International Monetary and Financial Committee

Thirteenth Meeting
April 22, 2006

Statement by Mr. Nout Wellink
President Nederlandsche Bank, Netherlands
On Behalf of Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, FYR of Macedonia, Moldova, Netherlands, Romania, Ukraine

Statement by Nout Wellink, on behalf of Gerrit Zalm, Minister of Finance of the Netherlands

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Representing the constituency consisting of Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Republic of Macedonia, Moldova, the Netherlands, Romania, and Ukraine.

This statement presents the view of my constituency on the topics to be addressed at this year's IMFC meeting: the global economy, the IMF Strategic Review and debt relief and debt sustainability. In addition, this statement gives our opinion on the Fund's income policy and capital account liberalization.

World Economic Outlook

1. Despite the run-up in oil prices over the last two years, world GDP growth in 2005 remained strong, while inflationary pressures were relatively modest. Looking forward, short-term global prospects continue to be bright. For the United States (US), robust growth is set to continue and Japan's expansion is expected to remain solidly on track. Furthermore, the outlook for economic activity in Europe suggests a firm recovery. Finally, economic activity in China, as well as in most other emerging markets and developing economies is expected to remain strong. Notwithstanding this positive short-term outlook, there are continued significant downward risks.

2. In the first place, the current account deficit of the US, which now stands at 6.4% of GDP, is set to remain large this and next year. To secure an orderly adjustment pro-active policies are required. The policy recipe is well-known: a structural increase of public and private savings in the US, more exchange rate flexibility in Asia and oil-exporting countries and increased domestic demand in surplus countries.

3. Secondly, the development of energy prices is an ongoing risk to the global economy, also in relation to external imbalances. The higher import bill has worsened the current account of the US. The *de facto* dollar peg of oil exporters may also contribute to the build-up of imbalances, as it limits the role of the exchange rate as adjustment channel. It is crucial that

second-round effects through prices and wages be kept at bay, especially as the disinflationary effects of globalization diminish. In addition, policy should contribute to a reduction of the energy intensity of economic activities, by diversifying the sources of energy and thereby increasing the supply share of renewable sources. Stepping up investment in exploration and refining capacity also remains necessary.

4. Thirdly, the rising tide of protectionist pressures constitutes a real risk for the world economy. Sustainable economic growth should remain the overriding objective of trade policy. Restricting the movement of goods, services, labor, and capital is economically unwise; it may only give short term relief and has major costs for the domestic and global economy. Globalization requires much in terms of flexibility, not just of countries, but also of firms and employees. When the globalization process is accompanied by structural reforms at the national level, the benefits of integration can be reaped more quickly as adjustment costs will be lower. At the same time, adequate levels of social protection, in combination with incentives to acquire new skills are crucial in facilitating the adjustment process.

5. Fourthly, a correction related to global external imbalances could potentially disrupt the capital flows that finance current account deficits. This could trigger a (sudden) increase in long-term interest rates, which may undermine growth prospects in regions where the economic recovery is still fragile. It may also seriously affect the housing sector, particularly in countries where house prices are elevated and where household debt levels are high. Moreover, even though many emerging market economies have been able to improve the structure and level of their external debt markedly, many remain vulnerable to a change in financial market sentiment.

6. Fiscal positions in several countries are unsustainable in the medium term and pose a final ongoing risk to the world economy. In many industrialized countries, fiscal positions have improved only marginally despite the ageing population. To prepare the economies for this challenge, it is crucial to benefit from the present favorable economic climate and to step up consolidation efforts. Besides, labor participation should be raised, while pension and health care systems should be reformed. Increasing the flexibility and dynamics of labor and product markets contributes to higher growth. This is particularly relevant for the euro area, where the key challenge remains raising its economic potential.

The IMF Strategic Review

7. My constituency welcomes the report of the Managing Director on implementing the Fund's medium-term strategy and would like to address the following issues of the review: i) surveillance, crisis prevention and crisis resolution, ii) the role of the IMF in low-income countries, iii) capacity building and technical assistance and iv) quota and voice.

Surveillance, crisis prevention and crisis resolution

8. **My constituency fully supports the proposals of the Managing Director to strengthen financial sector surveillance and to better integrate financial sector issues into Article IV reports.** We welcome the establishment of a taskforce to develop an analytical framework aimed at ensuring this integration. Some of the instruments currently used for the FSAP, such as stress-tests, could be part of the Article IV template that is currently being developed.

