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Interview

Krueger welcomes IMFC green light to continue developing sovereign debt proposal



Several people have said to me that they thought collective-action clauses were market-based, but that the SDRM was not. That has surprised me.

On September 1, 2001, Anne Krueger took up the reins as the IMF's First Deputy Managing Director. She brought with her a wealth of experience from the public and private sectors, including long stints in academia—most recently as an economics professor at Stanford University—and, from 1982 to 1986, as the World Bank's Vice President for Economics and Research. She is a Distinguished Fellow and past President of the American Economic Association.

IMF SURVEY: One closely watched item at our spring meetings was what would be decided on the IMF's proposal for a sovereign debt restructuring mechanism (SDRM) to help better resolve financial crises. Did the International Monetary and Financial Committee give the go-ahead for your proposal?

KRUEGER: Certainly it was a go-ahead for the IMF's proposal. As you know, *(Please turn to the following page)*

Köhler joins launch of Ghana's Investment Advisory Council

In recent years, it has become increasingly clear that one of the best ways for developing countries to raise the living standard of their people and join the ranks of advanced economies is to attract inflows of investment capital. With that in mind, Ghana took a further step toward making its economy more attractive to investors, launching the Investment Advisory Council (IAC). IMF Managing Director Horst Köhler, on the last leg of a five-country African tour, joined President John Kufuor and senior domestic and foreign business executives for IAC's inaugural meeting on May 3.

The IAC is intended to promote dialogue between the government and senior executives of local and international companies on ways to improve the investment climate. Kufuor stressed that his administration was committed to fiscal discipline and the rule of law and would ensure that investments in Ghana were safe.



Köhler (left) and President John Kufuor open the inaugural meeting of Ghana's Investment Advisory Council in Accra.

Investment trumps aid

"The success of countries that have . . . gone from third world to developed country status in one generation clearly shows that it is not aid or donor generosity that makes the difference: it is more *(Please turn to page 149)*

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Krueger stresses Doha Round

(Continued from front page) we did not, and do not, have every last detail of the proposed mechanism worked out. So, at each stage, we've asked our members whether we should keep developing it. And the committee certainly gave us a clear go-ahead for that.

At the same time, the international community is also keen to make progress on a complementary approach—namely, more ambitious use of collective-action clauses. Obviously, if that can be put into effect more quickly, it would help. We think, however, that the SDRM could do a number of things that these clauses would not achieve. So we are following a twin-track approach and working on both.

IMF SURVEY: How quickly could the collective-action clauses take effect?

KRUEGER: Anyone can put a clause in any bond issue anytime. But there are important jurisdictions in which there is no clear statutory basis that allows for the rights of a minority of creditors to be modified without their consent. And there are also jurisdictions in which a contract cannot be retroactively altered, which is a big problem. One possibility would be to have a country without collective-action clauses in its outstanding bonds offer to exchange them for new bonds that include them. If you did this at slightly more favorable terms, it could give people an incentive to switch over.

IMF SURVEY: In a recent interview with the *IMF Survey*, Professor Rudiger Dornbusch commented that he was surprised to see such a proposal coming from you. He thought you would have shared his worry about taking the job away from capital markets and giving it to some really bad institutions. Where does this proposal come from?

KRUEGER: Several people have said to me that they thought collective-action clauses were market-based, but that the SDRM was not. That has surprised me. I would have thought that anybody looking at the way modern market economies operate would see a rule of law as market-based. We have domestic bankruptcy laws, which are an indispensable part of a well-functioning market system. I see no reason why a similar approach would be any less market-based internationally than it is in a domestic context. But, some have argued for subsidizing the insertion of collective-action clauses, which is obviously not market-based.

IMF SURVEY: How long would it be before the SDRM could be operational? What are the financial implications for the IMF?

KRUEGER: We think it would probably take an amendment to our Articles of Agreement, not to extend the legal authority of the IMF but rather to allow the key decisions in the restructuring process to be made by the debtor and a supermajority of creditors. If we have agreement fairly soon and people want to do this, then it would simply be a question of how long it would take countries to ratify the amendment to the Articles. It wouldn't be something that could be done this year.

As for the financial implications for the IMF, it's hard to say what they would be. There is no reason in principle why the creation of an SDRM would automatically mean more or less IMF lending than takes place now. In addition, debts owed to the IMF would not be included in any restructuring under the mechanism. This reflects the fact that we provide a public good by lending when the private sector is unwilling to do so—and at rates well below those the private sector would charge. Including loans to the IMF in any restructuring would curtail our ability to do this.

IMF SURVEY: Of course, neither the SDRM nor a collective-action approach would help Argentina. How can the problems there be resolved?

KRUEGER: We have been talking with the authorities, and we are anxious to have a program that we can support as soon as possible. The international community is determined to help Argentina emerge from the current crisis, but support can be given only to a program that is strong and comprehensive enough to regain the confidence of the Argentine people and lay the basis for strong growth.

Our early contacts with the new economics team of Minister Roberto Lavagna encourage us that there will be continuity in our discussions and that the new team will move quickly to build on the progress made in the previous months. The 14-point plan put forward by the President and provincial governors recognizes the need for a comprehensive approach to Argentina's current situation. Now that plan needs to be developed into a consistent and sustainable program. This involves several key steps—for example, restoring order to the banking system, the payments system, and the foreign exchange market. A sound macroeconomic policy framework is, of course, essential in its own right and to restore confidence in the banks. Another key issue is amending the insolvency legislation and repealing the antismuggling law to provide a legal framework consistent with international standards. This is essential to get credit flowing again and to restore investor confidence, without which it will be very difficult to revive investment and growth in Argentina.

The 14-point plan put forward by the [Argentine] President and provincial governors recognizes the need for a comprehensive approach to Argentina's current situation.

—Anne Krueger

A critical area is addressing the fiscal weaknesses that have been at the heart of Argentina's difficulties and restoring a sound consolidated budget position over the medium term. Of course, there are limits to the adjustment that can be achieved in the midst of a sharp contraction of the economy. And it is also important to strengthen the social safety net at this difficult time. Nevertheless, rebuilding confidence and restoring growth will require an early start on structural reforms to pave the way for a sustainable fiscal position. That is why we have emphasized the importance of including the provinces in the fiscal framework and why we are seeking an early end to the practice by some provinces of issuing paper that circulates as a money substitute.

We look forward to working with Minister Lavagna and his team on this agenda. But the situation clearly remains volatile and the risks are significant. So it is essential that the new economic team move quickly and decisively.

IMF SURVEY: The IMF recently appointed a Director of Special Operations to enhance its ability to respond to critical situations. What needs is this meant to address, and how do you see it functioning in Argentina and in other areas?

KRUEGER: The idea is to have a place within the institution that can support and strengthen the response of area departments when crises arrive. After all, we don't have that many people working on a given country at any given time in the area departments. The Special Operations team has proved extremely helpful in dealing with Argentina's crisis. Quite clearly, we'll have to integrate this arrangement better into the institution for use in other cases. But area departments will stay in charge of country programs. There's no intention of changing that. However, we do want to provide additional resources to handle individual problems and to have people who are alert to some of the things that come up regularly in crisis situations, but not in normal surveillance situations or normal programs.

IMF SURVEY: What should the IMF's role be with regard to poverty and low-income countries?

