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Statement by Mr. Didier Reynders
Deputy Prime Minister and Minister of Finance of Belgium

On behalf of Austria, Belarus, Belgium, Czech Republic, Hungary, Kazakhstan, Luxembourg, Slovakia, Slovenia and Turkey

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At the 19th International Monetary and Financial Committee
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World Economic Outlook and Financial Market Developments

Since our last meeting in October 2008, the world economy has been gripped by a severe loss of confidence and a synchronized collapse of activity.

By now, the causes of the crises have been better understood, as are the corrections needed to avoid a repetition. The negative feedback loop between a weakened financial sector and the real sector must be stopped urgently. Restoring the strength of banks and other critical financial institutions is a priority task. Monetary and fiscal stimulus to support demand in the short term should be so designed as to preserve confidence in price stability and fiscal sustainability. International cooperation is critical for effective financial sector regulation and supervision, preserving global financial stability, preventing serious disruptions caused by reversals in international capital flows, and avoiding a surge in protectionism.

Abundant external payments surpluses accumulated by emerging market and oil exporting countries, and accommodating monetary policy created an environment of low interest rates, expanding credit, economic buoyancy and rapidly rising asset prices. This, in turn, fueled additional and increasingly risky credit to finance excessive consumption and ever more expensive housing. In several countries, procyclical fiscal policy added to the overheating. Taxation rules promoted both debt financing and rising housing prices, thereby increasing the vulnerabilities of households and their creditors.

Most important, financial sector regulation and supervision failed to prevent the corruption of market discipline. Distortive incentives were imbedded in ill-conceived remuneration schemes. Risk management failed in the face of poorly understood risks associated with complex and opaque new financial structures that were often motivated by "regulatory arbitrage" to help avoid the need to comply with the most essential rules of prudential regulation. The systemic risks created by linkages between regulated and non-regulated financial institutions and markets were not addressed.

Lack of timely and adequate disclosure of risks assumed by financial institutions and the inadequate frameworks for handling the failures of systemically large financial institutions added to a widespread loss of confidence, disorderly deleveraging, a severe credit crunch, and a widespread deep recession which further undermined the strength of credit institutions.

Although the IMF warned about the risks associated with the failure to correct global imbalances, its analysis fell short in laying bare the accumulation of unsustainable debt burdens in major advanced economies, and of the metastasis of impaired assets in the financial sector. How such a shortcoming in the IMF surveillance can be explained and corrected is a critical issue for the IMFC, the Executive Board and Management. In this connection, we should review the responsibility of member states as well, as Fund surveillance is a collaborative endeavor. I will return to this topic when discussing the "Early Warning Exercise" that the Fund is asked to develop in collaboration with the Financial Stability Board.

International cooperation over the last 18 months between the Fund, financial standard setting bodies, the European Union and other important groupings has resulted in a broad consensus on a number of important reforms.

Preserving financial stability should be an explicit responsibility that complements the central bank's primary mandate of maintaining price stability, and for which adequate information authority and regulatory power should be given.

Regulation and supervision must cover all systemically important financial institutions and markets. We encourage the staff to expand its analytical work on how to identify systemically important institutions, and to better understand direct and indirect financial linkages that might propagate system-wide shocks. Capital adequacy and liquidity buffers should be strengthened over time. Pro-cyclicality should be reduced by requiring the building-up of additional capital during good times. Public disclosure should be improved to enhance both market discipline and confidence. The supervision of international financial groups requires more effective international cooperation.

In the European Union, the process of financial integration should continue. EU countries are committed to significantly strengthening the financial stability frameworks, and the regulation and supervision of financial institutions that operate outside their national borders. Cross-border financial integration also requires a solid framework for resolving financial distress in such institutions and the sharing of possible associated fiscal burdens among the affected countries.

Financial institutions in advanced countries remain under severe stress in the face of significant losses associated with structured financial products, and increasingly, credit impairment caused by the severe economic downturn. This hampers the capacity to finance trade, investment and consumption. Restoring the strength of financial institutions is essential for promoting the recovery.

Since the intensification of the financial crisis in September last year, countries in our constituency have extended deposit insurance schemes to maintain depositor confidence, in line with EU decisions. As elsewhere, our governments have, when needed, recapitalized viable banks and insurance companies, provided guarantees for medium-term bank funding and set up schemes for removing impaired assets from banks' balance sheets. As the Fund's Global Financial Stability Report emphasizes, more such actions may be needed. The Euro Area Action Plan offers the assurance that, when needed, such actions will be taken in a timely, non-distortive and transparent manner. Government ownership of banks should be temporary, divested when stable market conditions allow.

