

IMF's strategic review progressing

Speaking at Rome's Aspen Institute, Managing Director Rodrigo de Rato reviewed progress in the IMF's work to reshape its priorities and directions over the medium term, so that it can help its members meet the challenges of globalization. He highlighted the need to sharpen the focus of Fund surveillance on the interaction between macroeconomic and financial developments and to adapt the Fund's relationship with its emerging market members.



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Stefania Salsari/Aspen Institute Italia

How South Asia can adjust to higher oil prices

South Asia depends heavily on oil imports, and sharply higher prices are taking their toll on balance of payments and fiscal positions. The South Asian Association for Regional Cooperation met in Sri Lanka to devise effective strategies over the medium term. Given that permanent external shocks eventually require macroeconomic adjustment, the IMF's Wanda Tseng suggested that a good first step is moving to full pass-through of price increases, with measures to cushion the impact on vulnerable groups.



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Eriana K. Gochhayat/ANP

Learning more from financial sector assessments

The IMF–World Bank Financial Sector Assessment Program is designed to ferret out weaknesses in countries' financial systems and spur remedial actions. But has it been effective? And is the IMF making the most of its findings? The IMF's Independent Evaluation Office (IEO) recently reviewed this voluntary program and found the overall quality of the assessments high. But the report's chief author, David Goldsbrough, says the IMF needs to make better use of the messages that emerge from these assessments.



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Henrik Gschwindt de Goo/IMF

A more assertive role for the IMF?

Should the IMF be more assertive in tackling global imbalances? And, if so, how should it flex its muscles? A panel sponsored by the American Enterprise Institute weighed in on the topic, focusing on how the IMF could toughen its surveillance over exchange rate issues. Tim Adams (right), U.S. Undersecretary for the Treasury, suggested that this might be a good time to "destigmatize" the Fund's "special consultations" with countries whose exchange rates seem out of line.



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Chris Igo/US Treasury

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What's on

FEBRUARY

28–March 1 Joint IMF–Africa Institute high-level seminar, “Realizing the Potential for Profitable Investment in Africa,” Tunis, Tunisia

MARCH

7–10 International Conference on Agrarian Reform and Rural Development, Porto Alegre, Brazil

APRIL

3–5 Inter-American Development Bank Annual Meeting, Belo Horizonte, Brazil

4–6 Seventh International Scientific Conference, “Modernization of Economy and the State,” State University–Higher School of Economics, with World Bank and IMF participation, Moscow, Russia

5–6 World Economic Forum on Latin America, São Paulo, Brazil

22–23 IMF–World Bank Spring Meetings, Washington, D.C., United States

24 United Nations Economic and Social Council High-Level Meeting with the IMF, World Bank,

World Trade Organization, and United Nations Conference on Trade and Development, New York, United States

MAY

3–6 Asian Development Bank Annual Meeting, Hyderabad, India

20–22 World Economic Forum on the Middle East, “Embracing the Future: Unleashing the Potential of the Middle East,” Sharm El-Sheikh, Egypt

21–22 European Bank for Reconstruction and Development Annual Meeting and Business Forum, London, United Kingdom

22–23 Organization for Economic Cooperation and Development Forum 2006,

“Balancing Globalization,” Paris, France

22–27 World Health Assembly, World Health Organization, Geneva, Switzerland

31–June 2 World Economic Forum on Africa, “Going for Growth,” Cape Town, South Africa

JUNE

15–16 World Economic Forum on East Asia, “Creating a New Agenda for Asian Integration,” Tokyo, Japan

19–23 World Urban Forum III, Vancouver, Canada

JULY

15–17 Group of Eight Summit, St. Petersburg, Russia

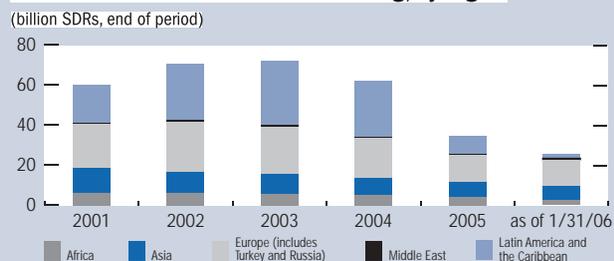
IMF Executive Board

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

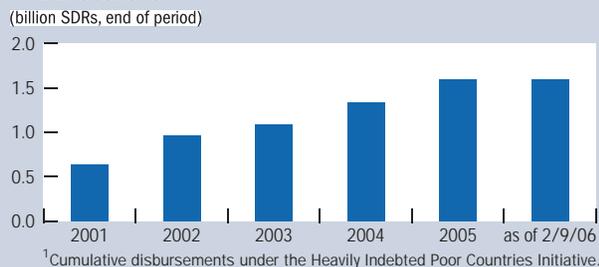
At a glance

IMF financial data

Total IMF credit and loans outstanding, by region



HIPC debt relief¹



Note on IMF Special Drawing Rights

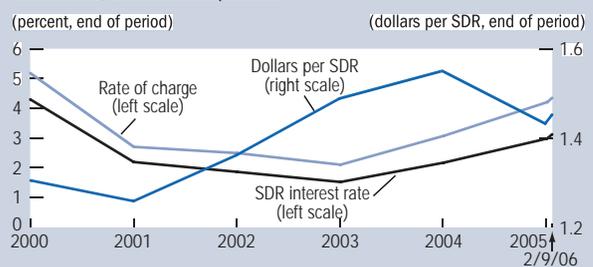
Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are

Major currencies, rates per SDR

	February 14, 2006	Year ago (end of period)
Euro	1.205	1.169
Japanese yen	168.382	159.059
U.K. pound	0.826	0.803
U.S. dollar	1.433	1.515

Related rates

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



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

De Rato outlines further progress with IMF's strategic review

IMF Managing Director Rodrigo de Rato outlined progress under way in the IMF's review of its medium-term strategy in a February 9 address in Rome. Stressing that the IMF must adapt to be able to continue to serve its members, he told his audience at the Aspen Institute that the IMF must, among other priorities, sharpen the focus of its surveillance and adapt its work with emerging countries.

Surveillance remains central

The Fund's surveillance of individual economies and the global economy is, de Rato observed, "the international community's chosen instrument to promote global financial and economic stability." The Fund has strengthened this key tool, he said, but it must now sharpen its focus—monitoring larger and systemically important economies more intensely and paying closer attention, in global surveillance, to the critical interaction between macroeconomic issues and financial sector developments and vulnerabilities.

To bolster the IMF's understanding of financial and capital markets, de Rato said, he decided to merge two existing departments to create "a single center of excellence" for all aspects of the Fund's financial, capital market, and monetary policy work. Going forward, steps will also be taken to "secure more effective integration of financial sector specialists into our country work."

On exchange rate surveillance, de Rato said an enhanced focus on exchange rate issues is needed. He welcomed several suggestions advanced by U.S. Treasury Undersecretary Tim Adams (see page 64), noting that they echo "very well" some of the IMF's own thinking. De Rato also raised the possibility of expanding the IMF's multilateral analysis of equilibrium exchange rates to include emerging market countries and advanced economies. "Such a globally consistent analysis could deepen the exchange rate discussion" in the Fund's country consultations, he said. De Rato also called for more prominence to be given to globalization issues—including country developments with international ramifications and the worldwide effects of demographic changes.

Redefining emerging country relations

Globalization has had perhaps the most profound effect on emerging market countries and the IMF's work with them. Once the focus of intense crisis-resolution efforts, many of these countries have benefited in recent years from domestic reforms, built-

up reserves, and calm markets, but de Rato said it is unrealistic to think that favorable market conditions would continue indefinitely, and many emerging markets remain vulnerable.