KRUEGER: The evidence is overwhelming that, when you have macroeconomic instability, the poor are hurt the most. High inflation hits the poor the hardest, as they have fewer defenses. So I see our role first and foremost as providing governments with the tools and know-how to achieve macroeconomic stability, which is necessary for growth. And growth, in turn, will help the poor the most. In addition, on the budget side we can help countries in developing poli-

cies addressed more directly to the needs of the poor, such as rural health clinics or primary education.

IMF SURVEY: On trade, how detrimental do you find the current U.S.-E.U. flap over steel? Is there hope for a Doha Development Round? What do the developing countries need to do to position themselves to take advantage of it?

KRUEGER: Do I see it as a setback? Yes. Whether it's major, that's still a question. Certainly, it would have been better if it had never happened. Canadian lumber and U.S. agricultural subsidies are also now on the table. It is certainly true that if the developed countries increase their protectionism, then the prospects for growth in developing countries aren't as good as they would be.

Still, I do have hopes for Doha. One of the things that is forgotten in these discussions is that anything that makes the global economy more buoyant helps developing countries. When the world economy is more buoyant, right away that tends to increase commodity prices. It gives countries that are getting their trade and exchange rate regimes and their incentive structures sorted out access to markets. Moreover, when developing countries liberalize their own trade, they're also helping themselves. Sometimes, something like the Doha Round can be useful to give that final push to countries to do more of what they need to do anyway. It's easier to do politically if you've got the international commitment. Of course, everybody comments on the waste involved in agricultural subsidies. Getting rid of some of them or reducing them would be much easier in a round in which you have Japan, Europe, and the United States all liberalizing agriculture at the same time.

IMF SURVEY: Why would it be any easier politically to act on subsidies now than before?

KRUEGER: One reason is that the European Union is about to get larger, and it is going to find the subsidies so costly. The Doha Round might be a face-saving way for it to finally act.

IMF SURVEY: As the former Chief Economist of the World Bank, and now as First Deputy Managing Director, what do you think is the right role for research at the IMF?

KRUEGER: In academia, a researcher does whatever he or she wants. The real difference in an international financial institution is that a bigger chunk of the research has to be linked—but not necessarily always very closely—with the problems and issues with which the institution is grappling. It wouldn't be appropriate here, for example, to work terribly hard on aspects of auction theory that pertain to telecoms. This is an important research field, but we can't

Everybody comments on the waste involved in agricultural subsidies. Getting rid of some of them or reducing them would be much easier in a round in which you have Japan, Europe, and the United States all liberalizing agriculture at the same time.

—Anne Krueger

afford to have an academic department where everybody is going after everything.

When the IMF was first established, it did really outstanding work on balance of payments issues. For a long time, it was way ahead of academics in terms of understanding balance of payments phenomena. The IMF's Research Department became the premier place for doing research on these issues. Academics need to understand what the policy issues are, and where underlying research can really help. Without a research department at the IMF to form that bridge, there would be problems. Also, having strong analytical people within the IMF is helpful in terms of commenting on various policy issues, such as the SDRM and debt sustainability. So I see the Research Department as an integral part of the IMF, standing back a bit from day-to-day operations, but giving all of us help in thinking about those issues.

IMF SURVEY: I hear you've been walking around to departments. Impressions?

KRUEGER: I regularly see lots of senior people from departments, but in the course of my daily work I

don't often get to meet many others. So it's very helpful to just go around and meet people and find out what they are doing. It's surprising how quickly one can form impressions of what's going on. Once I've finished going around the departments, I'm hoping to get together with groups of younger IMF staff on an informal basis every now and then. But I'm still busy with my walk-about. I was going to try to do one a week, but I've been here eight months and probably done eight departments, which tells you how little spare time there is.

IMF SURVEY: Professor Dornbusch also told the *IMF Survey* that one of your best qualities for this job was that you had no problem saying "no." Any reaction?

KRUEGER: I keep hearing this, but it kind of surprises me. Certainly economic analysis and an understanding of issues do provide some insights. Also, you aren't doing any favors lending to countries if they are just going to end up more heavily indebted, with no improvement in their prospects. So where there isn't much prospect of anything successful coming out of it, I don't have any great difficulty in saying that I don't think we ought to lend. ■

IMF plans to set up five regional training centers in Africa

In a keynote speech in Accra on May 3 at the end of his one-week African tour, IMF Managing Director Horst Köhler said the IMF planned to establish five regional centers in Africa to beef up locally based technical assistance and training. It was often not lack of political will but lack of capacity, he said, that blocked progress in economic reform. The IMF—responding to a request from African heads of state last year—had been working to enhance its assistance for capacity building in Africa.

Köhler's visit to Africa took him to Tanzania, the Democratic Republic of Congo, Côte d'Ivoire, Burkina Faso, and Ghana. During the tour, he signed memorandums of understanding with President Benjamin Mkapa of Tanzania and President Laurent Gbagbo of Côte d'Ivoire to open the first two African Technical Assistance Centers in Dar es Salaam and Abidjan. These centers are expected to be up and running later this year.

The capacity-building plan, carried out in close cooperation with the World Bank and other donors, would, Köhler stated, concentrate on the IMF's core areas of expertise—including macroeconomic policy, tax policy and revenue administration, public expenditure management, macroeconomic statistics, and building sound financial sectors.

He observed there was mounting evidence that the policy approach embodied in poverty reduction strategy papers (PRSPs) was helping to set the stage for stronger growth, faster poverty reduction, and economic development. The review of the PRSP process recently completed by the IMF and the

World Bank had confirmed that the process was widely accepted as a promising way to tackle poverty. Köhler said the encouraging feedback from the PRSP review was corroborated during discussions he had held during his African tour. Governments were becoming more transparent and accountable and were listening more to the views of their citizens. With limited public resources, they were spending more on primary and secondary education and spending it more effectively. Moreover, an increasing number of donors were using the PRSPs in planning their own support for African countries.

While the progress so far has indeed been encouraging, a lot more work needs to be done, Köhler said. The IMF and the World Bank must do a better job of identifying the potential sources of sustained growth. The institutions should be prepared to discuss alternative ways to achieve agreed goals. Donors need to avoid unnecessary complications and delays in aid flows and give more weight to the needs and priorities of African countries in place of their own domestic political and commercial interests.

Köhler said that, at the end of this, his third visit to Africa since his appointment in 2000 to head the IMF, he was more convinced than ever that successful implementation of reform programs required national ownership. Countries must have room to select measures that they believe are in their best interest. He was also encouraged that the New Partnership for Africa's Development, formulated by African leaders themselves with the goal of ending Africa's marginalization, was emphasizing regional surveillance and "peer review." Köhler hoped the time was coming when African countries would learn mainly from African success stories.

It was often not lack of political will but lack of capacity that blocked progress in economic reform.

—Horst Köhler

Köhler urges candor, openness

(Continued from front page, bottom) the inflow of investment capital,” Kufuor said. His political party had long expressed the belief that the private sector was the best instrument for moving the economy forward. To ensure that the private sector did not encounter bottlenecks that impaired its performance, the Ministry for Private Sector Development had been set up “to ease the path of business.” The new ministry would instill a new culture in Ghana whereby public servants would act to promote, rather than obstruct, investment.

