Editor’s Note

The first research summary in this issue surveys research done at the IMF on macroeconomic policies and income distribution. Experience shows that widening income disparities tend to erode the political and social consensus required for the sustainability of macroeconomic and structural reforms, especially in developing countries. The need to understand the linkages between macroeconomic policies and income distribution has, therefore, become an important focus of IMF research.

In light of recent developments in some emerging markets, dollarization—the subject of the second article—is both highly topical and of considerable analytical interest.

The country/area study in this issue covers the euro area. With the advent of European Economic and Monetary Union, IMF surveillance of this area has involved analytical work on issues common to all twelve countries, as well as on areawide issues relating to indicators, instruments, and transmission channels of macroeconomic policies.

The special topic article describes a new IMF website on Balance of Payments Statistics—a useful compilation of data sources and information on conceptual issues related to external sector statistics. Also included in this issue are the summaries of proceedings of two recent IMF conferences, including the second Annual IMF Research Conference.

—Eswar Prasad

Research Summaries

Macroeconomic Policies and Income Distribution

Aleš Bulíř

The relationship between income inequality and economic policies is of considerable interest to both academics and policymakers. It is also a complex one: macroeconomic policies, structural changes, and redistributive interventions affect income distribution, while income inequality considerations can influence the selection of policies and reforms as well as their implementation and degree of success. The increasing focus on poverty alleviation in IMF-supported programs has further highlighted the need for a better understanding of the nexus between macroeconomic policies and income distribution. This article provides an overview of IMF research in this area.

(continued on page 2)

Dollarization

Andrew Berg

Dollarization manifests itself in two forms: one voluntary and the other largely involuntary. The former type, called full or de jure dollarization, occurs when a country adopts a foreign currency, often the U.S. dollar, as its sole legal tender. The involuntary form, called partial or de facto dollarization, is less under the direct control of the authorities and occurs when a foreign currency circulates alongside a national currency, with bank deposits and loans possibly also denominated in a foreign currency. Most researchers place full dollarization within the realm of exchange rate regime choices in the economic literature, while partial dollarization is typically analyzed as an outcome of disorderly macroeconomic conditions. These two branches of analysis are nonetheless closely linked, as full dollarization is a more attractive choice for countries that find themselves largely dollarized de facto. This article surveys recent research at the IMF on the theoretical and empirical aspects of both partial and full dollarization.

(continued on page 5)

In This Issue

| Macroeconomic Policies and Income Distribution | 1 |
| Dollarization | 1 |
| IMF Staff Papers Special Issue | 7 |
| Call for Papers | 7 |
| Country/Area Study: The Euro Area | 8 |
| Second Annual IMF Research Conference | 10 |
| Investor Relations Seminar | 12 |
| Visiting Scholars | 13 |
| External Publications by IMF Staff | 14 |
| IMF Working Papers | 17 |
| Special Topic: Balance of Payments Statistics | 20 |
Macroeconomic Policies (continued from page 1)

The relationship between macroeconomic stabilization and inequality is of keen interest to the IMF’s member countries. Stabilization policies can contribute to reductions in inequality by, for example, lowering inflation and reducing the volatility of the exchange rate and other macroeconomic variables. However, a highly unequal income distribution could vitiate the ability of countries to institute sustainable stabilization programs. For instance, rising inequality in some transition economies may have undermined the necessary consensus required to implement market-oriented reforms. Dolinskaya (forthcoming) arrives at this conclusion for Russia, especially given that the redistribution system seems to amplify regional inequality. In contrast, redistributive policies that mitigated the early-transition increase in inequality may have been crucial for the success of Poland’s “big bang” reform strategy (Keane and Prasad, forthcoming).1 Research is under way to analyze in more detail the relationship between inequality and the durability and success of IMF-supported stabilization programs.2

IMF staff have made significant contributions to the literature linking various economic and structural policies with income distribution. While some papers have developed theoretical models, the bulk of IMF research in this area has been empirical in nature, emphasizing both cross-country and country-specific studies.3

Given the core areas of IMF policy advice, of particular interest have been variables measuring inflation and the volatility of financial variables. Inflation is often regarded as a regressive tax that disproportionately affects the poor. The panel data evidence suggests that inflation indeed worsens income inequality, but inflation variability appears to have an even stronger impact than the level of inflation (Bulíř and Gulde, 2000).4 Modeling nonlinearities in this relationship differently, Bulíř (2001) finds inflation to be significant for income inequality in cross-country regressions: bringing inflation down from a hyperinflationary level reduces inequality significantly, while further declines bring negligible reductions.5

Evidence from a growing body of IMF research suggests that only well-targeted fiscal policies can affect income inequality (and poverty) and that, in the absence of such a targeted mechanism, it may be better to rely on the trickle-down effect of economic growth on inequality.6 In addition, the success in affecting inequality depends on the scope of redistribution policies and their execution. Tanzi (1998) argues that the primary avenue for government to affect income inequality is through its contribution to human capital creation.7

