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On behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, Uzbekistan

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1. Introduction

The Fund's role and operations are currently undergoing a wide-ranging review. This process is driven by the comprehensive medium-term strategy, which is now becoming operational. In the specific area of governance reform, we should aim for achieving tangible results in implementing the Governors' resolution on Quotas and Voice agreed in September 2006. The reform agenda also addresses a range of other fundamental issues, such as a new income model for the Fund, and improved collaboration with the World Bank. The Fund's governance, activities, and finances in the years to come will depend on the outcome of the reforms underway. Considerable effort is still needed to build the necessary consensus among members.

I am of the view that, rather than trying to invent the IMF anew, guidance for these reforms must come from the institution's core mandate to foster macroeconomic and financial stability on the global, regional, and national levels. Its character as a financial institution able to provide financial resources to members remains vital. In addition, the significant expansion in international financial linkages makes it imperative that the Fund be a center of competence in integrating financial sector analysis and traditional macroeconomic assessments. By focusing on its expertise and core competences, the Fund can best contribute to enhancing global welfare. A clear delineation of responsibilities among existing multilateral institutions and fora is a precondition for effective cooperation in this global orchestra.

I agree that the Fund's finances should be put on a more stable footing. In the context of assessing a possible new income model, more general questions pertaining to the Fund's overall costs and its cost-efficiency are legitimate. The strategic orientation and the financial realities facing the Fund need to be jointly evaluated.

2. The global economic and financial environment

The world economy continues to enjoy an extensive period of strong and balanced growth, with all regions profiting. This favorable economic performance is supported by generally subdued inflation and still low real interest rates, improved fundamentals in many emerging markets, and abundant liquidity. Absent an unforeseen systemic shock, these conditions should remain dominant in the near term.

In industrialized countries, the continuing broad based recovery in Europe and in Japan can be expected to counterweigh the slowdown in the U.S. With robust and improving domestic demand in the euro area, it seems appropriate for monetary policy to become less accommodating. It is notable that the macroeconomic outcome in the Central European EU members has turned out better than projected, while for many of these countries it will be crucial to maintain a sustainable current account position. Productivity enhancing structural reforms in Europe should continue, in particular with a view to improving the functioning of labor markets. At the same time, the fiscal and macroeconomic challenges from ageing populations need to be further addressed. The situation in Switzerland exemplifies the challenge faced by other European countries of determining the adequate macroeconomic policy stance in an environment of strong output growth and yet very low inflation. Underlying structural improvements as well as shifting relative prices of tradables and their production costs may have mitigated the build-up of inflationary pressure and are arguably underpinning a sustainable higher growth path.

The strong and increasingly broad-based growth in transition and developing countries is very welcome. I am especially pleased to note the continued strong growth performance of the CIS countries. It is also encouraging that sub-Saharan Africa is set to continue its period of strong growth.

Global external imbalances remain historically large, but – since a soft landing in the U.S. should provide an important market-led corrective – they seem to present somewhat less of a risk to global stability today. However, the recent financial market turbulences are a reminder not to become overly complacent. Chances are that beneath the surface of the current remarkable global expansion, accompanied and fueled by dynamic financial market innovations, risks are building up that are yet to reveal themselves fully. The current environment of high liquidity and low market volatility encourages risk-taking and leverage and has given rise to an aggressive search for yield by market participants. In addition, there are cyclical phenomena, such as the carry trade, that are bound to revert at some point. While acknowledging such systemic vulnerabilities, the beneficial role of international capital markets in efficiently intermediating financial flows and diversifying risks must also be emphasized. In the more recent past, markets and institutions have been able to cope well with the risks inherent to an innovative and liquid environment. Given these risks, it is important at this juncture that the positive forces underpinning the global economy, namely trade and cross-border investment, are allowed to play out. Furthermore, stability-oriented macroeconomic policies and resilient, well regulated financial systems are as important as ever. Global financial firms can be channels of systemic cross-border shocks, which calls for an intensive dialogue among national supervisors.

3. Strategic Reforms—Implementing the Medium Term Strategy

The Fund's strategic reform agenda is proceeding apace. In this phase of change, it is important for the Fund to also reflect on past successes and shortcomings. The Independent Evaluation Office (IEO) has been contributing crucially to these reflections. The IEO can do so only if it is – and is perceived as – independent, which will ultimately reflect well on the legitimacy of the Fund's activities. Among the many areas of work in progress, I will comment on selected elements which are at a critical juncture.

