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Building on Africa's Progress

Evangelos A. Calamitsis, Director of the IMF's African Department, recently spoke with the IMF Survey *about the IMF's work in Africa. Calamitsis, a Greek national, has headed the African Department since 1994; he holds a Ph.D. in economics from Harvard University.*

Calamitsis: While Africa's recent progress has been encouraging, much remains to be done to achieve sustainable growth and reduce poverty.

IMF SURVEY: *Economic performance in Africa ranges widely from economies doing quite well to economies in difficult circumstances. To what do you attribute this?*

CALAMITSIS: Africa's economic performance, at least until recently, was characterized by too many cases of uneven or weak policy implementation leading to poor results. For the first time in a generation, however, we are now witnessing encouraging signs of progress, with an increasing number of countries registering substantial rates of economic growth, while reducing inflation and financial imbalances. This relatively favorable overall performance, particularly since 1993–94, conveys the sense that Africa is on the move.

Within this general framework, several countries have been doing much better than others, mainly because they have been rigorously implementing a wide range of sound macroeconomic policies and structural reforms. A number of countries in Eastern and Southern Africa, as well as in the CFA franc zone, have been doing particularly well. The centerpiece of the IMF's strategy in Africa has been to support such adjustment and reform efforts through the concessional ESAF [enhanced structural adjustment facility] lending window, as well as through complementary technical assistance. At present, 21 African countries are implementing comprehensive programs supported by ESAF arrangements. The countries whose economic performance has been weak have generally not been doing as well on the policy front or have been following "stop-and-go policies" from one year to the next. Other countries have suffered greatly from social and political instability. Although Africa's recent economic progress has been encouraging—with real GDP growth averaging about 5 percent—much remains to be done to achieve sustainable growth and reduce poverty in the context of financial stability.

IMF Survey: *How do you explain the relatively weak growth response even in those African countries that have improved their macroeconomic environment and liberalized their markets?*

CALAMITSIS: One reason growth has not responded more strongly is that domestic and foreign private investment has not increased as fast as expected. In many cases, private initiative is still constrained by extensive regulations, inefficient tax and banking systems, and the lack of economic security. Furthermore, some countries have been giving conflicting signals regarding their commitment to private sector development, which should be the engine of growth. This is why, as we look to the "second generation of reforms" that the IMF's

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Managing Director has recently cited, there is need for more decisive action to eliminate existing obstacles and constraints on private sector development.

IMF SURVEY: *Given the overall track record of adjustment and reform in Africa, which of the "success stories" can serve as models for weaker-performing African countries?*

CALAMITSIS: My long experience in the IMF has taught me to be cautious about publicizing "success stories" because of the vulnerability of most African countries. Nonetheless, a number of countries have been making steady progress, albeit not without some weaknesses. For example, Benin, Botswana, Côte d'Ivoire, Ethiopia, Ghana, Mali, Mauritius, Mozambique, Senegal, and Uganda have been pursuing policies that have moved their economies forward; for the CFA franc countries within this group, I am referring to the period after the 1994 devaluation.

IMF SURVEY: *What are the implications for the poor African countries of the decline in official development assistance [ODA]? How can they best adjust to this situation, and what can industrial countries do to help?*

CALAMITSIS: The decline in ODA has been taking place over several years, and many African countries have already achieved considerable adjustment. Unfortunately, this trend, which partly reflects the pressures on aid budgets in donor countries, is coming at a time when we are beginning to see some good results and when reforming African countries need to be encouraged. On the other hand, there are some important compensating factors. The debt problems of the heavily indebted poor countries are being seriously addressed; and some new ideas about providing support to developing countries—particularly in sub-Saharan Africa—through greater access to industrial country markets are being considered and could be very helpful.

IMF SURVEY: *You referred to the debt problem, which the IMF and the World Bank are seeking to address by coordinating an initiative for the heavily indebted poor countries [HIPCs]. How do you respond to critics charging that the HIPC initiative provides too little relief and demands excessive adjustment over too long a period of time?*

CALAMITSIS: This criticism is unjustified and not fully informed. The HIPC initiative is proceeding very well. It represents a strong commitment by the international financial community to reduce to sustainable levels the external debt burden of eligible countries that successfully complete a period of strong policy performance. We already have an important decision on Uganda, and preliminary discussions are being held concerning the eligibility for the initiative of Burkina Faso and Côte d'Ivoire, as well as Bolivia.

A key question is why the intended debt reduction is not delivered quickly by collapsing all stages of the initiative. In other words, having reached the "decision point" [following the first three-year period of adjustment], why not advance to the "completion point" immediately or very soon thereafter without a second three-year adjustment period? The answer is that, in all relevant cases, an agenda of unfinished key reforms still has to be implemented to ensure a lasting solution to the country's problems and an exit from continuous reliance on exceptional external assistance. The decision in the case of Uganda is a realistically flexible one under which the completion point is to be attained within one year. But this is only because Uganda has been given a lot of "credit" for its strong policy performance over a long period of time. In most other cases, once the decision point is reached, it will take some three additional years to complete key unfinished reforms. However, during this period, the indebted country is not only assured that its debt problem will be dealt with, but it also continues to benefit from concessional assistance and a flow rescheduling of its eligible external debt.

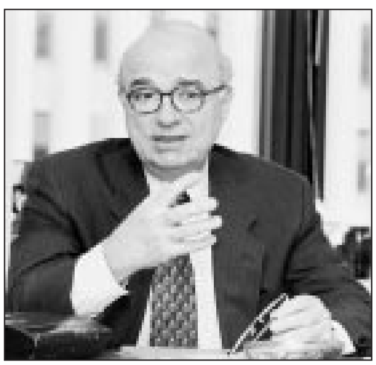
IMF SURVEY: *The IMF is increasingly emphasizing the importance of good governance. How are African countries faring on this score, and how much emphasis is the IMF giving to this issue in the context of its Article IV consultations and assistance to countries with IMF-supported adjustment programs?*

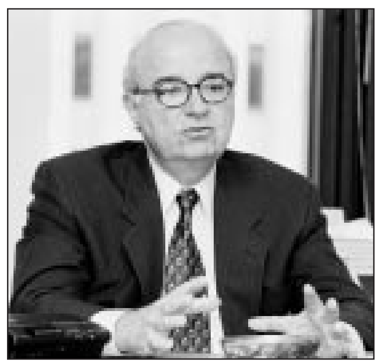
CALAMITSIS: The IMF's approach has been evolving in the light of experience. Traditionally, the focus has been on the key macroeconomic policy areas, such as exchange rate policy, as well as fiscal and monetary stability. With time, our approach has been to focus increasingly on structural adjustment and reform issues as well. In this regard, we believe that effective management of public resources—whether by the central government or by public enterprises—is very important for growth and financial stability.

