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., September 24, 2005.

Main messages

- *The global expansion appears reasonably firm, but medium-term vulnerabilities remain and short-term risks seem increasingly tilted to the downside. Therefore, the key priorities should still be continued fiscal consolidation in the US, further structural reforms in Europe and Japan, and additional exchange rate flexibility coupled with financial market reforms in Asia.*
- *With recent threats of protectionism and the risk of a crumbling multilateralism, a successful completion of the Doha Round must stay on top of the political agenda so as to safeguard the extensive benefits of global integration and the value of a strengthened, more predictable and fairer international trading framework.*
- *The heightened probability of a more persistent shift in oil prices – and attendant volatility – is rightly accorded a central place in the policy debate. More investment in the entire energy complex is needed in the years to come to meet the prospective increase in demand. Even more important, greater attention to fiscal and regulatory measures is called for to encourage energy efficiency and incentives for promoting energy saving technologies and alternative sources of energy.*
- *Continued real and financial globalization put a premium on high-quality and well-focused multilateral and bilateral surveillance by the Fund. The scope of Fund surveillance on capital account issues, including the benefits and inherent risks of liberalization, should be clarified. We therefore welcome the proposals put forward in the Managing Director's report on the Medium-Term Strategy and believe that they form a valuable starting point for further discussions.*
- *The Fund has a vital part to play in the global efforts to reach the Millennium Developments Goals (MDG). Recent moves to enhance assistance to countries facing balance of payments problems arising from exogenous shocks, to strengthen surveillance and signaling and to improve the design of Fund supported programs will increasingly tailor Fund assistance to the needs and preconditions of low-income countries.*
- *We welcome the political commitment to make further progress towards the MDGs and we are pleased that the global fight against poverty is on top of the international political agenda. We stress that debt relief must be additional contributions where further efforts are necessary to deliver the firmly committed increases in official development assistance towards the UN target of 0.7 percent of gross national income. The clear commitment by the G8 to provide additional resources, on a fair burden sharing basis, is crucial so that the Fund's lending capacity to PRGF-eligible countries in the future is assured*.

Challenges ahead for the World Economy

1. The global expansion still appears reasonably firm, but key vulnerabilities remain and risks seem increasingly tilted to the downside. Oil and other energy prices have picked up further, regional external imbalances and growth divergences persist, and the global housing market is stretched. Thus, the medium-term challenges related to sustainability have – if anything – been accentuated.

Therefore, the key priorities are still continued fiscal consolidation in the US to engineer a needed 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.

2. A successful completion of the Doha Round must stay on top of the political agenda. We urge all involved parties to engage constructively and show a readiness to reach necessary and viable compromises in the coming critical months. Surely, few question the extensive benefits of global integration and the value of a strengthened, more predictable and fairer international trading framework, but recently threats of rising protectionism and the risk of a crumbling multilateralism have forcefully reminded us about the worrisome low momentum in the ongoing WTO negotiations.

3. A notable feature at this stage in the current global business cycle is the historically low long-term interest rates, which continue to be underpinned by benign inflation expectations. However, to a great extent, the present low bond yields also reflect very low long-term real interest rates. The contrast between expectations of healthy global output growth and the low level of investment and real interest rates is stark.

4. The heightened probability of a more persistent shift in the oil price - and attendant volatility - should also feed into the policy debate. While price increases for other fossil fuels have been less prominent, a wider trend towards higher prices could well be in the offing, reflecting the increased influence of countries with high or growing demand for energy. The tight situation in oil and natural gas markets – and the vulnerability to further potential shocks – was highlighted by the impact of hurricane Katrina. The ongoing efforts to improve transparency in energy markets – including timely and accurate data on demand, supply, stocks, reserves and trade – are essential to form reliable price expectations and assess necessary policy responses. Also, changes in prices must be effectively transmitted to consumers and producers in order to limit imbalances with respect to supply and demand. We generally acknowledge the need to encourage investment in the entire energy complex in the years to come to meet the prospective increase in demand. Still, even more important, we must – within the broader objective of promoting sustainable development – more forcefully focus on fiscal and regulatory measures to encourage energy efficiency through appropriate pricing and incentives for promoting energy saving technologies and alternative sources of energy.

5. In the US, the recent devastating hurricane Katrina will – at least temporarily – impact negatively on the strength of the expansion. Unless the repercussions turn out more widespread and long-lasting than currently envisaged, a continued gradual withdrawal of monetary stimulus remains appropriate. Although the fiscal deficit has declined, an ambitious consolidation plan is important in order to increase national savings and thus guard against a potentially disruptive decline in the US dollar and a heavier burden on interest rates. Exploring ways to enhance government revenues could be part of the consolidation efforts. Given the need to conserve energy and the huge current account deficit in the US, aggravated by high petroleum imports, an energy tax should be given special consideration.

