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Statement by the Hon. **SAULI NIINISTO**,  
Governor of the Bank for **FINLAND**,  
on behalf of the Bank Nordic Countries,  
at the Joint Annual Discussion

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I am pleased to have this opportunity to address the Joint Annual Discussion on behalf of the Nordic countries in the World Bank. Let me also welcome the Democratic Republic of East Timor as the latest member country of the Bank.

In my remarks, I will briefly discuss the implications of global economic environment for the financing of developing countries and for the finances of the Bank. Secondly, I will comment on the role of the Bank in implementing the Monterrey consensus. Finally, I have some remarks on the very timely question of debt sustainability.

*Global Economy and its Implications for the Bank*

The global economic situation is marked by considerable uncertainty. There are several factors in the USA, in the Euro area and in Japan, which indicate that prospects for global recovery do not seem very promising. Moreover, Latin America is facing problems with potential repercussions for the global financial market. These developments in Latin America are an important new example of the need to maintain credibility, especially in cases of high indebtedness.

There are indications that financial flows to developing countries have been affected by Argentina's debt default and increased political uncertainty in some of the major developing country markets. However, while net debt flows have been particularly affected, equity investments such as FDI have fared markedly better. The declining trend in foreign borrowing by developing countries is not all bad; in the current circumstances, there is a need to focus more on preventing excess indebtedness early enough, particularly in developing countries, since over indebtedness clearly reduces possibilities for active poverty reduction programmes.

Current unrest has implications for the financial situation of the World Bank. Demand for official sector loans will increase as market supply for loans to emerging market countries and developing countries diminishes. At the same time, the Bank is also facing a deteriorating credit portfolio as a result of global economic environment. We must emphasise the need for prudent risk management in these circumstances, meaning adequate reserves and loan loss provisioning. We should also consider the need to rethink lending policy and link it to policies ensuring debt sustainability in debtor countries.

*The Role of the World Bank in Implementing the Monterrey Consensus*

Conferences in Doha, Monterrey and Johannesburg have advanced common understanding and rooted common commitments to accelerate the implementation of the Millennium Declaration. This process has been an important expression of an increase in multilateralism in the economic and political relationship of countries.

We now have a commonly agreed framework for measuring development results embodied in the Millennium Development Goals. While there are obvious advantages from explicit policy targets, we should note that implementation and monitoring and data reliability issues require close collaboration between the Bretton Woods Institutions, the UN and WTO.

There is an emerging consensus on development process and policy requirements. Allocation of responsibilities is important: sound policies and good governance form the basis for all countries, and developing countries implementing them should be rewarded with increased and more effective development assistance and market access. Liberalization of trade and increased market access opportunities are key elements which can significantly help the development process. The Bretton Woods Institutions should support the process within their mandates, although the multilateral Doha round will be of vital importance. However, steps can be taken quite quickly if political will exists, as for example, the “Everything but arms” initiative demonstrates.

The role of the Bank in implementing the Monterrey Consensus is crucial. The Bank should work in partnerships and in co-operation with International Financial Institutions, the UN and WTO. Division of labour could be strengthened based on comparative advantages of these institutions. Intensified co-operation requires harmonization and simplification of procedures to facilitate effective aid. Indeed, effectiveness of aid and measuring progress are key questions.

We should also note that incentives created by aid are important. Aid should be targeted primarily to countries which succeed in achieving domestic preconditions for sustained financing of growth. In this respect, we welcome the IDA performance-based allocation. Data shows that best performers receive considerably more IDA loans than worst performers. But naturally, the Bank should also devote attention to countries willing, but so far not able, to do what it takes to be among the best performers.

The Bank should follow a country-led approach. There is a consensus that ownership is a crucial precondition for successful programmes. Ownership can be enhanced by effective use of the PRSP approach with the aim of developing stronger institutions and policies in recipient countries. Policies against corruption should be emphasised as a major determinant of investment climate. We already have positive experiences from the PRSP approach and the next step is effective implementation.

### *Debt Sustainability*

Debt relief has become one key part of the current development policy because over indebtedness has caused financial crisis or generally impaired growth and poverty reduction. HIPC initiative and models for sovereign debt restructuring are examples of methods to tackle this problem. But a word of caution is needed: these approaches all have a potential weakness, if they are implemented as one-time solutions without change in policies.

What is needed is lasting results from debt relief and restructuring arrangements. PRSP programmes, debt relief and lending from International Financial Institutions should be based on careful analysis of debt sustainability which is based on realistic assessment of future growth of production and exports. The role of sound policies must be emphasised. Recipient countries should borrow new net debt only if capacity to carry debt increases.

In some HIPC cases, the question of “Topping-up” arises when debt levels are still unsustainable because of exogenous reasons, even after receiving full relief at the completion point. While flexibility in implementing topping up is needed, it should be noted that significant long to medium-term shocks should be considered in this regard. Also, the principle of fair burden-sharing should be applied for topping-up. We should avoid using the IDA grant component to bail out lenders who do not contribute under the existing framework. Generally, it is important that the Bank clarifies policies related to the use of IDA grants in respect to HIPC countries.