International Monetary and Financial Committee

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Statement by George Osborne
Chancellor of the Exchequer, United Kingdom

On behalf of the United Kingdom

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Chancellor of the Exchequer, H.M Treasury, United Kingdom

<u>Securing the Global Economic Recovery</u>

Since we met in April, the global recovery has suffered further setbacks. The continued deleveraging process, tight credit conditions and policy uncertainty have all weighed on growth in the advanced economies. Economic activity in emerging market and developing economies has also slowed, reflecting both domestic and external factors. The latest forecast is for slow and fragile global growth, with triple risks to the recovery - continued instability in the euro area, the US fiscal cliff and slowing in emerging markets.

Recent action by central banks has created more accommodative financing conditions but the need for fundamental structural reform remains. As I highlighted in April, the key underlying issue is the failure of policymakers to deliver the actions required to restore confidence. While important commitments have been made, much more still needs to be done to implement these effectively. In particular:

<u>*Ensuring fiscal sustainability*</u>. The priority for most advanced economies remains putting in place credible medium-term fiscal consolidation plans to put public sector debt on a downward path. National circumstances will determine the appropriate pace and scale of consolidation. Those facing significant fiscal vulnerabilities will need to implement more accelerated plans. In the UK we have a large fiscal deficit and a systemic financial sector, which makes credible consolidation important for domestic as well as global financial stability. However, adjustment remains most pressing in the euro area periphery and will need to be accompanied by institutional reforms at the euro area level to deliver greater fiscal integration and budgetary coordination, as well as a fully-fledged banking union. In the US, credible medium-term consolidation plans are still required and the authorities also need to deal with the immediate challenges of a potential fiscal cliff and further increases in the debt ceiling.

<u>*Repair and reform of the global financial system.*</u> This process still remains incomplete and there are worrying signs of emerging financial fragmentation, particularly in emerging Europe. It is vital that the agreed Basel III capital and liquidity standards are fully implemented in a consistent and non-discriminatory manner. This is not only the key to a more resilient financial system but also one that can facilitate the safe and free movement of capital and contribute towards stronger and more sustainable growth. International collaboration is of paramount importance. The UK remains fully committed to maintaining a leadership role in the global reform agenda, particularly in reforms to address the risks associated with systemically important financial institutions (SIFIs). In the UK, the Government has set out detailed plans to implement the recommendations of the Independent Commission on Banking, which the IMF think will limit the frequency and severity of banking crises and strengthen the resilience of the financial system.

<u>*Rebalancing global demand and delivering stronger, more sustainable growth.*</u> The IMF's latest analysis shows that the shrinkage in global imbalances can largely be explained by the reduced demand in deficit countries. Unless the membership takes coordinated action to tackle the underlying causes of imbalances, this temporary improvement is likely to be reversed as the recovery picks up. In advanced economies a combination of structural

fiscal reforms to ensure long-term sustainability and a strengthening of institutions are required, alongside product and labour market reforms to unlock new sources of growth. Emerging market economies must implement their own structural reforms to facilitate a move away from external sources of growth towards stronger domestic demand, particularly consumption. Greater exchange rate flexibility and financial deepening will also help to facilitate this shift. Finally, I urge the membership to resist all forms of protectionism and reaffirm its commitment to free trade and investment - key engines for global growth and development.

I look forward to discussions with colleagues in Tokyo on how the membership can effectively deliver a concerted, coordinated policy response to these policy challenges.

<u>The role of the IMF</u>

<u>Strengthening the IMF's Financial Safety Nets</u>

In order to ensure that the IMF had adequate resources to support the potential needs of the full membership, a number of members came together at the Spring Meetings to make further bilateral contributions to the IMF's finances. The UK pledged around $15 billion as part of this global effort. I welcome the further pledges that have been made since then. All told, these pledges will increase the resources available to the Fund by over $450 billion. I encourage all members who made pledges to conclude their bilateral agreements as soon as possible. If these resources are used it will be important to ensure that they support well-designed IMF programmes with appropriate conditionality. Risk-mitigating measures should also apply.

