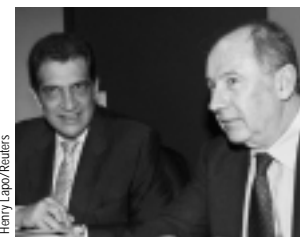


## NEWS: De Rato commends efforts in Andean countries

On the second leg of a visit to the Andean region of Latin America, Rodrigo de Rato on February 17 praised Ecuador authorities, including Minister of Economy and Finance Mauricio Yépez (see photo), for policies that have lifted economic growth and lowered public debt. He expressed hope that continued efforts, notably in pursuing fiscal sustainability and creating space for public investment, would lay the basis for greater prosperity.



Henry Lupo/Reuters

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## REGIONAL FOCUS: Mid-East financial sector development

While Middle Eastern and North African countries have progressed in reforming their financial sectors over the past 30 years, their efforts have been eclipsed by faster reform and growth in other regions, notably East Asia. A new IMF study compares financial sector development in Middle Eastern and North African countries and finds that the role of the state is key in explaining the region's uneven progress in financial sector reforms.



Joe Ravelle/Getty Images

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## COUNTRY FOCUS: India's quest for higher growth

India's economy took off in 2003/04 to growth levels not seen in more than a decade. But to keep growing at this rate, the country needs to curb large fiscal deficits, lower debt, reduce poverty, develop infrastructure, and diminish market rigidities. The government coalition has set an ambitious reform agenda. In an interview, mission leader Wanda Tseng and division head Jerald Schiff of the IMF's Asia and Pacific Department talk about the challenges ahead.

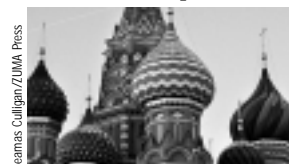


John MacDougall/APP

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## RESEARCH: Did Russia's flat tax boost revenue?

In 2001, Russia's government reduced the personal income tax to a single rate of 13 percent. Since then, tax revenues have soared, leading flat tax advocates to cite the Russian experience as evidence that tax revenue can be raised by cutting tax rates. But a new IMF study—the first of its kind—suggests the increase in tax revenues experienced by Russia is probably due less to increased tax compliance and more to high economic growth that increased wages and, by implication, tax revenues.



Seamus Culligan/ZUMA Press

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# What's on

## FEBRUARY

**23** IMF Managing Director Rodrigo de Rato to speak at Columbia University, New York

**23–24** IMF–Arab Monetary Fund, High-Level Seminar on “Arab Economic Integration: Challenges and Prospects,” Abu Dhabi

**28–March 2** High-Level Forum on Harmonization and Alignment for Aid Effectiveness, Paris, France

**28–March 2** IMF Managing Director Rodrigo de Rato to visit Morocco, Tunisia, and Algeria

**28–March 9** IMF–Japan Center for International Finance High-Level Seminar on “Macroeconomic Management and the Japanese

Experience in Economic Development,” Tokyo, Japan

**28–March 11** Beijing+10 Conference: 49th Session of the Commission on the Status of Women, United Nations, New York

## MARCH

**14–15** IMF–DfID–InWEnt High-Level Seminar on “Foreign Aid and Macroeconomic Management,” Maputo, Mozambique

**16** OPEC: 135th Meeting of the Conference, Isfahan, Iran

**17–18** IMF seminar for legislators, Dili, Timor-Leste

**20–21** OECD: China in the World Economy: China Development Forum 2005, Beijing, China

**23–24** IMF seminar for legislators, Phnom Penh, Cambodia

## APRIL

**5** IMF's *Global Financial Stability Report* (April 2005) released

**8** IMF Book Forum, Thomas Friedman, *The World Is Flat: A Brief History of the 21st Century*, Washington, D.C.

**10–12** Inter-American Development Bank Annual Meeting, Okinawa, Japan

**13** IMF's *World Economic Outlook* (Spring 2005) released

**16–17** 2005 Spring Meetings of the IMF and the World Bank Group, Washington, D.C.

**18** ECOSOC High-Level Meeting: IMF, World Bank, WTO, and UNCTAD at UN Headquarters, New York

**18–20** Asian Development Bank, International Conference on Achieving Results in the Private Sector, Manila, Philippines

**19–20** IMF High-Level Seminar on “Asset Securitization and Structured Finance,” Washington, D.C.

**20–22** WTO Public Symposium, “WTO After 10 Years: Global Problems and Multilateral Solutions,” Geneva

### IMF Executive Board

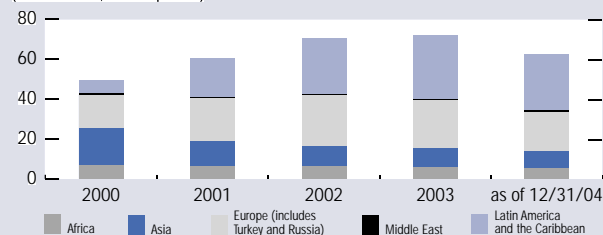
For an up-to-date listing of IMF Executive Board meetings, see <http://www.imf.org/external/np/sec/bc/eng/index.asp>.

## At a glance

### IMF financial data

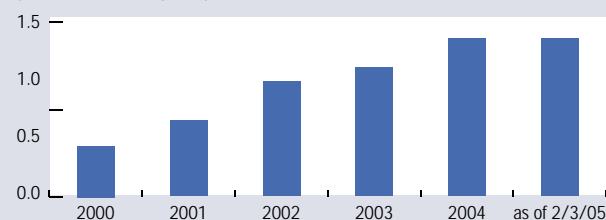
#### Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



#### HIPC debt relief<sup>1</sup>

(billion SDRs, end of period)



<sup>1</sup>Cumulative disbursements under the Heavily Indebted Poor Countries Initiative.

#### Note on IMF Special Drawing Rights

Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are

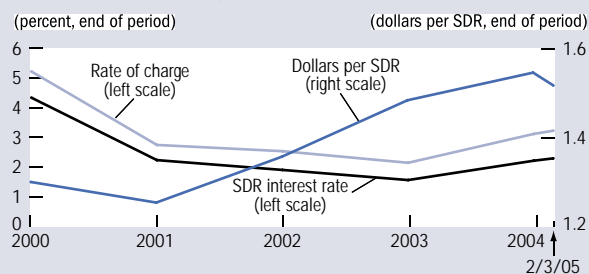
#### Largest outstanding loans

(billion SDRs, as of 1/31/05)

Nonconcessional		Concessional	
Brazil	16.12	Pakistan	1.04
Turkey	13.74	Zambia	.57
Argentina	8.98	Congo, Dem. Rep. of	.53
Indonesia	6.24	Ghana	.30
Uruguay	1.71	Tanzania	.27

#### Related rates

SDR interest rate, rate of charge on IMF nonconcessional loans outstanding, and dollars per SDR



allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

## De Rato urges Andean nations to accelerate reforms

Wrapping up the second leg of a four-country Andean visit, IMF Managing Director Rodrigo de Rato on February 17 congratulated Ecuador's authorities on a strong macroeconomic performance in 2004 and an impressive effort to lower inflation, strengthen the country's fiscal stance, and reduce public debt. At the same time, he urged the authorities to press ahead with reform efforts to boost prospects for sustained growth and poverty reduction.

