International Monetary and Financial Committee

Twelfth Meeting
September 24, 2005

Statement by Commissioner Joaquin Almunia
On behalf of the European Commission

Statement of Commissioner Joaquin Almunia to the International Monetary and Financial Committee, on behalf of the European Commission

Washington, September 2005

The **global economy** continues to expand robustly, albeit more modestly than in 2004. The outlook is favourable although widening external imbalances, and uncertainties about how they will be corrected, are a cause for concern. Furthermore, rising oil prices and the tight market conditions may start producing stronger effects on growth and inflation than witnessed thus far. The Commission therefore welcomes the measures taken by the International Energy Agency to release 2 million barrels a day of oil and oil products from existing emergency stocks. The Commission also encourages oil producing countries to improve their investment climate, in order to support an expansion of their supply capacity and calls on oil companies to increase investment in oil exploration, production, refining capacity and alternative energy sources. Consumer countries need to rein in their demand by increasing energy efficiency and making use of innovative technologies and new sources of energy. Bringing energy intensity in major consuming countries to the same level as that existing in Europe would reduce global oil demand by almost 12 million barrels per day. The Commission welcomes the progress made in improving the transparency of oil markets, but encourages further efforts in this direction.

Growth in 2005 has been weaker than expected in the **euro area** so far, but it is expected to pick up gradually to reach potential in 2006. In spite of the pressure from high oil prices, headline inflation has been very stable this year. The monetary stance has remained supportive of a further increase in economic activity. Driven by the weakening of the euro exchange rate, overall monetary conditions have been loosened since the beginning of the year. Short- and long-term interest rates in the euro area (both in nominal and real terms) are extremely low by historical standards. General government deficits in the euro area countries are expected to post a marginal improvement this year. In cyclically-adjusted terms, this reflects a broadly neutral fiscal stance. Macro-economic policies in the euro area should remain supportive of a well-balanced economic expansion and the full realization of current growth potential, especially in the current context, where oil price hikes represent a downside risk.

Further **budgetary consolidation** continues to be of utmost importance for a number of Member States to rein in excessive deficits. Compliance with the commitment to sound public finances has a confidence instilling effect for growth and employment prospects. If coupled with pension and health care reforms, it will also contribute to the long-term easing of budgetary pressures due to population ageing. The reform of the **Stability and Growth Pact** has now fully entered into force. The reformed Pact presents a better and more balanced framework, improving the economic underpinning of the EU fiscal rules. The reform of the Pact also reinforces its capacity to foster discipline, while dealing with the diverse economic realities of the 25 EU Member States. It will contribute to increased ownership of the Pact at national level, thanks in particular to the encouragement of economic reforms to foster growth and job creation, and to the introduction of a more flexible path to correct excessive deficits. Given the increased degree of judgement introduced by the reform, making the new agreement fully operational and ensuring compliance with it are the challenges that lie ahead.

The Commission will continue to ensure a transparent, impartial and forceful implementation of the rules to all Member States.

Regarding the **euro area exchange rate**, six of the new Member States have joined the Exchange Rate Mechanism (ERM II), which aims at facilitating a smooth adoption of the single currency by countries that fulfil the necessary conditions. The prospect of joining the mechanism for those new Member States that have not yet joined represents a catalyst for reform.

The Commission sees a compelling case for urgent action to spur European competitiveness in the context of the re-launched **Lisbon Strategy**, with a view to accelerating the implementation of structural reforms. This would allow the EU to better respond to the challenges of ageing populations and of ongoing globalisation. Three major areas for action have been identified: boosting knowledge and innovation; making the EU an attractive area in which to invest and work; and enhancing employment. The governance of the strategy has been modified, with an aim to establish a partnership between the Community and Member States, with a clearer and more streamlined distribution of tasks and responsibilities. As a result, Member States' ownership of the Lisbon agenda should be enhanced.

By improving the allocation of capital, enhancing productivity, and providing wider opportunities for risk sharing, an integrated and efficient financial sector will raise the growth potential of the EU economy. The pace of **EU financial integration** accelerated markedly with the introduction of the euro in 1999, which has stimulated interest in cross-border financial transactions by eliminating foreign exchange risk for the bulk of financial flows within the EU. The integration process has benefited from efforts to create a common EU regulatory framework by implementing the Community's Financial Service Action Plan (FSAP) 2000-2005. The various measures in the FSAP are now mostly adopted at the EU level and must now be implemented by the Member States. Turning to the next phase of the financial integration process, in 2006 the Commission will recommend priorities for action over the following 5 years. The next phase of the process is likely to focus on consolidation of existing measures and on the need for better regulation.

The expansion in the **United States** continues at a solid pace. The tragic devastation inflicted by Hurricane Katrina has created some economic uncertainty. It remains important to bring short-term interest rates towards a neutral level, and to reduce the structural general government deficit. The best strategy to lower the risk of a disruptive adjustment of global imbalances is to make efforts to raise domestic public and private saving.

Economic activity in **Japan** is gradually picking up speed, mainly driven by domestic demand. Deflation is also gradually coming to an end. However, government finances need to be consolidated. A renewed impetus for the implementation of structural reforms is needed, in order to increase Japan's potential rate of growth.

