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To: Members of the Executive Board

From: The Secretary

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

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

Att: (1)

Other Distribution:
Department Heads

Development Committee: The Managing Director's Written Statement

1. The agenda for the Development Committee's meeting in September 1997 includes topics that are central to the task of ensuring that developing countries—and in particular the poorest countries in sub-Saharan Africa—reap the potential rewards of the increasing globalization of the world economy. The challenge that we now face, especially in light of the declining trend in flows of official development assistance, is how best to nurture and accelerate the development of a vibrant private sector that can seize the opportunities of integrated world markets, and hence become the mainspring of more rapid and sustainable growth needed to alleviate poverty. This statement addresses several issues relevant to fostering private sector activity and, to this end, the appropriate role of the state.

I. Private capital flows

2. Many developing countries are already benefitting from their success in achieving macroeconomic stability and implementing outward-oriented market-based structural reforms, which have contributed importantly to their continued solid economic expansion over the last few years. Prospects for growth have also improved.

3. The policies of many of the middle-income emerging market countries have also been associated with a high level of private capital inflows, which in turn has contributed to their strong growth performance. However, the recent financial market pressures in some of these countries have once again brought to the forefront the critical importance of disciplined macroeconomic policies and structural reforms to prevent the emergence of large external deficits and address fragilities in the financial sector. In this latter regard, the Bank and Fund are making increasing efforts to encourage and assist countries in strengthening their financial systems. To maximize the effectiveness of the resources of both institutions, we have recently reached agreement on ways to enhance our collaboration in helping countries in this task; progress in this area will be kept under close review.

4. While there has been strong growth of private capital flows to developing countries as a group, many of the poorest countries have yet to benefit significantly from them. The World Bank's Action Plan proposes the deployment of the Bank's financial resources and expertise to "leverage" greater private sector involvement, including foreign participation, in infrastructure development. We welcome this approach and the related necessary strengthening of MIGA's resources, which should help overcome some of the barriers to private involvement in key sectors where investment is greatly needed to facilitate economic expansion.

II. Private sector activity and governance

5. More generally for developing economies, we need to foster an environment conducive to private sector investment and activity in all sectors. An important component of this wider task is the effort to combat corruption and strengthen governance—which the Development Committee will also be discussing. The Fund's role in governance issues is described in the Report of the President of the World Bank and myself to the Committee, entitled *Helping Countries Combat Corruption and Improve Governance*. The Fund's involvement in this area has been, and will be, limited to economic aspects of governance, principally by assisting countries to improve the management of public resources, inter alia, through greater transparency and accountability, and to establish a stable economic and regulatory environment. These are essential to secure the confidence of private investors and savers. The Executive Board of the Fund recently endorsed guidelines on how the Fund should approach governance issues. These guidelines provide for a more comprehensive treatment of governance issues of relevance to the Fund, in both our surveillance and program policy advice, and ensure evenhanded treatment of all member countries. The degree of the Fund's involvement in governance issues will be guided by an assessment of whether poor governance would have a significant current or potential impact on macroeconomic performance and on the ability of the government to pursue macroeconomic policies in a credible manner. The responsibility for governance issues rests first and foremost with the national authorities, and we will build on the authorities' own willingness and commitment, and conduct ourselves with appropriate discretion in this sensitive area.

III. Liberalization of Capital Accounts

6. An open and liberal system of capital movements can also have a favorable impact on investment and growth. In view of the Fund's role in the international monetary system and its near universal membership, there is now general agreement that the Fund is well placed to promote the orderly liberalization of capital movements. Specifically, it is agreed that the Fund's Articles of Agreement should be amended to make this liberalization one of the purposes of the Fund and to extend the Fund's jurisdiction to capital movements. At the same time, it has been emphasized that the obligation to liberalize capital movements will need to be subject to appropriate safeguards. Furthermore, in order to maximize the gains from liberalization, appropriate macroeconomic and exchange rate policies and a proper pace and sequence of capital account liberalization and structural measures, especially in the monetary and financial sectors, and adapted to the circumstances of individual countries, will be essential. The Fund will aim to assist its members in this area through its policy dialogue and technical assistance and, in order to give confidence to members undertaking such liberalization, will stand ready to provide financial support, if necessary, under adequate safeguards. During the coming months, the Executive Board will continue its efforts to forge a consensus on the provisions of an amendment to the Fund's Articles.

IV. Experience under ESAF-supported programs

7. The Fund has also addressed the central theme of fostering private investment and entrepreneurship in the context of its comprehensive review of the experience over the last decade under structural adjustment and reform programs supported by the Enhanced Structural Adjustment Facility (ESAF) since its inception ten years ago. The first phase of this review, conducted by Fund staff, was recently discussed by the Fund's Executive Board; a second component, an evaluation by outside experts, is under way. The first phase of the review confirmed that countries that have undertaken reform and adjustment programs with the support of the ESAF now have economies that are stronger and more market-oriented than a decade ago. These achievements have contributed to the encouraging recent improvements in economic performance of the ESAF users, especially in Africa; over the last decade, the gap between growth rates of per capita real income of ESAF users and the average of other developing countries has narrowed. However, the gap in living standards between these and other developing countries is still large, and thus we must renew our reform efforts to bring the economies of the poorest countries to a higher sustainable growth path.

