



International Monetary and Financial Committee

Thirteenth Meeting
April 22, 2006

Statement by Federal Minister of Finance Karl-Heinz Grasser
Chairman of the EU Council of Economic and Finance Ministers

**Statement by Federal Minister of Finance Karl-Heinz Grasser,
in his capacity as Chairman of the EU Council of Economic and Finance Ministers,
at the 13th International Monetary and Financial Committee
Washington, D.C. – Saturday, April 22, 2006**

1. I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses on: the world economy – and in particular the outlook and policies for the European Union; the Strategic Review – in particular surveillance issues, the role of the Fund in emerging market and low income countries, quotas, voice, and representation, and the governance of the Fund; progress with ODA and debt relief; and the role of the Fund in combating money laundering and the funding of terrorism.

Economic Situation and Outlook

2. Global economic activity continued to expand rapidly in 2005 and world trade also grew strongly. GDP growth was relatively strong in North America and emerging Asian economies, including China and India, and lower, but increasing, in the EU and Japan. The outlook is for a continued robust expansion in 2006, due to the growth momentum in much of Asia. There are, however, continued significant downside risks to global growth, including adverse oil price developments, in particular if they are supply-driven, and a disorderly unwinding of the persisting global imbalances.

3. Economic activity in the EU is gathering pace. Annual average real GDP growth stood at 1.6% in 2005 for the European Union as a whole and 1.3% for the euro area. The outlook for 2006 points to a firming recovery, in particular boosted by continued robust private investment growth and strong export demand, reflecting solid world trade growth and further gains in competitiveness in some Member States. The positive business climate indicators and rising employment prospects should contribute to stronger household confidence and household consumption, which remains hesitant. The balance of risks to growth has improved since our last meeting.

4. A key challenge at the current juncture is consolidating the present global expansion through sound economic and structural policies, while continuing to promote openness and delivering the adequate response to the energy-related challenges. In this context:

- The large current account imbalances are not sustainable over the medium-term and ensuring an orderly correction is a shared responsibility of all major players. In the framework of international cooperation, appropriate macroeconomic and structural policies should be put in place to sustain growth and facilitate the orderly adjustment of excessive current account deficits, as well as large surpluses in order to avoid increased protectionist pressures, sharp movements in exchange rates or risks to financial stability. Moreover, there may be downside macro-economic risks coming from protectionist measures and unilateral moves. An open multilateral trading system is a necessary pre-condition for higher, sustained growth. In particular, increased saving in the US and more domestically generated growth in the Asian countries are key for contributing to an orderly adjustment of the global imbalances.

- In the EU, a more dynamic growth is needed. The refocused Lisbon strategy implies a commitment to progress on the structural policies' side to increase the growth potential of the EU and its resilience to shocks. To this end, the Union's priorities have been reinforced towards promoting knowledge and innovation, fostering competition and attracting more people into the labour market, to achieve higher rates of sustainable economic growth and employment creation. Budgetary outcomes in a number of EU Member States improved in 2005 and are expected to continue to improve in 2006 and 2007. Fiscal consolidation, in line with the Stability and Growth Pact, remains on top of the agenda. The challenge of long-term sustainability of public finances is being addressed through further fiscal consolidation, reform of pension systems and structural measures to raise employment rates.
- In the context of higher oil prices, greater threats to security of supply and the challenge of climate change, it is central to step up efforts to improve stability of the oil market and the global energy outlook. Europe is committed to modernise its energy policy so as to ensure increased security of supply, competitiveness of European economies, affordability of energy supply and environmental sustainability. The energy intensity of economic activities should be reduced, the share of energy supply from renewable sources be increased and sources of energy be diversified. Enhancing the global energy policy dialogue between oil producing and consuming countries and the private sector remains central to improve the smooth functioning and stability of markets. Significant investment is needed in exploration, production, energy infrastructure, and refinery capacity. Ongoing efforts, including in existing energy fora, are important to help enhance transparency, timeliness and reliability of demand and supply data, facilitate necessary investments in exploration, production, transportation, and refining capacity, as well as improve energy efficiency. More effective international cooperation on energy efficiency should be developed. Climate change is a serious and long-term challenge; with the poorest people and countries among the most vulnerable to its effects. To help meet this shared global challenge, we call for prompt agreement on a generous fourth replenishment of the Global Environment Facility. We agree that supporting clean energy and climate change are key priorities; and look forward to further detailed proposals from the World Bank to leverage public and private investment into low carbon energy, energy efficiency and adaptation.

Strategic direction of the IMF

5. We welcome the report by the Managing Director on Implementing the Fund's Medium Term Strategy. Detailed discussion of these proposals is needed and we look forward to close involvement in that process. The world economy is facing important changes and the IMF has to adapt to this new context. The Fund needs to ensure a better focus on its core responsibilities and to increase coherence and efficiency within and across its areas of activity.

