STATEMENT BY THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Attached for information of the Members of the Development Committee is a Statement from the Managing Director of the International Monetary Fund, Horst Köhler, for the Committee’s April 13, 2003, meeting.
DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR’S WRITTEN STATEMENT

I. INTRODUCTION

1. Our meeting today takes place against a backdrop of uncertainty in political events and in the global economy. This should not deter us from continuing to work together as actively as possible to pursue sustained economic growth and poverty reduction. We have seen a number of gains in economic and social indicators in many developing countries, but too many countries, particularly in sub-Saharan Africa, are lagging behind. Good development outcomes require accelerated growth and a stronger focus on the needs of the poor in the development process. This is most likely to come about when sound policies are country-owned and country-specific, supported by strong institutions, and when national efforts are reinforced by a supportive global economic environment. When these conditions are in place, development assistance can be highly effective. This two-pillar strategy was firmly endorsed by the international community in the Monterrey Consensus and was reaffirmed at the Johannesburg Summit. The task now is to ensure its consistent and coherent implementation by all development partners.

2. The Fund is committed to contributing to this agenda in our core areas of competence, strengthening macroeconomic frameworks and supporting related structural and institutional reforms. In this statement, I shall summarize our assessment of the world economic outlook, and, with special reference to the items on the agenda of the Development Committee, describe the Fund’s activities to support the approach laid out at Monterrey.

II. GLOBAL ENVIRONMENT AND POLICY RESPONSE

A. Overall Outlook and Policy Response

3. The global recovery was somewhat stronger than expected in the second and third quarters of 2002, resulting in GDP growth of 3 percent, or slightly higher than forecast in the September, 2002 World Economic Outlook. However, the pace of global recovery has slowed since that time, particularly among the industrial countries. This can be seen by stagnant industrial production in industrialized countries, slower world trade growth, soft labor market conditions, and only a tentative recovery in global fixed investment. Against this backdrop, global equity markets have fallen and the U.S. dollar has depreciated. However, the margins for bond yields for some emerging markets have narrowed, reflecting clearer signals about future policies in these countries as well as global portfolio shifts from equities to high yield fixed income assets.

4. The short-term outlook remains subject to considerable uncertainty. The global economy, however, has shown remarkable resilience in the face of large shocks in recent years, and in many countries the economic fundamentals have been strengthened. In addition, growth should be supported by the policy stimulus in the pipeline, the easing of the...
headwinds to growth from the bursting of the equity market bubble, and the inventory cycle. On the assumption that the uncertainties surrounding the conflict in Iraq are broadly resolved in the near term, with little spillover outside the region, there is good reason to expect the global recovery to gradually reassert itself during the course of this year. Against this background, the *World Economic Outlook* projects global growth of 3¼ percent in 2003—¼ of a percentage point higher than in 2002—and 4 percent in 2004.

5. It is difficult to estimate today with any precision the lasting costs of the war in Iraq, but many countries appear to be in a relatively good position to withstand the effects through prudent use of reserves and other sources of financing and policy adjustment. The countries likely to be most seriously affected include those geographically close to the conflict, developing countries which could face lower commodity prices for exports and higher oil prices, and possibly those highly dependent upon tourism.

6. But economic weaknesses pre-date the conflict in Iraq. Other factors of uncertainty include the recovery remaining heavily dependent on the United States and uncertainty about the future course of asset prices. Finally, a number of emerging markets remain vulnerable to the global downturn. Against this background, policymakers face considerable uncertainty, and they will need to remain flexible and adapt quickly to changing circumstances. With inflationary pressures remaining moderate, monetary policy in industrial countries should remain accommodative and scope for further easing exists should it be needed. With regard to fiscal policy, the situation differs between countries, but the room for maneuver in many is limited by the high levels of public debt. The automatic fiscal stabilizers, however, should be allowed to operate fully.

7. Over the medium term, however, fiscal consolidation remains a central priority around the globe, particularly in industrialized countries which face mounting pressures from aging populations. Also important for the medium term will be policies to reduce global dependence on the United States and to foster an orderly reduction in global imbalances. This will require tackling long-standing structural impediments to growth, particularly in Europe and Japan; reestablishing a sound medium term fiscal position in the United States; and a shift from external to domestic sources of growth in emerging Asia.

