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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STATEMENT BY THE ACTING MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Attached for information of the Members of the Development Committee is a Statement from the Acting Managing Director of the International Monetary Fund, Anne Krueger, for the Committee's April 25, 2004, meeting.

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DEVELOPMENT COMMITTEE: THE ACTING MANAGING DIRECTOR'S WRITTEN STATEMENT

I. INTRODUCTION

1. We are meeting at a time when increased effort is needed by development partners to secure the commitments made at Monterrey to help achieve the Millennium Development Goals (MDGs). The improved world economic environment, and a growing realization that MDG financing needs to be scaled up, provide an opportunity to make substantial progress in the next year in carrying out these commitments.

2. The Global Monitoring Report (GMR), prepared by the Bank and Fund staffs with the active cooperation of a number of other entities, is a compendium of information on progress that countries and institutions are making toward establishing appropriate policies for achieving the MDGs, and provides an analysis of the key accountabilities and priorities for action.[1] It emphasizes that developed countries should pay further attention to cooperative actions to sustain growth over the medium term, and scaling up official development assistance. Developing countries are generally making good progress toward implementing stronger macroeconomic policies, but more is needed, particularly on fiscal soundness and governance. All countries, developed and developing, have a collective responsibility to ensure the timely and successful conclusion of the Doha Round. International financial institutions need to strengthen their roles in low-income countries, including by deepening their involvement in the PRSP process, seeking to reconcile countries' spending requirements for achieving the MDGs with the need to maintain sound macroeconomic policies, including debt sustainability, and improving coordination of their support with country priorities.

3. The Fund is working to reinforce its own activities through its policy advice and technical and financial assistance, both to low-income member countries and to the rest of the membership. In this statement, I shall summarize the Fund's assessment of the world economic outlook and explain in more detail the Fund's activities to improve its support for helping low-income countries make progress toward achieving the MDGs.

II. GLOBAL ENVIRONMENT AND POLICY RESPONSE

A. Overall Outlook and Policy Response

4. Since September 2003, the global economy recovery has become broader and deeper.[2] The strengthening of the recovery has been based upon a sharp pick up in industrial

[1] *Global Monitoring Report 2004—Policies and Actions for Achieving the MDGs and Related Outcomes* (SM/04/91, 3/12/04).

[2] *World Economic Outlook—Prospects and Policy Issues* (EBS/04/35, 3/8/04).

production, a strong rebound in global trade, and a broad-based rally in financial markets, reflected in increases in equity prices, further decreases in bond spreads, and a rebound in private financing flows to emerging markets. Growth has been strongest in the U.S. and in the emerging markets in Asia, particularly China. Fund estimates of global GDP growth in 2003 have been revised upward to 3.9 percent, with growth of 4.6 percent expected in 2004 and of 4.4 percent in 2005. Despite the faster growth and increases in oil and commodity prices, inflation has remained subdued, reflecting excess capacity, continued weakness in labor markets, and increased competition in domestic and global markets.

5. With the global recovery increasingly established, the balance of risks to the outlook has clearly improved, with some upside potential for short-term growth. Nevertheless, significant downside risks remain, and a number of challenges need to be addressed. Continued geopolitical uncertainty poses risks, including to the stability of oil prices. An orderly resolution of global imbalances is still important for global growth prospects. At some point, interest rates will also need to rise from current very low levels, and there is a risk of significant volatility in asset markets if these increases are sharper than expected. Weak medium-term fiscal positions—especially in industrialized countries facing changing demographics—could put further upward pressure on interest rates.

6. The current broadly favorable economic outlook provides a good opportunity to respond to these challenges, particularly those which affect the medium term, and to rebuild room for future policy maneuver. The main policy actions needed can be summarized as follows:

- As the recovery continues, monetary policy will inevitably need to become less accommodative. The key challenge for central banks will be to communicate their policy intentions as clearly as possible to minimize the risks of abrupt changes in expectations and financial market instability.

- Cooperative policy-making across regions to rebalance demand and support growth will be important for an orderly resolution of global imbalances. The main elements should include medium-term fiscal consolidation in the U.S., structural reform in the Euro area, banking and corporate sector reforms in Japan, and greater exchange rate flexibility and structural reform to support domestic demand in most emerging markets in Asia.

