Global Challenges, Global Solutions: Some Remarks[1]

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Mr. Chairman

1. Recent experience suggests that globalization offers incredible opportunities but also poses immense challenges. If the years before the global financial crisis - the period of the so called 'Great Moderation' - demonstrated the benefits of globalization, the devastating toll of the crisis showed its costs. Just as in the case of an economy, there are price setters and price takers, in the international economy too, there are economies which shape the forces of globalization and those that have to shape their policies to adjust to those forces of globalization. The post-crisis reform effort - whether here at the IMF or at the other global fora such as the BCBS, FSB, WTO - is all aimed at managing the forces of globalization for maximizing our collective welfare. For these reforms to be sustainable, it is important that they are even handed as between those who shape the forces of globalization and those who have to adjust to the forces of globalization.

EMEs in the Global Context

2. Before I get to specific issues, let me make a brief comment on EMEs in the global context. The shift in the global balance of power in favour of EMEs is by

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[1] Lead intervention by Dr. Duvvuri Subbarao, Governor, Reserve Bank of India and Leader of the Indian Delegation, at the International Monetary and Financial Committee (IMFC), IMF, Washington D.C on April 16, 2011.

now a familiar story. It may be useful to put some numbers around that. Setting GDP at 100 in the base year of 2000, against the aggregate growth of 17 per cent in the decade 2000-10 of advanced economies, emerging market and developing countries (EMDCs) grew by 82 per cent and BRICs (Brazil, Russia, India, China) by a whopping 127 per cent. When we look at shares in global GDP, the share of advanced economies in the global GDP dropped from 80 per cent in the year 2000 to 67 per cent in 2010, with a mirror increase in the share of EMDCs.

3. 2010 was a year of recovery, and EMEs powered this by contributing to nearly three quarters of global growth in 2010. EMEs were also the motive force behind the estimated expansion of world trade by 12 per cent last year, an impressive reversal from shrinkage of 11 per cent in 2009.

4. These trends have an interesting implication for the decoupling hypothesis, which was intellectually fashionable before the crisis. As a matter of fact, the crisis failed to validate the decoupling hypothesis, as all EMEs were affected, admittedly to different extents. What the crisis, in fact, reinforced is that the economic prospects of advanced economies and EMEs are interlinked through trade, finance and confidence channels.

5. Let me now move on to specific issues. In the context of the theme of the session, I want to address five topics which are all interconnected.

Global Rebalancing

6. First is the issue of global rebalancing**.** Global rebalancing will require deficit economies to save more and consume less, while depending more on external demand relative to domestic demand for sustaining growth. Surplus economies will need to mirror these efforts - save less and spend more, and shift from external to domestic demand. The problem we have is that while the adjustment by deficit and surplus economies has to be symmetric, the incentives they face are asymmetric. Managing rebalancing will require a shared understanding on conducting macroeconomic policies to minimize disruptions to macroeconomic stability. These adjustments have several components. Importantly, letting exchange rates remain aligned with economic fundamentals, and an agreement that currency interventions should not be resorted to as an instrument of trade policy should be central to a coordinated approach at a multilateral level.

Capital Flows

7. That takes me to the second facet of global imbalances - return of lumpy and volatile capital flows. Since capital flows have become such an emotive topic around the world in recent months, it is important to be mindful of a few realities. First, EMEs do need capital flows to augment their investible resources, but such flows should meet two criteria: they should be stable; and they should also be roughly equal to the economy's absorptive capacity. The second reality that we must remember is that capital flows are triggered by both pull and push factors. The pull factors are the promising growth prospects of EMEs, their declining trend rates

of inflation, capital account liberalization, and improved governance. Among the push factors are the easy monetary policies of advanced economies which create the capital that flows into the EMEs.

8. To the extent that lumpy and volatile flows are a spillover from policy choices of advanced economies, managing capital flows should not be treated as an exclusive problem of emerging market economies. How this burden is to be shared raises both intellectual and practical challenges. The intellectual challenge is to build a better understanding of the forces driving capital flows, what type of policy instruments, including capital controls, work and in what situations. The practical challenge is the need to reach a shared understanding on an organizing framework for cross border spillovers of domestic policies in capital-originating countries, and the gamut of policy responses by capital receiving countries.

9. Managing capital flows involves two important things. First, we need to make a judgment on how important the externalities are. And, second, we need to make an objective assessment of what combinations of policies may be used to minimize their impact. Now that it is broadly accepted that there could be circumstances in which controls can be a legitimate component of the policy response to surges in capital flows, policymakers must have the flexibility, and discretion, to adopt macroeconomic, prudential and capital account management policies. Importantly, they should be able to do so without a sense of stigma attached to particular instruments.

Framework for the Adjustment Process

10. Let me now move on to the third issue which is the framework for the adjustment process to secure and preserve global financial stability. The adjustment process should ensure that individual actions of countries add up to a coherent path forward. I want to emphasise two aspects of this.

- First, the IMF's surveillance function is critical - it assumes a vital, pre-emptive role in preserving global and national stability. The forthcoming Triennial Surveillance Review provides an opportunity to take stock of the steps taken and to assess recent experience, including the adequacy of the legal framework for surveillance.

- Second, reserve accumulation has to be viewed in the context of economic growth and development. The insurance that reserves provide against sudden stops and reversals of capital flows far outweigh the opportunity costs of holding reserves. The experience of the crisis has amply demonstrated this. What constitutes an adequate level of reserves is a country-specific question, involving a judgment based on practical experience. Clearly, there can be no "one-approach-fits all" to such assessments.

Global Reserve Currency

11. My fourth point relates to a global reserve currency. The recent crisis has brought home the complex challenges arising from the world having a single

reserve currency. In the ongoing search for solutions, one option is to have a menu of alternative reserve currencies which fulfill the required criteria – full convertibility; the exchange rate determined by market fundamentals; a significant share in world trade; liquid, open and large financial markets in the currency issuing country; and also the policy credibility to inspire the confidence of potential investors. There is a debate on whether the SDR can be a reserve currency. For the SDR to take on this significant role, several prerequisites have to be in place, which are now well known and need no elaboration here. At the present time, the SDR does not satisfy these conditions. Thus, we see the move to a multicurrency world as a gradual evolution.

Protectionism

12. The last issue I want to raise concerns protectionism. Recent international developments mark an 'ironic reversal' in the fears about globalization. Previously, it was the EMEs which feared that integration into the world economy would lead to welfare loss at home. Those fears have now given way to apprehensions in advanced economies that globalization means losing jobs to cheap labour abroad.

13. There is concern in some quarters that even as open protectionism has been resisted relatively well during the current crisis, covert protectionism has been on the rise. The short point is that in the years ahead, the pressures for protectionism will mount, and protectionism will also take new forms. Global welfare will be maximized when collectively we resist short-term pressures, and put our collective long-term interest ahead of individual short-term advantage.

Global Cooperation

14. Mr. Chairman, the thrust of all that I have said is that global challenges demand global solutions. The need for global cooperation in solving our most pressing problems of today is vital. The crisis has taught us that no country can be an island, and that economic and financial disruptions anywhere can cause ripples, if not waves, everywhere. The crisis also taught us that given the deepening integration of countries into the global economic and financial system, uncoordinated responses will lead to worse outcomes for everyone. The global problems we are facing today are complex, and not amenable to easy solutions. Many of them require significant, and often painful adjustments at the national level; and in a world divided by nation-states, there is no natural constituency for the global economy. At the same time, the global crisis has shown that the global economy, as an entity, is more important than ever. The IMF is central to these reforms so that it continues to spearhead and weave together the fabric of international cooperation. This is in the common interest of all of us.