International Monetary and Financial Committee

Fifteenth Meeting
April 14, 2007

Statement by the Hon. Peter Costello

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Treasurer of the Commonwealth of Australia
to the International Monetary and Financial Committee
14 April 2007

On behalf of the constituency comprising Australia, Kiribati, Korea (Republic of), Marshall Islands (Republic of the), Micronesia (Federated States of), Mongolia, New Zealand, Palau (Republic of), Papua New Guinea, Philippines, Samoa, Seychelles, Solomon Islands and Vanuatu

We strongly support the Managing Director's medium term strategy and we thank the Managing Director for his efforts in securing progress. Some advancement has been made in many areas, importantly including in strengthening surveillance. However, many key tasks remain outstanding, most notably in the area of governance reform – which is critical to the ongoing effectiveness and legitimacy of the Fund. Meeting the timetable we have set for ourselves to achieve meaningful quota and voice reform is challenging, but essential. It will require the Fund and its members to work collaboratively to ensure that our shared goals for the Fund can be reached.

The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

The outlook for the world economy is for continued robust growth. Growth has become more balanced across the regions of the globe, including a likely soft-landing in the United States, solid growth in Europe and Japan and continued growth in Asia. Growth has been supported by lower oil prices and reduced inflationary pressures. However, risks to the outlook remain on the downside, although they have moderated somewhat since the time of our last meeting. The main risks to the global outlook include: rising inflation pressures as output gaps continue to close; further spikes in oil prices; further deterioration in the US housing market; and a modest rise in the potential for increased volatility in global financial markets notwithstanding improved resilience in many markets. The impact of the slowing US housing sector from the deterioration in the sub-prime mortgage sector may not yet have fully played out and could have wider consequences than are at this stage expected. The extent of the impact in part depends on the second round effects on consumption and on the robustness of other components of growth in the US. In this regard, while there is cause for comfort in rising incomes, weak growth in business investment despite high corporate profits warrants close monitoring.

A disorderly unwinding of global imbalances also remains a risk to the outlook. Consequently, coordinated and timely policy actions are important to facilitate an orderly and effective resolution of global imbalances through a combination of complementary adjustments across the major economies and regions. These continue to include a shift to domestic consumption and appropriately phased exchange rate reform in China; increasing saving in the US; structural reforms to raise potential growth in Japan and Europe; increasing investment by oil-exporting nations in domestic capacity; and recovery in investment in South East Asia. These policy actions that help address imbalances should also have positive implications for domestic economic performance and help sustain strong global growth. In this regard, we welcome the progress on the Fund's first multilateral consultation on this topic. We will be interested to closely review the mode of the first multilateral consultation before initiating further multilateral consultations on new topics.

We welcome the revival of the Doha round of multilateral trade negotiations. While this is a positive development, anti-globalisation and protectionist pressures persist in many places. The Fund should continue to play an active role in assuring the world of the benefits of trade and globalisation and the need for adequate measures to cushion the impact of changes on the vulnerable through good policy settings in education, flexible labour markets and welfare systems.

Adaptation of the IMF Surveillance Framework

We welcome the continuing efforts to strengthen the Fund’s surveillance over its members. The discussions since the Annual Meetings on the 1977 Decision on Surveillance over Exchange Rate Policies and on a surveillance remit have been useful in reviewing the formal basis of the Fund’s work in this area and in promoting a widely held and shared understanding of surveillance. Moreover, introducing a remit would improve the transparency and accountability of the Fund’s surveillance activities. We support the emphasis being given to improving the practice of surveillance and in this regard look forward to the forthcoming discussion of the Independent Evaluation Office report on exchange rate policy advice, especially with respect to efforts to improve the consistency, and effectiveness of the Fund’s surveillance and the dialogue with which the Fund engages its members on exchange rate issues. In the coming months, these efforts to refine the formal basis of surveillance over exchange rates, as well as the practice of surveillance, should be progressed in conjunction with each other. They will need to be mutually supportive and widely acceptable to the membership.