- Fiscal consolidation will be important more broadly for restoring medium-term fiscal positions, including in industrialized countries which require reform to their pension and health care systems. Similarly, developing countries will need to take measures to improve public debt sustainability.

- Open markets and the resumption and successful conclusion of the Doha Round negotiations will be important for broad-based global growth and poverty reduction in low-income countries.

- Fulfillment of commitments made in Monterrey, both by the international community and low-income countries, will be needed for substantial progress toward achieving the Millennium Development Goals.

B. Regional Outlooks

7. The global recovery will continue to be led by the *United States.* Although monetary and fiscal policy stimulus will begin to wane in 2004, solid investment growth, growing productivity, and a pick up in employment are expected to sustain growth. The United States also needs to establish a credible fiscal framework that will help ensure a return to a balanced budget (excluding Social Security) over the medium term, and to begin the reforms necessary to place health care and retirement entitlement programs on a sound financial footing over the long term. There are nascent signs of a recovery in the E*uro area*, particularly an increase in fixed investment, but private consumption remains quite weak and euro appreciation, geopolitical uncertainties, and balance sheet restructuring could serve to dampen the outlook. Further monetary easing may be required if domestic demand does not pick up and provided inflation remains benign. Medium-term policy priorities are further structural reform and fiscal consolidation. GDP growth in *Japan* has continued to exceed expectations, based on strong external demand—notably from China—and increasing support from investment and consumption. Continued efforts to ease deflationary pressures and strengthen the bank and corporate sectors should build on the already achieved progress in these areas.

8. In *emerging markets*, there has been a rebound in activity in every region, aided by improved fundamentals, strong private capital inflows, and low financing costs.

- GDP growth has been strongest in *emerging market Asia*, underpinned by accommodative macroeconomic policies, rapidly expanding trade, competitive exchange rates, and recovery in the information technology sector. Growth has been particularly strong in China, and gradual steps to a more flexible exchange rate regime—combined with steps to strengthen financial markets—will help underpin sustained growth with price stability. There could also be greater exchange rate flexibility in countries where the cyclical upturn is strongest and further reserve accumulation could exacerbate inflationary pressures. This would also allow the region to contribute to more balanced global growth.

- In *Latin America*, an export-led recovery is expected to pick up in 2004, as strengthening domestic demand provides further support. Against the backdrop of high public debt levels, implementation of measures to reduce vulnerability to possible financial market deterioration will be important to ensure sustained growth.

- Growth in the *transition countries* remains solid, led by Russia and Ukraine. To sustain growth, these countries will need to continue with reforms to improve the investment environment, strengthen banking and judicial systems, and remove trade barriers within the region. *European Union accession countries* are expected to experience a more moderate upturn, linked with the performance of the Euro area, and those countries where current account deterioration has occurred will need to focus on fiscal consolidation.

- In the *Middle East,* growth is expected to slow down somewhat in 2004 as a result of slow growth in oil production. Fiscal consolidation will be important for reducing these countries' vulnerability to oil price fluctuations.

- In *sub-Saharan Africa,* growth is projected to strengthen further in 2004, as a result of improving macroeconomic fundamentals, higher commodity prices, improved political stability and better weather conditions, as well as rising oil and gas production in some countries. Sub-Saharan African countries need to take steps to promote stronger private sector activity and investment, reduce vulnerability to exogenous shocks, develop infrastructure, and strengthen institutions, governance, and transparency, along with efforts to avoid the resurgence of civil conflicts.

III. Role of the Fund Regarding its low-income Members over the medium term

9. The GMR confirms that, while the international financial institutions have made progress in redirecting their work to support achievement of the MDGs, more work is needed. The Fund is examining its policies and operations to ensure that its involvement with its low-income membership addresses these objectives as effectively as possible. This process was started in August of last year, when the Executive Board held the first in a series of discussions on the role of the Fund in low-income countries. The discussion established that the Fund needs to remain engaged in assisting low-income countries over the long term, with the Poverty Reduction Strategy Paper (PRSP) approach and the Monterrey Consensus providing the appropriate framework for the Fund's engagement. It established that the overall objective of Fund engagement is to promote a more stable macroeconomic and institutional framework in support of private sector investment and growth, as well as greater resilience to shocks. Over the long run, this will permit the evolution from sustained program engagement and predominantly donor financing, moving to a point where countries can rely increasingly on private sources of financing. This evolution will be supported by Fund technical assistance and policy advice provided in the context of surveillance. The upcoming Independent Evaluation Office report on PRSPs and the PRGF, and the review of design of PRGF-supported programs as well as various other efforts underway, should provide information to enable us to refine this vision further.