Ensuring high quality assessments and crisis prevention tools

I fully support updating the Fund's guidelines for surveillance. There is a good case to be made for revising the 1977 Decision on Surveillance over Exchange Rate Policies. Such a revision would better account for the developments in the international monetary system since the late 1970s, thereby also doing justice to the widespread adoption of floating exchange rate regimes and open capital accounts. Concretely, this means better articulating both the scope and the modalities of surveillance. Such wording would also need spell out that domestic macroeconomic and financial policies are instrumental for external stability and must therefore be an integral part of Fund assessments. For other policy areas, this relevance would need to be argued convincingly. Ultimately therefore, an amendment should underscore that the surveillance process with members be comprehensive in its coverage of macroeconomic and financial policies, focus on international linkages, be candid, adhere to the principle of evenhandedness, and continue follow a cooperative approach. In doing so, the revised Decision would reflect current best practice derived from the Fund's long-standing experience. An assessment of the consistency of exchange rate levels with the macroeconomic framework should clearly be part of Fund surveillance. However, there must be full transparency on the technical difficulties and uncertainties inherent to assessing exchange rate misalignments. Also, I would not want to see any new obligations introduced for members with regard to exchange rate policies.

While a revised surveillance decision will provide better guidance for the future conduct of surveillance, it is a necessary but not sufficient step to improve its quality and effectiveness. Other initiatives are under way that will provide for this: Regarding *process*, I would see merit in setting tangible objectives and priorities for Fund surveillance over a three-year horizon by means of a surveillance remit elaborated by the Executive Board and deliberated in the IMFC. This could make the dialogue among the parties involved more focused and would enhance the Fund's transparency. On *form*, Fund reports on consultations with members need to fully reflect the discussions with the authorities and contain sufficient detail to back up the analysis in order to provide the necessary information to the Executive Board, and to add value for market participants and policy makers. In terms of *content*, much will be achieved by strengthening the focus on financial sectors and by reconciling financial sector analysis with traditional macroeconomic assessments. Over time, this is bound to also further enhance the Fund's capacity to pinpoint and advise its members on systemic risks. The FSAP has proved to be a valuable instrument that has allowed both member countries and the Fund to broaden their knowledge in this area. Going forward, it will be a challenge for the Fund to integrate these sector-specific findings into the regular surveillance process. With regard to *scope*, the Fund's multilateral surveillance provides essential global public goods in the form of thorough analysis of global economic and financial developments, transmission channels, and policy challenges. The multilateral consultations place the Fund at the center of fostering a collective understanding and brokering potential action to mitigate global risk.

With a view to preventing financial vulnerabilities from building-up in emerging markets, I believe that a new liquidity instrument could fit into the Fund's mandate. Such an instrument would need to fill a well-defined niche and be complementary to existing Fund facilities and to private sector credit lines. Targeting it at those members with financial market access and potential (capital account related) external vulnerabilities – but not actual balance of payments need – meets this requirement. However, many important elements for a feasible instrument design remain to be addressed. Also, it has to be determined how such an instrument could be sufficiently appealing to potential users while safeguarding the Fund's finances. Striking this balance entails setting-up a strict but objective qualification and monitoring framework.

Advancing institutional reforms

The Governors' Resolution on Quotas and Voice Reform has provided the Fund with a roadmap for advancing with governance reform. Broad consensus, specifically on determining a revised quota formula, an increase in basic votes, and a further ad-hoc quota increase, will be needed to live up to the Resolution. Given the near-global membership of the Fund, this is inevitably challenging. I trust, however, that the Executive Board, Management, and Fund staff will make the necessary efforts to obtain a balanced solution within the tight time frame given.

