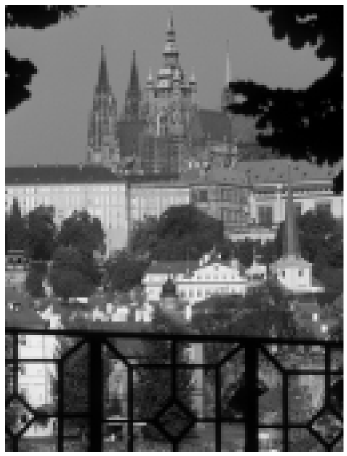
IMF SURVEY

www.imf.org/imfsurvey

International Monetary Fund
VOLUME 33
NUMBER 3
FEBRUARY 16, 2004

Köhler calls for new European Union members to strengthen policies before adopting euro

Enlargement of the European Union (EU) from 15 to 25 members on May 1 will bring significant benefits for old and new members alike, notably through an expansion of trade, IMF Managing Director Horst Köhler said at a conference on euro adoption in Prague on February 2–3. However, to seize these benefits, both current and new EU members will need to reinforce their foundations for long-term growth and prosperity.



Prague hosted the February 2–3 conference on euro adoption.

While Europe continues to possess significant economic strengths—including good public infrastructure, a well-educated workforce, and high domestic saving rates—many of its economies have underperformed in recent years compared, for instance, with hubs in Asia, where growth has outpaced Europe by 5 percentage points a year over the past decade, Köhler said. Europe needs to accelerate implementation of structural reforms, especially in its labor and product markets, to ensure that it can take full advantage of its large internal market and compete in the global economy.

Unlike the United Kingdom and Denmark, which have permanent opt-out clauses, the 10 accession countries are all committed to eventually adopting the euro as their national currency. Joining the common currency will deliver a significant boost to economic development through increased trade and financial flows by lowering transaction costs and *(Please turn to the following page)*

Book Forum

Do developing countries have a say at the IMF?

In March 2002, the industrial countries committed themselves—under the Monterrey Consensus—to increasing the voice and participation of the developing countries in the World Bank and the IMF. But, according to Ariel Buira (Director of the Group of 24 Secretariat and former IMF Executive Board Director) and his coauthors of the recently published book—*Challenges to the World Bank and the IMF: Developing Country Perspectives*—industrial countries are not keeping their promise. At a February 5 IMF Book Forum, moderated by Thomas Dawson (Director of the IMF's External Relations Department), Buira, joined by Carol Welch (Director of the International Program at Friends of the Earth), took a closer look at these issues.

Ariel Buira

Developing countries account for a growing share of the world's output and trade, and newly industrializing countries have become major economic players, but they have yet to see their growing economic clout reflected in their representation in the IMF, Ariel Buira said. He and his coauthors argue that the governance of the IMF does not meet the standards of transparency, accountability, and legitimacy that it prescribes to member countries. This is troubling, he noted, because "with resources of over $300 billion, the IMF may well be the most important international institution, at least for most developing countries." *(Please turn to page 35)*

In this issue

and...

Gains from euro adoption are not automatic

(Continued from front page) eliminating market risks, Köhler said. A forthcoming study by IMF staff suggests that, over the long term, euro adoption could raise GDP by as much as 20–25 percent in most Central European countries.

But these gains are not automatic, according to Köhler. The loss of the monetary policy instrument after euro adoption will shift the burden of adjustment to other channels, notably fiscal policy and wage and price flexibility. Western Europe's own experience of the 1990s showed that while in some countries euro adoption served as an incentive for economic reform and adjustment, in others—especially the larger countries—it did less so.

Early and ambitious fiscal adjustment will help accession countries protect themselves against destabilizing capital flows in the run-up to adopting the euro. In some cases, he said, this adjustment ought to go beyond the requirements of the Maastricht criteria for deficits (below 3 percent of GDP) and public debt (less than 60 percent of GDP). Moreover, financial market supervisory agencies need to be acutely aware of the risks to domestic financial stability stemming from the rapid credit growth that is likely to accompany euro adoption. ■

New members and the Maastricht criteria

Four conditions—described in the Maastricht Treaty, which sets out the legal principles for Europe's Economic and Monetary Union—must be met before countries can adopt the euro. The conditions, which must be assessed at a single point in time are

- annual average inflation rate that does not exceed that of the three best performing member states by more than 1½ percentage points;
- annual average nominal interest rate on the 10-year benchmark government bond that is no more than 2 percentage points above the corresponding average in the same three countries;
- a fiscal deficit below 3 percent of GDP and public debt less than 60 percent of GDP; and
- trading of the country's currency against the euro without severe tensions within "the normal fluctuation margins" of the Exchange Rate Mechanism (ERM2) for at least two years.

The full text of the Managing Director's speech is available on the IMF's website (*www.imf.org*).

Growth, dollar top Group of Seven agenda

German Finance Minister Hans Eichel (left), Japanese Finance Minister Sadakazu Tanigaki, IMF Managing Director Horst Köhler, and World Bank President James Wolfensohn at the February 2004 Group of Seven meeting in Boca Raton, Florida.

Meeting amid media and market attention to the weak dollar, the finance ministers and central bank governors of the seven major industrial countries (Group of Seven) on February 7 reaffirmed their belief that exchange rates should reflect economic fundamentals, adding that "excess volatility and disorderly movements in exchange rates are undesirable for economic growth."

They also emphasized that "more flexibility in exchange rates is desirable for major countries or economic areas that lack such flexibility to promote smooth and widespread adjustments in the international financial system, based on market mechanisms."

While the dollar took center stage in media attention, the statement issued at the end of the weekend-long meeting in Boca Raton, Florida, indicated that a wide range of issues was discussed. The representatives were upbeat about global growth prospects for 2004 but remained concerned about the uneven pace of growth in the seven countries. Supply-side structural policies that enhance flexibility, they reiterated, hold the key to higher productivity growth and increased employment.

The importance of combating terrorism and boosting economic growth in the Middle East also featured prominently in the discussions. The IMF and the World Bank were called upon to "make permanent and comprehensive their assessments of countries' efforts to combat terrorism financing," and the group expressed its commitment to further enhancing transparency and supervisory standards in financial markets, particularly in noncompliant offshore centers (see related story on page 38).

The finance ministers and central bank governors welcomed steps taken on the monetary front in Iraq, progress on the reform and reconstruction efforts in Afghanistan, and IMF and World Bank plans to provide both countries with financial and technical assistance. The group also urged other countries to join in efforts to reduce the debt burdens of Iraq and Afghanistan.

Finally, in a discussion of reforms of the international financial system, the meeting reviewed progress on "improved surveillance, collective action clauses, limits on exceptional access, measuring results, and the use of other mechanisms, including grants, to avoid heavy debt burdens." The ministers and central bank governors also called on Argentina to "implement policies in line with its IMF program" and to "engage constructively with its creditors to achieve a high participation rate in its restructuring."

Buira, Welch argue for IMF governance reform

(Continued from front page) Given the IMF's great influence, two questions on the quality of its own governance arise: how to attain adequate voice and representation for all members in the institution's decision-making process and whether the IMF meets the standards of transparency and accountability needed to ensure the legitimacy of its decisions, the ownership by member countries of the programs it supports, and the proper use of the public resources at its disposal.

