Office Memorandum

To: Members of the Executive Board November 4, 2011

From: The Secretary

Subject: **Ms. Shafik's Report to the Executive Board on Her Travel to the Middle East and Europe—October 22–28, 2011**

Attached for the **information** of Executive Directors is Ms. Shafik's report to the Executive Board on her travel to the Middle East and Europe, October 22–28, 2011.

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Ms. Shafik's Report to the Executive Board on Her Travel to the Middle East and Europe

October 22-28, 2011

1. On October 22, 2011, I participated in the Gulf Cooperation Council (GCC) Joint Meeting of the Committee of Financial and Economic Cooperation and the Committee of Governors of Central Banks in Abu Dhabi.[1]

2. In my intervention, I focused on the implications of global economic developments for the GCC region and ways to enhance our collaboration. As for the impact of global economic developments on the GCC, I noted the important role that the GCC countries played in helping stabilize global oil markets, particularly the increase in GCC oil production in response to the disruptions in supply from Libya earlier this year. I also noted that the GCC economies were indeed in a strong position to face a worsening in global economic and financial conditions, although this did not make them immune to spillovers. Oil prices have already declined and could fall further. Moreover, greater risk aversion could raise borrowing costs for firms and make funding more difficult, posing potential new policy challenges. I emphasized the need for policies to balance short-term support with longer-term sustainability—a somewhat similar situation to that faced by advanced economies, notwithstanding very different initial conditions. I also emphasized the need for GCC member countries to continue to strengthen the foundations of sustainable, strong long-term growth in the non-hydrocarbon economy, which would help create jobs and alternative sources of income.

3. In general, country authorities noted that their strong economic position and sound banking systems provided considerable assurances for managing spillovers from a worsening of global conditions, most notably from Europe. Staff undertook a request from the authorities for Fund staff to prepare a study on the lessons of the European crisis for GCC countries, in particular with regard to fiscal frameworks.

4. As for enhancing the GCC-IMF collaboration, my remarks focused on the importance of working together to support those countries in the wider region that are going through major economic and social change. In addition to direct financial assistance from GCC countries, deepening existing trade agreements to improve market access for MENA's exports would be an important contribution. I also noted that the IMF stood ready to form partnerships to support this process. There was also a MENA-wide need for technical support on designing and implementing reform strategies, including on subsidies, equitable tax systems, and financial sector development. In this relation, I reiterated our readiness to assist both with technical advice and financial assistance, and called for the GCC financial support for the Middle East Regional Technical Assistance Center (METAC).

5. Participants noted that it was important that the IMF had learned the lessons from its past policy advice. I emphasized that we have taken many of these lessons to heart. In Fund

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[1] The GCC countries include Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, and the United Arab Emirates.

programs we were now assessing the impact of macroeconomic policies on the most vulnerable groups and are designing mitigating measures. We were also studying the macroeconomic links between growth and job creation to strengthen our understanding of inclusive growth. Participants also asked for Fund support in strengthening statistics and I informed them that we are planning with the Moroccan authorities a high-level conference for early next year to launch a concerted effort to improve statistics in the region. The conference's agenda includes the creation of "Arabstat", a regional statistical institution that would cover all Arab countries.

6. On October 23-24, I participated in the World Economic Forum (WEF) Special Meeting on Economic Growth and Job Creation in the Arab World in Jordan. The conference brought together hundreds of high ranking officials, business people, financial sector professionals, academics, youth leaders and media from the Middle East, Europe and the United States. My participation in the meeting was centered around three sessions covering employment and job creation in the region and how to strengthen trade in the MENA region. The visit to Jordan also provided me with the opportunity to meet the recently-appointed Minister of Finance Mr. Toukan and Central Bank of Jordan Governor Mr. Shahin.

7. During the WEF session on employment challenges, which was opened by H.M. Queen Rania Al Abdullah, participants were in general cautious on employment prospects due to the downside risks posed by the global economy but nonetheless hopeful due to the political progress in several countries in the region. I emphasized the importance of building a better climate for business and trade that will help create new jobs and improve growth in the region. In this regard, efforts to remove obstacles to job creation such as excessive regulation and to creating a stable economic environment were seen essential, including for youth employment.

8. There was recognition among participants that in the years leading up to the Arab Spring, there was an increasing sense that economic policies had not produced outcomes perceived as fair. There was agreement that to succeed, the region's economies would now need to focus on improving its economic governance, by strengthening public institutions, both fiscal and financial; modernizing regulatory institutions to improve the business climate and level the playing field for private sector participants. Improving the delivery, coverage and cost effectiveness of social protection; and enhancing the quality and dissemination of information and statistics were also seen important. In this regard, I emphasized the need to create more room in budgets by making costly subsidies more efficient—replacing them with well-targeted safety nets to protect the most vulnerable.