Schwartz and Ter-Minassian (1995) claim that there is not necessarily a trade-off between redistributive and efficiency goals of expenditure policies in developing countries, especially over the medium term.8 Unfortunately, in most of these countries, tax and transfer policies have often not been used effectively to reduce income inequality, in part owing to difficulties associated with the introduction of progressive taxation and targeted redistribution.9

The country-specific character of redistribution is difficult to capture in cross-country studies. Individual country case studies are particularly relevant for economies that have undergone severe crises, transition economies, and other economies with pronounced economic changes. Clements (1997) finds that Brazil has been one of the most unequal societies—in part owing to its history of hyperinflation—and income distribution remained unequal after the Real Plan of July 1994, because social expenditures primarily benefit upper-income groups.10 Baldacci, De Mello, and Inchauste (2002) provide evidence of the impact of the Tequila crisis on Mexico’s income distribution.11 Several pa-
pers have addressed the distributional impact of the profound socioeconomic changes undergone by transition economies. Most authors agree that, while labor earnings disparities widened in the initial stages of transition, consumption and income inequality remained subdued in countries with well-targeted redistribution policies (Keane and Prasad, 2001). In contrast, those countries that failed to establish a system of targeted transfers have seen a significant widening of consumption and income inequality.

Finally, case studies of countries with pronounced economic changes, for example, China, the Philippines, and Uganda, support the notion that redistribution policies and their impact are country specific. China’s case is particularly interesting: although regional inequality has widened, the urban-rural income distribution appears to be more equal in fast-growing, coastal regions than in those with little or no trade, and these changes are reinforced by China’s redistribution policies. In contrast, income distribution in Philippines has been remarkably stable over the last two decades and little of the “trickle-down” effect of economic growth has been observed. In Uganda, income inequality increased during the 1989–95 period of structural adjustment, owing to a lack of a formal social safety net benefitting the poor.

In research on the OECD countries, Vanhoudt (1997) reports that economic fundamentals explain three-quarters of inequality variation across countries and over time. Cole and Towe (1996) find that the dynamics of the U.S. distribution of income is dominated by cyclical income fluctuations. Decressin (1999) analyzes the Italian redistribution system and concludes that it is not an efficient redistributive and risk-sharing mechanism.

The debate on income inequality in low-income countries is generally overshadowed by concerns about the dynamics of poverty: unlike income inequality, poverty reduction is considered to be a desirable goal of government policies. IMF research on this topic has focused on the linkages between macroeconomic policies, market-oriented reforms, and poverty. On the one hand, there appears to be no medium-term trade-off between stabilization and poverty; that is, fiscal expansion financed with more inflation today does not permanently lower poverty. On the other hand, the evidence suggests that fiscal tightening in the context of IMF-supported structural adjustment programs is associated with increased social spending and less poverty (Gupta, Dicks-Mireaux, Khemani, McDonald, and Verhoeven, 2000).
Books from the IMF

The Modern VAT
Liam Ebrill, Michael Keen, Jean-Paul Bodin, and Victoria Summers

Probably the most important tax development of recent years has been the remarkable rise of the value-added tax (VAT), now a central component of the tax systems of over 120 countries. In particular, the VAT has recently become a key component of tax reform in many developing countries. The IMF Fiscal Affairs Department has played a major role in this process, and this book—the first comprehensive treatment of the tax for over a decade—sets out the lessons of its unique experiences.

The book is aimed at academics, policymakers, practitioners, and others with an interest in this increasingly important tax. Starting with an assessment of the key principles of the VAT, and new evidence on its effectiveness, the book covers the central issues in both policy design (such as the optimal rate structure, treatment of financial services and other problem areas) and administration (including audit, refund processing, and organizational structures).

Full-text versions (or, in some cases, detailed summaries) of books published by the IMF are available online at the Research at the IMF website at http://www.imf.org/research. Follow the link to IMF Publications.

Much of the research on partial dollarization has focused on its underlying causes. Savastano (1996) emphasizes that, while macroeconomic instability is the cause of dollarization, its manifestation depends on the institutional framework. Countries that did not allow dollar deposits, for example, observed more capital flight and increased use of foreign currency, whereas countries with sufficiently flexible financial systems, such as Brazil, saw a proliferation of indexed domestic currency instruments, instead of dollarization.1 A central feature of de facto dollarization is that it tends not to abate, even after the macroeconomic instabilities that caused it have been brought under control. Mongardini and Mueller (2000) find some econometric evidence of such a “ratchet effect” in foreign currency deposits in the Kyrgyz Republic, but not in cash dollars in circulation (for which they have some survey data).2

The literature on partial dollarization makes a distinction between currency substitution—dollarization of money as a means of payment—and asset substitution, which refers to dollarization of stores of value. Earlier research, such as Agénor and Khan (1996), focused on currency substitution, examining the rate of return on foreign currency in money demand functions.3 As Savastano (1996) notes, however, most of the available data is on interest-bearing, foreign-currency time deposits, for which a focus on asset substitution makes more sense. Moreover, the Asian crisis motivated increased analysis of dollarized loans as well as other financial deposits; large quantities of loans were dollar-denominated and this had important implications for the economic effects of exchange rate fluctuations. More recent research on dollarization has thus concentrated on asset substitution.