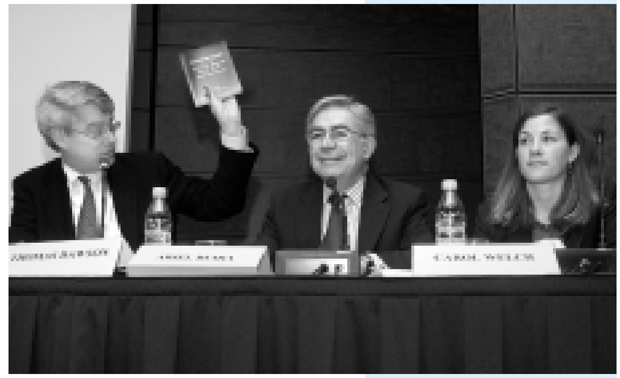
Shifting the balance of power

How is voting power at the IMF determined? At the 1944 Bretton Woods Conference that created the IMF, participants weighed two approaches—one that linked votes solely to members' contributions, or quotas, and another that was based solely on the legal principle of the equality of states. A compromise was worked out whereby member countries were given one vote for every $100,000 of quota plus 250 basic votes.

Over time, however, basic votes have become irrelevant, Buira noted. With the nearly 37-fold increase in quotas over the past 60 years, the share of basic votes in the total number of votes has declined from 11.3 percent to 2.1 percent, as the IMF's membership has quadrupled from 45 to 184 countries. This has substantially shifted the balance of power in favor of large-quota countries. The Group of Seven industrial countries currently have a combined total vote of 47.7 percent, and, together with the votes of the Swiss Director, they account for 50.3 percent. If the votes cast by the Dutch and Belgian Directors are added, the combined vote of these countries exceeds 60 percent. Imbalances also exist within the developed world. The European Union (EU), with a combined GDP somewhat smaller than the United States, holds virtually 30 percent of the total vote, versus the United States's 17 percent.

On top of this, Buira added, the IMF's Articles of Agreement stipulate that some decisions require a qualified majority of the votes cast, further concentrating power in the larger countries, which have a higher proportion of the total votes. At the Bretton Woods Conference, it was initially proposed that qualified majorities be required in only two cases (one being quota adjustments), but the subsequently accepted Articles of Agreement required qualified majorities—either 70 or 85 percent—for decisions in nine areas.

With the First Amendment to the Articles of Agreement, the number of these decisions rose to 18, and, with the Second Amendment, the number rose to 53. An 85 percent qualified majority gives the United States (with its 17 percent vote) veto power; a 70 percent qualified majority gives the European Union veto power. Buira noted that since voting itself is weighted, qualified majorities should not be necessary. But the countries that have favored such majorities have not been prepared to do away with them, he said.



Thomas Dawson, (left) introduces Ariel Buira, editor and coauthor of *Challenges to the World Bank and the IMF: Developing Country Perspectives*. Carol Welch is at right.

The greatest concerns for nongovernmental organizations (NGOs) regarding governance issues, Carol Welch said, are the single U.S. veto, the overrepresentation of European seats, and the lack of representation of emerging markets and the larger constituencies—particularly sub-Saharan African countries that have many active programs. "NGOs are calling for a change in the voting structure," she said, "so that there would be no more than 10 countries per constituency, that no single country could have veto power, and that there would be a fairer allocation of power between creditors and borrowers." In her view, the establishment of other short-term lending institutions, such as an Asian Monetary Fund that would be more representative of Asian countries, would be enough of a threat to the IMF's legitimacy that it would create internal incentives within the IMF to change governance.

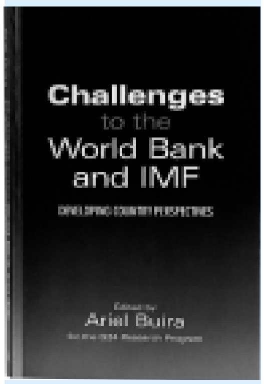
Dawson noted that "in discussions like this, we tend to overlook the fact that on most issues, the IMF Board does deal by consensus when differences break out, and they are quite often not along North-South lines." Dawson doubted that an Asian Monetary Fund—if it were indeed to come into effect as an operating institution—would behave, at least in its internal operations, very differently than from the IMF. "These are financial institutions, and the creditors in each institution will want to make sure that their own resources are safeguarded," he said.

Quotas: in dire need of review?

In addition to being the main determinants of voting power in the IMF, quotas also regulate members' access to IMF resources and capital contributions to the IMF. The original quota formula had the political objective of reflecting the relative quota shares that the U. S. president and secretary of state had agreed to give the big four wartime allies, said Buira. The United States was to have the largest quota, around $2.9 billion; the United Kingdom, including colonies, an amount about one-half the U.S. quota; the Soviet Union, a quota slightly less than that of the United Kingdom; and China, somewhat less. The original formula to determine each country's quota share was based on 2 percent of national income, 5 percent of gold and dollar holdings, 10 percent of average imports, and 10 percent of maximum variation in exports, with these last three percentages to be increased by the ratio of average exports to national income.

With variations in the weight given to these variables, and some changes in the definition of the main variables, the IMF continues to use the original formula to determine quota shares. An element of discretion is used in selecting the formulas to be applied in each case for determining members' quotas, and other considerations also come into play.

Buira saw the determination of quotas as lacking transparency with results that were increasingly unrepresentative of the relative importance of member countries' economies, with some Asian countries, in particular, now being underrepresented. Canada and China, for example, have the same quota, even though China's economy is much larger than Canada's, whether compared in purchasing power parity terms or at current exchange rates. Strong vested interests, he added, make changes to the quota formula difficult. In any case, Welch was skeptical that any likely quota increase would make a significant difference in developing countries' borrowing capacities. Senegal's quota, for example, "would have to quadruple," she observed, for it to borrow the amount of financing it really needed from the IMF with minimal conditionality. She doubted that a quadrupling of quotas could be attained.



Inadequate IMF resources

One of the IMF's purposes is to make resources available to members so that they can correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity. "To finance an adjustment without a recession, you need a lot of money," Buira said, and "if you have very little money, your adjustment will be very sharp and very painful."

The IMF's quotas as a percentage of world imports have declined from 58 percent in 1944 to around 3 percent in 2004, largely because the industrial countries—which have not resorted to IMF financing in the last 25 years—have become reluctant to contribute more. Buira had real doubts about whether the IMF's resources were adequate for it to fulfill its mission, and he noted that its limited resources aggravate the contractionary nature of most of the adjustment programs it supports, and result in more stringent conditionality. Consequently, the programs experience a high rate of failure. In the IMF's defense, Dawson pointed to a recent study by the IMF's Independent Evaluation Office that indicates that IMF-supported adjustment programs include more variety than a simple one-size-fits-all contractionary approach. In response to concerns about "creeping conditionality," he noted that "we as an institution are being asked to do much, much more" in the economic, social, and political areas.

Transparency and accountability

Welch acknowledged that the IMF has made quite a bit of progress in improving the transparency of its own operations—for example, increasing the number of loan program documents that are available to the public. But there is always, she said, room for improvement. Both she and Buira called for greater transparency in IMF Executive Board operations, with Welch asking, in particular, that loan documents be made public upon their circulation to the Board (not after Board approval) and that Executive Directors' statements to the Board and minutes of Board meetings—albeit redacted for sensitive information—also be released to the public.

Buira was also troubled by the lack of transparency in appointments of the Managing Director and senior staff, 75–80 percent of whom are from a small number of industrial countries. But his greatest concern is that geopolitical and strategic considerations often come into play in determining whether a country is meeting loan conditions, which have now been extended into such areas as governance and institutional reform that no longer have easily quantifiable fiscal and monetary targets.