Shared billing for public, private sectors

Köhler, who also delivered a statement at the start of the IAC meeting, said that, while good governance was the top priority for establishing a favorable investment climate in a country, the provision of effective infrastructure for the private sector ranked a close second. A generation ago, he said, “it was fashionable to debate whether the state or the private sector should lead the way for economic development,” but it is now accepted that development requires both an honest, well-functioning state and a dynamic private sector. The promotion of favorable conditions for the private sector was where the IMF would base its cooperation with Ghana. Köhler was encouraged that Ghana—the first sub-Saharan African country to achieve independence in the postwar period—has become a leader in trying to build a “golden age for business.” The IMF’s vision, he emphasized, was not of new IMF-supported programs and loans for Ghana, but of the country’s economic “graduation” into a future as a nation with processing industries selling into developed-country markets.

Köhler recalled that he, with the World Bank, had been instrumental in formulating the concept of the IAC. The idea arose from his experience as the head of the European Bank for Reconstruction and Development—before his appointment to head the IMF—in supervising the establishment of similar bodies in Eastern Europe and the former Soviet Union. Although the results of these efforts had been mixed, one promising outcome was that, after about 18 months, governments began to realize that they needed to listen to business leaders.

Urging the IAC’s members to hold open and candid discussions, Köhler observed that, whereas diplomatic language might be appropriate in other forums, it risked blurring the council’s message. The council would be successful only if the government was willing to follow through on its commitments.

Köhler said staff of the IMF and the World Bank would attend Ghana’s IAC meetings as observers and offer assistance and support where needed. The two institutions’ resident offices in Accra also stand ready to cooperate with the council’s working groups and to provide information. The institutions would also consider any technical assistance requests related to the work of the council, especially for follow-up implementation needs and capacity building, in their respective areas of expertise. He urged the council’s members to consider the IMF and the World Bank as partners in their endeavors. The establishment of the IAC, Kufuor added, marks a fundamental shift in the IMF’s traditional role of policing fiscal and economic management and promoting capital investment. ■

Simon Willson
IMF External Relations Department

Attracting portfolio flows to Ghana

When Ghana’s new Investors Advisory Council (IAC) held its debut meeting on May 3, members identified 18 problem areas in government policy, which have been assigned to relevant ministries for action within six months. They include regulatory reforms related to land ownership and mining and labor laws; safety and security; infrastructure, especially for energy, telecommunications, and information technology; financial services infrastructure; public sector sensitivity to the private sector; restoration of competitiveness to the mining sector; the economy’s dependence on aid and commodity exports; and the need for a partnership among government, private sector industries, and labor.

The IAC meeting, chaired by J.H. Mensah, Ghana’s Senior Minister and Chair of the government’s economic management team, was closed to the media to encourage

candor in the exchanges between business and the government. According to the statement, members had followed IMF Managing Director Horst Köhler’s recommendation that both sides in the discussions be blunt, clear, and persistent and that they demand action.

Ghana’s Minister of Private Sector Development, Kwamena Bartels noted that the government intended to make Ghana a preferred destination for foreign direct investment, reverse the “brain drain” of skilled workers and executives, and put Ghana on the screens of global portfolio investors. Minister Bartels and the office of President John Kufuor would coordinate operations with the various ministries involved to ensure implementation of the agreed actions and resolution of the issues identified by the IAC. The members encouraged President Kufuor to invite a delegation of Ghanaian business leaders to accompany him on future overseas visits. The IAC will meet again in November 2002 to evaluate the ministries’ actions.

ABCDE 2002

Trade, investment, and productivity have key roles in development

While the UN Conference on Financing for Development, in March 2002, was one of the “big events of the year in development,” the most pressing issue now on the development agenda is to “stop the talk and get on with implementation,” declared World Bank President James Wolfensohn at the Fourteenth Annual Bank Conference on Development Economics (ABCDE), held in Washington on April 29–30. Among the wide-ranging themes discussed in the sessions were trade and poverty; Africa’s future: rural or industrial development?; education and empowerment; and investment climate and productivity. Conference highlights are covered below.



Andrew Berg



Alan Winters



Julio Nogués

In his opening remarks, Wolfensohn laid out the key questions associated with implementation: How can development be managed in a coherent, well-coordinated way? How can the effectiveness of development efforts be improved? And how can what’s proved effective be scaled up and rolled out in a sustainable way? Nicholas Stern, Chief Economist and a Senior Vice President at the Bank, echoed the call for action in his keynote address by urging the development community to change the way things are done and be willing to finance the cost of that change rather than underwrite the cost of not changing, as it had done sometimes in the past. The Bank, the IMF, and other international financial institutions have the critical ability, through their convening and advocacy roles, to bring about change at the international level, Stern pointed out. An important example of the convening role, Stern said, is the way in which the IMF and the World Bank support developing countries in carrying out the poverty reduction strategy process. This process requires that poor countries seeking low-cost loans from the IMF and the World Bank prepare comprehensive poverty reduction strategies with wide popular participation. The biggest challenge now in the area of advocacy, according to Stern, is to “change hearts and minds in rich countries on trade issues the same way we changed hearts and minds on debt issues.” But explaining to people in rich countries that subsidies are deeply damaging to both themselves and developing countries is very difficult, he said.

The links between trade, growth, and poverty were taken up in more detail by Anne Krueger, IMF First Deputy Managing Director, and Andrew Berg, of the IMF’s Research Department. Krueger and Berg concluded from their survey of the literature that trade liberalization in developing countries indeed tends to increase growth and that this growth is essential for poverty reduction. But they cautioned that “openness is not a ‘magic bullet.’” Trade policy is central, but just one of many determinants of growth, which is also promoted by strong institutions, macroeconomic stability, a supportive international environment, and avoidance of conflict.

Alan Winters, Professor of Economics at the University of Sussex, concurred with Krueger and Berg’s point about the importance of trade liberalization for poverty reduction. But Winters argued that the links between trade policy and poverty reduction are “less direct and strong than the volume and stridency of the current debate about the new round of trade talks would suggest.” In fact, Winters warned that parts of the agenda for the Doha Round of trade talks could actually threaten growth because they could distract resources from some of the higher-priority agenda items—such as cutting trade barriers in agriculture, which has great potential to reduce poverty. For this reason, Winters urged keeping the Doha agenda simple and focused on issues relevant to development. He recommended, for example, deferring the “Singapore issues,” arguing that investment, competition policy, government procurement, and trade facilitation should be taken up later. Discussant Julio Nogués of Di Tella University in Argentina echoed this sentiment, pointing out the large gap between developing and developed countries in terms of capacity for negotiating trade policy.

Why hasn’t Africa diversified?

Focusing on Africa, the region with the highest proportion of poor people, Paul Collier, Director of the World Bank’s Development Economics Research Group, observed that “30 years ago, the whole developing world was dependent on primary commodities; now Africa is uniquely dependent.” Other developing regions have undertaken massive diversification of their economies to avoid the problems inherent in an overreliance on commodities: exposure to large price shocks (and their negative consequences for output), poor governance, and a substantially

higher risk of civil war. Given the push for diversification elsewhere, does this mean Africa has an immutable comparative advantage in primary commodities? Based on the main findings of his paper, “Primary Commodity Dependence and Africa’s Future,” Collier argued that Africa’s resource endowments and locations are not intrinsically different from those of other regions. Rather, he said, Africa has bucked the overall trend toward diversification because its investment climate is poor and the costs of doing business are high. Under these conditions, its options are limited.

