

Speech to UNCTAD

In farewell address, Managing Director calls for 'reinvigorated multilateralism' to humanize globalization and combat poverty

Immediately prior to leaving office as IMF Managing Director, Michel Camdessus delivered his final speech to the Tenth United Nations Conference on Trade and Development (UNCTAD) in Bangkok on February 13 (see page 50). Renewing his recent pleas for an all-out effort to address the "systemic threat of poverty," Camdessus cited "incoherence" in efforts to move to the necessary higher level of international cooperation. He called for a "reinvigorated multilateralism," which would imply extending the vision for the world's economic and financial system beyond trade and payments to cover the whole gamut of international transactions. The need is to convince the public and political leadership, Camdessus said, that only multilateralism can succeed in humanizing globalization. To that end, it is essential to ensure that the IMF and other multilateral institutions are seen—far more visibly—to have the legitimate support of their shareholders.

As a move in that direction, Camdessus suggested replacing the annual Group of Seven (or Eight) economic summit meeting every two (Please turn to the following page)

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Michel Camdessus addresses the United Nations Conference on Trade and Development (UNCTAD) in Bangkok.

Three countries to benefit from enhanced HIPC

Bolivia, Mauritania, and Uganda have become the first three countries to receive debt-service relief under the enhanced Heavily Indebted Poor Countries' (HIPC) Initiative, the IMF and the International Development Association (IDA) have announced. Relief for Bolivia and Uganda will amount to \$1.3 billion each and for Mauritania, to \$1.1 billion. The enhanced assistance will be provided after the three countries, in concert with civil society, adopt strategies to reduce poverty and will help finance social expenditures.

The press release announcing the assistance for Bolivia notes that this country's macroeconomic performance has improved dramatically over the past decade, with inflation declining from hyperinflationary levels to 3.1 percent in 1999 and official international reserves and foreign direct investment increas-

ing significantly. In addition, the external debt burden, although still high, has eased considerably. Despite these improvements, about 70 percent of Bolivia's population continues to live in poverty.

Uganda became eligible for debt relief under the enhanced initiative through the effectiveness of its poverty reduction strategy thus far and the authorities' sustained commitment to macroeconomic stability. Although one of the poorest countries in the world, Uganda reduced its incidence of poverty by 18 percent between 1992/93 and 1996/97. It also increased the net primary school enrollment rate to 94 percent in 1998/99 from 56 percent in 1995/96. The assistance under the enhanced HIPC Initiative is expected to reduce Uganda's external debt and debt-service burden by \$50 million a year over the next 26 years. (Continued on page 56)

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It is the opening of trade that will finally make the difference, especially for the poorest countries.

—Camdessus

(Continued from front page) years with a meeting of the heads of state and government of the countries that have Executive Directors on the Boards of either the IMF or the World Bank. Such a meeting, he said, would be representative of the entire IMF membership of 182 countries and establish a clear and stronger link between the multinational institutions and a representative grouping of world leaders, endowing it with “unquestionable legitimacy.”

Before leaving Washington, Camdessus spoke on several of the issues with which he has been closely associated during his 13-year tenure as head of the institution. During a press conference at IMF headquarters on February 8 (see page 53), Camdessus said he was proud of the efforts of the past several years to make the IMF more transparent, despite a continuing uphill battle to change ingrained attitudes toward the institution. Stressing that the IMF’s ultimate objective was country ownership of economic reform programs, Camdessus pointed to recent conferences in Libreville and Cancún, where heads of government in both Africa and Latin America pledged to launch campaigns against corruption and poverty and to promote governance. For its part, the community of international institutions has responded with the debt-reduction initiative for heavily indebted poor countries (HIPC); in fact, Camdessus said, the IMF Executive Board had just

announced implementation of the enhanced HIPC Initiative for the first three beneficiaries—Uganda, Bolivia, and Mauritania (see page 49).

Responding to a question, Camdessus said that the recent events in Seattle during the World Trade Organization meeting sent a message about the need to establish clearer rules of the game and to clarify where the responsibilities lie for the economic governance of the world. Demonstrators in the street should not be allowed to intimidate those who are democratically elected, Camdessus emphasized, but the international community also needs to be responsive and sensitive to what nongovernmental organizations, academics, and other representatives of civil society have to say. Nevertheless, paralyzing the body created to introduce fairness and regulation in international trade is not a good response. “It is the opening of trade that will finally make the difference,” especially for the poorest countries, Camdessus said.

On February 8, the Executive Directors adopted a resolution recording their “profound appreciation of the leadership he provided to the IMF during a uniquely momentous time” (see page 55).

Accompanying this issue of the IMF Survey is an eight-page special supplement on the IMF under the leadership of Michel Camdessus. ■

Managing Director’s speech to UNCTAD

Following are edited excerpts from IMF Managing Director Michel Camdessus’s address to the Tenth United Nations Conference on Trade and Development (UNCTAD) in Bangkok on February 13. This was Camdessus’s last speech as IMF Managing Director. The full text is available on the IMF’s website (www.imf.org).

Let me reflect with you on the paradox of the present situation: promise—unprecedented prospects in certain fields—but financial instability and “exclusion,” the so-cruel situation of the poorest, and the anxieties of so many in the world. One must recognize that there are serious reasons for this anxiety, even if the world has recently overcome, with unprecedented speed, the most severe crisis of the last 50 years, and even if the world today enjoys better prospects for sustainable growth, with global output slightly over 3 percent for advanced countries and about 5 percent for developing countries.

Positive dynamics in recent history

Let me mention three positive dynamics:

- A major economic crisis is being overcome, and we can build a more stable world on its lessons.

- A new paradigm of development is emerging.
- We recognize better now that globalization, if properly handled, can become a major opportunity for the progress of the world.

First, meeting here in Asia, we can only note the resilience demonstrated by Asian economies to this most severe crisis, the courage demonstrated by the authorities in facing adversity, and the capacity of the international community to respond promptly to such a shock with the technical and financial assistance needed.

These recoveries are outstanding experiences on which to build, but it is remarkable to observe also that they rest on, or have developed in parallel with, positive developments in the way the international community approaches its economic challenges. A new paradigm of development is progressively emerging here. Let me emphasize two of its key features.

First, a progressive humanization of basic economic concepts. It is recognized that the market can have major failures, that growth alone is not enough or can even be destructive of the natural environment or precious social goods and cultural values. Only the pursuit of *high-quality* growth is worth the effort.

The world has not yet demonstrated that it is concerned enough or capable of overcoming the greatest concern of our times—poverty.

—Camdessus

Second, at a deeper level, we observe also in recent approaches a striking and promising recognition of the convergence between a respect for fundamental ethical values and the search for efficiency required by market competition. This augurs well for attaining the highest-quality growth we now seek.

At the same time, a new perception of globalization is emerging. Globalization can now be seen in a positive light, not what some have portrayed it to be—a blind, potentially malevolent force that needs to be tamed—but, rather, a logical extension of the same basic principles of economic and human relations that have already brought prosperity to many countries and the best means of improving the human condition throughout the world. But if such powerful dynamics for a better world are at play, why such anxiety, why such rejection in many circles of globalization as a symbol of the new economic trends? Because the world has not yet demonstrated that it is concerned enough or capable of overcoming the greatest concern of our times—poverty.

Poverty

The widening gaps between rich and poor within nations, and the gulf between the most affluent and the most impoverished nations are morally outrageous, economically wasteful, and potentially socially explosive. Now we know that it is not enough to increase the size of the cake; the way it is shared is deeply relevant to the dynamism of development. If the poor are left hopeless, poverty will undermine the fabric of our societies through confrontation, violence, and civil disorder. We cannot afford to ignore poverty, wherever it exists. But it is in the poorest countries that extreme poverty can no longer be tolerated; it is our duty to work together to relieve suffering.

