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Spring meetings

Ministers to discuss global economic outlook, poverty reduction, and financing of terrorism

When key financial officials meet at IMF headquarters on April 20, the more promising global economic outlook—and what can be done to ensure continuing recovery in the coming months—will top the agenda. The gathering, the fifth meeting of the International Monetary and Financial Committee (IMFC), will also focus on recent efforts to fight money laundering and the financing of terrorism as well as the international community's poverty reduction agenda.

IMFC chair Gordon Brown (left) with Development Committee chair Trevor Manuel.

The IMFC, which will be chaired by Gordon Brown, the U.K. Chancellor of the Exchequer, comprises 24 IMF Governors, who are finance ministers, central bank governors, or others of comparable rank, representing the IMF's 183 member countries.

The IMFC is expected to discuss the global economic situation and the policies needed to address current risks and vulnerabilities and strengthen global growth. IMF Managing Director Horst Köhler will make introductory remarks, most likely centering on the need to carefully gauge at what point to withdraw measures aimed at stimulating growth, and the need in the years ahead to correct global imbalances.

He is also expected to report on key items on the IMF's policy agenda. He will *(Please turn to the following page, top)*

Krueger modifies sovereign debt plan to lighten IMF role, after wide consultation

IMF First Deputy Managing Director Anne Krueger spelled out her suggestions for a debt restructuring mechanism in a speech at the Conference on Sovereign Debt Workouts at the Institute for International Economics on April 1 in Washington. It is a modified version of the plan she first floated last November, with the emphasis on putting debtors and creditors, rather than the IMF, in the driver's seat. Even so, her modified plan goes further than the U.S. proposal, as articulated by Undersecretary of Treasury John Taylor the following day.

Krueger said the IMF's latest plan, reflecting input from extensive talks with private creditors, nongovernmental organizations, academics, IMF member countries, and the IMF's Executive Board and IMF staff, differs from the earlier version mainly in that the IMF's legal authority need not be extended significantly. The restructuring process requires a sound statutory basis, she said, but control over major decisions should be in

Krueger: Wider use of collective action clauses "would take us only part of the way."

the hands of the debtor country and a supermajority of its creditors rather than of the IMF. She stressed that relying entirely on a contractual approach using collective action clauses—as proposed by the U.S. Treasury—would give ownership to the debtor and creditors. But *(Please turn to the following page, bottom)*

Ministers to weigh global picture

(Continued from front page, top) draw on reports to the IMFC on strengthening crisis prevention and resolution (including IMF management's newly revised suggestions for a framework for a sovereign debt restructuring mechanism for countries with debt problems); the IMF's role in low-income countries; and streamlining conditionality and enhancing country ownership of economic reform programs.

April 2001 IMFC meeting at IMF headquarters, site of the upcoming spring meetings.

The discussion of the last two items will take place against the backdrop of the recently concluded UN Conference on Financing for Development, in Monterrey, Mexico. Leaders there reaffirmed the two-pillar approach for fighting global poverty (self-help and help for self-help) and pledged to dramatically step up efforts to meet the Millennium Development Goals (including halving global poverty by 2015 and ensuring universal primary education; see page 101). Köhler is expected to brief the IMFC on the outcome of the meeting—adoption of the "Monterrey Consensus"—and next steps. He is also expected to report on recent IMF–World Bank reviews of the poverty reduction strategy paper (PRSP) process and debt relief for the heavily indebted poor countries (HIPCs), and an IMF review of its Poverty Reduction and Growth Facility (PRGF).

The committee is also expected to discuss efforts to combat money laundering and the financing of terrorism, a topic that took on new urgency in the wake of the tragic events of September 11. And the committee will receive a progress report on the IMF's Independent Evaluation Office, which was established in the summer of 2001. A press conference by Brown and Köhler will follow the IMFC meeting.

Ministers and other senior officials of the Group of 24, representing the developing country members of the IMF, will meet on April 19. This meeting will be followed the next day by those of the Group of 10 and the IMFC.

The spring meetings will conclude on April 21, with a meeting of the Development Committee, a joint committee of IMF and World Bank Governors. It will be chaired by Trevor Manuel, South Africa's Finance Minister. Besides the joint IMF–World Bank reports on poverty, debt relief, money laundering, and financing of terrorism, ministers are expected to review a recent World Bank study on the effectiveness of aid and an action plan for accelerating progress toward universal education. ■

Modified sovereign debt proposal

(Continued from front page, bottom) this approach would not be as effective as a statutory approach in today's global financial markets, where debt is often owed in the form of instruments held by thousands of diverse creditors.

Case for reform

Over the last two or three decades, the integration of international capital markets and a shift from syndicated bank loans to traded securities have transformed the way emerging market countries obtain finance. Sovereign borrowers increasingly issue debt in a range of legal jurisdictions—using a variety of instruments—to a diverse and diffuse group of creditors. These developments have enhanced the efficiency of international capital markets, but as global capital flows have grown dramatically, so too have the risks of disruption posed by the threat of reversal of these flows.

Emerging market economies have become increasingly vulnerable to crises of confidence, akin to runs on banks. Nervous investors occasionally overreact to the onset of these crises and adopt "herdlike" behavior that only exacerbates the situation. This was the case in 1997 and 1998 in southeast Asia, for example, when the economies in this region suffered enormous economic pain following the sudden reversal of huge capital inflows and the associated shortage of foreign currency.

These far-reaching developments in capital markets over the last three decades have not been matched by the development of an orderly and predictable framework for creditor coordination that spells out the roles of the debtor, creditors, and the international community, Krueger observed. Because the creditor community is increasingly diverse and diffuse, coordination and collective action problems result when scheduled debt service exceeds a country's ability to repay. In contrast, during the debt crisis of the 1980s in Latin America, most of the debt was owed to just a few banks—making coordination much easier.

The sovereign borrower may find it very difficult to get its creditors to agree collectively to a restructuring that reduces the net present value of its obligations to a manageable level. Even if such a restructuring would be in the interests of creditors as a group, some may prefer to "free-ride," hoping that they will ultimately be repaid in line with their original contracts.

"Like a patient with a toothache avoiding a trip to the dentist, a debtor country will all too often delay a necessary restructuring until the last possible moment, draining its reserves and increasing the eventual cost of restoring sustainability," Krueger pointed out. Creditors also suffer when fears about some being unfairly favored over others block agreement on a restructuring. This can leave all parties concerned with no option but to accept a disruptive and potentially contagious unilateral default—or a bailout of private creditors that contributes to moral hazard.

How plan would work

How can these destabilizing scenarios be avoided? Krueger indicated that the key step would be to enable a supermajority of creditors—across the broad range of credit instruments—to make the terms of restructuring binding on the rest, thus doing away with the free-rider problem, making early agreement more likely, and eliminating the threat of unilateral legal action by creditors after a sovereign default.

Krueger hoped that having the provision in place would encourage debtor countries to restructure before a default occurred. But where this wasn't possible, the mechanism would require three key elements to create an environment for quick and orderly restructuring and to address collective action problems.

- First, the debtor would need protection from legal action after suspension of payments and during negotiations. This stay on legal action would be of fixed duration—around 90 days—but potentially renewable.
- Second, creditors would need adequate assurance that their interests were being protected during the stay—specifically, assurance that the debtor would not make payments to nonpriority creditors and that the debtor would follow sound economic policies.
- Third, there would have to be a guarantee that any new financing provided by private creditors after the stay's introduction would not be involved in the restructuring.