In meetings with President Lucio Gutiérrez, President of Congress Omar Quintana, Minister of Economy and Finance Mauricio Yepéz, Central Bank President Angel Polibio Córdova, and other officials, de Rato said that "I am pleased that, through the intensified surveillance of the authorities' 2005 economic program, we will continue to have a close relationship with Ecuador." He agreed with the authorities on the importance of adhering to the fiscal responsibility law and taking steps to improve the quality of spending and to create fiscal space for public investment and spending on social priorities.

De Rato also underscored the need for economic diversification, increased competitiveness, and moving forward on social security and civil service reforms to boost growth and raise living standards. In this regard, de Rato said he was very encouraged by steps taken by President Gutiérrez to design and implement a poverty reduction strategy and strengthen the country's social safety net.

### Progress in Colombia

A day earlier in Bogotá, de Rato praised "Colombia's pursuit of sound economic policies" that has allowed it to share fully in the region's best growth performance in a decade. Meeting with President Alvaro Uribe, Finance Minister Alberto Carrasquilla, Banco de la República General Manager José Darío Uribe, and a wide range of legislative and civic leaders on February 16, de Rato pointed to the clear dividends Colombia has drawn from policies pursued under a precautionary Stand-By Arrangement with the IMF. Growth has steadily increased, while inflation has

declined to relatively low levels, the external situation has remained comfortable, and public debt has continued on a downward path.

De Rato welcomed the government's intention to formulate a successor economic program that is expected to again be supported by a precautionary Stand-By Arrangement with the IMF. In doing this, the government was committing itself to firmly entrenching macroeconomic stability, consolidating a sustainable fiscal position, and pursuing key structural reforms to lay the foundation for higher growth, lower unemployment, and reduced poverty.

In particular, de Rato added, the IMF shared Colombia's belief that "sustained fiscal reforms would improve public savings and create room for expanding public and private investment." The IMF is committed to working with countries to ensure that infrastructure needs can be met within the context of overall fiscal sustainability.

### On to Bolivia and Peru

On the next leg of his Andean visit, de Rato was scheduled to meet with Bolivian authorities in La Paz on February 18. He is expected to focus on the challenge of building a stronger consensus in support of critical measures for Bolivia to secure economic stability and growth. Atop the agenda are likely to be the issues of providing an environment for efficient development of Bolivia's hydrocarbon resources so as to raise living standards and of bringing down the country's substantial fiscal deficit and debt.

Finally, in Peru on February 19, de Rato will meet with senior government officials and leaders from a broad range of political parties. Peru had one of the highest growth rates in Latin America in 2004 and is likely to be commended for its economic performance and urged to continue pursuit of fiscal consolidation and growth-enhancing reforms. De Rato is also expected to highlight what can be done to strengthen political consensus for reforms to sustain faster growth and spur poverty reduction. ■



In Bogotá, de Rato talks with a young girl during his visit to Hogar Sagrada Familia and Hogar Comunitario—part of Colombia's efforts to help the most vulnerable.

Jose Miguel Gomez/Reuters

## Azerbaijan sees robust economic growth, but poverty remains

Despite robust growth and relatively low inflation in recent years, combating poverty remains a key challenge in Azerbaijan, the IMF said in its annual economic assessment. In 2000–03, economic growth was driven by foreign direct investment in the oil sector, related spillover effects in the construction and transportation sectors, substantial gains in agriculture following land reform in the mid-1990s, and solid growth in non-oil exports. Prudent macroeconomic policies and some progress in structural reforms also contributed to growth, rising gross international reserves, savings in the Oil Fund, and declining external debt ratios, the IMF Executive Board concluded.

The Board said effective management of the oil revenue surge is an important challenge and welcomed the recent adoption of a long-term strategy targeting a sustainable use of oil wealth and strong growth in non-oil sectors. It further supported the government's decision to increase non-oil fiscal deficits gradually over the next three years, a move consistent with the strategy.

The Board encouraged the authorities to strengthen the implementation of structural reforms, which aim at diversifying the economy, reducing rigidities, and creating an investor-friendly

Azerbaijan	2001	2002	2003	2004	2005
				Projections	
			(percent change)		
Real GDP	9.6	9.7	10.8	7.8	21.6
CPI (end of period)	1.3	3.3	3.6	10.0	5.0
			(percent of non-oil GDP)		
Non-oil fiscal balance	-10.4	-14.9	-16.0	-14.4	-16.8
			(percent of GDP)		
External public debt	20.2	20.1	20.1	17.5	14.6

Data: IMF staff report.

environment. It particularly stressed the importance of enhancing financial and energy sector reforms and improving governance.

The use of the exchange rate as a nominal anchor has served Azerbaijan well, and the overall mix of macroeconomic policies has been appropriate, the Board agreed. To keep inflation low, the Board recommended that the authorities allow upward pressure on the real exchange rate, arising from the targeted rise in non-oil fiscal deficits, to lead to nominal appreciation.

Although some progress has been made in alleviating poverty, the Board urged the authorities to design and implement targeted social assistance and increase pro-poor government spending to cushion vulnerable groups against the adverse impact of reforms. ■

## Lao P.D.R.'s economy rebounds in 2004, but risks linger

The Lao People's Democratic Republic's economy rebounded in 2004 from a number of shocks in 2003, including a drought and the regional impact of the Severe Acute Respiratory Syndrome (SARS). Macroeconomic stability has been restored and poverty has continued to decline, the IMF said in its regular economic assessment. Annual inflation, which had surged into double digits in 2002, has fallen gradually since mid-2003. The IMF's Executive Board welcomed the improved economic management but urged faster progress in mobilizing domestic revenue, improving public expenditure management, restructuring state-owned banks and enterprises, and promoting private sector activity.

Despite some advancement of key structural reforms, the Board stressed more needed to be done, particularly in the fiscal area, given the country's substantial expenditure needs and high public debt. The immediate priority was to address risks to the 2004/05 budget outlook stemming from ambitious revenue targets and substantial increases in wage expenses. The Board encouraged the authorities to strengthen revenue administration by recentralizing tax and customs administrations, and by introducing a value-

Lao P.D.R.	2001	2002	2003	2004	2005
		Estimates		Projections	
				(percent change)	
Real GDP growth <sup>1</sup>	5.8	5.8	5.3	6.0	7.0
Inflation (period average)	7.8	10.6	15.5	11.2	7.8
				(percent of GDP)	
Overall government budget balance (including grants)	-4.4	-4.0	-5.8	-3.9	-4.1
External public debt	68.9	73.2	91.7	84.4	81.4

<sup>1</sup>The government estimates real GDP growth in 2003 to be 5.8 percent. Data: IMF staff report.

added tax in early 2007. It also stressed the importance of improving accountability and monitoring of public spending.

Monetary policy has been restrained over the past year, but the recent rapid expansion of state bank credit could potentially undermine monetary discipline. On exchange rate policy, the Board considered the country's flexible exchange rate system appropriate as long as interventions remain limited to smoothing operations.