De Rato also saw room for the IMF to adapt its role as lender. Emerging market countries have repeatedly sought "contingent financing for crisis prevention, with substantial access and assurances that the money will be available to members when they need it." He looked to the IMF's Executive Board and others for advice on how to meet this demand. He suggested that one possible option was "an instrument carrying relatively high access" and available in a single purchase if a capital account crisis occurs—subject to a Fund-supported program being in place and on track. "We owe it to our emerging market members to address this issue," he said. "If and when they need our help, we must be ready."

Leveraging competencies

Despite increased debt relief and donor commitments, many low-income countries are still a long way from reaching the Millennium Development Goals. The Fund can play an important role in helping countries, "but to be effective, we must focus on our core competencies," where the Fund's advice can be most useful. These areas include fiscal, monetary, and exchange rate policies; reforms and institutions essential to macroeconomic and financial stability; and advice on how to adapt macroeconomic policy to handle higher aid flows. Capacity building in these areas is also an increasingly important aspect of the IMF's work. But given scarce IMF resources, the IMF will need to mobilize more donor support and consider levying some charges, consistent with countries' ability to pay.

Ensuring credibility

Finally, on the key issue of the IMF's own governance, de Rato underscored that the Fund's credibility going forward rests on its perceived legitimacy as a truly representative international institution. The concerns of emerging market countries, whose voting shares have not kept pace with their growing economic clout, and the erosion of the relative importance of the "basic votes" accorded to low-income countries will need to be taken up, he said, whether in a formal quota exercise or via ad hoc means. ■



De Rato (right): Steps will be taken to "secure more effective integration of financial sector specialists into our country work."

Stefania Salsusti/Aspen Institute, Italia

IMF issues first annual report on transparency

In its 2005 review of the Fund's transparency policy, the Executive Board requested regular updates on transparency at the Fund, including publication rates of staff reports on country surveillance (Article IV consultations) and Fund-supported economic programs. Consistent with that request and with the organization's continued efforts to promote greater transparency, the IMF released its first annual report on key trends in the implementation of its transparency policy. The report, released on February 1, shows publication trends for a wide range of staff reports, documents of countries' policy intentions, and IMF policy papers. It covers publication rates of different types of documents, lags in publication, recourse to deletions, and member countries' publication rates.

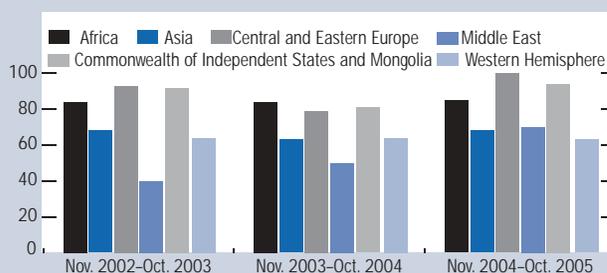
In 2003, the Executive Board endorsed the move to a policy of voluntary but presumed publication of most country reports, in particular all staff reports on country surveillance and on the use of Fund resources (UFR), as well as of most policy papers. This first annual report shows that the publication rate for Article IV and UFR staff reports discussed by the Executive Board between November 2004 and October 2005 reached 82 percent, up from 78 percent a year earlier. More-

over, 93 percent of all country documents outlining economic programs and 71 percent of all policy papers discussed by the Board in the same period were published. ■

Growing more transparent

Several regions, notably the Middle East and Central and Eastern Europe, have made significant strides toward greater transparency.

(percent published)¹



¹Publication rates refer to annual consultation (Article IV) and Use of Fund Resources reports considered by the IMF's Executive Board in each of the three time periods identified and published, respectively, by end-December of 2003, 2004, and 2005. Data: IMF.

More active role encouraged for private sector as Mauritius adjusts

After nearly two decades of impressive economic performance, Mauritius has seen its growth slow in recent years because trade preferences for textile and sugar exports have been phased out and the cost of petroleum imports has risen sharply. Growth is projected to remain slow over the next two fiscal years, according to the IMF's annual economic review.

The country's current account is now in deficit, the real effective exchange rate has depreciated, and net foreign official reserves have declined, although they remain at comfortable levels. On the fiscal side, a lack of adjustment of petroleum prices for six months (because of the temporary suspension of the automatic price mechanism) has undermined the overall fiscal position, which may deteriorate further in 2005/06.

The authorities recognize the need for fundamental reforms. To this end, IMF Executive Directors underscored the importance of a comprehensive strategy of structural reforms and policies geared toward macroeconomic stability. Specifically, Directors encouraged the authorities to explore a more active role for the private sector and emphasized the importance of creating a more flexible labor market to help workers transfer from declining industries to more dynamic ones. In the textile and sugar sectors, efforts to boost enterprise efficiency and seek new opportunities for textile exports are promising.

More broadly, Directors recommended that the authorities carefully monitor the financial situation of major state-owned enterprises and avoid support schemes for sugar and textile sectors that contribute to public outlays. A strong and credible medium-term fiscal strategy will be essential, Directors said, to contain public debt and ensure fiscal sustainability.

Exchange rate and monetary policies will also play a key role in securing external competitiveness in the short run. In this regard, Directors largely favored a cautious approach to containing inflationary pressures. They supported a request for technical assistance to develop a more diversified range of instruments but did not advocate, at this time, the adoption of a full-fledged inflation-targeting regime. ■

Mauritius	2000/01	2001/02	2002/03	Prov. 2003/04	Est. 2004/05
	(annual percent change, unless otherwise noted)				
Real GDP	6.0	2.5	2.9	4.2	3.5
Consumer prices (period average)	4.4	6.3	5.1	4.1	5.6
Real effective exchange rate ¹	2.8	-1.4	-1.7	-3.8	-6.0
Unemployment rate (percent of labor force)	9.1	9.7	10.2	10.3	11.0
Current account balance (percent of GDP)	3.4	5.4	2.4	0.8	-3.0

¹Fiscal year from July to June.

Data: Mauritian authorities and IMF staff estimates.

Strengthened economic management helps Zambia boost growth

After more than two decades of stagnation, Zambia's economy has recently grown robustly, according to the IMF's latest economic review. During 2000–05, real GDP growth averaged 4.5 percent a year, as mining recovered and construction picked up because of a surge in housing demand. But poverty remains widespread, and the economy is still vulnerable to shocks.

Growth slowed in 2005, owing to a drought-related shortfall in maize production and disruptions in mining activity. Inflation—in the high teens during most of 2005—moderated at year-end, partly in response to the sharp appreciation of the Zambian kwacha, but remains high. The appreciation was driven by strengthened market sentiment stemming from record-high world copper prices, a perceived commitment to prudent fiscal and monetary policies, and Zambia's improved debt sustainability outlook.

Through improved fiscal management, Zambia has reduced its overall deficit (including grants) while allowing for increased spending for poverty reduction. It is also implementing structural reforms to increase the efficiency and effectiveness of the public sector, improve debt management, deepen the financial sector, and promote private sector development.

The IMF Executive Board welcomed Zambia's efforts to strengthen public finances, which have helped improve macroeconomic stability and boost growth, and the authorities' com-

mitment to increase poverty-reducing spending. Noting potential pressures during an election year, the Board urged the authorities to maintain disciplined financial policies to safeguard the gains. It also encouraged them to accelerate pension reforms—necessary to avert a major risk to the public finances—and to remove impediments to business activity, expand access to credit, and improve infrastructure.

