International Monetary and Financial Committee

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April 24, 2010

Statement by His Excellency Sultan N. Al-Suwaidi
Governor of the Central Bank 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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1. Global economic prospects are brighter than when we last met, but considerable risks and uncertainty remain. The financial crisis, and the related sharp depression, has inflicted tremendous damage across the world in the form of loss of wealth, lost growth, unemployment, and a surge in public debt which will take many years to overcome. Thanks to bold public interventions, however, the worse scenarios have been prevented. Looking forward, balancing the withdrawal of support against the need to facilitate job creation remains a challenge. Although financial conditions have eased, credit remains tight, and further reforms are necessary to safeguard financial stability. The crisis has brought into focus major fault lines in policy frameworks, highlighting the role of the Fund in crisis prevention and resolution, and making this an opportune time to reflect on its future role and effectiveness.

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

2. The recession is turning out less severe than anticipated. Asia's resilience significantly contributed to the global recovery, and with the upside surprise in growth for the United States, the *World Economic Outlook* (*WEO)* forecasts that world output growth will exceed 4 percent in 2010 and 2011. For some European countries, however, sizeable current account and fiscal deficits are exacerbating funding pressures and are likely to weigh on near-term growth. Indeed, turbulence in sovereign bond and currency markets is becoming a risk of rising likelihood and potentially high cost (*Early Warning Exercise*). For the time being, the negative output gap will keep inflationary pressures subdued in most economies. Although systemic financial sector risks have receded, the more favorable outlook is susceptible to downside risks related to rising public debt in many advanced economies. Moreover, significant bank exposures to real estate continue to pose risks in many countries.

3. Policymakers need to tackle a wide range of issues to safeguard the recovery. A top priority in the short term for the advanced economies is credible fiscal consolidation plans to avoid higher risk premia which have spillover effects on global financial conditions. Financial sector repair is also a short-term priority, as well as further progress in regulatory reforms to avoid the conditions that led to financial crisis. It has thus far proceeded at a slow pace and remains critical to restore healthy credit growth and resumption of securitization. However, we take positive note of the substantial reduction in anticipated write downs in the most recent Global Financial Stability Report (*GFSR*). For several emerging market and

developing countries (EMDCs), where the recovery is stronger and more firmly established, the case for further fiscal stimulus may have waned. For some EMDCs, an added challenge is to absorb rising inflows in search of higher yield without triggering a new boom-bust cycle. Other EMDCs economies will have to compete with the higher financing needs of advanced economies to meet the rollover needs of their corporate and banking sectors in the coming two years.

4. As called for in our last Communiqué, the Fund has provided useful principles for orderly and cooperative *Exiting from Crisis Intervention Policies*. The pace of exit will necessarily depend on the strength of recovery in each country. For most advanced economies, fiscal consolidation should precede the normalization of monetary policy. Initiating a credible fiscal consolidation plan would help confidence and thereby encourage investment and employment decisions, in addition to creating fiscal space to address future shocks. With limited scope on the expenditure side, policymakers will be faced with the unpopular but inevitable need to consider revenue policies. Meanwhile, monetary authorities are beginning to withdraw extraordinary support to the financial sector, but can in many instances maintain their accommodative stance so long as inflationary expectations remain subdued. The unwinding of financial crisis measures should be flexible, gradual and consistent for countries with strong linkages.

5. Less immediate but equally important, policy shortcomings that contributed to the crisis will need to be addressed. These include in particular gaps in the regulatory and supervisory frameworks in advanced economies that failed to forestall excessive risk-taking. There is also a need to better coordinate monetary and regulatory policies while withdrawing exceptional support. We welcome the ongoing efforts in this regard by the Fund, in collaboration with the FSB and standard setters, to create a more disciplined financial system with stricter requirements for capital and liquidity. A number of weaknesses have been addressed, but further efforts are needed with respect to strengthening the capital framework for banks, mitigating cross-border liquidity problems, strengthening accounting standards on valuation and provisioning, and reducing the moral hazard posed by systemically important institutions. Many financial institutions, especially those whose profitability has been restored on the back of official interventions to stabilize the system, need to direct profits toward building capital buffers.

