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Statement by the Hon. **VITOR CONSTANCIO**,
Governor of the Fund for **PORTUGAL**,
at the Joint Annual Discussion

Statement by the Hon. Vítor Constâncio
Governor of the Bank of Portugal
at the Joint Annual Discussion

Mr. Chairman, Ladies and Gentlemen,

I begin by welcoming Timor-Leste as a new member of our Institutions. Over the years Portugal has supported the emergence of Timor-Leste as an independent and democratic nation and we will continue to support its future development.

The world economy is going through an hesitant recovery that is still being threatened by several additional risks. Nevertheless, it should be pointed out that, in view of last year shocks and the correction of equity prices, the world economy has shown considerable flexibility and resilience. This has been particularly true so far of the financial sector. The overall performance benefited from the proper response of macroeconomic policies. In Europe, both monetary and fiscal policies have been used to help stabilize the situation. Interest rates have been reduced since last year and stay now at historically low levels in real terms. Fiscal policy has also played its role by allowing automatic stabilizers to operate. Monetary and fiscal policies are therefore not restrictive and stand ready to help economic agents to overcome the effects of a post-bubble economic environment.

In the European Union, several countries allowed the fiscal position to deteriorate beyond what was foreseen in the context of the Stability and Growth Pact. My own country breached the 3% limit to the budget deficit. More recently, the date foreseen for several countries to achieve a budgetary position close to balance was postponed to 2006. These developments, regretful as one may consider them, do not put into question the basic objectives of the Stability and Growth Pact. Countries that do not respect the 3% limit to the deficit have to quickly correct the situation. The Portuguese Government is committed to do so and is applying difficult measures required to reduce the deficit which only proves that the Pact is working. The extension of the timetable to 2006, in order to avoid an excessively pro-cyclical stance of fiscal policy, was accompanied by the adoption of targeted annual deficit reductions that ensure the credible maintenance of the final objective of balanced budgets. It is of course unfortunate that countries did not take the opportunity during the years of higher growth to achieve a balanced fiscal position. In fact, it is only after this has been attained that the Pact works as initially conceived by allowing the full operation of automatic stabilizers thus providing adequate flexibility to respond to economic developments without endangering the respect for the 3% limit to the nominal budget deficit. Nevertheless, it is important to stress that the framework adopted for macroeconomic policy in the European Monetary Union remains in place and stands ready to ensure price stability and an environment favorable to economic recovery.

Short-term economic problems should not lead us to loose sight of the structural reforms required by the world economy: strengthening the international financial system, building a more free and fair trade system, and achieving a more equitable distribution of the results of globalization.

We welcome the progress made in improving several aspects of crisis prevention. Improved surveillance, transparency and implementation of codes and standards have shown some progress. Further work on sustainability analysis and early warning systems should be forthcoming. Financial stability reports should stress the need for financial institutions in advanced countries to implement proper risk management systems and build a stronger capital base. Recent years of recurring crisis and surprising shocks indicate the need for more capital. Other developments helpful for crisis prevention have been the change to a more careful consideration of capital account liberalization and the recognition of the advantages of a more flexible exchange rate regime.

Access to limited and conditional IMF financing should always reflect the results of an adequate sustainability analysis while recognizing the quality of the policies adopted by the countries themselves in order to reward merit, as it has been the case with the recent Board decision about Brazil, an approach that we welcome. Crisis management requires new ways to deal with debt restructuring to make it a more orderly and timely process. Rules to facilitate negotiations between creditors and debtors are required. Provisions to regulate in that context, the operation of standstills, incentives to new lending and lending into arrears have also to be clarified and improved. Besides the introduction of collective action clauses on a contractual basis, complementary work on a statutory mechanism has also to continue. There is misplaced resistance in some quarters to these reforms, but it should be understood that they are important to avoid overshooting in fluctuations of capital flows with excesses in both directions. Better prevention and management of financial crisis will work in the interest of all concerned.

Continued progress for an open and stable international system depends also on achieving a more equitable sharing of its benefits. Regarding trade this requires the implementation of the promises of the Doha Agenda. To promote a true round for development requires increased access to markets of products from developing and emerging countries instead of increased protection as recently seen. It is also essential to strengthen our policies aimed at pro-poor growth and poverty reduction.

The World Bank and the IMF deserve praise for the development of the Poverty Reduction Strategy and for the involvement of all stakeholders in its implementation.

This is particularly true in the case of the HIPC Initiative. This initiative has been instrumental to provide some breathing space to the poorest highly indebted countries. It was revised in order to increase its effectiveness in addressing debt overhang of many countries. It has so far delivered visible results although slower than anticipated. However some important challenges remain before us in order to make the initiative a success story of international cooperation. First we face the obligation to finance the additional costs of the initiative resulting from modifications we agreed upon. Canceling debt directly affects the capacity of many development institutions to continue providing concessional resources to the world poorest countries. Therefore financing multilateral costs remains critical. Debt relief is an integral part of the concerted effort to remain engaged in supporting those countries that are fully committed to take on the serious challenge of reducing poverty and improving the well being of their people. In implementing the Monterrey Consensus we have to deliver our part of the global deal we signed on.

Second, several HIPC countries remain vulnerable to excess indebtedness. Achieving and maintaining long-term external debt sustainability remains the critical objective of the Initiative and the true measure of its success. Several elements are crucial to ensure debt sustainability. While external financing as well as improved access to markets for developing countries' exports are essential and to which we are committed, HIPC countries efforts to address structural vulnerabilities are even more important. Financial assistance and trade liberalization can not be a substitute for sound policies and implementation of reforms, including improved governance and institutions. It is the other side of the global deal in the spirit of the Monterrey Consensus.

With the NEPAD African leaders have committed themselves to achieve better governance in the continent and improve institutions and policies essential to development. But in view of the present plight of Sub-Saharan Africa it is clear that official aid will have to be increased if the main Millennium Goals are to be achieved in Africa. Aid beyond debt relief is essential for new programs in education or for preventing the spread of infectious diseases.

A final word about middle-income countries where any crisis is bound to affect more the poor segments of the population. The Bank and the Fund should enhance their collaboration in programmes to strengthen financial, institutional and corporate structures in these countries alongside policies directed to the poor.

The Fund and the Bank deserve our support in their vital role to promote a more equitable and sustainable growth as a condition for a viable international open system.

Thank you.