



International Monetary and Financial Committee

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Statement by the Honorable Gerrit Zalm Minister of Finance of The Netherlands

Representing the constituency consisting of Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Republic of Macedonia, Moldova, the Netherlands, Romania, and Ukraine

**Statement by the Honorable Gerrit Zalm
Minister of Finance of The Netherlands¹
to the International Monetary and Financial Committee
Washington, DC, April 16, 2005**

1. IMF Strategic Review

My constituency welcomes the initiative of Managing Director Rodrigo de Rato to undertake a strategic review of the Fund's roles and responsibilities. This review offers a good opportunity to address in a broader context issues that are usually dealt with in isolation. In our view, **the key challenge will be to focus the Fund on its coherent core areas** of macroeconomic and financial stability and, supporting that, the microfunctioning of public finance and the financial sector, and to increase effectiveness and efficiency in these areas. This will allow the Fund to remain relevant for all its members, which is a *sine qua non* for the coherence, credibility and evenhandedness of the Fund.

When the strategic review succeeds in focusing the Fund on well-defined core areas, the logical next step would be to **improve the division of labor with other multilateral organizations, in particular the World Bank.** Each organization should have its own well-defined and distinct mandate, working together with a sharp sense of who does what.

Governance issues form a logical part of the strategic review. On this issue, my constituency would like to emphasize that with 184 members, **the Fund is a truly global and inclusive organization, in which each country has a say on the decisions made through its constituency.** In this regard, we would like to mention the **advantages of mixed constituencies.** My constituency would also like to point at the efforts made so far to strengthen the most heavily burdened constituency offices of the developing and transition countries. There is, therefore, no reason to talk the Fund into a governance complex. Naturally, further improvements can be made in the effectiveness and efficiency of decision-

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making processes within the Fund. Hence, my constituency supports updating the amount of basic votes.

The foreseen budget reform should be an important part of the strategic review. In the view of my constituency, the budget process should become the platform for setting priorities and for accountability. This requires a transparent multi-year budget that integrates expenditures, incomes, the balance sheet and an annual decision cycle that promotes coherence and rationality.

2. World Economic Outlook

After the economic recovery gained further momentum in 2004, the **short-term global economic outlook continues to be fairly benign.** Prospects for the United States and especially China remain robust, while in the euro area, economic growth proceeds at a slower pace and Japan will be recovering from what fortunately seems to be a short and mild recession. Noteworthy are also the good growth prospects for the countries in my constituency I am also representing, with GDP growth forecasts for 2005 ranging between 3.7% (Israel) and 8.0% (Armenia).

Global imbalances remain the most important downward risk to the world economy.

Although – as the Fund states - the current era of globalization could make the adjustment of imbalances less complicated, more balanced and more gradual, the need to adjust has not changed. Since a disorderly adjustment of the imbalances would have major consequences for the world economy, we should strive for a gradual and timely correction. This correction should take place through a number of channels, particularly through a structural increase in US savings (both public and private) and through a gradual move towards more exchange rate flexibility in Asia. Stepping up growth by improving structural reforms (i.e. the Lisbon agenda) in Europe would be welcome as well, but predominantly from another perspective. Such reforms are needed to better exploit EU countries' economic potential and to prepare for ageing, but cannot be expected to do much to reduce US external deficits.

3. Surveillance and crisis prevention

Surveillance is the Fund's core instrument, and the challenge is to ensure that it is focused, while at the same time relevant and even-handed for all members. **My constituency believes that an increased and consistent focus on financial sector issues in Article IV**

consultation reports is needed. Second, debt sustainability analyses should – as agreed to – become a standard part of Article IV consultation reports and furthermore be better integrated into policy advice. Also, the extent to which member states have followed up on earlier Fund advice as well as the latter’s appropriateness should be systematically assessed. Member states that have neglected sound policy advice and consequently run into balance of payments problems should be scrutinized to have a convincing program. These suggestions will not only increase the effectiveness of surveillance, but also foster the accountability of the IMF in delivering clear and high quality advice. **At the same time, the Fund should be selective in focusing surveillance on topics that are most relevant in a particular situation.** This implies that the macro-relevance of selected issues such as labor and product markets (outside financial services) should always be clarified and that better use should be made of the expertise of other international institutions.

