



DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)



DC2009-0006
April 24, 2009

**STATEMENT BY THE MANAGING DIRECTOR
OF THE INTERNATIONAL MONETARY FUND**

Attached for information for the Members of the Development Committee is a Statement from the Managing Director of the International Monetary Fund, Dominique Strauss-Kahn, for the Committee's seventy-ninth meeting to be held in Washington, D.C., on Sunday, April 26, 2009.

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DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR'S WRITTEN STATEMENT

I. INTRODUCTION

1. The world economy is going through a period of exceptional stress and uncertainty. Advanced and developing economies are facing a sharp downturn in international trade, production, and cross-border capital flows, amid the most serious crisis of confidence since the Great Depression. Governments and central banks in many advanced and developing nations have taken bold and often unprecedented initiatives to address the crisis, but the persistent fragility of public confidence in the financial system has so far limited the effectiveness of these policies. With risks to the global outlook firmly on the downside, a strong, comprehensive, and well-coordinated global response is needed to restore confidence and support economic growth. The firm commitments made by G-20 leaders to bolster the world economy are an encouraging step in this direction.

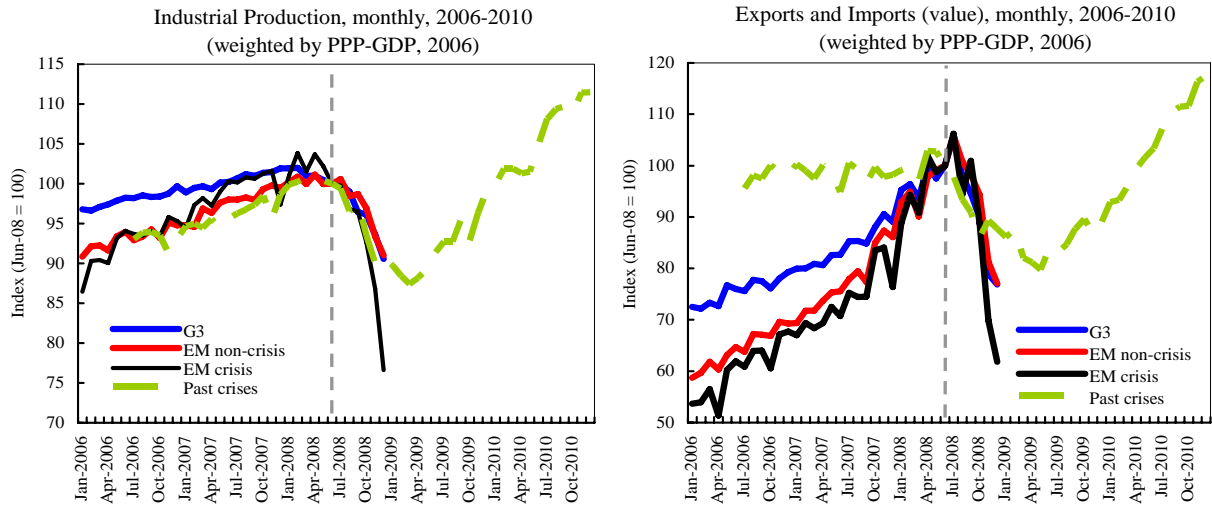
2. As discussed in more detail in the 2009 Global Monitoring Report, economic conditions in developing countries have been rapidly deteriorating in recent months, seriously undermining progress towards the Millennium Development Goals. While the channels of transmission of the crisis to developing countries may differ according to individual country circumstances, all regions are experiencing major setbacks in the poverty reduction effort because of declining incomes and rising unemployment. In these circumstances, the Fund has a crucial role to play in helping countries address the crisis. In this statement, I will give a brief overview of the key economic and financial problems affecting developing countries, and discuss recent initiatives taken by the Fund to support efforts to bolster their economies.

II. THE GLOBAL CRISIS AND DEVELOPING COUNTRIES

3. Global economic activity will contract in 2009 at the fastest pace since the Second World War, and the prospects are subject to unusually large downside risks. The April 2009 *World Economic Outlook* projects a decline in global output by 1.3 percent this year, and world trade is sharply declining. The contraction in output is most strongly felt in advanced economies, reflecting the corrosive interplay between financial stress and weak economic activity. Developing countries, however, are increasingly feeling the fallout from the crisis through trade and financial channels. With weak commodity prices and economic growth in developing countries not expected to exceed 1.6 percent in 2009, many countries will experience declines in per capita incomes this year. Helped by the cushioning effect of lower commodity prices, a gradual global recovery could take hold in 2010, conditional on sizable monetary and fiscal policy support and comprehensive steps to stabilize financial markets.

