



International Monetary and Financial Committee

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Statement by Mr. Rostowski

EU Council of Economic and Finance Ministers



Brussels, 20 September 2011

**Statement by Minister of Finance Jacek ROSTOWSKI,
in his capacity as Chairman of the EU Council of Economic and Finance Ministers, at
the IMFC Annual Meeting, Washington, D.C., September 24, 2011**

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.

I. ECONOMIC SITUATION AND OUTLOOK

2. The world economy faces significant economic policy challenges and we must continue to collaborate to place the global economy on a more stable and resilient foundation. Fiscal consolidation, structural reforms and financial repair in particular in the advanced economies continue to be key challenges at the current juncture. We also remain concerned that many distortions underlying the large pre-crisis imbalances stay in place – including undervalued exchange rates in key emerging surplus economies, and insufficient domestic savings in some advanced economies. It is of central importance for us at this meeting, to give a strong signal of reassurance that the implementation of our commitments taken at international level including fiscal consolidation, financial repair and structural reforms will go forward, thereby contributing to restore global economic confidence.

3. The pace of world growth is slowing. Ongoing concerns on fiscal prospects for the US, Japan and parts of the EU, as well as concerns on the strength of the global economic recovery, have led to a sharp increase in risk aversion for investors and in uncertainty for consumers globally. This comes against the background of weakening economic activity and high unemployment in some advanced economies and elevated oil and food prices, and does not bode well for the global growth outlook. In the United States, weak employment and consumption trends are limiting overall growth prospects the recent sell-off in equity markets and the negative confidence and wealth effects it might entails have increased the risk of recession. On top of this, weak employment and consumption trends are limiting overall growth prospects. Emerging economies still look resilient but need to address overheating pressures. World trade appears to be halting since the turn of the year. Available data for July and leading indicators suggest a continuation of this weak trend in the third quarter.

4. The economic recovery in the EU and euro area is slowing, amidst the recent turmoil in financial markets and an external environment that has become more challenging. After robust growth in the first quarter of 2011, the pace of economic activity eased in the second quarter of 2011 reflecting the impact of higher oil prices but also less buoyant global growth and increased uncertainty in the wake of the looming debt concerns in Europe and elsewhere. Looking ahead, economic growth is expected to remain moderate in the second half of 2011, according to the European Commission's September 2011 interim forecast. In the medium term, the economic growth in the EU and euro area is expected to remain subdued with significant downside risks. Inflation in the euro area is likely to remain above

2% over the coming months, while risks to medium-term price developments have become more balanced.

Policy Developments

Macroeconomic and structural policies

5. Fiscal consolidation is a top priority for all countries in the EU, even though the extent of necessary adjustments differs across the countries. Fiscal plans in the Stability and Convergence Programmes reflect this priority: they show a considerable reduction in the general government deficit to reach a budget deficit of 1½% of GDP in the EU aggregate and around 1½% of GDP in the euro area in 2014. Overall, the time profile of the consolidation plans is front-loaded and based mainly on expenditure reductions. The aggregate debt ratio is expected to go down as from 2013. These developments are in line with the Toronto G20 commitments of at least halving deficits by 2013 and stabilising or reducing government debt ratios by 2016. Fiscal consolidation is also the focus of joint EU-IMF economic adjustment programmes undertaken by Greece, Ireland and Portugal.

6. At their summit on 21 July, the Heads of State and Government of the euro area reaffirmed their commitment to do whatever is needed to ensure the financial stability of the euro area as a whole and its Member States. The decisions taken there are now being decisively implemented. Since the beginning of the sovereign debt crisis, important measures have been taken to stabilize the euro area. This included the decision to significantly strengthen the stability mechanism established for Member States in distress in order to improve its effectiveness and address contagion. The mechanism will be made more flexible, allowing it to (i) act on the basis of a precautionary programme; (ii) finance recapitalisation of financial institutions, through loans to Member States, including in non-programme countries; and (iii) intervene not only in the primary but also in the secondary markets if necessary to address exceptional financial market circumstances and risks to financial stability. The effective lending capacity of the existing temporary European Financial Stability Facility (EFSF) will be brought to € 440 billion. The permanent European Stability Mechanism (ESM) with an overall effective lending capacity of € 500 billion will enter into force in June 2013 to safeguard the stability of the euro area as a whole going forward. The ESM will be able to employ intervention instruments similar to those of the EFSF.

