International Monetary and Financial Committee

Twenty-Second Meeting
October 9, 2010

Statement by Didier Reynders

On behalf of EU Council of Economic and Finance Ministers

Statement by Mr. Didier REYNDERS, Minister of Finance
in his capacity as Chairman of the EU Council of Economic and Finance Ministers,
at the IMFC Annual Meeting, Washington, D.C., October 9, 2010

1. I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses notably on the world economy, in particular the outlook and policies for the EU, and on IMF policy issues.

Economic Situation and Outlook

2. The global economy recovered by more than expected in the first half of 2010, led by strong growth in emerging market economies, particularly in Asia. It is set to moderate somewhat in the second half of the year, following the expected weaker support from inventory building going forward and the phasing out of stimulus measures in most countries. Private engines of growth should gradually kick in, but in contrast to developments in emerging market economies, the underlying momentum in many advanced economies remains soft. The positive signs we have witnessed in the first half of 2010 are encouraging though, particularly as in the EU private demand has started to lend support to growth and to add to the positive impact of the rebound in world trade. Nevertheless, in other developed countries the outlook for consumption remains uncertain.

3. Major challenges remain in place. Unemployment remains at very high rates in many countries, and weighs on the prospects for solid private consumption growth. Priority should be given to mitigating the negative consequences of the recession in an appropriately co-ordinated way. In this respect, the focus should be on tackling the high levels of unemployment by providing all the necessary support to lift economic growth and the growth potential through structural reforms, while, at the same time, achieving fiscal sustainability in a credible and growth-friendly way.

4. The current increase in public debt levels generates major risks and considerable uncertainty about the economic recovery by triggering market concerns, weighing on the growth capacity of the economies and making the already daunting challenge of ageing tougher to manage. These challenges are common to many economies.

5. The resurfacing of global imbalances, a major medium-term challenge for global macro-economic and financial stability, weighs on the outlook. Global imbalances narrowed considerably during the crisis but remain large and are widening again. This issue is part and parcel of the G20 Framework for Strong, Sustainable and Balanced Growth. All the major economies should do their part, otherwise previous efforts risk being erased by possible future crises.

6. Nervousness persists in the global financial markets, on the back of uncertainties regarding the strength and sustainability of the economic recovery. This reflects the need for tackling two dimensions of the crisis, both the lasting consequences of the damage in the financial sector and the longer-term fiscal implications inflicted on the economies.

Policy Developments

7. Since the Spring Meetings, the EU has taken determined action to safeguard financial stability and has put in place additional mechanisms that are at hand to address crises when they occur. The EU has set up the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF) to provide emergency funding backstop should a euro area Member State find itself in financial difficulties.

8. While the EU framework for budgetary surveillance has generally led to results which overall compare relatively favourably on a global scale, the crisis demonstrated the need to strengthen and complement the existing framework to ensure fiscal sustainability. Moreover, a formal framework to address macroeconomic imbalances in the euro area is needed. The surveillance of economic and budgetary risks and the instruments for prevention, in particular the excessive deficit procedure, will be strengthened so as to attain sustainable progress. In the medium term, an appropriate framework for crisis resolution is needed. A task force has been set up to reform the governance of the euro area and the EU. The task force is making good progress and will soon report on the central elements of the governance reform.

9. To address vulnerabilities in the current financial system, the EU is pursuing financial market reforms, which will improve both macro- and micro-prudential oversight.

a) Macroeconomic and structural policies

10. Fiscal prudence is important, not only to address the significant long-term challenge of ageing, but also in light of the existing market concerns. Ambitious fiscal consolidation is required, taking into account the specificities of countries' situations, beyond the withdrawal of stimulus measures, in order to halt and eventually reverse debt accumulation and restore sound fiscal positions. Budgetary policies in the EU have helped to stabilise the sharp economic downturn at the height of the recent crisis. Under the coordinating umbrella of the European Economic Recovery Plan, several Member States have not prevented automatic stabilisers from playing their role and implemented targeted discretionary measures. Although the aggregate fiscal stance in the EU remains supportive in 2010, many countries have accelerated the implementation of their consolidation plans to curb market concerns and to reduce uncertainty. Consolidation should be growth-friendly and combined with the implementation of structural reforms aiming at increasing potential growth.

