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Statement by SHA ZUKANG
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MR. SHA ZUKANG
UNDER-SECRETARY-GENERAL FOR ECONOMIC AND SOCIAL AFFAIRS
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World economic situation and prospects

The current outlook for the world economy is grim, probably closer to the pessimistic scenario outlined in the United Nations' *World Economic Situation and Prospects 2008*: growth of the world economy is expected to drop significantly from the 3.7 per cent of 2007 to below 2 per cent in 2008.

The U.S. housing slump has spread to the U.S. economy at large, leading to declines in employment, industrial production, retail sales, and consumer sentiment. While an outright contraction of U.S. GDP in 2008 is likely, there is also concern that the slowdown will extend into 2009. While slowdowns in the developed economies of Western Europe and Japan are already evident, more spill-over effects from the U.S. slowdown are expected to become manifest in other economies worldwide via international linkages of trade and finance. While the nature of the world economy and the sources of economic growth have changed significantly in recent years, the optimistic case, based on the 'decoupling' thesis, remains unpersuasive. Nevertheless, there are grounds for confidence in the underlying economic strength of the real economy, which could provide the bases for recovery if other conditions become more conducive.

The fastest growing developing countries and economies in transition will not be immune to the US slowdown, even though they are more capable of absorbing external shocks, thanks to their improved economic conditions and considerable accumulation of foreign exchange reserves. The simultaneous sell-off in the equity markets of emerging economies in early 2008 may signal a reversal of the capital inflows to these markets; such a trend may intensify if the financial strains in developed markets get worse. The sharp decline of commodity prices by nearly ten per cent over a few days in mid-March 2008 – the largest percentage decline in two decades – serves as an alarming reminder of the vulnerability of many developing countries whose growth rates largely depend on the exports of commodities.

International Cooperation to Sustain Global Growth and to Regulate Finance

Policymakers in developed and developing countries face the challenge of attempting to moderate the depth of the global slowdown and to safeguard economic development efforts amidst an economic slump and continued financial turmoil in the developed economies. As noted in previous UNDESA statements, while a global slowdown cannot be avoided because of the weight of the US economy, early resolution of the financial crisis and rebalancing of global demand will reduce its negative impacts. Emerging economies with large export surpluses can boost domestic demand while allowing a measured appreciation of their exchange rates and without jeopardizing the sources of their growth.

Central banks of major developed economies have adopted significant measures to contain the financial turmoil, including a combination of substantial reductions of policy interest rates and full use of monetary resources, as in the case of the US Federal Reserve's recent intervention to arrange for a rescue of a major investment bank. With banks increasingly unwilling to lend or pass on lower interest rates, it appears that monetary policy options are constrained. Fiscal policies, to sustain output and employment, are already beginning to be deployed.

International cooperation should also be extended to ensure that the economic slowdown does not slow progress towards achieving the internationally agreed development goals, including the Millennium Development Goals (MDGs). Sustaining growth in the developing countries is a clear priority and is also consistent with rebalancing global demand.

Protecting low-income countries from external economic shocks, including the recent increases in food prices – such as through improved compensatory financing mechanisms that can provide resources quickly or new ones where gaps exist – is an urgent priority. Existing compensatory facilities do not provide sufficient resources relative to the shock and have high conditionality, which limits their effectiveness for events beyond the control of the affected country. Because of high conditionality, countries have responded to shocks by tightening fiscal and monetary policy, thereby undermining their own reform processes, instead of attempting to access these official facilities.

The transformation of the mortgage market collapse in one country into a multi-country financial crisis highlights the inter-related nature of national financial systems, including regulatory policies and standards. International cooperation is required in setting standards and improving regulation. More intrusive and stricter regulation and standards in one national jurisdiction would give undue advantages to competitors based in other jurisdictions. However, with globalized financial markets, the activities of less regulated competitors are no longer confined to their home markets and threaten to undermine stability elsewhere.

Many regulatory standards, such as Basle II on capital adequacy of banking institutions, have been designed with little participation by developing countries; they are not adequately suited to the institutional realities of these countries and rarely designed to promote development financing. These standards determine the access that developing countries have to international finance. Developing countries need to become full participants in the regulatory policy setting, if only to protect themselves from the harmful effects of external financial developments, as in the current situation.

Voice and Representation in the Bretton Woods Institutions

The IMF Executive Board has recommended to the Board of Governors the adoption of the staff proposal on a second-round of *ad hoc* quota increases of close to ten per cent. Basic votes will be tripled, partly offsetting their decline in total voting power. The realignment of quota and voting shares will lead to a net increase of 2.7 percentage points in the voting share of emerging markets and other developing countries as a whole. This is a very modest change achieved due to the use of a compression factor; the willingness of several advanced countries to forego part of the quota increases for which they are eligible; and the application, to several emerging market and developing countries, of a greater weight to the PPP GDP measure than for other countries.

These *ad hoc* adjustments suggest that the new formula *per se* has not achieved the stated goal of providing a simpler and more transparent means of reflecting members' relative positions in the global economy. At this critical time of global financial crises, and with the legitimacy and relevance of the Fund at stake, the proposed reform is too modest to provide real impetus to the ability of the Fund to play a significant role in international monetary and financial matters.

The World Bank has also launched its own process of voice and participation reform. The outcome of the Fund's quota and voice reform is likely to exert a strong influence on the direction of the Bank's actions. It should be recognized, however, that the Bank has a manifestly different mandate so that, following precedents set in other development financing institutions, it can consider voting weights of at least fifty per cent for the main users of its funds, that is, for its developing country members.

Doha Conference to Review the Monterrey Consensus

The international discussions in anticipation of the Monterrey review conference scheduled to be held in Doha, Qatar from 29 November to 2 December 2008 have attracted strong participation by Member States of the United Nations. The ongoing global financial crisis and the list of unresolved questions in external debt, private capital flows, domestic resource mobilization, and systemic issues have mobilized numerous experts and elicited a variety of suggestions from member governments. We are grateful for the strong participation of the international financial institutions in these discussions and look forward to a successful outcome in Doha.

The Doha review of implementation of the Monterrey Consensus provides an opportunity to update the parameters of the Consensus in the context of both obstacles encountered thus far and profound structural changes in the world situation. Since 2002, many developing countries have improved their macroeconomic management and fiscal balances, and have developed their financial sectors. The current financial crisis suggests that, while developing countries have shown significant progress in meeting their commitments, instabilities and weaknesses in the international financial system have not been addressed adequately. Inadequate regulatory approaches in the developed countries continue to threaten sudden stoppages to development financing. If the international financial system is unable to provide stable financing, it should at least "do no harm" to the efforts of developing countries to develop their own financial capabilities. In another part of the Monterrey Consensus, developed countries are not on track in meeting their promises on increasing official development aid. In the case of trade, the Doha round of negotiations is behind schedule and mired in disagreement over whether what is stake is truly developmental.