International Monetary and Financial Committee

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Statement by Alistair Darling
Chancellor of the Exchequer, United Kingdom
On behalf of the United Kingdom
Statement to the International Monetary and Financial Committee by the Right Honourable Alistair Darling MP, Chancellor of the Exchequer

The Spring Meetings are taking place against the backdrop of one of the most severe shocks to the global economy since the establishment of the IMF. Recent events have highlighted that the links and bonds between economies are strong and growing, but that instability in national markets can quickly spill over into global markets. With international action we can address these challenges.

The global economy and financial markets: outlooks, risks and policy responses
Since July 2007, global financial markets have experienced a period of sustained disruption and volatility. At the time of the Annual Meetings, the disruption was in its early stages, and the potential impact on the real economy was highly uncertain.

In the UK, as set out in the recent Budget, GDP growth is forecast to slow to 1¾ to 2¼% in 2008, before recovering in 2009. A combination of the UK’s strong macroeconomic framework, and its promotion of open and flexible labour, product and capital markets have enabled the economy to cope with adverse shocks from the ongoing disruption. We are not complacent about the potential challenges, but we have confidence in the UK’s record of improved resilience and stability.

Despite the impact of financial market disruption on the public finances, the UK Government continues to meet its fiscal rules in line with the fiscal framework. The recent Budget provides support to the economy in the short term while taking action to maintain sound public finances in the medium term, thereby contributing to the UK’s overall objective of maintaining macroeconomic stability.

Actions to tackle the immediate situation
The financial system currently faces a number of inter-related challenges. Policy-makers and central banks around the world have already taken action in response to these developments. Lower than anticipated interest rates have helped to counterbalance tighter credit conditions; this week the Bank of England cut interest rates to 5 per cent. Major central banks, including the Bank of England, have taken coordinated actions to address elevated pressures in short-term funding markets.

Actions to strengthen the UK and international financial system
Market-led actions must also play a key role in reducing uncertainty, improving confidence and restoring normal market functioning, as well as in delivering more resilient financial markets for the future. We fully support the Financial Stability Forum’s recommendations and their rapid implementation. To do this, we need regular progress reports from national supervisors and international bodies, and regular updates on implementation of the action plan.
As a first step, financial institutions should make risk disclosures in their mid-year reports in order to reduce uncertainty, improve confidence between financial institutions and encourage the restoration of normal functioning markets. This needs to be supported by corresponding action by international accounting bodies and market participants in order to enhance transparency around the valuation of structured products and banks’ off-balance sheet exposures.

Market turbulence has also highlighted the need for better risk management and stress testing practices within banks and other financial institutions. As a priority, implementation of the Basel II framework will improve the prudential regulation of, and better risk management by, banks. These actions need to be supported by action in two further areas, because in times of stress liquidity in financial markets can dry up very quickly. In the UK, the Financial Services Authority is consulting on improvements to its regulatory framework for the management of liquidity risk; this should be supported by international action through the Basel Committee.

Credit ratings agencies also need to take action to strengthen the quality and integrity of the ratings process and enhance the information content of ratings, including through strengthening the IOSCO code of conduct to address conflicts of interest in the activities of ratings agencies. We welcome the initial steps that have already been taken by some credit ratings agencies and by IOSCO, but we should not hesitate to take action if the market-led response proves inadequate.

**Actions being taken in the UK**

In the UK, we are taking action to strengthen the stability and resilience of the financial system. In particular, bringing forward legislation, alongside actions by the Bank of England and the Financial Services Authority (FSA), to: reduce the likelihood of banks failing; to reduce the impact of failing banks on financial stability; to put in place effective compensation arrangements in which consumers can have confidence; to strengthen the role of the Bank of England in relation to financial stability, and enhance coordination across the Authorities in the UK as well as internationally.

**Resisting protectionism**

The Doha Development Round is at a critical point. We have a matter of weeks to secure agreement on agricultural and industrial goods if we are to have a chance of a deal in 2008. Success would send a positive signal to businesses and markets and counter the protectionist threat. Failure to reach a deal would impinge on global growth, and would hit the poorest hardest.

In this context, it is also important that the Fund delivers on its commitment to produce a code of conduct for Sovereign Wealth Funds by the Annual Meetings that has a broad base of support from governments and SWFs. This will help address concerns over the lack of transparency and perceived motivations of Sovereign Wealth Funds.
Implementation of the Medium-Term Strategy
Recent events have underlined the importance of global interlinkages and the need for international cooperation through forums such as the IMF. The Fund faces the dual challenge of maintaining both its relevance and legitimacy at a time when integration makes cooperation more necessary.

