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Interview with David Burton

Asia's economic outlook bright, with China leading the way



Burton: "China will need to strike the right balance between preventing overheating and avoiding an unduly sharp cutback in investment."

David Burton, a U.K. national who has worked at the IMF since 1981, took over as Director of the Asia and Pacific Department in late 2002. Laura Wallace spoke with him about the dramatic changes

that are now shaping the region, including the increasing economic prominence of China, deepening regional integration, a bigger emphasis on transparency, and the recent massive buildup of foreign exchange reserves.

IMF SURVEY: What is the IMF's assessment of the outlook for Asia in the near term and the longer term? What are the risks to this outlook?

BURTON: With the global economic expansion strengthening and deepening, the near-term prospects for Asia look good. For emerging Asia—which includes all of Asia except Japan—we expect growth this year to be over 7 percent, broadly the same as last year. This rate incorporates a modest slowdown in growth in China, to perhaps about 8½ percent, as investment, which is overheated in some sectors, is cut back. For most other countries, we see significant pickups in growth on the back of strong export performance. *(Please turn to the following page)*

Globalizing IT services, investing in human capital should generate high-skill U.S. jobs

In the 1990s, widespread investment in information technology (IT) boosted U.S. labor productivity growth and contributed to the country's economic dynamism. At a March 11 discussion, "White-Collar Outsourcing," hosted by the Institute for International Economics (IIE), Catherine Mann (Senior Fellow, IIE) argued that an even wider diffusion of IT throughout the U.S. economy, coupled with an upgrade of domestic IT skills, will spur a second wave of productivity growth. This, she said, can be achieved through a combination of the globalization of software and IT services, which will make the overall IT package affordable for more businesses, and domestic adjustment policies aimed at helping U.S. workers climb up the IT skills ladder, "as rungs on the bottom are moved elsewhere or eliminated entirely."

The most important driver of IT price declines is technological change. But in the 1990s, globalized production and international trade also helped lower prices 10–30 percent more than they would otherwise have been. The lower prices, Mann said, were key to broad-based investment in IT capital throughout the U.S. economy, which was responsible for more than half of the acceleration in labor productivity and added at least \$230 billion to GDP over 1995–2002. *(Please turn to page 85)*



The 1990s saw demand for high-skilled IT workers, such as computer software engineers, rise in the United States.

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Japan still needs to battle deflation

(Continued from front page) Moreover, the balance of short-term risk is probably on the upside, with the global economy gathering steam and the information technology sector, in particular, doing well. A downside risk is avian flu, but that seems to be receding.

Looking further ahead, there are reasons to be optimistic, though significant risks are present. Our baseline scenario for 2005 shows growth slowing only slightly, as some economies revert to growth rates that are more likely to be sustainable. However, the risks are familiar—including the need for an orderly adjustment of global current account imbalances and for managing the transition to higher interest rates globally and probably higher spreads on emerging market debt. In addition, China will need to strike the right balance between preventing overheating and avoiding an unduly sharp cutback in investment, particularly as a sharper slowdown than we have in our baseline scenario would have ripple effects around the region. More generally, for growth to remain strong in Asia, the region needs to continue with its agenda of domestic reforms. This means completing corporate and financial sector restructuring and, in some countries, further reducing high debt burdens.

IMF SURVEY: Quite a few Asian countries—Indonesia, the Philippines, India, Korea, and Taiwan Province of China—have elections this year. Are there concerns over their political resolve to carry out reforms?

BURTON: There is always a risk that preelection spending will put a dent in the budget—this is especially a concern in countries where the budget deficit is already big—and that politically difficult reforms will be postponed. We hope that once these elections are over and the political picture is clarified, there will be a new resolve to carry forward with needed reforms.

IMF SURVEY: How much progress has Japan made in restructuring its financial and corporate sectors? And is its period of stagnation finally over?

BURTON: Japan has made significant progress. If you look at the corporate sector, profitability has increased, particularly in the bigger, more export-oriented firms. On the banking side, too, the big city banks have made quite a lot of progress in dealing with their nonperforming loan problem. Progress is a bit less marked in the regional banks. As for the recovery, it's been driven not just by rising exports—hence, by the global recovery—but also by a pickup in private investment, reflecting progress in restructuring. There is more to do, and it's certainly too early to say that deflation is beaten. For the longer

term, a big challenge will be reducing the high debt level and narrowing the large fiscal deficit.

IMF SURVEY: The ASEAN+3 economies—the 10 members of the Association of South East Asian Nations plus China, Japan, and Korea—are strengthening regional financial cooperation and trade integration.

What is the IMF's view on the macroeconomic impact?

BURTON: These initiatives could potentially strengthen growth and financial stability in the region, and we have supported them. Their macroeconomic impact has so far, however, been relatively modest. The various bond market initiatives could deepen financial markets, diversify sources of finance away from bank financing, and reduce dependence on foreign-currency-denominated borrowing—something that has been a big concern in the region ever since the Asian financial crisis. The Chiang Mai Initiative—a system of bilateral swap arrangements—hasn't needed to be activated, but if it ever were, the loans involved would be pretty large. As for trade, the worry is that there is a proliferation of bilateral and regional initiatives that could lead to very complex tariff systems. Asia needs to maintain an outward-looking focus and not see these initiatives as substitutes for broader integration into the global economy.

IMF SURVEY: Do you feel that fears about the China threat have abated, at least in Asia, and that many Asian nations now regard the country as a major trading and business opportunity? Is the phenomenal growth in intraregional trade, particularly into and out of China, accelerating the pace of regional economic integration?

BURTON: I do think fears have abated. When I visited the region about 18 months ago, there was a lot of concern about competition from China. But these days, China is seen as much, if not more, of an opportunity than as a threat. The reason for this change is pretty clear: growth and a sharp rise in imports by China from the rest of Asia—close to 45 percent last year. This trade has helped many economies in the region recover. In fact, we even hear a slightly different concern—that is, hints of overdependence on China.

IMF SURVEY: Some say that East Asia, led by China, is becoming a second engine of global growth after the United States. Is China's growth sustainable, and how important is the future performance of the Chinese economy for others?

BURTON: East Asia, and particularly China, certainly is becoming an engine of global growth. In 2002, for example, East Asia accounted for about 44 percent

China's imports from the rest of the region have been growing rapidly, helping to spur recoveries in several countries, including Japan and Korea.

—David Burton



of global growth in terms of purchasing power parity weights. It also absorbed almost one-fourth of the rest of the world's exports. China, of course, accounted to a large extent for these impressive statistics. Also, China's imports from the rest of the region have been growing rapidly, helping to spur recoveries in several countries, including Japan and Korea.

Can China keep going at its recent pace? As I said earlier, growth may slow a little bit in the near term, but in the medium term, prospects are pretty good that China can keep growing quite rapidly—although not necessarily at 8–9 percent—if it tackles needed reforms. The priorities for reform are well known and include strengthening the banking system, where much remains to be done, and tackling the still large problems of the state-owned enterprise sector.