The new quota formula should reflect the IMF's mission. With international financial stability at the heart of this mission, a country's quota should duly reflect its importance in the international financial system and its contribution to international financial stability. This includes a member's ability to contribute resources to the Fund in case of a global financial crisis. A new formula must thus include a variable reflecting financial openness. The openness variable should have at least equal weight to GDP. A stock variable, such as the international investment position (IIP), would best capture a country's importance in the financially globalized world. This is particularly called for as cross-border financial flows and the corresponding economic linkages have strongly increased. Furthermore, the relative weights of members in the global economy should be reflected by GDP at market rates. Given that the Fund's mandate is focused on the system of international exchange, purchasing power parities are not relevant. Moreover, both the Fund's liquidity needs and its loans are calculated at market exchange rates. Given the current efforts to improve governance and enhance the voice of members, there is a strong case for using a meaningful compression factor as part of the quota formula, which is clearly preferable to an arbitrary redistribution mechanism outside the framework.

An institution of almost global membership like the Fund must ensure that the voice of all countries be heard. An increase in the basic votes would be a valuable contribution to this end. I also welcome the intended mechanism to keep the share of basic votes constant thereafter. This, as well as the increase in basic votes, must be part of a well-balanced agreement.

Strengthening the financial position

It is of utmost importance to preserve the financial integrity of the Fund. If it is to fulfill its central role in promoting global financial stability, it needs both adequate reserves and the means to finance its budget. I welcome the measures already taken to mitigate the budgetary pressures. These pressures to keep administrative costs under control are likely to remain, even if the current low level of lending were to reverse at some point in the future. Further strategic decisions may thus still lie ahead so as to achieve an expenditure level consistent with the new income realities.

In addition to assuring the soundness of the Fund's finances, a new income model should also better align the coverage of costs with the IMF’s different areas of activity. The Committee of Eminent Persons has presented a package of proposals that I can broadly endorse. Of course, details will need to be further analyzed, in particular with regard to mobilizing part of members’ quotas for investment purposes. It is worth considering to combine the proposals with other ideas that have been discussed on earlier occasions. For example, all members could make a uniform level of unremunerated reserve positions available for investing, requiring a smaller amount of quota resources to achieve the same amount of revenue.

The proposed sale of gold holdings would need to be part of a package of income measures. Such sales must preserve the financial solidity of the Fund, be strictly ring-fenced, and not add to the announced volume of sales from official sources. As to a re-imbursement of PRGF-ESF Trust expenses, this is well justified and easy to implement. Charges for direct services to members such as technical assistance can be contemplated, not primarily for reasons of income generation, but to set the right incentives and enhance IMF transparency and accountability.

Defining the role in LICs

I believe the Fund can best contribute to growth and poverty reduction in low-income countries by supporting these members in achieving and maintaining macroeconomic stability. The Fund should help ensure that debtors attain and preserve debt sustainability in the wake of the implementation of the Initiatives for Heavily Indebted Poor Countries and Multilateral Debt Relief. It is also called on to assist these countries in building macroeconomic and public financial management frameworks to deal with aid inflows, while adhering to stability-oriented policies. In this context, it should be noted that a stable macroeconomic environment is essential for growth and poverty reduction.

With a view to the Millennium Development Goals, I welcome the cooperation among the many multilateral and bilateral partners in line with their respective mandates and expertise.

The Fund will need to clarify its policies further to play its part most effectively. The Report of the External Review of IMF–World Bank Collaboration is very welcome in this regard. Its deliberations should lead to a clearer division of labor between the two institutions in terms of responsibilities, financing, and accountability. In doing so, the different mandates and core competences as well as their resource constraints have to be taken into account. This is a precondition for improved cooperation, also in areas where overlaps in substance are unavoidable. The Fund should focus on macroeconomic policy advice. It should also stand ready to provide short-term financing in case of balance of payment needs, as well as technical advice in the area of its core competences. Conversely, the Fund has no role in actively mobilizing or coordinating aid flows. The World Bank, for its part, rightly embraces a broader scope of activities based on a medium- and long-term mandate.

4. Conclusion

Given today's global financial linkages and spillover potential, the Fund has an important role in monitoring these developments and actively anticipating systemic problems. I would argue that its broad mandate for strengthening international financial stability and promoting growth is particularly relevant in the current favorable economic environment: buoyant markets and substantial growth worldwide have shifted the focus on strengthening fundamentals and crisis prevention. This being said, the Fund's capabilities as a crisis manager may be tested again before long. The Fund must thus retain its intellectual and resource capacity to fulfill its role as a crisis lender. In this respect also, the current efforts to better integrate financial sector analysis into its operations are well warranted.