6. Another medium-term priority is to accelerate structural reforms to restore potential growth to earlier levels in an environment of subdued consumer demand and possibly higher savings rate in the U.S. In some cases, in addition to reviving credit, greater product and labor market flexibility is necessary to help restore losses to potential output and support employment creation. In some emerging markets with particularly high savings rates, strengthening social safety nets, access to finance, and financial instruments could, over time, help reorient growth toward more domestic demand and gradually facilitate currency adjustments. However, a substantial and premature currency adjustment, even if accompanied by strong fiscal stimulus, may depress growth in those economies, with adverse implications for global growth. In this regard, we draw attention to the findings of recent Fund analysis that higher output performance has not been associated with floating exchange rate regimes, suggesting the need for a more nuanced approach than the Fund's standard call for greater exchange rate flexibility.

7. As for the Middle East, the region was acutely affected but is poised for a relatively speedy recovery, supported by public spending and a rebound in commodity prices. Those two factors could sustain activity in the near-term until the recovery in advanced economies takes hold. Moreover, the impact on exports, tourism, remittances, and foreign direct investment were generally milder than had been feared. Inflation has declined as demand pressures abated in both oil producing and oil-importing countries. While equity markets have recovered to varying degrees, real credit growth has remained sluggish mainly reflecting weak demand as investments are placed on hold due to uncertain global prospects. Countries that experienced significant real estate corrections are strengthening their financial sector balance sheets as well as supervision and resolution frameworks. We concur with the key risk identified in the *WEO* that the global recovery might not be sustained and oil prices could fall sharply, which could have important implications for oil exporters and their regional trading partners. Domestic financial conditions could also come under renewed stress if global conditions tighten again, but the region's relatively limited exposures and strong capital positions will mitigate the impact of such eventuality.

II. The Post Crisis Role of the Fund

8. The crisis has demonstrated that the larger risks in a globalized world are systemic in nature and it has highlighted specific weaknesses in the Fund's surveillance. More effective bilateral surveillance of the large advanced economies is warranted, with greater focus on macro-financial linkages, cross-country analysis, and cross-border spillovers. Indeed several reviews including the *IEO Evaluation of IMF Interaction with Member Countries* drew attention to the lack of sufficient depth of analysis, risk assessments, and candor in staff reports of large advanced and emerging market economies. In considering ways to bolster the value and traction of Fund surveillance, care is needed to preserve evenhandedness and the mechanisms of peer review through the Board, and not to compromise the quality of Fund analysis and advice.

9. Bilateral surveillance must remain the central pillar of Fund activities and the main vehicle to enhance the value and traction of surveillance. The Fund could further exploit its access to country statistical information and analysis and better leverage its expertise. Spillover analysis could be enhanced and more prominently inform Article IV reports and could be included in the WEO and GFSR, which are well-recognized and respected flagship products of the institution. On the other hand, a proliferation of new formats, including "spillover reports" and "staff country notes" would undermine the established procedures and familiarity of these reports without addressing the lack of interest in the Fund's views by the larger countries. Moreover, the *Review of the Fund's Transparency Policies* indicated that some mission chiefs felt constrained in drafting candid staff reports by the expectation of publication, suggesting that the Fund's publication policy may be compromising the quality and effectiveness of surveillance.

10. The usefulness of a "multilateral surveillance decision" is somewhat doubtful in view of the low appetite for Fund engagement by large economies. Such a decision is not necessary to explicitly empower the Fund to initiate consultations with a group of members when global or multi-country issues require collaboration or collective action. The same *IEO Evaluation* saw scope to increase the Fund's contribution to international policy coordination

as a way to increase traction and strengthen surveillance. In this connection, the Fund's involvement in the *G-20 Mutual Assessment Process* held out the prospect of greater engagement by larger countries with the Fund. However, its designation as technical assistance, and the exclusion of the vast majority of the membership who are affected by spillovers from the process, limits its usefulness as a mechanism for enhancing Fund surveillance. The low appetite for greater engagement with the Fund in the context of surveillance and policy coordination was reflected in the leaders' September statement making "the G-20 the premier forum for their international economic cooperation for building a stronger global economy, reforming the financial system, and lifting the lives of the poorest".

11. The Fund acted swiftly to adapt its lending facilities to meet the needs of its membership and we welcome further consideration of ways to enhance the effectiveness of the Fund's instruments for crisis prevention and management of systemic risks. In this regard, we see merit in lengthening the duration of purchase rights under the Flexible Credit Line (FCL) and basing the access level on genuine financing requirements rather than an implied access cap. Similarly, efforts to increase the predictability of qualification through transparent criteria would enhance the desirability and effectiveness of the instrument. However, we do not support pre-assessment of FCL qualification as part of the Article IV consultation process.

