DEVELOPMENT COMMITTEE

(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
on the
Transfer of Real Resources to Developing Countries)

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Implementing the Monterrey Consensus

After half a century of development economics experience and research, it seems there is a consensus that the most effective model of development is likely to be private-sector led, with an effective governance framework and endowed with basic physical infrastructure and a critical mass of human and social capital. Moreover, in a globalized world, it should be opened to trade and have access to open markets. The Monterrey Consensus captures these ideas in a development compact of mutual responsibilities and accountabilities between developing and developed countries in a partnership based upon country-owned and driven strategies embodying sound policies and governance together with increased and more effective development assistance. The focus on development effectiveness and scaling up, and the work being made on case studies and on measuring and managing towards quantifiable results will certainly enhance this framework, and will help the development community to identify the countries and sectors where more work needs to be done to achieve the Millennium Development Goals on time.

One aspect of the global environment that received special attention in Monterrey was the functioning of international goods and capital markets. In particular, it was widely recognized that the increasing integration of countries to global markets has produced a remarkable increase in the volume of trade and financial flows to developing countries. However, growing global economic and financial integration has also heightened vulnerability of emerging market countries to external shocks, volatility and, in the worst cases, crises and contagion.

Market stability should be of central concern to the Development Committee in the Monterrey Consensus implementation framework.

Crises and contagion in emerging markets make the attainment of the Millennium Development Goals by 2015 more difficult. Years –sometimes decades– of achievements in poverty reduction are lost in a few months after a crisis starts, and the disease may well spread to other countries (as the cases of Argentina and Uruguay show).

It is much harder for developing countries to bear the risks of market fluctuations than it is for industrialized ones, but they are forced to bear those risks. Usually, the consequences of this burden are disastrous: debt burdens that look moderate, for example, become unbearable after devaluations, and some countries lose years of development achievements in a matter of months. Markets have failed to develop appropriate mechanisms for risk distribution and risk management, and the international economic institutions in this Development Committee should begin to discuss undertaking this role.

From these perspective, the World Bank Group could –and should– play a more active role in crisis prevention and management without invading the mandate and sphere of action of the International Monetary Fund, which focuses on international macroeconomic stability. The development lessons and experience it has acquired over fifty years of implementing projects in over 70 countries across a number of sectors give the World

Bank Group the technical credentials to contribute from a microeconomic and sectoral perspective to economic surveillance, crisis prevention and to identify solutions targeted at reactivate economic growth. Therefore, economic stability and growth are issues that the Development Committee should address to implement the Monterrey Consensus, to reduce the reputational risk that economic crises pose to the international financial architecture and to avoid backward steps in poverty reduction.

According to the Monterrey Consensus, the two pillars that should support sustained growth are a good investment climate and the empowerment of poor people in a framework of good governance. The PRSP/CDF[1] process shows the progress achieved to date in strengthening the second pillar. However, the Development Committee should increase its emphasis to strengthen the first pillar, which is composed of two elements: private sector development and market access. In a recent World Bank study it was shown that trade with North America drove the Mexican recovery much more than the IMF bailout.[2] It follows that creating markets for developing countries' goods and providing credit to their companies are crucial elements to reactivate economies in crises, especially in solvency ones. This is what countries like Argentina need today and where the World Bank could play an active, *counter-cyclical* role. We therefore encourage the World Bank Group to increase its work in international trade and private sector development, especially in crises situation where the "real" economy needs a jump-start. At the same time, industrial countries should not give contradictory signals when calling developing countries to be open for trade while erecting non-tariff barriers in their own markets via subsidies, norms or complex anti-dumping mechanisms. Trade should be used as an instrument for economic stability.

PRSP/HIPC Initiative Review

We welcome that the Highly Indebted Poor Countries (HIPC) Initiative is making steady progress. Since the Initiative started, Spain, Mexico and Venezuela in our chair have contributed to close the overall financial gap by searching creative and pragmatic bilateral solutions. Spain has been closely working with Guatemala to solve bilateral

[1] Poverty Reduction Strategy Papers/Comprehensive Development Framework.

[2] Olivier Lafourcade, Marcelo Giugale and Vinh H. Nguyen (eds.), *Mexico: A Comprehensive Development Agenda for the New Era*, World Bank, Washington, 2000.

claims,[3] as Mexico did with Nicaragua and Venezuela with Bolivia.[4] A multilateral approach led by Spain is also under way with Costa Rica.[5]

We are concerned with the rising costs of the initiative and the increasing financial gap to cover them. Today, the total cost for the HIPC Initiative stands at an estimated US$37 billion in 2001 Net Present Value (NPV) terms for both bilateral and multilateral creditors. Because canceling debt directly affects the capacity of multilateral development institutions to provide concessional lending to the world's poorest countries, increasing multilateral costs raise a yellow flag to the whole process.