Debt relief under the enhanced Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative has greatly improved Zambia's external debt sustainability. Directors welcomed the authorities' resolve to avoid building up new external debt. ■

Zambia	2002	2003	2004	Est. 2005
	(annual percent change, unless otherwise noted)			
Real GDP	3.3	5.1	5.4	4.3
Consumer prices (average)	22.2	21.4	18.0	18.3
Real effective exchange rate (average) ¹	-5.8	-1.7	8.1	12.2
Export volume (goods)	11.2	1.8	16.6	5.5
Overall fiscal balance, cash basis (percent of GDP)	-6.3	-6.6	-1.7	-2.7
External official debt service ^{2, 3}	11.4	15.2	18.2	7.0

¹Estimate for 2005 reflects data for January–August.

²After debt relief.

³In percent of exports of goods and services.

Data: Zambian authorities and IMF staff estimates.

Guinea's new economic team committed to tackling poverty, addressing imbalances

During the early part of this decade, Guinea's economic performance deteriorated, largely because of weak policies and low export prices, according to the IMF's annual economic review. Growth slowed, inflation accelerated, international reserves dropped below one month of imports, and the external public debt remained unsustainable.

Economic performance improved in 2005, with a moderate recovery of real GDP growth. Inflation has declined since mid-2005 but will still exceed the government's yearly goal. The overall fiscal deficit (excluding grants) contracted significantly.

This improved performance followed a tightening of fiscal and monetary policy and measures to unify and liberalize the foreign exchange market. The authorities are also taking measures to enhance the business environment for the private sector, especially in banking supervision, governance, mining, and the judicial system. And they have adopted plans to improve delivery of electricity and water services and are privatizing government assets.

The IMF Executive Board welcomed the authorities' commitment to address macroeconomic imbalances, boost growth, and fight poverty, and it commended the steps taken in 2005. But more needs to be done if Guinea is to achieve macroeconomic

stability and reach the Millennium Development Goals. Directors therefore urged the authorities to implement promptly the measures adopted in their economic program. Guinea needs to achieve fiscal consolidation and diversify the export base to reduce its vulnerability to external shocks. The water and electricity sector reforms and the privatization of government assets, Directors said, should stimulate private sector-led growth and improve social conditions.

These steps will allow Guinea to move eventually to an IMF arrangement and reach the completion point under the enhanced Heavily Indebted Poor Countries Initiative. It can then benefit from the Multilateral Debt Relief Initiative. ■

Guinea	2002	2003	Est. 2004	Proj. 2005
Real GDP (annual percent change)	4.2	1.2	2.7	3.0
Consumer prices (annual percent change, average basis)	3.0	12.9	17.5	31.4
Exports, f.o.b. (million U.S. dollars)	708.5	731.7	743.2	789.9
Gross official reserves (months of imports of goods and nonfactor services)	2.3	1.2	0.8	1.1
Overall fiscal balance (percent of GDP; commitment basis, excluding grants)	-6.2	-8.9	-5.9	-1.4

Data: Guinean authorities and IMF staff estimates and projections.

For more information, please refer to Public Information Notices Nos. 06/03 (Mauritius), 05/158 (Zambia), and 05/165 (Guinea) on the IMF's website (www.imf.org).

High oil prices pose challenges for South Asia

With high oil prices likely to persist over the medium term, many oil-importing countries must decide how to adapt. The South Asian Association for Regional Cooperation (SAARC) met in Colombo, Sri Lanka, on January 20 to share their experiences with higher oil prices and discuss strategies. It also invited the IMF, represented by Wanda Tseng (Deputy Director, Asia and Pacific Department), to participate. In her remarks, summarized below, she surveyed the region's initial response, including partial price pass-through, external borrowing, and the use of reserves. Looking forward, she recommended moving to full pass-through and automatic price adjustments to encourage efficient energy use, as well as measures to cushion the impact on vulnerable groups.

Over the past two years, South Asia has been hit particularly hard by the doubling of world oil prices (see chart, left). Its terms of trade deteriorated by about 5 percent during 2004–05, reflecting higher import prices for oil and lower prices for garment exports after the Multifiber Agreement expired. This contrasts with virtually no change in the terms of trade of Asia as a whole over the same period, and a 9 percent improvement for developing countries as a group, with many of them benefiting from higher prices for nonfuel commodities. In addition, because of high oil intensity (the ratio of oil consumption to total energy consumption), South Asia's net oil imports also rose more sharply than those of Asia as a whole—by 2.3 percent of GDP in contrast to 1.2 percent of GDP (see chart, right).

Exports and remittances helped mitigate the impact of higher oil prices on South Asia's external current account, but non-oil imports were also buoyant. Despite falling textile and clothing prices, non-oil exports rose as a share of GDP in five of the six countries in the region. In some countries, workers' remittances increased as well, aided by the outpouring of help after the tsunami (Sri Lanka) and the fact that many South Asians (especially from Bangladesh and Sri Lanka) work in oil-producing countries. But non-oil imports also boomed, leaving most South Asian countries with higher current account deficits than could be accounted for by increased net oil imports.

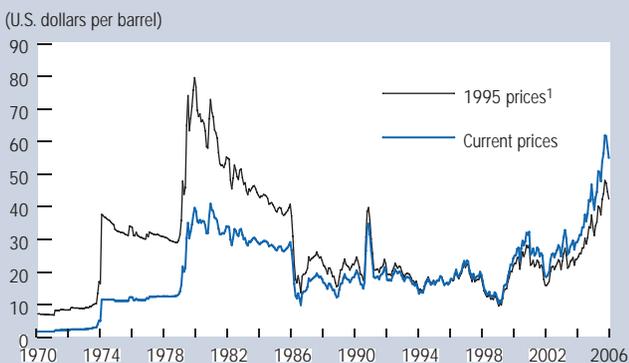
Overall, the impact of higher oil prices on growth has been muted. Apart from the Maldives, which sustained major damage from the tsunami, the oil shock coincided with a pickup in growth across South Asia. But inflation picked up as well, increasing by 3 percentage points a year, on average, in South Asia during 2004–05, compared with 1 percentage point for Asia as a whole.

Coping with the oil shock

How has South Asia responded to the oil shock? During 2004–05, most South Asian countries financed their current account deficits through external borrowing—usually by the government. The exceptions included Sri Lanka and the Maldives, where capital grants also played a significant role. Reserve coverage of imports declined in nearly all countries, too—with reserves in Bangladesh, Sri Lanka, and the Maldives falling below the equivalent of three months of imports.

Rising oil prices

Sharply higher world oil prices now pose significant challenges for macroeconomic management.

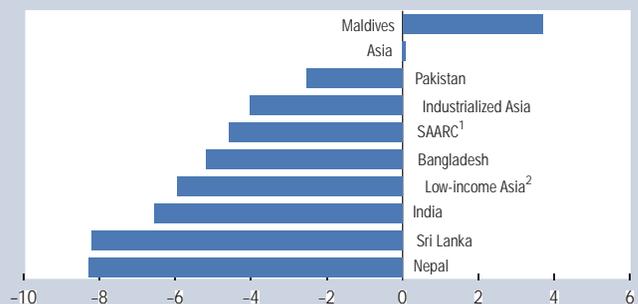


¹Deflated by U.S. consumer price index.

Data: IMF, Commodity Price System database; and CEIC Data Company Ltd.

Deteriorating terms of trade

South Asia has been particularly hard hit by the oil shock. (percent change, 2004–05)



Note: The terms of trade are defined as export deflator divided by import deflator. The change is calculated from 2003:Q4 to 2005:Q4 (estimated).

