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Statement by the Hon. **TOMMASO PADOA-SCHIOPPA,**
Governor of the Fund for **ITALY,**
at the Joint Annual Discussion

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1. The Global Economic and Financial Outlook

This year's Annual Meetings take place at a crucial moment for the global economy. Although growth remains robust and the outlook positive, downside risks have increased. The pace of the US economy has decelerated towards its potential and inflation remains above the long-term objectives of the monetary authorities. Growth has accelerated in the Euro-area, with domestic demand progressively replacing exports as the main driving force of the recovery. However, it is too early to say whether this improvement is the result of conjunctural factors or the beginning of a sustained upturn. The economic expansion also continues in Japan, albeit at a lower rate than expected.

The largest emerging market economies have continued to grow at a rapid pace, providing substantial stimulus to the global economy. In recent years, a number of emerging market economies have been able to address important sources of vulnerabilities, thus increasing their resilience to shocks. Fiscal positions have improved, inflationary pressures have been broadly kept in check, and the implementation of structural reforms has accelerated. Nonetheless, some of these countries remain susceptible to turbulences in financial markets.

In Africa**,** economic expansion has been robust in both oil-producing and oil-importing countries, although individual performances vary substantially. Improved governance and increased aid flows have strengthened the potential of these economies and their resilience to external shock. Despite the recent good performance, growth rates in Sub-Saharan Africa are expected to remain below 7 percent, the minimum rate necessary to meet the Millennium Development Goals. Further reforms to strengthen domestic policy so as to improve the business climate and foster private investment, particularly through foreign direct investment, are of fundamental importance to raise the potential and to expand the absorptive capacity for further increase of aid flows.

Although the outlook for the global economy remains favorable, downside risks have increased in the past few months. These include the possibility of a sharper decline in the US housing markets and the disorderly unwinding of global imbalances as they continue to grow.

Addressing global imbalances is a shared responsibility of all major players in the world economy. We welcome the efforts of the IMF to promote a better understanding of these issues with the launching of the first round of multilateral consultations. Although the process is only at the beginning, it looks promising and we look forward to some concrete results in the near future.

The EU’s greatest contribution to reducing global imbalances is its commitment to a rapid implementation of the Lisbon Agenda. The completion of the internal market should foster competitiveness and thus enhance private consumption. At the same time, greater productivity should raise the potential growth and increase the area’s contribution to the global economy.

Although the US fiscal position has improved recently, structural measures are needed to tackle the challenges stemming from the aging of the population. The recovery of the Japanese economy should lead to an acceleration of structural reforms, which are necessary to ensure growth and fiscal sustainability in the long term.

The largest Asian countries and the oil-producer countries should take advantage of the current favorable conditions to modernize their economy and become more resilient to future shocks. Greater exchange rate flexibility and structural reforms to enhance domestic demand will contribute to an orderly unwinding of global imbalances.

2. Implementing the IMF's Medium-Term Strategy

Surveillance and crisis prevention

Surveillance should remain at the core of the IMF’s activities; however, it should be revamped to meet the new challenges of the global economy and the growing integration of financial markets. Providing the membership with appropriate and timely policy advice to deal with existing vulnerabilities and growing regional and global spillovers is the IMF’s key responsibility.

We welcome recent efforts to expand the scope of surveillance and develop a new framework for its implementation. The new approach of a multilateral consultation has been launched to provide a forum for discussions to achieve a broader mutual understanding of global issues and foster agreement on policy actions.

The bilateral surveillance framework needs to be revised to promote prioritization, selectivity, and a closer link between domestic policies and external stability, including exchange rate policy. Revising the 1977 Decision on Surveillance over Exchange Rate policies will help establish a new framework to provide unifying guidelines, clarify priorities, and improve procedures.

Financial market and exchange rate issues should regain their central role in the surveillance process. The recent progress in upgrading the IMF's analytical capability on financial issues is a step in the right direction. The key challenge is to develop a consistent framework where financial and traditional macroeconomic assessments are fully integrated.

Despite the recent improvements to stabilize their economies and reduce vulnerabilities, the emerging-market countries remain exposed to significant global risk. While surveillance remains central to the task of fortifying domestic policies, different ways to improve the Fund's facility array to prevent crisis in countries with a strong macroeconomic framework might be explored.

We believe, however, that precautionary arrangements and the exceptional access framework are already effective tools to assist members in signaling the strength of their policies and provide them with significant IMF resources. Thus, we remain skeptical about the possibility to design a new facility able to address the shortcomings of the CCL and to reconcile a full insurance instrument with the necessary safeguards for IMF resources.