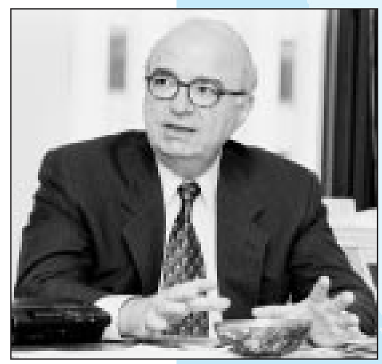
Good governance is critical in at least two respects. First, it helps ensure that public resources are well managed and corruption and fraud are vigorously addressed. As corruption has been a problem in a number of cases, we have been giving it due attention, particularly where it has a substantial macroeconomic impact. Good governance is also important in ensuring a level playing field, secure property rights, and a reliable legal system. In Africa, there are still problems in these areas, and they are being addressed with the help of the IMF and other institutions.

IMF SURVEY: *The IMF has emphasized the importance of countries building a domestic consensus for reform. To what degree have African governments sought to engage in a dialogue on reform with representatives of their civil societies?*

CALAMITSIS: The whole political environment in Africa has changed markedly. Whereas some 30 years ago, most countries were operating under authoritarian or quasi-authoritarian regimes, there has been a great transformation in recent years, with democratic institutions being established and free elections held in many countries. This has involved more public debate on various issues, underscoring the need for consensus building among the public sector, the private sector, trade unions, religious groups, and the civil society at large. There is now a growing awareness that reforms can be more sustainable if governments can get larger segments of civil society behind them. Efforts to mobilize such support are being made in an increasing number of African countries with considerable success.







In this context, the quality of adjustment is essential. It has to be seen as more equitable, more oriented toward the protection of social services, rather than, say, defense or other unproductive expenditures, so as to enlist the support of the bulk of the population. In addition, dealing with complex structural issues, such as eliminating labor market rigidities, requires a constructive dialogue with trade unions; such a dialogue is indeed critical to reaching understandings on policies needed to foster growth and reduce unemployment.

IMF SURVEY: *The U.S. administration has formulated an initiative for Africa, and African development has featured prominently at the recent Summit of the Eight in Denver. Is the IMF's current strategy for helping Africa achieve sustainable growth adequate and supportive of such initiatives?*

CALAMITSIS: The IMF has several effective instruments for supporting Africa's development efforts; these certainly complement and reinforce the latest initiatives. We have the ESAF, which we believe has been very useful, and we have made efforts to ensure its continuation to promote high and durable growth in the reforming countries. We also have other facilities that will be continued, together with programs of technical assistance and training focused on capacity building. Furthermore, the HIPC initiative is designed to help the eligible countries implement the reforms needed to ensure sustainable financial positions and stronger growth.

At the same time, the IMF has been reflecting on the most appropriate focus of its policy advice and dialogue with African member countries. In this respect, our thinking coincides to a large extent with the major statements recently made in Denver. As the Group of Seven economic statement indicated, developing countries, particularly in sub-Saharan Africa, need to implement comprehensive, market-oriented reforms to promote financial stability, trade and investment liberalization, sustainable development, and growth. Although many African countries have recently managed to attain or exceed real GDP growth of 5 percent, this is not enough, given where they started and their still high rates of population increase, which average about 3 percent a year. Africa certainly needs more rapid and equitable growth with financial stability. It would thus be important to implement a growth strategy focusing on five basic elements:

- ensuring and consolidating macroeconomic stability;
- substantially increasing private investment, both domestic and foreign, through deregulation and the establishment of an environment conducive to economic security in all of its aspects;
- redefining the role of government, with a view to limiting its scope to certain key functions, notably providing basic infrastructure and social services, and delivering these services efficiently;
- making a decisive effort to speed up trade liberalization; and
- strengthening institutional capacity and human resource development.

This list does not imply that we in the IMF are modifying what we have been saying for many years. Rather, we are stressing that certain policy areas merit greater attention. For example, African countries should open up their economies to trade and investment more rapidly than they have so far, in order to boost efficiency and growth. We are urging them to do so. The quid pro quo, of course, should be greater access to industrial country markets for the goods in which Africa has a comparative advantage.

The IMF's specific contributions to the new global partnership for the development of Africa would be to define a set of "best practices" to improve the business environment and foster growth; extend more technical assistance, and help strengthen macroeconomic policy and management capacity; foster civil service reform and trade liberalization; help attract foreign investors in Africa; disseminate information to potential investors on macroeconomic and financial developments and the business environment in African countries; and provide expanded access to ESAF where bolder reforms involve larger financing requirements and, where necessary, assistance under the HIPC initiative.

Africa needs more rapid and equitable growth, with financial stability.

IMF SURVEY: *What assistance, if any, is the IMF currently offering African countries in post-conflict situations?*

CALAMITSIS: Rwanda is the first African country to benefit from the IMF's policy of emergency assistance in post-conflict cases; a loan of about $12 million was approved in April 1997, in support of the government's economic program for this year. Rwanda's administrative capacity is still too limited to implement a comprehensive structural adjustment program that could be supported by the ESAF. So the emergency assistance is a first step in the process of medium-term adjustment and reform. We have also initiated discussions with Angola in the context of the Article IV consultation on the possibility of emergency assistance.

IMF SURVEY: *Efforts at regional integration in Africa have been ongoing. Are they contributing to improving Africa's growth prospects?*

CALAMITSIS: One of the constraints of many African countries is that their markets are small, and several are landlocked. If they can integrate their economies into larger units, they can expand their production and trade. These larger units, however, should also pursue an outward-oriented growth strategy. Significant progress is being made in this direction in the context of the Central African Economic and Customs Union, the West African Economic and Monetary Union, and the Southern African Development Community. The IMF, the World Bank, and other institutions have been providing policy advice to these bodies, with a view to enhancing their cooperation and improving the growth prospects of their member countries. ■

Denver Summit Highlights Global Cooperation And Integration

Realizing the full benefits of globalization while meeting the challenges it presents was a recurring theme in the June 20–22 Denver Summit of the Eight. Since 1975, the heads of state of the major industrial countries (since 1976, the Group of Seven (G-7)) have met annually to discuss major economic and political issues affecting individual countries and the international community. This year's summit marked the first time Russia participated fully in most of the discussions. Below is a summary of the major points covered during the Denver Summit, based on the summit communiqué and a statement issued separately by the G-7, entitled "Confronting Global Economic and Financial Challenges."

