International Monetary and Financial Committee

Thirteenth Meeting
April 22, 2006

Statement by His Excellency Sultan Bin Nasser Al-Suwaidi
Governor of the United Arab Emirates Central Bank
On behalf of Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Maldives, Oman, Qatar, Syria, United Arab Emirates, and Yemen

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I. The Global Economy and Financial Markets—Outlook, Risks and Policy Responses

1. It is encouraging that the global economy has continued to grow at a stronger pace than forecasted since our meeting last September. Of significance is the fact that economic growth has also become more balanced among regions and, in spite of the increase in energy prices, inflationary pressures have remained subdued. Relatively low level of long-term interest rates and favorable financial market conditions, coupled with accommodative macroeconomic policies, were certainly contributing factors to these positive developments. The prospects are for a further strong expansion in the world economy in 2006, with the growth, witnessed in various regions in 2005, being solidified on a broad basis.

2. Despite the favorable outlook, risks remain slanted to the downside, notably owing to increasing global imbalances, the possibility of an abrupt increase in interest rates, a correction of housing prices particularly in the U.S. following a period of rapid increases, and unanticipated events that may affect the flow of global oil supplies. The most serious risk in our view stems from a process of a disorderly adjustment in the global imbalances. We concur with the rationale that instead of fostering complacency, the present favorable environment provides global policymakers with a unique opportunity to address key vulnerabilities, particularly an orderly resolution of global imbalances.

3. The emphasis on the need for a timely, gradual, and coordinated solution to reducing imbalances has formed the core of the Fund's advice for a number of years, but there has been little progress in addressing the issue. We urge the Fund to assume a more proactive stance in addressing these imbalances, and the conference that has just taken place is a positive step in this direction. We would like to warn, however, against the use of the asymmetric leverage of the Fund on small emerging markets in shaping their policies towards addressing global imbalances. Given the limited ability of the Fund to influence policies in large economies, it is not appropriate to focus the pressures on weaker economies in this regard as has been the case in the recent past.

4. Actions by both the deficit and surplus countries will be needed to reduce global imbalances. In this respect, and given the high and growing U.S. current account deficit, a major part of the adjustment would by necessity have to be borne by the U.S. We see a need for a clear and determined fiscal retrenchment in the U.S. and actions to redress the saving/investment imbalance. Surplus countries should also collaborate actively in the global effort aimed at addressing global imbalances, by achieving a better balance between externally and domestically-led growth. We are less sanguine, however, about a generalized recommendation made to surplus countries to appreciate their exchange rates. Such exchange rate appreciation alone is insufficient to address imbalances. We see that efforts aimed at balancing savings/investment disparities could contribute more efficiently, by reducing the current account surpluses in these countries, to reducing global imbalances.

5. A serious problem clouding the world economic outlook concerns protectionism. Protectionist measures both in the current and capital accounts are emerging in some major countries. These could have a detrimental effect not only on the correction of global imbalances but also to the prospects for solid growth in the global economy. We hope that the recent incidents in blocking cross-border capital transactions are not the beginning of a new era of capital controls fed by excessive nationalism or vested interests. We urge the Fund as the guardian of the international monetary system to take a very firm and strong stand on addressing this issue. Action along these lines would well enhance the lagging reputation of the Fund.

6. We would like to draw attention to developments and reform policies in the Arab countries, and their contribution to global adjustment. The Middle East region continued its solid expansion in 2005, with healthy growth in both the oil and non-oil sectors, despite a difficult security and political environment. This strong performance is mainly attributable to sound economic policies and wide-ranging reforms focused on opening up the region's economies, reducing the role of the state, and improving the investment environment to encourage domestic private activity and attract foreign direct investment. Two major developments have supported these efforts: first, the increase in oil prices which had a positive spillover effect on the whole region, and second, what appears to be a structural shift in regional investor preference towards the region. Along with increased confidence and optimism in the region, these factors have contributed to robust inflows and ample liquidity, thereby supporting asset markets activity. In this connection, although stock prices have recently witnessed a correction in some countries, their still strong levels indicate the strength of the underlying economic fundamentals.

