International Monetary and Financial Committee

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Statement by Mr. Per-Kristian Foss
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On behalf of Nordic and Baltic countries i.e. Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

Statement by Mr. Per-Kristian Foss, Minister of Finance, Norway, on behalf of the Nordic and Baltic countries i.e. Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden, to the IMFC Meeting in Washington D.C., April 16, 2005.

Main messages

- A strengthened operational strategy with due respect for the Fund's mandate and clear policy prioritization is essential in maintaining the Fund as a lean, effective and flexible institution. However, the strategic discussion has become narrower than originally hoped for.
- The Fund has a valuable role in assisting low-income countries (LICs) to achieve economic growth, maintain macroeconomic stability and preserve debt sustainability as key components in their poverty reduction efforts.
- Debt relief for the poorest indebted countries should continue to be based on the debt sustainability framework and a track record of reforms and sound policies, supported by strong conditionality. Concerns related to efficiency and fairness in relation to other low-income countries warrant serious consideration. Bilateral contributions must remain the principal source for financing the Fund's involvement in these countries.
- The most credible, reliable and durable approach to financing the funding gap for the Millennium Development Goals would be to make faster progress in increasing aid budgets and raising the ratio of Official Development Assistance (ODA) to Gross National Income (GNI) to 0.7 percent.
- The sustainability of the global recovery is dependent on ambitious fiscal consolidation in the US to make room for internal and external adjustment, further structural reforms in Europe and Japan to stimulate growth, and additional exchange rate flexibility coupled with financial market reform in Asia to promote more balanced economic development. As the recovery increasingly takes hold, the process of normalizing interest rates must continue to safeguard monetary and financial stability.
- A successful completion of the Doha Round is vital for advanced and developing countries alike. Concrete progress in the coming negotiations is the common responsibility of all countries.

The Fund's Medium-Term Strategy

We welcome the progress so far in consideration of the Fund's guiding principles, operational strategies and longer-term direction, although the approach has become narrower than originally hoped for. A strengthened operational strategy with due respect for the Fund's mandate and clear policy prioritization is essential in preserving the Fund as a lean, effective and flexible institution.

The guiding principle of supporting members in designing and implementing sound economic policies and strong institutions is deeply rooted in the Fund's traditional emphasis on macroeconomic stability, international trade, and well-functioning goods and factor markets.

A clear guiding principle and a coherent operational strategy can direct the Fund towards its longer-term goals. The following should be emphasized:

- The Fund's role and mandate are – if anything – reinforced by an increasingly globalized world economy. The focus should continue to be on surveillance, financial support to countries in distress and technical assistance. The Fund's engagement must always be anchored in its core mandate. Entrusting other institutions with non-core activities would allow the Fund to focus its comparative advantage on promoting macroeconomic and financial stability.
- The Fund should continue to improve the effectiveness of its surveillance. Enhanced transparency and access to economic and financial information are vital to global financial stability. Increasing interdependence and potential for spill-over effects will also require development of more effective regional surveillance tools.
- The Fund's financial support should be based on unambiguous rules founded on economic considerations and tailored to country-specific circumstances. Financial assistance should be more selective, supporting only robust and credible programs, and should always include a clear exit strategy. The lending instruments should be simple, transparent and have interest and repayment terms that safeguard the temporary use of Fund financing.
- The Fund's governance needs to be strengthened. Decision processes need to become more transparent with early involvement of the Executive Board, confirming its role as the central policy-making body.

Against this background, the Nordic-Baltic constituency believes the following issues deserve particular attention:

- A firmer focus on the role and modalities for bilateral surveillance, further concentrating on potentially vulnerable and/or systemically important countries, and greater selectivity regarding issues of macroeconomic relevance.
- A recognition that debt sustainability analysis is a central tool in crisis prevention and lies at the core of the Fund's responsibility, implying that such analysis should feature as an integral part of all country surveillance and program reports.
- A comprehensive review of the crisis resolution framework is overdue, including the role of private sector involvement, the lending into arrears policy and the rationale for a debt restructuring mechanism.
- A further clarification of Fund financial assistance to low-income countries, bearing in mind that close surveillance, clear signaling and effective capacity building are the primary tools, while concessional lending should be selective, limited and temporary.

The Fund's Role in Low-Income Countries (LICs)

The Fund has a valuable role in assisting LICs to achieve economic growth, maintain macroeconomic stability and preserve debt sustainability as key components in their poverty reduction efforts. By pursuing sound economic policies and establishing strong institutions, LICs will be better-placed to make efficient use of aid and debt relief. This would increase the willingness of donor countries to provide much-needed assistance, reinforcing the current focus on the Millennium Development Goals (MDG).

The Fund has an essential responsibility in safeguarding this virtuous circle by exercising selectivity in its surveillance, signaling and lending, emphasizing that recipient countries are required to display genuine political commitment to good governance and to have the necessary capacity to absorb significant increases in external assistance.

