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To: Members of the Executive Board

From: The Secretary

Subject: **Managing Director's Statement to the Development Committee**

Attached for the information of Executive Directors is the Managing Director's written statement to the Development Committee. This statement will also be issued as a Development Committee document.

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Department Heads

DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR'S WRITTEN STATEMENT

1. At the Annual Meetings last year, I received the strong support of the IMF's membership for the Fund to play an active part in the international effort to make globalization work for the benefit of all. To best fulfill this role, the Fund is refocusing its activities in line with its core responsibilities, strengthening its financial sector work and surveillance, and it is learning from and adapting to new challenges. We will also work more closely with other international organizations, especially the World Bank, and reinforce our technical assistance for capacity-building in member countries.

2. Since our last meeting, prospects for global growth have weakened significantly, led by a marked slowdown in the United States, a stalling recovery in Japan, and moderating growth in Europe and a number of emerging market economies. Other regions of the world have not taken up the slack. Declines in world equity markets and financial difficulties faced by Argentina and Turkey heighten further the risks in the global economy.

3. Given the rapid response by several central banks in both advanced and emerging economies there is a reasonable prospect that the slowdown in global growth will be short-lived. Moreover with inflationary risks receding, most advanced economies, except Japan, have room to further ease monetary policy and, as a second line of defense, provide fiscal stimulus, which the United States is expected to do. Also, while a number of emerging market countries continue to face serious difficulties, external and financial vulnerabilities have been reduced since the 1997-98 crises, and the shift to more flexible exchange rate arrangements has improved countries' ability to manage external shocks.

4. Nevertheless, there is uncertainty about the outlook and there is a need to guard against the risks of a deeper and more prolonged downturn. The extent of the downturn will be affected by the policy decisions of all countries. In this regard, it will be essential to build confidence by demonstrating the resolve to press ahead with growth-oriented structural reform, particularly in Japan and Europe. Forceful action to open markets and liberalize trade would be of benefit to all members. Emerging market and developing countries, for their part, should stay the course of structural reform and sound macroeconomic policies.

5. The slowdown in global growth will have an adverse impact on many low-income countries, especially in Africa, where its negative effects on exports could be augmented by a further weakening in commodity prices. Building upon the recent strengthening of economic policies in many of these countries, policy-makers need to improve the environment for private investment, strengthen public service delivery, improve tax administration, enhance governance, build up administrative capacity, and continue to reduce trade barriers.

6. Advanced economies have a special responsibility to assist the efforts of low-income countries, particularly at the present juncture, and to eliminate all barriers to the exports of

developing countries, especially the poorest ones. In this regard, the recent initiative of the European Union to eliminate tariffs and quotas immediately on almost all exports of the least developed countries as well as market-opening initiatives announced or implemented by other countries are welcome. In view of the importance of open and competitive markets for promoting growth and global prosperity, it is vital for countries to find common ground to launch as soon as possible new multilateral trade negotiations

I. PROMOTING INTERNATIONAL FINANCIAL STABILITY

7. It is the task of international economic policy to tap the rich opportunities of globalization for all while limiting its risks. To tackle these tasks more effectively, the Fund is listening to and learning from others, and accepting the new challenges generated by the structural changes in the global economy. For this purpose, the Fund is in a process of change to refocus and make more effective its efforts to promote macroeconomic and financial sector stability which are preconditions for sustained growth and poverty reduction. The centerpiece of the Fund's strategy to strengthen the international economic and financial system is crisis prevention. In addition, when crises do occur, the Fund must be ready, in conjunction with others including the private sector, to act decisively to resolve crises and restore growth. During the past year, the Fund has taken steps to fulfill this strategy. We have strengthened the IMF's financial sector work, notably through the Financial Sector Assessment Program (FSAP), and surveillance activities, consolidated its financial facilities and taken steps to encourage their more effective use, and begun efforts to streamline conditionality in Fund arrangements. We are doing this in collaboration with other participants in the international financial system to make the best use of our respective expertise and ensure an appropriate division of labor.[1]

8. To improve crisis prevention and thereby help to strengthen the IMF's surveillance activities, prevention, we are implementing several initiatives:

Strengthening financial systems. In response to the globalization of financial markets and the recognition that financial sector problems are the root cause of many crises, the Fund has intensified its focus on financial sector surveillance. In particular, the capacity to assess member countries' financial sector strengths and vulnerabilities has been improved through the joint Bank-Fund FSAP which also draws on the expertise of members' central banks, supervisory agencies, other institutions, and standard setters. Future implementation of the FSAP has been agreed for at least 24 countries in each of the coming two years and we are establishing the priorities for country assessments, and support and technical assistance for corrective reforms. The FSAP and the Financial System Stability Assessment (FSSA)

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[1] See *Report of the Managing Director to the International Monetary and Financial Committee on the IMF in the Process of Change.*

reports have become the preferred vehicle for financial sector assessments as input to Fund surveillance. We are also extending our financial sector work to include voluntary offshore financial (OFC) assessments—by end-March 2001, 17 OFC missions had been conducted and missions to 25 jurisdictions are planned for 2001.

