International Monetary and Financial Committee

Twelfth Meeting
September 24, 2005

Statement by Mr. Gordon Brown
Chairman
Chancellor of the Exchequer United Kingdom
On behalf of United Kingdom

UK Statement to the IMFC

Gordon Brown, Chancellor of the Exchequer and UK Governor of the IMF

Introduction

We meet in Washington in a year that has brought us face to face with both the immediate and long term challenges that arise from what future historians will describe as the biggest restructuring of the global economy the world has seen since the industrial revolution.

In particular, Asia will soon be manufacturing more than Europe and is now consuming 30 per cent of the world's oil – one of the reasons for the doubling of oil prices and the return of inflationary pressures. While the rapid growth in Asia's exports into Europe brings the threat of manufacturing jobs losses and a new protectionism.

In Britain over the last eight years, when faced with global economic challenges, we have had the strength to take the right long term decisions to overcome them. To protect against the old British stop-go, in 1997 we made the Bank of England independent and created a new regime of monetary and fiscal disciplines that have stood the test of time:

- monetary policy set to meet our symmetric inflation target, which has allowed the Bank of England to act pre-emptively as circumstances change while securing inflation expectations at low levels for the long term; and

- fiscal policy set over the economic cycle allowing it to support monetary policy at times of economic slowdown while ensuring the public finances remain on a long-term sustainable course.

This framework has withstood the global challenges we have faced. The 1998 Asian crisis required action to ensure growth in Europe. In 1999 an IT bubble, in 2000 a stock exchange crash, in 2001 and 2002 a US downturn all required pre-emptive cuts in interest rates and supportive fiscal policy to meet our inflation target and keep the economy moving forward.

As a result of our new economic model for stability - Bank independence, low debt, fiscal responsibility – Britain has enjoyed not only the lowest inflation and the lowest interest rates and the lowest unemployment for thirty years but Britain has had the longest sustained period of continuous growth – 52 consecutive quarters – in our history. This stability has only been possible because we rejected the old-style backward-looking approach to monetary and fiscal policies based on asymmetric inflation targets and nominal fiscal deficits that take no account of the economic cycle, debt and the important role of public investment.

Oil

Now facing the highest sustained oil prices for a quarter of a century we will continue to have the strength to take the right long term decisions.

When we met in Washington in April, the price of oil Brent crude reached a then new nominal high of $55 per barrel. Since then the price of Brent has increased by a further fifth and peaked shortly after Hurricane Katrina at just under $70 per barrel, while the US West Texas Intermediate (WTI) peaked at over $70. Oil prices have trebled since 2002 and doubled since 2004, and currently are estimated to be $18 higher on average in 2006 than the IMF forecast five months ago.

Concerted international action - with dialogue among producer and consumer nations - is required to tackle the risk to global growth posed by current high and volatile oil prices and stabilise the market for the long term. This was endorsed by European Finance Ministers last week and we now ask the IMFC to do the same.

The proposals include: in the short-term, an immediate increase in appropriately priced supply in response to rising demand; greater transparency, particularly from OPEC, about oil reserves and plans for development to ensure there is no unnecessary uncertainty in the market which may cause instability and speculation; additional investment in production and refining capacity; new funds from the World Bank to support the framework that is already being developed for investment in alternative sources of energy and greater energy efficiency in developing countries; and the adoption by the IMF, with an invitation to oil-producing countries to contribute, of a facility to help developing countries affected by commodity price shocks. It is also important that the IMF continues its work in analysing the oil market and working closely with its members to help address the challenges high prices pose for them.

Global economy

It is a measure of success of a decade of anti-inflation policies that the most recent increase in oil prices has not seen a return to the stagflation of the 1970s. However, stability in the oil market is a precondition for global prosperity and high oil prices are already having a negative impact on world economic growth. Estimates from international organizations and independent analysts, such as the OECD and the IMF suggest that oil prices sustained at their current level could reduce growth in the developed countries by up to 0.5 percentage points.

