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Statement by the Hon. **SVEIN INGVAR GJEDREM**,  
Governor of the Fund for **NORWAY**,  
on behalf of the Fund Nordic and Baltic Countries,  
at the Joint Annual Discussion

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*1. Introduction*

1. Mr. Chairman, it is my pleasure to address the joint annual meeting 1999 on behalf of the Nordic-Baltic constituency consisting of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Sweden as well as my own country: Norway. The present meeting takes place in a more sanguine atmosphere than last year's. During the year, international financial markets have come closer to a state of normality and the economic outlook appears brighter in several regions. However, these encouraging developments do not leave room for complacency.

2. The financial crises in Asia, Russia and Brazil have caused great hardship in the affected countries. Furthermore, a large number of smaller countries have experienced significant economic and financial stress during the last couple of years. Last autumn, the Russian crisis caused serious disruptions to international financial markets, which yet again demonstrated how national financial crises can have far-reaching or even global repercussions.

3. The IMF has played an important and positive part in the resolution of the recent crises. The fruits of this work can now be seen. The developments in Asia and Latin America are encouraging although significant problems remain. Developments in Russia have been mixed.

4. We should use the current "breathing space" to learn from the recent crises. We must take steps to reduce the likelihood of new crises, as well as to improve our handling of them. These topics will occupy the main part of my speech.

*2. Crisis prevention*

5. IMF's main role is to be the guardian of a stable international monetary and financial system. To this end, the natural starting point is to seek to prevent financial crises from happening or spreading.

6. The Nordic and Baltic countries fully support the work on a strengthened international financial architecture. We note with satisfaction that the recent crises have not, in general, led to the adoption of exchange restrictions or other steps that prevent efficient resource allocation. Instead, the focus has been on adopting positive rules to enhance the functioning of markets.

7. Improved statistics and more transparency should have a stabilising effect on capital markets. Standards for economic policy will draw attention to necessary action for domestic policy makers, and make it easier for international investors to make informed decisions.

8. We favour a central role for the IMF in helping countries to open up their capital accounts in an orderly and properly sequenced way. The Fund should be given appropriate jurisdiction over the liberalisation process. An opening of countries' capital accounts must be preceded by a strengthening of the domestic financial system; for example, through more information and improved regulation and supervision. Furthermore, liberalisation must be accompanied by adequate macroeconomic and structural policies.

9. However, liberalisation of the capital account should, as far as possible, be synchronised with the liberalisation of trade in goods and services. One-sided integration into the world markets may be destabilising and increase exchange rate volatility. The new multilateral trade round to be launched in December, coupled with a strengthened international financial architecture, is important for the overall stability of the world economy.

10. International interbank loans with very short maturities played a major role in some of the problems in Asia. On the debtor side, the crises have revealed serious cases of deficient debt management, and we encourage the Fund to work with national authorities to improve debt management policies. The ongoing work on changing the Basle rules on capital ratios is also essential and should encourage more prudence on behalf of creditors.

11. The recent crises have yet again taught us the importance of solid macroeconomic "fundamentals". Large government deficits and a rapid debt build-up make a country vulnerable to changes in investor sentiments. When seeking to strengthen the budget, it is important to work on the expenditure side as well as the revenue side. With respect to the latter, we support the IMF's work aimed at making countries improve their tax systems.

12. The most appropriate exchange rate regime depends on the economic circumstances facing the individual country. However, experience reveals the risk of upholding a rigid exchange rate policy when there are underlying pressures in the economy and financial markets are characterised by rapid capital movements. Exchange rate pegs require a high degree of prudence in macroeconomic as well as financial sector policies.

13. The newly released report on external evaluation of Fund surveillance is interesting reading. We would like to draw attention to the recommendation that the IMF put more emphasis on identifying macroeconomic vulnerabilities. An important part of the prevention policy is to identify which shocks are likely to arise and analyse how member countries most effectively can absorb these shocks. Moreover, as recommended in the report, it is important that the Fund strengthen its co-operation with other international financial institutions.

14. The lesson with respect to crisis prevention can be summed up in one sentence: Financial stability requires solid macroeconomic “fundamentals” and resilient financial markets. This message is not new. On the contrary! What is new is that liberalised capital markets and new information technology have increased the urgency of the message. The financial markets have become less forgiving.

