FOIA Number: 2006-0467-F

FOIA MARKER

This is not a textual record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

Collection/Record Group: Clinton Presidential Records

Subgroup/Office of Origin: Speechwriting

Series/Staff Member: Jeff Shesol

Subseries:

OA/ID Number: 19946

FolderID:

Folder Title:
IMF [International Monetary Fund] / World Bank 9/29/99 - International Financial Architecture

Stack:	Row:	Section:	Shelf:	Position:
S	91	6	9	1

Amherst Coll
Oct 26, 63

"~~The~~ A nation reveals itself not only by the men it produces, but also by the men it honors, the men it remembers."

1. CNN
2. ABC
3. MSNBC
4. AP/REUTERS
5. WASHINGTON POST

TO: Jeff Shesol
David Halperin

FROM: Sharon Yuan

Attached are four background papers for the speech. We are still waiting for more info from Treasury, Rick and Tom. We will send those to you as soon as we get them.

1. Treasury Poverty Reduction Paper
2. Sec. Summers Draft Speech
3. Draft Interim Committee Statement
4. State Paper on Stability Pact Initiative on Corruption

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

cc Rich

UNDER SECRETARY

HIPC
Event

August 25, 1999

FAX FOR:	James Steinberg (NSC)	Fax:	456-9490
	Lael Brainard (NEC)		456-1605
	Alan Larson (State)		647-5713
	Robert Lawrence (CEA)		395-6958

FROM: Timothy F. Geithner TFG w/mg for
Under Secretary (International Affairs)

Following up on HIPC discussions at Cologne, in particular the need for an enhanced framework for poverty reduction, please find attached a short paper setting out our current thinking on this subject and how we might pursue it in the World Bank and IMF.

[U.S. Treasury Draft, 8/24/99]

New Directions for IMF and World Bank Support for Growth and Poverty Reduction in Poorest Countries

Introduction and Summary

At the Cologne Summit, leaders called for an expanded debt initiative to provide faster, broader and deeper debt relief to heavily indebted poor countries pursuing sound policies and demonstrating a commitment to reform and poverty reduction. Leaders noted that the new initiative should be built on an enhanced framework for poverty reduction, to be developed by the international financial institutions (IFIs) in consultation with other institutions and with civil society. A well-designed framework would accommodate and promote a number of mutually reinforcing objectives--poverty reduction, sustainable development and good governance--while reinforcing the incentives for reform and growth.

The call for an enhanced framework for poverty reduction was envisioned, therefore, as part of the enhanced HIPC initiative. Yet it makes sense to apply this concept to World Bank and IMF/ESAF programs generally. This note sets out a series of proposals--drawing on experience, academic work, and suggestions put forward by civil society--intended to ensure that World Bank and IMF assistance more effectively support poverty reduction and sustainable growth in IDA/ESAF-eligible countries.

The approach would be based on 5 elements:

1. *A growth-oriented, integrated strategy for poverty reduction and human development.*

2. *Increased and more effective fiscal expenditures for poverty reduction.*

3. *Enhanced transparency, including monitoring and quality control over fiscal expenditures.*

4. *Greater public ownership of programs.*

5. *Stronger incentives for follow through on poverty reduction.*

A strengthened approach to poverty reduction would involve a number of changes at the operational level for the World Bank and the IMF:

- *changing the framework for official support* -- the new framework would involve, among other things, a significant change in the relative roles of the Bank and the Fund, as well as much closer collaboration between the IMF, the World Bank and recipient governments at the design stage of planned operations, with the Bank sharpening its focus on achieving verifiable progress on poverty reduction, the Fund improving the complementarity of its macroeconomic recommendations, and both institutions including as performance criteria in their relevant program documents a set of core reforms and other measures required to reduce poverty;

- *sharpening the poverty focus and content of programs* – programs should be grounded in an assessment of the root causes of poverty in a particular country, and consist of an integrated, coherent set of steps needed to reduce poverty – in other words the program should be a strategy in the true sense of the term;

- *making programs more transparent and accountable* – this will require more concrete efforts to strengthen national ownership of programs and encourage broader participation by civil society in all phases of the process;

- *for HIPCs, improving the mechanism for providing debt relief* – the mechanism should be simpler and more clearly focused on ensuring that relief is linked to and supportive of sustained government efforts to reduce poverty and promote human development.

In order to get the most benefit from this approach, eligible countries, for their part, will need to take the lead on a number of fronts where progress lies primarily, if not solely, in their hands. Most important, governments will need to demonstrate at the highest political levels, and through specific actions, a commitment to poverty reduction and the reforms and domestic funding needed to give effect to such commitment. This means, for example:

- taking resolute steps to improve governance and to increase transparency and accountability, especially with respect to public expenditures;

- assuring that domestic resource decisions fully reflect the priority given to poverty reduction;

- working more closely and openly with civil society groups; and

- implementing the macroeconomic, structural and legal reforms that will support economic growth and a rising standard of living for all.

Elaboration of Specific Elements.

1. A growth-oriented, integrated strategy for poverty reduction.

The new approach would be based on an integrated strategy for poverty reduction prepared by the recipient country in cooperation with the World Bank and IMF, and in consultation with civil society groups. The centerpiece of the strategy would be a core set of monitorable poverty reduction goals, such as:

- increasing literacy;

- reducing infant/child mortality;
- lowering AIDS incidence;
- improving environmental conditions.

In line with recent World Bank proposals, such poverty reduction goals and, critically, the steps required of the national authorities and assistance providers to achieve them, would be identified as part of the Comprehensive Development Framework (CDF) process envisioned by World Bank President Wolfensohn. This process, led by the national authorities, would involve full participation by the Fund, especially as concerns the definition of macroeconomic policies that are directly linked to poverty reduction goals and the elaboration of options and/or proposals for addressing trade-offs that are made necessary by resource constraints. The results of this multiparty process would be incorporated in an integrated strategy reflected in a framework document jointly endorsed by the national authorities and the Executive Boards of the World Bank and IMF. An appropriate name should be found for the framework document and its underlying strategy. One possibility: the Integrated Strategy for Growth and Poverty Reduction.

The strategy should be broad enough to accommodate the full range of mutually reinforcing macro-economic, structural and public policy steps required to make progress in reducing poverty. More specifically, the essential components of the strategy would be:

- Verifiable poverty reductions objectives focusing on results or outputs (e.g., the percentage by which literacy rates increase). These should be consistent with an internationally-agreed set of performance indicators. (One possibility is the OECD Development Assistance Committee's "International Development Goals.") The World Bank should lead this exercise and explore how it can best draw on expertise in relevant U.N. agencies, civil society groups and other appropriate organizations.

- A macroeconomic component linked to ESAF financing (or, where appropriate, Staff Monitored Programs) with targeted conditionality that gives greater attention to the social implications of adjustment.

- Government-Bank-Fund agreement on major objectives in the areas of good governance and institution building--focused on improving the transparency of government budgets and improved public expenditure management--and on key areas of Bank-Fund overlap, such as financial sector reform.

These and other components would be more fully articulated and made operational in subsidiary World Bank and IMF programs. They would be embodied in the Letter of Intent for a revised version of the Enhanced Structural Adjustment Facility (ESAF), in HIPC decision documents, and, for the World Bank, in a range of program documents, including Country Assistance Strategies (CAS), CAS progress reports, and Letters of Development Policy for specific lending operations.

The precise mix of action steps will, of course, vary from country to country consistent with priorities identified as most critical for poverty reduction. In some cases rural health and secondary road development, for example, will be key; in other cases, an emphasis on, for example, agricultural extension, preventing environmental degradation and primary education will be appropriate. However, based on what we already know about the circumstances of most HIPCs and other IDA/ESAF-eligible countries, certain elements will tend to be an essential part of each strategy. For example, steps to encourage more rapid and broad-based economic growth (on a per capita basis) will help ensure that poverty reduction is sustained, and will help advance the day when the poor experience discernible improvements in their lives. Institution building and improved governance, important in their own right, will also support a host of other objectives, such as increased investment (to promote growth) and transforming public institutions into part of the solution rather than part of the problem.

2. **Increased and more effective fiscal expenditures for poverty reduction.**

The fiscal policy choices that a government makes are critical to the achievement of poverty reduction goals. A new approach in this area is called for and would be a centerpiece of the integrated strategy. We would envision two key components.

Social expenditure floor. Though much of the focus on poverty reduction is, appropriately, on the quality of inputs (see section 3, below), there needs to be an agreed, secure floor in the national budget for social expenditures which rises over time and is protected in the event of economic crisis. The establishment of such a floor and identification of growth rates from it would be joint conditions (among others) in the subsidiary implementation documents described in 1 above. Failure to meet this or other joint conditions would be grounds for suspending HIPC or other IMF/ESAF and World Bank support.

This change would need to be underpinned by more effective Bank-Fund collaboration to ensure that social expenditures are explicitly incorporated in the integrated strategy, in relevant Bank and Fund operational documents, and, of course, in the government's national budget. The establishment of an appropriate social expenditure floor should begin with a thorough analysis of the quality and availability of basic services that have a strong link to poverty reduction; this would include, for example, health, education and sanitation services, and certain aspects of public infrastructure (e.g., rural road networks). Joint work by the Bank and the Fund under a revised procedure for more forward-looking public expenditure reviews and Medium-Term Expenditure Frameworks would also be key as a "quality control" mechanism (see also part 3 below).

Capturing the gains from debt relief. We need to ensure that savings freed up by debt relief, as well as a share of other bilateral and multilateral support (including ESAF), are "captured" and channeled in directions that support poverty reduction. There are a variety of approaches for achieving this. One possibility is to direct such savings into a special stand-alone poverty reduction/human development fund or "window." Under this approach, countries receiving

HIPC debt relief would be required to channel resources equivalent to the amount of HIPC savings into a fund established by the recipient government. In addition to HIPC savings, other bilateral and multilateral support, including some portion of ESAF assistance, might also be channeled into the fund.

Another possible approach is for the country to channel the savings from debt relief into existing or newly created poverty reduction programs in the national budget. To facilitate monitoring, all such programs could be pulled together, in an accounting sense, into a "poverty reduction budget" within the national budget.

The most crucial elements in both of the above approaches would be a commitment by the government to increased transparency in budgetary expenditures and the creation of mechanisms for effective monitoring by civil society groups, UN agencies or others in the donor community of such expenditures.

3. Transparency, including monitoring and quality control over increased fiscal expenditures.

Transparency not only helps ensure that there are increased fiscal expenditures but also builds public confidence in and support for the strategy (see also 4 below). Such transparency should be based on the following steps at a minimum:

- mandatory release/publication of the integrated poverty reduction strategy and relevant subsidiary documents (e.g., IMF Letters of Intent; World Bank Country Assistance Strategies and progress reports, HIPC documents, and reports coming out of a strengthened Public Expenditure Review/Medium-Term Expenditure Framework process);

- mandatory publication of the national budget, including detailed, regularly updated information about funds in the special poverty reduction/human development account and disbursements therefrom (both the amount and purpose of such disbursements);

Such information should be made available via a number of channels and in a form that is understandable and accessible to the general public.

Transparency, while essential, is not sufficient. There should also be one or more mechanisms to ensure regular <u>monitoring and accountability</u> of increased fiscal expenditures, as well as, critically, to promote <u>quality of expenditures</u>. While the precise form could vary from country to country, possibilities include one or a combination of the following:

- the creation (where not already in existence) with World Bank and/or IMF support of a quasi-independent government agency for auditing national accounts;

- annual audits by such an agency with the results released to the public; annual audits by a recognized international accounting firm with results released to the public;

- a revised procedure for more pro-active, forward looking, mandatory and re-named version of Public Expenditure Reviews and Medium-Term Expenditure Frameworks; also, a requirement that recommendations coming out of such exercises be implemented as a condition for HIPC or other IMF/ESAF and World Bank support;

- the Bank should also assist the country in establishing a coordination mechanism with the full donor community to: (1) identify conditions that would materially improve the quality and development impact of fiscal expenditures, and (2) develop strategies for implementing these measures.

To support the creation of credible monitoring/accountability mechanism, and to help ensure that recommendations are implemented, the World Bank and the IMF will need to finance or provide technical assistance aimed at strengthening public budget formulation and execution, with an emphasis on budgeting, accounting and auditing.

