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, Pier Carlo Padoan in his capacity as Chairman of the EU Council of Economic and Finance Ministers, at the IMFC Autumn Meeting, Washington, D.C., 10-11 October, 2014

1. I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses on the global economy, in particular the outlook and policy challenges, and on IMF policy issues.

I. ECONOMIC SITUATION AND OUTLOOK

2. The global economy continues along a gradual but uneven recovery path. The recent financial market tensions are a reminder that the global economy remains vulnerable, even as growth and trade are accelerating after a weak start into the current year. This emphasises the need to continue to strengthen domestic macroeconomic frameworks and to implement structural and financial sector reforms to foster confidence and sustainable growth.

3. Although with differences across Member States, real GDP growth in the EU in the second quarter came out below expectations, suggesting that the underlying momentum of activity has slowed down. This may partly reflect one-off factors and the intensification of the geopolitical tensions in several regions over the summer but also highlights the fragility of the recovery and the weakness in global demand. Unemployment rates have continued declining since mid-2013 but remain at historically high levels and large differences among countries persist. Inflation is expected to remain at low levels over the coming months, before increasing only gradually during 2015 and 2016.

4. The European Central Bank recently cut its key interest rates further, by 10 basis points. Moreover, it announced an ABS purchase programme and a new covered bond purchase programme to facilitate new credit flows to the economy. In June, the ECB already had decided to introduce targeted longer-term refinancing operations. If needed in view of the inflation outlook, the ECB is committed to using additional unconventional instruments within its mandate.

5. In Ukraine, the EU started delivering on its pledge to provide strong economic and financial support to help stabilise the situation, assist with the transition and encourage political and economic reform. Under new programmes put in place since March, we have already disbursed EUR 850 million in loans and grants and are planning to release over EUR 1 billion more in the coming months. Further financial assistance might be needed to help Ukraine restore macroeconomic stability depending on the outcome of the next IMF review mission. We welcome the progress Ukraine achieved in the implementation of its IMF programme, which unlocks access to significant official financing. At the same time, we urge the authorities to retain their reform commitment notwithstanding the difficult geopolitical situation and continue to introduce measures for improving governance and transparency.

Policy challenges

6. Europe is aware of its responsibility to strengthen the economic recovery and to increase the level of potential growth:

- The EU Member States are in the process of implementing important structural reforms to address weak medium-term prospects and foster job creation, in particular to tackle youth unemployment, but also to boost potential growth. Structural reforms aim in particular at removing rigidities in product and services markets, improving network industries, encouraging sustainable investment and boosting innovation and research. Labour-market reforms aim at increasing levels of participation and stimulating job-creation. Reducing the tax burden on labour should help to increase cost-competitiveness and employment. On 26-27 June 2014, the European Council endorsed country-specific recommendations for reform in the EU Member States. The main challenges facing Member States in 2014-2015 set out by the European Council are the following: (i) Tackling unemployment and the social consequences of the crisis; (ii) Reducing debt and ensure the sustainability of public finances; (iii) Shifting to growth-friendlier taxation; (iv) Boosting investment; and (v) Making EU economies more competitive. The EU Council and the European Commission will closely monitor the implementation of the recommendations.

- The EU pursues a differentiated and growth-friendly fiscal consolidation, delivered through the framework of fiscal rules that take into account headline (nominal) as well as structural balances. Based on the Commission's spring forecast, the fiscal stance in the euro area as a whole is expected to be broadly neutral in 2014, while debt ratios are projected to stabilise at around 96% of GDP and to start to decline slightly in 2015. The large consolidation efforts undertaken by EA Member States over the last couple of years have led to visible results. This achievement has allowed reducing the pace of fiscal consolidation overall, although many EA Member States still face significant consolidation challenges in order to reduce high debt ratios. The European fiscal rules differentiate fiscal targets according to each Member State's situation. EU Member States are considering using the existing scope for more growth-friendly fiscal consolidation, including an adequate mix of growth-friendly expenditure cuts and revenue measures, accompanied by structural reforms to enhance the economic growth potential. Structural reforms that enhance growth and improve fiscal sustainability should be given particular attention, including through an appropriate assessment of fiscal measures and structural reforms, while making best use of the flexibility that is built into the existing Stability and Growth Pact rules.

