International Monetary and Financial Committee

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On behalf of the EU Council of Economic and Finance Ministers

Statement by Minister of Finance, Rimantas Šadžius in his capacity as Chairman of the EU Council of Economic and Finance Ministers, at the IMFC Annual Meeting, Washington, D.C., 11-13 October, 2013

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, in particular the outlook and policy challenges, and on IMF policy issues.

I. ECONOMIC SITUATION AND OUTLOOK

2. The latest World Economic Outlook by the IMF confirms that that global growth remains weak, and the global recovery will become more differentiated. Risks to the global outlook have dampened but remain elevated. The world economy continues to face significant economic policy challenges and we must continue to collaborate to place the global economy on a more stable and resilient foundation to sustain the recovery. In this respect, we welcome the agreement by G20 leaders in St Petersburg to cooperate to ensure that policies implemented to support domestic growth also foster global growth and financial stability and to manage their spillovers on other countries.

3. The latest economic data point to a gradual recovery in the EU and the euro area. GDP rose by 0.3% in the euro area, which is no longer in recession, and by 0.4% in the EU during the second quarter of 2013, compared with the previous quarter according to Eurostat. Improving business activity and sentiment provides encouraging signs, including in euro area countries most affected by the crisis whose economies have begun to stabilise.

Policy challenges

4. The EU has taken further measures to strengthen the European economic recovery. We have kept up the momentum on structural reforms to boost growth, competitiveness and job creation. EU Member States are following through with ambitious reform agendas.

5. Sound public finances are key to ensure confidence of markets and thereby foster sustainable growth. Thus, concerns about fiscal sustainability and fragile market confidence in a number of euro area countries have called for a medium-term strategy aiming at ensuring a lasting reduction of public deficit and debt levels. European fiscal rules promote differentiated fiscal consolidation, according to each Member State's fiscal situation; focus on progress achieved in both nominal and structural terms that is, corrected for the impact of the economic cycle and one-off and temporary measures; and pay special attention to growth-friendly fiscal strategies. The fiscal effort undertaken so far has been sizeable, especially in the Member States most affected by the crisis. However, to bring debt-to-GDP ratios on a downward trajectory and further anchor stability, comprehensive fiscal consolidation must continue and be backed by sufficiently ambitious reform programmes and a revival of euro area growth.

6. The EU is keeping the momentum on structural reforms to foster competitiveness, employment, and domestic sources of growth. We have at the June European Council taken a number of additional actions to address the critical issue of youth unemployment. Youth unemployment requires an ambitious and targeted approach through measures focused on competitiveness, labour market flexibility and education. We will also continue our efforts on economic rebalancing in the euro area which has made substantial progress over the past two years. Much of the adjustment achieved has already taken place in the previously high-deficit

countries in the euro area. As a group, these countries recorded a current account surplus of 0.9% of their GDP in 2012. A large share of adjustment is structural in nature, thanks to a major effort in terms of structural reforms and also due to a reorientation of resources towards internationally tradable sectors and as such, is not expected to go away once the overall economic situation improves.

7. We are repairing the credit channel, by completing bank balance sheet repair and thus contributing to overcome financial fragmentation. Low lending volumes are partly due to low credit demand, but they are also due to low supply of credit as banks deleverage, build up capital and repair balance sheets and increased credit risks especially for SMEs in some countries. The European Council of 27-28 June endorsed a Commission-EIB proposal to help restore lending to the real economy by leveraging resources from the EU budget with European Investment Bank lending. The initiative aims to provide banks with risk-sharing – through guarantees and/or securitisation - which should allow an increase of the volume of credit available for SMEs in the short to medium term. To ensure that banks have sound balance sheets, a comprehensive assessment will be conducted before the ECB will start direct supervision of banks. Appropriate arrangements, including the establishment of national backstops, will be made ahead of the completion of this exercise. The European Banking Authority (EBA) has also recently issued a Recommendation on capital preservation addressed to supervisory authorities across the EU, which aims to preserve the enhanced capital base that banks built up in response to EBA's 2011 recapitalisation Recommendation. In addition, demand factors that add to credit fragmentation are being addressed through structural reforms that aim at improving the competitiveness and profitability of the corporate sector.

8. The completion of the Banking Union is key to ensuring financial stability, reducing financial fragmentation restoring confidence in the banking sector, and improving the smooth functioning of Economic and Monetary Union. Important progress has been made. Looking at the supervisory pillar, the formal adoption of the Regulation on the Single Supervisory Mechanism (SSM) should take place in the autumn and the SSM should become fully operational in the following twelve months. On the second pillar dealing with resolution, the European Commission in July 2013 presented a proposal for a Single Resolution Mechanism (SRM). This is currently discussed by the EU Council of Ministers with a view to reaching agreement in the Council by the end of the year so that it can be adopted together with the European Parliament before the end of the current parliamentary term, in line with the indications by the European Council of 28 June. Also, the main features for direct recapitalisation by the European Stability Mechanism were agreed in June.

