International Monetary and Financial Committee

Tenth Meeting
October 2, 2004

Statement by Mr. Zalm

ECONOMIC AND FINANCIAL COMMITTEE

THE SECRETARIAT

Brussels, 10 September 2004
ECFIN/CEFCPE(2004)REP/50231 final

Statement by Minister Gerrit Zalm, in his capacity as Chairman of the EU Council of Economic and Finance Ministers, to the IMFC Autumn 2004 meeting

1- I submit, in my capacity as Chairman of the EU Council of Economic and Finance Ministers, this statement which focuses on: the world economy; crisis prevention and resolution in Emerging Market Economies (EMEs); the role of the Fund in low income countries; the financing of the HIPC Initiative.

Economic situation and outlook

2 - The recovery in global economic activity is further broadening. The present momentum and the rapid expansion of world trade underpin confidence in a renewed period of strength for the world economy. Despite the persisting high level of oil prices, which gave rise to inflationary pressure in recent months and which may dampen domestic demand, the outlook remains on the whole positive, although remaining global imbalances still represent a downside risk.

3 - Economic activity in the EU-25 is also expanding, albeit overall at a relatively moderate pace. Real GDP growth in the EU-25 picked up at the end of 2003, consolidated in the first half of 2004 and is expected to maintain momentum in the remaining months. In the euro area, the contribution of domestic demand to the recovery has so far been uneven among Member States, but a gradual strengthening is expected. In the corporate sector, progress with the consolidation of balance sheets, accommodating financial conditions, and strengthening confidence should buttress growth in investment spending. Private consumption has shown signs of strengthening since early 2004, although household confidence remains subdued. Increasing world demand, political instability in a number of oil-producing countries, and limited spare capacity continue to exert upward pressure on oil prices. High oil prices may dampen demand growth in the global economy. We should, however, remain watchful for a building up of inflationary pressures, as high oil prices can also pose upside risks to price developments.

4 - Policy makers in all major countries and economic areas are confronted with the key economic challenge of supporting and consolidating the recovery through sound economic and structural policies.

- Sound fiscal policies have a central role to play in all major zones. The present economic momentum should be effectively used to implement budgetary consolidation and to focus on the medium and long-term sustainability of public finances in a number of major economic areas. The appropriate measures to be taken in this respect should not be postponed any longer. In the EU, Member States remain strongly committed to sound public finances as a basis for strong economic growth and increased employment. Special attention will also be paid to growth-promoting policies that do not lead to budgetary costs, such as those aimed at reducing the administrative burden for the business sector. The Stability and Growth Pact will continue to play a central role in the EU budgetary framework.

- The EU members remain committed to achieving faster progress in the implementation of structural reforms with a view to raising their economic growth potential, increasing flexibility and achieving higher rates of employment in the long run. Over the past few years, progress has been made in implementing structural reforms in product, labour and financial markets. However, much remains to be done to achieve the Lisbon objectives and it is necessary to step up the pace of reform.

- The Doha Development Agenda Framework Agreement achieved at the WTO General Council is an important step towards realising the significant benefits available to all countries of trade liberalisation for productivity, growth and development. All countries, including the EU, must now maintain the commitment and flexibility they have shown so far to make significant progress before – and beyond – next year's Ministerial in Hong Kong.

-All major countries and economic areas must play their part in contributing to the adjustment of global imbalances by putting in place the appropriate economic policies. The euro area's view on the euro exchange rate remains unchanged: the euro must keep its value over the medium and long run, in line with economic fundamentals. We highly value stability and excessive exchange rate moves are not desirable.

Crisis prevention

5 - We welcome the Fund's continuing efforts to strengthen surveillance and crisis prevention. A focus on implementation of policy initiatives is now needed. In order to further improve surveillance along the lines of the recent Biennial Surveillance Review, the Fund should:

- Strengthen regional aspects of surveillance, including by having (informal) Board discussions on the world's main regions and preparing papers on regional aspects of key policy issues and by better integrating bilateral with multilateral surveillance reports;
- Monitor exchange rate developments and regimes more closely and systematically, and allow for a candid appraisal of the appropriateness and consistency of a country's exchange rate regime with underlying domestic policies and external vulnerabilities;
- Further enhance coverage of financial sector issues in Article IV reports, preferably on the basis of a standardized framework for financial sector surveillance;
- Implement a systematic balance sheet approach in surveillance activities, in particular in emerging markets , and strongly encourage those countries to collect and provide the Fund with the necessary data;
- Strengthen debt sustainability analyses (DSA), in particular by including DSA's based on different policy scenarios in surveillance documents on a routine basis and integrating these analyses into the main text of staff reports and IMF lending policy;[1]
- Apply greater selectivity in the choice of (macro-relevant) topics included in surveillance with more focus on country-specific areas of vulnerability and with a wider use of appropriate outside sources of information, notably World Bank, OECD and RDBs assessments;
- Encourage a fresh perspective in surveillance of programme countries, by being more open to alternative viewpoints from the private sector, other institutions and academia and by further promoting that surveillance and programme missions have different staff compositions and timing;
- Evaluate the relevance and appropriateness of past policy advice and present an assessment of the extent to which earlier IMF advice was followed-up by the countries' authorities; [2]

[1] Only in a third of all Article IV reports in the first half of 2004, the main text included conclusions based on the DSA.
[2] Only some 40% of the sample included a comprehensive assessment of the authorities' response to earlier IMF advice.