IMF SURVEY: China's trade surplus with the United States and the European Union has continued to increase. Is China playing fair with respect to international trade?

BURTON: You have to look at what's happening to China's trade in totality, not just to its bilateral trade with particular countries or regions. Over the past two or three years, China's trade surplus with the United

States and the European Union has gone up by some \$40 billion, but at the same time, China's trade deficit with the rest of Asia has widened by about the same amount. China's overall trade surplus has changed little in recent years. What is behind these developments? There's an ongoing restructuring of the production process in the region, with China becoming a manufacturing hub for exports to the rest of the world, while it imports parts from other Asian countries.

IMF SURVEY: The massive accumulation of foreign exchange reserves by key Asian countries has been one of the most striking global financial developments of recent years. Its aim has been to prevent or slow currency appreciation, even in some cases against the depreciating dollar. Particularly given the low returns—negative in real terms—on these reserves, has it really been in these countries' interests to lend to major industrial countries in this way? The IMF has been calling for greater exchange rate flexibility. Shouldn't it be pressing, in the context of its surveillance role, for more progress in this direction?

BURTON: After the Asian crisis, a lot of countries in the region needed to rebuild their reserves to reduce their vulnerabilities to future crises [see box below].

IMF urges China to pursue greater exchange rate flexibility

Following are excerpts of David Burton's address at the 2004 Credit Suisse–First Boston Asian Investment Conference in Hong Kong SAR on March 23.

"There is a view that the inflexibility of exchange rates in the region—especially in China—reflects a deliberate development strategy centered on export-led growth and an undervalued exchange rate. Some observers have also argued that the accumulation in reserves may be sustainable for some time, especially as the large supply of low-wage labor in China will keep inflationary pressures in check. It is certainly true that reluctance to see exchange rates strengthen against the dollar stems in part from concerns about the implications for growth and job creation. At the same time, it should be remembered that China stuck to its peg to the dollar throughout the Asia crisis while other countries in the region were depreciating sharply. Also, China maintained subsequently the present peg as the dollar strengthened through 2001. So China's exchange rate policy, in my view, at least partly represents a desire for stability and continuity. That said, I do not buy the argument that China's reserve accumulation can be sustained indefinitely without inflationary consequences. Even though the pool of low-wage labor is large, pressure will be put on the prices of other scarce factors, including land and skilled labor. And we can already see signs that inflation in China is picking up. In the end, real exchange rates will adjust one way or another.

Concerns have been raised by some observers that it would be premature for China to move toward exchange rate flexibility before resolving the weaknesses in its financial system. But this argument presupposes that greater flexibility would be accompanied by capital account liberalization that could trigger outflows from banks. In fact, there is no reason why limited exchange rate flexibility should pose significant risks for the financial system if capital controls stay in place. And experience in many other countries, with India a relevant recent example, shows clearly that managed exchange rate flexibility can be successfully introduced before capital account liberalization has gone very far.

What is the best way for China to proceed? Unfortunately, there is no ideal first move toward flexibility. Options include widening the band against the dollar or pegging the renminbi to a basket of currencies, or some combination of the two. A step-adjustment could also be made as part of an initial move. Any approach, however, could involve costs. In particular, inflows could be exacerbated in the short term if the move was seen as a prelude to further appreciation. This risk could be ameliorated by some very cautious further loosening of controls on capital outflows. There are, though, no easy or risk-free solutions to this complex issue, and it is for the Chinese authorities to decide how best to move toward their stated medium-run goal of exchange rate flexibility."

The full text of David Burton's speech is available on the IMF's website (www.imf.org).

China's trade surplus with the United States and the European Union has gone up by some \$40 billion, but at the same time, China's trade deficit with the rest of Asia has widened by about the same amount.

—David Burton

You can argue that, by now, reserve positions are really quite comfortable—if not more than comfortable—in many countries, and there isn't a need to build up reserves any further. Certainly, it is costly to hold reserves because the inflows have to be sterilized, and that, in turn, can make monetary control difficult, something we've seen in China and some other countries. That is why, for some time, the IMF has been strongly encouraging greater exchange rate flexibility in a number of these countries. This can also make a contribution to the orderly resolution of the global imbalances in current account positions.

IMF SURVEY: *Is India the new China?*

BURTON: India is definitely emerging as a force in its own right in the global economy. It has been growing rapidly in recent years, and growth has really picked up of late—to about 8 percent. That partly reflects recovery from drought, but there's more going on than that. Industry has been doing well, reflecting progress with corporate restructuring. Also, exports to China, especially of steel, have been doing well. Of course, everyone knows the story of the incredible growth in the information technology sector. But India isn't as open as China, which probably holds it back and keeps it from having as big an impact on the global economy.

IMF SURVEY: *Is opening up further a key priority for India?*

BURTON: Yes, India has got to keep going with reforms if it wants to keep growing.

Trade liberalization is certainly one area where it really needs to focus, because its trade restrictiveness is much higher than in other countries in emerging Asia. Reforms in the agricultural sector will also be important for raising productivity and incomes of the large rural population. And India has to deal with its very large public debt and high fiscal deficit—something the IMF has been harping on for a while. There are some signs that the deficit is beginning to come down, but it will take a big effort to put things on a sustainable path.

IMF SURVEY: *You've spent a lot of your time in the IMF working on Asia. What changes have been the most significant? How have these changes affected countries' relationships with the IMF?*

BURTON: There have been several important changes: the new emphasis on regional integration and cooperation, the very large role of China, and the greater emphasis on the need for transparency and best prac-

tices in areas such as the financial sector, corporate governance, and statistics—prompting us to provide increased amounts of technical assistance in some of these areas. The nature of the IMF's relationship with the region has also changed. After the Asian crisis, we had big financial support packages with a number of countries. Now that period is over. Korea and Thailand have fully paid back their loans, and Indonesia has reached the point where it doesn't need an IMF program any more. So our relationship with these countries is a normal one of surveillance and providing technical assistance. This is a healthy evolution.

IMF SURVEY: *The IMF is supporting programs in a number of smaller Asian nations with its concessional lending facility, the Poverty Reduction and Growth Facility. How would you assess Asia's record in recent years in poverty reduction? How does it compare with Latin America and Africa?*

BURTON: Asia has done quite well in recent years, certainly relative to other regions. This is particularly true in the fastest growing economies, like Vietnam, which have focused on rural sector reform. In fact, one lesson we've learned is that growth needs to be broad-based to make a real dent in poverty. Cambodia has been growing quite fast over the past few years, but the growth has been concentrated particularly in the textile sector and not so much in the rural areas, so we don't see the poverty indicators improving very much. Other countries, like Mongolia and Nepal, need to grow much more quickly. Overall, Asia is probably better placed than other regions to reach some, if not all, of the Millennium Development Goals by 2015. But the poorer countries in Asia are going to need a lot of help in this effort. ■



India has benefited from incredible growth in its IT sector. Above, employees monitor an incoming call at a 24-hour call center in Bangalore, India.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
March 15	1.61	1.61	2.13
March 22	1.60	1.60	2.11

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/cgi-shl/bur.pl?2004).