4. Greater public ownership of programs.

Public understanding of and support for programs begins with public participation in their development. The government bears primary responsibility for consultations with civil society groups and the general public. That said, many governments may need the support of assistance providers (bilateral or multilateral) to help foster the creation or strengthening of civil society groups as well as mechanisms for consulting them. The World Bank and IMF, for their part, need to consult with a broader range of government ministries and civil society groups in developing the programs that will make operational the overarching poverty reduction strategy.

Specific mechanisms for increasing public participation will vary from country to country but could include the following:

- face-to-face meetings between, on the one hand, national authorities and Bank/Fund teams working on the integrated strategy, and, on the other hand, local NGOs/associations representing various constituencies (e.g., labor, environment, business); a report on such consultations and how they contributed to the development of the strategy should be included in the framework document in which the strategy is set out;

- more frequent press conferences by joint teams and/or resident representatives;

- meetings with the general public (in the fashion of "town meetings") organized and hosted by the national authorities.

5. Stronger incentives for follow-through on poverty reduction

To help ensure effective implementation of the poverty reduction strategy, a set of core reforms (macro and structural) and other specific measures required to reduce poverty in measurable ways should be incorporated as performance criteria in Bank and Fund program documents for HIPC debt relief as well as ESAF and IDA funding. If the Executive Board of the Bank concludes that core poverty reduction measures are not being implemented or progress towards poverty reduction targets is insufficient, then HIPC relief, ESAF disbursements, and, at least, fast-disbursing World Bank loans would be suspended. Similarly, if the IMF Executive Board concludes that progress on macroeconomic reforms critical for poverty reduction is insufficient, then suspension of the aforementioned assistance would occur. This implies that the scope of ESAF conditionality will need to be broadened to include, at least, floors on poverty-reduction expenditures within the agreed fiscal envelope, as well as other criteria essential for poverty reduction.

To monitor the effectiveness of the poverty reduction strategy, an external review should be conducted after an appropriate period of time, perhaps two or three years. The review's findings should be published and the public provided an opportunity to comment on them.

DRAFT

September 23, 1999

STATEMENT OF TREASURY SECRETARY LAWRENCE H. SUMMERS AT THE DEVELOPMENT COMMITTEE OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND WASHINGTON, D.C.

September 27, 1999

Introduction

The millennium marks a significant moment in time. It should also inspire us to renew and revitalize our collaborative efforts to promote growth and development in the poorest countries, and to eradicate global poverty. Our shared experience over the past fifty years has been marked by some astonishing successes as well as some deep disappointments. It underscores the scope and complexity of the enormous challenge we confront, and the need to focus resolutely on what works. The Development Committee remains a concrete expression of our firm and persevering commitment to meet this challenge and advance the common good.

Unprecedented globalization and technological change make the challenge even greater, as does the divergent pace of economic and social development progress among countries and regions.

The Development Committee's attention over the last two years has focused heavily on the advanced emerging economies and the collaborative efforts needed to address financial shocks with systemic implications. This crisis generated a remarkable process of international consensus building. While there has been considerable progress toward a return to stability, much more needs to be done if we are to see a sustained and better balanced global economic recovery. We also believe it is now important to shift the attention of the policy community to global poverty and to dedicate commensurate energy to more effectively address the development challenges faced by the world's poorest countries.

Progress in improving living standards in the poorest countries has been disappointing and overall poverty remains unacceptably high. Sub-Saharan Africa's per capita income is today somewhat lower than it was in 1980. The number of people living on incomes of less than a dollar a day is now expected to increase from 1.2 billion in 1987 to 1.5 billion next year and close to three-quarters of Africans' private wealth is estimated to be overseas. In many countries, the modest improvements experienced in health and education indicators have begun to stagnate or, in some cases, decline. Countries affected by AIDS have experienced the loss of all the gains in life expectancy achieved over the last fifty years. Clearly, we need to find new and more effective approaches to poverty reduction.

A long and difficult road lies ahead if we are to prevent huge portions of the world's people from remaining marginalized, mired in poverty and without satisfaction of their basic needs, and bypassed by technological change. No one could be satisfied with such an outcome. It diminishes international welfare and is a recipe for global instability, the spread of disease, and environmental and humanitarian disasters.

It is clear that the commitment and the domestic efforts of developing countries are central to successful poverty reduction. We also want to encourage a broad international commitment to give our priority to the fight against global poverty and transform our policy approach to helping these poorest countries. We do know unambiguously that some things do contribute to equitable growth. There is, for example, a growing consensus that countries -- and the donors trying to assist them -- ought not only to pursue sustainable growth but also focus more explicitly on attacking poverty, by concentrating public resources and attention more effectively on the interventions that most affect poverty. The vast human dimensions of the problem underscore the importance of urgent action to put into place a framework to operationalize this strategy.

The United States seeks a global development partnership, owned by recipients and donors alike, that strengthens the framework for combating poverty at its roots. Our goal should be to build on lessons learned and make whatever changes are necessary in policies and institutional strategies and processes to ensure that development assistance can and does make an important difference on the ground in improving human welfare. Expressions of commitment and political will must be translated into action. While the challenges are formidable, we are confident that a renewed collaborative effort can significantly reduce poverty in the coming years and help make the International Development Targets a reality.

<u>The Basic Conditions Which Make Development Work</u>

While development experience provides many and often complex examples, we do know that there are four broad critical pre-requisites for sustainable growth and poverty reduction.

1. Sound and transparent economic management, including market-encouraging macro-economic policies conducive to private enterprise, and financially viable banking institutions;

2. A policy framework which focuses more on poverty considerations by integrating growth objectives, including those for agriculture and rural development, with poverty reduction;

3. Priority attention to human development, particularly the provision of far stronger and more efficient basic education and health services to equip the poor to respond more effectively as opportunities improve; and

4. Good governance, including fully functioning institutions incorporating transparency, accountability, the rule of law, and the participation of civil society.

These are, in effect, the basic conditions that make development work.

Comprehensive progress in all four areas is integral to sustaining successful long-term development. Yet very few of the poorest countries can be satisfied with their situation in any single category. As countries look more systematically at policy frameworks and public expenditure programs to sharpen their poverty focus, they will have to tackle -- and not duck or put off -- their most glaring and fundamental problems, notably including corruption.

Admittedly these conditions are easy to prescribe but often very difficult to achieve. For example, there is the widespread public concern about the impact of adjustment programs on the provision of social services to the poor and the often seemingly intractable problem, which we also confront in our own country, of ensuring that poverty reduction is a cross-cutting theme across the broad range of public policy. There is also the problem of overcoming vested interests.

Difficult as these obstacles are, we believe that if governments fully embrace and take ownership of sound development strategies to achieve growth and poverty reduction, they can be overcome. If they cannot, external assistance, as research continues to show, will be of little help and may even be counterproductive. Action and performance, not words or intentions, should determine allocations of assistance. Such ownership may have to be built and deepened in stages, but this process must be rigorous and sustained. Improved transparency and participation, and better informed and increasingly involved constituencies in civil society, should be viewed as key mechanisms for helping to generate necessary public ownership and confidence.

The Bank and Fund, along with the broader development community, need to encourage and support the efforts of the poorest countries to build and maintain development frameworks reflecting individual country circumstances and incorporating sound development principles. The roles of the IFC and MIGA to harness private sector initiative are also crucial.

It is also important to approach environmental management and poverty reduction as an integrated whole. "Environmental" problems -- such as unhealthy drinking water, poor sanitation, soil depletion, deforestation, and pollution -- are increasingly concentrated in low-income countries, where institutional and technical capacity to solve them is also weak. These problems have long-term economic costs that are not fully understood, and they impact disproportionately on the poorest. The international financial institutions and their borrowers therefore need to be more alert to opportunities to improve the environmental sustainability and quality of their activities across the board. MDB policies on environment and natural resource issues are essential ingredients in a process to enhance development in a way that makes poor peoples' lives better. In some areas, these policies are quite strong. In others, we believe further improvements are needed, and we intend to work towards this goal (e.g., intensified efforts in the area of energy efficiency and renewable energy) which could result in substantial and cost-effective improvements in the lives of the poor in both urban and rural areas). But in all cases, it is imperative that agreed policies be fully implemented -- which has not always been the case to date.

The World Bank and IMF and a Renewed Development Framework

The Development Committee and our member governments will continue to rely heavily on the World Bank Group and the International Monetary Fund in the new millennium to promote sound economic management and governance, encourage policy reform, facilitate the flow of trade and capital, and, most importantly, reduce poverty. These vital institutions, in close partnership with the regional development banks, must be forceful advocates of policies which lead to both sustainable development and social progress.

For those countries that demonstrate a commitment to sound development policies, the support of the Bank and Fund can make an important difference in improving welfare and promoting the common good. All too often, however, commitments and intentions have triggered external financing with disappointing results. It is performance that counts.

We believe the Bank and Fund should use their pivotal leadership roles to help re-energize development efforts to combat global poverty. We also believe they must undertake the fundamental internal policy and process changes needed to enable them to sharpen their focus on achieving verifiable progress on poverty reduction. In sum, the Bank and Fund must do a better job in using their technical and financial resources to help catalyze positive poverty outcomes.

We believe it is imperative for both institutions to work collaboratively in drawing from the lessons of the past fifty years to build pragmatic collaborative partnerships with those of the poorest developing countries that are committed to reform and poverty reduction.

We welcome and strongly encourage the transformed approach now underway in the Bank and Fund to elevate poverty reduction as an overarching objective of their programs in IDA/ESAF countries. This approach must be applied consistently. It must be sustained. And it must be implemented vigorously. It is essential that macroeconomic policies, sound economic management, social development policies, and poverty reduction be mutually reinforcing. This will lay a secure basis for sustainable growth.

We would also like to see much closer collaboration between the Bank, Fund and recipients at the design stage of planned operations, with the Bank sharpening its focus on achieving verifiable progress on poverty reduction and the Fund improving the complementarity of its macroeconomic recommendations. The centerpiece of these partnerships, led by recipient countries, could be the Poverty Reduction Strategy Papers and an agreed core set of monitorable poverty reductions goals, such as: increasing literacy, for both women and men; reducing infant/child mortality; lowering the incidence of AIDS; and improving environmental conditions. In many countries, progress on poverty reduction will require meeting specific targets for the rural sector which often contains high concentrations of the most vulnerable.

We believe both institutions should routinely articulate core reforms and other measures required to reduce poverty as performance indicators in their respective programs.

- In contrast to past practices where social considerations were often a secondary concern, Summers — Development Cte

particularly in the IMF, Bank and Fund programs should be grounded in an assessment of poverty and its determinants, and consist of integrated, coherent sets of steps needed to reduce poverty. In the Bank this will mean integration of poverty impact assessments into Country Assistance Strategies.

- The Bank, Fund, and recipient government programs should be more transparent and accountable, with substantially expanded public access to programs and policies helping to strengthen national ownership of programs, ensure greater accountability of decision making, and encourage broader participation by civil society in all phases of the process.

Country implementation performance, not just plans or intentions, on agreed poverty indicators should be the crucial determinant in a more selective allocation of Bank/Fund resources.

The World Bank's engagement plays an important role in avoiding financial crises by helping countries to take preventative action to reduce vulnerabilities to sharp swings in global capital flows. We encourage the Bank to deepen the cooperative work underway with the IMF on assessments of countries' implementation of international codes and standards and in the broader area of financial sector reform, including financial sector program design and technical assistance. In the area of corporate governance, we applaud the establishment of the Global Corporate Governance Forum by the Bank and the OECD, and we hope that the Forum will promote the speedy implementation of the OECD corporate governance principles. In addition, we look forward to the Bank's contribution, in cooperation with the IMF, to the development of best practices for public debt management. We appreciate the Bank's ongoing work on good practices in social policy, and urge that good social policies and practices be given operational effect in World Bank and IMF programs.

The HIPC Initiative

The HIPC Initiative is a concrete example of our renewed commitment to help the world's poorest countries. As President Clinton said earlier this year: "Our goal should be that no country committed to fundamental reform is left with an unsustainable debt burden that diminishes its ability to meet people's basic human needs and to spur growth."

The Initiative also provides a unique opportunity to find the right way for the Bank, Fund, and recipient governments to more effectively target support on social objectives while also enhancing national ownership and participation, and to design effective economic reform policies while also protecting and advancing core social priorities. It is an important test of the Bank and Fund's ability to implement a new and more closely coordinated approach to the poorest countries.