**B. Regional Outlooks and Policy Responses**

8. The performance of the *United States* is central to the global outlook. Recent economic data have been disappointing, and growth this year is expected to be somewhat weaker than in 2002. But once geopolitical uncertainties have been resolved, a recovery in confidence and investment, together with the additional fiscal stimulus in the pipeline, should underpin stronger growth from the second half of 2003. The continued strong productivity performance of the U.S. economy also bodes well for future prospects.

9. Despite a modest recovery in 2002, growth in *Japan* is expected to remain subdued in 2003. Surveys indicate that deflationary expectations are becoming more entrenched and aggressive monetary easing is needed, combined with measures to strengthen the banking
and corporate sectors. Moreover, a credible medium-term fiscal consolidation strategy will be important as a means of addressing the high public debt.

10. In the euro area, growth continues to be disappointing and forecasts for 2003 have been revised down sharply. Easier monetary policy should be the first line of defense against any future softening of growth, and structural rigidities in product and labor markets need to be addressed with greater urgency. In addition, the automatic fiscal stabilizers should be allowed to operate fully, even if that leads to deficits above the three percent threshold in Europe in 2003.

11. In emerging markets, growth prospects for 2003 have been revised down slightly, in part because of the weaker outlook in advanced countries and higher oil prices, but also because of the uncertain external financing environment.

- There are signs of a pickup in activity and an improvement in market sentiment in much of Latin America, but the situation remains difficult for some countries. It will be important to sustain efforts to lower public sector debt levels and improve the maturity structure of the debt, as well as to persevere with structural reforms in the financial sector, in trade, and in labor markets.

- Emerging markets in Asia have been performing well, underpinned by exports and domestic demand. Comfortable external positions in the region provide a foundation for further progress with structural reform, particularly in the financial sector, which will be needed to underpin strong domestic demand and reduce global imbalances.

- Growth in countries in central and eastern Europe has been sustained by continued strong foreign investment, and by strong domestic demand and rising energy prices in the oil-exporting Commonwealth of Independent States. In the latter, the momentum for structural reform needs to be maintained to sustain investment spending. The low-income CIS countries need to further foster investment through diversifying industrial production and strengthening the services sector.

12. In the Middle East, the increase in oil prices is benefiting many countries, but the security situation is taking its toll on tourism and foreign investment. To sustain GDP growth, efforts will be needed to invigorate the private sector and trade and to absorb a fast-growing labor force.

13. In Africa, despite higher non-fuel commodity prices, growth slowed in 2002 primarily due to bad weather leading to sharp declines in agricultural output. Food shortages in some countries have been aggravated by weak governance, resulting in a tragic famine affecting some 38 million people. Growth has also been affected by political turmoil, particularly in Zimbabwe and Côte d’Ivoire, which has had adverse externalities for growth in neighboring countries. Near-term growth prospects will be influenced by weather and the security situation, and medium-term growth will critically depend on the implementation of country-
led development strategies, including measures to improve governance, build institutional capacity, stimulate private sector activity and trade, and address the HIV/AIDS pandemic.

III. ACHIEVING THE MDGs AND RELATED OUTCOMES

14. In the next 25 years, the world’s population is projected to grow by about 2 billion people, almost all of it in developing and emerging market economies. Without a concerted effort to change the status quo, many of these people will live in poverty. The two-pillar architecture of the Monterrey Consensus, reaffirmed by the Johannesburg Declaration, provides us with the basis for doing better. And the Millennium Development Goals (MDGs) set out the objectives that countries have signed up to reach by 2015.

15. For many low-income countries, the Poverty Reduction Strategy Paper (PRSP) approach serves as the nexus of the two-pillar partnership and is the central country-level vehicle for making more ambitious progress toward the MDGs. The PRSP approach continues to gain momentum, with the number of full PRSPs approaching 30.

16. The Fund has a key role in supporting low-income countries’ efforts to develop and implement these strategies, focusing its contribution on its core areas of competence. These areas are principally: macroeconomic policies and supporting institutions that are critical to growth; strengthening public expenditure management and revenue mobilization; and promoting sound national financial sectors and a stable international financial system. A strong macroeconomic policy framework also provides a basis for more efficient and effective use of external assistance. We are progressively adapting our instruments, policies, and procedures to help low-income countries implement their PRSPs, and to make progress toward achieving the MDGs. One aspect of this is more clearly defining and delineating the Fund’s expected contribution relative to those of other development partners, particularly the World Bank.

