DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)

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FIGHTING POVERTY AND STRENGTHENING GROWTH IN LOW-INCOME COUNTRIES

Joint Memorandum from the President of the World Bank
and the
Managing Director of the International Monetary Fund

The attached joint memorandum will be considered at a joint session of the Development Committee (DC) and the International Monetary and Financial Committee (IMFC) on April 29, 2001.

THE WORLD BANK GROUP

INTERNATIONAL MONETARY FUND

WASHINGTON, D.C. 20433

MEMORANDUM

DATE: April 18, 2001

TO: Members of the Development Committee
Members of the International Monetary and Financial Committee

SUBJECT: **Fighting Poverty and Strengthening Growth in Low-Income Countries**

Poverty remains the greatest challenge facing the international community. More than a billion people still live on less than $1 a day. In many low-income countries, the fundamental building blocks that poor families need to better their lives—ranging from access to basic education and health care to a decent physical environment—are still not in place.

The International Development Goals (IDGs)[1] set by UN conferences held in the early 1990s and adopted by the Millennium Summit provide a vision of a world in which the burden of poverty and its miseries are much reduced. But this vision will not be achieved without the concerted efforts of both developed and developing countries to achieve sustained growth that favors the poor; to ensure access to basic social services for men and women alike; to open global markets for trade and technology; to reduce the current burden of debt; to provide sufficient resources in support of economic and social development; and to stamp out the corrosive effects of corruption on the prospects of the poor for a better life. Furthermore, the international community must pay special attention to the proliferation of violent conflict in low-income countries. Unless contained, these conflicts will prevent many countries from making sustained progress towards the IDGs.

Within this vision, the Bank and Fund have an important role to play. Eighteen months ago Ministers endorsed enhancements to the Heavily Indebted Poor Countries (HIPC) Initiative. They also accepted proposals to link debt relief, as well as International Development Association (IDA) and Fund concessional lending, to comprehensive development strategies described in Poverty Reduction Strategy Papers (PRSPs) embodying the principles of the Comprehensive Development Framework

[1] The targets of the IDGs (to be reached in most cases by 2015) cover the areas of poverty, infant, child, and maternal mortality, education, reproductive health, and the environment. The IDGs were specified in *A Better World For All* (June 2000). The Millennium Declaration Goals (MDGs), endorsed by heads of state of over 160 countries in September 2000, are broadly consistent with the IDGs.

(CDF)—country ownership, a long-run holistic vision, partnership, and a focus on outcomes and results—and in line with the core elements of the strategy for addressing poverty described in the 2000/01 World Development Report.[2]

Progress Reports on the enhanced HIPC Initiative and the PRSP approach were prepared in April and September 2000. Updated reports on implementing the PRSP approach[3] and the HIPC Initiative[4] serve as background to the Committees' reviews of progress at these Spring meetings.[5] As these documents indicate, much has been done since the Annual Meetings in Prague to achieve the speedy implementation of the HIPC Initiative and to make the early stages of the PRSP approach a success. But major challenges remain. In what follows, we wish to draw Ministers' attention both to the substantial progress achieved, and to some of the challenges and how we propose to address them. Before doing so, we would like to share with you some of the key outcomes of the meetings that we held with 22 Heads of State and civil society leaders during our recent joint visit to Africa—meetings which reinforced our conviction of the importance of moving forward with the PRSP approach and HIPC Initiative to help poor countries attack poverty.

A. Joint Visit to Africa

At the Annual Meetings in Prague, we reaffirmed our commitment to put special emphasis on Africa as part of our wider commitment to the global battle against poverty. In February of this year, we made the first joint visit to Africa by the Heads of the Bretton Woods Institutions. Our primary purpose was to listen to the vision of African leaders about how Africa can accelerate growth, reduce poverty, and position itself to benefit from globalization. We also wished to discuss how the Fund and the Bank can best assist African nations in these endeavors. We were deeply impressed by these leaders' conviction that Africa's future lies in its own hands, and by their commitment to far-reaching changes that will allow the continent to attack the roots of poverty and to share more fully in global prosperity.