Bold macroeconomic stimulus policy may help cushion the downturn and advance the recovery, if coordinated internationally and designed so as to maintain long-term confidence.

The ECB has taken immediate action to provide ample liquidity and lower interest rates as required by the gravity of the present situation. Whenever central banks decide to implement unconventional quantitative easing and direct credit intermediation, care should be taken to preserve the ability to unwind these operations in a timely manner. Today, confidence depends on the trust of economic agents that the central bank will be able and determined to preserve price stability in the medium and long run.

In Europe, we have a solid understanding on the need to allow fiscal stabilizers to operate fully, and on the effectiveness of additional fiscal stimulus that is implemented in a coordinated manner by countries with adequate fiscal space. The Fund has given wise advice on how to maintain confidence in long term fiscal soundness, notwithstanding a significant increase in public debt ratios projected for the next few years. Fiscal stimulus measures should be fast acting, temporary and targeted to areas with potentially the most powerful effects on growth and growth potential. Simultaneously, governments should commit to take the measures needed to address long-term fiscal weaknesses, in particular the rising fiscal cost of an aging population. The solvency of sovereign creditors is a centerpiece of financial stability. It should be carefully preserved.

The crisis has taken a large toll on employment and inflicted severe social costs. Government and social partners should adhere to the principles agreed at the recent Social Summit in Rome and support employment creation with high quality education, job training and labor market policies. We ask the Fund to cooperate closely with the ILO.

Global imbalances created a fertile ground for the present difficulties. Although shrinking, imbalances of current accounts remain large. Major imbalances must be corrected gradually but steadily in a manner to enable a sustainable recovery.

Given especially the weak prospects for demand for their exports to the United States and elsewhere, China and other East Asian countries should rely more on domestic consumption to support continued growth. This will require consistent efforts in these countries in the years to come. More flexible exchange rate regimes will be helpful. Robust social safety nets should give more confidence to consumers to reduce the high levels of savings in large surplus countries. In high deficit countries, particularly the United States, domestic demand should grow at a slower pace than overall GDP, as savings must be rebuilt.

A track record of good policies especially pays off in times of crisis. The large differences in the way the crisis has affected individual countries in emerging Europe are explained by diverging macroeconomic performance and vulnerabilities such as high debts, current account deficits and exposures to exchange rate risks. Membership of the EU provides a strong anchor for policy discipline but in and by itself it should not be relied upon as a guarantee for easy financing. In today's crisis, adequate external financial support from the EU, the IMF, and other international financial institutions in support of adequate policies in emerging Europe is critical to preserve confidence and give time for policies to yield their positive effects.

The worsening of the international environment affects the real economy in the Czech Republic. However, its fundamentals remain strong thanks to a track record of credible monetary policy and strong fiscal performance which underpinned high productivity growth and a comfortable external position. The country's banking sector is sound and resilient. Lending by subsidiaries of foreign banks is predominantly in local currency and, in aggregate, fully financed by domestic deposits.

Hungary's vulnerabilities require that the fiscal deficit is firmly curtailed, debt dynamics reversed, the strength of financial institutions bolstered, and international competitiveness enhanced. The country is making progress on all these fronts under a program supported by the IMF and the EU. Together with the commitments of major foreign banks to maintain their level of financing of economic agents in Hungary, the government's policies will enhance confidence and financial stability, thereby allowing them to yield their full effect.

Turkey's manufacturing output is hit by the contraction in main exporting markets. Foreign financing is less readily available, particularly for the corporate sector. Fortunately, Turkey is now in a stronger position than in the past to confront the global shock. The fiscal situation has improved significantly with public debt around 40 percent of GDP at end 2008. A flexible exchange rate, low inflation, and a well-capitalized banking sector have made the economy more resilient. Turkey continues to pursue policies that will ensure long-term fiscal soundness, improve tax efficiency and achieve high sustainable growth underpinned by an up to date infrastructure and a well-trained work force. Discussions on a new Stand-By Arrangement with the Fund should be finalized soon.

