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Rato sees continued strong global growth despite recent rise in oil prices

The IMF remains positive about prospects for strong global growth in 2004 despite recent sharp increases in oil prices, the institution's new Managing Director Rodrigo de Rato told reporters on June 9. Speaking at his first press conference since formally assuming his duties two days earlier, Rato noted that increasing strength in parts of the world economy and rising demand are likely to compensate for oil prices that are now $5 a barrel higher than forecast in the IMF's April *World Economic Outlook*. Spring projections had global growth at 4.6 percent in 2004, and, Rato said, "we don't see a risk that will be revised downward."

In opening remarks to the journalists, Rato reiterated that he is "deeply honored" to have the opportunity to lead the IMF. Although important challenges await both him and the IMF, he expressed confidence that the institution can contribute to its members' well-being—particularly through "high-quality, independent macroeconomic policy advice" and financial support when needed.

Rato took questions from the press at IMF headquarters on June 9.

Rato's first week in office was spent in meetings with senior staff and the three Deputy Managing Directors, and chairing a session of the Executive Board. He indicated that he would be traveling to seek the views of the IMF's member countries. Later in June, he will visit Japan, China, Singapore, and Vietnam. Trips to Africa and Latin America are scheduled before the IMF's fall annual meeting and to other regions thereafter.

What should the IMF's role be?

Should the IMF focus on macroeconomic matters and mitigating financial crises and leave development work to others, notably the World Bank and regional development banks? The question, posed by one reporter but echoing an ongoing debate among shareholders and academics, drew a forceful reply from Rato. There will be few opportunities to reduce poverty without macroeconomic stability and growth, he said, adding that he was not one of those who think development is one thing and macroeconomic stability, another.

The IMF, Rato observed, has the specialized capacity to help countries overcome crises and design financial policies. It also has expertise that can be used to collaborate with other organizations. Different international and regional institutions have different mandates, he said, but "we are all working in the same direction." In the area of trade, which is a clear prerequisite for development and growth, the IMF is collaborating not only with the WTO [World Trade Organization] but also providing technical assistance to countries to help them cope with complicated negotiations and the new rules of open economies.

Argentina and its creditors

Reporters also pressed Rato for his views on the status of Argentina's recovery and ongoing debt negotiations. The Managing Director complimented the country's "better than expected" macroeconomic performance but underscored that more progress is needed in key areas if the country is to put the crisis behind it. Here he pointed to the need to keep working on fiscal agreements with the provinces, the closing of an agreement with all creditors, the strengthening of the financial system, and a legal and administrative environment that *(Please turn to the following page)*

Rato sees UN action on Iraq as important step

(Continued from front page) will be helpful for private investment. An IMF team, Rato added, will shortly be going to Buenos Aires and will be working with the authorities to determine the degree of progress that has been made and "how we should proceed in the future."

Iraq and the IMF

Could the UN Security Council's endorsement of a sovereign interim government in Iraq pave the way for IMF postconflict assistance? The UN action, Rato said, clearly is "a very important step regarding the future of the new Iraqi Government" and the collaboration the IMF will have with it. The passing of the resolution will facilitate the international recognition of the interim government—a step required for a normalization of Iraq's relations with the IMF. Emergency Postconflict Assistance could be the first step in IMF financing assistance; technical assistance and training programs are already being provided on a wide range of issues. ■

The full transcript of Rodrigo de Rato's press briefing on June 9 is available on the IMF's website (*www.imf.org*).

Regional and bilateral free trade schemes should be pursued with caution

In recent years, the United States has embarked on a strategy aimed at establishing regional and bilateral trading arrangements with partners spanning the globe. What are the costs and benefits associated with these arrangements? In an IMF Working Paper, Alvin Hilaire and Yongzheng Yang of the IMF's Policy Development and Review Department lay out the main issues. Christine Ebrahim-zadeh of the IMF Survey *spoke with them.*

Hilaire: Regional arrangements are likely to offer the greatest benefits and to entail the least trade diversion if they cover a wide range of products and include a diverse group of countries.

IMF Survey: Are bilateral and regional trade agreements—rather than multilateral agreements—driving U.S. trade policy?

Hilaire: U.S. trade policy is running along three parallel tracks. The first entails lowering tariffs on imports from certain countries without requiring a commensurate reduction in these countries' tariffs, as is the case with sub-Saharan African countries under the African Growth and Opportunity Act. The second, multilateral, track involves proposals under discussion at the World Trade Organization's Doha Round. And the third track, which has gained increasing momentum, focuses on bilateral and regional free trade agreements (FTAs). What is driving U.S. trade policy is a set of three goals: increasing U.S. exports of goods and services, enhancing the investment climate abroad, and cementing geopolitical and security links. This last element is especially relevant with regard to the Middle East, where the United States is rigorously pursuing FTAs.

IMF Survey: Does the energy the U.S. expends on bilateral or regional arrangements come at the expense of a more vigorous push on multilateral trade negotiations?

Yang: There is no simple answer to this question. On the one hand, arguments have been made that competition for bilateral and regional trade arrangements creates incentives for countries to liberalize in the context of these agreements, which, in turn, favors deeper liberalization in the context of multilateral negotiations. Proponents of this view argue that "competitive regionalism" can catalyze global trade liberalization. It is often said that the establishment of the North American Free Trade Agreement (NAFTA) helped to move the earlier Uruguay Round forward when it was at a crossroads.

On the other hand, some observers worry that regional approaches to trade liberalization could weaken incentives for multilateral liberalization, and there are few signs yet that the recent push for regional arrangements has helped the Doha Round. Indeed, with the current round at a critical juncture, many countries seem to be following the U.S. lead and are placing increasing emphasis on bilateral or regional FTAs, possibly reducing the urgency to work toward a breakthrough at the multilateral level.

IMF Survey: A standard argument against preferential trade arrangements is that trade may be diverted away from lower-cost suppliers that are not members of the arrangement. How great a concern is this?

Hilaire: This could be of major concern to nonmembers, because they may see a sharp dip in their exports to members, depending on the level of tariffs levied on their goods. But this is not the whole story—consumers in a member country may indeed be able to pay less for imports (since these goods no longer bear tariffs from partner countries)—but these goods replace the lower-cost ones on which the government used to collect revenue. So the country may end up worse off when the loss in revenue is consid-

ered. Furthermore, later on, when preferential treatment is eroded because of subsequent multilateral liberalization or other preferential arrangements, the country may face considerable adjustment costs in attempting to regain competitiveness.

IMF Survey: Is this your only concern?

Yang: Apart from the trade diversion issue, we have several other concerns. First, negotiating regional or bilateral arrangements can be quite time-consuming and difficult, and small nations may find it difficult to cope with these demands while, at the same time, participating fully in multilateral trade talks. Second, there is a danger of trade blocs forming that would raise barriers against each other and marginalize small countries; this runs the risk of fragmenting global trade. Third, countries may become vulnerable if they come to depend on preferential arrangements that could be withdrawn or become less important as other partners enter. Fourth, a plethora of sometimes overlapping trade agreements can carry considerable administrative costs and lead to confusion because of the need to negotiate and police separate agreements. Jagdish Bhagwati refers to this as the "spaghetti bowl" effect. Fifth, the inclusion of additional elements—such as labor standards, environmental issues, intellectual property rights, and capital movements—in trade treaties may work to restrict trade and hinder development, especially for poor countries in which institutions are weak.

