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

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Mr Chairman, fellow governors and delegates, on behalf of Australia, I would like to take this opportunity to thank the Government of the United Arab Emirates and the people of Dubai, for their gracious hospitality in hosting these meetings.

The past 12 months have been challenging for the international community. A number of downside risks have receded and there are some promising signs that global growth may be strengthening. However, our economies still face many challenges and a number of downside risks continue to weigh on the outlook.

Restoring confidence in the world economy will require continued efforts by member countries to ensure a sustained recovery in growth.

Of significant concern is the world's continued over-reliance on the US economy as the major source of growth, with European growth remaining weak and on-going Japanese growth uncertain.

The sustainability of a number of large global macroeconomic imbalances are a concern. The fiscal positions of most advanced industrial economies have deteriorated, with all G-7 countries except Canada running large fiscal deficits. In the case of the US, the deterioration of the fiscal position has put pressure on the current account deficit, creating the possibility of a rapid and disorderly adjustment when it unwinds.

Ageing populations will soon, and in some cases are already beginning to, affect the economic performance of a number of industrialised economies, placing further pressure on existing fiscal positions. There is an urgent need now for many countries to adopt credible fiscal frameworks that embed today's necessary fiscal stimulus in a medium term program of fiscal consolidation.

The Australian economy has remained resilient over the past year despite a weak world economy and the most extensive drought in Australian meteorological records. Key factors behind this robust economic performance have been sound macroeconomic management based on the Government's medium-term fiscal and monetary policy frameworks, combined with a sustained commitment to structural reform. Accordingly, the IMF described the Australian economy '...as one of the strongest economies of the developed world...'. Looking forward, the Australian economy is expected to grow solidly in 2003-04, albeit at a little below trend, underpinned by a gradual recovery in global economic conditions and recovery from the drought.

Australia is not complacent however and recognises that it is not immune to the challenges faced by other economies. We will continue to pursue sound long-term economic policies to avoid fiscal pressures and maintain living standards in the context of an ageing population. We are therefore actively pursuing policies to increase labour force participation and raise productivity — importantly this includes a continuing commitment to vigorous action to reducing barriers to trade and investment.

The progress of the Doha round of trade negotiations is very disappointing given the obvious potential benefits of trade liberalisation to the international community. We have all lost by the failure in Cancun, but particularly those in developing countries.

As part of the Monterrey Consensus, developed countries agreed to deliver lower trade barriers - the deadlock at Cancun highlights how far we are from making tangible progress on this front.

Agricultural support and protection from OECD countries, which totalled over \$US 300 billion last year, represents a crippling tax on the agricultural exports of developing countries. To put it into further perspective, agricultural subsidies are worth over five times annual aid flows to developing countries. Aid will not compensate developing countries for the denial of economic opportunities caused by trade restrictions.

The key developed countries must now exercise leadership to bring the Round back to life. They, and other WTO participants, must put aside their individual differences in favour of the overall benefits of multilateral trade liberalisation, as demonstrated by the experience of the GATT. As Finance Ministers, we have a critical role to play in pushing for comprehensive trade liberalisation.

In that regard, Australia welcomes the vocal support of the IMF and World Bank in promoting successful outcomes for the Doha round, including through packaging their support to assist countries in implementing commitments made as part of the Doha round.

This year's IMF/World Bank Annual Meetings serve as a timely reminder of the importance of international efforts to ensure peace, stability and economic prosperity in the Middle East. Since we met last year, we all face a new challenge in seeking to aid the Iraqi people to build an open, outward-oriented economy in a free and democratic Iraq. The task is a formidable one. Australia has committed significant humanitarian aid and has provided staff for the Coalition Provisional Authority. The latter have made a substantial contribution working with free Iraqi colleagues in areas such as agriculture and the development of the 2004 Iraqi budget.

