International Monetary and Financial Committee

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Statement by Guido Mantega**,** Minister of Finance, Ministerio da Fazenda, Brazil

On behalf of Brazil, Cape Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, Trinidad and Tobago

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World Economy

1. The global economic outlook has improved slightly since we last met in October. Financial markets are less volatile than last year, and tail risks have diminished. The American economy has been improving gradually, with a rebound in private demand and some encouraging trends in the real estate market. Emerging market countries are facing the challenges of superabundance of international liquidity with sound and pragmatic policies, avoiding imbalances that could hamper their dynamism in the medium term.

2. The Japanese government has recently launched a new and bold program of economic growth, based on fiscal and monetary stimulus and structural reforms. Naturally, the effects on financial markets, especially foreign exchange markets, occurred almost immediately, with the depreciation of the yen being most noticed. If fiscal measures are indeed implemented, especially those that rapidly stimulate domestic demand, we should expect a more balanced policy mix, contributing positively to the world economy.

3. Despite some progress, we cannot unmistakably declare that the worst is behind us. Some European economies continue to show signs of weakness and inability to grow consistently. The euro area is in recession, with a projected decline in GDP this year.

4. Emerging market and developing countries are inevitably affected by recession or weak growth in advanced economies. Even the most dynamic EMDCs have been unable to sustain the high growth rates of previous years. International trade is a matter of particular concern, given the weak figures that have been released in the last couple of years.

5. I remain concerned with the macro policy mix in most advanced countries. Expansionary fiscal policy can be more effective than monetary policy as a tool to rekindle demand and activity. Increased public investment, including in infrastructure, combined with policies to stimulate private investment, may be the best way to promote recovery. In some important advanced economies, there seems to be space for fiscal stimulus, especially if backed by credible medium and long term adjustment plans.

6. Unemployment remains very high, notably in the periphery of the euro area and among the young. In most advanced economies, unemployment is still well above pre-crisis levels. Thus, the main challenge for policy makers in these countries is to ensure economic recovery and employment growth.

7. We must recognize that the global economy is still facing severe difficulties. There is a risk of a prolonged crisis, despite all our efforts in the G20 and other international fora.

8. The collective decisions we all should take is to stimulate domestic demand. There will be no global recovery if all countries search, at the same time, for foreign markets. It is our internal demand that will compensate the contractionary impacts coming from the international markets.

Capital Flows

9. Some rebalancing of macro policies in advanced economies could reduce negative externalities for emerging markets affected by unconventional monetary policies. These spillovers often complicate economic policy management in our countries and confront us with difficult tradeoffs. Traditional responses to excessive capital inflows such as tightening fiscal policy, lowering interest rates or allowing exchange rate appreciation are often costly or inappropriate. We cannot (and should not) subordinate fiscal policies to the humors of hot-money inflows (and outflows). This would be both unrealistic and undemocratic.

10. Thus, emerging markets may also need to rely on "unconventional" measures. By including capital controls in our tool-box, we can avoid over-burdening fiscal, monetary and exchange rate policies. Capital controls, as well as macro prudential measures, albeit not always appropriate, need to be ready for use. They should be accessible and exposed at the shelf to persuade investors that our governments are determined to use them, if necessary and in the right doses.

11. The IMF has to be supportive of this approach, not just tolerate it reluctantly, as in its "institutional view" document. The Fund has a special responsibility in promoting coherence in global economic policy making. Currently, it is advising advanced economies to loosen monetary policies while asking emerging market countries to tighten them. But widening interest rate differentials will invite more capital flows to emerging markets. If the IMF puts forward these contrasting pieces of advice, it has to go one extra mile and fully recognize the role of capital account regulations.

An Unreformable IMF?

12. IMF reform may be at its nadir. Target dates have been missed, delays and procrastination have become routine. The Fund missed the October 2012 deadline for the entry into force of the 2010 quota and governance reform. It then missed the January 2013

target for the completion of the review of the quota formula. Now we learn that the discussions of the next general quota review, which we have agreed to complete by January 2014, have also been postponed. No clear date has been set to initiate these discussion and we risk missing a third deadline.

13. These setbacks come after a period in which we achieved some progress with the entry into force of the 2008 quota and voice reform and the agreement by the Board of Governors on the 2010 quota and governance reform. Since 2011, however, IMF reform has stalled.