Quotas and voice

A continuous effort to ensure a full involvement of the whole membership in the decision-making process is essential for a universal institution to preserve its credibility and effectiveness in facing the new challenges posed by the global economy.

The resolution of the Board of Governors is of fundamental importance to strengthen IMF governance. The immediate ad-hoc quota increase in favor of the most underrepresented cases, identified on the basis of robust and objective criteria, is a first step that confirms the commitment of the institution in that direction.

In the coming months, a new quota formula should be agreed upon in order to guide a second round of ad-hoc quota increases, aimed at addressing the other critical cases of under-representation. The new quota formula should be simple and transparent and should reflect appropriately the position of member countries in the economic and financial system while taking into account the different functions of quotas.

An essential component of the agreement is a sharp increase of the basic votes that will substantially lift the low-income countries' quota share, thereby helping reverse the current erosion trend of their voting power. In the future a mechanism to preserve the weight of basic votes on the total voting power will help further protect low-income countries' voting share.

3. The role of the IMF and the World Bank in low-income countries

The IMF and low-income countries

The IMF has an important role to play in low-income countries (LICs), namely supporting their efforts to achieve macroeconomic stability and implement pro-growth structural adjustment. These are essential steps towards achieving the MDGs.

A set of new instruments has been created to strengthen the role of the IMF in LICs, including the Policy Support Instrument and the Exogenous Shock Facility. In addition, debt relief under the HIPC and MDRI initiatives has contributed to improve the financial position of LICs and has freed resources that can be dedicated to poverty-reducing expenditures. We share the view that the sunset clause of the HIPC Initiative should go into effect at end-2006, while grandfathering all countries that are assessed to have met the income and indebtedness criteria based on end-2004 data. We ask the IMF to explore alternative options to finance HIPC and MDRI debt relief for these countries.

Looking forward, the IMF should remain closely engaged with LICs through surveillance, capacity building, and financial assistance, focusing on the areas of its core expertise. In particular the IMF should continue to strengthen its policy advice with a view to assisting LICs in the design of a sound policy mix aimed at (i) effectively managing increasing aid flows and the fiscal and balance of payment space created by debt relief, and (ii) preserving debt sustainability. In this regard, we welcome the ongoing work to refine and enhance the Joint Debt Sustainability Framework (DSF), which is, in our view, an essential tool for borrowers and creditors alike to reach consistent financial decisions and avoid the accumulation of new unsustainable debt, particularly in post-MDRI HIPCs

Governance and Anti-corruption

We strongly support the World Bank's efforts to strengthen its work in promoting good governance and in tackling corruption seriously, effectively, and firmly. This is a critical development issue that is conducive to the achievement of the Millennium Development Goals (MDGs). The Bank, as a multilateral development organization, should remain engaged with all its members and must address governance and anti-corruption from a development perspective and within its mandate. We believe that the principal objective of the World Bank Group's governance work should be to help build capable, accountable, and responsive states that deliver services to the poor, promote private sector-led growth, and tackle corruption effectively and firmly where this is an issue that needs to be addressed.

Country ownership is a core principle underpinning development and should be maintained. The Bank's new strategy should aim at supporting developing countries in proposing and developing their own solutions to their distinct national challenges and then helping them deliver on their governance commitments. The implementation of this strategy should not result in any trade-off that may lead to a dilution of important priorities, in particular the achievement of the MDGs, the Bank's consistent engagement across its membership, the reference to alignment and harmonization principles, the implementation of the results framework, and a willingness to take risks.

4. The World Bank's Engagement with IBRD Partner Countries

The relationship between the World Bank Group and its middle-income partner countries (MICs) is crucial and at the heart of the Bank's financial model, which is very dependent on the ability to generate business in MICs, on the attractiveness of its products (financial and non-financial), and the quality of its policy advice.

The Bank should devote more analysis regarding the differentiated demand of Bank products among MICs, which differ substantially from each other. Some of these countries still demand bundled services (financial products, plus knowledge and policy advice services), while some others prefer unbundled products. To the extent that MICs are increasingly expected to demand unbundled products, the Bank will need to diversify its revenue sources and achieve greater transparency by identifying them distinctly.

The IBRD partner countries will also increasingly demand International Public Good-related products and services. The provision of collective goods is an area the Bank must explore thoroughly and with an innovative spirit. We feel that the Bank is especially well-placed to take a global leadership role in matching demand in these countries.

Finally, we look forward to the work of the External Review Committee. Defining an effective division of labor between the Bank and the Fund, based on their comparative advantages, and enhancing coordination are key to improving the quality of the assistance that the two institutions can provide to low-income members in their ongoing efforts to achieve the MDGs.