Renewing the IMF's Commitment to Low-Income Countries

Speech by Rodrigo de Rato
Managing Director of the International Monetary Fund
At the Center for Global Development
Washington, D.C.
July 31, 2006

As Prepared for Delivery

View a Webcast of the event

1. Thank you very much. I would like to thank the Center for Global Development for hosting this event, Liliana Rojas-Suárez for moderating, and Kemal Dervis, Ricardo Hausmann, and Dennis de Tray in advance for their comments. And I would like to thank you for your attendance.

2. Earlier this year, I set out a road map for implementing the International Monetary Fund's Medium-Term Strategy. This afternoon I want to talk about a particular aspect of the strategy: the Fund's relationship with low-income countries. The Fund is strongly committed to our low-income country members and to the international effort to reduce poverty: this is one of the most important areas of our work, and one where the stakes are very high. The Medium-Term Strategy proposes that we renew our commitment and improve our effectiveness in helping low-income countries by focusing on what we do best, and on tasks where we can make the greatest contribution. Let me begin by offering a broader perspective, both on the Medium-Term Strategy and the current position of low-income countries.

3. The Medium-Term Strategy is based on the premise that the Fund needs to adapt to help all of its members deal with the challenges of 21st century globalization. The strategy covers all areas of the Fund's activities, including the way we conduct surveillance of individual members' economies and of the global economy; our instruments for preventing and dealing with crises in emerging markets; and the Fund's own governance. The measures proposed in the strategy are important not only for systemically important countries and emerging markets, but also for low-income countries. Tackling global imbalances will reduce the risk of chaotic exchange rate movements, abrupt shifts in financial markets, and crippling protectionism. Avoiding crises in emerging markets will help keep down the cost of low-income countries' borrowing and maintain demand for their exports. And low-income countries as well as clearly underrepresented emerging markets have reason to be concerned about their voice and representation in the Fund.

4. But another very important part of the road map set out in the Medium-Term Strategy, which I want to focus on today, is the Fund's plans to renew and refocus its work specifically on low-income countries.

5. To set a course, you need to know where you are and where you want to go. We have a clear destination, agreed by the international community: helping low-income countries meet the Millennium Development Goals. Over the last few years we have made some progress toward that destination, especially in reducing poverty. A number of countries in Asia and Latin America are now well-positioned to meet the income poverty goal, and although less progress has been made in sub-Saharan Africa, macroeconomic outcomes have improved in many countries. For example, growth in Africa over the last two years is the highest it has been in a decade. Average inflation in the continent—excluding Zimbabwe—

has been below 10 percent, the lowest in a quarter of a century. To a large extent, this is the result of efforts made by low-income countries themselves: for example, inflationary bank financing of fiscal deficits in sub-Saharan Africa is now negligible. But the international community, including the Fund, has helped. So we have come some distance along the road.

6. But a look at the conditions in which many people in low-income countries still live shows that we still have a long way to go, especially in sub-Saharan Africa. The stark fact is that in that region too many countries are not on track to meet any of the Millennium Development Goals. So we must do more.

7. A year ago this month, at the G-8 Gleneagles summit, and at the United Nations Millennium Review Summit in September, the international community renewed its pledge to help accelerate progress towards the Millennium Development Goals. They agreed to support a decisive reduction in debt owed by many low-income countries. They agreed to increase aid for many more. And there was agreement that if the fruits of debt relief and higher aid were to be enjoyed by the people who needed them most, there would have to be better use of resources and better governance. Let me now talk about what the Fund has done, is doing, and can do to help in each of these areas.

8. The Fund has already made an important contribution to lowering debt. Following the Gleneagles and UN summits, the IMF moved quickly to give 100 percent debt relief on debt owed by 19 poor countries. Our debt relief began flowing in January, and other international financial institutions have followed. The dimensions of Fund relief vary, but combined with the expected debt relief from the IDA and the African Development Fund, total debt relief from the Multilateral Debt Relief Initiative will be about $50 billion. Our work in this area is not done, but we are making progress.