Dawson pointed out that a great deal of progress has been made in increasing the transparency of Board activities. For example, he said, "the United States, the United Kingdom, France, Germany, and a number of other countries publish annual reports for their civil societies and parliaments on their representation in the institution—this is something that is to be encouraged." In Dawson's view, the IMF is both reactive and proactive, and, he said, "the IMF's increased transparency itself is increasing accountability; it is allowing our actions to come under more immediate and well-informed criticism and puts pressure on us."

What to do?

If the voice and representation of developing countries and transition economies are to improve, Buira said, the IMF's Executive Board will need to be restructured. He suggested this could be accomplished by reducing the representation of European countries and increasing developing country representation. If EU quotas are adjusted for intra-EU trade, for example, their quota share would decline by 40 percent.

He also recommended a revision of quota formulas to better reflect the relative sizes of members' economies, the use of a purchasing power parity–based measure of GDP to avoid distortions from exchange rate fluctuations and remove the bias against developing countries, and a restoration of the original role of basic votes. The objective of governance reform, he stressed, is not for developing countries to dominate the IMF but to ensure a better balance in the representation and decision-making process and thus to enhance the democratic legitimacy of the institution. ■

Copies of *Challenges to the World Bank and the IMF: Developing Country Perspectives*, by Ariel Buira (editor), Aziz Ali Mohammed, Bernhard Gunter, James Levinsohn, Gerald Epstein, Ilene Grabel, K.S. Jomo, Javier Guzman, Rodolfo Padilla, Barry Herman, Martin Khor, and Ravi Kanbur, are available for $24.95 each from the World Bank. For ordering details, please see *http://publications.worldbank.org/howtoorder*.

Staying abreast of what's on at the IMF's Board

On February 9, the IMF began publishing the weekly calendar of its Executive Board. The calendar, which will be updated on a rolling basis, contains the tentative schedule of formal meetings and seminars (the schedule is usually finalized the day prior to each meeting). The Executive Board approved the release of its calendar as part of the latest review of the IMF's transparency policy, which was completed in September 2003 (see *IMF Survey*, October 20, 2003, for more details). The calendar is available on the IMF's website (*www.imf.org*).

The Executive Board is the IMF's main decision-making body. It approves all IMF-supported programs with member countries, reviews the IMF's annual evaluations of its member countries' economies (the Article IV consultations), and maps out the organization's policies and procedures. The Board bases its discussions on papers prepared by the IMF's management and staff.

The Executive Board consists of 24 Executive Directors appointed or elected by the organization's 184 member countries. Five are appointed by their own countries. These single chairs represent the 5 members with the largest quotas—the United States, Japan, Germany, France, and the United Kingdom. Another 3 Directors are elected by single countries—China, the Russian Federation, and Saudi Arabia. The remaining 16 Executive Directors are elected by groups or "constituencies" of countries. One group, for instance, whose Executive Director is from Belgium, comprises that country, Austria, Belarus, the Czech Republic, Hungary, Kazakhstan, Luxembourg, the Slovak Republic, Slovenia, and Turkey.

While each country's votes are determined mainly by the size of its quota (its capital contribution to the IMF), the Executive Board very rarely bases its decision making on formal voting. Instead, under a practice of consensus decision making that has been in place since the early days of the IMF, the Chair of the Board—who is the Managing Director—is responsible for ascertaining the "sense of the meeting." This usually takes the form of a statement known as the "summing up" that is read to the Board at the end of most Board meetings and often, but not always, made public thereafter. Executive Directors are not subject to time constraints in expressing their positions, reservations, and questions. In that environment, the influence of an individual Executive Director on IMF policies can reach well beyond his or her voting power.

For more information on the governance of the IMF, please see Leo Van Houtven's *Governance of the IMF—Decision Making, Institutional Oversight, and Accountability.* The pamphlet is available both in hard copy (see page 39 for ordering details) and on the IMF's website.

Interview with Barry Johnston

IMF's offshore assessments probe for weak links in global financial system

Amid rising concerns that offshore financial centers might be a weak link in the international financial system, the IMF was asked in 2001 to assess the adequacy of the regulation and supervision of these centers. In November 2003, the IMF's Executive Board commended the "significant progress" that had been achieved by the Offshore Financial Center Assessment Program and called for continued regulatory monitoring as well as steps to bolster transparency, enhance technical assistance, and encourage greater collaboration to improve standards and facilitate the exchange of information. Barry Johnston of the IMF's Monetary and Financial Systems Department talks with Sheila Meehan of the *IMF Survey* about the program and its priorities.

IMF Survey: Since offshore financial centers were established in the 1960s and 1970s, there have been periodic concerns about laxly regulated centers being used for tax evasion and money laundering. What prompted the IMF's membership to ask it to take a closer look at these centers?

Johnston: Offshore centers originally evolved through regulatory arbitrage—in effect, transactions moved offshore in response to monetary policy measures and regulations in major industrial countries. The chief question after the financial crises of the 1990s was whether these offshore jurisdictions—many of them nonmembers of the IMF or dependent territories—could contribute to potential vulnerabilities in the global financial system. Specifically, the IMF was asked to examine whether there might be weaknesses in regulatory and supervisory systems or financial integrity concerns.

In response to heightened concerns about the stability of the global financial system, the IMF was already placing greater emphasis on financial supervision and regulation worldwide. It was natural to extend our efforts to the offshore centers. We knew we needed more statistics and more background on the centers. The fear was that, in the absence of surveillance, vulnerabilities would go undetected.

IMF Survey: Critics have argued that the IMF assessments are meant to squeeze the offshore centers and

Recent publications

IMF Country Reports ($15.00)
(Country name represents an Article IV consultation)

03/370: Anguilla—Overseas Territory of the United Kingdom: Assessment of the Supervision and Regulation of the Financial Sector
03/371: Montserrat—Overseas Territory of the United Kingdom: Assessment of the Supervision and Regulation of the Financial Sector
03/372: Austria
03/373: Portugal: Report on the Observance of Standards and Codes—Fiscal Transparency Module
03/374: Former Yugoslav Republic of Macedonia: Financial System Stability Assessment, Including Reports on the Observance of Standards and Codes on Banking Supervision, Payment Systems, Monetary and Financial Policy Transparency, and Anti–Money Laundering and Combating the Financing of Terrorism
03/375: Indonesia: Eighth Review Under the Extended Arrangement and Request for Waiver of Performance Criteria
03/376: Indonesia: Ninth Review Under the Extended Arrangement
03/377: Indonesia: Tenth Review Under the Extended Arrangement and Request for Waiver of Applicability
03/378: Republic of Armenia: Joint Staff Assessment of the PRSP
03/379: Republic of Armenia: Fourth Review Under the PRGF and Request for Waiver of Performance Criterion
03/380: Vietnam
03/381: Vietnam: Selected Issues
03/382: Vietnam: Statistical Appendix
03/383: Togo
03/384: Niger: PRSP Progress Report
03/385: Equatorial Guinea
03/386: Equatorial Guinea: Selected Issues and Statistical Appendix
03/387: Niger: Joint Staff Assessment of the PRSP Progress Report
03/388: Thailand: Statistical Appendix
03/389: Romania: Financial System Stability Assessment
03/390: Sudan
03/391: Islamic State of Afghanistan
03/392: Argentina: Request for Stand-By Arrangement and Request for Extension of Repurchase Expectations

that smaller offshore centers are scrutinized more closely than larger onshore centers.