17. Within this framework, the Fund is pursuing a broad agenda of work on low-income country issues. This work program has four main elements:

   o Better aligning PRGF-supported programs and PRSPs;
   o Defining the role of the Fund in low-income countries over the medium term,
   o Exploring the merits of enhancing the Fund’s role in helping countries deal better with exogenous shocks; and
   o Continuing to implement the enhanced HIPC Initiative and to help countries improve the sustainability of their debt positions.

18. The Fund’s efforts are one element of the broader cooperative approach by all donors. The Fund is working with others in the international community to: facilitate the expansion and balanced growth of trade; and improve the effectiveness of aid through better harmonization of donor procedures and policies.
A. Better Aligning PRGF-Supported Programs and PRSPs

19. The Fund is continuing its work to improve the alignment of the content and procedures of PRGF-supported programs with country PRSPs. Before the Annual Meetings, staff will prepare, jointly with the Bank, an annual review of progress under the PRSP approach for the respective Executive Boards. The Fund Board recently discussed a number of options for dealing with some of the issues associated with this alignment, including:

- Improving program design and content through: more realistic macroeconomic projections, based on systematic analysis of the sources of, and obstacles to, growth; accommodating higher aid inflows; establishing clear links between the PRSPs and the macroeconomic frameworks underpinning budgets and PRGF-supported programs; further improvements in public expenditure management; and incorporating poverty and social impact analysis into program design.

- Adapting our processes and procedures to reinforce country ownership and facilitate donor alignment with the PRSP by supporting the internal alignment of the PRSP with the national budget, and synchronizing the cycles of the PRGF and the PRSP/budget; and

- Rationalizing PRGF documentation to demonstrate clearly the links between the PRGF and the PRSP’s objectives, to better indicate how policy choices have been made, and to reduce overall reporting requirements.

20. Staff are working with government official and researchers in developing countries as well as donors and academia to identify areas where analytical research is needed to better support PRSP implementation. We are particularly interested in deepening our understanding of the linkages between macroeconomic policies and growth. A technical workshop was held in Washington on April 3-4, 2003 to assess the current knowledge base and set priorities for future international research, and a joint Fund-Bank research conference on macroeconomic management and growth in low-income countries is planned for the first half of 2004.

21. While the major focus of this low income country work has been on sub-Saharan Africa, the Fund, together with the World Bank, the European Bank for Reconstruction and Development, and the Asian Development Bank, has also been working closely with the authorities and bilateral donors to achieve the goals of the CIS-7 Initiative launched at the 2002 Spring Meetings. Under the Initiative, most CIS-7 countries have intensified their reform efforts, and the momentum of these actions is being supported by debt relief and additional resource pledges by donors. The Fund has maintained a close policy dialogue with

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1 The CIS-7 countries are Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan.
these countries in an effort to strengthen reforms and ensure progress towards debt sustainability.

**B. Role of the Fund in Low-Income Countries Over the Medium Term**

22. Macroeconomic stability is a necessary platform for sustained high growth, and for effective policies targeted to poverty reduction. Many low-income countries have made considerable progress toward macroeconomic stability, but this stability remains fragile, and, at the same time, low-income countries will require large amounts of donor assistance for a number of years in order to meet the MDGs. These facts raise the question of how the Fund can best support low-income countries in managing these challenges, including through the Fund’s direct financial support and its role in catalyzing other donor financing. Fund staff are preparing a paper for an initial Board discussion in June that looks at how the Fund’s role may need to evolve in order to better meet the diverse and changing needs of low income member countries.

**C. Exploring the Merits of Enhancing the Fund’s Role in Helping Countries Deal Better with Exogenous Shocks**

23. At the request of the Fund Executive Board and the Development Committee, staff are also preparing a companion paper to look at the analytical and empirical issues related to the impact of exogenous shocks. It will look at whether there is a case for more systematic focus on shocks in Fund-supported programs and surveillance. It will also look at whether Fund financing should be better targeted to mitigate the impact of shocks, and describe possible options. As it examines the role of the Compensatory Financing Facility (CFF) in dealing with shocks, the Board discussion will serve as a first part of the review of the CFF.