How would decisions made by the debtor and a supermajority of creditors be made binding on all creditors? Krueger acknowledged that wider use of collective action clauses—which would allow a majority of creditors to impose a deal on the remaining minority—would help resolve some debt problems, but she emphasized that this "would take us only part of the way." Her approach calls for a universal treaty rather than piecemeal changes to national legislation. Such a treaty would set up an international judicial panel to arbitrate disputes more effectively and to oversee voting.

Krueger: "The use of the mechanism would be for the debtor to request, not for the IMF to impose."

While an amendment to the IMF's Articles would be used to empower this panel, Krueger's proposal would not transfer significant legal authority to the IMF itself: the essential decision-making power would rest with the debtor and a supermajority of its creditors. "The IMF would still do the initial validation just because it takes a while to assemble a creditors' committee. But once that committee was assembled, it would take over," Krueger explained.

She also stressed that the use of the mechanism would be for the debtor to request, not for the IMF to impose. This would mirror the situation in well-designed domestic bankruptcy regimes, where most restructurings take place "in the shadow of the law" rather than in court. So if a debtor could strike an agreement with creditors of its own accord, it would not have to resort to the mechanism.

Collective action clauses

The next day, Undersecretary of Treasury John Taylor told the audience that he favored a "decentralized, market-oriented approach" that centered on a wider use of collective action clauses. Borrowers and lenders in any particular case would determine both the contracts and the associated workout process on their own terms. At the same time, however, borrowers and lenders would be expected to follow legal templates that would conform to at least three key guidelines. That is, in each case, there would have to be majority action, engagement, and initiation clauses that would, respectively, allow a supermajor-

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Krueger's proposal would not transfer significant legal authority to the IMF itself; the essential decision-making power would rest with the debtor and a supermajority of its creditors.

ity to agree to a restructuring, describe the actual negotiating process in the event of a restructuring, and indicate how the debtor would initiate the restructuring.

Taylor's proposal considers two possible ways to induce borrowers and lenders to put these new clauses in their contracts: any country that already has or wants an IMF program could be required to include the clauses; or slightly lower charges could apply for IMF borrowing by countries that include these clauses.

Krueger felt her updated approach combined the strengths of Taylor's approach and her earlier proposal. "We think that relying entirely on a contractual approach using collective action clauses gives ownership to the debtor and creditors," Krueger said. "But it can't deal effectively with different sorts of debts across different credit instruments in the comprehensive way that a statutory approach could." ■

Public's views sought on study of fiscal adjustment in IMF programs

The IMF's Independent Evaluation Office (IEO) is seeking public comments, by April 28, on a draft issues paper for an evaluation of fiscal adjustment in IMF-supported programs. This topic has been the subject of past IMF staff reviews, but the IEO study will take a fresh look at it, address past criticisms, and determine what can be learned from experience and incorporated into future programs.

The IEO, which is charged with objectively and independently evaluating vital issues in IMF-related work, selected fiscal adjustment as a topic because it has been a key element in IMF-supported programs and because academics and civil society have often been critical of the design of past fiscal adjustments on the grounds that they have entailed unnecessarily high social costs.

The draft issues paper surveys some of these criticisms, among them that excessive fiscal adjustment in low-income countries reflects too cautious an assessment of potential donor financing; that fiscal adjustments in middle-income countries may have been too contractionary by not fully predicting the decline of private spending that results from a crisis; and that too much of the adjustment burden falls on government spending, with programs not paying enough attention to protecting critical social spending or implementing compensatory measures to protect vulnerable groups. The issues paper also surveys IMF reviews and staff studies that have addressed some of the issues raised by external commentators.

Program design

The draft issues paper focuses on three broad areas of inquiry: quantitative issues (how large a fiscal adjustment should be), qualitative issues (how fiscal adjustment can be made more compatible with countries' social objectives), and the interaction of fiscal adjustments with accompanying reforms. On the quantitative side, the study would look at whether, for example, past IMF-supported fiscal adjustments have been excessively contractionary or had the unintended effect of depressing output. On the qualitative side, it would examine whether IMF-supported programs could improve the efficiency, sustainability, and equity of fiscal adjustment by using other mixes of revenue and expenditure measures. And, it would ask whether reforms that entail fiscal costs could be sequenced differently to minimize strains on the budget or, where reforms are urgent, whether the budget can be used more aggressively to compensate for the social cost of such policies.

Process

The draft issues paper indicates that the study would review not simply *what* the IMF recommends but *how* the IMF arrives at its recommendations. The study intends, in particular, to examine how the IMF interacts with authorities in what are often crisis situations and explore whether this process can be made more cooperative and transparent. And, given the limits imposed by the typically short time frame of an IMF-supported program, it will ask how the IMF can encourage sustained fiscal reforms over the long run and independent of a specific program.

Evaluation nitty-gritty

To accomplish its objectives, the evaluation will follow two levels of analysis. First, there would be a statistical examination of fiscal adjustment in IMF-supported programs in the 1990s. This is expected to yield patterns of fiscal adjustment that will provide the basis for the second level of analysis, an in-depth look at the experiences of programs in four countries. These studies are meant to provide lessons on what the IMF could do differently in the future.

The IMF provides support in a wide variety of country contexts. In selecting the case studies for the fiscal project, the IEO has not included programs in capital account crisis countries because these are the subject of an ongoing evaluation. The case studies will instead concentrate on three middle-income countries (at the lower range of per capita income) with Stand-By Arrangements—Ecuador, Philippines, and Romania—and one Enhanced Structural Adjustment Facility/Poverty Reduction and Growth Facility (PRGF) country—Tanzania. Next year, the IEO is expected to undertake a more detailed study of PRGF countries, covering all aspects of PRGF programs.

All these studies will involve collaboration with a local consultant. The IEO expects to interact with staff, government authorities, civil society organizations, and academics who have worked on the subject. The IEO has invited comments on the issues paper, and these will be taken into account in preparing the final terms of reference. The final terms of reference will be posted on the IEO's website, and concerned individuals and organizations will be invited to submit substantive inputs addressing items in the terms of reference.

Public comment is sought on all aspects of the draft issues paper. The full text of the paper is available on the IEO's website (www.imf.org/ieo).

UN conference

World leaders adopt "Monterrey Consensus" to fight poverty, ensure sustainable development

For five days in March, Monterrey, Mexico, was the epicenter of the debate over how best to finance the fight against poverty. At the close of the UN International Conference on Financing for Development, world leaders adopted the "Monterrey Consensus"—a plan to mobilize resources—amid pledges of higher foreign aid, better use of aid, freer trade, enhanced debt relief, and an increased emphasis on capacity building.

Monterrey's unprecedented gathering, under UN auspices, of international organizations, heads of state or government, ministers, and leaders of civil society organizations and businesses reflected the heightened urgency, renewed momentum, and potent mix of ideals and pragmatism now injected into the fight against poverty. The conference was not, as UN Secretary-General Kofi Annan reminded participants, about abstractions but about the fate of "millions upon millions of individual men, women, and children."

On March 22, the 51 heads of state or government, along with ministers of finance, trade, development, and foreign affairs, committed themselves to eradicating poverty, achieving sustained economic growth, and promoting sustainable development to move the world toward "a fully inclusive and equitable global economic system." The Monterrey Consensus had been negotiated by UN member states before the conference, reflecting consultations with civil society organizations, businesses, the IMF, the World Bank, and other agencies.

As IMF Managing Director Horst Köhler told delegates, there was encouragement to be drawn from the "unprecedented degree of agreement about what is required to overcome world poverty. The Monterrey Consensus defines the right priorities. It makes clear that nothing will work without good governance, respect for the rule of law, and policies and institutions that unlock the creative energies of the people and promote investment—including foreign direct investment. It also recognizes that when poor countries are ready to live up to these responsibilities, the international community should provide faster, stronger, and more comprehensive support."