Globalization offers many opportunities for increased prosperity, but it also poses new challenges. The increasing "openness and interdependence of our economies, with deep trade linkages and ever greater flows of private capital, means that problems in one country can spill over more easily to affect the rest." Another challenge is ensuring that all segments of society—and all countries—have the opportunity to share in the prosperity that global integration and technological innovation have made possible. Unemployment and economic insecurity pose further challenges. "Sound economic policies and the structural reforms necessary to allow markets to function properly are essential."

In their statement on economic and financial issues, the heads of state of the G-7 announced their intention to work together with other countries to promote open markets for trade and investment and to support global financial stability; and to promote the successful integra-

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
June 23	3.95	3.95	4.33
June 30	4.01	4.01	4.39

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 U.S. dollar, weighted 39 percent; deutsche mark, 21 percent; Japanese yen, 18 percent; French franc, 11 percent; and U.K. pound, 11 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 109.6 percent) 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.
Data: IMF Treasurer's Department

tion of transition and developing countries into the global economy. In this context, the G-7 welcomed the new round of Russian economic reforms launched this year and noted that full implementation of Russia's latest IMF-supported program is critical.

Acknowledging that the rapid growth of global trade and private capital flows requires continuing adaptation and reform of the international financial institutions, the heads of state pledged to work collaboratively with the institutions to strengthen the effectiveness of the international monetary system. They cited as particularly important the IMF surveillance and its efforts to help countries build long-term potential through trade and investment liberalization. The G-7 statement called for early agreement on an amendment of the IMF's Article of Agreements that would give it a specific mandate to promote capital account liberalization. The heads of state also sought "substantial agreement" toward a proposed amendment of the IMF's Articles to provide for an "equity" allocation of SDRs by the time of the IMF-World Bank Annual Meetings in September.

The G-7 statement welcomed the IMF's progress in promoting improved transparency. Increased attention to financial sector problems that could have significant macroeconomic implications and the promotion of good governance could, the statement noted, help prevent financial crises. Appropriate transparency in the IMF's activities with member countries was equally important.

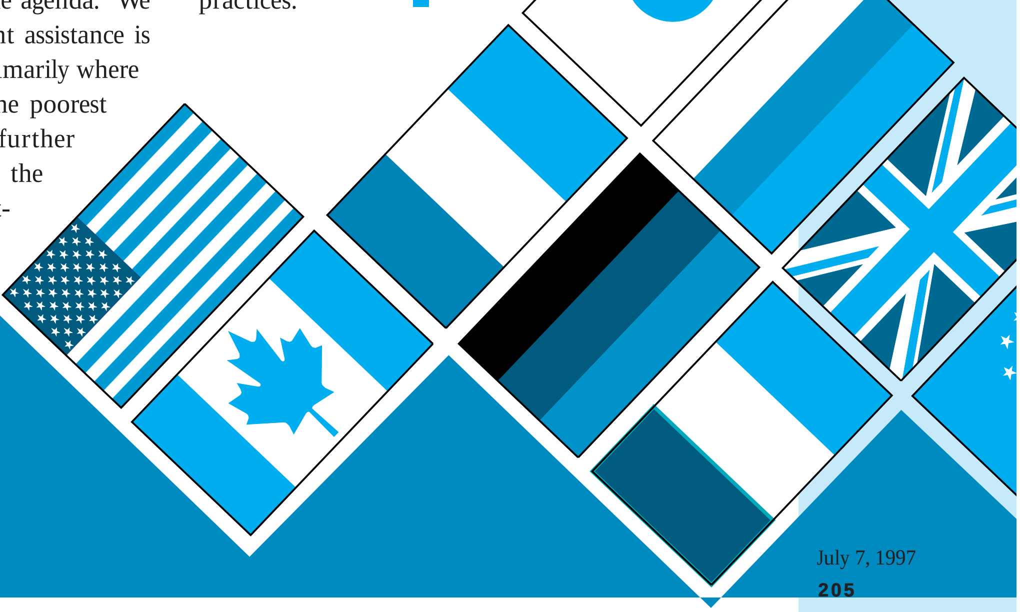
The G-7 leaders acknowledged their responsibility for ensuring that the international financial institutions have the multilateral support and financial resources needed to carry out their mandates. In this context, the G-7 asked the IMF's Executive Board to work toward completing the Eleventh General Review of Quotas by the time of the September Annual Meetings.

Integration of the poorest countries into the global economy was an important item on the agenda. "We must ensure that adequate development assistance is available and that it be concentrated primarily where it will have the greatest impact—on the poorest countries in danger of being left further behind." The G-7 therefore welcomed the substantial progress made in implementing the debt initiative to help heavily indebted poor countries (HIPCs) implement the bold reforms needed for debt relief. They noted the specific mechanisms that the IMF and the World Bank had established to provide effective multilateral debt reduction for countries qualifying under the HIPC initiative, as well as the readiness of the Paris Club of official creditors to participate on the basis of fair burden sharing.

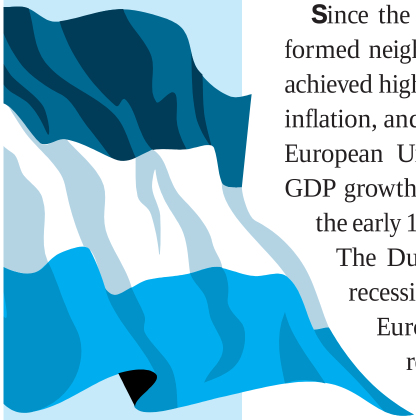
G-7 leaders also outlined a comprehensive strategy for promoting development in Africa, based on the New Global Partnership for Development initiated a year earlier at the Lyon Summit. The objective is not only to facilitate the progressive integration of African countries into the world economy, but also to foster the integration of poor populations into the economic, social, and political life of their countries. Initiatives already undertaken by an increasing number of sub-Saharan countries had produced a welcome acceleration of growth since 1994, the G-7 statement indicated. International financial institutions should provide the support needed to help these countries create an environment for domestic capital formation, private sector-led growth, and successful integration into global markets.

Development assistance should be concentrated on the poorest countries in danger of being left behind.

The G-7 leaders encouraged the efforts of international financial institutions to promote good governance in their "respective areas of competence and responsibility." They urged the IMF and the multilateral development banks to strengthen their efforts to help countries fight corruption, including through measures to ensure the rule of law, improve the efficiency and accountability of the public sector, and increase institutional capacity and efficiency—all of which help remove economic and financial incentives and opportunities for corrupt practices. ■



From Dutch Disease to Dutch Miracle?

