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Statement by the Hon. **WOLFGANG RUTTENSTORFER**,  
Governor of the Bank for **AUSTRIA**,  
at the Joint Annual Discussion

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Temporary Governor of the Bank for AUSTRIA  
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Europe's economy and economic policies have entered an important stage in two respects. First, economic wisdom strongly suggests that good economic fundamentals should translate into healthy growth. Second, the run-up to the third stage of Monetary Union has reached an important, albeit sensitive, point.

Inflation is slowing further from an already low level and economic sentiment indicators have recently reached a record level for the last seven years. However, growth is picking up less forcefully than inflation is coming down and employment shows a disappointing performance, despite the fact that EU-Member States are undertaking steps to enhance the employability and skills of workers and the unemployed, and to improve the functioning of labor markets.

The Austrian economy is broadly following the mainstream of European economic indicators. Trade-offs between these indicators, however, differ slightly compared with our European neighbors. In spite of lower than average GDP-growth unemployment is not increasing, but on the other hand there are no benign effects of sizeable fiscal consolidation on interest rates. The latter phenomenon does not indicate a credibility problem of Austrian policy, but points to an overall nominal interest rate floor represented by that of Germany, probably caused by the still diverging business cycles of the world's biggest industrial countries. Fortunately, exchange rates in the European Union have recently adjusted themselves to equilibrium levels. Thus, in 1997 the competitive position of Austrian manufacturing has improved by some 5 percentage points compared with the level prevailing after the 1995 exchange rate turbulence in Europe. This gives us confidence for growing exports, a traditional prerequisite for an upswing in Austria.

Two factors make the current upswing less employment friendly than in the past. First, enterprises continue to invest in labor-saving technologies. Second, profits do not translate into domestic real investment to the degree that they previously did. The latter phenomenon has become more important in recent years, not only due to the growing internationalization of

business but also as a reaction to an unhealthy tax competition. We thus require a higher degree of international cooperation to overcome vicious downward spirals of tax competition.

At present, domestic policy priorities continue to center on further consolidating our public budgets, including reforms to maintain the viability of our public pension system in the long-run; to solving labor market problems; liberalising energy and telecommunication sectors; and to encourage the restructuring of our economy, especially capital markets, in the face of globalizing economic competition. While this policy-mix successfully assures that both budget consolidation and growth and employment targets can be balanced, it does not leave space for expansionary policies of the traditional type. These issues highlight the necessity for our governments to also restructure the state as we know it today. To ensure its viability in the future we will have to reduce activities across a certain range, in order to focus on core activities.

Our consolidation strategy amounting to savings of 4 % from an implicit deficit of 7 % to now less than 3 % of GDP, which in 1996 was successfully implemented with a two-year budget will be pursued further. In July 1997, the government decided on a budget package which covers two years, i.e. 1998 and 1999. The early announcement of a consolidation of another one percent of GDP shows that the fulfillment of the Maastricht stability criteria is a sustainable one.

I am convinced that Austria will be in the first group of participants. This conviction is shared by the financial markets. The latter suggest a relatively large number of participants in EMU, despite the fact that meeting the fiscal criteria for a number of countries might still depend on the resurgence of growth this fall. Earlier concerns about a trade-off of price-stability in the Euro-zone and the number of participants seem to have disappeared in light of the surprising convergence of inflation rates in Europe. Still, Austria's population needs to be convinced to take on the Euro as means of payment and as storage of wealth, despite its readiness to accept and to undertake tough fiscal consolidation.

At the international level, the Fund for some time has been trying to find instruments to deal with the consequences of the increasing globalization of economies and financial markets. A whole new series of policy initiatives have been developed or can be considered as work in progress. Some of these policy responses, like the expanded supplemental lines of credit available to the IMF in the form of the New Arrangements to Borrow (NAB) have reached the stage of legislative approval in several countries. Austria will be among the NAB-lenders and is

likely to complete, this fall, the legal steps needed for its participation in this international financial safety scheme.

Other critical components of the Fund's policy response, like the Data Dissemination Standard to ensure timely and reliable provision of financial and economic information to the public, have been agreed to by the membership. Besides improving the availability and quality of data, the Fund's policy dialogue has become more transparent and open than formerly, as can be seen in the publication of its Article IV policy recommendations in the form of Press Information Notices (the so-called PINs). The new emergency mechanisms established by the IMF following the Mexico crisis have been utilized while assisting Thailand and appear to have worked well.

Nonetheless, more needs to be done. The recent crisis in Southeast Asia's financial markets has underscored the critical importance of a sound financial system, and the need for the Fund to pay more attention to financial sector issues that are capable of threatening macroeconomic stability.

Despite the strengthening of the Fund's surveillance role resulting from Mexican crisis-induced innovations in the Fund's policy instruments, the limitations of the Fund's surveillance and the need for further improvements have become visible. It turns out that the information provided by member countries has been neither sufficiently comprehensive nor sufficiently reliable. Countries have ignored the Fund's warnings about problems with their balance of payments and financial sectors and have not heeded the policy recommendations of various organizations of the international financial community. The national and regional costs of such neglect have been high.