9. However, the Fund still has another important task before it: to ensure that there is not another debt crisis. There is a serious risk that the hard-won gains from debt relief will be lost if the countries concerned borrow to finance expenditures that are not growth-promoting, and thus replace the debt that has been removed with large amounts of new debt, possibly on worse terms. There are already signs of new lenders—some private, some official—rushing in now that debt has been reduced. The experience of some of the low-income countries of the former Soviet Union, which started out with no debt in the early 1990's and quickly became heavily indebted, demonstrates how quickly things can go wrong. For example, the Kyrgyz Republic had virtually no debt in 1992, but by the end of 1999 had accumulated external liabilities equal to close to 100 percent of GDP. The primary responsibility for preventing this lies with the borrowing countries and with official lenders, but the Fund can help both. We can help countries understand the risks of a rapid build up of debt and design medium-term debt strategies aimed at avoiding unsustainable debt. To do this, we have designed, together with the World Bank, a forward-looking debt sustainability framework specifically for low-income countries, to assist them in making their financing decisions. We can also sound the alarm to official creditors when debt or debt service levels are likely to become a problem. Sometimes they will not like this advice, but they should listen to it, and we should give it.

10. Telling countries to avoid debt is likely to be most effective if we can offer them alternative sources of finance. As the Irish playwright George Bernard Shaw wrote, "I can't talk religion to a man with bodily hunger in his eyes." It is therefore important that the international community address the urgent needs of low-income countries by offering sufficient grants and highly concessional

loans to enable them to finance development without relying on expensive debt. This leads me to the second part of the Gleneagles compact: a significant increase in aid. The Fund has long been an advocate of higher aid. We also make the case for more aid in every low-income country where more aid can be absorbed and where it can help countries meet the Millennium Development Goals. We are also emphasizing to donors the importance of providing early and predictable commitments of support over the longer term: some donors are beginning to do this, but it is unfortunately still the exception, not the norm. Predictable support is critical to allow developing countries to plan effectively. Donors must also deliver their assistance more efficiently, reducing costs and aligning the assistance with countries' plans for reaching the Millennium Development Goals. The Paris Declaration provides an agreed framework for enhancing aid effectiveness, and should be implemented in full.

11. The Fund has also been a consistent advocate of the effective use of aid. Better outcomes from increases in aid flows will depend not only on the amount of the support, but on its effective use. This depends partly on macroeconomic policies, and one of the Fund's responsibilities is to help countries manage their macroeconomic policies in ways that maximize their capacity to absorb aid and debt relief. This begins with realistic assessments of the amount of aid that will flow in. It doesn't do low-income countries any favors to pretend that they will receive more aid than they actually will—in a world where commitments still usually exceed disbursements. And it doesn't help our members to pretend that challenges don't exist in handling scaled-up aid. But the Fund can help by ensuring that macroeconomic frameworks are sound and that adequate public expenditure management systems are put in place, so that scaled-up resource flows reach their targets. We can also advise countries on how to deal with the risks that higher aid will hurt international competitiveness by causing an appreciation of the currency or higher inflation. There will be cases where some real appreciation is warranted, and in others there might be scope for directing resource transfers to help remove bottlenecks to improved productivity and productive capacity in the economy. The Fund has already published a primer on scaling-up, and continues to work with low-income country policy makers and donors on this challenge.

12. The Fund is also strongly committed to making sure that countries have the fiscal space they need to expand social programs, especially in health and education. I want to remove any misconceptions about our views on this. I have repeatedly heard concerns expressed, especially by NGOs, about budgetary ceilings limiting social sector outlays. Fund-supported programs have for many years focused on the need to maintain poverty-reducing spending, especially education and health spending, including in times of fiscal stringency. We consider national budgets as the prime vehicle for investing in human capital and, indeed, many programs include floors on poverty-related spending. When additional donor grants are made available for such spending, fiscal targets in IMF-supported programs will be adjusted to ensure such money can flow to the programs supported by donors, so long as the resources can be put to effective use.