8. The ESAF review provides a number of important lessons on how we can build upon recent progress to develop stronger medium-term programs. Some of the key themes are germane to the agenda for today's meeting.

- A chief lesson is the need for bolder strategies of reform. In particular, stronger fiscal adjustment is required to mobilize national saving—which in ESAF countries remains low by comparison with other economies and in relation to pressing investment needs—and to help reduce inflation. These countries must also reform the administration of their taxes and public expenditures and improve the transparency of the fiscal accounts. The structure of tax systems would benefit from increased reliance on broad-based consumption taxes to facilitate reduced reliance on international trade taxes. Strengthening the quality and composition of public expenditure, through improving the efficiency of all expenditures, reorienting social programs to focus on basic social expenditures, and reducing excessive military expenditure, would also benefit these countries. In many cases, there is also considerable scope to raise savings over the medium term through far-reaching and sustained reforms of public enterprises and the civil service. To ensure the sustainability of these reforms, social safety nets should be provided for vulnerable groups that may be adversely affected in the short run by some reform measures.

- A further lesson is the need to pay particular attention to reforms that bear most directly on private sector development. Macroeconomic adjustment will deliver a quicker and stronger supply response if it is accompanied by structural measures to encourage private investment and entrepreneurship. In this regard, reform of public enterprises—and more especially, privatization or commercialization—can be a potent tool for attracting foreign direct investment and a signal of the government's commitment to market-based policies and private sector orientation. Sound banking systems are essential for macroeconomic stability and improving financial intermediation, and must be strengthened and maintained. Progress toward greater economic openness has been made, especially through the liberalization of exchange and payment systems; however, trade liberalization should now be deepened by lowering tariff rates and simplifying tariff structures.

V. Strategy for sustainable growth in Africa

9. These lessons are also central elements of the *Strategy for Sustainable Growth in Africa* that the Fund and the Bank are pursuing as part of a global partnership in support of Africa's own development goals. As such, they are already being used to strengthen ESAF-supported programs for countries in Africa. The thrust of this strategy is to promote open trade and investment through a decisive effort to speed up the process of privatization, accelerate and deepen trade liberalization, reform and strengthen the financial sector, support regional integration, and redefine the role of the government to focus on the provision of essential public services. A key function of government must be the creation of an environment conducive to private sector activity, including a stable and predictable macroeconomic environment and respect for property rights and the rule of law.

10. Our joint aim through this strategy is to contribute to substantially higher and sustainable growth, to the reduction of poverty and to the integration of Africa into an increasingly interdependent global economy. I say contribute, because it is clear that strong leadership and determination by African governments and the support of industrialized nations will be essential to tackling an ambitious agenda for growth.

11. The Fund's contribution to this effort will include support of stronger reform programs through correspondingly strong support under the ESAF within existing access policy. It will also involve strengthened provision of technical assistance and training for capacity building, particularly in the areas of tax administration, public expenditure management, macroeconomic policy and management, bank regulation and supervision, and statistics. Already, the Fund has been working with African countries in facilitating the successful implementation of the regional Cross-Border Initiative. Also, the Fund is taking stock of the technical assistance needs of a selected group of African countries in order to set up effective and targeted technical assistance programs, in coordination with the Bank, to improve, on a sustainable basis, domestic institutions and capacity in policy formulation and implementation.

VI. The ESAF-HIPC Initiative

12. I am also pleased to be able to report that the Fund and Bank have made further progress in implementing the Initiative to provide debt relief to heavily indebted poor countries (HIPCs). Decisions by the Fund and Bank have been taken to provide assistance to Bolivia and Burkina Faso since the Committee last met. For Uganda, commitments are now in place from most creditors to provide assistance. We have also held preliminary HIPC discussions for Côte d'Ivoire, Guyana, and Mozambique.

13. The Fund and Bank have agreed on a proportional approach on sharing the costs of the HIPC Initiative between multilateral and bilateral creditors, on a case-by-case basis—a decision based on a helpful statement from the Paris Club. The costs of assistance would be shared by creditors in proportion to the present value of their outstanding claims at the completion point after the full use of traditional debt-relief mechanisms. On this basis, the Fund and the Bank recently reviewed the costs of its participation in the Initiative. The estimated cost is somewhat higher than previously projected, and a considerable portion of expected commitments is likely to be made in the near future. Therefore, we need to address urgently the issue of financing the ESAF and HIPC initiatives. This summer, we have further stepped up our efforts to secure maximum feasible bilateral contributions, and I have asked for renewed efforts from a number of countries. In light of the further pledges obtained from members at the time of the Annual Meetings, an assessment will be made as to whether further steps will have to be considered to secure the needed resources.

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14. International cooperation is essential to advance the well-being of developing countries. It is also critical to efforts to improve governance and lies at the heart of the HIPC Initiative. In these endeavors, the Fund stands ready to continue to play a major part.