The IMF and the World Bank have a crucial role to play. Australians were horrified by the bombing of the UN headquarters in Baghdad and our sympathy goes out to those who were injured in the blast and to the families of those who died. We have been heartened that despite the bombing, the international financial institutions and the UN family are maintaining their commitment to Iraq. At the conference in Madrid next month, we hope the international donor community will demonstrate a strong resolve to help the Iraqi people meet the significant challenges of reconstruction.

The Pacific region has faced a particular set of challenges over the past year. Despite the best efforts of many, the Solomon Islands has gradually slipped into disorder and lawlessness. The people of the Solomon Islands have been living in fear and the economy has collapsed, and a humanitarian crisis has been in the making. For those reasons, regional economies came together to respond to the request of the Solomon Islands government this year to provide help. Together with New Zealand, Fiji, PNG and other nations of the South Pacific we have joined a multi-country regional

assistance mission, concentrating on the areas of law and order and economic and budget stabilisation.

The problems of the Solomon Islands cannot be remedied overnight. Long-term economic reform will be needed to create a viable future for the Solomons. Australia has been pleased at the willingness of the international financial institutions to re-engage and bring their expertise and financial resources to bear on these problems.

IMF

The legacy of the capital account crises of the last decade continues to raise issues of how to best prevent economic crises, and manage the fallout when they occur. The IMF has responded to these challenges and has taken a number of steps to enhance the effectiveness of its surveillance activities.

The ultimate test, however, of the Fund's surveillance strategy is the impact of its advice on member countries. On this key criterion, further progress could be made.

In the case of developing and program countries, central to the Fund's effectiveness is its ability to act as a 'confidential policy adviser'. This involves encouraging country ownership of program policies and developing strong, candid working relationships between staff and country authorities to ensure advice reflects political realities. In this regard, we welcome staff initiatives to bring a fresh perspective to the surveillance of program countries.

But surveillance is not just about program and developing countries. At the present time, there is just as much riding on the quality of economic policies in the major economies as there is on the policies of developing economies. The IMF must therefore remain as vigilant in promoting sound policies in the more advanced economies as it is in developing and emerging markets.

The challenge for the Fund in industrial countries is to ensure that its advice adds value amongst a number of competing sources of advice. The key to enhancing the effectiveness of IMF advice in these countries — indeed in all countries — is its ability to tailor its advice to addressing the individual policy weaknesses of its members, bearing in mind the broader implications for the stability of the international financial system.

While crisis prevention is the preferred means of promoting financial stability, the international community must be in a position to deal effectively with the possibility of new crises emerging. The IMF's work on the SDRM provided valuable impetus for the wider use of collective action clauses and the development of ideas on a voluntary code of conduct for debt restructuring.

The Fund's new criteria for exceptional access provide another important element to improving the crisis resolution framework. The measures adopted by the Fund should help ensure appropriate financial assistance is provided within the context of a sustainable policy framework in the recipient country. For the new policy to work, it will be incumbent on the Board to build up a track record in applying the new access

principles in practice — in doing so it must resist short term pressures to provide funding when policy settings are not consistent with a sustainable economic position.

The recent improvements in growth rates in low-income countries are a welcome development. But further improvements are needed to ensure adequate progress towards poverty reduction and the Millennium Development Goals.

While we all recognise the Fund has an important role to play in these countries, its role needs to complement and not duplicate that of the World Bank, other multilateral development banks, bilateral donors and the private sector.

Moreover, the Fund must ensure that it has the appropriate tools to deal with the challenges of low-income countries in their various stages of development. The owners of the Fund need to ensure that what we ask of the institution in low-income countries is within its capabilities and areas of comparative advantage. Strengthening the Fund's surveillance capacity is a necessary condition in this regard.

These Annual Meetings provide an important forum for the owners of the Fund to consider the future direction of the institution in these challenging times and provide sign-off on its agenda.

For such a dialogue to be meaningful, the Fund must represent all its membership adequately. It is therefore crucial that future quota increases include a rebalancing of quota shares to reflect the relative under-representation of certain countries, particularly in the Asia region, relative to economic weight. It is also important that all countries have the capacity to express their voice in the debate. In this light, Australia supports recent initiatives to increase the capacity of the largest member constituencies at the IMF and World Bank to contribute more effectively to the operation of the institutions.

