International Monetary and Financial Committee

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Statement by Christine Lagarde
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France

On behalf of France

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Minister of Economic Affairs, Industry and Employment

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1. The recovery has begun gradually but unevenly

The recovery is indeed underway in most of our economies but is developing at different speeds across regions. The emerging economies are currently supporting the global recovery thanks to strong domestic demand. Although some stimulus measures are coming to an end and support from the inventory cycle is expected to fade, recent indicators suggest that growth should continue to pick up in the first half of 2010.

Significant risks remain. Two of them deserve special attention: a jobless recovery in some countries on the one hand, and the effects on growth in the short term from the necessary fiscal consolidation. If our policies are poorly coordinated and lack credibility, trade flows and financing costs will be affected to the same extent.

Another risk we must closely monitor is the rise in **commodity prices.** After hovering in the range of USD 70-80 per barrel for over six months, oil prices have risen since the beginning of the month; this could be a source of concern in the near future.

2. Credible exit strategies must be identified promptly and implemented according to the circumstances of each country

Supported by public demand and **inventory rebuilding,** the recovery must now be consolidated by more-self-sustaining engines of economic growth. Strategies to achieve this transition must be particularly well-calibrated and coordinated if we wish to avoid jeopardising the fragile gains of recent months. In particular, **the pace of implementation will depend on the circumstances characterising each country**. In countries where growth remains highly dependent on public support, consolidation must wait until the recovery becomes better established and is driven mainly by the private sector. The European Union countries, under the Stability and Growth Pact, have committed to a process of fiscal consolidation to be implemented no later than 2011, provided that forecasts continue to indicate a sustained recovery, which should reduce the public deficit of the EU as a whole to below 3% of GDP in 2013.

Outside the EU, synchronization is less of a requirement for consolidation than it was during the implementation of recovery plans, and countries must be able to consolidate as a function of economic activity. Those with a current-account surplus can likely consolidate later.

Fiscal consolidation strategies must be credible to permit continued accommodative monetary conditions and to strengthen market confidence. The situation on the credit market has stabilised but remains relatively degraded. Lending to non-financial corporations continues to decline due to persistent weak demand and continuing tight lending standards, particularly for SMEs. While a portion of the exceptional measures to provide liquidity has been withdrawn, with the improvement in the situation in the money market, some measures of support remain necessary. It is desirable that they be withdrawn only following sustained improvement in the supply of credit and without causing further distortions in the interbank markets.

Finally, widespread implementation of ambitious structural reforms should provide a boost to our economies: innovation, R&D and green growth, for instance, are all areas to be explored to create more sustainable models. It is in this context that France has decided to implement a program of future-oriented investments, which aim to raise the productivity of the French economy and thus stimulate potential growth through targeted projects in the areas of higher education, training, research, innovation, and sustainable development.

3. **The situation in the emerging countries is a reminder of the need for measures to reduce the accumulation of foreign exchange reserves**

Faced with inflationary pressures and the strength of the recovery, it appears that emerging countries should quickly implement their monetary exit strategies, while taking into account the risks associated with the development of asset bubbles. Massive inflows of short-term capital into the major emerging countries have led to currency appreciation and a distinct rebound in equity markets, which have returned to pre-crisis levels. These developments should be monitored attentively.

In this connection, we, like the IMF, believe that temporary capital controls can be useful in certain circumstances. However, such capital controls should not extend beyond a few quarters, as their effectiveness declines over time, and they must not create distortions.

The very strong accumulation of foreign exchange reserves that we are witnessing in emerging countries also raises questions. Reserve accumulation strategies have received support from the fact that during the recent crisis, the emerging countries with the greatest foreign exchange reserves seem to have generally suffered less than the others. But if those strategies can be justified at the level of an individual country, they are not optimal for the global economy. The discussions underway that aim to limit the need for reserve accumulation and offer alternatives to such strategies should therefore be intensified.

4. **In the current context, coordinating our economic policies is an absolute necessity and, in particular, should draw on the Framework for Strong, Sustainable and Balanced Growth.**

The various risks faced by our economies, along with the resurgence of reserve accumulation in certain emerging countries, further reinforce **the need for strong international coordination of economic policies**. The Framework for Strong, Sustainable and Balanced Growth is an excellent tool for this. The active participation of the IMF in this exercise is particularly appreciated.

