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The IMF and Nordic-Baltic Cooperation

This article gives a brief outline of the main activities of the International Monetary Fund, especially those which are in a high profile at the moment, and Nordic-Baltic cooperation within the Fund. In 2002-2003, Iceland chairs this cooperation.

Establishment and Role of the IMF

The International Monetary Fund has its roots in the United Nations conference held at Bretton Woods in New Hampshire, USA, in 1944.[2] At this conference, the foundations were laid for the establishment of three international institutions: the International Monetary Fund (IMF), World Bank (officially the International Bank for Reconstruction and Development (IBRD)) and the International Trade Organization (ITO). The ITO was never established, however its intended functions were partly taken on by the General Agreement on Tariffs and Trade (GATT) until the World Trade Organization (WTO) began operation in 1995. The Bretton Woods conference was attended by delegates from 45 countries who agreed to create a new framework for economic cooperation to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression earlier that century. The new framework was designed to promote international monetary cooperation, exchange stability and orderly exchange arrangements.[3]

Iceland was one of the 29 founding nations of the IMF. Its member states now number 184. IMF resources are mainly derived from the quota subscriptions that countries pay when joining the IMF. Quotas are intended to reflect broadly the members' relative size in the world economy and consequently the industrialised nations contribute the largest share. Originally, the IMF's role was to ensure stability in world trade by making resources available to members in order to correct maladjustments in their balance of payments when necessary. The Fund has performed this role by surveillance of the development of its members' economies. It has also provided members with credit facilities and technical assistance in order to strengthen their economies. The IMF has evolved in step with changes in the global economic environment and undertaken new tasks without neglecting its mission. In recent years a strong focus has been placed on ensuring financial stability and preventing financial crises. In cooperation with other international institutions, the IMF has also participated in the systematic reduction of debt among the poorest countries under the HIPC Initiative.

Organisation

The highest authority of the IMF is its Board of Governors which comprises one representative from each member country, usually the Minister of Finance or Governor of the Central Bank. The Board meets once a year as a rule. Reporting to the Board of Governors is the International Monetary and Financial Committee, previously the Interim Committee, which meets twice a year, in spring and autumn. The committee acts in an advisory capacity

1. The authors work in the International Department at the Central Bank of Iceland where they liaise with the IMF.
2. IMF website: http://www.imf.org.
3. From the IMF Articles of Agreement, which were incorporated into Icelandic law and printed in the *Government Gazette,* C, no. 18/1978, Central Bank of Iceland 1979.

towards the Board of Governors and provides guidance for the Executive Board's work.[4] Day-to-day management of the IMF is in the hands of the Executive Board, which convenes two or three times a week. Reports by IMF staff are put before meetings of the Executive Board. Among the issues that the Executive Board addresses are members' economic developments and positions, the state of the world economy, lending to individual members, measures to prevent financial crises, support for the poorest members and last but not least the Fund's strategy and its surveillance role.

Main Tasks

Among the main tasks the Fund has been engaged in recently are ways to prevent and solve financial crises. Others include the IMF's surveillance role, financial stability, debt relief for poor countries, the Fund's lending, and assistance to Turkey, Argentina and Brazil. Discussion of the importance of good governance and transparency has also featured high on the IMF's agenda. The following is a more detailed account of these projects.

1. Solutions to Debt Service Problems

Indebted countries, especially developing countries and transition economies, commonly encounter debt service problems. When foreign lending to sovereigns was mainly in the form of syndicated bank loans it was relatively easy to convene creditors and negotiate a debt restructuring. Now sovereigns have turned increasingly from bank loans to bond issues to raise capital making creditors a much larger and more dispersed group. Therefore, agreements on debt restructuring are more difficult to coordinate. A solution to this problem has therefore been considered necessary and a "twin-track" approach has been under consideration at the IMF. The first, aims at establishing a collective forum between creditors and debtors by incorporating comprehensive restructuring clauses, so-called Collective Action Clauses (CACs) in debt instruments. CACs, found in sovereign bond contracts, authorise bond holders to call a meeting at which a majority can agree on debt restructuring. The CACs only apply to a single bond issues and thus do not solve the problem of aggregating claims across instruments. The second, a statutory approach, would attend the problem of aggregation by creating a legal framework under the aegis of the IMF. This approach has been called the Sovereign Debt Restructuring Mechanism (SDRM) and would be established to create an orderly debt restructuring process allowing *inter alia* a qualified majority of a country's creditors to approve a restructuring agreement that would be binding to all. The idea is that sovereigns could activate the mechanism if their debt is considered to be unsustainable and the country is insolvent. This arrangement would follow similar rules to those applying to corporate bankruptcy in many countries, especially in the USA. The purpose is to expedite and ensure satisfactory resolution of sovereign debt service difficulties, thereby reducing disruptions to global credit markets and the persistent lack of confidence that can result from countries ceasing to service their debt. These proposals on the CACs and SDRM are being developed and a concrete proposal on debt service problems is yet to be decided upon in the Executive Board at the IMF.