- We have made further progress towards the completion of the Banking Union. The Comprehensive Assessment of banks' balance sheets by the European Central Bank for the euro area is well on track. The assessment includes an asset quality review as well as a stress test carried out in cooperation with the European Banking Authority for the EU. The results of the Comprehensive Assessment will be made public in the second half of October, before the ECB will assume its supervisory role in November 2014. Moreover, Member States have reached a political understanding on the operational framework for a new instrument through which the European Stability Mechanism (ESM) can directly recapitalise banks once the national procedures have been completed. To complement the Single Supervisory Mechanism, the EU has agreed on the Single Resolution Mechanism (SRM), which introduces a centralised system of decision making for resolution. The SRM will be supported by a Single Resolution Fund (SRF), financed by the banking industry. Options and modalities to enhance the borrowing capacity of the SRF should be developed. During the transitional period until 2023, bridge financing will be available from national sources and from the ESM in line with agreed procedures. A common backstop will be developed during the transition period. We have also enhanced the EU deposit insurance regime by adopting a framework harmonizing national deposit guarantee schemes.

- Fostering public and private investment is a top priority for the EU. The EU Ecofin Ministers at their informal meeting in Milan in September have launched a discussion on ways to boost investment in the EU, including structural reforms to improve the business environment, measures to better identify projects; and greater predictability of long-term policy. Given the current constraints in public finances, getting the long-term financing process of the EU economy right is central to increasing growth. The EU is therefore focusing on a number of areas including: i) mobilising public and private sources of long-term financing, ii) making better use of public finance, iii) developing capital markets including reviving the market for high quality securitisation instruments, iv) improving SME's access to finance, v) attracting private finance to infrastructure, in particular exploring ways to attract more investment from institutional investors for infrastructure projects, and vi) enhancing the overall environment for sustainable finance. The European Investment Bank (EIB) group is equally working on these challenges.

- We will also continue our efforts on economic rebalancing in the euro area which has made substantial progress over the past years. Significant progress has been made in the previously high-deficit countries. The main challenges of a cross-country nature now concern the lingering impact that deleveraging pressures in many countries have on medium-term growth; the burden of private debts and of the external liabilities in a context of very low inflation and slow growth; and the need to provide credit to viable investments in the vulnerable economies, under a fragmented financial system. Moreover, the very high level of unemployment in many economies represents a major policy and social challenge. Although the current account surpluses do not raise risks similar to large deficits, the size and persistence of the current account surplus in some member states deserve close attention and may point to the need to further strengthen domestic sources of growth, and particularly investment.

7. The European Union is approaching the halfway point of its Europe 2020 growth strategy adopted in June 2010, which contains five headline goals on employment, education, social inclusion, innovation and climate/energy. The review of the Europe 2020 Strategy represents an opportunity to further focus policy objectives and instruments on growth and employment, especially through investment and structural reforms necessary for ensuring job-rich, sustainable and inclusive growth. Following the communication taking stock of the strategy in March 2014, the European Commission in May launched a public consultation on the Europe 2020 strategy to gather the views of stakeholders. The mid-term review of Europe 2020 will be discussed by the March 2015 European Council.

8. Consistent implementation in the field of financial regulation continues to remain a key priority for all G20 members so as to ensure a global level playing field and in order to avoid regulatory arbitrage, legal uncertainty and inconsistent cross-border regulatory regimes. The EU has largely completed the implementation of the main G20 commitments. This includes the implementation of the Basel III framework through the Capital Requirements Directive/Regulation, applicable since the 1st of January 2014, which will deliver a stable and transparent banking sector working for the interests of the real economy. The EU has also implemented the OTC derivatives recommendations through the European Market Infrastructure Regulation and the revision of the Markets in Financial Instruments Directive/Regulation. The Deposit Guarantee Scheme Directive and the new framework for the recovery and resolution of banks (in line with the Financial Stability Board Key Attributes), the so-called EU Banking Recovery and Resolution Directive, and the Single Resolution Mechanism, another important pillar of the Banking Union, have all now entered into force. At the end of January 2014, the European Commission put forward a proposal for a regulation on banking structural reform to address remaining risks posed by “too-big-to-fail” banks, and a proposal for a regulation on enhancing the transparency of securities financing transactions which will implement the G20-FSB shadow banking recommendations. Finally, the EU stresses the importance of a structured international cooperation in the financial

regulatory areas, allowing regulatory jurisdictions to defer to one another when justified by the quality of their respective regimes. We remain committed to working with our international partners in this context.

