



International Monetary and Financial Committee

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**Statement by Per-Kristian Foss
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On behalf of the Nordic and Baltic countries:
Denmark, Finland, Estonia, 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, Finland, Estonia, Iceland, Latvia, Lithuania, Norway, and Sweden, to the IMFC Meeting in Washington D.C., April 24, 2004.

Main messages

- To sustain the global recovery beyond the short run it is urgent to address structural impediments in labor, product and financial markets and to reduce regional financial imbalances, including by ensuring sustainability of fiscal policies and exercising due restraint in accumulating foreign reserves.
- Improved surveillance is vital to reduce countries' vulnerability to crises. Enhanced transparency will continue to increase the impact of the Fund's policy advice.
- Strict implementation of the framework for exceptional lending is needed to foster appropriate market discipline and safeguard the Fund's resources. We call for further progress in developing effective instruments for debt restructuring.
- Sustainable development in low-income countries depends importantly on building sound institutions and promoting good governance. Achieving the Millennium Development Goals would also rest on further trade liberalization and increased development assistance. Some refinements in the Fund's lending instruments are needed to enhance its important, if limited, financing role in low-income countries. The monetary character of the Fund's general resources must, however, be preserved.

Challenges ahead in the World Economy

Global economic prospects have improved since our last meeting. The recovery is broadening and deepening, and the risks are now more balanced. Inflation pressures are still subdued due to widespread spare capacity, strong productivity growth and intensified competition worldwide, while a firm pick up in commodity prices signals that deflation risks have diminished. Capital flows to emerging markets have begun to revive and borrowing costs have dropped substantially.

The strength of the upswing is, however, uneven. Exchange rates – especially the euro-dollar rate – have been volatile, reflecting structural imbalances in the leading industrial countries. Moreover, remaining fragilities and maladjustments could undermine the durability of the cyclical upturn if not addressed with the necessary determination. The key challenges are the persistent regional imbalances, the growing concerns over public finances and the unfinished agenda for structural reforms. A note of caution is also warranted as regards the strong and broad-based compression of interest rates and interest premiums on emerging market debt, which partly reflect easy monetary conditions globally and possibly insufficient differentiation of risk among borrowing countries by creditors. Market participants, lenders and borrowers alike, should increasingly prepare for a normalization of international interest rates, and take appropriate measures to prepare for future challenges.

Moreover, policy makers should vigorously pursue increased trade liberalization in order to promote the growth inducing effects of freer trade. The strong growth in

emerging markets not only enhances living standards for citizens and consumers in their domestic markets, but also increases export market opportunities and the purchasing power of consumers in North America, Europe and Japan. The interchange with emerging markets in terms of foreign direct investment is mutually advantageous for them as well as the rest of the world. A successful conclusion of the Doha round would substantially benefit the global economy.

In **Europe**, a recovery is taking hold as the international expansion strengthens. The export sector should continue to support the upswing in activity, but a further appreciation of the euro would have a dampening impact. While domestic demand has lagged behind, private consumption is likely to gather momentum with real income gains due to low inflation and interest rates. However, the relatively weak employment outlook is still a moderating factor. Strengthening business confidence and improving financial conditions are encouraging investment. To underpin confidence and foster growth in the medium term, a reinforced commitment to the agreed fiscal framework is essential. To sustain economic growth and employment at a higher level, beyond the removal of cyclical slack, steadfast and forceful implementation of structural reforms – including progressing further on the internal market – should be undertaken.

In the **EU-acceding countries** the overall outlook for growth is brightening further, extending a decade of impressive economic adjustment and reform in the run-up to the historical enlargement of the European Union by ten new members. EU membership will provide a substantial boost to economic development. Going forward, fiscal consolidation and structural reforms remain important challenges, particularly in view of euro entry preparations.

The **US** recovery seems to have strengthened. Expansionary monetary and fiscal policies have provided substantial stimuli. As business investment increasingly contributes to private domestic demand and the depreciation of the dollar supports net exports, growth should continue at a brisk pace even if private consumption growth should decelerate. With a benign inflation outlook, low short-term interest rates could continue for some time, although the pressures on asset prices need to be closely monitored. As public debt continues to rise, a prudent plan for fiscal consolidation should be resolutely implemented in order to reduce the structural fiscal deficit – a decisive factor in reducing the current account deficit and securing stable international currency relations.

The cyclical situation in **Japan** is improving. Export growth has been the main driving force, while support from domestic demand remains modest. In order to nurture confidence in the household and business sectors, continuation of an accommodative monetary policy stance is warranted. A credible strategy to consolidate public finances over the medium term is called for as soon as the recovery is firmly established. Further progress in resolving the problems in the banking and corporate sectors will also help to maintain confidence in the durability of the upswing.

