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World Bank Group

STATEMENT TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE ON BEHALF OF THE WORLD BANK GROUP

OCTOBER 9, 2010

Global Economic Prospects

The global recovery has proceeded somewhat more strongly than expected. According to the IMF's World Economic Outlook, the recovery will take place at a variable-speed, with most advanced economies recovering slowly and emerging markets and developing countries recovering more rapidly. The Bank shares the view that increasingly domestic rather than rebound factors are shaping the recovery in individual countries. Among developing countries, strong policy responses in India and China have allowed these economies to regain industrial production levels consistent with their pre-crisis growth paths. Significant spare capacity remains in Eastern Europe and Central Asia. Low-income countries (most of which are less directly connected to international finance and trade) were not as hard hit, but were more vulnerable and had less scope for fiscal stimulus.

The Bank shares the Fund's concern with competition for funds in the face of very large high-income country financing needs, of around $7.5 trillion in 2011. Additionally, banks face up to $4 trillion of refinancing needs during the same period. This high demand for funds, plus the rising yields that have accompanied the crisis, imply higher borrowing costs for developing-countries. But even as long-term capital is becoming more expensive, the Fund is correct to highlight the risk to developing countries from a rise in short-term interest-rate sensitive capital flows. A more balanced policy mix of greater exchange rate flexibility and tighter fiscal policy (at least for some emerging economies) would be helpful in this regard. The Bank also concurs on the potential usefulness of limited and temporary controls on inflows and on the need for the liberalization of outflows as part of the strategy to limit undesirable capital flow pressures.

We agree that there is a need to restore financial sector health and make progress on regulatory reforms in a coordinated manner. At the same time, the challenge faced by the financial sector in emerging market economies is fundamentally different than in high-income countries where the focus is correctly on regulatory reform. Financial systems in emerging markets were more regulated in the first place, they therefore have smaller adjustment needs in this respect. With the notable exception of developing Central and Eastern Europe, the financial sector in developing countries faced a smaller shock. For these countries, reform needs to focus on removing impediments (regulatory and in the business climate, more generally) that prevent a deepening of their financial sectors. Conditions in many of these markets limit the potential of their financial sectors to support growth, hinder economic diversification via the efficient economic allocation of productive resources, and reduce their capacity to absorb increased external capital inflows and recycle huge pools of domestic savings via FDI.

Managing Risks and Preparing for Crisis

The World Bank welcomes the recent reforms to IMF financing facilities. These represent important contributions to an improved global financial safety net. Precautionary facilities such as the strengthened Flexible Credit Line and the new Precautionary Credit Line have the potential to promote macroeconomic stability and confidence in the economies of many developing countries, without which sustainable growth and development are not possible.

At our meetings last spring, the World Bank Group (WBG) articulated its contribution to assisting developing countries—especially LICs—enhance their ability to manage the risks associated with closer integration into a global environment. Beyond the WBG's existing arsenal of insurance instruments and crisis initiatives, the Bank remains committed to the development of new and innovative mechanisms and instruments to help countries manage volatility, including in the development of global approaches to disaster and post-conflict needs assessments. This objective is evident in recent efforts to assist countries to improve the targeting of their social safety nets and the work of the Rapid Social Response (RSR) Program to empower LICs to become more crisis-resilient by facilitating knowledge transfer from successful safety net programs and by leveraging Bank as well as donor resources. At a "macro" level, efforts to make permanent the $1.65 billion pilot Crisis Response Window (CRW) in the context of IDA16 replenishment discussions can help ensure that scarce concessional resources are targeted to those LICs which are the most severely impacted by exogenous shocks, without undermining debt sustainability.

At the onset of the financial crisis, the International Finance Corporation (IFC) launched initiatives to help private enterprises in the developing world navigate unprecedented market conditions. Together with partner governments and international finance institutions, support for the initiatives totalled more than $11 billion in FY10, including over $6 billion for IFC's own account, $2 billion in direct support from partner governments and IFIs through IFC, and $3 billion in parallel financing arrangements. IFC crisis responses also include trade initiatives, with the Global Trade Finance Program issuing $3.46 billion in guarantees and the Global Trade Liquidity Program financing more than $6 billion of trade volume; the Microfinance Enhancement Facility, launched with KfW, has raised over $440 million, and disbursed $93 million in FY10; and the Infrastructure Crisis Facility which committed $100 million to projects in four countries.

Work is also underway to develop a more integrated approach to supporting the capacity of natural resources-rich developing countries to manage their resources in good times and enhance their preparedness for economic shocks and periods of slow growth. This approach will seek to draw on expertise in the macroeconomic, fiscal, political economy and governance-related aspects of resource management.