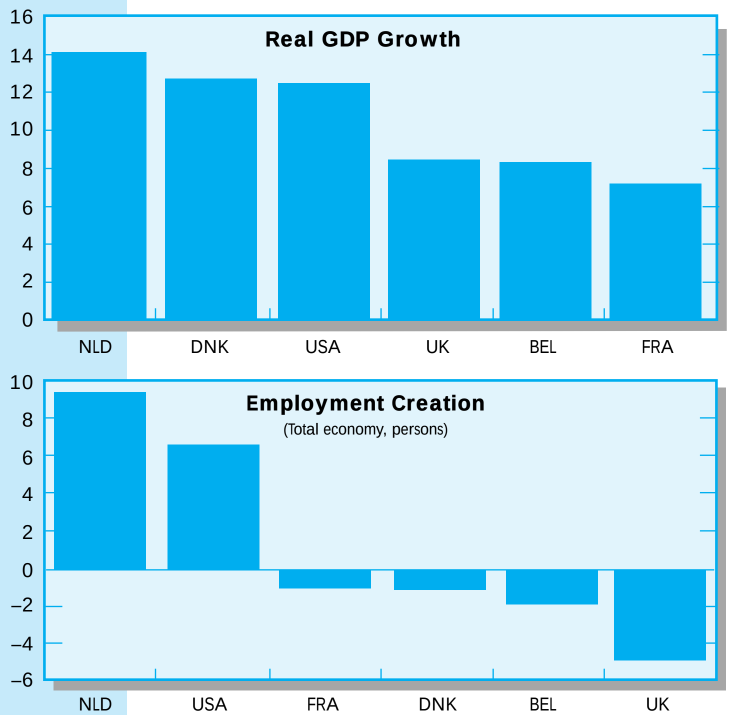


Since the early 1990s, the Netherlands has outperformed neighboring countries on several fronts. It has achieved higher employment and GDP growth and low inflation, and the lowest long-term interest rates in the European Union (EU). The Netherlands' per capita GDP growth, which was well below the EU average in the early 1980s, has been above it since the late 1980s.

The Dutch economy also suffered less from the recessions in 1992–93 and 1995 than other European economies. This performance represents a marked turnaround from the early 1980s, when the country faced a deep recession, the profitability of firms was close to zero, unemployment had risen sharply, and the fiscal deficit amounted to 9½ percent of GDP. Recognizing the need for a fundamental shift in macroeconomic and structural policies, the Dutch authorities—in consultation with labor unions—embarked on a comprehensive economic reform program in 1982.

GDP Growth and Employment Creation, 1990–96

(Cumulative growth, in percent)



Note: BEL = Belgium, DNK = Denmark, FRA = France, NLD = Netherlands, UK = United KIngdom, USA = United States.

Data: OECD, *Economic Outlook* and IMF, *World Economic Outlook*

Fifteen years of gradual but mutually reinforcing reforms have paid off in terms of economic growth, macroeconomic stability, and employment growth. An important element in the improved economic performance has been the recovery of profitability of firms, which by the late 1980s had returned to the level of the early 1970s. This recovery, bolstered by wage moderation, led to a strong increase in corporate saving and investment.

Pre-1982 Deterioration Linked to Excessive Wage Growth

During the late 1970s and early 1980s, the Dutch economy deteriorated markedly in response to years of excessive wage growth, which eroded business profits, and uncontrolled government expenditure, which led to unsustainable fiscal deficits. The economy also suffered from "Dutch disease": higher international energy prices increased the government's natural gas revenues, which financed higher transfers to households and added to the real appreciation of the currency.

Rapid wage growth in the 1970s pushed the share of labor income in firms' value added to unprecedented levels: by the early 1980s, at 95 percent, it was 12 points higher than a decade earlier. At the same time, the income share of capital declined to less than 6 percent in 1980 from 17 percent in 1970. In an environment of high interest rates, the profit share fell even more sharply and by the early 1980s, the enterprise sector had virtually ceased to make profits. Weakened competitiveness and declining profitability stifled investment, and although wage increases stimulated consumption, this increased demand was reflected in a deteriorating current account, rather than stronger output growth.

Over time, rapid wage growth induced firms to substitute capital for labor. Productivity increased, but the balance between capital and labor moved substantially out of equilibrium. Employment stopped growing over the course of the early 1970s, and by the early 1980s it started to decline. Stagnant economic growth and lower employment aggravated the fiscal situation, which the government addressed on the revenue side. The resulting increase in the tax burden exacerbated wage pressures and was again translated into lower profit shares.

Reform Centers on Orthodox Measures

In 1982, a new government took office with the objective of pursuing fiscal consolidation and reducing state intervention in the economy. The reform package, implemented in 1982 and continuing through the mid-1990s, has featured a mix of orthodox measures—tight fiscal policy coupled with "getting incentives right." The package has included spending-based fiscal consolidation, a tight and credible link of the guilder to the deutsche mark, and wide-ranging structural reforms—particularly in the related areas of social security and the labor market—and was accompanied by notable wage moderation. Recently, the deregulation of product markets has gained momentum, helping increase domestic competition and employment.

Fiscal Consolidation. From 1983 to 1993, fiscal policy aimed at restraining public expenditure growth to reduce the deficit and cut the collective burden of taxes and premiums. The government set limits on the collective burden, forcing spending reductions to take the lead in reducing the deficit. In the late 1980s, growth was much stronger than expected, allowing for expenditure overruns while still observing the deficit target. In 1994, the authorities switched to medium-term expenditure targets, with ceilings set on spending by the central government, social security, and health care. Public expenditure fell to 54 percent of GDP in 1996 from 66 percent in 1982, and the broadly measured deficit declined to 2½ percent of GDP from 9½ percent.

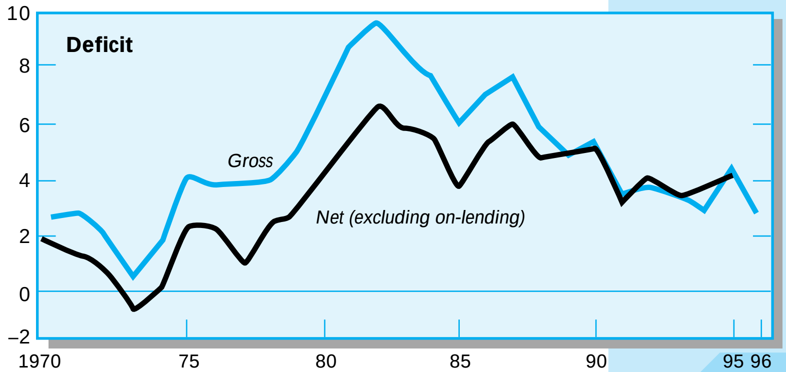
Monetary Policy. Since 1982, monetary policy has aimed solely at maintaining the fixed exchange rate link with the deutsche mark. Other than a final devaluation in 1983, the guilder-deutsche mark parity has remained unchanged for almost 14 years. The credibility of the link was clearly established in the exchange market turmoils of 1992 and 1993, when the guilder-deutsche mark parity did not come under attack. Moreover, while the exchange rate bands of almost all currencies in the European Monetary System were widened, the guilder-deutsche mark exchange rate was left unchanged.