IMF Survey: Can regional or bilateral arrangements be structured to maximize their benefits?

Hilaire: Regional and bilateral arrangements are no substitutes for multilateral liberalization. They are not going to go away, however, and may even proliferate further. Regional arrangements are likely to offer the greatest benefits and to entail the least trade diversion if they cover a wide range of products and include a diverse group of countries. Many free trade agreements already cover manufactured products; the inclusion of services and agricultural goods may bring even greater benefits. Also, if it is carefully managed, developing countries stand to gain from integration with developed countries—not only through trade but also through positive spillover effects on investment and the business climate. Similarly, FTAs may play an important role in helping lock in broader reforms, such as in the legal environment and customs administration.

IMF Survey: Do U.S. bilateral and regional trade arrangements meet these criteria?

Yang: Yes, they meet several of the criteria. For example, the Free Trade Agreement with Central American countries (CAFTA) provides broad market access for goods and services and includes strong rules on investment, government procurement, and competition policy. But there are long transition periods for several agricultural products; tariffs will persist on some sensitive imports; and the rules of origin for textile products are quite restrictive.

Going forward, two major challenges remain for the United States. One is to ensure that the pursuit of FTAs does not undermine the momentum for multilateral liberalization, which we consider to be the first-best policy. The other is to tailor FTA rules to suit the needs of developing countries. That will mean avoiding excessive labor and environmental standards and refraining from using trade remedies—safeguard, antidumping, and countervailing measures—as a protectionist instrument.

U.S. free trade agreements

Existing	Year of agreement
Israel	1985
Canada	1993
Mexico	1993
Jordan	2001
Singapore	2003
Chile	2003
Morocco[1]	2004
Central America[1]	2004
Australia[1]	2004
In the works	Expected date
Southern Africa	2004
Bahrain	2005
Egypt	2005
The Americas	2005

[1]These have been signed but not yet ratified.

IMF Survey: In your study, you carry out simulations of U.S. FTAs with Chile, Central America, and Australia. Why did you choose these three, and what did you find?

Hilaire: The three arrangements cover an interesting range of countries from which we thought we could draw important lessons. Chile already had low tariffs and a number of bilateral FTAs; the group of Central American countries already had strong trade ties with the United States; and Australia was geographically remote but had a strong interest in agricultural exports and investment relations with the United States.

What our study highlights is that, for the United States, the gain from each agreement is small but positive. With its large size and diversified trade structure, the United States suffers little from trade diversion. U.S. trading partners' exports rise in industries where they have comparative advantages, but they do also experience some welfare losses from trade diversion. In addition, nonmembers of the new agreements see their welfare decline—this includes countries such as Mexico and Canada that have prior FTAs with the United States.

We also found that FTAs could greatly lose their value or have negative effects if a sensitive sector, such as agriculture, is excluded. Finally, our simulations support one of our main concerns about FTAs—that

Yang: With the current Doha Round at a critical juncture, many countries seem to be following the U.S. lead and are placing increasing emphasis on bilateral or regional free trade agreements.

is, they could reduce incentives to participate in multilateral liberalization. For instance, in the case of CAFTA, Central American countries may, in the short term at least, gain more from CAFTA than from a multilateral reduction in trade barriers.

IMF Survey: What lessons does your study hold for policymakers—both within the United States and abroad?

Yang: Let's start with policymakers abroad. First, it is clearly important to develop closer trading links with major partners, especially if they increase investment or encourage policy reforms that improve productivity. Second, care must be taken not to rely on preferential arrangements as a panacea because, over time, other countries may join and whittle away that preferential access. Third, countries should adopt policies appropriate to their specific conditions and development needs. For example, Latin American countries that rely on textile and garment exports should aim to streamline and improve domestic production to deal with upcoming global competition. This is a more durable solution than a temporary gain from preferential access to the United States.

For the United States, the lessons are similar. Moreover, given its size and leadership role, the United States can set the tone in shaping regional arrangements that complement a more stable global system incorporating multilateral and nondiscriminatory lowering of trade barriers within a common set of rules. The global framework would allow for treatment of many issues, such as barriers to agricultural trade and antidumping, which have proved to be difficult to handle at the bilateral and regional levels.

Finally, policymakers should be aware that regionalism may not be in the interest of the world economy in the long run. The multilateral approach—with its key objective of eliminating discrimination in trade—has been a cornerstone of global prosperity since World War II. In a world of regionalism and bilateralism, we could end up in a prisoners' dilemma in which countries seek advantages over each other through discrimination ("competitive" regionalism), whose outcome would be in no one's interest. ■

Copies of IMF Working Paper No. 03/206, "The United States and the New Regionalism/Bilateralism," by Alvin Hilaire and Yongzheng Yang, are available for $15.00 each. Please see below for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

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HIPC=Heavily Indebted Poor Countries
PRSP=Poverty Reduction Strategy Paper
PRGF=Poverty Reduction and Growth Facility
ROSC=Report on the Observance of Standards and Codes

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Malaysia positions itself as a gateway to ASEAN and East Asia

Just hours after signing a Trade and Investment Framework Agreement with the United States on May 10, Rafidah Aziz, Malaysia's Minister of International Trade and Industry, spoke at the Institute for International Economics in Washington, D.C. She focused her remarks on the potential benefits to foreign direct investors of selecting Malaysia as an export base within the Association of Southeast Asian Nations (ASEAN) and made the case for why Malaysia is opting to negotiate bilateral trade agreements in the face of the stalled Doha Round.

What does Malaysia hope to gain from its bilateral economic relations with the United States? Rafidah saw the agreement as a means to encourage collaboration between the countries' private sectors and provide a formal channel for their governments to move forward on commercially oriented initiatives, such as trade and investment facilitation, protection of intellectual property rights, and capacity-building programs. The agreement could, she said, lead to further economic arrangements—perhaps even a free trade area.

Rafidah encouraged her predominantly U.S.-based audience to view Malaysia, given its strategic location, as a gateway to other ASEAN member countries and the broader region. "East Asia is evolving as a region, and ASEAN is the prime mover in this," she said, noting that ASEAN's young population and rising per capita incomes offer a long-term dynamism that may be lacking in other countries and regions with aging populations.

Rafidah also insisted that the region's long-term vision of an ASEAN Economic Community—a single market providing for the free flow of goods, services, skilled labor, and capital by 2020—is not a pipe dream. So far, the member countries have identified 11 priority sectors for accelerated integration—agro-based products, air travel, automotive products, electronics, fisheries, health care, rubber-based products, service sectors of electronic commerce, textiles and apparel, tourism, and wood-based products—and are now working to forge a mutual recognition arrangement for key products widely traded within ASEAN. The hope is that by November 2004, ASEAN leaders will be able to sign an agreement providing for the integration of these 11 sectors across the member countries.