The IMF's Crisis Response and Reform Agenda

Thanks to its universal membership, its highly competent staff and recent reforms, the IMF is well equipped to help countries address the global crisis in a coordinated manner. The Fund should support all its members both in their crisis prevention and resolution efforts.

The new lending framework

More than ever, the Fund should continue to assist member countries deal with actual or potential balance of payments needs while safeguarding its own resources. The reform of the lending framework constitutes an important improvement.

The SBA continues to be the main instrument for providing financial support to member countries. The abolition of the SRF, CFF and SLF has made the lending framework more coherent.

High-access precautionary SBAs and the FCL will be beneficial for their users. By approaching the Fund early and using the financing as a precautionary measure, countries are more likely to stave off pressures on their reserves, avoid more serious problems, and thereby ultimately reducing the economic and social costs of the crises. The Fund's Board and Management should exercise evenhandedness when taking decision on granting access to the SBA and FCL.

Conditionality should continue to be well tailored to the economic and financial situation of a country and should be based on what is needed to make the country's balance of payments position sustainable.

The increase in normal access limits should be matched by a proper alignment of the surcharges.

Fund resources

We support a substantial increase in IMF's resources so that it can adequately support the needs of member countries in the short term. Fair burden sharing is needed in raising resources. Austria, Belgium, the Czech Republic, Luxembourg, the Slovak Republic and Slovenia will provide short-term temporary support, to help ensure the transition toward an enlarged and expanded NAB. The activation procedures of the NAB should be revisited in order to ensure that they are appropriate for the present circumstances.

We look forward to a quick ratification of the Fourth Amendment by all member countries. We also support a general SDR allocation, based on a thorough analysis of the implications of such a decision.

Low-income countries

The Fund's role in helping low-income countries is even more critical in times of crisis. The Fund should continue to assist these countries in implementing macroeconomic policies and reforms that foster high and sustainable growth, help reduce poverty and maintain debt sustainability.

The Poverty Reduction and Growth Facility continues to be important. A long-term poverty reduction strategy is still critical for most low income countries (LICs). We also welcome the ongoing work on how to better assist LICs that face short-term balance of payments problems.

We support an increase in access limits if adequate safeguards are in place to ensure debt sustainability and sufficient resources are available. Proposals to increase subsidy resources should be fully consistent with the Fund's income model and the need to increase precautionary balances.

We support a more flexible approach of concessionality. This approach should be more firmly anchored in the Fund's Debt Sustainability Analysis. It is important that less concessional financing be provided only to countries with a sufficiently strong public management capacity and for projects with obvious profitability. Clear rules should be established to ensure that less concessional financing does not discourage other donors and lenders.

Surveillance

The economic and financial developments in recent years show the need of high quality bilateral, regional and multilateral surveillance. Given its global membership, the Fund is uniquely placed to embed its bilateral surveillance in a global context. IMF members should more firmly follow-up on IMF policy recommendations.

Evenhandedness in surveillance is essential for the Fund's credibility. The Fund's analysis must be comprehensive, taking into account the overall macroeconomic situation of a member country and its policy mix, including monetary and fiscal policies and domestic and external debt management policies. It is important that FSAPs be regularly conducted for all countries. The surveillance process could strongly benefit from further integration of financial sector analysis into that process. We are ready to explore the inclusion of capital account surveillance into the Fund's mandate.

Surveillance could clarify the risks surrounding the baseline scenario. Imbalances and vulnerabilities should be identified at an early stage. The early warning exercise should feed into Fund's surveillance.

A comprehensive, sustainable and efficient budget

The recent rise in Fund's lending activity and the associated rise in projected income should not delay the pace of the income reform. Income from charges and surcharges should be used only to cover the cost and risks related to Fund's lending. Other costs of the functioning of the Fund should be covered by adequate other sources of income. The key role of Fund's precautionary balances under the new income model should be to protect the Fund against credit risks.

We encourage all member countries to accelerate the adoption of all necessary measures so as to implement the agreed income model.

The Fund needs an integrated and more detailed budgetary framework with adequate resources to fulfill its mandate independently and efficiently. The medium term budget should include a comprehensive and transparent cost accounting of all Fund activities.

Governance

We call on all IMF members to swiftly ratify the reform of quota and voice agreed in April 2008. We support that the next Quota Review should be concluded by January 2011.

We support a merit-based selection of senior management without geographical preferences.