More specifically on the 1977 Decision, we believe that surveillance will be most effective if members understand their obligations and staff have well defined responsibilities in undertaking surveillance. Revising the decision could clarify these objectives and responsibilities. Of course, the new decision should not create new obligations, nor should it be too rigid and constrain surveillance from adapting to changing circumstances.

The foreshadowed improvements to the Fund’s methodology for assessing the effectiveness of surveillance in the next triennial review are welcome. We also look forward to a review of the implementation of streamlining of surveillance. We have some concerns about how streamlining is being implemented and would appreciate an early opportunity to take measured decisions about its future application.

The increasing attention given by Fund staff to spillovers and regional surveillance is pleasing. However, there is room for continued improvement in regional surveillance to analyse issues and themes relevant to groups of countries in a regional context. In particular, it would be useful to examine the role of the regional economic outlook publications and the processes used in their preparation. Using the insights gained from regional and multilateral surveillance effectively in bilateral surveillance should also be strengthened. Multilateral surveillance more broadly is progressing well, as is reflected by the high quality World Economic Outlook and Global Financial Stability Report.

Other Elements of the IMF's Medium-Term Strategy

Report to the Managing Director by the Committee of Eminent Persons on the Sustainable Financing of the Fund

We welcome the Crockett Report on the sustainable financing of the Fund. We agree that in the current low lending environment, there is a case for bolstering Fund income, and that this needs to be done in a timely fashion.

The Report's recommendations will need to be developed into firm proposals that will require further careful consideration in the coming months. The governance and transparency arrangements for proposals including in relation to investment of Fund resources will also need to be clearly set out before decisions can be taken. In our view, it is premature to rule out any options in advance of this preparatory work being completed.

To complement the Crockett Report, the Fund should also carefully review the expenditure side of its budget in a medium-term context. This should be done in a strategic way that reflects the Fund's mandate and core responsibilities, rather than merely seeking to minimise costs at the margin.

Charging for technical assistance is a broad and complex issue that should not be driven merely by the desire to raise Fund income and to cut expenditures. Any move to introduce charges for the Fund's bilateral services would need to be coordinated with the charging arrangements of other technical assistance providers to avoid creating inappropriate disincentives to obtaining Fund assistance. Such a change would also need to avoid denying needed support to countries that need but cannot afford the services.

IMF Quotas and Voice

Delivering on the promised reforms to quota and voice will be crucial to ensuring the ongoing legitimacy and effectiveness of the Fund. The new quota formula should be simple and transparent, consistent with the roles that quotas have, and should capture members' relative positions in the global economy. It should also achieve broader support by giving greater recognition of fast-growing emerging market economies and low-income countries – and should not result in a greater share for advanced countries. Quota and voice reform is not a zero sum game and will be of benefit to all members.

The agreement to increase the quota share of China, Korea, Mexico and Turkey at Singapore was an important downpayment on the reform process. Some progress on the second stage of reforms has already been made, but there is a great deal still to be done if we are to meet the goals we set for ourselves at Singapore. We urge all members to continue to be ambitious in pursuing reform, and to take advantage of the momentum that now exists. It is now time for flexibility on the part of all members. Without this, there is a real risk that the reforms will deliver only a marginal change to voting rights, and fail to address concerns about the Fund's legitimacy.

In relation to the design of a new quota formula, we continue to support a simple and transparent approach, with a predominant weight for GDP. While GDP should be measured mainly at market exchange rates, we would be prepared to consider some role for GDP measured at purchasing power parity. We consider that there are significant conceptual and measurement problems in relation to the openness variable and it therefore should have a greatly reduced weight. Reserves currently have a modest weight and that should continue, without the need for capping.

In order to make progress, the Executive Board should shortly start to consider all elements of the quota and voice reform package together, including the new quota formula, the second round ad hoc increase and the increase in basic votes. Continued outreach efforts from management and staff will also have a central role to play in forging a compromise that can lead to a resolution.