¹Unweighted average. Excluding Bhutan. SAARC = South Asian Association for Regional Cooperation.

²Excluding net oil exporters.

Data: IMF, World Economic Outlook database.

Healthy economic growth in 2004–05, however, helped offset increased borrowing. For most South Asian countries (except for Bhutan and the Maldives), external debt fell as a share of GDP. Nonetheless, with external debt above 45 percent of GDP in the majority of countries, indebtedness remains at vulnerable levels and is higher than the Asian average of 30 percent of GDP.

South Asian countries also responded to the oil shock by raising administered fuel prices. On average, they achieved full pass-through for gasoline price hikes since 2003. Their adjustment is comparable to industrial Asia's and more ambitious than that of other regions. However, for diesel and kerosene, the average pass-through has been 90 percent and 60 percent.

The incomplete pass-through (as well as the taxation of oil products) took a toll on public finances. Total oil subsidies amounted to 0.8 percent of GDP, on average, during 2004–05 for South Asian countries compared with an average of 0.4 percent for Asia as a whole (see chart, below). Budget subsidies in South Asia accounted for about 20 percent of total government expenditure; the remainder was financed by borrowing from state-owned banks, delayed payments to suppliers, and equity erosion of state-owned enterprises in the energy sector.

In fiscal and monetary policy, the region has made a limited adjustment to the oil shock. Since 2003, the stance of fiscal policy has been eased or remained the same in all but two South Asian countries (India and Nepal), and money growth has picked up in four (Bangladesh, Bhutan, India, and Sri Lanka).



The IMF's Wanda Tseng with Sri Lankan Central Bank Governor Sunil Mendis.

Robena Jayasinghena/Central Bank of Sri Lanka

Moreover, with the exception of Bangladesh, real effective exchange rates have appreciated in all South Asian countries, contributing to the strong growth of non-oil imports.

Future policy options

A permanent terms of trade shock eventually requires macroeconomic adjustment, and the optimal speed of that adjustment is determined by a country's access to external financing, its level of international reserves, constraints imposed by external and public debt, and its stage in the business cycle.

With oil prices likely to remain high, the full pass-through to domestic consumers is the best policy on both fiscal and efficiency grounds. Subsidization of petroleum products can crowd out productive expenditures, increase public debt, and undermine the financial positions of public enterprises. Below-cost prices also create distortions (for example, using kerosene to adulterate diesel) and prevent the adjustment in domestic demand that facilitates a return to a sustainable external balance. In the longer term, correct price signals induce countries to adopt alternative energy sources and pursue more energy-efficient technologies, which will serve the countries when they face future oil shocks.

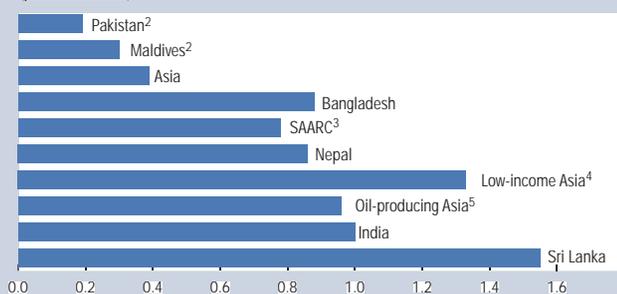
Some countries, for social equity reasons, have not passed on the full cost of oil price increases. But subsidies are typically inefficient and regressive, as evidenced by the substantial leakage of existing subsidies to high-income households. A more efficient and effective way to help the poor is to eliminate oil subsidies, use some of the proceeds to compensate them through well-targeted safety nets, and still record budgetary savings.

Consideration could also be given to converting ad valorem excise taxes on petroleum products to specific rates. Ad valorem taxation can increase tax revenues procyclically in oil-importing countries, placing an additional adjustment burden on the private sector.

South Asia needs to reconsider the balance between financing and adjusting to the oil shock. Those countries with high debts and low external reserves will need to adjust more rapidly. As experience has shown, a determined and timely adjustment is preferable to a large and disruptive one and eventually helps to minimize the negative effects often associated with external shocks. ■

Costly oil subsidies

Subsidies¹ remain for diesel and kerosene products. (percent of GDP)



¹2004–05 average for budget oil subsidies and losses of state-owned energy enterprise.
²No data available for quasi-fiscal losses.
³Unweighted average. SAARC = South Asian Association for Regional Cooperation.
⁴Excluding net oil exporters.
⁵Low income.
 Data: IMF, Asia and Pacific Department.

This article is based on "Macroeconomic Challenges of High Oil Prices in the SAARC Region," by Wanda Tseng, Olin Liu, Erik Lueth, and Marta Ruiz-Arranz.

New EU members provide lessons in opening up capital accounts

Nearly two years ago, on May 1, 2004, eight transition economies—the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia (EU8)—joined the European Union (EU), together with Cyprus and Malta. One of the requirements for membership was full capital account liberalization. Sizable or volatile capital inflows, particularly those sensitive to interest rates, can pose difficulties for monetary and exchange rate policy. A recent IMF Working Paper looks at the EU8's experiences with freeing up capital flows to draw lessons for other countries that will need to take this path.

The Czech Republic and the Baltic countries (Estonia, Latvia, and Lithuania) liberalized their capital accounts relatively quickly, with most transactions already unrestricted by 1995. In contrast, Hungary, Poland, the Slovak Republic, and Slovenia took a more cautious approach, achieving full liberalization only between 2001 and 2004. Different starting conditions help explain the varying liberalization strategies. Relatively high external debt in Hungary and Poland, for instance, made these countries more vulnerable to external shocks.

In terms of sequencing, the EU8 tended to liberalize foreign direct investment (FDI) before financial credit and portfolio flows, inflows before outflows, and long-term flows before short-term flows. This approach can be explained mainly by initial uncertainty about the success of the transformation. During the first years of transition, the authorities feared that high inflation and depreciating currencies might trigger capital flight. But the relatively fast macroeconomic stabilization in most of the countries dispelled this fear, and, from the second half of the 1990s onward, it proved more difficult to manage capital inflows than potential outflows.

As for the composition of flows, FDI was the largest component during the period under review (1995–2003), followed by other investment (financial credit) and portfolio investments (see table). More than FDI flows, other investment and interest rate-sensitive portfolio flows posed considerable difficulties for monetary authorities in terms of economic policy, external vulnerability, and financial stability. These inflows contributed to credit booms and exchange rate appreciation pressures in an environment where monetary

authorities had to find a delicate balance among furthering disinflation, minimizing sterilization costs, and maintaining external competitiveness.

Policy responses

Capital account liberalization opened the gate for substantial net inflows into the EU8 countries. EU8 authorities responded in a variety of ways, depending on the nature of the inflows and the country's short-term macroeconomic goals. After all, FDI flows usually require different responses than do interest rate-sensitive or portfolio equity flows. Policies also need to be attentive to concerns about inflation, economic growth, and current account balances.

The use of monetary and exchange rate policies was not an option for the Baltic countries, which had currency board and hard peg arrangements, but was the most common response to capital flows in the Central European countries. Initially, these countries had some form of fixed or crawling band exchange rate regime—apart from Slovenia, which had a managed float. In these frameworks, authorities used sterilized intervention widely in reaction to all types of inflows. Cautious interest rate cuts following the path of disinflation were also an integral part of the policy mix.