At a time of ongoing global imbalances, this shock to the world economy threatens to derail already slowing growth. On the basis of the IMF's latest estimates, growth in the G7 economies is expected to slow from 3.4 per cent in 2004 to 2.6 per cent in 2005. On some estimates, US growth could be reduced by 0.5 per cent in the second half of this year due to Hurricane Katrina. While in some regions growth has been stronger than expected growth in the UK's largest export market, the euro area, at 1.2 per cent this year is again expected to be lower than originally forecast. Of the three largest euro area economies, Germany and Italy have been in recession during the past 12 months while growth in France is forecast to slow to below 2 per cent. So while UK exports to the rest of the world have remained robust, net exports to the slower-growing euro area have been weaker than expected.

Housing market

And in Britain, not only have we faced the consequences of the global oil shock and weak growth in the euro area, but we have had to manage the transition from double-digit growth in house prices down to a more sustainable level, moderating from 23 per cent in the year to the final quarter of 2002, to 11 per cent in the second quarter of 2004 and to 4 per cent in the second quarter of this year.

In each of the past three house price cycles - in the mid 1970s, in the early 1980s and again in the early to mid 1990s - a period of such rapid house price growth has been accompanied by a rapid rise in inflation and sharp increases in interest rates followed by sustained falls in real house prices, rising unemployment and recession. But it is because of the new framework for economic stability - with interest rates low and stable, inflation low and employment at record highs - that the economy is better placed to adjust to the moderation in the housing market. So that instead of the old British stop-go, house prices are adjusting free of recession.

UK economy

In previous decades any one of these shocks – the biggest sustained rise in oil prices for a quarter of a century, recession in some of our main export markets and adjustment in the housing market - would have the tipped the British economy into recession.

In the last oil shock, inflation rose to 25 per cent, unemployment surpassed 2 million and the British economy was the first in, last out and worst hit by world recession. Today inflation is 2.3 per cent and employment is at a record high.

The point of our monetary and fiscal framework is that we can not only take long term decisions that ensure stability, but that we can respond quickly to changing trends. The Bank acted proactively last year to meet its inflation target and slow house prices. This year as European growth has slowed and oil prices have risen it has been able to be proactive bringing rates down.

But no country can insulate itself from the ups and downs of the world economy. With European activity much lower and oil prices much higher, there has been an impact on growth right across the continent, including the UK. We will update our forecasts in the Pre-Budget Report. But while trends so far this year suggest the UK is likely to see growth at or slightly below our cautious view of trend it is because of the tough forward-looking decisions we have taken in monetary and fiscal policy that, even despite the new challenges we now face, Britain is continuing to grow faster this year than the other major European economies, all of whom are forecast to grow by less than 2 per cent with just 1.2 per cent growth in the euro area.

We will continue to take no risks with inflation and steer a long term course of stability, and in doing so reject the old short-termist easy option, the inflationary pay rise and the resort to the old industrial conflicts. By taking no risks with stability Britain remains well placed to respond to any pick up in global growth next year.

Globalisation

Rising Asian demand for oil – itself partly the result of rapid Chinese and Indian growth rates – starkly illustrates that we are witnessing the biggest global economic and industrial restructuring shift in economic power in our industrial history.

Twenty year's ago, developing countries produced only 10 per cent of manufactured goods. This is forecast to rise to 50 per cent in the next few years. China alone manufactures 30 per cent of the world's televisions, 50 per cent of the world's cameras, 70 per cent of photocopiers, and possibly, soon, 60 per cent of world clothing. The global sourcing of goods is now combined with vast technological innovation, from the internet, the DVD and the e-mail to digitalisation – all virtually undeveloped less than a decade ago.

With the pace of innovation faster than at any time, the scale of industrial transformation greater, the breadth of competition more global, the shift in manufacturing activity more profound, the prize for success greater but the penalties of failure greater too – in particular, there can be no hiding place in protectionist policies.

Nor up against these flows and forces should governments do nothing. Even with global manufacturing and technology replacing old skilled work, we must not now abandon the goal of high and stable levels of employment. Indeed with the right long term policies we can seize rather than squander the opportunities of globalisation.

Nations will rise and fall depending upon their ability to master globalisation. As with companies no country today, however prosperous, can take its economic success tomorrow for granted.