9. The EU is approaching the end of a comprehensive programme of financial services reform addressing all of the G20 commitments. In particular, it includes the implementation of the Basel III framework through the Capital Requirements Directive/Regulation (CRD/CRR IV) applicable as of the 1st of January 2014; the implementation of the OTC derivatives recommendations through the European Market Infrastructure Regulation (EMIR); the revision of the Markets in Financial Instruments Directive / Regulation (MiFID / MiFIR), being close to adoption; and the new framework for the prevention, management and resolution of banks in line with the Financial Stability Board Key Attributes (the Banking Recovery and Resolution Directive) being close to adoption. Finally, on international coordination aspects, EU and US regulators (CFTC) made a significant step forward in mid-July addressing many cross border issues in the OTC derivatives field however challenges remain that need to be addressed in this area. The EU stresses the importance of international cooperation in the financial regulatory areas, allowing regulatory jurisdictions to defer to one

another when justified by the quality of their respective regimes, as well as on identifying and listing non-cooperative jurisdictions. We remain committed to working with our international partners in this context.

II. IMF POLICY ISSUES

10. We have made further progress to increase the legitimacy, credibility and effectiveness of the International Monetary Fund. It is important that we continue our efforts to ensure the Fund's capability to address the challenges of today's international monetary and financial system.

Governance

11. The priority at this stage is the ratification of the 2010 IMF Quota and Governance Reform. All 28 EU Member States have already fully concluded national ratification procedures for the 2010 Proposed Amendment on the Reform of the IMF Executive Board and the Fourteenth General Review of IMF Quotas. The EU encourages all IMF member countries that have not yet ratified it to do so expeditiously. The implementation of the 2010 IMF Quota and Governance Reform is key to the Fund's legitimacy and will result in a governance structure that better reflects the realities of the world economy. In this context, advanced European countries reaffirm their commitment to reduce their Executive Board representation by two chairs as part of the 2010 IMF quota and governance reform agreement by the time of the first regular election of the Executive Board after implementation of the 2010 Quota and Governance Reform.

12. EU Member States reconfirm that they stand ready to continue constructive discussions on the quota formula and the 15th General Review of Quotas in order to reach an agreement by the agreed deadline of January 2014. EU Member States emphasize in this regard the January 2013 agreement by IMF members which states that all elements are interconnected and that we should go forward by way of an integrated package. An integrated package implies that no decision on any of the single review elements can be taken in isolation. The EU considers that the agreement on the quota formula and the 15th General Review of Quotas need to be fully anchored in the relevant IMF bodies, where all IMF members are represented. The interests of the entire membership of the Fund need to be taken into account.

13. New data confirm that the current quota formula captures dynamic developments in the world economy and is already delivering on the aim of increasing the Fund's representativeness thus further enhancing its legitimacy. The four principles which underpinned the 2008 reform of the quota formula continue to provide the appropriate basis for the current review. In particular, EU Member States believe that it is important that the formula seeks to capture the multiple roles of quotas. The main variables of the quota formula should remain both GDP and Openness which best capture the role and mandate of the IMF.

14. In particular, openness captures the stake countries have in the global economy, in line with the IMF mandate to promote cooperation and facilitate international trade. Openness reflects the Fund's mandate and in particular its increased focus on spillovers and economic and financial interconnectedness, which is based on the lessons of the recent crisis. It is an indispensable part of the formula and its weight should at least be maintained. The methodology of openness should be maintained. EU Member States will only be able to consider dropping the variability variable as part of an integrated package approach after it is

determined how its weight would be reallocated. We believe that a significant part of its weight should be reallocated to the openness variable, given the January 2013 agreement that openness should continue to play an important role in the formula.

Surveillance

15. The EU welcomes significant improvements in Fund surveillance in recent years, including the adoption of the Integrated Surveillance Decision which will ensure a better integration of bilateral, regional and multilateral surveillance. The EU also welcome the Fund’s institutional view on capital flows, which will help transpose the Fund’s view on the liberalization and management of capital flows into its policy advice. The IMF should monitor reforms by countries that aim at reaping the benefits of free capital movements including capital account openness. The coverage of financial sector issues and macro-financial linkages is also being clarified and improved through the Fund's Financial Surveillance Strategy. The EU reaffirms the need to enhance the Fund’s financial surveillance through the implementation of the Financial Surveillance Strategy and close cooperation with the Financial Stability Board. The EU supports the strengthening of the IMF's debt sustainability analysis, which is reflected in the updated Guidance Note for Public Debt Sustainability Analysis (DSA) in Market Access Countries.