JOHNSTON: There seemed to be some concern that we would apply different standards to offshore centers, but the IMF takes a global approach to financial sector assessments and uses uniform instruments. When we review banking systems, we use the Basel Core Principles. When we evaluate anti–money laundering efforts, we apply the [Financial Action Task Force] FATF-40 recommendations. And over the past two years, while we were assessing the Cayman Islands, The Bahamas, Jersey, Guernsey, and the Isle of Man, for example, under the offshore financial centers program, we also undertook assessments under the FSAP [Financial Sector Assessment Program] for the United Kingdom, Germany, Japan, Switzerland, Hong Kong, and Singapore, among others.

I'd also like to add that offshore financial centers, while geographically small, account, by our calculations, for about 20 percent of total cross-border banking flows. The concern about offshore centers has always been that they can attract business in two ways: by delivering more efficient services or by offering a weaker, less costly regulatory structure. We are finding that the more established, wealthier centers do compete on the basis of efficient services, but newer, smaller, and poorer centers have not yet had the time to develop the skills, the depth of expertise, and the knowledge base to support an efficient financial industry and thus have weaker regulatory systems. The world has changed, and there is a much lower tolerance now for weak regulatory standards. A jurisdiction that is not following minimum international standards could raise the prudential risk of financial instability. Plus, criminals are extremely good at finding loopholes—which is why you need global standards to combat money laundering and financing of terrorism.

IMF SURVEY: There has been criticism of the quality and effectiveness of efforts to prevent the financing of terrorism. From the IMF's perspective, how far along are we in this effort?

JOHNSTON: First, let me be clear that the IMF does not chase the criminals. We help jurisdictions set up the necessary legal and financial infrastructure, provide technical assistance to draft laws and regulations, work with the authorities to develop the required expertise and set up the financial intelligence units needed to gather information from the financial services indus-

Johnston: "The concern about offshore centers has always been that they can attract business in two ways: by delivering more efficient services or by offering a weaker, less costly regulatory structure."

03/393: Bulgaria: Report on the Observance of Standards and Codes

IMF Working Papers ($15.00)

03/243: "Evolution and Performance of Exchange Rate Regimes," Kenneth Rogoff, Aasim M. Husain, Ashoka Mody, Robin J. Brooks, and Nienke Oomes

03/244: "The Effects of Fiscal Policies on the Economic Development of Women in the Middle East and North Africa," Nicole L. Laframboise and Tea Trumbic

03/245: "China's Integration into the World Economy: Implications for Developing Countries," Yongzheng Yang

03/246: "Volatility and Comovement in a Globalized World Economy: An Empirical Exploration," Ayhan Kose, Eswar S. Prasad, and Marco E. Terrones Silva

03/247: "Budget System Reform in Transitional Economies: The Case of the Former Yugoslav Republics," Jack Diamond and Duncan Last

03/248: "Multinational Enterprises, International Trade, and Productivity Growth: Firm-Level Evidence from the United States," Wolfgang Keller and Stephen R. Yeaple

Occasional Papers ($25.00; academic rate $22.00)

No. 227: *U.S. Fiscal Policies and Priorities for Long-Run Sustainability*, Martin Muhleisen and Christopher M. Towe

No. 228: Capital Markets and Financial Intermediation in the Baltics, Alfred Schipke, Christian H. Beddies, Susan M. George, and Niamh Sheridan

Other

Policy Discussion Paper No. 03/6, "International Trade in Services: Implications for the Fund," Alexander C. Lehmann, Natalia T. Tamirisa, and Jaroslaw Wieczorek ($15.00)

Publications are available from IMF Publication Services, Box X2004, IMF, Washington, DC 20431 U.S.A.
Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

For information on the IMF on the Internet—including the full texts of the English edition of the *IMF Survey*, the *IMF Survey*'s annual *Supplement on the IMF*, *Finance & Development*, an updated *IMF Publications Catalog*, and daily SDR exchange rates of 45 currencies—please visit the IMF's website (*www.imf.org*). The full texts of all Working Papers and Policy Discussion Papers are also available on the IMF's website.

try, and ensure that there are trained staff to implement the laws and regulations.

Has all of this been accomplished in all jurisdictions? No, but then FATF only adopted its special recommendations on countering the financing of terrorism in the autumn of 2001. By contrast, countries have had 10–15 years of experience with the anti–money laundering regulations. What we can say at this juncture is that a very high degree of attention, training, and technical assistance is being given to this issue globally.

Johnston: "Rather than there being a stigma attached to the IMF's coming in, now there is something wrong if a jurisdiction is not assessed by the IMF."

IMF Survey: What exactly is the relationship of the offshore assessments to those done under the FSAP? Why not simply conduct an FSAP assessment for these centers?

Johnston: IMF member countries can request an assessment under the FSAP rather than under the Offshore Financial Center Assessment Program. One difference between the two is that the offshore program covers 17 jurisdictions that are not IMF members or are dependent territories. Another difference is that the offshore assessments look exclusively at financial regulatory systems, reflecting, at least in part, the concerns about the risks to the international financial system and cross-border financial flows. FSAP assessments also look at the vulnerability of the domestic financial system.

IMF Survey: Now that the IMF has assessed 40 of the 44 offshore financial centers—and will likely assess the remaining 4 over the next year or two—will the focus of the program change?

Johnston: The IMF's Executive Board has asked us to continue our regular assessments. What has changed is that, in addition to our regular assessments every four or five years, we will conduct risk-focused assessments that can be triggered by concerns arising from, for example, growth of activity; a new type of business; or specific events that raise questions about the adequacy of the regulatory framework. This will give us greater flexibility to respond to developments.

IMF Survey: The Board asked the program to encourage greater transparency. How will this be done?

Johnston: One priority is to get the centers themselves to publish more information on their activities, and the IMF will help by developing minimum publication guidelines. Centers are currently reluctant to publish, partly because they fear that competitors will use the information they release. Having the IMF develop minimum publication guidelines will, in effect, level the playing field.

Another priority is the treatment of the summary assessment reports themselves, which will now be sent to the Executive Board. The program was set up under the IMF's technical assistance mandate, and, as such, the Executive Board saw our assessments only if the jurisdiction agreed to publish them. Otherwise, the reports remained confidential between the IMF staff and the jurisdiction. In fact, most jurisdictions currently do publish their reports, but from now on the summary assessment reports will always be sent to the Executive Board. In effect, these reports will be treated exactly like FSAP reports.

IMF Survey: The Executive Board seemed keen to see the IMF collaborate more with other international agencies and national authorities to improve standards and increase the exchange of information.

Johnston: Last May, the IMF sponsored a roundtable in Washington for offshore and onshore supervisors and standard setters. That meeting provided a forum to discuss issues of common interest, and it highlighted the need to strengthen information exchange among supervisors and regulators. We're planning a follow-up discussion in the next few months and a second roundtable later in the year to discuss specific proposals that could then be considered by broader groups. At this stage, we are still identifying key shortcomings. As these discussions progress, we aim to develop a road map on how to tackle the major impediments to information exchange. But some of these initiatives will clearly take time.

IMF Survey: Will the Board's request for an intensification of technical assistance entail changes in the composition or focus of the IMF's efforts?

