International Monetary and Financial Committee

Ninth Meeting
April 24, 2004

**Statement by His Excellency
Mohamed K. Khirbash
Minister of State for Finance and Industry
Ministry of Finance and Industry, United Arab Emirates
Representing the constituency consisting of
Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Maldives, Oman, Qatar,
Syrian Arab Republic, United Arab Emirates, and Republic of Yemen**

Statement by His Excellency
Mohamed K. Khirbash
Minister of State for Finance and Industry
Ministry of Finance and Industry, United Arab Emirates

International Monetary and Financial Committee Meeting
Saturday, April 24, 2004
Washington, D.C.

The Global Economy and Financial Markets

It is heartening that since our last meeting in Dubai, the pickup of economic activity—particularly in the United States, Japan, China, as well as a number of other Asian countries—has been gaining momentum and strength. While growth in the euro area has been lagging and indicators of a pick up in economic activity are still not firm, emerging economies, for the most part, have had a good year, with generally accommodative external funding conditions. Although growth in many Latin American countries was on the low side as a number of these countries are undergoing macro adjustments, these adjustments should lay the foundation for a faster and more solid growth in the period ahead. In low-income countries, the incidence of poverty appears to be on the decline, but this improvement was concentrated in Asia, while poverty indicators in Sub-Saharan Africa have deteriorated and per capita income stagnated. There has been, however, encouraging signs of improvement in the macroeconomic performance of many countries in the region, supported in many cases by the initiation of structural reforms and the current boom in commodity prices. What is needed now is sustained growth, which requires the absence of civil conflicts and the implementation of appropriate policies, including human resources development and institution building. These efforts need to be supported by timely and adequate levels of financial and technical assistance as well as improved market access.

In spite of the tensions in the Middle East, the region witnessed progress in economic reforms and a strengthening of growth. Increased foreign exchange reserves and continued efforts to widen the revenue base and further strengthen the banking sector are serving to enhance the resilience of the region's economies. Foreign direct investment and equity prices increased. The challenge now is to enhance the business environment in order to create new job opportunities for the rapidly expanding labor force. This effort will need to be supported by a return of peace and prosperity, especially in Iraq and Palestine.

The improved global outlook is, however, subject to a number of downside risks. As the current recovery strengthens, and given the high level of liquidity in some major economies, financial policies have been tightened in some countries. The time may be fast approaching when financial policies would need to be tightened further particularly in the U.S. and China. Determining the appropriate timing and degree of the adjustment in both the fiscal and monetary stance will be key to reducing the risk of aborting the recovery or contributing to other global problems. In the United States, the increase in defense outlays, as well as the added pressure on public finances emanating from the social security system and, more generally, an underfunded pension system, underscore the need to put in place a set of measures directed at sustained budget consolidation within a credible medium-term framework. While fiscal imbalances in other industrial countries are not as serious, and their economic conditions are not as vibrant as those in the U.S., nevertheless should a recovery take hold in Europe and Japan, policies directed at fiscal consolidation, particularly through public expenditure restrains, would be called for.

Communication between the monetary authorities and market players will be key to a smooth and gradual transition from an accommodative to a neutral and then to a restrictive monetary stance, should that be needed. Monetary authorities would need to avoid creating uncertainties or surprising the markets. Initiating the change in the monetary policy stance for the United States may well begin later this year or early next year. Should the budget deficit in the U.S. continue at today's high level, monetary policy would have to be tightened further to compensate for the budgetary excesses. In this eventuality, the policy mix would contribute to increasing the risk of financial instability and further aggravating global imbalances, rather than correcting them. The impact on indebted emerging markets could also be damaging as interest rates rise.

Many of the major economic players have relied on export-based growth. Japan, the Asian countries in general, and Europe are particular cases in point where domestic demand is relatively weak. Not only does this state of affairs make these countries vulnerable to sudden weaknesses in export demand, but it also does not contribute to a resolution of the global imbalances. Policies should be directed at promoting tax reforms, trade and product market liberalization, and labor mobility, to bring about an environment conducive to increasing demand and narrowing output gaps.

While today's payment imbalances may be sustained for some time given the continued inflows, both official and private, to finance the large current account deficit in the United States, there are significant risks of a disorderly adjustment, involving abrupt capital and/or exchange rate movements and increased protectionist pressures. For the present, the rest of the world is willing to accumulate a growing stock of financial assets, but how long can this last? Major foreign assets centers could stop accumulating dollar assets to boost their reserves; markets are prone to swift changes in sentiments and should, therefore, not be left in the driver's seat to resolve the imbalances.

The abundant liquidity has been instrumental in bolstering investment confidence, but has also resulted in excesses in a number of major economies, including that of the United States. Specifically, the low levels of interest rates have contributed to increasing household debt and asset price inflation. The low interest rate environment has also led market players to attempt to improve returns by assuming higher risk investments. With the increased exposure of market players to higher risks, there may be an inclination for the monetary authorities to further inject liquidity to delay the inevitable. Policymakers should be aware of this risk and take measures to avert it or to ameliorate it. In addition, the proliferation of financial instruments and the risks attached to them, and the increasing transfer of these risks from banks to the non-bank financial sector, and on to end users, calls for a review of the consistency of regulations and supervision across different segments of financial markets.

