BOARDS OF GOVERNORS ● 2002 ANNUAL MEETINGS ● WASHINGTON, D.C.

INTERNATIONAL MONETARY FUND

WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Press Release No.34

September 29, 2002

Statement by the Hon. **PETER COSTELLO**,
Governor of the Fund and Bank for **AUSTRALIA**,
at the Joint Annual Discussion

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Mr Chairman

Since we last met two years ago – before the tragic events of 11 September last year – much has changed in the world economic outlook. And the challenges now are much greater.

In the wake of 11 September, the international community responded quickly and decisively to undertake important changes which will deter and intercept the financing of terrorism. Our ability to act together in a timely and effective manner provides evidence of what we can achieve when we cooperate in a determined way. It is useful to reflect on this experience as we face the challenges ahead in lifting global growth and development opportunities.

In 2001, world economic growth slowed to around 2 per cent, the lowest rate in almost a decade. Despite conditions improving in the first half of this year, the recovery has been weaker and more drawn-out than previously anticipated. While the outlook is for continuing modest recovery, noticeable downside risks are evident. These risks reflect the impact of the falls in equity markets, the loss of confidence in corporate governance, and the potential for rising oil prices

Of major concern is the sustainability of large macroeconomic imbalances between the large industrialized economies. The US current account deficit is now at historically high levels while weakness in final domestic demand in the Euro area and Japan has made these economies increasingly reliant on external, and particularly, US demand.

Policies that promote and re-balance world economic growth by supporting an orderly reduction in global imbalances must remain a priority for all national authorities. In Japan and Europe it is evident that domestic policy reform will be required to promote longer term growth. Failure to undertake the necessary policy responses not only constrains consumer and investor confidence today but makes the eventual adjustment harder and more painful.

Immediate, decisive and clear policy actions designed to gradually unwind imbalances between the major industrialized economies is far preferable to the potential instability caused by the rapid unwinding of imbalances international financial markets can mete out in the face of perceived policy shortcomings.

In Australia, we have found over a long time that macroeconomic and structural reforms have resulted in very strong productivity gains, solid employment growth and higher non-inflationary potential growth.

One of the clearest benefits we have derived from these reforms has been in strengthening our resilience to adverse external developments. Australia came through the Asian crisis relatively unscathed, and more recently has continued to record strong growth despite the slowdown in most of the rest of the world. As result, Australia has now completed its eleventh year of practically uninterrupted growth, the longest economic expansion since the 1960s.

This is not to dismiss the potentially adverse impact on our growth – as well as those of our major trading partners in East Asia – from protracted weakness in the global economy.

A return to a strong and growing global economy also offers the best prospects for assisting developing economies in achieving the growth necessary to continue reduce the numbers of people living in poverty. It is salutary to note the impact that the Asian crisis had on halting, and even reversing, the substantial improvements in poverty alleviation that had occurred in Asia during the decades preceding the crisis. More recently, events in Latin America have also seen the numbers facing poverty in countries such as Argentina increase. These events, continuing problems in Africa, and a weak global outlook, pose serious challenges to our efforts towards making further progress in reducing the incidence of poverty around the world.

Reducing the number of people living in poverty remains a fundamental issue for the international community. Australia welcomed the Monterrey Consensus and its premise that attacking poverty and promoting development requires a partnership of actions of both developed and developing economies. And we were pleased to see many of these themes reinforced at the recent World Summit on Sustainable Development.

In particular, we welcome the emphasis placed on national governments implementing policies appropriate for domestic resource mobilization and the attraction of foreign direct investment, particularly in the areas of governance and rule of law. We also endorse the emphasis placed on a conducive external environment and, in particular, the need for broad based trade liberalization.

Trade liberalization is vital for more rapid growth – and growth is the best answer we have to deal with poverty. There is no shortage of analysis that shows the potential benefits to economic growth and welfare that would accrue to both developing and developed countries from comprehensive trade liberalization.

And yet, trade-distorting agricultural subsidies in developed countries still amount to $US350 billion per annum or almost seven times aid flows. EU support for the cattle and dairy industries amounts to around ten times, per head of cattle, the OECD's support per person in a developing country. Much more is spent propping up inefficient and unsustainable activities in developed countries than is spent on aid to developing countries. Moreover, existing trade policies in many industrial countries in fact directly neutralize the effectiveness of aid.