Johnston: The demand for technical assistance to combat money laundering and terrorist financing is growing and will continue to grow, reflecting the global interest in these initiatives.

Another issue is the demand for technical assistance from the newer, poorer offshore financial centers. For the IMF, one question is whether these centers, given their size and resources, have the underlying capacity to set up the fully fledged supervisory systems needed to meet international regulatory standards. One suggestion at the Board was to look for ways to outsource some of the supervisory and managerial technical assistance needs to bilateral donors. We are looking for ways to help these centers be consistent with their own resource capacities.

IMF Survey: Ultimately, what constitutes success for the Offshore Financial Center Assessment Program?

Johnston: In the short term, the yardstick is whether jurisdictions meet international supervisory and regulatory standards. In the longer run, it is the ability to reduce or avoid a serious financial crisis or abuse originating through offshore centers. At the end of the day, our concern is to reduce global financial vulnerabilities.

Another way to measure short-term success is participation. It's voluntary and has been well received by most jurisdictions. When we started the assessment program, the offshore centers had just been through a period of intense scrutiny. The centers were quite concerned that the IMF initiative would be yet another naming and shaming exercise. As the program evolved, the centers came to understand that the IMF assessments really are voluntary, uniform, and cooperative.

The centers also came to see the IMF's approach as objective. Our assessors do a thorough job of analyzing the regulatory system and enter into a real dialogue with individual jurisdictions. That dialogue is reflected in our reports. The jurisdictions also realized that if they took action to address vulnerabilities before we finalized our reports, their steps would be reflected in our reports.

After the centers had experience with the way the IMF conducts its work, they recognized that the assessments were quite a positive step and could enhance their integrity. And there is some evidence that jurisdictions that were initially reluctant to come into the program are now much more open.

There's quite a difference of perceptions compared with those commonly held about programs supported by IMF financing. Rather than there being a stigma attached to the IMF's coming in, now there is something wrong if a jurisdiction is not assessed by the IMF. Moreover, if the jurisdiction is assessed and doesn't publish, there is a sense that something is wrong. Major jurisdictions, in response to market pressure, are publishing their assessments. It is much more preferable now to publish, identify weaknesses, and explain how the jurisdiction will deal with identified weaknesses. Markets have generally reacted favorably. What seems to matter is the willingness to recognize shortcomings and their dangers to take action to address them. Though it was not necessarily what we anticipated when we set out, in some ways the IMF's assessments have become quite an important part of the whole quest for integrity by financial centers. ■

For more information about the Offshore Financial Center Assessment Program, please see IMF Public Information Notice No. 03/138 (November 28, 2003) on the IMF's website (*www.imf.org*).

Why statistics matter: African seminars raise awareness

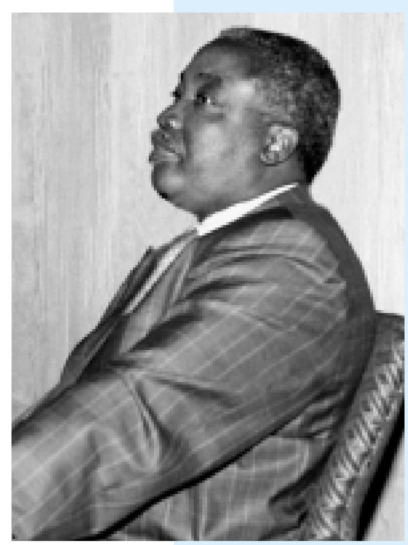
In 2003, the IMF began a campaign to raise public awareness of the importance of high-quality statistics and the role of the General Data Dissemination System (GDDS) in developing national statistical systems. Wipada Soonthornsima, Chief of the IMF's General Data Dissemination System Unit, reports here on the impact of National Awareness Seminars in Anglophone Africa.

It is difficult to overemphasize how critical reliable data are, Immanuel Ngatizeko, Director General of National Planning Commission of Namibia, observed at a December 10 National Awareness Seminar in Windhoek. Statistics, he said, speak all languages, affect all policies, and touch all aspects of people's lives. Policymakers are particularly indebted to timely, high-quality statistics, he added, to help guide their work, assess the impact of their policies, and change direction when needed.

It was just this sense of the power of high-quality data that prompted the IMF's Statistics Department to launch an outreach effort to raise public awareness of the role of statistics and spotlight the contribution of the GDDS in developing effective national statistical systems. The National Awareness Seminars also encourage the public to secure the information it needs to better understand and evaluate government performance.

Promotion of statistical information lies at the heart of the GDDS and its goals of helping participating countries meet international standards and disseminate timely and reliable economic, financial, and sociodemographic data to the public. Statistics, particularly in developing countries, often do not receive the recognition and the priority they

Ngatizeko: "Statistics speak all languages, affect all policies, and touch all aspects of people's lives."



deserve. As a first step toward remedying this, the IMF and the World Bank, with the financial support of the United Kingdom's Department for International Development (DFID), helped countries launch a series of awareness seminars under the GDDS project for Anglophone Africa in May 2003. To date, seminars have been held in seven countries: Botswana, Kenya, Namibia, Sierra Leone, Sudan, Swaziland, and Zambia.

Participants in the Windhoek seminar. The gathering provided a forum for an exchange of views between producers and users of data.

The most recent seminar took place in Windhoek, under the joint sponsorship of the Central Bureau of Statistics and the Bank of Namibia. It featured a progress report on the country's efforts to strengthen its statistics, as well as discussions on the role of the GDDS in statistical capacity building and poverty reduction, and IMF initiatives in statistical work programs. As is typical of the series, the day-long event brought together a wide range of participants—producers and users of economic and sociodemographic statistics from government agencies, academia, the private sector, donor agencies, international organizations, the media, and the public at large—to discuss steps to improve the quality of statistics, broaden the availability of statistics to the public, and foster closer cooperation between producers and users.

The Windhoek session was unique in the seminar series in including GDDS coordinators from 12 of the 14 countries involved in the project. In separate workshops on December 9 and 11, coordinators exchanged views and shared experiences on the role of the GDDS in national statistical systems and in technical assistance efforts.

Transparency and more

As reflected in the theme of Kenya's GDDS awareness seminar in July 2003—"If you can't measure, you can't manage it"—good data can have wide-ranging benefits, including more effective management and greater accountability. Indeed, participation in the GDDS can demonstrate not only a government's commitment to better statistics but also its desire for increased transparency. A well-informed public can hold governments accountable for policies and results.

The GDDS, as Ngatizeko pointed out in remarks to the Windhoek gathering, can also play an important role in enhancing foreign investment, which can be a critical element in economic development and poverty reduction. The GDDS metadata disseminate statistical information to a global audience and allow investors to assess the quality of available data as they make investment decisions.

Aiding poverty reduction

For countries intent on reducing poverty in the context of a program supported by the IMF's Poverty Reduction and Growth Facility, the GDDS can play a key role in helping identify the data needed and monitoring progress. Namibia, Ngatizeko said, is finalizing its national development goals—Vision 2030—and high-quality, timely, comprehensive, and reliable statistics will be needed to track the realization of these aspirations and measure progress toward achieving the UN Millennium Development Goals.

Statistics can help strengthen policy debates and improve implementation strategies. Making relevant statistics available to the public also allows it to have a greater say in developing the country's poverty reduction strategy paper (PRSP). And the PRSP, in turn, can provide a framework for developing and disseminating relevant statistics for Millennium Development Goal indicators (see box, page 43), policy benchmarks, and monitoring.