Enhancing relevance
Substantial progress has been made since the Annual Meetings on improving the relevance of the Fund. Now we need to maintain momentum for reform. The greatest surveillance challenges are now multilateral, and the Fund is uniquely placed to lead this work, and we strongly welcome an increasing focus on macro-financial stability links. To strengthen surveillance further, we should aim for more focus, transparency and accountability in setting surveillance objectives, notably in the new Statement of Surveillance Priorities and Responsibilities to be agreed around the time of the Annual Meetings. The Fund should also become a centre of expertise on the understanding and analysis of linkages between financial markets and the macroeconomic sector. Finally, the linkages between bilateral and multilateral issues and analysis need to be strengthened. The UK believes the establishment of a Multilateral Surveillance Department within the IMF would give new impetus to this multilateral work.

The recent market turbulence has highlighted the particular importance of detecting and assessing emerging financial sector risks, and coordinating national responses. We want the IMF, working closely with the Financial Stability Forum, to strengthen its financial sector surveillance. Together the two should form an early warning system on financial risks, making more of the existing work, improve its understanding of the transmission mechanisms within global financial markets and between financial markets and the real economy, and developing new and better analytical instruments, such as the extension of the vulnerability exercise to the advanced countries. The IMF and FSF should jointly make regular reports to a Ministerial level meeting of the IMF and FSF, which should discuss the risks and responses. This should then lead to national actions to address the risks.

Legitimacy and effectiveness
Crucial to the Fund’s credibility in the eyes of its members is a legitimate process of governance that more accurately mirrors the realities of the global economy, particularly the growth of emerging markets, and that increases the voice of the poorest members. We are grateful to the Managing Director for this proposal and the UK has already voted to approve this landmark Governors’ Resolution.

We look forward to considering wider issues of Fund governance following the forthcoming report of the IEO. The effectiveness of a system of international economic cooperation requires the commitment of the membership to take national action which will not only benefit an individual economy, but also the global economy. This commitment requires political consent and consequently needs a strengthened political process at its heart. This in turn supports the effectiveness and the legitimacy of the international system. One way in which political legitimacy could be strengthened would be to establish
an IMF Council as provided for in the Fund’s Articles of Agreement. A Ministerial Council could foster a stronger sense of political ownership and responsibility for the work of the Fund.

We also welcome the progress made by the Board in putting proposals on income and expenditure forward in the report to the Governors. However we must not lose sight of the fact that there is still much work to be done if we are to have in place a Fund finance model that is transparent, sustainable and flexible. We look forward to progress in the coming months on a dividend policy, reserves policy, and joint regular reviews of expenditure and income. It is also important that the Fund is able to take forward the sale of a limited part of Fund gold reserves, and that it does not lose sight of the vital role it plays in promoting growth and stability in low-income countries.

**Development**

Since signing up to the Millennium Development Goals in 2000, much progress has been made. However, much remains to be done. We committed to cut infant mortality by two thirds by 2015, but are unlikely to do so until 2050; and we agreed that in 2015 there would be primary education for every child, but we are unlikely to meet this target before 2100. Recent rises in food prices are having a negative impact on the Goals relating to hunger and nutrition. The progress is particularly slow in low-income countries in Africa and in Fragile States.

The IMF has a vital role to play in supporting low-income countries as they seek to achieve these goals. Its policy advice supports the macroeconomic stability which is an essential building block for growth. Fund technical assistance provides invaluable assistance to countries’ management of their fiscal, monetary and financial affairs. Fund financing through the PRGF and debt relief have helped many low income countries in Africa and elsewhere to stabilise their economies and set the pre-conditions for growth. Liberia provides the most recent example of the indispensable role the IMF can play in delivering debt relief and supporting stability in support of countries’ own reform efforts.

The challenge for the Fund is now to maintain and build on these achievements at a time when its own resources are constrained. This will require the Fund to focus on its areas of core competence, where it can add the most value. For example, work on debt relief must be complemented by additional work on debt sustainability. For while countries themselves have the primary responsibility for their new borrowing strategies, the IMF and World Bank can play a crucial supporting role through their advice and analysis.

We call on the IMF and the World Bank to develop an international strategy as a matter of urgency to address the elements of the food crisis. The institutions should support governments and agencies to address food insecurity by assessing the underlying causes, working with governments to develop social safety nets for the poorest, and providing short-term access to IMF support for net food importing countries – for example through the ESF.
The IMF has played a useful role in a number of fragile states. However, the institution lacks instruments to ensure the type of intensive, long-term engagement which these countries require. We encourage the Fund to take this work forward so it can play a full role in supporting efforts by country authorities and the international community to support stabilisation and growth efforts in such environments, building on the work of institutions such as the OECD DAC.