2010—A year of Transformation for the World and for Asia

An Address by Dominique Strauss-Kahn, Managing Director of the International Monetary Fund
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As Prepared for Delivery

Good morning. It is a great pleasure to speak at this plenary session of the Asia Financial Forum's annual meeting. I wish to thank the Hong Kong Trade and Development Council for inviting me to share my views on Asia's role in the new economic order.

Over the past decades, Asia has become a major player in the global economy. Today, Asia is leading the world in terms of economic recovery from the crisis. And over the coming decades, the region's continued dynamism will give it an even greater role.

As economic power grows, so too does Asia's interest in promoting the successful performance of the global economy. And as the region enhances its role in the global policy debate, I see great potential for the world to benefit from Asia's ideas and experience. We all have a lot to learn from Asia.

Speaking for the IMF, one of our priorities is to deepen and indeed renew our engagement with Asia. We recently established an advisory group of eminent persons from across the region. We are also seeking to strengthen our ties with regional groups, such as ASEAN and EMEAP. This July, the IMF and the Government of Korea will be co-hosting a high-level conference, focusing on the region's economic dynamism, and what I believe will be Asia's leadership role in the 21st century.

2010, of course, is going to be a crucial year—the first year after the crisis when countries can lift their eyes to the longer term-horizon. A year of transformation for the world.

And, I might add, a year of transformation for the IMF. To speed our ability to respond to crises, the Fund has changed a lot over the past two years—reforming lending instruments, streamlining conditionality, and improving governance. But we recognize that to serve our membership even more effectively, we must go further.

In broad terms, we are looking at a fundamental reform of our mandate; focusing more on systemic, not just country-level risks, especially in the financial sector; and on developing financing instruments that provide the kind of insurance needed to tackle modern crises.

I will not say more on this transformation of the IMF today, but promise that you will hear more about it in the year ahead.

Today, I want to touch on three issues.

First, to set the backdrop, I will present the IMF's view on the global economic outlook. Second, I will highlight some of the key priorities for building a stronger post-crisis global economy. And third, I will share my thoughts on how Asian leadership can help bring about the changes needed to secure a successful new economic order.

I. Global Economic Outlook

Beginning with the outlook, the global recovery appears to be stronger than previously anticipated. We expect growth in 2010 to exceed our previous projection of 3 percent—this will be updated later this month. That is the good news. I would emphasize, however, that the situation remains fragile and recovery is proceeding at different speeds in various regions.

In most advanced economies it is likely to be sluggish, and still dependent on government support. High unemployment, in particular, is a major concern—especially in Europe and the U.S. This is why policy support should be maintained until there are clear signs of a recovery in private demand and employment growth. Also, to tackle the jobs crisis, governments should shift part of their stimulus spending to support employment.

Turning to emerging market economies, the outlook is considerably better. As I said, the recovery is being led by Asia, thanks to the resilience of domestic demand, sound economic frameworks, and a swift policy response to the crisis. For the Asia region (excluding Japan), growth is likely to exceed 7 percent this year (which was our forecast last October).

This means that many emerging market economies will be able to exit from crisis support measures sooner than the advanced economies—with monetary tightening generally preceding fiscal tightening.

The differing speeds in economic recovery have been reflected in the performance of financial markets. As you know, there has been a resurgence in capital flows to emerging markets, with Asia receiving a large part. These flows appear to be driven primarily by fundamentals, reflecting the favorable outlook for these economies. Expectations of future currency appreciation are also playing a role.

The return of capital to emerging markets is generally a positive development. Let us not forget that as the crisis unfolded, there was tremendous concern that these flows would cease altogether, or even reverse. Understandably, however, policymakers in recipient countries are concerned now with how to manage these flows—their impact on exchange rates, domestic demand, financial stability—and the danger of asset bubbles.

What tools can policymakers use to respond to surges in capital flows? In many countries, exchange rate appreciation should be the key response—especially in those where the exchange rate is undervalued based on medium-term considerations. Other policies include lowering interest rates, accumulating reserves, tightening fiscal policy and prudential policies in the financial sector. Capital controls can also play a role, particularly where the surge in capital flows is expected to be temporary, or where exchange rate overshooting is a real danger. The right policy mix, of course, depends on each country's circumstances. I see this as a pragmatic issue.

II. Building a Stronger Global Economy

Turning to my second issue—building a stronger global economy—let me begin with financial sector reform.

A. Financial sector reform

In Asia, banking systems have on the whole proved resilient. But worldwide, progress in this area is critical for building a global economy that is less prone to crises in the future.

The lessons of this crisis are clear: regulation and supervision must be stronger—and smarter. Closer scrutiny of financial firms is needed at the institutional level. We also need significantly better monitoring and management of systemic risks.

Already we have seen good progress in devising proposals for how to reform the financial sector. But I see two major problems for achieving lasting reform. First, as financial markets and economies recover, there is a real danger that political momentum for reform is lost. Second, the financial sector itself seems to be going back to business as usual.

This must not be allowed to happen. We cannot return to the financial system of yesterday.

An important question is who should bear the costs imposed by the financial sector's more risky activities. One thing is clear: we must move away from a system that privatizes the gains and socializes the losses.

As you may be aware, the G-20 has asked the IMF to look into this issue. Our work is being guided by two objectives. First, how can we make the financial system safer, so that it poses less systemic risk? And second, what can be done to reduce the financial burden on taxpayers of a financial crisis?

In this context, we are looking at a range of options—including financial sector taxes, as well the formation of resolution funds, and the possibility of capital charges. We have not ruled anything out. We will present our initial analysis at our Spring Meetings in April.