### *3. IMF's lending policy*

15. Mr. Chairman, irrespective of the positive efforts aimed at prevention, the world will experience new financial crises in the future. The IMF is, and will continue to be, the major institution appropriate to address them. Therefore, we find it useful to raise a few key points about the IMF's lending policy.

16. The catalytic effects of the IMF's programmes are of paramount importance. This requires that the credibility of IMF lending must not be undermined. Loans should only be extended to countries undertaking genuine and strong steps to solve their economic problems. The conditionality must not be weakened, even if the consequence, in some cases, may be that loans cannot be extended to countries experiencing serious difficulties.

17. In general, the Fund should put more emphasis on adjustment requirements. In particular, the IMF should not bail out governments running unsustainable deficits for extended periods of time. Support should be given only when the crisis country undertakes significant adjustment efforts and it is clear that the country has assumed “ownership” of the programme. Increased attention should also be given to the use of “prior actions”.

18. As part of a strengthened financial architecture, the Contingent Credit Line initiative should contribute to reducing the spreading of future crises. However, to achieve this, the facility must not create new moral hazard problems. It is important that the eligibility requirements are interpreted very strictly, that the countries involved conduct a firm and credible policy, and that serious steps are taken to involve the private sector. We note that this facility has, so far, not been used.

19. Moral hazard problems will be reduced if the private sector were involved to a larger extent in crisis resolution. The overriding principle should be that the private sector must be involved primarily on a voluntary basis. However, we believe there is a need to establish a framework which clarifies the roles of the various actors in international financial crises. It is important that transparent ex-ante rules are instituted, leading to a strengthening of the pricing mechanism. The IMF has an important role to play in such a framework.

20. A number of countries have taken steps to stimulate long-term private sector involvement; for example, by establishing private contingency credit lines. The IMF should encourage countries to undertake such initiatives. The ongoing work to promote

the establishment of creditor committees and the introduction of collective action clauses in bond contracts should be intensified. We support that the IMF follows a restrictive lending practice with the aim of involving private sector lenders.

21. It is an often-raised concern that such steps would increase the cost of borrowing for emerging markets. We are not entirely convinced by this argument. First, the main aim must be to achieve a better pricing of international loans, reflecting the underlying productivity of capital. Secondly, if the steps lead to increased financial stability, the risk premium could actually fall.

22. In sum, moral hazard problems and a tendency towards a reduction of the catalytic effects of IMF programmes suggest that some adjustment of the Fund's lending policy is warranted. We should seek to tip the balance towards more adjustment and local "ownership" of the programmes. Furthermore, we strongly support active steps to involve the private sector in the resolution of crises.

#### *4. The HIPC initiative*

23. The Nordic-Baltic constituency supports the enhanced HIPC initiative, as well as the proposal to put more focus on social reforms in ESAF programmes. The ESAF/HIPC arrangement is an important tool for supporting macroeconomic reforms in the poorest member countries.

24. We very much welcome the agreement in the IMF on the financing of the ESAF/HIPC arrangement. We appreciate that the gold sales are envisaged to be a one time operation of a highly exceptional nature.

#### *5. Final comments*

25. In the same way as "ownership" is important in individual programmes, it is important that the global community assumes "ownership" of the ongoing process in order to strengthen the international financial architecture. The participation of all countries must be assured in the work. The constituency structure of the IMF and the World Bank safeguards this. We consider it vital that work on the architecture, to the greatest extent possible, be within the established framework of the Bretton Woods institutions. Furthermore, while preserving the principle of genuine participation of the whole membership, there is a strong need to consider how to strengthen the policy-making bodies of the Fund and improve their working methods. Progress in this area is crucial to ensure the continued leadership of the Fund in international monetary and financial matters.

26. The increased globalisation has brought about a number of benefits but also a range of challenges. Recent years have seen an unprecedented number of countries experiencing economic and financial problems. The relative calm experienced during the last few months should not let us defer the difficult task of devising new and better rules

for strengthening the international financial system and stabilising the world economy. The International Monetary Fund will play a key role in this endeavour.

27. It must be underscored, however, that the complexity and composition of the economic problems facing the world are such that increased co-operation is called for. The IMF must work closely with the World Bank, regional development banks, the BIS, and other institutions. The rapid changes in the world around us underscore the need to continue to adopt and reform the IMF. New challenges await