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Statement by Steven Vanackere
Deputy Prime Minister and Minister of Finance, Belgium

On behalf of Austria, Belarus, Belgium, Czech Republic, Hungary, Kosovo, Luxembourg, Slovak Republic, Slovenia, Turkey

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At the 25th International Monetary and Financial Committee
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Global Economic Challenges

The task to correct in many countries the large imbalances, which have been an important factor underlying the crisis, remains unfinished. A lot has been done; in most countries much remains to be done. Probably the most challenging of all tasks will be, in countries with a rapidly aging population, to regain dynamism and competitiveness needed to maintain and improve welfare levels, care for the elderly and create adequate employment for the present and future young generations.

The crisis had to a large extent its origins in the build-up of excessive debt by households or the public sector. A faulty financial sector contributed to this process, much to its own demise. Distortive incentives played a perverse role. Macroeconomic policy, financial supervision, and international surveillance failed to address at an early stage significant market failures and also design flaws in the European Monetary Union.

Important progress has been made with lowering excessive debt levels of households, strengthening the balance sheets of the financial sector and lowering fiscal deficits.

The fiscal challenges of the US and Japan are daunting. The debt dynamics in these countries critically depend on maintaining low real interest rates at which the debt stock is financed, thus preserving market confidence. Both countries should adopt a comprehensive medium-term fiscal consolidation plan.

The US tax system could become more effective. Lowering tax exemptions and a federal VAT would be helpful reforms. The long-term sustainability of the social security and public health care systems should be addressed.

The European Union has strengthened its economic governance. The fiscal rules of the Stability and Growth Pact on deficits and the pace for reducing debt ratios exceeding 60 percent of GDP have been tightened. They must be better anchored in national legislation. New economic imbalances, in particular the loss of competitiveness by euro area members, as indicated by divergent developments in unit labor cost and large persistent current account imbalances will be corrected at an early stage. The Commission has received extensive powers to ensure adherence to the new fiscal and economic imbalances rules. With the same purpose, ex-ante, policy coordination under the so-called European Semester, is strengthened. There is now a single timetable for the submission of national fiscal stability and convergence programs and national structural reforms programs.

New financial assistance mechanisms in the euro area are sufficiently flexible and received adequate resources to preserve financial stability.

Full and timely implementation of the adjustment programs in Greece, Ireland and Portugal, supported by the Fund and the euro area countries, remains critical for restoring stability in the euro area.

Other EU members are committed towards reaching their agreed fiscal targets in the next few years and to reduce excessive debt levels with an adequate pace. Most of them are making significant progress

Success with this task critically depends on resuming more vigorous growth, reducing unemployment and preserve social cohesion. The “Paradox of the thrift” under which aggressive upfront fiscal consolidation lowers growth, worsens debt dynamics and paradoxically triggers a loss of confidence, must be avoided. The Fiscal Compact rules set structural deficit objectives. This allows, within margins, automatic fiscal stabilizers to work. However, carefully planned fiscal consolidation that adheres to its targets is a process which enhances confidence, and hence consumption and investment demand.

Fiscal repair is essential to restore the strength of financial institutions that have significantly financed the public debt. Shareholders must also contribute when the capital adequacy of their institution falls short of what is needed for maintaining market funding, liquidity and adequate solvency under prudential regulation.

Additional bank capital should help avoid a reduced credit extension in different parts of Europe. The recent Vienna Initiative 2 and cooperation within the EU supervisory colleges have been instrumental in maintaining euro area parent banks’ support for their subsidiaries in Central and Eastern Europe. It should be stressed that the vulnerability to withdrawal of external credit significantly differs among CEE countries. In some of these countries, local deposits exceed bank loans and bank subsidiaries are a source of liquidity for their European parent banks.

In this period of fragile recovery, and in the absence of inflationary expectations, continued accommodative monetary policies and ample central bank liquidity provisioning remain justified. However, the monetary authorities should remain vigilant to avoid potential distortive effects on asset price developments, international capital flows and long-term financial stability.

Important as short term support for economic activity is, the far more important task is addressing the structural rigidities in both labor and product markets to enhance productivity and international competitiveness. Such a comprehensive strategy should not wait to be implemented.

With the crisis, the growth potential of most advanced economies is now significantly lower than estimated prior to the crisis. This seriously affects debt dynamics and sustainability. With population aging, the European Commission projects a further drop of potential growth, possibly below 1 percent, unless structural reforms increase both the demand and supply of labor, productivity and competitiveness. Raising the level of workers' skills and encourage innovation, entrepreneurship and sustainable intelligent growth are all central objectives of Europe's 2020 Strategy.

In many emerging market countries, growth rates, although slowing, remain encouraging. Several emerging market countries continue to attract significant amounts of capital inflows that may induce overheating. In these countries, a tighter fiscal policy stance and capital flow management measures can help preserve stability. Enhanced exchange rate flexibility can also help to rebalance global demand. The recent decision of the Chinese authorities to take additional steps in the liberalization process of the Yuan exchange rate is therefore welcome.