7. The disbursement of the fifth tranche of the bilateral loans to Greece took place in July, on the basis of a comprehensive reform package, including a medium-term fiscal strategy and an ambitious privatisation programme, which passed Greek parliamentary vote. On 21 July, the euro area agreed to support a new programme for Greece and, together with a call for continued contribution of the IMF and the voluntary contribution of the private sector, to fully cover the financing gap. As far as the general approach to private sector involvement in the euro area is concerned, the euro area Heads of State and/or Government have stated that Greece requires an exceptional and unique solution. The total official financing will amount to an estimated € 109 billion and the strict implementation of the programme will be closely monitored. The maturities of the existing Greek facility as well as of future EFSF loans to Greece will be lengthened and the interest rates of future EFSF loans to Greece reduced. To support the Greek economy, EU funds will be mobilized and comprehensive technical assistance will be provided. Moreover, the maturities of the loans to Ireland and Portugal provided under the EFSF are being lengthened and their interest rates decreased. EU funds

will also be mobilised. Furthermore, on 14 July and 12 August, staff teams from the European Commission, the European Central Bank and the International Monetary Fund concluded their quarterly reviews of the Irish and Portuguese governments' economic programmes with the assessment that the programmes remain fully on track.

8. The EU is embarking on deep and comprehensive reforms of its economic governance to reinforce economic policy coordination. (i) Fiscal surveillance will become stronger and more coherent with the reinforcement of the Stability and Growth Pact. (ii) Stronger budgetary frameworks, including the setting up of fiscal rules, will be implemented at national level, based on an EU directive. (iii) A new Excessive Imbalances Procedure aims at preventing and correcting excessive macroeconomic imbalances. New financial sanctions will be introduced.

9. Economic surveillance in the EU has already benefited from the introduction of the so-called 'European Semester' during the first half of 2011. The first European Semester provided horizontal policy guidance for Member States on fiscal and macroeconomic policies as well as on structural reforms. It concluded in June with the adoption of country-specific policy recommendations to Member States. In addition, under the "Euro Plus Pact", all euro area countries and six other EU Member States have committed to additional steps towards improving competitiveness, employment, fiscal and financial sustainability and to engage in structured discussions on tax policy issues, notably to ensure the exchange of best practices, avoidance of harmful practices and proposals to fight against fraud and tax evasion. Member States are determined to ensure full implementation of the reinforced economic governance framework.

10. On structural reforms within the EU, we are implementing the "Europe 2020 strategy", a strong and consistent programme of structural reforms to enhance growth and employment. This coherent framework aims at increasing productivity and labour force participation. The overall aim of the strategy is to enhance growth and strengthen Member States' adjustment capacity. In the context of this strategy the EU is committed to prepare and implement the structural reform agenda with more emphasis on long-term growth prospects. In line with advice given by the Fund these measures will include deeper market integration and improved market flexibility in line with the Single Market Strategy. They will result in better functioning of labour market and in opening up services and goods markets. These efforts should lead to an improvement in the business environment, thus enhancing entrepreneurship, innovation, and productivity.

Financial market policies

11. The EU continues to work on and implement a comprehensive regulatory reform agenda for the financial sector which stretches over all financial market segments including: the full implementation of G20 commitments on financial regulation, implying the timely and consistent implementation of Basel III, a full and consistent implementation of remuneration principles and standards and the OTC derivatives recommendations endorsed by the G20. the revision of the Markets in Financial Instruments Directive, the Market Abuse Directive and the Transparency Directive, and the development of a more appropriate crisis management and resolution framework for the financial sector. In addition, new or amended regulation has been or will be proposed on European Market Infrastructure, Short Selling and Credit Default Swaps, Credit Rating Agencies, Central Securities Depositories and the harmonisation of certain aspects of securities settlement, as well as on Solvency II for the insurance sector. The

EU is looking forward to further progress, at international level, on identifying and listing non-cooperative jurisdictions (including public listing).