- Strengthen the impact of surveillance by factoring into programme discussions the extent to which countries have not followed-up on appropriate earlier Fund advice, for example by requiring prior actions concerning the issues that were not taken up by the authorities;
- Increase the focus of Public Information Notes (PINs) on key recommendations and present them in a simple and accessible manner.
- Management should set monitorable strategic objectives to guide staff in the conduct of surveillance, to allow a link to a multi-year budget and to allow Management and the Board to make informed decisions on priorities in the Fund's surveillance activities.

6 - Experience has shown that surveillance alone does not always send sufficiently strong signals for financial markets and donors. Fund programmes provide for a strong signal on the basis of their conditionality, Board involvement and national ownership. We ask the Fund to examine the need to provide strong signals for countries wishing to continue a programme relation with the Fund but having no or very limited need for Fund financing, and ways to do so without increasing the country's debt burden, for instance through instruments with no access to Fund resources (non borrowing programs), (low access) precautionary SBAs and low access PRGF.

Crisis resolution

7 - The Fund´s involvement in recent severe financial crises has led to a high level of concentration of IMF credit to borrowers and to the Fund´s financial support exceeding the regular programme horizon. Therefore, priority should be given to the further rigorous implementation of existing IMF policies, most notably the Fund´s exceptional access framework and the strong presumption of SRF use in exceptional access cases. Together this would ensure equal treatment of member states, encourage involvement of the private sector in the resolution of crises, reduce creditor and debtor moral hazard and limit the risks to the financial position of the Fund. EU-countries agree that it is particularly important in exceptional access cases that Fund financial assistance should only support sound policies, even when that requires a significant policy shift in the debtor country to assure the sustainability of external debt or the exchange rate.

8 - In the future, further steps should be considered to ensure timely exits for exceptional access cases.

9 - The Fund should only lend into arrears (LIA) if a debtor country makes a significant policy adjustment in an effort to resolve arrears and engages in negotiations with its private creditors in good faith to restore debt sustainability. The criteria to judge "good faith" could be further clarified, in particular by specifying key elements of a constructive dialogue. Staff should also prepare a report assessing compliance with the "good faith" criteria with programme reviews (similar to the special reports assessing exceptional access criteria) and Board documents could be published in order to provide the same information to all the parties involved in the debt restructuring, to reduce concerns for possible bias in the Fund's assessment.

10 - Going forward a more comprehensive approach to sovereign debt restructurings is needed. Despite progress with the implementation of Collective Action Clauses, which EU members have actively supported, more work is needed on timely, orderly and effective restructuring that ensures an appropriate involvement of the private sector. Moreover, a Code of Good Conduct would establish principles for a constructive dialogue between a debtor and its creditors, inter-creditor treatment and instruments to foster the debt restructuring process. We strongly encourage leading bond issuing emerging countries and the private sector to make substantial progress with their negotiations on the contents of a meaningful Code.

Role of the Fund in Low Income Countries

11 - The IMF has an important role to play in low income countries, which is targeted at the creation of macro-economic stability, the strengthening of public finance and national financial sectors, and thus fostering economic growth and poverty reduction. However, the emphasis in the Fund's involvement in these countries should lie on surveillance and technical assistance as well as appropriate financing. Whereas the Fund should use its instruments to assist low income countries in creating a macro-economic environment conducive to economic growth and the delivery of the Millennium Development Goals (MDGs), development partners - in particular the World Bank - should concentrate on structural adjustment. All these efforts should be aligned to meet the development objectives as formulated in the national Poverty Reduction Strategy Papers (PRSPs). We believe that a more equal income distribution in development countries can help contribute to enhanced sustained economic growth and poverty reduction.