9. **The introduction of this new template should go hand in hand with an increased focus and streamlining of Article IV consultations,** by concentrating surveillance first and foremost on the core areas of expertise of the Fund. **Since the Fund should remain relevant for all its members,** focus should be adjusted according to the case and risks at hand. Thus, simplification of bilateral consultation procedures should be explored for all countries and focus and timeliness should be the norm rather than the exception. In addition, the legitimacy of Fund advice, experience sharing and best practice dissemination among members are maximized when **all Article IVs are discussed in the Board.**

10. **At the same time, more attention should be given to multilateral surveillance and its linkage to bilateral surveillance.** By increasing the integration of bilateral and multilateral surveillance, the IMF can strengthen its analysis and policy advice on the impact of international economic and financial developments in individual article IV consultations. Vice versa, the IMF can raise authorities' awareness of the regional and multilateral effects of their policies. In the view of my constituency, the proposal to strengthen multilateral surveillance by starting a new supplemental multilateral consultation procedure, in which the IMF consults with selected groups of countries, does not yet constitute a compelling way forward. Such a procedure should in any case be transparent and secure the central role of the Board and the IMFC. More forcefully bringing together the policy recommendations of bilateral consultations in the Board could also strengthen multilateral surveillance.

11. **My constituency welcomes the objective of the Managing Director to strengthen exchange rate surveillance and to review the 1977 decision on guidance on exchange rate regimes.** We also endorse the proposal to expand the work of the Consultative Group on Exchange Rates (CGER) to include all major emerging markets, but are hesitant about publishing equilibrium level analyses. More contemplation is needed on the effects this can have on markets and policies. Exchange rate surveillance should be enhanced foremost by more analysis on whether a chosen policy is appropriate within its macroeconomic context.

12. **My constituency is of the opinion that any proposal for a contingent financing facility needs to address convincingly the issues of moral hazard, exit, conditionality, stigmatization and involvement of the Board**. We would be prepared to consider such a proposal, but it does not seem to have taken sufficient shape yet. Limited access precautionary arrangements are well suited to signal strong policies to financial markets, as experiences in many countries illustrate.

13. **My constituency agrees with the Managing Director that more work is needed on the modalities of the Fund's role in sovereign debt restructuring.** In this regard, we believe that the dissemination of timely and accurate information (e.g. debt sustainability analyses) by the Fund is of primary importance. This may facilitate restructuring negotiations between the debtor and private creditors, by providing them with a common starting point. Since these issues are part of the 'Principles of stable capital flows and fair debt restructuring', the IMF should clarify its role in the implementation of these Principles.

14. **In addition, the Fund needs to develop a consistent approach for exit from exceptional Fund access and should further examine the use of alternative contingency strategies in exceptional access arrangements**. Since the exceptional access framework provides clear and important rules for the Fund's role in capital account crises, we are not in favor of modifying this framework.

The role of the IMF in low-income countries

15. **The Managing Director provides a number of valuable proposals to strengthen the Fund's role in low-income countries.** The IMF has an important role to play in these countries and its policy advice, capacity building and financial assistance should focus on macro-critical areas. Fund program engagement should, as a standard practice, include

alternative policy scenarios assuming a higher level of aid. Where useful and possible, these scenarios could include a so-called MDG scenario.

16. As the Managing Director rightly states, the implementation of this approach necessitates a **sharper division of labor and subsequent more efficient collaboration with the World Bank** and, where needed, other Multilateral Development Banks. My constituency subscribes to the elimination of the Joint Staff Assessment Notes, so as to free up much needed resources. Nevertheless, we feel that the IMF should continue to assess, within its mandate, national development strategies, such as the PRSP. Where possible, the Fund should continue to base its support on these strategies.

17. **The Fund has an important role in helping to prevent unsustainable build-up of debt in low-income countries**. The Fund should take the outcome of the Debt Sustainability Framework into account when deciding on its own financial support to countries that risk debt distress. Also with respect to non-program countries, my constituency finds that the Fund has a responsibility in assessing debt sustainability and in signaling debt-overhang to donors and the Board.