7. Oil exporting countries in the region have appropriately responded to increases in oil prices. Compared to past oil booms where budgetary expenditures were linked to oil proceeds, spending of additional oil revenues was less pro-cyclical and more growth-inducing. Current fiscal policies aim at striking an appropriate balance between expenditures and savings to minimize growth volatility. A significant part of the oil windfall was also used to reduce public debt and build financial cushions, thereby serving the purpose of ensuring intergenerational equity. Oil-exporting countries in the region continued to play a

constructive role in ensuring an additional supply of oil in response to the increasing global demand, thus supporting international oil price stability.

8. We would emphasize that the Fund's advice on the pace of spending in oil-exporting countries in the region needs to be guided by the country-specific factors to ensure an effective contribution to solving global imbalances. A multitude of factors determine the appropriate pace of spending additional oil revenues including constraints relating to the ability to identify and manage productive domestic investment projects, the capacity to ensure price stability and avoid any overheating of domestic economies, and the state of development of capital markets to intermediate financing.

9. The recommendation for the GCC countries to allow inflation to rise so as to achieve real exchange rate appreciation as a means of contributing to a reduction in global imbalances does not constitute sound economic advice and will not lead to the intended consequences. Inflation has large distorting effects, and sustained economic growth can only take place in a framework of price stability. An appreciation of real exchange rates in the GCC countries would have virtually no effect on the reduction in their trade surpluses, since these countries produce very little in terms of import substitutes or in terms of exports other than oil. On the contrary, a rise in inflation would reduce real income in these countries thus likely lead to a reduction in imports and aggravate the problem of global imbalances.

II. IMF Medium-Term Strategy

10. We welcome the Managing Director's Report on the implementation of the Medium-Term Strategy (MTS) as a step towards updating the scope of the Fund's mandate in light of the new challenges facing the world economy. We continue to strongly support the overall effort to refocus the Fund on its core activities and agree with the need to clearly prioritize its tasks. There is no doubt that the continued relevance of the Fund will depend on its ability to strengthen the objectivity and independence of its surveillance, to design instruments that respond to the needs and demands of the membership at large, and to enhance its internal governance, which is not improving.

11. As a multilateral institution with a critical mandate, the Fund should have a mandate-driven budget and not a budget-driven mandate. The focus of the medium-term strategy should be first and foremost on defining the mandate, which would subsequently determine the required resources envelope. In our view, addressing the issue should not be by tailoring the Fund's mandate to available resources. In view of the projected continued decline in the demand for use of Fund resources, we fully agree that a new business model is needed for generating the income of the Fund. We support the proposal to establish an external committee to advise on reforming the Fund's income mechanism. We are confident that the membership will, on a fair and equitable basis, be ready to undertake the necessary measures to put the income position on a secure and sustainable footing in order to support the Fund's mandate.

12. Fund surveillance needs to be more effective, with particular attention devoted to strengthening its multilateral aspect. We agree with the need to emphasize a more global perspective while increasing the focus on essential issues in all surveillance activity. The increased focus should not, however, be interpreted rigidly, and the importance of taking into consideration country specific characteristics should remain paramount in bilateral issues. Moreover, equal emphasis should be placed on the role of the Fund as both an overseer, and a confidential advisor. These two aspects need to be always balanced for effective surveillance.

13. The proposed new “supplemental surveillance consultation” in a multilateral format is, in principle, a positive step towards increasing the attention to issues of systemic importance. However, the proposal remains vague at this stage, and a number of issues would need to be resolved regarding its implementation, including the format of reporting to the Board and the IMFC. We look forward to a more detailed proposal in this area.

14. We agree that exchange rate surveillance needs to be strengthened and we welcome the intention to review the 1977 Surveillance Decision. However, we caution against undue focus on exchange rates at the expense of other policies. We agree to a broadening of the work of the Consultative Group on Exchange Rates (CGER) to include major emerging markets’ currencies. However, given the market sensitivity of the information, especially for the latter, we strongly object to the publication of assessments of Equilibrium Exchange Rates. Informal Board discussions of these assessments could provide a venue for candid multilateral debates and for the dissemination of relevant information without risking an adverse impact on more vulnerable economies. Moreover, given the inherent methodological pitfalls in the analysis and referencing of equilibrium real exchange rates, and the often wide differences in the results of alternative models, these assessments should be interpreted with extreme caution.