The government completed its National Growth and Poverty Eradication Strategy for accelerating growth and improving the living conditions of the poor. These efforts will likely require continued support from the international community. The present arrangement with the IMF under the Poverty Reduction and Growth Facility was approved in April 2001 and extended by one year to April 2005. ■

For more information, refer to Public Information Notices No. 05/2 (Lao P.D.R.) and 05/6 (Azerbaijan) on the IMF's website ([www.imf.org](http://www.imf.org)).



## Latin America set for steady growth

Latin America is poised for sustained economic growth at the recently achieved levels of 4–5 percent a year, if countries continue to pursue sound macroeconomic policies and strengthen the structural reforms that many have begun in recent years, said Anoop Singh, Director of the IMF's Western Hemisphere Department. Speaking at the launch of a new IMF study *Stabilization and Reform in Latin America*, Singh noted that “the region has every reason to be optimistic as it looks and plans ahead,” adding that contained inflation and a strong external environment contributed to the favorable situation.

The study explored why macroeconomic volatility continued during the 1990s and why growth rates in the region hovered below 3 percent a year, while other emerging market regions grew much faster, especially Asia. It concluded that much of the reform efforts and institution-building at the time was undermined by policy inconsistencies, continuing structural rigidities, and corruption. “The emphasis needs to be not on short-term policies but on taking the time to develop the institutional structures that will ensure the sustainability of policy,” Singh said.

What should Latin America do to make the region more crisis resistant? The study cites six priority actions, beginning with **improving fiscal management**. During the 1990s, rising debt ratios were symptomatic of deeper weaknesses in fiscal systems. But the current cyclical upturn has allowed countries to improve policies and has yielded stronger fiscal positions and room in budgets to provide additional support to the poor. Singh added that almost all countries are focusing their policy mix on bringing public debt down and improving its composition to build sustainability, accommodate social spending, support growth, and reduce poverty.

Second, central bank autonomy needs to be increased to bolster the **credibility of inflation targeting**. Many countries

have exited exchange rate systems, adopted inflation-targeting regimes, and taken steps to improve institutional frameworks.

Third, most Latin American countries should continue to **strengthen their financial systems**, revive and sustain credit flows, and create greater resilience to shocks. Financial sector

reforms in the early 1990s often focused on deregulation, privatization, and liberalizing foreign entry but, too often, underlying prudential frameworks proved inadequate to avert crises. “Financial systems have been the sources of vulnerability in the past,” Singh said. “They need to be the sources of growth, and that is the challenge that the region is currently facing.”

Fourth, in the area of structural reforms, countries need to **step up labor market reforms**—an issue that was virtually absent in the 1990s but began to attract attention in recent years. The study found that with greater trade integration and more international competition, labor needs to be able to move across employment sectors. “Those countries that are able to facilitate and bring about shifts between sectors will benefit most from globalization,” Singh said.

Fifth, **the state should refocus its role** in reducing corruption, providing social safety nets, reforming the judicial system, and helping with transitional problems arising from more liberal labor markets. “This is not a laissez-faire world. This is not a world where things are left completely to markets,” Singh said, adding that states also need to set up the legal infrastructure for private investment to take place and for a business environment to thrive.

Finally, the region needs to **expand trade** with the rest of the world. Although most Latin American economies liberalized trade in the late 1980s and early 1990s, the impact in terms of increasing openness was typically limited. In recent years, considerable progress has been made by many Latin American countries in reducing the mismatch between low trade openness and high capital account openness. ■

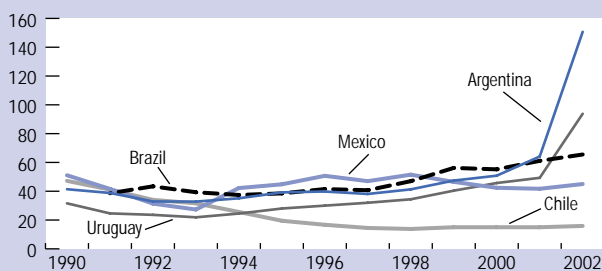


Henrik Schmidt/De Groot/IMF

Singh: “The lesson of keeping inflation low and its importance to bringing poverty down has been well learned.”

### Latin America must lower its public debt

Debt ratios drifted up in the 1990s.  
(percent of GDP)



Data: IMF, *World Economic Outlook* database.

Copies of *Stabilization and Reform in Latin America*, IMF Occasional Paper No. 238, by Anoop Singh, Agnès Belaisch, Charles Collyns, Paula De Masi, Reva Krieger, Guy Meredith, and Robert Rennhack, are available for \$25 each (\$22, academic price) from IMF Publication Services. See page 48 for ordering details.

## Sizing up financial sectors in the Middle East and North Africa

**A** recent IMF study proposes policies that could improve the financial sector's performance in the Middle East and North Africa region. While the study finds that financial development varies considerably across the region, it is clear that more needs to be done to reinforce the institutional environment and promote nonbank financial sector development. Susan Creane, Rishi Goyal, and Randa Sab discussed their main findings and methodology with Jacqueline Irving of the IMF Survey.

**IMF SURVEY:** Compared with most other developing country regions, the Middle East and North Africa performed well

but ranked far behind East Asia. What accounts for this sharp difference in financial sector development?

**CREANE:** We based our regional comparisons on available quantitative data, since the kind of information we used in our more comprehensive index is not easily available over time or for other countries. These data show that for the Middle East and North Africa region, credit to the private sector was about

40 percent of GDP in 2002; in contrast, credit to the private sector in East Asia averaged over 100 percent of GDP. Since both theory and empirical research suggest that the availability of financing spurs growth, these numbers alone are striking.

Our analysis also found that the institutional environment is a key driver of financial development. A look at some of the best-known cross-country databases, such as the *International Country Risk Guide's* ratings or the Heritage Foundation's index of economic freedom, shows that East Asian countries on average score notably above Middle Eastern and North African countries on these variables, including government involvement, protection of property rights, and ease of loan recovery. And, excluding the region's best performers (the Gulf Cooperation Council or GCC countries, Lebanon, and Jordan), the gap is sharply wider.

**IMF SURVEY:** What accounts for the uneven progress on financial sector reforms across the Middle East and North Africa region?

**GOYAL:** The role of the state seems to be key in accounting for the considerable variation across the region. The more finan-

cially developed countries tended to feature smaller or no monetary financing of the fiscal deficit, a smaller degree of public ownership of financial institutions, and greater use of indirect monetary policy instruments such as open market operations. These countries also implemented stronger prudential regulations and supervision of the financial sector; developed higher-quality human resources, including management and financial skills; and maintained a stronger legal environment.

**IMF SURVEY:** You found that the incomplete development or nonexistence of secondary markets for government securities hinders broader use of open market operations by central banks. Does sharia, which forbids the earning of interest under Islamic law, play a role here? Or have some countries developed an Islamic alternative to conventional treasury bills?

**SAB:** Alternative instruments to conventional treasury bills that are compliant with Islamic financial principles have been developed in recent years and are playing important roles in some of the region's countries. Iran has issued Government Participation Certificates for funding government operations, while Sudan has issued central bank and government bills known as Central Bank Musharaka Certificates and Government Musharaka Certificates, respectively. Nevertheless, secondary markets for these instruments remain underdeveloped.

