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"A Mandate for Action"

Address by Dominique Strauss-Kahn
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Good afternoon. I am delighted to be here today, to talk about the global financial crisis, and in particular, how the IMF sees the challenges facing us at the moment. I will deliver a few remarks, and then I will take some questions.

I would like to do a little stock taking, as we stand on the eve of the Spring meetings of the IMF's membership, having come from a highly successful summit of the G-20 leaders in London. I was impressed by the appreciation of leaders for the seriousness of the global recession, and by their genuine commitment to take action.

One big storyline of the summit—if you judge from press coverage at least—was that the IMF emerged as a winner, especially given the unprecedented tripling of our resources. I think this gets it backwards. The real winner is the global economy. Leaders focused on what must be done across the board—some of this involves the IMF, and some involves others. They focused on urgent actions needed to restore growth today, and also on what must be done to fix some of the underlying problems that caused the crisis in the first place. So, we know what we must do, we have a mandate to do it, so let's do it. For our part, the IMF is ready to play its role.

We all understand the stakes. 2009 will almost certainly be an awful year—we expect global growth to enter deeply negative territory. This is a truly global crisis, and nobody is escaping. It originated in advanced economies, and spread like wildfire across the world. Emerging markets are being hit hard, facing the double punch of a sharp drop in export demand and a sudden stop in capital inflows, and this threatens to undo the impressive gains in growth and convergence achieved over the past decade or so. Of possibly even greater concern, the crisis has also arrived on the shores of low-income countries, and threatens to cast millions back into poverty—the human consequences here could be absolutely devastating.

The freefall in the global economy may be starting to abate, with a recovery emerging in 2010, but this depends crucially on the right policies being adopted today. Of course, the solutions differ by country, but there must be a coherent and coordinated response by the international community.

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As you know, we have asked for three things to be done, and I am happy that the G-20 leaders have made progress on all three fronts. These are: financial sector reform, fiscal stimulus, and financial support.

First, the need to fix the financial sector—this is essential if we are to get the global economy moving again. Until this is done, attempts to restore demand are likely to falter. Policymakers must cleanse banks' balance sheets of toxic assets, accompanied by restructuring, and, where needed, recapitalize viable institutions. We need forceful and urgent action, as well as coordination among the affected economies. The new U.S. plan is a major step forward, but its success hinges on the willingness of banks to sell their toxic assets.

Second, the need for a global fiscal stimulus—the IMF has been recommending, as early as January 2008, a 2 percent of GDP discretionary loosening for countries that have the fiscal space to do so. Countries have largely delivered in 2009, and I was impressed by the degree of international coordination—many countries did the same thing at the same time for the same reason. This cooperation was unprecedented. But efforts need to be sustained in 2010, because we are not out of the woods just yet.

Third, the need for urgent action on the financing front, especially to alleviate pressures on emerging markets, to help them overcome the economic and social costs of the crisis. This is the area where the G-20 was boldest, agreeing to triple the IMF's lending capacity to an unprecedented $750 billion, and—in addition—to at least double its concessional resources for lending to low-income countries. We now have the resources to make a difference. At the same time, the G-20 agreed to expand global liquidity by $250 billion, brought about by an increase in "Special Drawing Rights", the IMF's own reserve asset that borrowing nations can draw upon if needed.

This is significant as a symbol of the IMF's role as a global lender of last resort. Together, these decisions deliver the necessary financial support to the global economy, which should boost confidence and help turn the tide of the crisis—if complemented by the right policies at the national level, of course.

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These are the three urgent priorities. They are the necessary steps to recovery. But, we must remember, this crisis was caused by a number of fundamental flaws in the national and international financial architecture, and we need to address these shortcomings. Again, I was impressed that the G-20 leaders did not shy away from these issues. There are really four key areas going ahead: better regulation, better surveillance, better financing arrangements, and better international cooperation. The IMF has a key role to play in some, but by no means all, of these areas.

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Let me begin with better regulation. This crisis has shone a light on the failures of financial regulation and market discipline. Financial institutions and other investors took decisions that in retrospect proved spectacularly risky. Regulators paid little heed to the underlying risk or the degree of interconnectedness between activities and institutions. They stood on the sidelines as the financial system conjured up newer, riskier, innovations, and as an enormous shadow banking system arose beyond the regulatory net.

Strengthened financial regulation and supervision are key components of preventing future crises. The first priority is to expand the regulatory perimeter, to encompass all activities that pose economy-wide risks. Ideally, all systemic institutions should come under prudential rules—covering capital, liquidity, orderly resolution, and early intervention. We also need to reduce conflicts of interest, fill gaps in information, and make sure that banks hold more capital during good times to build up cushions when things turn bad. The international community is well aware of these issues, and is working toward solutions, but I must emphasize that this is not ultimately the responsibility of the IMF, even if we are part of the Financial Stability Forum. Our role is to monitor the implementation of any agreed outcomes through our surveillance process.