Surveillance

6. Surveillance needs to be made more effective. Bilateral, regional and multilateral surveillance should be better integrated. Surveillance should be strengthened to reinforce its credibility, independence and authority. Fund surveillance should increase its focus on

analysis of financial sector and capital market developments and the implications for both domestic and global financial stability. We therefore support the Managing Director proposals to integrate more closely macroeconomic and financial market analyses in multilateral surveillance, and to increase the coverage of financial sector issues in bilateral surveillance.

7. While policy choices in the field of exchange rates are in principle a matter of individual choice by members, we agree with the Managing Director that more emphasis must be given to the original goal of surveillance, i.e. assessing the consistency of exchange rates policies with national and international stability. We support the review of the 1977 surveillance decision, in particular to see how exchange rate surveillance needs to be adapted to a world of capital mobility and the increasing number of floating exchange rates. In that respect, increasing global integration means that spillovers arising from members' policies potentially have a greater impact today than in the past given the stronger economic linkages between countries. As proposed by the Managing Director, the multilateral dimension of bilateral surveillance should be strengthened notably through an increased focus on spillovers. The impact of systemically important economies' policy should be assessed in depth in both bilateral and multilateral surveillance. The Fund's mandate should be sharpened and its near universal membership should help it to influence countries in taking into account the impact of their domestic economic policy on other countries, thereby fostering cooperative solutions to global economic challenges. Strengthening of the regional perspective may well help reach these objectives.

8. We welcome the proposal by the Managing Director of greater role for the analysis of exchange rates. However the proposal to publish assessment of exchange rates could raise difficult technical and market sensitive issues and needs to be considered very carefully. The proposal for a new supplemental consultation procedure involving systemically-important countries and other relevant entities, as envisaged in the MD Report also needs further explanation. It would need to pay due regard to the need to involve all members in the work of the Fund

9. Finally, we welcome the objective of streamlining procedures, while emphasizing the importance of Fund surveillance remaining relevant to all of its members. We look forward to more detailed discussion of the Managing Director proposals.

Role in Emerging Markets

10. In order to maintain its effectiveness and relevance, the Fund should ensure that its financial instruments meet the needs of the whole membership and respond to the changing global economy.

11. Progress is needed on crisis prevention, reflecting on past experiences. In the light of the possible benefits, EU Member States support further examination of the Managing Director's proposal for Contingent Financing for Crisis Prevention, including whether and how serious issues related to conditionality, moral hazard, exit, effects on the Fund's balance sheet, consistency with Fund's financing mechanism and charges, and a weakening of private sector involvement could be resolved in designing such an instrument.

12. Progress is also needed in the field of crisis resolution. We support a comprehensive review of the Fund's role in debt restructuring. Furthermore, we strongly encourage the leading bond issuing emerging countries and the private sector to make progress with the

implementation of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets, and invite the IMF to stay involved and monitor this progress in its own analyses. In particular, it will be important to monitor whether the current voluntary approach is valid or whether a more comprehensive framework is needed to establish proper incentives for debtors and creditors to reach rapid agreement on a restructuring.

Role in low income countries

13. The Fund's role in low income countries remains central and should focus on its core responsibilities: policy advice, capacity building and financial assistance on macro-critical issues and institutions relevant to financial stability and economic growth, with a view to reducing poverty, optimising the impact of aid and ensuring debt sustainability, which are key elements to achieve the Millennium Development Goals.

14. On finance, EU countries recognise the need to provide, on a fair burden-sharing basis, financing to the PRGF and Exogenous Shocks Facility, in order to meet the SDR 1 billion needs per year as assessed by the IMF, whilst recognising that, in the longer term, economic development should allow low income countries to graduate from concessional financing.

15. To further strengthen the Fund's technical assistance, while dealing with the growing demand, a more focused and integrated approach is needed. Technical assistance should be closely linked to the Fund's surveillance or program relationship with a country and set within an explicit medium term perspective. In this respect, the Afritac's initiative is a real opportunity for the Fund to play a key role in deepening existing relationships for capacity-building in the area of macro-economic and financial sector reform in African countries, within the framework of country-led poverty reduction strategies. It could be useful to explore the possibilities of increased donor financing of the provision of technical assistance.

16. Finally, in each of these areas, we call on the Fund and the World Bank to enhance and make more effective their cooperation and collaboration, based on a clear understanding of the institutions' respective roles.

The Fund's organisation and governance

17. We welcome the attention of the Strategic Review to the Fund's governance. In order to underpin the smooth operation of the Fund and to reinforce the credibility of the advice it offers it is crucial that the Fund's own operations in terms of budgeting and governance structures reflect international best practice.