Social Security and Labor Market Reforms. Measures to encourage participation in the labor force and job search included lowering the replacement ratio for unemployment and disability benefits to 70 percent from 80 percent; shortening the duration period for unemployment benefits; tightening eligibility criteria for social benefits, particularly disability; cutting the tax burden on individuals; and, most recently, privatizing sickness benefits. Measures to stimulate demand included substantially cutting real minimum wages, especially for youths; reducing social premiums across the board; further reducing nonwage labor costs, specifically for low-skilled workers; and, most recently, virtually eliminating employers' social contributions for the low-skilled, long-term unemployed. In Europe, where rigidities in the labor market have caused high rates of unemployment, the Netherlands approach stands out as an example of reforms to increase flexibility.

Wage Moderation. In late 1982, labor unions and employers formally agreed to moderate wage growth to stimulate employment creation. By the late 1980s, this new wage strategy had become widely accepted by labor unions, employers, and political parties in the Netherlands. Several factors helped to encourage wage moderation. For example, the reduction in the collective burden of taxes and premiums allowed real net incomes to rise, even in the absence of gross wage increases and substantial cuts in the real minimum wage and in social benefits; and a decline in real government wages helped to underpin wage restraint in the private sector. A rapid rise in the participation of women in the workforce and a strong increase in the working-age population also encouraged support for wage moderation: with a sizable increase in labor supply, wage pressures were less likely to emerge.

Fiscal Policy Experience

(General government, in percent of GDP)



Data: Netherlands Ministry of Finance, Miljoenennota, 1997, and OECD, *Economic Outlook*

Product Market Reforms. Product market deregulation became part of the economic reform program in the early 1990s, with the aim of increasing domestic competition and providing more opportunities for business expansion and job creation, particularly in the service industry. Measures have included an extension of shopping hours, more flexible business licensing requirements, and a strengthening of anticartel measures, supported by the recent introduction of legislation to limit cartels and control mergers.

Can the Dutch Experience Be Replicated?

The Netherlands' turnaround in economic performance has been hailed by some as "the Dutch miracle" and an example for other economies. It certainly can be argued that the Netherlands—as a very open economy faced with a crisis—had little choice but to opt for flexibility to remain competitive in a climate of increasing globalization. The approach to reform was gradual, and implementation broadly consultative. Nevertheless, although there was a consensus from the beginning on wage moderation, acceptance of other reforms developed only over time. Moreover, the enduring change in the labor unions' wage-bargaining approach can be seen as a rational response to government cuts in benefits and minimum wages, with wage moderation counterbalanced by income gains through sustained tax cuts under a new fiscal strategy.

The improvement in overall performance was accompanied by a slowdown in productivity growth. The slowdown, however, reflected—at least in part—the impact of a reversion toward equilibrium relative levels in the mix of capital and labor, as well as low-skilled employment creation—both positive developments.

Unique initial conditions on the supply side of the labor market clearly amplified the impact of reforms. These included a low labor force participation rate, with relatively few women in the workforce; rapid demographic growth, which underpinned wage moderation; and above-equilibrium wage rates, a reduction of which triggered rapid employment growth. This was a propitious setting for the effective implementation of measures on the demand side. Under current circumstances, with wages close to equilibrium, even stronger supply-side measures would have been needed to foster such strong employment growth.

The recent improvement of the Netherlands' economy has been partly a correction from a weak starting position. Indeed, the overall tax burden and debt ratio are still excessive, and labor force participation remains low; and the number of workers receiving disability and unemployment benefits remains close to record highs. Nevertheless, the reforms are noteworthy for the remarkable employment creation and turnaround in participation they have achieved since the early 1980s. The "stock" or "level" problems that remain emphasize that the reform process is still far from complete.

In essence, the "Dutch miracle" is neither a miracle nor uniquely Dutch, but rather illustrates the mutually reinforcing impact and central importance of relatively orthodox reforms, both macroeconomic and structural, pursued consistently over a long period. ■

Western European Division
IMF European I Department

Meeting with Church Leaders Highlights Strategy Beyond Debt Reduction

At the initiative of the Pontifical Council for Justice and Peace, church leaders met with the heads of international financial institutions active in Latin America, including the IMF, to discuss policies and priorities for sustainable economic development in the region. The Konrad Adenauer Foundation of Germany sponsored this historic event, held June 9–10 at the Vatican. Participants included IMF Managing Director Michel Camdessus; World Bank President James Wolfensohn; President of the Inter-American Development Bank, Enrique Iglesias; World Bank Vice President for Latin America, Shahid Javed Burki; and representatives of the Presidency of the Council of Latin American Episcopal Conferences (CELAM) and the U.S. and German Catholic and Episcopal Conferences.

The Vatican hosted a meeting of church leaders and heads of international financial institutions.

The meeting provided an opportunity to increase mutual understanding of the nature of the problems confronting Latin America and the different mandates and roles of international financial institutions working in the region. Church leaders stressed the need to address the growing level of poverty and widening income distribution gaps—factors undermining social cohesion in Latin America—and called for a social dimension to be incorporated in economic policymaking. They also expressed concern with Latin America's debt burden and the decreasing levels of social expenditures resulting from requirements to reduce budget deficits.

