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Statement by Henry M. Paulson, Jr.
Secretary of the Treasury, United States
On behalf of United States

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

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CONTACT Ann Marie Hauser, (202) 622-2960

STATEMENT BY U.S. TREASURY SECRETARY HENRY M. PAULSON, JR. AT THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE MEETING

WASHINGTON, D.C. – I welcome the opportunity to discuss global economic and financial developments and IMF reform this morning. Let me take this opportunity to thank Rodrigo de Rato for his able leadership of the IMF, for the reform accomplished during his tenure and the groundwork laid for additional reform. I look forward to working with Dominique Strauss-Kahn, as he takes on this role. Let me also welcome my highly talented and experienced colleague, Tommaso Padoa-Schioppa, as our new IMFC Chair.

The World Economy

Today's meeting takes place against the backdrop of continued strength in the global economy, though downside risks have increased following recent financial turbulence. Real global GDP growth is expected once again to be near 5% this year and next, with emerging markets providing well over half of that growth. In addition, there has been some progress toward strengthening domestic demand abroad on a sustainable basis, which should help maintain forward growth momentum. Nonetheless, recent stress in financial markets is a reminder to all of us that continued vigilance is required.

Recent credit market events will impose some penalty on US economic growth, but I expect continued growth. Our financial institutions are in a strong financial position, and our economic fundamentals are healthy: low unemployment, rising real wages, and strong global growth is boosting U.S. exports. We have made considerable progress in reducing the federal deficit in the past few years. Our fiscal year just ended with a budget deficit of 1.2% of GDP. This is half the U.S. 40-year average, with growth of expenditures being at a 10-year low. The FY2007 deficit was down to 1.2% of GDP compared to 1.9% last year and 3.6% in FY2004. Key to the strength of the U.S. economy is our commitment to open trade and investment, as President Bush underscored in his public statement on open economies this past May.

Our financial markets are working through a reassessment and repricing of risk. In some sectors, this reassessment has played out more quickly, liquidity has returned and markets are operating more normally. In other sectors that are characterized by more complex securities or that rely more heavily on securitization and ratings, conditions are improving, but adjustment will take longer to play out.

Fortunately, the global economy's underlying strengths should limit the negative effects that the turmoil might have on global real economic activity. We need to learn from these events, and take steps to address the policy issues that arise. We welcome the work of the Financial Stability Forum on these issues, and the participation of the IMF in this work.

In recent years, we have witnessed a remarkable rise in cross-border official assets, coupled with projections of continued rapid accumulation. This appears to represent a significant structural shift in the international financial system, where free market economies are fundamentally based on private sector allocation of resources to their most efficient uses. The increase in size and number of sovereign wealth funds (SWFs), in particular, has received increasing attention due to their potential implications for financial markets and investment. Our fundamental premise is that open financial markets and investment policies are beneficial to our well-being and SWFs, first and foremost, should be seen in this light. That said, the growing importance of SWFs merits cautious, well-considered public policy responses. The United States believes a multilateral approach to SWFs that maintains open investment policies is in the best interest of countries that have these funds, and countries in which they invest. The IMF is uniquely positioned to identify best practices for SWFs, building on the existing Guidelines for Foreign Exchange Reserve Management. Best practices would provide multilateral guidance to new funds on how to make sound decisions on how to structure themselves, mitigate any potential systemic risk, and help demonstrate to critics that SWFs can be constructive, responsible participants in the international financial system. Recipient countries of SWF investment also have a responsibility to maintain openness to investment and should work through the OECD to develop best practices for inward government-controlled investment. Last night's G7 outreach dinner with countries that have sovereign wealth funds was an important initial step in the process of developing consensus and collaboration around this important issue.

The successful conclusion of the Doha Round of trade talks is both more difficult and more important, as global growth slows and protectionist sentiments resurface. At this critical juncture, major trading nations, both developed and developing, need to step up and lower barriers to trade to ensure a successful Doha Round in order to sustain the future growth of global incomes. As finance ministers, we have a special responsibility to ensure that the benefits of greater openness in financial services are fully appreciated.