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

Data: IMF Finance Department

Tax credit may entice firms to step up IT training

(Continued from front page) Without a globalization of IT hardware production, GDP growth in the United States might have been 0.2 percentage point less a year in the second half of the 1990s, she added.

At the same time, globalization did not, on balance, undermine competitiveness as U.S. multinational firms maintained a net positive trade balance in IT hardware exports. By sourcing their components abroad, Mann said, these firms were able to build a competitive foundation for enhanced export competitiveness for IT hardware.

What about IT jobs?

The diffusion of IT investment throughout the U.S. economy is reflected in the fact that two-thirds of U.S. workers who use IT in their occupations—such as programmers, systems engineers, analysts, and database administrators—work in non-IT sectors. But has investment in IT equipment and software translated into job creation? They move in lockstep, said Mann, pointing to the rate of change in the number of jobs and investment in IT software processing equipment, both of which boomed beginning in 1991, peaked in 1997, and declined dramatically in 2001. In 2003, however, growth in IT investment picked up again, and the decline in IT job growth moderated.

Moreover, over the course of the 1990s, the demand for workers with the highest IT skills rose rapidly in conjunction with investment in IT. Mann compared IT employment numbers for 1999 with those for 2002. Over that period, she noted, about 241,000 people in the sector—data entry operators, computer operators, and computer programmers who earned between \$23,000 and \$64,000 a year—lost their jobs. Over the same period, however, the number of computer software engineers whose annual salary averaged nearly \$75,000, grew by more than 115,000. The data do not differentiate, however, between jobs lost because they moved abroad and jobs made obsolete by new technology and possibly replaced by higher-paid positions. But this very rapid increase in the demand for more sophisticated IT skills is important for policymakers to keep in mind, Mann said.

Future sources of productivity gains

The sectors of the U.S. economy that had the greatest uptake of IT during the 1990s were wholesale trade, securities and commodities brokerages, depository institutions, and telecommunications. These sectors, which also contributed most to productivity gains, are intensive users of skilled IT workers and have

managed to retain a positive financial balance in the trade accounts. In contrast, two other large sectors—health services and construction—stand out for not being IT-intensive and for having below average productivity growth. Small and medium-sized enterprises also generally invested less in productivity-enhancing IT. Mann emphasized that IT-based productivity gains could be achieved in these lagging sectors, particularly if globalization of software and services takes on the pattern of the price declines that have characterized the globalization of IT hardware production. Getting these sectors to improve their use of IT capital, she said, would enhance IT diffusion, leading to job creation and productivity gains.

A major obstacle facing the industries that did not participate in the productivity growth of the 1990s is the increasing share of software costs as part of the IT package. “What was globalized and globally sourced in the 1990s was IT hardware,” Mann said, but increasingly important on that hardware platform are software and service applications. As the platform price has fallen, the proportion of services and software in overall costs has increased, and now represents at least 50 percent of the total package of software services and hardware.

The second obstacle to meeting the needs of these lagging sectors is the difficulty and cost involved in writing software applications for these industries. The big players in the software and service application industries “have gone and picked up the \$1,000 bills that are on the sidewalks,” explained Mann, adding “there are lots and lots of \$100 bills down there, but it has not been worth their while, yet, to pick them up.” One thing that will increase the attention that software firms pay to these unexploited opportunities is the capacity to outsource production of IT products that are more routine and do not involve design, marketing, integration, or analysis of customer needs. Outsourcing these jobs will reduce the price of software and service applications and will generate increased investment in IT and, along with it, Mann indicated, more jobs for IT workers.

Investing in people

Mann conceded that the specter of losing white collar jobs looms large: the globalization of software and IT



Mann: “Higher-paid jobs that demand IT skills are projected to grow very quickly in the United States, especially as more sectors of the economy and more businesses use IT packages.”

services means that some IT jobs will be performed abroad. The job categories that are projected to shrink, however, are at the low-wage, low-skill end of the IT job spectrum. Higher-paid jobs that demand IT skills are projected to grow very quickly in the United States, especially as more sectors of the economy and more businesses use IT packages.

For workers hurt by international competition, Mann supported extending unemployment benefits and wage insurance. More generally, she called for a strategy to ensure open markets abroad for internationally competitive services. But it will also be vital, Mann explained, to ensure that U.S. workers are prepared to fill higher-skill jobs. To be able to compete internationally and be domestically strong, “we need to invest in people,” she said. To this end, Mann recommended the introduction of a tax credit for investment in human capital, based on the same rationale as that for the tax credits for research and development and capital investment. Specifically, the tax credit for investments in human capital would mitigate the

incentives that firms now have for not training workers because they fear losing them to rival firms. Firms could apply for a partial investment tax credit to cover the cost of training. Asked why the firm should receive the credit as opposed to the individual, she said that the firm plays a vital role in matching workers’ skills to specific jobs. And, in general, job training done through firms is significantly more successful than when done through other venues.

How likely are firms to take advantage of a tax credit for human capital? And, even if they do, how likely is it that workers truly in need of training will receive it? This selection problem applies to other tax credits, Mann said, but “if it’s good for capital and good for research and development, then why not apply it—with all the well-known warts—to people?” We ought to take this opportunity now, she said, “rather than wait for years.” ■

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Available on the web (www.imf.org)

Public Information Notices

- 04/16: IMF Executive Board Discusses Financial Risk in the Fund and the Level of Precautionary Balances, March 5
- 04/17: IMF Concludes 2004 Article IV Consultation with Bosnia and Herzegovina, March 5
- 04/18: IMF Concludes 2004 Article IV Consultation with Canada, March 10
- 04/19: Follow-Up on the Recommendations of the Independent Evaluation Office Report on Fiscal Adjustment in IMF-Supported Programs, March 11
- 04/20: IMF Concludes 2003 Article IV Consultation with Sri Lanka, March 12
- 04/21: IMF Executive Board Reviews Technical Assistance, March 17
- 04/22: IMF Discusses Liberia’s Postconflict Situation and Prospects through June 2004, March 18

Transcripts

- “In Defense of Globalization,” IMF Economic Forum, February 18
- Press Conference by Horst Köhler, IMF Managing Director, February 25
- Press Briefings by Thomas C. Dawson, Director, IMF External Relations Department, February 26, March 10

Press Releases

- 04/45: IMF Releasing Semiannual Reports on the Incidence of Longer-Term Program Engagement, March 5
- 04/46: IMF Executive Board Reviews Pakistan’s PRSP, March 8

