



International Monetary and Financial Committee

Fifteenth Meeting
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**Statement Federal Minister of Finance by Peer Steinbrück
Chairman of the EU Council of Economic and Finance Ministers**
On behalf of EU Council of Economic and Finance Ministers

Statement by Federal Minister of Finance Peer Steinbrück, in his capacity as Chairman of the EU Council of Economic and Finance Ministers, to IMFC Spring 2007 meeting

1. I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses notably on the world economy – and in particular the outlook and policies for the European Union –, quotas and voice reform in the IMF and the implementation of the IMF's medium term strategy.

Economic Situation and Outlook

2. Global economic activity remained robust in 2006. GDP growth was relatively strong in North America and emerging Asian economies, including China and India, and increasingly robust in the EU and Japan. While there are risks, the outlook is for a continued, albeit somewhat slower, expansion in 2007, with a soft landing of the US economy.

3. In 2006, the cyclical recovery in the EU firmed and became more broad-based. In particular, domestic demand, which had been weak in several large Member States, strengthened. Growth moved above potential in 2006 and is expected to remain at or slightly above potential in the near to medium term. The labour market has continued to develop favourably in terms of rising employment and moderate increases in labour costs. The EU economy has benefited from the effects of structural reform towards increasing GDP growth and well-contained inflationary pressures, which could sustain the present upswing. The economic recovery provides a strong opportunity for pursuing needed structural reforms.

4. Annual inflation in the EU is forecast to decline to around 2% in 2007 and 2008. Thus far indicators of more underlying inflationary pressures suggest that second round effects from the higher energy prices have been rather limited. Looking ahead, labour cost indicators continue to signal wage moderation, but a pass-through of commodity price increases and potential stronger-than-expected wage increases given the robust GDP growth and tightening labour markets could also constitute upside risks to the inflation outlook.

5. 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- and climate-related challenges. In this context:

- Global imbalances remain an important challenge. Recent cyclical developments have gone some way towards a welcome rebalancing of global growth. While current account imbalances increased further in 2006, they are showing some signs of stabilizing, helped by the earlier decline in oil prices and some rebalancing of domestic demand growth. It is important that their orderly correction be promoted. This is a shared responsibility, requiring measures to increase savings in the US, growth enhancing structural reforms in the EU and Japan and increasing exchange rate flexibility in some emerging economies in Asia. In this regard, we welcome progress made in the context of the multilateral consultation on global imbalances. They have contributed to an improved understanding of the issue among the participants and have fostered the implementation of policies consistent with the strategy endorsed by the IMFC in September 2006. We call for determined implementation of the policy plans identified in the context of the multilateral consultation. The EU remains fully committed to support the re-launch of the Doha trade negotiations announced in Geneva. In this regard, we stress the need for an ambitious, balanced and

comprehensive agreement. Maintaining and strengthening the multilateral trade system based on the WTO is of paramount importance for the growth and employment prospects of the global economy, as well as for development. We call on key partners to act in the same spirit of constructive commitment in order to bring the negotiations to a successful close.

- Global equity prices fell abruptly at the end of February. This was triggered by a sharp decline in the Chinese stock market index and by a downward revision of growth expectations in the US, but may also be interpreted as a correction of the preceding steady rise of prices in equities and other financial assets, in a context of record low volatility. Prices in major bond markets rose and exchange rate movements reflected some unwinding of the widespread carry trades. This episode of financial market turbulence appears to have been short-lived and overall the international financial system has proven its resilience to this type of shock, although risks of further volatility remain.
- The EU economic policy strategy remains oriented towards improving the conditions for more growth and jobs and fostering the success of the European Economic and Monetary Union (EMU). Some progress has already been made, but the EU needs to build upon the reforms already underway and turn to some of the areas where progress remains limited, such as fostering competition, increasing incentives in benefit systems and improving the adaptability of labour markets. Sound macroeconomic policies are essential to support a well-balanced economic expansion and the full realisation of the current growth potential. Fiscal consolidation remains important, not least in the context of population ageing. Some progress has been made towards securing more sustainable public finances, including by reforming pension systems. Member States are committed to making full use of the present positive budgetary developments and favourable economic outlook to speed up consolidation in accordance with the revised Stability and Growth Pact. In addition, they aim to improve the quality of public finances, by raising the efficiency and effectiveness of public spending and making tax and revenue systems more conducive to sustainable growth and employment creation.
- Progress in implementing structural reforms is crucial to increase the growth potential of the EU, promote stability and support a smooth functioning of EMU and promote the resilience to shocks. The re-launched Lisbon strategy therefore reinforces the Union's priorities of achieving growth and employment by strengthening the Internal Market and Europe's competitiveness, promoting knowledge and innovation, unlocking business potential, increasing employability and creating more jobs. The annual preparation and assessment of National Reform Programmes under the revised Lisbon Agenda, and their debate in national Parliaments and with stakeholders, as well as the Community Lisbon Programme at EU level, are important elements in that process. An effective, efficient and equitable response to the challenges of climate change and its consequences for global economic development require international collective action. The EU has committed to transforming Europe into a highly energy-efficient and low greenhouse-gas emitting economy. We invite all countries to contribute as well. Based on cost-effective competition, diversification of sources, subsidiarity and cooperation between Member States as well as a positive framework for investment the EU will pursue an integrated approach to climate and

energy policy to ensure secure availability of affordable energy and promoting environmental sustainability.

