



International Monetary and Financial Committee

Sixteenth Meeting
October 20, 2007

Statement by Didier Reynders

Deputy Prime Minister and Minister of Finance, Belgium

On behalf of Austria, Belarus, Belgium, Czech Republic, Hungary, Kazakhstan, Luxembourg,
Slovak Republic, Slovenia, Turkey

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At the 16th International Monetary and Financial Committee
Washington, October 20, 2007

The countries of our constituency pay tribute to Mr. de Rato for his accomplishments as Managing Director of the International Monetary Fund. We congratulate Mr. Strauss-Kahn on his appointment as Managing Director and look forward to working with him.

The Global Economy and Financial Markets

The performance of the world economy remains outstanding on most accounts. However, there is a risk that the stretch of five years of unprecedented, continued high growth could end in the near future. Indeed, the past few months have been a difficult period for financial stability, as uncertainties about the size and allocation of losses related to subprime mortgage and possibly other types of credit caused a significant squeeze of liquidity.

Major central banks have taken prompt and justified action by providing the liquidity needed to preserve the functioning of critical financial markets and payment systems. Their actions have protected financial systems and economies from serious damage without assuming responsibility for the decisions of investors. However, the vulnerabilities of highly integrated markets in which risks are transferred with increasingly complex financial structures, must be carefully reviewed. Country authorities and managers of financial institutions must draw lessons from the recent turmoil. This requires close international cooperation in which the Fund should assume a critical role.

A number of preliminary lessons and conclusions should be further examined, including proposals for updating prudential regulations and supervisory practices. Incentives for maintaining responsible credit standards should be preserved and strengthened. Transparency about risk exposures should be adequate in order to facilitate correct pricing and preserving market liquidity. The methodologies for assessing credit and other risks in connection with new complex financial instruments should be well explained and understood. Prudential supervisors and risk managers of financial institutions should be well aware of the reputational risks related to innovative financial structures, used for transferring risks outside the balance sheets of banks, particularly if such credits and derivatives continue to be marketed and serviced by the originating banks. Finally, non-standardized complex financial transactions and structures which lack transparency have

proven to run considerable liquidity risks. These risks must be more properly monitored and managed.

How severely the financial sector difficulties will affect the real economies will depend on several factors. One is the room available for central banks to lower interest rates, or to postpone interest rate increases, without damaging the inflation outlook. Also, a significant impairment of bank capital, resulting in a credit crunch, could significantly weaken output growth, particularly in countries where enterprises rely heavily on bank credit. However, most banks are well capitalized and able to write down impaired mortgages and other loans to their true value. This preserves their capacity to provide credit.

The last half-decade has seen the strongest and most broad-based span of global growth since the 1960s. As the Fund's economic Counsellor rightly observed, this success is the result of both good fortune and good design.

In most emerging market countries, substantial institutional reforms have significantly improved the investment climate, while successful monetary and fiscal policies have greatly enhanced stability and overall creditworthiness. Significant capital inflows to these countries have contributed to economic buoyancy.

It is particularly encouraging to observe that the recent turbulence in advanced countries' financial markets has so far only mildly affected emerging market economies, in sharp contrast with experiences during previous decades. However, the IMFC should call on countries to prepare their economies to be resilient in the face of unavoidable reversals of capital flows and other adverse shocks.

Sustaining successful economic performance in emerging market economies is one of the greatest challenges in the period ahead, and indeed for the world economy. The Fund is justified in projecting continued high growth in the emerging market economies, led by China and India. However, successfully managing large capital flows to these economies, containing inflationary pressures, and above all rebalancing their growth patterns will require timely policy actions. Being cautious with fiscal spending in times of buyout capital inflows will help moderate upward pressures on the exchange rate and will prove right to sustain growth when capital inflows decline or reverse. In order to be successful at the global level, it is imperative that the likely slowdown in the U.S. economy is offset, not only by sustained growth in Europe and Japan, but foremost by a significant rebalancing of output towards domestic demand in China and other surplus emerging market economies. These goals could be advanced if the Renminbi's exchange rate would more accurately reflect China's vast and growing current account surplus.

The commitments undertaken by the major economic entities in the world during the Fund's multilateral consultation on global imbalances remain valid and should be implemented.

The economic policies of the European Union remain oriented toward long-term sustainability of public finances and conditions that stimulate investment and employment in a knowledge-based economy. These tasks can be successfully implemented, particularly if pushed forward during economic upswings when employment growth makes welfare reform more easily accepted. The statement of the European Presidency provides a fuller account of progress with the implementation of our economic policy strategy in Europe.

Robust productivity growth and successful trade and financial integration underpin the rapid economic convergence of the Central European countries of our constituency with the rest of the European Union. Hungary in particular, is implementing successfully an ambitious program of fiscal adjustment supported by structural reforms. Continued strong international competitiveness will ensure that current account deficits can be prudently financed while enhancing the output capacities of these economies. The authorities are vigilant about the risks of overheating caused by rapid credit expansion. They recognize the importance of prudent macroeconomic policies, vigilant bank supervision and structural reforms that improve economic flexibility.

Turkey's economic performance remained strong. The economy grew by 6 percent last year. Annual average growth rate was 7.4 percent during the last five years, making Turkey one of the fastest growing economies in the world. Public net debt fell to 45 percent of GNP in 2006. The current account deficit is stabilizing and FDI inflows remain robust. Strengthened economic fundamentals helped Turkey to weather well the most recent turmoil in global financial markets. Prudent policy implementation and commitment to a structural reform agenda should further enhance the growth potential of the economy and provide the necessary buffer against any adverse shocks.