But it is not enough to keep these issues in the domain of international conferences. We must make sure in our work with individual countries and people that these principles become operational. The challenge is to work together to build up the capacity of developing countries to fight against poverty and to mobilize the necessary resources to support their efforts.

Even with enhanced support from abroad, it is the *poor countries* themselves that are on the front line. Already, many of them have been showing what can be done when the ultimate objective is human development, including the alleviation of poverty. Their experience suggests an approach with five components:

- country-driven strategies that make poverty alleviation the centerpiece of economic policy, together with a renewed emphasis on rapid private sector-led growth;
- sound macroeconomic policies, high rates of saving and efficient investment in both physical and human capital;

- promotion of the free market and an outward orientation of economic policies;
- strong economic, social, and political institutions that support the functioning of markets; and
- strong social components—well-targeted and cost-effective social safety nets, a shift in public spending toward basic social services in education and health care, and efforts to provide income-earning opportunities for the poor.

But if the *content* of a program is important, the degree of national *support* for it matters equally. Success lies in national “ownership” of the policies, through a participatory approach that engages civil society in a constructive dialogue.

The *development partners* can support the efforts of the poorest countries in three areas. First, on the *trade* front, they can assign the highest priority to providing unrestricted market access for all exports from the poorest countries, including the heavily indebted poor countries (HIPCs), so that these countries can begin to benefit more deeply from integration into the global trading system. Second, they can work strenuously to encourage *flows of private capital* to the lower-income developing countries, especially foreign direct investment. Third, they can back up all the pledges to reduce poverty with *financial support*. The multilateral organizations can be counted upon to do their part. The IMF has replaced its concessional facility, the Enhanced Structural Adjustment Facility (ESAF), with the Poverty Reduction and Growth Facility (PRGF), focusing on poverty reduction as an explicit objective of our programs. This will be our central instrument for assisting the low-income countries.

Reinvigorated multilateralism

Everything I have said today calls for us to move to a higher level of international cooperation. And yet, incoherence in our efforts threatens us permanently; we risk stumbling at the first hurdle. To avoid it, we need to ensure greater coherence in international policymaking. For that, a reinvigorated multilateralism must be the response. But the international community is giving with one hand and taking away with the other. Governments have made the far-reaching decision—in the framework of the Bretton Woods institutions—to reduce by about one-half the debt of 35 or 40 heavily indebted poor countries through our HIPC Initiative. But those same governments have failed—in the framework of the WTO [World Trade Organization]—to launch a trade round or even to take the very modest step of eliminating trade barriers to the exports of the poorest countries, especially HIPCs.

I find similar incoherence in our insufficient progress in advancing in parallel toward peace and development, particularly in Africa. We have heard that development is the other name of peace. Why do

We need to convince the public and political leadership that only multilateralism can succeed in humanizing globalization.

—Camdessus

we forget the converse: that peace is the other name of development? So, I have no hesitation in reiterating several suggestions that have been made to contain the arms trade and military expenditures.

We cannot allow these incoherences, together with all the regressive forces in the world, to frustrate the hopes fostered by the new dynamics operating in our world. What, then, should we do? The response is straightforward; we must embrace a renewed commitment to the principles of multilateralism.

This implies extending our vision for the world's economic and financial system to cover not only trade and payments, but the whole gamut of international transactions—to create an open, competitive, and stable international environment. Clearly, the trade talks need to be put back on the rails, and in doing so we need to convince the public and political leadership—in developing and developed countries alike—that only multilateralism can succeed in humanizing globalization.

There is another domain where I would suggest more coherence in the attitude of governments—it is in their political support to multilateral institutions. Some governments from time to time find it convenient not to express their public support for actions they support wholeheartedly in our executive bodies. In a world where we are blessed with vibrant public opinions, where demagogic campaigns can develop in

a flash, we will all be unable to discharge our ever-growing responsibilities if we are not perceived for what we are, the faithful instruments of the community of nations. Therefore, it is essential to ensure that the IMF and other multilateral institutions are seen, far more visibly, to have the legitimate political support of their shareholders. One reform that I have recently proposed—the introduction of a supreme decision-making body in the IMF—would respond to this problem. Far from leading to an undue politicization of the IMF, this would simply, in the eyes of the public, place responsibility squarely where it already rests. But governments remain to be convinced.

While globalization has until now operated at the whim of more or less autonomous financial and technological forces, it is high time that we take on these responsibilities and take the initiative, so that progress toward world unity can be made in the service of humankind. All this requires institutions that can facilitate joint reflection, at the highest levels whenever needed, and that are capable of ensuring that globalized strategies are adopted and followed when it appears that problems can be dealt with effectively only at the global level.

A suggestion that goes in that direction, and that is especially motivated by the pursuit of coherence, would be to replace—every two years—the Group of Seven (or Eight) summit with a meeting of the heads of state

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and government of the countries that have Executive Directors on the Board of either the IMF or the World Bank. Provided such meetings were prepared with the active participation of all the countries of the respective constituencies, this would be thoroughly representative of the entire membership of 182 countries. As it would be attended by the Secretary General of the United Nations and by the heads of the relevant multilateral organizations, it would offer a way of establishing a clear and stronger link between the multinational institutions and a representative grouping of world leaders with unquestionable legitimacy.

Final press conference

Camdessus cites success of increased transparency, calls country ownership IMF's 'ultimate objective'

Following are edited excerpts of IMF Managing Director Michel Camdessus's final press conference in Washington, D.C., on February 8. The full text of his remarks is available on the IMF's website (www.imf.org).

CAMDESSUS: My only purpose this morning is to bid farewell to all of you and to thank you for your attitude toward the IMF, and myself, during my long stay here. You have been very fair, very professional, and very courteous. I'll give you, immediately, a scoop. On Tuesday morning, February 15, I will be a nonentity. You will hear no more about me. So today, I can really speak my mind.

I am the son of a journalist. When I came here, I had an understanding of the press and only positive feelings about the press and media. But I had also recently had three years' experience as a central banker. Thirteen years ago, in central banking, the virtue was not transparency but secrecy. I was split between these two things, but you convinced me, promptly, that I should go back to my genes and my inclination to speak as much as possible.

Now, at the end of this experience, I have a feeling of success and a feeling of failure. As for the sense of success, I believe you will recognize that we have made this institution distinctly more transparent. I have been preaching the golden rule of transparency to the world since the Mexican crisis at least. Further steps are certainly needed, but we are truly moving in the direction of positive change in the IMF.

The failure is that, in spite of that, we have not been able to change attitudes toward the image of this institution. There are still people around the world who can, without provoking an outcry, say that the IMF kills babies. You have the old demagoguery that pretends we don't serve the common good. You have vested interests trying to destroy us because they know that we destroy them. You cannot confront the family

Strong dynamics are at play in our history, bearing the promise of greater financial stability, of a new paradigm of development, and of a better chance to humanize globalization. These dynamics can make it possible to fulfill our universal pledges to reduce poverty and, through a reinvigorated multilateralism, to better address our problems in their global dimension. We cannot delude ourselves about the enormity of the challenges, but positive dynamics for high-quality and equitable development are given to the world today; may it suffice that we cooperate in a full spirit of responsibility and solidarity as good citizens of one village. ■

monopolies in Indonesia, the *chaebols* in Korea, and so on, without provoking negative campaigns.

We suffer a lot. It's possibly the price of a very strong contribution to the international common good. But we will have to continue working, together with the World Bank, to explain that all these necessarily tough programs serve a common good. If we see today—and I am happy to leave in such a context—the world economy exceeding all forecasts for growth, it is, I presume, the effect of our efforts and the actions of the very valiant, courageous, professional staff of this institution, and I am proud to say that.

