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WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Statement by the Hon. **JAN VINCENT ROSTOWSKI,**
Governor of the Fund for the **REPUBLIC OF POLAND,**
at the Joint Annual Discussion

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When we met a year ago, the global economy was entering a severe downturn, with the meltdown destabilizing financial markets, with a dramatic loss of confidence as well as with considerable uncertainties regarding further developments of economic and financial activity. The 2009 Spring Meetings witnessed major deterioration of the global economic performance but also showed some signs and hopes for a turnaround which was expected as a result of the firm and comprehensive policy responses. Today the world economy has indeed rebounded and is beginning to stabilize and to pull out of recession. However, the timing and the pace of the expected recovery remain uncertain. The unprecedented severity of the recession should encourage us to thoroughly analyze its anatomy and consequences, to draw lessons and to increasingly consider the post-crisis outlook.

We see several relevant lessons from the current financial and economic crisis:

- both markets and policies may trigger a crisis. Financial markets are not free from inherent flaws, mainly those related to the asymmetry of information. This is the ground which may aggravate the negative consequences of wrong policies and result in meltdowns which require determined policy responses, including those with unorthodox measures;
- booming financial markets encourage complacency and contain seeds of major reversals. Long term optimism, excessive liquidity as well as low risk aversion create incentives to build up leverage, often in ways which are not sufficiently transparent. These risks are reinforced by an environment containing a broad range of extremely complicated and sometimes insufficiently tested financial products;
- links between macroeconomic and financial stability as well as between individual risks and their aggregate implications have not been comprehensively explained. Macroeconomic and financial stability were, to a large extent, treated separately whereas rising risks from an excessive performance of the asset markets and of credit growth were not adequately translated into macroeconomic effects;
- policy measures designed to prevent asset bubbles and credit booms are needed. Beyond monetary policy which is focused on price stability, the asset market developments could be addressed by financial regulation providing for financial stability;
- emerging economies are no longer the major and independent source of international financial vulnerability and instability. The current global crisis originates from the advanced economies and has spilled over, through trade and financial channels, to the emerging world. Due to improved fundamentals and

prudent policies, several emerging economies have turned out to be relatively resilient to the crisis;

- with the turnaround from the crisis on the horizon, consistent and internationally coordinated exit strategies designed to unwind extraordinary policies in a timely manner, have to be carefully prepared. Otherwise, expansionary monetary and fiscal policies as well as significant public support of the financial sectors can produce excessive inflation and public debt as well as policy distortions. It is important that policy measures employed to contain the crisis are not interpreted as permanent deviations from well established policy positions;
- there is an obvious need for an internationally coordinated policy response. Globalization leads to a considerable exacerbation of externalities: decisions taken in one country have effects on other countries; individually rational decisions may prove to be irrational from a collective standpoint. Appropriate policies in a country do not necessarily mean that there are no international systemic problems, as domestic factors which trigger crisis situations are amplified and propagated by global financial markets.

An extraordinary expansion of financial innovations and markets as well as their globalization are among the major drivers of the robust, yet volatile, economic growth during the last two decades. These factors highlight the critical role of international financial institutions, and of the IMF in particular, in the context of the current crisis. While admitting that building up systemic vulnerabilities was not addressed in a timely manner and that the IMF policy advice lacked some traction, we strongly emphasize that the Fund's response to the crisis is, to a considerable extent, adequate and increasingly focused on a pro-active attitude.

The governance reform agenda is broad, and progress is already visible. The Fund should permanently adjust its governance to the changing conditions in the world economy. However, we think that the current size and composition of the Executive Board strikes the right balance between legitimacy and efficiency of the Fund. Improved governance, together with other assets such as abundant resources, intellectual credibility and global membership should define the central role of the IMF in the international financial system. We welcome the emerging consensus in favour of a merit-based and transparent process for the selection of senior management, both for the IMF and the World Bank, irrespective of nationality. We welcome measures to further strengthen the IMF bilateral and multilateral surveillance. In several GFSRs and WEOs the Fund has correctly identified and foreseen different risks to financial stability, including those stemming from global imbalances. In the area of surveillance, the issue of linking macroeconomic analysis and financial surveillance, which has been neglected in the past, is now brought to the fore on the IMF agenda. The strengthening of FSAPs and GFSRs allow the Fund to use its comparative advantage in macro-financial analysis. We note that multilateral surveillance faces significant challenges in transition from design to actual implementation as exemplified in the case of multilateral consultations on global imbalances or of the 2007 Surveillance Decision. However, we believe that a joint early warning exercise by the IMF and FSB will further enhance the quality of multilateral surveillance. Bilateral surveillance could emphasize the issue of the post-crisis outlook advising country authorities on exit strategies from robust policy responses to the crisis and lend credibility to their commitment to return to balanced positions. A strengthening of the surveillance of systemic countries seems desirable.

Tripling the Fund's financial resources and redirecting them to emerging countries which are most affected by the crisis is the appropriate decision. This move is supported by reforms in the lending framework. These measures should be critical in restoring global financial stability.