Indeed, the consensus called for a new partnership between developed and developing countries—one that simultaneously recognizes that "each country has primary responsibility for its own economic and social development" and that "domestic economies are interwoven with the global economic system" to such an extent that trade and investment now offer powerful means to aid countries in the fight against poverty. The leaders also underscored that peace and development are mutually reinforcing; they committed themselves to promoting national and global economic systems that are just, equitable, democratic, participatory, transparent, accountable, and inclusive.

On March 21, leaders of international organizations (from left) Horst Köhler, IMF; James Wolfensohn, World Bank; Kofi Annan, United Nations; and Mike Moore, World Trade Organization, met with the press to discuss the Monterrey conference.

A few national leaders and some nongovernmental organizations were disappointed that the conference had not proposed outright debt cancellation; the use of innovative sources of finance, such as SDRs; and various forms of international taxation, including a tax designed to discourage short-term capital movements. Some also felt that the broad question of global governance—notably, developing country representation in international dialogues and decision-making processes, including with respect to such institutions as the IMF, the World Bank, and the Bank for International Settlements—had not been adequately addressed. And a few participants regretted that the consensus did not tackle the issue of global public goods.

Shared responsibilities

In a roundtable cochaired by Köhler and South African President Thabo Mbeki, conference delegates agreed that the underlying theme of the conference was a belief in shared responsibilities and mutual commitment. This echoed the internationally supported "two-pillar" approach of self-help and help for self-help.

Developing countries must lay the foundation for their own development and poverty eradication. This means taking the initiative to mobilize domestic resources, pursue appropriate policies, improve governance, invest in needed economic and social infrastructure, and strengthen domestic financial systems. It also means taking steps to attract inflows of productive capital—including a transparent, stable, and predictable investment climate; sound macroeconomic policies; and sound institutions that permit businesses, both domestic and foreign, to operate efficiently and profitably, with maximum development impact.

But determined efforts on the part of developing countries must be matched by greater international resources for development. The consensus thus calls on international institutions to increase their support through export credits, cofinancing, venture capital, risk guarantees, and other means to boost contact and cooperation between enterprises in developed and developing countries. It supports new public-private financing mechanisms and underscores the need to sustain sufficient and stable private flows to developing and transition countries, design measures to increase the transparency of financial flows, and lessen the volatility of short-term capital flows. It also cites the need for more careful attention to currency and liquidity risks, calling for enhanced regulation and supervision of financial institutions and orderly and well-sequenced liberalization of capital flows.

U.S. President George W. Bush

The link between responsibility and international support was emphasized for countries in crisis as well. President Eduardo Duhalde of Argentina noted that his country was struggling with its worst-ever recession but was determined to replace the old order with a new system rooted in a firm macroeconomic foundation that featured a balanced public budget, a single currency, a floating exchange rate, and progressive elimination of financing and payment restrictions. In that way, the country hoped to build a competitive market economy and return to a path of growth and integration with the world. That transformation, he stressed, would need the understanding and cooperation of the international community.

French President Jacques Chirac

The next step for proceeding with the Monterrey Consensus, delegates agreed, was to build within their own countries the public support needed to translate this collective vision into individual country action. Köhler noted that the international financial institutions have an important role to play in reinforcing the momentum for reform and in building consensus. He cited the poverty reduction strategy paper (PRSP) approach as the basic framework for partnership with poor countries and noted that the IMF had correspondingly refocused and streamlined conditionality to create greater scope for national ownership of policies. He also suggested that the international community's support be based on four priorities: trade, aid, debt relief, and capacity building.

President of Venezuela Hugo Chávez Frías

Trade

The consensus points to international trade as a key engine for development—what Köhler calls the most important avenue for self-help because it generates income and reduces aid dependency in poor countries, creating a win-win situation for all. Member states reaffirmed their commitment to trade liberalization, stressing its role in promoting economic growth, employment, and development.

To draw full benefits from trade, however, industrial countries must address their own trade-distorting subsidies—particularly in agriculture—and antidumping measures. Developing and transition countries, for their part, must establish appropriate institutions and policies and follow through on their vow to reduce barriers to trade among themselves. Köhler said that he shared the World Trade Organization's desire to make Doha the start of a true "Development Round."

Aid

The consensus recognizes that a substantial increase in official development assistance and other resources will be required if developing countries are to meet the Millennium Development Goals—including halving global poverty by 2015 and ensuring universal primary education. Leaders urged developed countries that have not yet done so to make concrete efforts to increase aid toward the target of 0.7 percent of GNP. Recipient and donor countries, with the help of international institutions, resolved to make development assistance more effective.

How much aid would be enough sparked some of the conference's liveliest debates. U.S. President George W. Bush reaffirmed his country's commitment to bring hope and opportunity to the world's poorest people and called for a new "compact for development," defined by greater accountability for rich and poor nations alike. He cited hope as an answer to terror and opportunity as a fundamental right to human dignity. He announced that over the next three budget years, the United States would boost its core development assistance by 50 percent and dedicate these resources to a new Millennium Challenge Account devoted to projects in nations that govern justly, invest in their people, and encourage economic freedom.

French President Jacques Chirac said he wanted to see a new wind of generosity and hope blowing in Monterrey. Now that the world is no longer frozen in hostile blocs, it could, he said, set about accomplishing its common destiny. "What can be done against terrorism can surely be done against poverty," he added, proposing that the world seize this moment to work together to reach the target aid goal of 0.7 percent of GNP, create an economic and social security council, fulfill the Kyoto objectives, and establish a World Environment Organization. The European Union announced that member states collectively would set an interim target for themselves of 0.39 percent of GNP by 2006.

President Hugo Chávez Frías of Venezuela, speaking for the Group of 77 developing countries and China, called on global leaders to recognize, in the most profound way, that the world is "upside down"—a situation that can be reversed only with greater aid. Rwanda's Minister for Finance and Economic Planning, Donald Kaberuka, said aid must play a catalytic role, for countries will grow out of poverty only by participating fully in world trade and investment.

Shaukat Aziz, Pakistan's Finance Minister, stressed that aid should not be a permanent crutch, but a means to allow recipient countries to stand on their own feet. He also underscored the need to make fighting corruption a high priority on the global agenda. In particular, while the war against corruption should be globally coordinated, laundered money shouldn't find a safe haven anywhere. His statement reflects the silent revolution that is taking place with respect to addressing corruption, a taboo subject in UN conferences and national dialogues of the past. One of the lesser-noticed aspects of the Monterrey Consensus is an urgent call for a UN convention against corruption "in all its aspects."

Reducing debt

The consensus sees external debt relief as a means of freeing up resources that could be redirected to development efforts. It urges vigorous and expeditious pursuit of debt-relief measures, including within the Paris and London Clubs, and cites as critical the speedy and full implementation of the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. While pledging full support for ongoing debt-relief efforts, Köhler noted that the ability to lend and borrow is an important element of financing for development: "trust that contracts will be honored is essential for a modern economy and a stable international financial system," he said.

Leaders also encouraged exploration of innovative mechanisms to address the whole range of debt problems, including those of middle-income and transition countries. While they welcomed the debate on IMF management's proposal for a sovereign debt restructuring mechanism, they noted an urgent need to better define the roles of the IMF and private creditors in financial crises to resolve unsustainable debt situations in a faster, more orderly, and less costly manner.