Our paper does not specifically analyze the impact of sharia on financial development, but some countries, such as Sudan, have recently developed quite interesting instruments and markets. Sudan's financial development index rating,

### Constructing new financial development measures

The IMF study surveys IMF country economists on financial development issues in 20 Middle Eastern and North African countries during 2000–03 on six main themes: banking sector development, nonbank financial development, regulation and supervision, financial openness, and institutional quality, as well as the monetary sector and monetary policy. The research team also drew on macroeconomic and financial time-series data from the IMF's *International Financial Statistics* and *World Economic Outlook*, and the World Bank's *World Development Indicators*, as well as measures of institutional development from the PRS Group's *International Country Risk Guide* and the Heritage Foundation. To better assess financial sector development in each country according to the six themes, the authors applied this data to develop new indices that go beyond the simple and "standard" quantitative indicators and monetary aggregates used in the existing literature on financial development in the report.



Stephen Jaffe/IMF

Susan Creane

including on the monetary development theme, improved sharply in our 2002–03 survey, compared with 2000–01, which we associate with the government’s policy of macroeconomic stabilization and reform.

**IMF SURVEY:** To what extent are countries in the region developing sharia-compliant financial products as a means of developing their financial sectors?

**CREANE:** Islamic banking and finance is very important for financial sector development in the region—particularly for those countries, such as Iran and Sudan, where all financial transactions must be done in accordance with Islamic principles. In the majority of the other countries, there are either Islamic banks or windows at conventional commercial banks dealing with Islamic products. In the GCC and some other countries, the rapid global growth in Islamic finance has spurred interest in creating complex Islamic financial products and markets in investment banking, offshore banking, fund management, and Islamic insurance.

**IMF SURVEY:** The region scored relatively well on financial regulation and supervision yet relatively poorly on the strength of institutional environments. Don’t these findings seem somewhat at odds?

**GOYAL:** Countries that performed relatively well on regulation and supervision also tended to rate relatively well on the institutional environment. This was part of a more general pattern where countries at higher levels of financial development, on average, outperformed countries at lower levels for each of the six themes (see box). This finding on relative rankings within each theme should not be surprising: financially more advanced countries were more developed, on average, in every area.

Comparisons across themes are more challenging, since they entail absolute rather than relative rankings and depend on the rating scale as well as data availability. So it is easier to contrast a country’s performance on a particular theme with another country’s performance on the same theme than it is to compare any one country’s performance across two different themes.

Nevertheless, the finding that countries scored relatively well on regulation and supervision, yet relatively poorly on overall institutional strength, may not be all that puzzling when one considers the role of public financial institutions. Countries in which the financial sector is dominated by public sector institutions rated well on regulation and supervision relative to their institutional environment index, arguably because, by definition, such financial systems are regulated and supervised.

Weak institutional environments in many cases reflect inadequate systems for protecting and enforcing property

rights. And some countries with banking sectors dominated by large foreign banks that are supervised by home authorities in countries with more developed financial sectors scored relatively better on financial supervision than on their institutional environments. Also, data limitations constrained us from measuring potentially important differences in countries’ loan classification standards and capital quality.

**IMF SURVEY:** Do your findings point to a prioritization of steps that Middle Eastern and North African countries might take to strengthen their institutional environments?

**SAB:** We do not recommend particular priorities or steps per se, but we do urge them to combine prudent macroeconomic policies with structural reforms.

Macrostabilizing measures, such as following prudent fiscal and monetary policies—including maintaining low inflation—should be complemented by a structural environment that enables financial development. Countries should concentrate their efforts on those areas that have been weakest. For some countries, this means the government should reduce its involvement in the financial system, including by cutting back on public ownership of financial institutions, reducing its intervention in credit allocation, and minimizing monetary financing of budget deficits. At the same time, it should enhance competition, invest in human resources, promote nonbank financial development, and strengthen institutional quality, particularly the legal environment. In several countries, reforms should also seek to improve the quality of the judicial system, reduce bureaucracy, and strengthen property rights. ■



Rishi Goyal



Randa Sab

Copies of *Financial Sector Development in the Middle East and North Africa*, IMF Working Paper 04/201, are available for \$15.00 each from Publication Services (see page 48 for ordering details) or on the IMF’s website ([www.imf.org](http://www.imf.org)).

## India needs deeper reforms to unlock full growth potential

India has emerged as one of the leading economic forces in the world. How can the country sustain high growth rates, while facing large fiscal deficits and debt, rural poverty, and underdeveloped infrastructure? Wanda Tseng, mission chief for India and Deputy Director, and Jerald Schiff, Division Chief for India, both of the IMF's Asia and Pacific Department, spoke with Conny Lotze of the IMF Survey.

**IMF SURVEY:** The fast pace of growth in recent years seems to have been mainly cyclical. How can India sustain higher growth?

**TSENG:** India is one of the fastest growing economies in the world and is certainly looking to continue growing strongly. This momentum is underpinned by dynamism in industry and services, and the emergence of a new investment cycle supported by strong credit growth. Now is really a golden opportunity for India to implement reforms and realize the economy's tremendous potential—growth rates of 8 percent or more. The key reforms include fiscal consolidation to make room for much needed investment in infrastructure and social sectors, greater openness and integration with the global economy, improvements in the business climate, and agricultural and labor market reforms.

**IMF SURVEY:** Are there risks to India's growth prospects?

**TSENG:** On the domestic front, there is the risk of not accomplishing the needed policy reforms—notably the failure to bring the fiscal deficit under control—which could push up interest rates and hold back investment. Externally, higher oil prices pose a risk, as India is heavily dependent on imported oil.

**IMF SURVEY:** Is India's fiscal position sustainable?

**TSENG:** No, but it is no secret that a public sector deficit at 9 or 10 percent of GDP and debt levels of 80 to 85 percent of GDP are not sustainable. There is recognition of this problem, as the recently adopted fiscal responsibility law demonstrated. Although the deficits have been financed with apparent ease, they have held back growth. For example, the fiscal situation has constrained infrastructure investment, which is only half of the Asian average, crowded out private investment, left little room for dealing with exogenous shocks, and made reforms in other areas, such as the financial sector, difficult.

**IMF SURVEY:** But how can the government plan to spend as much as an additional 10 percent of GDP on its social agenda, as laid out in its Common Minimum Program, while staying committed to fiscal consolidation?

### India will benefit from pro-growth fiscal consolidation

Despite high world oil prices and a disappointing monsoon, India's economy is expected to grow at a robust pace after expanding in 2003/04 at its fastest rate in more than a decade, the IMF said in its annual economic assessment, which the authorities have agreed, for the first time, to publish. The IMF's Executive Board praised India's economic resilience but cautioned that large fiscal deficits and public debt remain a key constraint on sustained rapid growth.

The Board welcomed the new government's ambitious reform agenda focusing on creating jobs, reducing rural poverty, and addressing fiscal imbalances. It welcomed the new fiscal responsibility law, in particular the intention to eliminate the current deficit by 2008/09 through front-loaded tax reform and better quality in spending; and it encouraged the authorities to strengthen state finances.

