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Statement by the Hon. **JAEWAN BAHK**,
Governor of the Bank and the Fund for the **REPUBLIC OF KOREA**

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Governor of the Bank and the Fund for the Republic of Korea**

1. Greetings

First of all, I'd like to give my special thanks to the IMF and the World Bank for this excellent arrangement.

2. The recent state of the global economy

As you all remember, three years ago, we were here at this same place, to do all that was possible to weather the financial and economic crisis, and such concerted efforts kept a second Great Depression at bay.

At the last year's G20 Seoul Summit, we made our historical achievements as well. Agreement was reached on IMF/WB governance and quota reforms, and the Seoul Action Plan was also launched to contribute to the Framework for Strong, Sustainable and Balanced Growth.

Yet today, we are here again with another huge challenge and responsibility on our shoulders.

Economic recovery showed signs of slowdown from this year, and financial markets are again in turmoil with the fiscal deterioration and lingering concerns about a credit rating downgrade in advanced economies.

A big worry now is that the current situation would not be just limited to a fiscal crisis in a couple of countries, but likely lead to a systemic risk to the overall global economy.

That's because what we're seeing in the market reflects very different challenges from the 2008 financial crisis.

First, the current crisis stems from the fiscal side.

Back in 2008, the crisis originated in the private and financial sectors and led to sluggish global demand. Therefore, the fiscal and monetary stimulus enabled us to get out of the crisis.

However, the challenges this time are mainly due to concerns about public finances. There is a growing call for fiscal adjustment now, but fiscal tightening all over the world could cause growth to falter again. Moreover, the already abundant liquidity makes the effect of additional monetary loosening very limited.

Second, unlike back then when all the countries experienced and suffered the economic downturn, the situation today is all different from country to country.

Advanced economies are experiencing fiscal deterioration and sluggish growth whereas emerging economies are concerned about overheating. Furthermore, some underdeveloped countries suffer a food crisis due to price spikes in agricultural products.

Given such distinctive country-specific circumstances, international coordination that was possible back then won't be easy this time, and the risk of negative spill-over through capital flows should be getting only large.

Third, the current situation is "a crisis of confidence" regarding collective will and governments' capacity to deal with ongoing problems.

The market right now desperately calls for strong political commitment to push through fiscal austerity, policy capability to facilitate fiscal consolidation coupled with economic recovery, and the very right system to prevent the crisis contagion.

Though we face such challenges, it doesn't necessarily mean there is no key to resolve the current situation. I believe finding out answers to tackle this crisis, no matter how difficult they may be, should be our job today.

During this year's Annual Meetings, our first and foremost task should be to present a clear vision and strategy and take bold and swift action in an effort to rebuild market confidence.

3. Suggestions to stabilize the global economy

In this respect, I'd like to offer three policy suggestions to tackle the challenges facing the global economy.

First, more aggressive, systematic and balanced approach is needed to ensure fiscal sustainability.

Countries facing fiscal challenges need to come up with more concrete, substantive and implementable mid- and long-term fiscal consolidation plans. Countries whose primary

worry is solvency risk, need to give priority to reassuring markets through more fundamental structural reforms based on determined political leadership.

For countries whose fiscal position is relatively sound, potential factors like aging should be taken into consideration to design credible and sustainable strategies.

I believe, what is required now is to gain market confidence in our capability to restore fiscal sustainability. Rather than short-term fiscal consolidation plans, we need credible mid- and long-term ones that can balance short-term risks to growth and fiscal sustainability.

Besides, in terms of how to do the fiscal tightening, we must find various measures that can also shore up economic growth. As part of this, we must remain focused on reducing spending that has limited direct impact on short-term demand while maintaining and even expanding growth promoting expenditure such as investment in infrastructure, R&D and education.

Much of our emphasis should be also on accelerating structural reforms fast enough in a wide range of areas, such as labor and product market reforms, to increase growth potential.

Second, we must prevent the spread of the debt crisis from advanced economies to emerging economies that could otherwise pose a systemic risk to the global economy.

In that sense, countries with the large size of the economy should take into account how their fiscal and monetary policy would affect stability in other countries. As regards this issue, it is very timely and meaningful that the IMF attempts to strengthen its surveillance through spillover reports considering the interconnectedness between countries, and between sectors.

Emerging economies, for their part, need to step up efforts to mitigate excessive capital flows with strengthened monitoring on capital movements, and the introduction of various macro-prudential measures.