12. The recent stress tests of the EU-wide banking sector helped to identify remaining pockets of vulnerability and paved the way for bringing the EU banking sector in a better position now to absorb shocks of extreme magnitude. These remaining pockets of vulnerability are currently being addressed following recommendations by the European Banking Authority. Remedial actions concern both failing banks but also banks (with core Tier I Ratio under the adverse scenario above but close to 5% and which have sizeable exposures to sovereigns under stress). The measures privilege private sector solutions but also include a solid framework for the provision of government support in case of need, in line with EU state aid rules.

II. IMF POLICY ISSUES

13. The IMF has a key role to play in supporting macroeconomic and financial stability and growth at the global, regional and individual country level, not least through Fund surveillance. While we have made significant reform progress in recent years to increase the legitimacy, credibility and effectiveness of the IMF, it is important that we continue our efforts to enhance the Fund's capability to address the challenges of today's international monetary and financial system. We need to have a closer look at how to further improve the Fund's mandate, surveillance framework and governance structure.

Surveillance

14. In the IMF, important steps have been taken recently to deepen and strengthen the multilateral and regional aspects of surveillance. We welcome the recent spillover reports as well as the Fund's substantive, technical input and advice to the G20 Mutual Assessment Process. We strongly support an increased focus on the multilateral dimension of surveillance and agree to continue the spillover exercise next year. Surveillance needs to be more tailored and focused, in particular on external stability. We need to enhance the traction, evenhandedness and candidness of the IMF's surveillance. We also need to strengthen surveillance of the financial sector, macro-financial linkages, capital flows, global liquidity, foreign exchange reserve holdings, cross-country spillovers and exchange rates. There are strong synergies between the different multilateral, regional and bilateral surveillance exercises, but we need to ensure that they are well integrated. We welcome the introduction of the consolidated Multilateral Surveillance Report for the IMFC, covering the main policy messages from the WEO, GFSR, Fiscal Monitor and other multilateral surveillance products.

15. EU members welcome the 2011 IMF Triennial Surveillance Review (TSR) as an occasion to take stock of the IMF's intensive work over the past years to deal with shortcomings in its surveillance framework and to address remaining gaps. There has been considerable progress made on bilateral and multilateral surveillance since the beginning of the crisis, although progress is still needed on several points. The TSR contains valuable suggestions for enhancing traction which is key to improving Fund surveillance. We believe that the policy debate within the IMF should, besides discussion in the Board, also take place at a sufficiently senior political level. We need to create an environment that encourages candor and diverse views as well as greater willingness by members to implement IMF policy advice. Further work is also needed on possible options for reform of the legal framework of

surveillance, including an assessment of the 2007 bilateral surveillance decision, a possible multilateral/unified surveillance decision or an amendment of the Articles of Agreement.

The international monetary system

16. EU members welcome the Fund's contribution to the on-going work on how to create a more stable and resilient International Monetary System. We should continue to look at the inter-linkages between global liquidity, reserve accumulation and capital flows.

17. There are undeniable merits in providing a cooperative approach on the issue of potentially destabilising capital flows. EU members thus strongly support the development of coherent conclusions for the management of capital flows. The objective should be for countries to aim at a carefully sequenced liberalisation of their capital accounts, ensuring that the necessary macroeconomic and prudential policies and institutional frameworks are in place. Sound domestic macroeconomic frameworks and sound financial regulation and supervision are key to reap the benefits of capital flow. We call on the IMF to play a central role in monitoring capital flows and spillover effects from macroeconomic policies of core economies that may have a bearing on capital flows, as well as in advising its members on how to cope with such flows.