2. The IMF's Surveillance Role

Surveillance of member countries' economies is one of the chief tasks of the IMF. There are two main types of surveillance. First, country surveillance which takes the form of regular comprehensive consultations by an IMF mission to member countries in order to study their economic position and outlook, and second, the compilation of a comprehensive study of the state and outlook for the world economy and the global financial system. The country consultations are referred to as "*Article IV consultations*" as they are mandated by Article IV of the IMF's charter. Surveillance of member countries involves an evaluation by the Fund of whether members' economic developments and policies are conducive to sustainable economic growth and stability. Discussions with members address matters such as exchange rates, fiscal and monetary issues, balance of payments and financial stability. At the end of its visit the mission issues a concluding statement and subsequently compiles a staff report. A large number of countries, including Iceland, now make these staff reports pub-

4. Ólafur Ísleifsson: Alþjóðagjaldeyrissjóðurinn , *Vísbending, December* 7, 2001, no. 48 vol. 19.

lic. It is left to the discretion of members whether to follow the Fund's economic advice. IMF surveillance has evolved considerably over the years. During its early days the Fund mainly monitored the fiscal and monetary position and balance of payments, but with deregulated capital movements surveillance has increasingly shifted to other areas, not least financial stability and ways to avoid financial crises.

3. Lending

The IMF offers credit facilities to members with balance of payments problems. These loans generally carry more favourable terms than those available in ordinary financial markets but are also conditional upon economic reforms being made in the borrowing country. Apart from providing conventional loans and emergency loans, the Fund has been working with heavily indebted developing countries with the aim of reducing their debt burden. Industrial nations have not needed financial assistance from the IMF for a long time now. Iceland last received a loan from the IMF in 1982 and the UK negotiated a loan from the Fund in the mid 1970s. At the moment 88 IMF member states have loan agreements with the Fund and its outstanding lending now amounts to 90 billion US dollars. The largest loan agreements made this year have been with Turkey and Brazil. Both these countries have experienced considerable difficulties but are systematically working in cooperation with the IMF on putting their economies back on course. Ways of assisting Argentina have also been sought recently. A state of economic emergency has prevailed there since the government ceased being able to meet its foreign debt service towards the end of last year and the exchange rate of the peso was unpegged from the US dollar.

4. Financial Stability

In the wake of the financial crisis which hit Asia in 1997, the IMF and the World Bank launched an action program to strengthen the financial infrastructure of member countries, in cooperation with their governments. This joint Financial Sector Assessment Program (FSAP) was introduced in 1999. The IMF was assigned the task of evaluating the financial systems of member countries, examining their structure, risk factors and legal framework. At the end of 2000 an IMF mission comprising experts in financial stability and payment systems visited Iceland. It studied the strengths and weaknesses of the financial system and how closely it adhered to international standards for financial markets. Iceland was one of the first IMF members to undergo a comprehensive financial stability assessment. The results were published on the websites of the Central Bank of Iceland and IMF. The goal is to complete studies of all 184 members by the end of 2005. This project is making good progress.