9. Participants also agreed that MENA countries have been trading far below their potential, owing to the restrictiveness of their trade policies, which in some of these countries are among the most restrictive in the world. Many countries in the region have tariffs almost twice the size of those in emerging Asia. And despite geographic proximity, countries such as Egypt, Jordan, Morocco, and Tunisia have lagged behind others in trade integration with Europe. These countries also face significant problems with access to European markets, which has resulted in weak export performance and sluggish growth. There were many calls

for greater opportunities for market access for MENA countries. These countries could also forge closer ties with new trade partners in the fast-growing emerging markets.

10. The WEF meeting also gave me the opportunity for considerable media outreach, as I also had a number of interviews with regional Arabic broadcasters and international outlets. The interviews focused primarily on the Fund's economic outlook for MENA, measures needed to address unemployment in the region, the fiscal policy strategies countries should adopt and the status of talks regarding a possible IMF supported program in Egypt. The WEF in Jordan was also the opportunity to post my first blog piece for the recently launched Arabic blog (http://blog-montada.imf.org/).

11. On October 26, I delivered a lecture at the London School of Economics titled *"The World Economy: How did we get here and where are we going?* The lecture was well attended by LSE officials, academics, students, and media representatives. My presentation was based on the Fund staff assessments provided in the context of the September 2011 WEO, the GFSR, and the recent G-20 surveillance note. In general, participants raised questions on a wide range of topics, including the G20 agenda, the financial transactions tax, reform issues in Europe, and implications for growth.

12. On October 27, I participated in conference entitled "*Iceland's Recovery—Lessons and Challenges,*" held in Reykjavik and jointly sponsored by the Icelandic government, the Central Bank of the Iceland, and the IMF. The conference brought together Icelandic academics, representatives of Iceland's civil society, prominent international academics and observers, and IMF staff and management. The conference was organized around four sessions (agenda attached): crisis management, the road to recovery, challenges ahead, and a wrap-up panel discussion. I participated in the panel discussion along with Icelandic academic Gylfi Zoega, the Governor of the Central Bank of Iceland, Simon Johnson, and Paul Krugman, and moderated by Martin Wolf. I also had bilateral meetings with the Prime Minister, Minister of Finance, Minister of Economic Affairs, and Central Bank Governor. I would like to thank Mr. Andersen and Mrs. Alfredsdottir for their participation in the conference. In addition to participating in the conference, I also gave an address on the world economic outlook and lessons for Iceland at the University of Iceland as part of its centennial celebration.

13. The conference involved a very lively and frank discussion on Iceland's crisis and recovery. There was broad agreement that the achievements under Iceland's Fund-supported program were very impressive, and that the Fund had played a key role in helping Iceland recover from crisis. The fact that Iceland managed its adjustment while maintaining its social safety net and actually improving income distribution was widely admired. Key program design issues—such as the use of capital controls—received widespread support from the international speakers but were questioned by some of the Icelandic speakers. Other main areas of discussion included household and corporate debt restructuring and Iceland's future exchange rate regime. On the former, there was consensus that this is a very difficult issue with no easy solutions. There was broad recognition that Iceland has put in place many measures to try to cope with high levels of household and corporate debt, although some

speakers called for even more debt write downs. On Iceland's future exchange rate regime, opinion among the speakers was divided as to whether Iceland should eventually join the euro or retain its own currency. However, in the wrap-up panel discussion, it was acknowledged that Iceland would face challenges regardless of its exchange rate regime.

14. The conference was very well attended, with some 350 participants, almost half from the public. Each session had a Q&A segment where members of the audience were given an opportunity to ask questions—this also helped ensure that a wide range of voices were heard. News coverage (mainly in Iceland) was excellent, with both media reports as well as many participants (including some of the Fund's critics) praising the openness of the debate and the variety of views expressed. This outcome reflects well on the Fund and, by consequence, on the program. In particular, the Fund came across as an institution that listens and learns. The effort to bring in outside economists and academics, as well as Icelandic voices who were critical of the program, paid off, as it helped put the program in a global perspective and ensured that a wide range of opinions were represented. In my view, this conference offers an excellent blueprint for an end-of-program exercise in countries where the achievements are significant and potentially of wider interest.