GDDS is a powerful tool for statistical development

The General Data Dissemination System (GDDS) is designed to provide countries with a comprehensive framework for developing a statistical system. It facilitates the assessment of the current state of economic and sociodemographic statistics, identifies weaknesses, sets plans for addressing these weaknesses systematically within a time frame, and explicitly identifies any technical assistance that may be needed.

Countries, in turn, use the GDDS metadata to enhance the development, implementation, and coordination of technical assistance. With up-to-date information, the metadata also act as a planning and monitoring tool. And, in the context of the World Bank's Statistics Capacity Building (StatCap) lending program, the GDDS metadata contribute to the process of assessment, strategic planning, and coordination of statistical programs across agencies and donors; implementation; reporting; and evaluation.

Participation in the GDDS has increased steadily. In May 2000, the first 7 countries posted metadata on the IMF's website (*www.dsbb.imf.org*); at present, 66 countries do so (excluding 3 GDDS participants that now subscribe to the next level—the Special Data Dissemination Standard).

The awareness seminar held in Sierra Leone in November 2003 recognized the GDDS as integral for the development of national statistical strategies and strengthened statistical capacity in support of the data requirements of the PRSP, the initiatives of the New Partnership for Africa's Development, and the Millennium Development Goals. Kona C. Koroma, Development Secretary in Sierra Leone's Ministry of Development and Economic Planning, noted that her nation stands to benefit immensely from the GDDS initiative. Its efforts to fight poverty and promote better lives for its people would be more effective if the authorities had access to better statistics. But she also recognized that producing quality data, achieving proper governance, and managing the statistical system effectively represent enormous challenges for Sierra Leone. And Mohamed Sampha Fofanah, the country's Deputy Central Bank Governor, added that the GDDS is especially important for countries like Sierra Leone that have just emerged from a devastating civil war and need to rebuild their statistical systems.

Lessons and enhancements

Many participants saw these seminars as a means of bridging the considerable gap between producers and users of statistics and as a way of providing up-to-date information on statistical methodologies and dissemination techniques. Clearly, too, the public appreciated having direct contact with official statistical producers and being able to express their views on the quality of statistics. Indeed, the seminars' questionnaires provided data to producers who have not yet established explicit means of gauging the usefulness of their statistics and gave them a basis for soliciting more regular and formal feedback from users. The seminars also allowed producers and potential technical assistance donors to exchange views.

Overall, the GDDS campaign has proved effective in raising public awareness of the importance of statistics, motivating the public to exercise its right to information, and generating increased public appreciation of government commitment to transparency and accountability. Experience from the first round of seminars will now feed into a number of enhancements, notably more emphasis on an appropriate mix of participants from the private and public sectors; content geared to the interests of the various groups and delivered at the appropriate level of technical detail; inclusion of a broader range of perspectives, with more presentations, in particular from nongovernmental sectors; and greater attention to the vital role of media in raising awareness.

There have also been suggestions that future seminars include a larger number of senior policymakers and parliamentarians, that there be greater consultation with users, that the GDDS be extended to a wider range of data categories, and that consideration be given to organizing these sessions for other countries. The IMF's Statistics Department stands ready to assist member countries by providing relevant information for such seminars. Ultimately, however, it will be for the countries themselves to take the steps needed to utilize the GDDS and its metadata to the fullest. ■

At the Sierra Leone seminar, Mohamed Sampha Fofanah (left), Deputy Central Bank Governor, and Kona C. Koroma, Development Secretary, highlighted the benefits of participating in the GDDS.

Millennium Development Goals and the GDDS

In November 2003, the IMF's Executive Board approved inclusion of the Millennium Development Goal indicators in the General Data Dissemination System (GDDS) (see *http://dsbb.imf.org*). The eight goals—which seek to eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria, and other diseases; ensure environmental sustainability; and establish a global partnership for development—are reflected in 21 targets and 48 indicators (see *http://www.un.org/millennium goals*). Of the indicators, 35 are generated by national statistical systems and 26—mostly pertaining to sociodemographic data—come within the scope of the GDDS.

Several GDDS participants have already amended their metadata to incorporate these indicators. (See, for example, Pakistan's information (*http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorylist/?strcode=PAK)*).

Photo credits: Denio Zara, Michael Spilotro, and Eugene Salazar for the IMF, pages 33, 35–37, 39–40, and 44–48; Robert Sullivan for AFP, page 34; Ernst Conrad, pages 41 and 42; and Statistics Sierra Leone, page 43.

Razin Economic Policy Lecture

Calm before the storm? Rogoff sees more crises in the offing

Emerging markets appear to be sailing in calm waters: spreads on emerging market bonds are at a historical low and inflation appears tamed around the world. But the current state of affairs is no source of comfort to Kenneth Rogoff, Professor of Economics at Harvard University and former IMF Economic Counsellor. Speaking at Georgetown University on January 29, he suggested that spreads may be too narrow for some of the more vulnerable countries, and predicted more emerging market crises in the years ahead.

After a round of snowstorms, like the one that hit Washington, D.C., recently, there is a tendency to want to believe that the worst of winter is over. To Rogoff, a similar mood prevailed at the recent World Economic Forum in Davos, Switzerland, on emerging market debt crises. Many distinguished speakers hoped against hope for the end to debt crises, but there are many reasons, he said, that such a feat may not be within our grasp.

Assaf Razin (left) presenting the 2003–04 Razin Prize to Georgetown University student Edouard Vidon. The prize was established in 1997 in memory of Razin's son, Ofair.

Learning the wrong lessons

For a start, Rogoff expressed concern that economists such as Jagdish Bhagwati, Joseph Stiglitz, and Dani Rodrik are emphasizing the wrong lessons from the Asian crisis. They see clear perils but few gains from opening up emerging markets to private capital flows. But this is deeply misleading, he argued, not least because the main culprit in the financial crises was a fixed exchange rate system. Like a metal umbrella that keeps rain out very effectively until lightning strikes, the fixed exchange rate system often brought about brisk economic growth until a crisis hit.

Moreover, Rogoff observed, integration with the global financial market is indispensable to economic development beyond a certain level. Yes, China and India—aided by capital controls—did escape the Asian crisis relatively unscathed, while Korea—with an open capital market—was hit hard. But that argument holds only so far. China and India had per capita income levels about one-tenth of Korea's, and at some point they, too, will have to cross the bridge and integrate with the global financial market.

Sovereign default and institutions

Rogoff also rejected as naive a view that suggests that the crises of the 1990s could have been averted had different guardians sat at the helm of the international financial system. Sovereign default, he pointed out, is hardly a new phenomenon. It has been with us for more than 500 years and, over the past two centuries, has been associated with emerging markets. In the earlier centuries, these emerging markets were European countries, and they, too, defaulted. Indeed, the all-time record for sovereign defaults (13) is held not by a current emerging market country but by an earlier one—Spain.

Still, Rogoff said, some countries have historically been less capable of bearing debt and more prone to default, and they have defaulted on their sovereign debts repeatedly. Others—in apparently similar economic situations—have rarely or never defaulted. The divergence between these two groups of countries is unmistakable, even allowing for the inherent randomness of the incidence of debt crises, which are triggered by a confluence of irreducible uncertainty and a crisis of confidence.

