



Statement by Mr. Stanley Fischer
First Deputy Managing Director
To the IDA Deputies
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Thanks very much Sven, and thanks for the invitation to talk about IDA from the viewpoint of the Fund. The Managing Director in his speech at the Annual Meetings earlier this week said that IDA was critical to our efforts in the low-income countries. That's true. The message we have is very simple--that significant reductions in IDA will make it far more difficult for the Fund to play an effective role, especially in the poorest countries. What I'd like to do is to take a few minutes to substantiate that statement.

The basis for collaboration between the Fund and the Bank is the complementarity of macroeconomic and structural adjustment. It goes two ways. Structural adjustment in the absence of macro stability is frequently ineffective, and on the other side, macroeconomic adjustment without structural changes to promote growth is simply not sustainable. The most common question we get asked after the start of a Fund program is "when can we expect growth?", and we always say that provided that you are making the structural changes, and provided you maintain macroeconomic stability, growth will come. But it takes time, typically somewhere between three and five years after you stabilize, for growth to begin, provided that the reforms have taken place. However, if you don't do both stabilization and reform, growth won't come and poverty will not be reduced.

IDA is in a very serious sense the linchpin of the international community's efforts to assist the poorest countries. Last year IDA disbursed around \$6 billion. ESAF, which is the Fund's concessional loan window but with less favorable terms than IDA, disbursed \$1.2 billion. Even on balance-of-payments funding, IDA disbursed in structural and sectoral adjustment loans about \$ 2.4 billion, substantially more than ESAF. So in discussing IDA we are talking about the major element in the IFIs' contributions to assisting the poorest countries.

Now how do IDA and Fund operations interact? First, there is a lot of policy advice and policy reform that comes with IDA; second there is a lot of technical assistance; and third, there is the financial assistance itself.

Thanks to the donor community, which insisted on PFPs, joint policy advice is a very important component of what we do together. The ability we have to work together and agree with our Bank colleagues on the framework in which countries will move in the next three years--even recognizing that things never turn out as planned--is the basis on which we interact, with each other, but more importantly, with member countries.

Second, public expenditure reviews, on which we have just agreed to cooperate further with the Bank, particularly in the context of IDA and ESAF countries, are critically important for the way we do macroeconomic adjustment. Everybody always asks us, "How do you make sure you don't cut health and social and education spending?" The answer is--we try hard, and we try to reach agreements with member countries, but basically we don't really have the ability in the Fund to

fully tie down those details which make the difference to the poverty impact of our operations in the longer run. Nor in the short run do we have as good an ability as we have in the framework of joint work with the Bank to monitor direct poverty alleviation measures and ensure that they are carried out within the agreed upon overall macroeconomic targets. Without our cooperation with the Bank in these countries, which is IDA dependent in many ways, our ability to operate effectively, particularly in reducing poverty in the short run and long run, will be significantly reduced. Now you may well say, "If that is such a good idea why don't you do public expenditure reviews anyway with or without IDA?" and no doubt we will try. But we also know that there will be countries where we won't have operations if there is a significant reduction in IDA, and it's much more difficult to get policy priorities implemented without financial assistance.

Public expenditure reviews do a great deal to help with governance, which is one reason we are increasingly focusing on them. They make the government realize what it's doing in an economic program. Both we and the Bank encourage that these details be made public. By fostering transparency, you reduce corruption. By fostering participation, you reduce corruption. These elements will be reduced inevitably if IDA funding is reduced. And of course, these reviews are also useful for donor coordination.

These are very real benefits from IDA. A large part of the problem in the IDA discussion is that it's very hard to get your hands on hard numbers. It's difficult to say, "Well, if IDA's cut back by half, this and that and the other will

follow". But it is clear that the Fund's ability to work with the poorest countries, and the Bank's role in those countries, will be severely set back.