Capacity building

Köhler noted that "slow progress in the reforms needed to fight poverty often reflects a lack of institutional capacity rather than of political will." That is why the IMF recently opened regional technical assistance centers in the Pacific and the Caribbean. And that is why he is proposing to set up regional centers in Africa in the IMF's core areas of responsibility, as part of its support for the New Partnership for Africa's Development—itself an example of the "two-pillar" approach. The consensus calls for reinforcing national efforts in capacity building in developing and transition countries "in such areas as institutional infrastructure, human resource development, public finance, mortgage finance, financial regulation and supervision, basic education in particular, public administration, social and gender budget policies, early warning and crisis prevention, and debt management."

Dialogue and monitoring

Of course, making pledges isn't new for the international community, so this time leaders took extra steps to ensure the implementation of agreements and commitments reached in Monterrey. They called for continued dialogue and a follow-up international conference to review progress on implementation, with the modalities to be set no later than 2005. The challenge now, Köhler told delegates, will be to "transform this consensus into concrete action, with a sense of urgency" and "to develop a comprehensive and transparent system to monitor progress toward the Millennium Development Goals." He called for more clearly identifying the responsibilities of poor countries and their development partners. He also said that he wouldn't hesitate to subject the IMF to the scrutiny of such a monitoring system, "provided that it did not produce bureaucracy and would apply equally to all the parties involved." ■

Axel Palmason
IMF Office at the United Nations

A silent revolution is taking place with respect to addressing corruption, a taboo subject in UN conferences and national dialogues of the past.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
March 25	2.33	2.33	2.74
April 1	2.32	2.32	2.73

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/cgi-shl/bur.pl?2002).

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

Data: IMF Treasurer's Department

Interview with Carol Carson

Inflation targeting requires not more statistics, but new ways of presenting them

More than a dozen countries have adopted inflation targeting, which, in the context of a floating exchange rate, sets a publicly announced inflation goal as the anchor for monetary policy. The operating procedures of many other central banks now have much in common with inflation targeters, too. A recent conference, organized by the IMF's Statistics Department, brought together officials from central banks and statistical agencies, many from the countries that have adopted inflation targeting. Carol Carson, Director of the Statistics Department, spoke to Prakash Loungani about the goals of the conference and the main conclusions reached.

Carson: "Floating exchange rates appear to provide a safe solution for a wide range of countries as long as inflation expectations are anchored through an inflation targeting regime."

LOUNGANI: Why did the IMF's Statistics Department host a conference on inflation targeting? What was the IMF's role in all this?

CARSON: The IMF was trying to play matchmaker. In many countries, as the IMF's Managing Director noted in his opening remarks, the central bankers sit at one end of town and the authorities at the national statistics agency, at the other. In Germany, the two are even in different cities. But the two agencies have to learn to talk to each other to make inflation targeting a success; central banks implement the inflation target, but statistical agencies produce the inflation numbers. Given increasing interest in inflation targeting and the dozen or so member countries that have already adopted inflation targeting, it seemed useful to bring people together to compare experiences.

On our part, the conference was also an attempt to be a bit forward-looking. Many of our statistical initiatives have come about in the aftermath of crises. For instance, we started emphasizing the need for honest data on international reserves after the Mexican crisis of 1994–95 and the need for more data on countries' debt structure in the midst of the Asian crisis. With this conference, we were trying to think ahead to see what types of statistical challenges would be posed by the adoption of inflation targeting. Which statistics, for example, are needed, and what does it take to compile them? These are the types of issues, ideally, that you want to give careful thought to.

LOUNGANI: But you're not predicting a new rash of crises as a result of countries' adopting inflation targeting, are you?

CARSON: No, of course not. In fact, as the Managing Director said, we expect quite the opposite. Pegged or heavily managed exchange rate systems have been a source of many recent crises. Floating exchange rates appear to provide a safe solution for a wide range of countries as long as inflation expectations are anchored through an inflation targeting regime.

LOUNGANI: So what conclusions were reached about the statistical challenges posed by the adoption of inflation targeting?

CARSON: The consensus at the conference was that inflation targeting will not require a quantum leap in terms of the amount of information needed. Central banks already look at a lot of data before they make decisions; they will continue to do so under inflation targeting. What is different is that the data will now have to be "sliced and diced" in a different way. Inflation targeting will place much more emphasis on uncovering inflation expectations—on measuring what the public expects inflation to be. And this, in turn, will mean a greater reliance on expectations surveys and on forward-looking indicators, such as yields on indexed debt, the term structure of interest rates, stock indices, and real estate prices.

The way information is made available to the public under an inflation targeting regime is quite important: clarity is critical. The inflation numbers released by the statistical agencies should be easy to understand. The central banks or statistical agencies should have already laid the groundwork for the public's grasp of what these numbers mean. They have to articulate the goals of monetary policy and the operating procedures of the central bank. And they have to tell the public—clearly and beforehand—how the central bank will respond to inflation numbers.

LOUNGANI: One whole session at the conference was devoted to the issue of how to define and measure the inflation target. Why is this contentious? Why not just pick the consumer price index (CPI) and be done with it?

CARSON: The devil is in the details. The CPI, or "headline" CPI, has been the obvious choice for countries that have moved to inflation targeting—it is familiar to the public and produced in a timely manner by an independent agency, usually the statistics agency. But there are details to consider. For instance, should the inflation target be defined in terms of the headline CPI, or should certain volatile components of the CPI be excluded? A sequence of seemingly small choices like this can make a big difference to the credibility of the inflation targeting regime. Down the road, countries may well decide to go back to first principles and reexamine whether the inflation target should be defined in terms of another index—say, the GDP deflator or the producer price index.

LOUNGANI: How does this conference tie in with the IMF's numerous other statistical initiatives in recent years?

CARSON: For almost a decade now, events have served to remind us that we live in an information age and that sharing more and better data is not just useful but essential. After the Mexican crisis, the international community pushed to make sure that countries that intend to tap international financial markets provide accurate and timely statistics on such variables as international reserves. That's the core principle embodied in the Special Data Dissemination Standard (SDDS)—the first of our recent initiatives. But we soon realized that many member countries needed to build up their statistical capacity before they could subscribe to the SDDS. That provided the impetus for the General Data Dissemination System, which gives countries a framework to evaluate their needs and set priorities.

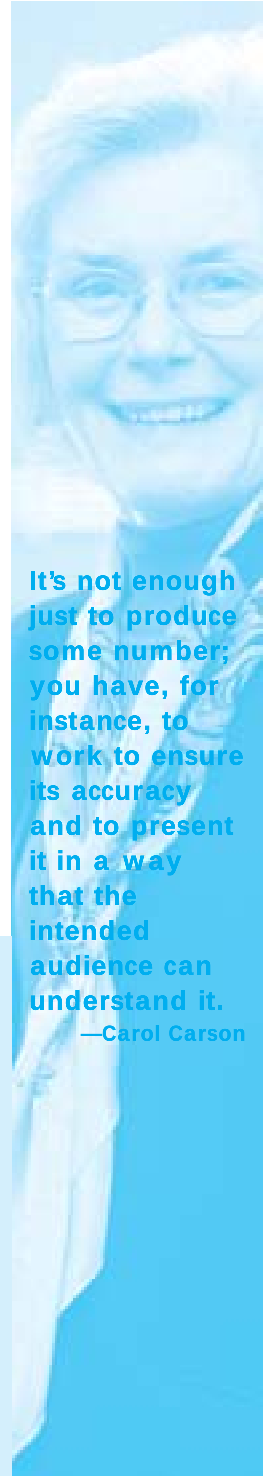
More recently, the international statistical community has concluded that it's not enough just to produce some number; you have, for instance, to work to ensure its accuracy and to present it in a way that the intended audience can understand it. We developed the Data Quality Assessment Framework—DQAF, or "decaf"—to assess country practices and capabilities in this regard.

LOUNGANI: So how does inflation targeting tie in with the DQAF?

