# International Monetary and Financial Committee

Eleventh Meeting
April 16, 2005

**Statement by The Hon. Duck-Soo Han**
**Deputy Prime Minister and Minister of Finance and Economy of the Republic of Korea**
On behalf of Australia, Kiribati, the Republic of Korea, the Republic of the Marshall Islands, the Federated States of Micronesia, Mongolia, New Zealand, the Republic of Palau, Papua New Guinea, Philippines, Samoa, Seychelles, Solomon Islands and Vanuatu

**Statement by The Hon. Duck-Soo Han**
**Deputy Prime Minister and Minister of Finance and Economy of the Republic of Korea[1]**
**to the International Monetary and Financial Committee**
**Washington, D.C. - April 16, 2005**

## The Fund's Strategic Directions

We welcome the ongoing process to review the Fund's strategic directions, initiated by the Managing Director's outline for the strategic review in his address to the Board of Governors, on 3 October 2004. The Executive Board discussion on 28 March 2005 on the Fund's medium-term strategy, building on their preliminary reflections on the Fund's strategic directions, is a step in the right direction towards the task of identifying the operational and organizational implications of the medium-term strategy.

This constituency has long advocated the need for the Fund to adopt a more strategic approach to its operations. Against its mandate and the significantly changing economic and financial environment, the Fund now needs to reshape its strategic direction. In our mind, the Fund's core role is the stability of the international financial system and, from that, monetary and fiscal stability and associated good governance around foreign exchange, public debt and financial sector regulation. Surveillance is at the heart of the Fund's operations and needs to be able to embrace national, regional and global dimensions.

In order to achieve a timely, productive, and inclusive outcome for the medium-term strategic review, the review needs the backing of strong leadership, and budget reform where priorities align with the Fund's core role. If shareholders want the Fund to increase its activities, they would need to either reduce efforts directed in low-priority items, provide further funding, or alternatively by identifying efficiency gains. The strategic review, in coordination with other reviews on financing of the Fund and the modernization of budget processes, and the employment, compensation benefits review, should be viewed as an integrated package, which will drive changes in the operation of Fund management and the Board, and also the deliberations of future IMFC meetings.

As set out below, meaningful reform is long overdue for adjustments to quotas, voice and representation to reflect the changing composition of the world economy. This issue needs political action as a high priority.

---

[1] On behalf of the constituency comprising Australia, Kiribati, Korea (Republic of), Marshall Islands (Republic of the), Micronesia (Federated States of), Mongolia, New Zealand, Palau (Republic of), Papua New Guinea, Philippines, Samoa, Seychelles, Solomon Islands and Vanuatu.

**Global Economic Outlook and Policy Challenges**

The global expansion remains broadly on track, underpinned by generally supportive macroeconomic policies and notably benign financial market conditions since the IMFC last met. Following last year's performance—the strongest in three decades—growth is expected to moderate to a more sustainable pace in 2005. At the same time, the expansion has become increasingly uneven. Growth has been strong in the United States, China, emerging Asia, as well as most emerging market and developing countries, but disappointing in Europe and Japan. Looking to 2005, global growth is likely to be slower but solid, supported by still accommodative macroeconomic policies, improving corporate balance sheets, supportive financial market conditions, a gradual rise in employment, and continued strong growth in China. Nevertheless, the balance of risks is still tilted to the downside. There appear to be key risks to the short-term outlook: firstly, the increasingly unbalanced nature of the expansion, with global growth significantly dependent on the United States and China; secondly, a possible significant tightening of financial market conditions, which can adversely affect domestic demand in the United States, prompt financial market deleveraging and asset price corrections more broadly, and lead to a widening of risk premia in emerging market financing conditions; and thirdly, a further sharp increase in oil prices, which are likely to remain worryingly high for the foreseeable future. The conjuncture of exchange rate adjustment, increased interest rate risk premia and high oil prices, poses particular risks for continued economic expansion in emerging markets and lower income countries. This includes emerging Asia and the Pacific Island states.

While inflation and inflationary pressure remain relatively subdued, there are risks of inflationary pressure from tightening labour markets, increased oil prices, and strong external inflows for countries with less flexible exchange rates, including in emerging Asia.