HIPC debt relief is not an end in itself, but a means to an ultimate objective: a successful development process for countries where today children are more likely to be malnourished than go to secondary school, and where more than forty percent of the populations lacks access to clean water. HIPC provides a window of opportunity to translate sound policy prescriptions into meaningful and decisive action.

The Bank and Fund and members of the Development Committee have worked hard to design an effective HIPC framework which promotes a number of mutually reinforcing objectives --- poverty reduction, sustainable development, and good governance --- while reinforcing the incentives for reform and growth. Successful implementation of HIPC would constitute a major step towards meeting the internationally agreed upon target of halving the proportion of the world's population living in absolute poverty by 2015. HIPC is an important investment in our own future and in the world we will inhabit in the 21st century.

At the Cologne Economic Summit meeting, the G-7 nations agreed to further strengthen the development impact of HIPC by providing faster, deeper, and broader debt relief for those countries demonstrating a commitment to poverty alleviation. Ministers also endorsed efforts to integrate more fully the benefits of debt relief into growth-oriented country strategies for poverty reduction and human development. They stressed the crucial importance of preparing such strategies in open, transparent, and participatory processes.

The HIPC framework can only work in the context of appropriate national policies and with the right institutions and practices; and it can only work with the right kind of support from the international community.

In order to achieve the desired development impact, eligible HIPC countries need to clearly assume leadership in establishing the right policy framework. We all know that the more policies are genuinely "owned" by a country the better they tend to work. Most specifically, governments will need to forcefully demonstrate at the highest political levels, and through specific actions, a commitment to poverty reduction and the reforms and domestic funding needed to give effect to such commitment. This means, for example:

- Taking concrete steps to improve governance and to increase transparency and accountability, especially with respect to public expenditures. A demonstrated commitment to eliminating the scourge of corruption and its corrosive effects on economic growth and poverty reduction must be a central feature of the integrated strategy. Shining a light on public economic policies and practices is one key mechanism to address this need;

- Ensuring that domestic resource decisions fully reflect the priority given to poverty reduction;

- Working more closely and openly with civil society groups; and

- Implementing the macroeconomic, structural, and legal reforms that will support economic growth and a rising standard of living for all including the most vulnerable.

Close coordination among the World Bank, IMF, and the regional development banks is also essential so that a country's support for poverty reduction is recognized and fully integrated in all IFI programs. I welcome the joint meeting of the Development and Interim Committees as representing tangible progress in this area.

Achieving these objectives will require substantial capacity building at the World Bank and IMF and, even more importantly, within the borrowing countries themselves to support the type of participatory, transparent and deliberative procedures that are at the core of a more country-driven and poverty-focused strategy. It is critically important that efforts should commence immediately, both at the institutions and within eligible countries, to address institutional and other problems of absorptive capacity which impede the effective use of social and other poverty-focused expenditures. In the HIPC context, we should expect to see substantial, concrete progress in poverty reduction efforts in advance of the completion point for each beneficiary country as part of a progressive, iterative medium-term strategy.

Financing HIPC

As members are aware, the costs of the HIPC Initiative are substantial, a reality which underscores the importance of utilizing debt relief in a way that achieves maximum sustainable development effect. It is crucial to ensure a financial framework with adequate resources to fund HIPC costs. It will be particularly important to maintain a very close linkage between the timing of debt relief and an eligible country's demonstrated performance and its absorptive capacity to use resources effectively.

It is important for bilateral creditors to move expeditiously to obtain secure funding for the substantial additional costs that they will incur under the enhanced HIPC framework. We also believe it important for all of the international financial institutions to accelerate their efforts to identify financing approaches that maximize the use of their own internal resources. In many cases, this may entail some difficult trade offs, although these must be measured in terms of the potential development benefits that HIPC debt relief can bring.

It is clear that even with new innovative ways to generate internal resources, the African Development Bank (AFDB) will continue to rely heavily on bilateral contributions to the HIPC Trust Fund to help fully fund its participation in the HIPC Initiative. We also belief that the Inter-American Development Bank (IDB) will require some bilateral support.

We welcome the steps which the World Bank has already taken to help fund its participation in the HIPC Initiative. It is also our view that, unlike the AFDB and IDB, the World Bank has a resource base of sufficient scale and flexibility to generate the resources necessary to fully cover its HIPC costs, particularly if its debt relief is phased commensurate with country performance and capacity.

The President has submitted to the Congress a revised budget request of nearly $1 billion. This will cover the direct costs of HIPC relief on debt owed to the United States. It will also provide a significant U.S. contribution to the HIPC Trust Fund to help fund other multilateral costs assuming other countries make comparable efforts.

I would now like to comment briefly on some other important development issues, including World Bank-specific matters.

Trade and Development

We urge the World Bank to continue encouraging trade and investment liberalization in developing countries. Open, transparent, and well-governed markets, both domestic and international, are an essential foundation for sustainable development and poverty reduction.

We are poised to launch a new round of international trade negotiations at the upcoming Ministerial meeting of the World Trade Organization (WTO) in Seattle. This Ministerial represents a particularly important opportunity for the global community to further reduce barriers to new market opportunities in support of development and growth.

Key areas include:

- Continuation of the work begun in the Uruguay Round to liberalize trade in agricultural products, including through the abolition of agricultural export subsidies;

- Further negotiations to reduce and eliminate tariff and non-tariff barriers to trade in nonagricultural goods, an area which holds particular potential for developing economies;

- New negotiations aimed at creating more open and transparent customs regimes and further liberalizing services activities, which will greatly enhance institutional capabilities in those sectors; and

- Conclusion of an agreement on transparency in government procurement, thereby addressing one source of resource-draining bribery and corruption.

As these negotiations begin, particular attention must be made to better integrate developing countries into the world economy and to help them to fully realize the benefits of open trade. Trade liberalization is mutually beneficial to both developed and developing countries. The World Bank is in a unique position to help developing countries realize these benefits and better make the link between their international trade commitments and their development goals.

In this regard, we urge the Bank to work with its borrowing member countries in adopting a comprehensive development approach to trade liberalization. Increased emphasis should be placed on encouraging economic diversification, recognizing the linkage between agricultural trade reform and poverty alleviation, minimizing the social impacts of trade liberalization, developing alternative sources of revenue for governments that rely heavily on customs duties, ensuring that sustainable environmental objectives are met, and ensuring complementary transport and communications infrastructure are in place.

Trade and investment reform should be more consistently and fully integrated into all Country Assistance Strategies and should also become part of the Comprehensive Development Framework. The World Bank can play an important role in promoting appropriate regional and sub-regional trade integration as a means of facilitating developing countries' participation in the global economy. The Bank can also assist in the development of trade-related infrastructure and institutional foundations, many of which are critical for a flourishing trade regime. In this regard, we support the commitment of the Bank to provide sustained assistance as part of its current programs for trade-related capacity building for those members that request it as part of their development strategies. Also, we support the work by the World Bank under the WTO Integrated Framework and the research and analytical support it is able to provide to facilitate developing country preparations for trade negotiations. We are not yet convinced, however, of the wisdom of establishing an intermediary that would subsidize crop insurance to help developing countries cope with highly volatile international commodity markets.

We note with satisfaction the success of initial efforts at enhanced cooperation and coordination among international institutions as a result of decisions taken at the end of the Uruguay Round. We would encourage the development of further efforts to deepen and broaden policy and program cooperation in the future.

IDA-12

The IDA-12 agreement will be the cornerstone of the Bank's development assistance efforts in the poorest countries over the next three years. The agreement, now approved by Governors, embodies a policy framework designed to improve the effectiveness of IDA lending. These policies are integral to the replenishment and need to be fully implemented in a timely manner.

We are seriously concerned at the slow pace and/or the vagueness of guidance provided to Bank staff on implementing some of the key IDA-12 provisions, including:

- The commitment to provide comprehensive and specific diagnostic inputs for Country Assistance Strategies to ensure they fully reflect the findings of up-to-date building blocks, such as Public Expenditure Reviews, Poverty Assessments, Country Financial Accountability Assessments, Country Procurement Assessment Reports, and National Environmental Action Plans;

- The commitment to improve diagnostic treatment of cross-cutting issues in the CAS such as gender, environment, core labor standards, and the financial sector;

- The commitment that policy and program performance and governance issues, as determined by clear and monitorable indicators, should determine the size, design, and delivery of a country's IDA program;

- The commitment that CASs should be prepared with the active participation of government, civil society and donors and be publicly available; and

- The commitment to heightened centrality of public expenditure analyses that consider the role of non-development expenditures -- including military expenditures and subsidies to state owned enterprises -- and whether reallocation of these could enhance the development impact of IFI or national public spending.

It is vital that these commitments be taken more seriously in order for IDA to play the vital development role envisioned by donors.

Moreover, it is important that existing Bank policies, especially in the areas of safeguards, disclosure, fiduciary controls, and environmental protection, be applied more consistently. These are all reasonable standards which exist to strengthen the Bank's development impact. We urge Management to improve staff training on policies and to improve its vetting process to ensure that Bank policies are taken seriously and applied rigorously to all Bank projects.

World Bank Partnership with the African Development Bank

As has been discussed in previous meetings, enhanced collaboration among the multilateral development banks is important to an improved international financial architecture and to the effectiveness of development assistance in reducing poverty. The United States welcomes the progress made by the Team of Independent Experts advising the World Bank and African Development Bank on a strategic partnership between the two institutions and in offering suggestions pertinent to the drafting of a memorandum of understanding between them. We encourage both institutions to proceed quickly toward a memorandum of understanding establishing a deeper and more formalized partnership. We believe such a formalized partnership would enhance collaboration in areas such as common strategic visions; country strategies; harmonization of missions, disbursement procedures and reporting requirements; and staff exchanges to strengthen networking.

We look forward to a similar agreement between the World Bank and the Asian Development Bank, as is currently being discussed in the two institutions.

World Bank Capital Adequacy

We welcome the attention which Management and members have given to safeguarding the Bank's financial soundness and risk-bearing capacity. Financial strength is fundamental to the Bank's ability to respond quickly and effectively to the evolving development needs of our borrowing members.

We agree with the External Advisors and the Bank's own analysis that the Bank is now operating on a firm financial basis. We also recognize that projections regarding the Bank's future financial position depend heavily on judgments on the prospects for the world economic environment and the potential future demands on – and inherent risks of – the Bank's portfolio. And, there is also the basic question of strict Bank adherence to a policy, which we strongly support, of selective lending based on country performance and comparative advantage.

We do not believe that there is now a credible case that the Bank needs to substantially increase its hard loan window lending capacity. Rather, we believe that a more selective, performance-based lending program is the single most important element of an adequate cushion against downside risk scenarios. We also believe that Management and the Board should look more closely at the opportunities for mobilizing additional support from within the Bank's existing resource framework.

In all cases, it will be important to keep both the Bank's financial situation and the nature and composition of future lending under close review.

We have also been asked by IFC management to consider a possible capital increase for that institution. We would like to discuss this further with Management and the Board, but at this point do not see a strong case for a capital increase.

Corruption and Money Laundering

There is increasing awareness that corruption contributes to distortion of investment flows, poor economic performance, reduced confidence in financial institutions, and vulnerability to financial instability. It is one of the most serious impediments to development and poverty reduction, and is a problem that must be forcibly addressed head on.

As a follow-up to the OECD Anti-Bribery Convention and Vice President Gore's Anti-Corruption conference in Washington in February 1999, we strongly urge complete ratification and implementation of the OECD Convention by all signatories.

We also call on the Bank and the IMF to perform an authoritative review of their procedures and controls and those of borrowing countries to identify ways to strengthen safeguards on the use of IMF and World Bank funds, especially in situations where there is a heightened risk of diversion or misappropriation of funds. We encourage strong membership support of this effort.

The United States also intends to work with our G-7 partners and others to coordinate anti-corruption efforts and assistance and complete a WTO agreement on transparency in government procurement. In addition, we are considering ways to institutionalize international measures to identify, block and seize illicit financial flows gained through crime.

We view concrete steps to enhance cooperative and multilateral efforts to combat money laundering and financial crimes as a crucial component of the international financial agenda. We therefore welcome the fact that the World Bank, IMF, and regional development banks are acutely aware of the serious problems posed by international money laundering. The structural reform assistance provided by the IFIs in recent years has helped selected countries improve their banking supervisory capacity, adopt financial sector reforms, and strengthen public institutions and the rule of law. We continue to believe that corruption and other governance considerations should be taken into account in allocating IFI resources, and that government failure to address the problem of systemic corruption should have important consequences.

