BOARDS OF GOVERNORS ● 1998 ANNUAL MEETINGS ● WASHINGTON, D.C.

INTERNATIONAL MONETARY FUND
WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

J

Press Release No. 11
October 6 - 8, 1998

Statement by the Hon. **WOLFGANG RUTTENSTORFER**,
Governor of the Fund and the Bank for **AUSTRIA**,
on behalf of the Member States of the European Union,
at the Joint Annual Discussion

STATEMENT BY MR. WOLFGANG RUTTENSTORFER, GOVERNOR OF THE FUND AND THE WORLD BANK FOR AUSTRIA, ON BEHALF OF THE MEMBER STATES OF THE EUROPEAN UNION

Since Austria currently presides over the Council of the European Union, I have the honour to address this meeting on behalf of the Union. My speech will centre on the following topics: on the outlook of the world economy, on the progress made towards the European Economic and Monetary Union and on the European Union's contributions towards international financial stability.

Global economic and financial conditions have become more volatile in the course of this year. World economic growth has slowed down, mainly as a result of the economic and financial turmoil which started in Asia and has spread to other regions. The impact of increased global financial instability is unevenly distributed. While growth in industrial countries has generally remained steady, the situation in many emerging economies has deteriorated markedly, sometimes despite the pursuit of sound policies.

The short-term outlook for the world economy points to sustained growth in 1999, but the risks are higher on the downside. Key factors in this context are the pace of recovery in Asia, the resumption of sustainable growth in Japan, the vigorous implementation of a market-oriented economic reform program in Russia, and the containment of contagion effects to other regions. Global inflationary pressures are set to remain fairly subdued. To a large extent, this is due to the general commitment around the world towards stability-oriented policies, which were supported by the behaviour of world commodity markets, where prices have fallen markedly.

Financial conditions in emerging Asia have stabilised somewhat as a result of strong policy responses to the crisis, but the impact of the crisis on domestic demand, output and employment in the countries affected is far from over. Liquidity constraints, financial sector weaknesses and corporate bankruptcies continue to put a severe strain on economic activity. However, external balances have improved considerably, and export volumes have begun to pick up, thus contributing to a recovery of growth. The European Union fully backs the IMF-supported economic and structural reform programs undertaken by the countries affected. Continued persistent implementation of these programs should restore confidence and lead to a resumption of capital inflows.

The economic situation has also deteriorated in Japan, which is most closely linked to the countries in crisis, and which is suffering from a protracted weakness in domestic demand as well as long-standing financial sector problems. The European Union urges Japan to take the necessary structural reform measures - particularly in the banking sector - and to implement a sustainable fiscal policy in order to ensure a strong domestic-demand-led recovery.

Russia has fallen into a deep economic and political crisis which was accentuated by the announcement of unilateral measures in mid-August. The European Union calls on the government of Russia to take all necessary steps towards the re-establishment of credibility within and outside the country, towards solving its structural budget problem, which is the essential precondition for the control of inflation, and towards restructuring the financial and corporate sectors.

Economic conditions are uneven in other parts of the world. The US economy continues to enjoy a robust expansion. A moderate slowdown in domestic demand, together with favourable developments in commodity prices and the appreciation of the dollar has somewhat reduced the risk of overheating and should enable the US economy to contain inflation. Latin American countries have substantially strengthened their macroeconomic performance and are generally pursuing sound domestic policies that in some cases need to be accompanied by a strengthening of their budgetary positions. However, financial market contagion has increased financial instability and poses serious challenges for macroeconomic management. In this context, greater market awareness of country-specific circumstances may be called for. Growth in developing countries has slowed only moderately. In a large number of countries, sound macroeconomic policies and the commitment to market-oriented structural reform have improved the economies' medium term growth potential. Still, large disparities in economic performance remain. The transition countries of Central and Eastern Europe have generally shown steady growth and resilience vis-à-vis financial market fluctuations. In a number of countries, policy measures to contain external imbalances and to avoid overheating were implemented.

The European Union and its Member States continue to be fully committed to promoting international co-operation and to maintaining a stable and sound economic environment. They actively contribute to resolve the current difficulties in Asia both through bilateral and multilateral channels. The recently-created ASEM Trust Fund, to which the Union and a number of Member States contribute, will provide Asian countries with technical assistance and advice on restructuring their financial sectors and on measures to deal with the social problems caused by the crisis. We also welcome the private sector involvement, including European banks, in resolving the financial difficulties of Asian countries.

The European Union also remains strongly committed to its strategic partnership with Russia. Resumption of financial aid, however, is contingent upon the presentation of a convincing market-oriented reform program by the Russian government and credible steps towards its implementation. If so requested, the European Union will restructure its technical aid towards Russia, in order to better assist in the process of institution building.