Collier proposed export-processing zones for African countries as one way of lowering these high costs and becoming more competitive in manufacturing. While he predicted that Africa will have no choice but to live with dependence on primary commodities for the next decade, he stressed that this does not lessen the urgency of addressing the associated problems. A range of policies would help, according to Collier, including making aid contingent on commodity prices and increasing transparency in corporate payments of primary commodity rents to governments.

In a thought-provoking presentation, “Could Africa Be More Like America?” Adrian Wood, Chief Economist of the United Kingdom’s Department for International Development, argued that the two regions share important similarities that have been almost completely neglected and upon which useful policy lessons for Africa can be drawn. For example, because Africa, like America, has abundant land, it will always have a larger primary sector and a smaller manufacturing sector than the land-scarce regions of Asia and Europe. And because much of Africa’s land is far from the sea—as much of North and South America’s land is—Africa is apt to have demographic and economic patterns comparable to that in America. That is, it will likely have relatively low concentrations of people living in its interior, and these people will be engaged primarily in agriculture and mining. Inhabitants in the more heavily populated urban coasts will likely be employed in industrial activities. But Africa’s tropical climate and its division into smaller economies will probably never quite allow it to catch up economically with North America, Wood suggested. He distinguished three policy priorities for a land-abundant region such as Africa: applying knowledge to nature by promoting scientific research, education, and training in agriculture and mining; spending more on transport and communications to facilitate the movement of people; and ensuring widely distributed access to land and education to minimize inequalities.

Productivity and prosperity

Reflecting on the guiding premise of the Bush administration’s approach to development policy, U.S. Treasury Undersecretary for International Affairs John Taylor cited increased productivity as essential for growth and poverty reduction. Greater numbers of higher-productivity jobs are “the explanation,” he said, for why some countries are rich. Taylor also reminded the gathering that the founders of the International Development Association (IDA), the World Bank’s concessional lending window, considered raising productivity to be a main purpose of the IDA and stated this explicitly in its very first principle.

Focusing on “a rather narrow slice” of the many important factors that affect the investment climate, productivity, and growth—specifically in African countries—Kenneth Rogoff and Carmen Reinhart, Director and Deputy Director, respectively, in the IMF’s Research Department, examined the role of price and exchange rate stability. Taking a historical perspective, they looked at why Africa has lagged other regions in attracting investment and concluded that four main weaknesses have hobbled the investment climate: bouts of high inflation, frequent currency crashes, the high incidence of war, and the likelihood of high free market premiums in countries that have dual exchange markets and multiple exchange rates. With regard to high inflation and frequent currency clashes, Reinhart and Rogoff found Africa’s experience little different from those of developing Europe and Asia; indeed, in some cases, Africa’s experience had been better. But in terms of conflicts and high free market premiums, historically, Africa has been different from all other regions.

Wars are an extreme form of instability, and Africa has had more than its share, Reinhart and Rogoff noted. Forty percent of the countries in Africa had at least one war during 1960–2001; 28 percent had two wars or more. Not only are wars likely to deter foreign direct investment, Reinhart and Rogoff pointed out, they also are often a source of another deterrent to foreign direct investment—inflation.

How prevalent have dual exchange markets and multiple exchange regimes been in Africa, and how have they harmed the investment environment? For one-third of the 1970–98 period, parallel market exchange premiums exceeded 50 percent in the sub-Saharan African countries that do not peg their currencies to the euro. Reinhart and Rogoff argued that these high premiums are “breeding grounds” for signif-



Paul Collier



John Taylor



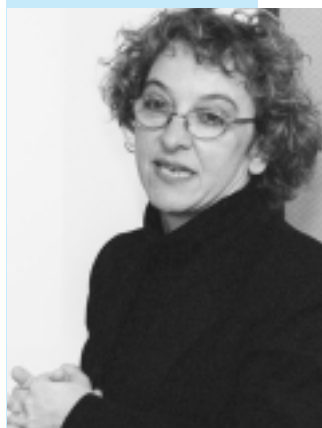
Carmen Reinhart

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Andrei Shleifer



Graciela Kaminsky

icant governance and corruption problems. While it takes persistence and consistency for a country to build an attractive investment climate, Rogoff emphasized that unifying multiple exchange rate regimes would reduce the distortions to which they give rise and be a key element in a transparent macroeconomic framework.

In a presentation on “The New Comparative Economics: A New Look,” Andrei Shleifer, Professor of Economics at Harvard University, explained the varying performance of capitalist economies by looking at differences in how they regulated market activities and legal procedures. There are, Shleifer stressed, “no perfect institutions” for market economies that are “suitable for every country and every time.” Legal history, level of development, and law and order all matter in determining the institutions that are most appropriate for a particular country, he said.

Effects of financial liberalization

Is financial liberalization worth it? Several papers presented during a parallel afternoon session of an economists’ forum explored the question and generally agreed that the results were mixed. Carmen Reinhart of the IMF and Ioannis Tokatlidis of the University of Maryland found that “as regards savings, anything goes.” After financial sector reforms, savings increased in some regions but fell in most cases. Overall, they argued, financial liberalization delivers greater access to interna-

tional markets, although the effects appear uneven across regions and income groups.

Graciela Kaminsky, Professor of Economics at the George Washington University, presenting the results of her research with Sergio Schmukler of the World Bank, concluded that financial liberalization can trigger changes in institutions that, in turn, support better-functioning financial markets. This is certainly true, they said, in the long run, as the excessive boom-bust patterns that may occur as an early response to liberalization tend to disappear. Looking specifically at equity flows to developing countries, Hali Edison of the IMF’s Research Department and Francis Warnock of the U.S. Federal Reserve Board’s International Finance Division said that the effect of freeing capital controls on future equity inflows varied by country and likely depended on whether or not controls were altered when they were binding.

The ABCDE, historically, features an assortment of topics. This year was no exception. Other papers covered intellectual property rights, restructuring and agricultural development in transition countries, network industry privatization, service delivery and quality of life in urban areas, health, financing constraints to the growth of small and medium-sized enterprises, making public services work for the poor, political economy of fiscal outcomes in federal countries, and the economic geography of poverty. Copies of the papers presented at the conference are available on the World Bank’s website at www.worldbank.org/abcde. ■

Jacqueline Irving
IMF Survey

Available on the web (www.imf.org)

News Briefs

- 02/37: IMF Managing Director Horst Köhler to visit Tanzania, Democratic Republic of Congo, Côte d’Ivoire, Burkina Faso, and Ghana, April 25 (see page 149)
- 02/38: IMF Completes Fifth Review of Indonesia Program, Approves \$347 Million Disbursement, April 26
- 02/39: African Regional Technical Assistance Center to Be Established in Tanzania, April 29
- 02/40: IMF Approves \$77 Million Disbursement to Jordan, April 30
- 02/41: IMF Facilitates Establishment of Islamic Financial Services Board, May 1 (see page 157)
- 02/42: African Regional Technical Assistance Center to Be Established in Abidjan, April 30

Public Information Notices

- 002/47: IMF Concludes 2001 Article IV Consultation with Costa Rica, April 24
- 02/48: IMF Concludes 2001 Article IV Consultation with Portugal, April 26

- 02/49: IMF Concludes 2002 Article IV Consultation with Burkina Faso, May 1
- 02/50: IMF Concludes 2001 Article IV Consultation with Gabon, May 3
- 02/51: IMF Concludes 2002 Article IV Consultation with Jordan, May 3

Speeches

- “Building a Better Future in Africa,” Horst Köhler, IMF Managing Director, Accra, Ghana, May 3
- Opening Statement by Horst Köhler, IMF Managing Director, at a Press Conference in Kinshasa, Democratic Republic of Congo, April 30

Transcripts

- Transcript of Press Briefing by Thomas C. Dawson, Director, IMF External Relations Department, April 30

Communiqués

- Group of Ten, April 21
- Development Committee, April 21

Globalization: a blessing or a curse?