- 04/47: Cape Verde Formally Begins Participation in the IMF’s General Data Dissemination System, March 8
- 04/48: The Kyrgyz Republic Subscribes to the IMF’s Special Data Dissemination Standard, March 8
- 04/49: IMF Executive Board Reviews Noncomplying Disbursement to The Gambia, March 8
- 04/50: IMF Staff Statement on Indonesia, March 9
- 04/51: IMF Acting Managing Director to Recommend to the Executive Board the Letter of Intent of the Authorities for the Second Review of the Stand-By Arrangement for Argentina, March 10
- 04/52: IMF Staff Statement on the Conclusion of the Seventh Review Discussions Under Turkey’s Stand-By Arrangement, March 15
- 04/53: IMF Completes Fourth Review of Madagascar’s PRGF-Supported Program, Approves an Augmentation of Access Under the PRGF Arrangement, and a Disbursement of \$34.7 Million, March 17
- 04/54: IMF Issues Warning on Website’s Misuse of the Fund’s Name, March 19
- 04/55: Statement by a Group of IMF Executive Directors on the Selection Process for a New Managing Director, March 19 (see page 89)
- 04/56: IMF Completes First Review Under Burkina Faso’s PRGF Arrangement and Approves \$5.1 Million Disbursement, March 19
- 04/57: IMF Executive Board Completes Second Review of Argentina’s Stand-By Arrangement, March 22 (see page 93)
- 04/58: IMF Executive Board Completes First Review of Dominica’s PRGF Arrangement, March 24

PRGF=Poverty Reduction and Growth Facility
PRSP=Poverty Reduction Strategy Paper

Strong financial sector key to sustained economic growth in the Baltics

Estonia, Latvia, and Lithuania have experienced strong economic growth since gaining their independence following the breakup of the Soviet Union in 1999. Economic growth has gone hand in hand with the rapid expansion of the financial sector. But now that the transition to a market economy is largely complete, the financial sector is faced with new challenges as the three countries prepare to join the European Union (EU) on May 1. Will the Baltics be able to sustain their impressive economic performance? Their financial sectors appear, for the most part, to be well placed to take on a more important role in financial intermediation. But can governments do more to help banks and capital markets prepare for the future? These issues are addressed in a new IMF Occasional Paper, *Capital Markets and Financial Intermediation in the Baltics*, by Alfred Schipke, Christian H. Beedies, Susan M. George, and Niamh Sheridan.

There is consensus among economists that a well-functioning financial system is important to long-term economic growth and stability. In the Baltics, economic growth was, until recently, generated in large part by the privatization of state-owned enterprises. This process relied less on the financial system and more on financing provided mainly through foreign direct investment.

But with privatization largely completed and EU membership just around the corner, the financial sectors in the three Baltic countries are poised to take on a more important role. In the words of Alfred Schipke, chief author of the Occasional Paper: "Economic growth, which was very strong over the past decade, was supported by foreign direct investment and internally generated funds. But with privatization now largely complete, the financial system will have to play a more important role in ensuring that savings are channeled to those who want to invest."

Market infrastructure and corporate governance frameworks are fairly modern, and all three countries have seen significant improvements in their

institutional and legal frameworks, as legislation has been introduced to comply with the terms of the *acquis communautaire* (the EU's body of law). The three countries have also enacted legislation that complies with international best practices in accounting and auditing.

But can the three governments do more to help banks and capital markets prepare for the future? Some economists have argued they should take steps to develop their fledgling capital markets to reduce their heavy reliance on bank-based financial intermediation.

Market- or bank-based financing?

When describing how funds are channeled from savers to investors, economists distinguish between bank- and market-based (bond- and equity-based) financial systems. In small economies with less developed financial systems, corporate bond and equity financing is often not a viable alternative to bank financing for a number of reasons. Retail investors often refrain from investing in the stock market for fear of being exploited by insider trading and prefer instead to use bank deposits for their savings. And bond and equity markets are often underdeveloped because there are not enough large enterprises to make corporate issues of debt or equity cost-efficient. This is the case in the Baltics, where bank-based financing still prevails.

Does it make a difference in terms of economic growth whether a country's financial system is mainly bank- or market-based? One view holds that bank-based systems are better placed to mobilize savings, identify sound investment projects, and exert corporate control (particularly at the early stages of development). Another view argues that markets are better suited to allocate capital, provide risk management tools, and mitigate the problems of concentration in the banking system. Empirical research has focused mainly on the United Kingdom and the United States as classical market-based economies, and on Germany and Japan as leading examples of mainly bank-based economies. "At the end of the day, however, it does not really matter whether financial intermediation is bank-based or based on capital markets, as long as the structure of the system is sound, regulation is strong, and debt supervision is stringent," Schipke explains.



Photo credits: Denio Zara, Padraic Hughes, Eugene Salazar, and Michael Spilotro for the IMF, pages 81, 82, 85, 90, and 91; John T. Barr for AFP, page 81; Claro Cortes IV for Reuters, page 83; Indranil Mukherjee for AFP, page 84; World Bank, page 87; and Diango Cissé, pages 94–96.

If small countries want to encourage the development of the market-based component of their financial systems, they can take a number of steps, notably

- eliminate distortions that favor banks over capital markets. In the case of the Baltics, income generated in savings accounts is given a tax break but income generated through capital markets is taxed;
- ensure that there is a solid market infrastructure with good corporate governance;
- permit the government to use the public debt market as a vehicle for developing a private market for corporate debt. The authorities in Chile and Hong Kong SAR approached markets not because they needed funds (both countries were running fiscal surpluses) but because they wanted to establish a government debt market that could provide a benchmark for corporate debt; and
- use pension reform to encourage development of a market-based system. All three Baltic countries have recently moved to a pension system that relies to a much larger extent on private funding (see box).

As Schipke explains: “Now that there are pension funds looking for investment opportunities, this will help spur the development of capital markets.” But whether reforms will mainly favor local or international capital markets depends on the particular rules and regulations that govern pension funds. “Estonia has the most liberal regulatory environment, which basically allows pension funds to invest anywhere in the euro zone. Initially, Latvia’s regulatory framework was a little more restricted because the government wanted to foster the development of the local capital market. There are pros and cons to both models. The drawback to Latvia’s approach is that assets are less diversified because they are all in the domestic economy.” In fact, Schipke notes, Latvia has opened up and now allows pension funds to be fully invested abroad.

Pension reform in the Baltics

All three Baltic countries decided to reform their pension systems in the mid-1990s by moving from a purely pay-as-you-go system to a three-pillar pension system. The first pillar is a scaled-down and modified version of the former pay-as-you-go publicly funded pension system. The second pillar is a mandatory and fully funded system of privately managed pension accounts, and the third pillar provides tax incentives for those who want to make additional voluntary contributions to a pension fund. The second pillar, in particular, is increasing the demand for investment opportunities in the Baltics.

Merits of foreign ownership of banks

Another way for small open economies to strengthen and diversify their financial sectors is by encouraging foreign ownership of banks. Over the course of the past several years, the percentage of foreign ownership has increased dramatically in Estonia and Lithuania, but less so in Latvia. Although the share of foreign ownership is relatively high in the Baltics, other small open economies such as New Zealand and Malta are also notable for the dominance of foreign banks. Is foreign ownership of banks good or bad?