Combating money laundering. The Fund is taking steps to enhance its contribution to international efforts to counter money laundering, which is a problem of global concern that requires concerted and more vigorous national and international efforts. Fund activities in this area will concentrate on its core competencies, promoting a more effective regulatory and supervisory environment, and related technical assistance. We have recognized the Financial Action Task Force (FATF) forty recommendations as the appropriate standard for combating money laundering. We will work with the FATF to review standards and procedures in this area and help adapt them to the Fund's work.

External vulnerability indicators and early warning systems. Much has been done to increase the focus of Fund surveillance on member countries' vulnerability to crises, but much still remains to be done. We are working to improve the analytical frameworks for assessing external vulnerability and on identifying principles for external liability management, as well as assisting members in the assessment of reserve adequacy and management. Also, the Fund and the Bank, working in collaboration, have developed Guidelines for Public Debt Management as an important instrument for assisting countries' efforts to improve their debt management practices and reduce financial vulnerability. The creation of the new International Capital Markets (ICM) department will strengthen our work on vulnerability issues across a broad front and serve as a vehicle for enhancing the Fund's outreach and collaborative efforts.

Standards and codes. The development and assessment of countries' observance of standards and codes provides recognition of improvements made by countries and identifies areas where further reform and capacity building are required. The Fund has made this one of its priority areas for technical assistance. To better integrate this work into the Fund's policy advice, the Executive Board has agreed on a list of international standards and codes relevant for Article IV surveillance and on modalities for discussing members' observance of standards and codes in the context of Article IV surveillance, and on their publication consistent with the voluntary nature of Reports on the Observance of Standards and Codes (ROSCs).

Transparency and accountability. The implementation of transparency initiatives has progressed significantly over the past year. Since 1999, when a pilot project for the publication of Article IV staff reports was introduced, there has been broad-based participation by the membership in these initiatives. To further increase the openness of its operations and of its members' policies, in January 2001 the Fund Executive Board formally adopted the decision and modalities underpinning the Fund's policy of voluntary publication of country staff reports; the Fund will encourage such publication, mindful of the specific circumstances of each country.

IMF financing facilities. In November 2000, a number of important changes were made to allow the Fund's financing facilities to play a more effective role in supporting members' efforts to prevent and resolve crises, and to help ensure a more efficient use of resources. The Contingent Credit Line (CCL) has been modified to make it more attractive to potential users. Changes include less intensive monitoring, simplification of review and activation mechanisms, greater automaticity of disbursements, and reduced charges and commitment fee. To encourage the more rapid repayment of Fund resources following the resolution of balance of payments difficulties, and thereby ensure that such resources are available to those members who need them most, the following changes have been introduced: repurchase expectations to encourage members in a sufficiently strong position to make repayments in advance of their repurchase obligations; surcharges on Fund credit outstanding above certain thresholds to deter large use of Fund resources for longer than is necessary; and the long-term financing available under the Extended Fund Facility will be more carefully reserved for members facing relatively long-term balance of payments problems where the structural weaknesses underlying these problems are being addressed. Also, in cases where credit outstanding is above a certain level there will be enhanced post-program monitoring, with the involvement of the Fund's Executive Board.

Involving the private sector. Since the endorsement by the IMFC in Prague of the framework for the involvement of the private sector in the resolution of financial crises, there have been two strands in the Fund's work in this area. The first concerns the development of the framework, while the second concerns the application of the framework to Argentina and Turkey. As regards the first strand of the Fund's approach, work on strengthening the framework for private sector involvements has included a review of experience with the restructuring of international sovereign bonds, and a workshop on the importance of corporate workouts in resolving systemic crises and promoting financial stability. With respect to the second strand, in support of strengthened adjustment programs for both Argentina and Turkey, in late 2000 the Fund decided to apply the catalytic approach to securing private sector involvement. Both were judged to have strong prospects for regaining spontaneous access to international capital markets. The catalytic approach was complemented by voluntary agreements with specific groups of creditors. In the event both programs ran into difficulties in early 2001 associated with both political developments and policy slippages. In the coming months, work now underway is expected to help strengthen the underpinnings of the Fund's policy of involving the private sector. This work includes promoting constructive relations between members and their creditors, an examination of issues associated with the comparability of treatment of Paris Club and private sector claims, and strengthening the basis for assessing the prospect for countries emerging from crisis to regain access to international capital markets.