Is globalization a positive force or a destructive force? On April 11, panelists at an IMF Economic Forum entitled “Globalization: North-South Linkages” explored what has happened to growth, poverty, and inequality as a result of trade and financial liberalization.

The panelists were Graciela Kaminsky, Professor of Economics at the George Washington University; David Dollar, Research Manager, Development Research Group, World Bank; and Carol Graham, Deputy Director of Economic Studies, Brookings Institution. Carmen Reinhart, Deputy Director of the IMF’s Research Department, moderated. The panelists seemed to agree that globalization may not bestow benefits uniformly across the globe but that it does more good than harm.

Graciela Kaminsky pinpointed the dichotomy that characterizes most discussions of globalization by asking if financial liberalization is a blessing or a curse. The answer depends on what literature you read. Those who consider globalization a blessing, she explained, look at the long-run effects, arguing that it improves the functioning of financial markets, allows risk to be diversified across countries, and triggers economic growth.

The opposing view, that globalization is a curse, looks at the short-run impact, citing evidence that most of the financial crises of the 1980s and 1990s were preceded by financial liberalization. This was true of all the Asian crisis countries, Kaminsky noted, which suffered recessions caused by excessive booms and busts in stock and real estate markets.

However, she said, there is evidence that, as liberalization persists, financial markets become much more stable. And this leads to the important question of how—and whether—liberalization and reform should be sequenced. Some argue that it is risky to open up a financial system that is not prepared to cope with free capital movements. For example, if a country has capital controls, its banks tend to be inefficient and have poor balance sheets. Dismantling the controls opens the floodgate to capital flows, and already-bankrupt banks can easily obtain new funding. A financial crisis is likely to erupt.

Thus, the solution appears to lie in cleaning up the institutional system before deregulation occurs. But others point to evidence that changes in institutions do not occur before financial liberalization, Kaminsky said. In fact, liberalization is needed to trigger an improvement in institutions. She urged policymakers to proceed carefully: if a financial crisis takes place after liberalization, capital controls are reinstated—as

has happened in Latin America—too soon for the country to derive any benefits.

Trade benefits the poor

Turning to trade, David Dollar said that North-South relations had changed dramatically over the past 20 years. Developing countries once exported mostly primary products, but many have now switched to services and manufactured products, which are also tied to foreign direct investment. Some developing countries may trade less today than they did 20 years ago, but

some others are participating very actively in the trade side of globalization. These “new globalizers,” as he called them (such as Bangladesh, Brazil, China, India, Mexico, and Vietnam),

include some of the world’s poorest countries. The countries that are less well integrated with the global economy are often poor (some sub-Saharan African countries fall in this group) but also include a number of lower-middle-income countries.

What is the impact of integration and nonintegration on poor countries and poor people? Some argue that expanded trade makes the rich richer and the poor poorer, while others say that, under some conditions, globalization helps developing countries grow and reduce poverty. Dollar said that World Bank and other studies support the second belief.

First, the research shows that developing countries that embraced globalization have generally seen accelerations in their growth rates over the past 20 years. During the 1990s, Dollar noted, they grew almost twice as fast as the rich countries (5 percent versus 2 percent)—and even excluding China, the most populous nation, the rate is still 3.5 percent. While acknowledging that causality was difficult to prove, he said there was pretty solid evidence that participation in trade and foreign direct investment was very good for developing country growth.

Second, Dollar said that World Bank studies also show that globalizing developing countries reduced their poverty rates in the 1990s and, at the same time, made rapid social progress. Wages and school enrollment rates have risen, and infant mortality and child labor have declined. Nor is there evidence that a systematic relationship exists between measures of global-



Carmen Reinhart (left) fields questions for panelists (left to right) Graciela Kaminsky, Carol Graham, and David Dollar.

There is evidence that, as liberalization persists, financial markets become much more stable.

—Graciela Kaminsky

ization and changes in inequality. In some of the new globalizers, inequality has increased, while in others income distribution has shifted in favor of the poor.

Third, integrating with the global economy is not only about trade and investment policies. Developing countries also need to put in place a range of other policies that will enhance the investment climate. For example, Bangladesh has reduced formal tariffs enough to qualify as a globalizer, but corruption and inefficient practices at its main port create bottlenecks in the transportation network that are tantamount to an 8 percent export tax. Problems clearing goods through customs are also common in a number of other developing countries and need to be addressed.

The bottom line? According to Dollar, since 1980, despite increases in world population, the number of poor people has declined by about 200 million because of rapid growth in low-income countries. Integration, he concluded, has been “one part of a successful strategy for many low-income countries to grow faster and reduce poverty.”

Are the poor getting poorer?

Carol Graham explored the question of income inequality in more depth. Much of the work examining this question has looked at Gini coefficients, which she described as “static measures—snapshots in time of particular countries’ income distributions and of the whole distribution.” So Graham and Nancy Birdsall (President, Center for Global Development) studied movements up and down the income ladder. Income mobility, Graham granted, is harder to measure—it involves obtaining data for the same group of people over time—but reveals much more than Gini coefficients.

To illustrate the relationship between globalization and income mobility, Graham and Birdsall compared mobility rates in Peru for the period during which it liberalized trade and implemented market-oriented reforms (that is, it embraced globalization) with those in the United States. They found that Peru, an emerging market economy, had both more upward and more downward mobility than the United States, widely known as the land of opportunity. Although unable to provide the reason, they reported that Peru’s opening to free trade had changed the rewards for education. Contrary to the expectation that unskilled labor would benefit the most from the opening to free trade, Graham said, skilled labor and better-educated groups saw the highest rewards. The explanation, she suggested, was that the real rewards went to countries with cheaper unskilled labor in Asia.

How well do people think they are doing? According to Graham, people’s perceptions do not

necessarily match the facts. In a sample survey, Peruvians with the greatest income gains over a 10-year period tended to have the most negative perceptions. They were generally not the poorest people, who tend to do quite well when trade is liberalized, but those who fell roughly in the middle of the income distribution. These “frustrated achievers,” Graham observed, not only saw themselves as doing less well than they actually were, but they also rated themselves less satisfied with their jobs and less optimistic about their economic situations. They also tended to be less favorably disposed to democracy and to feel that society should limit the incomes of the rich. Although surprising, these results are not unique to Peru. Over a 5-year period, Russians, even more than Peruvians, perceived themselves as doing very badly when they were, in fact, doing very well.