I am also very happy to leave the IMF at a time when there is not so much talk about the IMF around the world. This confirms for me what my eminent friend [IMF First Deputy Managing Director] Stan Fisher used to say—namely, that when you have a crisis, and when difficult measures are announced, these are the IMF's policies. But when success starts emerging, and the skies are more sunny, then the policies are the policies of the country, and you don't hear any more about the IMF. This is our ultimate objective—ownership. Countries then own their policies and their successes, and we are happy to see that, and people forget about us.

I had two extremely rewarding occasions this last month. The Libreville meeting with 20 African heads of state and participants from 45 countries discussed how to make the most of the new set of instruments that we have put in place for debt reduction and growth in the poorest countries. The Libreville declaration [see *IMF Survey*, January 24, page 18] was their declaration. I urge you to reread it and to compare it with what the finance ministers of Latin America said in Cancún in their communiqué. You will see that there is a silent revolution going on in the world.

What we have tried to promote is a kind of second generation of reform based on stronger institutions,

I have been preaching the golden rule of transparency to the world since the Mexican crisis at least.

—Camdessus

better governance, fights against corruption, more transparency, economic policy focused on poverty alleviation, and reduced inequalities. All of that is starting to take shape, and it is owned by these countries. Three years ago, you would not have had many African heads of state launching a powerful fight against corruption. Now they do that together. Now Latin American countries

join forces, including with the Caribbean countries, to fight corruption and money laundering and promote good governance.

Of course, industrial countries and our institutions must play their part, and I'm happy to leave you the very day when the first three cases of implementation of the enhanced HIPC [Heavily Indebted Poor Countries] Initiative—Uganda, Bolivia, and Mauritania—have just been decided by our Executive Board. It's not the end of the fight. A lot will have to be

done for this difference to be discernible to the man on the street. You know of my fight, and that of all my colleagues in the IMF, to at least have the world deliver on its pledges at the UN conferences over the last 10 years. We must have extreme poverty reduced by half by the year 2015. By enacting all of these pledges, you can trigger a new dynamism in the world.

A recent letter to members of the International Monetary and Finance Committee (IMFC) and to the IMF's Executive Directors called on the organization to have a more open and transparent process for choosing a new Managing Director.

CAMDESSUS: I have not seen this letter, but I hope the next IMFC will want to review what is in my judgment a too-protective process of selecting a Managing Director and draw appropriate lessons. But you will certainly understand that at this critical moment in this process, it wouldn't be proper for me to make the process even more complicated by introducing my personal views into this discussion.

What should the IMF do, in a proactive sense, to get its message across? Is it taking any heed of what happened in Seattle?

CAMDESSUS: First of all, what the IMF must do every day is more transparency, and I would like to express my thanks to the External Relations Department, which during the past 13 years has done with the modest means put at its disposal everything it could to communicate the realities—not the image—of the IMF. We will never have the means to match, dollar for dollar, all the campaigns around, which are not all, as you know, those of generous, disinterested, idealistic NGOs [nongovernmental organizations].

But we should take seriously what Seattle told us, and you will do me this justice to recognize that I have not waited for Seattle to tell us that the people of the world want the IMF to be seen as more accountable. For years I have pressed for the establishment of a council, so that the responsibility can be seen where effectively it is. We are accountable to 182 countries of the world, and they take every day, frequently by consensus, all the decisions of this institution. But because it is difficult and because politicians are politicians, they don't always take responsibility for what is being done here.

I do believe that Seattle tells us something about the need to establish clearer rules of the game and clarify where the responsibilities lie for the economic governance of the world. We will always have the extremely difficult problem of taking into proper consideration the views of the governments that sit on our boards—and the elected bodies behind them—and the views of civil society. We shouldn't allow demonstrators in the street to intimidate those who are democratically elected and responsible to their people, but we must be very sensitive and attentive to what all these nongovernmental agencies, academia, and all the rest tell us, because there are certainly serious questions for the future. The world must find a response to this extremely difficult reconciliation problem.

This being said, we shouldn't be naive. To paralyze the body created to introduce a little bit more fairness and regulation into international trade just five years after its creation is certainly not a good response. And to not allow it to take an immediate decision on opening the major industrial countries' markets to the products of the poorest countries is totally inconsistent with the decision we took a few months ago to reduce the debt of the poorest. It is the opening of trade that will finally make the difference.

You have been a kind of symbolic figure to the Korean people during the country's sudden collapse and sudden resurgence. Many people now say that Korea should "graduate" from the IMF. Is it now time for Korea to forget about the IMF?

CAMDESSUS: First of all, I am delighted for the Korean people. This is due in some part, perhaps, to the perceptiveness of the staff of the IMF and its Executive Board as to what the country's problems were and where action had to be taken urgently. But it is chiefly due to the courage, the sense of sacrifice, of the people of Korea and to the leadership of President Kim Dae Jung and his government. Korea was fortunate to have such a man take the helm just at that very moment. History will remember that.

Now, yes, there is resurgence, with stability, and all the prospects for higher-quality growth in Korea. But vigilance is always in order. Korea can forget about the IMF, but Korea should not forget the policies it adopted



Camdessus: Seattle tells us something about the need to clarify where the responsibilities lie for the economic governance of the world.

or the reforms it launched. There are still things to do, particularly for corporate restructuring, for consolidating the financial sector, for maintaining the proper budgetary and financial discipline, and for continuing to strengthen its social policies. But knowing President Kim Dae Jung, Korea's government, and the good sense of the Korean people, I have no doubt that these things will be well taken and the effort maintained.

Graduation—a country renouncing IMF financing at the end of its program—is for the IMF the most splendid victory. We are delighted, provided graduation is about forgetting the IMF but not forgetting its policies. And what I now say about Korea will apply soon, I presume, to Thailand and, I hope, to many other countries.

Relations between the IMF and Russia in the last decade had a lot of ups and downs, and generally more negative than positive results. What are the main lessons for the IMF and for Russia? And were there any mistakes on the IMF's side?

CAMDESSUS: The first obvious lesson is that when you try to help a country out of 70 years of a Marxist-Leninist regime, you are not in a business-as-usual operation. If I regret something, it is possibly to have shared, somewhat, everyone's illusion that this could be done rapidly. Possibly it could have been done rapidly

if everybody had felt as mobilized for change as the IMF was, if everybody had taken as many risks for change in Russia as we did. But this was not the case. We were frustrated many times by the Russian authorities' half-hearted implementation of the agreed programs. We were disappointed by the lack of sufficient support by the state Duma for these policies and by delays in adopting the indispensable legislation to establish a level playing field. Was that a reason for us to say, well, they don't deliver, let them go their way?

No, the role of this institution is to continue working, and working hard, whatever the frustration, to create the conditions for a resurgence. I feel proud to have done that. You will have the impression that it is not that much of a change. But Russia is a country where the democratic rules for presidential elections and the basic principles of a market economy are not challenged, and where the government and all political forces now recognize that the only route for the future is reform and further integration in the world economy.