Ize and Levy-Yeyati (1998) show that the degree to which the financial system is dollarized depends on relative volatilities of the inflation rate (more volatility makes foreign currency deposits less risky) and the real exchange rate (more volatility makes these deposits more risky in terms of domestic prices). Ize and Levy-Yeyati also explain the persistence of dollarization after stabilization in terms of the fact that real exchange rate volatility, in many cases, decreases faster than inflation volatility.4 Catão and Terrones (2000) present a model of the banking system which emphasizes how banking and credit market imperfections determine deposit and loan dollarization.5 Mourmouras and Russell (2000) show how, in the absence of interest-bearing bank deposits, foreign currency surrender requirements may lead to smuggling as a way for residents to accumulate cash dollars.6

The implications of partial dollarization for monetary and exchange rate policies and financial supervision is critical to the operational work of the IMF. Berg and Borensztein (2000) conclude that a high degree of currency substitution strengthens the case for fixing the exchange rate, while dollarization as asset substitution has various offsetting effects.7 Ize (2001) argues that inflation targeting may be feasible even in the presence of substantial currency and asset substitution.8 Baliño and others (1999) emphasize that dollarization—understood as asset substitution—has implications similar to those of capital account openness in general.9 Poirson (2001) concludes that countries with a high degree of partial dollarization are, in fact, more likely to choose a more rigid exchange rate regime.10
IMF researchers have analyzed a variety of country experiences with partial dollarization. Unterberdoerster (2002) discusses the case of Vietnam; Fritz-Krockow and others (2001) look at Haiti; and Rumberg and others (2000) analyze dollarization in Cambodia. Zamaróczy and Szá (forthcoming) estimate the amount of cash dollars in circulation in Cambodia and conclude that the country is almost completely dollarized. Lizondo and others (2001) analyze monetary policy and the advisability of inflation targeting in Peru. 

Interest in full dollarization has grown sharply in recent years, both out of dissatisfaction with the alternatives and because several countries, including El Salvador and Ecuador, joined Panama among the ranks of sizable, fully dollarized countries. Berg and Borensztein (2000) analyze the costs and benefits of full dollarization as compared with its closest alternative, a currency board. They attempt to quantify the tradeoffs in the case of Argentina, in particular the cost of foregone seignorage and possible benefits from lower borrowing costs. They observe, however, that the potentially most important considerations—notably, the loss of the “exit option” to devalue in the face of major shocks, and the advantages of deeper integration—are harder to evaluate. They conclude that two groups of countries are most likely to find dollarization attractive: those already highly integrated with the United States (or other country whose currency is to be adopted) and those already highly dollarized de facto. 

Several papers have looked more closely at the various costs and benefits of dollarization. Bogotić (2000) argues that growing partial dollarization and financial development imply that seignorage losses from dollarization would be small in many cases. Parsley and Wei (2001) find that currency boards, and especially dollarization, strongly promote goods market integration, far beyond what is directly associated with exchange rate stability alone.

Dollarization is sometimes seen as an irreversible decision but Liberia, one of only two countries with a long history of dollarization (the other is Panama) reintroduced its own currency in the 1980s. Indeed, Abrams and Cortés-Douglas (1993) provide what amounts to a manual for introducing a new currency, based on the experiences of countries that “de-dollarized” after the breakup of the Soviet Union.

As Mishkin and Savastano (2000) emphasize, actual experiences with dollarization are limited, and the long history of dollarization in the most important case, Panama, is mixed. Bogotić (2000) reviews the experience of Panama and concludes that it has been broadly positive. De la Torre and others (forthcoming) describe the deep banking and exchange rate crisis that led to Ecuador’s January 2000 move to full dollarization and emphasize dollarization’s stabilizing role; Offerdal and others (2000) provide an early, cautiously positive, assessment of the outcome. The addition of countries like Ecuador and El Salvador to the ranks of fully dollarized countries will provide important material for future research.

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Augusto de la Torre, Roberto García-Saltos, and Yira Mascaro, “Banking, Currency, and Debt Meltdown: Ecuador Crisis in the Late 1990s, “ forthcoming in Latin American Financial Crises, ed. by Albert Berry (University of Toronto); and Erik Offerdal, Mariano Cortés, Mayra Zermeño, Alvin Hilaire, Gabriela Basurto (Inter-American Development Bank) and Atish Ghosh (IMF).