However, the biggest challenge for the Initiative is debt sustainability after HIPC. We are worried about the deteriorating outlook for many HIPC countries that arrive at their Completion Points with unsustainable debt indicators due to exogenous factors outside their control such as global economic downturns, falls in commodity prices and crises in emerging markets. In this regard, we welcome the flexibility the Initiative has to ensure a sustainable exit to debt overhang by providing, when appropriate, additional debt relief at the completion point. Our chair underscores, however, that this should be on a case-by-case basis for countries that have suffered a fundamental change in their economic circumstances due to extraordinary external shocks. Regarding the methodology proposals for this topping up, we see no basis to exclude from the calculations the additional bilateral debt reduction that some creditors are providing. Doing so would fundamentally misrepresent the countries' actual debt situation and result in inequitable treatment among debtor countries.

A red flag must be raised against many commercial creditors who exploit the HIPC initiative by seeking full payment –and even profits– from insolvent borrowers, while official bilateral and multilateral creditors are making their best efforts to reduce the debt overhang in poor countries. This fact does not only widen the financial gap to sustain the Initiative, but also contributes to increase an already asymmetrical burden-sharing of overall HIPC costs. Our chair wants to be clear on this last point: in our view, the transfer of net-income from Multilateral Development Banks to finance the HIPC Initiative raises severe moral-hazard concerns among "good borrowers", as their debt-service payments end up being transfers of resources from already poor countries to poorer ones. We strongly encourage all commercial creditors and bilateral donors to fully participate in the HIPC initiative, as many countries in our chair have done.

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[3] Spain swapped outstanding claims against Guatemala for this country's debt against Nicaragua. This swap resulted in an effective debt cancellation of Nicaraguan debt by Spain of US$351, finally solving the debt problems among the three countries. Regarding Costa Rica, Spain is willing to lead a multilateral solution, too.

[4] Since the Initiative started, Mexico granted debt relief to Nicaragua through a buy-back with a 92% up-front reduction. Venezuela latter wrote-off its claims on Bolivia. Neither Mexico nor Venezuela belong to the Paris club.

[5] In the same spirit, two countries in our chair –Nicaragua and Honduras– have successfully completed their PRSPs and have reached the Decision Point under the Initiative. Work is currently in progress in both countries towards reaching the Completion Point.

Moving forward, we believe that the best approach to HIPC should be a constructive one that triggers real economic growth. HIPC relief provides a sound basis for an exit from unsustainable debt, and ensuring it requires actions and reforms by HIPC countries and the international community overall, stressing partnership among all parties involved and harmonization of policies and procedures from donors. Moreover, while HIPC countries must continue their commitment towards economic and social policies and institutions and private sector development, as embodied in their PRSPs, developed countries must answer with open markets and free trade, as it is estimated that gains from trade exceed by far the most ambitious debt relief scheme. It is trade more than aid what these countries need.

Harmonization of Operational Policies and Procedures

The harmonization of policies and operational procedures is certainly an essential contribution to development effectiveness when we bear in mind that the development community has currently over 333,000 projects in more than 140 countries. The core of this harmonization exercise must therefore be the coordinated effort to boost productivity with the aim to improve development effectiveness. This principle must guide work in borrowing countries –by reducing the time and costs of addressing the multitude of donor requirements –as well as in donor countries and institutions –by minimizing duplication and other costs.

Moreover, following the lessons in development effectiveness after half a century of Bank operations, we recognize that the harmonization exercise may also contribute to ownership of the development strategies by the client countries. We therefore welcome the Bank becoming more engaged with other development partners to improve coordinated support to country-led assistance strategies.

In this light we welcome the progress in harmonization and call for moving faster to the next ambitious steps.

Proposed Action Plan for Enhancing the Bank's Ability to Help Clients in Their Fight Against Money Laundering and Financing of Terrorism

Our chair strongly supports the joint effort by the World Bank Group and the International Monetary Fund to intensify work on Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT).

We strongly support the preparation of a single comprehensive assessment methodology for compliance with AML/CFT measures, and we believe that a full evaluation of its implementation is essential for everyone on a voluntary basis. In particular, we believe that voluntary nature of the process should be stressed, because the international development community must avoid to imply any kind of new conditionality

with AML/CFT assessments, especially since they are not performed on every Paris Club member. In this regard, we welcome the fact that the United Kingdom approached the Financial Action Task Force (FATF) to visit them and carry out an assessment of their compliance with the forty FATF recommendations for AML and the eight special recommendations on CFT, alongside and to the same timetable as their Financial Sector Assessment Program (FSAP). We encourage other industrialized countries to follow the UK to give transparency to this initiative. Furthermore, we call the World Bank and the International Monetary Fund to work on incentives to stimulate a positive voluntary response to the assessment of each country's compliance with AML/CFT in their financial systems.