FOR AGENDA

SM/01/335

November 9, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Joint Statement of the Managing Director and the President of the World Bank to the International Monetary and Financial Committee and Development Committee on Supporting Low-Income Countries in Light of Changes in the World Economic Situation**

Attached for consideration by the Executive Directors is a joint statement by the Managing Director and the President of the World Bank to the International Monetary and Financial Committee (IMFC) and Development Committee (DC) on supporting low-income countries in light of changes in the world economic situation, which is tentatively scheduled for discussion on Monday, November 12, 2001. Directors' understanding for the unavoidably short circulation period is appreciated.

It is intended to circulate this statement to the IMFC and DC following the Executive Board meeting, and to post it on the Fund's external website.

Questions may be referred to Mr. Dorsey (ext. 34047) and Ms. Redifer (ext. 36979).

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND
THE WORLD BANK

Joint Managing Director/President Statement to the IMFC and Development Committee Supporting Low-Income Countries in Light of Changes in the World Economic Situation

November 2001

1. Reducing global poverty remains one of the foremost challenges of our time. Safeguarding progress in light of the recent deterioration in the global economic situation will require a renewed and strengthened commitment by low income countries as well as by the international community as a whole. Over the past eight weeks, the IMF and the World Bank have been working with low income member countries, and with other development partners, to assess the country-by-country economic and financial impact of recent events, and the responses that will be necessary to maintain the momentum of the fight against poverty.

Economic Outlook for Low-Income Countries More Uncertain

2. In the aftermath of the September 11 terrorist attacks, economic policy throughout the world will need to be framed in an environment of unusually large uncertainty. Short term economic forecasts have been revised downwards for virtually all major economies; capital markets have tightened considerably with a flight to quality across many investor categories; and slower world growth prospects have been translated into lower demand for developing country exports and lower prices for many primary commodities. Fortunately, economic fundamentals in many countries were on a reasonably sure footing, and policy responses have already taken place or are underway to deal with the economic downturn and the September 11 aftermath. As a result, we continue to expect that there will be a recovery during the coming year. However, there is also the possibility of a worse outcome, involving even lower growth and increasing financing difficulties for many countries.

3. The worsened international economic situation has affected low-income countries through a number of channels. Lower demand for their exports, which account for 30% of GDP on average for these countries, comes at a time when prospects for net export earnings were already deteriorating due to a downward trend in agricultural commodity prices, some of which continue to be distorted through production and export subsidies. In particular, prices of cotton, coffee and copper, three commodities on which many low-income countries are dependent, are lower than they have been for many years, and even lower commodity prices may be in store.

4. For oil-importing countries, the current downward trend in oil prices will serve to offset part of the impact of lower commodity prices on export earnings. As a result, while the outlook for individual countries varies widely, real GDP growth is projected to continue for the group as a whole, albeit at somewhat lower levels. However, there are substantial uncertainties in the growth forecast for the poorest countries. These countries were in a precarious situation to begin with, and it must be noted that their external financing positions can be hit disproportionately hard—even with continued growth—given factors such as further declines in tourism receipts and workers' remittances from abroad. The average impact of the negative effect on the external

situation of these countries is estimated to be on the order of roughly one percentage point of GDP, and for some oil exporting countries the gap could be a multiple of this (or several percentage points of GDP). For both groups of countries, the first line of defense in cushioning against the adverse impact of slower growth on external financing is maintaining sound macroeconomic policies and adhering to existing adjustment programs. However, where policies are sound, additional external financing on appropriate terms will also be a key component of the response to the deterioration of their external accounts.

IMF and World Bank Support to Low-Income Countries

5. IMF and World Bank staff will continue to work with country authorities to monitor the situation. In the light of recent events, the IMF has reviewed its existing financial instruments and modalities; these continue to appear adequate to respond to the current needs of the membership, and the Fund will be ready to consider adjusting them, if necessary, in the light of future developments. The Fund is currently providing concessional resources under the PRGF to support 39 low-income member countries and we will review and augment these resources as needed. In other low-income countries with sound policy frameworks and demonstrated financial needs, Fund staff are working with authorities to set up new PRGF-supported programs. For members not ready to undertake a three-year structural reform program but where stabilization policies can be agreed, stand-by arrangements may be considered. For some developing countries, the Fund's Compensatory Financing Facility (CFF) can provide assistance in the case of temporary export shortfalls.

6. With the new projections, we anticipate that demand for PRGF resources for next year could be as high as $1.5-2.0 billion. While this is high by historical standards, it should be manageable with existing projected resources, if limited to one year. However, this underscores the urgency of mobilizing the remaining PRGF resources (SDR 0.7-1.2 billion) to reach the full complement of SDR 4-4.5 billion in new loan resources needed for the years 2002-2005, at which time the self-sustaining PRGF is expected to begin operations.