IMF Staff Papers, Special Issue November 2001
Proceedings of the First Annual IMF Research Conference
Edited by Eduardo Borensztein and Robert Flood

This special issue of IMF Staff Papers contains a selection of papers presented at the first annual IMF Research Conference held in Washington, DC, in November 2000. The papers in this volume were written by IMF authors and invited contributors from a group of distinguished outside scholars. Also included is the text of the first Mundell-Fleming lecture, delivered by Maurice Obstfeld, and a set of remarks by Robert Mundell on the intellectual history of the Mundell-Fleming model.

International Macroeconomics: Beyond the Mundell-Fleming Model
Maurice Obstfeld (University of California at Berkeley)

Do Monetary Handcuffs Restrain Leviathan? Fiscal Policy in Extreme Exchange Rate Regimes
Antonio Fatás (INSEAD and CEPR) and Andrew K. Rose (University of California at Berkeley)

Exchange Rate Regimes and Economic Performance
Eduardo Levy-Yeyati and Federico Sturzenegger (Universidad Torcuato Di Tella)

The Interest Rate-Exchange Rate Nexus in Currency Crises
Gabriela Basurto (Inter-American Development Bank) and Atish Ghosh (IMF)

Call for Papers
Third Annual IMF Research Conference

The third Annual Research Conference of the IMF will take place at the organization’s headquarters in Washington, DC, on November 7–8, 2002. The conference will provide a forum to discuss innovative research by IMF staff and leading outside economists and will facilitate an exchange of views among the participants. The main theme of this year’s conference will be Capital Flows and Global Governance, which can be interpreted broadly. More information and details about possible topics can be found at the Research at the IMF website at www.imf.org/research.

Interested contributors should submit a proposal to the Program Committee (email to ARC2002@imf.org) by March 22, 2002. The Program Committee will evaluate all proposals in terms of originality, analytical rigor, and policy relevance and will communicate its decision by late April. The Program Committee consists of S. Wei (Chair), X. Debrun, G. Gelos, H. Huang, O. Jeanne, L. Kodres, and A. Spilimbergo.

Consumption and Income Inequality During the Transition to a Market Economy: Poland, 1985–92
Michael Keane (Yale University) and Eswar Prasad (IMF) 

Bail-Ins, Bailouts, and Borrowing Costs
Barry Eichengreen (University of California at Berkeley) and Ashoka Mody (IMF)

Crisis Resolution and Private Sector Adaptation
Gabrielle Lipworth and Jens Nystedt (IMF)

IMF Staff Papers, the IMF’s scholarly journal, edited by Robert Flood, publishes selected high-quality research produced by IMF staff and leading outside economists to a broad audience, including academics and policymakers in IMF member countries. The papers selected for publication in the journal are subject to a rigorous review process. They are available online at the Research at the IMF website: http://www.imf.org/research.
The introduction of a single currency in Europe in January 1999 and the changeover to euro notes and coins on January 1, 2002 present new challenges to policymakers. In this context, a sound understanding of the new environment is vitally important. Recent research at the IMF on the euro area has been motivated by the need to shed light on a wide range of issues, with a specific focus on providing the tools that will allow policymakers to evaluate the appropriateness of area-wide macroeconomic policies. This article provides an overview of this research and focuses on work covering monetary, exchange rate, and fiscal policies.

Since the beginning of Stage Three of European Economic and Monetary Union (EMU) in January 1999, the European Central Bank (ECB) has conducted monetary policy at the euro-area level. The ECB’s framework, which aims at preserving price stability in the euro area, consists of a two-pillar strategy.

Under the first pillar, the ECB announces a reference value for the growth of the monetary aggregate M3 and revises it annually. This reference value serves as a guidepost for developments in the monetary sector in that any persistent deviations from that value signal risks to price stability. The underlying assumption is that a stable money demand for the euro area exists. This has motivated research at the IMF on examining the stability of euro-area money demand and the appropriateness of the ECB’s reference value (Calza, Gerdesmeir and Levy, 2001; Kontolemis, 2001). More specifically, Kontolemis (2001) shows that the reference value for M3 growth chosen by the ECB is somewhat low, based on recent trends, and argues that—given the uncertainty relating to velocity trends—a monitoring range may be more desirable, from a communication viewpoint, than a point reference value.

Under the second pillar, the ECB monitors a wide range of other economic indicators—including output developments—that may contain information regarding risks to price stability. In this respect, the measurement of the output gap is crucial for policymakers. Ross and Ubide (2001) provide one of the first attempts to measure the euro-area output gap. In addition to comparing different measures of the output gap, their paper assesses how these compare in forecasting inflation and in mimicking the properties of coincident measures of the business cycle.

