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 September 22, 2003, meeting.
A. Development Committee: The Managing Director’s Written Statement

II. INTRODUCTION

1. The global situation as we gather for the 2003 Annual Meetings presents important challenges and opportunities. The task for the international community is to build a stronger and more broad-based global recovery, address global imbalances, and strengthen long-term growth fundamentals. The Millennium Development Goals (MDGs) are ambitious and will require significant efforts by the countries themselves and all development partners. A renewed effort to achieve a successful Doha Round is vital for global growth and our development objectives.

2. The broad principles of the comprehensive development strategy expressed in the Monterrey Consensus on fighting poverty and achieving the MDGs, together with the Poverty Reduction Papers (PRSP) approach and the HIPC Initiative, provide the framework for the Fund’s engagement with its low-income members. There are encouraging signs that sustained implementation of good policies in low-income countries within this framework is beginning to bear fruit, but more needs to be done to achieve the sustained growth necessary for rapid progress towards the MDGs. The Fund is committed to play its part in our core areas of competence and we are in the process of examining how we can best contribute to support better growth outcomes and poverty reduction in low-income countries.

3. In this statement, I shall summarize our assessment of the world economic outlook and address the items on the agenda of the Development Committee.

III. GLOBAL ENVIRONMENT AND POLICY RESPONSE

A. Overall Outlook and Policy Response

4. In April 2003, the global forecast was subject to considerable uncertainty due to the conflict in Iraq and weaker-than-expected activity in late 2002 and early 2003. At that time the forecast that a pickup in global economic activity would resume in the latter half of this year was beset by downside risks. Since then, the balance of risks has improved and forward-looking indicators such as business and consumer confidence have risen, particularly in the United States, and equity markets have also strengthened. Recently, there have been growing indications of increased activity, including investment, particularly in the United States, Japan and some emerging market countries, notably in Asia. There is significant policy stimulus in the pipeline in the United States following easing of fiscal and monetary policies, but less in the euro area and Japan. Overall, global growth is expected to be 3.2 percent in 2003, rising to 4.1 percent in 2004.

5. With the pace and robustness of the recovery still an open question, it will be important for monetary policies to remain accommodative for the time being. Fiscal policies in industrial countries will need to focus increasingly on medium-term consolidation given
the prospect of rising demographic pressures, while structural reform is needed in nearly all countries to reduce widening global imbalances and continuing dependence on the United States for global growth. Also important in this respect will be measures to boost national savings in the United States, especially by strengthening the fiscal position.

B. Regional Outlooks

6. The global recovery will continue to be led by the United States where indicators have shown the most improvement, despite a weak labor market and considerable excess capacity, and where there is the most policy stimulus in the pipeline. Growth prospects in Japan have been revised significantly upward for both 2003 and 2004, as a result of a stronger second quarter outturn than expected, stock market increases and stronger external prospects. In the euro area, the forecast for 2003 has been revised downward again, reflecting weak private domestic demand and euro appreciation, although tentative signs of improvement are now appearing. A pickup is projected in 2004, underpinned by external demand, lower interest rates and automatic stabilizers, but it is expected to be quite gradual.

7. In emerging markets, the outlook continues to be driven by developments in industrial countries, external financing conditions, geopolitical factors, and country-specific developments.

- External confidence in Latin America has improved markedly, but with a number of countries facing debt problems and political uncertainties, the region remains vulnerable to a reversal in sentiment.

- With the apparent end of the SARS epidemic in Asia, growth is expected to pick up in the second half of 2003 and remain strong in 2004, aided by policy easing in several countries and robust growth in China. The pace of recovery will depend importantly on a rebound in domestic demand and a continuation of the nascent recovery in the information technology sector.

- Growth in the transition countries remains solid, led by Russia and Ukraine, while European Union accession countries continue to benefit from strong direct investment flows although weak euro area demand remains a risk.

- In the Middle East, the fragile security situation remains an issue. GDP growth forecasts have been revised upward in 2003 as a result of higher oil prices and production, but the projected fall in oil prices adversely affects the outlook for 2004.