Organizational change, dialogue and consultation with others. In the past year, the Fund has intensified its efforts to be a center of excellence in financial sector work and to increase the complementarities of its work with that of other institutions, thereby improving its support for and promotion of the stability of the international financial system. The Fund is reorganizing to enhance its ability to identify external and financial sector vulnerabilities and to propose timely corrective measures. For this purpose a new ICM department is being established. The Fund has also become more open in order to better learn from the views and experience of the private sector, including through the Capital Markets Consultative Group established last year to foster a constructive engagement with the private sector. Finally, work with other international organizations and participation in international and regional fora has been enhanced.

9. A key element of refocusing of the Fund's work is to streamline and enhance the effectiveness of the Fund's conditionality. Conditionality should respect the policy choices of member countries. The design of Fund-supported programs must reflect countries' circumstances and their capacity to implement: no one size fits all. Furthermore, the national ownership of policies is important for the successful implementation of policy programs. For this reason, the Fund must support member countries' efforts to build up their capacity for designing and implementing policies. Last month, the Fund's Executive Board undertook an initial general review of the issues and principles related to conditionality, and we are moving ahead with refocusing Fund conditionality. We are focusing the Fund conditionality more sharply on macroeconomic policies and those structural conditions that are critical to a program's macroeconomic objectives. We are also striving for a clearer division of labor with the World Bank to help the Fund reduce the Fund's conditionality outside its core areas while ensuring that those measures that are key to program objectives are covered by the Bank. While structural conditionality in each program will need to be dealt with on a case-by-case basis, the intention is to shift toward a presumption of greater selectivity rather than comprehensiveness. As a next step in reviewing the Fund's policies regarding conditionality, the Fund is seeking the views of outside observers and practitioners via its website, as well as through a conference to take place in June.

10. Recently, the Fund's Executive Board reviewed the role of the Fund in governance issues. They welcomed the heightened attention given to improving governance, by national authorities, the Fund and other institutions, as a key factor influencing economic performance. While emphasizing the need to exercise judgment and sensitivity, the Board recognized the importance of addressing governance issues with a significant macroeconomic impact, both through initiatives that promote good governance across the membership and through specific measures to address particular instances of poor governance and corruption. The two-sided nature of corruption should be addressed, and in this connection the staff will follow up on the implementation of OECD-led initiatives to combat the bribery of foreign public officials in the context of surveillance.

II. FIGHTING POVERTY AND STRENGTHENING GROWTH IN LOW-INCOME COUNTRIES

11. Widespread poverty is both unsustainable and morally unacceptable, and remains the paramount challenge facing the international community. The International Development Goals and Millennium Declaration Goals provide an ambitious vision of the world in which the hardships of poverty are much reduced. These are ambitious goals and require a concerted effort by both developed and developing countries to achieve sustained pro-poor

growth. The Fund and the Bank are firmly committed to supporting this effort in which we have an important role to play.[2] In this regard, since we last met in Prague, we have made substantial progress in the implementation of the enhanced HIPC Initiative and the PRSP approach.

12. Earlier this year, Jim Wolfensohn and I made our first joint visit to Africa, to listen to the vision that African leaders have for improving living standards across the continent: to accelerate growth, reduce poverty, and position Africa to benefit from globalization. We also discussed how the Fund and the Bank can best assist African nations in these tasks. We were deeply impressed by the conviction of African leaders that Africa's future lies in its own hands. These leaders made clear that their efforts to reduce poverty and share more fully in global prosperity must start with, and build upon, peace, democracy, and good governance. Rapid growth would also depend on building a strong human resource base, including by strengthening support for education and health, especially to tackle the devastating effects of HIV/AIDS. To benefit fully from globalization they agreed that stronger regional cooperation and integration could serve as a catalyst for improved domestic policies and thereby make investment in their economies more attractive. Also, they stressed the need for assistance from the international community, especially in the near term, to help Africa realize its potential for higher, pro-poor growth. They welcomed the new cooperative approach of the Bank and the Fund for supporting country-developed poverty reduction strategies.