CARSON: The DQAF is designed with broader goals in mind, but data quality—in the sense of an effective framework—is exactly what underpins a successful inflation targeting regime.

LOUNGANI: Are we at a point now where the IMF can help central banks and statistical agencies by putting together a code of conduct for inflation targeters?

CARSON: No, our knowledge is not quite ready to be codified, but we've certainly learned enough from various country cases to put together a loose-leaf binder of what has worked and what hasn't. ■



It's not enough just to produce some number; you have, for instance, to work to ensure its accuracy and to present it in a way that the intended audience can understand it.
—Carol Carson

Available on the web (www.imf.org)

News Briefs

02/22: IMF Completes Second Review Under Lesotho's PRGF Arrangement and Approves $4 Million Disbursement, March 18

02/23: IMF Completes Second Review Under Ethiopia's PRGF Arrangement and Approves $30 Million Disbursement, March 18

02/24: IMF Completes Second Review of Stand-By Arrangement with Brazil, March 26

02/25: IMF Completes First Review of Pakistan's PRGF-Supported Program, Approves $107 Million Disbursement, March 27

Press Releases

02/13: IMF and World Bank Support $950 Million in Debt-Service Relief For Sierra Leone Under Enhanced HIPC Initiative, March 19

02/14: IMF Completes Third Review and Approves New Stand-By Credit for Uruguay, March 25

02/15: IMF Approves in Principle $365 Million PRGF Arrangement for Côte d'Ivoire, March 27 (see page 107)

Public Information Notices

02/32: IMF Concludes 2001 Article IV Consultation with Lesotho, March 21

02/33: IMF Concludes Post-Program Monitoring Discussions with Thailand, March 21

02/34: IMF Concludes 2001 Article IV Consultation with Bosnia and Herzegovina, March 22

02/35: IMF Concludes Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs), March 25

02/36: IMF Concludes 2001 Article IV Consultation with New Zealand, March 27

02/37: IMF Concludes 2001 Article IV Consultation with the Republic of Palau, March 28

Speeches

"Growth and Reform in Russia," Anne Krueger, IMF First Deputy Managing Director, Conference on Post-Communist Economic Growth, Moscow, March 20

"The Monterrey Consensus and Beyond: Moving from Vision to Action," Horst Köhler, IMF Managing Director, International Conference on Financing for Development, Monterrey, Mexico, March 21 (see page 101)

"New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking," Anne Krueger, IMF First Deputy Managing Director, Conference on International Debt Workouts: Hopes and Hazards, April 1 (see page 97)

Transcripts

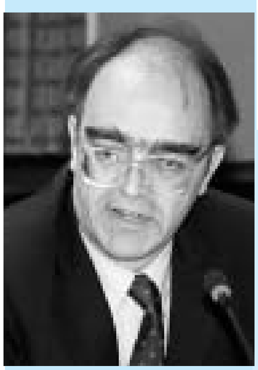
Economic Forum, "New Ideas for Reducing Poverty," March 15

Press Briefing, Thomas C. Dawson, Director, IMF External Relations Department, March 28

How can we measure the credibility of inflation targeting regimes?

Edgar Ayales

Malcolm Knight



Roger Clews

Central bankers were once notoriously inscrutable: "If you understood what I just said, you must not have heard me correctly," U.S. Federal Reserve Board Chair Alan Greenspan famously quipped. No more. Central banks now aim for clarity in their communications with the public. Nowhere is this change more apparent than in countries with inflation targeting regimes. Adoption of explicit targets for inflation compels central banks to monitor public and market opinion on whether their targets are credible. One issue the recent IMF conference on inflation targeting (see interview with Carol Carson, page 104) looked at was how central banks—inflation targeters in particular—try to measure credibility.

A dozen or so countries (see table below) have opted to combine a floating exchange rate with a monetary policy that seeks to achieve a publicly announced inflation goal. While the initial batch of inflation targeters were industrial countries, recent converts have tended to come from the ranks of emerging market countries. The operating procedures of many other central banks, such as that of the U.S. Federal Reserve, now have much in common with inflation targeters, even though these banks choose not to announce an explicit target for inflation.

Adoption of an explicit target compels central banks to maintain open lines of communication with the public and with markets. These central banks must explain the rationale for the target and the actions being taken to achieve it. And they must monitor whether their announced targets are "credible," that is, whether the public has faith that the central banks will achieve their announced targets.

Who has adopted inflation targeting?

Since New Zealand adopted inflation targeting in July 1989, it has been joined by Canada (February 1991), United Kingdom (October 1992), Sweden (January 1993), Australia (April 1993), Czech Republic (December 1997), Poland (March 1999), Israel (June 1999), Brazil (June 1999), Chile (September 1999), South Africa (February 2000), Thailand (April 2000), Hungary (June 2000), Colombia (December 2000), Korea (December 2000), Iceland (March 2001), Norway (March 2001), and Mexico (June 2001). For additional information, see IMF Occasional Paper No. 202, *Adopting Inflation Targeting: Practical Issues for Emerging Market Countries*, by Andrea Schaechter, Mark R. Stone, and Mark Zelmer.

How are we doing?

Ed Koch, former mayor of New York City, was famous for seeking instant referendums on his job performance by stopping people on the streets of the city and asking them, "How am I doing?" Under an inflation targeting regime, central banks operate very much in the Ed Koch mode, always asking the public and the markets, "How are we doing?" If the central bank has announced that its inflation target is, say, 3 percent, but markets expect inflation to be 6 percent, the answer to the question is clearly: "Not very well."

So how can central banks uncover market expectations of inflation and thereby gauge the credibility of the inflation targeting regime? Participants at the conference discussed a variety of possibilities. The simplest and most direct way is to use surveys of inflation expectations to see if there is a meeting of minds between the central bank and the public. When inflation targeting is first introduced, there may be significant differences between the central bank's inflation targets (and forecasts) and the public's expectations of inflation. But, as the IMF's Edgar Ayales, Randall Merris, and Alfredo Torres explained, if the central bank starts to achieve its inflation targets, it begins to gain credibility; over time, this credibility will be reflected in a convergence of the central bank's targets and the public's forecasts of inflation.

Take Canada, which has targeted inflation for over a decade. The Bank of Canada's Malcolm Knight noted that expected inflation in survey data has, over time, moved progressively closer to the midpoint of the Bank's announced inflation target range. Moreover, the diversity of opinion across various forecasters on what inflation is likely to be has been diminishing. Both these features suggest, he said, that "the Bank of Canada has developed increasing credibility over the inflation-targeting period." Inflation expectations are becoming "solidly anchored" on the midpoint of the target range for inflation announced by the Bank of Canada.

Indexed debt's role

Another way to gauge credibility is through the issuance of indexed government debt—that is, government IOUs whose return is tied to the rate of inflation. The Bank of England's Roger Clews explained how the difference between the return of indexed debt and the return on standard (nonindexed) debt provides a measure of inflation expectations. Imagine, he said, that a government issues a very simple bond promising to pay

£100 in a certain number of years. Imagine that the government also issues another bond that pays off at the same time and pays £100 "uplifted by the ratio of the price level when it pays off to the price level now."

The relative price of the two bonds "will clearly be closely connected to what people think the price level will be when the bonds pay out relative to now." In other words, the difference in yields between the two bonds provides a measure of what the markets expect inflation to be. A comparison of this implicit measure of inflation expectations with the announced inflation target serves as a referendum on the credibility of the central bank's policies.

How well have inflation targeters done by this metric? Clews presented evidence for the United Kingdom that once allowance is made for certain institutional features of U.K. prudential regulation, the implicit measure of inflation expectations is fairly close to the Bank of England's inflation target. Likewise, the Bank of Israel's Meir Sokoler noted that measures of inflation expectations derived from the country's well-functioning indexed debt markets line up quite well with the Bank of Israel's inflation target.