The Board noted that tax revenues needed to be enhanced and lower-priority spending reduced to address India's infrastructure needs, and expressed concern about the proposal to spend foreign exchange reserves on infrastructure. It urged the authorities to attract private sector participation and create jobs by enhancing the invest-

ment and business climate, improving the regulatory framework for public-private partnerships, reducing overregulation, and liberalizing rigid labor laws. Further, the Board said agricultural reform is critical to growth and poverty reduction.

India's balance of payments position remains comfortable, which the Board saw as an excellent opportunity to accelerate trade liberalization. Monetary policy was aimed at curbing inflation pressures while ensuring sufficient liquidity. Exchange rate policy has become increasingly flexible. The Board also encouraged the authorities to step up efforts in building a strong and globally competitive financial sector and thus improve resource allocation.

India	2001/02	2002/03	2003/04	2004/05 <sup>1</sup>
			(percent)	
Change in real GDP at factor cost	5.8	4.0	8.5	6.6
			(percent of GDP)	
Current account balance	0.7	1.2	1.7	-0.2
Central government balance	-6.3	-6.0	-5.1	-5.0
General government balance	-10.1	-9.6	-9.7	-9.3

Note: Data are for April-March fiscal years.

<sup>1</sup>Staff estimates for 2004/05.

Data: IMF staff report.



**TSENG:** The authorities are aware that the goals of its agenda can only be achieved over the long term and would require massive investments, both public and private. So, they need to create fiscal space, especially by raising revenue and reducing inefficient spending such as subsidies. They also need to involve the private sector in infrastructure financing and attract more foreign direct investment [FDI].

**IMF SURVEY:** [The fiscal responsibility law does not cover state finances. How can fiscal discipline be achieved at both central and state levels?](#)

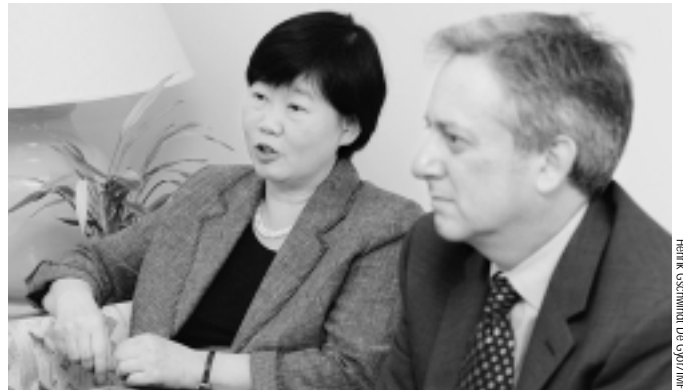
**SCHIFF:** The fiscal responsibility law is a good step, but it is not perfect. There are a number of states that have enacted their own fiscal responsibility legislation, but more needs to be done. States still account for about half of the general government deficit. Also, the government plans large increases over time in infrastructure and social spending, which are the purview of the states. So the pressure on states to improve their fiscal positions will only intensify. A critical step will be to implement the value-added tax in the states on April 1 as planned. Other important areas for reform include the power sector, where subsidies are sizable and inefficient, and state pension schemes, which are a rising burden on states.

**IMF SURVEY:** [Why the opposition to the proposal for using the Reserve Bank of India's foreign exchange reserves to finance infrastructure?](#)

**TSENG:** The infrastructure gap needs to be closed. But we wonder whether this is the best way to do so. First, this approach would require raising the fiscal deficit ceiling, which could undermine the credibility of the fiscal responsibility law in its very first year of existence. Second, it could compromise perceptions about central bank independence and reverse the good progress made in recent years in lowering inflation expectations and interest rates. Third, experience has shown that once business constraints are removed, properly packaged infrastructure projects could attract private investment.

**IMF SURVEY:** [What are the reasons for India's services sector boom?](#)

**SCHIFF:** There are a number of factors behind the boom in India's services sector. Technological advances, which have allowed services to be delivered at great distances, have, of course, encouraged outsourcing. This is an area where India is a world leader. Domestic demand for services is also rising as incomes grow. However, policies have also played a key role. The services sector has been less heavily regulated and taxed than other sectors. We found that particular services grew much faster once they were open to FDI, trade, or private ownership. This can serve as a model for other parts of the Indian economy.



Henrik Gschwind De Goo/IMF

Tseng (with Schiff): "A public sector deficit at 9 or 10 percent of GDP and debt levels of 80 to 85 percent of GDP are not sustainable."

**IMF SURVEY:** [How can India create the 110 million new jobs it will need over the next 10 years, given its demographics?](#)

**SCHIFF:** The growth of the service sector will have only a modest impact on employment. Even the most optimistic assumptions point to the IT sector employing some 2 million people by 2008, less than 1 percent of the labor force. The type of job creation India needs will have to happen primarily in labor-intensive manufacturing. Hence, India needs to pursue the reform agenda. Labor market reforms, in particular, are needed for India to reap the benefits of trade openness.

**TSENG:** And a major shift in jobs away from agriculture is rather unrealistic. About 60 percent of the population work in agriculture, producing  $\frac{1}{4}$  of GDP. So there is room to increase productivity. It makes perfect sense that the government is focusing on enhancing rural infrastructure. Incentives for farmers to diversify and export more also need to be improved.

**IMF SURVEY:** [Why is FDI in India so much lower than in other emerging markets, for example, China?](#)

**SCHIFF:** The government has made attracting FDI a priority and has removed several restrictions recently. India's FDI regime is no longer particularly restrictive by international standards. The problems lie much more with the overall quality of the business climate, for example, cumbersome regulation. But in many areas, improvements have been made, and a number of investor surveys indicate that India will be one of the top two or three destinations for FDI in coming years. So pushing ahead on reforms now would have a big payoff later. ■

For more information, refer to IMF Public Information Notice No. 05/12 on the IMF's website ([www.imf.org](http://www.imf.org)).

## The new Russian Revolution?

**A**t the start of 2001, Russia lowered personal income tax rates dramatically by establishing a single rate of 13 percent. Tax revenues from personal income tax soared that year, leading advocates of the reform to claim that the tax cuts had more than paid for themselves. But was it the cut in tax rates that caused the increase in tax revenues? Prakash Loungani of the IMF Survey interviewed Michael Keen and Anna Ivanova of the IMF, who have just coauthored with Alexander Klemm one of the first studies to answer that question.

**IMF SURVEY:** Why do you call this “arguably the most important tax reform of the past decade”?

**KEEN:** Whenever you have a lowering of tax rates followed by an increase in tax revenues, it grabs a lot of attention. This pattern fits in with the flat tax agenda, whose most extreme advocates—in the United States and elsewhere—claim that you can raise tax revenue by cutting tax rates. Given Russia’s leadership role among the transition economies, the reform has been much emulated there, for instance in Ukraine, Slovakia, Georgia, and Romania.

**IMF SURVEY:** Why did the Russian government feel the need to implement a single tax rate of 13 percent?

**IVANOVA:** Tax evasion has been widespread in Russia. And the system was not very fair, because taxes were paid by honest low-income taxpayers, but high-income taxpayers managed to avoid their taxes. By introducing a flat tax the government hoped that those who had been avoiding tax obligations would have a greater incentive to pay taxes, and thus the tax system would actually become fairer. Improving tax compliance was one of the big objectives of this reform.