13. The Fund and the Bank see a new partnership emerging to support the efforts of African and other countries to implement sound poverty reduction and growth strategies founded on "help for self-help," and countries' own efforts will continue to remain at the center of the Fund and the Bank's approach. The two pillars of this partnership comprise resolute action by country leaders to improve their own economic and social policies and greater and stronger support from the international community.

14. The self-help pillar entails poor countries taking charge of their own future, recognizing that there can be no substitute for appropriate policies and strong efforts. They need to take actions to build an improved climate for private sector initiative and investment to enable enterprises to compete in world markets and foster growth that is less dependent upon official financing in the long term. Many will need to speed up the implementation of outward-oriented reforms and to improve their overall performance with respect to macroeconomic management, governance, and social sector policies. The other pillar requires a new partnership and a spirit of renewed cooperation. In this regard, we urge stronger action by the international community in four areas. First, we strongly endorse free market access for poor countries to world markets and urge industrial countries in particular to open their markets and reduce trade-distorting agricultural subsidies. Second, donors need

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[2] See *Joint Report of the President of the World Bank and Managing Director of the IMF to the Development Committee and International Monetary and Financial Committee on Fighting Poverty and Strengthening Growth in Low-Income Countries.*

to ensure that development assistance is made in addition to HIPC debt relief and that it is on concessional terms. Third, we call upon developed countries to move towards the UN target for official development assistance of 0.7 percent of GNP. Finally, the donor community should continue to work to simplify and harmonize aid procedures to make such aid more effective and alleviate the administrative burden on the countries.

15. On the part of the Fund and the Bank, we have made considerable progress in implementing the PRSP approach and the enhanced HIPC Initiative, and are reinforcing our support for post-conflict countries. The PRSP approach is still at an early stage and has focused primarily on the preparation of interim PRSPs, many of which have been prepared in connection to reaching decision points under the enhanced HIPC Initiative. Moving forward towards strong full PRSPs that link public actions to priority poverty reduction goals will be critical in 2001, when up to 20 countries may complete their first full PRSP. We are pleased that the PRSP approach is now widely embraced by the authorities of the poorest countries and by the international donor community, and it should become a key vehicle for coordinating external assistance and building domestic ownership for poverty targets and poverty-reducing programs. All concerned in the preparation of PRSPs are learning by doing, and it must be recognized that the content and processes underpinning these strategies will evolve in the light of experience. Moreover, many of the gains in poverty reduction and growth will likely emerge only over time. Therefore, countries and their development partners, including the Fund and the Bank, must be ready to refine and improve the process in the light of experience.

16. The development of PRSPs poses considerable challenges for the countries concerned and the Bank and Fund are working to support them. For this purpose we have taken a number of steps since we last met in Prague. In response to countries' requests for greater clarity, we have prepared guidelines for Joint Staff Assessments of full PRSPs, which outline the key areas that both institutions will focus on when assessing PRSPs. We are also expanding the learning activities for PRSP country teams, and are working actively with development partners to support country capacity-building and ownership. The broad-based consultative approach underpinning the PRSP is meant to improve the quality of the strategy. But we must also recognize and respect the fact that countries will need to develop consultative processes that are suitable to their own institutional structures and that the final responsibility for strategic priorities rests with national authorities.

17. Effective public expenditure is essential to ensure that domestic resources, external assistance, and budgetary savings from HIPC assistance are used for their intended poverty-related purposes. We are therefore taking steps to support countries' efforts to strengthen their public expenditure management systems, thereby facilitating the delivery of urgently needed assistance for poverty reduction while laying the foundations for stronger expenditure systems over the medium term.

18. Social impact analysis—the impact of policies and programs on vulnerable groups—should be an integral part of PRSP preparation and be carried out under national leadership. In the near term, given the limited national capacity in this area, countries will

need to draw upon assistance from development partners, both to undertake work and build capacity on social analysis. In light of weak national capacity and data limitations, expectations of what can be achieved in the near term need to be tempered accordingly. The Bank and the Fund will contribute to this effort in their areas of expertise, and the Fund is committed to integrating social impact analysis into the design of programs supported by the Poverty Reduction and Growth Facility.

19. The Fund and the Bank are working together to refine their respective lending instruments and streamline conditionality to better support countries' efforts to implement poverty reduction strategies and to promote country ownership. At the Fund, we are applying conditionality more selectively in PRGF arrangements, and the Bank is introducing the Poverty Reduction Support Credit (PRSC) to help ensure broad-based support for PRSPs and suitable coverage of social and structural policy areas. We are also working to improve the division of labor between the two institutions, with each concentrating on its primary area of responsibility and drawing on the expertise of the other institution in the specification and assessment of reform measures in complementary areas.