The move to more flexible exchange rate arrangements was motivated partly by the increased volume of capital flows, and, following the floating of their countries' currencies, monetary authorities increasingly differentiated their policy responses depending on the nature of the inflows. In the Czech and Slovak Republics, where inflows were dominated by FDI, the authorities continued to react mostly with sterilized intervention. In contrast, in Poland and Hungary, which attracted large amounts of interest rate-sensitive inflows in addition to sizable FDI inflows, the authorities abandoned sterilized intervention and allowed significant appreciations of their currencies. At the same time, interest rate policy became more active in the three countries—the Czech Republic, Hungary, and Poland—that had introduced formal inflation-targeting regimes.

Experience with fiscal policy as a response to capital inflows was mixed. Fiscal policy can mitigate the effect of inflows, but it is a relatively inflexible tool because of the prolonged budgetary procedures and the policy response lag.

Prospective capital account liberalizers should strive for relatively fast and sustainable disinflation to eliminate these interest rate differentials while aiming to minimize risks to the current account, financial stability, and economic growth.

In Estonia, Latvia, Lithuania, and Slovenia, tight fiscal policy generally helped to offset the effect of capital inflows. In the larger Central European countries, looser fiscal discipline did not help and, in some cases, exacerbated the difficulties caused by the inflows. Loose fiscal policy contributed to the slowness of disinflation in Hungary and the Slovak Republic and to large current account deficits in the Czech and Slovak Republics and Hungary. The lack of fiscal response placed most of the burden of disinflation on monetary and exchange rate policies, especially in Poland and Hungary.

Other policy responses to capital inflows were capital controls in Slovenia and early repayment of external debt in Hungary, Poland, and the Slovak Republic. Banking regulation and supervision continuously improved during the transition period, helping countries monitor and reduce the risks related to heavy capital flows. But measures directly responding to capital flows—such as the tightening of the reserve requirements on foreign liabilities by Latvian authorities—were rare.

Lessons learned

Successful transition economies and developing countries must learn to live with large capital inflows but should try to control the size and volatility of the interest rate-sensitive component of these inflows. In an environment of increasingly open capital accounts, interest rate-sensitive inflows can pose difficulties for monetary and exchange rate policy until the interest rate differentials with mature markets are narrowed or eliminated.

Prospective capital account liberalizers should therefore strive for relatively fast and sustainable disinflation to eliminate these interest rate differentials while aiming to minimize risks to the current account, financial stability, and economic growth. Achieving these goals requires highly coordinated and disciplined economic policies, with a larger role for fiscal policy in managing domestic demand than there has been in most EU8 countries. Policymakers should keep the following lessons in mind:

Interest and exchange rate policy. Interest rate policy is usually less effective in influencing domestic demand in emerging economies than in mature markets, and monetary and exchange rate policy independence is not as strong as it may seem. The interest rate transmission mechanism can be weak because of the easy availability of foreign exchange-denominated loans, high demand for borrowing related to low initial debt levels in the private sector, and the structural liquidity surplus in the financial system. In addition, exchange rate pass-through is generally stronger in emerging economies than in mature economies; therefore, relying predominantly on domestic interest rates as the main policy instrument may not be effective for reaching monetary policy goals.

Sizable net capital inflows

Foreign direct investment made up the lion's share of net inflows during 1995–2003, when the bulk of EU8 capital account liberalization occurred.

	Foreign direct investment	Portfolio investment into debt securities	Portfolio investment into equity securities	Other investment
	(billion U.S. dollars)			
EU8	134.0	19.3	8.2	41.4
	(percent of total)			
Poland	63.3	15.9	2.3	18.4
Czech Republic	81.6	-9.9	6.6	21.7
Hungary	76.9	21.5	7.2	-5.7
Slovak Republic	52.5	10.7	0.9	35.9
Lithuania	40.6	15.0	2.0	42.4
Slovenia	38.1	18.8	-2.3	45.3
Latvia	48.3	-19.2	1.0	69.9
Estonia	53.2	2.7	11.9	32.2

Note: Financial derivatives are not reported because their weight is negligible. Data: IMF, *International Financial Statistics*.

Speed of disinflation. Given the need to reduce domestic nominal interest rates and the uncertainties about the interest rate transmission mechanism, the speed of disinflation is key. If disinflation is slow, interest rate-sensitive portfolio inflows will tend to be persistent, given the prolonged period of sizable interest rate differentials, as Hungary and Poland discovered. Persistent inflows can lead to rapid credit growth and a large current account deficit. Thus, the policy mix should focus on relatively fast and sustainable disinflation while aiming to minimize risks to the current account, financial stability, and economic growth.

Fiscal and incomes policies. Since monetary policy has limited effectiveness, and openness to global capital markets reduces monetary policy's room to maneuver, fiscal and incomes policies should play major roles in managing demand. If disinflation is to be achieved quickly, fiscal and wage discipline is essential.

Cautious approach. The cautious approach to liberalizing the capital account seems to have mitigated somewhat the impact of large flows in the more vulnerable EU8 countries. As the examples of Hungary and Poland show, countries with slow disinflation and relatively developed securities markets are especially advised to open up their capital accounts cautiously. ■

Zsófia Árvai
IMF Monetary and Financial Systems Department

Copies of IMF Working Paper No. 05/213, "Capital Account Liberalization, Capital Flow Patterns, and Policy Responses in the EU's New Member States," by Zsófia Árvai, are available for \$15.00 each from IMF Publication Services. Please see page 64 for ordering details. The full text is also available on the IMF's website (www.imf.org).

AFRITACs step up efforts to build capacity in Africa

In a vigorous endorsement of the regional approach to technical assistance delivery and its responsiveness to member country needs, IMF Managing Director Rodrigo de Rato recently announced that a third Africa Regional Technical Assistance Center (AFRITAC), for Central African countries, could be established if the requisite external funding could be secured to complement the IMF's contribution. The IMF's decision follows an independent evaluation of the first phase of operations at the East and West AFRITACs and an IMF Executive Board review of the effectiveness of the IMF's five regional technical assistance centers worldwide. Executive Directors cited the important contribution that these centers make to the IMF's technical assistance program and lauded donors for their support, which has been crucial not only in providing financing but also in building broader country ownership of reforms and strengthening coordination of capacity-building efforts in member countries. The review also provides the basis for the East and West AFRITACs to move forward with an ambitious agenda in their second phase of operations.

When East AFRITAC opened in 2002, and West AFRITAC a year later, the intent was to expand the regional technical assistance concept to other parts of Africa, but only after the first two centers had established a track record and their effectiveness could be independently evaluated. A team of three independent evaluators (each nominated by donors, recipients, and the IMF) completed its assessment in 2005.

A strong start

How well is the regional technical assistance delivery concept working in Africa? The evaluators, in a report published in April 2005, found the AFRITACs to be an effective channel for capacity building and one that all beneficiary countries appreciated. In the evaluators' eyes, the centers "distinguish themselves from other delivery modes by their responsiveness to client needs, proximity to member countries, quick response time, familiarity with local context and issues, and relevant leadership." The report praised the centers' contribution to enhancing country ownership of reforms, increasing regional solidarity and the use of African experts, and improving accountability.

Nonetheless, the evaluators also saw room for improvement. They urged even greater use of African experts, stronger links between capacity-building plans and poverty-reducing strategies, and increased communication and coordi-

dination with donors and regional institutions. AFRITAC member countries and the IMF devised an action plan outlining steps to address these recommendations, better integrate the centers' work plans with those of the IMF's technical assistance departments, and improve the tracking of results.