Understanding the monetary policy transmission mechanism in the common currency area is, of course, crucial for the ECB. Research at the IMF has focused on measuring and explaining differences in the transmission mechanism of monetary policy across countries (for example, Ramaswamy and Sloek, 1998), and drawing implications for policymaking at the euro-area level. Clements, Kontolemis, and Levy (2001) observe that the large differences in the responses of prices and output to (unanticipated) changes in interest rates, across the 12 countries cited in earlier research, reflected both differences in the countries’ monetary frameworks prior to adopting the euro, as well as differences in the monetary policy transmission mechanisms as such. The study attempts to isolate and explain differences that are due to the transmission mechanisms themselves, and hence are likely to persist under EMU. By taking into account the new institutional framework of EMU—fixed intra-euro-area exchange rates and a common monetary policy across countries—the study provides a better measure, than earlier work, of the effects of (unanticipated) monetary policy changes on prices and output for the euro area as a whole and across countries. Moreover, the study shows that differences in the financial systems across euro-area countries are important and explain some of these differences in the transmission mechanism. In a related study, Belaisch, Kodres, Levy and Ubide (2001) provide an in-depth look of the banking system in the euro area and highlight some of the differences across countries.

In this uncertain environment, the continuing weakness—and unpredictability—of the euro exchange rate has complicated the formulation of monetary policy. A recent contribution by Meredith (2001) attempts to explain the sources of the depreciation of the euro since January 1999. This paper argues that the depreciation of the euro since the introduction of the common currency is a continuation of a trend observed since the mid-1990s. This trend is largely explained by the strong...
performance of the U.S. stock market since the beginning of the 1990s, relative to Europe, and is not the consequence of the introduction of the euro as such. The surge in equity prices since the mid-1990s created a demand shock that disproportionately affected the United States. More recently, the fall in the euro is also attributed to (global) portfolio shifts that followed the introduction of the new currency. Hence, the ECB’s monetary policy actions are not considered directly related to the decline in the exchange rate value of the euro, and should remain focused on the broader macroeconomic environment rather than on exchange rate considerations.

Fiscal policy remains highly decentralized across the 12 euro-area countries, although countries are required to abide by the rules of the Stability and Growth Pact (SGP). According to the SGP, countries are committed to achieving sound fiscal positions by adhering to a medium-term budgetary objective of “close to balance or surplus.” Work at the IMF dating back to 1997 discusses the institutional setup of the SGP (see Begg, 1997, for example) and its ability to overcome a past procyclical bias, which was an unfortunate historical characteristic in many euro-area countries (Jaeger, 2001, for example). Indeed, recent work in this area focuses on asymmetric fiscal policy behavior over the cycle and the way that institutions, including the SGP, can prevent this practice. Related research by Detragiache, Milesi-Ferretti, Daban, and Symansky (2001) explores the benefits of rules-based approaches to fiscal policymaking in the four largest economies of the euro area and argues that countries should place more emphasis on spending rules within the SGP.

In addition, recent IMF research on the euro area has also addressed other related issues. Decressin, Estevao, Gerson, and Klingcn (2001) demonstrate that output growth in France, Germany, Italy and Spain, during the last expansion, has been more employment intensive than during previous growth episodes and argue that this is a result of sustained wage moderation in the euro area. Finally, Ford and Gerson (2001) examine the policy implications of inflation differentials in the euro area, and conclude that in cases where such differentials are not driven by macroeconomic fundamentals such as productivity differentials, fiscal policy is a more appropriate means to offset them.


9A number of contributions by IMF staff on the euro are also included in the volume by P. Masson, T. Krueger, and B. Turtelboom, eds., EMU and the International Monetary System (IMF: Washington DC, 1997).


Visit the Research at the IMF website www.imf.org/research
Second Annual IMF Research Conference
Summary by Jeromin Zettelmeyer

The second Annual IMF Research Conference was held in Washington, DC, on November 29–30, 2001. The conference focused on the economic consequences of large devaluations and currency crises, stabilization policies in emerging markets, and the political economy of economic reforms and IMF programs. The Mundell-Fleming lecture was delivered by the Chief Economist of the IMF, Kenneth Rogoff, in honor of Rudiger Dornbusch, whose influential “overshooting model” of the exchange rate was published 25 years ago. The conference agenda and brief descriptions of the papers follow.

The Consequences of Large Devaluations and Currency Crises

Why Are Rates of Inflation So Low After Large Contractionary Devaluations? Ariel Burstein, Martin Eichenbaum, and Sergio Rebelo (Northwestern University) Discussant: Ilan Goldfajn (PUC Rio and Banco Central do Brasil)

Credit Stagnation in Latin America Adolfo Barajas (IMF) and Roberto Steiner (Universidad de los Andes) Discussant: Alejandro Werner (Banco de México)

Boom-Bust Cycles in Credit-Constrained Economies: Facts and Explanation Aaron Tornell (UCLA) and Frank Westermann (University of Munich) Discussant: Paolo Pesenti (Federal Reserve Bank of New York)

Output Response to Currency Crises Poonam Gupta (IMF), Deepak Mishra (World Bank), and Ratna Sahay (IMF) Discussant: Nouriel Roubini (New York University)

Cheap Labor Meets Costly Capital: The Impact of Devaluations on Commodity Firms Kristin Forbes (U.S. Treasury) Discussant: Jingqing Chai (IMF)

