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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

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Statement by the Hon. **MATTI VANHALA**,
Governor of the Fund for **FINLAND**,
on behalf of the Fund Nordic and Baltic Countries,
at the Joint Annual Discussion

As spoken

Matti Vanhala
Governor of the Bank of Finland,
on behalf of Denmark, Estonia, Finland, Iceland, Latvia,
Lithuania, Norway and Sweden
(Fund)

Mr Chairman
Mr Camdessus
Mr Wolfensohn

I am honored to address this meeting on behalf of the Baltic countries: Estonia, Latvia and Lithuania; the Nordic countries: Denmark, Iceland, Norway, Sweden — including of course my own country Finland.

First of all, I wish to join my colleagues in welcoming the Republic of Palau as a new member.

Mr Chairman,

We have, in recent months, encountered increasing economic uncertainty, and market turmoil, that we did not foresee a year ago. What started out as a local financial crisis in Southeast Asia turned into a contagion, shaking investor confidence, not only in Asia, but in all emerging markets, and brought elements of uncertainty into the robust economies of Europe and the US. The outlook for the world economy in 1999 has weakened, as the potential for broader and deeper downturn is being recognized. Even in the best of scenarios, we shall have to live with tension in the global economy and in particular in world financial markets.

This meeting provides a well-timed opportunity for the international community to review the challenges, and the strategies to meet them.

One of the most significant institutional changes in international monetary arrangements ever B the launch of Europe's single currency – will coincide with the current period of turbulence and uncertainty in the world. The European Central Bank will assume responsibility for the euro. It will define its policies, and its international role, including its relationships with multilateral institutions, among them the IMF. The emergence of the euro zone as an area of monetary stability, with the euro as a key international currency, will make a major contribution to the international economy.

Crisis and contagion during the last 12 months have demonstrated how interdependent economies have become. Economic prospects for Asian countries at the center of the crisis will depend critically on the external environment; in particular on Japan as the second largest economy in the world. A resumption of solid growth in domestic demand in Japan is the key to recovery in Southeast Asia. Persistent stagnation in Japan will increase the ultimate real costs for Japan, and for the rest of the world. There is a need for Japan to succeed in breaking the prevailing impasse, rebuilding confidence and reflating the economy. A resolute restructuring of the banking sector is necessary.

The situation in Russia is of a different nature, but equally serious. Persistent difficulties in the implementation of fiscal consolidation and market reform progressively undermined what had been achieved, namely a stable ruble and low inflation. The current Russian situation is an illustration of what happens when confidence in economic policy and in money collapses altogether. We see a dangerous, rapid deterioration of economic conditions.

The overwhelming priority for the Russian authorities now is to halt the destructive downward spiral. The first requirement is that the Russian government gain the political backing, and the credibility needed to enact legislation and to devise and implement programs. Close, continuous contact between the Fund and the Russian authorities is needed, but the key to stabilization lies with the Russian authorities. There is a role for the international community to consider financial support for Russia, once the necessary steps for sustained stabilization and reform have been taken.

The Russian crisis, with its turbulence and spillover effects, will no doubt put pressure on the neighboring Baltic markets. The Baltic states, seeking integration into the European economic community, as well as a diversification of their economic relations, have weathered recent turbulence quite well. This must be attributed in large part to their prudent fiscal and monetary policies, their focus on strengthening the banking system and developing the private sector. They will continue to follow the solid and strict macroeconomic policies which now shield them against contagion.

Mr. Chairman. There is a debate on the mandate and the role of the IMF. Work is progressing, in the Fund and elsewhere, on blueprints for a strengthened architecture of the international monetary system. If there is an early lesson from the crises, it is the need for preventive safeguards in the global financial system. There is a need for improved surveillance techniques, with the focus broadened to capital flows and the health of the financial systems in member countries. In a strategy for fostering stronger financial systems, international principles and good practices for sound banking are necessary.

The Fund has already adopted important new policies on increased transparency and openness. We should develop further ways of sharing information with actors in the market as regards data, economic policy formulation and actual performance.

Transparency on the part of the Fund should involve greater openness on its own policy advice to members. This is a sensitive aspect of the bilateral relationship between the Fund and its members, but, today, in any serious preventive approach to crisis management, such a change must be considered.

Another priority is finding ways to involve the private sector in official efforts to prevent and resolve financial crises. There is a legitimate public concern about the moral hazard created by the Fund and other public bodies engaging in so-called “bail-outs”. We must devise procedures to bind creditors in, rather than bail them out. Orderly mechanisms for settling and restructuring debts are needed.

The Fund is the forum where we can discuss the problem issues of the global monetary system. It is the *only* organization with a truly global membership *and* a mandate for surveillance and policy advice. The IMF is needed as a catalyst for solutions in crisis situations. Above all, it is needed for the prevention of such situations. In the light of the experience which has accumulated in the last five years, it appears appropriate that the emphasis of the Fund’s contribution be shifted towards stricter policy advice and conditions, and away from financing.

Nevertheless, the IMF cannot perform a central role in the prevention and management of crises unless it has adequate resources. It is a matter of grave concern that the IMF’s usable funds have dropped to a level that leaves little room to respond to systemic risks in the world economy. It is critical that the increased level of Fund quotas agreed under the Eleventh Review becomes effective as soon as possible. Completion of the adherence process for the NAB would be a complement.

High on our agenda is also the integration of the poorest countries into the global economy. Considerable progress has been made in implementing the HIPC Initiative during the past two years. However, further progress is needed. At the same time, evaluation should continue, so that the resources released by debt relief are used wisely. Debt relief without true adjustment and reform would be wasted. Now there is a need to re-focus on the efforts to secure adequate financing for the Fund’s ESAF and the HIPC Initiative. Financing should be based on the principle of fair burden sharing, with a special responsibility for major economies.

Before concluding, Mr. Chairman. Capital flows are straining the international monetary system. The topic of capital account liberalization is on our agenda. The current world economic situation has brought forward arguments for temporary controls on short-term capital movements as a remedy in times of crisis. It has been argued that controls provide breathing space.

We would consider the imposition of currency controls a risky strategy — usually not effective even in the short-term, and certainly ineffective and detrimental in the long-term. —Any country that decides to integrate itself into the world economy through increased foreign trade and by recourse to foreign savings in the financing of its development effort, will face open markets for goods and capital, and, indeed, will need open markets. We believe in an orderly and well-sequenced liberalization of capital accounts. Obviously, capital account liberalization should take place in the context of a strong domestic stabilization policy, and whenever needed, reforms that strengthen the macroeconomic framework. Moreover, efficient financial supervision should be in place. The Fund can best promote capital account liberalization through advocacy and jurisdiction, supporting the former with the strength of the latter.

Finally, Mr. Chairman. The search for a new global financial architecture should not be pursued by individual international organizations in isolation. In this respect, and taking into account the respective roles of the two Bretton Woods Institutions, I welcome the review of the collaborative experience between the World Bank and the Fund in strengthening financial systems.

Thank you very much!