6. In the euro area, where the cyclical upturn so far has been weak and uneven, priority should be given to further decisive, consistent and forward-looking fiscal and structural policies that will help revive confidence, support domestic demand, increase growth potential and underpin an expected pick-up in activity. Better functioning labor and product markets are needed to reduce the high structural unemployment and unleash entrepreneurial dynamism. Over the medium term, an improvement in public finances should gain increasing priority so as to prepare for the fiscal burden of demographic changes. A wait-and-see attitude in monetary policy is currently appropriate with uncertain and mixed signals on potential price pressures.

7. Economic growth in the new EU member states and accession countries remains strong largely because of the ongoing stimulus from the deepening of the EU integration. Although still quite high, mostly investment related current account deficits are gradually decreasing and are largely financed by foreign direct investment and EU transfers. Prudent fiscal and monetary policies remain essential in addressing potential vulnerabilities, and financial sector development has to continue to be monitored closely in the context of large foreign exchange debt financing of domestic demand.

8. In Japan, the conditions for a more positive development are increasingly put in place after years of efforts to resolve the structural after-effects of the "bubble years". Welcome improvements in the financial system, corporate sector and labor market could signal a more permanent shift to the better. A cautious approach to consolidating macroeconomic policies must be maintained so as to nurture the incipient recovery – monetary policy should remain accommodative until deflation risks are eliminated and premature fiscal restraint must be avoided. At the same time, steadfast fiscal and financial sector reforms are still necessary to create the conditions for lasting improvements. A medium-term framework for fiscal consolidation should be put in place to arrest the worrying rise in government debt.

9. In China, the introduction of increased exchange rate flexibility – although insufficient if not followed up with further adjustments – is an indication of a policy change commensurate with the country's own needs and its role in the global economy. As in the rest of emerging Asia, more exchange rate flexibility will - in combination with a more independent monetary policy and further financial reforms - facilitate a more balanced economic development and support domestic demand, which is still rather weak.

The International Monetary Fund and Policy Matters

10. We welcome the Managing Director's recent report on the Fund's Medium-Term Strategy. Its focus on overarching principles and proposed actions provides a valuable starting point and we look forward to further work on elaboration on the next steps before the IMFC Spring 2006 meeting.

11. We very much welcome the emphasis on the need of the Fund to be more at the

centre of the multilateral dialogue on issues related to its core mandate. Viewing the Fund's future work in light of the opportunities and challenges raised by globalization is meritorious and would help identifying the most likely impediments to macroeconomic and financial stability across the membership in the years ahead. Moreover, it serves as a guideline for the Fund in order to move closer to its original mission, and should support the delineation of an efficient division of labor and cooperation with other institutions such as the World Bank and the WTO.

12. We fully share the view that surveillance should continue to be at the core of the Fund's activities, and should focus on macroeconomic issues germane to global monetary and financial stability. Exchange rate issues should remain central to the Fund's role. Article IV consultations and FSAP activities can be made more focused.

13. We firmly believe that international capital flows and global financial stability are among the most prominent features that have affected the Fund in the last decade. The recent report by the Independent Evaluation Office on the IMF's Approach to Capital Account Liberalization provided a balanced account of the Fund's involvement, and offered timely and constructive recommendations for the Fund going forward. These recommendations should be followed up by further work on issues related to capital account liberalization, including analysis into the causes and potential policy implications for the procyclicality of international capital flows. Based on this, the Fund could take on a more active role in giving advice in these matters as part of its surveillance. Such a role does not call for an amendment of the Articles of Agreement.

14. We think that the scale and scope of future Fund lending could have deserved a more prominent role in the strategy discussion. The Fund is continuously called on to establish policies and facilities to meet the demand for financing to member countries. At the same time, various aspects of the Fund's finances have been reviewed in recent years. While it is understandable to address these issues gradually and separately, the piecemeal approach has resulted in a complex overall financing and lending structure. We believe the time has come to make a serious effort to examine the potential for simplification.

15. We look forward to the continuation of the debate on crisis management. While the market-based approach to crisis resolution framework has witnessed important progress in recent years, the Fund continues to have an essential role, particularly through the exceptional access framework and lending into arrears policy. We strongly support the intention to launch a review of the Fund's policy instruments in this context, including a discussion on exit strategies, so as to better shape market participants' expectations of official involvement in crisis resolution.