In the case of the United States, Vincent Reinhart of the U.S. Federal Reserve Board presented evidence that the difference between the yields on indexed and nonindexed debt has fallen from about 3½ percent in 1997 to about 2 percent today. While the U.S. Fed does not explicitly announce an inflation target, the narrowing of this differential suggests that the market expects the Fed to keep inflation at around 2 percent.

Paradox of success

Reinhart and other participants at the conference noted a "paradox of success" that can at times hamper, to some extent, the ability to uncover inflation expectations. As a central bank becomes more successful in meeting its inflation target, its credibility with private markets rises. This has the paradoxical effect of making the private sector expend less energy and fewer resources on forecasting inflation: the central bank is going to achieve its inflation target, the private sector reckons, so why not just use the central bank target as the inflation forecast? Hence, an important independent check on the credibility of the central bank's policies is lost. Canada's Malcolm Knight noted in a similar vein that, as inflation becomes more predictable, the advantages of issuing indexed debt are reduced; over time, liquidity in the indexed debt market is reduced—"it can dry up." ■

Prakash Loungani
IMF External Relations Department

Meir Sokoler

Vincent Reinhart

IMF resumes lending to Côte d'Ivoire

The IMF has approved an SDR 292.68 million ($365 million) loan under the Poverty Reduction and Growth Facility (PRGF), resuming lending to this West African country after a three-year hiatus. The loan became effective on March 28 after a World Bank review of Côte d'Ivoire's interim poverty reduction strategy paper (PRSP). Côte d'Ivoire can immediately draw up to SDR 58.54 million (about $73 million) under the PRGF arrangement.

IMF First Deputy Managing Director Anne Krueger said that "Côte d'Ivoire has been broadly successful in the implementation of a six-month staff-monitored program under difficult sociopolitical conditions, and the IMF is encouraged by the government's demonstrated discipline in macroeconomic management and its commitment to implement structural reforms in a determined manner."

She went on to say that the policies to be pursued in the first year of the program "are expected to begin to lay the foundation for sustained growth by focusing on macroeconomic stabilization measures and key structural reforms. Particular attention will be paid to better-focused and stronger action in the priority sectors of health, education, security, and basic infrastructure, and on legal and regulatory reforms to create a business environment in which private enterprise can flourish.

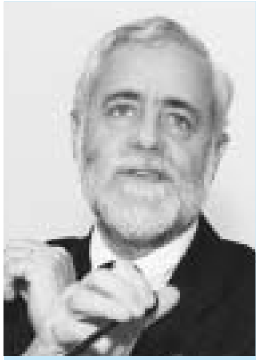
During 1994–97 and 1998–2001, the IMF supported reform programs instituted by the Ivoirien government to boost growth and achieve financial viability. In 1998, Côte d'Ivoire was declared eligible for external debt relief under the IMF–World Bank Heavily Indebted Poor Countries (HIPC) Initiative. The second program, however, was suspended in 1999 because of a political crisis and significant problems with governance and fiscal management that derailed the country's reform efforts.

Programs supported by the PRGF are intended, over time, to be based on poverty reduction strategies designed by the government with the participation of civil society and development partners and set out in a PRSP. This process is meant to ensure that the programs are founded on macroeconomic, structural, and social policies that will foster growth and reduce poverty. With the preparation of a realistic interim PRSP, the Ivoirien authorities have made a good start toward producing a national poverty reduction strategy and should complete a full PRSP by the end of July 2002.

Krueger said that "the authorities should adhere to their timetable for the completion of a PRSP…which is expected to guide the allocation of public resources in future years. The government will build the political support for the reforms and seek technical and financial assistance from multilateral and bilateral donors. Provided the authorities maintain a good track record of policy implementation, Côte d'Ivoire could reach the decision point under the enhanced HIPC Initiative in September 2002."

For more information, see the full text of Press Release No. 02/15 and News Brief No. 02/27 on the IMF's website (www.imf.org).

Conference debates complex links between macroeconomic policies and poverty reduction



Eduardo Aninat

Martin Ravallion

Rohini Pande

Robert Townsend

Do better-designed macroeconomic policies—more attuned to the needs of the poor—hold a key to more effective poverty reduction? If so, much will depend on better data and more detailed analysis of what works and why. The IMF's Research Department convened the Conference on Macroeconomic Policies and Poverty Reduction, on March 14–15, to spotlight new findings. The gathering, which follows through on an April 2001 forum, provided a platform for debate on the impact of economic reforms and financial crises on the poor, the effectiveness of social safety nets and aid, and the question of what to do about the debts of illegitimate governments.

In his opening remarks, Eduardo Aninat, Deputy Managing Director at the IMF, observed that "while there exists a great deal of scholarship and much experience on poverty and poverty eradication, many of the links between macroeconomic policies and poverty are not well understood." Sustained growth is necessary for poverty reduction, he pointed out, but it is clearly not sufficient. Countries and their development partners must deepen their understanding of the types of policies that foster poverty-reducing growth. Aninat also noted that policymakers face a formidable challenge in developing the ability to monitor and analyze the social impact of policies before, during, and after the implementation of key reforms.

Picking up on Aninat's challenge to examine the links between macroeconomic policies and poverty reduction, several studies examined whether and how economic reforms could be harnessed to reduce inequality and poverty. Stefan Dercon (Oxford University) found that 1990s reforms in rural Ethiopia, especially the liberalization of agricultural prices, helped some grow out of poverty. Those with better "endowments" of land, labor, and access to roads, he observed, were better positioned to benefit from the opportunities that agricultural reform provided.

From his study of Argentina, Bangladesh, and India, Martin Ravallion (World Bank) concluded that as aggregate government spending declined in line with fiscal contractions, targeted spending on the poor also declined—the "nonpoor" tend to be protected during fiscal adjustments. Boosting pro-poor spending in periods of fiscal contraction is desirable, he emphasized, but it is not politically easy.

Orazio Attanasio (University College, London), Pinelopi Goldberg (Yale University), and Nina Pavcnik (Dartmouth College) examined trade reform in Colombia and discerned an indirect link between trade liberalization and increased wages for skilled workers. Sectors that saw a large reduction in protective tariffs tended to be labor-intensive with a higher percentage of low-skilled workers. And it was these sectors that saw their wages decline relative to other sectors. At the same time, the study found that the premium for skills had risen over time. But overall, it found that trade liberalization in Colombia had only a modest impact on income distribution. This case study and others, T.N. Srinivasan (Yale University) remarked, raised an interesting political economy question—namely, why is protectionism greater in sectors with more lower-skilled workers?

Robin Burgess (London School of Economics) and Rohini Pande (Columbia University) challenged the conventional view that large-scale credit intervention by governments ends up benefiting elites. Their study of rural banks in India suggested that the government's promotion of "social banking"—that is, the expansion of banking in rural areas to achieve social objectives—did help reduce inequality and poverty. The credit that this program provided, they explained, enabled the rural poor to diversify into nonagricultural production and employment.

The finding that large-scale credit intervention by the government can help reduce poverty contrasts sharply with current thinking, which argues that microfinance is more effective in providing credit to the poor and marginalized. One drawback, Jonathan Morduch (New York University) noted, is that microfinance is too scattered and its projects too small to make an appreciable dent in poverty. Other participants pointed out that while social banking may have helped reduce poverty in rural India, it still left unanswered the question of whether it was really the most cost-effective way to do so.