Economic Integration and the Exchange Rate Regime: How Damaging Are Currency Crises? Axel A. Weber and Günther Beck (Frankfurt University) Discussant: Charles Engel (University of Wisconsin)

Stabilization Policies and Economic Reforms

The Effectiveness of Fiscal Policy in Stimulating Economic Activity: An Empirical Investigation Emanuele Baldacci, Marco Cangiano, Selma Mahfouz, and Axel Schimmelpfennig (IMF) Discussant: Alberto Alesina (Harvard University)

Interest Rate Effects on Output: Evidence from a GDP Forecasting Model for South Africa Janine Aron and John Muellbauer (Oxford University) Discussant: Eswar Prasad (IMF)

Why Do Many Disinflations Fail? Javier Hamann and Alessandro Prati (IMF) Discussant: Holger Wolf (George Washington University)

IMF Programs: Who Is Chosen and What Are the Effects? Robert Barro (Harvard University) and Jong-Wha Lee (Korea University) Discussant: Tim Lane (IMF)

Budget Support versus Project Aid: A Theoretical Appraisal Tito Cordella and Giovanni Dell’Ariccia (IMF) Discussant: Craig Burnside (World Bank)


What Explains the Success and Failure of Fund-Supported Programs? Anna Ivanova (IMF), Wolfgang Mayer (University of Cincinatti), Alex Mourmouras and George Anayiotos (IMF) Discussant: Patrick Conway (University of North Carolina)

Conditionality and Ownership in IMF Lending: A Political Economy Approach Allan Drazen (Tel-Aviv University) Discussants: Jeffry Frieden (Harvard University), and Mohsin Khan (IMF)

The papers presented in the first set of sessions examined the consequences of large devaluations and currency crises from four angles: inflation, credit, real output, and economic integration. Burstein, Eichenbaum and Rebelo ask why inflation
after large contractionary devaluations has typically been much lower than purchasing power parity would predict. Their paper gives an answer that is consistent with the law of one price holding for pure tradeables. First, they point out the share of internationally tradeable goods in the CPI is much lower than typically assumed once one accounts for distribution services and goods produced locally for the domestic market. Second, they present an equilibrium model in which a devaluation generates low nontradeables inflation because the crisis tightens private borrowing constraints. Barajas and Steiner present a set of stylized facts on the credit slowdown in several Latin American countries since 1998, and attempt to econometrically disentangle the causes of the slowdown for Colombia, Mexico, and Peru. Tornell and Westermann document the stylized facts of boom-bust credit and output cycles in emerging markets in the last two decades. They go on to present a tradeables/nontradeables model with asymmetric financing constraints and balance sheet effects that rationalize these cycles, and use the restrictions implied by their model to estimate a structural vector autoregression.

Using a large panel of countries and crisis episodes, Sahay, Gupta, and Mishra find that the consequences of currency crises on GDP differ widely. About 40 percent of currency crises in fact seem to be expansionary. Crises tend to be contractionary if they are preceded by large capital inflows, occur at the height of a boom and in an open capital account environment, and if competitors also devalue. Forbes studies the effects of devaluations on the output growth and profitability of commodity firms between 1996 and 2000, and finds that devaluations tend to stimulate output and profits in the short run, but that long-run effects are mixed and depend on capital labor ratios and changes in real interest rates. Finally, Weber and Beck examine economic integration, measured by the degree to which consumer prices move in tandem across different locations. They find that the major currency crises of the 1990s had significant disintegration effects by this measure, both through increased “border effects” (i.e., disintegration across countries) and by increasing relative price dispersion within countries.

Four of the papers presented on the second day dealt with issues associated with stabilization policies and economic reforms: Aron and Muellbauer, who look at monetary transmission in a particular country case (South Africa), Baldacci, Cangiano, Mahfouz, and Schimmelpfennig, who explore the effectiveness of fiscal policy in responding to a recession in a broad selection of countries, and Hamann and Prati, who ask why some stabilizations are quickly reversed while others have more enduring success. The main finding of Hamann and Prati’s paper is that about 85 percent of dichotomous outcomes (success or failure) can be predicted without knowledge of poststabilization domestic variables. Exchange rate–based stabilizations appear more likely to succeed, and initial conditions such as the level of precrisis inflation, a history of inflation, and the structure of political institutions matter. Finally, Eble and Koeva look at the determinants of support for market reforms using a Russian longitudinal household survey. Their main finding is that economic self-interest goes a long way toward explaining why individuals are opposed to or in favor of market reforms; however, ideological factors also appear to be important in explaining the preferences of particular groups, such as pensioners.