B. New sources of growth

Looking ahead, as you in Asia are so good at doing, new sources of growth are needed in most of the world's economies to ensure a robust global economy. What does this mean?

First and foremost, strong growth must be restored. This will require a rekindling of private demand. In many countries, structural reforms will be needed. In particular, labor and product market reforms can boost productivity, and speed the transition. Efforts to boost the "green" economy can also support this restructuring effort.

A second goal is for growth to be sustainable. That is, to restore and sustain private demand, both consumption and investment will be needed. For sure, this will require dealing with pending fiscal challenges.

Third, global growth should be balanced. For this to happen, economic policies must be consistent with healthy external positions. This means maintaining sound fiscal, monetary, and exchange rate policies, and also avoiding domestic market distortions.

To achieve this, all countries will need to play their part.

Countries that have traditionally run large current account deficits recognize that they need to raise saving—often both private and public—and boost productivity. In the United States, for example, this is beginning to happen, with the household saving rate already up sharply since the start of the crisis, to about 5 percent in 2009. It could rise even higher.

Countries that have traditionally run large current account surpluses and relied heavily on export-led growth recognize that new growth drivers, in their own countries, will need to be found. In China, for example, the government is taking steps to boost private consumption.

These major shifts in growth patterns will not be easily achieved—and certainly not overnight. But if we can move in this direction in the coming year, we can have a "win-win" situation, with more sustainable global growth for all.

C. Stronger International Policy Collaboration

For this economic transformation to be successful, international policy collaboration will need to be more effective.

The recent experience in dealing with the crisis gives cause for hope. The nations of the world pulled together to respond to a profound economic—and potentially human—calamity. Governments worked together on many fronts—undertaking concerted and significant monetary easing; implementing large fiscal stimulus, where possible; and shoring up ailing financial sectors.

This spirit of cooperation has produced a much strengthened framework of international collaboration. The G-20—in which Asia is playing a major role—has emerged as a key forum for the world's major economies to discuss policy priorities. These priorities have then been taken forward to the IMF, where its 186 members have provided the broad-based international endorsement needed to make them truly global in spirit and in commitment.

So—much has already been achieved in terms of strengthening the international policy dialogue. But we can—and must—do even more.

The G-20's new Mutual Assessment Framework is an important step. Through this process, the world's largest economies will be accountable—to each other—for adopting the policies needed to ensure strong, stable and sustainable growth over the medium term.

The IMF is providing analytical support for this innovative approach to multilateral cooperation. And I believe that this new framework can be one of the keys to the transformation of the global economy in 2010 and beyond.

Let me also add here one other issue that is of immense importance to the long-term welfare of us all—the tackling of climate change. A major challenge emerging from last month's meeting in Copenhagen is how the large amounts of resources needed to finance adaptation and mitigation efforts will be financed. This is a very complex subject that will require the highest level of international collaboration. The IMF will do everything in its power to contribute to a solution.

III. Asia's Role in the New Economic Order

My final—and most important—topic today is Asia's role in the new economic order.

The transformation that has taken place in Asia over the last decade has been truly remarkable. Rapid growth has raised the region's share in the global economy to a third, and has allowed hundreds of millions to escape poverty. The strength of Asia's economies has helped them weather the recent crisis and lead the world into recovery. Continued strong growth has the potential to lift a billion people out of poverty and into the global economy.

To sustain this performance, Asia—like the rest of the world—will need to adapt to new challenges presented by the post-crisis economy.

From my conversations with Asian leaders, I can tell that this imperative is widely recognized. They are moving rapidly to identify the key elements of a new model that can deliver sustained economic growth. In particular, they realize that because there are limits to the pace of export growth, domestic and regional demand will need to play an increasingly important role in underpinning Asia's growth.

This does not mean that Asia should become inward looking. Rather, it means reinvigorating domestic demand and boosting intraregional trade. Such a recalibration of Asia's growth model is in the region's self-interest, since it would reduce the region's dependence on demand from outside Asia. As I indicated previously, it is also in the global interest.

What should this recalibration look like?

In many Asian economies, stepping up public investment is an important part of the solution. Asia has significant long-term development needs, including in infrastructure and education.

Investment in low-carbon, or "green" growth would also be useful. Technological innovation is key to managing climate change at a reasonable cost. And innovation in Asia is already making major contributions.

And as I already noted earlier, in China a shift towards stronger private consumption will be essential for developing new sources of growth.

The region's long-term success will also depend critically on the active participation of Asian nations in international efforts to build a stronger global economy. As Asia's economies have risen in global stature, so too has their voice on the international stage—and their responsibility to help find solutions to global policy challenges. As I mentioned, Asia is represented at the G-20 by six countries. And as you know, Asia will host the G-20 Leaders Summit in November.

At the IMF too, Asia's role is rising. As our governance reforms proceed, Asia's economic voice—reflected in its quota at the IMF—is being brought more into line with its weight in the global economy.

Now is the time for Asia to use its stronger voice to contribute even more to the shaping of the post-crisis global economic landscape. Potentially, this is a historic moment for Asia. A moment of transformation.

IV. Concluding Remarks

Let me conclude by setting in context the challenges facing the world in the coming period:

2008 was a year of humility: our confidence in markets, institutions, and the status quo turned out to be complacency; we learned how fallible, fragile, and interconnected we are.

2009 was a year of unity: the world pulled together to collaborate and redeem the promise of international cooperation.

2010 must be a year of transformation—we must complete the global project to address the failings in regulation, economic policy, and governance that lay behind the crisis.

The challenges are great. But the rewards are even greater. And Asia has a crucial role to play. Working together, I am confident that we will find the way to secure economic success—for Asia, and for the world.

Thank you.

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