To achieve these goals, the leaders made the following points. First and foremost, they stressed the need to deal with conflict and weak governance, emphasizing that sustainable poverty reduction and growth must start with—and build upon—peace, democracy, and effective institutions. Second, they recognized that prospects for rapid growth will depend on building a strong human resource base, which requires strengthening support for education and health. In particular, they emphasized the critical need to combat the devastating effects of HIV/AIDS. Third, they stressed the common goal of positioning Africa to benefit from globalization and agreed that stronger regional cooperation and integration were indispensable to increase the competitiveness of their

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[2] *World Development Report 2000/01: Attacking Poverty*, World Bank, 2000.
[3] *Poverty Reduction Strategy Papers—Progress in Implementation*.
[4] *Heavily Indebted Poor Countries (HIPC) Initiative: Status of Implementation*.
[5] Other related documents that have been circulated to the Executive Boards and serve as background to the Committees' deliberations include: *Joint Paper on HIPC Initiative—The Challenge of Maintaining Long-Term External Debt Sustainability*, *Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries*, and *Assistance to Post-Conflict Countries and the HIPC Framework*.

economies. They emphasized that opening of markets of industrialized countries to African goods, and access to global capital markets, were essential for promoting and sustaining growth. But they also stressed that for the near term, the availability of adequate concessional flows would be key to helping many African countries realize their potential for higher, pro-poor growth. All the leaders welcomed the recent progress under the HIPC Initiative; some called for further action on debt cancellation. They also welcomed the move towards more streamlined conditionality by the Fund and Bank and stressed the importance of aligning conditionality with country-owned development strategies.

In response, we stressed that African countries should expect support from the international community, commensurate with their efforts to design and implement sound poverty reduction and growth strategies—"help for self-help." And we pledged to the African leaders that the Fund and the Bank are ready to support them in these endeavors. We returned from our visit even more certain of the need for greater support by the international community for the efforts undertaken by African countries. In particular, we believe that there is a clear need for opening the markets of developed countries to all of the exports of African and other poor countries. Developed countries also need to increase their official development assistance and to improve its effectiveness, including by aligning it fully with the country-led poverty reduction strategy process.

These two elements, international support, combined with the efforts of African countries themselves to improve their own economic and social polices, offer Africa a better chance to attain the IDGs to which we all have subscribed. Finally, as we have already noted, our discussions reinforced our conviction that our collective efforts on the PRSP approach and the enhanced HIPC Initiative over the past 18 months are central to successfully supporting poor countries in attacking poverty and enhancing growth. The remainder of this note outlines progress and prospects with respect to PRSPs and the enhanced HIPC Initiative.

B. The PRSP Approach

Progress to date. The PRSP approach is still in its early stages of development. Calendar year 2000 was dominated by the preparation of interim poverty reduction strategies (I-PRSPs), many of which were provided to the Executive Boards of the Bank and the Fund in connection with reaching decision points under the enhanced HIPC Initiative. Since our last report at the Annual Meetings held in Prague, the Boards have considered 19 I-PRSPs and two full PRSPs, bringing the total as of end-March 2001 to 32 I-PRSPs and four full PRSPs, the majority of which were prepared by African countries.

During the remainder of calendar 2001, about 20 countries may complete their first full PRSPs. Many of these countries are HIPCs which reached their decision points in 2000 and seek to move toward their completion points under the Initiative. As the process moves forward, it will be essential that the quality of full PRSPs—both in terms of their content and participatory processes—not be sacrificed to speed of preparation. At the same time, expectations regarding the content of countries' first full PRSPs and the processes involved in their preparation need to take account of individual country circumstances, along with the fact that PRSPs are "living documents." All concerned—countries as well as their development partners (including the Bank and the Fund)—are learning by doing in the PRSP context, and strategies will evolve in the light of experience. Hence, the number (and even the initial quality) of PRSPs will be only a preliminary indicator of success. The program will stand or fall on the basis of sustained poverty reduction and growth efforts at the country level and their measurable outcomes, which are likely to emerge only over a period of years. We must also be ready to refine and improve the process in light of early experience.