7. The Bank's existing instruments and policies make available a wide variety of options to provide new financial assistance to low-income countries affected by the economic downturn and the September 11 events and their aftermath—including both new lending and disbursements under existing and loans. The Bank will use these options flexibly to meet countries' financial needs and support sound poverty reduction strategies and social programs. New or supplemental adjustment lending may be an option for affected countries with sound macroeconomic policies and reform programs. The Bank may also, within existing policies, advance the preparation or increase the scope of selected new investment projects, such as social funds, or provide supplemental investment operations where the impact of the crisis has led to project cost overruns. Emergency recovery operations may be provided in countries where the September 11 events have led to serious short-term economic dislocations, such as caused by a sharp increase in the number of refugees. The Bank also has the flexibility, within existing policies, to increase or accelerate disbursements under existing operations, as appropriate.

8. Projected IDA lending for FY02 is $7.8 billion, up from $7 billion before the September 11 events. Beyond the current fiscal year, the initial estimate of lending during the IDA 13 period (FY03-05) was $23 billion (SDR18 billion). Estimates completed after the

September 11 events suggest that the crisis and ongoing economic downturn, especially if prolonged, could result in significant incremental needs during IDA 13, particularly for countries in Africa and Asia. Meeting the needs of low-income countries, and especially of those that are now facing even greater challenges, places a premium on successfully concluding the IDA13 replenishment negotiations during the next meeting of IDA Deputies in December 6-7, 2001.

The Heavily Indebted Poor Countries (HIPCs)

9. The heavily indebted poor countries are an important subgroup of low-income countries. While the growth impact in these countries will not differ from that of the group as a whole, their financing positions have the added dimension of a high debt burden. The primary purpose of the HIPC initiative is to bring the debt burdens of these countries to sustainable levels, and this should remain the guiding principle for its role during the current downturn. The Initiative, as currently structured, provides significant flexibility in responding to any adverse impact on HIPCs, both in the immediate and longer terms. First, interim debt relief under the enhanced Initiative provides significant flow relief beginning immediately at the decision point. We encourage creditors who are not yet providing interim relief to explore the possibility of doing so. In recent years both bilateral and multilateral creditors have increased interim relief to HIPCs in response to natural disasters, and some bilateral creditors are providing debt relief beyond the HIPC framework.

10. Second, in terms of long-term debt sustainability, the enhanced framework provides for the consideration of additional assistance at the completion point if there has been a fundamental change in a country's economic circumstances due to exogenous developments. The relevant operational procedures have recently been approved by both Boards. To the extent that recent events represent a major exogenous shock, our staffs, together with country authorities, will analyze the impact of recent events on each country in detail in the debt sustainability analysis undertaken as HIPCs reach their completion points. Preliminary assessments by staff of the impact of the projected economic downturn suggest that the need for additional debt relief under the enhanced HIPC framework may be modest and limited to a few cases.

Broader International Response Is Necessary

11. The efforts of the Bank and Fund must necessarily be part of a much broader international response. The regional development banks have been active partners in assessing the economic and financial impact and providing advice on appropriate responses. They also have significant parallel programs of support underway. Similarly, bilateral donors will need to fulfill and expand upon existing commitments, for all regions. Where appropriate, export credit agencies will need to remain engaged to ensure continued availability of trade finance.

12. A new trade round and maintaining momentum on various industrial country initiatives will be important for increasing poor countries' access to world export markets. The Fund and Bank are participating in the WTO Ministerial currently taking place in Doha, which we hope by the time of the Ottawa meetings will have made a decisive start in launching a new trade round, one which gives special weight to the needs and concerns of developing countries. We are also committed to the success of the UN Financing for Development Conference next March. The IMF and the World Bank have participated actively in the preparations for the conference and we

will continue to support the UN in ensuring that this conference results in creative ideas to improve the international community's involvement and effectiveness in support of appropriate domestic policies to promote sustained growth and reduce poverty. We also encourage donor countries to increase official development assistance funding to resume progress toward meeting the United Nations goal of 0.7 percent of donor country GNP.

Looking Forward

13. Since the beginning of 2000, the country-driven PRSP process has provided a framework for IMF/World Bank support to low income members, both concessional assistance from IDA and under the PRGF, as well as the delivery of HIPC debt relief. It has also increasingly become the framework adopted by other development partners for their support. Experience to date with the PRSP approach augurs well for its contribution to improving both the poverty focus of national development programs and the effectiveness of donor support for these country-led efforts. HIPCs and other low-income countries must continue to move forward responsibly and expeditiously with designing and implementing their poverty reduction strategies, with a particular focus on how new resources can be most effectively directed to the needs of the poorest and most vulnerable.

14. The Fund and the Bank welcome comments and suggestions for further improving the design and implementation of PRSPs. All concerned are learning by doing and it is particularly important that we refine and improve the process in light of early experience. In this regard, we are looking forward to the joint review of the PRSP approach, which we are undertaking over the coming months. We are committed to drawing on the views of the PRSP countries themselves, and of international institutions, donors, and civil society organizations, with a view to benefiting from their diverse perspectives and experiences and making any needed modifications in the PRSP framework. In parallel, the IMF will also conduct a review of the initial experience under the Poverty Reduction and Growth Facility (PRGF). These reviews will be ready for consideration by the April 2002 meetings of the IMFC and DC.