We are particularly concerned that higher oil prices continue to persist, reflecting limited spare capacity and an environment of growing demand. This could be particularly damaging to countries in Asia that are heavily dependent on imported oil supplies, as well as to smaller nations such as in the Pacific, that have limited capacity to respond flexibly to higher oil prices. In parallel with underlining the importance of stability in oil markets, we emphasize that measures to promote stability should be taken to include steps to enhance dialogue between oil producers and consumers; eliminate overly restrictive regulatory frameworks that impede investment in the oil sector; increase transparency in oil markets; and promote energy sustainability and efficiency.

The policy challenges facing the global community have not changed since the IMFC met last October. Among the key elements of this strategy for the global imbalance are—fiscal consolidation in the United States; steps towards greater exchange rate flexibility, supported by continued financial sector reform, in emerging Asia; and continued structural reforms to boost growth and domestic demand in Japan and Europe. Many developing countries, particularly in Latin America, remain vulnerable to possible adverse changes in market sentiment, which require further efforts of fiscal consolidation to improve public debt sustainability. While this overall policy strategy will have varying economic impacts in different countries and regions, the pursuit of this agenda will lead to more sustainable macroeconomic settings and external positions, and stronger medium-term growth.

The key role of the Fund is to monitor and encourage the implementation of this strategy through its multilateral and bilateral surveillance. Since the risk of global imbalances has become a standard line, reiterated in successive WEOs and in numerous fora, and given the fact that little progress has been made in implementing policies, the Fund needs to increase the traction of its policy prescriptions to more deeply explain the nature of risks, how they pertain to individual countries and regions, and what the consequences are for policy. Especially, the focus needs to shift to the benefits of reform and the consequences of inaction for individual countries and regions. We reiterate the collective responsibility of the membership to ensure that the strategy is implemented in a timely and effective manner.

**Strengthening Surveillance**

Surveillance remains at the heart of the Fund's operations. The Fund's bilateral, regional, and multilateral surveillance make up its principal means of promoting a healthy global financial system and sound economic policies and performance in member countries. Surveillance also serves as the main instrument for crisis prevention. A number of issues to be addressed include:

- How to focus surveillance on the Fund's core macroeconomic role while linking this with essential microeconomic foundations that support external, monetary and fiscal stability and thereby enhance growth.

- How to make surveillance meaningful to authorities, legislators and the wider community. There is a pressing need to foster ownership within the community and this means good analysis and policy design, a clear understanding of the political environment, and an ability to communicate and facilitate public debate.

- How to safeguard the Fund's role as confidential advisor, while upholding the transparency principle. It is particularly important for member countries to have open discussions with the Fund staff on operational realities and feasibilities of domestic policy. The Fund should not compromise its ability to deliver, when necessary, difficult policy messages in adverse political circumstances.

- How to make sure surveillance can embrace national, regional and global dimensions. Building relationships with, and coverage of, emerging regional groupings will become increasingly important. Especially where there are spillover and contagion effects, the Fund must be able to facilitate co-operation and co-ordination to safeguard the international financial system. The Fund is uniquely placed to observe and assess commonalities and policy lessons, and another way to embrace regional and global dimensions would be to make more use of cross country analysis.

- How to enhance the role of the Fund's surveillance activities on member countries and regional groupings.

- How Fund analysis and advice can be a better signaling device to other international agencies and creditors on development issues for low-income countries.

Surveillance needs to be effective, through good policy design, political astuteness and communications to the community. To this end, further consideration should be given to where both the timing and intensity of Fund surveillance is tailored more to the country's circumstances and, most importantly, the extent to which the Fund can add value. In this regard, we welcome that the Fund has begun to implement a strategy to strengthen surveillance further since the last IMFC, based on three components: strengthening the Fund's economic analysis and policy advice through the identification and pursuit of specific objectives for the immediate future; improving the quality of the policy dialogue with member countries and the effectiveness of communication; and a more systematic approach to assessing the effectiveness of surveillance.

As part of the moves towards greater strategic planning within the Fund, we would encourage the Board and Management to develop a work plan as to how the Fund can, through bilateral, regional, and multilateral surveillance, research work and communication strategies, help advance faster progress in addressing the medium-term challenges confronting the global economy. The Fund's priority over the medium term should ensure that surveillance has the greatest possible impact in encouraging all members to adopt policies and reforms that support stability and sustained growth.