**D. Implementing the Enhanced HIPC Initiative**

24. Our joint work with the World Bank on the enhanced HIPC Initiative continues to move forward and our priority is to help countries establish and maintain long term debt sustainability. Since the Annual Meetings, Benin and Mali have reached their completion point, bringing the total up to eight countries. Most of the 18 countries in their interim periods continue to receive assistance, but their progress to completion point has been slower than expected, partly because of the time needed to prepare high-quality PRSPs, and partly due to difficulties in implementing their economic reform programs. Similarly, of the 12 countries that have not yet reached their decision points, most have been affected by political instability/conflict, although the Democratic Republic of the Congo has been making progress. Where conditions have been conducive, the Fund has remained engaged in these countries, either by providing Emergency Post-Conflict Assistance and/or by helping put in place staff-monitored programs, to help build adequate capacity to move to a PRGF-supported program.

25. Full creditor participation is essential for ensuring the objectives of the Initiative, and there has been progress in bringing additional non-Paris Club creditors on board. The Executive Board recently reviewed creditor participation issues under the Initiative, with a
special focus on HIPC-to-HIPC debt relief and on creditor litigation problems. With regard to the first, the Board supported the concept of a trust fund to channel donor assistance to finance HIPC-to-HIPC debt relief. While Fund staff will provide technical assistance and discourage legal action on the part of creditors, it was agreed that the Fund does not have a mandate to mobilize or finance legal defense for countries facing creditor litigation.

26. But it is important to bear in mind that debt relief is only a starting point. Many HIPCs’ debt situations will continue to be fragile, and a sustainable position will require sound economic policies, good governance, prudent debt management, as well as adequate and sufficiently concessional new financing. Staff are supporting these efforts by developing the analytical tools for better assessing debt sustainability in low-income countries. Staff are also developing guidance on how to help countries improve the design of financing strategies, including the appropriate mix of loan versus grant financing. Fund and Bank staffs plan to conduct outreach to a wide range of stakeholders to better inform this work.

E. Facilitating the Expansion and Balanced Growth of Trade

27. An important element of making globalization work for all will be greater efforts, by all countries, to ensure that developing countries secure improved market access for their exports. Recent delays in negotiations under the Doha Trade Round are a source of concern for all. All parties should redouble their commitment to advance the Doha Development Agenda, and achieve a successful WTO Ministerial meeting in Cancún. As Cancún draws closer, gaps in negotiating positions remain very large, especially in the critical areas of agriculture and public health. If we want to move beyond the rhetoric then the time to deliver on the Doha and Monterrey promises is now. I urge the advanced economies, in particular, to take leadership on this issue, recognizing that trade is a powerful vehicle for global recovery, and for achieving the MDGs. Developing countries, as well, must fully integrate in the multilateral system in order to reap the most benefits. I am grateful to Dr. Supachai, the Director General of the WTO, for accepting the invitation to participate in the forthcoming IMFC meeting, and I hope that he will receive strong support from our Governors.

28. For our part, the Fund is strongly supporting the Doha Development Agenda, and Fund staff have prepared a review of progress in the negotiations. We have also been covering market access issues more candidly and comprehensively in our multilateral and bilateral surveillance operations, and are currently conducting a review of the Fund’s trade policy advice. We are also helping ensure inclusion of trade policy considerations in PRSPs, including through joint PRSP learning events with the World Bank and through the Integrated Framework for Trade-Related Technical Assistance.

2 Developments in the Doha Round and Selected Activities of Interest to the Fund (SM/03/120, 4/7/03).
F. Donor Coordination

29. The Development Committee (2001) and the Monterrey Consensus both called on donors to harmonize their procedures and practices in order to increase the efficiency of aid. Since 2001, a number of major initiatives have been undertaken, recognizing that differing donor practices and objectives put an undue strain on the limited administrative capacity of recipient countries, raise transaction costs, and undermine country ownership. These initiatives culminated in the High-Level Forum on Harmonization held in Rome in February this year, where the good practice principles developed over the past two years were adopted with a view to ensuring that: development assistance supports the priorities of the recipient country; donors commit to adopt internal procedures to facilitate harmonization; and that donors provide coordinated TA and generally empower recipient countries to lead the harmonization effort.