For Britain, we are determined to make the correct long term decisions – to invest in education of all, to build our science and technology, and value enterprise and flexibility – we can combine our stability, our creativity, our belief in hard work and education, our openness to the world so that more so than any other country we can turn globalisation from a threat to an opportunity.

Achieving the Millennium Development Goals

Developed countries have made significant steps in 2005 in committing to increased aid and 100% debt cancellation. We know that both developed and developing countries must deliver on these commitments and do more if we are to achieve long-term global prosperity. In addition, action on trade is essential to ensure that the Doha Development Round delivers real benefits to developing countries.

The HIPC Initiative has played a significant role in alleviating the burden of unpayable debt in 28 countries; writing off 70 billion dollars and reducing debt payments from an average of nearly 24 per cent of government revenues to 11 per cent, and with 65 per cent of resources released from debt relief now going to health and education. And so we will work together to ensure the completion of the HIPC Initiative so that all eligible countries can benefit from HIPC debt relief, so that all creditors participate; and to ensure that the initiative is securely and fully financed.

But, we know that a substantial increase in resources for debt relief is needed in order to build on the success of HIPC. This was recognised by the G8 in June, when we put forward proposals for providing 100 per cent multilateral debt relief for HIPCs. We welcome the work by Staff since then to demonstrate the benefits of the proposals and indicating how the operational issues can be dealt with.

We must now move swiftly to implement the proposals, so that the poorest countries can begin to benefit from the predictable and reliable stream of funding that the debt service savings will provide.

The UK Government will maintain its unilateral initiative to provide its share of multilateral debt service of eligible non-HIPC IDA only countries and urges other governments to pay their share. If debt is to be kept sustainable in the future, we will need to complement debt cancellation with aid. Earlier this year, the EU committed to double its aid by 2010, from around $40 billion to over $80 billion a year. The G8 then confirmed that global ODA will increase by almost $50 billion a year by 2010, with at least $25 billion flowing to Africa. All member States who joined the EU before 2002 have now set a timetable to reach the longstanding goal to spend 0.7 per cent of national income on aid by 2015. The UK has set a clear timetable to reach 0.7 per cent by 2013.

However, we know that 2010 and 2015 are too late to mobilize the scale of finance we need if we are to achieve the MDGs by 2015. Innovative financing mechanisms are needed to help deliver and bring forward the required financing.

That is why we have put forward our proposal for an International Finance Facility (IFF), a complement to our commitments to 0.7, to increase the resources available for the poorest countries now, when they are needed most. The IFF is specifically designed to bring forward donor aid commitments. Using existing and new resources, the IFF will be able to increase aid to the levels required to meet the MDGs, ahead of 2010.

The Bank and Fund have conducted further detailed analysis of the IFF and work on it is technically advanced. As a first step, on 9 September, the UK – in partnership with France, Italy, Spain and Sweden – launched a pilot International Finance Facility for Immunisation (IFFIm). The IFFIm will ensure the provision of an additional $4 billion over the next ten years to support the work of the Vaccine Fund and the Global Alliance for Vaccines and Immunisation (GAVI), tackling some of the deadliest diseases in some of the world's poorest countries. Frontloading resources through the IFFIm is expected to save 5 million children's lives by 2015, and a further 5 million adult lives thereafter.

We all know that more aid needs to go hand in hand with better aid. In order to achieve the MDGs it is crucial that the international community prioritises the poorest countries, and improves the effectiveness and long-term predictability of aid. In order to deliver better aid, donors need to increase co-operation, harmonise operational procedures and align aid behind country-owned priorities in accordance with the commitments in the Paris declaration on aid effectiveness agreed on 2 March 2005**.** Finally, developed and developing countries must continue to work together to tackle corruption.

The international community must grasp the opportunity presented by the Doha Development Agenda of world trade talks to achieve an ambitious outcome that makes a real contribution to poverty reduction. It is essential to maintain momentum on the key issues of interest to developing countries, particularly agriculture, leading up to the Hong Kong Ministerial in December. An ambitious agreement providing significant increases in market access for developing countries, substantially reducing trade-distorting subsidies, including the elimination of agricultural export subsidies, and providing effective special and differential treatment for developing countries is key to increasing growth in developing countries, integrating the most vulnerable countries into the world economy, and maintaining the credibility of the multilateral trading system.