And now, Phase II

The independent evaluation also provided a starting point for the IMF and other stakeholders to reflect on goals for the AFRITACs' second phase (May 2006 through April 2009). Donor support for the AFRITACs' first phase amounted to over \$18 million, with contributions from the African Development Bank, Canada, China, Denmark, Finland, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Norway, the Russian Federation, Sweden, Switzerland, and the United Kingdom. In advance of the second phase, an IMF-sponsored donors' conference in Paris in September 2005 discussed the funding needed to continue operations for the next three years.

In an address to the conference—attended by AFRITAC member countries, donors, other collaborating agencies, and IMF representatives—Abdoulaye Bio-Tchané (Director, IMF African Department) underscored how much the AFRITACs had accomplished, thanks to the firm support of donors and collaborating agencies, but noted that more needed to be done. The impressive growth of sub-Saharan African economies in recent years, as well as the prevailing favorable economic conditions worldwide, provides opportunities, he added, to secure even greater advances in Phase II. The chairs of East AFRITAC, Dr. Abraham Kidane (Senior Economic Advisor to the Government of Eritrea), and West AFRITAC, Jean-Baptiste Compaoré, M.P. (Minister of Finance and Budget of Burkina Faso), echoed these sentiments.

Conference participants generally agreed with this positive assessment and endorsed a proposed general strategy and work plan that remained focused on areas of IMF expertise but included more resident advisors in the centers, on-the-job training for member country officials, and results-based performance indicators to track center activities.

Following the Paris conference, IMF staff worked with donors and AFRITAC member countries to finalize Phase II plans before the steering committee meetings of the West and East AFRITACs, held on December 1 and December 6, respectively. Donors also pledged a total of \$15.5 million to finance Phase II. Coupled with a projected Phase I surplus

AFRITACs meet training needs

The IMF launched its Africa Regional Technical Assistance Center (AFRITAC) Initiative in response to calls from African heads of state for more help in strengthening institutions and enhancing their ability to design economic policies. East AFRITAC, which opened in Dar es Salaam, Tanzania, in 2002, serves Eritrea, Ethiopia, Kenya, Rwanda, Tanzania, and Uganda. West AFRITAC—temporarily located in Bamako, Mali—serves Benin, Burkina Faso, Côte d'Ivoire, Guinea, Guinea-Bissau, Mali, Mauritania, Niger, Senegal, and Togo.

This regional approach aims to deliver capacity-development assistance in the IMF's areas of expertise—public resource management, financial systems, and macroeconomic statistics. This assistance is largely demand-driven and responsive to country needs, closely linked to the poverty-reducing strategies of member countries, and coordinated with technical assistance provided by other donors and IMF headquarters. To these ends, the AFRITACs are designed to deliver technical assistance primarily through resident advisors (who not only develop a deeper knowledge of country needs and circumstances, but can also react more quickly to them). The regional provision of technical assis-

tance also recognizes the similar economic and policy challenges that neighboring countries often face, while regional training events allow country officials to share their experiences. Finally, the regional approach emphasizes the dynamic and collaborative relationship among the centers' member countries, donors, and cooperating organizations—a relationship embodied in a strategy-setting steering committee for each center.

Since their establishment, the AFRITACs have boosted the annual volume of IMF technical assistance to the region by almost 30 percent. In FY2005 alone, some 800 participants attended 24 AFRITAC training seminars and workshops. About half of these events were organized jointly with the African Capacity Building Foundation, a major partner of the initiative. Individual countries also saw significant achievements. For example, with East AFRITAC assistance, Kenya and Uganda have now implemented fully integrated domestic tax administrations. In the West, Guinea, Mauritania, and Togo have substantially enhanced their statistical systems and now post their metadata (the methodologies underlining the production of their statistics) on the IMF's website (www.imf.org).

that donors agreed to roll over, a Phase II budget of \$17.5 million was endorsed by both steering committees.

What's ahead

The East and West AFRITACs have set new priorities for the coming three years. Their goal is to consolidate and build on the gains of the past three years, with key enhancements including an added resident advisor for each of the centers; the introduction, when possible, of professional postings for civil servants from member countries; and even greater use of African expertise. Consideration will be given to the role that AFRITACs should play in coordinating technical assistance to countries and in helping them develop comprehensive capacity-building plans. The centers' work plans and strategic direction will also be updated through new needs assessments, taking into account countries' poverty-reducing strategies.

Technical assistance will focus on the following priorities in the second phase:

Public financial management. This will entail continued support of treasury management reforms and efforts to enhance the regulatory framework for managing public finances, assist in budget preparation, and address governmental fiscal relations.

Revenue administration. Emphasis will be on the operational level to complement tax policy advice and assistance

provided from IMF headquarters. The aim is to establish modern revenue administrations with a capable professional staff.

Financial sector supervision. The goal is to bolster capacity to build risk-based supervision systems, consolidate supervision, improve the resolution of weak banks, upgrade off-site supervision, and reform the legal and regulatory supervisory frameworks.

Monetary operations, public debt management, and financial markets. The key priorities remain pursuing payment system reform and developing domestic money and government debt markets. Best practices in reserve management will continue to be introduced.

Macroeconomic statistics. The centers will provide continued assistance with issues related to member country participation in the IMF's General Data Dissemination System, including better links between the system and countries' poverty-reducing strategies.

In terms of AFRITAC governance, initial arrangements have worked well and will largely be maintained. There is room, however, to better disseminate information on AFRITAC projects and work plans on the centers' secure websites. A results-based monitoring system will also be piloted to track performance. ■

Seng Chee Ho
IMF Office of Technical Assistance Management

Independent evaluation

IEO report on FSAP

Fund needs to make more use of results of financial system checkups

In 1999, the IMF and the World Bank established the joint Financial Sector Assessment Program (FSAP) to strengthen their monitoring of countries' financial systems and enable them to provide better policy advice. To date, close to half of IMF members (85 countries) have completed or are close to completing an assessment. However, a significant number of countries of systemic importance or with potential financial sector weaknesses have not yet agreed to participate in the program or in updates after initial assessments have become outdated. The IMF's Independent Evaluation Office (IEO) recently reviewed the experience of the program, focusing on the role of the IMF. The IEO's David Goldsbrough, who headed the study, spoke to Elisa Diehl of the IMF Survey about the findings.

IMF SURVEY: The IEO found that the FSAP, overall, has improved the Fund's ability to conduct financial sector surveillance. But it also found that the assessments have not been "mainstreamed" into the Fund's regular surveillance. What does that mean, and how can the problem be corrected?

GOLDSBROUGH: It means that the assessments have identified the problems that need correcting and that the FSAP reports to the IMF's Executive Board have captured these issues without too much loss of candor. But the Fund has tended not to absorb and use the reports' messages as much as it could. An Executive Board Article IV discussion is meant to serve as a strong peer review of countries' policies. Financial sector issues, unless a red flag is raised—and typically there isn't a major red flag—tend to play second fiddle.

Many FSAP mission leaders told us they could have said a lot more at the Board discussion if they'd been asked questions. All the information is in the report, but it has tended not to be picked up unless the Fund's Article IV report—its annual review of a country's economy—has given it prominence. Also, if there were differences of views between the FSAP team and the area department team about FSAP findings, the area department's views prevailed. It's a question of internal incentives. If the country authorities are not convinced there's a problem and don't own the message coming

out of the FSAP, the natural inclination is for area department staff to give the authorities the benefit of the doubt. That may downplay the vulnerabilities too much. These are expensive exercises, and the Fund should make sure that the messages are fully absorbed.

IMF SURVEY: How should the IMF's financial sector surveillance work be distributed between financial sector assessments, including updates, and its Article IV reports?

