

Erkki Liikanen: The IMF - internal governance, crisis management and its involvement in low-income countries

Statement by Mr Erkki Liikanen, Governor of the Bank of Finland and Governor of the International Monetary Fund for Finland, on behalf of the Nordic-Baltic Constituency, at the Joint Annual Discussion, Washington DC, 3 October 2004.

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Introduction

I am honoured to address this distinguished audience on behalf of the Nordic-Baltic constituency consisting of Denmark, Estonia, Iceland, Latvia, Lithuania, Norway, Sweden, and Finland. We are gathered here in Washington at a time when the IMF has just passed the 60 year mark. This milestone gives us an excellent opportunity to reflect on the main challenges of this institution.

I start with a comment on the economic outlook. The overall picture is quite comforting, even though higher oil prices have added to the downside risks. The main challenge now is to establish a firm foundation for sustainable growth.

The opportunity offered by the present situation should be used to address global imbalances, to move towards more sustainable fiscal positions and to press ahead with structural reform. The recent agreement to continue the Doha trade round was a welcome step forward in our efforts to bringing the fruits of sustainable growth to all. Industrial countries must shoulder their responsibilities for the progress made in trade liberalization, and low-income countries need to take action to ensure the reduction of trade barriers between them.

I want to focus first on surveillance and the Fund's internal governance, second on our way of dealing with crises, and third on the Fund's involvement in low-income countries.

The Fund needs to become more candid in its surveillance...

First, is the question of surveillance. In Fund terminology, surveillance has a positive ring; it is about shared economic security. In recent years, increased transparency has made the Fund's surveillance more accessible. The move to presumed publication of the Fund's reports is the latest achievement in this field, and it is important that we continue to encourage all member countries to follow this new policy.

The recent biennial review provided us with valuable information about the state of surveillance and guidance on the way forward. It is important to deepen the coverage of regional and global spillovers and to improve the integration of bilateral, regional and multilateral surveillance. The Fund's surveillance over euro area policies is a good example in this respect. We might sometimes disagree on policy conclusions, but I appreciate the comprehensive and candid view given on the policies of our region. The Nordic-Baltic constituency includes countries either inside or closely linked to the European Union, and for that very reason we have a wider interest on the issue. Having been personally involved in European cooperation for a long time, I appreciate the "outsider view" that the Fund can bring to the European discussion.

Of course, becoming better at multilateral and regional surveillance is dependent on the quality and efficiency of bilateral surveillance. The Fund staff's own report, together with the Independent Evaluation Office's (IEO) report on the Fund's Role in Argentina, served as an eye-opener for many of us. The evaluation report makes a convincing case concerning the shortcomings of surveillance in this instance. I quote, "Little substantive discussion took place with the authorities on whether or not the exchange rate peg was appropriate for Argentina over the medium term, and the issue received scant analysis within the IMF" unquote.

The Fund gave the authorities the benefit of the doubt for too long and did not acknowledge that temporary positive developments were not supported by structural changes. None of us want to see a repetition of this, and therefore we need to emphasize reform and insist on having structural issues of macroeconomic importance adequately addressed in Fund surveillance and programs.

...while further improving internal governance

The evaluation report also shows that there is a need for further discussion on how to enhance internal decision-making and ensure that our representatives in the Executive Board are fully informed about all issues relevant to the decision-making process. Critical decisions are, however, sometimes made outside the Board. This undermines the ability of the Board to exercise the powers that we as Governors have given them. It also calls into question the accountability of this institution. On top of this, it may weaken the credibility the Fund vitally needs.

In this respect the clarity that the exceptional access criteria bring to decision-making is most welcome. The use of this promising vehicle has been limited to date. The exceptional access criteria focus on the early involvement of the Executive Board. A well-informed and alert Board is the best guarantee that the staff and management do not prejudice the Board's decisions. It is up to all parties concerned to make sure that the agreed rules are followed.

Enhancing the voice and participation of developing countries in the Fund's decision-making process is another important area. The Nordic-Baltic constituency is in favour of improving developing countries' participation in international fora and is ready to consider realistic measures to achieve this. One way to do this is to increase basic votes.

There is a need to change our way of dealing with crises

Secondly, is the question of the way we prevent and handle crises. The Fund's success in preventing and handling crises is not measured by the amount of finance it disburses. Precautionary arrangements have become more and more common in recent years. I have noted the latest suggestion to create a so-called policy monitoring arrangement. However, it is an open question whether there would be demand for such an arrangement or whether the existing tools can serve the same purpose that a policy monitoring arrangement is supposed to do.

Another interesting discussion has centred on the exceptional access framework and on considerations of its proper functioning. In general, I feel that the existing framework with early Board involvement should be left unchanged for the time being. We should make sure that we apply the exceptional access criteria, as they are defined, in order to have a predictable and equitable framework in place.

The call for a strong exceptional access framework is reinforced by the fact that there has been limited progress on other aspects of the crisis resolution framework. Issues related to private sector involvement have been put on the back burner for too long, making the current system still tilted towards bailing out the private sector. It is a welcome development that the use of collective action clauses has become so widespread, but we should also develop other tools to involve the private sector. The Fund's lending into arrears policy provides guidance on how to react in such a situation, but I believe that the policy would benefit from more operational criteria that would make the policy easier to apply. Well-defined rules on debt restructuring do not have to lead to easier defaults but rather to a more predictable and orderly process.

Stepping up our efforts to reduce poverty in low-income countries

Thirdly, is the question of the international community's efforts to reduce poverty in low-income countries and on the role the Fund can play in this, without compromising its core function. The attainment of the Millennium Development Goals depends on sound policies, good governance, and adequate financing. Trade liberalization especially in agricultural products would give a boost to low-income countries. Ensuring better and equal access to basic services such as education and health care, reducing poverty and underpinning a more equal income distribution, would help to enhance and sustain growth.

An operational framework for debt sustainability would enable both the countries themselves and the donors to better tailor policies to be consistent with the countries' long-term debt sustainability. Further work on a debt sustainability framework would also facilitate our discussion about what is needed beyond the present HIPC Initiative. The decision to extend the initiative for two more years was a welcome move in order to ensure equal treatment of eligible countries. However, there is a need to consider new ways of addressing long-term growth and sustainability issues in both HIPC as well as in other low-income countries.