China as a partner

"Because China is a market that no one can ignore, rather than cry over China as a competitor," said Rafidah, "we see China as a market." Although Malaysia's economy is small vis-à-vis China's, she pointed out that Malaysia has its own globally competitive niches. Rafidah explained how she visits China to encourage Chinese entrepreneurs to invest in Malaysia, where they can make use of the economy's comparative advantage in natural resources. Moreover, Malaysian-based manufacturers have found a growing, higher-income market in China for luxury products—which has helped make China the fastest growing market for Malaysia.

Malaysia's Minister of International Trade and Industry, Rafidah Aziz.

Malaysia is also taking steps, Rafidah said, "to forge closer economic partnership arrangements that would entail free trade areas between ASEAN and three regional partners: China, Japan, and South Korea." These negotiations have begun with China, setting 2010 as the target for a free trade area with ASEAN, and a study on an ASEAN–Korea Free Trade Area is in progress.

Commenting on the stalled Doha Round of multilateral trade negotiations, Rafidah said that, although the negotiations are unlikely to come to any conclusion in the near future, "this does not matter for Malaysia because trade goes on." While conceding that a multilateral trade agreement would be good in the long term, she argued that it makes sense for Malaysia to continue to negotiate trade agreements on a bilateral basis. In her view, this would not detract from the multilateral trading system.

Keeping up

What must Malaysia do to remain competitive globally? According to Rafidah, the focus now is on further improving the business and investment climate, including by removing remaining administrative impediments, notably at the local district level, to registering and operating a business. Another way to improve the business and investment climate, she suggested, is by reviewing and fine tuning relevant policies. One aspect of this is identifying profitable new areas for the private sector and Malaysia, more generally. Among the new areas already identified are manufacturing-related services, the biotech sector, and commercially oriented agriculture. ■

How has NAFTA affected the Mexican economy?

Ten years ago, Canada, Mexico, and the United States launched the world's largest free trade area under the North American Free Trade Agreement (NAFTA). The agreement represented a watershed in global trade policy because of the size and comprehensiveness of the free trade area it created. More important, perhaps, is that it was struck between one developing and two highly developed economies. With continued controversy surrounding the costs and benefits of increased trade and financial flows, NAFTA provides an interesting case study to gauge their effects on developing countries. In an IMF Working Paper, M. Ayhan Kose of the IMF's Research Department and Guy M. Meredith and Christopher M. Towe of the IMF's Western Hemisphere Department assess the impact of NAFTA on growth and business cycles in Mexico. Christine Ebrahim-zadeh of the IMF Survey *spoke with them.*

Towe: NAFTA has helped spur a dramatic increase in trade and financial flows between Mexico and its NAFTA partners, as well as economic growth in Mexico.

IMF Survey: What were Mexico's key objectives entering into NAFTA?
Towe: Mexico wanted to accelerate economic growth by promoting trade and financial flows with its NAFTA partners, but, as we discuss in the paper, other considerations were also in play. Some observers have argued, for example, that Mexico was also keen to use the agreement to help secure the permanence and credibility of its economic reform program, thereby improving its risk profile and boosting foreign investment inflows.

IMF Survey: Have these objectives largely been met?
Towe: This question is a little bit tricky to answer. As our paper emphasizes, isolating the effects of NAFTA on Mexico is difficult given the significant other shocks that occurred during this period. For example, Mexico suffered a severe financial crisis in 1994, and it is difficult to gauge how much of Mexico's recovery can be attributed to cyclical causes rather than to NAFTA. Similarly, the global cyclical boom during the latter half of the 1990s and the more recent slump have also played an important role in driving growth and business cycles in emerging markets like Mexico. Nonetheless, our paper tries to disentangle some of these effects and concludes that NAFTA did help spur a dramatic increase in trade and financial flows between Mexico and its NAFTA partners, as well as economic growth in Mexico.

IMF Survey: How has the agreement affected trade flows between Mexico and its NAFTA partners?
Kose: If you simply look at the statistics, there has been a significant change in trade flows since the inception of NAFTA. For example, Mexico's exports to the United States and Canada more than doubled in dollar terms between 1993 and 2002 as Mexico's trade (the sum of exports and imports) with NAFTA partners rose from 25 percent of its GDP in 1993 to 51 percent in 2000. The question, then, is whether this remarkable increase has been driven by NAFTA. Using various econometric methods, several recent studies have analyzed the impact of NAFTA on the growth of trade flows in the region. Some of these studies have used aggregate data, while others have employed sectoral series. In the paper, we provide a brief survey of these studies. I think it is fair to say that most of these studies have found that the agreement has had a positive impact on the growth of trade flows.

IMF Survey: Has the nature of trade changed since NAFTA?
Kose: Yes, trade within the region has changed markedly since NAFTA. First, Mexico's export base has shifted toward manufactured goods. Second, vertical trade—or the value of a country's imports that are embodied in its exports—has increased among the NAFTA partners. The obvious example of this is the rapid growth of *maquiladores*, which import inputs from the United States, process them, and re-export them back to the United States. Third, intraindustry trade between Mexico and NAFTA partners has risen significantly. Moreover, NAFTA has resulted in a substantial increase in the variety of products traded between Mexico and its partners.

IMF Survey: Have these changes in trade and financial flows affected business cycle developments in Mexico?
Kose: One of the main objectives of our paper is to examine how free trade agreements affect business cycles in member countries. This is a particularly important empirical question since the past 15 years has witnessed a significant increase in the number of these arrangements. Although these agreements have typically led to a substantial expansion of trade and financial flows among the member countries, economic theory does not tell us much about how this would affect the dynamics of business cycles. In the case of NAFTA, however, our results suggest that the increase in regional integration has had a substantial effect on business cycles. In particular, the agreement

appears to have been associated with increased comovement of business cycles in Mexico and its NAFTA partners. For example, the output correlation between Mexico and its NAFTA partners rose from almost zero before NAFTA to around 0.75 during 1996–2002. Moreover, there has been a marked decline in macroeconomic volatility in Mexico. We argue that this decrease in volatility has reflected the encouragement that NAFTA provided to intraindustry and vertical trade, which has increased the importance of regional rather than country-specific shocks in driving business cycles in Mexico.

IMF Survey: Have regional cycles changed?

Kose: Yes, regional factors have become more important in driving business cycles in Mexico since the advent of NAFTA. In the paper, we undertake a deeper analysis of the increase in business cycle comovement using a recently developed econometric model. We find that structural changes in the Mexican economy that have reduced the role of country-specific shocks in driving the Mexican business cycle have led to a concomitant increase in the role of regionwide shocks. In addition, we use a dynamic, multicountry model to analyze the importance of structural factors and find that reductions in trade frictions that boost trade flows lead to a concomitant increase in business cycle interdependence in the member countries.

IMF Survey: Has NAFTA also affected Mexico's growth performance?

Meredith: Our study examines a variety of factors that affect economic growth. We found, for example, that there has been a dramatic increase in the average growth rate of investment since NAFTA. In addition, contributions of investment and exports to GDP growth have sharply increased. Recent empirical studies suggest that NAFTA has significantly raised total factor productivity in Mexico and has been instrumental in improving macroeconomic as well as institutional policies in Mexico. We conclude that the agreement has favorably affected Mexico's growth performance over the past decade, and our conclusion is supported by a broad range of studies, which we survey in the paper.