18. **My constituency is not in favor of developing a new instrument for post-conflict countries.** We do not see a need for extending IMF involvement in these countries, except possibly in the field of capacity-building. Instead, if the current Emergency Post Conflict Assistance (EPCA) facility is judged to be inappropriate, changes could be considered in its design to further accommodate the specific needs of post-conflict countries. Furthermore, conditionality should be based, where possible, on countries' own reform agendas, without weakening the standard of conditionality.

Capacity building and technical assistance

19. **My constituency agrees with the Managing Director's report that capacity-building efforts should become more aligned with the needs of member countries and evolving Fund priorities**, especially those identified in surveillance. Therefore, we share his views on priority setting and would like to add that technical assistance programs should get a longer-term focus. In order to increase the effectiveness of technical assistance, a strengthening of ownership is also warranted. To this end, countries receiving technical assistance could be requested to facilitate missions or projects, for instance by extending logistical support. **Charging fees could also help to increase ownership and prioritization, but this should**

never prohibit the poorest countries´ access to technical assistance and not too much should be expected from this as a source of income. Trust funds could be a useful tool to assist low-income countries in this respect. My constituency supports exploring this issue further, but external financing should not distort priority setting for technical assistance by the Fund.

Quota and voice

20. Good governance is of key importance for the inclusiveness and responsiveness of an organization. Adequate voice in the IMF and a distribution of quotas reflecting developments in the world economy should be assured. **My constituency agrees that concrete and durable progress can and should be made on the issue of quotas and voice by the Annual Meetings in Singapore.** To accommodate individual emerging markets that are strongly underrepresented on the basis of the current quota formulas, **we could support partial ad hoc quota increases for a selected group of countries.** Furthermore**, we support an increase in the number of basic votes for all members, aimed at strengthening the voice of developing and transition countries.** In our opinion, solving the issue of quotas and voice deserves high priority and we are ready to agree on a substantial package of measures – including basic votes - at the Annual Meetings in Singapore. In addition, we emphasize the advantages of a mixed constituency as a bridge-building model between borrowing and non-borrowing members of the IMF.

Debt relief and debt sustainability

22. **My constituency welcomes the implementation of the Multilateral Debt Relief Initiative** by the IMF as of 1 January, and the agreement reached by the World Bank Board to start implementation on 1 July. This debt relief should help recipient countries to achieve the Millennium Development Goals. It is of utmost importance, once debt relief under the HIPC Initiative and the MDRI has been provided, that these countries maintain debt sustainability. We therefore **welcome the recent examination of options aimed at preventing creditors from indirectly obtaining financial gain from debt forgiveness, grants and concessional financing activities without paying for it (“free riding”)** following the improved creditworthiness of the involved countries, since this could undermine the development of these countries and disrupt the intended effectiveness of debt relief. Furthermore, **we recommend the adoption of the IMF/World Bank Debt Sustainability Framework by both debtors and official bilateral and multilateral creditors** as the main instrument to contain irresponsible accumulation of new debt by borrowing countries.

The Fund's finances

23. In the view of my constituency, **the current business financing model, based almost exclusively on margins on adjustment lending, is no longer tenable. A new, longer-term model is necessary that reduces the Fund's dependency** on the level of outstanding credit and reduces the volatility of interest charges for debtor countries. Such a model should also take the Fund's expenditure side into account. To further guarantee its independence, the Fund should look for additional sources of income, such as an investment account, including the proceeds of a limited sale of gold. The strategic review and the introduction of the medium-term budget mechanism offer an opportunity to set priorities and posteriorities, which should lead to expenditure savings. Next to that, a general efficiency drive would be appropriate.

24. My constituency notes the proposal of the Managing Director to establish an external committee reviewing the Fund's finance structure. Although management and staff should be able to provide the Board with adequate proposals, external support may be useful, in order to catalyze political momentum, particularly in the area of modern reserve management. The Fund's audit and risk management institutions should be strengthened, including the role of the Board in this area.

Capital account liberalization

25. My constituency urges the Fund to clarify its approach towards capital account liberalization, as has also been suggested by the Independent Evaluation Office (IEO) in 2005. Regarding the IEO's recommendations, **my constituency supports the proposed nuanced approach to capital account liberalization**, which, building on the recognition of the ultimate benefits of liberalized capital flows, regards the sequencing and the broader context of necessary reforms as more important than the speed of liberalization. In case capital controls are applied, these should be temporary and designed in such a way as to reduce distortions, while never being seen as a substitute for reforms.