At this time, we are experiencing a discontinuity in financing but not in dialogue. I believe the price of continued support and, at times, the blame for supporting Russia is a small price compared to what is achieved. So I wait with great tranquility the judgment of history. ■

IMF Executive Board adopts resolution of appreciation for Michel Camdessus

The Executive Board of the IMF met on February 8, to bid farewell to Michel Camdessus, Chairman of the Board and Managing Director of the IMF since January 1987. At the close of the meeting, and on behalf of the full Board, Karin Lissakers, the Executive Director for the United States, read the following resolution of appreciation:

“WHEREAS on February 14, 2000, Mr. Michel Camdessus will conclude a long and a distinguished period of service to the IMF's 182 member countries and to the international community on relinquishing the post of Managing Director of the IMF and Chairman of its Board of Executive Directors that he has held since January 16, 1987;

“WHEREAS Mr. Camdessus has steered the IMF through a period of unprecedented challenges with verve, skill, vision, and dedication;

“WHEREAS Mr. Camdessus has presided with unbounded energy over a strong, coherent, and effective institution;

“WHEREAS Mr. Camdessus has contributed immeasurably to fostering sound economic policies in widely diverse economies and promoting the IMF's role as the central forum for international monetary cooperation;

“WHEREAS Mr. Camdessus has led the way in helping prepare the IMF's universal membership to meet the challenge of maximizing the rewards and minimizing the risks of a truly open global world economy;

“WHEREAS Mr. Camdessus has catalyzed the IMF's membership to create new instruments and policies to deal with historic global changes, while safeguarding and strengthening its traditional ones; and

“WHEREAS Mr. Camdessus, having always kept in clear view the human dimension of economic issues, has played a vital role in placing high-quality growth and reduction of poverty at the center of the international community's concerns, and has been a principal architect of the international debt reduction initiatives and the Poverty Reduction and Growth Facility in the IMF;

“NOW, THEREFORE, IT IS RESOLVED: That the members of the Executive Board record their profound appreciation of the leadership he provided to the IMF during a uniquely momentous time, their deep regret at his leaving, and their best wishes to him and his family in all their future activities.” ■



(Continued from front page) Mauritania, according to the IMF press release, “has established a good track record of adjustment and reform on the macroeconomic, social, and political fronts.” The country has implemented structural reforms and achieved fiscal consolidation and, as a result, GDP has grown by about 5 percent a year since 1992, and social indicators have improved significantly. However, 50 percent of the population remains under the poverty line. The assistance to Mauritania represents debt-service savings of about \$36 million a year over the next 10 years, or about 40 percent of total yearly debt-service obligations, the press release states.

Also in February, the IMF approved a three-year Extended Fund Facility arrangement in the amount of SDR 3.6 billion (about \$5 billion) to support Indonesia’s economic and structural reform program, as well as the second-year program for the Kyrgyz Republic under the Poverty Reduction and Growth Facility (PRGF) equivalent to SDR 21.5 million (about \$29 million).

In the press release announcing its decision, the IMF notes that Indonesia made considerable progress under its previous extended arrangement (see *IMF Survey*, August 31, 1998, page 269) in restoring macroeconomic stability, addressing the financial crisis, advancing structural reforms, and ensuring food security. However, the country must do more to revive the real economy and lay the foundation for a sustained recovery that will increase employment and reduce poverty.

Through its new program, Indonesia is seeking to restore economic growth to 5–6 percent by 2002 and to keep inflation to less than 5 percent a year. As the pace of investment in Indonesia picks up over the next several years, the press release notes, the country’s current account is expected to weaken but the

declines should be offset by official financing and improvements in private capital flows. To achieve its objectives, Indonesia will implement a range of fiscal policy measures, including a gradual reduction of untargeted subsidies; civil service wage reforms, along with efforts to reduce corruption; and fiscal decentralization, which is intended to preserve fiscal neutrality. At the same time, the authorities are proposing measures to protect small households from the impact of the lower subsidies. Social spending, the press release says, will also aim to strengthen poverty-alleviation programs, support rice distribution, and provide health, education, and employment services.

The Kyrgyz economy grew strongly in 1997 and the first half of 1998, before deteriorating in the second half of 1998 and 1999, largely as a result of the Russian financial crisis. Consumer price inflation reached about 40 percent by the end of 1999. The PRGF program aims to raise real GDP growth to 4–5 percent a year over the medium term and to stabilize inflation at about 5 percent by 2003. It also aims to reduce the cash fiscal deficit and increase the country’s international reserves. To achieve its objectives, the government’s fiscal policy entails preventing new arrears from emerging, containing public sector wages, and reforming the civil service while increasing revenues to 14 percent of GDP. Structural reforms under the program include reducing state intervention in decision making and accelerating the restructuring and privatization of state enterprises. The country’s overall poverty reduction strategy is to reduce by half the current level of poverty. ■

The complete texts of Press Release Nos. 00/4, 00/6, 00/7, 00/8, and 00/9 are available on the IMF website: www.imf.org.

Photo Credits: Sukree Sukplang for Reuters, page 49; Denio Zara, Padraic Hughes, and Pedro Márquez for the IMF, pages 54 and 61.

Correction

In the *IMF Survey* dated February 7, 2000 a photo caption on page 46 inaccurately states that Argentina’s Convertibility Plan eliminated the peso and adopted the U.S. dollar. The text of the caption should read: Argentina’s Convertibility Plan provides, inter alia, for a currency board arrangement under which the domestic currency, the peso, can be exchanged on a one-to-one basis for the U.S. dollar.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
February 7	4.08	4.08	4.64
February 14	4.09	4.09	4.65

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (as of May 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members’ remunerated reserve tranche positions. The rate of charge, a proportion (currently 113.7 percent) of the SDR interest rate, is the cost of using the IMF’s financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/external/np/tre/sdr/sdr.htm).

Data: IMF Treasurer’s Department

IMF arrangements help Baltic and CIS countries to strengthen their economic governance

Among transition economies, the need to reduce corruption and improve governance was perhaps nowhere greater than in the 15 countries that emerged from the former Soviet Union. The IMF has been fully engaged with the Baltic countries and Commonwealth of Independent States (CIS) to achieve macroeconomic stability and pursue critical structural reforms. In fulfilling its mandate to provide economic policy advice to its members, the IMF has also played an indirect role in strengthening governance and battling corruption in the region.

In a new IMF Working Paper, Thomas Wolf and Emine Gürgen briefly review the relationship between governance and corruption and the high economic costs corruption exacts. Their paper, *Improving Governance and Fighting Corruption in the Baltic and CIS Countries: The Role of the IMF*, summarizes the related steps the IMF has taken to date. Much remains to be done, and the authors outline an agenda for the IMF in the coming years.

Poor governance breeds corruption

While there will be opportunities for corruption in any society, the quality of governance can make an enormous difference. Appropriate strictures and proper enforcement are critical, but according to Wolf and Gürgen, it is even more essential that authorities address underlying governance problems that can give rise to corruption. Indeed, the authors argue, a fundamental assumption underlying IMF conditionality in the Baltic and CIS countries is that improving governance in economic policy areas will help reduce corruption.

The study explains that poor economic governance has three broad dimensions:

- *Excessive government intervention and discretion* (notably, the regulation of private entities and the adoption of preferential schemes). Foreign exchange and trade restrictions, price controls, directed credits, and tax exemptions, for example, offer tempting opportunities to officials to elicit bribes or kickbacks. Although most countries in the Baltic-CIS region have liberalized, excessive state intervention remains a problem, especially in many CIS countries, and foreign firms have often either been barred to protect local interests or have found themselves the target of demands for bribes. Officials have also awarded exclusive licenses or sold utilities to well-connected individuals.

- *Lack of government transparency and accountability and poor management.* It is important for governments to maintain arm's-length relations with the

economy, avoid conflicts of interest, establish an efficient and well-paid civil service, develop an open budgetary process and impose strong expenditure controls, establish an efficient tax system, avoid arrears, and broadly maintain transparent government and central bank operations. In several countries, customs or other officials have engaged in smuggling operations that have undercut legitimate businesses; nominally privatized firms have been sold to close relatives of officials and then received large

Key measures in IMF arrangements to improve economic governance

Measures ¹	1992–95		1996–99	
	Number	Percent	Number	Percent
Liberalization, deregulation, and privatization	133	61.9	193	43.4
Government transparency, accountability, and good economic management	52	24.2	161	36.2
Establishment of a stable, rules-based, and competitive environment	30	14.0	91	20.4
Total	215	100.0	445	100.0

¹Prior actions, performance criteria, and structural benchmarks in IMF Stand-By, Enhanced Structural Adjustment Facility, and Extended Fund Facility Arrangements.
Data: IMF, *Improving Governance and Fighting Corruption in the Baltic and CIS Countries*

government support; humanitarian aid has been diverted for personal gain; and chronic underpayment or nonpayment of civil servants has fostered pervasive low-level corruption.