My constituency finds it important that countries are able to give a strong signal towards donors and financial markets on the quality of their macroeconomic policies without substantial financial involvement of the Fund. While surveillance performs an important role with regard to content, it is often considered as a relatively light signal. A Fund program can therefore provide a valuable addition. **In this context, we would like to highlight the positive experiences in our constituency with precautionary arrangements,** which give a strong signal through their upper credit tranche conditionality, without necessarily leading to Fund financing. **Similarly, low-access PRGF programs provide a valuable signaling instrument** without substantially impacting countries’ debt situations. Given the overall positive experience with low-access and precautionary arrangements to date, further consideration could be given to new instruments for low-income countries under the condition that any possible new instrument (e.g. non-borrowing program) is characterized by the same levels of conditionality, Board involvement and ownership as current Fund programs and has a clear value-added to existing instruments.

Also on the issue of signaling, my constituency would like to call attention to a recent survey of the Fund held under donors and low-income countries. This survey revealed that EU donors generally believe that - from a donor perspective - more and better information is needed from the IMF. EU donors agreed that the existing Fund toolkit can be used in a better way, for example through: i) regular information on the status of a PRGF program, especially if reviews are delayed or effectively off-track; ii) regular Fund

assessments when a PRGF arrangement is not yet or no longer in place; iii) better explanation, especially of off-signals, and iv) more textured information in addition to on/off signals to enable donors to assess whether there is substantive reason to change financial support. These suggestions are expected to somewhat loosen the linkage between IMF on/off signals and aid decisions, thereby allowing the Fund to continue catalyzing finance and a lower risk of unjustifiable stop-and-go processes in bilateral aid flows.

My constituency is not in favor of new instruments that would serve as a financial insurance through ex ante commitments of high-access credits. These instruments have several drawbacks. First of all they are likely to raise moral hazard. Secondly, in case a crisis occurs, these instruments lack the conditionality designed to address the underlying cause of a crisis. This could severely undermine the effectiveness of the Fund's intervention and jeopardize the Fund's resources. Ultimately, being a member of the Fund provides the best insurance.

4. Crisis resolution

My constituency continues to call for strict adherence to the IMF's exceptional access framework, in order to increase the involvement of the private sector in crisis resolution, limit moral hazard and ensure equal treatment of member states. My constituency encourages the Fund to consider the use of contingency strategies as a regular element of all new arrangements involving exceptional access. These contingency strategies could provide a viable policy alternative in case a liquidity crisis deepens and solvency problems surface. In such a situation, curbing access by activating the contingency strategy may also help to safeguard the Fund's resources.

Furthermore, my **constituency encourages the Fund to secure a consistent exit policy for countries with pre-existing exceptionally high exposure** (since exit strategies from exceptional access are only possible under the exceptional circumstances clause of the current framework, given that these countries do not face an immediate capital account crisis). To ensure a decline in Fund exposure, access under such policy should be low and subject to strict limits. **My constituency believes that low access precautionary arrangement should play an important role in an exit policy for countries that are not yet ready to return to a surveillance-only relation.**

My constituency welcomes the *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets* and calls on debtor countries and private creditors to apply them. An evaluation of the Argentine debt restructuring process could provide valuable insights into the role of the IMF in solvency crises. My constituency encourages the Fund to design a transparent policy with regard to its communications and its sharing of information (e.g. debt sustainability analyses) during debt restructurings.

5. Conditionality

In line with the conditionality guidelines, **my constituency believes that Fund programs should be built around clear macroeconomic goals and strategies which are reflected in similarly clear, ambitious and attainable conditions.** In line with the core areas of the Fund as defined above, these goals and conditions should be focused on external adjustment and macroeconomic and financial stability. In this regard, my constituency welcomes the Fund's observation that conditionality has indeed focused more on the areas within the Fund's mandate in recent years.

