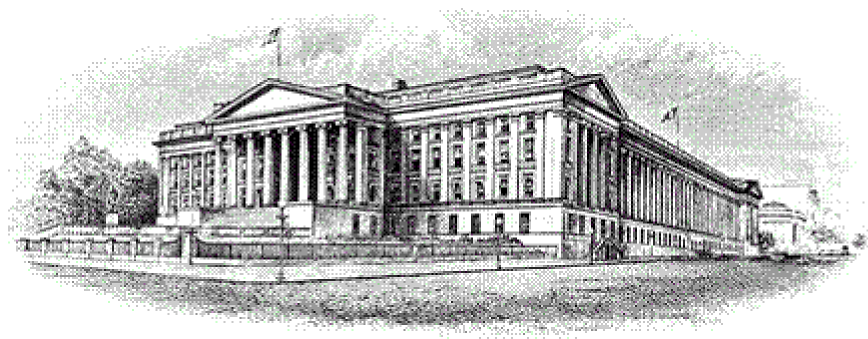
# International Monetary and Financial Committee

Fifteenth Meeting
April 14, 2007

**Statement by Henry M. Paulson, Jr.**
**Secretary of the Treasury United States**
On behalf of United States



# U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

**EMBARGOED UNTIL** 10 a.m. (EDT), April 14, 2007
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## STATEMENT BY U.S. TREASURY SECRETARY HENRY M. PAULSON AT THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE MEETING

**WASHINGTON, DC—**Today's meeting is taking place against the backdrop of a continued strong and resilient global economy, which provides a favorable setting for overcoming the challenges we face. Both advanced and emerging economies have put in place improved policy frameworks that are underpinning sustained growth. With global growth expected to be near 5% this year, the past five years mark the strongest period of world growth since the early 1970s. Recent bouts of moderate financial turbulence, in mid-2006 and again in early 2007, have tested the system, but it has performed well. While ongoing vigilance is required, inflation risks appear contained and international trade continues to expand.

Prospects for the U.S. economy are good. While economic activity slowed below potential in late 2006, we expect GDP growth to rebound to 3% by the end of this year. Inflation risks appear to be contained, while the labor market is healthy – with 7.8 million new jobs created since mid-2003, low unemployment and strong real wage growth. I am happy to report that the U.S. continues to make excellent progress in steadily shrinking our federal fiscal deficit, which fell from 3.6% in FY2004 to 1.9% in FY2006, a pace faster than most thought likely. We are committed to keeping the U.S. economy open to trade and investment, which underpins our economic strength, and to opposing protectionism whenever and wherever it arises.

Trade liberalization remains essential to economic growth for all countries and a key catalyst for poverty reduction in the less developed countries. Now that Doha Round negotiations have resumed, we must seize the opportunity to reach agreement. All countries will benefit from an agreement, and all countries – both developed and developing – must contribute through real market access commitments in agriculture, manufacturing, and services, including financial services. The financial sector in particular is the backbone of a modern economy with virtually every other sector of the economy depending on its services.

Over the last several months, the United States has been a participant in the IMF-sponsored Multilateral Consultations on global imbalances. While these consultations were never intended to produce joint policy commitments, they have still contributed importantly to improved understanding about the participants' shared responsibilities for promoting adjustment of imbalances. Indeed, there has been some re-balancing of global demand over the last year, but it is important to ensure that the cyclical upturn now underway in many countries is translated into lasting improvements in underlying potential growth. Looking forward, we hope for faster sustained demand growth from Europe and Japan, more demand growth from major surplus countries, and greater exchange rate flexibility in Asian emerging economies, especially China. The counterpart to a falling U.S. trade deficit, by definition, is falling trade surpluses in other economies.

## Progress on IMF Reform

The IMF is an essential organization for international monetary cooperation. It has proven this since its inception – fostering growth and integration in the wake of World War II; strengthening international surveillance after the breakdown of the Bretton Woods System; helping the global financial system overcome the debt crises of the 1980s and 1990s; and facilitating the transition of command economies. In serving the global economy, the Fund has adapted to changing times while adhering to its basic principles. The world is fast changing again. For the IMF to remain modern and relevant, it must re-invent itself. That is what our discussions on the Medium Term Strategy are all about.