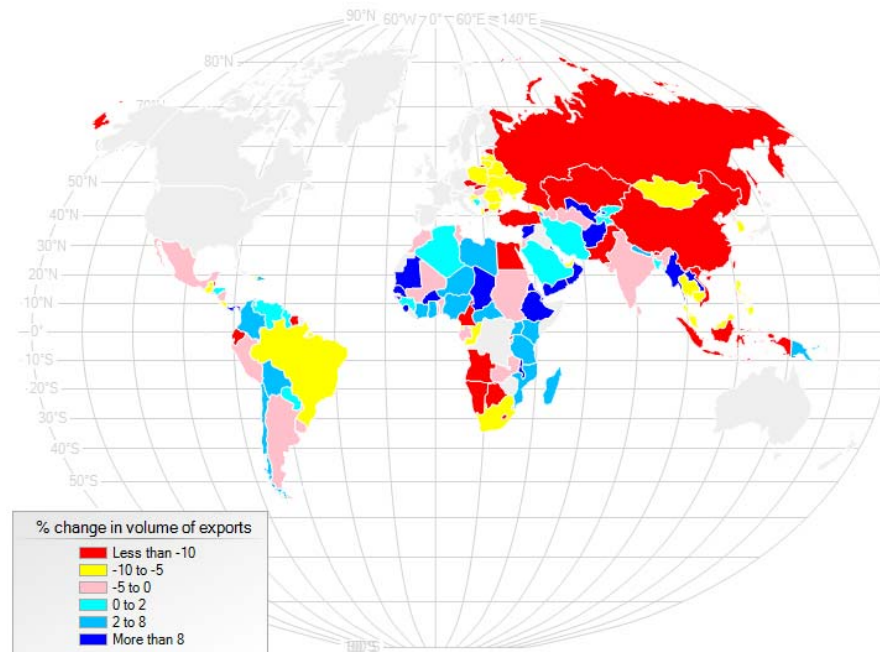
4. While all developing countries are hit by the crisis, the nature and intensity of their problems differ, dependent on the degree of integration in the global financial system, composition of exports, and vulnerability to external shocks. Several broad channels of transmission can be distinguished:

Figure 1. Industrial production and world trade, 2006-2010



- *All developing countries are experiencing the effects of sharp declines in the volume of world trade. Emerging economies, especially those in East Asia, are hit by a sharp drop in demand for manufactures and construction activity, two sectors highly sensitive to the business cycle. Overall, the volume of developing country exports is projected to fall by 6.4 percent in 2009, an exceptionally strong decline in comparison with past crises.*

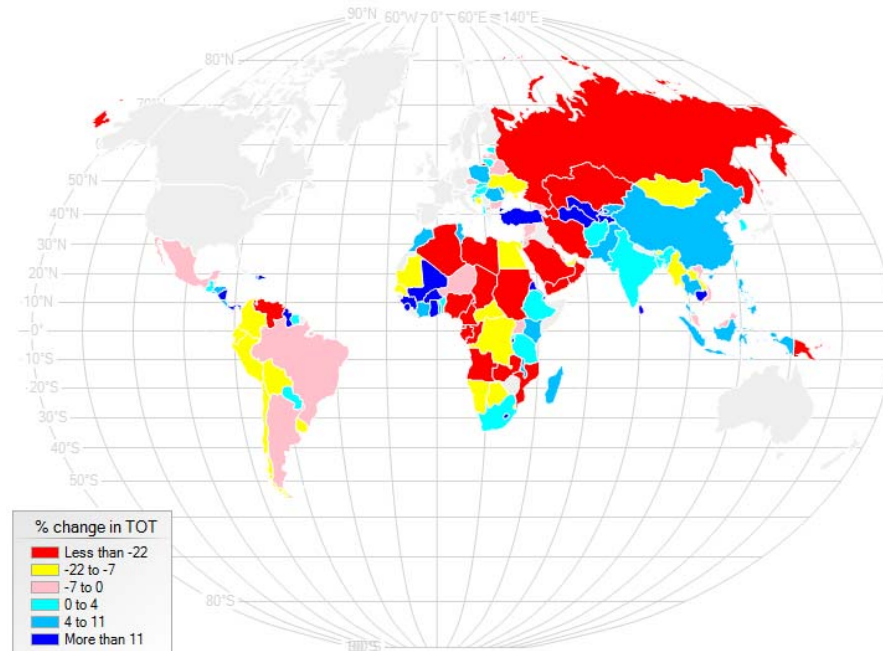
Figure 2. Forecast Percentage Change in the Volume of Exports, 2009