The Nordic-Baltic constituency fully endorses active participation of the Fund in the global efforts to reach the MDGs. Profound changes in policies – at all levels and among all partners – are needed. Increased trade, enhanced aid and well targeted debt relief are key elements. We welcome the review of the Fund's work on trade, and encourage further efforts in line with its conclusions.

The Nordic-Baltic constituency remains convinced that the most credible, reliable and durable approach to financing the funding gap for the MDGs would be to make faster progress in increasing aid budgets and raising the ratio of ODA to GNI to 0.7 percent. Many developed countries fall well short of their commitments as the average ODA for OECD DAC members in 2004 was 0.25 percent of GNI. Therefore, we urge donor countries to set clear objectives and deadlines for honoring the political commitment to reach the UN target for ODA set three decades ago and reaffirmed in the Monterrey Consensus.

Proposals for other sources of development financing have been put forward in recent years. Their economic justification, long-term impact and political viability can still be discussed, although proposals for certain limited pilot projects have gained momentum.

- The International Finance Facility (IFF) could be a relevant instrument for front-loading future aid flows for countries that are not meeting the UN target for ODA and that are able to make binding pledges of further increases in aid. Such an IFF must ensure additional funds, and result in a short-term increase followed by a steady and predictable flow of funds after 2015.
- Different proposals for global taxes have been put on the table. While technical issues may appear broadly resolvable for some tax instruments, we note that significant issues remain to be addressed, not least that they will require a high degree of international co-operation and political acceptability in complicated policy areas. Some may nevertheless deserve closer consideration if warranted also on their own merits, for example on environmental grounds.

The Nordic-Baltic constituency underscores that such proposals must be viewed as additional to agreed increases in ODA.

The Nordic-Baltic constituency calls for careful consideration of the recent proposals to reduce debt to international financial institutions (IFI) by up to as much as 100 per cent. Where it would be the most efficient means of assistance, we see merit in directing debt relief towards the poorest debt-ridden countries based on the debt sustainability framework and a track record of reforms and sound policies, supported by strong conditionality. Debt relief should not, however, be allowed to compromise the IFI's capacity to lend to other low-income countries that are dependent on concessional borrowing for their economic development. Moreover, debt cancellation is not necessarily the most effective and equitable way of supporting the efforts to achieve the MDGs. The proposal could undermine poor countries ability to borrow and their willingness to honor their obligations in the future. It also risks benefiting countries with a history of excessive spending, reducing the incentives to maintain sound public finances.

We remain skeptical of the use of the Fund's gold for debt relief. Gold reserves are an important part of the Fund's financial solidity, and provide security for financial contributions that are necessary for the Fund's lending to LICs. We endorse bilateral funding as the main source for involvement by the Fund. Thus, we continue to support a self-sustained Poverty Reduction and Growth Facility (PRGF), supplemented by additional bilateral loans if needed. We welcome the decision to subsidize emergency assistance for natural disasters for PRGF-eligible members. Members in the constituency have provided substantial financial contributions to this effect, and urge other countries to contribute as well.

The Nordic-Baltic constituency strongly supports the work on improving the nationally owned Poverty Reduction Strategy (PRS) and the Fund's continued efforts to streamline and sharpen the PRGF. We endorse an advisory role for the Fund in helping countries to deal with aid flows, focusing on the macroeconomic aspects of potential capacity constraints. We look forward to further explorations of the factors behind the lack of growth in many LICs, including an examination of the balance between external adjustment and financing in Fund-supported programs that has turned out to be insufficient to stabilize debt ratios even after HIPC debt relief.

The Nordic-Baltic constituency joins the call, conveyed in the recent Independent Evaluation Office (IEO) report, for increased effectiveness in the Fund's Technical Assistance (TA), agreeing with the assessment that TA should remain focused on LICs and countries that have to make substantial adjustments. Key priorities should be to strengthen country authorities' ownership and commitment, facilitating an effective priority-setting process. PRSs and needs that emanate from country-centered policy frameworks are essential for prioritization of demand.

The Nordic-Baltic constituency continues to strongly support efforts to enhance the voice and participation of developing countries in the decision-making of the Bretton Woods Institutions. Important progress has been made in some areas, which include strengthening the capacity of the offices for developing country constituencies at the Fund and the World Bank and capacity-building initiatives in developing countries. As an additional measure, we support augmenting the voting power of developing countries through an increase in basic votes. We are open for consideration of further steps.

Challenges ahead for the World Economy

The global expansion continues at a good pace, although some of the larger economies returned to sub-par growth towards the end of last year. Conditions in international financial markets are currently broadly favorable. The outlook for inflation remains relatively benign, although price pressures will eventually arise as the global recovery progresses, exacerbated by the spike in oil prices.