**IMF SURVEY:** How did you go about trying to study the effects of the reform?

**KEEN:** A panel survey of over 3,500 Russians gave us their reported after-tax incomes before and after the reform. We used that reported income to figure out the taxes they would

have paid in the year 2000, before the reform, and in 2001, a year after the reform.

Using these imputed—rather than actual—tax payments is no doubt a big limitation. But it is reassuring that the key features of our data match the official aggregate statistics very closely. The average wage in the survey matches the average wage for the Russian population as a whole reported in official statistics. And, strikingly, the increase in income tax revenues among the people in our survey is virtually identical to the increase reported by Russian tax authorities for the economy as a whole. That suggests that our sample probably does represent a reasonable microcosm of what was going on in the country at large.

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**IMF SURVEY:** What technique did you use to isolate the effects of the tax reform?

**IVANOVA:** We used a difference-in-difference approach—a technique similar to the treatment and control group method that is used to isolate the effects of a new drug. For people at the lower end of the income distribution, the tax rates were essentially unchanged after the reform. Any changes in tax payments among people in this group cannot, therefore, be attributed to the tax reform. They became our control group. For taxpayers at the upper end of the distribution, tax rates were much lower after the reform than before. That was our treatment group. Then we estimated by how much tax payments, income, and labor hours have changed for the treatment group compared with the control group after the reform.

**IMF SURVEY:** And you found?

**KEEN:** The complete opposite of what the more extreme flat tax advocates would have predicted: Tax payments went up noticeably more for the control group than for the treatment group. That’s quite strong evidence to us that the surge in tax revenues that Russia experienced must be due to something other than the tax reform. Why else would tax revenues have gone up among the control group that experienced little if any change in tax rates?



Michael Spilbrin/IMF

The surge in tax revenues that Russia experienced must be due to something other than the tax reform. Why else would tax revenues have gone up among the control group that experienced little if any change in tax rates?

—Michael Keen

**IMF SURVEY:** Did the reform improve tax compliance as had been hoped?

**KEEN:** Yes, we do find some indirect evidence of that. Our estimate of compliance is derived by comparing reported incomes with reported consumption. If consumption—how much people say they are spending—is higher than the income they are declaring, they probably have some sources of income they are not telling you about. So we take consumption as a better indicator of someone's true income than the number they happened to report as their income in the survey. If the gap between income and consumption narrows, we treat that as evidence of increased compliance.

We find that after the reform, the gap narrowed much more for the treatment group than for the control group. To us, that's indirect evidence of increased compliance among the treatment group—that is, among the high-income individuals. But even after we allow for this improvement in tax compliance, our main finding holds: there is still no evidence that tax revenues went up by more in the treatment than in the control group.

**IVANOVA:** Moreover, the increase in compliance might have been due not to the reduction in the tax rate itself but to changes in other parts of the tax code that took place at the same time and the administrative changes intended to improve enforcement and compliance.

**IMF SURVEY:** OK, so there were big increases in reported tax revenues in both the treatment and control groups. If these are not a result of the tax reform, what accounts for them?



Michael Slobin/IMF

The contribution of higher oil prices to the overall growth of the economy can explain why wages went up and why tax revenues went up.

—Anna Ivanova

**IVANOVA:** Answering that question was not the main focus of our research, but our view is that the big increase in reported tax revenues simply reflects overall economic growth and, perhaps, some changes in the labor market. When you look at the macro evidence, you see that wages grew very fast across the whole population, just as they did for people across our sample. We also see that almost all sources of tax revenues increased that year, not just the revenues from the personal income tax—that, too, suggests a common underlying explanation. The obvious candidate behind all these developments is the increase in oil and gas prices that took place around that time. The contribution of higher oil prices to the overall growth of the economy can explain why wages went up and why tax revenues went up.

**IMF SURVEY:** Has there being any reaction from Russian officials to your study?

**KEEN:** I believe they are aware of our work, but we haven't had any reaction.

**IVANOVA:** I think the government views the reform as successful and, as we were discussing earlier, other countries have adopted it too, presumably because they view it as a success. But it is interesting that the Russian government itself is reportedly considering moving back from a flat tax to a somewhat more progressive system. ■

Copies of IMF Working Paper No. 05/16, *The Russian Flat Tax Reform*, by Anna Ivanova, Michael Keen, and Alexander Klemm, are available for \$15.00 each from IMF Publication Services. See page 48 for ordering details. The full text is also available on the IMF's website ([www.imf.org](http://www.imf.org)).



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## Price variability of life annuities adds a wrinkle to retirement planning

Life annuities are a little used but potentially sound investment for retirees, particularly for those who lack an employer-provided or public pension. With these annuities projected to become more popular in the future, retirees will need to know much more about them. One key thing to keep in mind, says Sandy Mackenzie of the IMF's Research Department, is that the price of, or premium on, these annuities can fluctuate substantially. That can complicate retirement planning—and even entail hardship.

Why have life annuities attracted so little interest? For one thing, demand for private annuities—which are normally funded and underwritten by life insurance companies—has been crowded out by public pensions. Potential annuitants have also been discouraged by a lack of familiarity with and an understanding of this unusual financial instrument.

Cost can be another factor. Annuities are typically bought by people who expect to live longer than the average. Insurance companies take this into account in pricing annuities, making them relatively unattractive for the population at large. And, finally, tax systems often favor housing and other investments that compete with annuities.

### What is a life annuity?

In return for a large up-front payment, nominal life annuities pay recipients a fixed sum, usually monthly, for the rest of their lives. Annuities provide longevity insurance, furnish a predictable income, and impose discipline on the recipient's spending, since control of the capital is ceded once an annuity is set up.

An indexed life annuity would also provide inflation insurance. The typical public pension system, for example, pays an indexed life annuity. The combination of inflation insurance and longevity insurance is very valuable. At present, however, private financial institutions offer indexed annuities in only a few countries, including Chile, Israel, and the United Kingdom, where the governments have issued indexed debt and have thus assumed the risk of inflation.

Finally, for the long-lived, the return on a life annuity should exceed the rate of return of the financial instruments that back it. The annuity provider pools premiums from a group of annuitants, invests them in bonds, and makes payments only to those who survive from one year to the next. No payments are made to the estates or families of the deceased.

That said, in many countries some fundamental trends are at work that are expected to boost the demand for annuities over time:

- **Demographic changes.** The absolute number of the elderly and their share in the population in advanced and most emerging market economies will grow rapidly in the first half of the 21st century.

- **Pressure on public pensions.** Demographic shifts are expected to exert substantial pressure on public pension systems. This will likely result in cuts in retirement benefits. The adoption of individual accounts could also entail cuts in the public benefit (depending on how payouts from the accounts are regulated).

- **A decline in defined-benefit pensions.** In countries like the United States and the United Kingdom, employer-provided defined benefit plans are becoming an endangered species. As defined-contribution pension plans become more common, annuities are likely to become—by choice or requirement—a more important source of retirement income.

### Premium variability

Assuming that more elderly people seek, or are forced to seek, life annuities, there is still the matter of fluctuations in annuity prices or premiums. Insurance companies fund annuities with a combination of bonds and equities—in the United States, annuities are backed mainly by bonds. The premium paid per dollar of regular income would in principle be expected to vary with what economists call the yield curve—that is, the relationship between the rate of interest and the maturity of the interest-bearing security.