The IMF forecasts increasing **global imbalances** from 2010-11. I agree with this diagnosis. Global imbalances were a major factor in fragility before the crisis and remain a leading risk for the future. The structural reforms that will be required to rebalance global growth will take time. The G20 Framework must therefore be a sustained process that continues after 2010.

5. **Implementation of decisions taken to strengthen financial regulation is essential**

Continuing to strengthen financial regulation is necessary to restore sustained confidence among participants and lay the foundation for more robust, more stable growth. The decisions already taken must be implemented rapidly in a uniform manner in order to avoid distortion of competition and regulatory arbitrage. We note in particular that although compensation practices are moving in the right direction, implementation work must continue on the Financial Stability Board's Principles for Sound Compensation Practices and

Implementation Standards for the financial industry.

Many projects have been launched which should be finalised rapidly. A major project underway concerns the **strengthening of prudential standards conducted by the Basel Committee.** France fully supports this project, because it is essential for banking system stability. Macroeconomic impact studies of these proposals must nevertheless be conducted with precision before selecting and incorporating the proposed measures into the Basel framework.

We must also continue to work towards **standardisation of derivative instruments**, **mandatory clearing** of those standardised derivatives and their trading on organised exchanges, as well as increased transparency requirements for OTC derivatives and additional capital requirements for financial institutions trading in non-standardised derivatives.

We must continue to move forward in implementing the recommendations of regulators to increase transparency on commodity markets and the related derivatives markets. We should also consider strengthening the international standards for the regulation of those markets and participants in those markets, to prevent the destabilising effects of speculation on commodity prices.

Financial sector taxation is a useful complement to regulation in order to correct negative externalities caused by financial sector activity. We appreciate the work conducted by the IMF to help the international community to assess the comparative benefits of the various options. The goal of the tax, which France wishes to see targeted wherever such activities are systemic (e.g., banks and hedge funds) is to reduce such negative externalities. Each State must be free to assign the proceeds of the tax to the general budget or to a resolution fund, taking into account the specificities of both its financial sector and its legal environment. It is essential that the purpose, scope, taxable basis and rate of taxation on the financial sector are defined and approved at the international level, in order to avoid creating distortions of competition between different banking and financial systems, and to avoid any incentive for regulatory arbitrage. Finally, for the tax to contribute effectively to strengthening financial stability, it must focus on risk behaviours that are inadequately measured by micro-prudential regulation, for example, market-risk weighted assets or potentially illiquid market instruments.

6. **The IMF must continue to assist the international community in its work to build a more robust, better-balanced world, and to do so, must pursue governance and mandate reform**

The IMF has played a fundamental role in recent months in mitigating the effects of the crisis. Its surveillance work has alerted us to the risks that still weigh on our economies and advised us on measures to deal with them. The IMF has also continued to provide financial support to its members in greatest difficulty, mobilising substantial resources. In this context, the tenfold increase and the greater flexibility of the new lending agreements approved by the Board must be rapidly implemented to achieve a better balance among members in the cost of funding the IMF.

The low-income countries have been severely affected by the crisis and a special effort should be made on their behalf. The IMF, alongside the multilateral development banks, has been at the heart of the response by the international community in supporting them; this has put its concessional resources under considerable pressure. In this context, France fully supports the establishment of the new framework for low-income countries which should lead to greater mobilisation of concessional resources and thus help maintain the long-term sustainability of the resources in the Poverty Reduction and Growth Trust (PRGT).

To show firm support for the IMF, France, together with the UK, will shortly put in place a loan equivalent to USD2 billion of Special Drawing Rights (SDRs) to the IMF's concessional facility and calls on other donors to provide their fair share to this support.

While the financial support provided by the IMF has undeniably helped to cushion the effects of the crisis, the fact that the crisis occurred and the initial experience in dealing with it prompt us to conduct a thorough examination regarding the evolution of the IMF. France is committed to further improving the credibility, effectiveness and legitimacy of the Fund. For this to be the case, the governance and mandate reforms, despite their complexity, must both be completed in an ambitious manner and on schedule. The Istanbul decisions have provided a new impetus to this work, which we must continue.

a) *First of all, it is essential to address all aspects of IMF governance in a comprehensive manner, with a consistent approach and a single calendar.*

The IMF governance reform is an essential element in strengthening the legitimacy, credibility and effectiveness of the IMF. It must be addressed comprehensively and not sequentially, in keeping with our commitments. Otherwise, the reform that we must complete by the end of January 2011 would be an imperfect response to the imperative of modernizing the Fund.

