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INTERNATIONAL DEVELOPMENT ASSOCIATION
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Statement by the Hon. **ZHOU XIAOCHUAN**,
Governor of the Fund for **THE PEOPLE'S REPUBLIC OF CHINA**,
at the Joint Annual Discussion

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Governor of the People's Bank of China
2006 Joint Annual Discussion
Singapore
September 19, 2006**

Mr. Chairman, Distinguished Governors, Ladies and Gentlemen:

We are happy to see the global economy continues to grow at a brisk pace. Global growth is more broadly based and more balanced. The momentum of economic growth in the United States remains strong; the economic recovery in the euro zone is on track; Japan, which has moved out of deflation, has a more solid growth; and the major emerging market economies in Asia and Latin America are on a fast growth path.

But it should be noted that intensifying geopolitical conflicts have led to elevated and fluctuating oil prices, adding to inflationary pressures in leading advanced and emerging market economies. Concerns over rising inflationary pressure and tighter monetary policy have caused larger volatility of asset prices in some of these economies; and, confronted with rising inflation pressure and the possibility of an economic slowdown, countries face critical policy challenges. In addition, protectionist pressures are mounting. Trade friction has spread from goods to services trade and investment. The Doha Round negotiations are in a stalemate. All these cast a shadow over the prospects of sustainable global growth.

We wish to make the following appeals. First, all relevant parties should work together to resolve international and regional disputes through consultation and dialogue, create a stable international environment for energy security, and prevent additional oil price shocks. Second, the major economies should, as soon as possible, establish a policy framework for mutual respect and coordination to stabilize market expectations through prudent and orderly adjustment and prevent massive turbulence in the financial markets. Third, all countries should share the responsibility, strengthen dialogue, and contribute to an orderly unwinding of global imbalances.

In 2006, the Chinese economy is maintaining its rapid growth momentum while inflation remains moderate. In the first six months, China's GDP increased by 10.9 percent y-o-y; CPI rose by 1.2 percent. Policies to boost domestic consumption have been effective. In the first eight months of 2006, retail sales increased by 13.5 percent. Overall, the Chinese economy is expected to grow at a fast pace. At the same time, the Chinese government is

conscious of the issues and risks it faces, such as excessive investment and credit expansion, further disequilibrium in the balance of payments, and rising inflationary pressures.

To address these issues, prudent fiscal and monetary policies have been taken to prevent overheating. The People's Bank of China pursued its open market operations flexibly, raised both the benchmark lending rate and the reserve requirement ratio twice to contain the fast growth of credit. Further steps have been taken to improve the exchange rate regime to allow more flexibility. We are convinced that the impact of these policies will be felt over time.

The medium and long-term challenges to China's economy include the need to address the economic structural problems, environmental concerns and job market pressures. Although significant progress has been made in financial reform, there is a long way to go in improving the governance of financial institutions. We shall pursue our efforts to accelerate economic restructuring and modify our economic growth model, and widen economic liberalization to achieve balanced and sustainable development.

Boosted by buoyant economic development in the Mainland, the momentum for growth in **the Hong Kong and Macao Special Administrative Regions** remains strong. In Hong Kong SAR, GDP grew 8 percent in the first quarter and registered a real growth of 5.2 percent in the second quarter. Employment keeps improving. Domestic demand is expanding and investment expenditure is rising steadily. In the meantime, inflation remains moderate. The GDP growth in 2006 is expected to be in the range of 4-5 percent while the CPI increase will be 2 percent. In the first half of the year, Macao SAR's economy grew as much as 17.7 percent, led by flourishing tourism, rising fixed-asset investment, and growing private consumption; the government recorded a fiscal surplus; the unemployment rate dropped to below 4 percent; and exports grew over 40 percent. Economic growth in Macao SAR is expected to remain strong for the rest of the year.

Mr. Chairman,

We commend the Fund and the Bank for their efforts after the Asian financial crisis in strengthening surveillance, improving governance, and promoting economic growth and poverty reduction in the developing countries. To meet the challenges of globalization, Managing Director Rodrigo de Rato has proposed a medium-term strategy framework, drawing up a detailed strategic plan for the institution's future development.