IMF Survey: In recent years, Mexico has begun to face competitive pressures—particularly from China, but also from elsewhere in Latin America—at a time when U.S. demand has slumped. Looking to the future, what does this imply for Mexico?

Meredith: While stronger U.S. growth this year is also leading to cyclical recovery in Mexico, these longer-term developments underscore the importance to Mexico of designing proactive policies, particularly in the area of structural reforms, to raise international competitiveness. There are several areas in which reforms are critical. For example, Mexico's energy sector suffers from a lack of investment and has not exploited new opportunities. Rigidities in several other markets also remain major obstacles to economic growth. To illustrate, Mexico has one of the most rigid labor market institutions in the region, discouraging development of the formal labor sector. Moreover, comprehensive tax reform is essential to reduce dependence on oil revenues and generate the resources needed to improve public infrastructure and education. The role of social objectives—which include giving higher priority to education and human capital development, combating corruption, and dealing with poverty issues—in advancing economic development is also critically important. Addressing these challenges will be central to recovering the growth momentum experienced in the latter part of the 1990s from membership in NAFTA.

IMF Survey: What are the lessons for other countries in Latin America as the region works toward the Free Trade Area of the Americas (FTAA)?

Towe: The most important lesson is that countries should take early advantage of the boost to trade and financial flows that can result from free trade agreements and ensure that the necessary structural reforms are in place to sustain the benefits of these agreements. The NAFTA experience suggests that the FTAA could have potentially significant effects on the region's developing country members. We should resist drawing too strong a lesson from Mexico's experience under NAFTA, given that Mexico also benefited from a depreciated peso, the strength of the U.S. economy, and a common border with the United States. But that said, our analysis does suggest that the FTAA could boost economic efficiency, foreign investment, and trade flows, as well as help promote greater macroeconomic stability in the region. ■

Copies of IMF Working Paper No. 04/59, "How Has NAFTA Affected the Mexican Economy? Review and Evidence," by M. Ayhan Kose, Guy M. Meredith, and Christopher M. Towe, are available for $15.00 each. Please see page 168 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

Kose: Structural changes in the Mexican economy that have reduced the role of country-specific shocks in driving the Mexican business cycle have led to a concomitant increase in the role of regionwide shocks.

Meredith: Longer-term developments underscore the importance to Mexico of designing proactive policies, particularly in the area of structural reforms, to raise international competitiveness.

More timely statistics can reduce countries' borrowing costs

New research finds that emerging market countries can save millions of dollars in interest payments a year by adopting a statistical standard developed by the IMF. Research by John Cady of the IMF's Statistics Department shows that spreads in seven emerging market countries declined by some 75 basis points—a reduction of about 20 percent—following their subscription to the Special Data Dissemination Standard (SDDS). For countries with large external debt, this "discount" is particularly good news. Camilla Andersen of the *IMF Survey* spoke with Cady about the significance of his findings.

Cady: Data transparency, in my view, can have a beneficial impact on the growth potential of a country.

The IMF established the SDDS in 1996 to help its member countries provide timely and reliable economic and financial data to the public and markets (see box below). The request to establish a statistical standard came from the Group of Seven (G7) countries, which were reacting to the debt crisis in Mexico, Cady said. "The idea was that more transparency in the area of economic and financial statistics could help avert similar crises in the future." Because of the crisis in Mexico, the initiative was originally aimed at emerging market countries wanting to tap international capital markets. So far, 57 countries have subscribed to the standard. A significant number are emerging market countries, but the list also includes many industrial countries.

Why statistics matter

The steady flow of economic and financial data can make a big difference to countries seeking to reduce their borrowing costs and make more room for spending on development. According to Cady, "the provision of statistics allows the public as well as the markets to formulate their own opinions about a country's economic policies."

For the more statistically advanced countries, markets generally conduct their own economic analysis. But forecasting how specific policies will affect a country's economic outlook becomes more difficult when reliable and timely statistics are in short supply. These problems are often compounded by a challenging economic environment. For example, inflation makes projection very difficult, which, in turn, affects investment plans and other economic decisions. "The more transparent a country is in terms of the current situation and its economic policies, the more concrete the private sector can be about its investment decisions.

SDDS at a glance

Subscription to the SDDS is free but could entail costs in terms of upgrading statistical systems to meet the requirements of the standard.

Once a country has decided to subscribe, it commits to providing data according to a specified format and its own release calendar. It must also provide a comprehensive description of how data are collected and disseminated (this information is known as metadata). All this information is then posted on the IMF's website (*www.dsbb.imf.org/ Applications/web/sddshome*).

The SDDS applies to 18 categories of economic and financial statistics and covers four sectors of the economy.

- The **real sector** covers national income accounts, industrial production, the labor market, and consumer and producer prices.
- The **fiscal sector** covers the public sector and the operations of the central government, as well as central government debt.
- The **financial sector** covers interest rates and the stock market, as well as analytical accounts of the central bank and the banking sector.
- The **external sector** looks at the balance of payments, international reserves and foreign currency liquidity, merchandise trade (imports and exports), the international investment position, exchange rates, and external debt.

The IMF does not check the accuracy or quality of data provided by SDDS subscribers, but it does ensure that countries release information according to the standard and their own preannounced release schedule.

How the SDDS discount works

The SDDS discount is best explained through a hypothetical example.

- Let's say that a country plans to issue bonds worth $1 billion and that the interest rate on U.S. 10-year treasury bonds (often used as a benchmark for emerging market debt) is approximately 400 basis points, or 4 percent.
- If the country has a spread over the U.S. interest rate of 300 basis points, its borrowing costs will amount to 700 basis points, or 7 percent a year.
- But if the country is benefiting from the SDDS discount, the interest rate would be only 625 basis points, or 6.25 percent.
- Rather than paying interest equivalent to $700 million over the full 10 years of the $1 billion bond issue, the country would be paying only $625 million.
- The total savings that can be attributed to SDDS subscription would amount to $75 million—or $7.5 million on an annual basis.

We know that investment is generally an engine of growth, so data transparency, in my view, can have a beneficial impact on the growth potential of a country," Cady said.

How are interest spreads determined?

Cady investigated the effect of SDDS subscription on foreign currency borrowing costs of new bond issues for seven emerging market countries—Argentina, Brazil, Colombia, Mexico, the Philippines, South Africa, and Turkey. A number of factors influence interest rates and, by extension, interest rate spreads. These include the pace of growth, the rate of inflation, and the government deficit and debt. Country-specific shocks may also influence interest rates. For example, if a particular country is experiencing a crisis, foreign investors can either refuse to buy its debt or demand a higher risk premium. In his study, Cady sought to account for the effects of macroeconomic variables and specific bond characteristics before measuring the effect of the SDDS. He found that the seven countries experienced an average reduction of 75 basis points in their interest rate spreads following their subscription to the standard. From late 1996 to 2002—the time period of the study—this reduction amounted to a discount of approximately 20 percent over the average spread (see box below).