Financial safety nets should be also established in parallel at the global level to absorb potential external shocks sufficiently.

The IMF's crisis response capacity has much increased in the wake of the financial crisis as well evidenced by capital increase and improved lending facilities. Yet the Fund should further strengthen its capacity to better cope with a crisis in large advanced economies, and to address a systemic risk that could lead to widespread crises.

For these reasons, we must expedite the approval process on the Fund's quota increase that was agreed last year, and discussion must begin now on the expansion of the Fund's available resources. It is also important that agreement should be reached as early as possible to introduce new credit lines and to enhance collaboration between the Fund and regional financial safety nets like CMIM.

Last but not least, the international community must provide continuing support to low-income countries which are especially vulnerable to economic crisis.

The recent deteriorating fiscal situation in advanced countries makes us worry about a potential decline in Official Development Assistance (ODA). However, we have to remember that ODA holds the key to sustainable growth that can allow creation of new global demand.

To this end, we need to explore a variety of ways to ensure that there shouldn't be a reduction in the volume of ODA. These include emerging economies' larger contributions, facilitating Public Private Partnership (PPP) projects, and securing new resources to fuel further development.

In the meantime, efforts should be also made to enhance the aid effectiveness within the limited resources available to us.

We have to first reduce overlaps or duplications, and consolidate similar projects if possible, between individual countries and Multilateral Development Banks (MDBs), as well as between MDBs.

Furthermore, the assessment of development projects should be strengthened to give a priority to those with high effectiveness from the perspective of recipient countries.

In this respect, I believe that the Bank has a larger role to play. On top of that, I'd like to ask for your participation in the 4th High Level Forum on Aid Effectiveness (HLF-4) to deliver tangible outcomes, which is scheduled this November in Korea.

4. Korea's policy response

Facing the recent market turmoil and the subsequent economic slowdown, Korea will do its utmost to preemptively mitigate lingering risks, and also continue to play its part as a responsible member of the international community.

First, while we will continue to pursue stable macroeconomic policy, Korea has been putting in place policy tools to curb capital flow volatility such as Macro-prudential Stability Levy.

Efforts are also being made to improve fiscal health as well.

Korea maintains a relatively solid fiscal position, but considering potential risk factors, for example, aging and unification, we have already implemented mid- and long-term credible consolidation plans.

In an attempt to secure fiscal sustainability, we aim to achieve balanced budget by 2013 through such as diversifying the tax base, increasing the effectiveness of expenditure, and improving fiscal management system.

Meanwhile, under the stance of fiscal soundness, we will strengthen strategic resource allocation to expand our economic foundation of growth, including job creation, green growth, and human resources development.

Building on that, we will try our best to strike a balance between ensuring fiscal consolidation and promoting economic growth.

Lastly, what's all the more important is Korea's efforts will remain focused on supporting low-income and underdeveloped countries even with the stance of fiscal soundness in place.

As an example of having successfully transformed from a recipient to a donor country, Korea has been keen to share our development experience with developing countries through Knowledge Sharing Program (KSP), and continued to expand its support to those countries in need of KSP.

Furthermore, we'll facilitate our cooperation with MDBs like the World Bank in line with such bilateral ODA.

Our newly established Trust Fund worth 40 million dollars at the Bank to support green growth in developing countries will be an excellent example for such cooperation. Notably, a variety of cooperative projects with the Bank to be financed by the Trust Fund, are in the pipeline. One of these will be jointly operating the Financial Advisory Center to prevent another financial crisis in East Asia.

5. Conclusion

Challenges facing the world economy now will be a critical test for all of us.

Just like we pulled together three years ago, we need to rekindle a spirit of global coordination, and take this crisis as another stepping stone to leap forward in the global economy.

John Maynard Keynes, the greatest economist who made a great contribution to the establishment of the Fund and the Bank, once stated that "Be confident that we are suffering from the growing pains of youth, not from the rheumatics of old age," and underlined the need for confidence in overcoming the crisis amid the Great Depression.

He also suggested that "activity and boldness and enterprise, both individually and nationally must be the cure," as one of the strategies to weather the crisis.

Finally, make no mistake we must address today's challenges boldly and swiftly with our greater political resolve of a spirit of union. We must make our greater commitment to demonstrate our firm leadership and vision for tomorrow. Let's get reminded that time and tide wait for no man.

Thank you very much.