However, restricting capital movements is the wrong response to the financial turmoil in some emerging market economies. In my view, the Declaration of the Interim Committee on the Liberalization of Capital Movements Under an Amendment of the Articles of Agreement draws the right policy conclusions. While dealing with such problems of financial markets crises as contagion effects and herd behavior, we need to recognize the growing importance of private capital flows for financing investment and growth in the world economy. It is necessary to maximize its benefits through an orderly process of capital account liberalization as envisaged

in the planned amendment of the Articles, combined with policies promoting the development of sound financial systems. These, of course, are necessary but not sufficient conditions.

We welcome the recent agreement on the basic features of the Eleventh Quota Review. This quota increase will permit both to strengthen the Fund's resources and to correct the underrepresentation of some countries in terms of their quotas. Thereby, it will enable the Fund to continue to fulfill its mandate in the international monetary system. Like a number of other countries, Austria will receive a special quota increase which will help to narrow the imbalance between its relative position in the world economy and its capital share in the IMF. This is a step in the right direction but further adjustment will need to be made in the future.

We welcome the consensus on amending the Articles of Agreement to permit a special one-time allocation of SDRs. This long overdue agreement will double the present amount of SDRs and equalize the SDR-to-quota ratio of all members at 29.3 percent. This will allow the transition countries in my constituency to fully participate in the Fund's SDR Department.

With regard to the Highly Indebted Poor Countries, I should say that I am gratified that the first six cases of debt relief under the HIPC initiative have come to the Boards of the Bretton Woods institutions, thereby testing the practicality of the HIPC approach. This success, together with the recent publication of the guidelines of the Bretton Woods institutions on governance - put in place to prevent misuse of public national and international funds and improve the management of public resources - breaks important new ground in development assistance.

The HIPC initiative demonstrates how much satisfactory net income results are needed. Multilateral relief, with equitable contributions from all - also major - participants, needs to be supplemented by unilateral action. Therefore, Austria has decided - in an additional effort to its Paris Club contributions - to write off an amount of up to \$130 million in outstanding loans to 11 mostly Sub-Saharan countries. In addition to that, Austria contributes to the Multilateral Debt Fund for Uganda and similar activities are planned for Mozambique. We welcome that the World Bank and the IMF are doing their best to implement expeditiously the Debt Initiative and we support the IBRD net income contribution.

Whilst there are positive developments in these areas, the ongoing decline in bilateral official development finance puts an increased responsibility on the Multilateral Development

Banks. In this context we welcome the World Bank's strategy to emphasize the role of the private sector in the development process and to support its stronger involvement. To provide financial and technical assistance to support this process will have an important leverage effect, thus supplementing or, wherever possible, even replacing traditional official development aid. Yet, as we know from our own experience, it is of great importance to set prudent framework conditions which guarantee satisfactory results for all stakeholders. The World Bank Group with its outstanding and outreaching capacities carries a major responsibility in this respect.

The high priority given to corruption and governance is crucial for economic and social development and also important in the context of stronger private sector involvement, where both the World Bank Group and the IMF play a major role in developing appropriate responses. The World Bank must, as a corollary, reinforce its support in capacity building and in establishing the necessary framework conditions in client countries. In our view it is the Bank's responsibility to react appropriately if corruptive symptoms undermine its lending and non-lending activities. We are looking forward to the elaboration of operational rules and procedures in this respect, not least to safeguard the reputation of the Bank as an effective development institution.

A stronger involvement of the private sector in the development process won't render the World Bank superfluous. Even if clients' demand for loans is flat and there is ample headroom, the Bank's income dynamics require a rethinking of its role and thus possibly new strategies. We recognize that there are at the same time many interests and claims on the Bank's income and expenses, and on its net income. To safeguard the effectiveness of the World Bank as the major multilateral financial institution in the long run, priorities will have to be set on the basis of profound analysis and discussions which won't be an easy task. A number of, in principle, sensible strategies would entail major shifts in the Bank's role, structure, personal composition and income level and composition.

Finally, I am pleased to have signed the MIGA Convention in April 1997 at the occasion of my first attendance of a Development Committee Meeting. The Austrian Instrument of Ratification was transmitted to the headquarters of The World Bank Group on September 10, 1997. MIGA provides an extremely effective instrument for greater private sector involvement in the development process. MIGA's capital constraints result not least from its successful work and the rapid expansion of its guarantee volume. This very positive development demonstrates not only the confidence of private investors in the economic development in borrowing countries

but it also contributes to the relief of aid finance for the benefit of countries and projects which really need it.

It is our opinion that this positive development must not be hampered by capital constraints. We therefore support a quick solution for adapting MIGA's capital base to the demand for guarantees and are ready to contribute our share.

In concluding, let me say that the present global challenges are making themselves felt in each and every country. Those who are trying to actively manage this change will succeed. Those who merely attempt to stem the tide will fail. Looking at the Bretton Woods institutions, I am convinced that, though in differing manners, they are at the forefront of those who are actively managing change, and helping the tides of change to move forward in an orderly manner.