30. The Fund is committed to implementing these principles in its own work, reflected by our own alignment efforts. We have also prepared, jointly with the World Bank, a framework for harmonizing donor budget support in the context of PRSPs, which will be tested in the coming months in a few African countries, in collaboration with the Strategic Partnership with Africa and interested bilateral donors. Effective harmonization led by recipient countries can also help facilitate the streamlining of program conditionality, enhance ownership of reforms, and develop a deeper partnership between donors and recipients.

31. Let me turn briefly now to the two specific agenda items for the Development Committee discussion, for which joint Bank-Fund staff papers have also been circulated

IV. MEASURING PROGRESS ON MDGS

32. At the request of the Development Committee and in the spirit of shared accountability for implementing the Monterrey Consensus, the Fund and the Bank have proposed a framework for monitoring the policies and actions needed on the part of developing and developed countries and international institutions to achieve the MDGs. The proposal is to provide an annual global monitoring report—prepared by the Bank and Fund staffs in cooperation with the UN, DAC, WTO and regional development banks—for the Development Committee, to enhance its discussion and to maintain the focus on implementation.

33. The proposed monitoring framework provides a preliminary assessment of progress, for both pillars of the Monterrey partnership. In developing countries, the report emphasizes the centrality of stronger economic growth to achieve MDGs, complemented by policies and actions to empower the poor to participate in enhancing growth. It highlights priorities for creating an environment for private sector development, improving public sector governance,

3 Achieving the MDGs and Related Outcomes: A Framework for Monitoring Policies and Actions (DC/03/3, 3/26/03).
and improving critical service delivery to poor people. In industrial countries, it emphasizes the need for increased market access for developing country exports, including through reducing domestic agricultural subsidies; for more and better aid, including adequate support for global programs on education, HIV/AIDS, and water; and for implementation of good practices in delivery of development assistance. It identifies priority areas for the Bank and the Fund, notably the need for continuing work with partners to improve PRSP implementation, support crisis prevention and volatility management, promote the implementation of standards and codes, support country capacity building, and research critical linkages between policies and the MDGs and related outcomes.

34. I look forward to the views of Ministers on the priorities and monitoring approach set out in the paper and to their guidance on how the Fund, working with the Bank, can help to take this work forward for future meetings of the Committee.

V. ENHANCING THE VOICE AND PARTICIPATION OF DEVELOPING AND TRANSITION COUNTRIES

35. A number of steps have already been taken to enhance the voice and participation of developing and transition countries in decision making at the Bretton Woods Institutions. These include: the PRSP approach to align Bank and Fund assistance with country-grown strategies; greater transparency in decision making, including through direct and broad consultation on policies that affect developing countries; more dissemination of evaluation findings, and other information that allows affected parties to better debate decisions. Concerns nevertheless remain, including about the voting strength of developing countries—specifically, whether some rapidly growing emerging market economies are underrepresented in terms of their share in the world economy, and whether an increase in basic votes should be considered to strengthen the voting power of the smallest members. Similarly, there has been concern about the regional composition of the Executive Board, as well as the excessive workload of Executive Directors for large, multi-country constituencies, in particular, the constituencies involving a large number of program countries; and limitations on the support that certain developing country Executive Directors receive from their capitals.

36. In response to the September 2002 request of the Development Committee, the staffs of the Bank and the Fund have prepared a technical note that provides an inventory of key issues concerning the voice and participation of developing and transition countries and lists possible avenues for change. Meanwhile, the Fund’s Executive Directors have already taken measures to address the staffing constraints of the two Sub-Saharan African constituencies, whose needs are most pressing. In addition, the IMF Institute will organize special courses for staff in the offices of the African Executive Directors that blend financial programming.

4 Enhancing the Voice and Participation of Developing and Transition Countries at the World Bank and IMF (DC/03/2, 3/27/03).
workshops and lectures on macroeconomic policies, to help ensure a deeper understanding of the theory and design of adjustment programs.

37. The Fund's Executive Board is scheduled to continue its consideration of measures to strengthen the governance of the Fund in the context of the Thirteenth General Review of IMF quotas. We expect to provide a progress report to the IMFC at the Annual Meetings this Fall.

VI. CONCLUSION

38. The global economy is facing considerable uncertainty, heightened by current geopolitical issues. However, we must stay the course in our commitment, working together to make decisive progress on the agenda as defined in Monterrey. The Fund is participating actively and determinedly in this effort. The Fund is but one actor, however, and success will depend on the active participation and commitment of all.