Representatives of international financial institutions pointed out that Latin America had achieved much over the past decade in terms of economic stability and growth. While poverty remains a problem, a large number of countries had made progress in reducing it. They emphasized the importance of appropriate macroeconomic policies to attract private capital to underpin investment and growth, especially in an era of declining official development assistance. Debt had ceased to be the outstanding problem for most countries in the region, with the exception of a few that are eligible for assistance under the joint IMF-World Bank debt initiative for heavily indebted poor countries. The international financial institutions' representatives emphasized that several other elements are essential for improving living standards in Latin America, including:

- reducing state intervention in the economy and increasing transparency of government operations to limit the opportunities for corruption and enhance public accountability;
- creating a simple, transparent regulatory system that is equitably enforced, encourages competition, and eliminates unnecessary business costs, thereby promoting efficiency and growth;
- establishing a reliable judicial system to give confidence to savers and investors; and
- reducing unproductive government expenditure to make room for more investment in basic infrastructure and in human capital through higher levels and improved quality of expenditure on education. ■

Arab Economies Face Need to Achieve Higher Sustained Growth

The dynamic nature of globalization amplifies the benefits of growth but also intensifies the perils of stagnation. For the Arab economies, whose recent past has been characterized by an extended period of disappointing growth, the options are particularly sharply etched. Following strong growth in 1970–85, the region's growth rate fell over the next decade. While East Asia boomed and per capita incomes in developing countries as a whole rose by over 40 percent, the per capita income level of the Arab region stagnated. Fortunately, following significant progress in macroeconomic stabilization and structural reforms in several countries, the region's growth picked up in 1996–97 in the context of lower inflation, increasing foreign exchange reserves, and declining debt burdens.

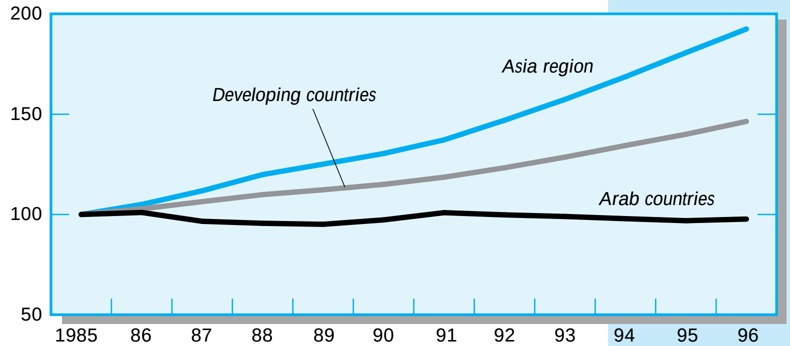
The necessity of decisively reversing the legacy of slow growth of 1985–95 and ensuring that the growth momentum emphasizes human development and the quality of life were the principal themes of a conference, held in Sana'a in early June, on Sustainable Growth in the Arab States. The conference, jointly sponsored by the government of Yemen, the IMF, and the United Nations Development Program (UNDP), explored conditions for the region to enjoy the fruits of its considerable resource endowment and globalization. The emphasis was on high growth, whose benefits are widely shared in the interest of human development and which is consistent with wise use of the region's natural resource. The symposium, organized around papers by IMF and UNDP staff, interwove economic and social concerns. The UNDP presentations emphasized human resource development, sound environmental policies, and the role of private finance in the human development effort. The IMF staff focused on the interrelated issues of the role of investment and savings in promoting growth, globalization and growth prospects, and appropriate public sector/private sector balance.

Growth, Investment, and Savings

The first IMF paper, prepared by Mohamed A. El-Erian, Amer Bisat, and Thomas Helbling of the Middle Eastern Department and presented by El-Erian, argued that for Arab economies to overcome the legacy of slow growth, it was essential to improve the level and efficiency of domestic investment and develop a larger and more stable source of funding for investment.

In describing the region's growth record, the authors noted that, after the period of high growth of the 1970s and early 1980s, economic performance languished as policies were insufficient to offset unfavorable developments in the external environment: growth fell, the rate of capital accumulation declined, and the region's domestic savings mobilization faltered. As a result, in comparison to other developing country regions, the Arab region as a whole did not sufficiently exploit the opportunities offered by developments in the international economy,

Comparative Real Per Capita GDP Growth
(Index 1985 = 100)

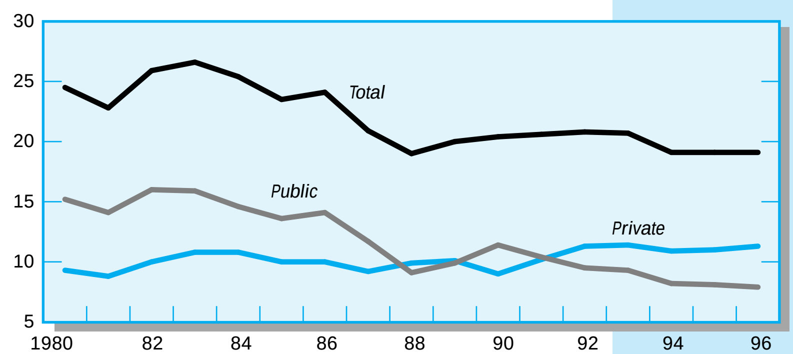


Data: IMF, *World Economic Outlook* and staff estimates

particularly economic globalization. Those Arab countries that maintained appropriate reforms and stabilization measures, however, reaped the benefits in terms of above average growth and low inflation.

Several encouraging developments have characterized the most recent years—developments that augur well for the region's economic outlook. El-Erian cited,

Arab Countries: Investment Rates
(Percent of GDP)



Data: IMF, *World Economic Outlook* and staff estimates

among others, Jordan's annual average growth rate of 6 percent since 1990, low inflation, and buoyant export growth, which has resulted from the steadfast and sustained implementation of reform measures; the budgetary improvements achieved by the oil-exporting countries of the Gulf; Algeria's improving financial balances; Tunisia's expanding presence on international capital markets; and Egypt's increasing attractiveness to domestic and foreign investors.

In seeking to understand the Arab world's historical growth performance, El-Erian noted that in their research, he and his co-authors had identified two fundamental sources of growth: increases in factor inputs (capital and labor) and increased efficiency in the use of these inputs ("total factor productivity"). It is important to determine the sources of growth, he argued, because policies that hasten accumulation of knowledge and technology tend to have a longer-term impact than those that encourage accumulation of physical capital. Improvements in total factor productivity are particularly desirable.

In measuring total factor productivity growth rates in Arab economies, El-Erian cited disappointing results for the period of low growth and low investment (1986–95)—with positive annual growth rates of total factor productivity recorded in only 4 of the 13 countries surveyed. These findings confirm the limitations of import substitution and inward-directed development strategies and intimate that declining levels of investment had undermined these countries' access to technological progress.

The key, and interrelated, challenges facing the Arab economies are, then, to provide for continued growth in the capital stock; encourage a sharply stronger and broad-based improvement in total factor productivity; and ensure that investment funding is both increased and stabilized. Building on recent progress, the Arab economies are now actively engaged in strengthening the enabling policy environment. These economies are now emphasizing, El-Erian said, the role of the private sector as the engine of growth and the complementary role that the public sector can and should play to support productive private sector activity.