The yield curve normally slopes upward. When it shifts up across all maturities (or most of them), the premium per dollar of payment goes down, and vice versa. Annuity providers may try to stabilize premiums to gain market share, so premiums may not move in lockstep with interest rates. Over time, however, there is a clear relationship between interest rates and the premium per dollar of income.

People nearing retirement are well advised to obtain a large share of their income from a stable source. Traditionally, a public pension performed this function for many people. With the probable decline in public pensions over time, however, the income of retired people may become both more variable in amount and less guaranteed over time. Annuities may provide a reasonable substitute for public pensions, but





Older people may increasingly need to turn to life annuities for a steady stream of retirement income.

without the steady predictability or, unless they are indexed, the inflation insurance that public pensions had provided.

### Planning for uncertainty

The price that must be paid for a certain amount of income can vary substantially. By one estimate, in the 1980–93 period, U.S. life annuity prices, or premiums, for 65-year-old men varied from as little as \$97,000 to as much as \$130,000 for a monthly income of \$1,000 (see IMF Working Paper 04/230). For 1990–2002, an IMF study relying on an indirect estimate based on the yield curve found that there was a 20 percent chance that premiums might be either 10 percent or more above their average or 10 percent or more below their average. The apparent decline in variability from the earlier period is likely attributable to the fact that nominal interest rates were less variable in the later period. Of course, the variability of annuity premiums, in and of itself, does not make them fundamentally different from other financial instruments. What is different is that annuities may be called upon to replace some or all of a relatively stable source of income, like a public pension.

Given the potentially valuable role that life annuities can play as a source of retirement income, is there some way to reduce premium variability or mitigate its effects? One possible step is to stagger the purchase of annuities over several years. This strategy could reduce premium volatility, but at a cost. Buying several smaller annuities is likely to cost more than buying one big annuity. Another strategy might be to defer the purchase of the annuity. Premiums should decline

as the annuitant ages, but here, too, the option comes with potential costs. The money that would have bought the annuity will need to be temporarily parked in an investment that normally would have a lower yield than the annuity. And neither strategy guarantees a low or even a moderate premium.

For retirees for whom life annuities are the sole or an increasingly important source of retirement income, the irreducible unpredictability of annuity premiums will have to be dealt with. And that means basing retirement planning on conservative assumptions. To avoid unpleasant surprises, retirement planning should assume that premiums will be above their recent average. This, in turn, means that people will have to save more for retirement. And it also means that in the years leading up to retirement, people—or their financial advisor, if they can afford one—will need to become thoroughly acquainted with annuities, and with indexed annuities, if a market develops for them.

The good news is that the financial environment in most countries has been stable, and severe fluctuations in annuity premiums appear unlikely. Moreover, as the annuity market develops, competition may increase, and premiums may decline over time. It is also possible that annuity products may come to differentiate among classes of the population according to their life expectancy, much as life insurance does. This will make annuities more affordable for groups with lower than average life expectancy, who tend to be less well off.

Annuities may provide a reasonable substitute for public pensions, but without the steady predictability or, unless they are indexed, the inflation insurance that public pensions had provided.

—Sandy Mackenzie

So the moral of the story for retirees is that life annuities can indeed play a valuable role in providing secure income, but careful, and conservative, planning must take account of premium variability. There is a moral for governments, too. A stable financial environment may be particularly helpful to retirees, who vote and whose numbers are on the rise just about everywhere. ■

Copies of IMF Working Paper 04/230, *Can the Private Annuity Market Provide Secure Retirement Income?* by G. A. Mackenzie and Allison Schrage, are available for \$15.00 each from IMF Publication Services. See page 48 for ordering details. The full text is also available on the IMF website ([www.imf.org](http://www.imf.org)).

## New tools to help gauge financial soundness

Statistical coordinators and compilers from about sixty countries met late last year in Washington, D.C., to launch a Coordinated Compilation Exercise that is intended to catalyze the collection of cross-country comparable Financial Soundness Indicators (FSIs). These indicators, which assess weaknesses and strengths in countries' financial systems, alert national authorities to potential threats and help the international community and the IMF safeguard the stability of the international financial system.

After the Asian and other financial crises of the late 1990s, it was clear the world needed new tools to detect vulnerabilities in financial systems. The IMF developed a broad set of indicators and analytical techniques under the general rubric of "macroprudential analysis." FSIs are a part of this new tool kit. This set of core and encouraged indicators, developed in cooperation with experts and with inputs from countries, is designed to evaluate the health of a country's entire financial system, in contrast to bank prudential indicators, which help gauge the well-being of individual institutions.

Once the set of indicators was agreed upon, however, there was still the matter of how the IMF could help countries develop their capacity to compile these indicators, and what the IMF could do to promote cross-country comparability of FSIs, coordinate the compilation efforts of national authorities, and disseminate the FSIs to increase transparency and strengthen market discipline. All of these tasks fell to a Coordinated Compilation Exercise endorsed by the IMF's Executive Board.

A first step was the preparation of a *Compilation Guide on Financial Soundness Indicators* by IMF staff, which reflected the consensus of experts as well as the comments of the public. The *Guide* sets definitions and provides guidance on how indicators should be compiled and disseminated. It discusses in detail the set of 12 core indicators, which cover the banking sector. Also discussed are the 27 encouraged indicators for the banking and other sectors. The practicality and relevance of these encouraged indicators, the *Guide* acknowledges, may vary across countries.

Once the *Guide* was finalized, the IMF's Executive Board recommended that a Coordinated Compilation Exercise be undertaken in support of country compilation efforts. The exercise was conceived as a pilot project that would involve

some 60 member countries of the IMF. Participation, which was by invitation and voluntary, entailed a commitment to compiling and submitting to the IMF at least the core set of indicators for year-end 2005 data.

Participating countries were encouraged to use the *Guide's* recommendations as far as possible in compiling their indicators, as this would contribute to greater cross-country comparability. But flexibility was built in, too, with countries permitted to use existing methodologies. Given this flexibility, the exercise will also prepare "metadata"—that is, textual descriptions of the methodology and compilation practices

actually used in compiling the FSIs (and which may differ from those recommended in the *Guide*). The IMF will publish the data and metadata on FSIs in one release by end-2006.

With the broad goals of the exercise in place, the IMF's Statistics Department convened a meeting in Washington, D.C., on November 18–19, 2004, to give participants the opportunity to discuss and finalize the specific terms of

reference for the exercise. Participating countries also gave feedback to IMF staff on the draft report forms that will be used by their countries to disseminate FSI data and metadata. The results of a staff survey of current FSI compilation practices served as the starting point for the exercise.

The meeting also provided participants with the opportunity to benefit from each others' views and experiences. One issue that featured prominently was the trade-off between flexibility in using national practices in the compilation of FSIs and the potential gains from producing cross-country comparable FSIs on the basis of the *Guide*.