- *Need for stable, rules-based, competitive environment to nourish market activity.* A strong private sector needs the rule of law; enforceable contracts and property rights; effective court systems and bankruptcy procedures; stable, fair, and transparent tax systems; and effective bank supervision and regulation. Unfortunately, discretion and unstable legal and regulatory environments remain the rule, especially in many CIS countries. In some instances, licenses for foreign-owned financial service companies have been revoked, and government measures have been used to tilt the playing field in favor of domestic investors and shareholders.

Cost of corruption

Corruption exacts a heavy toll. It undermines the moral authority of governments, the confidence of the citizenry, and the attractiveness of that economy for potential investors. But corruption also has very real economic costs. It is likely to increase distortions in the allocation of resources; exacerbate income inequalities and poverty (some will benefit from the bribery, kickbacks, and preferential deals, but these will most assuredly not be the poorest); and negatively affect

growth through increased costs, reduced incentives to invest, and the diversion of talent and enterprise into rent seeking rather than productive activities.

Corruption imposes a particularly onerous burden on the most innovative and potentially most productive segment of the economy—small-scale enterprise. There is also evidence that it shifts resources from socially beneficial investments (health and education) into “white elephant” projects and discourages foreign direct investment. Ultimately, corruption reduces domestic savings and investment, stimulates capital flight, and weakens the domestic banking system. In their totality, these costs inhibit investment and growth, discourage aid flows, and lower the standard of living.

Governance issues in IMF arrangements

To achieve financial stability and lasting economic growth, the IMF advises countries to focus on correcting macroeconomic imbalances; reducing inflation; and promoting trade, exchange rate, and other market reforms. More recently, the IMF—cognizant of the impact that poor governance has on the effectiveness of reform efforts—has widened its concerns to pay greater attention to institutional reforms and gover-

nance issues. The IMF has pursued a more comprehensive treatment of governance issues within its mandate and expertise, taken a more proactive stance to promote policies and help develop institutions that can eliminate opportunities for the misuse of public positions and resources, aimed at evenhanded treatment of all member countries, and enhanced its collaboration with other multilateral organizations, notably the World Bank.

The conditions (or “conditionality”) under which the IMF has extended resources to countries in the region include aspects of all these dimensions of economic governance. IMF conditionality has addressed government regulation of economic activity and preferential schemes; government transparency, accountability, and good economic management; and the creation of a stable, rules-based environment for market activities. But while all IMF-supported adjustment programs have contained similar policy actions, Wolf and Gürgen note there has been a great deal of variation in the sequencing and frequency of measures, reflecting disparate starting conditions and varying degrees of political will, as well as shifting policy emphases.

In their study of IMF programs during 1992–99 in the Baltic-CIS region, Wolf and Gürgen found that

Available on the web (www.imf.org)

Press Releases

- 00/4: IMF Approves \$5 Billion Extended Arrangement for Indonesia, February 4
- 00/5: IMF Approves Second Annual PRGF Loan for Bolivia, February 7
- 00/6: HIPC Debt Relief for Uganda Increased to a Total of \$2 Billion: Additional Relief for Uganda’s Poverty Reduction Programs, February 8
- 00/7: IMF and IDA Support \$1.3 Billion Debt-Service Relief Eligibility for Bolivia Under Enhanced HIPC, February 8
- 00/8: IMF Approves Second Annual PRGF Loan for Kyrgyz Republic, February 9
- 00/9: Mauritania Qualifies for \$1.1 Billion Debt Relief Under HIPC to Support Poverty Reduction, February 10

Press Briefings

Transcript of Michel Camdessus’s farewell press conference, February 8

News Briefs

- 00/9: Statement by IMF Managing Director Michel Camdessus on the Death of Manuel Guitián, February 8
- 00/10: IMF Executive Board Adopts Resolution of Appreciation for Michel Camdessus, February 9

Public Information Notices (PINs)

- 00/5: Thailand, February 10
- 00/6: Tajikistan, February 14

- 00/7: Norway, February 15
- 00/8: Dominica, February 16
- 00/9: Australia, February 15

Speeches

Development and Poverty Reduction: A Multilateral Approach—address by Michel Camdessus at the Tenth United Nations Conference on Trade and Development, Bangkok, February 13

Letters of Intent and Memorandums of Economic and Financial Policies

- Bolivia, December 20, 1999
- Kyrgyz Republic, January 22
- Estonia, February 11

Policy Framework Papers

- Kyrgyz Republic, January 25

Notes: PINS are IMF Executive Board assessments of members’ economic prospects and policies. They are issued following Article IV consultations—with the consent of the member—with background on the members’ economies; and following policy discussions in the Executive Board at the decision of the Board.

Letters of Intent and Memorandums of Economic and Financial Policies are prepared by a member country and describe the policies that the country intends to implement in the context of its request for financial support from the IMF.

Policy Framework Papers are prepared by the member country in collaboration with the staffs of the IMF and the World Bank. These documents, which are updated annually, describe the authorities’ economic objectives and macroeconomic and structural policies for three-year adjustment programs supported by Enhanced Structural Adjustment Facility resources.

the growing emphasis on governance typically extended beyond measures formally included in IMF conditionality. Nevertheless, the IMF exerts its most visible influence through the agreed-upon conditionality, since noncompliance with these targets normally interrupts the flow of IMF financing. Essentially, all the reviewed IMF programs included efforts to

- liberalize the economy (by lifting price controls, opening the trade system, and eliminating exchange controls);
- strengthen the budgetary process (by improving revenue collection, streamlining government spending, and bringing extrabudgetary funds under budgetary control);
- eliminate wage, pension, and social benefit arrears (by imposing quantitative performance criteria to phase out arrears in an orderly fashion);
- reform the banking system (by granting central bank independence, meeting international accounting standards, and strengthening banking regulation and supervision);
- privatize, restructure, or liquidate public enterprises (by encouraging specific intermediate targets to be met and by advocating effective bankruptcy provisions); and
- improve the legal, accounting, and statistical frameworks (by pressing for the adoption of laws, accounting frameworks, and data standards that meet international standards).

Through these efforts at improving governance, the IMF has sought to create an environment less conducive to corruption. Wolf and Gürgen also found that, over time, the emphasis of IMF conditionality had shifted increasingly toward tackling problems of government transparency and accountability and establishing a rules-based economy. The IMF's technical assistance and training efforts have concentrated on the design and implementation of fiscal and monetary policies, institution building, the collection and processing of statistical data, and the drafting and review of financial legislation. These efforts have effectively complemented the IMF's surveillance and financing activities.

Future IMF emphases

The IMF is committed, Wolf and Gürgen stress, to helping curtail corruption through policy and institutional reform and an intensification of efforts to promote transparency and accountability. The IMF has drafted and is actively encouraging member countries to adopt codes of good practice in fiscal and monetary management. In several countries, the IMF is also preparing, with the cooperation of the local authorities, experimental reports on the observance of standards and codes to identify areas where transparency can be improved and to contribute to informed lending

and investment decisions. The IMF has also encouraged countries to undertake self-assessments, and it has launched and recently expanded a standard of sound practices for the provision of economic and financial data to the public.

