

International Monetary and Financial Committee

Thirteenth Meeting
April 22, 2006

Statement by Mr. Eero Heinäluoma

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On behalf of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

Main messages

- *The world economy is currently strong, but risks related to growing global imbalances, rising energy and other commodity prices and intensifying protectionism should be addressed.*
- *The Fund is well-placed to be the central forum for discussions on systemic issues. We therefore welcome the proposals in this direction in the Medium-Term Strategy.*
- *Enhancing the effectiveness and relevance of surveillance is the most important element in the Managing Director's report on the Medium-Term Strategy.*
- *We welcome the prompt implementation of the multilateral debt relief initiative (MDRI) for the first group of eligible countries, and stress the need to adhere to good governance and sound macroeconomic management. Avoiding a rebuild of unsustainable debt must be ensured.*
- *Increased aid flows and freed-up resources from MDRI should be used for MDG spending and to support macroeconomic and financial stability. The Fund has an important role to play in advising member countries to ensure that these objectives are achieved*

World Economy

1. The outlook for the world economy this year is strong, and the global recovery is now becoming more broadly based, as evidenced by upward revisions to forecasts for many emerging market economies, Japan, and to some extent, also for Europe. While the broadening of the expansion should contribute to an orderly reduction of global imbalances, they remain a major challenge for policy makers.
2. An abrupt and disorderly correction in the unsustainable external payment imbalances remains a major risk. A proactive, but gradual adjustment is now necessary to avoid a potentially sharp and disruptive adjustment later. The countries with largest external imbalances bear a special responsibility in this respect.
3. The strength of the global economy in the face of high and volatile oil prices is welcome, reflecting that the surge in oil prices until recently has primarily been demand driven and that the global economy has become more resilient to energy price shocks. However, full effects of higher energy prices may not yet have been felt in consumer demand and prices. In view of this, high and volatile energy prices also remain an important risk. We continue to stress the need for higher investment in the entire energy complex and measures to foster energy efficiency, as necessary means to meet the prospective increase in energy demand in the years to come.

4. Another potential risk for the global economy is growing protectionism. These tendencies have recently become stronger and may negatively affect growth prospects if they continue to escalate. One important milestone this year with significant potential benefits for the world economy is the end-2006 deadline for Doha trade negotiations. A successful completion of the Doha Round would strengthen global integration and ensure a more predictable and fairer international trading framework. We encourage all countries to work towards this common goal. Pursuing the Aid for Trade agenda will also be an important part of the efforts to realize the benefits of trade liberalization.

IMF's Medium-Term Strategy

5. The IMF's medium-term strategy has raised considerable interest and expectations both within the institution and among wider audience. The Managing Director's report responds well to our expectations and provides a good basis for further work. We look forward to the upcoming discussions on how to turn the suggestions presented in the Managing Director's report into detailed proposals. We believe that enhancing the effectiveness and relevance of surveillance is the most important element in the Managing Director's report.

Macroeconomic and Financial Surveillance

6. We agree with the Managing Director that there is a need to further promote discussion on issues that are of systemic importance and that the Fund is uniquely placed to play an important role in this area. The proposal to introduce a new multilateral consultation procedure could be a vehicle to achieve this goal, but the Executive Board would need to be fully involved.
7. The regional dimension in surveillance must be strengthened and we welcome the first steps in this regard. We support the Managing Director's proposal for regional work plans, focusing on the main policy issues facing the region, the intra-regional linkages, and the implications of global surveillance. Elaborating further on this proposal will hopefully help the Fund to find an optimal format for regional surveillance.
8. We support the Managing Director in his call to put more emphasis on exchange rate surveillance. While the choice of an exchange rate regime is up to each country, the IMF has a central role to play in assessing the consistency of domestic policies with regard to the chosen exchange rate regime and the impact of that regime on other members and the global economy.
9. IMF surveillance and policy advice is a public good that helps to promote sustained global growth and financial stability. With its global membership, the IMF is well-placed to conduct high-quality and timely surveillance of its members' policies. As surveillance is the core function of the IMF, its centrality should be strengthened and sharpened. The effectiveness of surveillance is to a large extent dependent on the availability of Fund surveillance reports not only to national authorities but also to a wider audience. We find it important to strive for increased transparency of IMF surveillance.
10. We believe IMF surveillance should be more selective, focusing on macroeconomic and financial sector vulnerabilities. Given the complexities of structural issues and the Fund's comparative advantage, the Fund should mainly concentrate its work on issues that promote sound macroeconomic developments and financial stability. Deepening global integration with growing capital flows requires that the Fund increasingly takes into ac-

count regional and global spillovers of members' economic policies, including exchange rate policies, in its bilateral surveillance. Closer ties between multilateral, regional and bilateral surveillance are needed. Therefore, we welcome the Managing Director's proposal to increase the multilateral dimension of Article IV surveillance through a strengthened focus on spillovers and cross-country experience. We see merit in streamlining Article IV consultations. One way to streamline is a move to a 24-month cycle in highly stable and nonsystemic countries when appropriate. Another option is the MD's proposal with a streamlined procedure in alternate years.

