

U.S. DEPARTMENT OF THE TREASURY

Press Center



Statement by Secretary Henry M. Paulson, Jr. at the International Monetary and Financial Committee Meeting

4/12/2008

HP-921

Washington, DC – Today's meeting takes place against the backdrop of considerable challenges to the global economy. In recent years, global economic conditions have been quite favorable, with growth averaging nearly 5% per year. 2008 will be a more difficult year, with headwinds coming from adjustments in the U.S. economy, financial market stress, higher commodity prices, and higher than desirable inflation. Downside risks will vary, and many European and emerging market economies have stood up relatively well so far to the recent financial turmoil, but no economy is entirely immune from global forces. In this context, it is critical for policy makers to put in place sound policy frameworks that support growth and enhance economic resilience.

Following several years of what, in retrospect, was unsustainable home price appreciation, the U.S. economy is undergoing a significant housing correction. The weak housing market, together with high energy prices and stress in financial markets is penalizing U.S. economic growth. While I am confident in the long-term economic prospects of the United States, clearly for the moment, the risks facing the U.S. economy are to the downside. We are responding vigorously. First, we have adjusted macroeconomic policy to support the broad U.S. economy while the corrections take place in the housing and credit markets. The President and Congress responded with a bipartisan fiscal stimulus package that will inject more than \$150 billion into our economy in the near term and boost GDP growth this year. Second, the Administration has supported a number of initiatives – both private-sector led and public-sector initiatives – in response to the housing correction, designed to prevent avoidable foreclosures and maintain viable credit markets while allowing the needed adjustment to proceed.

Since last August, financial markets have been reassessing risk, re-pricing assets and de-leveraging. It took time to build up recent excesses and it will take time to work through the consequences. We must expect more bumps in the road. Global financial institutions are making progress, with some announcing write-downs and acting to raise capital. Additional disclosures of risks and material conditions and sound capitalization continue to be important, as does the ability of financial market participants to provide liquidity and of banks to extend credit. I have confidence in our capital markets and in their resilience, flexibility, and strength.

In the United States, the President's Working Group on Financial Markets (PWG) released recommendations in mid-March to improve market transparency and disclosure, risk awareness and risk management, capital and regulatory policies, practices regarding and use of credit ratings, and market infrastructure for over-the-counter derivatives products. We are working closely through the G-7 and the Financial Stability Forum (FSF) to address global challenges and take concrete actions. We support the recommendations of the FSF, which are broadly consistent and complementary to PWG recommendations. The FSF has focused its efforts on risk management; transparency, accounting, and valuation of structured products; credit rating agencies, prudential oversight and arrangements for dealing with stress in the financial system. While no silver bullet exists to prevent the excesses of the past from re-occurring, working together we can strengthen market discipline, enhance risk management and improve the efficiency and stability of our capital markets.

The IMF, as a member body of the FSF, has an important role to play in providing analytic support and conducting financial surveillance of its member countries. We support complementary roles, with the IMF reporting findings from its monitoring of financial stability risks to FSF meetings, and in turn incorporating FSF conclusions into its surveillance work.

Openness to trade and investment helps underpin global growth and has been a source of strength for the U.S. economy. We remain committed to opposing protectionist sentiment wherever it may be found and to advancing greater openness globally. The Doha Development Round is at a critical juncture if negotiations are to be completed by the end of the year. The United States is willing to step forward with the necessary leadership – however, a significant contribution by the advanced developing countries is critical to Doha's success. Doha's development promise can only be met through agreement to significantly open markets, including financial services markets.

IMF Reform

In today's rapidly evolving global economy, the IMF must reform to retain its relevance and legitimacy. Strong international cooperation – and an effective IMF at the center of such cooperation-- remains as important as ever to global growth and financial stability. But to meet today's challenges, the Fund must sprint quickly and far to adapt to rapid technological change, the rise of dynamic emerging market economies, and the increasing internationalization of financial markets. In this context, the IMF needs to sharpen its focus on: 1) exchange rate surveillance; 2) openness to international investment, particularly meeting policy challenges posed by sovereign wealth funds; and 3) supporting global financial market stability. The Fund must also maintain its capacity to provide balance of payments support to countries in crisis, and to promote macroeconomic stability in low-income countries, while avoiding straying into the World Bank's development mandate.