According to Schipke, “the impact of foreign institutions in the Baltics has been very positive. It has facilitated the restructuring and consolidation of the banking system and given the three countries access to cheaper financing because the credit rating of these institutions is very high. It has also allowed them to better manage risks because the parent banks had more advanced risk management systems. Finally, foreign ownership has contributed to scale efficiencies.”

But as with most things in life, says Schipke, foreign ownership could also have a negative impact. This is best illustrated by Estonia, where, he says, “you have two banks dominating the domestic banking system. Both of them are foreign banks from one country—Sweden. At least theoretically, there is potential for spillover from the Swedish banking system to the Estonian banking system. If Sweden were to go into a prolonged recession, that would affect its banking system and possibly curtail credit lines to Estonia. The Baltics—especially Estonia—also depend strongly, in terms of the real sector, on Sweden. Sweden is the second largest importer of Estonian goods, so recession in Sweden could lead to a double whammy, so to speak, for Estonia.”

To assess the magnitude of the risk posed by foreign bank ownership in Estonia, Schipke and his colleagues looked at the lending portfolio of the Swedish parent banks. “It turns out that one bank is highly diversified in Europe, so a recession in Sweden would have only a marginal impact on its performance, because it also has lending operations in other parts of the EU,” he explains. “The other bank is more heavily invested in Sweden, but even in that instance, there is a high probability that, with further European integration, that bank might start to diversify. The best scenario would be a more diversified lending portfolio of the parent banks. This would make it less likely that they would be affected and less likely that there would be spillover to the Baltic states.”

Benefits of regional integration

Small open economies can reap significant benefits from regional integration through efficiencies of

scale, increased competition, and access to wider markets. This is the case for the three Baltic countries as they prepare to join the EU on May 1.

The EU's new member states will, for instance, benefit from the free movement of goods and services. Theoretically, this should reduce barriers to entry into the banking sector even further and ensure that national regulators do not discriminate against foreign banks. Free movement of services implies that a bank licensed to operate in one member country will not need additional approval to set up branches and subsidiaries in another. Since this should lead to more competition, smaller countries are likely to benefit because foreign banks could set up branches and subsidiaries (or threaten to do so) without incurring high regulatory costs. This, in turn, should reduce financing costs, especially for small and medium-sized companies.

In contrast, there is still no unified European capital market. The principles guiding European financial markets have so far been regulatory competition with minimal harmonization of rules (even mutual recognition of national rules has not yet taken place). Capital markets remain segmented, and raising capital across borders is still subject to regulatory barriers. But if the EU were to move toward a more unified capital market structure, this would result in significant scale efficiencies for the three Baltic countries. The greatest benefits for the Baltics, in terms of both efficiency gains and risk reduction, would occur if the countries adopted a common European platform for payments and settlements. Currently, however, such a platform doesn't exist, and the three countries have had to adopt and improve their own national systems first to participate in the Trans-European Gross Settlement System (TARGET).

With their entry into the EU, the three countries will also reap macroeconomic benefits. According to Schipke, membership in ERM2 (the transitional exchange rate mechanism that countries have to join at least two years before they adopt the euro) and the adoption of the euro “will eventually reduce financing and hedging costs—for the time being, there still is a small exchange rate risk.”

Lessons for other countries

Can small open economies learn from the successful liberalization of the financial sector in Estonia, Latvia, and Lithuania? In Schipke's view, “The experience of the Baltics demonstrates the importance of having financial sector liberalization go hand in hand with strong regulation and supervision. Initially, the Baltics liberalized their financial systems without adequate regulation and supervision, which resulted in banking crises in all three countries. But over the past couple of years, the countries have revamped their regulatory frameworks, and that has resulted in stability.” He adds that “the Baltics also teach us the importance of macroeconomic stability. The combination of a sound fiscal policy framework and a strong financial system is an important factor in ensuring economic growth. Finally, the Baltics have been very successful at regional integration.” ■

Copies of Occasional Paper No. 224, *Capital Markets and Financial Intermediation in the Baltics*, by Alfred Schipke, Christian H. Beddies, Susan M. George, and Niamh Sheridan, are available for \$25.00 each. Please see page 92 for ordering details.

IMF directors call for open process to find new IMF chief

On March 19, the G-11 Executive Directors, representing emerging and developing countries from Asia, Africa, Latin America, and the Middle East, joined by a group of Executive Directors from Australia and Switzerland, who each represent a range of countries, along with the Executive Director from the Russian Federation—well over 100 countries—met to discuss the selection process for a new Managing Director of the IMF, arising from the resignation of Horst Köhler.

- The above group indicated that the candidate nominated for the position must be an eminent person, familiar with the goals of the institution.

- The process of identifying and selecting the candidate must be open and transparent, with the goal of attracting the best person for the job, regardless of nationality. A plurality of candidates representing the diversity of members across regions would be in the best interest of the IMF.

- All members of the Executive Board should be consulted in the process of considering candidates that lead to the selection of the Managing Director and informed in a timely manner regarding candidates, including their credentials and knowledge of the institution.

The full text of IMF Press Release No. 04/55 is available on the IMF's website (www.imf.org).

Easing trade finance crunches could lessen severity of crises

Companies in emerging market economies rely heavily on bank-financed trade credits to support exports and imports. Trade finance is an important source of working capital, but during recent financial crises, it fell dramatically. Firms, strapped for cash, faced difficulties in maintaining production, exports, and imports with adverse consequences for the country's trade and growth performance. *Martin Gilman and Jian-Ye Wang of the IMF's Policy Development and Review Department have taken a closer look at this problem; Christine Ebrahim-zadeh of the IMF Survey spoke with them.*



Gilman: "Ironically, trade credit lines are among the first to get slashed despite the fact that they are usually the least risky assets."

over 80 percent in Indonesia during the Asian crisis. Sharp declines in trade finance were also observed in Russia, the Philippines, and Thailand in 1997–98 and in Turkey in 2000–01. The scale of the collapse appeared to be out of proportion with the level of risk. After all, trade finance usually takes the form of short-term credits secured against goods that earn foreign exchange, and the default rate on this category of financing has traditionally been very low.

What concerned us is that a collapse in trade finance meant that a country's ability to export—and therefore to increase export earnings to help it get out of a crisis—could be seriously compromised. We wanted to determine whether there was any general pattern or common thread among these collapses. Another concern was whether something could have been done, in retrospect, to limit the extent of the collapse or mitigate its impact.

IMF SURVEY: What drove the cutbacks in trade credit—a reduction in demand or a shortfall in supply?

GILMAN: Indications are that supply-side factors were primarily responsible for the sharp decline in trade finance. In recent crises, in line with perceptions of heightened risk, banks raised interest rates, shortened maturities of credit lines, and charged higher fees for confirming letters of credit. In Brazil, for example, interest rate spreads on bank-financed trade facilities increased from about 1 percentage point to 6 per-

centage points over LIBOR and maturities fell from 360 days to as little as 30 days. Also, insurance, when it was needed, became more difficult to obtain as trade insurers tightened their coverage policies.