The remaining four papers focused specifically on issues related to IMF (or other international financial institutions) lending and conditionality. Barro and Lee show that IMF stabilization loans have no effect on long-run growth once the endogeneity of the lending decision—which may depend on borrower characteristics which themselves affect growth—is properly dealt with (simple regressions show a negative relationship). Their analysis uses political and institutional variables, such as the size of the borrower country’s quota, its political proximity to the U.S. and other big shareholders as regression instruments. Cordella and Dell’Ariccia show that an international donor’s choice between conditional budget support and project aid should depend on the trade-off between two distortions: the fungibility problem associated with project aid, and the inability to observe all relevant government actions in the case of conditional budget aid. Ivanova, Mayer, Mourmouras, and Anayiotos analyze the determinants of IMF program implementation and find that domestic political economy factors, such as the strength of special interests, lack of political cohesion, and ethnic and linguistic divisions contribute crucially to program failure.

Finally, Drazen surveys the debate on the relationship between conditionality and ownership, pointing out some incongruences and suggesting how they could be resolved. He then develops the case in which there is full ownership on the side of the borrower country government, but conditionality is nevertheless desirable because it strengthens the position of the government vis-à-vis an interest group that opposes reforms.

Selected papers from this conference will be published in a special issue of IMF Staff Papers in 2002.

Proceedings of IMF conferences and seminars, including agenda and papers, can be obtained through the “Conferences, Seminars and Workshops” link at the Research at the IMF website at http://www.imf.org/research.
The IMF and the Institute of International Finance jointly hosted the first seminar on investor relations in Washington, DC, on November 5–6, 2001. The seminar, organized by the IMF Institute, brought together country officials and international lenders and investors. The participants examined the role that Investor Relations Programs (IRP) can play in sovereign borrowing and discussed the experience of countries with existing IRPs. Seminar participants, by and large, felt that IRPs had a positive impact on attracting foreign capital and lowering its cost, but cautioned against seeing them as substitutes for sound economic policies in debtor countries.

Anne Krueger and Charles Dallara welcomed the participants and asked them to examine the ways in which a frank, meaningful, and sustained dialogue between country authorities and international lenders could contribute to stabilizing and lowering the risks associated with cross-border flows of private capital.

The idea of having an IRP has its roots in modern corporate finance theory. With its emphasis on maximizing shareholder value, the theory recognizes the crucial role information asymmetry, and attendant incentive problems of moral hazard and adverse selection, play in determining the capital structure of a corporation.1 Equity financing, being an unsecured form of lending, is very susceptible to informational problems. As a consequence, historically the debt contract has been preferred by lenders.2 Academics and practitioners alike have realized the importance of reducing informational asymmetries for ameliorating the agency problem, and the perception of risk by outside investors.3 Such information provision has been pivotal for the development of equity markets and, as a consequence, has allowed firms to reduce their reliance on debt and internal funding as the main sources of finance.4

Corporations in the United States have long recognized the importance of providing stakeholders with relevant and timely information and their investor relations offices (IROs) assist stakeholders in differentiating among investment choices.5 The information exchange between borrowers and lenders has been given considerable structure and substance through financial disclosure regulations (which, in the United States, are formulated by the Securities and Exchange Commission).

What is an IRO? At the corporate level, an IRO is the main link between a firm and its stakeholders. Such an office also benefits other observers such as ratings agencies and analysts. The office is charged with maintaining regular contact with market participants, providing them with timely and reliable financial data, and conveying to the market the management’s vision and philosophy. This helps in differentiating the firm from its competitors, and contributes to enhancing its brand name. An IRO also serves the equally important role of conveying to management the markets’ assessment of the firm’s actions and future prospects. Seminar participants from the corporate sector stressed that an IRP represents good risk management practice, in that it helps foster a culture of accountability within the firm.
A country’s IRO can be located either within the central bank or the ministry of finance. A sovereign IRO’s credibility depends on its ability to provide the market with timely and reliable data, realistic assessments of policies, and discussion of a believable forward-looking strategy. An IRP not only allows officials to communicate with investors, but also provides invaluable feedback from the market to country officials regarding the market’s perception of policies. It should provide an open and candid line of communication not only in normal periods, but also during times of stress.

As emphasized by seminar participants, the credibility of an IRP depends crucially on the reputation and experience of those in charge of the IRO. The senior officials in the IRO should be able to moderate effectively the needs and concerns of lenders to key officials and organizations. At the same time, they should also help foster a country strategy for dealing with market players and communicate effectively the views and concerns of policymakers to domestic and international markets.

The credibility of an IRP is enhanced by providing similar information to all stakeholders (domestic and foreign), avoiding rosy forecasts, and disclosing contingent liabilities. If a problem exists, the IRO should alert investors of the potential for bad news, but place it in the proper context by conveying to markets that officials not only understand the nature of the problem, but have also developed strategies for dealing with it. Representatives from large investment banks emphasized the importance of low turnover among IRO staff for developing and maintaining the trust of market players.

