



International Monetary and Financial Committee

Eleventh Meeting
April 16, 2005

**Statement by Honorable Burhanuddin Abdullah
Governor of Bank Indonesia**

On behalf of Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao P.D.R., Malaysia,
Myanmar, Nepal, Singapore, Thailand, Tonga, and Vietnam

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Representing the constituency of Brunei Darussalam,
Cambodia, Fiji, Indonesia, Lao P.D.R., Malaysia, Myanmar, Nepal,
Singapore, Thailand, Tonga, and Vietnam

The Global Economy

1. We are pleased to note that the global expansion is expected to remain broadly on track, spearheaded by stronger than expected growth in the US and supported by continuing robust economic activity in China. With sound macroeconomic policies in place, growth in emerging Asia continues to remain robust in 2005, underpinned by broader-based growth with stable labor market conditions and higher disposable incomes while some countries have tightened monetary policies in view of the greater risk of inflation.
2. Despite this benign global outlook, growth prospects going forward remain subject to substantial downside risks. We are of the view that the world economy continues to be plagued by geopolitical concerns, rising global economic imbalances, high and volatile commodity prices, especially oil prices, unsustainable fiscal deficits and continuing structural weaknesses in many countries. These factors underscore the importance of achieving the concerted and co-operative effort that is needed to bring about an orderly adjustment of global imbalances. With policy interest rates generally below neutral levels, most countries will eventually need to raise interest rates. Against this backdrop, the downside risks in the US are more ominous in view of high and volatile energy prices, high household debt to income ratios, and possible overvaluation of some real estate markets. More determined efforts are needed in the US to address the issue of fiscal sustainability and resolve the twin deficits problem. The acceleration of structural reforms in the labor market and the financial sector are necessary in the Euro area and Japan respectively.
3. On the call for more flexibility in exchange rates in emerging Asia, the Asian countries with flexible exchange rate regimes have already seen their currencies appreciate vis-à-vis the dollar. For the countries with fixed exchange rate regimes, structural reforms have been undertaken and domestic fundamentals strengthened to ensure that the exchange rate continues to be well supported by strong economic foundations and that external shocks can be absorbed through domestic price flexibility. These efforts have ensured that their currencies remain fairly valued against those of their trading partners.

The Fund's Medium-Term Strategy

4. The Fund's mandate and its main focus on preserving external, financial and economic stability and functioning as the main forum for cooperation and coordination at the center of the international monetary system continues to remain valid and relevant today. This is achieved through its role in surveillance of the global economic and financial system and as provider of policy advice and technical assistance to its membership.
5. The guiding principle for the Fund's medium-term strategy should be to help and encourage members to adopt sound policies and put in place robust institutions as it is important for such policies to be firmly entrenched in institutional frameworks that reinforce them and make them more likely to be sustained in the future. Good and effective institutions are essential for the implementation of policies that support stability and sustained growth. While the important role that broad institutions play in a country's economic prosperity is undoubted, the Fund should focus its efforts on developing 'specific' institutions in the monetary, fiscal and external sectors to fulfill its mandate of promoting monetary and financial stability.
6. On the issue of capital account liberalization, we are of the view that the Fund should not play a 'central' role in this area. Past and recent experiences have clearly demonstrated that capital account restrictions are justified in some cases. At the same time, countries are already proceeding along the liberalization path, as they see fit, and as warranted by their own set of economic and financial circumstances. Therefore, the role for the Fund should be to ensure effective surveillance and that the necessary supporting infrastructure, especially adequate financial resources and appropriate financing instruments, are in place to help countries faced with capital account vulnerabilities or difficulties.

Effective Fund Surveillance

7. In light of the continuous new developments in the global economic environment, the expanding role of emerging markets, growing trade and financial interlinkages of countries, increased capital flows as well as heightened risks and volatility in financial markets, effective surveillance for crisis prevention must be the key focus of Fund activities. In this respect, the Fund has a crucial role to play as a confidential and impartial advisor. Quality and persuasiveness of staff advice are key for effective surveillance. Developing a good relationship as well as trust and rapport with the country authorities and principal stakeholders through a greater degree of cooperation between Fund staff and country authorities/stakeholders would enhance ownership through greater buy-in of the authorities. This underscores the importance of high technical expertise and good communication skills of the mission team, which should be augmented by a deep understanding of relevant country specific circumstances.

This in turn implies a need for diversity to include recruitment of staff with adequate training and experience in different countries.

8. Vulnerability analysis and assessments of financial sector soundness and developments in capital markets are important areas of focus for Fund surveillance activities. Work in this area should be strengthened given their criticality for crisis prevention. With the intensification of financial globalization, the Fund should take advantage of its unique role in undertaking surveillance of individual countries to also pay particular attention to the risks of spillovers from regional and advanced economies. In this regard, there is a need to further develop and make effective use of the Fund's capabilities in financial sector and capital market surveillance. In light of this, the Fund must stay ahead of the curve and be on the research frontier with respect to the early detection of vulnerabilities for the prevention of monetary and financial crises. As such, priority should be given to more in-depth research on cross-border capital flows and sources of vulnerabilities within the financial system as well as corporate and household balance sheets.