As regards waivers, it appears that the bulk of waived structural performance criteria is accounted for by delayed but nevertheless delivered measures, and experience shows that some of these waived measures are implemented with short delay. At the same time, reoccurring delays in implementation can undermine the sustainability of a Fund program. Therefore, my constituency is of the opinion that **waivers should only be granted if a condition is not met as a consequence of external factors that lie outside of the responsibility of the government in question and compensating policy measures have been taken to prevent a weakening of the program.** My constituency looks forward to staff's further research whether the conditionality guidelines have, as intended, led to better program implementation, no later than March 2008.

6. The role of the IMF in low-income countries

My constituency believes the IMF has an important role to play in all member countries, including in low-income countries. We therefore welcome the planned review of Fund's role in the PRS process. Within this review, we believe attention should, among others, be given to the following issues. First, as was also concluded by the IEO evaluation of 2004, the level of ownership within the PRSP/PRGF process needs further improvement. To this end, emphasis should shift from procedures and documentation towards the strengthening of

(capacity for) policy formulation and implementation. This can, *inter alia*, be done through better aligning procedures and policy measures with national policy cycles and strategies. Moreover, my constituency urges the Fund to more actively assist governments in formulating different macroeconomic scenarios, including contingency plans to help low-income countries better mitigate the effects of adverse external shocks. Finally, we ask the Fund to further analyze why the level of external adjustment reached in most low-income countries is even lower than originally targeted and how this affects debt sustainability and Fund financing.

My constituency welcomes the UN year of microfinance. Microfinance contributes increasingly to economic growth in low-income countries. Working together with private banks and applying sound market principles helps developing microfinance institutions. Low-income countries can support this development, particularly by having in place adequate prudential supervision and sound regulation of these micro-finance institutions and by improving the overall business climate.

My constituency would also like to call attention to the Fund's role as a provider of Technical Assistance (TA). We believe that the Fund should give due attention to its role, responsibility and available resources in providing TA within the current Strategic Review. As a recent IEO evaluation shows, the IMF should enhance an integrated and streamlined approach in providing TA, especially in light of a continuously growing TA need in low-income countries. My constituency believes that the Fund's TA should stem from and be in line with the Fund's surveillance and/or program relationship with a country, where the latter should be closely aligned to the PRSP. To facilitate this and help guarantee successful TA, high level commitment and ownership in the receiving country are of the utmost importance as well.

7. Debt relief

My constituency supports the idea of providing further multilateral debt service relief to low-income countries in order to stimulate development and help these countries achieve the Millennium Development Goals. My constituency believes multilateral debt service relief should be given as part of a coherent and integrated development strategy, which includes further trade liberalization. Furthermore, debt service relief can be made more effective by taking the following modalities into account.

First, we propose that debt service relief be in principle open to all IDA-only countries, thereby guaranteeing equal treatment. Second, since debt service relief is in fact a form of budget support, it should only be given to countries that conduct sound budgetary policies. If budgetary policies deteriorate, debt service relief should be suspended. Third, in order to reduce moral hazard, sound debt management should be a condition as well. This implies that if a low-income country continues to borrow when it has surpassed its debt sustainability threshold, the debt service relief should be suspended as well. Finally, in order to increase participation in the debt-relief initiative, my constituency wants to give donor countries the possibility to determine themselves which qualifying countries they want to grant debt service relief. The IMF and World Bank can play a coordinating role by monitoring for which countries there is a financing gap.

The financing of multilateral debt service relief should be additional. The Netherlands is willing to pay for part of the IDA/AfDF debt service relief for our qualifying partner countries and poor members of our constituency in line with our share in IDA. To finance the IMF debt relief, a relatively small amount of gold could be sold to create an investment account as part of the Fund's balance sheet from which only the accrued profits would be used for debt relief. In this way, resources are freed for additional debt relief, while the financial position of the Fund and IDA/AfDF remain solid. To limit possible negative consequences for the gold market, the proposed gold sale should in principle be accommodated within the current Central Bank Agreement for 2004-2009. We welcome the recent IMF paper on this issue.

We hope other countries will support this form of debt service relief and by doing so will increase their ODA effort, in line with the Monterrey commitments.

On the recently agreed debt sustainability analysis framework, **my constituency urges the IMF and the World Bank to implement this framework in a consistent manner**, meaning that both institutions commit themselves to the framework and that both will make future financing dependent on the sustainability analyses made in the context of the framework.