10. A number of PRGF-eligible countries have achieved basic macroeconomic stability and are implementing reforms needed to solidify medium term growth. Although they are likely to remain vulnerable to shocks for some period of time, these countries will be increasingly ready to move to a relationship similar to that of the rest of the Fund's membership, one focused on surveillance and episodic financing rather than prolonged program-based engagement. Indeed, a challenge ahead is to find the right mechanisms to facilitate these transitions, while at the same time ensuring that adequate capacity is developed and a stable macroeconomic framework is maintained in order to ensure effective

use of increased donor aid inflows. At the same time, it must be recognized that a number of countries will not make these transitions for some time to come. To serve the various needs of its low-income members best, the Fund's focus will remain on: providing advice and assessments of policies in its areas of expertise; making available suitably tailored financial support; providing technical assistance; enhancing the coordination of donor support to poor countries; and advising both recipient countries and donors on financing options consistent with development needs and longer-term debt sustainability considerations.

A. Areas of Progress Since the 2003 Annual Meetings

Adaptation of Instruments and Financing for Low-income Membership

11. Following up on the August 2003 Board discussion, staff held discussions with donors and recipients on how the Fund's role should evolve in practice. Following these consultations, a paper was presented providing a number of options on how the Fund might adapt its instruments and financing to support better the diverse needs of its low-income members and contribute to the intensified international effort toward the achievement of the MDGs.[3] The paper (on "Instruments and Financing") was discussed by the Executive Board on March 31. There was agreement on the following:

- For members with continuing balance of payments needs, norms are to be established for tapered access levels to PRGF resources under successive arrangements, but with access decisions still taken on a case-by-case basis; clearer guidelines are to be established on using blended PRGF/GRA resources.

- For members with limited balance of payments needs, low-access arrangements were seen as providing the best recourse for countries still vulnerable to shocks and still interested in the macroeconomic monitoring associated with upper credit tranche conditionality. The Executive Board requested that staff consult further with members and donors, with a view to proposing a mechanism of strengthened surveillance that would have frequent monitoring and Executive Board engagement. This could ensure a smoother transition from reliance on successive PRGF arrangements to a surveillance relationship. In addition, the existing policy of post-program monitoring is to be extended to members exiting PRGF arrangements with outstanding access of more than 100 percent of quota.

- Members emerging from conflict need adequate time to strengthen implementation capacity before embarking on adjustment programs that could be supported by PRGF

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[3] *The Fund's Support of Low-Income Countries—Consideration of Instruments and Financing (*SM/04/32, 2/24/04).

arrangements. The Board therefore agreed that longer duration and more tapered access to emergency post-conflict assistance as well as more frequent assessments of policy performance should be a possibility.

- To help low-income members respond better to the adverse impact of exogenous shocks, guidelines are to be devised to make PRGF augmentation more systematic and consistent. Also, provided resources from bilateral contributions are available, Emergency Natural Disaster Assistance from the Fund should be subsidized, as is the case with Emergency Post-Conflict Assistance. Staff was also asked to develop specific proposals for a new facility from the PRGF Trust that would provide lending on PRGF terms but have the design features of a stand-by arrangement.

12. On the financing side, the paper presented a number of options on how to continue PRGF financing over the medium term, given that interim PRGF resources are estimated to be depleted sometime toward the end of 2005 or mid-2006. Estimates indicate that financing capacity on the order of SDR 0.8-1.2 billion annually would provide a reasonable basis for PRGF lending operations during 2006-2010. After 2010, it is anticipated that the financing requirements for PRGF operations may decline, but it would remain important for the IMF to maintain a significant financing capacity to address low-income members' balance of payments needs. The precise financing requirements beyond 2010 will need to be examined closer to that time. The Board broadly agreed that the best financing option would be use of available resources in the PRGF Reserve Account to begin "self-sustained" operations in 2006, while supplementing lending capacity with additional bilateral loans. This option would meet the projected financing requirements in 2006-2010 and also allow for the continuation of self-sustained PRGF operations beyond 2010 at a significant level. Generally, the Executive Board did not favor changing the terms of PRGF financing, or to give grants from the PRGF Trust.