A durable change—one that allows the Arab economies to match and sustain the high growth rates of the East Asian economies and thereby generate employment opportunities for their rapidly growing labor force—will require an economic and financial environment that promotes high and efficient investment in physical and human resources. Encouragingly, sustaining high economic growth is now at the top of the policy agenda of most, if not all, Arab economies. While the specific policy priorities vary—reflecting the heterogeneity of the countries in the region—four elements are key to the region's growth challenge and its increasing orderly integration into the global economy:

• maintaining stable macroeconomic conditions;

• accelerating structural reforms that deepen and widen the private sector's role in an increasingly outward-oriented economy;

New Economic Information Center Launched in Cairo

On June 11–12, a new Economic Information Center was launched in Cairo, with the objective of improving the flow of economic information to the public in Egypt and eventually in other Arab countries. Three events marked the initiation of the center's activities. An opening session featured Atef Ebeid, Egypt's Minister of the Public Enterprise Sector; A. S. Shaalan, the Executive Director representing Egypt on the IMF Executive Board; Ali Ghoneim, Managing Director of Al-Ahram; and scores of leading Egyptian editors and economists. The remaining sessions included briefings for journalists on the activities of the center, economic reforms in Egypt, and the challenges of globalization; and a discussion for academics and business leaders sponsored jointly by the Economic Information Center and the Egyptian Center for Economic Studies.

The government of Egypt created the Economic Information Center to promote public understanding of basic economic concepts and support for sound reform policies in Egypt and elsewhere in the Arab world; keep key groups and the public informed of global economic developments and prospects; promote and contribute to informed debate on current economic issues; and provide accessible and timely financial and economic data and publications.

The preliminary program of activities for the Cairo Economic Information Center includes periodic seminars and workshops designed to meet the needs of the financial media, academics, labor unions, parliamentarians, business leaders, and investors. Over time, the center will expand its activities throughout the Arab world. It will also provide regular briefings for the media and interested groups on international developments, including key reports issued by international financial institutions. The center will similarly serve as a resource center, providing the latest economic and financial publications in Arabic and English and affording access, via computers, to national and international financial data and other resource centers. The Cairo Economic Information Center is designed to complement the efforts of existing centers and it is cooperating actively with other organizations to support common interests and activities.

The center's activities have been well received, observed Shaalan. Coverage in the press has been excellent. He noted that commentators welcomed this effort to meet a well-recognized need for more, and better, information on economic development and the IMF's willingness to provide support for such an initiative. "Indeed, the IMF's growing involvement in the region reflects the confidence that has been established with the governments, the private sector, and increasingly the media," Shaalan said, noting that there is now much greater appreciation in the region for the IMF's expertise on economic and financial issues and its contribution to economic reform efforts.

• strengthening institutions and expanding information flows that help underwrite sound investment decisions and minimize disruptive market responses to changing economic conditions; and

• raising the level and quality of investment in social sectors that improves the human resource base.

The growth objectives and the reforms they entail will present challenges for policymakers, but El-Erian was encouraged by the broad awareness in Arab economies of the importance and urgency of meeting these challenges. Heartening, too, he noted, was the increasing involvement and participation of the private sector in the development process.

Globalization and Growth Prospects

A paper by Patricia Alonso-Gamo, Annalisa Fedelino, and Sebastian Paris Horvitz of the IMF's Middle Eastern Department reviewed the impact on the growth prospects of the Arab region of the rapid globalization of economic activity in the wake of economic liberalization and technological change in transport and communications. Alonso-Gamo, who presented the paper, noted that Arab countries were not well integrated in the world economy, did not benefit from the recent surge in foreign direct investment and private capital flows to developing countries, and risked becoming marginalized.

After analyzing the link between integration and growth, Alonso-Gamo argued that Arab countries' growth will need to be outward oriented, owing to their structural and economic characteristics, while traditional and highly volatile sources of growth are slowing down. Thus, to attain rapid and sustained growth—essential to keep pace with their rapidly growing population and labor force, and pressing social needs—Arab countries will need to overcome existing rigidities and implement measures that promote integration with the world economy. Indeed, since globalization cannot be stopped, the real issue is to implement domestic policies that help countries adapt to the realities of change, while minimizing the costs.

Alonso-Gamo underscored that globalization presents challenges to Arab countries. It heightens the opportunity cost for those that lag behind in integration, but it also offers unprecedented opportunities. Arab countries have much to gain from globalization, but their ability to realize these gains will depend primarily on the quality of their domestic policies.

Economic Performance and Government Intervention

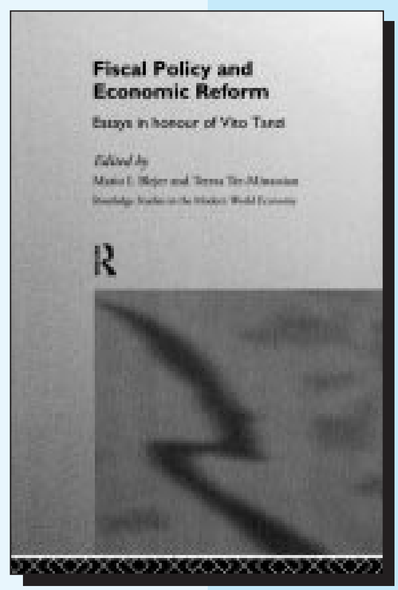
A critical question facing the Arab economies is the role of the public sector. As in several other developing countries, governments in the Arab world have assumed a direct and extensive role in production and in the capital accumulation process. Presenting a paper prepared by Rakia Moalla-Fetini of the IMF's Middle Eastern Department and John Waterbury of Princeton University, Waterbury demonstrated how the quality and nature of government policy interventions—and the strategic attitude followed toward the private sector (that is, whether it replaces the private sector or fosters its development)—have played a prime role in determining the dynamics and sustainability of growth.

Differences in performance among Arab countries said Waterbury, derived in part from differences in the type and quality of government interventions during the traditional phases of the state-led import substitution development strategy and, more important, from differences in the way governments adjusted to crises. He also argued that the difference in growth performance between the Arab world and other regions was associated in part with the anti-private sector stance adopted by some countries early in their development process. Under the public sector-led import substitution approach, state intervention restricted the scope for a private sector-led market economy.