These beliefs, Graham said, have major policy implications. For example, insecurity is a huge issue. Most Latin American countries have no unemployment insurance or broadly available social insurance. Although the poorest members of society are generally protected during a recession, those in the middle do not have a safety net. “If we’re interested in sustained public support for globalization and the kinds of policies that reduce poverty and help countries grow over time,” Graham concluded, “we should think about this.”

How to measure openness

In the question-and-answer session that followed, Dollar fielded several questions about the connection between openness and growth. Hans Peter Lankes, Chief of the Trade Policy Division in the IMF’s Policy Development and Review Department, pointed out that the countries that scored highest on Dollar’s empirical tests of openness and growth were not actually the most open and had not liberalized as much as some other countries that had lower scores. In fact, he noted, China, India, and Vietnam were late liberalizers.

Dollar responded that he had defined globalizers factually, on the basis of increases in trade over the past 20 years, which he believes is a better measure of globalization than a country’s policies. Having served as an advisor to Vietnam, he had firsthand knowledge of that country’s reforms, in which trade liberalization played an important part. Vietnam reduced and stabilized inflation, gave land to peasant families, and liberalized trade simultaneously in 1989. Almost overnight, the rice crop increased, and Vietnam became the third largest exporter of rice in the world. In the first year, the income of the poor began to rise. This is a nice example of how different reforms interact,” Dollar said, and shows that trade liberalization is tied directly to the improvement in people’s lives in Vietnam. ■

Paris21

Building capacity to get good statistics

When world leaders, development experts, and non-governmental organizations convened recently in Monterrey, Mexico, they committed themselves to reaching internationally agreed development goals and acknowledged that more could be done to help countries strengthen their institutional capacity to achieve these goals. Hot on the heels of that conference and following up on its own work to improve statistical capacity in low-income countries, the IMF's Statistics Department sponsored a seminar on April 29–30 to weigh progress made, tap country views, and chart a course for future work.



Participants gather for the opening session of the Paris21 seminar on Statistical Capacity Building Indicators.

What do we know and what do we still need to know? The IMF's seminar on Statistical Capacity Building Indicators asked the managers of data-producing agencies from some twenty developing countries to review progress to date and help shape the course of the exercise. Opening the two-day exchange, Carol Carson, head of the IMF's Statistics Department, stressed "the time is ripe to look seriously at the question of statistical capacity, statistical capacity building, and statistical capacity building indicators."

Recent global summits have pointed to the crucial role that effective institutions can play in the development process, and converging trends have increasingly emphasized the need for good statistics. Carson cited, among other trends, the new "evidence-based" approach to poverty reduction and the greater transparency required by an international financial structure that places a premium on timely and accurate information sharing. The case is now being made for greater resources for improved statistics and revitalized attention to statistical capacity. But these developments have also prompted a realization that more needs to be known about what statistical capacity is, how needs can be determined, and how progress can be measured.

Why statistical indicators matter

In both international and national statistical communities, the issue of indicators has become more topical. Why? First, there are ever more pressing calls for accountability for technical assistance. Donors want measurable results, and national authorities want to know whether the results warrant the use of their own resources. And everyone wants to know what lessons have been learned.

Second, with globalization, statistics have assumed an increasingly international dimension, and national statistics are taking on the features of an international public good. Third, national authorities will soon reach a critical point at which they must begin reducing their

reliance on external aid and increasingly sustain their statistical capacity with domestic resources. It is imperative that countries prepare for this transition.

Paris21

In response to a growing interest in and need for a "culture" in which policymaking and monitoring rely on hard data, a global consortium of policymakers, statisticians, and other users of statistical data formed Paris21 (PARTnership in statistics for development in the 21st century) in November 1999. Under the aegis of Paris21, the Task Team on Statistical Capacity Building Indicators was established in May 2001. Chaired by the IMF and with representatives from the World Bank, the UN Statistical Division, the UN Economic Commission for Latin America and the Caribbean, the UN Economic Commission for Europe, and Afristat (an organization in Africa involved in the statistical development of 17 member states), this team is the first systematic attempt to develop indicators of statistical capacity building that can be applied internationally.

Developing these indicators is neither a quick nor a simple task. A long and cumbersome statistical process necessarily precedes data dissemination. The phenomena that need to be measured must be demarcated; the target population has to be identified; samples and questionnaires need to be designed; and data must be collected, evaluated, and edited. Adding to the complexity are the large number of agencies involved and the widely varying scope and quality of their data products.

Given this complexity, the team devised a strategy that featured both systematic and consultative approaches. The first step entailed adopting a frame of reference that could capture the full statistical system in all of its complexity. The IMF's six-part Data Quality Assessment Framework was selected. It provides for a set of institutional prerequisites and five essential dimensions: integrity, methodological soundness, accuracy and relia-



Task team members (left to right) Thomas Morrison, Advisor, IMF Statistics Department; and Willem De Vries, UN Statistics Division.

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At a closing session discussing the lessons learned are (from right) Ch. Davaasuren (Mongolia), Timothy Holt (consultant), D. Devi Manraj (Mauritius), Bounthavy Sisouphanthong (Lao PDR), Zarylbek Kudabaev (Kyrgyz Republic), Hussein Shakhateh (Jordan), and Soedarti Surbakti (Indonesia, with back to the camera).

bility, serviceability, and accessibility.

The second step describes the full gamut of statistical operations according to this structure, and the third step derives indicators from this frame of reference.

The fourth step—concurrent with the third—entails extensive consultation with both donors and country participants on the scope and nature of these indicators. The IMF-sponsored seminar is part of this consultative process.

At the end of this process, there will be a set of indicators—typically one or two pages long—that provides a snapshot of a country's statistical capacity. It is anticipated that the indicators will include two broad types:

- Quantitative indicators will provide for an overall description of selected aspects of the statistical sys-

tem, including the numbers of staff, surveys, and publications in broad areas such as economic data, population, education, poverty, and health.

- Qualitative indicators will focus on a few representative data in broad areas—such as GDP for the economic area, measuring, for instance, the extent to which international methodological guidelines are followed in the production of these data.

Country input

What did seminar participants have to say about the framework and the preliminary work on indicators? According to the country participants, the seminar proved particularly useful in familiarizing them with the framework from which the indicators are derived. Equally important, there were significant areas of agreement, and the seminar provided country participants with an opportunity to give direction on how the indicators should be presented and pose issues that the task team will have to consider further.

Recent publications

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- 02/62: *Holding International Reserves in an Era of High Capital Mobility*, Robert P. Flood and Nancy P. Marion
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- 02/78: Republic of Slovenia: Statistical Appendix
- 02/79: Nicaragua: Report on Observance of Standards and Codes—Fiscal Transparency Module
- 02/80: Guatemala: Request for Stand-By Arrangement
- 02/81: Senegal: Second Review Under the Third Arrangement Under the PRGF
- 02/82: Pakistan: First Review Under the Three-Year Arrangement Under the PRGF

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- 211: *Capital Account Liberalization and Financial Sector Stability*, by a Staff Team Led by Shogo Ishii and Karl Habermeier
- 213: *The Baltic Countries: Medium-Term Fiscal Issues Related to EU and NATO Accession*, Johannes Mueller, Christian H. Beddies, Robert M. Burgess, Vitali Kramarenko, and Joannes F. Mongardini

World Economic and Financial Surveys (\$42.00; academic price: \$35.00)

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- Foreign Direct Investment in Africa—Some Case Studies*, Anupam Basu and Krishna Srinivasan (\$10.00)

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Participants endorsed the systematic structure within which indicators would be presented and stressed the need to limit the number of indicators and ensure that they are simple to interpret and apply. Participants also agreed that although these indicators are being developed for managers of data-producing agencies to help them delineate their needs, this should not preclude their use by third parties, if and when required.

