Statement by

The Honorable Antonio Fazio
Governor of the Bank of Italy
Constituency of Albania, Greece, Italy, Malta, Portugal
San Marino and Timor-Leste
STATEMENT BY HON. ANTONIO FAZIO, GOVERNOR OF THE BANK OF ITALY
CONSTITUENCY OF
Albania, Greece, Italy, Malta, Portugal, San Marino and Timor Leste,
Development Committee, Washington, D.C., October 2, 2004

I. Introduction

Much work has been done since Monterrey to implement the Millennium Development Goals (MDGs). However, the documentation before us today shows that progress has been mixed and particularly slow in Sub-Saharan African countries. Both the target of gender equality in education and the health goals are at a very high risk. The poverty reduction target will only be reached in the aggregate by 2015 if countries continue with current reforms. Progress can be accelerated by refining our result-based approach. It is, therefore, highly appropriate that we now focus our attention on what demonstrably makes aid more effective as an instrument to achieve the MDGs.

II. A Clear Strategic Focus

It is now well-understood that reaching the Millennium Goals will require additional financing, but there is also a clear recognition that aid per se is not the solution to the development challenge. Aid can play a catalytic function, but, in order to do so, it must be effective. It must be directed to its most productive uses and complemented by increased domestic resource mobilization and private capital flows. These, in turn, will only come about with further strengthening of the policy environment in developing countries.

The documentation in front of us argues that developing countries taken as a group could use larger volumes of aid effectively due to their now stronger policy frameworks. It also recognizes, however, that individual countries face specific absorptive capacity constraints whose depth and scope vary depending on the country’s unique situation and level of development, with Middle Income Countries (MICs) at one end of the spectrum and difficult cases such as Low-Income Countries Under Stress at the other. Absorptive capacity constraints are rooted in basic social, cultural and political realities; constitutional provisions and administrative processes; weak institutional capacity; and poor quality of physical and human capital.

For poorer countries, country-owned Poverty Reduction Strategy Papers (PRSPs) continue to be an essential tool. Their implementation, however, needs to be carefully monitored both by governments and donors. Going forward, PRSPs should take a more comprehensive and balanced view of the multiple factors contributing to sustained poverty reduction and improved social indicators and must include an in-depth analysis of the sources of economic growth. In this respect a healthier private sector, with unleashed entrepreneurial energies, should provide a broader and deeper revenue base to
the government, and is a critical lynchpin in the virtuous cycle that generates more fiscal space for needed social and infrastructure expenditures.

In the case of MICs, constructive and long-term strategic partnerships between them and the donor community should be further encouraged. In particular, the Bank needs to maintain a balance between working as an effective catalyst of development resources and playing an independent advisory role while preserving the broad safeguards which are the hallmark of its involvement in projects.

One issue greatly debated with reference to the MICs is that of the integrity of the Bank’s policy in the environmental and social areas. From our perspective, there is no doubt that the International Financial Institutions (IFIs) in general, alongside their catalytic role, continue to have an important function in safeguarding the environmental and social aspects of development, and the two must be carefully balanced.

Finally, effective strategic focus requires stronger developing country ownership of development programs. In this context, we acknowledge the efforts of the Bretton Woods Institutions (BWIs), particularly the World Bank, to move the debate on “voice” forward. Voice has been rightly approached both as an issue of adequate and effective representation for the developing and transition countries (DTCs) in their Boards and one of strengthening the DTCs’ ownership of operational programs. With respect to representation, we are open to consider efforts to align the voting power of member countries more closely with their current economic status, and to explore the feasibility of other measures, provided a broad consensus could be reached. But we also believe in the fundamental need for strengthening voice at the operational level. Better communication, at all stages of strategy and program formulation and implementation, is an important way to assure this. In this context, we strongly encourage the Bank to make strategic communication an integral component of all its programs and projects.