Brazil and Mexico were cited as examples of successful IRPs that had helped “decouple” the countries from others in the region. The benefits of differentiation had included lower interest rate spreads for sovereign debt, and a wider set of financing options. Participants mentioned Turkey as a case where the absence of an effective IRP had hindered the country from benefiting from much needed private capital flows, despite serious attempts at dealing with its financial problems. In his concluding remarks, Gerd Häusler stressed that an IRP is neither a panacea nor a substitute for sound macroeconomic management—a view shared by all participants and, some felt, illustrated by the Argentine case.

5See, for example, the IRO web sites for Lockheed Martin and ING: http://www.lockheedmartin.com/investor/ and http://www.ing.com/ing/contentm.nsf/homeinvestors!ReadForm&sc=investors&lan=en.

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Michael Bleaney; University of Nottingham, U.K.
Michael Bordo; Rutgers University
John Boyd; University of Minnesota
Kevin Carey; American University
Menzie Chinn; University of California, Santa Cruz
Carl Claussen; Central Bank of Norway
Giancarlo Corsetti; University of Rome III, Italy
Thomas Cosimano; University of Notre Dame
Allan Drazen; University of Maryland
Jayasri Dutta; University of Birmingham
Michael Funke; Universitat Hamburg, Germany
Pietro Garibaldi; Universita Commerciale Luigi Bocconi, Italy
Morris Goldstein; Institute for International Economics
Cheikh Gueye; BCEAO, Senegal
Gregory Hess; Oberlin College
Shigeru Iwata; University of Kansas
Mahmood Khan; Simon Fraser University
Amartya Lahiri; University of California at Los Angeles
Francois Leroux; Ecole des Hautes Etudes Commerciales, France
George Mbangue; University of Yaounde II, Cameroon
Emmanuel Ogunkola; National University of Lesotho, Lesotho
Andrew Rose; University of California, Berkeley
Xavier Sala-i-Martin; Universitat Pompeu Fabra, Spain
Fondoh Sikod; University of Yaounde II, Cameroon
Mark Taylor; Warwick Business School, U.K.
Juergen von Hagen; University of Bonn, Germany
Thomas Willett; Claremont Graduate University
Yishay Yafeh; The Hebrew University, Israel
Eduardo Yeyati; Torquato di Tella University, Argentina
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Marie Montanjees

The IMF Statistics Department has created a public website dedicated to disseminating information on balance of payments concepts, data, and related ongoing statistical work. The website (http://www.imf.org/bop) is intended to provide easier access to data sources, information on methodology, as well as updates on various IMF initiatives aimed at improving the quality and timeliness of balance of payments and other external sector statistics.

The vast amount of information available on the IMF Balance of Payments website is organized into separate modules and is accessed through easy links. The contents of the major modules are described below.

- **Balance of Payments Committee**: provides information on the activities of the IMF Committee on Balance of Payments Statistics, a group of expert data compilers established in 1992 to advise the IMF on methodological and compilation issues affecting balance of payments and international investment position statistics. The site publishes the annual reports of the committee and papers on the committee’s research activities, such as the statistical measurement of repurchase agreements, drug smuggling, travel expenditures, and shuttle trade.

- **Balance of Payments Newsletters**: provides the IMF’s Balance of Payments Statistics Newsletter from 1995 to the present. The newsletter contains information on developments in balance of payments statistics taking place in different countries and in international organizations.


- **Direct Investment Methodology**: covers the IMF/OECD survey of data sources and methodological practices used to compile foreign direct investment (FDI) statistics, including the report on the 1997 survey that covered 114 countries. Reports on the 2001 update of the survey for the 30 OECD countries and selected non-OECD countries will be posted on the site shortly, as well as summary descriptions of the compilation practices, data sources, and methodology for specific countries.

- **External Debt Statistics**: provides a link to the text of the interagency External Debt Statistics: Guide for Compilers and Users, which covers the measurement and presentation of external debt statistics and the compilation and analytical use of external debt statistics. The site also provides a link to the joint BIS/IMF/OECD quarterly external debt data obtained primarily from creditor and market sources.

- **Financial Derivatives**: covers recent methodological developments in the derivatives area, including a link to the text of a working paper on the statistical measurement of financial derivatives.

- **International Reserves**: covers the data on international reserves and foreign currency liquidity that are now prescribed for the Special Data Dissemination Standard (SDDS). The site includes links to (i) data for 43 IMF member countries, presented in the standard “template” format and in U.S. dollars and (ii) the text of the International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template.

- **International Trade in Services**: presents the text of the interagency Manual on Statistics of International Trade in Services. The manual was prepared to meet the needs of statistical compilers, governments, and international organizations that use statistical information on services trade in international negotiations, and of researchers and other users who wish to assess developments in international services markets.

- **Portfolio Investment**: covers the IMF Coordinated Portfolio Investment Survey (CPIS), conducted by major investing countries to improve the reporting of portfolio investment data. The site provides information on the first CPIS in 1997 and publishes the text of the Coordinated Portfolio Investment Survey Guide (second edition), which sets out the definitions and classifications used for the second CPIS in 2001.