8. In sub-Saharan Africa, growth is projected to rise to 3.6 percent in 2003, due to improved macroeconomic policies, rising commodity prices, and debt relief. This is despite political instability in some countries and adverse weather which—together with the high incidence of HIV/AIDS—are contributing to food shortages. Depending on improvements in political stability and weather, GDP growth could pick up markedly in 2004.
IV. PROGRESS IN DOHA ROUND

9. I regret the outcome of the WTO Ministerial in Cancun. As I stated earlier this month, together with Mr. Wolfensohn and Mr. Johnston, trade liberalization is a central element of the global strategy to achieve the MDGs. All countries have an interest in an outcome that will boost global growth, and therefore must redouble their efforts to bring about a timely and successful conclusion to the Doha Development Round. It is incumbent on all members, through their actions, to reach the common objective of strengthening the multilateral trading system and to resist protectionist pressures. A genuine commitment to liberalization by the industrial countries implies opening up their markets and reducing subsidies — including in agriculture. Developing economies also have their part to play—and it is one that will bring them enormous gains as in many cases barriers to trade among the developing economies are even higher than between rich and poor nations.

10. It is important to bear in mind that the rules-based architecture of the multilateral system has been one of the key sources of economic progress over the past half-century. It is also the only viable way to protect the interests of developing countries. Development Ministers have a key role to play within their own governments in highlighting the overall benefits of further trade liberalization.

11. While we do not expect the temporary costs of adapting to trade liberalization stemming from the Doha Round to be significant for the vast majority of countries, for some it may entail short-term adjustment costs. I am pleased to say that the Fund has proposed to make financial assistance available to developing countries that face a net negative impact on the balance of payments in the near terms from the effects of the Round. The Executive Board has already agreed to this proposal in general terms, and will consider more specific proposals this fall.

12. This initiative will be in addition to the Fund’s already rich program of technical assistance and policy advice on matters relating to trade liberalization, including through the Integrated Framework for Trade-Related Technical Assistance. We are also helping ensure inclusion of trade policy considerations in Poverty Reduction Strategy Papers (PRSPs), and are working on assessments of the impact on textiles trade of the expiration of the Multifiber Arrangement in 2005 and on African agriculture in the context of the Doha Round. We are conducting a review of the Fund’s trade policy advice in the context of Fund-supported programs. Importantly, we have also intensified our coverage of market access issues in our multilateral and bilateral surveillance operations.

V. THE FUND’S CONTRIBUTION TO THE GLOBAL EFFORT TO REACH THE MDGs

13. Achieving the Millennium Development Goals is an ambitious undertaking, and there remains a good deal of room for stronger international cooperation to reach them. The Fund is firmly committed to uphold its part of the two-pillar architecture of the Monterrey Consensus by providing financial and technical assistance focused on its core areas of expertise. The PRSP approach serves as the operational framework for the two-pillar
partnership, providing the central country-level vehicle for making progress toward the MDGs. As such, the PRSP approach provides the framework for the countries’ macroeconomic reform programs supported by the Poverty Reduction and Growth Facility (PRGF).

14. The Fund continues to pursue a broad agenda of work on low-income country issues, through surveillance, technical assistance, and financial support for reform programs. And the Fund continues to refine its policies and procedures to ensure it makes the most effective contribution possible for helping low-income countries make progress toward achieving the MDGs. In the next six months, our work program will focus on four main elements:

- Aligning PRGF-supported programs and PRSPs;
- Exploring what the nature of the Fund’s role in low-income member countries should be over the medium term;
- Helping countries deal better with exogenous shocks; and
- Implementing the enhanced HIPC Initiative and providing countries guidance on how to maintain debt sustainability.

A. Aligning PRGF-Supported Programs and PRSPs

15. The recent PRSP progress report and supporting background paper prepared by the Bank and Fund staffs found that there is evidence of wide-ranging progress in the development of the PRSP approach. Recently-completed PRSPs have built on the lessons learned in earlier PRSPs, and countries that are more advanced in the process are successfully adapting and implementing their strategies. Full PRSPs have been completed for 32 countries, and interim PRSPs for another 21 countries.

16. The PRSP is an instrument charged with multiple objectives that can often conflict, posing difficult challenges for low-income countries. The wide range of proposals and multiple demands coming out of the participatory process can result in a lack of prioritization. Moreover, ensuring that the PRSP meets the expectations of the international community can conflict with country ownership. This is further complicated by the need to improve donor alignment and harmonization around national strategies. Countries’ abilities to manage the tensions in the process will depend crucially on building technical and administrative capacity, which will inevitably require time and donor support. Countries will also need to make tough decisions in prioritizing competing demands. Development partners, for their part, will need to support and respect country priorities in sequencing their own advice and assistance.