Many of the issues still to be clarified centered on how to develop benchmarks for the indicators. For instance, the indicator for the accuracy and reliability of data could be that adequate source data are exploited. For this indicator's benchmark, it will also be important to define degrees of adequacy of source data. This may mean determining whether, at one extreme, the source data are well managed (that is, for instance, that survey coverage frames are kept up to date) or poorly managed (for example, the frame is out of date or totally nonexistent). For timeliness and periodicity, a participant suggested that the benchmark rating could be based on the

IMF's General Data Dissemination System, which "is very useful for measuring statistical capacity building."

Next steps

Once the findings of the seminar are reviewed, an amended version of the indicators will be devised and tested over the next month or so in a small number of countries and amended further as experience warrants. The immediate goal will be to submit a first draft of the indicators to the Paris21 Steering Committee in mid-June and to have a final version available for its October annual meeting.

Countries would then, over the short term, have a bird's-eye view of their statistical capacity. Over the longer term, it is hoped that the development of effective statistical systems whose products are relevant to national needs will spur the country authorities to increasingly provide the resources needed to sustain these systems. ■

Lucie Laliberté
IMF Statistics Department

IMF facilitates establishment of Islamic Financial Services Board

On April 21, the central bank governors of Bahrain, Indonesia, the Islamic Republic of Iran, Kuwait, Lebanon, Malaysia, Pakistan, Saudi Arabia, Sudan, and the United Arab Emirates and senior officials from the Islamic Development Bank and the Accounting and Auditing Organization of Islamic Financial Institutions agreed to create an organization to promote good regulatory and supervisory practices and uniform prudential standards for Islamic financial institutions. That decision follows extensive consultation, coordinated by the IMF with the collaboration of the Islamic Development Bank and the Accounting and Auditing Organization of Islamic Financial Institutions.

Over the past decade, Islamic financial institutions have seen an impressive growth in assets worldwide, including in internationally active banks. Their financial products, based on the principles of Sharia'a (Islamic law), avoid interest payments and rely on contracts (including some based on profit and loss sharing) linked to real transactions. These products carry unique risks. The mixture of credit, market, and operational risks varies according to the design of the contract and the nature of the underlying real transactions. Contracts involve both current and future delivery and thus require careful identification, measurement, monitoring, and control of the underlying risk profiles. In addition, the markets for short-term and liquid instruments are underdeveloped, which has increased liquidity risks for these institutions and constrained the central banks' ability to manage systemic liquidity.

National supervisory authorities have been trying to adapt existing international standards to the specific risk characteristics of Islamic financial institutions and to design new asset-backed

instruments for liquidity management. During the IMF–World Bank Annual Meetings in Prague in September 2000, central bank governors and senior officials of Islamic financial institutions asked the IMF to help them form a standard-setting body. In the ensuing consultative process, V. Sundararajan and David Marston of the IMF's Monetary and Exchange Affairs Department spearheaded a series of meetings with central bank governors, as well as several technical meetings that helped work out the details of the organization.

The product of this work—the Islamic Financial Services Board (IFSB)—will be based in Kuala Lumpur, Malaysia, and will complement the efforts of the Accounting and Auditing Organization of Islamic Financial Institutions, which sets accounting and disclosure standards. The IFSB will maintain close ties with other bodies being set up to promote Islamic financial instruments and markets. To help strengthen and harmonize prudential standards, the IFSB will also

- set and disseminate standards and core principles—as well as adapt existing international standards—for supervision and regulation, consistent with the Sharia'a principles, for voluntary adoption by member countries;
- serve as liaison for and promote cooperation with other standard setters in the areas of monetary and financial stability; and
- promote good practices in risk management in the industry through research, training, and technical assistance.

Participating governors and senior officials asked Dr. Zeti Akhtar Aziz, Governor, Bank Negara Malaysia, to head a steering committee that would oversee the establishment and inauguration of the IFSB.

V. Sundararajan and David Marston
IMF Monetary and Exchange Affairs Department



At the April 21 meeting (from left), governors Dr. Mohsen Noorbakhsh (Central Bank of the Islamic Republic of Iran), Hamad Al-Sayari (Saudi Arabian Monetary Agency), and Dr. Zeti Akhtar Aziz (Bank Negara Malaysia) discuss the creation of the IFSB.

Interview with Eduard Brau

Protecting the IMF's resources aids central banks too

The IMF's Safeguard Assessment Program is an important element in the continuing efforts to promote transparency and accountability of economic policy-making institutions, in this case central banks. Launched after instances of misreported data and designed to protect IMF resources, the program has found a receptive audience among central banks. Eduard Brau, head of the IMF's Treasurer's Department, explains how the pilot project was created and why the program is now a permanent feature of IMF operations.

IMF SURVEY: The IMF has been lending its resources to member countries for quite some time. What prompted the recent concern about the misuse, or potential for misuse, of IMF resources?



Brau: "Incomplete or misleading information compromises our ability to judge policy aspects correctly and undermines the very integrity of our operations."

BRAU: In the late 1990s, we discovered that two large borrowers had misreported information to us and gained access to our resources under false pretenses. This was very serious. Incomplete or mislead-

ing information compromises our ability to judge policies and developments correctly and undermines the very integrity of our operations. At the same time, some in the advanced countries, including the United States, also alleged, but were not able to prove, large-scale misuse of IMF resources.

Traditionally, and especially in the context of negotiations to use IMF resources, the staff spends an awful lot of time checking the accuracy of information provided to them. After these cases of misreporting, there was a lot of head scratching about how it could have occurred. We concluded that our checking had not gone deep enough.

In one prominent case, information was kept off the central bank's balance sheet. The central bank did not provide a consolidated statement of its financial position. This was a major no-no, but one that we did not know was happening. In another instance, the country provided a consolidated statement, but with certain round-tripping transactions that artificially inflated the value of net international reserves. External auditors

had picked up on this but reported it in internal communication to the governor of the central bank, and we had no access to these documents.

When misreporting is discovered, the IMF's Executive Board normally asks the country to repay the resources it had incorrectly obtained, and remedial action is taken. But this is after the fact. What this misreporting experience told us was that we had to take preventive action to protect our resources. This led to the creation of the Safeguard Assessment Program, which is a mechanism to help prevent misreporting and possible misuse of IMF resources.

IMF SURVEY: How was the Safeguard Assessment Program devised?

BRAU: We drew on the advice of a group of prominent experts from advanced and developing economies. With the help of these experts—deputy governors of central banks, a chief accountant of a major financial regulatory agency, a chief auditor of a major central bank, and others—our staff created a pilot assessment program. We were looking for a careful methodology that could reassure us that a country wanting IMF financing had a central bank with reliable auditing, reporting, and control systems in place. And we wanted this methodology grounded in generally accepted codes and standards, particularly the IMF's code on transparency in monetary and financial policies. When we had all this, we were able to develop detailed assessment tools based on these broad, well-established principles.

IMF SURVEY: What triggers a safeguard assessment?