Banks, being leveraged institutions, are sensitive to perceived changes in risk and tend to reduce asset exposure to a crisis country to avoid large losses and potential insolvency. Ironically, trade credit lines are among the first to get slashed despite the fact that they are usually the least risky assets. Under pressure from shareholders, the nonrenewal of trade credit is the easiest, quickest, and cheapest way of reducing country exposure. In a market facing a crisis, participants engage in herd behavior—they all rush for the exit together.

IMF SURVEY: What are the main consequences of this sharp decline in trade credit?

WANG: When firms involved in foreign trade are faced with a sudden loss of liquidity—that is, when they no longer have access to relatively low-cost, foreign-currency-denominated working capital, it is hard for them to maintain their production and trade activities. These adverse effects on the trade sector may extend to the wider economy. Many firms involved in trade must then turn to the spot foreign exchange market to make payments and service their debt. This increases demand in the foreign exchange market. The decline in trade credit may also reduce the supply of spot foreign exchange because, as trade activity declines, foreign exchange earnings from exports also drop. The resulting pressure on the exchange rate can compound the country's external debt and payment difficulties and increase country risk, leading to further cutbacks in all funding, including trade finance. Finally, the scarcity of trade credit may blunt the stimulus to expand exports stemming from the exchange rate depreciation that typically accompanies a crisis. This impedes economic adjustment and recovery.

IMF SURVEY: Are crisis-induced collapses in trade finance a more serious problem now than during the 1980s debt crisis?

GILMAN: In some ways, yes, although I qualify that by saying that we need to get a better handle on the data to make that determination. The annual volume of international trade financed by commercial credits is in the trillions of dollars, but these transactions are so routine and taken for granted—outside of crises—that there has not been an international effort to col-

lect systematic data on trade credits. We are trying—with the help of commercial banks, multilateral development banks, export credit agencies, and other international financial institutions—to piece together the existing data to get a better handle on what happened. Having a solid empirical base, of course, is also important to determine what can be done to prevent future trade finance collapses.

With that caveat, we can surmise that the collapse in trade credit has become more serious in modern capital markets. Traditionally, export credit agencies, particularly in the industrial countries, played an important role in trade finance. And this was still the case in the 1980s. At the same time, banks were in the business of providing firms with both long-term finance and short-term trade finance. This meant that banks' interests were aligned with those of countries in crisis to the extent that they had incentives to provide trade credit to limit the scale of economic dislocation and thereby protect the value of their long-term claims.

But the world has changed since the 1980s. With the development of international capital markets and global banking networks, export credit agencies now have only a marginal role in providing short-term lending. In addition, long-term finance is now provided predominantly by bondholders rather than by banks, and banks' incentive to maintain trade credit lines in difficult times has been significantly weakened.

WANG: Also, in the 1980s, many countries still had exchange controls. To qualify for exemptions from these controls to export and import, firms would have to have their trade-related transactions monitored by banks through documentation relating to shipping, customs, and financing. In the 1990s, with the widespread liberalization of capital movements, international banks moved away from such documentary credits and, instead, began providing revolving lines of credit to banks—and even enterprises—in emerging markets.

These changes have made it more difficult to distinguish between trade credit and other types of short-term finance, which, in turn, reduces international banks' confidence that payment priority would be granted by a crisis country to trade credit over other types of short-term financing. In addition, with the removal of exchange controls and the liberalization of capital movements in many developing countries, trade finance has become more vulnerable to surges of capital flight and changes in investor confidence.

IMF SURVEY: *Were any successful steps taken during the recent financial crises to deal with collapses in trade finance?*

WANG: Several initiatives were launched. For example, in Korea, Indonesia, and Brazil, country authorities—with the support of official bilateral creditors in the case of Korea and Indonesia—provided funding directly or through the domestic banking system to exporters and importers to alleviate the shortage in trade finance when international banks reduced their trade credit lines. In Indonesia, where the domestic banking sector was weakened by mounting nonperforming loans, the central bank deposited \$1 billion of its international reserves in 12 foreign banks. This money served as a guarantee for letters of credit issued by Indonesian banks for the financing of imports by export-oriented firms. This measure was deemed to be helpful; no claim was made on the central bank's deposit.

Multilateral development banks intervened by providing financing to government agencies for on-lending to the private sector and to private sector financial intermediaries for on-lending to their corporate clients. In some cases they provided guarantees as a means of reducing risk perceptions. For example, during Brazil's financial difficulties in late 2002, the IFC [International Finance Corporation] extended loans to Brazilian banks that were major players in the country's trade finance sector so they could continue to provide pre- and post-shipment export finance to their clients. The IFC loans were complemented by loans syndicated among several dozen international banks, as well as the Inter-American Development Bank. Through this initiative, the IFC mobilized private sector financing of about \$1 billion or so and helped facilitate Brazil's recovery.

IMF SURVEY: *What actions should policymakers take to avert shortfalls in trade financing in the future?*

GILMAN: Above all, the focus needs to be on implementing the right economic policies and institutional reforms to strengthen the legal and regulatory framework for international transactions, foster competition in foreign trade and trade finance sectors, and deepen local capital markets. Better banking supervision could also help mitigate the decline in credit during a crisis. Certainly, removing policy uncertainty early on would go a long way toward reducing perceived risks.

To help induce a quick resumption of trade finance by the private sector, the authorities in crisis countries could, for example, make foreign exchange available for appropriately documented trade finance transactions. They could also facilitate risk sharing among private and public, domestic and foreign creditors and insurers.



Wang: "With the removal of exchange controls and the liberalization of capital movements in many developing countries, trade finance has become more vulnerable to surges of capital flight and changes in investor confidence."

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PRGF=Poverty Reduction and Growth Facility

PRSP=Poverty Reduction Strategy Paper

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Even in the presence of a sound macroeconomic reform strategy, however, there may be circumstances in which targeted support to the trade sector could be useful to mitigate a generalized loss of access to trade finance and prevent a liquidity crisis from becoming a solvency crisis. Such financing could be provided by a country's central bank with resources from multilateral creditors or official bilateral creditors. As Jian-Ye just mentioned, recent experience suggests that the trade finance facilities of multilateral development banks can be effective in mobilizing additional private sector funding during a period of heightened risk aversion. Such support could include direct provision of financing or guarantee of financing to government agencies and intermediaries for on-lending to the private sector. A more coordinated approach by export credit agencies could enhance the effectiveness of external support.

Finally, the involvement of private sector trade credit providers can help facilitate a rapid return to confidence and financing. Such participation could be in the form of a formal or informal agreement between the country authorities and international commercial banks to maintain these banks' trade credit exposure to the country.

IMF SURVEY: Is the IMF in a position to help in its capacity as lender or policy advisor?

