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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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Statement by the Hon. **TAN SRI NOR MOHAMED YAKCOP**,
Governor of the Fund and the Bank for **MALAYSIA**,
at the Joint Annual Discussion

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Global Economic Outlook

We welcome the strengthening and broadening of the global economic recovery since our meeting in Dubai last year. We are further encouraged by the strong performance and recovery in many developing economies, which has been aided by improved fundamentals and a rebound in the external sector.

An outstanding concern is the need for appropriate policies involving authorities in major financial centres, especially the G-3, to mitigate risks emanating from the extent and severity of the global imbalances. Such policies entail cooperation to maintain orderly market conditions to facilitate the smooth adjustment of the external imbalances, while cognizant of the need to encourage measures to strengthen growth further. Key elements of such policies should incorporate strategies of the US to restore medium-term fiscal balance, to advance the pace of structural reforms in the Euro area, to ensure further progress in the banking and corporate sector reforms in Japan, and for Asia, to continue with structural reforms to support domestic demand.

We welcome the greater resilience and stability of the global financial system and the broadening of global growth. These have resulted in improved corporate and banking sector earnings, as well as low inflation, which led to stable, and low yield in major bond markets. Accommodative monetary policies have made available low cost external financing especially for emerging markets. Notwithstanding the above, the question remains as to how much interest rate should rise as economy continues to expand. During the transition toward higher interest rate, it is important to manage the rise in interest rate to ensure that global growth is sustained.

Malaysia's Economy

Malaysia has benefited from the continued strengthening of the global economy, reinforced by the strong domestic demand that had supported growth for the previous couple of years when the external environment was less than encouraging. Thus, for the first half of 2004, Malaysia's economy expanded at an accelerated pace of 7.8%, with the manufacturing and services sectors as key contributors to growth. More importantly, private investment activity recovered strongly to become the engine of economic growth. The robust economy further strengthened the nation's macroeconomic fundamentals and resilience as indicated by the low inflation, 81 consecutive months of trade surplus, rising international reserves, full employment, as well as a healthier banking system. Given the strong economic performance during the first half of the year and a generally encouraging external environment, the economy is expected to record the highest GDP growth since 2001 that is at 7% for 2004.

Going forward, monetary policy will remain accommodative and will continue to support growth and ample liquidity is expected to continue supporting financing needs of the private sector. The financial system experienced a smooth transition to a new market-based interest rate framework introduced in April 2004. The average base lending rates of financial institutions is on the decline with the overall financial position of the banking system remaining sound. On the exchange rate, the current regime continues to facilitate increasing trade and investment flows. The present exchange rate regime is supported by the rising international reserves, low external debt, low inflation and sound banking system.

The significant domestic restructuring undertaken since the Asian crisis and strengthened economic fundamentals continue to underpin the sustained growth performance of the Malaysian economy. We anticipate the growth momentum to continue for 2005. Forward-looking indicators continue to point towards strong and sustainable growth. Improved consumer and business confidence, favourable commodity prices, stable employment conditions, low inflation and rising incomes are expected to support further growth in the Malaysian economy. Meanwhile, Malaysia is resilient to high oil prices given that it is a net oil exporter. The impact of imported inflation should be modest.

In the context of the uncertainties in the external environment, the Budget 2005, which was tabled recently in Parliament, continues to build from past achievements to strengthen the foundation and competitiveness of the economy. The focus will be on enhancing the effectiveness of Government financial management, improving the delivery system and competitiveness, accelerating the shift towards a higher value-added economy, developing human capital and improving the quality of life, particularly those in lower income groups. The Government will also continue its pragmatic fiscal policy of striking a balance between prudent financial management and pro-growth strategies which has resulted in the gradual declined in the deficit from 5.6% of GDP in 2002 to 5.3% in 2003, with an expected further reduction to 4.5% in 2004 and 3.8 % in 2005.

IMF Surveillance

The IMF should be more focused on surveillance issues central to its mandate; and that the quality of policy dialogue between IMF and member countries should be improved by making better use of cross-country experiences. In addition, the IMF should not overdo the need for transparency at the expense of its role as a confidential advisor to members. Equally important, considerations to make IMF surveillance more effective should include the accountability factor where the IMF should be held responsible for the policy advice that they provide to member countries.

Aid Effectiveness and Financing Modalities

We agree that larger and more effective aid flows are critical in implementing the international development agenda. We also agree that concerted efforts are needed on several fronts, in particular reform of the international trading system and in improving the ways aid is delivered. At the same time, development assistance must be aligned to country priorities. Equally important is the need to strengthen the capacity of countries to absorb and effectively use aid. We also support continuing work on efforts to look at innovative mechanisms to provide additional aid. In this regard, we support the agenda on financing modalities as proposed, namely:

- continue working on the feasibility of the more promising global taxes: and
- exploring the blending of aid and other financial sources to augment existing resources.

Investment Climate

The investment climate is a very important factor to sustain and generate economic growth. The increasing mobility of capital flows across borders, facilitated by the more liberal investment regime, globalisation as well as ICT necessitated that economies pay special attention to providing at least the basic facilities required to retain and attract new business activities. Of course, with increasing competition for FDI, resulting from the slow growth in FDI from source countries coupled with increased demand for such flows from new and emerging market economies in recent years, the basics will just not be enough.

Countries are coming under increasing pressure to go beyond the basics to provide highly attractive fiscal and non-fiscal incentives to attract potential investors and even retain those who are already in the country. However, in trying to outbid one another, the capital recipient countries have to be cautious that they do not fall into a trap ala a `price-war' which could ultimately reduce the returns from such capital flows for all involved.

Infrastructure Development

Malaysia fully agrees that infrastructure is an indispensable pre-requisite to support investment, trade and other economic activities as well as to address poverty. We have on many occasions and in many international fora leading to the Monterrey Consensus emphasised the critical importance of infrastructure and the need to identify new and specialised sources of financing to support infrastructure development particularly among developing countries. In this regard, Malaysia strongly supports the initiatives undertaken by the World Bank. Malaysia requests serious consideration on our proposal for an appropriate kind of global infrastructure tax and a specialised global fund to actively promote and aid infrastructure development particularly for developing economies.

Infrastructure is a major contributor to economic growth, poverty reduction and achievement of the Millennium Development Goals. Malaysia has always given emphasis to infrastructure development as evidenced from the allocation of funds throughout the years.

The focus of infrastructure development in Malaysia is moving towards improving quality of service, efficiency of delivery, affordability as well as the user pay concept. Hence the private sector has been and will continue to be encouraged to participate in the provision of infrastructure facilities and services, with emphasis on public-private partnerships, particularly for operation and maintenance as well as financing.

Voice and Participation of Developing and Transition Countries

Malaysia takes note of the work that has been carried out by both the Bank and Fund in addressing institutional and structural issues to enhance the voice of developing and transition countries in the operation and the decision making of the Bretton Woods institutions. While we have made further progress, particularly on capacity building assistance for the most over-stretched Executive Directors and constituencies, we have yet to achieve much progress on the more challenging institutional and structural changes, such as quota, voting power and the under-representation of developing countries in the Board.

Debt and Debt Sustainability

At the Spring Meetings, we broadly supported the principles underlying the proposed framework for debt sustainability in low-income countries while acknowledging that the modalities and operational implications remained to be thrashed out to provide lenders with a measure to determine the appropriate level of debt. Today, we welcome the opportunity to discuss this in the upcoming debt agenda especially in view of the recent extension of the Heavily Indebted Poor Countries (HIPC) Initiative sunset clause.