Other Asian countries are enjoying impressive growth, primarily based on rapid technological catch-up and market-oriented reforms. Domestic demand is the main component of growth, but also export growth is strong. Nevertheless, economic policymakers in some countries face important challenges, inter alia in addressing the need to restructure the banking and corporate sectors. Consolidation of public finances is a precondition for successful use of countercyclical fiscal policies when needed.

Continued massive build up of foreign reserves in some countries may pose growing problems, with monetary consequences that could seriously put at risk global economic and financial stability. Furthermore, a move towards more flexible foreign exchange regimes in these countries could help to correct regional imbalances and should be carefully assessed.

In **Latin America**, **Argentina** has experienced a strong rebound in economic activity, but a forceful implementation of structural reforms hand in hand with improved governance is necessary to ensure its sustainability. Constructive debt negotiations are a precondition for normalizing the relation with international capital markets and we urge the authorities to accelerate this process. **Brazil** is in a good position to benefit from its strong policy performance, at the same time as steadfast progress in structural reforms should strengthen the growth potential of the economy, prompting a further improvement in the investment climate.

Challenges for achieving increased economic growth across **Africa** remain, despite some progress in strengthening the macroeconomic policy framework. The recent increase in commodity prices should also have a positive effect, providing a boost to export growth. Further strong efforts from the countries themselves are needed to foster sustainable development, not least in securing good governance, avoiding military unrest and implementing a strategy for mitigating the effects of HIV/AIDS. The international community also has an important role to play in assisting the countries to achieve the Millennium Development Goal of halving extreme poverty in Sub-Saharan Africa. A resumption and successful completion of the Doha Round would be crucially important to further integrate African countries in the global economy.

The international community has an important role in rebuilding **Iraq**. IMF is providing help through its economic policy advice, debt sustainability analysis and technical assistance. The Fund's involvement should remain firmly anchored within its mandate.

The International Monetary Fund and Policy Matters

Crisis Prevention and Resolution

Crisis prevention and resolution continue to be the main challenges for the IMF and its members. Sustained and determined efforts are rightly placed on crisis prevention. For crisis resolution a stronger and clearer framework than is currently available would lessen the number and severity of crises.

Crisis Prevention

The Nordic-Baltic Constituency welcomes the significant progress that has been made in recent years in improving the Fund's surveillance and look forward to the 2004 biennial review. Candid assessments and close follow-ups on advice are crucial to secure an increased impact of surveillance. Moreover, the role of transparency is paramount, as it fosters accountability among policy makers and allows sound economic policies to reduce risk premiums in financial markets. In addition, sharper focus on debt sustainability analysis and vulnerability assessments will assist countries in their efforts to generate resilience to economic shocks and to give early warning about potential

problems.

The greater weight attached to governance issues in recent years is highly welcome, as it accentuates the importance of strong institutions in supporting and sustaining sound policies. The Nordic-Baltic Constituency fully supports the comprehensive assessment of policy frameworks and institutions in the context of internationally recognized standards and codes as vital in safeguarding economic and financial stability in member countries.

The Fund's surveillance should be more focused on potentially vulnerable countries and on multilateral issues. Staff resources should be allocated accordingly. Comprehensive and critical economic assessments of industrial countries and countries of systemic importance should, nevertheless, remain a priority due to their significance to the world economy. In view of this, excessive volatility in exchange rates, which could present a risk to global financial stability, would call for enhanced attention.

Some of the countries in the Nordic-Baltic Constituency have had very positive experience with the use of precautionary arrangements as a tool for strengthened surveillance. We encourage the use of such arrangements within normal access limits also when used as an exit strategy from the use of Fund resources.

Crisis Resolution

The international community should continue the work to better involve the private sector in the handling of financial crises, based on the framework agreed in Prague in 2000. This is vital for several reasons. First, a forceful and well-founded framework would provide strong incentives for investors and debtor countries to behave prudently and thus reinforce the efforts in crisis prevention. Second, the Fund's resources are insufficient to meet the financing needs of all countries in crises, and even if possible, excessive Fund financing would be more harmful than helpful through the increased moral hazard problems that would arise. Finally, a fair and equitable involvement of the private sector is crucial to promote the necessary support for the role of the Fund in safeguarding global financial stability.

In our view, however, the agreed framework has not been consistently adhered to in recent years. The amount of Fund financing has been larger than anticipated and the involvement of the private sector has been disappointing. The concept of catalytic financing has been questioned. Moreover, it is unfortunate that an extended duration of the Fund's exposure to some countries, even though capital market access appears to have been normalized, has cast doubt on the temporary character of Fund financing.