As the IMF Executive Board's report to the IMFC notes, the issues underpinning long-term global stability and proper functioning of the international monetary system (IMS) are interrelated, with progress in one alleviating pressure on the others. The WBG concurs with the assessment that many of the current challenges to stability reflect a world in which emerging markets grow relatively quickly, often with export-oriented

growth strategies. It is in this regard that the complementarity between World Bank and IMF mandates contributes to promoting greater stability in the IMS. The mandate of the WBG places it firmly in the center of efforts to help foster economic diversification in emerging market economies and to provide support for the longer-term development of robust financial systems.

The Bank is fully supportive of the objectives underpinning the decision to better integrate Financial Sector Assessment Program (FSAP) stability assessments with IMF surveillance in order to improve the quality and scope of the IMF's surveillance in the financial sector, to better gauge financial sector risks more frequently in countries with systemically-important financial systems, and to improve the IMF's ability to anticipate and mitigate financial sector crises. The costs of inadequate surveillance in this area are significant, and are often disproportionately born by the poorest and most vulnerable.

At the same time, an increased emphasis on the stability aspects of the FSAP should not lead to neglect of the longer-term aspects of financial-sector development, including capital market development, financial-sector infrastructure, competitiveness and efficiency of financial markets, and access to finance and financial inclusion. These are areas where crucial longer-term reforms contribute to better-balanced, multi-polar growth. In this regard, FSAP stability assessments should not be seen as a substitute for the more holistic assessment of growth, stability, and development in the financial sector that is embodied in a full FSAP update.

The resource demands of an intensified FSAP effort should not come at the expense of the needs of smaller developing countries. Not only does experience show that crises can be triggered by financial instability in countries with seemingly non-systemic financial sectors, but also that financial-sector development is a key ingredient to economic growth and is therefore a crucial for poverty reduction and achievement of the MDGs across a broad range of countries.

Bank-Fund Collaboration

The series of global crises—food, fuel and financial—and the consequent global recession have illustrated how important it is that the IMF and World Bank work together closely, both to realize the important synergies between respective expertise and mandate--including, but not respected to the financial sector--but also to ensure the efficient delivery of the most well informed advice to our respective client countries.

The managements of both the Bank and the IMF remain committed to the Joint Management Action Plan for Strengthening Bank-Fund Collaboration (JMAP), adopted prior to the crisis and subsequently refined and refocused to reflect lessons learned about what does, and does not, contribute to better and more valuable collaboration. In May 2010, the Executive Boards of both the Bank and the Fund endorsed a joint management report on JMAP implementation that stressed the need to focus on providing efficient and effective support to members. As a result, regular consultations between Bank and Fund staff working at the country-level have been mandated to facilitate the sharing of information and the coordination of work programs and analytical cross support. A Task

Force on Information sharing has been formed that will develop recommendations on how to improve information flow between the two institutions. Finally, efforts are underway to remove unnecessary impediments to staff movement between the two institutions, and to improve incentives for institutional collaboration.

Voice and Participation

Successful completion of voice reforms at the Bretton Woods institutions is essential to ensure that they have the legitimacy necessary to carry out their mandates. At its meeting in April 2010, the Development Committee endorsed a package of voice reforms for the Bank and the IFC,[1] building on the first phase of voice and participation reform approved by the Board of Governors in January 2009. Resolutions were sent to Governors for approval in July 2010. The IBRD resolutions will be approved on receipt of favorable votes of at least 75 percent of total IBRD shareholding. The IFC resolution will be approved on receipt of at least 85 percent of total IFC shareholding.

Voice reform will increase the voting power of developing and transition countries (DTC) in IBRD by 3.13 percentage points, bringing it to 47.19 percent. This represents a total shift of 4.59 percentage points to DTCs since 2008 (including the first phase of voice and participation reform). The 2010 realignment includes a selective capital increase of $27.8 billion with paid-in capital of $1.6 billion. The IFC voice reform includes an increase in basic votes and a selective capital increase of $200 million, representing a total shift of 6.07 percentage points to DTCs, bringing DTC voting power to 39.48 percent and moving towards a broad and flexible alignment with IBRD shareholding. In addition, in line with the first phase of voice reforms, countries in the two current Sub-Saharan Africa constituencies will be represented by three Executive Directors to be elected at the 2010 Regular Election this fall. The Governors' resolutions require that Bank and IFC shareholding will be reviewed every five years starting 2015.

[1] These were set out in *World Bank Group Voice Reform: Enhancing Voice and Participation of Developing and Transition Countries in 2010 and Beyond* (DC2010-0006)