WANG: Certainly, the IMF can help countries assimilate lessons from the past. We could also play a supporting role in facilitating a country's efforts to address a decline in trade finance. In situations where the authorities have sought IMF financing in support of an economic adjustment program and there are concerns about the loss of access to trade finance, IMF staff could facilitate authorities' efforts by exploring ways to encourage the maintenance of trade finance. IMF-supported programs could also build in the flexibility to accommodate the use of external resources and foreign exchange reserves in support of well-designed trade finance schemes. ■

The full text of "Trade Finance in Financial Crises—Assessment of Key Issues," prepared by the IMF's Policy Development and Review Department in consultation with the International Capital Markets and Monetary and Financial Systems Departments, is available at <http://www.imf.org/external/np/pdr/cr/2003/eng/120903.pdf>.

IMF approves second review of loan to Argentina

The IMF Executive Board on March 22 completed the second review of Argentina's performance under a three-year \$13.3 billion loan, paving the way for a disbursement of about \$3.1 billion. In completing the review, the Executive Board approved the modification of a structural performance criterion and a waiver for the nonobservance of a performance criterion. Below are excerpts of a statement made by Anne Krueger, Acting Managing Director and Chair, after the Executive Board's discussion.

"Argentina's economy continues to recover rapidly, facilitating steady improvements in employment and poverty indicators. Progress is also being made in implementing reforms in key structural areas such as the banking system and the utilities sector. The authorities have indicated their willingness to negotiate with their private creditors with the aim of reaching an early comprehensive and sustainable sovereign debt restructuring.

The authorities' commitment to reach a collaborative agreement with their private creditors on a sovereign debt restructuring is welcome. The main elements of the authorities' framework include: (1) appointing investment banks throughout the restructuring process to assist in preparations and help market the debt exchange offer; (2) engaging in constructive negotiations with all representative creditor groups; and (3) formulating an offer that will result in a

sustainable debt for Argentina and attain broad support from creditors. The authorities have already implemented elements of this agreed debt restructuring strategy: three international and three domestic investment banks were appointed and the terms of their engagement were disclosed; and 25 representative creditor groups were invited to hold separate discussions in Buenos Aires during March 24–April 16, 2004. The groups invited include the Global Committee for Argentine Bondholders, domestic institutional and retail holders such as the Asociación de Ahorristas de la República Argentina, and European retail bondholder organizations such as the Comitato Investitori di Titoli Argentini. The authorities will endeavor to avoid a piecemeal approach to the debt restructuring and intend to finalize, with the assistance of their investment banks, an appropriate minimum participation threshold necessary for a broadly-supported restructuring.

Consistent implementation of this debt restructuring framework will be essential for the continued support of the international community. In particular, the authorities' intention to discuss with creditors all aspects of the debt exchange offer, including how best to take into account proposals received from creditors, is crucial. The authorities are encouraged to work diligently to design a debt exchange offer that attains the highest possible creditor participation, reduces the risk of protracted litigation, and restores debt sustainability," Krueger said.

The full text of Press Release No. 04/57 is available on the IMF's website (www.imf.org).

Public finance tops West AFRITAC's agenda

On February 5, the West Africa Regional Technical Assistance Center (West AFRITAC) held its third steering committee meeting in Bamako, Mali, to review progress and agree on the center's work plans for the year ahead. Both recipients and providers of technical assistance expressed keen enthusiasm about the progress the center had made in its short time in operation, agreeing that it is on the right track. Steering committee participants encouraged the center to continue to improve coordination with recipients and other technical assistance providers and to devise more regular and effective means of monitoring and reporting on the costs and outcomes of capacity-building activities.

With 8 of the 10 countries served by West AFRITAC being members of the West African Economic and



Agustín Carstens, IMF Deputy Managing Director, delivers the opening address at the steering committee in February. Seated next to him is Bassary Touré, Mali's Minister of Finance and the steering committee chairman.

Monetary Union (WAEMU), there are some special considerations for technical assistance that distinguish West AFRITAC, based in Bamako, Mali, from East AFRITAC, its counterpart in Dar es Salaam, Tanzania. While monetary policy and bank supervision feature prominently in the work of East AFRITAC, there is more of an emphasis on

public finances in West AFRITAC. Three of that center's six resident advisors specialize in public finance, and a fourth advisor specializes in government finance statistics. This is because fiscal policy is the centerpiece of the adjustment programs in the WAEMU countries, which have relinquished the ability to conduct an independent monetary policy. The bulk of the center's activities so far has concentrated on strengthening public expenditure management and fiscal and customs administrations, and on improving government finance statistics.

Maintaining priorities

Like its counterpart in East Africa, West AFRITAC intends to maintain the priorities it set in 2003 and largely build on activities begun toward the end of the year, grouped broadly under fiscal administration, public expenditure management, debt management and financial markets, supervision of microfinance institutions, customs administration, and statistics. For example, center staff will visit Burkina Faso and other countries to help strengthen capacity for fiscal administration and budget management.

In the coming months, the center will help Benin and Guinea define the institutional responsibilities for the different agencies involved in debt management. Mauritania will receive help in undertaking a diagnostic of the computerized system of debt management. Specific technical assistance missions intended to follow up on earlier recommendations for customs administration are scheduled for Benin, Guinea-Bissau, and Togo. And, in collaboration with the Bamako-based Economic and Statistical Observatory for Sub-Saharan Africa (AFRISTAT), the center will undertake a number of activities associated with improving real sector statistics.

Under the work plan for this year, the center's experts will conduct regional workshops on a broad range of topics, including fighting tax and customs fraud and evasion, computerizing customs administration, managing program budgets and the medium-term expenditure framework, computerizing expenditure management, compiling government finance statistics, applying best practices in microfinance supervision, combating money laundering and financial crimes, and issuing government paper and debt management. Each resident advisor is basically in charge of preparing the workshop in his area of expertise, identifying specialized local or regional short-term experts to supplement his own knowledge.

While the main priorities are not changing this year, certain new activities will be added, in line with the priorities set by the countries the center serves. West AFRITAC shows considerable flexibility in delivering its assistance, pointed out Norbert Toé, the center's coordinator. For example, while the center had planned a large volume of activities for Guinea-Bissau in the 2003 work program, a coup d'état in September put a temporary halt to most of those activities. Following the installation of a transition government, West AFRITAC rapidly deployed resources to help Guinea-Bissau prepare a 2004 budget, which was submitted to donors for financing. Over the coming year, West AFRITAC intends to step up assistance to this postconflict country.

During its first three months of full operations, West AFRITAC provided the majority of its assistance through long-term resident advisors. For 2004—and based on the budgeted resources—the work of the resident advisors will be supplemented with significant short-term expert assistance. Since the resident advisors “backstop” the short-term experts, the fields of expertise are broadly similar, Toé explained, but short-term experts add their more specialized skills

to contribute to a specific aspect of the issues tackled. With the growing need for computerized budget execution and debt management, skilled computer technicians have been in particularly high demand in these early stages of the center's operations.

Prioritizing better coordination

Because the center has so far directed most of its efforts toward capacity building at the regional level—given

that most participating countries are members of a regional economic and monetary union—West AFRITAC has been working particularly closely with the Central Bank for West African States and the WAEMU Commission. Like East AFRITAC, the center has also been cooperating with the African Development Bank, as one of the major contributors to the AFRITAC initiative, and the Harare-based African Capacity Building Foundation (ACBF).