To achieve greater transparency and accountability, improved economic management, and a more rules-based environment for market activity, the IMF has recognized that a number of areas warrant further attention. These include acceleration of public sector reforms and the downsizing of government (including a clearer specification of what constitutes government activity); improved management and oversight of the use of public funds; integration of all extrabudgetary government activity into the government budget; phasing out of barter arrangements in foreign trade; separation of central banking and treasury operations; and adoption of good practices in the conduct of monetary and fiscal policy and the creation and administration of tax codes. The IMF also suggests further attention to privatization and public enterprise restructuring; regulatory reforms (particularly a reduction of the regulation of business activity); reform of the legal system; greater progress on civil service reforms; and the creation of independent audits for central and state banks as well as for government and public enterprise operations.

Progress in these and other areas and strict enforcement of existing sanctions on corrupt practices can bear fruit, but Wolf and Gürgen caution against naïveté. Corruption, they underscore, has a long history in the region and often reaches into the topmost layers of government. Rooting it out will be difficult, particularly to the degree that these countries continue to lack a free press, a truly independent judiciary, and an effective political opposition. It is also crucial for the public to understand the true costs of corruption, for without public outrage, little true reform can be achieved.

Members' use of IMF credit (million SDRs)		
	January 2000	January 1999
General Resources Account	1.42	455.72
Stand-By Arrangements	1.42	0.97
EFF	0.00	45.73
CCFF	0.00	409.02
PRGF ¹	20.71	41.53
Total	22.13	497.25

EFF = Extended Fund Facility
 CCFF = Compensatory and Contingency Financing Facility
 PRGF = Poverty Reduction and Growth Facility

Figures may not add to totals shown owing to rounding.
¹Formerly ESAF—the Enhanced Structural Adjustment Facility.

Data: IMF Treasurer's Department

These elements are beyond the IMF's control, the authors observe, but the IMF can, in closer collaboration with the World Bank, "ensure the delivery of effective, consistent, and timely advice." And, because corruption is a dynamic process, with a breathtaking ability to find and use loopholes, the IMF needs to keep abreast of changing policies and maintain closer

contacts with nongovernmental organizations and the private sector. ■

Copies of IMF Working Paper 00/1, *Improving Governance and Fighting Corruption in the Baltic and CIS Countries: The Role of the IMF*, by Thomas Wolf and Emine Gürgen, are available for \$7.00 each from IMF Publication Services. See page 52 for ordering details.

In 1999, the Poverty Reduction and Growth Facility (PRGF) replaced the IMF's Enhanced Structural Adjustment Facility (ESAF).

Stand-By, EFF, and PRGF Arrangements as of January 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By			39,897.68	12,711.81
Bosnia and Herzegovina	May 29, 1998	April 28, 2000	77.51	24.24
Brazil	December 2, 1998	December 1, 2001	10,419.84	2,550.69
Cape Verde	February 20, 1998	March 15, 2000	2.50	2.50
El Salvador	September 23, 1998	February 22, 2000	37.68	37.68
Korea ¹	December 4, 1997	December 3, 2000	15,500.00	1,087.50
Latvia	December 10, 1999	April 9, 2001	33.00	33.00
Mexico	July 7, 1999	November 30, 2000	3,103.00	2,068.60
Philippines	April 1, 1998	March 31, 2000	1,020.79	475.13
Romania	August 5, 1999	March 31, 2000	400.00	347.00
Russia	July 28, 1999	December 27, 2000	3,300.00	2,828.57
Thailand	August 20, 1997	June 19, 2000	2,900.00	400.00
Turkey	December 22, 1999	December 21, 2002	2,892.00	2,670.28
Uruguay	March 29, 1999	March 28, 2000	70.00	70.00
Zimbabwe	August 2, 1999	October 1, 2000	141.36	116.62
EFF			14,035.13	8,826.90
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	March 19, 2000	58.50	5.26
Bulgaria	September 25, 1998	September 24, 2001	627.62	313.82
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Indonesia	August 25, 1998	November 5, 2000	5,383.10	1,585.40
Jordan	April 15, 1999	April 14, 2002	127.88	106.56
Kazakhstan	December 13, 1999	December 12, 2002	329.10	329.10
Moldova	May 20, 1996	May 19, 2000	135.00	47.50
Pakistan	October 20, 1997	October 19, 2000	454.92	341.18
Panama	December 10, 1997	December 9, 2000	120.00	80.00
Peru	June 24, 1999	May 31, 2002	383.00	383.00
Ukraine	September 4, 1998	September 3, 2001	1,919.95	1,207.80
Yemen	October 29, 1997	March 1, 2001	105.90	65.90
PRGF			3,484.52	1,934.65
Albania	May 13, 1998	May 12, 2001	45.04	14.11
Bolivia	September 18, 1998	September 17, 2001	100.96	67.31
Burkina Faso	September 10, 1999	September 9, 2002	39.12	33.53
Cambodia	October 22, 1999	October 21, 2002	58.50	50.14
Cameroon	August 20, 1997	August 19, 2000	162.12	36.03
Central African Republic	July 20, 1998	July 19, 2001	49.44	32.96
Chad	January 7, 2000	January 7, 2003	36.40	31.20
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	161.98
Djibouti	October 18, 1999	October 17, 2002	19.08	16.36
The Gambia	June 29, 1998	June 28, 2001	20.61	13.74
Ghana	May 3, 1999	May 2, 2002	155.00	110.70
Guyana	July 15, 1998	July 14, 2001	53.76	35.84
Honduras	March 26, 1999	March 25, 2002	156.75	80.75
Kyrgyz Republic	June 26, 1998	June 25, 2001	73.38	43.00
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	27.28
Madagascar	November 27, 1996	July 27, 2000	81.36	40.68
Mali	Aug 6, 1999	August 5, 2002	46.65	39.90
Mauritania	July 21, 1999	July 20, 2002	42.49	36.42
Mongolia	July 30, 1997	July 29, 2000	33.39	15.95
Mozambique	June 28, 1999	June 27, 2002	58.80	50.40
Nicaragua	March 18, 1998	March 17, 2001	148.96	53.82
Pakistan	October 20, 1997	October 19, 2000	682.38	417.01
Rwanda	June 24, 1998	June 23, 2001	71.40	38.08
Senegal	April 20, 1998	April 19, 2001	107.01	57.07
Tajikistan	June 24, 1998	June 23, 2001	100.30	53.34
Tanzania	November 8, 1996	February 7, 2000	181.59	0.00
Uganda	November 10, 1997	November 9, 2000	100.43	17.85
Yemen	October 29, 1997	October 28, 2000	264.75	114.75
Zambia	March 25, 1999	March 24, 2002	254.45	244.45
Total			57,417.33	23,473.36

¹Includes amounts under Supplemental Reserve Facility.

EFF = Extended Fund Facility.

PRGF = Poverty Reduction and Growth Facility.

Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

Nordic tiger measures new challenges

Finland confronts the 'dilemmas of success,' weighs policy coordination options

Finland's economy has rebounded impressively from a deep crisis in the early 1990s, and its public finances have been rebuilt. On this sound foundation, the authorities face new challenges in the coming decade, including the impact of a rapidly aging population, risks of overheating in the real economy and asset markets, and high structural unemployment.

From crisis to sustained expansion

Finland's recovery from the recession of the early 1990s is one of Europe's success stories. Its recent economic growth has been well above the European Union (EU) average, and unemployment has fallen from over 16 percent to below 10 percent. Finland's story of crisis and recovery has elements in common with a number of other strong performers.

- An external shock—the impact of collapsing trade with the former Soviet Union—triggered the crisis, but deep-rooted problems, such as an overvaluation of the markka, a terms of trade deterioration, and the bursting of an asset price bubble, sharply deepened the severity of the crisis.

- A comprehensive policy package fostered a recovery of confidence. The authorities devalued the currency and exercised firm restraint over public spending. In fact, public spending fell by some 10 percentage points of GDP in six years—one of the strongest performances in the European Union. The public finances shifted from a deficit of 7 percent of GDP in 1993 to a small surplus in 1998. Together with a firm monetary policy, this cleared the way for Finland to

become, in 1999, a founding member of European Economic and Monetary Union (EMU).