We urge the IFIs and their members to be alert to the opportunities for further engaging in these priority efforts. We specifically encourage the institutions to expand efforts to help countries, in the context of financial sector reform, to create transparent and accountable financial systems, identify and interdict illicit financial flows, strengthen financial supervisory institutions, and promote adoption of appropriate anti-money laundering policies and measures.

We also continue to urge the MDBs to give priority attention to developing uniform procurement rules and documents of the highest standard and to help countries combat corruption.

Labor

It is our position, supported by ample evidence, that the core labor standards, in conjunction with a responsive and equitable legal and institutional framework of labor relations, can have a positive impact on poverty alleviation in general and on productivity, income distribution, and civil society specifically.

The ILO's 1998 Declaration on Fundamental Principles and Rights at Work, representing a consensus among labor, employer, and government representatives of a membership that closely parallels that of the Bretton Woods institutions, demonstrates that the values reflected in internationally recognized labor rights are broadly shared. Therefore the debate should no longer focus on whether core labor standards are good or bad for development and growth, but how to achieve growth and development in a manner consistent with internationally recognized worker's rights.

We welcome the Bank paper's careful treatment of labor market flexibility and the desirability of policies that encourage such flexibility. But this is only part of the challenge. We are quite concerned that by addressing only this narrow sector of labor market policies, the Bank is missing a real opportunity to support forward looking policies on labor markets that are consistent with core labor standards during good times as well as bad. We urge the Bank to revisit this issue of vital concern to industrial and developing countries alike.

It is also essential that the Bank, together with its borrowers, move forward on the implementation of the labor provisions contained in the IDA-12 agreement, and that all the IFIs ensure that their projects and programs are consistent with core labor standards and work cooperatively with the ILO and other labor institutions to promote programs and policies beneficial to working people.

Military Spending

Consistent with our efforts to encourage the most productive utilization of limited donor and domestic resources, the United States believes greater attention needs to be placed on improving military spending accountability. We encourage the international financial institutions to ensure the full transparency of military spending within the range of borrowing countries' public expenditures and their accounting and reporting mechanisms. We believe it is incumbent on the IFIs to be fully knowledgeable of the audit and accountability systems in place for military expenditure -- like all expenditure -- prior to extending assistance. We consider this necessary to better ensure that assistance is supplementing a country's own best efforts to reduce poverty and pursue equitable economic growth, rather than simply making it easier for the country to engage in excessive military spending. Equally important is the very reasonable expectation that countries receiving assistance should maintain transparency and accountability in the management of all public resources, including military spending.

I hope that all members of the IFIs will join us in prioritizing the issue of military spending -- recognizing that accountability of military spending is integral to the growth and development mandates of the IFIs -- and promoting active and well coordinated IFI engagement on public expenditure and accountability issues, issues which are also essential components of the HIPC Initiative.

Conclusion

In concluding, I would like to highlight the fact that we are meeting at a time of increased public scrutiny of both bilateral and multilateral financial institutions. There is widespread skepticism of the benefits of development assistance and other official financing. In the eyes of many, the overall disappointing economic performance of the poorest countries reinforces the perception that our development efforts over the last half century have been a failure.

A renewed commitment to change the framework for assisting the poorest countries, reinforced by the HIPC Initiative, is needed to jumpstart the process for reducing global poverty. I recognize the scope of the challenges this will entail. Development is not an easy process and there are no quick fixes. Yet we can all do a much better job in reaching and engaging the poor and in ensuring that economic growth and social progress are mutually reinforcing. Genuine commitment and performance by the poorest countries themselves is the linchpin. But well targeted external assistance is also crucial. My government is committed to working with the Bank and Fund and their members to help meet this vital challenge.

DRAFT

Draft 9/23 6:00 p.m.

INTERIM COMMITTEE STATEMENT

Introduction

I would like to extend a warm welcome to our new Chairman, Gordon Brown. We look forward to working together at a time when the Interim Committee is undergoing an important process of change that we believe will make it more effective in its oversight of the IMF.

When we last met in April, Secretary Rubin began with a note of caution: While welcoming a number of positive developments during the preceding year, he underlined that serious challenges remain and expressed his view that the balance of risks for the global economy remained on the downside.

Today, there is again reason to welcome a number of positive developments. IMF staff have recently revised upward their projections for global growth. Capital flows to emerging markets are showing signs of recovery. A number of countries which were in the midst of crisis one year ago have stabilized and are taking important steps towards recovery.

And yet a cautionary note is still appropriate. While the balance of risks for the global economy may have tilted somewhat in the right direction, it would be a mistake to see this trend as in any way inexorable. Economic conditions in a number of countries and regions are still fragile. As discussed further in the following section, near-term action on a number of fronts is necessary if we are to see a sustained and better balanced global economic recovery.

To take a longer term perspective, as we meet for the last time in this century and on the threshold of a new millennium, it is appropriate to take stock of where we have come, in those areas that concern us here, and what remains to be done. If we think back to the world in which the IMF was founded in 1945, and recall the purposes for which the Fund was created, we can justifiably say that the IMF has contributed to an international financial and trading system that is far stronger than the system that prevailed during the first half of this century and before.

Thanks to the IMF, the "machinery for consultation and collaboration on international monetary problems," as it is described in Article I of the Articles of Agreement, now encompasses virtually the entire world and helps ensure serious, constructive deliberation on such problems, even if the solutions are sometimes elusive. The destructive competitive exchange rate devaluation of the early 1930s is now rare. Exchange restrictions, once a thicket obstructing trade and payments, have been substantially thinned if not eliminated over the years. Perhaps most important, by offering constructive policy alternatives, backed by financing, to countries facing balance of payments or broader economic problems, the IMF has made adjustment less painful and facilitated an extraordinary expansion of international trade, which has contributed to employment creation, to growth, and to peaceful relations among nations.

However, we can also see that the challenges ahead will require further, substantial reforms in the IMF. A changed IMF is needed for the changed world that we now have. In many areas, a start has been made, but much more remains to be done. As we look towards the future we need to redouble our efforts to find better approaches if not answers to fundamental questions.

-- How do we strengthen the international financial system against crisis and develop better mechanisms to deal with crisis when it occurs?

-- How can we help ensure that international assistance in all its forms -- from debt relief, to balance of payments support, to technical assistance -- is used to its greatest effect to promote sustainable, broad-based growth that benefits the poor?

-- How do we balance concerns about intrusiveness in national affairs and a desire to promote national "ownership" of reform programs with a desire to see governments take bolder steps to, for example, build stronger social safety nets, implement core labor standards, empower civil society groups, reduce the role of government in the economy, and address critical issues related to governance, corruption and crony capitalism?

-- How do we promote genuine collaboration among international institutions on issues of common concern without compromising their ability to deliver in areas where they have a comparative advantage?

-- What must we do to strengthen the fight against corruption and build better safeguards on the use of international public funding to avoid its misuse or diversion?

A strong and effective IMF, working in concert with other institutions, will be an important part of our efforts to address these questions. Going forward, the IMF will, in particular, need to:

Elevate the importance of growth and poverty reduction among the IMF's core objectives. As discussed further below, there is need for greater consistency and mutual support between a country's social sector/poverty reduction objectives on the one hand, and ESAF-supported policies and financing on the other. The IMF, in cooperation with the World Bank, needs more actively to press countries to channel scarce public funds away from unproductive purposes such as showcase projects and excessive military spending toward priorities that support growth and poverty reduction. Ensuring adequate funding for high-yield investments in human resources must be a higher priority. To make progress in this area, there will need to be greater transparency in and accountability for government spending, including military spending.

Give greater attention in IMF program design to social sector, labor and environmental concerns. The goal is to design programs in a way that preserves and strengthens critical social safety nets, with due attention to core labor standards, and protects as far as possible the poorest and most vulnerable members of society, as well as environmental programs, from the costs of economic adjustment.

Push forward with steps underway to increase transparency. This effort should continue until we reach a point where certain key documents, notably Letters of Intent and related program documents, are systematically released without exception.

Reinforce incentives to sustain good performance. To maximize the benefits of their adjustment efforts and IMF assistance, countries should be encouraged to maintain strong performance as long as possible. Towards this end, the IMF should enhance its monitoring of policy commitments while a country's drawings on the Fund are outstanding, even after program conditions have ended. Consideration of new lending commitments should be fully informed by past performance.

Elevate the importance of governance and corruption considerations in decisions about IMF funding, while strengthening safeguards on the use of resources provided by the IMF. This point merits special emphasis. It is entirely appropriate for the IMF Executive Board (as well as the Boards of other IFIs) to block or suspend financing in cases where there are serious governance or corruption concerns, even if other factors would support providing assistance. When borrowers misuse financial assistance provided by the IMF, this not only sets back economic stabilization and development objectives but also undermines the will and ability of donors to provide assistance. The IMF needs urgently to follow through with and build upon a number of general and specific steps to address this problem. In particular, the IMF should:

- *Develop policies and procedures to examine reserve management more broadly, so as to reduce the vulnerability of a country's exchange rate and payment system to inappropriate use.* The objective here is to achieve transparent operations and prevent preferential access to foreign exchange except as specified in the IMF program.

- *Strongly encourage countries to comply with principles in the Code of Good Practices on Transparency in Monetary and Financial Policies, and provide for more systematic (and regular) audits of central banks in program countries.* If warranted, audits should be conducted prior to disbursement and on a recurring basis (e.g., quarterly) with IMF missions reviewing the audits to determine whether further corrective steps are called for.

- *Assess vulnerabilities of the foreign exchange and payments system of borrowers to inept or corrupt deployment of scarce reserves, and provide advice on the construction of institutions, policies and procedures to correct such vulnerabilities.*

- *Require, where there are governance concerns regarding a borrower, external review of reserve management practices and procedures for sale of foreign exchange to public and private sector entities.*

- *Strengthen incentives for borrowers to guard against misuse of IMF resources or failure to correct vulnerabilities.* At present, the IMF is limited to the ability to cease disbursements and, in certain circumstances, to request advance repayment. This ability should be broadened, for example to provide for advance repayment in a broader set of circumstances of improper practices, even if no formal violation of IMF conditions has occurred or if the IMF program has ended.

Developments in the World Economy; Policy Requirements for Sustained, Better Balanced Global Economic Recovery

Prospects for recovery in the major industrial economies and the world economy as a whole look better now than a year or even six months ago, though we need to guard against complacency. Encouragingly, the U.S. economy continues to show strong, non-inflationary growth. Recovery seems to be solidifying in emerging markets in Asia. There are signs of modest improvement for Europe, and indications that decline in Japan may have ceased. An environment of low inflation and some resumption of financing flows to emerging markets have contributed to this general picture.

However, there are still downside risks. While the United States looks to have another year of strong growth, we cannot indefinitely provide the main stimulus to growth. Other regions need to step to the fore. Asian emerging market economies, for their part, have much to do in terms of reform, especially in the corporate sector, if they are to lay a durable foundation for financial and business systems in the future. A number of South American countries – Argentina, Brazil, Colombia, Ecuador, Venezuela – are still facing difficult situations. Latin America has continued to see a slide in net private capital flows from around $105 billion in 1996 to approximately $66 billion expected this year. We are concerned about Russia.

Avoiding the downside risk, and creating conditions for sustained, better balanced global economic recovery will require action on a number of fronts.

Europe. While recovery seems to be occurring on the modest scale long forecast, growth will still be well below last year's pace and far too dependent on exports. The IMF projects little change this year in the Euro-11's high ($80 billion) aggregate current account surplus. And the Fund expects the surplus to rise to nearly $100 billion in 2000.

Rising surpluses will prevent Europe from making a major contribution to recovery in emerging market countries. Stronger domestic demand is needed, in place of reliance on exports. In addition to supportive macroeconomic policies, Europe needs to emphasize structural reforms in labor and product markets that would make investment more attractive, thereby boosting domestic demand and employment and reducing high external surpluses.