12. Further discussion is warranted for proposals to introduce new instruments. For members with good policies that do not qualify for the FCL, the Precautionary Credit Line (PCL) may provide a useful instrument, when underpinned by policies that address remaining vulnerabilities. The unilateral granting of Multicountry Swap Lines (MSL) to countries that are assessed as systemic could be further considered, although we remain somewhat skeptical about it as it could have a negative signaling effect for excluded countries.

13. While these initiatives to strengthen the global safety net are welcome, they are unlikely to forestall the need for reserves. Commodity-exporting countries need reserve buffers due to their susceptibility to export price volatility. Similarly, members who face large short-term or speculative capital inflows need to self-insure against sudden outflows. The availability of Fund support serves a complementary or backup function, but own reserves will likely remain the first line of defense, supported by prudent macroeconomic policies. Research evidence that points to the improved output performance of countries with higher reserves during the crisis lends support to this view.

14. In view of the sharp increase in demand for Fund concessional financing and limited available resources, it is urgent to meet the target for additional loan resources to ensure timely funding of the new low income country (LIC) facilities. We welcome the recent pledges by countries, and the Fund's clarification on the use of SDR holdings for this purpose and their consideration as reserve assets. Access to scarce resources for concessional funding should be preserved for members with low levels of income and related vulnerabilities. In this regard, clarifying criteria for eligibility and graduation from concessional LIC facilities was appropriate.

Governance Reforms: Increasing Fund Legitimacy and Effectiveness

15. Governance has a pivotal role for the Fund, and quota reform remains the most central issue for governance at the Fund. Those who believe that the Fund lacks legitimacy and effectiveness believe the Fund lacks those two aspects because the quotas are so skewed and a few members can force decisions. Legitimacy and effectiveness necessitate quota and voice reform, which would open the door for other reforms.

16. It is also important for the Fund to remain a quota-based institution. A large quota increase is warranted to meet members' needs and to restore the size of the Fund relative to a number of metrics such as global GDP and capital flows. Notwithstanding a substantial increase in quotas, the reformed and expanded NAB will continue to be needed as an essential backstop against tail risks. Any quota increase, which will take place in conjunction with a redistribution of quota resources, must be conducted in such a way as to protect the current voting shares and Board representation of EMDCs and allow a net shift of at least 5 percent in quota shares to EMDCs as a group.

17. The initial proposals and simulations for realignment of quota shares are still far from achieving fair representation and voice for the membership**.** A sizeable shift of EMDCs' share by 7-10 percentage points, as we earlier called for, would advance the reform agenda in a meaningful manner. It is disappointing that the simulations represented a net shift of only 1.7-3.6 percentage points to EMDCs. This unfavorable result stems from using a formula that is widely believed, by the vast majority of members (who are under-represented under the current formula and therefore lack sufficient votes to change it), as seriously flawed and therefore cannot generate a fair distribution. To reach these meager results one-off boosters were used, as arbitrary fixes outside the quota formula, to give more weight to PPP GDP and rapid growth, but no attempt has been made to correct the formula's specification of variability and openness. Whether or not the formula is adjusted, we should go back to the original goal of shifting quota shares from advanced to emerging economies (rather than from over-represented to under-represented) as agreed in earlier IMFC communiqués.

18. A number of proposed reforms to strengthen the IMFC are under way, including with respect to agenda setting and conduct of meetings. With respect to leadership, it would be preferable to maintain the current practice of basing it on country as it provides greater continuity. Rather than limiting the number of speakers at the plenary session, participants could be encouraged to circulate written statement in advance of the meeting, and to focus oral interventions largely to points that are raised in the circulated statements. We would also be especially interested in reforms that address the overlap with the G20.

19. The IMFC implicitly has the mandate to hold the Board accountable and to decide on the appropriate modalities for doing so. We are open to a move to an all-elected Board, especially if accompanied with limits on the concentration of voting power. However, it is difficult to decide on this issue, and on elimination of appointed chairs and reformulation of constituencies, before quota realignment. On double majority rules, these should apply to major strategic issue so that important decisions are not passed by a few members with majority voting power. There is broad agreement on the process for selecting the Managing Director; the principles have been set forth over the years but political influences have

typically taken over in practice. These principles of a transparent merit-based selection were reaffirmed at the conclusion of the work by the Executive Board Working Group.

20. While welcoming the introduction of a Diversity Scorecard, it is regrettable that the Fund has not hired a single staff member at the managerial level from the Middle East region in the last six years. Greater efforts are needed to attract senior level specialized macroeconomists from that region.