Further progress was made in the process of Bulgaria's and Romania's accession to the European Union last April, with the signing of the Accession Treaty. This foresees accession by 1 January 2007, with the possible delay of one year, in case of major shortcomings in preparation for membership. Last December, the European Council considered Turkey sufficiently compliant with the political criteria for accession and decided to open accession negotiations. Membership negotiations could start soon. Accession negotiations with Croatia will start once the country has demonstrated full cooperation with the UN International Criminal Tribunal for the former Yugoslavia. The prospect of accession has served as an anchor for reform in all these countries, which have continued to enjoy solid growth and strengthened macroeconomic stability. The Commission also fully and effectively supports the European perspective of the other **Western Balkans** countries.

Since its inception in 2003, the EU policy towards its neighbours has made considerable progress and has potential large economic benefits. Greater legislative and regulatory convergence with the EU, particularly in those areas that are important for improved market access, should lead to higher investment and growth, especially if accompanied with greater liberalisation of trade in services and agricultural products. Action Plans have been agreed with seven countries (Moldova, Ukraine, Morocco, Tunisia, Jordan, Israel and the Palestinian Authority), and negotiations are ongoing or about to be launched with five other (Egypt, Lebanon, Armenia, Azerbaijan and Georgia). The focus is increasingly on implementation and monitoring. A renewed impetus has recently been given to the **EU-Mediterranean** dialogue on economic policy issues, when the first EU-Mediterranean meeting of ministers of finance and economy took place in Morocco in June 2005.

The Commission welcomes the continued strong economic performance in **Latin America.** Macroeconomic policies generally remain prudent, but the Commission stresses the importance of using the currently benign situation to press ahead with fiscal consolidation and structural reform. Such efforts should be complemented with policies aimed at enhancing social cohesion and deepening sub-regional integration. In early September, EU and Mercosur Ministers agreed on a roadmap for further trade negotiations. **Asia** continues to grow robustly, and the region is increasingly playing a role as an engine of global growth. The Commission welcomes the recent moves by China and Malaysia to a managed floating exchange rate regime with reference to a basket of currencies, as steps in the right direction towards greater exchange rate flexibility. Greater exchange rate flexibility is in the Asian region's interest, since it should support the transition to more balanced growth.

More than ever**, EU development policy** remains committed to the framework of the Millennium Development Goals (MDGs), with its ultimate objective of poverty eradication in developing countries. More and better aid is crucial, and the EU has now made ambitious commitments, including the firm determination to reach the long-standing UN target of 0.7% of aid in Gross National Income by 2015, to be achieved through an interim target of 0.56% by 2010. This would result in an annual ODA of €20 billion more by 2010 than what is expected for 2006. The EU supports the G8 proposal of further multilateral debt relief for the Heavily Indebted Poor Countries, even though some issues of equality of treatment, additionality, and financing are still to be clarified. But aid alone will not be sufficient to kick-start a self-sustained development process.

The successful conclusion of the **Doha Development Agenda** (DDA) remains the top EU trade policy priority. Further multilateral trade liberalisation, alongside stronger and better multilateral trade rules, are fundamental to enhancing global growth, instrumental to supporting the integration of developing countries into the global economy, and integral to making further progress with poverty reduction and ensuring the achievement of the MDGs. The development aspect of the round remains crucial. The Commission encourages all developed countries, and developing countries in a position to do so, to match the EU Everything But Arms initiative, and grant duty and quota free access to all imports from Least Developed Countries. Further trade liberalisation must be supported by strengthening the capacity of weak and vulnerable developing countries to participate fully in the more open markets that will be created by a successful DDA outcome. The Commission supports the swift establishment of an Aid for Trade initiative, along the lines of what was recently proposed by the IMF/World Bank Staff. This should be supplemented by bilateral pledges, such as the Commission's own €1billion pledge. In the run up to the next WTO Ministerial, there is an urgent need for all WTO participants to demonstrate their political commitment to the round by taking the difficult decisions that remain.

The Commission is taking an active part in the fight against the **financing of terrorism**, with several pieces of legislation underway at EU level, such as the 3rd Money Laundering Directive and the Regulation on payer's information accompanying funds' transfers. Both pieces of legislation aim at aligning Community legislation with the Financial Action Task Force 'special recommendations' on combating terrorist financing. The Commission is involved in the coordination of the freezing of terrorist assets in line with the international obligations resulting from the UN Charter. It is also providing technical assistance to third countries to strengthen their capacity to fight terrorism financing. The Commission welcomes IMF monitoring of members' efforts in combating terrorism financing and believes this work can usefully contribute to coordinating and prioritising technical assistance so as to maximise its benefits.

The Commission remains a supporter of efforts to strengthen the **voice and representation** of emerging market and developing countries in the Bretton Woods Institutions, through exploration of avenues such as increasing basic votes, and further enhancing the capacity of delegations' offices to engage with the Fund. The Thirteenth General Review of Quotas also provides an opportunity for progress. **Surveillance** is central to the Fund's role in promoting sound economic policies and financial stability, and helping to prevent crises. While considerable progress has been made to adapt and broaden the coverage and transparency of IMF surveillance, sustained efforts are needed to enhance its effectiveness. Progress with the implementation of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets would contribute to improving the framework for crisis resolution.