International Monetary and Financial Committee

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September 24, 2005

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

Statement by The Hon. Duck-Soo Han[1]
Deputy Prime Minister and Minister of Finance and Economy of the Republic of Korea
to the International Monetary and Financial Committee
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The Fund's Strategic Directions

We welcome the ongoing process to review the Fund's strategic directions and support the Managing Director's objective of maintaining the relevance of the Fund as an essential element of today's international financial environment. The medium-term strategic review has now come to a stage of identifying key deliverables after a series of discussions including Initial Reflections on 28 March and the Managing Director's Report on 31 August.

From our point of view, the Fund's core mandate should continue to be anchored to international monetary co-operation, global prosperity and financial stability, and temporary balance of payment support. Core competencies should continue to focus on providing confidential policy advice on macroeconomic policy frameworks and associated exchange rate and financing sector regimes. Unfortunately, the Fund has picked up a plethora of roles – without abandoning the old ones – and does not really have a method for allocating resources across competing priorities. The strategic review with an organizing principle around globalization, closely tied to the Articles of Agreement, should help prioritize Fund work, prevent it from being ineffective due to being stretched too thinly, and enable it to keep up with meeting major macroeconomic challenges that lie ahead.

In order to achieve a timely, productive, and inclusive outcome for the medium-term strategic review, the review needs to be coordinated with a Medium-Term Budget that takes into account financial realities, appropriate resource allocation and risk management. The strategic review will also need to encapsulate other reviews on financing by the Fund, and the upcoming employment, compensation and benefits review later this year. We not only seek a well-managed Fund, but a staff that is technically expert, has well rounded policy advising experience, is able to communicate to member governments and communities, and broadly represents the diversity of the membership.

We are concerned that the sheer volume of paperwork confronting the Board is hindering its ability to provide strategic guidance on the larger issues of surveillance, crisis resolution, and program engagement.

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[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.

We encourage the continuation of the review process, which will have implications for the operation of Fund management and the Board, and also the deliberations of future IMFC meetings. We are hopeful that the identified priorities, coupled with concrete actions over the coming years, can lead to a Fund fully prepared to face the future with greater relevance and legitimacy.

Global Economic Outlook and Policy Challenges

Following strong growth in 2004, the global economy during 2005 has exhibited more moderate growth, while inflationary pressures remain subdued. However, the downside risks are increasing with wide growth divergences and increasing global imbalances, against a background of record-high oil prices and gradually rising interest rates.

Global growth is being led by the United States and China, while the euro area remains subdued. Japan is regaining momentum and emerging Asia and the Middle East are recovering well, while Latin America and Africa are showing good signs of a much needed expansion. US economic growth remains strong, underpinned by strong income growth and low interest rates, which together continue to boost the housing market. We have concerns over the impact of a possible correction in the housing market, while the current account deficit remains a major risk. Overall growth forecasts for the euro area have been marked down this year, while economic performance across the area varies considerably. Among other reasons, fiscal deficits and long-drawn-out structural reforms, given ageing pressure, make the area more susceptible to external shocks. In Japan, financial sector restructuring, labor market improvements and corporate sector profitability are now leading to higher consumption and solid investment, while China's expansion continues to exceed expectations.

Against this background, global imbalances continue to rise, particularly among the US, Asia and oil-exporting countries. The continued willingness of foreign investors, especially Asian countries, to hold US dollar assets has so far enabled the large US current account deficit to be financed easily, but it will not continue forever. To address global imbalances smoothly, we call for more decisive implementation of a cooperative strategy by all major players. Over the past six months, some progress has been made, notably through important steps towards allowing for greater exchange rate flexibility in Asian countries, namely, China and Malaysia. It is important that this process continue so that real exchange rate adjustment does not occur at the expense of rising inflation. However, the latest WEO suggests global imbalances cannot be solved through exchange rate adjustment alone. Fiscal consolidation in the U.S. itself has to play its part, as does structural reform in Europe and Japan. The WEO analysis also highlights that the current imbalances are not the result of a glut of savings but inadequate investment in Asia, and that a more investor-friendly environment in parts of Asia would help address this situation. Oil-exporting countries also need to play their part in correcting current imbalances by using higher revenues for judicious investment.

In this context, the persistence of high and volatile oil prices is becoming a central risk in the medium-term, particularly to oil-importing developing countries, although the growth impact of recent oil price increases has so far been relatively modest. We consider it important to increase investment in refinery capacity as well as strengthen energy conservation.

The policy challenges facing the global economy have not changed much since the IMFC met last April. Therefore, the key elements of the cooperative strategy remain the same, and we all are well aware of it. It should not be a blame game. On the contrary, we need to note that implementing the strategy will serve all our own best interests as well as contribute to the smooth adjustment of global imbalances.

Strengthening Surveillance

Surveillance remains one of the core responsibilities of the Fund. Surveillance needs to be effective through good policy design, political astuteness and communication to the community. The Fund's priority over the medium term should be to ensure that surveillance has the greatest possible impact in encouraging all members to adopt policies and reforms that support macroeconomic stability and sustained growth. We welcome continuing efforts to strengthen IMF surveillance through focused analysis which better integrates the Fund's bilateral, regional and global surveillance modalities. While stressing the importance of greater long-term and in-depth Fund analysis of the global economy in the context of the WEO and GFSR, we are keen to extract the most from existing IMF products and to ensure their quality continues to strengthen. In order for the Fund to get traction and influence outcomes, we are looking for more streamlined, focused and relevant products, not necessarily more products.