11. More attention should be devoted to the links between the financial sector and the general macroeconomic stance. The main challenge now is to further increase financial sector expertise and fully integrate already existing expertise into the Fund's multilateral, regional and bilateral surveillance. We welcome the Managing Director's decision to merge the International Capital Markets Department (ICM) and the Monetary and Financial Systems Department (MFD) into one "knowledge center" of financial, capital market, and monetary issues.
12. Going forward, it is essential that the work of the newly established department will be adequately integrated into macroeconomic surveillance. In this respect, the Managing Director's proposal to involve financial market experts regularly in Article IV mission teams is a welcome one. In more general terms, incentives to follow an expert track within the Fund should be strengthened. Finally, the Global Financial Stability Report would benefit from a stronger focus on financial sector surveillance (including the FSAP process) as well as a more clear distinction of its content vis-à-vis the World Economic Outlook.

The IMF's role in Emerging Market Countries

13. The Fund's role in emerging market countries is changing, and the Fund should consider whether its crisis prevention and crisis resolution policies correspond to the new circumstances. We believe that the Fund's existing exceptional access policy remains broadly appropriate. We recognize that there is some tension between rules and practice, insofar as several recent high access cases have not taken place in an acute phase of capital account crisis but have rather been aimed at supporting members emerging from such a crisis. To ensure that the exceptional access framework secures predictable financial crisis management, fosters appropriate market discipline and safeguards the resources of the Fund, we need a strong framework that is credible and reflects actual policies and existing realities.
14. We have been skeptical towards new Contingent Credit Lines (CCL)-like lending facilities. Nevertheless, we recognize the need that warrants further analysis of a new financing vehicle for crisis prevention. We welcome more analysis by the management on the subject.

The IMF's Role in Low-Income Countries

15. We share the widely held view that the low-income countries have the primary responsibility to put in place sound policies and strong institutions needed for social and economic development. The Fund, in turn, should - through policy advice, technical assistance, including capacity building, and financial support - help low-income countries in establishing and maintaining macroeconomic and financial stability so as to foster dura-

ble growth and poverty reduction. The Fund should only focus on economic issues and institutions relevant to macroeconomic and financial stability.

16. We welcome the prompt implementation of the multilateral debt relief initiative (MDRI) for the first group of eligible countries. Debt cancellation, however, is not an end in itself but only means to free resources for spending in priority areas and to make progress towards the Millennium Development Goals (MDGs). For the IMF, the most critical issue going forward is to continue to actively support low-income countries while at the same time ensuring that countries do not rebuild unsustainable debt. Adherence to principles of good governance – including fighting corruption – accountability and sound economic management as well as strict implementation of the debt sustainability framework is crucial, including assessing the appropriate volumes and terms of lending for MDRI recipient countries. Furthermore, continuous assessment of the results of the MDRI, including progress reports and medium-term debt strategies, is important to guarantee that the freed-up resources are used for MDG-spending. The Fund is also well suited to assist low-income countries in strengthening their public expenditure systems.
17. The Fund has an important role to play in advising member countries on how to ensure that increased aid flows support economic and financial stability on a viable basis. How this issue should be approached should be thoroughly discussed in the period ahead.
18. Close cooperation between the World Bank and the IMF is necessary not only in the context of the MDRI but also more generally in all activity related to low-income countries. We fully support the proposal by the Managing Director to review the modalities for inter-agency coordination and division of labor within a framework of the newly established task force on Fund-Bank cooperation.
19. As emphasized in the last IMFC Communiqué, the PRGF remains the main instrument for IMF financial support to low-income countries. In our view, this is still a valid statement. In practice this means that the lending capacity of the PRGF needs to be ensured. It is important that the G8 fully delivers on its commitments to provide additional resources.
20. Another vehicle for Fund involvement in low-income countries is the Policy Support Instrument (PSI). We encourage countries that may not need Fund financial assistance to apply for a PSI, which is a signalling device of the Fund's endorsement of sound economic policies being implemented.

Quota and Representation

21. Quotas should ensure adequate representation of all IMF member countries and reflect economic strength and openness as well as the ability to contribute financially to the IMF's activities. According to the current quota formulas, some member countries are clearly underrepresented while others are overrepresented. In our view, the most viable solution to this issue will be an agreement on partial compensation for the most underrepresented countries via an ad hoc quota increase.
22. Moreover, voice of developing countries needs to be strengthened. Different options, for example capacity enhancing measures to raise developing countries' voice should be explored. We support an increase in the basic votes.

The IMF's Finances

23. Outstanding Fund credit is on a declining trend reflecting improved market access for actual and potential Fund borrowers as well as early repayments by Brazil and Argentina. We welcome the early repayments and are pleased to see that these countries were able to exit from Fund financing.
24. The early repayments have also acted as a wake-up call on how the Fund's income is generated. While the Fund's income mechanism has served it well in the past, the income mechanism has come under pressure as the level of outstanding credit has declined. Keeping the current system unchanged, i.e. increasing the rate of charge to reach the net income target, is not a viable option. Other options that do not depend on outstanding credit should be considered to permanently broaden the sources of income, such as using investment revenues from limited sale of gold.
25. In the upcoming discussions, the aim should be a system that is robust, equitable, transparent and simple. The discussions should adequately take into account the medium-term strategic review and link the income side properly to expenditures through an integrated medium-term budget. The possibility of curbing the Fund's administrative expenditures must be carefully explored.