14. The obstacle to the entry into force of the 2010 reform has been the delayed ratification by the United States Congress. In the case of the quota formula review, the main obstacle is resistance to change on the part of overrepresented European countries. In other words, America is unable and Europe unwilling to follow through with agreed reforms. The institution's major shareholders are gambling, perhaps unwittingly, with the IMF's legitimacy and credibility.

15. European countries are overrepresented in the institution and seem extremely resistant to adjust their voting power to the changes in the world economy. The United States played until recently a constructive role in the reform process but is now holding back its continuation. As other countries complete their internal procedures, the US may soon find itself in the embarrassing situation of being the only G20 country and IMFC member not to have ratified the 2010 reform.

16. One should not lose sight of the political agreement that underlies IMF reform. After the crisis broke out in the advanced economies in 2007/2008, there was some movement in terms of international governance. The G20 replaced the G7 as the main forum for international economic cooperation. The G20, with strong participation of emerging market countries, decided to boost the IMF's borrowed resources in a major way. These borrowing arrangements were negotiated as a bridge to quota increases that would allow a realignment of quota shares and voting power in the institution. The Fund would thus be gradually weaned into the 21st century.

17. That was the political agreement. It has not been honored so far. Emerging market countries have done their part. Major advanced countries have yet to do theirs.

BRICS Contingent Reserve Arrangement and New Development Bank

18. Last March, in their summit meeting in Durban, the BRICS Leaders took important steps to enhance economic and financial cooperation among the five countries by agreeing to establish a New Development Bank and a Contingent Reserve Arrangement.

19. The Contingent Reserve Arrangement, with an initial size of US$ 100 billion, will be established as a self-managed precautionary arrangement to provide mutual support and help forestall short-term liquidity pressures. It will contribute to strengthen the global financial safety net and complement existing international arrangements as an additional line of defense.

20. The New Development Bank will mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries. It will also supplement the efforts of existing multilateral and regional development institutions.

21. I expect both negotiations to be finalized by the time of the next BRICS Summit that will be held in Brazil in 2014.

Small States

22. There has been progress on the small states agenda since the 2012 Annual Meetings. In March 2013, the Executive Board discussed a set of insightful staff papers highlighting the common characteristics and challenges of small states. The papers lay the groundwork for improved engagement between the Fund and its smallest and most vulnerable members. The Informal Working Group of Executive Directors on Small States, coordinated by our chair, made a strong call for definitive outcomes from this initial diagnostic, including: (i) institutionalization of an analytical work program on small states; (ii) review of guidance for surveillance of these members; (iii) expanded technical assistance; and (iv) strengthened cooperation with other international institutions engaged with small states.

23. The recent revision of the eligibility framework to concessional lending included a first practical step in favor of certain small middle income states by introducing special provisions for countries designated as "micro states" – those with a population below 200 thousand. For micro states, the costs of reconstruction in the event of natural disasters and diseconomies of scale have proven particularly serious and access to concessional lending can be crucial for them. A desirable second step would be the introduction of special provisions for other similarly vulnerable small states.

Review of the IMF's Facilities for Concessional Lending

24. Our constituency is less happy with the recent review of the concessional lending facilities, in particular with the decision to reduce access in terms of quotas by one half when the 2010 reform enters into force. This decision affects not only low income countries (LICs) but also a number of small middle income states that are eligible to concessional lending. These countries were led to support the 2010 reform with the expectation that the doubling of the overall size of quotas would provide them with higher access levels, even in the case of

those members that would lose quota share. This expectation will not be fulfilled. As many as 16 countries that are presently eligible to concessional financing will face reduced access in SDR terms once the 2010 reform is implemented.

25. With this decision the Fund runs the risk of being perceived as treating its members in an uneven manner. In practice, access limits are binding for LICs as countries falling within this grouping are seldom granted exceptional access. On the other hand, the Fund has been granting exceptional access to its other members, those that borrow from the General Resource Account (GRA), leading to a heavy concentration of the Fund's resources in a handful of middle income and advanced countries, mainly European.

26. The Fund's management needs to make a more vigorous effort to raise funds for the concessional lending facilities. Last year, enormous work was put into raising hundreds of billions of dollars in bilateral loans for the GRA in order to deal with the fallout from the crisis in the euro area. Nothing remotely comparable was done to raise resources for concessional lending.