Meanwhile, there is much to be done in the short term. We intend to continue to support PRSP countries by engaging in debates and consultations over policy and by providing analytical support and technical assistance as requested by the national authorities. More generally, we see the need over the year ahead to respond to two critical challenges. With respect to country strategies, there will be a need to help countries move from description of existing policies and expenditure patterns to preparation of new policy and expenditure options that are focused more sharply and rigorously on poverty reduction outcomes and on accelerating growth. For the poverty reduction effort as a whole, it will be necessary to support the transition from strategy preparation to implementation, including the mobilization of the funding needed for the resulting strategy. And action by all partners will be needed to make the PRSP a truly inclusive process which serves as a common framework for support by all development partners in each country. The sections that follow outline some of the ways in which we are addressing these challenges.

Facilitating the PRSP process. The Bank and Fund have taken a number of steps during the past six months to facilitate the PRSP process, particularly with regard to the transition to full PRSPs, and to fully mainstream the PRSP approach into our financial assistance programs. In response to countries' requests for greater clarity regarding the basis upon which Bank and Fund staffs will assess PRSPs, the staffs have prepared guidelines for Joint Staff Assessments (JSAs) of full PRSPs, which outline the key areas that both institutions will focus on when assessing PRSPs. These guidelines will be revised periodically in light of country experience and feedback from development partners. We are also expanding learning activities for PRSP country teams, and are working actively with development partners to support country capacity building and ownership.

The PRSP approach is not meant to be limited to countries' dialogue with the Bretton Woods Institutions. Rather, it is intended to serve as a broad framework within which both domestic stakeholders and development partners can engage in and support the design and implementation of country-owned poverty reduction strategies. Countries are developing consultative processes that are suitable to their own institutional structures, in many cases building on existing processes. But, while broad based consultations are meant to improve the quality of the strategy, the final responsibility for setting strategic priorities lies with national authorities. We are particularly pleased that the PRSP approach is now widely embraced by the international donor community, and that external development partners are seeking to help countries prepare and implement their strategies. While it is widely agreed that PRSPs ought to become key vehicles by which governments in low-income countries can better coordinate their external assistance, additional efforts are needed by all development partners to better harmonize their operations, policies, and procedures, and by governments to facilitate donor involvement in their national processes. There is also scope for additional donor financing to help meet countries' extensive needs for technical assistance and capacity building.

Supporting tracking of poverty-reducing public spending. We fully share the emphasis that PRSP countries, other development partners and civil society groups have consistently placed on improving national public expenditure management systems, so that domestic resources, external assistance, and budgetary savings from HIPC assistance are effectively used for their intended, poverty-related purposes. Our preliminary assessment of public expenditure management systems in 25 low-income countries has indicated that, while the Bank and Fund have increased their assistance in this area substantially over the past 4 years, a further scaling-up of country efforts and donor assistance in this area is needed.[6] In response, we are working on action plans with countries where public expenditure, procurement, and financial management systems are weak to strengthen these systems, building on diagnostic work of the Bank, the Fund, and other partners. We are also developing a Program on Public Expenditure Management and Accountability, with likely funding from the European Union, the Bank, and bilateral donors. Meanwhile, in the short run, we are recommending the expanded use of "virtual" poverty funds that rely on existing data systems to help track poverty-reducing spending. While these funds cannot substitute for putting in place effective public expenditure management systems over the medium term, we believe that they can serve as an intermediate bridging mechanism until more comprehensive expenditure management and tracking systems are developed. We believe that this approach will help lay the foundations for enhanced expenditure management systems over the medium term, while avoiding delays in delivering urgently needed debt relief and concessional assistance to eligible countries.

