.

As the UN has previously indicated, the unwinding of these imbalances in a disorderly manner could lead to a serious global downturn. The last two months have seen a significant fall in the value of the US dollar due to liquidity injections in response to the credit crisis. A sharply falling dollar could lead to distress in many financial markets and, in many countries, to severe contractions in exports. Any unilateral or bilateral attempt to adjust the imbalances will be ineffective and could be counterproductive. In contrast, an internationally coordinated strategy could help mitigate the contractionary effects of global rebalancing, and buttress confidence in the stability of financial and foreign exchange markets. A concerted stimulus in Europe, Asia and the major oil-exporting countries could then offset the contractionary effect of adjustments occurring in the US economy.

A sharp slowing down of global growth is likely to put developing countries at particular risk. Many of them, including commodity producers, remain highly dependent on demand for their products in industrialized countries. This is especially true of the world’s 50 least developed countries. Any marked decrease in these countries’ earnings would severely affect the resources available for making the necessary investments to achieve the Millennium Development Goals. Collective action must be taken to prevent this.

**Legitimacy, relevance, voice and participation in the Bretton Woods institutions**

Concerted policy action and strengthened multilateral surveillance require credible international mechanisms to guide such processes. Yet, the legitimacy and relevance of global financial institutions, which should serve as fora for discussions on critical global issues and as vehicles for multilateral action, have sharply declined. Net financial flows from the Bretton Woods institutions have tended to be negative in the last ten years, in some years, significantly so. The recent build-up in international reserves by developing countries, ostensibly for “self-insurance”, and their sharply reduced use of World Bank resources, particularly by middle income countries, cannot be dissociated from questions about how well the Bretton Woods institutions meet the needs and concerns of the majority of developing countries. At this point in time, significant reforms in the voice and representation in these institutions should be viewed as a matter of utmost urgency for both agencies.
The September 2006 meetings’ reforms claimed to address the imbalances in representation in the International Monetary Fund by increasing the voting shares of four dynamic emerging economies and promising to double the total share of the basic vote, thus enhancing voice and representation of low-income countries. However, in the most recent IMF staff paper on quota and voice reform, proposals could lead to an increase in the voting power of advanced countries, rather than developing countries. Restructuring IMF voting allocations is a political decision of the world community which should result in genuinely significant reforms in the distribution of voting power in the IMF to achieve effective global governance.

**Financing for Development: Monterrey follow-up conference in Doha in 2008**

The current financial turmoil is a manifestation of deeply rooted economic interdependence among economies and points up the importance of multilateral approaches in dealing with critical economic matters.

The Monterrey Consensus produced a global partnership for development in which developing countries would adopt policies to improve the mobilization of domestic resources while developed countries pledged to provide additional financing and improved access to their markets to ensure that these policies had the potential to produce the desired results, in terms of growth, macroeconomic stability and poverty reduction.

Since then, developing countries have introduced macroeconomic policies to achieve price stabilization and orderly government finances, along with microeconomic reforms to increase economic efficiency and various measures to improve governance and the rule of law. However, more prudent macroeconomic policies and adjustments have not always yielded the growth, job creation and increased efficiency in social spending that are needed to make adequate progress towards poverty reduction.

As noted above, official assistance has not only fallen short of requirements, but has actually declined in terms of the real transfer of resources. Direct contributions to national budgets of developing countries -- generally recognised as a surer means of making aid more effective -- have declined. And political interests continue to influence the flow of aid more so than interest in achieving the internationally agreed development goals, including the MDGs. The Monterrey follow-up process thus has to provide more clear-cut commitments from advanced countries, as well as more effective mechanisms for monitoring and channelling financial and trade support to developing countries.

The UN General Assembly has called for an international conference on financing for development to be convened in Doha in the latter half of 2008 as a follow-up to Monterrey to “reaffirm goals and commitments, share best practices and lessons learned, and identify obstacles and constraints encountered, actions and initiatives to overcome them and important measures for further implementation, as well as new challenges and emerging issues.” We urge the active participation of all stakeholders in the preparatory process for this conference, which begins next week with the Assembly’s two-day High-level Dialogue on Financing for Development. We must seize this opportunity to strengthen implementation of the Monterrey Consensus and its contribution to development.