13. Macroeconomic management of aid flows is important, but the challenges of broader macroeconomic management have not gone away. One of the core responsibilities of the Fund is to help countries with these challenges, and especially to promote macroeconomic stability, which is the prerequisite for sustainable growth. Promoting macroeconomic stability is the area where the Fund has the clearest comparative advantage. This is true both in our lending activities and in our role as a trusted advisor to low-income country governments

and central banks. Therefore, our main focus must continue to be on policies and institutions that are critical to economic and financial stability—particularly fiscal, monetary, and exchange rate policies. Increasingly, in low-income countries as well as in industrial countries, we also need to strengthen our work on financial markets.

14. There are also policy areas that may not be critical to macroeconomic stability but are critical to economic growth. In these areas, the role of the Fund is less clear-cut, and will have to be worked out in a pragmatic, case by case way, reflecting our mandate and expertise. I believe that the Fund's role is particularly important in two areas.

15. The first concerns trade. Most of the discussion of trade policy in recent months has focused on the WTO negotiations on the Doha Round. This is appropriate: increased trade, bolstered by multilateral agreements, has been a cornerstone of growth in the global economy for many years, and is fundamental to the prospects of low-income countries. This makes what happened in Geneva last week very painful. I hope that this is a pause, rather than a collapse, in the negotiations, and that negotiators will persevere and try to conserve the gains that have already been made. I am referring especially to measures that are of particular concern to the poorest countries, such as phasing out export subsidies—including on cotton—and providing quota- and duty-free access from the poorest countries to developed and large developing country markets. The donor community should also push forward vigorously with the delivery of Aid for Trade.

16. We should also not forget the benefits that can flow from trade reform in developing countries themselves. Regardless of what happens in multilateral discussions, low-income countries can benefit from reforming their own trade regimes. The main winners from highly protected trade regimes in low-income countries are usually among the wealthiest people in those countries. And the main losers are the poor, who have less access to imported goods and miss out on the growth that follows from a flourishing export sector. And of course, the economy as a whole also loses. I would also urge all countries—including low-income countries—to be cautious in pursuing bilateral and regional trade agreements. Multilateral trade reform remains the best way forward, and there are potential costs from bilateral agreements in trade diversion, confusion, and demands on limited institutional capacity.

17. The Fund also has a significant role to play on financial sector issues. One of the key elements of the Fund's Medium-Term Strategy is the recognition that an up-to-date understanding of financial sectors is increasingly critical in a world of globalized capital movements. If a financial sector is not sound, there are profound risks to macroeconomic stability and serious difficulties in macroeconomic management. Monetary policy can be used much more effectively if financial and capital markets function well. Broad, well-functioning financial systems are also crucial for economic growth. In many low-income countries financial sectors are underdeveloped. When formal financial market access is unavailable, the poor are left with informal services, which are often very costly. For example, people sometimes have to pay $60 to send $300 in remittances. Financial sector development can also promote growth and reduce poverty by removing credit constraints on the poor.

18. In these areas, and in others, we share tasks and expertise with the World Bank, and it is important that our efforts be well-coordinated. Paul Wolfowitz and I are committed to making the relationship between the Fund and the Bank work

at both the global and the country level. We have set up a small group of external experts, led by Pedro Malan, to advise on this, and they will report later this year. And at the country level we are already working to establish clearer lines of responsibility between the two institutions.

19. It is also important that the Fund work well with the donor community. The relationship between donors and low-income countries has changed in recent years, with greater emphasis on country-led development strategies, and the Fund must adapt to reflect these changes. The Fund's role is not to coordinate donors, but we do need to work well with everyone. We need to have regular information exchanges. Missions and resident representatives must collaborate in the field with joint donor groups—which in practice means that our resident representatives must be prepared to assume a larger role. And all parties must be ready to work out cooperative arrangements where more than one partner has expertise and in situations where none of the partners involved in helping a low-income country are willing and able to take the lead in specific growth-critical areas. In these last circumstances, it is not reasonable to expect the Fund to develop expertise on areas beyond our mandate and competence. The Fund cannot be the advisor—or the condition setter—of last resort.