We need the political will to seize the opportunities for broad based agricultural trade liberalization presented by the Doha trade negotiations agenda.

Greater coherence is needed between trade and aid.

But comprehensive trade liberalization will generate far greater and certainly more sustained benefit for developing countries than increasing aid resources. Further progress in the Doha trade negotiations will play a key role in catalyzing improvements in global confidence and growth. A benchmark of the Doha round's success or failure will be the degree of progress made in reducing farm protection. This is vital for the poorest economies. As they enter the arena of international trade, some of their earliest export opportunities will be in agricultural products.

The experience of the last 50 years is unmistakable. Countries that have been able to open themselves up to the world economy have made the best gains in addressing poverty.

Crisis prevention and resolution

The main challenge for the IMF is to improve crisis prevention and resolution.

Seven years after the Mexican financial crisis of 1995, emerging market economies still average more than one major crisis each year. Much has been done, but the simple fact is that the incidence and severity of crises has not decreased.

It is highly disconcerting that a number of countries that have catapulted into crisis did so from the position of IMF programs, where one assumes the Fund would have been at its most influential.

There is a clear message. The Fund must continue to work to make its analysis and advice more timely and effective, and to ensure that this is reflected in better program design. In our view, the key area for improvement is more timely identification by the Fund of the policy changes needed to avert crises, and the need for the Fund to be influential in getting member countries to adopt these changes.

Of course, national authorities are ultimately responsible for implementing policy, and the Fund cannot dictate to members. Nonetheless, management and the Executive Board must be prepared to take the hard judgements in surveillance and in program design.

Assessment of debt sustainability needs to be a core competency of the Fund. Unless all the factors that affect debt sustainability are considered – including the maturity profile; currency denomination; debt servicing capacity; and sensitivity to adverse external developments – the Fund will not be in a position to provide appropriate policy advice or assess the likely success of any program.

In this respect, attention should also be paid to the terms at which countries regain access to financial markets. The challenge for Fund programs is to facilitate a return to markets at terms that do not impose excessively high costs, constrain domestic policy flexibility or sow the seeds of future crises.

The large scale of recent IMF programs emphasizes the need to improve the framework for determining access to IMF resources. As the amount of IMF financing increases it is appropriate that the justification for this financing is comprehensive and rigorous. It is also important that decisions about financing are not just based on simple rules, but thoroughly grounded in approaches that re-emphasize such factors as need, capacity to repay and exposure of the Fund.

The evidence from recent crises suggests that at some stage many countries will need to engage the private sector in debt restructuring. We urge swift action by the international community towards the implementation of debt restructuring proposals, including both statutory and contractual approaches. Australia wants to see further progress on the sovereign debt restructuring mechanism, and we are ready to move with the international community to include collective action clauses in future international debt issues.

Of course, no conceivable proposal for new crisis resolution mechanisms can ever substitute for timely advice, good judgement and effective decision-making. Ultimately, the credibility and effectiveness of the Fund as an institution relies heavily on –and will be assessed on - the quality of its analysis and advice, as well as its ability to engender market confidence in that advice.

If the Fund is to be effective it must be able to involve all members. In this respect, governance at the Fund needs to more closely reflect members' relative economic standing, while maintaining participation by smaller, developing countries. This issue needs to be tackled directly and resolved as a matter of priority. Australia strongly supports the calls by our Asian neighbours for an increase in their representation at the international financial institutions.

Poverty alleviation

If the Millennium Development Goals are to be achieved, it will be necessary to ensure a significant and ongoing focus on the real development needs of the Asia-Pacific Region. The region is home to around two-thirds of the world's poor – or 800 million people.

The Monterrey and Johannesburg conferences appropriately placed emphasis on the importance of national policies in developing countries, the opportunities provided by trade liberalisation, and the need for more effective and higher aid volumes. The Bank has a critical role in play in each of these spheres, in concert with the Fund, as appropriate.

We continue to place critical importance on sound country policies and strong institutions. We see improvements in governance as an absolute necessity for achieving significant and sustained progress in reducing poverty.