By end-March 2005, countries will send the IMF an interim progress report, including the first draft of FSI metadata using the standard report form. In addition to continuous consultation by correspondence, regional meetings will be held in mid-2005 and mid-2006. The regional meetings in 2005 will focus on further progress under countries' work programs, while the regional meetings planned in 2006 will discuss the penultimate draft FSI metadata and preliminary FSI data. ■

Andreas Georgiou, Russell Krueger, and Xiuzhen Zhao  
IMF Statistics Department



Stephen Jaffe/IMF

Participants from about sixty countries met to finalize the terms of reference for the coordinated exercise.

## Stand-By, EFF, and PRGF arrangements as of January 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
(million SDRs)				
<b>Stand-By</b>				
Argentina	September 20, 2003	September 19, 2006	8,981.00	4,810.00
Bolivia	April 2, 2003	March 31, 2005	128.64	26.80
Brazil	September 6, 2002	March 31, 2005	27,375.12	10,175.48
Bulgaria	August 6, 2004	September 5, 2006	100.00	100.00
Colombia	January 15, 2003	April 14, 2005	1,548.00	1,548.00
Croatia	August 4, 2004	April 3, 2006	97.00	97.00
Dominican Republic	January 31, 2005	May 31, 2007	437.80	385.26
Gabon	May 28, 2004	June 30, 2005	69.44	27.78
Paraguay	December 15, 2003	September 30, 2005	50.00	50.00
Peru	June 9, 2004	August 16, 2006	287.28	287.28
Romania	July 7, 2004	July 6, 2006	250.00	250.00
Turkey	February 4, 2002	February 3, 2005	12,821.20	907.20
Ukraine	March 29, 2004	March 28, 2005	411.60	411.60
Uruguay	April 1, 2002	March 31, 2005	1,988.50	139.80
<b>Total</b>			<b>54,545.58</b>	<b>19,216.20</b>
<b>EFF</b>				
Serbia and Montenegro	May 14, 2002	May 13, 2005	650.00	187.50
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
<b>Total</b>			<b>794.40</b>	<b>311.23</b>
<b>PRGF</b>				
Albania	June 21, 2002	June 20, 2005	28.00	8.00
Azerbaijan	July 6, 2001	July 4, 2005	67.58	12.87
Bangladesh	June 20, 2003	June 19, 2006	400.33	251.83
Burkina Faso	June 11, 2003	June 10, 2006	24.08	17.20
Burundi	January 23, 2004	January 22, 2007	69.30	42.90
Cape Verde	April 10, 2002	April 9, 2005	8.64	2.49
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Congo, Democratic Republic of	June 12, 2002	June 11, 2005	580.00	53.23
Congo, Republic of	December 6, 2004	December 5, 2007	54.99	47.13
Dominica	December 29, 2003	December 28, 2006	7.69	4.71
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	June 4, 2004	June 3, 2007	98.00	70.00
Ghana	May 9, 2003	May 8, 2006	184.50	105.45
Guyana	September 20, 2002	September 12, 2006	54.55	37.06
Honduras	February 27, 2004	February 26, 2007	71.20	50.86
Kenya	November 21, 2003	November 20, 2006	225.00	150.00
Kyrgyz Republic	December 6, 2001	April 5, 2005	73.40	9.56
Lao People's Democratic Republic	April 25, 2001	April 24, 2005	31.70	13.58
Madagascar	March 1, 2001	March 1, 2005	91.65	11.35
Mali	June 23, 2004	June 22, 2007	9.33	8.00
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Mozambique	July 6, 2004	July 5, 2007	11.36	9.74
Nepal	November 19, 2003	November 18, 2006	49.91	35.65
Nicaragua	December 13, 2002	December 12, 2005	97.50	41.78
Rwanda	August 12, 2002	August 11, 2005	4.00	1.71
Senegal	April 28, 2003	April 27, 2006	24.27	17.33
Sierra Leone	September 26, 2001	June 25, 2005	130.84	14.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	29.40
Tanzania	August 16, 2003	August 15, 2006	19.60	11.20
Uganda	September 13, 2002	September 12, 2005	13.50	6.00
Zambia	June 16, 2004	June 15, 2007	220.10	55.02
<b>Total</b>			<b>3,326.40</b>	<b>1,616.42</b>

EFF = Extended Fund Facility.

PRGF = Poverty Reduction and Growth Facility.

Figures may not add to totals owing to rounding.

Data: IMF Finance Department.

## Many countries still lack a fully transparent budget process

How open are governments about their budgets? This question was at the core of a survey of 36 developing and transitional countries designed by The International Budget Project (IBP), a nonprofit group working with civil society organizations, to evaluate public access to accurate, comprehensive, and timely budget information. Overall, the report found that most countries freely provide information on the government's budget proposal but have a much harder time when it comes to providing access to monitoring reports and involving the public or legislatures in the budget process.



“Civil society is very keen to get access to budget documents so it can evaluate the government's policy intentions, its policy priorities, and their implementation,” said IBP analyst and the study's lead author Pamela Gomez during a recent presentation to IMF staff. “Public access to budget documents is essential to ensure that governments are financially accountable.”

In the three categories measured, most countries (26) fared best in the first category, which examined the information the executive branch made available in its budget proposal to the legis-

lature. The countries scoring negatively in this category usually do not provide multiyear budgets and/or comprehensive information such as government assets, tax expenditures, and extra-budget funds.

In the second category, which examined the information provided in monitoring reports, few countries (12) fared well, according to the IBP report. Many countries fail to provide midyear reviews to assess budget implementation, and either provided incomplete information or no year-end report at all. This raised serious concerns because a year-end report should serve as the government's key accountability document, according to the IBP.

But the weakest aspect of the budget process in most countries surveyed (28) concerns the executive's failure to facilitate public understanding and discourse on the budget. Most executives fail to provide adequate and transparent information, and official avenues for legislative and public input in the budget process tend to be lacking. For example, only five countries provide significant information about the distribution of tax burdens, essential to an informed debate on how existing and proposed revenue policies affect various income groups, and only six countries produce a “citizens budget,” the nontechnical presentation of the budget designed for a broad audience.

The IBP questionnaire, which was completed by nongovernment researchers in the surveyed countries, primarily regarded the content and timeliness of public budget documents, based on international good and best practice guidelines, and did not go into the quality of budget information. The IBP, which is part of the Washington-based nonprofit Center on Budget and Policy Priorities, plans to expand the initiative to 60 countries.

For more information, please refer to [www.internationalbudget.org](http://www.internationalbudget.org). ■



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### Limited transparency

Countries typically freely make their budget proposals available to the public but provide little additional budget information.

	Number of countries	Percent of total
Pre-budget statement	19	53
Executive budget proposal	35	97
Citizens budget	6	17
In-year monitoring reports	27	75
Mid-year review	17	46
Year-end evaluation reports	29	81
Audit reports	24	67

Data: International Budget Project.

Note: The 36 countries surveyed were Argentina, Azerbaijan, Bangladesh, Bolivia, Botswana, Brazil, Bulgaria, Burkina Faso, Colombia, Costa Rica, Croatia, Czech Republic, Ecuador, El Salvador, Georgia, Ghana, Honduras, India, Indonesia, Jordan, Kazakhstan, Kenya, Malawi, Mexico, Mongolia, Namibia, Nepal, Nicaragua, Peru, Poland, Romania, Russia, Slovenia, South Africa, Uganda, and Zambia.