11. The Stability and Growth Pact remains the appropriate framework for coordinating fiscal policies and the ongoing excessive deficit procedures set clear guidelines for the fiscal consolidation requirements. The plans transmitted by Member States to the Commission reflect the principles agreed by the Council in autumn 2009 concerning differentiation across countries, timing, size and accompanying policies. Under these procedures, all Member States are committed to start consolidation in 2011 at the latest. In countries with particularly severe fiscal challenges, consolidation is already under way. The Commission has assessed the adequacy of the consolidation measures included in these consolidation plans. The first evaluation carried out last June has shown that the implementation of the fiscal exit strategy is largely on track. The key challenge ahead is to continue implementing measures to achieve

medium-term targets to follow the path towards fiscal sustainability and to strengthen the strategy's credibility.

12. As to intra-euro-area macroeconomic imbalances and competitiveness developments, the financial crisis has been speeding up adjustment of external imbalances of euro area Member States, though changes in relative prices have been limited so far. In the absence of significant price adjustments, the recent current-account rebalancing comes at high costs in terms of unemployment and subdued growth. Against this background a number of euro area Member States have taken significant measures to address macroeconomic and structural weaknesses though further significant reforms will be needed. Also, recent strength in key core economies has the potential to facilitate intra-area adjustment. Member states regularly review measures of fiscal and structural policies as to enhance the adjustment. Moreover, the design of a formal process to address macroeconomic and competitiveness imbalances is taking shape. Continuing to address the underlying causes of significant divergences in competitiveness developments in the euro area remains a matter of common concern.

13. Urgent and substantial progress in implementing structural reforms in goods, services, labour and financial markets, is crucial to increase the growth potential of the EU and its resilience to shocks. To that end, the "Europe 2020 strategy", which was finalised at the June European Council, goes beyond marginal adjustments to the existing Lisbon Strategy. Key elements of the strategy address the main bottlenecks to growth across the EU; it focuses on macroeconomic imbalances as well as structural reforms to product and labour markets, and strives to adopt ambitious R&D and innovation strategies. In previous years, structural reforms have had positive effects, especially in terms of supporting employment, and are helping to cushion the impact of the crisis. Improvements have been made in the Internal Market's regulatory framework and in reducing administrative burdens. In particular, the adoption of new EU legislation on services is a major step towards the deepening of the internal market and its full and timely implementation is urgent. Progress is also being made in enhancing the integration of European financial markets in the context of the Financial Services Action Plan. Firm implementation of the on-going reforms, as well as further reform efforts will be crucial in order to achieve higher rates of sustainable growth and employment creation in the long run and to cope with the challenges of globalisation and of ageing.

b) Financial market policies

14. The recent adoption (7 September) of the new supervisory framework is a major step, and it is expected to be in place in 2011. The first pillar, the European Systemic Risk Board (ESRB), will monitor and assess risks to the financial system and provide recommendations for action when necessary. The second pillar will comprise the European supervisory authorities for banking, insurance, and securities as well as the national supervisory authorities. The EU is working on several legislative proposals that will deal with capital requirements, liquidity buffers, compensation practices, accounting standards, and derivatives markets. It also seeks to strengthen the regulation of alternative investment funds and credit ratings agencies.

15. EU banks and policy makers continue to make progress with respect to financial market repair. This is crucial for this sector to contribute to the recovery. The banking system

is gradually proceeding with restructuring, consolidating its return to viability. The EU-wide stress test – published in July and conducted by the Committee of European Banking Supervisors (CEBS) in cooperation with the European Central Bank (ECB) and EU national supervisory authorities – was an important exercise that provided insights into the strength of EU banks. Results confirmed the overall resilience of the EU banking sector and provided a meaningful and consistent view of banks' exposures to sovereign debt – an essential component of the exercise in enhancing transparency. Although it is still too early to assess the full impact of the stress tests, the initial market reaction was largely positive and results appear to have driven encouraging developments in the interbank market where signs of easier access to financing seem to have emerged.

