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Statement by the Hon. **BIRGIR ISL. GUNNARSSON**,
Governor of the Fund for **ICELAND**,
on behalf of the Fund Nordic Countries,
at the Joint Annual Discussion

Statement

by Mr. Birgir Ísl. Gunnarsson, Governor, Central Bank of Iceland
on behalf of Denmark, Finland, Iceland, Norway, Sweden
Estonia, Latvia, and Lithuania
to the 1997 Joint Annual Meetings of the World Bank
and the International Monetary Fund

I have the honour of addressing this meeting on behalf of the Nordic and Baltic countries – Denmark, Finland, Iceland, Norway, Sweden, Estonia, Latvia and Lithuania – on matters relating to the International Monetary Fund. At the outset I would like to thank the Chinese Government for the hospitality extended to us here in Hong Kong. Following the return of Hong Kong to China earlier this year, I would also like to use this opportunity to extend my best wishes for the future of Hong Kong and of China in general, both of which have shown an impressive economic performance in past years.

World Economic Outlook

The Nordic and Baltic countries support stability-oriented economic policies conducive to growth and expansion of world trade. In addition to sound public finances, ongoing sweeping changes in many parts of the world that go to this effect are increased market orientation, dismantling of trade barriers, liberalisation of capital flows and privatisation of public enterprises. All of these measures have provided tangible results as is evidenced by the healthy expansion in the world economy and strong rise in the volume of world trade. Currently, the world economy is expanding at the strongest pace in a decade with the trend growth rate in the world economy around 4 ½ percent while global inflation remains subdued. It is encouraging that the expansion is firmly underpinned by strong growth in various parts of the world.

While several advanced economies are operating at a relatively high capacity level, the slow growth of many economies of continental Europe is far from satisfactory and suggests the need for more vigorous structural reform policies. Moreover, in past years a slowdown and even recessions have followed episodes of relatively rapid growth in many countries. Given that experience, the overall current positive developments in the world economy create the challenge of sustaining the healthy non-inflationary growth of the recent past.

In the advanced economies, the current developments have been largely characterized by the high degree of price stability that remains an impressive achievement shared by most of these countries. Indeed, the low inflation levels and widespread commitment to stable prices count among the major factors that contribute to the solid economic growth and the favorable

prospects of sustaining the current expansion in the period ahead. In the economic outlook, however, there are various elements of concern, among them, the risk of overheating in some countries. It is vital that we stay on guard to counter the possibility of inflation rising again. We must be prepared to use the policy measures available to us in this regard.

It is encouraging that in the developing countries real GDP growth is expected to remain relatively buoyant at about 6 ½ percent in 1997 with similar growth being projected for the coming year. Macroeconomic stability and prompt implementation of necessary reforms are fundamental to sustain this improvement in the period ahead and enhance the generally positive long-term prospects for these countries. The growing number of successful economies in the developing world is opening new markets and creating increased production capacities.

In countries in transition as well as developing countries it is clear that many challenges remain to be addressed to safeguard and further extend the progress that has been achieved. The experience of several countries in transition suggests that the process of turning centrally planned systems into market economies is providing successful results. This is particularly evident in the countries that have pursued the most comprehensive stabilization and reform policies. These countries are increasingly being re-integrated into the world economic and financial system. The less advanced transition economies need to increase their efforts and embark on comprehensive reform programmes that include the establishment of the institutions of market economy and the development of financial markets capable of efficiently channeling funds into productive investments.

In regard to general policy formulation in all countries, there is no alternative to the policies that have proven most successful and conducive to sustainable growth. We need a balanced mix of monetary and fiscal policies to ensure economic stability and growth in the long-term. With monetary policy directed at price stability the design of sound fiscal policies must take into account the need to foster savings as a prerequisite for investment and growth. We need structural policies to free up economic resources bound by restrictions in the form of excessive regulations and impediments to trade and capital flows. We need comprehensive labor market reform that together with efforts in the field of education and training can facilitate new economic dynamism and tackle the unemployment problem. In order to safeguard long-term growth we need environmentally sound policies. We need free and open markets that allow developing countries and transition economies to earn their way to economic prosperity through a vibrant world trade that is beneficial to all countries.

World Monetary System

In light of the imminent formation of the Economic and Monetary Union in Europe with one single currency replacing various national currencies, the world monetary system is at an important juncture. The replacement of the currencies of several economies of this size and state of development with a single common currency is unprecedented in history. With its

systemic consequences the European Monetary Union will create new challenges for the world monetary system. But while EMU will be a major change it will not be a sudden change. The establishment of the common currency will reflect a process of four decades within Europe characterized by strengthening economic and monetary ties.

For participating countries the European Monetary Union will represent a change in the monetary policy regime where national monetary policies will be replaced by a policy attuned to conditions throughout the euro area. The effects of the EMU on the world economy will depend on the economic performance in Europe and the extent to which the euro is used in international transactions. Given the scope of the changes that the European Monetary Union entails it is important that a smooth transition to the new monetary regime will be effected.

Role of the Fund

The International Monetary Fund plays a vital and central role in the surveillance of the global economy and world monetary issues. Given the need to efficiently detect problems in the world economy and provide an early warning of unfavorable developments to facilitate prompt policy response, I would like to underline the importance of the surveillance functions of the Fund in regard to the world economy as well as surveillance of individual member countries' economic policies. The recent market turbulence in South-East Asia has highlighted the importance of strong and confidence-building macro-economic and structural policies and early policy action when imbalances build up. The Fund has an important surveillance role in that regard but the ultimate responsibility lies with the countries themselves. The Fund also has a vital role to play as a catalyst for financial flows to developing countries and transition economies. In this function the Fund must continue to build on the basis of established practices, with strict conditionality and taking into account the revolving character of its resources.

We must at all times ensure that the Fund has the capacity necessary to carry out the functions specified in its mandate. Thus, I welcome the agreement by the Executive Board on the quota increase. I also welcome yesterday's unanimous decision on the special one-time SDR allocation.

The increasingly open and liberal system of capital movements is highly beneficial to the world economy. Capital liberalization backed by sound macroeconomic and structural policies is conducive to investment and growth. Future positive developments of global financial markets and the prevention of market turmoil would be enhanced by an international agreement to promote orderly capital liberalisation. Thus, we support an amendment of the Articles of Agreement in order to extend the Fund's mandate to cover also capital movements.

I would also like to welcome the launch of the initiative for heavily indebted poor countries. It is essential that this one-time effort be further secured through adequate financing based on the principle of fair burden sharing.

Mr. Chairman.

The Fund has a central role to play to strengthen future prospects for growth and employment in all its member countries based on the agreed principles of the 1996 Interim Committee Declaration on Partnership for Sustainable Global Growth. Looking ahead, further economic cooperation and policy coordination constitutes the basis to meet the future challenges in the world economy.