Japan. Japan may have reached the end of its long decline in GDP, and a number of important policy steps have been taken. But it is far from clear that a sustained recovery is on the horizon. Such a recovery will require a resumption of sustained growth in private demand. Until a recovery is firmly established, Japan needs to continue with measures to promote domestic demand-led growth, including supportive monetary policies and continued fiscal stimulus at a pace strong enough to prevent a fall-off in the strength which the fiscal program has been imparting. In addition, work needs to continue on improving the banking sector, notably by permanent disposal of bad assets. Finally, support for structural reform would also help to provide an environment for a durable recovery.

Latin America. Much of the region has suffered from recession. Although growth is expected to resume across Latin America next year, during this time of unsettled international financial markets countries need to maintain disciplined macroeconomic policies and deepen economic reforms, including strengthening of the financial sector. Brazil, the region's largest economy, faces the particular challenge of implementing structural reforms needed to ensure medium-term fiscal sustainability.

Russia. The IMF and other institutions have played a critical role in supporting the difficult and complex process of Russia's economic transition. However, the capacity of the IMF and World Bank to help bring about effective policies depends on the will and capacity of Russian authorities and the Russian people to carry forward reforms in their national interest. It is critical that Russia intensify efforts to combat corruption and money laundering and cooperate fully with the international financial institutions on the development of adequate safeguards to ensure that funds provided by the IFIs are used for their intended purpose.

Promoting open markets. Trade liberalization can make a strong contribution to our efforts to sustain growth and stability in the global economy, as well as promote development and poverty alleviation. Open, transparent and well-governed markets, both domestic and international, are an essential foundation for prosperity.

We are poised to launch a new round of international trade negotiations at the upcoming Ministerial of the World Trade Organization in Seattle. This Ministerial will make decisions that will set the direction for the international trading system well into the next decade. It represents a particularly important opportunity for the global community to further reduce barriers to new market opportunities in support of development and growth. Key areas include:

- continuation of the work begun in the Uruguay Round to liberalize trade in agricultural products, including through the abolition of agricultural export subsidies;
- further negotiations to reduce and eliminate tariff and non-tariff barriers to trade in non-agricultural goods, an area which holds particular potential for developing economies;
- new negotiations aimed at creating more open and transparent customs regimes and further liberalizing services activities which will greatly enhance the institutional capabilities in those sectors; and
- concrete steps such as an agreement on transparency in government procurement by the Seattle WTO Ministerial, as well as support for open and transparent customs regimes, which complement Fund initiatives to combat corruption and promote good governance.

As these negotiations begin, particular attention must be paid to better integrate developing countries into the world economy and to fully realize the benefits of free trade. The IMF can actively support this process by making the case for trade liberalization in its policy dialogues with borrowing countries. For example, trade liberalization themes should be a key component of Fund surveillance and programs. Fund support for social safety nets and improved labor conditions is also critical to promote further trade liberalization.

There are a number of areas where the IMF, World Bank, and WTO have shared interests, and we support the institutions' continued commitment to this coherence exercise. A strong foundation for effective institutional coordination and cooperation has been laid as a result of decisions taken at the end of the Uruguay Round. We are encouraged by the efforts underway for the heads of all three institutions to enhance policy and program cooperation in the future.

Over the course of the past year, the IMF has continued to play an important and central role in helping to restore stability. Plans for the deployment of a new temporary facility to deal with possible disruptions caused by the Y2K problem, discussed further below, is but one example.

<u>Progress in Strengthening the International Monetary and Financial System</u>

At the spring meetings, the Interim Committee noted that broad agreement had been reached on key aspects of a strengthened architecture and welcomed actions by the Fund in a number of important areas. The Committee underlined, however, the importance of carrying forward work on a number of issues and implementing proposals related to, for example, forestalling and resolving financial crises, international standards and Fund surveillance, and institutional reforms.

A. Involving the Private Sector in Forestalling/Resolving Financial Crises

Our overall goal should be to ensure that, if required, official finance supports programs that offer a viable solution to a country's immediate financial problem and lay the basis for sustained growth. We want to draw on the strength and flexibility of markets, and help markets work well. Recent experience has confirmed the need to maintain sufficient flexibility to address diverse cases effectively.

The G-7 Finance Ministers' Architecture Report laid out principles, considerations and a set of possible tools to guide official action in this area. Such a framework provides flexibility to craft solutions tailored to the unique circumstances of each case, while also providing greater policy clarity. Our challenge now is to move forward in applying the principles and considerations outlined in this framework to concrete cases. We are pleased that recent IMF work has supported this broad policy approach.

Central to effective crisis response is determining the appropriate level of official finance to support the return of normal market access. In some crisis cases, a bank run psychology may have taken hold, and creditors may be withdrawing funds from a country that clearly has the capacity to meet its payments if given time to make appropriate adjustments. When a country's underlying capacity to pay is strong and prospects for the restoration of market access on viable terms are good, it is appropriate for the official sector to provide temporary financial support while the country undertakes the reforms needed to restore confidence and regain access. This, in conjunction with efforts to explain a country's reform program to the markets, will normally be sufficient to overcome temporary financing difficulties and lay the basis for recovery. In some limited circumstances, it may also be appropriate to seek additional support for the country's policy program from private creditors, through voluntary arrangements to provide for maintenance of exposure levels or a refinancing/restructuring of the country's debt obligations. Emphasis should be placed on approaches that encourage the rapid restoration of full market access.

In other cases, the early restoration of full and spontaneous market access on terms consistent with medium term external sustainability may not be realistic, and the use of a broader spectrum of policy tools as laid out in the G-7 Finance Ministers' Report of June, may be warranted to provide for an adequately financed program and a sustainable medium-term payments profile. In any event, it will be critical that debtors and creditors work cooperatively to find a solution to the country's debt problems, with the official focus on the development of a viable overall strategy for a country, not on managing the details of restructuring. The IMF should establish clear parameters, and then leave scope for debtors and creditors to work constructively to find solutions that provide a viable path forward. In this process no one category of private external creditors should be regarded as inherently privileged.

We welcome the IMF's move to refine its criteria for lending into arrears on the full range of private sector obligations. With this policy in place, there is no need to seek a more heavy handed capacity to provide for a temporary stay on litigation.

Problems of creditor coordination can potentially interfere with developing orderly and cooperative solutions to a country's financial problems. The broader use of contractual provisions that can facilitate creditor coordination could therefore contribute to rapid orderly crisis resolution. We encourage the IMF to make the use of such provisions a component of international best practices in debt management and to focus attention on the use of such provisions in international surveillance. But we also need to remember that it is not our role to design the ideal forum for the negotiations between debtors and creditors. We should push all sovereign debtors to maintain an ongoing dialogue with their creditors, since relationships established in normal times create capital that can be drawn on during periods of difficulty. But we also need to remember that non-binding procedures and principles to guide the establishment and operation of ad hoc committees will only work if a wide range of private creditors "buys into" the resulting protocol/ procedures and principles.

[Insert on clauses in sovereign foreign currency issues, if G-10 agrees to move ahead.]

B. Choices of Exchange Rate Regimes

The recent crises demonstrated the critical importance of exchange rate regime choices in reducing vulnerability to crisis. The most crucial principle coming out of this experience is that whatever regime is adopted it should be credible and supported by consistent macroeconomic policies and robust financial systems. Each country must choose the exchange rate regime that suits its own needs. However, unsustainable exchange rate regimes can be a threat to other countries and to the international system. That means that we all have a stake in the regime chosen by others and how it is managed. The IMF must now sharpen and highlight its advice to countries in this area.

We cannot help but be struck by the fact that at the center of each recent crisis was the same exchange rate regime: fixed but adjustable. Countries are more vulnerable when their exchange rate regime provides a clear target for market participants to bet against without an equally clear commitment to supporting domestic policies backed by institutional arrangements. Fixed but adjustable pegs also encourage risk-taking by the private sector, which may be less likely to hedge foreign currency exposure and less likely to be concerned about currency mismatches than it should be.

A commitment to fixity requires a willingness to subordinate other policy goals, when necessary, to that of managing the exchange rate. In cases where countries choose to fix rates, for example as part of a comprehensive effort to fight inflation, experience shows that institutionalizing that commitment can be important, perhaps even necessary, for credibility. Such institutionalization requires extraordinarily stringent policy discipline.

Recent work by the IMF suggests that, for emerging market economies with substantial involvement in global financial markets, floating rates should be an increasingly relevant, if not universal, choice.

We believe it is imperative that the Fund enhance the attention it gives to exchange rate sustainability in the context of surveillance and bring to the process the results of the best research and analysis. In particular, the IMF should focus on the need for countries with fixed/adjustable pegs to develop exit strategies.

The key area where the IMF must press ahead is in its exchange rate advice in the context of IMF supported programs. We strongly believe that the international community should not provide large-scale official financing for a country intervening heavily to support a particular exchange rate level, except where: that level is judged sustainable and certain conditions have been met, such as where the exchange rate policy is backed by a strong and credible commitment with supporting arrangements, and by consistent domestic policies. Going forward, it will be important to shape expectations generally so that countries do not intervene heavily to defend their exchange rate in anticipation of official support.

C. Orderly Liberalization of Capital Movements; Debt Management

Another important area of reducing vulnerability of emerging markets involves improving the way that they manage their exposure to potential large swings in international capital flows. Some advocate capital controls as a way to do this.

Recent work by the IMF on country experiences with capital controls suggests that a cautious approach is advisable. While controls have on some occasions been effective, they have frequently been ineffective and often costly. Experience underlines most clearly that capital controls cannot substitute for sound macroeconomic policy and that strong prudential standards and implementation are important accompaniments to capital account liberalization. These perspectives reinforce our view that stronger prudential regulation and better debt management are the best ways to manage the risks created by large international capital flows, and are key for emerging markets seeking to reduce their vulnerability.

Accordingly we have called on the IMF and World Bank to work together to develop a set of best practices in debt management and to report by year-end. We would like to see them draw from diverse sources, including developing countries that have extensive experience and enjoyed success in this area. We think it would be useful to approach the issue from the "macro" prudential perspective of changing the country's overall liability position rather than focusing on the more limited "building block" issues.

D. Institutional Reform/Strengthening and/or Transforming the Interim Committee

We welcome the agreement to strengthen and transform the Interim Committee and enhance its effectiveness. Its permanent status will help ensure that it continues to play a crucial role in advising and reporting to the Board of Governors on critical issues. Its expanded terms of reference, encompassing, *inter alia,* the international monetary *and financial* system, will be reflected in its new name: The International Monetary and Financial Committee. This morning's joint meeting with the Development Committee is an example of the kind useful collaboration between a strengthened Interim Committee and other institutions on key issues that we would like to see going forward.

Y2K Contingency Planning

There is a potential risk that Y2K-related disruptions in some IMF emerging market countries could lead to a variety of problems in the financial and real economic sectors. In light of this, we support a contingency plan that would allow a stronger IMF role if this proves necessary as the millennium date change approaches.

In addition to the outreach efforts taken by the IMF to date, we urge the IMF to take the following additional steps:

-- Survey the adequacy of member countries' lender-of-last-resort capacity in order to identify possible responses by their monetary authorities to strains on their currencies or banking sectors.

-- For program countries, examine whether there is scope, in the event of extraordinary Y2K-related difficulties, for a more flexible response through relaxation of constraints on intervention and on repurchases.

-- Establish a new, temporary facility that would allow member countries to borrow under specific conditions in order to respond to extraordinary pressure on their currencies or banking sectors stemming from Y2K-related problems.

Regarding this last point, the United States welcomes the statement by the Managing Director to the Interim Committee urging favorable consideration of a temporary IMF facility for Y2K-related balance of payments difficulties. We urge the Executive Board to follow up on its discussion of September 16, resolving outstanding issues as quickly as possible. It will be important to structure this facility in such a way that it does not undermine existing programs and minimizes risk of moral hazard. Countries seeking access to the new facility would need to, for example:

-- be in good standing with the IMF and satisfy IMF staff and management that the substantial capital outflows they are experiencing are due to Y2K-related volatility rather than policy weaknesses or other exogenous shocks;

-- undertake prompt corrective measures to deal with their Y2K-related problems;

-- be prepared to make prompt repayment and accept premium interest charges on IMF financing.

To help reduce the risk that members might need to seek access to the new facility, we urge that public and private sector officials press ahead this autumn with Y2K contingency plans in the financial sector and between the financial sector and other critical sectors, such as power and telecommunications.