16. Furthermore, financial regulation and supervision reforms continue to be pursued within the EU and should be appropriately coordinated at the global level in order to maintain a level playing field. In particular, this applies to ongoing reforms of capital requirements regulation, accounting standards, the regulation of credit rating agencies, hedge funds, private equity and derivatives markets, and rules on compensation practices and non-transparent and non-cooperative jurisdictions. The EU and its global partners must ensure that interactions between various regulatory measures or differences in approach avoid distortions and do not provide opportunities for arbitrage.

c) Contributing to a more favourable international environment

17. Implementing the G20 commitments not to impose new trade and investment restrictions and not to create new subsidies to exports is essential. There is a need to re-affirm that it is in our mutual interest to support trade, and to avoid competitive devaluations and anticompetitive measures. The current exchange rate developments bode ill in this respect, as well as the lack of progress on the Doha Development Round. All types of protectionist measures should be rejected ("standstill commitment").

IMF Policy Issues

18. The realignment of quotas, the Fund's resources, mandate and lending framework and wider governance reforms are all important and interlinked issues which need to be addressed as part of the on-going IMF reform process. The reforms should be delivered together as a single, comprehensive package, within the same time frame. The reform process should be fully anchored within the relevant IMF bodies, and should engage all members of the IMF. Progress is urgent so as to improve the credibility and legitimacy of the Fund and to ensure that the IMF is fully capable of addressing in an effective way the new challenges posed to the global economy in the 21st century. EU members will continue to contribute constructively towards finding an agreement on the remaining open issues.

Quota reform

19. Almost all EU members have ratified the 2008 quota and voice reform. The 2008 reform should be put in place before the completion of the current reform.

20. The EU members support a substantial re-distribution of quotas reflecting the relative weights of the Fund's members in the world economy and their capacity to support the Fund's work, with all countries taking their fair share in the financing burden. The main objective of the quota review should be to reduce out-of-lineness by reducing over- and under-representation relative to calculated quota shares across the entire membership, with appropriate safeguards for the poorest members. The 2008 quota formula should serve as the sole basis to determine whether a country is over- or underrepresented. Although not perfect, the formula as it stands now appropriately reflects the mandate and purpose of the IMF, and a re-opening of the formula would dramatically endanger our capacity to conclude the quota review by end January 2011, at the latest.

21. Consistent with this objective, the current quota review should achieve a 5% to 6% shift of quota shares from over- to under-represented countries. We expect this shift to go primarily to the benefit of dynamic Emerging Market and Developing Countries (EMDCs). In this context, "dynamic" EMDCs should be those under-represented according to the formula and according to the PPP GDP criterion as suggested by the IMF.

22. To enhance the quality of the shift, both over-represented advanced countries and over-represented emerging market countries should make a contribution. In particular, all over-represented advanced countries should take their fair share in the realignment and not be exempted from contributing to the shift. The review should ensure that no country is more misaligned after the reform than it was before, and that no over-represented country becomes underrepresented as a result of the reform. Against this background, EU members reject the idea of "partial protection" and insist that underrepresented advanced countries should be treated equally and receive an increase in their quota shares, unless they volunteer to forego such an increase.

23. EU members emphasise that the shift should be based as much as possible on a selective quota increase, but also recognise that in the end some degree of ad-hoc allocations will be necessary to reach consensus. Ad hoc allocations should, as a rule, be based on the existing quota formula. Ad-hoc increases outside the formula can be considered but should be strictly limited to an "as needed" basis to deliver further realignment. The ad-hoc allocations should aim at resolving a limited set of country-specific issues such as the protection of the voting shares of low-income countries, cases of significant out-of-lineness, and to prevent over-represented countries from becoming underrepresented.

24. EU members support protection of the voting shares of Low Income Countries (LICs) in the IMF through an ad-hoc increase of quotas. The protection should be provided for individual countries within the group of LICs (as opposed to for the group as a whole). Regarding the determination of the list of poorest countries, EU members favour the PRGT-list, but are open to discuss alternative options.

The Fund's resources

25. The main determinant for the financial size of the IMF should be the IMF's long-term ability to meet member countries' balance of payments financing needs, while preserving the IMF's character as a quota based institution. A quota increase will be necessary to achieve a

reallocation of quotas, but this should not be the primary determinant for the IMF's financial size. This also means that issues related to quota realignment can be more appropriately handled through the quota allocation methodology. In order for the IMF to effectively discharge its functions in the future, we believe that the final compromise should include a substantial quota increase of up to a doubling.