For France, an essential element of this reform is strengthening the Governors' involvement in IMF governance, in order to enhance the policy traction and adoption of the Fund's work and not leave strategic decisions to outside bodies. The IMFC should have authority over certain topics, but this does not mean activating the Ministerial Council as provided in the Articles of Agreement. We must work serenely in identifying those decisions that lie within the scope of the Ministers and Governors, and I invite the Executive Board to submit proposals by the next annual meetings.

Opening the process for selecting senior management is a legitimate request and as such must be the case for all International Financial Institutions. Selection should be conducted irrespective of the candidates' nationality, at both the World Bank and the IMF. In the same way, we must make progress regarding diversity of the executives of the Fund and the World Bank, both geographically and in terms of professional experience and academic background.

France is not in favor of reducing the size of the IMF Board of Directors, which strikes the right balance between legitimacy and effectiveness. The effectiveness of the Board of Directors can be improved by streamlining procedures. As for ways of reducing the "democratic deficit" sometimes referred to, we believe that lowering the thresholds for voting by qualified majority warrants serious examination. We also welcome the work on the possibility of extending the double majority, provided that that does not diminish the IMF's decision-making capacity.

Quotas should better reflect the economic weight of members in the global economy. The reform should focus on reducing the gap in each member's share relative to its calculated share, and therefore ensure that no country currently under-represented would be under-represented to a greater degree than before, and also to ensure that no country that is over-represented becomes under-represented. For this to be the case, the quota share calculation formula we agreed in 2008, and which we agreed would be the foundation for our work, must be used. This formula, which is not perfect, is the result of two years' work and is the only possible compromise. An attempt to change it would entail a high risk of not being able to complete the quota reform on schedule, that is, the end of the year. For the same reason, the reform must ensure that all countries that are over-represented, including emerging countries, contribute to the reform, with the exception of low-income countries, which must be protected, in keeping with out commitments to do so. I also stress the need to promptly ratify the agreement we reached in 2008, so it can finally take effect.

b) *The crisis has shown us that the IMF's mandate should be strengthened in a sustainable manner*

The crisis has shown the **shortcomings in surveillance of members' economies**. Financial regulation proved insufficient; macro-financial risks were underestimated; and global imbalances, which contributed to the crisis, failed to be reduced. The IMF should be better equipped to anticipate future crises, and the range of its observations should be strengthened. In particular we must ensure that the IMF exercises reinforced surveillance of the financial sector and better integrates bilateral and multilateral surveillance. The historical crisis that we have just experienced calls for in-depth changes in both areas, and the ideas for work recently presented to the Board are promising, especially the integration of FSAP into the field of surveillance. Nor should we rule out more ambitious reforms, for example by amending the Articles of Agreement to explicitly include the objective of financial stability, which would underscore our policy determination. Similarly, it would be desirable for that work to result in the adoption of a Decision on surveillance by the Ministers, in order to strengthen their involvement in this field as well.

Similarly, **while the 2008-2009 reform of the lending framework** was a success, as evidenced by the introduction of the Flexible Credit Line, there remains room for further improvement. I very much welcome the work on further strengthening the Fund's Toolkit, which should improve its capacity for the prevention and treatment of crises. At this point, we must not be over hasty in dismissing the options for renovating the IMF's instruments and thereby pre-empt the international examination of the introduction of international financial safety nets. I invite the fund to mature these proposals in order to assess their feasibility.

c) *Finally, the examination of the Fund's future is inseparable from a reflection on reforming the international monetary system.*

Modernizing the IMF mandate is only **one stage in the wider reform of the international monetary system** which we must address in the coming months. I urge the Fund to deepen this examination in the follow-up to the Istanbul decisions.

The monetary system should reflect the reality of the multipolar world in which we live. We must prepare this transition today, and put in place the conditions conducive for it to occur without too rapid or destabilizing adjustments.

The IMF can play a central role in this process through its surveillance over the alignment of exchange rates, of course, but also by developing the new tools we need. At the same time, we must also develop a shared doctrine on capital flows, the appropriate level of reserves, and the development of domestic capital markets; these are areas in which I call upon the IMF Management and the Executive Board to accelerate their work in the coming months