Supporting social impact analysis. Another concern of countries and development partners that we share is the importance of assessing the impact of policies and programs on the poor and other vulnerable groups. Ideally, social impact analysis should be an integral part of PRSP preparation and carried out under the leadership of national authorities. In the near term, given the limitations on national capacity in this area, countries will need to draw upon assistance from bilateral and multilateral agencies with relevant expertise—including our own institutions—both to help carry out the work and to strengthen national capacity for social analysis. Bank staff are developing improved methods to help countries in assessing the social impact of policies, and for evaluating the social impact of our own policy recommendations and lending. The Fund will also contribute to this exercise in its areas of expertise (i.e., macroeconomic policy and related topics) and will draw on and integrate into its policy advice relevant analysis

[6] SM/01/16, Revision 1, March 28, 2001, and IDA/SecM2001-0052/1, March 30, 2001.

on the social impact of key policies supported by Poverty Reduction and Growth Facility (PRGF) arrangements. We are committed to integrating social impact analysis into the PRSP process as speedily as possible, while recognizing that early expectations need to be moderate in this area, owing to its inherent complexity.

Refining lending instruments and streamlining conditionality. The Bank and the Fund are working together to make their own operations more supportive of countries' efforts to implement poverty reduction strategies. One aspect of this effort is streamlining and focusing our conditionalities on the policies and public actions contained in countries' poverty reduction strategies with the objective of linking our support clearly to country ownership. The Fund's Board has called for a more streamlined and focused application of conditionality, and early experience with new three-year PRGF arrangements suggests that there has already been positive movement in this regard. The Bank is introducing the Poverty Reduction Support Credit (PRSC) as an IDA lending instrument that is sufficiently flexible and broadly based to ensure suitable coverage of social and structural policy areas. The first proposed PRSC, for Uganda, is being presented to the Bank's Executive Board in April 2001, while a second PRSC, for Vietnam, is expected to follow in May. Over time, we expect PRSCs to become an increasingly important element of the Bank's overall support for low-income countries' poverty reduction strategies. We are also working to improve the division of labor between the two institutions, with each concentrating on its primary areas of competence and expertise. Thus, Fund conditionality will not normally extend into social and structural policies outside its areas of expertise except when these areas are critical to a country's macroeconomic objectives. Where possible, conditionality on these aspects of policy would be covered instead under IDA lending operations, especially PRSCs as they are phased in. There may, however, be cases during the phase-in period where the PRGF may take on a broader scope and include some structural measures outside the Fund's primary areas of expertise because of their importance to the overall success of the country's program. In these cases, the specification and assessment of such conditions will be done in consultation with Bank staff. We believe that these initiatives will allow us to serve countries better as they move from strategy preparation to public action in support of poverty reduction.

C. The Enhanced HIPC Initiative

Progress to date. By March 2001, twenty-two countries—more than half of those expected to receive debt relief under the enhanced HIPC Initiative—had reached a decision point, allowing them to benefit from debt service relief amounting to about $34 billion over time. All 22 decision point countries are now receiving interim relief from some creditors, with others expected to follow. One country, Uganda, has reached its completion point under the enhanced HIPC Initiative, at which point debt relief was delivered unconditionally, and several more are expected to do so by the end of 2001. The countries that have yet to reach a decision point under the enhanced framework include a few that are likely to reach a decision point this year; but many more are conflict-affected, including several that have protracted arrears to the Bank and the Fund. Yet others could have sustainable debt burdens after traditional relief mechanisms and thus are not expected to need relief under the Initiative, or have indicated that they will not seek HIPC assistance.