IMF's Role in Promoting Sustainable Growth and Reducing Poverty

A. Integrating Social Sector Issues in Fund Policy Advice and Programs; Adapting ESAF

The IMF has long played a critical and positive role in supporting the creation of conditions that promote sustainable growth and the reduction of poverty, primarily through its Enhanced Structural Adjustment Facility (ESAF) and its predecessor the Structural Adjustment Facility (SAF). As the Fund rightly points out in its recent progress report to the Interim and Development Committees on the HIPC initiative: "Sustained poverty reduction requires rapid economic growth as well as macroeconomic stability and structural reforms that allow a transition to a higher path of sustained growth. These are the objectives of ESAF-supported lending which must be central to any poverty reduction strategy."

Recent reviews of ESAF and the Fund's experience with integrating social sector issues in its policy advice point to substantial recent progress in terms of both inputs and outcomes under ESAF-supported programs. But they also reveal a need for improvement. In particular, there is need for greater consistency and mutual support between a country's social sector/poverty reduction objectives on the one hand -- and the fiscal choices they make to achieve these objectives -- and ESAF-supported policies and financing on the other.

We welcome, therefore, the proposed changes in the objectives and procedures for the IMF's ESAF as part of a broader integrated framework for poverty reduction involving the IMF, the World Bank, and other assistance providers. This framework would also apply to countries eligible for HIPC relief.

The first and most fundamental change would be that the design of IMF-supported macroeconomic policies take more fully into account their potential impact on social and sectoral programs aimed at poverty reduction while ensuring macroeconomic stability. Greater attention must be accorded to more rapid growth, full transparency and more effective monitoring procedures, closer collaboration with the World Bank and other institutions with relevant expertise, participation of civil society in design as well as implementation, and, not least, good governance. ESAF lending operations would key off of a comprehensive Poverty Reduction Strategy Paper (PRSP) prepared by the national authorities with assistance from the World Bank, the IMF and others. The PRSP would be endorsed by the Executive Boards of both the World Bank and the IMF. ESAF performance measures would explicitly incorporate a set of key poverty reduction targets set out in the PRSP.

These changes, which should involve fundamental changes at the operational level for both the IMF and the World Bank, are most welcome and, if vigorously implemented, would substantially reinforce their impact on poverty reduction. In some respects, however, we think they do not go far enough.

Consistency in Lending Decisions. The new integrated strategy will serve as an important vehicle for enhanced coordination in the operations and advice offered by the IMF and the World Bank. The institutions should also take additional steps to ensure consistency in their lending decisions. For example, if the Executive Board of the Bank concludes that core poverty reduction measures are not being implemented or progress towards poverty reduction targets is insufficient, then HIPC relief could be delayed, World Bank loans would be suspended, and, at the same time, these concerns should be reflected in consideration of ESAF program decisions. Similarly, if the IMF Executive Board concludes that progress on macroeconomic reforms critical for poverty reduction is insufficient, this should be reflected in considerations of World Bank programs, as well as IMF programs and HIPC decisions.

Additionality. With respect to HIPC countries in particular, we need to ensure that savings freed up by debt relief provide for true additionality and improved outcomes from social expenditures. The point is often made that the quality of social expenditures is as important, if not more important, than quantity. Development experience attests to the validity of this view. Yet quantity also matters. This is true especially in the HIPC context given that the HIPC initiative is, or should be, devoted to freeing resources for priority social needs.

How to ensure such additionality? There is no single formula. But we believe that, properly implemented in the context of transparent budgetary procedures, poverty action funds can have substantial benefits. In Uganda, this instrument provided an important entry point for civil society into decision making and oversight of priority poverty reduction expenditures. We recognize that such funds are not a panacea and can create their own set of problems if necessary checks and balances are not in place. Accordingly, we encourage IMF and World Bank staff to work with interested governments to explore prospects for establishing such vehicles in an effective manner and on a case-by-case basis. Another option is to pull poverty reduction programs together, in an accounting sense, into a detailed "poverty reduction budget" within the national budget. This would facilitate monitoring, including with respect to the additionality of HIPC-related savings.

B. Securing IMF Financing for ESAF and HIPC

We welcome the consensus that has emerged on steps to secure IMF financing for ESAF and HIPC, including the mobilization of funds in the IMF's SCA-2 account and of a portion of the IMF's gold holdings. On this latter point, we support the move to mobilize a portion of the IMF's gold holdings via non-market sales in an amount up to 14 million ounces. We have been working closely with Congress in order to obtain authorization to support these steps.

Standards and Transparency Initiatives

Standards/Financial Sector Reform

We have made considerable progress in defining a core set of international financial and economic policy standards relating to public transparency, banking supervision, securities markets, insurance and corporate governance. The prototype Compendium of Standards, which the Financial Stability Forum is in the process of developing, owes a great deal to the Fund's early efforts to incorporate key financial and economic policy standards in its surveillance.

More work must be done to specify those standards that are key to strong financial systems and to develop new standards where there are gaps, such as for deposit insurance. We are confident that the Fund will play a critical role in this process. As standards are identified, the focus should increasingly shift to implementation and monitoring.

As countries become familiar with the standards which the international community views as critical to financial stability, their commitment to meet or exceed these standards -- to take steps to increase the transparency of their monetary and financial policies, to improve the quality of banking supervision, to ensure good corporate governance and accountability -- should become a matter of public record.

As countries "sign on" to these core standards, the Fund, along with the World Bank, and supplemented by national financial regulators, must play an important role in assessing whether and how countries meet these commitments. This too should be linked into the Fund's surveillance function, but also back into the standards-setting and promulgation loop. New standards may be required to fill "gaps" such as for bank deposit insurance schemes and public debt management, and the Fund will certainly play a leading role in developing these.

To help build strong national financial systems, it is important not only for the country to know how it measures up, but it is important for others with an interest in financial stability to also be in the know. For markets to work efficiently and effectively, more and better information is key, and this can best be gained through greater transparency and disclosure. The international community cannot regulate this to happen, but it can build incentives for positive behaviors by both the providers and users of capital. I anticipate that the Fund will play a leading role in this effort as well.

Transparency

One of the central lessons from recent crises is that enhanced transparency and disclosure would facilitate market discipline and government policies – as well as helping expose vulnerabilities earlier. We have already seen considerable progress in following up on this lesson through promulgation of standards and best practices for transparency in the Fund's core areas of expertise.

> *SDDS*. As the prevailing standard for release of national economic data, the SDDS is gaining credence as it becomes more widely used by both countries and the market. We look forward in particular to widespread implementation of the new template for reporting of international reserves. The SDDS will also benefit from further strengthening with respect to external debt and addition of macro-prudential indicators in order to help illuminate the soundness of financial sectors. We look forward to progress on these fronts before the end of the year. In order to promote wider use of the SDDS and compliance with it, we are working with other industrial countries to encourage foreign sovereign borrowers to include a statement on their status with respect tot he SDDS in their offering or listing documents.

> *Monetary/financial code*. We welcome finalization of the Code of Good Practices on Transparency in Monetary and Financial Policies, and support its endorsement by the Interim Committee. This Code can make an important contribution to public understanding of monetary and financial policy goals and instruments, and should support critical objectives in promoting good governance and combating corruption. In particular, we look forward to the Code, in conjunction with IMF surveillance, playing a role in promoting

transparency and accountability in the operations of central banks and financial agencies. We note that Fund staff is pushing ahead with the development of a supporting document that provides a fuller description of each transparency practice of the Code, its rationale, and practical considerations regarding implementation. We urge that staff complete the supporting document by the time of our spring meetings.

Fiscal Code. Now in the implementation phase, we look forward to the integration of the Code on Fiscal Transparency in the ongoing Article IV surveillance process. For our part, we are participating in the self-evaluation process and encourage other countries to do so.

Further steps to increase transparency in the private sector are also underway. In particular, we look forward to the work of one group of international regulators that is developing a comprehensive framework of disclosure by private market financial institutions. We also look forward to the work of a second group of international regulators that is reviewing types of aggregate data (such as net positions and turnover data) in foreign exchange markets that could help market participants assess and manage foreign exchange risk.

The IMF itself must also participate in the drive for greater openness. Already, its operations are becoming more open, as decisions made over the last year are implemented. The adoption of a more systematic approach to releasing information about policy changes, reform commitments of countries benefitting from IMF financial assistance, and the results of Article IV reviews is helping to dispel the image of the IMF as a secretive, unaccountable institution. The pilot program on transparency in Article IV reviews is showing encouraging results. We need to push forward with this effort, however, until we reach a point where such documents, including Letters of Intent and related program documents, are systematically released without exception.

Conclusion

Notwithstanding some encouraging developments in the world economy, this is not the time to become complacent. We still face a number of challenges in fostering a strong and sustained world recovery to promote improved living standards with financial stability.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGO TIME WILL BE SET
Text as Prepared for Delivery
September 23, 1999

STATEMENT OF TREASURY SECRETARY LAWRENCE H. SUMMERS AT THE PRE-G7 PRESS CONFERENCE

We can at these meetings take some satisfaction from the fact that conditions in global markets are better than they were a year ago. What is most important now is that we not take this recovery in global confidence for granted.

Five core global priorities stand out.

First, achieving balanced and sustainable growth in the major industrial economies:

- The United States' economic performance has continued to be exceptional. But it will be crucial that Americans not take our economic expansion for granted and that we continue to plan prudently: in particular, by reserving a lion's share of projected budget surpluses to pay down the national debt, and avoiding inappropriate and economically unwise tax cuts of the kind that the President vetoed today.

- Crucial to a sustained and balanced United States expansion is greater balance in the growth of the global economy.

- Some upturn in demand appears to be under way in Europe. Looking ahead, recovery should be increasingly based on domestic demand. It will also be essential to achieve structural reforms that can support higher levels of investment and the more rapid creation of private sector jobs.

- There are now some initial signs that Japan's economy is moving out of the deep recession in which it had been mired for so long. It seems clear that policy steps taken over the past year to stimulate the economy and stabilize the financial system

LS - 115

are having an effect. However, prospects for the future remain uncertain, particularly in light of the weakness in private demand. A continued Japanese commitment to continued stimulus, using all available tools, will be critical until a solid, self-sustaining recovery led by domestic demand is firmly entrenched.

Second, extending and deepening recovery in the emerging market economies:

- We can all be encouraged by the turnarounds we have seen in several emerging markets over the last year. Nonetheless, lasting recoveries will only come through continued commitment to economic reform. And here progress continues to be uneven, with some countries having yet to put in place viable strategies for long-term reform and growth.

- The situation in Russia remains a serious concern. We will discuss with the Russian authorities this weekend their prospects for putting a credible reform strategy in place, and certainly the dominant issue will be the establishment of a functioning rule of law.

- With respect to the Y2K problem, we expect the IMF this weekend to agree to establish a special short-term facility to enable it to respond, in the event that such support could be useful, to international liquidity problems relating to Y2K that may arise in some countries.

Third, intensifying efforts to build a strong and stable global financial architecture:

- The reform of the international financial architecture is a continuing challenge. There can be no question that the international financial institutions are indispensable – but that does not mean we can be satisfied with them as they are.

- We are coming to understand better the roots of the financial crises of recent years and I expect that we will have discussions at these meetings of critical priorities; notably, the need for more sustainable debt management and exchange rate policies in emerging market economies and more sophisticated tools for crisis response.

- Let me also say that I look forward to the formation of the new G20 group of key industrial and emerging market economies. This will be formally launched at these meetings and I expect will have its first meeting before the end of the year.

Fourth a new approach to development assistance for the poorest countries:

- This partial recovery in global confidence affords us a unique opportunity, at the dawn of a new millennium, to focus on what is one of the more important financial problems – and certainly the overarching moral problem – which the 20th century has left unsolved. Namely, the failure of large parts of the world to achieve even the most basic standard of living for the people who live there.

- We expect these meetings to endorse the Cologne initiative for the Highly Indebted Poor Countries. This has as its centerpiece a major change in the World Bank and IMF's approach to these countries focused on ensuring that our official development assistance translates into much greater reductions in poverty.

- We also expect broad agreement on how to finance this initiative, with a central reliance on mobilizing the IMF and World Bank's own resources. To meet our share of needed bilateral contributions the President has now submitted an amended budget request asking Congress for nearly $1 billion in appropriations over the next four years.