Improved Framework for Assessing Debt Sustainability and the Enhanced HIPC Initiative

13. The durable achievement of the MDGs depends on ensuring that the large financing needed does not lead to an excessive build up of debt. To this end, Fund and Bank staff have been working to develop a forward-looking framework to guide borrowing decisions of low-income countries, as well as financing decisions of their creditors and donors, as described in the separate note.[4] For the framework to become fully operational, some of its modalities and operational implications remain to be clarified. Besides further considerations on how to arrive at joint assessments of debt sustainability in individual countries, the two institutions need to determine how the framework should be incorporated into their operations and how

[4] See April 2004 Bank/Fund *Note on Debt Sustainability* prepared for the Development Committee Meeting, and *Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications* (SM/04/27, 2/03/04).

to coordinate decisions with other creditors and donors to ensure that resources are provided to low-income countries on terms that are consistent with debt sustainability.

14. Substantial progress has been made in implementing the enhanced HIPC Initiative, as described in the note and the HIPC statistical update.[5] Later this year, the Fund and Bank Boards will consider the sunset clause of the HIPC Initiative, which comes into effect at end-2004.

Review of Bank-Fund collaboration

15. A second review of the 2001 enhanced framework for Bank-Fund collaboration was discussed by the Fund and Bank Boards in March.[6] Based on survey responses from national authorities and staff country teams, the review found that the two staffs typically share a common perspective regarding critical areas for reform, that the division of labor between the two institutions is clear, and that close collaboration is increasingly serving to strengthen national ownership of reform programs. The review also pointed to the need for sustained efforts at collaboration and to areas for further improvement. Our view is that this can be best addressed by, among other things, reconstituting an expanded Joint Implementation Committee (JIC) to bolster collaboration at the country team level and to discuss cross-cutting issues pertaining to both low- and middle-income countries. Close and joint work in thematic areas, such as public expenditure management and poverty and social impact assessments, will also be a fruitful avenue for strengthening collaboration, national ownership, and effectiveness of program design and policy advice.

Doha Negotiations and the Trade Integration Mechanism

16. At last year's Annual Meetings, Ministers called on the Fund and Bank to continue pressing for meaningful progress on trade negotiations and a successful conclusion of the Doha Development Round. The Fund is committed to helping its members take full advantage of the opportunities of more open trade and to manage the risks better. It already plays an important role in advocating the benefits of open trade in the context of surveillance, and promoting trade-related reforms through the provision of technical assistance and program support.

17. In following up on the Annual Meetings, we have also taken two specific initiatives. In November 2003, the Managing Director of the Fund and the President of the World Bank wrote an open letter to heads of state and government that emphasized the need for political

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[5] *Heavily Indebted Poor Countries (HIPC) Initiative—Statistical Update* (SM/04/109, 3/31/04).

[6] *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Progress Report* (SM/04/57, 2/25/04).

leadership if the ambitious goals of the Doha Development Agenda were to be achieved, and if trade was to live up to its potential as a key source of growth in our common efforts to meet the MDGs. The letter noted that trade liberalization is not a "concession," but rather a step that helps promote opportunity and productivity in countries that undertake it. Multilateral liberalization offers the most scope for achieving these benefits—bilateral and regional arrangements are no substitute.

18. To provide added assurances to countries that are concerned about the adjustment costs associated with multilateral liberalization, the Fund Board decided on April 2 to establish a new Trade Integration Mechanism (TIM). The TIM is designed to help countries identify the nature and size of possible shocks to their balance of payments, and formulate appropriate policy responses, as well as increasing the predictability of Fund financial support to countries facing temporary balance of payments shortfalls as a result, for instance, of greater competition in their export markets or adverse changes in their food terms of trade. Countries will be able to avail themselves of the TIM in the context of programs supported by stand-by, extended, or PRGF arrangements. Since balance of payments shortfalls of this type are unlikely to be large for most countries, the TIM is expected to create only moderate demands on Fund resources. The Fund's Board emphasized that the TIM is to be a temporary policy, designed to address concerns associated specifically with the current round of multilateral trade negotiations, and a decision on its continuation will be taken in three years' time.