Fundamental to the IMF's relevance is the vigor with which it carries out its core mission of surveillance over members' exchange rate policies. The Fund's surveillance work on fiscal, monetary policy and financial sector issues is strong. The new exchange rate surveillance decision provides an improved framework, but more important is how IMF staff carries out its day-to-day work in this area. We believe surveillance discussions have become more focused on key exchange rate issues, but staff must follow through consistently with strong analytics and clear views and judgments on exchange rate policies, particularly where currencies are not set by market forces in deep, liquid markets. The IMF's implementation of the new surveillance decision is still a work in progress. Strengthened implementation of this core mandate is integral to IMF legitimacy; insufficient progress would put success of the broader modernization effort at risk.

Last October, the IMFC recognized the systemic importance of rapidly growing sovereign wealth funds. The IMF has responded to the international community's call for analytic work on sovereign wealth fund best practices by setting forth a broad framework and process to guide work going forward. We welcome these steps, and look forward to a timely and credible set of sovereign wealth fund best practices ahead of the Annual Meetings this fall. It will be important for the Fund to work closely with both sovereign wealth fund countries and recipient countries to ensure a comprehensive, high-quality product.

Reform of the IMF's governance structure is overdue. I welcome the opportunity to join emerging market countries and the broader IMF membership in supporting a quota reform package. While we would have preferred a more ambitious reform package, this reform is a first step forward in the right direction, which boosts the weight of dynamic emerging markets and will result in a governance structure that better reflects the realities of the global economy. It improves on the status quo. We are particularly pleased that GDP will have a stronger weight in the quota formula, which will position dynamic emerging markets to see their voice in the IMF rise in the years to come. The voice of the poorest countries will also be protected. Achieving consensus on an issue of this kind was not easy, as political realities posed significant constraints and headwinds. But this package has gained the broad support of emerging market and developing countries, and represents a consensual first step forward. With this package, the Fund cannot rest on its laurels, however. Its governance structure will need to continue evolving in the years ahead, and in particular the Fund must refine the new quota formula to better reflect the realities of trade among countries.

As part of governance reform, we call on other IMF members to join us in supporting a smaller, more strategically focused Board. The Board is simply too costly and a smaller and more streamlined Board could focus more strategically on the management of the institution and less on the voluminous crush of papers. In this regard, we favor reducing the number of Board chairs from 24 seats presently to 22 seats by 2010 and 20 seats by 2012. To facilitate consolidation of seats, we also favor eliminating the current practice of permitting the five largest shareholders to appoint their own directors, and instead believe all Board chairs should be elected.

We welcome progress toward putting IMF finances on a sustainable footing. We support Managing Director Strauss-Kahn's proposal for staff cuts on the order of 10% and a \$100 million reduction in the medium-term administrative budget, in real terms, to meet a medium-term budget gap estimated at \$400 million. For our part, we recognize that new sources of income are also necessary and we are committed to seeking Congressional authorization for a limited sale of IMF gold to finance an endowment. Looking forward, on-going budget discipline will be critical to ensure that savings are not eroded.

Other Key Issues

We must continue to apply vigorous efforts to combat money laundering, terrorist financing and other forms of illicit finance, in order to protect the international financial system from abuse and to support global financial stability and economic development. To this end, we have revised the mandate of the Financial Action Task Force (FATF) to include in its important work combating the financing of WMD proliferation, in addition to other forms of illicit financing. We commend the ongoing close cooperation between the FATF, the IMF and the World Bank. We emphasize the importance of preserving the IMF's capacity to provide assistance in implementing international standards to countries that are systemically important to the global financial system.

We urge all nations to vigorously implement the financial provisions of UNSCR 1803, particularly with respect to the financial institutions identified in the resolution. We further underscore the recent statements by the FATF highlighting the money laundering and terror financing risks to the international financial system emanating from Iran. Accordingly, we urge all nations to advise their financial institutions of these risks of dealing with Iranian commercial banks, and the Central Bank of Iran, and we recommend increased vigilance towards all Iranian commercial and financial relationships.