The 22 countries now receiving relief under the Initiative will benefit from a significant reduction in debt stocks and debt service payments. In combination with traditional debt relief and pledges of additional bilateral debt forgiveness, the external indebtedness of these 22 countries will be reduced by almost two-thirds in NPV terms (from US$53 billion to US$20 billion), bringing their indebtedness to levels below the average for all developing countries. Debt service savings in these countries are also substantial, about US$1.1 billion annually, and debt payments as a percentage of exports, GDP, and government revenues will fall dramatically. Interim assistance offers countries an opportunity to receive immediate benefits while providing them time and support needed to fully articulate in their PRSPs the priorities and programs to be supported by debt relief funds, as well as by public resources in general. Based on early indications, the resources freed up by debt relief will be allocated in large part to health, education, HIV/AIDS prevention and treatment, rural development and water supply, and road construction. However, realizing these benefits also requires prompt action on the delivery of relief by all creditors, and we call on them to take the necessary steps to make this happen.

The coming year presents its own challenges in the implementation of the Initiative, with new countries coming forward for debt relief and countries now receiving relief preparing for completion points. The first challenge—moving forward with new decision point cases—presents special difficulties, as most of the countries which have yet to qualify for HIPC relief are either currently engaged in or have recently ended internal or cross-border armed conflict, and many are struggling with severe governance problems. At the same time, these countries need external financing, including debt relief, for poverty-reducing programs and the reconstruction process. Meeting the second challenge involves helping to ensure that countries remain on track with their macroeconomic and reform programs for reaching their completion points, which in turn entails helping them to develop full PRSPs.

Maintaining long-term external debt sustainability. The enhanced HIPC Initiative significantly reduces the likelihood of debt servicing problems and provides a good basis for achieving debt sustainability. We also welcome the steps taken by a number of countries to forgive all bilateral debt owed by the poorest countries. But long-term debt sustainability can only be achieved if the underlying causes of the debt problem are addressed. Our staffs have prepared an analysis of the prospects for long-term debt sustainability of the 22 HIPCs already past their decision points. This analysis confirms that assuring debt sustainability depends not only on the absolute level of debt but also on the successful implementation of a comprehensive set of policies that achieve better economic performance and poverty reduction, on strengthening governance and public institutions, on assuring access to adequate concessional flows from the international community, on sound debt management, and on developments in the global economy. The poverty reduction strategies being drawn up by HIPCs signal a new and much greater level of effort on the part of both countries and the international community to strengthen the economic reform agenda and to forge greater social cohesion, which together constitute a potential source of growth that could be unlocked by the PRSP approach.

D. Assistance to Post-conflict Countries

We have proposed to the Boards a set of measures to enable a robust engagement by our institutions in countries emerging from conflict. These include technical and capacity building assistance, paying particular attention to governance, ensuring that resources are available on appropriate terms, and bringing eligible countries into the HIPC process. Most countries emerging from conflict will require substantial technical assistance from both the Bank and Fund for rapid restoration of the critical functions of government. The Boards agreed that Bank and Fund staff, in consultation with other providers of technical assistance, should develop an early assessment of, and action plan for, meeting these countries' needs. They also asked staff to explore various options for financing the institutions' participation in this effort, and to report back to the Boards. The Fund's Executive Board encouraged bilateral donors to provide interest subsidies so that the Fund's emergency post-conflict assistance could be provided to low-income countries on concessional terms and agreed that the Fund would set up a multi-donor Administered Account for these subsidies. We look forward to contributions from the membership for this purpose.

A key challenge in the coming year will be to help those remaining HIPC-eligible countries which have been affected by conflict to develop the performance track record that will enable them to move towards their decision points and begin receiving debt relief as quickly as possible. The need for debt relief in these countries is particularly acute, given the severe poverty and major reconstruction needs that many of them face. The Boards have agreed that the existing HIPC Initiative framework has the necessary flexibility to accommodate the special circumstances of these countries. While recognizing that many of these countries face urgent financing needs, Directors also stressed the importance of adequate conditionality and of ensuring that the debt relief is used effectively for poverty reduction. In that regard, they emphasized the importance of establishing mechanisms for tracking poverty-related spending and securing transparency in military spending. They also agreed that the track records for these countries should include a focus on rebuilding capacity and improving overall governance. We will also consider frontloading HIPC assistance to the extent possible, taking into account the countries' debt service profile and absorptive capacity. In some cases, access to HIPC assistance will require the resolution of arrears to our institutions and others; to facilitate this we are proposing that arrears clearance plans for individual countries be worked out jointly and in consultation with other creditors.