The main global risks are:

- A destabilizing development in exchange rates, if global imbalances are not addressed more comprehensively.
- A sharp rise in interest rates, if the presently optimistic expectations of a successful convergence are not met or if unpleasant surprises to the inflation outlook should materialize.
- A further spike in oil prices, if capacity expansions in the oil market remain insufficient in the face of lasting strong demand, or if geopolitical uncertainties intensify.

Also other risks call for close monitoring: a possible hard landing in China; falling house prices, which might dampen consumer demand in several countries; and continued weak domestic demand in the euro area and Japan.

The euro area is currently performing below its full potential, highlighting the fragility and unevenness of continental Europe's economic recovery. Monetary policy will need to stay accommodative and cautiously adapt to changes in the inflation outlook. As domestic demand is weak, comprehensive efforts are needed to boost confidence and growth in Europe. Structural reforms and further market integration, such as emphasized in the Lisbon Agenda, need to be revitalized to spur efficiency, flexibility, innovation and productivity. In addition, common, credible and rapid implementation of fiscal restraint is vital for strengthening momentum towards sound and sustainable fiscal positions.

The new EU member states should continue to build on the successes that facilitated their EU membership. Implementation of structural reforms and consistent macroeconomic policies have been essential ingredients in ensuring a fast convergence process in these countries, especially in the Baltic States. At the same time, some imbalances remain. Therefore, maintaining prudent policies, in particular determined and persistent fiscal consolidation, are essential for further progress in convergence and are a precondition for eventual EMU participation.

Growth in many of the transition economies has been robust and the structural reforms of recent years are paying off. We encourage the continuation of these reform efforts, which increase the resilience of the economies and lay the foundation for sustainable growth.

In the United States the recovery has maintained momentum. However, a worrying widening of the external deficit raises serious questions regarding sustainability. The stimulus from fiscal policy must be gradually withdrawn. Given the magnitude of the deficit, a credible and concise plan for fiscal consolidation – starting now – is urgently needed. More progress on the fiscal front would reduce the potential for an abrupt and disorderly fall in the dollar, with its likely associated sharp increase in interest rates.

In Japan, recent weak developments strongly suggest that a continuation of the highly accommodative monetary policy stance is justified. There is, however, a pressing need to address the medium-term problems of fiscal deficit and public debt, while recognizing the necessity of striking a balance between addressing these problems and the short-term risk of derailing the fragile recovery. With supportive macroeconomic policies, further progress in structural reforms – particularly in the banking and corporate sectors as well as the labor market – should rekindle the positive sentiment that marked the earlier phase of the current recovery.

Continued strong growth in China will likely necessitate further market oriented policy measures to engineer a soft landing. A key step would be to introduce additional flexibility in the exchange rate, facilitating a desirable tightening of monetary conditions through a gradual lifting of interest rates. Strengthening the banking sector's ability to assess risks and allocate capital effectively would be critically important. In addition, a more balanced pattern of growth would promote the development of the non-tradable sector, making the economy more robust in the face of external shocks and less reliant on extremely high rates of investment.

Emerging Asia is also performing strongly. With rapid growth the possible build up of domestic and external imbalances must be followed closely. Allowing the real exchange rate to reflect the region's economic strength would contribute to mitigate such problems. Further deepening of the domestic financial markets is vital for enhancing financial stability. We encourage countries in the region that have not participated in the Financial Sector Assessment Program (FSAP) to consider doing so.

Strong growth in Latin America has continued, but further consolidation of public finances is essential to reach more sustainable debt levels. This should also imply a reduction in the region's reliance on Fund credit. In this context we welcome the Brazilian decision not to request a successor program, following impressive performance in recent years. Enhancing the institutional autonomy of central banks should be an important priority to extend the remarkable progress in disinflation. Strengthening financial systems, broadening and deepening involvement in the global economy and reforming product and labor markets would further reduce vulnerabilities and create conditions conducive to sustainable growth.

After completing the debt-restructuring in Argentina we call on the authorities to reestablish a sincere dialogue with the IMF and continue to work towards implementing necessary structural reforms that will support normalizing their relationship with international capital markets. Any new program must be based on an IMF assessment that the treatment of the hold-out creditors is consistent with the Fund's lending into arrears policy.

Many African countries have benefited from the strong growth in global trade and the substantial rise in commodity prices. We are especially pleased by the current growth in the Sub-Saharan countries and hope this will be a cornerstone in achieving the permanent high growth rates needed for further progress towards the Millennium Development Goals. Continued efforts to build effective government is key to lasting progress. Further strengthening the momentum initiated by NEPAD, supporting the ambitions of the reformed African Union and taking up the global initiatives launched this year for helping Africa, are offering real hope if implemented in an environment of renewed commitment to sound economic policies and good governance.

A successful completion of the Doha Round should remain a top priority as international trade is vital for economic prosperity in developed and developing countries alike. Particular emphasis must be placed on improving developing countries' market access. Concrete progress in the coming negotiations is the common responsibility of all countries, so as to pave the way for decisive and lasting breakthroughs at the Ministerial Conference in Hong Kong in December 2005.