Fifth, strengthened efforts to combat global corruption:

- In the wake of recent developments in Russia, the United States and others in the G7 will be calling for authoritative reviews by the IMF and the World Bank to identify ways to strengthen safeguards on the use of IMF and World Bank funds. We believe and expect that this review should focus its attention on three critical areas:

  - First, systematic use of external audits. Whenever the IMF provides finance in an environment where there is a risk that those funds will be misused, it should require external audits of the recipient central bank. The IMF has to be moving to a point where this is routine practice.

  - Second, new IMF program requirements to enhance countries' internal safeguards against misappropriation. For example: requiring that the central bank establish clear and transparent rules for the provision of foreign exchange to commercial banks and other key entities in the payments system so as to limit the scope for insiders to offer preferential access to favored groups

  - Third, strengthening the IMF's capacity to deter and penalize misuse of its funds, including in "post-program" cases where all disbursements have been made.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 4:30 PM EDT
Text as Prepared for Delivery
September 23, 1999

"THE GLOBAL ECONOMIC AGENDA"
TREASURY SECRETARY LAWRENCE H. SUMMERS
REMARKS TO THE WORLD ECONOMIC AND DEVELOPMENT CONGRESS
WASHINGTON, DC

Thank you. Looking around today, we can take some satisfaction from the fact that conditions in global markets are better than they were a year ago.

The marked change in the global outlook is a tribute to the strong domestic policy responses that we have seen in many of the economies hit by crisis, and the international support that we were able to mobilize to support those responses. It is also in part a reflection of the somewhat more balanced growth that has been achieved among the major industrial economies, where developments have hinted at the possibility that the United States can cease to the single main engine of global economic growth.

What is most important now is that we not take this recovery in global confidence for granted:

- All of the major industrial economies need to focus policies on balanced growth.
- Progress in some emerging market economies has been significant. But the pattern of recovery remains uneven, and all must press ahead to assure lasting growth.
- Much has been achieved in the reform of global financial architecture, but crucial priorities for protecting long-term stability and growth remain.
- Countries in Sub-Saharan Africa that account for a large share of the global population still cannot provide the most basic standard of living for their people.

LS - 116

- And the threat of corruption looms large, both within countries and internationally.

I would like to address these five core global priorities today.

I. Achieving balanced and sustainable growth in the major industrial economies:

The United States' economic performance has continued to be exceptional – as we approach a tenth year of expansion. But all of us should guard against the assumption that the good times will continue indefinitely. That means private lenders and borrowers planning prudently; it means households putting aside savings based on their future needs and not the continuation of recent rates of return. Most importantly, it means reserving a lion's share of projected budget surpluses to pay down the national debt, and avoiding inappropriate and economically unwise tax cuts of the kind that President Clinton vetoed today.

Crucial to a sustained and balanced United States expansion will be greater balance in global economic growth. This makes it especially important for there to be stronger growth in the other major industrial economies.

Some upturn in domestic demand appears to be under way in Europe. Looking ahead, recovery must be increasingly based on domestic demand. It will also be essential to achieve structural reforms that can support higher levels of investment and the more rapid creation of private sector jobs.

Even more critical to more balanced global growth – and recovery in Asia especially -- will be a lasting turnaround in Japan, the world's second largest economy and, until this decade, perhaps the most striking success story in the industrialized world. There are now some initial signs that Japan's economy is moving out of the deep recession in which it had been mired for so long. It seems clear that policy steps taken over the past year to stimulate the economy and stabilize the financial system are having an effect.

However, prospects remain uncertain in the face of continued weakness in private demand, notably business investment, and persistent deflationary pressures. Private forecasters are unusually divided, with many expecting growth to fall back again next year. In this context, Japan's commitment to continued stimulus, using all available tools, will be critical until a solid, self-sustaining recovery led by domestic demand is firmly entrenched.

II. Extending and Deepening Recovery in the Emerging Market Economies

We can all be encouraged by the turnarounds we have seen in many of the emerging market economies in the past year. Forceful domestic policy steps in Korea, Thailand, the Philippines and Brazil – combined with the substantial financial support that was mobilized by the official community – have brought important progress in setting these countries on the path to recovery. Market confidence in these and other emerging market economies is on the mend.

However, while many emerging market economies are now beginning to see the rewards of strong policy measures, this progress can only be sustained by continued commitment to economic reform – in the financial sector especially.

We must also remember that other countries have not yet put a viable long-term basis for economic growth stability in place. Russia, in particular, remains a critical concern as it confronts the consequences of its economic and financial collapse in August of 1998 in a turbulent domestic political environment. We will discuss with the Russian authorities this weekend their prospects for putting a credible reform strategy in place, and certainly the dominant issue will be the establishment of a functioning rule of law.

III. Intensifying Global Financial Architectural Reform

The core challenge of the World Bank and the IMF and their shareholders must always be to look to the long-term – and to ensure that they are doing all they can to support the development of a strong and stable, truly global financial system.

There is no question that the international financial institutions are absolutely indispensable. But that does not mean we can be satisfied with ~~them as they are~~ them as they are

Financial crises of the scale and severity we have seen recently pose a major threat to the construction of such a system—to which the international community has rightly and vigorously responded in what has come to be called the reform of the global financial architecture.

Important progress has been made in this effort. But critical priorities remain, especially with regard to encouraging the adoption of more sustainable debt management and exchange rate policies by national governments, and developing more sophisticated tools for crisis response.

These are among the issues that we would expect the new G20 group of key industrial and emerging market economies to discuss when it meets for the first time later this year. This new group, to be launched formally this weekend, will account for more than 80 percent of global GDP and will institutionalize this Administration's long-standing belief that the future of the new global economy cannot be a matter for the discussion of the major industrial nations alone.

IV. A New Approach to Development Assistance for the Poorest Countries.

With the partial recovery in global confidence we also have an opportunity to intensify the International Financial Institutions' search for more effective ways to support enduring growth in the very poorest countries.

Sub-Saharan Africa's per capita income is today lower than in 1980. Indeed, in parts of Africa, children born today are more likely to die before their fifth birthday than to learn to read, and teenage girls are more likely to become HIV positive than to graduate from high school.

In the end, the only ones who can offer those children a better future are the governments and citizens of the countries themselves. But when many of the poorest are also laboring under weight of the debts they owe to the international community, we owe them a fresh look at the way we try to help.

More than fifty years of development assistance has taught us that where countries are truly committed to inclusive, enduring growth – international support can make a powerful difference. But equally, we have seen how often strong commitments and good intentions – on both sides – fail to translate into concrete improvements in the lives of the poorest. At best, such failed support leaves countries no better off than before. At worst, it traps the country, and us, in a cycle of lending which is devoted in part to assuring that past loans can be repaid.

At the Cologne Summit, the G7 leaders committed the international community to confront these lessons head on, with an expanded initiative for the Heavily Indebted Poor Countries (HIPC). Together with earlier debt relief commitments, the Cologne Initiative would more than triple the amount of debt relief available under the HIPC framework, from $13 billion in today's dollars to as much as $50 billion.

At these meetings we expect broad agreement on how to finance this initiative, with a central reliance on mobilizing the IMF and World Bank's own resources. To help meet our share of needed bilateral contributions the President has also this week submitted an amended budget request asking Congress for nearly $1 billion in appropriations over the next four years.

Debt relief is only a means to a much higher objective. We believe that most important of all to the success of this effort will be the establishment of a new framework for the international community's efforts to combat poverty – one that is centered around the belief that countries themselves must take the lead in poverty reduction efforts if lasting change is to be achieved.

Under our new approach, governments would need forcefully to demonstrate, at the highest political levels, a commitment to poverty reduction and the reforms and domestic funding needed to give effect to such commitment.

That means:

- A growth-oriented, integrated poverty reduction plan, drawn up by the recipient countries themselves, with the support of the World Bank and IMF, and centered around measurable and monitorable targets for infant mortality, literacy and other key indicators.

- A requirement that the recipients of debt relief earmark the savings from debt relief for genuinely additional spending on poverty reduction.

- Concrete steps to raise transparency – for example, through mandatory publication of the national budget and new mechanisms to monitor and improve the quality of public spending.

- Steps to enhance national ownership and understanding of programs: for example, through involving more civil society groups in the elaboration of the poverty reduction plan and through more extensive dialogue between these groups and the World Bank and IMF.

V. Strengthened Efforts to Combat Global Corruption

One set of problems that has perhaps been given insufficient emphasis in the past – but whose importance has recently been greatly underlined – is those relating to corruption.

The United States has for some time been a leading force in international efforts to combat corruption. For example, we have led efforts to conclude – and ratify among all its signatories – the OECD Anti-Bribery Convention, and to complete a WTO agreement on transparency in government procurement. Our efforts to combat these issues on a domestic level have been vigorous and ongoing; notably, in the release, earlier today, of a comprehensive National Money Laundering Strategy.

We have also successfully urged the IMF and the World Bank to give greater explicit consideration to problems of governance and corruption in all its country programs. This has brought concrete actions, and reflected most recently in the IMF and World Bank's decisions in Indonesia.

There is perhaps no stronger antidote to corruption than successful economic reform. Anders Aslund has made this point very powerfully in the case of Russia, where the state-controlled price of a ton of crude oil in 1990 was the same as the free-market price of a pack of Marlboros. This created opportunities for quick fortunes to be made by those able to purchase oil domestically and resell it overseas. He has estimated that at least 79 percent of GDP was lost in this type of distortion in 1992.

In its continued support for economic and structural reforms that combat this kind of distortion, the IMF has been an important anti-corruption force where policy makers are committed to change. But as the Russian case has shown all too clearly, no amount of international effort will bring about change if that domestic commitment is lacking.

However, especially in light of recent events, there is one kind of corruption that the International Financial Institutions can and must make it their business to confront: namely that involving the misappropriation or diversion of their own resources.

As I said in my testimony to Congress earlier this week, we and other G-7 countries this weekend will be calling for authoritative reviews by the IMF and the World Bank to identify ways to strengthen safeguards on the use of IMF and World Bank funds, especially in cases where there is heightened risk of diversion or misappropriation of funds.

We believe and expect that this review should focus its attention on three critical areas:

First, systematic use of central bank auditing requirements as a routine safeguard in IMF programs.

Whenever the IMF provides finance in an environment where there is a risk that those funds will be misused, it should require external audits of the recipient's central bank. More generally, the IMF has to be moving to a point where this is routine practice.

There is also a need for a clear understanding of the IMF's ability to insist on external audits of other parts of the government – when there are reasonable grounds for suspicion that they are involved with the inappropriate use of IMF funds.

Second, broader consideration of IMF program requirements that would enhance the recipients' internal safeguards against the misuse of official funds.

Audits are an important tool but they are not sufficient. The IMF also needs to upgrade its capacity to spot potential weak points in the program country's foreign exchange and payments system – and help countries to address those weaknesses as part of IMF programs.

Especially relevant, in this context, would be lack of transparency and accountability in the central bank's reserve management procedures, intervention in the foreign exchange market and off-market provision of foreign exchange to commercial banks – all of which provide opportunities to divert funds for improper purposes or provide preferential access to hard currency to favored groups.

Third, strengthening the IMF's capacity to deter and penalize misuse of its funds, including in post-program cases where all disbursements have been made.

Under present policies, the IMF's capacity to penalize countries for permitting the misappropriation of official funds comes down to the capacity to cease disbursements and in limited cases to request advance repayment. This is a powerful weapon that we would expect the IMF to make full use of and develop in the future. The review should consider a wider range of circumstances under which penalties for corrupt use of funds can be applied – including those situations where disbursements have been completed and IMF programs are no longer in force.

VI. Concluding Remarks

Each of these issues are important and complex, involving both the public and the private sectors and concerted actions at both the national and international level. To be sure, no one country or group of country has all the answers – which is why dialogue in a wide variety of fora is so essential. But I hope and expect that in this improved global environment we will have an opportunity at these meetings to take this agenda forward. Thank you.

-30-

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 4 PM EDT
Text as prepared for delivery
September 22, 1999

"PRIORITIES FOR A 21st CENTURY GLOBAL FINANCIAL SYSTEM"
TREASURY SECRETARY LAWRENCE H. SUMMERS
REMARKS AT YALE UNIVERSITY
NEW HAVEN, CT

Summary

A year ago the world was facing what was generally declared to be the most serious situation in global financial markets in fifty years. Now, as policy makers come together once again for the Annual Meetings of the World Bank and International Monetary Fund (IMF) in Washington, important challenges remain. But it is fair to say that we have pulled back from the abyss.