18. On budgeting, we call on the management to consistently implement the new budgetary medium term framework to ensure it supports the IMF's strategic objectives flexibly and efficiently, with the organisation reaching for the highest standards of public sector practice in the definition and measurement of objectives. We also support an increase in transparency concerning the Fund's expenditures and expect that the budgetary medium term framework, to be in place for FY07, will provide transparent costing for each of the Fund's activities, such that political decisions can verifiably be translated into a reprioritisation of resources. Reform to the budget process should also aim to make the Fund's income more robust and predictable, and less volatile. IMF Board and management should work constructively and cooperatively on the possible options to find appropriate long term

solutions relatively soon given the projected sharp decline of the Fund's income over the medium term. The investment account should be introduced shortly.

19. On governance, we continue to believe that the Executive Board is critical to the Fund's ongoing success and legitimacy. The Board should focus its time and resources on key strategic issues and ensure accurate and transparent information processes and decision making, involving all Board members. We believe also that there is scope to strengthen the role and effectiveness of the IMFC, with a view to securing a higher degree of influence for this Committee in providing strategic direction in the Fund's work.

20. The EU Member States continue to support further measures to improve the responsiveness of IMF to all its shareholders. We share with the Managing Director the objective of making concrete and durable progress on quotas and voice at the Annual Meetings in Singapore. The EU Member States therefore support pragmatic ways to achieve progress and ensure a mutually agreeable solution to the whole membership. In this context, we acknowledge that some emerging market countries as well as some EU countries are under represented according to the current quota formulae. We also consider that voice for the developing and transition countries should be further enhanced and their participation in the decision-making process further strengthened. Any solution should be based on a set of clear and objective criteria. The principle of equal treatment among IMF members should be preserved. Any package taken at the Annual Meetings should address each of these elements.

21. Ad hoc quota increases will probably be needed in any global solution and therefore need to be considered. Although EU member states have an aggregate quota that is lower than calculated quota according to the existing formulae, and particular EU member states are significantly under-represented, EU members may consider, in the context of a global agreement, a reduction in their quota share, if others are willing to do likewise. A reallocation of quotas for over-represented to under-represented countries would increase the scope for quota adjustment, but would require the consent by all countries that would lose quotas. Different options to address the issue of the developing countries' voice in the Fund could also be explored, including an increase in the basic votes.

22. We recognize that there are longer term issues which may need to be addressed in due course. In that respect, we take note of the proposal included in the Managing Director's report to re-examine the selection process of the Managing Director of the Fund. In our view, this issue should be part of a broader approach concerning the top management of the IFIs.

Debt relief and development finance

23. Last year we made important progress on development including commitments on multilateral debt relief, aid effectiveness, and increasing resources for development. Now these commitments must be implemented. We welcome the adoption of the necessary decisions by the IMF and World Bank Boards to implement 100 per cent multilateral debt relief within the framework of the Multilateral Debt Relief Initiative, making the initiative tangible for many developing countries. We encourage the African Development Fund to follow as soon as possible. Looking ahead, we stress the importance of ensuring that the resources provided through debt relief are used effectively to support poverty reduction, and of securing debt sustainability.

24. We recognise the need for additional resources. We welcome all efforts to this end through general budgetary allocations or the introduction and participation in innovative

sources of financing. In that respect, the EU Member States collectively reconfirm their commitments to increase their ODA to 0.70 % of GNI in 2015 and to the interim target of 0.39 % of GNI in 2006 and 0.56 % of GNI by 2010. Some EU Member States have launched the International Finance Facility for Immunisation (IFFIm) and several Member states have decided to implement, along with several emerging and developing countries, an air ticket solidarity levy earmarked to development and the purchase of drugs against pandemics. We recognise that Advance Market Commitments (AMCs) for vaccines appear as a potentially promising market-based mechanism to support research and development of vaccines for diseases which affect the poorest countries.

25. Recognising the vulnerability of all countries especially the poorest, to natural disasters, we call on international institutions to improve their response.

26. Lastly, we confirm our support for the national and international processes already established to minimise the risk and deal with the potential threat posed by a pandemic influenza.

Anti-money laundering/ Combating the Financing of Terrorism

27. Member states continue to have grave concerns about the abuse of the international financial system to finance terrorist acts and to launder the proceeds of criminal activities. They renew their commitment to support the 40 Recommendations and 9 Special Recommendations of the Financial Action Task Force (FATF) and will continue to support the important work of the IMF in evaluating the implementation of these standards as part of the Financial Sector Assessment Programme. In this context, the EU gives its full support to the ongoing efforts in implementing the next phase of IMF's specific programme on the Off-shore Financial Centres.

28. To build a truly global framework to prevent abuse of the financial system will require all countries to have appropriate safeguards. The Member States recognise the importance that FATF-Style Regional Bodies play in contributing to this framework and calls on these groups to accelerate the pace of implementation of international standards. The IMF should continue to assist competent authorities in this process and support countries by providing well targeted, prioritised and effective assistance. The Fund should continue to work with FATF to ensure that FATF-Style Regional Bodies have the experience and capabilities to promote implementation of international standards amongst their members in a structured and effective way. Following the recent internal reorganisation, the Fund should remain fully involved notably through the FSAP process in anti-money laundering and combating the financing of terrorism.