Primary versus secondary markets

Cady focused his research on the issuance of debt in primary markets, something that sets his study apart from other recent studies on the impact of the SDDS. Countries issue bonds (usually denominated in dollars, euros, or yen) in the primary market, whereas bonds that have already been issued trade in the secondary market. This distinction is important because it identifies who reaps the benefit from the SDDS discount, Cady explained. If the yield on a country's bonds declines in the secondary market, the country itself does not benefit. But if interest rates in the primary market decline, "it is the country itself that captures that reduced interest rate, so the costs of borrowing are going to be reduced, and the treasury—and ultimately the taxpayers—will benefit."

According to Cady, the gains accrue to the country immediately upon subscribing to the SDDS, but apply only to new debt. For the gains to apply to all debt, countries must undertake a debt rollover—that is to say, they must replace old debt with new bonds. Interestingly, "other researchers who have studied the secondary market found that the discount applies immediately to secondary market transactions," Cady said.

Does transparency elsewhere matter?

The SDDS was the first in a series of internationally agreed initiatives developed in the 1990s stemming from the realization that reliable and timely information about a country's economic situation could help prevent future crises. It also appears to deliver the most immediate and long-lasting benefits to countries. Other transparency initiatives, such as the publication of IMF country reports, also have an effect, but it is much more transient, Cady said (for more information, see *IMF Survey*, January 19, page 12). "If a staff report contains some news relevant to capital markets, spreads react immediately, but the impact tends to dissipate quickly. In contrast, the SDDS appears to have a continuing and stable effect on spreads. Why is that? I hypothesize that the SDDS gives markets an assurance of a continued flow of information, be that good or bad—and apparently markets are willing to compensate countries for that continuing flow of information." ■

Copies of IMF Working Paper No. 04/58, "Does SDDS Subscription Reduce Borrowing Costs for Emerging Market Economies," by John Cady, are available for $15.00 each from IMF Publications Services. Please see page 168 for ordering information. The full text of the paper is also available on the IMF's website (*www.imf.org*).

"The provision of statistics allows the public as well as the markets to formulate their own opinions about a country's economic policies."
—John Cady

World Economic Outlook

Why we should be concerned about credit booms

Credit to the private sector has expanded rapidly in several emerging market countries over the past two years. While credit growth is generally associated with improving economic conditions and with the expansion and increasing sophistication of services offered by banks and other financial institutions (a process known as financial deepening), excessive credit growth has raised concern because of its role in previous financial crises. Based on findings in the April 2004 *World Economic Outlook*, Marco Terrones of the IMF's Research Department explains why we should be concerned about credit booms and what policymakers can do to control them.

Terrones: Credit booms pose significant risks for emerging market countries because they are often followed by sharp economic downturns and financial crises.

Credit booms are periods of unusually sharp expansions in credit that eventually collapse because they become unsustainable. They should not be confused with periods of strong credit expansion—often associated with financial deepening in emerging market countries—which can help spur economic growth.

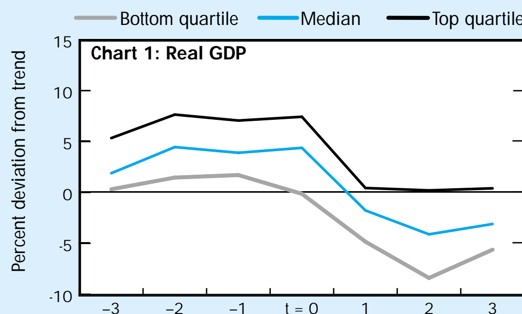
Because lenders are uncertain about the creditworthiness of borrowers, they usually require some sort of collateral—such as real estate or equipment—thereby setting in motion a mechanism known as the "financial accelerator" (see box, page 175). This mechanism can result in credit booms. Indeed, the experience of the 28 emerging market countries included in the *WEO* study corroborates the importance of the financial accelerator.

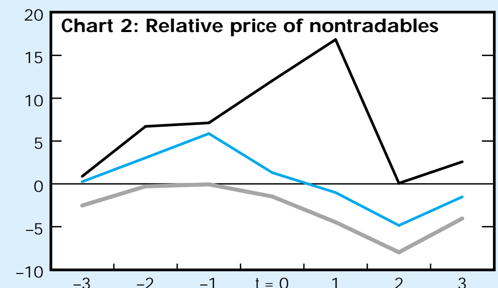
What do credit booms look like?

The *WEO* team found that credit booms are associated with a cyclical upturn followed by a sharp downturn in economic activity. This suggests that credit booms have strong negative effects on the economy; indeed, in the worst cases they are associated with serious recessions (see Chart 1). The team also found that credit booms are associated with a rapid increase and subsequent fall in the price of nontradables (goods or services that cannot easily be exported, such as haircuts) relative to tradables (goods or services that can easily be exported, such as grain or television sets) (see Chart 2). Despite this, credit booms do not have a major effect on inflation—partly because most emerging market countries have very open economies, which helps keep price pressures at bay through increased competition. This suggests that rising domestic demand is vented mainly through a weakening of the current account and an appreciating exchange rate. Therefore, maintaining price stability—particularly for countries that have adopted an inflation-targeting framework—might not in itself help prevent a credit boom or bust. Finally, the *WEO* team found that banks lend more to the private sector and borrow more abroad during credit booms.

Besides these observations, credit booms in emerging market countries typically:

- are less common than episodes of rapid credit growth (defined as periods when average real credit growth exceed 17 percent over three years). This reflects the fact that some countries are able to sustain rapid credit growth as their banking systems mature and expand their services.
- take place simultaneously in many countries. This suggests that capital flows and financial liberalization play an important role. Credit booms are more likely to occur when capital inflows are large: two-thirds of the credit booms observed in the 28 emerging market economies happened during periods of large capital inflows. In contrast, only one-third of the periods characterized by rapid yet sustainable credit growth are associated with high capital inflows.





Note: A credit expansion in a given country is identified as a boom if it exceeds the standard deviation of that country's credit fluctuations around its Hodrick-Prescott trend by a factor of 1.75. *t* denotes the year the credit boom started.
Data: IMF, *International Financial Statistics;* Penn World Tables; World Bank, *World Development Indicators;* national authority publications; and IMF staff calculations

The financial accelerator

The financial accelerator may help explain why credit booms occur. Too much optimism about future earnings boosts asset valuations (such as the price of stocks or real estate), thereby enhancing the net worth of firms that hold the assets. This, in turn, increases a firm's ability to borrow and spend. However, this process is ultimately unsustainable. When it becomes clear that a firm is unable to satisfy expectations, its earnings forecast is revised down, thereby depressing asset prices and pushing the financial accelerator into reverse.

• are associated with banking and currency crises. About 75 percent of credit booms in emerging market countries were associated with banking crises, while 85 percent were associated with currency crises.

• often coincide with either consumption or investment booms and, to a lesser extent, with output booms (see Charts 3 and 4).

Coping with credit booms

Credit booms pose significant risks for emerging market countries because they are often followed by sharp economic downturns and financial crises. But credit booms are not easy to identify, leaving policymakers with the difficult choice of either reining in a credit expansion before it becomes obvious that it is unsustainable or letting the boom continue and risking a serious crisis. Policymakers should be most concerned if a rapid credit expansion is accompanied by other telltale signs of growing macroeconomic, financial, and corporate imbalances.