The international community needs to recognise and address the constraints faced by developing countries in benefiting from more open global markets. Many developing countries will not be able to

benefit from trade even with greater market access because they lack the economic capacity and infrastructure to trade competitively. We need to consider how best to provide the additional aid we have announced this year, to help developing countries build the capacity to enable them to produce and deliver goods to international markets competitively. We also need to deliver additional assistance to help vulnerable countries and their most vulnerable people adjust to more open markets. Finally, developing countries must have the flexibility to carefully decide, plan and sequence their trade reforms into their own development and poverty reduction strategies. Trade liberalisation must not be forced on developing countries through aid conditionality or a mercantalist approach to trade negotiations.

We welcome the existing work of the IMF on the assistance they give to poor countries to enable them to benefit from trade, and call on the Fund to build on this and to work with other partners through the integrated framework to explore further ways of building capacity to trade as well as easing adjustment in low income countries.

IMF's Medium-Term Strategy

As the structure of the global economy continues to change, the IMF's role should be to help the entire membership to maximise the benefit and meet the challenges that globalisation raises. The Fund needs to respond to the new challenges by clearly defining its mission and priorities.

The Managing Director's report on the Fund's Medium-Term Strategy is a welcome step forward, rightly acknowledging many of the challenges now faced by the IMF and providing a guide to the Fund's agenda and work programme over the next few years. But as the international monetary and financial system continues to evolve, there is an ongoing need for the Fund to reflect on how these changes will further redefine the IMF's role and priorities.

As this stage of the Fund's review draws to a close, the IMF should take forward the analysis begun in the report and develop its strategy for responding to the long-term challenges of globalisation.

Going forward, we welcome the progress the Fund has made in developing the new medium-term budget; together with the ongoing compensation review, this will provide the necessary framework within which important decisions can be made about the effective reprioritisation of IMF resources and which of the ideas presented in the Medium-Term Strategy should be put into practice.

In a modern, rapidly changing global economy, the Fund's surveillance role is crucial. In recent years, the IMF has made considerable progress in improving the quality and effectiveness of surveillance. We warmly welcome the emphasis of the Managing Director's report on the continued importance of stronger, more effective, and authoritative Fund surveillance. We can support many of the proposals in the report.

Nevertheless, we believe further improvements can be made to increase the quality and traction of Fund surveillance advice. In particular, there is a strong case for reconsidering the form of surveillance, as well as its focus. Key priorities for further reform should include establishing a framework for assessing the effectiveness of surveillance, as an important step towards improving its impact on members' policy decisions.

We continue to believe that the credibility and objectivity of IMF surveillance would be greatly enhanced by the development of proposals to separate surveillance from the Fund's lending decisions;

especially ensuring assessments of debt sustainability are independent from other lending decisions within the Fund. Further questions also remain about whether surveillance should be carried out principally through the Article IV or ROSC processes.

As the events of July have reminded the international community, fighting the financing of terrorism remains of crucial importance. As part of their work to ensure compliance with international codes and standards, the IMF has a central role to play in ensuring countries are meeting international counter-terrorist financing standards, and provided well-targeted technical assistance where necessary.

We look forward to further detailed consideration of these issues in the context of the next Biennial Surveillance Review.

Efforts by the IMF to harness the benefits and challenges of globalisation must be underpinned by an appropriate organisational structure. We welcome the attention of the Managing Director's report on this important issue. However, the emphasis of the report on refocusing and reprioritising the Fund's work presents an opportunity for a more fundamental review of the Fund's internal governance and management framework than that set out in the medium-term strategy.

The IMF should be at the cutting-edge of best practice in governance and management to ensure it does not lag behind the considerable progress made in modernising private and public sector management practices. The Fund should give further consideration to the most appropriate and effective governance structure in order to meet the challenges of globalisation over the long-term.

The Medium-Term Strategy places an important emphasis on the issue of quotas and representation at the Fund. This is an issue that affects the entire membership. Quotas should reflect changes in the world economy and we need to look at measures to enhance the voice of all members at the Fund. We look forward to full consideration of these issues as part of the 13th General Review of Quotas.