Further consideration should be given to tailoring both the timing and intensity of Fund surveillance to countries' circumstances and, most importantly, the extent to which the Fund can add value. In this regard, we welcome measures to streamline the effectiveness of country surveillance by focusing more on country needs rather than a standardized 'tick-box' approach. Another positive development is the shift to updates and follow−ups in the FSAP and standards and codes initiatives. This has been made possible by the broad coverage of these initiatives. We support efforts to prioritize updates/follow-ups according to country needs, thus minimizing their resource implications and maximizing outcomes. We also look forward to FSAP and related issues being further incorporated into the centrality of Article IV and program surveillance.

While we are in general agreement with the primary role of the Fund being that of a "trusted and confidential advisor", we also agree that, to improve traction and influence, the Fund has an important value-adding role of enhancing policy debate through a wider communications strategy. However, any wider communication strategy should take into account the sensitivities and preferences of the country concerned.

We broadly encourage moves to enhance the Fund's outreach activities (including in the regional surveillance context). These efforts will be more effective if they are backed by quality Fund reports/products which are made available in a timely fashion ahead of significant meetings. In our view, regional surveillance is not only relevant and important to major regions, but also to small economy regions such as the Pacific and the Caribbean.

Improving the quality of multilateral dialogue at the IMFC would be a welcome step in improving policy debate and multilateral collaboration, especially on issues of broad significance such as global imbalances. However, this also means less set interventions and more interactive debate. The IMFC's role is not being hampered by poor analytical work or the absence of Fund flagship reports, but because the arrangements are not conducive to frank, open and interactive dialogue.

Crisis Prevention and Resolution

The best defense against a crisis involves preventing it in the first place through sound economic and financial policies. Integrating financial experts into country teams would be helpful to enhance the capability to assess accurately vulnerabilities in emerging markets and disturbances in financial markets.

We support the proposal to review the effectiveness of the Fund's instruments to facilitate crisis resolution (especially given the length of time that the bulk of the Fund's credit continues to be tied up in exceptional access cases). The Lending Into Arrears policy is in need of clarification and this should be done expeditiously. We look forward to seeing that the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets and Collective Action Clauses (CACs) can continue to complement the Fund's crisis prevention efforts.

Regarding possible replacements for the Contingent Credit Line, or the provision of precautionary exceptional access as insurance against sudden capital withdrawals, such proposals entail moral hazard issues and financial risks for the Fund, and we have expressed concern when they have been raised in the past.

As noted above, we are also concerned that the sheer volume of paperwork confronting the Board is hindering its ability to focus on important issues such as crisis resolution. Crisis prevention and crisis resolution clearly are central components of the Fund's mandate and should not be abandoned to other parties.

We agree that, for the Fund to be able to effectively advise individual countries on which strategies are best suited for their particular capital account liberalization process, it needs to do more research in this area, given there is no solid body of analysis on how best to proceed with capital account liberalization.

Building Institution and Capacity

We support the proposal to give area departments of the Fund the central role in determining technical assistance priorities, and to gauge how effectively technical assistance outputs are converted into better institutional outcomes – moving to a medium-term strategy should facilitate such longer-term considerations.

Role of the Fund in Assisting Low-Income Countries

We welcome the consideration of the Fund's ongoing role in low-income countries. In particular, we are encouraged by the recognition that the Fund is stretched across a number of activities, some of which are outside of its core mandate. Although poverty reduction is now among the major roles of the Fund, 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 policy advice to promote sustainable growth. The Find's primary role should be policy advising and technical assistance, in co-ordination with the World Bank and other agencies.

Therefore, the proposed refocusing of Fund activities is most welcome. However, given the ongoing role of the Fund in low-income countries through the PRGF and the new Policy Support Instrument (PSI), which will be based on a PRSP or other strategy paper, we presume that the Fund would continue to be consulted by the World Bank during the formation stages of PRSPs.

We are hopeful that the enhancement of Fund facilities for low-income countries will be useful in addressing their varying needs. We consider that debt relief, future financing of the PRGF and the exogenous shocks facility should all be finalised as a top priority and in a manner that ensures these policies are consistent with each other.

It is widely recognized that weak institutions and lack of capacity are real constraints to the design and implementation of PRS in fragile and post-conflict countries. Given that this constituency represents quite a number of smaller (particularly island) states, we would stress that small states also face similar development constraints. The key development constraints for smaller states are their diseconomies of scale and/or isolation, vulnerability to external shocks and limited institutional capacity, which hamper policy design and implementation. We encourage the Fund to be involved in more discussions on small states.

Quotas, Representation and Voice

It has been 60 years since the IMF was established. The international financial system has changed dramatically but the basic governance of the Fund remains the same. Addressing the issue of quotas and under-representation is long overdue. Members' quotas should fairly reflect their economic strengths in the global community. The IMF is the most important international financial organization, and quotas of the Fund are fundamental to member countries' rights and obligations. When the Fund fails to be fair in its quotas distribution, it also loses its credibility and legitimacy. After suffering financial crises in the late nineties, many emerging Asian countries have accumulated over US$ 2,000 billion of foreign reserves, as self-insurance. For the Fund to retain relevance, it must urgently address the quota and representation issue.