9. The EU fully supports global action to tackle cross-border tax avoidance and tax evasion, which also matches its own objectives and achievements. In particular, we strongly support the work on international tax evasion and avoidance carried out by the OECD and the G20 and the implementation of the new global standard for the automatic exchange of financial account information in tax matter. EU Member States are committed to put in place this standard by means of the adoption by the Council before end-2014 of the 2013 Commission proposal to revise the Directive on Administrative Cooperation in the field of taxation. We also reiterate our support to the G20-OECD's Action Plan on Base Erosion and Profit Shifting (BEPS) endorsed by G20 leaders in September 2013 as a mean to address the main challenges of international tax avoidance.

II. IMF POLICY ISSUES

10. We have made 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. EU Member States welcome the agreement by the IMFC and G20 in April on how to progress on IMF quota and governance reforms. We reaffirm that our priority continues to be for all IMF members to ratify the 2010 Reform as soon as possible. All EU Member States have already fully ratified the 2010 Quota and Governance Reform. The EU encourages members which have not yet ratified the 2010 reforms 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 as well as a more balanced distribution between quota-based and temporary borrowed financial resources. 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 remain committed to continue constructive discussions on the quota formula and the 15th General Review of Quotas. In this regard, we recall that the IMFC agreed in April 2014 that, in case the 2010 reforms are not ratified by year-end, it will call on the IMF to build on its existing work and develop options for the next steps. EU Member States consider that it is most important that discussions on the quota formula and the 15th review continue to be treated as an integrated package, as also reiterated in the respective January 2014 report of the Executive Board to the Board of Governors. This implies that no decision can be taken in isolation. An agreement will need to take into account the interests of the entire membership and it should be fully anchored in the relevant IMF bodies, where all IMF members are represented. The July 2014 quota database update once again confirmed that the current quota formula captures dynamic developments in the world economy and can deliver 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.

13. 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.

Surveillance

14. The EU welcomes significant improvements in Fund surveillance in recent years aimed at strengthening IMF surveillance as the primary tool of the Fund in the area of crisis prevention. We welcome the 2014 Triennial Surveillance Review (TSR) as an opportunity to take stock of the progress made in this field. We broadly agree with its findings and

particularly welcome recommendations by staff in the following areas which should be a priority: strengthening external sector assessments and better integrating the analysis of risks and spillovers; widening the macro-financial surveillance and in this context better integrating FSAP recommendations into Article IV reports; continuing to integrate bilateral and multilateral surveillance and further defining the role of the Fund in providing policy advice on structural reforms, also taking advantage of cooperation with international organizations in this respect. We believe that the Fund should deliver on its recommendations within a flat real budget by suitably prioritising and sequencing its implementation activities, in line with the priorities noted above.

15. EU Member States underline the importance of regular reviews of the Fund's surveillance policy and support staff's recommendation to move comprehensive Fund surveillance reviews to a five year cycle. In this context, we look forward to the envisaged interim review that should focus on the implementation of the key recommendations of this TSR and on the assessment of its results.

16. With respect to the specificities of EU/EA surveillance, EU Member States underline that country surveillance should take due account of the degree of interconnectedness of IMF members participating in deeper forms of economic union or in monetary unions. Against this background, it is therefore key that Fund surveillance and advice fully reflect the specific policy-making frameworks and respective competences at EU Member States', the euro area and the European Union level. With a view to providing more consistent and effective surveillance, also in light of the recent reforms to strengthen European economic governance and surveillance, further work by staff should focus on an analysis of spillovers to understand the impact of shocks and policy decisions; a mapping of the main interlinkages and spillover channels between euro area countries; further analysis of extra- and intra-euro area imbalances; better alignment with the European policy timetable and more considerations on the euro area-wide macroeconomic policy challenges including the provision of stronger and more clearly formulated policy recommendations on structural reforms and their estimated impact in a monetary union. Continued close cooperation between the IMF and the European authorities will help ensure the high quality of policy advice.

17. EU Member States consider that streamlining and further integration of Fund surveillance products, while it should not undermine recent progress made with respect to the analysis of spillovers and external imbalances, could help increase the clarity and consistency of messages across such products, improve their traction, as well as contribute further to the efforts to improve the assessment of interconnections between economies and across sectors. We would encourage staff to consider the issue of Fund's surveillance streamlining at the earliest opportunity and in any case no later than during the mid-term review.