- Over the last few years, the structural reforms in the EU have had some positive effects. Relatively robust employment growth coupled with the substantial drop in unemployment in 2006, suggests that there has been structural improvement in the functioning of labour markets, with most estimates showing a gradual downward trend in the structural level of unemployment over the last decade. Nevertheless, strengthened reform efforts are needed in most countries to achieve higher rates of sustainable growth and employment creation in the long run, ensure smooth adjustment processes in the euro area, cope with the challenges of ageing and to reap the full benefits of globalisation.

Quotas and voice reform in the IMF

6. With the adoption of the resolution on quotas and voice, the September 2006 Meetings have initiated an integrated set of reforms, aimed at ensuring that quotas better reflect the weight and role of countries in the world economy and that the voice and voting power of low income countries be further enhanced.

New Quota formula

7. EU members will work constructively for a new quota formula to ensure that it produces an outcome which better represents the relative weight and role of members in the world economy and reflects fully the Fund's mission and purposes. Any new quota formula should be simpler and more transparent, and should be used to guide future quota distributions. It should set appropriate incentives to pursue policies consistent with IMF principles.

8. GDP and openness (both in trade and in financial terms) should be the main variables in the new quota formula and the weight of GDP should be increased. Variability should have a much lower weight than GDP and openness. If included, reserves should have a much lower weight than their average, implicit weight in the current formulas. We see no principled case for the calculation of GDP using anything other than market exchange rates: in the international monetary system, whose stability is the core responsibility of the Fund, countries' interactions (through trade or financial relations) take place at market exchange rates. Also, GDP at market exchange rates is the relevant measure of a member's ability to contribute to the Fund's finances. We strongly support improving the current openness variable by including some measure of financial openness and call on the IMF to continue exploring a suitable method for measuring financial openness. Given that the inclusion of reserves may contradict to some extent with the Fund's purposes, a low weight should be given to reserves, if they *are* to be included, and applying a cap to the level of reserves should be considered.

9. Considerations should also be given to the role the quota formula should play in ensuring cohesiveness and equity between the Fund's members. It should support a balanced distribution of quotas amongst all Fund members. One of the objectives should be to reach a transparent and stable quota system. In this respect, EU member states support the use of a compression factor in the formula as an alternative way of generating a distribution of

calculated quotas which is broadly acceptable to the whole membership by reducing the dispersion of quota shares, which exists however the conversion factor of GDP is defined.

Second round of ad hoc quota increases

10. Once a new quota formula has been agreed and with a view to achieving a significant further alignment of members' quotas with their relative positions in the world economy, a second round of limited ad hoc quota increases must take place to adjust the situation of the most under-represented members. In this exercise, EU members must be treated equally with other under-represented members, and the EU will actively support its under-represented members' reasonable demands. EU members agree that future general reviews of quota should be guided by Fund liquidity. They note that an established need for additional Fund liquidity is an essential precondition for any general increase in quotas.

Basic votes and capacity strengthening

11. EU members strongly support the objective of enhancing the voice and participation of low income and transition countries in the Fund. It is therefore essential that their voting share is increased through this process. Consequently, the firm decision in Singapore to significantly increase basic votes, providing for at least a doubling, would need to be implemented in line with the timetable in the resolution. EU members also support introducing a mechanism to safeguard the share of basic votes in total voting power. Similarly EU members support other options that would strengthen the voice of low-income countries, including steps to increase the staffing resources and the number of Alternate Executive Directors of particularly large constituencies.

Other governance issues

12. EU member states are ready to engage in a discussion of the appropriate selection criteria and processes for the senior management in all IFIs.

13. EU Member states are committed to reach, within the timeframe provided by the Resolution, a satisfactory outcome to the process of reform which strengthens the multilateral system of which the IMF is such an important part.

Implementing the IMF's Medium-Term Strategy

Surveillance

14. EU member states welcome the progress made in the reform of the IMF surveillance framework. Taken together the reform currently underway should enhance the focus, candor, even-handedness and effectiveness of surveillance. Surveillance should focus more on multilateral and regional issues and on the spillover effects of members' macroeconomic and financial policies on other countries, recognizing the role of the most systemically important countries, without downgrading the quality of its country-specific work. The integration of bilateral, regional and multilateral surveillance should also be strengthened. It is particularly important that the Fund should bring its coverage of financial sector and capital market developments, including at the global level, to the same level as its other core areas of expertise in surveillance. The revised decision should draw on the best practices already in use in Article IV consultations.