World Bank

Australia welcomes the efforts by the World Bank in progressing the Monterrey consensus and promoting the attainment of the Millennium Development Goals (MDGs). The international community has made encouraging progress in identifying the preconditions for sustainable development.

One thing that is striking from the Bank's research is that a great deal of the recent reduction in global poverty has occurred in Asia, despite it receiving relatively low levels of official development assistance (ODA) per capita.

This is consistent with the G-20's work on globalisation, which has highlighted the importance of good policies, good governance, outward-looking approaches to trade and investment, and market access in promoting development.

The World Bank can do more in stressing the fundamental role of trade in promoting development, particularly by emphasising enhanced trade capacities in Poverty Reduction Strategy Paper (PRSP) and Country Assistance Strategy work, and including appropriate trade facilitation measures in Bank assistance.

When used effectively, aid can support countries in developing sound policies and institutions to mobilise additional resources for development from a variety of sources, including domestic resources, international investment and trade.

Accordingly, Australia strongly supports the argument that the bulk of aid dollars should flow to countries with good policies and governance to maximise aid effectiveness.

It is still apparent that aid flows do not sufficiently take into account recipient countries' capacity to successfully absorb aid without undermining macroeconomic stability and/or fiscal and external debt sustainability.

A number of Asian countries have the policies and institutions in place to successfully absorb additional aid, and yet current relative aid flows do not reflect the region's capacity to contribute to the achievement of the MDGs.

It is also clear that countries with poor policies and institutions represent a significant challenge for the international community. Unless this challenge is addressed these countries will not achieve their MDG targets. It is critical that the international community remains engaged with these countries and finds new ways to build local support and capacity, so that over time additional assistance can be provided through traditional channels.

Australia has supported the Bank's efforts in engaging with poorly performing countries in our region, and we look forward to continuing to work with the Bank on the Low Income Countries Under Stress (LICUS) initiative. We also note that, among LICUS countries, those in post-conflict situations often have unique needs, and require a sustained commitment from the international community in order to rebuild infrastructure and provide basic social services.

Australia remains a strong supporter of the Heavily Indebted Poor Country (HIPC) Initiative and we place considerable importance on efforts to ensure debt sustainability in developing countries. Debt relief alone, however, is not sufficient to address poverty. Debt reduction is important, but needs to be accompanied by sustained improvements in countries growth potential. This again brings us back to the importance of good policies, good governance, increased access to world markets and expanding export and investment opportunities.

The role of country policies and institutions, and vulnerability to shocks in determining debt sustainability is also critical, and we welcome the forthcoming IMF/World Bank review of debt sustainability in low-income countries examining these issues.

PRSPs can also play a vital role in promoting good governance, however, despite recent progress, weak institutional capacity continues to limit PRSP implementation and poverty reduction efforts. To be effective PRSPs, must be integrated into policy formulation and budget planning processes.

Conclusion

Mr Chairman, the world economy continues to strengthen from some recent turbulent times, however, challenges remain. It is important that countries continue to implement necessary reforms to reduce their susceptibility to economic and financial shocks.

Moreover, we need to deliver on our commitment to the MDGs in order to improve the welfare level of the most impoverished nations and individuals. While aid has an important role to play in achieving the MDGs, it can only be a complement to sustained efforts to mobilise domestic resources through better policies and governance. But the developed economies have to match this commitment by providing greater trade and investment opportunities for the developing world.

We continue to support the involvement of the Bretton Woods institutions in this process. We look forward to the Bretton Woods institutions improving their sphere of influence and policy advice, equally with regard to both developing and developed economies.

The well being of our nations is dependent on the development of sound domestic policies, meaningful trade liberalisation and good governance which are fundamental if countries are to experience sustainable economic growth and ongoing poverty reduction.