1 Poverty Reduction Strategy Papers—Progress in Implementation (SM/03/279, August 8, 2003), and Poverty Reduction Strategy Papers—Detailed Analysis of Progress in Implementation (SM/03/279 Supplement 1, August 8, 2003).
17. For the Fund, an area of particular concern is how countries can strike the right balance in PRSP macroeconomic frameworks between the ambition necessary to make progress in reaching the MDGs and the need for a realistic framework for short-term macroeconomic and budgetary policies. In implementing PRSPs, countries are now confronting the problems that arise from trying to link PRSPs to the national budget process and are working to ensure that public expenditure management tools are sufficiently advanced to support PRSP implementation.

18. In the coming months, the Fund will be focusing intensively on:

- Helping design macroeconomic frameworks that are ambitious but realistic;
- Helping governments to synchronize the PRSP and budgetary cycles to strengthen the links between the poverty reduction strategy and governments’ policy development and implementation procedures;
- Providing technical assistance, especially to strengthen national budgetary processes and public expenditure management; and
- Working with donors to improve donor coordination and alignment of donor–supported programs with PRSP objectives.

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

19. The IMF Executive Board recently initiated a process of considering how the Fund can best support low-income member countries, including how the Fund can best contribute to the global effort toward achievement of the Millennium Development Goals (MDGs). This discussion has been partly prompted by the changing circumstances facing low-income countries. Many low-income countries have made significant progress toward achieving macroeconomic stability and their rates of economic growth have increased. But these achievements remain fragile, and a key challenge will be creating the conditions for sustained high rates of growth.

20. There are several general principles that will guide the Fund’s work with low-income member countries. First, the Fund needs to remain engaged in these countries over the long term to help them address the macroeconomic and institutional challenges they face. As noted above, the Fund’s support will continue to embrace the principles of the PRSP process and support for the MDGs. The Fund will focus on its core areas of competence, while ensuring that its work complements the work of the World Bank and other developmental institutions. The overall objective of Fund policy advice, as well as technical and financial assistance, will be to help low-income members move to a point where they can rely

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predominantly on private sources of financing. Finally we recognize that sustained improvements in low-income member countries’ economic outcomes depend significantly on the policies of the rest of the Fund membership. In its surveillance activities, the Fund is intensifying its focus on the implications of policies of the major economies for global growth and poverty reduction.

21. The Monterrey Consensus recognizes that development partners have complementary responsibilities toward low-income countries, and that there are clear advantages to specialization. These principles for the Fund’s work suggest that its role should predominantly be directed to: establishing macroeconomic frameworks that can support sustained high growth; identifying and helping countries manage sources of macroeconomic vulnerability; and strengthening institutions and policies that underpin sound macroeconomic management. In particular, the Fund will work to improve the design of PRGF-supported programs so that macroeconomic frameworks are geared toward the higher growth needed to make significant inroads in reducing poverty and are appropriately flexible in dealing with higher aid flows. Furthermore, we need to help low-income countries deal better with exogenous shocks and provide the support they need (see below).

22. Some evolution may also necessary in the Fund’s existing instruments to support its low-income country members:

- For post-conflict countries, the Fund provides Emergency Post Conflict Assistance, which is subsidized from a special trust fund. In some cases in the past, countries have moved too quickly from to PRGF-supported programs. We therefore need to consider whether longer bridges are needed to ensure that technical assistance and capacity-building are strengthened before countries move to PRGF-supported programs.

- For countries early in the stabilization phase, PRGF-supported programs are likely to be adequate to support their needs, but the nature of these programs and the extent of Fund financial support are likely to change as macroeconomic stabilization and the support for reforms become more entrenched.

- For countries with track records of sustained macroeconomic stability, Fund involvement should focus more on building the institutions necessary for them to move toward increased reliance on domestic and external private sector financing. However, the mix of financial support, surveillance, and technical assistance for these countries has to be carefully considered so that country needs are met, both in terms of Fund advice and the support of other donors.

23. It is also important to underscore the limitations of Fund involvement. As the Fund refocuses its work on its core areas and macro-critical structural issues, it is necessary to ensure that reforms outside the Fund’s areas of expertise, but no less critical for promoting private sector development and growth (such as the recognition and enforcement of property
rights) proceed apace. Thus, there is a need for continuing the work on collaboration with the World Bank and other development partners.