What should policymakers do if they detect signs that a credit boom is developing? They could consider one or more of the following actions:

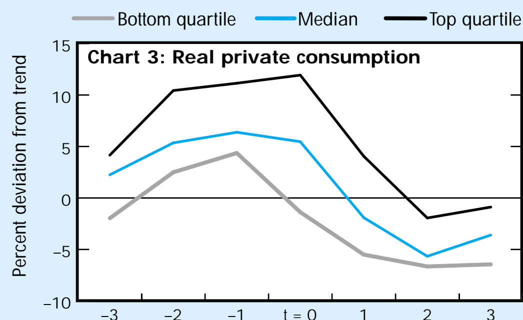
• ***Improve oversight of the banking system.*** Credit booms often involve a shift toward private credit, the quality of which is often worse than is evident when the loan was first made. To stem the tide of bad loans, bank supervisors should tighten the enforcement of capital adequacy requirements. A stricter monitoring of bank borrowing may also be warranted. In some cases, bank supervisors may also wish to reduce incentives for short-term external borrowing.

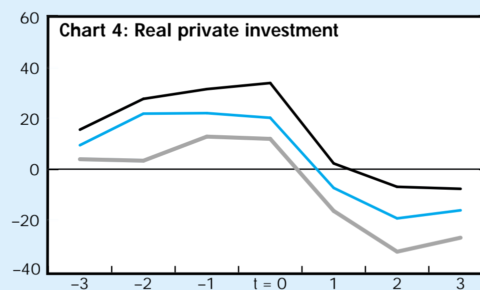
• ***Increase the scrutiny of corporate borrowing.*** As credit booms are usually associated with rapid increases in corporate leverage, firms and their accounting practices may need closer oversight to determine whether they satisfy disclosure requirements.

• ***Tighten macroeconomic policies even when inflation is subdued.*** A credit boom is typically accompanied by an unsustainable surge in domestic demand that is then followed by a severe contraction, so it may be appropriate to restrain credit growth by tightening monetary policy.

To reduce the risk of future credit booms, policymakers in emerging market countries should also strive to improve the quality of their institutions. Credit booms are less frequent and—when they do occur—less costly in industrial countries, which usually have a stronger institutional framework. Priorities should include strengthening the framework for formulating macroeconomic policies, improving regulation and supervision of the financial sector (to encourage prudent risk management), increasing the transparency of the corporate sector, and improving the quality of statistics. Such efforts would not only help preempt credit booms, but would also foster financial development and economic growth. ■

Copies of the April 2004 *World Economic Outlook* are available for $49.00 ($46.00 for academics) each from IMF Publications Services. See page 168 for ordering information. The full text of the *WEO* is also available on the IMF's website (*www.imf.org*).



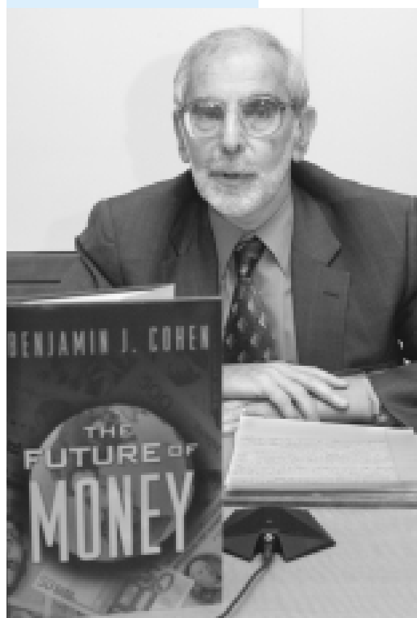


Note: A credit expansion in a given country is identified as a boom if it exceeds the standard deviation of that country's credit fluctuations around its Hodrick-Prescott trend by a factor of 1.75. *t* denotes the year the credit boom started.
Data: IMF, *International Financial Statistics;* Penn World Tables; World Bank, *World Development Indicators;* national authority publications; and IMF staff calculations

IMF Book Forum

Can central banks be outsourced?

Is the traditional link between money and national sovereignty being eroded? Many economists predict that states will increasingly give up their national currencies and "outsource" monetary management to either a foreign supplier or the joint institutions of a monetary union. But Benjamin Cohen, a professor of international political economy at the University of California, Santa Barbara, contends that these predictions are wrong. An IMF Book Forum, held on May 11, featured a discussion on Cohen's new book, *The Future of Money,* with Catherine Pattillo (IMF's Research Department), Carmen Reinhart (University of Maryland), and Kathleen McNamara (Georgetown University). The IMF's Ashoka Mody served as moderator.



Cohen: The "contraction contention" is a misleading representation of what is likely to happen in coming years.

The future number of currencies in the world "really does matter for us," Cohen said, "because it bears directly on the governance of money and the management of money, which in turn is a fundamental determinant of the distribution of wealth and power in the world." The traditional assumption is that the number of currencies is set roughly by the number of countries in the world, although there are always exceptions.

An emerging view, however, holds that because the traditional correlation between money and sovereignty is being eroded, the number of currencies will contract sharply in coming years. Many economists foresee states giving up their national currencies and either adopting a popular foreign currency, like the dollar or the euro, or joining a currency union modeled on Europe's Economic and Monetary Union. Monetary management for many countries will no longer be national but, in effect, will be outsourced. This assumes that monetary governance will be concentrated and simplified.

The logic underlying this belief is clear. Financial globalization's disintegration of barriers to the movement of money across countries has produced growing competition among national currencies—a process that Cohen termed the "deterritorialization of money." According to this reasoning, less competitive currencies will be eliminated in the same way that weaker products are eliminated by stronger products in the marketplace. From the point of view of money users, who obviously want to minimize their transaction costs, the fewer the currencies, the better.

Incomplete logic

Cohen argues, however, that this "contraction contention"—albeit popular with some very prominent economists—is wrong. The correlation between money and sovereignty is indeed eroding, but the number of currencies will expand rather than contract, and he predicted monetary governance would become more diffuse and complex rather than concentrated and simplified.

Although the logic behind the contraction contention is not incorrect, Cohen said, it is incomplete. It explains only the demand side's preference for a small number of currencies. Looking at the supply side—made up of states and the private sector—"preferences can be expected to run very much the other way," he observed.

First, a state will resist giving up its national currency because the government derives major benefits from its existence. A national currency enables a state's government to use its monopoly control of the money supply to supplement government revenue or to finance public spending. It provides an effective instrument for managing macroeconomic performance and means that the state is not dependent on another sovereign for command over its purchasing power and real resources. Moreover, it is a very important symbol of national identity.

Second, Cohen said, choices are much more nuanced than the contraction contention suggests. These other choices can allow for a degree of delegation of monetary authority without going to the extreme of full monetary union. In these cases, countries can choose to retain their national currencies and so preserve at least some of the benefits associated with having a national currency.