**Crisis Prevention and Resolution**

Implementation of sound macroeconomic policies and associated structural reforms are fundamental to crisis prevention. But crises will happen from time to time. The Fund needs to maintain a capacity for assisting members facing temporary financial difficulties. The emphasis here should be on temporary. There are good reasons for limiting assistance to those countries with temporary balance of payment difficulties. The role of the Fund should be a catalytic one that restores confidence – not filling the liquidity gap. Decision-making around exceptional access should thus be strengthened. Financial assistance should also be on the basis that the resultant policy program and conditionality will restore macroeconomic and financial stability on a sustainable basis, and that there is a credible exit strategy. These programs should not only be credible, but they should be implemented. Where the Fund judges that a situation is unsustainable, it should retain the right to say 'no' to giving financial assistance to a country in this situation. Crisis resolution also needs to address the issue of the role of the private investor. The Fund should not be perceived as the sole "lender of last resort" such that during a crisis, the Fund is facilitating the financing of capital flight. We need markets to adhere to the principle of "investor beware" and allow orderly debt restructurings to occur. Otherwise, moral hazard will result in markets underpricing risk.

**Role of the Fund in Assisting Low-Income Countries**

While we have discussed the issue of low-income countries at length, we have yet to draw a fully agreed succinct statement clarifying the role and involvement of the Fund in these countries. It is, however, obvious that through ongoing reviews we are getting more understanding on the needs and concerns of related parties and what the Fund should and should not do.

As this constituency has noted in the past, the Fund's involvement in low-income countries could be most effective when it focuses where the Fund has comparative advantage and expertise: provision of macroeconomic surveillance and policy advice and related technical assistance to promote sustainable growth. As the Managing Director has stated, there can be little hope of sustained poverty reduction without macroeconomic stability. This may require financial assistance, but the Fund's primary role should be surveillance, policy advice and technical assistance, in co-ordination with the World Bank and other agencies. Financial assistance from the Fund should remain in the context of balance of payments assistance.

When it comes to resources for assisting low-income countries, we support keeping the PRGF separate from GRA. This financial structure has served the Fund well by keeping the concessional lending side of the Fund separate from the traditional lending arm. Furthermore, we support in principle the option of a self-sustained PRGF, supplemented by further bilateral contributions to increase loan capacity.

We believe that further discussions are required on debt relief beyond the current HIPC arrangements, in particular, on what terms any further debt relief should be provided. We are certainly concerned that the recent Fund/Bank debt sustainability framework suggests that many low income countries still have debt levels that are too high. That said, further debt relief risks allocating scarce development resources on the basis of past debts, which are unlikely to be well correlated with current opportunities to use aid effectively or future development needs. Thus, it is important now to operationalise the Fund-Bank debt sustainability framework as a complement to the HIPC arrangements and as an integral part of Article IV surveillance, and to maintain strong conditionality to ensure that debt relief will be used effectively. Otherwise, debt relief will unduly reward the countries with the weakest policy frameworks, which are also the ones least likely to benefit from additional financial headroom. IMF credit outstanding to low-income countries forms a relatively small portion of their overall debt and unilateral debt relief could give other creditors a free ride. In this context, it would not be appropriate for the Fund to consider further debt relief in the absence of a wider debt relief proposal involving other multilateral and major bilateral creditors. We note that utilizing gold is one means by which the IMF could finance further debt relief. However, if there are to be such gold sales, they should be conducted in a way as not to disrupt the world gold market. In addition, the Fund's balance sheet must remain fundamentally sound.

We note the idea of installing a "shock fund" for low-income countries experiencing difficulties in the balance of payment account due to external shoks. The Fund should continue to analysise the need for such a facility, particularly if oil prices were to move higher, and the feasibility of making such a fund operational.

**Quotas, Voice and Representation**

The strategic review of the Fund will not be complete without political action on the issue of quotas, voice and representation. The issue of quotas and under-representation is long overdue and that, for a large number of fast-growing emerging market economies, quota shares are out of line with their increased importance in the world economy. This is a particularly important issue for the emerging Asian economies. We expected to see movement on this critical issue, but to our deepest regret, there is no "progress" report on the issue to this IMFC. Since the resolution of issues regarding quotas, voice and representation has considerable bearing on the Fund's perceived legitimacy – and hence on its effectiveness – we should seek a solution of how quotas, voice and representation can reflect the changing composition of the world economy. A concrete plan to garner shareholder support is needed on top of the standard quota review cycle to facilitate meaningful progress.