For many countries, the PRSP process can be a vital tool in making progress on this front. PRSPs play an important role in ensuring that improvements to governance arrangements are made, including strengthening institutions and improving policies. For this reason, the PRSP process must continue to be strengthened, and countries must be given the technical assistance to build their capacity to provide more reliable data, improve public expenditure management systems and undertake more realistic projections. Such actions should also assist in ensuring assistance is better linked to PRSP priorities, and placing PRSPs at the centre of a range of Bank, Fund and other donor activities.

The Bank together with the Fund must take every opportunity to promote the benefits of trade liberalization and build a consensus in support of liberalization in developed and developing countries alike. Australia also urges the international institutions to provide support to developing countries in order to benefit from the opportunities provided by trade. Australia has provided trade–related technical assistance to developing countries and is a substantial contributor to the Doha Development Agenda Global Trust Fund.

Where a sound policy environment is in place, and strong institutional capacity exists, aid can generate significant results. In recognition of the prominence placed on such issues, Australia placed considerable importance on maintaining its burden share in a very significantly expanded IDA13 replenishment, as well as providing an additional $A18 million commitment to HIPC, also aimed at maintaining our burden share. The latest contribution brings Australia's total contribution to the HIPC Initiative to $A77 million. In addition, Australia is also providing 100 per cent bilateral debt relief to countries qualifying for HIPC assistance.

Australia has been a strong supporter of the HIPC Initiative and we place considerable importance on its full implementation. The robustness of debt sustainability analysis is integral to the effectiveness of the HIPC process, and in this regard, we welcome the scope for flexibility, on a case by case basis, to provide additional debt relief to ensure debt sustainability. However, there is more to longer term sustainability than debt relief which is the start. But countries must go on to adopt rigorous institutional frameworks that assess appropriate future levels of borrowing, the productive investment of borrowed resources, realistic assessments as to the external environment, including access to export markets, and an ongoing commitment to longer term structural reform efforts.

Donor resources can never be unlimited, so making aid more effective will remain vital. In this context, we welcome recent moves to improve the measuring and monitoring of results, and the useful focus on outcomes. However, in developing indicators and measuring results, it will be important to take account of specific country circumstances. We would also attach considerable weight to closer matching of programs to the needs and capacities of developing countries.

It is also important to have the right indicators. Performance indicators are only useful if they are in fact a true indicator of the desired objective. Too often, achieving the desired objectives – such as poverty reduction – can be compromised or diluted by undue attention given to performance indicators serving as inexact proxies.

Indeed, much of the Bank's work – that part that supports sound economic policies and governance – may not be directly measurable through improvements in social indicators in the short term. Yet they are crucial to sustained economic growth, and must not be ignored. The Bank will need to remain focussed on its strength in supporting complex and sensitive activities that are crucial for development but are difficult for other donors.

In this context, I encourage the Bank to remain closely engaged in assisting poor performing states, those countries with weak policies and institutions. The international community cannot afford to disengage. The consequences would be felt by those least able to bear the burden - the poor.

Engagement strategies to assist poor performers need to be flexible and tailored to specific needs. A balanced approach will be required, with a focus on maintaining service delivery, engaging in dialogue and practical support for governance reforms, strengthening donor coordination and addressing conflict. Perhaps most importantly, realistic expectations are necessary, as we go about addressing this difficult and long-term task.

For our part, Australia plans to continue working closely with poor performing states in our region. We strongly support the Bank's work on its framework for assistance to Low Income Countries Under Stress and look forward to further discussions on this issue. The Bank and all donors should press ahead with work to increase harmonisation of policies as a way of reducing the administrative burdens on recipient countries. This is an area where Australia, together with New Zealand, has placed considerable emphasis and believes significant benefits can be realised from this process. We warmly welcome Italy's offer to host a high level forum in early 2003.

Conclusion

Mr Chairman, we face many challenges. An uncertain global outlook, financial crises in some key emerging market economies, a continuing need to combat the financing of terrorism, and the ongoing imperative to improve the welfare of the 1.3 billion still living in poverty.

We must commit ourselves to taking the actions required to improve the prospects for global development and prosperity, reduce vulnerability to, and the costs inherent in, crises, and strengthen our financial systems.

The IMF and the World Bank are playing a vital role, but we should not be complacent that everything that could be done is being done.

We must commit ourselves to taking the actions required to improve the prospects for global economic growth and prosperity. At the national level, in economic reform, at the international level in improving the financial architecture, and in our aid commitments, to fight the scourge of poverty.

Thank you.