- Exports of goods and services drove the economic upswing. Exports rose from less than 25 percent of GDP at the start of the 1990s to some 40 percent of GDP in 1997. The current account shifted from a deficit of over 5 percent of GDP to a surplus of the same size—by far the largest adjustment among advanced economies. Telecommunications, with Nokia the flagship, expanded particularly strongly. As recovery spread to other sectors, growth accelerated to an average of almost 5 percent over the past three years.

- The labor unions responded to the crisis and its aftermath with a policy of wage moderation, achieved through a centralized bargaining system. This helped foster the steep fall in unemployment and was consistent with a decline of inflation to very low levels.

New challenges

As Finland gains experience in managing its policies under monetary union, the authorities have cautioned that success must not breed complacency. Three challenges dominate the horizon. First, population aging over the coming decade and a half threatens to jeopardize the longer-run soundness of the public finances or trigger a further increase in Finland's already high tax burden. Second, while fiscal policy has been adapted to allow a fuller operation of stabilizers, the risk of overheating remains. Finland's economy con-

Camdessus pays tribute to former department head Manuel Guitián

On February 8, IMF Managing Director Michel Camdessus noted the death of Manuel Guitián on February 7 in Madrid at the age of 61. The full text of News Brief No. 00/9 is available on the IMF's website (www.imf.org).

"Manuel Guitián served the IMF with great distinction for 29 years until his retirement in late 1998 as the Director of the Monetary and Exchange Affairs Department," Camdessus said. "Manuel made notable contributions to the work of the IMF in many areas. In the 1970s and 1980s, he was one of the main architects of the design of macroeconomic adjustment programs, and he wrote extensively on this subject. In more recent years, he played major roles in coordinating technical assistance for monetary authorities in a number of countries, notably in Asia following the Asian crisis, and in the IMF's work related to capital

account liberalization. He was an early advocate of the code of good practices on transparency in monetary and financial policies. Manuel strongly held the view that the IMF was entrusted with an important and distinctive role. Drawing on his legal as well as economics background, he developed this argument with characteristic clarity and persuasiveness in *The Unique Nature of the Responsibilities of the International Monetary Fund* (1992), a pamphlet that deepened understanding of the role of the IMF.

"Manuel left a distinguished legacy of work at the IMF, but we who had the privilege to work with him here recall not only his impressive intellectual contribution and wise counsel but also his reliable collegiality and gentle friendship. He will be sorely missed," Camdessus said.



tinues to grow rapidly, while euro-area monetary conditions are tuned to the less cyclically advanced core economies. Third, the labor market is not functioning efficiently. It continues to be characterized by high structural unemployment on average and large disparities between regions. The IMF's most recent Article IV consultation with Finland and the subsequent IMF Executive Board discussion of the staff report focused on these issues.

Implications of the demographic shock

The IMF consultation underscored that the issues confronting Finland are closely linked, and the approach to population aging will be of central importance. Finland can use various policy instruments to deal with the fiscal impact of this demographic shock. It can tighten the medium-term stance of fiscal policy (to reduce debt levels and interest costs), and it can strengthen a range of structural policies, including the design of social benefits. The balance between these responses will have implications for labor market performance and the economy's resilience during cyclical fluctuations.

The authorities are convinced that fiscal consolidation must be the cornerstone of their approach to the demographic shock, and they are committed to achieving a significant fiscal surplus over the medium term. This will sharply reduce the public debt ratio—to 35 percent from some 50 percent of GDP over the next four years—unlocking interest savings that will partly offset the fiscal impact of population aging. But this is part of a broader overall strategy. A key aim is to cut taxes on labor income by some 1½ percent of GDP through 2003. To achieve these fiscal goals, the government program freezes real central government spending over the medium term and seeks to raise employment levels to near 70 percent of the working-age population. The program will attempt to boost employment through a mix of measures, including addressing tax traps, better targeting active labor market programs, and increasing the effectiveness of vocational training.

To help the authorities evaluate how different components of their strategy could come together most effectively, the IMF staff contrasted two medium- and long-run economic strategies (see chart, page 64). The first scenario featured modest structural reforms and large general government surpluses over the medium term. Even with surpluses of 5 to 6 percent of GDP over the next few years, however, it would be difficult to meet the costs of population aging without raising the burden of social contributions on labor income in the coming decades. This would increase employment-related taxes just when it would be crucial to increase labor market participation and employment to mitigate the demographic shock.

The IMF staff's second scenario would incorporate deeper reforms in the labor market, benefit programs, and pensions to raise employment—allowing somewhat lower fiscal surpluses in the medium term, and a larger cut, over time, in taxes on labor income. This could foster a virtuous circle, strengthening output and employment and thus the long-term position of the public finances. But these initiatives must be implemented on an urgent basis if a premature exit of the baby-boom generation from the labor force is to be avoided.

Addressing cyclical tensions

With the economic cycle in Finland well ahead of the euro-area average, the authorities are confronted with the dilemmas of success. Surveys confirm that corporations expect robust export growth, and consumer sentiment remains buoyant. Strong domestic demand continues to fuel a virtuous circle of employment growth and rising output, with the service sector expanding strongly. Overall, GDP growth should be at least 4 percent in 2000, and consumption and residential investment may be stronger than projected, given robust job creation, wealth effects from rising asset prices, and relatively low real interest rates.

With its broad and robust expansion intact, and monetary and financial conditions guided by other developments in the euro area as a whole, the Finnish authorities must seek nonmonetary means to counteract the risks of overheating. They have at their disposal fiscal and structural policies and official influence over wage setting. The authorities are particularly concerned to avoid a longer-run cost cycle that could damage employment or an asset price cycle that could jeopardize financial stability and sustained economic expansion.

An important focus of the IMF consultation was to assess when, and through which instruments, policy-makers should respond to price pressures (see box, page 63). On balance, the conclusions were that overheating in the real economy was probably not imminent, though it was an important watchpoint for the medium term. Currently, strong competitiveness and high productivity growth in the manufacturing industry help cushion the economy to some extent against these risks; and these factors also mean that Finland can tolerate a somewhat higher rate of CPI inflation than the euro-area average. Moreover, internal migration and rising participation should continue to ease isolated labor market bottlenecks, while the discipline of monetary union should encourage continuing wage moderation.

Asset price inflation, equally, does not appear to pose immediate dangers, although vigilance is called for. Corporate and household balance sheets have been rebuilt in recent years, and memories of the

early 1990s crisis remain fresh—with some institutions still working out property lending problems. And a sizable part of the rise in house prices thus far appears to represent a recovery from depressed levels. Nonetheless, there is a clear risk that residential and commercial real estate markets in the south—given continued internal migration—will remain under strong pressure and that asset prices will continue to be fueled by low interest rates.

While overheating may not be imminent, the authorities and the IMF staff discussed the need to move preemptively in various ways, conscious that some relevant reforms are hard to implement and will take time to have effect. In the fiscal field, first, the continued economic expansion provides an opportunity to press on with planned medium-term consolidation, which will help forestall risks of overheating. In 1999, the fiscal impulse was contractionary to the tune of $1\frac{1}{4}$ percent of GDP, and the overall stance of macroeconomic policies was probably broadly neutral. For 2000, projections suggest a further fiscal withdrawal of at least $\frac{1}{2}$ of 1 percent of GDP. To enhance fiscal stabilizers, the authorities are building up “EMU buffer funds” to finance unemployment benefits in periods of cyclical downturn, which will avoid repeating the past experience of procyclical rises in unemployment contributions.