Governance reform is a key element of the medium-term strategy. We support Managing Director de Rato's suggestion that the reform should seek not only to make the distribution of quotas better reflect changes in members' economic positions in the world

economy, but also to enhance the voice of low-income countries. These two objectives are equally important and indispensable. We are pleased to note that progress has been achieved in reform of the Fund's quotas. Ad hoc quota increases for a small group of countries are a good beginning. With regard to the second-stage reform plan, we support the reform package proposed by the Managing Director. We call on the Fund to strengthen its efforts to examine the second-stage reform plan, particularly on issues related to the quota formula and basic votes. We believe the new quota formula should be simpler and more transparent, that the basic votes should be increased by a significant margin, and a mechanism be in place to keep the basic votes at appropriate levels. We support the Managing Director's proposal to provide additional resources for strengthening the capacity of the offices of the African Executive Directors. We continue to call for the establishment of a more transparent procedure for the selection of the Managing Director.

We welcome the Managing Director's proposal to strengthen surveillance and improve its effectiveness in helping the Fund adapt to the globalization process. I would like to emphasize the following points. First, in all forms of surveillance, the Fund should always adhere to its purposes of promoting global exchange and macroeconomic stability, and respect the autonomy of member countries in choosing their own exchange rate regime as stipulated in the Articles of Agreement. The Fund's surveillance should seek to ensure that the macroeconomic policies adopted by its members are consistent with the objective of promoting economic and financial stability at the national and global level. Surveillance over a member's exchange rate policy should focus on whether the adopted exchange rate regime is appropriate and consistent with a member's macroeconomic policies rather than on the exchange rate level.

Second, the Fund should focus its surveillance on the systemically important countries issuing major reserve currencies. The fundamental weakness of the existing international monetary system lies in its undue reliance on a single currency. The excessive fluctuation of the major currencies, the abrupt reversal of capital flows, and the lack of effective preventive and assistance mechanisms are the major reasons for the frequent outbreak of crises since the collapse of the Bretton Woods system. The Fund should enhance its surveillance over the macroeconomic policies of countries issuing major reserve currencies, prevent their excessive fluctuation, and urge the relevant countries to strengthen hedge fund regulation so as to avoid sudden shocks on the financial markets.

Third, the Fund's surveillance should fit in with the actual conditions and be conducted within the framework of the Executive Board and the IMFC. In order for any new surveillance mechanism to win the consensus of its members and be effectively implemented, full consideration has to be taken of the applicability and limits of the theories and methodologies used as well as the diversity of member countries' specifics.

Dialogue and consultation on an equal footing are the basis of surveillance. A “command-style” surveillance may be counterproductive and even cost the Fund its credibility in the eyes of its members.

As for the Governance and Anti-corruption Strategy of the World Bank, we believe that improvement in governance is an integral part of a country’s development process. Development promotes good governance, and good governance supports development. Whether the Bank is able to achieve progress on governance and anti-corruption hinges on its strategy and approach. In promoting good governance and anti-corruption, several principles should be observed. First, abide by the principle of non-politicization as required by the Bank’s Articles of Agreement. Second, always regard development as the Bank’s core mission. Third, respect a borrowing country’s own decisions on development. Fourth, evaluate the effectiveness of the Bank’s governance and anti-corruption with facts on the ground. Fifth, focus on areas where the Bank has comparative advantages. Sixth, lead by a good example through improved internal governance.

Ensuring global energy security and containing global climate change not only has a bearing on economic growth and people’s livelihood in each individual country’s policies, it is also vital for maintaining world peace and stability, and promoting common development. The international community should push for substantial progress in the proposed Investment Framework for Clean Energy and Development.

Through years of effort, the international community has achieved encouraging progress on the issue of development. Nevertheless, the developing countries still face many challenges in promoting economic and social development. We call on the international community, particularly the developed nations, to take more active and effective steps to fulfill their promises with respect to financial assistance, debt relief, and market access, and conduct the necessary reforms to make the international economic system and rules more equitable and fair, so as to provide more opportunities for the developing countries to achieve the Millennium Development Goals.

As a developing country, China has provided assistance to other developing countries within its ability under the framework of South-South Cooperation, thus contributing importantly to the development of these countries. When providing assistance and concessional loans to other developing countries, China fully respects the needs and ownership of these countries. Assistance and loans from China are welcomed by these countries because such financial support has played a positive role in addressing the shortage of funds in these countries, promoting their economic and social development, and enhancing their strength for self-sustained growth.