20. I have talked about the need to work well with donors. But the most important relationships that the Fund has are with our member countries. Our primary purpose is to serve them. Our relationship with low-income countries has undergone some important changes in recent years, and the instruments that we use to support them are also changing

21. Our support is now more flexible and more tailored to the needs of members. Since 1999, the IMF's support has been centered on Poverty Reduction Strategy Papers, which are genuinely country-led efforts. Whenever we provide financial support—through the Poverty Reduction and Growth Facility, Emergency Post-Conflict Assistance, or the Exogenous Shocks Facility, introduced in 2005—we strive for country ownership and streamlined conditionality. Where financial assistance from the Fund is not needed or wanted, we have the Policy Support Instrument, also introduced last year, which is working well in Nigeria and Uganda, and is expected to be embraced by several other countries in the near future. An important complement to our policy advice and lending is capacity building through technical assistance and training targeted at key economic policies and institutions. We are currently reviewing our technical assistance to make it more demand driven. One aspect of this is to make technical assistance more regionally based. For example, we recently announced the establishment of a new Africa Regional Technical Assistance Center-AFRITAC—for central Africa, our third center in Africa and our sixth in the developing world.

22. There is another aspect of the Fund's relationship with low-income countries that needs attention. This is the voice and representation of low-income countries. The Fund is a financial institution, and it is reasonable that those countries that make a significant financial contribution should also have a significant influence over policies. But the Fund is also a global institution, and its legitimacy demands that all of the membership have fair representation and a voice that can be heard. At present, the relative quotas and voting shares of our members do not adequately reflect the increased economic weight of some of the largest emerging market countries. We need to change this. But in doing so, we need to protect the voice and representation of low-income countries that continue to borrow from the Fund but that have only a limited share in Fund voting. To achieve this, I would like to see an increase in the number of "basic votes," which are the minimum and equal number of votes, unrelated to quota

size, to which each member is entitled. I will be making some specific proposals on how to take these governance issues forward in the run-up to our Annual Meetings in September in Singapore, and I hope to secure the support of the membership for these.

23. Before concluding, I would like to also say a few words about a policy area where it is particularly important that the Fund cooperate with donors and low-income country governments. This is governance. Paul Wolfowitz made a speech focusing on this issue earlier today, and I very much agree with his comments. Governance was a key element of the Monterrey compact and it is an area where the Fund has a well-defined and important role to play. When governance issues are macroeconomically relevant and threaten the success of a program, we set conditions to address them. We also promote good governance through broader initiatives. For example, we promote transparency through the General Data Dissemination System, a framework to develop national statistical systems to which over 90 countries have subscribed. In some countries we are developing action plans to improve the transparency of Public Expenditure Management systems. We also support the Extractive Industries Transparency Initiative and give advice on transparent use of revenues from natural resources. Underlying this work is the belief that more public accountability and more transparency can raise the quality of public expenditure, cut corruption, and reduce poverty.

24. In the last year, we have heard many strong words of support for low-income countries from the international community, and we have seen some of these words translated into actions. But this year we must translate more of these commitments into actions. This will require planning as well as passion. I have laid out for you today the Fund's strategy for low-income countries. We are now at the implementation stage of this strategy, but this does not mean we are closed to new ideas. Indeed, the spirit of the Medium-Term Strategy for low-income countries is inclusive. Implementing it will require a cooperative effort with the World Bank, the donor community, and first and foremost the governments, civil society, and people of our low-income country members. And as we try to focus and order our actions, we continue to welcome advice from others. And so I look forward to hearing the views of panelists and to your questions and comments.

25. Thank you very much.