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Let me move to the second broad area—better surveillance. Before the crisis, almost everybody failed to pay enough attention to the strong ties between the real economy and the financial sector, and to factors like excess leverage, systemic risk, credit booms, and asset prices. These indicators were all sounding alarms before the crisis erupted, but were not always heard. We also realized that the world economy is interconnected in more ways than we had imagined.

It is fair to say that those charged with surveillance made some mistakes. We sometimes underestimated these interlinkages, both domestic and international. While we gave warnings, these warnings were not loud enough, and often tended to be overly cautious and nuanced. And we were simply too optimistic about the economic situation in advanced economies, lulled by the experience of strong growth and low and stable inflation. At the same time, when we did give warnings, these warnings were often ignored by policymakers.

This is not to downplay the role of the IMF. On the contrary, this crisis had taught us that the IMF is uniquely poised to offer guidance on precisely these issues—macro-financial linkages and spillovers across countries. It has the expertise and it has the experience. And as the crisis broke, the IMF gained renewed credibility with its realistic forecasts for the outlook and credit losses and by being among the first to pinpoint the policy responses that have now become part of conventional wisdom. It remains at the forefront of the debate, as can be seen from the G-20 summit.

But of course we can do better. The G-20 leaders expressed support for candid, even-handed, and independent surveillance. Our strategy will be to focus our surveillance on systemic risks from all quarters, better integrating the macroeconomic and financial sector work. We are expanding our vulnerability exercise to encompass advanced economies, and this will feed into a newly-developed early warning exercise—and here we will canvass a wide range of outside views and collaborate closely with the Financial Stability Forum, and its successor, the Financial Stability Board, benefiting from their deep understanding of regulatory issues.

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The third area pertains to better financing arrangements. What do I have in mind here? By dramatically increasing our resources, the world community has placed its trust in the IMF and we intend to live up to that trust. It cannot simply be "business as usual". The IMF needs to adapt. Its lending must become more flexible and better tailored to country circumstances. And we are adapting—we have introduced a package of reforms that transforms the way we do business, drawing lessons from the present crisis and also from past experience.

One key lesson is that prevention is better than cure. We would like to encourage countries to approach the IMF early on, hopefully before the crisis takes a toll on their economies. Indeed, the absence of an IMF insurance facility has been a major gap in the global financial architecture. We have fixed this by introducing a new flexible credit line that grants rapid upfront financing in large amounts—with no ex post IMF conditions—for countries with a proven track record. Mexico and Poland have already sought to access this new facility, and I expect more countries to follow. More generally, we are committed to providing larger amounts and more upfront financing across the board.

I must point out that IMF policy conditionality remains important, but it needs to be more streamlined. From now on, policy conditions will be more tightly focused on core reform objectives and will allow for greater flexibility, tailored to country circumstances. This should encourage countries to approach the IMF early on, before things get really bad. We also remain committed to protecting the most vulnerable, with many recent programs calling for an increase in social spending to cushion the impact of the crisis on the poor.

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The fourth—and final area—that I would like to address is better international cooperation. There is a need for stronger global coordination in macroeconomic and financial sector policymaking. We saw the benefits of cooperation with the global fiscal stimulus, and with coordinated liquidity provision. We saw the costs of non-cooperation when countries protected domestic banking systems at the expense of neighbors and ring-fenced assets in their own jurisdictions—and, looking ahead, we must avoid pressure on banks to favor domestic lending. I am pleased to say that coordination is improving, and the IMF is playing a key role in the multilateral approach to financing and surveillance.

For the IMF to fulfill its mandate effectively, however, it must have legitimacy with its members. Our voice must be respected in every corner of the world. This has not always been the case. We need to reform our governance structure to give more influence to emerging markets, speeding up a process begun over a year ago. In this context, I welcome the G-20 commitment to accelerate quota reform to early 2011. I also look forward to the U.S. Congress approving the legislation necessary to implement the reforms that were backed by our 185 member countries. These reforms will give a greater sense of ownership to emerging countries and foster global policy cooperation.

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So, these are main messages. The G-20 summit in London was a big success, and may well mark a turning point on this crisis. But, as we head into the Spring meetings, we have a lot of work ahead of us. I have mentioned three immediate challenges, and four more issues that must be addressed down the road, but hopefully, not too far down the road. It's time to act. In all of this, the IMF has been granted a great responsibility, and I hope we can live up to it. The world depends on it.

Thank you very much. I can now take some questions.