E. Promoting Trade in the Poorest Countries

Trade is vital for growth, poverty reduction, and long-term external debt sustainability, but over the past two decades the world's poorest countries have seen their share of world trade decline. The reasons for their increasing marginalization are complex—in part reflecting protection, deep-seated structural problems, weak institutions, poor governance, and distortionary policies that perpetuate anti-export biases at home—but, also, protection abroad. While the poorest countries need to act to help themselves, the barriers facing their exports must also be eliminated. These barriers include both subsidies for domestic producers in developed countries and direct limitations on access for the products of developing countries in both industrial and other developing countries.

Protection in industrial countries remains high on agriculture, textiles and clothing, and other labor intensive manufactures and inhibits the diversification of poorer countries' exports toward higher value-added products. Agricultural subsidies in industrial countries undermine developing countries' agricultural sectors and exports by depressing global prices and pre-empting markets. Many developing countries themselves have high tariffs, on average three to four times higher than those of industrial countries.

Many of the products exported by the least developed countries are the most affected by these limits on market access. Recent World Bank studies show that if the United States, the European Union, Canada, and Japan were to give unrestricted market access to the 49 Least Developed Countries, their net exports would increase by about 11 percent, and non-oil exports from Africa would expand by 14 percent. For this reason, we welcome recent market opening actions by the EU and some other industrial countries and call on other trading partners—developed and developing—to join them.

The Bank and the Fund are also taking active steps to help poor countries design trade policies for pro-poor growth in the context of the PRSP process. These efforts aim to ensure that reform packages both promote growth and protect the poor during the transition period. For the Least Developed Countries, we are participating, along with other multilateral agencies, in a revitalized Integrated Framework for Trade-Related Technical Assistance. This initiative is designed to help countries preparing their PRSPs to analyze options for trade integration and identify priorities for trade-related technical assistance within an overall development framework. On a pilot basis, a trust fund for Integrated Framework activities has recently been established with support from bilateral donors.

F. Conclusion

We have made a great deal of progress in implementing both the PRSP approach and the enhanced HIPC Initiative. Experience with the PRSP approach has been encouraging with respect to the seriousness with which countries have engaged in the process, the deepening of participatory processes in some countries, and the willingness of development partners to support the PRSP approach. Experience with the first 22 countries that have now reached a decision point under the enhanced HIPC Initiative has been equally promising. The Initiative has now begun to deliver broader, faster, and deeper debt relief. However, to meet our common objective of improving the lives of poor people in low-income countries, while avoiding a repetition of debt problems in the future, we all need to support and strengthen a common strategy with two pillars.

The self-help pillar entails action by poor countries to take charge of their own future, recognizing that there can be no substitute for their own policies and efforts. They need to act to build an improved investment climate for private enterprise to compete in world markets and foster growth that is less dependent upon official financing in the long term. Many will need to accelerate the implementation of outward-oriented structural reform and to improve their overall performance with respect to macroeconomic management, governance, and social sector policies.

The other pillar requires that the rich countries realize that without a bright future for the poor, the future cannot be bright for the rest of the world. The fight against poverty will require a new partnership and a spirit of renewed cooperation. Creditors and donors need to ensure that HIPC relief is provided in addition to development assistance and that aid is furnished on appropriately concessional terms, including grant financing. We strongly endorse free market access for poor countries to world markets and call upon the industrial countries to open their markets and to reduce their trade-distorting agricultural subsidies. We also call upon the developed countries to move towards the long standing United Nations target for official development assistance of 0.7 percent of GNP; current levels of foreign aid (0.24 percent of annual GDP) fall far short of this promise. It is only through such concerted actions by rich and poor countries alike that the International Development Goals for 2015 can be achieved and that the fight against poverty can be won.

James D. Wolfensohn — Horst Köhler