The roots of this divergence might be gleaned from the cause of the prime puzzle in international finance—namely, why more capital is not flowing into emerging markets. In principle, emerging markets have greater growth potential and offer more profitable uses for capital. In practice, however, emerging markets have great difficulty overcoming the risks associated with weak institutions. The returns in emerging markets, in Rogoff's assessment, are not high enough to compensate investors for bearing the political and credit risks bred by institutional weaknesses. Domestic institutional factors also appear to determine the proclivity of emerging markets to default.

Why lend? Why borrow?

From a policy perspective, Rogoff suggested, it is valuable to have a better grasp of the reasons that banks lend and countries borrow. On the lending side, the question is why investment banks are willing to continue to lend at low spreads even when defaults are reasonably certain to occur. The answer lies in the global diversification of lenders' portfolios. Occasional defaults push the returns from affected investments to the bottom, but average returns on global portfolios remain at acceptable levels.

On the borrowing end, political leaders struggling for funds are inclined to welcome capital inflows, viewing them a bit like steroid injections. Government borrowing is behind most emerging market debt crises; even the Asian crisis involved quasi government borrowing. But the same leaders who welcome capital inflows are extremely averse to facing up to the consequences, including debt restructuring, because these imply a loss of power (though not of life, as was the case, for example, in France, where beheading was once a part of the debt-restructuring process).

If crises are to be made less disruptive, Rogoff saw a need to take measures on both sides. For lenders, he said, it should be made more difficult for courts in rich countries to enforce debt contracts, thereby stimulating the development of nondebt instruments of financial flow. For borrowers, it should be made less difficult to work out debt restructuring arrangements.

Argentina, he said, offers a vivid example. The country now finds itself in a tight spot, short of a debt work-out agreement. High growth would encourage creditors to drive a tough bargain; low growth would keep creditors at bay but would be a Pyrrhic victory for Argentina. (And contrary to common perception, Rogoff said, the IMF is certainly not opposed in principle to debt restructuring, as is evident from the foiled attempt by First Deputy Managing Director Anne Krueger to introduce a systematic mechanism for restructuring sovereign debts.)

What lies ahead?

So given all of this, what does lie ahead for emerging markets? Rogoff viewed indiscriminately narrow spreads on emerging market bonds with alarm, suggesting that these spreads were highly likely to foment major crises for several countries. The risk is heightened, he added, by uniformly low inflation rates. Some countries cannot readily afford low inflation. Without recourse to inflation taxation to supplement small revenues, the deficits of these countries could result in even higher levels of debt. The current prevalence of flexible exchange rates will help avert some but not all crises. And thus Rogoff's prognosis: the world is likely to see two or three major emerging market crises within as many years.

Rogoff also alluded to what he termed the "mother of all debt problems" unfolding in the United States. Its external borrowing probably exceeds that of the rest of the world, he noted, and, at 25–30 percent, the U.S. ratio of net external liability to GDP even exceeds that of many crisis countries. Policymakers have typically condoned this extraordinary level of debt, arguing that it simply reflects the ongoing deepening of international financial markets. But Rogoff was unconvinced, warning that openness of the real economy determines the depth of adjustment when markets turn sour, and that does not bode well for the relatively closed U.S. economy.

In closing, Rogoff emphasized the need to learn how to live with risks and saw a ray of hope emanating from past experience. Markets tend to be more forgiving of countries that have shown momentum toward prudent and sound policymaking. The worst awaits countries that are caught on their heels. ■

Jaewoo Lee
IMF Research Department

Rogoff: The current prevalence of flexible exchange rates will help avert some but not all crises.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
February 2	1.59	1.59	2.10
February 9	1.60	1.60	2.11

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website *(www.imf.org/cgi-shl/bur.pl?2004)*.

General information on IMF finances, including rates, may be accessed at *www.imf.org/external/fin.htm*.

Data: IMF Finance Department

Practitioners in Development

What lessons do the 1990s hold for development?

What useful lessons can be gleaned from the often turbulent 1990s? In a February 2 lecture in the World Bank's Practitioners in Development series, Larry Summers—President of Harvard University, former U.S. Secretary of the Treasury, and former Chief Economist at the World Bank—offered practical advice in five areas. His remarks drew commentary from two who had also been in the trenches during that period: Pedro Malan, formerly a central bank governor and finance minister under Brazil's Cardoso government; and Michael Mussa, former IMF Economic Counsellor and Director of Research and now a senior fellow at the Institute for International Economics.

Summers placed particular emphasis on recognizing the "transcendent" importance of the quality of institutions and the closely related question of the efficacy of political administration.

For Summers, now more than three years away from the day-to-day demands of economic policymaking, the 1990s held five chief lessons for development practitioners: the importance of institutions; the practical steps that could be taken in financial crisis prevention, management, and resolution; the need to reconsider how much of a build-up in reserves is needed to help guard against future crises; the importance of reflecting further on the fungibility of development aid; and the priority of building a constituency for development in the richest countries.

Summers placed particular emphasis on recognizing the "transcendent" importance of the quality of institutions and the closely related question of the efficacy of political administration. Institutional capacity—or lack thereof, as evidenced, for example, by the inability in many countries to collect a bounced check or evict a person for failure to pay rent—surely has more to do with success and failure in development than has been suggested historically, Summers argued. The quality of a country's government cannot be dissociated from the quality and the functioning of its institutions, Malan added, while recalling that, back in 1958, Albert Hirschman's classic work highlighted how critical government efficiency is for economic development.

Mussa, too, gave top mention to the importance of institutions. Reciting from a 1947 speech delivered by George Marshall—best known for the Marshall Plan, which helped fund the reconstruction of Western Europe after the Second World War—Mussa noted that the transition of Central and Eastern Europe and the former Soviet Union from centrally planned to market-oriented economies had certainly brought the issue to the fore again. Harking back to Adam Smith's *Wealth of Nations* and Thucydides' history of the Peloponnesian War, Mussa showed how economic development has been linked with the quality of institutions and the protection of property rights for some time. "When ownership and control of all of society's wealth and productive assets are up for grabs every day," Mussa noted, "you don't get much economic development."

Disproportionate crisis punishment

Turning to the series of financial crises that erupted in emerging market countries in the 1990s, Summers surmised that in each case the eruption could be attributed to a "combination of policy error and bank run mentality," with the "crisis punishment heavily disproportionate to the policy crime." A serious problem afflicting the current system, he continued, is that there are, at any given time, several dozen countries that have borrowed money with wide spreads—300–600 basis points—which implies that the market believes the odds are 50 percent or greater that default will occur within a decade.

Summers argued that a capital market can function in either of two healthy ways. One is to emulate the functioning of the U.S. municipal bond market, whereby money is borrowed at small spreads (in this case, the collective judgment is that default is extraordinarily unlikely for those borrowing). The other is to emulate the functioning of the high-yield (junk) bond markets in the United States and Europe (where bonds are issued with wide spreads reflecting their high risk and with the market viewing the stated interest rate and principal as the maximum possible payoff). In this case, the bondholders know that they are unlikely to be repaid in full, and when they are not, there is renegotiation and then business resumes.

In contrast, emerging markets today are characterized by pricing associated with an expectation that crises will be likely, but when a crisis occurs, the market responds to it as a highly *unlikely* event. It doesn't make a lot of sense, Summers said, for the market to look at an emerging market country with a 500–600 basis point spread on its bonds, observe that this means that it is unlikely the bond will be paid in full, but then react at a later point with shock and horror when a crisis occurs. Stating that he was much more confident of the problem than of the best solution, Summers suggested it may be wiser to push for less and lower-yield cross-border debt than for an easier work-out solution. Taking into account the riskiness of high-yield debt, there is a lack of evidence that it is consistently used in ways to produce returns that are at least equal to its costs.