The IMF Action Plan

Fund surveillance

The Fund's surveillance practice has improved significantly in the last years: multilateral surveillance got more attention, spill-over reports were produced and financial sector surveillance was gradually increased

The Fund now pays great attention to ensure that a country's financial sector is stable and properly supervised. The decision that an in-depth assessment by the Fund is mandatory for financial sectors which rank among the 25 systemically most important ones was significant progress. Reinforcing the financial surveillance in all Article IV reports, which should remain the main vehicle for the Fund to fulfill both its bilateral and multilateral surveillance mandate, remains a key challenge.

We call on the Fund to spell out the priorities, objectives and the scope of its operational activities for its financial sector surveillance, and its cooperation with other stakeholders, in particular the Financial Stability Board and the standard-setting bodies.

Under the Fund's formal legal framework, bilateral surveillance is narrowly focused on countries' exchange rate policies and other policies that affect their domestic stability. This framework is out of date. Experience has shown that stability of individual countries does not ensure global economic and financial stability. All economic and financial policies, not only exchange rate policies, are important for promoting stability. The Fund must better integrated multilateral and bilateral surveillance. How a country's domestic policies may impact other countries and the global financial stability, and how a country can be affected by policies conducted elsewhere, should be part of surveillance.

The Fund's recent practice, and in particular its first spillover reports, have greatly evolved in this direction. The Board should adopt a decision that confirms and further clarifies and extends the Fund's recent practice of integrating bilateral and multilateral surveillance. This will greatly enhance transparency, accountability and evenhanded treatment of countries. This will ensure that countries are more responsive to Fund policy advice. Such decision should include the recommendation that countries strive to avoid economic and financial policies that result in instability elsewhere. It should also include specific guidance on monetary union members. Countries should be committed to discuss policies which the Fund determines as undermining the stability of the international monetary system. The effectiveness of Fund surveillance is largely based on persuasion and the willingness of member countries to take ownership of the process. In addition, in its interaction and communication, the Fund could help member countries to get domestic support for needed measures by clearly outlining their economic and social benefits and the costs of inaction.

Governance of the Fund

Many countries, including in our constituency, have already ratified and accepted the 2010 Quota and Governance Reforms. IMFC and G20 members in particular should lead by example and ratify the agreements before the 2012 Annual Meetings.

The Executive Board started to review the quota formula, as requested by the Board of Governors.

Most members in our Constituency agree that the quota formula should be based on economic criteria that are relevant for the mandate of the Fund. Openness reflects a member's involvement in the global economy, which lies at the core of the Fund's mandate. Most economies are now integrated into world capital markets and capital flows dwarf trade flows. The global crisis has shown that financial sectors have become interconnected and a channel for rapid transmission of crises across regions and at a global level. Therefore, the openness variable must be maintained in the formula at its current or at a higher weight and the current openness variable should be transformed into an interconnectedness variable, by including financial openness. Trade and financial inter-linkages are also relevant indicators for countries' ability to contribute financially to the Fund and for their potential need for Fund financial assistance.

The governance of the Fund must ensure the Fund's effectiveness and the trust of all its members. Critical is the independence of the Managing Director and the staff from political instructions in fulfilling their mandates and tasks. Members should fully uphold and have confidence in this cornerstone of the Fund's governance.

It is important that the reform process is fully anchored within the IMF bodies, including the IMFC, with a view to engage the entire IMF membership.

Fund resources

The euro area countries have taken vigorous measures to guarantee the stability and integrity of the Economic and Monetary Union. The decision of the Eurogroup Ministers on March 30, 2012, to significantly enhance the so-called European firewall is an important step forward in improving market confidence and the resolution of the crisis in Europe.

The overall ceiling for ESM/EFSF lending will be raised to EUR 700 billion. In addition EUR 49 billion out of the EFSM and EUR 53 billion out of the bilateral Greek loan facility have been paid out to support current program countries. As a result, some EUR 800 billion, or more than USD 1 trillion, is being mobilized for the overall firewall.

We agree with the Managing Director that the Fund's membership should now swiftly raise the Fund's lending capacity, as important challenges remain. The Fund's lending resources must be adequate. The euro area member states will provide EUR 150 billion additional bilateral contributions to the Fund. The rest of the membership should contribute its fair share.

Low-income countries

Low-income countries continue to suffer from the global crisis. Fund policy advice, financing, and technical assistance should be readily available to assist low-income countries with raising inclusive growth, creating jobs, ensuring long-term debt sustainability, and rebuilding policy buffers to deal with shocks.

The 2009 low-income country financing package should be completed to secure concessional financing under the Poverty Reduction and Growth Trust (PRGT) through 2014-15. For this purpose, the Executive Board has decided to distribute SDR 0.7 billion dividends originating from gold sale profits, provided that contributions at least equal 90 percent of these dividends will be paid into the subsidy account of the PRGT.