16. 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 includes strengthening the capacity of the offices for developing country constituencies at the Fund and the World Bank and capacity-building initiatives in developing countries, but more has to be done. 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, including an ad hoc increase in quotas to correct the present substantial misalignments that exist for some countries.

17. We note the progress made in aligning the Fund's budgeting and management systems with best international practices. A closer and clearer relationship between the IMFC communiqué, the MD's biannual statements on the work program and the medium-term budget framework would enhance predictability and sharpen planning and prioritization. This would help us to guide - and the Executive Board to govern - the institution in a transparent, credible and accountable way. This is all vital in preserving the Fund as a lean, effective and flexible institution.

The Millennium Development Goals (MDGs) and the Fund's Role in Low-Income Countries (LICs)

18. The Nordic-Baltic constituency shares the widely held view that the Fund's role in LICs should be based on a two-pillar approach: (i) LICs have the primary responsibility to put in place sound policies and strong institutions needed for their own social and economic development, while (ii) the Fund should – through policy advice, technical assistance, including capacity building, and financial support – help them in establishing and maintaining macroeconomic and financial stability so as to foster durable growth and poverty reduction. In addition, we fully endorse active participation of the Fund in the global efforts to reach the MDGs.

19. The Nordic-Baltic constituency is very pleased that the global fight against poverty is on top of the international policy agenda. Key elements are increased trade, coupled with support to strengthen developing countries' capacity to trade and cope with adjustment, enhanced aid and well targeted debt relief buttressed by sound economic policies in the recipient countries.

20. 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 official development assistance (ODA) towards the UN target of 0.7 percent of gross national income (GNI). Therefore, we welcome the renewed firm and time-bound commitment by many developed countries to reach this target. We urge those donors that have not yet done so to make concrete pledges towards this target. Moreover, the International Finance Facility could be a relevant instrument for front-loading future aid flows for countries that do not meet the UN target for ODA and that are able to make politically and legally binding pledges of further increases in aid also beyond 2015. 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.

21. We welcome the G8 debt cancellation proposal. We stress that debt relief must be additional contributions where further efforts are necessary to deliver the firmly committed increases in official development assistance.

22. We put strong emphasis on good governance, accountability and transparency as crucial components to releasing the benefits of debt cancellation. Clearly, countries receiving debt relief must be current on their repayment obligations, should be on track in their program relationship with the Fund, and must not have experienced serious lapses, including in governance. We emphasize that debt cancellation must be complemented by a close and consistent implementation of the strengthened debt sustainability framework, so as to ensure countries do not return to unsustainable debt positions. An active Fund involvement, also in HIPC post-completion point countries, could help ensure that debt cancellation will achieve its fullest potential.

23. The Fund is called on to cover part of the costs of debt cancellation through its own resources. The Fund's lending capacity must continue to be sufficient to assist its low-income members as appropriate, and a discussion on the design of financial involvement in these countries would need to be part of the deliberation on the Fund's future mandate and long-term strategy.

24. We accord great importance to the clear commitment by the G8 to provide additional resources, on a fair burden sharing basis, so that the Fund's lending capacity to PRGF-eligible countries in the future is assured. We firmly believe that fair burden sharing now must reflect quota shares and that a transparent follow-up mechanism on contributions is warranted to achieve this.

25. We consider the Policy Support Instrument (PSI) as a potentially valuable means to strengthen surveillance and signaling in low-income countries. By formalizing and codifying a judicious combination of existing surveillance and lending facilities, including high standards of conditionality and review so as to preserve the credibility of the Fund's "seal of approval", PSI could support countries in safeguarding sound policies and in ensuring debt sustainability when a formal financial arrangement is not called for. PSI could be particularly useful for countries benefiting from debt cancellation. Strict implementation of the new instrument and close cooperation with the World Bank will be needed to ensure credible signals.

26. We believe that the recent review of the PRGF program design highlighted crucial challenges for low-income countries in the years ahead. Assisting these countries in facing the policy trilemma - balancing higher public investment, promoting private sector development and maintaining debt sustainability - lies at the core of the Fund's mandate. Moreover, the relationship between spending and absorbing potentially large incremental aid flows points towards an important role for the Fund. Related to this is the Fund's role in institution building within areas that reinforce macroeconomic stabilization through coherent policies, fiscal transparency and governance, structural reforms in selected areas, and facilitating trade. Improved transparency, budgetary control and anti-corruption efforts could potentially reduce the volatility of aid flows as donors' confidence increases. It is crucial that the lessons from this review are reflected in future PRGF-programs.