Rather than focus on current developments, today I would like to step back to consider the kind of global financial system we would like to see in the future, and what the past few years have taught us about how to get there.

I. A Global Capital Market for the 21st Century

There may be no higher priority today than to build a global economy that can *be* truly global: that can make possible the safe and sustainable flow of goods, capital and ideas between the developed world and the developing one.

Supporting successful economic development in the developing world has always been – and will remain – an overriding global moral imperative. But it takes on increasing economic significance for the industrial countries today, when retirement rates in these nations are rising, rates of labor force growth are decreasing and the investment of retirement savings is a key concern. All of the world's population growth over the next 25 years, and most of its growth in productivity, will take place in the developing world.

LS - 111

We are thus entering an era when there will be exceptional global benefits to a growing and successful developing world. And let us be clear: a healthy capacity to mobilize capital in these economies – because of the trade that it finances, because of the technology it brings, and because of the opportunities it offers – has a very important part to play in that development.

A strong and safe system for a truly global flow of capital is what we should all want to see. Yet it is a vision that has been profoundly shaken, in recent years, by a new kind of threat: the threat of what might be called 21st century capital account crises.

In response, the United States has helped to lead a very far-reaching international effort to find the best ways to prevent these crises and respond to them when they arise. This has produced some important achievements, of which perhaps the most significant over the long term will be the rejection of the idea that it could be the work of the major industrial nations alone. We will see this reflected, this weekend, in the launch of what we will call the G20. This will be a permanent informal mechanism for dialogue on architectural issues among industrial and emerging market economies who between them will account for more than 80 percent of global GDP.

Now that the thick of these crises is behind us, now that we see signs of repair and reviving confidence in emerging markets and more balanced growth in the industrial nations – now is the moment to step back to reflect on these reform efforts, and on what the past few years have taught us.

As we do this, it will be crucial that we not turn our backs on the goal of a safe and sustainable, truly global financial system. But it will be equally important to recognize that such a system will not develop of its own accord – but will require a whole series of public and private actions, at the national and international level.

This is the goal that is truly at the center of global architectural reform. It will not be the construction of a single edifice. Nor will it be a journey to a concrete destination. Rather, it will be an ongoing and organic process comprising the work of many governments and private sector actors and the international community as a whole.

Let me reflect today on the core components of this effort – before highlighting the particular areas where we will be urging further action in the weeks and months ahead.

II. Our Strategy for Reform

The crises that began in Thailand in the summer of 1997 – and the Mexican crisis of 1995 – each had a variety of elements. But looking back we can now see that central to all of them was a sudden loss of confidence and large-scale withdrawal of capital by domestic and foreign investors – initially out of a concern about the fundamentals, but increasingly out of a concern not to be the last out as a kind of bank run psychology took hold.

In the wake of these experiences, the global imperative is easily stated. It is to build a global financial system in which capital account crises of this scale and frequency simply will not happen.

Our strategy for building such a system has had three core components:

- First, enhancing the capacity of emerging market economies to absorb capital safely.
- Second, reducing countries' vulnerability to sudden turnarounds in confidence, whatever their origin.
- Third, developing the most effective international tools for responding to these new kinds of crisis.

Of these, the first component – perhaps inevitably – has received the greatest amount of concerted international effort to date. This is because building safer systems will depend, first and foremost on countries getting the basics right.

These crises were novel in many ways but the root cause was as old as finance itself: too much money borrowed, much of it short-term, on the basis of too little capacity to repay. The best sources of protection against these crises in the future will be developing systems that can ensure that capital is better allocated – and that debts undertaken will more easily be repaid.

To be sure, the international community cannot impose these systems from the outside – we cannot force change if the national commitment is lacking. But we have established a broad consensus on the core ingredients for reform. And we developed much stronger support and incentives for countries to act.

A fundamental change in the basic quality of economic and financial policies in the emerging market economies has been – and must continue to be – at the core of our efforts to reduce the risk of these kinds of crises in the future. We must continue to raise the bar on what is expected of countries in these areas, and strengthen the incentives for countries to meet them.

However, we know well that in a more global capital market, even the best managed countries can have problems if unprepared for unexpected shocks: be it fluctuations in global financial and commodity markets, a crisis in a neighboring country, or a national disaster of their own. And at the international level, we know that crises – whether driven by bad policy or sheer bad luck – will inevitably occur.

As global confidence begins to return and memories of the crises begin to ebb, it becomes even more important for us press forward the frontier in the second and third parts of our strategy: to ensure that countries, investors and the international official sector are prepared for bad times as well as good.

II. Key Priorities for the Future: Reducing National Vulnerability to Shocks in Confidence

As I have said, these crises had many elements, but all were marked by a sudden turn in confidence that ultimately became self-perpetuating. As the psychology of the market shifted, investors began to weigh the level of a country's foreign reserves against the likely demands to take hard currency out in the succeeding months. The opportunity to fix the underlying problems that triggered the crisis without up-ending the economy drained away.

Countries need to work to find ways to reduce the risk of this kind of dynamic taking hold. In this regard, two areas have been especially highlighted by recent events:

First, more prudent management of national balance sheets

We have learned once again in these crises that countries need to pace the opening of their economy to foreign capital to their capacity safely to absorb that capital – or withstand its sudden withdrawal. But we should remember that the inflows which proved ultimately most destructive did not arrive uninvited.

Too many of the countries involved in recent crises were actively reaching for cheap short-term capital. We saw it in Mexico, with the increasing resort to issuing dollar-denominated *Tesobonos* in 1994. We saw it in Thailand with the Thai offshore banking facility and the government's decision to mortgage its reserves in forward markets. And we saw it in Russia in the encouragement of foreign purchases of GKOs.

In response to these crises, governments need to think long and hard about the strength of their own balance sheets – and the tax and regulatory incentives that are shaping the activities of private borrowers. The end goal should be debt structures – at the sovereign and private level – that help to cushion unexpected shocks, and that do not turn a slight dip in confidence into a rush for the door.

With significant contributions from the United States Federal Reserve, a number of international groups have looked at guidelines for improved risk management at a national level and some simple balance sheet rules for countries. These include rules of thumb for minimum levels of foreign reserves, and a suggested three-year minimum average maturity of public debt.

We believe that this work has provided a helpful starting point. The next steps must be to work with a wider range of economies to develop more sophisticated systems for evaluating an economy's vulnerability to different types of shock, and to establish stronger incentives for countries to put these in place.

That is why we successfully pressed for the IMF's new Contingent Credit Line to be structured to encourage safer debt management practices. And it why we are calling on the IMF and the World Bank to develop best practice guidelines in this area – and for broad macro-prudential indicators to be included in the next expansion of the SDDS.

Second, more sustainable exchange rate regimes

Looking at the crises of recent years, it is clear to us that a fixed, but not firmly institutionalized exchange rate regime holds enormous risks for emerging market economies in a world where fast-flowing capital and insufficiently developed domestic financial systems coincide.

- The promise of exchange rate stability has helped to encourage excessive foreign currency borrowing, both public and private, on terms which appeared attractive only because borrowers ignored the huge potential costs of an exchange rate move.
- The desire by governments to keep to that promise has led in many cases to still more borrowing to support continued defense of the exchange rate, leaving the country yet more vulnerable down the road.
- And when trouble came, the breaking of the promise has greatly exacerbated the general loss in investor confidence and withdrawal of capital that followed – with a spiraling impact on the debtor country's balance sheet.

It is also clear that when pegged exchange rates do collapse, the costs are visited far more widely than on the country itself – as we saw vividly in the spread of confidence problems across Asia and the emerging market economies as a group.

If international economic theory and experience teach us anything it is the incompatibility between maintaining both a fixed exchange rate and an independent monetary policy. A viable fixed exchange rate regime involves in some form the renunciation of monetary independence.

Going forward, the IMF must bring to the fore in its discussions with countries the challenges that this difficult reality brings to the choice of an exchange rate regime. The Articles of the IMF state that sovereign member countries are free to choose their exchange rate regime. This is as it should be. But the fact is that those policies are not made or implemented in a vacuum.

In particular:

- The IMF must help countries to avoid the trap of a regime that may appear to offer stability but that – if not solidly backed by credible institutional arrangements and consistent domestic policies – may encourage large risks to build up unnoticed.

- It must indicate clearly to the government concerned when domestic policies are on a collision course with the chosen exchange rate regime.

- And for countries that may use the exchange rate anchor as a response to hyperinflation, it must offer advice on how best to exit from this strategy before the costs become unacceptably high.

We further believe that the official sector should help shape the choices facing countries in favor of more sustainable regimes: via changed expectations about how it will respond to future crises.

With this in mind, the IMF's major shareholders agreed last June that it would be inappropriate for the international community to provide large scale official financing for a country intervening heavily to support a particular exchange rate level, except in certain limited exceptional circumstances, such as where the policy is backed by a strong and credible commitment with supporting institutional arrangements.

I would hope that this policy shift would influence country's currency choices going forward. Over time, we believe it should increasingly be the norm that countries involved with the world capital market avoid the "middle ground" of pegged exchange rates with discretionary monetary policies. And where countries choose the middle ground, and their own policies are not sufficient to stem an attack on a particular exchange rate level, the international community should have a compelling rationale before it provides funds for the country to defend it.

III. Crisis Response

After the experiences of the past few years, there is surely one point on which all can agree: when a crisis of the modern type is upon us, debtors, creditors and the international community as a whole all have an enormous stake in the restoration of confidence. And we all, going forward, have a stake in ensuring that we have the right means to achieve that in the different cases that will arise.

There are no easy answers to the question of what is the right mix of domestic policies, external official support and appropriate private sector involvement, if any, needed to restore confidence in the future crises that may arise. In this regard, recent experience has confirmed the need to have the flexibility to address diverse cases effectively. Certainly, investors should not consider official responses to one set of extraordinary circumstances to be a simple predictor of responses to the very different sets of circumstances that may arise in the future.

However, we can now say that recent experience yields some core guiding presumptions:

First, a crisis of confidence involving financing problems that are primarily of illiquidity should not be allowed to turn into something more serious. When investors start to withdraw large quantities of capital from a country whose underlying prospects are strong, the system as a whole has a stake in supporting policies that successfully turn those investors around. Here, the Supplemental Reserve Facility and the CCL – both of which allow for fast disbursing finance at premium interest rates and shorter maturities – have been important innovations.

We have also seen, notably in Korea in December of 1997 and Brazil last February, that voluntary private sector coordination in recognition of its mutual interest in avoiding withdrawals can be very constructive. Of course, emphasis on coordination problems and crises of confidence must never blind us to the fact that without the right national policies, any amount of external official support or extension of private debt obligations will be in vain.

Second, at one end of the wide spectrum of cases that we will need to confront will be those cases where the country has more fundamental problems; and where early restoration of market access on terms consistent with medium term sustainability may not be a realistic outcome. In these rare instances, a debt restructuring or reduction may be warranted.

This is never a step that can be taken lightly. The official sector should not and will not sanction a suspension of payments by a country that has the ability to pay, or that uses it as an alternative to adjustment or reform. To sanction opportunistic nonpayment would undermine the very basis of a global capital market.

However, a well functioning global capital market will also not be attained in a world that is distorted by the expectation that the official sector will protect investors – come what may. The official sector will not stand in the way of a suspension of payments when a country has an unsustainable debt load and is truly unable to meet payments.

In those cases where problems go beyond liquidity and debt restructuring is required, we would expect countries to develop an external financing plan as a core element of their IMF stabilization program – one that provides an appropriate balance of external financing between the official and private sectors. Such a plan must offer a viable solution to the immediate problem, without setting up new ones for the medium term.

While the IMF would set these broad parameters for an acceptable plan, we would expect the country itself to take prime responsibility for working with its creditors to devise that plan. In that context we will be looking for a solution that is reached cooperatively and transparently and that is broadly equitable across different categories of similarly situated credits. No one category of credits should be regarded as inherently privileged, but it is equally true that not every case will need to involve all categories of credits.

IV. Concluding Remarks

As I said at the outset, the reform of the global financial architecture is an organic and many-sided process that will never truly be completed. However, taken together, it is fair to say that the events of the past few years – and the changes they have helped to set in train – mark an important new stage in the system's evolution. What will be crucial going forward will to keep pushing back the frontiers in the areas I have highlighted – and to keep pressing for the safer policies and institutions at a national level upon which this new system will ultimately depend.

-30-