First and foremost, the IMF must fundamentally reform its approach to surveillance over exchange rates. Let us be clear: exercising firm surveillance over members' exchange rate policies is the core function of the institution. The 1977 Decision on Surveillance over Exchange Rate Policies must be updated to reflect the dramatic rise of capital flows and the wider use of market-determined floating exchange rates, and to sharpen the focus on fundamental exchange rate misalignment. This should enable firmer surveillance in areas where market forces are not the prevailing paradigm, such as insufficiently flexible exchange rate regimes, or areas where macroeconomic policies and performance are poor even if the exchange rate freely floats. The updating should be accomplished in a manner that creates no new obligations under the IMF Articles. It should also incorporate the realities of how surveillance is actually undertaken in this day and age, and ensure that the conduct of surveillance is even-handed and candid. If exchange rate issues are not debated critically and openly at the Fund, alternative venues and approaches will necessarily emerge. For us, reform of the IMF's foreign exchange surveillance is the lynchpin on which other reforms depend, and we look forward to action in this important area very soon after these meetings. Moreover, it is not simply enough to revise the 1977 Decision. The IMF staff must do a better job in addressing foreign exchange surveillance on a day-to-day basis, particularly in Article IV reports.

Second, as part of the modernization and re-invention process, the IMF's governance structure needs to be overhauled. The Fund no longer looks like the world economy in which we live. Marginal reforms that do not fundamentally alter relative quota shares are insufficient – bold action is needed to boost the share of dynamic emerging market countries. Major emerging markets are producing an increasing share of global output, assuming greater responsibility for the functioning of the system, and will increasingly drive global growth. We continue to support protecting the shares of the poorest countries through an increase in basic votes. We reiterate the commitment of the United States to forgo the additional quota due us in the second stage ad hoc increase beyond what we need to maintain our pre-Singapore voting share and we reiterate our as of yet largely unheard call on other similarly situated countries to join us in doing this.

As part of this broader reform package, we have listened to our colleagues in emerging markets and we will support a new liquidity instrument to promote further reduction of vulnerabilities to capital account crises, provided the instrument is well-designed. We expect the instrument to include a high standard for qualification and provide that a country, which fully draws its funding under the instrument and subsequently requires additional resources, do so under a new IMF program. Policy actions to deepen domestic local currency capital markets should be an important part of efforts to mitigate the risks to national balance sheets.

Two important external reports have been issued since we last met, both of which have provided useful insights on key issues facing the Fund.

The Malan Report on Bank/Fund Collaboration provides recommendations on sharpening the focus of the IMF's work in low-income countries. We very much agree with these recommendations. The Fund has a very important role to play in poor countries, through surveillance, technical assistance, and financing when appropriate. But the IMF is not a development agency, and we strongly concur with the report's recommendation that the IMF's financing role in low-income countries should focus on actual balance of payments needs, as it does in emerging market members.

The Crockett Report will help catalyze the Executive Board's thinking on the important issue of how the IMF finances itself in the longer-term. The IMF has ample reserves to cover shortfalls in the immediate term, permitting time to fully consider the merits of the Report's recommendations. In parallel, options for further budget restraint must also be fully explored. If low levels of credit persist, the Board will need to give serious consideration to the appropriate role and size of the IMF going forward. The Report puts forward a number of financing options, and we are prepared to consider each on their merits in time.

Since we last met, there has been important progress on strengthening the joint World Bank/IMF Debt Sustainability Framework and Debt Sustainability Analyses (DSAs) for low-income countries. Vigilance will be required to deter the rapid re-accumulation of debt for post-MDRI countries, and we urge emerging bilateral creditors to exercise good judgment and lend responsibly. To this end, we hope that lenders and borrowers will use the DSAs as a tool for analysis and decision making.

Vigorous global efforts to combat terrorist financing, WMD proliferation financing, and other forms of illicit financing are necessary to promote international financial stability and global security. We must continue to assist countries in implementing the Financial Action Task Force's (FATF's) international standards on money laundering and terrorist financing. The IMF and World Bank have been major partners in this vital global effort, and we look for their continued close collaboration with FATF going forward. We also call on all countries to fulfill their UN obligations by implementing UN Security Council Resolutions 1540, 1718, 1737, and 1747 against WMD proliferation, particularly the economic and financial provisions of those resolutions. We commend FATF's effort to examine the risks of WMD proliferation financing and to enhance surveillance of emerging threats to the financial system.

Thank you.

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