5. Debt Relief for Poor Countries

Many poor countries, especially in Africa, will not be capable of meeting their foreign debt service without outside help. The IMF and World Bank have jointly set up the Heavily Indebted Poor Countries (HIPC) Initiative to ease their debt burdens. The initiative is based on participation by the international community, in particular international financial institutions, and aims to put these countries' debt burdens onto a sustainable footing. The HIPC Initiative also particularly underlines the strengthening of social infrastructure in participating countries, especially health care and education, which are fundamental for ongoing social development and economic reforms. Two main conditions are set for assistance through the HIPC Initiative. One, that the national debt is unsustainable, and two, that these countries demonstrate willingness to cooperate and the capability to undertake economic reforms and development in cooperation with both the IMF and World Bank. The first step for the country is to put forward a Poverty Reduction Strategy Paper (PRSP). This is produced in collaboration between the national authorities, IMF and World Bank and in close cooperation with a broad-based domestic interest groups. Implementation is in local hands but the Fund and World Bank undertake surveillance and provide advice where possible. In general, it is assumed that the strategy is implemented for one year before a performance evaluation is made along with a decision on the next step, when new or ongoing goals are negotiated. Creditors are expected to be flexible and to assist with the HIPC Initiative. As before, the assumption is that a sensible economic policy is followed and efforts made to maintain economic stability, as well as working on systemic reforms. When the negotiated goals are achieved, debts will be written off or reduced to leave outstanding debt at a sustainable level, provided that no unforeseen external shocks occur.

6. Good Governance

The concept of governance *inter alia* includes fiscal and economic management as well as the legal framework for government measures. Good governance increases the probability that the economy will be efficient. More recently, attention has also focused on corporate governance, not least in major corporations. Corruption on the other hand is a narrower concept which involves the authorities' conceivable misuse of public funds or of their position. These two concepts are closely linked because an environment where governance is poor can breed all kinds of corruption. Many of the causes of corruption are economic in nature and may have damaging consequences for the entire economy. IMF emphasises good governance on the part of its members. One way the Fund has promoted good governance has been to provide technical assistance to member countries in order to help them to increase the transparency of government administration and hinder corruption. This issue is dealt with in the staff reports on the economies of member countries following regular visits by IMF missions. In cooperation with the World Bank, the IMF has also been working systematically on hindering money laundering and the financing of terrorist activities.

7. Transparency

In recent years, focus has been placed on increasing transparency among both governments and corporations. Good and easy access to information is critical for all policy making, and countries which have adopted transparent procedures appear to enjoy greater economic prosperity. The IMF has promoted the setting of rules on monetary and fiscal transparency[5] in member countries

The IMF has also made efforts to increase its own transparency. Ten years ago it published only a fraction of the documents that it produced. Now, however, the work of its staff is easily accessible on the IMF website.[6] Virtually all its policy work is published on the website and 60% of staff reports dealing with individual national economies are made public. All the industrialised countries publish their reports and so do most countries in Central America and Eastern Europe. On the other hand, only 20% of Middle East countries, 36% in Asia and 46% in Africa publish IMF reports on their economies. The Fund strongly urges member countries to make public the reports that it compiles. All internal audit of the IMF's activities is also made public.

The Nordic-Baltic Constituency

Iceland actively cooperates with the other Nordic and Baltic countries in the IMF. These countries constitute one of the Fund's 24 constituencies. Iceland chairs the constituency in 2002 and 2003. The Nordic countries have cooperated at the IMF for decades, while the Baltic countries joined the constituency in 1992 after being accepted as members of the Fund. Each constituency has one representative, usually a Minister of Finance or Central Bank Governor, in the IMF International Monetary and Financial Committee. Geir H. Haarde, Iceland's Minister of Finance, took a seat on the committee as the constituency's representative in the beginning of 2002. Furthermore, each constituency elects one representative to the Fund's Executive Committee and in the beginning of 2002 Ólafur Ísleifsson, Director of the International Department at the Central Bank of Iceland, took a seat there. The Nordic-Baltic Monetary and Financial Committee is responsible for cooperation between these countries in the IMF arena and shapes the constituency's policy. Two representatives from each country in the constituency are on this committee. Ingimundur Fridriksson, now one of the Governors of the Central Bank of Iceland, became chairman of the committee in the beginning of 2002. Iceland's other representative is Ólafur Davídsson, Secretary General at the Office of the Prime Minister. A committee of alternates works under this committee, comprising representatives of all eight Nordic and Baltic countries. Iceland's chairmanship in the constituency includes coordinating

5. See the article on transparency in *Monetary Bulletin* 2000/3.

6. http://www.imf.org.

the constituency's position regarding the main issues discussed by the Executive Committee at any time, a task which is handled by the Central Bank of Iceland. The constituency's views on major issues are coordinated before Executive Board meetings through the Nordic and Baltic countries' Central Banks and Ministries of Finance or Economic Affairs. In other respects the constituency's IMF office draws up its views towards individual issues on the basis of its acknowledged policy. Eight experts from the Nordic and Baltic countries are employed in Washington.