Now to the financing. There are many low-income countries, especially in Sub-Sahara Africa, which will continue to depend on aid for a very long time. There are very large differences among the 78 countries in IDA. In the Fund we divide them very roughly into four groups.

There's a group of 15 to 20 countries that we regard as sustained reformers, of which 10 are in Africa. This group will need aid for several more years, some of them up to a decade, but we see them on a path which will make it possible to reduce concessional funding.

There is another set of countries, about 10 of them, that have suffered from civil war or political turmoil. My list does not include Bosnia, but it is one such country, a country that we'll have to deal with, where reconstruction work is critical.

There are in the 78 about 10 transition economies and those countries, on average, are doing better.

And then there are the remainder, which we call slow to moderate reformers. Many of them have been adjusting for some time, but progress has been slow because of political difficulties and because of poor implementation capacity. Those

countries, provided they're willing to reform, will need to rely on financial and technical support from IDA for much longer, if it is available.

Now why do we distinguish among these countries? Because faced with a reduction in funding, the IMF is either not going to be able to have programs with some of these countries or will see its programs fail far more often. I learned from a veteran Bank staff member with whom I worked when I was here, the difference between the Fund and the Bank approaches to adjustment. He said that the Bank sets a growth target and goes out and raises the money to attain that growth target. The Fund takes the resources that are available and tailors the budget to make sure that the balance of payments is viable under those circumstances. Well that's exaggerated but it gives the flavor of the Fund's approach.

In the end, we take the availability of funding as given and figure out what is needed domestically to ensure that the balance-of-payments situation is viable, that the country will not be in a continuing balance-of-payments crisis. That means that as funding is reduced, domestic conditions will be tightened. The tighter the domestic conditions, the less likely governments will be able or willing to accept the programs. Even if programs are accepted, they will be less likely to be politically sustainable.

So in terms of what is going to happen to Fund programs as a result of the reduction in IDA funding, and given that IDA plays a very significant role in precisely the countries that we are most trying to reach, we will be less able to persuade governments to agree to adjustment programs--which in turn will mean

longer periods of macroeconomic instability. Eventually most governments do try to adjust, but if IDA is cut back severely, they will eventually agree in much worse conditions, and we will find far more programs breaking down because of the budget stringency that is required to contain the balance-of-payments. And it is likely to be the poorest countries that will be hit hardest.

Now let me come back to why it's difficult to establish convincingly that an aid cutoff will have really detrimental effects. It's because the cut-off is to a large degree an insidious problem. You are not able to say that a reduction of IDA by a billion overall or by hundred million in a given country will have a clear and immediate effect. Rather a few countries that would have adjusted sooner will adjust later. Others will adjust, but will have to squeeze the economy much harder, and investment rates will decline.

What really happens is that over the medium and long-term, growth rates are reduced. My impression is that the world is dividing more and more into countries that are growing quite rapidly and that we will not have to worry about within 10-15 years, and countries that need a sustained development effort that will take much longer. The inequality of income between countries is growing internationally, and what donor governments are doing will make that difference much worse, but the effects don't show up immediately. It's the situation 10 years away or 20 years away that is going to be much worse. There will be more crises, which will be attributed to a weak government or other factors rather than a lack of funding. But very frequently, an important contributing factor will be the lack of funding, even if we cannot quantify that fact in a convincing way.

We have to recognize that things are happening in the world that we didn't think conceivable a few years ago. There are countries which have had negative growth on average for 30 years--significantly negative growth. That was not imaginable some time ago, but it is a fact.

The problems that have to be dealt with in developing countries are profound, and a major cutback in IDA funds will reduce the world community's ability to work with these countries. The Fund will have fewer programs. We will have tougher programs when we get them. We will have less sustainable programs, especially in the countries that most need our support.

I know that I'm talking today to people who support IDA. I've been sharing with you a view from the Fund about what the process that is now taking place in donor capitals means for the countries which most need our help, and why it is critical to maintain support for IDA. Thank you.