15. In this context, we support a revision of the 1977 Decision on Surveillance over Exchange Rates Policies to create a coherent, comprehensive and consistent framework for surveillance and to focus surveillance on the elements most relevant to the Fund's core mandate. A revised decision should include a clear re-statement of the commitments which member countries make to each other and to the Fund under Article IV. This should provide clarification of the scope of these commitments in the changing global economy without expanding members' obligations under surveillance, and remaining at the same time sufficiently broad so as not to introduce undue rigidities. It should pay due regard to country specific circumstances and emphasize the need for even-handedness. The Fund's surveillance has a key role to play in analysing and advising on exchange rate regimes and their consistency with respect to both domestic macroeconomic policies and global and regional developments. We look forward to the Fund's report on the modalities of surveillance of monetary unions. We also welcome the introduction of concepts such as external stability and misalignments as a valuable input. We welcome the efforts by the Fund to build the broadest possible support for the review of the 1977 Decision. To this end it is important that the proposals are thoroughly debated, while ensuring sufficient momentum for the review to be completed in a timely manner. We look forward to completing this review on the basis of more specific proposals by the Fund.

16. We welcome ongoing efforts and the progress made by the Fund to clarify the accountability framework and measure the effectiveness of the Fund and recognise the role the remit can play in enhancing that effectiveness. We support the setting of a remit for IMF surveillance to clarify medium term objectives and operational priorities of surveillance, subject to further work on the issues involved and in the context of the surveillance package as a whole. Together with a revised 1977 Decision, this could contribute to attaining greater focus and effectiveness in surveillance, enhance transparency and accountability, and provide a vehicle for identifying priority issues for surveillance. The remit should respect the role of the Executive Board as the Fund's central body in charge of conducting the Fund's work on surveillance, as well as the role of the IMFC. We look forward to discussing further proposals by the Fund on these issues with a view to achieving progress by the 2007 Annual Meetings.

Crisis Prevention and Resolution

17. We note recent progress by the Fund on clarifying the design of new liquidity instrument for market access countries. It is important that the proposed Reserve Augmentation Line strikes a broadly appropriate balance between predictability of access and maintaining adequate safeguards for Fund resources, and is consistent with existing IMF facilities.

18. In addition, we emphasize the importance of continuing to strengthen the framework for resolving crises, in particular, the need to review the lending-into-arrears policy. This should inter alia address issues such as probabilistic debt sustainability analysis, price incentives and the appropriate role of the Fund in setting the 'resource envelope' for a restructuring.

Trade

19. We acknowledge the importance of Aid for Trade as essential in helping many developing countries gain the full benefit from trade. We reaffirm our pledges to delivering on

our Aid for Trade commitments, independent of progress in the Doha Round, and call on all other donors to do the same.

Low income countries

20. EU members consider that the IMF should give priority to enhancing the effectiveness and efficiency of its work in low income countries by focusing on macroeconomic stability and sustainable growth thereby supporting the achievement of the MDG's. In that context, we note the report by the External Review Committee on IMF-World Bank Collaboration. We agree that close cooperation between the two institutions is indeed key to delivering services more effectively and efficiently, based on a clear and equal partnership which takes fully into account the institutions' comparative advantages, respective mandates and responsibilities, while avoiding gaps and duplications. In this context, we consider that the proposals of the report deserve careful attention. We support a continuing financial role for the Fund, under its existing facilities, in low income countries according to its mandate.

21. We also welcome the IEO report on the IMF and Aid to Sub-Saharan Africa (SSA) as an important contribution to making the Fund's engagement with low-income countries more effective. The report's assessments and recommendations offer a good basis for further discussions on how to clarify the institution's mandate and policies to help SSA to achieve macroeconomic stability and growth and reduce poverty.

IMF financing

22. The EU Member States welcome the report from the Committee of eminent persons to study the sustainable long-term financing of the IMF. We agree with the Committee's analysis of the financial challenges facing the Fund in the medium-term. The measures proposed in the report offer a sound basis for further work in putting the Fund's financing on a more sustainable basis. EU Member States consider that in light of the Fund's projected financing gap, both its income and expenditure need to be addressed. While expenditure was outside the remit of the Committee, we agree that new revenue measures cannot be considered in isolation from what shareholding countries view as the Fund's missions, and the costs implied by these. The Managing Director's medium term strategy, which was welcomed by the IMFC, outlined these missions. Specific income and expenditure proposals should follow and reflect the continuing debate on the framework for implementation of that mission.

Other issues

23. EU countries call for continued action by all countries to develop and implement strong programs against money laundering and terrorist financing according to the 40 Recommendations and the 9 Special Recommendations of the Financial Action Task Force (FATF). We urge the FATF to review jurisdictions that have failed to recognise the international standards. We call on the IMF and the World Bank to closely cooperate with the FATF. EU countries are committed to the effective and timely implementation of UN Resolutions 1540, 1718, 1737 and have taken action to that effect; we call on other countries to do likewise. We support the recent decisions of the FATF on the financing of proliferation of weapons of mass destruction.