Use of Fund Resources and Other Financing Instruments

9. On program design and implementation, we would like to underscore the importance of ownership, flexibility and appropriate policy space. During the process of designing the program, Fund staff should engage not only the authorities but also the broader base of stakeholders in constructive dialogue. An inclusive approach involving more extensive participation is expected to improve communication and generate a common perception on domestic social and political objectives and economic priorities, thus also providing the Fund with a more comprehensive understanding of the member country's circumstances. This would contribute towards a more realistic Fund program. On the part of the member country, this common perception would promote greater ownership and commitment, which are key ingredients for the success of Fund programs.
10. The current access limits and the criteria for access to facilities for addressing current account crises and for the PRGF facility appear appropriate. However, in view of the significantly higher amounts of funds involved in capital account crises, we feel that the current quota level is no longer a suitable metric in determining the size of access to fund facilities. We note that exceptional access has come to be viewed as a rule and not the exception especially for countries facing capital account crises and we submit that this is largely because the current quota size does not correctly reflect the changing relative economic size of countries, especially of Asian economies.
11. The experience of the Asian crisis highlighted the need to prevent free capital movements from causing costly capital account crises. Prudent macroeconomic policies can provide the first and most important line of defense and the Fund has an important role in preventing this risk through its surveillance efforts. However, these are not sufficient conditions for the prevention of a capital account crisis. Experience

clearly shows that capital account crises arise from massive capital outflows due to sudden shifts in investor confidence and in cases of confidence crisis, there is asymmetry in the reaction time of investors in that investor confidence can evaporate fairly quickly but a significantly longer period is needed for the confidence to be restored. Hence, it is cheaper to prevent a capital account crisis than to resolve it, underscoring the need for an appropriate precautionary facility. Such a precautionary facility would need to incorporate features that take into account the difference in the nature of capital account crises compared to current account crises. It has to be more front-loaded in the sense that the first tranche has to be significantly larger and it has to be granted sufficiently quickly before investor confidence is lost. Although the Supplemental Reserve Facility does address to some extent the need for higher funding, this facility can only be requested **after** the country has experienced a capital account crisis.

Fund Support for Low-Income Countries (LICs)

12. The Fund has a crucial role to play in LICs, and should continue to focus its efforts on contributing to macroeconomic stability by assisting countries in undertaking the necessary reforms to achieve sustainable long-term growth and to reduce poverty. This support should continue to be both in terms of financial assistance and in providing policy advice and institutional capacity building through technical assistance. Other areas of support, in terms of facilitating resource flows and helping solve unsustainable debt situations should continue to help these countries achieve the Millennium Development Goals (MDGs).
13. We welcome the strengthening of the Fund's financial instruments for engaging low-income members through the augmentation of PRGF arrangements in response to shocks as well as guidelines on access to PRGF resources to ensure even handed treatment and best use of resources. In this regard, we are in favor of aligning the PRGF facility more closely in line with middle income country facilities to allow greater flexibility to lend for shorter periods than the current 3 year cycle. We are cognizant of the benefits of further debt relief but the resources are limited. Hence, further debt relief should be considered together with concrete proposals for additional financing such as higher bilateral donations and other innovative sources of financing so as not to jeopardize future PRGF lending operations. Since a good framework already exists under the HIPC Initiative, further debt relief might perhaps be best undertaken through augmentation of resources under the HIPC Initiative.

Effective Fund Management and Governance

14. Given the constraint on Fund resources in light of the rising scope of responsibilities, the Fund should prioritize its range of activities. Priority should reflect the wider view and needs of the entire membership and not activities that may be driven mainly by a few members.

15. At the same time, the Fund should explore options to broaden its income base, for example, through the establishment of an investment account. Establishing an investment account has its merits and deserves serious consideration. This is an opportunity for the Fund to broaden its revenue base without taking on excessive risks similar to that of private financial institutions. However, further work is needed on the formulation of proper investment guidelines to ensure transparency and minimize possible risks. Furthermore, in view of the increasing opportunity cost of the unrealized gains of the Fund's gold holdings, the Fund should assess the possibility and merits of using the proceeds from the sale of the Fund's gold in the investment account.
16. Finally and most importantly, we stress the criticality of addressing serious shortcomings in the Fund's governance structure, as well as a lack of sense of ownership of some members. In order to enhance the effectiveness and legitimacy of the Fund, all members of the institution must feel a sense of ownership. They must feel well represented and that they have a say in decisions taken by the Fund. As such, all members should have adequate voice and participation.
17. In this regard, our constituency strongly believes that countries' quota shares have to be reviewed and updated so that they reflect countries' relative positions in the world economy. A viable solution could be a rebalancing of quotas within the existing total whereby countries that are over-weighted could voluntarily transfer quota shares to countries that have grown quickly due to successful economic performance and are now grossly underrepresented. Without advancement in such an important area, the Fund's credibility will continue to be undermined due to the monopolistic behavior of large countries with veto power. In particular, the Fund runs the serious risk of losing its relevance in Asia unless the Fund effectively engages Asian countries by addressing this issue of the lack of voice and effective participation in the decision making process. The influence, credibility, and legitimacy of the Fund are contingent upon these changes. In this light, the upcoming 13th General Review of Quotas will provide an opportune time to achieve this objective, which should not be delayed any further. The ultimate goal is to see a Fund that performs important functions for the benefit of all member countries and cherishes the practice of consensus building in reaching Board decisions.