15. The emphasis on the integration of macroeconomic and financial market analysis in both multilateral and bilateral surveillance is appropriate; the merger of Monetary and Financial Systems Department and the International Capital Markets Department should be helpful in this respect. We support the strengthening of the coverage of financial issues in the context of bilateral surveillance, but caution against emphasizing these issues beyond what is warranted by the countries’ circumstances. That being said, the increased relevance of balance sheet vulnerabilities, the volatility of capital flows, the structures of public debt, and derivative instruments require increased attention to financial markets.

16. We support the increased focus and streamlining procedures proposed for Article IV consultations. While the goal to streamline surveillance consultation for a number of non-systemic and stable countries may be feasible, we believe the concerned countries’ authorities should be consulted in this respect. We should make sure not to deprive them unfairly of the Fund’s advice, which they may value and may contribute to the stability of their economies. We, furthermore, support the development of a multi-year rolling agenda that sets out the surveillance priorities over the next few years.

17. An adequate precautionary facility to accompany the suggested improvements in surveillance would enhance the Funds' involvement with Emerging Markets (EMs); Fostering an enhanced focus on crisis prevention provides an adequate context for engaging EMs at this juncture. We agree with the principles outlined in the report to set up a new vehicle with high-access financing, which would be made available automatically to a set of pre-selected countries. Nevertheless, we note that there are still many issues that need to be resolved before a decision can be made regarding the establishment of such a facility. We look forward to further deliberations on this subject.

18. On quota and voice, we welcome the recognition of the importance of a more balanced governance structure for enhancing the effectiveness and legitimacy of the institution. Reaching such a structure would require (a) ad hoc quota adjustments for the most glaring cases of underrepresentation; (b) an increase in basic votes, whose importance has declined sharply over time; and (c) a re-examination of the quota formulas. We agree on the need to move with dispatch to deal with these issues. We do not have any strong views on the best way to move forward, and can support any emerging consensus on this subject. On the selection process of the Managing Director, we welcome the proposal for enhancing the transparency of the process, which, in our view, should cover the whole management team. We await the details governing the implementation of the new selection procedures.

III. Low-Income Countries

19. We believe that a more effective engagement of the Fund in low-income countries (LICs) would require a refocusing of the Fund mandate to areas of macroeconomic relevance and core competence. The Fund has made significant strides in strengthening its toolkit to assist in instituting growth-conducive reforms in LICs. However, the Fund can be most helpful to the LICs if it concentrates its work in areas within its expertise. In this respect, we attach considerable importance to a sharper demarcation of roles between the Fund and the Bank, but also to a stronger coordination to prevent the occurrence of gaps in critical reforms. We look forward to the findings of the newly established External Review Committee on Bank-Fund collaboration, to assess the relevance of the 1989 Concordat to the evolving priorities of both institutions and guide improvements in interagency coordination.

20. As a multilateral institution, the Fund is committed to helping LICs meet their Millennium Development Goals (MDGs). In this respect, the Fund has a key role in supporting LICs address the consequences of the prospective scaling-up of aid inflows, including via official debt relief, while ensuring their consistency with macroeconomic stability and debt sustainability. Fund advice should center on the macroeconomic implications of aid on absorptive capacity, and on strengthening public expenditure management to mitigate the impact of the unpredictability of aid flows on budget execution and effective utilization of resources. Furthermore, while recognizing the implications of the composition of aid-financed expenditures on growth and competitiveness, decisions on the sectoral allocation of MDG-related spending should be relegated to the World Bank.

21. Strong efforts would be needed to ensure that the Fund's program design and surveillance is tailored in such a way that avoids an outcome where countries that benefit from debt relief do not get into a position where their debt situations might become unsustainable again. These efforts include a more refined use of the new Debt Sustainability Framework, and the Fund's assistance in the design of prudent medium-term debt management strategies. Program design and surveillance should also ensure that new borrowing is guided by the recently established debt sustainability thresholds. We welcome the Fund's work plan to examine further refinements to these thresholds, while striking a balance to avoid the proliferation of too many rating categories, and adopt a case-by-case approach to debt re-accumulation while working on guidelines that would allow for some flexibility.