Growth in the EU has become increasingly solid and even-based. The recovery, which was initially export-led, is underpinned by a healthy upswing in domestic demand, though obviously its future pace will also depend on global economic and financial conditions. In an environment of low inflation and low interest rates, private investment and consumption growth have strengthened. A high degree of convergence among European economies in the run-up to Economic and Monetary Union has been attained, as reflected in a sizeable reduction of budget deficits and inflation rates. These achievements, which have been acknowledged by the markets through low and converging long-term interest rates and a high degree of exchange rate stability, also during recent upheavals in the international financial markets, set the conditions for sustainable non-inflationary growth.

Regarding the introduction of the euro on 1 January 1999, the last phase of preparatory work on the policy and logistical framework is currently under completion. The legal and technical framework for the single currency is in place, ensuring legal certainty and facilitating a smooth transition for markets, businesses and consumers.

At the beginning of May, the decisions on first-wave EMU membership and the pre-announcement of the bilateral exchange rates used to determine the conversion rates which will be irrevocably fixed on January 1, 1999, were taken. EU Heads of State or Government decided that, having fulfilled the convergence criteria according to the Maastricht Treaty, eleven countries will introduce the euro on January 1, 1999. The pre-announced bilateral rates correspond to the bilateral central rates in the ERM, which are consistent with underlying economic fundamentals, and to which the exchange rates of participating Member States have tended to converge over the last two years. The calm and favourable reaction of financial markets to these decisions reflects the credibility and the sound economic footing of the EMU project.

The introduction of the euro will be accompanied by a framework designed to ensure stable prices, sound public finances and thus an adequate policy-mix in the euro area. On 1 June, the ECB and the ESCB were created. Their independence and commitment to price stability are enshrined in the EU Treaty. The ECB Council will shortly decide about the monetary policy strategy and framework which is most appropriate to the achievement of this aim. In all Member States, sound fiscal policies will be pursued in the framework of the Stability and Growth Pact, which sets strict rules for the application of the budget surveillance procedure stipulated in the Treaty.

As agreed at the Luxembourg European Council in December 1997, economic policy co-ordination and surveillance within the Union is being stepped up in view of EMU. Enhanced co-ordination and surveillance encompasses those national economic policies which have the potential to influence monetary and financial conditions throughout the euro area or the smooth functioning of the single market. This includes the monitoring of macroeconomic developments as well as budgetary surveillance and the monitoring of structural policies in labour, product and services markets. Also, as from January 1, 1999, a new European exchange rate mechanism will help to ensure that Member States outside the euro area participating in the mechanism orient their policies to stability and thus foster convergence.

While the Ecofin Council remains the core economic policy institution in the EU and the sole decision-making body, Ministers of the states participating in the euro-area - the so-called Euro-11-Group - meet on an informal basis to discuss issues connected with their shared specific responsibility for the single currency. Whenever matters of common interest are concerned, they are discussed by all Member States.

The single currency will allow businesses and consumers to reap the full benefits of the European single market by reducing transaction costs, eliminating intra-European exchange rate risk and increasing cross-border prices transparency. Thus, a stable euro will create a potential for more growth and employment in the EU, the realisation of which will also crucially depend on the implementation of various structural reforms, particularly in the labour markets.

Nevertheless, for the EU Member States a number of challenges remain. Unemployment, though recently receding, is still unacceptably high. Following common Employment Guidelines, Member States have developed Employment Action Plans which they are in the process of implementing. The four pillars of the Employment Guidelines aim at improving employability, developing entrepreneurship, encouraging adaptability in business and strengthening the policies for equal opportunities. To promote growth and employment, the EU Member States are also progressing with respect to structural reforms. Reforms of goods and services markets, as well as further efforts in reducing harmful tax competition, are under way. Member States and the Commission have agreed to undertake short, year-end reports on progress to improve the functioning of product and financial service markets. This will help the exchange of best practice. The further completion of the internal market requires additional action by promoting competition, reducing distortions and fostering the implementation of Community rules relating to state aids. Sustainable economic development in the Union should be based on respect for the environment. In order to minimise negative externalities, protection of the environment should be integrated in practice into the definition and implementation of economic policies.

The EU has also embarked on the project of enlargement. The Union has formally opened accession negotiations with the five CEECs (Poland, Hungary, the Czech republic, Estonia, Slovenia) most advanced in their transition, plus Cyprus. They and the five other applicant countries are supported within a comprehensive pre-accession framework.

The enlargement process creates enormous opportunities. The EU is providing key support for the CEECs' transformation into fully-fledged market economies and for their further integration into the world economy. An enlarged Union opens new dynamic markets and business opportunities, and will eventually lead to a single integrated market of more than 500 million people. Such a perspective is not only good for Europe itself, but for global trade and the global economy as a whole.

Preparing for EU enlargement is, however, not only a matter for the candidate countries. The EU itself has to adapt its institutional and decision-making structure as well as some of its policies. All this within the framework of stringent budgetary discipline.