24. On the financing side, the Fund has neither the capacity nor the mandate to contribute to the long-term flow of resources needed by its low-income member countries to meet the MDGs. Its financing role, consistent with its mandate, is to provide temporary financing to ease the burden of adjustment while macroeconomic imbalances are being addressed. While this may be a longer adjustment in low-income countries than in middle-income countries in the midst of a financial crisis, the Fund needs to be selective and must be willing to step back in cases where there have been successive Fund-supported programs and consider whether it is appropriate to continue such support.

25. In the coming months, the Fund will make an effort to reach out to bilateral and multilateral donors, low-income country officials and civil society organizations to discuss its role in low-income member countries.

C. Helping Countries Deal Better with Exogenous Shocks

26. Exogenous shocks, such as natural disasters, terms-of-trade shocks, and conflicts or crises in neighboring countries, can have a significant adverse impact on developing countries’ growth, poverty, macroeconomic stability, and debt sustainability. Low-income countries are particularly vulnerable to exogenous shocks, as they have a higher incidence of shocks compared to other developing countries and tend to suffer larger damage relative to GDP when shocks occur.

27. Countries can mitigate the impact of shocks through better preparation, and better policy responses, supported by the timely availability of external financial assistance. However, many low-income countries have limited capacity to build up cushions of reserves and fiscal resources as a buffer against shocks, and limited access to affordable market insurance. Therefore, timely external financial assistance can play an important role in helping countries mitigate the effects of shocks. Recent research indicates that external assistance is especially effective following a shock, and avoids the diversion of other resources from development purposes.

28. The Fund has an important role in providing countries with macroeconomic policy advice on how to prepare for shocks and how to respond once a shock hits. More systematic attention needs to be paid in both surveillance and program contexts to help countries devise policies to prepare better for shocks. The Fund can also help countries devise policies to respond to shocks, including helping select an appropriate mix of adjustment and financing. Moreover, it can play an important catalytic role by alerting donors when a country may have unaddressed needs for financing, particularly in the case of “silent crises,” such as commodity price shocks.

29. While grant assistance is generally more appropriate after a shock, the Fund can provide fast-disbursing balance of payments assistance when there is an unmet need and donor assistance is not immediately forthcoming. The Fund has a number of instruments that
can be used to provide financial assistance in response to shocks, but use of these instruments has been relatively limited and most are currently only available on GRA terms. In the coming months, consideration will be given to how the Fund’s response can be made more consistent and whether the terms of the Fund’s instruments targeted to financing shocks can be made more appropriate for low-income countries, with a follow-on Executive Board discussion expected by the end of this year.

D. The Enhanced HIPC Initiative and Debt Sustainability

30. Progress is being made in implementing the enhanced HIPC Initiative, albeit more slowly than earlier expected. To date, 27 of the 38 potentially eligible HIPCs have reached their decision points and eight of these have reached their completion points. The most recent countries to pass HIPC milestones were Benin and Mali, which reached their completion points earlier this year, and the Democratic Republic of Congo, which reached its decision point in July.

31. As of July 2003, 11 of the 19 countries in the interim period between the decision and completion points were performing satisfactorily under PRGF-supported programs, and another four were working towards resuming their programs. The remaining four countries in the interim period need more time to establish an adequate performance record. Most countries have also made progress in the completion of social and structural completion triggers. Most of the 11 countries which have not yet reached the decision point have had conflict or arrears problems, but a few may be able to start establishing a policy performance record by the end of 2004. Where conditions have been conducive, the Fund has remained engaged in these countries, either by providing Emergency Post-Conflict Assistance or by helping put in place staff-monitored programs to help build adequate capacity to move to a PRGF-supported program.

32. The 27 countries which have reached decision point account for the large majority of the total expected relief for the 34 HIPCs for which data are available. This assistance, together with traditional debt relief and bilateral assistance, will cut the stock of debt for these countries by about two-thirds in net present value terms, or to levels comparable to other developing and low-income countries. In addition, by 2001, the average debt-service-to-export ratio for HIPCs had already fallen to below the corresponding ratio in other low-income countries. The resulting savings have contributed to a substantial increase in poverty-reducing expenditures. There is also evidence that debt relief to the countries that have reached their decision points has been additional to other forms of financing, as both gross and net resource flows have increased in the period from 1997-2002, thereby restoring external financing to the levels of the early 1990s.