BRAU: A country's request to use IMF resources. Our Executive Board clearly indicated that the program would apply to new requests. Countries with existing arrangements would be required only to demonstrate that their central bank publishes an independently and externally audited financial statement. Financial arrangements with the IMF approved after June 30, 2000, however, require a full safeguard assessment.

The first step for us is to request information from the central bank. Once we examine this information, the staff concludes either that the requirements have been met, that questions remain to be answered, or that significant vulnerabilities appear to exist. In the latter two cases, the staff requests a visit to discuss these matters with the central bank on the spot. Usually the staff team is from the Treasurer's Department; at times,

they are joined by colleagues from the Monetary and Exchange Affairs Department and from the Office of Internal Audit and Inspection. Where possible, the staff will also ask outside experts to participate.

IMF SURVEY: *Can an assessment delay the release of resources?*

BRAU: The request for resources and the assessment are meant to be on parallel tracks. As soon as area [regional] departments alert us that negotiations for an IMF arrangement are in prospect, our department—Treasurer’s—initiates a request for documentation and, ideally, concludes the safeguard assessment before a program request is presented to the Executive Board for consideration. In practice, this is rarely possible, because of tight time frames, but the Board is keen that the safeguard assessment be concluded no later than the first review of the arrangement.

IMF SURVEY: *How does the IMF address the vulnerabilities it finds?*

BRAU: We first discuss them with the authorities. Where these vulnerabilities are serious, immediate remedies may be needed. In some instances, for example, we have discovered incorrectly valued net foreign assets. That can be a big problem that requires immediate correction.

In other cases, where, for instance, an independent external audit did not take place, the recommendation may be to do one beginning with the next financial year. When a central bank’s accounting standard does not meet minimum requirements, the suggestion would be to adopt an acceptable accounting standard, but this, of course, may require technical assistance and training where capacities are weak and may take longer. But the bottom line is that where vulnerabilities are significant, corrective actions should form part of the conditions attached to the use of IMF resources. And in severe cases, “prior actions”—steps taken before resources are disbursed—may be required.

IMF SURVEY: *Any big surprises from the pilot program?*

BRAU: The biggest surprise was a positive one. There was initial apprehension, including among some IMF Executive Directors, that central banks would view this as an intrusive exercise. Central banks, after all, had never undergone anything approaching this before. The biggest surprise has been how well central banks have received the program and how cooperative virtually all of them have been with us.

Why have the responses of the central banks been so positive? For one thing, we came with very specific, very hands-on recommendations grounded in widely accepted standards. All authorities want to run their

central banks well, so we often found we had allies in the central banks. I suspect many officials knew quite well what had to be done, but hadn’t yet been able to convince their leadership. It was always, so to speak, number five on the agenda, and they never quite got around to it. When we came and said something important needed to be done, an improvement was implemented—often very quickly. We were surprised at how many things did not require lengthy technical assistance, although this was available. Frequently, we provided a nudge in the right direction and it happened.

Of course, there were less pleasant surprises, too. We found at least 14 central banks, including 2 large borrowers from the IMF, that did not have, in early 2000, external audit mechanisms in place that met internationally accepted standards. In one case, we found a central bank that had never had an internal or an external audit of its financial statements. This was remedied very quickly. In other instances, there had been audits, but the financial statements were not published. This, of course, makes for zero accountability. In another country, we found that the independence of the auditor was patently compromised.

Frequently, too, the information supplied for regular IMF program monitoring was not, as a matter of course, reconciled to independently audited financial statements. This allows discrepancies to creep in—small at first but growing over time. We also found that many central banks were free to change accounting practices from period to period, which is not desirable. In some countries, the central bank authorities required the commercial banks to adopt International Accounting Standards within three years, but did not impose the same requirement on themselves.

IMF SURVEY: *After the 18-month pilot program, you had external and internal reviews of the program.*

Why both? And what did these reviews have to say?

BRAU: Our staff review was accompanied by an independent report by the panel of experts that helped us formulate the pilot project. We wanted an independent view to reassure ourselves and the Executive Board that what we had found and what we recommended was solid.

Because these assessments touch on sensitive matters, the detailed reports are kept confidential, and the Executive Board is provided with a summary of the findings. The panel of experts asked to review a range of the detailed reports. They selected the countries, reviewed the reports, and spoke with governors of central banks that had completed safeguards assessments. The panel of experts strongly concurred with us that the program had merit and had been well received.

The biggest surprise has been how well central banks have received the program and how cooperative virtually all of them have been with us.

—Eduard Brau



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They recommended that the program continue, with small technical changes that were chiefly intended to streamline the process and improve our outreach and public communication—something that has been addressed with the posting of the panel's report and the staff review paper on the IMF's website [www.imf.org].

The IMF's Board agreed with the panel's and the staff's recommendations and has converted this pilot program into a permanent feature of IMF operations.

IMF SURVEY: The Board praised the program highly but also cautioned against straying into institution building. Has this been an issue with central banks?

BRAU: This program is about safeguarding IMF resources; it is not about technical assistance. In most cases, the vulnerabilities are obvious and the central banks have moved to redress them. Where the recommendation involves an action that will require considerable time—such as the creation of an internal audit department in a central bank—we do not get into the details, which very quickly can get into institution building. Where the recommendation is to adopt a recognized accounting standard, we suggest a recognized standard. And if the central bank requests another year to implement such a standard, we can rearrange ourselves for that.

IMF SURVEY: What are the key challenges ahead?

BRAU: Doing all the work. The initial phase is very labor intensive. Seventy or so central banks are subject to the safeguard policy. In subsequent assessments, our work can be more focused, but the challenge will be to keep up with the large volume of work. This is quite a complex exercise and requires a sophisticated information system to ensure that the recommendations and agreed corrections are indeed carried out—not only on paper, but effectively.

IMF SURVEY: Can the program's benefits be made available to countries that do not have an IMF financing arrangement?

BRAU: Yes, definitely, at their request, and however we can be helpful. We have already had several instances in which countries without an IMF arrangement have sent central bank officials to us to learn about these assessments. We provide a three-day briefing on the program and share our methodology and tools with them. This is an open book—one we are very



From my point of view, the most important thing is leading by example.

happy to share. An Executive Director has suggested having the IMF Institute offer a course on it and found wide agreement with his suggestion. We are also thinking of holding a seminar for interested officials and the public during the fall Annual Meetings.

IMF SURVEY: And it all fits in rather nicely with the ongoing themes of transparency and accountability. The assessment program also seems to offer benefits quite beyond a country's access to IMF resources.

BRAU: Yes. From my point of view, the most important thing is

leading by example. A central bank cannot very credibly ask the commercial banks under its supervision to implement a generally accepted accounting standard that it does not fully comply with itself. A central bank is not unique with respect to transparency or accountability.

And these vulnerabilities are mostly avoidable, except, of course, in the very rare instances when otherwise suitable controls are consciously evaded. There is a consensus, now, about most good practices. The assessment program identifies problems, offers practical remedies, and often provides the nudge needed to get fixed what needs to be fixed. It's really a win-win situation for everyone. ■

Photo credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF; Simon Willson for the IMF, page 145 and 149.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
April 29	2.28	2.28	2.94
May 6	2.30	2.30	2.68

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?2002).

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

Data: IMF Treasurer's Department