Cohen also argues that privately issued currencies can be expected to proliferate. At one level, there are local community currencies, such as the provincial currencies circulating in Argentina at the height of its recent financial crisis. In recent years, local community currencies have been growing in number, as have transactions conducted in them. Even more important has been the emergence of electronic commerce, which is producing an incentive to create viable currencies that can likewise be described as

electronic. "My favorite example of this is airline miles," he said, pointing out that they serve all the functions of money—store of value, unit of account, medium of exchange—for a network of transactors.

Applying the logic to Africa

Referring to Cohen's earlier book, *The Geography of Money*, as an inspiration for her recent book written with Paul Masson, *The Monetary Geography of Africa*, Pattillo spoke of some of the similarities and contrasts in their work, applied specifically to Africa. For example, one similarity with Cohen's work is the attention that Masson and Pattillo give to political economy issues in discussing monetary unions—rather than the two extremes of a discursive political approach or a very strict economic approach.

Pattillo explained how she and Masson set up a model for examining the pros and cons of monetary union projects in Africa that has traditional optimal currency area features. Their model looks at the costs associated with the loss of national monetary sovereignty due to the need to adapt to real shocks that are asymmetric to those in the broader currency union and would thus ideally be met by a country-specific monetary policy. And they look at the advantages of a monetary union, which depends on savings through reduced transaction costs, which, in turn, depend on the extent of intraregional trade—which for Africa is very low.

But in their examination of the benefits of joining a monetary union, Masson and Pattillo's model also takes a cross-country look at differences in fiscal discipline and fiscal distortions, which tend to be related to political considerations.

"Obviously, countries that are more disciplined are not going to want to join in monetary unions with countries that are less disciplined," Pattillo said, "because the common central bank then will have an incentive to have more of an inflation bias, and there will be less stability for this regional currency."

Echoing some of the findings from Cohen's work, she and Masson found that many of these African monetary union projects are not sensible when analyzed from their model's perspective. But there may be scope for looser forms of regional monetary cooperation, she added, that would obtain some benefits of peer pressure and mutual groupings without full monetary union. Another strategy would be to build on the credibility of existing monetary unions by adding to them countries that have demonstrated their commitment and ability to deliver sound economic policies.

How could these sorts of arrangements come about? While Cohen's book suggests that the IMF could have a role as mediator in a country's discussions on its ideal currency regime, Pattillo wondered whether a move from IMF surveillance over exchange rate policy—already a difficult task—to the further step of surveillance over the entire currency regime would be resisted by countries on national sovereignty grounds. Although not denying that it would be asking a lot to expect countries to accept IMF direction on this much broader issue, Cohen responded that the alternative prospect of countries making decentralized decisions entirely at the national level could produce mutually inconsistent choices and, thereby, instability and volatility in monetary matters.

De jure and de facto currencies

For Reinhart, it is crucial to distinguish between de jure and de facto demand for—and use of—currencies in making predictions about the future of money. While concurring with Cohen that there likely will be many national or even provincial currencies in the future in a de jure sense, she questioned whether those currencies would, in fact, be much in demand. This is because greater capital market integration may lead to the effective use of fewer currencies, such as the euro and the dollar.

At the same time, Reinhart predicted that many developing countries will likely want to hold on to their sovereignty over the national currency—specifically their ability to depreciate against the major reserve currencies—even if a their residents prefer to hold other currencies. Forum moderator Mody suggested an analogy with the proliferation of languages, noting that, as globalization has proceeded, a few languages nevertheless have come to dominate for efficiency reasons in international commercial and other interactions, while national symbolic forces have been pushing in the other direction. The overall result has been a compromise in which only a small number of languages are used often.

Taking a sociological perspective, McNamara argued that the future of money will depend on how public and private actors view different types of money. Commenting specifically on whether the euro may come to rival the predominant status of the dollar as an international currency, she suggested thinking about currency as a social institution. If the history of currencies over time is any guide, she said, new forms of money seeking to rival the dollar's role may "face an uphill battle," because status tends to lag reality. ■

Photo credits: Denio Zara, Padraic Hughes, Eugene Salazar, and Michael Spilotro for the IMF pages 165–67; 170–72, 174, 176, 177, 179, and 180; and John Gibson for AFP, page 169.

Pattillo: There may be scope for looser forms of regional monetary cooperation that would obtain some benefits of peer pressure and mutual groupings without full monetary union.

Reinhart: Many developing countries will likely want to hold on to their sovereignty over the national currency—even if their residents prefer to hold other currencies.

Stand-By, EFF, and PRGF arrangements as of April 30

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	4,810.00
Bolivia	April 2, 2003	June 15, 2004	85.75	21.43
Brazil	September 6, 2002	March 31, 2005	27,375.12	10,175.48
Colombia	January 15, 2003	January 14, 2005	1,548.00	1,548.00
Dominican Republic	August 29, 2003	August 28, 2005	437.8	306.46
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
FYR Macedonia	April 30, 2003	June 15, 2004	20	8
Paraguay	December 15, 2003	March 31, 2005	50	50
Turkey	February 4, 2002	February 3, 2005	12,821.20	1,360.80
Ukraine	March 29, 2004	March 28, 2005	411.6	411.6
Uruguay	April 1, 2002	March 31, 2005	2,128.30	559.2
Total			**53,944.05**	**19,325.59**
EFF				
Sri Lanka	April 18, 2003	April 17, 2006	144.4	123.73
Serbia and Montenegro	May 14, 2002	May 13, 2005	650	350
Total			**794.4**	**473.73**
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	12.00
Armenia	May 23, 2001	May 22, 2004	69.00	19.00
Azerbaijan	July 6, 2001	March 31, 2005	80.45	38.61
Bangladesh	June 20, 2003	June 19, 2006	347.00	248.00
Burkina Faso	June 11, 2003	June 10, 2006	24.08	17.20
Burundi	January 23, 2004	January 22, 2007	69.30	42.90
Cameroon	December 21, 2000	December 20, 2004	111.42	31.83
Cape Verde	April 10, 2002	April 9, 2005	8.64	3.72
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	79.93
Dominica	December 29, 2003	December 28, 2006	7.69	5.02
Ethiopia	March 22, 2001	July 31, 2004	100.28	10.43
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Ghana	May 9, 2003	May 8, 2006	184.50	131.80
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guyana	September 20, 2002	March 19, 2006	54.55	43.03
Honduras	February 27, 2004	February 26, 2007	71.20	61.03
Kenya	November 21, 2003	November 20, 2006	175.00	150.00
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	19.12
Lao People's Democratic Republic	April 25, 2001	April 24, 2005	31.70	13.58
Lesotho	March 9, 2001	June 30, 2004	24.50	3.50
Madagascar	March 1, 2001	March 1, 2005	91.65	22.70
Malawi	December 21, 2000	December 20, 2004	45.11	32.23
Mauritania	July 18, 2003	July 17, 2006	6.44	5.52
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Nepal	November 19, 2003	November 18, 2006	49.91	42.78
Nicaragua	December 13, 2002	December 12, 2005	97.50	55.71
Niger	December 22, 2000	June 30, 2004	59.20	8.44
Pakistan	December 6, 2001	December 5, 2004	1,033.70	344.56
Rwanda	August 12, 2002	August 11, 2005	4.00	2.86
Senegal	April 28, 2003	April 27, 2006	24.27	17.33
Sierra Leone	September 26, 2001	March 25, 2005	130.84	28.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	39.20
Tanzania	August 16, 2003	August 15, 2006	19.60	14.00
Uganda	September 13, 2002	September 12, 2005	13.50	8.00
Total			**4,356.08**	**2,088.94**

EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.
Data: IMF Finance Department

Members drawing on the IMF "purchase" other members' currencies, or SDRs, with an equivalent amount of their own currency.