Source: IMF

- *Commodity exporters are also feeling the effects of lower demand and weak export prices for their products. While many fuel exporters have built up sufficient reserves to deal with lower prices, non-fuel commodity exporters are severely affected by declines in export receipts and deteriorating fiscal balances. In several countries, mines have been closed because world market prices for commodities have declined below break-even levels, contributing to rising unemployment.*

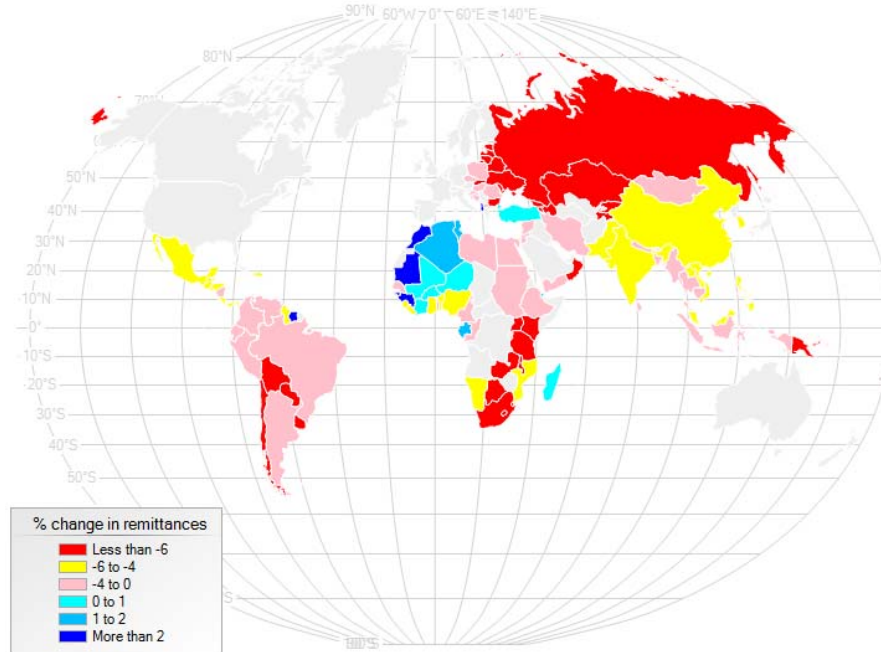
Figure 3. Forecast Percentage Change in the Terms of Trade, 2009



Source: IMF

- *Emerging economies are faced with sharp drops in private capital inflows, high financing costs, and rising roll-over risks for public and private sectors. Although external financing pressures and crisis risks have abated somewhat in the past month, advanced economy banks and investors have sharply reduced their exposure to emerging markets: total net capital flows are projected to drop by over US\$700 billion between 2007 and 2009. Both sovereign borrowers and private corporations will be affected, raising the prospect of increasing external debt defaults. Many enterprises may need government support to fill rising financing gaps, especially in countries where domestic credit markets are under pressure.*
- *Workers' remittances will drop sharply in 2009. In its latest update, the World Bank forecast a drop in remittance flows of between 5 and 8 percent from 2008 levels, with countries in Europe, Central Asia, and Latin American particularly affected.*

➤ **Figure 4. Forecast Percentage Change in Remittances, 2009**



Source: World Bank

5. The confluence of weak exports, deteriorating terms of trade, and sharply reduced private financing will cause steeply rising financing gaps in 2009. World Bank estimates of financing gaps for developing countries, including large emerging economies, run as high as US\$700 billion. Although these estimates are subject to large uncertainties, there is no doubt that developing countries are going through an extremely difficult period, with detrimental consequences for the poverty reduction effort.

6. The international community must therefore do more to help developing countries counter the effects of the crisis, as part of an effort to promote a global recovery and mitigate the poverty effects of falling growth. I would like to highlight five main areas of action:

- *Strong measures to restore the health of the financial system will be key to a sustained global recovery.* Governments and central banks in advanced economies must take comprehensive and coordinated action to provide liquidity to the banking system, remove toxic assets from banks' balance sheets, and address the solvency problems of systemically important financial institutions. Although advanced economies are most affected by the financial crisis, the need to address bank liquidity and solvency problems is also pressing in many developing countries. Equally important, prudential supervision and market regulation in advanced *and* developing economies must be strengthened in a well coordinated effort to deal with regulatory gaps.
- *Developing countries must step up efforts to strengthen social safety nets and support growth.* Rising poverty should be addressed with cost-effective, well-

targeted social safety nets to help the poorest and unemployed—many countries have a long way to go in this area. In addition, countries with strong external positions and fiscal space—including some of the large emerging economies—should consider additional monetary and fiscal stimulus to support domestic demand and global growth.