GOLDSBROUGH: A financial sector assessment looks at everything in an integrated manner, which can't be done all the time or for every country—it's too expensive, both for the Fund and for the authorities. For each country, the IMF should have a strategy for conducting financial sector surveillance. For some, that strategy might include relatively frequent FSAPs or updates. The key criterion is a country's systemic importance. If something goes wrong, will there be regional or global implications? And what are the indications of financial sector vulnerability? It's always a dangerous time when a financial sector is undergoing rapid change and reform. If such conditions exist, the IMF might want to give priority to a financial sector assessment and do updates more frequently. If they don't exist, you might want to do an initial assessment as a benchmark and then follow up through regular Article IV surveillance.



Henrik Gschwindt de Gyor/IMF

Goldsbrough: "We suggested that FSAP reports be more candid and that the recommendations be prioritized."

IMF SURVEY: In light of the proposed review of the IMF's Article IV coverage and process, how can the annual surveillance process be adjusted to make more effective use of FSAP findings?

GOLDSBROUGH: The IEO report made two proposals. First, to ensure that FSAP recommendations are absorbed into the surveillance process, we suggested that FSAP reports be more candid and that the recommendations be prioritized. The reports tended to make lots of recommendations without conveying a sense of which were the most important or urgent. We recommended that FSAP reports include a two-page summary of the most critical messages, which would make it easy to see if the messages are being picked up in the annual surveillance report. We also recommended that

FSAP team leaders be given a greater voice at the Executive Board meeting.

Our second proposal had to do with organizing the use of scarce technical expertise. The Fund doesn't have that many people who understand specific sectors of financial systems, and you still tend to have these so-called silo effects—that is, where the Fund isn't using the knowledge it's gained from the FSAP reports as effectively as it could. For instance, teams do an assessment for one country and then go to another country. There's little continuity, not just between the FSAP team and the area department team, but also within the Monetary and Financial Systems Department, where there's less interaction between the department's surveillance and technical assistance functions than there could be.

IMF SURVEY: Do countries have an incentive to agree to an FSAP?

GOLDSBROUGH: FSAPs are voluntary rather than mandatory, and we recommended that they continue to be voluntary. The evidence suggests that when countries are ready for their financial sector to be looked at and request an FSAP, they tend to make more productive use of the results. But it's important to recognize that strong financial systems are like a global public good. It's good not only for Mexico, Brazil, Germany, or Ireland to each have a strong financial system; it's also good for their economic partners. The IEO report suggested several ways to better signal the need and value of undertaking a financial sector assessment or an update, including IMF management clearly indicating to the Board those countries that it sees as the highest priorities, irrespective of whether they've volunteered, and periodic discussions by the Board of those priority countries.

Several IMF Executive Directors also said it would be important to consider why countries were not participating. Is it the cost of the exercise? Can the burden be eased through better planning? Or are countries concerned about the "beauty contest" aspect? They want to know what's wrong with their system and how to improve it but may be worried that they're going to get lower ratings than their neighbors. Those are legitimate concerns, and the way to deal with them is to downplay the ratings aspect because that's not the purpose of the exercise.

The real value added of the FSAP is that country authorities learn about their financial system and potential weaknesses and vulnerabilities and then take action to fix them. If that avoids crises or even larger spreads in borrowing costs

down the road, then the rate of return on that activity can be enormous.

IMF SURVEY: Other than leading by example, what is the incentive for the United States to agree to an FSAP?

GOLDSBROUGH: The United States has been reluctant to participate. It has said it would be expensive to analyze the world's most complex financial system and that the U.S. system has been so well analyzed that it already knows all the issues. To both those arguments, I'd say the FSAP offers a lot of value added. We've learned that from our assessments of other industrial countries.

Take Germany, for example. The authorities and other people we spoke to said the FSAP exercise did not raise issues they weren't aware of, but it was worth doing for several reasons. The FSAP raised a number of issues that needed to be discussed but hadn't been because they were politically inconvenient. For example, the FSAP recommended getting rid of a requirement that insurance companies distribute virtually 90 percent of their profits to their shareholders every year, which has made it difficult for the companies to build up reserves for bad years. What was essentially a consumer-oriented regulation had potential implications for the longer-term stability of the system.

In Ireland, which also has a sophisticated system, the FSAP again didn't tell the regulators anything they didn't know, but it took place during a huge debate over how to organize a U.K.-style consolidated regulator for the entire financial system. The central bank had run into political problems because of some consumer protection failures in the financial sector. A lot of politicians were saying the regulator should not be attached to the central bank. The FSAP report, pointing out some potential risks of detaching the regulator, affected the parliamentary debate. The FSAP served as a useful independent third-party observer. It had acknowledged technical expertise and brought in some of the world's best minds on these issues.

It's hard to speculate about what things in the U.S. system might be similar, but some parts of the U.S. financial supervisory system are not ideal—for example, the state-by-state insurance system. This is nothing new to people in the U.S. Federal Reserve, but the FSAP could be useful in identifying issues. Also, the demonstration effects are important. It is strange to say "this is a good diagnostic tool for everybody else, but we're above it." This is not the way peer review works. Either you're a part of it or you're not.

The real value added of the FSAP is that country authorities learn about their financial system and potential weaknesses and vulnerabilities and then take action to fix them.

—David Goldsborough

IMF SURVEY: Less than a year after its FSAP exercise was completed, the Dominican Republic experienced a major financial crisis. Why was the FSAP unable to identify problems on the horizon?

GOLDSBROUGH: The FSAP did its job; it identified major weaknesses in the regulation and supervision of the banking system as well as in balance sheets. It didn't identify the immediate cause of the subsequent crisis, which was that two

IEO recommendations

The IEO report spells out what actions the IMF should take, although, because the FSAP is a joint program, a number of actions could require the approval of the Executive Boards of both the IMF and the World Bank.

- The IMF's Executive Board and management should refine the criteria for setting priorities on the use of IMF resources for financial sector surveillance, including for the FSAP. Based on these priorities, IMF staff should identify the elements needed to strengthen financial sector surveillance in each country.
- IMF management should clearly signal to the Executive Board which countries are high priorities for FSAPs and updates, regardless of whether they volunteer.
- The IMF should strengthen the links between the FSAP and regular country surveillance by incorporating the key findings into the overall macroeconomic assessment of the country in a way that fosters a greater understanding of stability, a broader framework for policy recommendations, more meaningful discussion with authorities, and enhanced peer review discussion at the Board.
- The IMF and the World Bank should further improve the quality of the FSAP and strengthen its impact, for example, through better coverage of cross-border financial issues and better prioritization of recommendations and more candid discussion of the potential consequences.
- The IMF should modify the organization of its mission activities to use scarce financial sector technical expertise more effectively in the surveillance process.
- The IMF and the World Bank should maintain the current joint approach but further clarify the distinctive contributions each can make—with the IMF leading in cases in which domestic or global stability issues are at stake, and the Bank leading when financial sector development issues are paramount. Such clarity should include a clear delineation of primary responsibilities for setting priorities.
- The IMF, together with the World Bank and other providers of technical assistance, should design a clearer framework for coordinating follow-up technical assistance, based on each country's own action plans.

sets of books were being kept in one major bank and in several others. The FSAP didn't detect that outright fraud. But it can't be expected to—it isn't a substitute for effective auditing procedures.

But there was a failure on the part of the Fund in that the FSAP's messages didn't get translated into its Article IV surveillance. The staff report commented on different things about the financial system and essentially papered over the cracks. That was a mistake, and that meant there wasn't an effective Board discussion of those issues. But that doesn't mean that, if there had been an effective discussion, the crisis would have been avoided because, as I said, the damage had been done.