18. Capital flow management measures may constitute part of or complement to a broader macro-prudential approach to protect the financial system from unwarranted shocks, whereas they should never aim at preserving or perpetuating inappropriate macroeconomic policies such as keeping exchange rates undervalued. This means that there is no substitute for sound macroeconomic policies as a first line of defence. Capital flow management measures should rely on a precise assessment of the financial sector vulnerabilities making them necessary. Domestic macroeconomic measures and capital flow management measures other than capital controls should have precedence over the use of capital controls, where feasible. If controls are applied, they should be temporary, transparent, flexible, easily reversible to adjust to changing conditions, and they should be subject to periodic review.

19. In the discussions on global liquidity, the issues of reserve adequacy and drivers of reserve accumulation need to be taken into account. We are open to discuss global liquidity conditions in multilateral surveillance.

20. EU members welcome the substantial progress made in enhancing the lending instruments of the IMF and tailoring them better to countries needs. Last year's review of Fund lending instruments, together with bilateral and regional arrangements, has significantly extended our collective capacity to cope with systemic crises. We appreciate the creation of the new concessional financing framework for low income countries which has strengthened the Fund's ability to support these countries as they are becoming more open and integrated into the global economy. We are open to discuss the need for further enhancements of the IMF's toolkit to support countries during systemic stress. It will be important to clearly identify whether any additions to the Fund's lending toolkit are needed for crisis prevention or crisis resolution purposes. The need for additional mechanisms and facilities should be properly justified, and also be based on a thorough assessment of the existing instruments as well as financial implications and moral hazard concerns. Conditionality should continue to feature adequately in the Fund's lending toolkit.

21. EU members are also open towards establishing some general non-binding principles for the cooperation between Regional Financing Arrangements (RFAs) and the IMF. Regional Financing Arrangements are an important additional layer of the global stabilisation instruments, both for financing and monitoring. In Europe, we appreciate our cooperation with the IMF in designing our joint IMF-EU programmes, and based on our experience so far, we suggest that the principles should include issues such as ensuring an ongoing dialogue and mutual transparency; early co-operation for joint financial assistance programs, information sharing and joint missions; alignment of lending conditions and policy conditionality clauses to the extent possible; strengthened surveillance with the IMF and RFA each focusing on their respective fields of expertise; and good management of public communication. The cooperation also needs to take due account of the respective institutional frameworks, mandates and working methods, and exploit the comparative advantages of the respective institutions.

22. EU members emphasise that a decision to broaden the SDR basket should follow clear and transparent criteria and entail adequate preconditions to ensure the stability of the basket. Furthermore, any changes to the SDR basket should be consistent with the purpose and the role of the SDR. The broadening of the SDR basket would need to be judged against the actual benefits for the stability of the international monetary system. In particular, the requirement that the SDR should be stable in terms of the major currencies is important. However, better ways to measure the criteria underlying the free usability concept could be explored. Currencies admitted to the basket should, at a minimum, be widely used internationally and easily tradable, and have credibility in large and liquid markets. Consequently, currencies need to fulfil substantial convertibility standards.

IMF resources and broader governance

23. The expanded and modified NAB, which became operational earlier this year, have significantly boosted the IMF's resources available for crisis resolution, and thereby contributed to safeguarding global financial stability. This combined with the general quota increase agreed in 2010, will secure additional resources to support members' needs. It is crucial that the IMF remains a quota-based institution, while the NAB should continue to play the role as a back-stop to quota resources. We therefore urge all Fund members to take the relevant steps to complete in a timely manner the required ratification processes for the quota increase, agreed as part of the 14th General Review of Quotas, to become effective by the 2012 Annual Meetings.

24. Advanced European countries have committed to reducing their Board representation by two chairs at the latest by the time of the first election after the 2010 quota reform takes effect. We are currently discussing how best to fulfil this commitment. EU members will also play a constructive role in forthcoming discussions on the review of the current quota formula. It is important that the review process is fully anchored within the relevant IMF bodies. Finally, in order to enhance further the IMF's legitimacy and effectiveness, we continue to believe that greater engagement of ministers and central bank governors and increased accountability of the Fund is required, either through a strengthened and decision-making IMFC or e.g. an "International Monetary and Financial Board" (IMFB).