But the IMF consultation stressed that a key route to avoiding problematic labor cost or asset price cycles under monetary union is to enhance the flexibility of the real economy, notably through labor market reforms. This would help forestall domesti-

cally generated cost pressures and improve the economy’s resilience to shocks. As regards asset markets, the staff suggested that it would be advisable to remove distortions favoring owner-occupied housing (such as mortgage interest deductibility) and review the functioning of the land market, including municipalities’ approach to development.

A common theme thus emerged in evaluating the options to address both cyclical and longer-run demographic issues. Continuing structural reforms can play a key role in meeting the problems of population aging in an efficient manner, and they can also improve the economy’s resilience to cyclical stresses. In both areas, the trade-off between purely fiscal approaches and a blend of fiscal and structural reforms clearly favors the latter. And measures to improve the functioning of the labor market figure large in both these contexts.

Labor market issues

During discussions with the IMF, the authorities and the social partners noted that Finland’s generous social benefit system and the various routes to early retirement helped cushion one of the deepest recessions experienced in an advanced economy in recent decades. There is a growing recognition, however, that a different challenge must be met today: how to integrate more of the unemployed into the workforce. Indeed, broader employment would both help cushion the economy against the future shock of population aging and help alleviate other potential stresses under economic and monetary union.

When and how should cost and price pressures be resisted?

European Central Bank policy aims for low inflation in the euro area. Cost/price developments for a small, open economy such as Finland may well differ from those in the core economies. In deciding on the right policy response for Finland, it is important to distinguish between several phenomena:

- The competitiveness of the economy suggests a significant margin for real appreciation—via nominal appreciation of the euro and/or higher inflation in Finland’s trading partners.
- Productivity growth in manufacturing exceeds that in the service sector by more than is typical for the euro area, and the consumer price index (CPI) can thus rise slightly faster than the area average without endangering Finland’s competitiveness in traded goods.
- Generalized cost pressures could emerge in the labor market and depress employment, but recent trends in labor costs and aggregate employment do not indicate this as yet.
- Insufficiently differentiated wages can foster cost pressures through excessive wage increases at the low-skill level, where unemployment is already high.

- Bubbles may occur in asset markets—but the rise in property prices thus far largely represents a recovery from depressed levels; and while stock prices are high, the domestic impact is limited by nonresident ownership.

The first two influences cited above would justify slightly higher CPI inflation than the euro-area average. By contrast, it is important for policy to address risks of cost pressures, damage to low-skill employment, or asset price inflation. In the present setting, both fiscal and structural policies have a role to play. With the cycle ahead of the euro-area average and monetary conditions easy, fiscal withdrawal can help avoid a destabilizing cycle in costs and prices, and this coincides with the need for structural fiscal consolidation. More fundamentally, forestalling such problems requires structural reforms to raise potential output—for example, improving incentives for employment creation, job search, and better skill matching, and addressing distortions in the real estate market. Near-term fiscal tightening, by muting demand pressures, helps to buy time for such adjustments but is not sufficient to tackle supply-side constraints.



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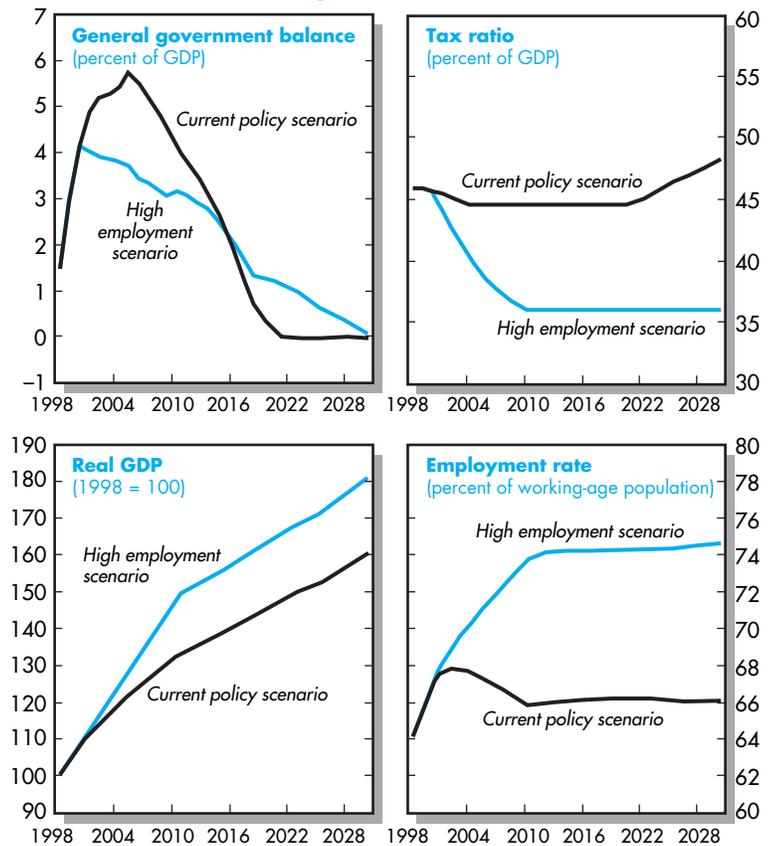
Over the past few years, Finland has taken steps to tighten unemployment benefit eligibility somewhat; enhance training programs; and permit greater flexibility in work-time arrangements, especially for small and medium-sized enterprises. It has also suspended inflation indexation for unemployment benefits and lowered personal income taxes. Together, these reforms improved the balance of incentives between seeking work or training, as against remaining on social benefits for an extended period.

Nonetheless, while unemployment has declined sharply, it remains high among the low skilled and in the northern and eastern regions. And Finland's employment ratio is unimpressive by international standards. The percentage of part-time and self-employed workers is low, reflecting taxes and regulations, and social benefits are still not strongly linked to readiness to seek work or training. Unemployment benefits, after taxes and transfers such as child and housing allowances, remain high over an extended period. And while strong centralized bargaining has favored wage moderation, wage differentiation remains limited.

A crucial priority now is to condition benefits much more directly on job search and job training efforts and to support job search efforts effectively through active labor market policies and improved training. This would be reinforced by a faster tapering down of unemployment benefits. In wage formation, it will be important not only to avoid excessive general settlements but also to increase the scope for differentiation among firms and sectors and in regions where productivity is low and job creation slow.

It is also vital to avoid a premature withdrawal of the baby-boom generation from the workforce—a key component in an effective strategy to handle the demographic shock. Current incentives tend to encourage employees approaching 55 years of age to drop out of the labor force and to discourage firms from hiring them. Ending this situation will require reforms in unemployment benefits and disability pensions. Moreover, pension entitlements will need to be linked to lifetime contributions, and the management of pension fund assets should be strengthened. This strategy would slow the fiscal impact of population aging and minimize perceptions that pension contributions are part of a heavy tax burden on labor income.

Finland: long-term fiscal scenarios



Data: IMF staff estimates

Fostering broad support for reforms

The authorities welcomed the emphasis on deeper structural reforms featured in the IMF staff's fiscal scenarios as a helpful input to the domestic policy debate. But the task of developing support for such reforms remains a demanding one, and the authorities stressed the importance of proceeding with fiscal consolidation—both to balance the central government budget and to ensure policy credibility until such structural reforms are in place. Success in achieving structural reforms will depend in no small measure on the authorities' skill in conveying the message that these reforms will serve the goal of equity (including intergenerational equity), will continue to protect those most in need, and will foster social cohesion by reintegrating the unemployed. The question remains whether a critical mass of measures to improve labor market performance can be put into place while cyclical pressures are still well contained and the demographic window of opportunity is still ajar. ■

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Note: Finland's authorities, convinced that transparency would enhance the quality of domestic debate on policy issues, published the IMF mission's conclusions for the first time as well as the staff report and documents related to the IMF Executive Board discussion. These and related documents can be accessed via the IMF's external website (www.imf.org).