16. EU Member States also welcome the IMF 2013 spillover report on the five most systemic economies which can contribute to a better IMF analysis of real and financial flows and their interconnectedness, as well as of potential risks. In the same light, the second pilot External Sector Report (ESR) provides a useful assessment of external sector developments and policies in the largest economies. It is important to highlight in this regard the need for continuous review of its methodology in order to improve and refine its tools, in particular to better take into account the specificities of currency unions and their members. The recent pilot Nordic Regional Report as well as additional cluster analysis such as the report on the German-Central European Supply Chain are a relevant step in developing the IMF's regional focus in its surveillance activities.

17. EU Member States welcome the commitment by the IMF and the BIS to carry out joint work on global liquidity indicators, with a view to a future incorporation the IMF surveillance, on the basis of reliable indicators. A strong surveillance framework should recognise the relationship between global liquidity and financial stability. Nevertheless, further research is needed to better understand this relationship.

18. The implementation of the recent reforms to Fund surveillance should ensure progress in enhancing the effectiveness of Fund surveillance. The EU welcomes the envisaged focus of the 2014 Triennial Surveillance Review (TSR) on effective implementation. We agree with the proposal to assess how the Fund can respond to post-crisis policy challenges, including an analysis of the need to focus its advice on macro-critical structural reforms where relevant and within the perimeter of the Fund’s mandate. In this regard, we would like to emphasize the importance of an effective and comprehensive surveillance of monetary unions and their members that should take proper account of their policy-making framework. We consider that the 2014 TSR would benefit from an analysis on how Fund surveillance and advice can better reflect the respective competences at EU Member States’, the euro area and the European Union level with a view to providing more consistent and effective surveillance.

19. EU Member States welcome the progress made in improving risk identification and policy analysis as part of the Financial Surveillance Strategy (FSS). However, in following up

on the focus on financial stability in the 2011 TSR, a review of the progress made on financial sector surveillance would be very valuable. Furthermore, attention should be given to the surveillance experience in connection with the new institutional view on capital flows as well as macro-prudential policy measures, taking stock of progress and identifying areas for improvement. It would be also very interesting to widen the analysis to include the role and the scope for complementarities of Fund surveillance with other international institutions. This has to be done respecting the different mandates and roles of these bodies.

20. We would further like to note that some streamlining of the various surveillance products continues to deserve consideration to help increase the consistency of messages across products and contribute further to the IMF's efforts to improve its assessment of interconnections between economies and across sectors. We encourage staff to further explore ways and make proposals in the upcoming TSR on how to improve traction. The EU considers that it would be useful if Article IV reports more consistently reviewed members' follow-up on previous IMF surveillance advice and the quality and relevance of the Fund's previous analysis and recommendations (an “accountability box”). The EU supports the regular conduct of Art IV consultations as well as mandatory and timely publication of Article IV reviews. Systemically important countries/regions should lead by example.

21. EU Member States call on all IMF members with overdue Article IV consultations and deficiencies in the provision of data to the Fund to fully cooperate with the IMF in line with their membership obligations. The availability and quality of economic data is essential to the proper conduct of IMF surveillance

Resources

22. The EU welcomes the progress to date on the 2012 commitments to increase temporary resources available to the IMF by USD 461 billion. While the vast majority of these committed resources has been made available to the IMF, we look forward to the rapid finalization of the remaining agreements.

IMF’s support to low-income countries

23. EU Member States welcome recent efforts by the Fund to bolster lending to low-income countries (LICs), including the agreement to use windfall gold sales profits to boost the concessional lending capacity for low-income countries. The EU calls on all IMF members to pledge the second distribution of gold sale windfall profits. We welcome the successful implementation of the HIPC Initiative and MDRI, which, together with stronger policies and improved economic prospects have helped expand and diversify external financing opportunities for low-income countries. At the same time, new financing and borrowing needs to be undertaken prudently. Against this background, EU Member States welcome ongoing efforts by the IMF and the World Bank to continue assisting low-income countries to strengthen their debt management capacity, in line with the existing IMF-World Bank debt sustainability framework for low-income countries. We also support continued work by the G20 towards promoting sustainable lending practices taking into consideration the IMF-WB Debt Sustainability Framework for LICs, aimed towards avoiding the build-up of unsustainable debt levels. We support inclusive discussions with low-income countries, including on the possibility of developing guidelines for sustainable financing.