It is also essential that the IMF continues to play its role in monitoring vulnerabilities and providing financial support to low income countries (LICs). Recent IMF analysis demonstrates the positive role played by Fund-supported programmes in raising economic growth, reducing poverty, and building macroeconomic buffers and institutional capacity in low income countries (LICs). Fund support is now more important than ever, as many LICs find themselves in a fragile position with weakened policy buffers and large exposures to global risk and volatility. For that reason, I welcome the recent decision to implement a framework that will ensure the long-term sustainability of the Fund's concessional financing facilities, including the use of $2.7 billion of remaining windfall gold sales profits. It is important that the membership ensures implementation of this decision in a timely manner, building on the announcement that the Fund now has the required assurances to allow the partial distribution of gold sales profits agreed in 2009. I urge the Fund to expedite the process for seeking assurance for this latest decision. The UK remains committed to playing its part and I can confirm that I will provide written assurance when the time comes.

<u>Reforming the Surveillance Toolkit</u>

Since our last meeting key steps have been taken to strengthen the IMF's surveillance toolkit, which will enable the Fund to provide candid and independent surveillance of the membership. In particular, I welcome:

- the new <u>Integrated Surveillance Decision</u> that was approved by the Board in July – this modernises the Fund's legal framework and bridges the gap between bilateral and multilateral surveillance. The scope of surveillance should be broadened to include all members' domestic policies relevant to domestic stability and the coverage of spillovers should also be improved;

- the pilot External Sector Report, which builds on the new External Balance Assessment methodology to enhance surveillance of exchange rates, foreign exchange reserves and global liquidity. This should improve the consistency and transparency of Fund analysis in this area;
- the agreement on a new Financial Sector Surveillance Strategy, that sets out important plans to strengthen risk analysis and upgrade the Fund's analytical tools and products. Improving the understanding of cross-border financial linkages and spillovers will be key to delivering more robust analysis in important areas such as work on capital flows, sovereign-bank feedback loops and the impacts of regulatory reforms; and
- the completion of the 2012 Consolidated Spillover Report, which builds on the 2011 spillover reports for the systemic 5 economies and more recent analytical work on networks and clusters. I urge the Fund to maintain momentum in this area by dedicating further resource to improving the understanding of financial interlinkages. In particular, I look forward to further work on the role of global financial centres.

If effectively implemented, these reforms will go a long way to addressing the key recommendations of the 2011 Triennial Surveillance Review and have the potential to increase the quality, scope and traction of surveillance. I look forward to reviewing progress on implementation at our next meeting in the spring.

Implementing the 2010 IMF Quota and Governance Reform

In 2010 we agreed an historic quota and governance reform package to maintain the credibility and legitimacy of the IMF. Since the spring, the membership has made progress in implementing a number of the reform package elements. However, it is now clear that the agreed deadline for the quota increase and Board reforms has been missed. While the required threshold for the quota increase has been achieved and sufficient members have ratified the Seventh Amendment to deliver the Executive Board reform, the remaining members with sizable voting power still need to ratify the amendments before the two elements will become effective. Like many members, the UK implemented these reforms in 2011 and I would urge those members who have not yet done so to do so as soon as possible.

I also welcome the substantial progress that has been made by advanced European economies to deliver their commitment to reduce their representation at the IMF Executive Board by two chairs.

The UK remains committed to the completion of a comprehensive quota formula review by January 2013. The current quota formula continues to deliver the shift towards dynamic emerging markets - some 2.1 per cent of calculated quota share since the 2010 agreement. However, it may be possible to make further refinements. To ensure that the formula remains appropriately balanced, the review should continue to be underpinned by the four agreed principles – it must be consistent with the multiple roles of quota, be broadly acceptable to the membership, feasible to implement and simple and transparent. The UK looks forward to making further progress in the coming months.