26. Any quota increase will also have a bearing on the size of the New Arrangements to Borrow (NAB). An increase in the overall size of quotas should thus be accompanied, as agreed, by a rebalancing of the NAB and/or bilateral resources as necessary to ensure an appropriate overall size and balance between quota and borrowed IMF resources, so that the IMF will remain a quota-based institution and the NAB will continue to play its role as a back-stop to quota resources. EU members that are participating in the NAB have either already completed or are striving to complete the relevant ratification processes by the end of 2010.

Broader governance reforms

27. EU members insist on a single and comprehensive package of both quota and governance reforms. Broader governance reforms are required to ensure a well-functioning and efficient institution but are also important to enhance the legitimacy of the Fund. At the end of this reform process, EU members expect to see enhanced ministerial engagement, a representative and more effective Executive Board, adapted voting modalities and a more diverse staff and management of the IMF. With regard to ministerial involvement, we would propose having a strengthened and decision-making IMFC or an "International Monetary and Financial Board" (IMFB) selecting the IMF Managing Director and setting the strategic direction of the Fund in areas such as the establishment of general surveillance and lending policy, quota reviews, and the allocation and cancellation of SDRs. In addition, in order to strengthen IMF surveillance and traction, the IMFC/IMFB should regularly review the risks and policy actions related to the global economic and financial situation, including on how member countries follow-up on IMF policy advice. On issues that have financial repercussions for Fund members, the IMFC/IMFB should be responsible for adopting recommendations to the Board of Governors, which will take the final decision.

28. EU members support a clearer delineation of responsibilities between Governors and Ministers, the Executive Board and IMF management, as well as increasing accountability of the Executive Board and management. While conferring a decision making power in certain areas to the IMFC or IMFB, the reform should ensure that the Executive Board continues to be responsible for conducting the business of the Fund and for preparing decisions and recommendations of the IMFC or IMFB.

29. While reforms to enhance the effectiveness of the Executive Board are important, EU members believe that the current size of the Executive Board of 24 seats strikes the right balance between inclusiveness/legitimacy and an effective functioning of the Fund. For that reason, we do not support a reduction of the size of the IMF's Executive Board. A reduction in the number of chairs from 24 to 20 is unlikely to yield any efficiency gains. Such a move would reduce notably the variety of views of the Fund’s members, although the Fund's membership has increased substantially since the last update of the relevant articles of the

Articles of Agreement in 1978. It would even increase the influence and voice of large single chairs. Instead we call for amending the Articles of Agreement to provide for 24 chairs.

30. EU members are ready to play their part in giving Emerging Market and Developing Countries a higher profile in the IMF Executive Board to better reflect the evolving economic positions of countries in the world economy. We are thus prepared to take our fair share of the effort, assuming that other countries will also contribute to a balanced compromise on the IMF quota and governance reform package.

31. EU members consider it important to lower the thresholds required for special voting majorities (from 85 percent to for example 60 percent on the vote regarding the size of the IMF Executive Board). This would contribute to a more inclusive decision making process. We also welcome further work on double-majority voting on a limited range of IMF policy/regulatory issues provided it does not undermine the IMF's decision-making capacity.

32. A balanced distribution of IMF staff is desirable, in terms of geographical origin as well as professional and academic background. EU members encourage the IMF to make additional progress on staff diversity.

33. EU members are ready to participate in a move regarding the appointment of the Head of the International Financial Institutions (IFIs). The heads and senior leadership of all IFIs could be appointed through an open, transparent and merit-based process, irrespective of nationality and gender. This move should apply to all IFIs including the IMF and the World Bank. It can be expected that such a move would enhance the visibility of Emerging Market and Developing Countries.

Mandate – surveillance and lending framework

34. We have already made considerable progress in reviewing the Fund's mandate, including its surveillance and lending framework. An adequate mandate is an additional lever for the Fund to gain legitimacy and effectiveness and will strengthen its ability to facilitate prosperity and stability in the world economy and international monetary and financial system. In carrying out its work, EU members stress the need for the IMF to collaborate closely with other international institutions, including the World Bank and FSB.