Look, Summers said, at each of the major financial crises of the 1990s. The situation was not one of an innocent country somehow overwhelmed by a flood of capital from a herd of speculators. It was, instead, a situation in which countries—for domestic policy reasons—"made very active efforts to dine with the devil (speculators) and ended up on the menu." Examples abound in the affected countries, he argued. Mexico's tesobonos (short-term government securities nominally issued in pesos but effectively indexed to the U.S. dollar) were customized to suit short-term speculators; the Thai offshore banking facility had as its objective attracting short-term interbank credit; the explicit purpose of the Korean capital control regime was to ensure that internal capital flows were short term rather than longer term for reasons of control; and Brazil's financial strategy involved the issuance of debt instruments carefully designed to meet the needs of hedge funds.

So the issue, Summers said, is not whether these countries should have had some type of Chilean-style capital controls. These countries were actually on the other side of neutrality in actively trying to attract short-term capital—and they were doing this not on the basis of any advice from the international institutions or major governments. Moreover, the implicit exchange rate guarantees entailed in pegged exchange rates, where they existed, had formed a "particularly pernicious subsidy to short-term capital."

Taking up this point, Mussa agreed with Summers' criticism of Mexico's tesobono issues but argued that

Malan said that development solutions must be found by those working within a given country. There is, he added, "no way that changes can be pressed from afar."

Available on the web (www.imf.org)

Press Releases

04/17: IMF Convenes Workshop on Anti–Money Laundering Measures at Joint Vienna Institute, January 29

04/18: Statement by IMF Deputy Managing Director Agustín Carstens at the Conclusion of a Visit to Tanzania, February 3

04/19: IMF Executive Board Completes Review of Procedures on Cooperation with Investigations on Fund Activities by Members' Auditing Institutions, February 3

04/20: IMF Completes Fourth Review Under Stand-By Arrangement with Bulgaria, Approves $39 Million Disbursement, Grants Waivers, and Extends Arrangement, February 4

04/21: Statement by IMF Deputy Managing Director Agustín Carstens at the Conclusion of a Visit to Mali, February 6

Public Information Notices

04/3: IMF Concludes 2003 Article IV Consultation with Algeria, January 29

04/4: IMF Reviews Georgia's Performance Under Past Fund-Supported Programs, January 30

04/5: IMF Concludes 2003 Article IV Consultation with the Republic of Moldova, February 2

04/6: IMF Concludes 2003 Article IV Consultation with Lesotho, February 5

Speeches

"The Euro—Towards Adopting the Common Currency in Central Europe," Horst Köhler, IMF Managing Director, Conference on Euro Adoption in the Accession Countries—Opportunities and Challenges, Prague, February 2

"Honduras's New Three-Year Economic Program," Anoop Singh, Director, IMF Western Hemisphere Department, Tegucigalpa, Honduras, February 2

Luncheon Address by Agustín Carstens, IMF Deputy Managing Director, Seminar on the Role of the IMF in Low-Income Countries, Dar es Salaam, February 3

Statement at Donor Meeting

Donors' Meeting, Bolivia, January 16

Transcript

Press Briefing by Thomas C. Dawson, Director, IMF External Relations Department, January 28

The *IMF Survey* (ISSN 0047-083X) is published in English, French, and Spanish by the IMF 22 times a year, plus an annual *Supplement on the IMF* and an annual index. Opinions and materials in the *IMF Survey* do not necessarily reflect official views of the IMF. Any maps used are for the convenience of readers, based on National Geographic's *Atlas of the World*, Sixth Edition; the denominations used and the boundaries shown do not imply any judgment by the IMF on the legal status of any territory or any endorsement or acceptance of such boundaries. Text from the *IMF Survey* may be reprinted, with due credit given, but photographs and illustrations cannot be reproduced in any form. Address editorial correspondence to Current Publications Division, Room IS7-1100, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-8585; or e-mail any comments to imfsurvey@imf.org. The *IMF Survey* is mailed first class in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged $79.00 annually. Apply for subscriptions to Publication Services, Box X2004, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

Brazil was probably right in shifting toward foreign-currency obligations to absorb some of the pressure of the real's depreciation in 2002. A clear lesson here, according to Mussa, is that emerging markets have much more limited options than industrial countries in terms of the types of currencies they can use for borrowing on international credit markets and in doing commercial business. It is for this reason, he continued, that the international financial community must devise better mechanisms for providing, in the event of financial crisis, conditional support (in international currencies) for countries that take responsible action to deal with the causes of their crises.

From left: Michael Mussa, James Wolfensohn, Larry Summers, and Pedro Malan at a February 2 Practioners in Development lecture at the World Bank.

But it is important to recognize, Mussa said, that financial crises happened well before the 1990s and have not been limited to emerging markets. What makes industrial countries apparently less prone to the damage from major international crises and less prone now than they were a century or more ago? Economic policy in industrial countries today is generally much better able to cushion the effects of economic and asset-price declines. And emerging market countries as a group tend to have insufficient flexibility in their fiscal and monetary policies to cope with crises and shocks, as well as relatively long histories of financial instability.

Borrowing from the poor

Referring to the accumulation of international reserves by emerging markets, particularly in Asia, since the crises of the last decade, Summers' third main observation was that policy advisors need to be careful what they ask for. Although he and others had recommended that these countries accumulate reserves to guard against future crises, this had proceeded so far that the largest international flow of fixed-income debt today takes the form of borrowing by the world's richest country at (probably) negative real interest rates from countries with very large numbers of poor. This raises questions about how well the system is working: building up reserves to help guard against the risks of future crises was—and remains—good advice, but the financing of the U.S. deficit by emerging market countries indicates that this advice has been taken too far.

Taking a somewhat less critical view—at least for a number of emerging market countries that have been developing their tradable sectors in tandem with their increasing exports to the United States—Malan emphasized that these countries "think it is to their advantage for the time being, and this is important." But, he cautioned, export-oriented growth is certainly not the only element needed for sustainable, poverty-reducing development.

Turning to his fourth observation, Summers cautioned the development community against losing sight of the set of questions associated with the fungible nature of aid money. Because aid flows are generally combined with other monies in a recipient country's overall budget, it is difficult to track aid's effectiveness or even to affirm that it is being used for the intended purposes. And if a donor gives aid for a project that the recipient government would have undertaken anyway, the aid, in reality, finances expenditures other than the intended project. This fungibility issue predates the 1990s, but, as Summers pointed out, there is a continuing need for careful reflection on its implications.

And, notwithstanding the good work done by the international development community over the past decade, there is a profound need—particularly in the United States—to build a constituency to promote development and poverty reduction, remarked Summers as a concluding observation. Young people as a group are inspired to work toward the solution of global ecological and health problems, he said, but they somehow tend not to take the same passionate interest in the continuing problem of the one billion people worldwide living on less than one dollar a day. And where this energy does exist, it commonly takes the form of anticapitalism and antimarket sentiment as much as it does a genuine desire to help the poorest. Malan echoed this view, adding that solutions must be found by those working within a given country. There is, he said, "no way that changes can be pressed from afar." ■

The webcast of the discussion can be accessed at *http://info.worldbank.org/etools/bspan/PresentationView.asp?PID=1015&EID=328.*