Sub-Saharan Africa has been enjoying its best period of sustained growth since independence. Improved consistent macroeconomic policies, trade integration and debt relief have enabled Sub-Saharan Africa to attract and benefit from private capital inflows. Policy makers should take full advantage of the recent economic momentum by continuing to implement institutional and governance reforms. This will create an attractive economic environment for domestic and foreign investment. Continued donor assistance must help cover the large financial needs of growth-promoting policies.

I would like to close my remarks on the world economy by calling attention to the effects of globalization on labor and growing inequalities. Research by the Fund shows that, rather than trade, it is technological development that is the main factor behind growing inequalities that can be observed in both advanced and developing countries. Trade integration and widespread access to technological advancement have helped tremendously in raising living standards in general. We policy makers should ensure that as many people as possible can participate in the opportunities provided by technological progress and globalization. To this end, better access to high quality education and affordable healthcare should be imperative policy objectives in all countries.

Governance of the Fund

We welcome the work by the Managing Director, the Board and the staff on the quota and voice reform. This work should include all members.

The Board should agree on a balanced quota formula, consistent with the Fund's mandate and which can be applied to all members.

We support a formula that gives a higher calculated quota to the most dynamic economies, many of which are emerging and transition economies. Consistent with the economic developments since the last general quota increase, this should result in higher calculated quotas for the group of emerging market economies which includes the transition countries.

A number of countries in this constituency agree that their calculated quota will decline. However, this could only be acceptable if this decline benefits the group of developing and emerging economies. Therefore, increasing the weight of GDP in the quota formula should be accompanied by a significant degree of compression. GDP in PPP terms could be helpful in increasing the quota share of a number of countries. This approach requires a thorough examination.

Openness of the economy is the variable that best reflects the Fund's core mandate. Therefore, it should get a large weight. As the Fund is a country-based institution, intra-currency union trade should not be excluded from the data that reflect a member's trade. Variability of current receipts is one important indicator of potential needs for Fund resources. Further work is needed on PPP and financial openness data.

All the countries in our constituency confirm their commitment to implement all elements of the Singapore Resolution, including at least a doubling of basic votes. However, simultaneous progress should be made on the income position of the Fund. Amendments to the Articles of Agreement should be submitted to the parliaments on both subjects at the same time.

The Financing of the Fund

The Fund and the membership should adopt expeditiously decisions to make the Fund's income more stable, predictable and sufficient to cover the Fund's expenditures and build up prudent levels of precautionary reserves. The income model should be flexible enough to allow for proper functioning of the Fund under future, not yet known circumstances.

We welcome the work done by the staff to elaborate and complement the proposals made by the Committee of Eminent Persons on Sustainable Financing. It is appropriate to involve the whole membership in the financing of the Fund and to rely on diverse sources of revenue. The burden sharing mechanism should also be reviewed.

In the light of the Fund's projected financing gap, both income and expenditures should be addressed. The Fund must limit its expenditures to what is necessary to implement its tasks in a most efficient way. Therefore, we welcome the enhanced budget discipline of the Fund. We urge the Fund to become fully transparent about the full cost of each of its activities, including technical assistance.

Surveillance

We commend the staff, management and the board for all the work done to update the 1977 Surveillance decision in light of the significant developments in the global economy and the best practices of Fund surveillance. The new Decision makes Fund surveillance more transparent. The strengthened focus on external stability in the decision should neither fundamentally change the way surveillance is conducted now, nor lead to an unduly stringent and rigid surveillance framework. The Board should ensure that the new decision is applied evenhandedly for all countries, large or small, whether they have a fixed or flexible exchange rate regime.

We invite the Board to work in the same way on a framework for regional and multilateral surveillance.

Oil exporters and Asian countries with large current account surpluses have sovereign wealth funds with ever larger amounts of assets under management. Transparency of these state-owned funds would help evaluate their effects on financial markets. Understanding their investment strategies should be part of the Fund's surveillance.

We look forward to the review of the first streamlined Article IV consultations. The Board should work on the modalities and the list of countries for which these consultations are appropriate and ensure that the quality and effectiveness of surveillance remains high. We also look forward to the Statement of Surveillance Priorities to be adopted by the Board when concluding the next Triennial Surveillance Review.

Fund's Role in Emerging Market Countries

The Fund should continue to provide prompt meaningful financial assistance to countries that need and deserve it. We invite the Board to conclude its discussions on a possible new liquidity instrument. The need for creating a new facility should be examined in light of a thorough review of the structure of the IMF's existing facilities and with a view to enhancing the signaling role of the Fund.

As requested by the IMFC at its last meeting, the Board should conclude its review of charges for Fund financial assistance and its maturities structure and review the Fund's "lending into arrears policy".

The Fund's Role in Low-Income Countries

A clear division of labor between international financial institutions is essential. The World Bank should remain the principle international financial institution responsible for long-term development issues. While the IMF's prime responsibilities lie within the field of macroeconomic policy advice, there is still a clear financing role for the Fund in low-income countries.

The Fund should continue working with the authorities of low-income countries to design and implement strong macroeconomic policies and strengthen economic governance. This will enhance the ability of low-income countries to use donor resources effectively, attract investments and foster sustainable growth and help reduce poverty. We welcome the work done by the Fund in designing policies to use effectively increased amounts of aid, as agreed at the Monterrey Consensus.

Improving revenue collection and strengthening public expenditures and debt management remain challenges for the fiscal sustainability in low income countries. We welcome the progress made in implementation of the HIPC and MDR initiatives. It is important that both borrowers and creditors, including emerging lenders, adhere to prudent borrowing and lending policies in line with the Fund/Bank debt sustainability framework.