33. The purpose of the enhanced HIPC Initiative is to reduce the burden of eligible countries’ external debt, thereby creating a basis for achieving debt sustainability. However, the Initiative alone cannot ensure long-term debt sustainability: this requires that sound economic policies be followed in the context of good governance, and that the amount and terms of new financing be consistent with countries’ debt-servicing capacity. The Fund’s
Executive Board has already held a preliminary discussion of the issues to be resolved in assessing and maintaining debt sustainability, including in countries that have reached their HIPC Initiative completion points; Fund staff have been exploring these issues more widely in close collaboration with the World Bank and in consultation with other interested parties. The aim is to devise a framework as the basis for advice to low-income countries and their creditors. The framework will need both to be consistent and take account of a range of indicators and country-specific circumstances. A joint paper is being prepared for discussion by the Boards of both the IMF and World Bank.

E. The Agenda Ahead

34. In summary, the key areas where evolution in the Fund's role in helping low-income countries achieve the MDGs is needed are as follows:

- To improve the design of PRGF-supported programs to ensure that macroeconomic frameworks are geared toward the higher growth needed to make significant inroads in reducing poverty and that are appropriately flexible in dealing with higher aid flows.

- To help countries address institutional and governance issues critical to more rapid private sector development. This will require even closer collaboration with other development partners, in particular the World Bank.

- To help countries better deal with exogenous shocks and provide the support needed—policy advice, technical assistance and temporary financial support—to help them put in place macroeconomic policies needed to help reduce their vulnerability to shocks.

- To ensure that we have the right set of instruments to help our low-income member countries meet their objectives over time and facilitate their transition to a point where they can move beyond sustained Fund financial support.

- To explore further the ways, in collaboration with the Bank, to help strengthen the design and implementation of countries’ financing strategies to improve debt sustainability, beyond the enhanced HIPC Initiative.

VI. Monitoring Policies, Actions and Outcomes Needed to Achieve the MDGs

35. At the April 2003 meeting, the Development Committee reiterated its commitment to monitoring policies and actions of both developing and developed countries and of development agencies to enable rapid progress towards achieving the MDGs. The current discussion on global monitoring focuses on developing an inter-agency monitoring
architecture, as well as on establishing a coherent global monitoring work program for developing and developed countries and for international financial institutions.3

36. The present work program is focused on the preparation—jointly by the Bank and the Fund—of the Global Monitoring Report (GMR) for issue in March/April 2004. For developing countries, three key tasks are identified in the report. First, a number of existing country policy assessments by various institutions should be upgraded. Second, efforts are underway to develop policy monitoring indicators for achieving the MDGs in the three key areas - private sector development, public sector governance, and human development. And finally, the Bank and the Fund are improving collaboration with the United Nations on MDG-related research.

VII. Enhancing the Voice and Participation of Developing and Transition Countries

37. The Report of the Executive Board to the IMFC on Quotas, Voice and Representation summarizes the status of discussions on the two tracks on which the issue of enhancing the voice and participation of developing and transition countries is being pursued: quotas and related topics, and administrative and capacity-building measures.

38. In January 2003, the Board of Governors concluded the Twelfth General Review of Quotas with no increase in quotas, and resolved that measures to improve the distribution of quotas and voting power will be considered during the period of the Thirteenth General Review of Quotas. At a recent meeting of the IMF Board, most Executive Directors saw merit in a package of measures that would involve changes in quotas and voting power in the context of the next general increase in IMF quotas. Further consensus building efforts amongst our members are needed at this point.

39. There has also been concern about the excessive workload of Executive Directors for large, multi-country constituencies, in particular, the constituencies involving a large number of program countries. Therefore, new rules have been agreed to expand the staffing of these offices. There are a number of other proposals underway to help enhance capacity in Executive Directors’ offices, including clarifying the qualifications and duties of staff of the offices of Executive Directors, additional training for Executive Directors’ new staff, and use of new technology to facilitate close and effective communication with authorities in capitals.

VIII. CONCLUSION

40. Development partners must redouble their commitment and efforts to do what is needed to make decisive progress towards the MDGs. The Fund is working hard to make an effective contribution, but its role is necessarily limited to its areas of responsibility. Ultimately, good development outcomes will require accelerated growth and a stronger focus on the needs of the poor in the development process. National efforts to this end must be reinforced by generous and wide-ranging support by the international community.