- *Bilateral donors must follow up on their commitments to increase aid to low-income countries.* The countercyclical function of aid is crucial in the current circumstances, because it will allow developing countries to maintain growth-supporting public spending and social protection. While the solid increase in core aid programs by members of the OECD Development Assistance Committee (DAC) in 2008 is welcome, current aid levels still fall well short of the G-8 commitments made at Gleneagles in 2005. In particular, the commitment to double aid to Sub Saharan Africa by 2010 is unlikely to be met.
- *Governments should eschew trade and financial protectionism.* Since the onset of the crisis, several governments have taken measures to protect domestic industries from foreign competition. Also, there is anecdotal evidence that banks in some countries are under government pressure to shift their lending activities to domestic markets. These policies are self defeating, because they will worsen the contraction in international trade and finance. To bolster the international trade system, all parties involved should make strong efforts to reinvigorate the Doha Round.
- *International financial institutions have a key role to play in softening the impact of the crisis in developing countries.* They are crucial in providing financing to cash-strapped public and private sectors in developing countries and supporting growth-oriented fiscal policy. They have also a key role in providing assistance in strengthening social safety nets and the quality of public spending.

III. THE POLICY RESPONSE OF THE IMF IN SUPPORT OF DEVELOPING COUNTRIES

7. Given its mandate and technical expertise, the IMF has a unique role in the international effort to turn around the global economy and reform financial sector regulation. In recent months, we have provided very large amounts of financial support to emerging markets and low-income countries facing balance of payments crises, and initiated a comprehensive reform of our lending framework to adapt it to the rapidly changing needs of our members. We have also continued to refine Fund surveillance, and several initiatives are under way aimed at strengthening our support for low-income countries.

A. The Immediate Crisis Response

We have taken several far-reaching initiatives in recent months in the context of our immediate response to the crisis:

- *Since October 2008, the Fund has provided about US\$49 billion concessional and nonconcessional balance of payments support to 21 countries. Emergency procedures were deployed to expedite decision making, and on a case-by-case basis, access was raised to exceptionally high levels to enable the Fund to fill large financing gaps.*
- *A new Flexible Credit Line (FCL) was introduced to provide large and upfront financing to countries with very strong fundamentals and policies. The first experiences with this new instrument are encouraging, as evidenced by the positive market response to the recent requests by Mexico and Poland for liquidity support under the FCL. The facility can be used on a precautionary basis or for actual balance of payments needs. As access to the FCL is restricted to those countries that meet strict qualification criteria, drawings under it are not tied to policy goals agreed with the country.*
- *Countries can also benefit from new High Access Precautionary Stand-By Arrangements (HAPA) as a regular lending window. Like the FCL, precautionary SBAs can be frontloaded, and take account of the strength of a country's policies and the external environment.*
- *Normal access limits for [emerging market and low-income] countries have been doubled to give confidence that adequate Fund support will be available in crisis situations. In exceptional cases, the Fund may decide to give higher access as has been done in recent months.*
- *Conditions linked to IMF loan disbursements have become more focused and tailored to countries' circumstances, and will be monitored in a more flexible way. In particular, structural reforms will from now on be monitored only in the context of program reviews; there will be no new structural performance criteria in Fund arrangements.*

8. The sharp increase in demand for Fund support and the need to maintain sufficient reserves for potential future demand requires a substantial expansion in our loan resources. The call by the G20 leaders for a new SDR allocation of US\$250 billion and a tripling of the Fund's nonconcessional resources, to US\$ 750 billion, represented a welcome and decisive response to this need; already, we have secured commitments for US\$224.5 billion in additional funds. The new SDR allocation would bolster the reserves of emerging and developing countries by about US\$100 billion, including US\$19 billion for low-income countries. We also plan to triple our concessional lending to low-income countries over the next two years and to double our medium-term concessional lending capacity, in line with

the call by G20 leaders, drawing on additional resources from agreed IMF gold sales and surplus income in a manner consistent with the Fund's income model.