B. The Agenda Ahead

19. Substantial follow-up work will be required in all these areas. Over the next six months, a number of projects will be undertaken, including:

- The preparation of specific proposals based on Executive Board discussion of the "Instruments and Financing" paper, including more detailed estimates of needs for PRGF financing. A separate paper will be prepared to consider how to facilitate the transition between use of financing, especially under PRGF arrangements, and surveillance, and the Fund's role in giving signals about macroeconomic performance to other development partners. The forthcoming biennial review of surveillance will provide an early opportunity to reflect on the available range of surveillance instruments and modalities.

- Follow-up work on making the debt sustainability framework operational and extending the assessment templates to surveillance activities, the annual Bank/Fund progress report on implementation of the enhanced HIPC Initiative, and a Board paper addressing issues associated with the end-2004 sunset clause of the HIPC Initiative.

- A Bank-Fund annual PRSP progress report to be completed prior to the 2004 Annual Meetings. This year the report will be enriched by the results of the forthcoming Independent Evaluation Office's (IEO) report (prepared in consultation with the

World Bank's Operations Evaluation Deparment—OED) on the PRSP approach and the PRGF.

- A joint report by the Bank and Fund on Financing Modalities Toward the Millennium Development Goals, scheduled to be completed by the Annual Meetings. This report will consider international financing facilities and other modalities to increase official development aid.[7]

- Continued engagement with the OECD DAC, the Strategic Partnership for Africa, and the multilateral development banks in efforts to enhance donors' harmonization and alignment in low-income countries, with the aim of improving aid predictability, aid effectiveness, and country ownership.

- A review of PRGF-supported program design focusing on how macroeconomic frameworks can best support sustained growth and poverty reduction, particularly through creating an environment conducive to stronger private sector growth.

- The creation of additional internal capacity to help integrate current and future Poverty and Social Impact Analysis (PSIA) into PRGF-supported program design.

- A careful consideration of the Financial Sector Assessment Program to ensure that the assessments contain essential information needed to address the particular problems faced by low-income countries in developing healthy financial sectors.

C. Voice, Representation, and Quotas

20. The Fund's effectiveness as a cooperative institution depends on all members having appropriate voice and representation. While the consensus-building mode of operation gives voice to countries with small quotas, efforts have been made nonetheless, within the current framework of voting power, to enhance the capacity of Executive Directors from developing and transition countries to participate effectively in decision making in the Fund, including by addressing staffing and other constraints faced by Directors with large multi-country constituencies. Further progress on the issue of voice and representation will require broader consensus among the Fund membership than currently exists, and continued strong efforts are needed to build agreement in this area. The Boards of the Fund and World Bank are scheduled to produce a report on voice and representation for consideration by the Development Committee at the 2004 Annual Meetings.

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[7] A progress report, *Financing Modalities Toward the Millennium Development Goals: Progress Note* (SecM2004-0107), was developed by the World Bank with the cooperation of IMF staff as background for the Development Committee meeting.

IV. Conclusion

21. Under current trends and policies in developed and developing countries, the Millennium Development Goal of cutting extreme income poverty in half between 1990 and 2015 will be met at the global level. Many countries, however, especially in sub-Saharan Africa, will fail even to come close to meeting this goal, and most of the critical health and education goals will not even be met globally. The international community must act quickly and forcefully to scale up its support for policies and actions to promote growth and sustainable poverty reduction.

22. The Fund has an important, although limited, role in this international effort, which challenges the institution to make its assistance to low-income countries as effective as possible. The work being done by the Fund, as summarized in this statement, is consistent with the basic principles laid out by the Executive Board in its August 2003 discussion and reaffirmed by the IMFC at the 2003 Annual Meetings:

- The Fund will remain engaged in assisting low-income member countries over the long term, with the PRSP approach and the Monterrey Consensus serving as the framework for its engagement.

- The Fund's work is concentrated in its core areas of expertise, in close collaboration with other development partners. Its contribution is focused on helping low-income member countries establish macroeconomic frameworks that can support high sustained growth and poverty reduction, identify and manage macroeconomic risks and vulnerabilities, and strengthen institutions and policies.

- Over the long term, we hope these efforts will support and facilitate countries' transition to market-based economies, with increasing reliance on private sources of financing.

- At the same time, we are underscoring to developed countries the need for them to open up their markets to exports from low-income countries and to increase official assistance.

23. The Fund will continue its work based on these principles and its close cooperation with the international community in our joint effort to meet the challenge of the Millennium Development Goals.