20. Considerable progress has been achieved in implementing the enhanced HIPC Initiative. By March 2001, 22 countries—more than half those expected to receive assistance under the Inititiative—had reached a decision point allowing them to benefit from debt relief. Uganda has reached its completion point under the enhanced HIPC Initiative, at which point debt relief is delivered unconditionally, and several more countries are expected to do so by end-2001. Together with bilateral debt relief, the external debt of the 22 countries will be reduced by almost two-thirds in net present value (NPV) terms, bringing their indebtedness to levels below the average for all developing countries. Furthermore, the debt service savings in these countries is substantial, about US$1.1 billion annually in 2001-03. Interim assistance will enable countries to immediately increase expenditures on poverty-related programs. In order to realize the full benefits of such assistance, I call on all creditors that have pledged to provide relief to do so promptly.

21. The enhanced HIPC Initiative sharply reduces the likelihood of debt servicing problems and provides a good basis for HIPCs for assuring debt sustainability. But long-term debt sustainability can only be achieved if the underlying causes of the debt problems are addressed, and if the HIPCs implement comprehensive policies to improve economic performance and reduce poverty, to strengthen governance and public institutions, and to improve debt management.

22. Moving ahead with the Initiative presents new challenges. First, for countries now receiving relief that are preparing for completion points, we will be helping to ensure that they remain on track with their macroeconomic and reform programs and to assist them develop full PRSPs. The second challenge is to move forward with new decision point cases. This effort presents special difficulties, as most of the countries which have yet to qualify for HIPC debt relief are either currently involved in or have recently emerged from conflict, and many are struggling with severe governance problems. At the same time, these countries

need external financing, including debt relief, for poverty-reduction programs and reconstruction.

23. Over the past decade, many low-income countries have suffered from armed conflicts that are a major impediment to economic and social development. The Fund and the Bank have a long history of working together effectively to help countries emerging from conflict. In order to ensure that we can provide assistance to these countries' in amounts and on terms appropriate to their circumstances, the Fund and the Bank have jointly reviewed their policies and each institution has agreed on measures to enhance its efforts. A main focus is on how to ensure adequate assistance to post-conflict countries under the HIPC Initiative.

24. Post-conflict countries form the majority of those remaining HIPC-eligible countries which have not yet been able to reach their decision points and begin receiving debt relief. The need for debt relief in these countries is particularly acute, given the severe poverty and major reconstruction needs that many of them face. While many of these countries face urgent financing needs, it will be important to have adequate conditionality and to ensure that debt relief is used effectively for poverty reduction. The Fund and the Bank Executive Boards have agreed that the existing HIPC Initiative framework has sufficient flexibility to accommodate the special circumstances of these countries, including with regard to the length of track record to decision point and the requirements for the completion point, the content of the track record, and the pace of delivery of interim assistance. They agreed that, during the pre-decision point period, emphasis should be placed on rebuilding capacity and improving overall governance. After the decision point, the focus should be on establishing mechanisms for tracking all poverty-related spending.

25. In some cases, access to HIPC assistance will first require the resolution of arrears to the Fund and the Bank. To ensure well-coordinated assistance in these circumstances, we envisage that Fund and Bank staff will prepare an arrears clearance plan, in consultation with each other and other creditors, once a post-conflict country has re-established peace, made adequate progress on rebuilding administrative capacity and restoring macroeconomic stability, and re-established relations with the international community.

26. As post-conflict countries are among the poorest in the world, the Fund Board has agreed that we will seek subsidies from donor countries so that the Fund's emergency assistance to poor post-conflict countries can be made available on concessional terms, and the Fund will set up a multi-donor Administered Account to handle these subsidies. I am pleased to tell you that some countries have already expressed interest in contributing and I encourage others to do so. Post-conflict countries frequently require substantial technical assistance from the Bank and the Fund for rapid restoration of the critical functions of government, and—for eligible countries—for meeting the specific requirements of the HIPC framework. For this purpose, Bank and Fund staff, in consultation with other technical assistance providers, will develop an early assessment of, and action plan for, meeting these countries' needs. We will also explore options for financing the Fund's participation in this effort.

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27. The international community has worked in partnership to help ensure a stronger financial architecture, decisively alleviate the hardships of widespread poverty, and achieve broad-based economic growth and prosperity. With a renewed commitment and spirit of cooperation we must continue to press ahead and deal with new challenges so that all may benefit from improved living standards. At the IMF, we have refocused our activities so that we may better strengthen our contribution to meeting this challenge together with the international community.