The United States' current account deficit is not just a U.S. problem; it is a global one and, hence, is in need of a global solution. The counterpart of the U.S. deficit is the surplus in the rest of the world. The imbalances thus run both ways. It is important that the various adjustment priorities be implemented in an internationally coordinated and calibrated fashion. This would allow the process of orderly adjustment in current accounts to be undertaken in the context of high global growth. In the absence of such coordination, the risk of financial dislocations and global stagnation would increase. The coordinated action involves a number of major countries and regions. The United States needs to restrain demand and bolster credibility by putting forward a clear and credible medium-term framework with specific measures to reduce the uncomfortably high budget deficit. Europe needs to introduce overdue structural reforms in its tax systems and in labor and product markets. In Asia, a number of countries need to assess their exchange rate policies. Policy makers should also ensure that the apparent rising wave of protectionist noise does not spill into trade policies, thus hurting global welfare and growth prospects.

While the recent increase in commodity prices, including oil, would have some impact on growth in importing countries, this increase has benefited exporting countries which have often suffered from depressed prices for prolonged periods. It would be important for both exporters and importers to collaborate together to ensure stable and fair prices. Most oil exporters have often reaffirmed their commitment to such an approach. Here, we note that the recent volatility in oil prices has largely reflected inadequate inventory management in major importing countries as well as geopolitical uncertainties.

Crisis Prevention and IMF Surveillance across the Membership

The aforementioned global risks highlight the need to further strengthen surveillance and sharpen its focus on the core areas of the Fund's mandate. In this connection, it is particularly important to preserve evenhandedness across the membership. We, therefore, welcome the increased focus on strengthening surveillance in systemically important countries, and call for an evaluation of the effectiveness of the Fund's policy advice to these countries. It is also important to strengthen the links between bilateral and multilateral surveillance. One important way to strengthen these links would be a systemic incorporation in surveillance of the impact of trade restrictions and subsidies at both the individual country level and the regional and global levels. Bilateral surveillance should provide more systemic assessments of the consequences of trade restrictions and subsidies on individual countries' economic performance. Multilateral surveillance should complement these individual country assessments through an appraisal of the aggregate or cumulative impact at a global level.

Applying various analytical tools, such as the balance sheet approach, would in many cases be useful in identifying sources of vulnerabilities. Given its taxing data requirements and sometimes limited predictive power, such as in the case of financial soundness indicators, this approach should not be applied across the board, but rather on a case by case basis when it is deemed relevant.

We welcome the increased transparency in the Fund and member countries. Transparency policy should, however, continue to be sensitive to possible market over reactions. We believe that the most effective way to encourage members to follow Fund's advice is continued reliance on the cooperative approach between the institution as a trusted advisor and its members. In addition, caution should be exercised in publicizing summary indicators that are not adequately qualified or not complemented by an informative qualitative analysis.

Program design also needs to be improved, learning from past experience. We welcome the work on public investment and fiscal policy, and believe that more work needs to be done on the quality of fiscal adjustment and the implications of cuts in public investment on the longer-term fiscal position through its impact on economic growth. Conditionality should remain focused and streamlined, and different policy options should be explored with the member in order to strengthen ownership and increase the chances of program success.

The Independent Evaluation Office (IEO) has been providing useful feedback on how to enhance Fund surveillance and program design. Improving the Fund's work in these areas and operationalizing the recommendations of the IEO will require additional resources. It is therefore important to better align the priorities for improving the Fund's work in the traditional core areas with the budget constraint, and to ensure that these are not crowded out by initiatives in other areas.

The size of the Fund has declined in relation to the world economy, while the vulnerabilities arising from increased trade and capital account openness are more evident. This necessitates an effective exceptional access framework that allows the Fund to play its central role in maintaining global financial stability, while minimizing the risks to its resources. The existing framework should continue to be enhanced, including by clarifying the conditions for approving exceptional access in precautionary and post-crisis cases. We welcome the Fund's readiness to assist countries facing increased vulnerabilities arising from trade liberalization and other current account volatilities. We believe that it would be desirable to maintain effective and swift mechanisms to address temporary volatilities facing middle- and low-income countries.

Progress in strengthening the voice and representation of developing countries, which would also contribute to enhancing governance and increasing the effectiveness of the Fund, has been limited. We believe that emphasis should be re-placed on consensus building and that the views of developing countries on policy issues should be better taken into account. Making the process of selecting the Managing Director and the President of the World Bank more open and transparent would also enhance governance. The procedures endorsed by the Executive Boards of the two institutions should provide guidance for the selection of their heads.

Technical assistance is a core responsibility of the Fund and plays a major role in helping member countries build their capacity to implement reforms. It is therefore crucial to continue to accord this activity high priority and to ensure that the allocation of assistance matches the needs of member countries. We welcome the decision to establish a technical assistance center in the Middle East, and look forward to its contribution to capacity building in the region.

Enhancing IMF Support to Low-Income Members

The Fund continues to have an important advisory, technical, and financing role in low-income countries which, we believe, is useful and effective in supporting further adjustment and reform efforts in an important segment of our membership. We support the policies intended to ensure an efficient use of PRGF resources by clarifying the criteria for blending PRGF and general account resources, and by establishing access norms under successive arrangements. We believe that these norms should be applied flexibly and not constrain the ability of a country to receive a higher level of Fund financing when warranted by financial and adjustment objectives. For countries with no immediate balance of payments need, but where Fund close engagement is important, we support the use of low access PRGF arrangements.

As we emphasized in the past, the success of the ongoing efforts (prudent domestic economic policies, higher levels of official development assistance, and debt relief) to reach the Millennium Development Goals in LICs, while maintaining debt sustainability, hinges on the ability of these countries to exploit their comparative advantage. Trade liberalization in industrial countries is critical in this connection and we, therefore, look forward to progress in the Doha Development Round. The Fund has an important role to play in monitoring developments in this area and in urging developed countries to remove costly subsidies and other barriers to trade and enhance market access for all developing countries.