IMF SURVEY: In what areas are the FSAPs most successful?

GOLDSBROUGH: The general quality of the FSAPs we looked at was very high. They were most valued as an independent review by a group of technical experts and as a tool to identify what needed to be done to improve the system. Follow-up wasn't perfect—because of the mainstreaming problems I mentioned earlier—but the IMF's surveillance of the financial sector after an FSAP was better than before, so these exercises have had a lasting impact. Another area where follow-up was not effective was in the organization of technical assistance. Countries expressed disappointment with those results. Clearly, a better framework is needed for coordinating help for countries to build capacity.

IMF SURVEY: What must the IMF do now to make more effective use of FSAP findings?

GOLDSBROUGH: FSAP findings can be better prioritized, and the language can be clearer. Beyond that, there are the various actions I mentioned to mainstream FSAP findings into the Fund's Article IV reports. The big issue is how priorities are set. What issues should an FSAP cover, and what countries should receive an FSAP or an update? If the incentives for participation are strengthened, then the question is where to devote the resources. There are trade-offs between emphasizing global financial stability versus financial sector development. The FSAP is a joint Fund-Bank exercise, but each institution within the overall framework has to take the lead in those separate areas and set the priorities within them. ■

The IEO's "Report on the Evaluation of the Financial Sector Assessment Program" is available on the IMF's website (www.imf.org).

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

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
(million SDRs)				
Stand-By				
Bolivia	April 2, 2003	March 31, 2006	145.78	34.28
Bulgaria	August 6, 2004	September 5, 2006	100.00	100.00
Colombia	May 2, 2005	November 2, 2006	405.00	405.00
Croatia	August 4, 2004	April 3, 2006	97.00	97.00
Dominican Republic	January 31, 2005	May 31, 2007	437.80	288.94
Iraq	December 23, 2005	March 22, 2007	475.36	475.36
Macedonia, FYR	August 31, 2005	August 30, 2008	51.68	41.18
Peru	June 9, 2004	August 16, 2006	287.28	287.28
Romania	July 7, 2004	July 6, 2006	250.00	250.00
Turkey	May 11, 2005	May 10, 2008	6,662.04	4,996.53
Uruguay	June 8, 2005	June 7, 2008	766.25	674.30
Total			9,678.18	7,649.86
EFF				
Serbia and Montenegro			650.00	62.50
Sri Lanka			144.40	123.73
Total			794.40	186.23
PRGF				
Armenia	May 25, 2005	May 24, 2008	23.00	16.44
Bangladesh	June 20, 2003	December 31, 2006	400.33	184.55
Benin	August 5, 2005	August 4, 2008	6.19	5.31
Burkina Faso	June 11, 2003	August 15, 2006	24.08	6.88
Burundi	January 23, 2004	January 22, 2007	69.30	28.60
Cameroon	October 24, 2005	October 23, 2008	18.57	15.92
Chad	February 16, 2005	February 15, 2008	25.20	21.00
Congo, Dem. Rep. of	June 12, 2002	March 31, 2006	580.00	26.53
Congo, Rep. of	December 6, 2004	December 5, 2007	54.99	39.27
Dominica	December 29, 2003	December 28, 2006	7.69	2.32
Georgia	June 4, 2004	June 3, 2007	98.00	56.00
Ghana	May 9, 2003	October 31, 2006	184.50	79.10
Guyana	September 20, 2002	September 12, 2006	54.55	18.52
Honduras	February 27, 2004	February 26, 2007	71.20	30.52
Kenya	November 21, 2003	November 20, 2006	225.00	150.00
Kyrgyz Republic	March 15, 2005	March 14, 2008	8.88	6.35
Mali	June 23, 2004	June 22, 2007	9.33	4.01
Malawi	August 5, 2005	August 4, 2008	38.17	32.75
Mozambique	July 6, 2004	July 5, 2007	11.36	4.88
Nepal	November 19, 2003	November 18, 2006	49.91	35.65
Nicaragua	December 13, 2002	December 12, 2006	97.50	27.85
Niger	January 31, 2005	January 30, 2008	26.32	14.57
Rwanda	August 12, 2002	June 11, 2006	4.00	0.57
São Tomé and Príncipe	August 1, 2005	July 31, 2008	2.96	2.54
Senegal	April 28, 2003	April 27, 2006	24.27	0
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	February 10, 2006	65.00	9.80
Tanzania	August 16, 2003	August 15, 2006	19.60	5.60
Zambia	June 16, 2004	June 15, 2007	220.10	33.01
Total			2,688.99	1,089.15

EFF = Extended Fund Facility.

PRGF = Poverty Reduction and Growth Facility.

Figures may not add to totals owing to rounding.

Data: IMF Finance Department

Dealing with global imbalances

A large and growing U.S. current account deficit, with corresponding surpluses mainly in Asia and oil-producing economies, has spurred concerns that these imbalances may come undone in a disorderly fashion. Should the IMF, tasked with oversight of global financial stability and exchange rate policies, be more proactive? And, if so, how? These were some of the issues discussed at a February 2 panel organized by the American Enterprise Institute.

U.S. Treasury Undersecretary for International Affairs Tim Adams made a case for the IMF to be more assertive. In its annual consultations with its members, the Fund focuses on domestic economic developments, he said. While the choice of exchange rate regime is a country's to make, the IMF should ask tough questions: is the exchange rate regime appropriate? Is it sustainable? And, where relevant, what is an appropriate "exit" strategy? The problem, according to Adams, is that too many countries wait until circumstances are dire before abandoning an unsustainable arrangement. This can be costly not only for the country concerned but also for other countries.

"It is time for the Fund . . . to reach judgments about the consistency of exchange rate policies with members' international obligations and to do that across the membership, particularly in systemically important countries," Adams said. Ted Truman (Institute for International Economics (IIE)) suggested that the IMF publish quantified estimates of the extent of misalignment of countries' exchange rates and be more explicit in its policy advice, stating the extent to which a currency should appreciate or depreciate.

Destigmatizing special consultations

Adams also urged the IMF to "destigmatize" its "special consultations" with countries whose exchange rates seem out of line. The IMF has held these consultations only twice (Sweden in 1982

and Korea in 1987). Yusuke Horiguchi (Institute of International Finance) proposed simultaneous special consultations with individual countries contributing to multilateral imbalances and having the IMF draw up a coordinated remedial action plan and thereafter publicly track countries' compliance. Along similar lines, Truman suggested special collective consultations with a group of Asian countries. Michael Mussa (IIE) ventured that the United States could start the ball rolling by requesting a special consultation for



Masoud Elernadi/IMF

itself. To examine the U.S. current account deficit and possible exchange rate misalignment, the IMF would have to look at the issue from a global perspective and explicitly address the role of Asian exchange rates.

Shared responsibility

IMF Managing Director Rodrigo de Rato, at a speech

the next day at the University of California, Berkeley, called Adams's suggestions "interesting and constructive" and noted that efforts to strengthen IMF surveillance over exchange rates were under way. He looked forward to continuing discussions on this with all member countries in the months ahead. He also emphasized that global imbalances should be seen "as a shared responsibility by governments in systemically important countries. This will make the necessary actions both politically easier and economically more effective." He called on the United States to increase domestic saving and on China and other Asian countries to allow more flexibility in their exchange rate regimes and to undertake broader policy reforms to boost domestic demand. De Rato cautioned against complacency. The key challenge is to unwind global imbalances gradually, he said, and, to do this, it is important to abandon the pretense that global imbalances don't matter or will cure themselves. ■

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