Role of the IMF in Emerging Market Economies

We support further work on the development of a new liquidity instrument for use by emerging market economies. Such an instrument may have the potential to contribute to crisis prevention and would be a useful addition to the Fund's toolkit. The wide consultation undertaken by the Fund on this topic is commendable and timely. The current benign international economic conditions are an opportune time to make progress and we do not view it as necessary to wait for countries to express concrete interest in the instrument before progressing design further. However, it would be helpful before the final introduction of the new instrument if potential users could express a positive approach to possibly taking up the instrument as part of their crisis prevention strategies. The instrument itself will only be useful if it overcomes the problems that hampered the former Contingent Credit Line. Ultimately, it will be very challenging to design an instrument that provides confidence to potential users that sufficient access will be available in a crisis while still safeguarding Fund resources.

We look forward to examination of the new methodology for assessing vulnerabilities and risk exposure and also the review of the exceptional access framework. We are pleased that a review of the lending into arrears policy is foreshadowed to take place soon, as, in our minds, it is well overdue. Also overdue is a review of fees and charges, which we would hope to see completed in the near future.

Report of the External Review Committee on Bank-Fund Collaboration and the Role of the IMF in Low-Income Countries

We urge the Fund to work closely with the World Bank in considering the issues raised by the Malan Report and look forward to further discussions on the recommendations of the review. We consider the Report's focus on cultural change and the need for a spirit of collaboration between the Fund and the Bank as well placed. Cultural change is a long and difficult process of evolution, but can be helped by reviewing the incentives facing staff. Leadership by Fund management and senior staff will be an essential element.

We welcome the Fund's recognition of the need to clarify its role in low-income countries, which is critical to ensuring that the Fund's support remains appropriate, effective and within its mandate. This refocusing should be in line with the Fund's comparative advantage and should not reduce its overall role in low income countries.

Following the Malan Report, it is timely for the membership to clarify the Fund's role in lending to low-income countries. In particular, it would be desirable to review the purpose and duration of lending under the Poverty Reduction and Growth Facility (PRGF), in order to better anchor it on balance of payment needs, as well as to reconcile this lending with debt forgiveness initiatives in the longer term. However, caution must be exercised as the PRGF enables strong and productive cooperation on macro-critical issues between the Fund and borrowers; can be an important source of financing for borrowers; and assists borrowers in mobilising donors.

The Fund's role in supporting the poverty reduction strategies developed by members is an important one. We look forward to the proposed review on the Fund's responsibilities in the Poverty Reduction Strategy Paper process, where the Fund is not the lead operator but needs to work in close collaboration with development partners. Debt sustainability is a key challenge to the long-term growth and stability of developing countries and we also support priority being given to work in this area.

The Policy Support Instrument's review in 2008 will provide an opportunity to review the eligibility criteria; in particular, whether a non-lending instrument would also be appropriate for middle income countries. We continue to support the Exogenous Shocks Facility, but question whether the instrument can be deployed sufficiently quickly in response to the fast emerging and sizeable needs of small and vulnerable economies. A review of this would also be warranted.

The upcoming examinations of the Fund's role in supporting sound macroeconomic policies and public financial management in relation to the potential scaling up of aid flows, and proposals to improve the Fund's support for post-conflict countries and fragile states are welcome.

Other issues

The recent decision on measures to make better use of Independent Evaluation Office (IEO) insights is welcome. The IEO is a key resource of the institution whose findings should be fully utilised. In this regard, we look forward to the forthcoming IEO review on aspects of Fund corporate governance, including the role of the Board. We continue to aim towards improving the effectiveness of the Fund Board, and expect the IEO to provide valuable suggestions.

Also in relation to reforming the governance of the Fund, we believe that the selection of the senior management of the Fund and the Bank should be based on merit, done transparently and ensure broad representation of all member countries. We will continue to push for rapid movement towards merit-based selection of both the Managing Director of the Fund and the President of the Bank.

The new strategic approach to technical assistance allocation has been in place for 18 months now and, over the coming year, we see merit in reviewing this experience and considering how to embed it in the budget context.

Finally, we wish to thank the now former Deputy Managing Director, Mr. Augustín Carstens and warmly welcome his successor, Mr. Murilo Portugal, who returns to the Fund.