The advent of the euro will be a major event for the international monetary system. The economic size of the euro area, the depth and liquidity of an integrated European financial market, and the pursuit of stability-oriented policies, notably fiscal and monetary policies will, over time, lead to the emergence of the euro as a major international currency. This development will, however, be neither sudden nor disruptive. As a stable international currency, the euro will be able to contribute to the smooth functioning of the international monetary system.

During their informal meeting in Vienna, European Economics and Finance Ministers have launched a discussion on the means to strengthen their contribution to the stabilisation of the international financial situation. We have come to the conclusion that:

- we should strive to put in place effective representation arrangements for the euro area on the international stage, with due respect to the Treaty provisions and to competencies that remain at the national level;

- we shall continue to participate actively in the process of answering the challenges posed by the current instability. Solutions would include the following actions and reforms:

IMF should be endorsed as the centrepiece of the global financial system and it should be endowed with sufficient means to meet its responsibilities. More thorough consultation between industrial countries and emerging countries is needed, as the role of the latter in the world economy is growing and more especially as they have been affected by each recent financial crisis. Urgent approval of the IMF quota increase and the NAB is critical and imperative for the smooth functioning of the international monetary system. It is also fundamental that the private sector is involved and contributes adequately to the solution of crises, both through informal co-ordination with international institutions and through a financial contribution towards solving the crises. Present instability shows us the need for improved surveillance, data and transparency. This should apply not only to banks but to other financial institutions as well, such as insurance companies, pension funds and hedge funds. Besides, all financial centres should comply with rules governing transparency, international co-operation and supervision.

In this context, the co-operation and division of labour between all international financial institutions (IFIs) become increasingly important. Their collective efforts to contribute towards the development of sound financial and corporate sectors are particularly welcome. Effective communication and collaboration between the IMF and the World Bank will be an important element in this respect. The World Bank and the Regional Development Banks will have to step up their efforts in supporting structural reforms, especially addressing the structural problems behind poverty. However, in their involvement in financial crises, their respective mandates should be fully respected. The leadership role of the IMF in financial crises is vital and lessons from the Asian crises will have to be incorporated into its future strategy and operational activities. In particular, this holds for the need to avoid moral hazard problems as much as possible. More IMF financing is never a substitute for necessary adjustment in the programme countries.

The attention of the IMF has also turned towards the capital account, as the growing level of international capital flows opens up new opportunities while at the same time imposing a new set of administrative and institutional challenges on many countries. We support the IMF in its endeavour to incorporate capital movements into its jurisdiction. Our goal should be to foster an orderly and well-sequenced liberalisation of the capital account. Sound financial sectors, effective prudential and supervisory systems and appropriate macroeconomic and exchange rate policies are preconditions for a successful capital account liberalisation.

We are glad to see the HIPC Initiative is well under way. We urge all members to move quickly to complete the financing of these initiatives as soon as possible. We look forward to a further strengthening of the financial base of the HIPC initiative and ESAF. We encourage eligible countries to pursue and where necessary strengthen adjustment efforts to qualify for this assistance.

It is regrettable that financing of the international financial institutions - and related activities like HIPC and the concessional funds of MDBs - is increasingly being imposed on only part of the international donor community. Recognition of the importance of a co-ordinated, common approach to various crises should lead us to a fair burden sharing among those involved. We urge all countries to make a strong effort to meet their responsibilities in this respect according to their weight and importance in global affairs. We welcome that countries that have not been traditional contributors intend to participate in the NAB and also have contributed to the solution of the financing of the response to the Asian crisis. This should, however, not lead other traditional contributors not to accept their fair burden.

Regarding the World Bank Group, the EU Member States welcome the strengthening of its operational capacity. This will reinforce the Bank's capacity to fight poverty effectively, to support structural reforms and to provide assistance to developing countries in achieving socially and environmentally sustainable growth. We welcome all efforts to safeguard the World Bank's financial integrity. To make world-wide development efforts more effective and to compensate for decreasing flows of ODA, stronger and more effective co-operation among bilateral and multilateral donors is of greatest importance. In this respect we welcome the Bank Group's attention to fostering private sector development. We welcome the approach of the World Bank Group to enhance national ownership and to include all major stakeholders in the formulation of development strategies.

The EU Member States welcome the Bank's support of the transition countries of Central and Eastern Europe. We appreciate especially the co-operation of the Bank group with EBRD and EU institutions in assisting those countries which prepare themselves to join the European Union. The focus of the Bank on structural issues in the public sector and governance issues is particularly useful to countries on the verge of EU membership.

The Member States of the European Union taken together, are by far the largest contributor of the IDA, and proved thereby its involvement in the ODA. This year we are focusing on its twelfth replenishment. EU Member States are participating in the negotiations very actively and are doing their utmost to successfully conclude the process within the next six months. As resources for concessional assistance and ODA in general are decreasing, it is even more important today that all donors take up their fair share in the replenishment and ensure that the IDA has a sufficient amount of funds available to help the world's 80 poorest nations to reduce poverty by means of achieving economically and environmentally-sustainable growth, in particular in those countries with strong policy performance.