Financial crises and the poor

Are the poor always the hardest hit by financial crises? Robert Townsend (University of Chicago), reviewing Thailand's experience, found that drought, floods, and illness had a greater immediate impact on people's lives than did the financial crisis. Not surprising, said Abhijit Banerjee (MIT), who maintained that the country's semiurban and rural people are "not playing in the Thai economy."

The breakdown of financial linkages that followed the crisis had a broader effect, however. Townsend argued that maintaining the viability of the financial system during a crisis is key to containing the ripple effects of the crisis. As Banerjee highlighted in his discussion of Townsend's paper, the two most vulnerable groups in the Thai crisis were the poor and small businessmen. For them, Banerjee said, old-fashioned programs such as food-for-work and loan write-offs would have helped.

Who gets hurt and who does not during a crisis? asked Emanuelle Baldacci, Luiz de Mello, and Gabriela Inchauste (IMF) in their study of Mexico's 1994–95 crisis. Already poor households, they argued, were not the hardest hit. Poverty rates soared in urban areas, in the Yucatan region, and in households headed by the young and the elderly. Elizabeth Frankenberg (UCLA), James Smith (Rand), John Strauss (Michigan State University), and Duncan Smith (UCLA) looked at Indonesia's experience and found that while some households were devastated by the crisis, others—notably rice producers and exporters—benefited from new opportunities.

Lant Pritchett (Kennedy School of Government) cautioned that the category "poor" is neither well-defined nor static, with people moving in and out of poverty, depending on their immediate economic circumstances. What this implies for policymakers, Pritchett said, is that safety nets are not enough. Invoking the terminology of mountain climbing, he proposed that the authorities devise safety "ropes" to prevent those who had raised themselves above the poverty line from slipping back into poverty.

Providing for the poor

How well did social safety nets do when they were most needed? In Thailand, Townsend contended, safety nets were in place during the crisis but did not target the most vulnerable. Similarly, Dercon's study of rural Ethiopia found food aid programs insufficient to protect the poor from shocks. He argued for more attention to the development of credit and insurance markets. Other papers stressed the importance of protecting pro-poor spending during financial crises and having well-targeted safety nets in place before a crisis strikes.

In Ravallion's view, deeper institutional and policy reforms are needed to protect public spending on the poor during fiscal adjustments. He proposed permanent, automatic protection programs that would support the poor during bad times but be withdrawn during good times. He held up the famine prevention and relief program of Maharashtra, India, as a model for successful insurance programs.

What can international financial institutions contribute to the development of effective social safety nets? They should, Ravallion argued ensure that "an effective safety net is in place with secure funding, as a crucial element of sound domestic policymaking, even in normal times." Angus Deaton (Princeton University) also suggested that the IMF and the World Bank conduct baseline surveys whenever an adjustment program is initiated. This, he said, would provide the means to assess the impact of reforms on the poor over time.

Does aid work?

In an analysis of aid's impact on recipient countries, Aleš Bulír and Timothy Lane (IMF) highlighted their finding that aid tends to be more volatile and unpredictable than domestic revenue, thereby undermining its potential positive effects and making it difficult for countries receiving aid to manage their fiscal affairs. (This is especially true, they said, for countries whose budgets are financed largely through aid.) Aid also tends to be procyclical. Countries receive more aid when they are growing and less aid when their economy slows, which exacerbates cyclical shocks rather than smoothing them out. Moreover, aid commitments are likely to overestimate disbursements. But none of this, Bulír and Lane conclude, should keep donors from being more generous or aid-recipient countries from formulating fiscal plans on more realistic projections.

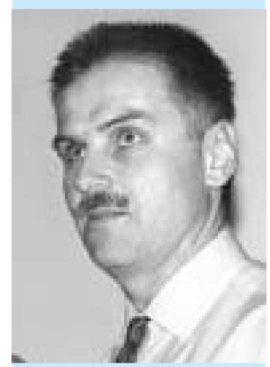
Alberto Alesina (Harvard University) wondered why skepticism about aid was swelling even as enthusiasm for debt relief continued unabated. The problem with aid, he said, is that it is neither well disbursed nor well used. In most cases, he said, less corrupt governments do not receive more aid. Typically, aid sparks a "war of attrition" among domestic constituents, leading to the adoption of inappropriate policies. Institutional reform would make aid more effective, and Alesina urged international financial institutions to make institutions, not policies, the focus of their conditionality. T.N. Srinivasan seconded this recommendation, saying the message for Monterrey was clear: the international financial institutions should focus on grants and institutional conditionality.

Odious debt

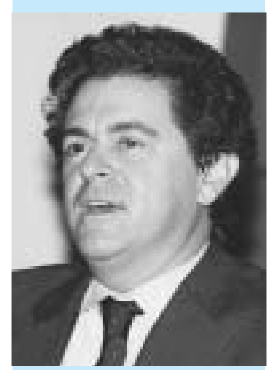
When illegitimate regimes incur debt, are successor governments responsible for repaying them? Michael Kremer and Seema Jayachandran (Harvard University) argued that sovereign debt incurred for private rather than public gain and without the consent of the people should be deemed "odious" and not transferable to successor governments. This would be a self-enforcing sanction, they said, because banks would have little incentive to lend to an illegitimate regime if successor regimes could refuse to repay. They also suggested that an independent, international institution composed of jurists, the UN Security Council, or perhaps domestic institutions of major creditor countries could be entrusted with the task of declaring debt odious.

Gabriela Inchauste

Lant Pritchett



Aleš Bulír



Alberto Alesina

Michael Kremer

But what if these jurors declared legitimate debts odious? What if the system backfires and simply creates incentives for markets to stop lending to developing countries? Such outcomes could be avoided, Kremer and Jayachandran argued, by having the declaration of odious debt made ex ante and by a supermajority. Conference participants pointed out, however, that such a system could nevertheless create perverse incentives and exacerbate conditions for people living under illegitimate regimes.

New ideas for reducing poverty

The conference ended with an economic forum with Nicholas Stern, chief economist, World Bank; Santiago Levy, Director General, Mexican Institute of Social Security; Nancy Birdsall, President, Center for Global Development; and Montek Ahluwalia, Director, IMF Independent Evaluation Office. Anne Krueger, IMF First Deputy Managing Director, moderated. On the links between growth and poverty reduction, Ahluwalia noted that India's experience validated the claim that strong growth helped reduce poverty over the longer term. Stern spotlighted World Bank and IMF efforts to develop a new "tool kit" that combined micro- and macro-level analysis to better assess the distributional and poverty impact of economic policies. As for safety nets, Birdsall echoed Pritchett's view that "safety rope" programs are useful, while Levy noted that direct monetary transfers are more effective than subsidies. (For details, see *IMF Survey*, March 25, 2002 issue). ■

Sabina Bhatia
IMF External Relations Department

The full text of the papers presented at the Macroeconomic and Poverty Reduction Conference are available on the IMF's website (www.imf.org). The June issue of the *IMF Research Bulletin* will provide summaries of the conference papers.

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IMF Working Paper

Despite prevention campaigns, southern Africa faces daunting challenges coping with HIV/AIDS

Southern Africa is the region of the world hardest hit by HIV/AIDS, with HIV prevalence rates ranging from about 15 percent to 35 percent of the adult population. Addressing an area in which little research has been done and few data are available, Economist Markus Haacker of the IMF's African Department studied the economic consequences of HIV/AIDS in nine southern African countries, including the effects on the health sector, public education, and the labor supply. He recently spoke to the IMF Survey *about his study.*

IMF SURVEY: What are the dimensions of the AIDS epidemic in southern Africa?