Stand-By, EFF, and PRGF arrangements as of February 29

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
(million SDRs)				
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	6,910.00
Bolivia	April 2, 2003	April 1, 2004	85.75	21.43
Bosnia and Herzegovina	August 2, 2002	February 29, 2004	67.60	0.00
Brazil	September 6, 2002	March 31, 2005	27,375.12	10,175.48
Bulgaria	February 27, 2002	March 15, 2004	240.00	26.00
Colombia	January 15, 2003	January 14, 2005	1,548.00	1,548.00
Croatia, Republic of	February 3, 2003	April 2, 2004	105.88	105.88
Dominican Republic	August 29, 2003	August 28, 2005	437.8	306.46
Ecuador	March 21, 2003	April 20, 2004	151.00	90.60
Guatemala	June 18, 2003	March 15, 2004	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
FYR Macedonia	April 30, 2003	June 15, 2004	20.00	8.00
Paraguay	December 15, 2003	March 31, 2005	50.00	50.00
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Turkey	February 4, 2002	December 31, 2004	12,821.20	1,701.00
Uruguay	April 1, 2002	March 31, 2005	2,128.30	559.20
Total			54,435.93	21,915.67
EFF				
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
Serbia and Montenegro	May 14, 2002	May 13, 2005	650.00	350.00
Total			794.40	473.73
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	12.00
Armenia	May 23, 2001	May 22, 2004	69.00	19.00
Azerbaijan	July 6, 2001	March 31, 2005	80.45	38.61
Bangladesh	June 20, 2003	June 19, 2006	347.00	248.00
Benin	July 17, 2000	March 31, 2004	27.00	1.35
Burkina Faso	June 11, 2003	June 10, 2006	24.08	20.64
Burundi	January 23, 2004	January 22, 2007	69.30	42.90
Cameroon	December 21, 2000	December 20, 2004	111.42	31.83
Cape Verde	April 10, 2002	April 9, 2005	8.64	3.72
Cote d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Democratic Republic of the Congo	June 12, 2002	June 11, 2005	580.00	106.63
Dominica	December 29, 2003	December 28, 2006	7.69	5.33
Ethiopia	March 22, 2001	July 31, 2004	100.28	20.86
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Ghana	May 9, 2003	May 8, 2006	184.50	131.80
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guyana	September 20, 2002	March 19, 2006	54.55	43.03
Honduras	February 27, 2004	February 26, 2007	71.20	71.20
Kenya	November 21, 2003	November 20, 2006	175.00	150.00
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	19.12
Lao People's Democratic Republic	April 25, 2001	April 24, 2005	31.70	13.58
Lesotho	March 9, 2001	June 30, 2004	24.50	3.50
Madagascar	March 1, 2001	November 30, 2004	79.43	34.04
Malawi	December 21, 2000	December 20, 2004	45.11	32.23
Mauritania	July 18, 2003	July 17, 2006	6.44	5.52
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Nepal	November 19, 2003	November 18, 2006	49.91	42.78
Nicaragua	December 13, 2002	December 12, 2005	97.50	55.71
Niger	December 22, 2000	June 30, 2004	59.20	8.44
Pakistan	December 6, 2001	December 5, 2004	1,033.70	344.56
Rwanda	August 12, 2002	August 11, 2005	4.00	2.86
Senegal	April 28, 2003	April 27, 2006	24.27	17.33
Sierra Leone	September 26, 2001	March 25, 2005	130.84	42.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	39.20
Tanzania	August 16, 2003	August 15, 2006	19.60	16.80
Uganda	September 13, 2002	September 12, 2005	13.50	8.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Total			4,660.86	2,335.29

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

Extended Fund Facility (EFF) arrangements are designed to rectify balance of payments problems that stem from structural problems.



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"There is room for further strengthening coordination of technical assistance providers' activities," commented Toé, citing this as a particular priority area for 2004. The staff of West AFRITAC is hopeful that designating a senior civil servant or a small team, in order to create a "single point of entry" in the beneficiary countries for all capacity-building and technical assistance issues, as well as developing a more proactive approach to information sharing by major technical assistance providers, will go a long way in addressing this issue. With a shift toward a more strategic and managerial role by the AFRITAC resident advisors in their respective areas of expertise, coordination will be enhanced, Toé said, explaining that positive steps have already been taken in this direction with respect to technical assistance on microfinance.

Because the center depends on the information it receives from key players in the region to be able to carry out its role most effectively, Toé stressed that coordination of technical assistance is a two-way affair, with the best results occurring when both providers and recipients share with the center the status of ongoing activities. More internal coordination between the country representative on the West AFRITAC steering committee and the beneficiaries of the technical assistance would also help, he added. Increased involvement of the IMF resident representatives in the field and regular contacts and information sharing between them and other providers of technical assistance are an essential part of this process. Moreover, an enhanced coordination process would help forge a broader alliance toward achieving the goals set forth in countries' Poverty Reduction Strategy Papers (PRSPs). The planned website for West AFRITAC should also facilitate coordination of these activities in the subregion.

During its February 2004 meeting, the steering committee stated explicitly that, going forward, it will be important to ensure that providers and recipients of capacity-building assistance more actively coordinate their activities to make the best use of technical assistance. For 2004, West AFRITAC plans to expand its cooperation with AFRISTAT, especially in the area of real sector statistics, while striving to enhance coordination with other regional institutions and major providers of technical assistance.

Developing indicators to monitor progress and increasing the transparency of reporting outcomes were also prominent issues on the steering committee's agenda. The center itself, its steering committee members, and other technical assistance providers,



Participating in the steering committee session: are (from left to right, in foreground) Norbert Toé (West AFRITAC's coordinator) and representatives of the World Bank, WAEMU, ACBF, and the regional Central Bank of West African States (BCEAO).

as well as the countries served, are collectively looking for better monitoring and reporting procedures and are identifying short-term indicators that lend themselves to measurement. One such indicator could take the form of a more efficient and shorter response time to national authorities' requests for technical assistance.

Advice for future centers

Asked what advice he would give to a newly established AFRITAC, Toé emphasized the importance of flexibility, especially given the newness of the initiative and the complexity of capacity building. "Care must be taken to ensure from the start that the countries themselves exert full ownership of capacity-building activities," he said, adding that "keeping in constant touch with the steering committee members and various contacts in the beneficiary countries also helps tremendously, as does communicating regularly with the stakeholders, especially the donors."

According to Toé, among the main lessons learned from West AFRITAC's early experience is that while recipient countries are most familiar with their administrative weaknesses, they need a helping hand to assist them in devising the most effective ways to strengthen their capacity. Moreover, frequent follow-up seems to be extremely useful in making sure that technical assistance recommendations are carried through. Another critical lesson is that countries should not view the reforms they undertake in the context of their PRSPs as another layer of conditionality but rather as a process they initiate to achieve the goals they have set for themselves. A central role of AFRITAC is to help strengthen countries' administrative capacity to better execute these reforms. ■