IMF Reform Agenda

The IMF is an essential institution for global monetary cooperation, and we place a high priority on supporting meaningful IMF reform in order to maintain its credibility and relevance in the rapidly changing global economy.

Firm surveillance over exchange rates is at the very core of the IMF's responsibilities in the international monetary system. The June 2007 revision of the 1977 Decision on Surveillance over Exchange Rate Policies was an extremely important achievement, but rigorous implementation is essential. The IMF's ability to carry out this priority function will define its relevance in the global economy in the years to come. Discussion of exchange regimes and rates, and the spillover effects of members' economic policies on other members, is the one area over which the Fund can claim a unique purview, which it should not sacrifice by failing to meet its own responsibility for surveillance.

The IMF's governance structure needs **fundamental** reform to reflect the realities of the evolving global economy. Quotas must be adjusted significantly to give greater weight to dynamic emerging market economies, while protecting the voice of the poorest countries. We repeat our commitment to forgo the additional quota we would receive in the second stage increase beyond what we need to maintain our pre-Singapore voting share. I call on all members to reenergize their work to forge a consensus on a strong quota reform package in order to bolster the legitimacy and relevance of the Fund and to keep members from drifting away from this critical global institution.

With a structural decline in IMF lending, the IMF's finances have become unsustainable. There has been much attention to possible new income sources and the Crockett Committee has made a constructive contribution. However, an equally important part of the solution must be to seriously reduce spending by re-aligning staff and expenditures to focus on the IMF's core mission. It is time to roll up our sleeves on the expenditure side. A plan for the swift reform of the Fund's expenditure and staffing must be an early priority for the incoming Managing Director. Alongside a concrete work plan for consolidation, we will work on longer-term sources of income for the IMF.

The IMF has an important role to play in low-income countries, providing policy advice and technical assistance in its core areas of expertise, and balance of payments financing, when needed. We welcome the IMF's efforts to re-focus its engagement with low-income countries on addressing the macroeconomic impacts of scaled up aid, but caution against the IMF's over-reaching on longer-term development issues better suited to the multilateral development banks. The IMF's main role with respect to the millennium development goals must be to help countries maintain macroeconomic stability and debt sustainability, and accelerate growth through appropriate macroeconomic frameworks. To this end, vigilant application of the Debt Sustainability Framework and renewed emphasis on the importance of responsible borrowing and lending decisions must be a cornerstone of the IMF's work in low-income countries.

We believe a clear division of labor between the IMF and World Bank, in terms of areas of policy focus and respective financing roles, will serve to strengthen the work of both institutions. We therefore welcome continued follow-up on the recommendations of the Malan Report on Bank-Fund Collaboration.

Other Key Issues

We must continue to apply robust efforts to combat illicit money flows to safeguard the financial system from abuse, support development and economic growth, and protect citizens worldwide. By implementing the Financial Action Task Force's (FATF's) international standards on money laundering and terrorist financing, countries worldwide can help make the global financial system an inhospitable venue for terrorists, proliferators, narcotics traffickers, and other rogue actors. FATF's close cooperation with the IMF and World Bank has been vital to these continued efforts, and we applaud their sustained commitment.

Moving forward, we urge FATF to continue its ongoing work to examine the risks of WMD proliferation finance, and its efforts to identify and engage intensely with jurisdictions that have failed to implement international standards. Further, we call on all countries to fulfill their UN obligations by implementing UN Security Council Resolutions 1540, 1718, 1737, and 1747 against WMD proliferation, particularly the economic and financial provisions of those resolutions. Continued vigilance by both the public sector and the private sector is vital to combating abuse of the international financial system by those who are pursuing weapons of mass destruction and their delivery systems in defiance of the international community.

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