The truth about markets

Why do some nations prosper while many continue to struggle? Why have market economies outperformed socialist or centrally planned ones, and why do failures occur in market economies—failures like booms and busts, and failures of certain corporations? These are some of the questions John Kay, British economist and *Financial Times* columnist, addressed at a May 25 World Bank presentation of his new book, *Culture and Prosperity: The Truth About Markets—why some nations are rich but most remain poor.*

In 1989, the repressive East German regime collapsed and the citizens of both East and West Germany tore down the Berlin Wall. Two years later, the Soviet Union disintegrated. The United States had won the cold war, as Kay states, "without firing a shot." During the decade that followed, the market triumphed as countries around the globe embraced capitalism and governments sold off companies that they had previously nationalized. Information technology, which boosted the U.S. economy's performance and resulted in an exceptional stock market boom, seemed to make conventional thinking about economics obsolete.

Capitalism under attack

But the decade, says Kay, "ended in a frenzy of speculation, followed by recrimination and self-doubt." Corporations that had never earned a cent of profit, and never would, were sold to investors for billions of dollars. Corporate executives filled their pockets and invented revenues and profits. As a result, many "Americans lost faith in corporations as their savings were eroded." Starting with the 1999 Seattle meeting of the World Trade Organization that broke up in chaos, "every subsequent international economic meeting would be besieged by demonstrators." Puzzled observers saw a seemingly triumphant capitalism come under renewed attack.

Revisiting the American business model

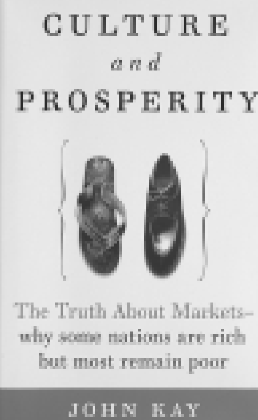
Despite the market economy's "public relations problem," business leaders and politicians continue to espouse, what Kay calls the "American business model," which may be summarized in four propositions:

- greed is the dominant motivation in economic matters;
- restrictions on the operation of free markets are costly and ought to be minimized;
- the economic role of the state should not extend much beyond protection of private property rights and the enforcement of contracts; and
- taxation should be limited to what is essential to perform these functions and to support a modest welfare safety net.

Kay challenges these propositions, arguing that "they bear little relation to a true account of how markets work," and that "attempts to redesign market economies in line with such principles have done at least as much harm as good to the effective operation of a market economy."

Role of self-interest

Economic behavior is not governed solely by narrow economic self-interest, Kay argues. The most successful entrepreneurs appear not to have cared much about making money for themselves. For Bill Gates—the richest man in the world—for example, information technology, not money, has been the consuming passion. For Warren Buffet, it's been the fun of investing and doing it successfully. Looking back over time,



Available on the web (www.imf.org)

Speeches

"Financial Sector Reform and Capital Account Liberalization," Takatoshi Kato, IMF Deputy Managing Director, Beijing International Finance Forum, Beijing, May 19

Press Releases

04/100: IMF Executive Board Reviews Fund's Income Position and Sets Rate of Charge for FY 2005, May 25
04/101: IMF Approves 14–Month $102 Million Stand-By Arrangement for Gabon, May 28
04/102: Statement of the IMF Mission in Grenada, May 28
04/103: Statement of the IMF Mission in Honduras, June 1
04/104: IMF Staff Statement on Discussions for the 2004 Article IV Consultation and Eighth Review of Turkey's Stand-By Arrangement, June 1

Public Information Notices

04/59: IMF Concludes 2004 Article IV Consultation with Hungary, May 24
04/60: IMF Concludes 2004 Article IV Consultation with the Republic of Slovenia, May 24
04/61: IMF Concludes 2003 Article IV Consultation with Swaziland, May 25
04/62: IMF Concludes 2004 Article IV Consultation with Peru, May 28

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Kay also cited Andrew Carnegie, "one of the greatest robber barons," who said that "the man who dies rich, dies disgraced." And John D. Rockefeller believed that his ability to make money was a God-given gift and that his duty to God was to exercise that talent.

Kay: The genius of markets "is that they are not dependent on the genius of any individual."

Markets must be embedded

Successful market economies operate within a complex social, political, and cultural context. In the absence of this context—in countries like Nigeria and Haiti, "whose economies do not work"—it is impossible to achieve the cooperative working relationships, the information sharing, the coordination of economic activity, and the development of trust between individuals and businesses—all elements that a complex modern economy depends on. Furthermore, Kay explains, if the characteristics of successful economic institutions could be divorced from their context, there would be far fewer poor countries in the world. It is because markets must be "embedded" that attempts to transplant the economic institutions of a market economy—most recently and most strikingly in Russia—have in many respects failed.

Many market economies

In Kay's view, a market economy in a free society is demonstrably the most effective form of economic organization. But there are many successful variations on this theme, as the diversity of the world's 20 or so most economically productive economies indicates. Each of these countries—located in North America, Western Europe, Asia, and Australia—is the distinctive product of a process of coevolution of economic institutions and political culture, rather than representative of the American business model. Many are not characterized by unrestrained greed, market fundamentalism, or a minimal state. Regulatory structures, for example, are pervasive in Denmark, Norway, and Switzerland. Norway and Denmark also have some of the highest tax rates found anywhere. And the United States—the world's largest economy—certainly does not have a minimal state.

What explains the range of development experiences around the world? The successes and failures are strongly correlated with the degree of institutional development, which gives reason for pessimism about development prospects in those parts of the world that are at an early stage of institutional coevolution. Asia, says Kay, has the most impressive examples of development outside the Western world. Given the coevolution of institutions in Asia, the biggest puzzle of economic history is why, two or three centuries ago, economic growth took off in Western Europe and not in southeast China.

Truth about markets

"If the strengths of the market economy were encapsulated in a single phrase, it would be disciplined pluralism—the process of perpetual experiment in market economies, in which most experiments fail and are terminated, but the few that succeed are quickly initiated." The genius of markets, Kay observes, "is that they are not dependent on the genius of any individual." In central planning, by contrast, or in autocratically managed corporations, a single voice articulates the right answer, and hierarchical authority is deployed to extract information and execute decisions. That, he concludes, is why less authoritarian countries and corporations tend to do better, at least over the long run. ■

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The Truth About Markets was published in the United Kingdom in 2003 by Allen Lane/Penguin Press. It is published in the United States by HarperCollins under a new title, *Culture and Prosperity: The Truth About Markets—why some nations are rich but most remain poor.*

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
May 31	1.72	1.72	2.65
June 7	1.79	1.79	2.76

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