12 - In developing its future work in low income countries and supporting effort to achieve the Millennium Development Goals, the Fund should build on the conclusions from the Independent Evaluation Office report on PRSPs and the Policy Reduction and Growth Facility (PRGF). While the PRSP-process has delivered important results, notably with regard to public finance management, fiscal flexibility, pro-poor public expenditures and streamlining conditionality; challenges remain, including the need for less emphasis on document preparation, and more emphasis on improving the capability of countries to develop and implement policies supportive of growth and poverty reduction. Furthermore we look forward to continued work on ensuring consistency between PRGF conditionality and macro economic frameworks and nationally owned poverty reduction strategies. We also welcome Fund work on signalling mechanisms and look forward to the development of instruments to allow the Fund to enable donors in providing stable, predictable and long term flows of development finance to low income countries. It might also be needed to better define the role of resident representatives in order to allow for a more active involvement of the Fund on the PRSP-processes on the ground.

13 - We welcome the joint work of the Bank and the Fund to define and operationalize a new framework for debt sustainability analysis in low income countries. The conclusions based on country specific debt sustainability assessments -agreed by both institutions- should feed back into the Bank and Fund's financing decisions. Beyond 2005, we support the so called self-sustained PRGF as a key Fund concessional lending tool, augmented if needed. Donors should provide financing consistently with the new debt sustainability framework.

14 - The provision of the finance necessary to meet the MDGs also requires further consideration. In this context, we look forward to the joint work undertaken by the Fund and the Bank on aid effectiveness and financing modalities.

Voice and representation of developing and transition countries

15 - EU-countries welcome that steps have been taken by the IMF and the World Bank to strengthen the voice of developing and transition countries. At the same time there remains scope for further measures. Initiatives to build capacity in developing countries to engage in discussions on country programmes and wider policy issues therefore deserve our full support. Similarly, delegation office capacity could be further enhanced. Another promising option is increasing basic votes to strengthen the relative voting power of developing and transition countries.

HIPC

16 - In April 2003 the EU Presidency speech to the IMFC stated that: "All EU Member States *intend to go beyond the HIPC targets by providing officially 100% bilateral pre-COD debt relief*

for all claims". This commitment remains valid today also for the enlarged EU and many Member States go even further and cancel some or all of their post-cod debt.

17 - For the EU it is important that full funding is provided to finance the costs (as identified by the IFI's) for all eligible countries including Sudan, Somalia and Liberia. In this respect, we would also like to invite the IMF and the World Bank to identify ways to secure this financing in the context of a fair and adequate burden sharing.

18 - In the context of the Enhanced HIPC Initiative, the provision of additional debt relief (''topping up'') would be presumed in cases where debt sustainability prospects have worsened because of an exceptional exogenous shock, to be assessed on a case by case basis, and despite the fact that the country is still pursuing sound economic and poverty reduction policies.. The costs of this additional debt relief also needs to be fully financed in the context of a fair and adequate burden sharing

19 - EU Member States would also agree on a possible change of methodology for the calculation of the topping up *s*hould a fair burden-sharing be obtained and provided that the net remaining financing gap for the IFIs is covered.

20 - All EU Member States can agree to a limited extension of the sunset clause of the HIPC initiative. Eligible HIPC countries should take all the necessary measures to reach the Decision Point and to come forward for HIPC debt relief.

Other issues

21 - We welcome Argentina's strong macroeconomic recovery, and urge the Argentine authorities to use the momentum to enhance its efforts to reach an agreement with private creditors shortly. Argentina is in a good position to fully and timely fulfil its current obligations to the IMF. We invite the Argentine authorities to implement as soon as possible the prior actions required for the completion of the third review of the IMF program. The program rests on a commitment by Argentina to realize a trend increase of the primary surplus for 2005 and beyond, ensuring that economic and debt sustainability is restored and the Fund's exposure to the country is placed on a downward path from 2006. Accordingly, the Argentine government should also provide the international investors community with a stable, predictable and investment-friendly framework.

22 - We strongly encourage the IMF/World Bank to strengthen the co-operation with the FATF (Financial Action Task Force on Money Laundering) and other multilateral bodies in the fight against money laundering and the financing of terrorism. We warmly welcome the IMF/World Bank commitment to conduct comprehensive assessments of the entire set of anti-money laundering and terrorist financing standards. We particularly appreciate the recent decision taken by the IFIs and the FATF on co-ordinating future assessments. We encourage all countries to continue their efforts to ensure the consistent application of the anti-money laundering and the anti-terrorist financing standards.

23 - We recognise the need for additional resources if the MDGs are to be met. We reconfirm our commitment to increase collectively our ODA from the 2001 level of 0.33% of GNI to 0.39% in 2006 (around an extra $7 billion a year), as a first step towards the longer term 0.7% target. Positively, we note that the latest indications show that, on current trends the 25 EU Member States could collectively easily exceed the 0.39% EU-target for that year.

24 - We welcome the recent proposals for reform of the IMF's budget process, and encourage the Fund to implement these reforms for FY2006. A comprehensive, rolling multi-year budget should reflect the Fund's strategy and work program. This could make the budget process the prime

platform for Board, Management and Staff to set priorities that add up within the envelope of available financial and staff resources, as it should be.