35. EU members stress the importance of effective crisis prevention anchored in stability-oriented macroeconomic and financial policies supported by effective crisis prevention instruments. The IMF's first priority should continue to be crisis prevention by offering timely, high quality and relevant surveillance, policy advice and warnings to the country concerned and to the international community. We welcome the recent initiatives on modernizing surveillance and on integrating financial sector analysis more appropriately into IMF's surveillance work. This is crucial to contribute to the proper functioning of the global economy and to improve the implementation of the Fund’s mandate to help safeguard global monetary and financial stability.

36. Bilateral surveillance must continue to be one of the main pillars of the IMF's surveillance framework, but we also support a deepening and strengthening of the multilateral and regional aspects of surveillance. In addition, we see scope in strengthening

the engagement of the IMF with regional/country groups of policy makers, where appropriate, and see merit in a brief and focused stand-alone document that will piece together the main policy messages from the Fund's multilateral surveillance publications. This should allow for more consistency of the IMF's policy messages and serve as an input to the IMFC. Clear, well-communicated policy messages should in turn help focus the discussion of Ministers, contribute to the peer review process and improve traction. We furthermore emphasise that for the IMF to be effective in its surveillance, greater willingness by members to implement Fund's policy advice is required.

37. EU members consider that the recent improvements in the IMF's toolkit could potentially help to partially counteract the build-up of excessive reserves, which continue to be one of the main elements preventing the adjustment of global imbalances. At the same time, it should be recognised that self-insurance is not at all the only driver of reserve accumulation. The improvement in the IMF's toolkit therefore needs to be embedded in the broader discussion of the functioning of the international monetary system, including ways to reduce excessive reserve accumulation for non-precautionary purposes.

38. We believe that the collaboration between regional financial arrangements and IMF instruments could be strengthened and clarified. The IMF should improve coordination at country and regional levels with regards to the conditionality, pricing and monitoring related to the use of financing instruments. The European Financial Stabilisation Mechanism, the European Financial Stability Facility and the EU Balance-of-payments facility already aim at this objective through the implementation of joint programmes with the IMF.

39. EU members welcome the recent decision on refining the Flexible Credit Line (FCL) and establishing the Precautionary Credit Line (PCL). Regarding the PCL, success will be contingent on its appropriate implementation, including the design of focused ex-post conditionality, defined through quantitative performance criteria when needed, and will need to be monitored closely. The design and implementation of IMF precautionary instruments should always aim at minimizing moral hazard problems and safeguarding the financial resources of the Fund. In the context of the functioning of the international monetary system, EU members see a need for further analysis and documentation on the proposals to establish a new Global Stabilisation Mechanism (GSM), before any decisions are taken. In particular, we think further work is needed to identify how to build a more stabile and resilient international monetary system; the IMF could play a key role to reflect on this issue and propose a way forward.

Role of the IMF in Low Income Countries

40. EU members support the IMF's continued role in low income countries (LICs), focusing on its core competences, i.e. macroeconomic stability and sustainable economic growth that support the achievement of the Millennium Development Goals. We welcome the modifications to the Fund's lending facilities and financing framework for LICs introduced early this year to reflect the evolving economic conditions in these countries and their increased vulnerability related to the global economic crisis. The New Poverty Reduction and Growth Trust is more flexible and tailored to the increasingly diverse circumstances of LICs which should help increase the efficiency of the lending instruments.

Non-cooperative jurisdiction

41. EU members remain strongly committed to reinforced action towards uncooperative and non-transparent jurisdictions that lack compliance with agreed international standards in the areas of taxation, financial supervision and anti money laundering and combating the financing of terrorism. In the prudential field, we welcome the identification by the FSB of the systemically most important non-cooperative jurisdictions and the use of a toolbox of positive and negative incentives to bring them into full compliance. We are committed to cooperate fully in the FSB review process to ensure high compliance and transparency. We also strongly support the public listing by end of 2010 of incompliant and/or non-cooperative jurisdictions and, if necessary, application of counter-measures.