18. To strengthen the Fund's policy dialogue with its members, EU Member States welcome the recommendations in the 2014 TSR on how to improve traction. In this context, we continue to deem it useful if Article IV reports reviewed more consistently members' follow-up to previous IMF surveillance advice and the quality and relevance of the Fund's previous analysis and recommendations (through an "accountability box"). We furthermore support the regular conduct of Article IV consultations as well as mandatory and timely publication of Article IV reviews. Systemically important countries/regions should lead by example. Moreover, EU Member States concur that Fund surveillance should be even-handed, which at times might mean that it should be more candid, particularly for systemic economies.

19. We also welcome the 2014 Financial Sector Assessment Program (FSAP) Review which provides a good basis to consolidate and extend the progress in this area since the 2009 reform. We also broadly agree with its main findings and key priorities. In particular, we

welcome the development of a macro financial approach to regulatory and supervisory standard assessments while maintaining a proper coverage of standards in anticipation of the scheduled 2016 review.

20. 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. EU Member States look forward to the upcoming Board discussion on the Review of the Fund's Framework for Addressing Excessive Delays.

The Fund's lending framework and the global financial safety net

21. Next to a strengthened surveillance framework, a well-designed lending framework and continued effectiveness of global financial safety nets remain crucial for effective crisis prevention and resolution. In this regard, the EU welcomes the conclusion of the review of the Flexible Credit Line, Precautionary and Liquidity Line and Rapid Financing Instrument. EU Member States recall their strong support for IMF precautionary instruments and agree that they have a useful role to play in the global financial safety net, while complementing the efforts of countries to further strengthen the resilience of their economies. The proposals endorsed in the review will contribute to improving the transparency and predictability of qualification assessments of the Fund's precautionary instruments, and further inform access and exit discussions.

22. In the context of the IMF's continuing efforts to strengthen its lending framework, EU Member States also thank staff for its preliminary considerations on possible reforms of the Fund's exceptional lending framework in the context of sovereign debt vulnerabilities and look forward to continuing this discussion. Any policy response should aim at strengthening the Fund’s exceptional lending framework, with assessments continuing to be made on a case-by-case basis, while safeguarding its resources and catalytic role. We also welcome the Fund's recent work on strengthening the contractual framework to address collective action problems in sovereign debt restructuring. We look forward to forthcoming work on related fields, such as official sector involvement and the lending into arrears policy.

Resources

23. The EU strongly supports the commitment in April 2014 by the IMFC and G20 Finance Ministers and Central Bank Governors to maintain a strong and adequately resourced IMF. The Forward Commitment Capacity appears adequate to meet foreseeable demands for IMF resources in the near term. However, according to IMF staff, sizeable downside risks remain. Against this background, the EU reiterates the importance that the Fund continues to have the resources needed to fulfil its mandate. The availability of resources as a backstop in case of need is crucial for the global financial safety net and provides confidence in the world economy. While noting that it is crucial that the Fund remains a quota-based institution, pending ratification of the 2010 reform, the Fund's resource structure will have to continue to rely on temporary borrowed resources under the NAB – and bilateral credit arrangements until their expiration – as a supplement to quota resources in case of need.

24. Against this background, the EU welcomes the recent finalization of the sixth set of Borrowing Agreements of the 2012 commitments to increase temporary resources as second line of defence after quota and NAB resources available to the IMF. We note that the EU is a significant contributor to this second line of defence with more than half of the total amount

pledged in 2012 bilateral resources coming from EU Member States. Moreover, we regret that not all pledges made by IMF members in 2012 are translated into Borrowing Agreements.

25. In light of the remaining downside risks, EU Member States have supported the one-year extension of the initial two-year terms of the 2012 Borrowing Agreements and the establishment of a new activation period under NAB for the period October 2014 – March 2015.

IMF's support to low-income countries

26. EU Member States welcome ongoing efforts by the Fund to bolster lending to low-income countries, including the agreement to use windfall gold sales profits to boost the concessional lending capacity for low-income countries and to ensure the longer term self-sustainability of the Poverty Reduction and Growth Trust based on the decision taken by the Executive Board in 2012. Debt reduction, through the successful implementation of the Heavily Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative, 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 further inclusive discussions with low-income countries, including on the possibility of developing guidelines for sustainable financing. We welcome the IMF agreement to provide a total of USD 130 million of emergency financial assistance to Guinea, Liberia, and Sierra Leone to help these countries combat the Ebola epidemic.