A firm commitment to a clear and predictable role of the Fund in crisis resolution is a crucial component of the overall crisis framework, and its consistent observance is necessary to maintain the credibility of the Fund and assure good governance within the Fund. In exceptional cases, financing above normal limits could be warranted. A heightened awareness is called for, however, to protect the financial integrity of the Fund and to preserve the preferred creditor status. It is paramount that exceptional financing is granted only if the criteria in the exceptional access framework are met, in order to secure private sector involvement, limit the Fund's exposure, and promote equal treatment of Fund members. When exceptional access is granted, incentives for

early repayment should be reinforced in order to safeguard Fund resources and secure their revolving character. Therefore, exceptional access should only be granted on Supplemental Reserve Facility terms.

To facilitate more orderly resolution of unsustainable debt situations, an effective restructuring process is needed, as demonstrated by the situation in Argentina. The increased use of Collective Action Clauses in international bond issuances is a welcome sign that creditors and debtors recognize the need for more predictability. The development of a Code of Conduct for debt negotiations is also welcome and we look forward to its finalization. These measures are, however, not sufficient to secure an orderly, predictable and effective debt restructuring. Work on establishing a Sovereign Debt Restructuring Mechanism should be continued. We believe that such a mechanism could make the debt restructuring process more predictable, speedier and reduce social and economic costs in a default situation. It could also strengthen the adherence to the IMF's access policy. The Nordic-Baltic Constituency therefore strongly believes that further efforts are required to maintain momentum in this important area.

The Nordic-Baltic Constituency also believes that a review of the good faith criteria in the Fund's lending into arrears policy is called for. Enhanced clarity would help to guide the expectations of investors and debtor countries about the conditions of the Fund program in their debt negotiations.

Combating money laundering and the financing of terrorism

We attach great importance to the Fund's role in ensuring global financial stability and the integrity of financial markets. Fostering compliance with international standards and codes is an essential part of this effort. We support that the Fund and the World Bank adopt a comprehensive and integrated approach for conducting Anti Money Laundering/Combat of Financing Terrorist Assessments, as this is simpler, more effective and produce reports that are integrated and consistent. While such an approach would imply a broadening of the assessments conducted by the Fund and the Bank, we stress the critical importance of sustained efforts by the international community in this vital work, where shared responsibilities and strong determination are crucially needed.

The Fund's role in low-income countries

The Monterrey consensus establishes a partnership between developed and less developed countries and defines a set of targets and responsibilities for member countries. We call on those developed countries whose official development assistance falls short of the Monterrey targets to increase their aid. We stress the importance of developed countries showing a particular responsibility in further trade liberalization and the resumption of the Doha round. Nevertheless, lasting improvements are dependent on developing countries implementing sound economic policies and good governance.

We fully support the ongoing work to define more clearly IMF's role in low-income countries. Within the Fund's core competence, the institution has an important role to play in helping to achieve the Millennium Development Goals. An essential component

is close cooperation with the World Bank, where a further development of the “lead agency” concept is necessary. We welcome the debt sustainability analysis as a valuable preventive measure, and strongly encourage its inclusion in Article IV consultations. Comprehensive debt assessments will help clarify countries’ prospective capacity to service debt, and consequently provide influential guidance for prudent borrowing decisions. Assistance from the international community should be more closely linked to demonstrated and sustained efforts by low-income countries to adequately address the domestic impediments to viable economic development. The Fund should continue its essential role in helping low-income countries improving the design of their reform programs and enhancing their ownership based on the countries’ PRSP (Poverty Reduction Strategy Papers). The Fund’s Technical Assistance provides helpful support in building sound institutions and promoting good governance - necessary underpinnings for sustainable development. We call on the Fund to give these issues a prominent place in the upcoming review on program design this summer.

The Fund has an important role to play in low-income countries through its concessional lending. The Fund should, however, be more selective in its lending policies. Caution is called for when there is doubt about the willingness to undertake necessary adjustment and when considerable capacity constraints prevail. It is essential that the Poverty Reduction and Growth Facility (PRGF) prepares for a gradual transition from prolonged use of resources to a surveillance relationship. We welcome the additional albeit limited use of Fund resources to support post conflict countries in strengthening their policy design and implementation capacity, including initiating institution building at an early stage. The adverse impact from exogenous shocks should be handled through the PRGF, with a reasonable combination of conditional adjustment and concessional lending.

As to the financing of the Fund’s activities in low-income countries, the Nordic-Baltic Constituency supports a self-sustained PRGF facility combined with additional bilateral loans. It is important early on to discuss and reach an agreement on a burden sharing arrangement among donors. The monetary character of the Fund’s general resources must be preserved, and we are therefore opposed to let them be used for financing concessional lending.