III. Implementing the MDG Agenda

Country-owned development strategies provide the overall framework for the donor community to support a country’s own priorities. This is the essential basis for harmonization of donors’ policies and procedures. How well harmonization is accomplished will depend on effective stewardship by developing countries, but also on the strong commitment by donors. The First High-Level Forum on Harmonization in Rome formally captured the commitments of all development partners, but the implementation record so far has been mixed. We encourage the Bank to propose an action plan to be discussed in the forthcoming Second High-Level Forum in Paris. We continue to view cooperation and coordination with the IMF and between the Bank and the other Multilateral Development Banks as an essential component of a successful harmonization agenda.

With regard to the actions that development partners are called to undertake to achieve the MDGs we have discussed at length in past meetings the need for further investment in education and health. We have also discussed progress in the “Education
for All Fast Track Initiative” and several global health partnerships, such as the “Global Fund to Fight AIDS, Tuberculosis and Malaria”, that Italy strongly supports. These remain important priorities, but the Bank now needs to accelerate progress in creating an enabling environment for the private sector, including the provision of physical infrastructure.

We are pleased with the progress made by the Bank in developing a deeper understanding of the investment climate and its micro-level components. These investment climate analyses must now be projected against the backdrop of the broader macroeconomic and governance frameworks and of the dynamics at play in the financial sector of individual countries, with special emphasis on access to credit particularly for Small and Medium Enterprises (SMEs). In this regard, we stress the importance of implementing effectively microfinance programs and initiatives. We also encourage the Bank to review its so far limited experience with operations specifically targeted at increasing the competitiveness of the economy and improving the business climate with a view to better integrating its advisory services (e.g., policy dialogue, business development facilities) and lending products in order to achieve greater catalytic and developmental impact.

We take note of the results achieved so far in the implementation of the Infrastructure Action Plan. An increase in the volume of infrastructure investments remains an important goal in the context of efforts to strengthen the overall climate for private investment. The World Bank Group and other IFIs have an important catalytic role to play in this respect by developing more flexible models for public-private partnerships and additional risk mitigation measures that would help secure long-term private sector funding for infrastructures.

Considering the related broad issue of financing the MDG agenda, since our last meeting work has been done mostly on the International Financial Facility (IFF) and on Global Taxation (GT), but exploration of other options has been limited. Additional analysis could cover options such as the use of incentives to attract remittances to development-oriented programs. Indeed, the benefit of remittances for economic development in recipient countries is becoming visible in a number of cases. Initiatives have been recently outlined by the G7 countries with regard to remittances sent from their economies to emerging and developing countries. Other mechanisms to involve the private sector in voluntary aid schemes could be explored, especially given the political and legal constraints that hinder both GT schemes and the general applicability of an IFF.

With respect to the role of the public sector in financing investments, developing countries have been emphasizing that more fiscal space is needed. But the way fiscal space should be created is through the strengthening of tax systems and the broadening and deepening of the revenue base. Increase in public spending should not put a country’s macroeconomic stability in jeopardy by leading to unsustainable debt levels. We see a lead role for the BWIs in efforts to coordinate financing strategies with respect to the most indebted countries.
Finally, we welcome the extension of the Sunset Clause of the Highly Indebted Poor Countries (HIPC) Initiative through the end of 2006, basing eligibility on HIPC income and indebtedness criteria that are applied using end-2004 data. Now it is essential that a sound debt sustainability framework be put in place as soon as possible, based on the ongoing work in the Fund and the Bank. It is indeed necessary to complement the ex-post debt relief provided by the HIPC Initiative with a more comprehensive debt sustainability framework, able to provide guidance to lenders and donors and to coordinate their financing in order to prevent the build-up of unsustainable debt. The new framework should be able to discriminate more effectively among countries based on performance and the level of concessionality they need, preserving in such a way the principle of selectivity in aid allocation and minimizing moral hazard. We also subscribe to the idea of complementing it with more effective and innovative instruments to deal with exogenous shocks.