B. Strengthening the Fund's Surveillance and Analytical Work

9. The Fund has made strong efforts over the past year to bolster its macroeconomic and financial analysis. The semi-annual *World Economic Outlook* and *Global Financial Stability Report* have become key analytical tools in the global response to the crisis, and the Fund plays an active role within the Financial Stability Board in designing new supervisory and regulatory frameworks for financial markets. We are also continuously adapting and strengthening our surveillance activities:

- *The IMF and the Financial Stability Board have begun joint semi-annual Early Warning Exercises (EWEs), which will integrate macro-financial and regulatory perspectives, identify specific macro-financial risks, and flag needed policy responses.*
- *We have expanded the vulnerability analyses of emerging markets to include advanced economies. The semi-annual Vulnerability Exercise for Advanced Economies (VEA), which started in March 2009, constitutes a key input for our assessment of systemic risks, potential shocks and cross-border spillovers in advanced economies.*
- *We are strengthening our financial sector analysis and surveillance. Financial sector advice given under the Financial Sector Assessment Program (FSAP) will be better integrated in our country surveillance activities.*

C. New Initiatives to Support Low-Income Countries

10. We are strongly committed to helping low-income countries dealing with the effects of the crisis, through our financial support, macroeconomic policy advice, and technical assistance. Low-income countries have made considerable progress in economic development over the past decade. At the same time, their economies have become more diverse, as reflected by differences in growth performance, integration in the world economy, and access to external private financing. The Fund must continue to adapt its toolkit of instruments to take into account the changing circumstances of its low-income members. Recent initiatives that will allow us to respond more flexibly in the future include the following:

- *We are working on detailed proposals for a new concessional short-term financing facility for low-income countries. While the Poverty Reduction and Growth Facility (PRGF) should remain the key instrument for low-income countries facing protracted balance of payments problems, some countries have reached a stage of development that no longer calls for a medium-term financing relationship with the Fund. The proposed new facility would meet the short-term balance of payments needs of such countries—including, but not limited to, those arising from exogenous shocks.*

- *We are also preparing proposals for a new multi-purpose emergency facility to meet urgent financing needs.* For low-income countries, this would replace various existing facilities that can be used in the aftermath of natural disasters, conflicts, or exogenous shocks, and will also allow us to respond quickly in other emergency situations where financing is critical to prevent a precipitous deterioration in economic and social conditions.
- *The rapidly changing patterns of external financing flows justify a comprehensive review of external debt policies in low-income countries.* While many low-income countries remain vulnerable to heavy external debt burdens, others have benefited from significant debt relief. Also, private sector interest in low-income countries is likely to resume its rising trend once the global recovery takes hold. In light of these trends, we are working on a new, more flexible, framework that will systematically differentiate limits on nonconcessional debt in Fund-supported programs, according to countries' specific circumstances.

11. We will also continue to provide debt relief to low-income countries under the HIPC Initiative and MDRI. At end-March 2009, 24 countries had reached their HIPC Initiative completion point, 11 countries their decision point, and 26 countries had received MDRI debt relief. Six additional countries are potentially eligible for HIPC Initiative assistance.

12. The global financial crisis has increased demand for our policy advice and technical assistance, which have proven critical in our support to low-income countries. With the help of our partners, we intend to expand the delivery of our technical assistance in Sub Saharan Africa, Central Asia, and countries in Central America and the Caribbean by establishing four more regional technical assistance centers (RTACs). The work of the RTACs will be complemented by multi-donor trust funds in the Fund's core areas of expertise in order to provide global geographical coverage and topical scope.

IV. FUND GOVERNANCE

13. I welcome the recent report by the Committee of Eminent Persons on IMF Governance Reform, chaired by Trevor Manuel. I hope that concrete proposals can be distilled from this work, which needs to be set alongside the perspectives offered by other reports and inputs.

14. Steady progress has been made in the approval process for the April 2008 Quota and Voice Reform. Once completed, the reform will increase the share of dynamic emerging markets and provide greater voice to low-income countries in the institution, including Sub-

Saharan Africa.¹ The G-20 and others have recently called for emerging and developing countries to have greater voice in the Fund and for the completion of the next quota review to be brought forward to January 2011. An earlier quota review could provide a welcome augmentation of the Fund's permanent resources, and would also be an opportunity to further realign quotas as envisaged under the 2008 reform. Advancing the quota review reinforces the need to complete the 2008 reform promptly.

¹ Thus far, about one-third of the 54 countries eligible for an ad hoc quota increase have consented with the increase. In addition, 10 percent of members (out of a minimum of 60 percent) have accepted the amendment; they represent 20 percent of the total voting power (out of a minimum of 85 percent).