HAACKER: Many economies in the region now have HIV prevalence rates exceeding 20 percent, with even higher rates for young adults. The countries in the region are Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia, and Zimbabwe. For example, in Zimbabwe the mortality rate of the working-age population now is estimated at 2.9 percent, 2.7 percent of which is HIV/AIDS-related (see chart, this page). As a consequence, life expectancy at birth has fallen from about 65 years to less than 40 years in this country.

IMF SURVEY: What is the impact on the composition of the population?

HAACKER: Most directly, HIV/AIDS affects the population through higher mortality rates, especially for young adults. The population growth rate declines, and the population becomes younger on average. Also, the rising number of AIDS orphans is a matter of concern. Frequently, the loss of a parent means that the family is no longer able to afford education.

IMF SURVEY: Has GNP been a significant factor in these countries' ability to combat the AIDS epidemic?

HAACKER: The quality of health services largely depends on the available resources. While Botswana or South Africa—the richest countries in the region—can make certain resources available for treating HIV patients, even basic treatments could be unaffordable for Mozambique. In South Africa, the provision of nevirapine—a relatively inexpensive antiretroviral drug that reduces mother-to-child transmission—through public health services is a contentious issue. And, while more advanced antiretroviral therapies for HIV patients may not become available through the public health service any time soon, recent reductions in the price of antiretrovirals to a number of developing countries mean that these treatments have become more affordable, at least for government and formal sector employees. The biggest challenge is to improve the quality of health services to the broader population.

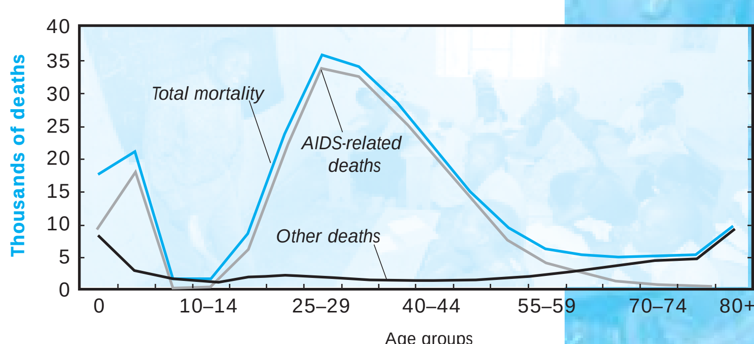
Haacker: "Reductions in the price of antiretrovirals to a number of developing countries mean that these treatments have become more affordable, at least for government and formal sector employees."

IMF SURVEY: Education would seem to be the way to both reduce the incidence of AIDS and boost growth. But what impact is HIV/AIDS having on the region's students and teachers?

HAACKER: Given the high costs of treating HIV/AIDS patients, strategies to combat the epidemic generally focus on prevention, including at schools. In my study, I analyzed the impact of HIV on the quality of education, as measured by pupil-teacher ratios. Based on predicted mortality rates for the general working-age population and demographic projections for the number of pupils, it seems that, as a result of HIV, 25–40 percent more teachers will need to be trained just to maintain current pupil-teacher ratios.

A second important issue is that many families affected by HIV cannot send their children to school because they can no longer afford school fees, or they

HIV/AIDS has taken a massive toll in Zimbabwe, one of the region's worst-affected countries[1]



[1]Mortality in 2000.

Data: International Programs Center, U.S. Bureau of the Census

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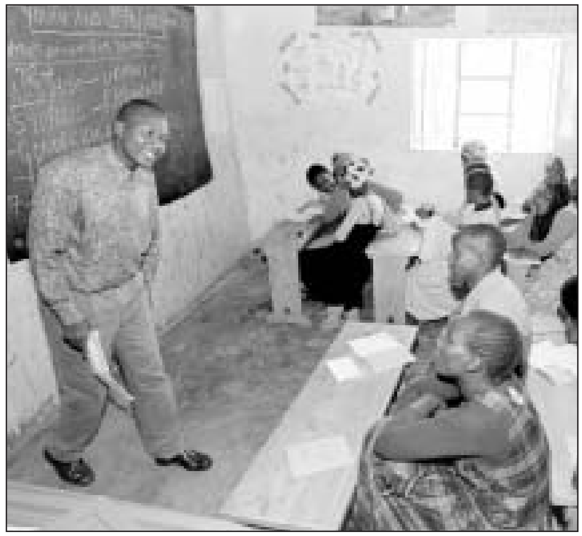
need the additional income from the younger members of the household. Thus, rather than improve economic growth or human capital by investing in the education sector, the issue is maintaining the gains made over the past few decades and avoiding a deterioration in the quality of education.


A community worker teaches an AIDS awareness class.

IMF SURVEY: How does HIV affect the public sector other than through health and education expenditures?

HAACKER: HIV/AIDS takes a heavy toll on public servants throughout the region. The U.S. Bureau of the Census projects that, in southern Africa, between 1 in 20 and 1 in 40 working-age adults will die in 2010, mostly due to HIV/AIDS. That translates into disruptions of public services and, probably, a decline in the quality of public services. If countries do not succeed in improving education to compensate for those losses, the number of qualified personnel throughout the public sector will decline. Even if the government succeeds in hiring more qualified people, the new hires would move from the private sector, so the overall picture regarding the availability of qualified personnel would not really change.

One aspect of the fiscal impact of HIV/AIDS that we do not understand very well is the effects on medical and death-related benefits. Some countries in the region have relatively well endowed public pension schemes, whereby the surviving spouse and underage children receive pensions. Even if the pension is related to the deceased's tenure in government, the overall payout from the pension system is likely to increase. Also, governments often run medical benefit programs, and their cost would increase manyfold if they provided full coverage for HIV.

IMF SURVEY: Is the epidemic having a different impact on the public sector than on the private sector?

HAACKER: In terms of the disruptions caused by the increased mortality of employees and the loss of human capital, the impact is similar. However, private companies are more flexible in addressing the costs related to HIV/AIDS. For example, a company facing much higher costs of medical and death-related benefits may reduce those benefits, thus shifting some of the burden to the public sector. But given the limited coverage of private health insurance, company insurance programs could help improve the availability of health care to HIV patients. In the longer run, companies' investment decisions will reflect the additional costs and the reduced supply of human capital associated with the HIV epidemic. Consequently, domestic investment and foreign direct investment are likely to decline.

IMF SURVEY: Is there any reason to feel optimistic about southern Africa's prospects for halting the spread of HIV/AIDS?

HAACKER: I find it hard to use the word optimistic about countries where 20–30 percent of the current population is infected. This means that, over the next 10 years, those 20 or 30 percent are likely to die even if a country succeeds in bringing down the numbers of new infections significantly.

Some countries—Senegal and Uganda—have succeeded in bringing down HIV prevalence rates through massive education and prevention campaigns. As other countries follow their example, we hope to see some decline in the number of new infections and of HIV prevalence rates over the next decade. But that would have no impact in the short run on the human suffering and the overall quality of life.

Regarding funds available for prevention and treatment of HIV patients, this is an area in which the World Bank has been very active. There has been some progress with the Global Fund Against AIDS, Tuberculosis, and Malaria—which has just made its first annual allocation of about $800 million, mainly to improve health services and prevention.

While we hope that increased prevention efforts bear fruit and the number of new infections comes down quickly, the region faces daunting challenges over the next decades. Even if prevention campaigns are successful, mortality rates will rise over the next decade, and the health sector faces a vastly increased demand for its services. More broadly, the loss of human capital, as well as the significant costs related to HIV/AIDS, will dampen domestic and foreign direct investment and slow down economic development. ■

Copies of IMF Working Paper No. 02/38, *The Economic Consequences of HIV/AIDS in Southern Africa*, by Markus Haacker, are available for $10.00 each from IMF Publication Services. For ordering information, please see page 110.