The Arab economies have now clearly recognized the need to shift to a private sector-led development strategy, with several of them already taking important steps in this regard. These efforts will need to be sustained if past experiences of state intervention are to be decisively overcome. ■

New Collection of Fiscal Policy Studies Published

Although fiscal policy is an essential ingredient in the economic policy mix, there is no "magic formula" for balancing fiscal policy and economic performance, according to the editors of a two-volume Festschrift honoring IMF Fiscal Affairs Department Director Vito Tanzi. The essays in one volume, *Macroeconomic Dimensions of Public Finance*, explore various aspects of the macroeconomic impact of fiscal policies. The companion volume, *Fiscal Policy and Economic Reform*, focuses on the role of these policies in the process of economic and structural reforms. Both volumes highlight interconnected issues that are relevant for both developing and advanced economies.



Contributors to the Festschrift, edited by Mario I. Blejer of the IMF's Monetary and Exchange Affairs Department and Teresa Ter-Minassian of the IMF's Fiscal Affairs Department, include specialists from academia, the IMF, and other international financial institutions.

From the Executive Board

Following are excerpts of recent IMF press releases. Full texts are available on the IMF's web site (http://www.imf.org) under "news" or on request from the IMF's Public Affairs Division (fax: (202) 623-6278).

Uruguay: Stand-By

The IMF approved a 21-month stand-by credit for Uruguay equivalent to SDR 125 million (about $174 million), in support of the government's 1997–98 economic program. The government of Uruguay does not intend to make drawings under the stand-by credit and will treat it as precautionary.

Uruguay: Selected Economic Indicators

	1994	1995	1996	1997[2]
		(percent change)		
Real GDP	6.4	–2.0	4.9[1]	3.0–4.0
Consumer prices (end of period)	44.1	35.4	24.3	14.0–17.0
		(percent of GDP)		
Overall fiscal balance	–3.1	–1.7	–1.7	–1.7
External current account balance	–2.7	–1.2	–1.5	–1.8
		(months of imports of goods and services)		
Gross international reserves	5.0	5.2	5.1	5.0

[1]Preliminary.
[2]Program.

Data: Uruguayan authorities and IMF staff estimates

1997–98 Program

Uruguay's 1997–98 economic program is framed in a medium-term strategy that seeks to reduce inflation to single-digit levels by the end of 1998 in an environment of sustained output and employment growth and to achieve a viable external position. The program aims at real GDP growth of at least 3 percent in 1997 and 3 percent in 1998, led by expanded investment and exports; a reduction in the rate of inflation to 14–17 percent by end 1997; and a further strengthening of the international reserve position.

Structural Reforms

Structural reforms already initiated will continue under the program. Reform of the main social security system is expected to be completed in 1997. State reform is expected to reduce government positions through the elimination of vacancies, outsourcing, and reduction in employment. The government is also increasing the participation of the private sector in activities previously reserved for public entities.

Addressing Social Needs

Uruguay has the lowest level of poverty in Latin America and the Caribbean, and is one of the few countries in the region that have achieved significant and sustained reductions in poverty since the mid-1980s. Special efforts are being made under the program to further assist the most vulnerable groups in society, which include children of poor families, young mothers, and low-income workers, through specific targeted programs.

Uruguay joined the IMF on March 11, 1946; its quota is SDR 225.3 million (about $314 million), and its outstanding use of IMF credit currently totals SDR 2.0 million (about $3 million).

Press Release No. 97/27, June 20

Mozambique: ESAF

The IMF has approved the second annual loan for Mozambique under the enhanced structural adjustment facility (ESAF) in an amount equivalent to SDR 25.2 million (about $35 million), to support the government's economic program for 1997/98. The loan will be disbursed in two equal semiannual installments.

The government met all the objectives of the 1996/97 program, supported by the first annual loan under the ESAF approved on June 21, 1996 (Press Release No. 96/33, *IMF Survey*, July 1, 1996). Real GDP increased by 6.4 percent in 1996 from 1.5 percent in 1995, while end-of-period inflation declined sharply to 16.6 percent from 54.1 percent. The government also carried out a number of structural reforms.

1997/98 Program

In the context of a medium-term strategy, the program for 1997/98, supported by the second annual ESAF loan, aims to increase nonenergy GDP by 5 percent in 1997 and total GDP growth by 6 percent; to cut end-of-

Mozambique: Selected Economic Indicators

	1995	1996[1]	1997[2]	1998[2]
		(percent change)		
Real GDP	1.5	6.4	6.0	11.6
Nonenergy real GDP growth	1.5	6.4	5.0	5.0
Consumer prices (end of period)	54.1	16.6	14.0	10.0
		(percent of GDP)		
Overall government budget balance (before grants)	–20.9	–17.0	–21.5	–20.9
		(million U.S. dollars)		
External current account balance (including grants)	–337.6	–384.5	–376.5	–456.7
		(months of imports)		
Gross international reserves	2.7	4.4	5.1	5.0

[1]Preliminary.
[2]Program.

Data: Mozambican authorities and IMF staff estimates and projections period inflation to 14 percent in 1997 from 16.6 percent in 1996; and to increase gross international reserves to the equivalent of about 5.1 months of imports of goods and nonfactor services in 1997 from 4.4 months in 1996.

To these ends, the government will restrict the overall budget deficit before grants to 21.5 percent of GDP, after a deficit of 17 percent of GDP in 1996. The program envisages a tight monetary policy and maintenance of a floating exchange rate system.

Recent IMF Publications

Working Papers (7.00)

97/61: *Cointegration and Long-Horizon Forecasting*, Peter F. Christoffersen and Francis X. Diebold

97/62: *European Monetary Union and International Capital Markets: Structural Implications and Risks*, Alessandro Prati and Garry Schinasi

97/63: *Does Public Disagreement on Monetary Policy Unsettle the Markets?*, Timothy Lane and Hossein Samiei

97/64: *Contrasting Monetary Regimes in Africa*, Patrick Honohan and Stephen A. O'Connell

97/65: *Experiences with Monetary Integration and Lessons for Korean Unification*, Goohoon Kwon

97/66: *Real Exchange Rate Levels, Productivity, and Demand Shocks: Evidence from a Panel of 14 Countries*, Menzie Chinn and Louis Johnston

97/67: *What Type of Contracts Underlie Aggregate Wage Dynamics?*, Esteban Jadresic

97/68: *An Analysis of External Debt and Capital Flight in the Severely Indebted Low-Income Countries in Sub-Saharan Africa*, S. Ibi Ajayi

97/69: *Exchange Rate Regimes and Location*, Luca Antonio Ricci

97/70: *World Commodity Prices as a Forecasting Tool for Retail Prices: Evidence from the United Kingdom*, Alicia Garcia Herrero and John Thornton

97/71: *A Primer on the IMF's Information Notice System*, Alessandro Zanello and Dominique Desruelle

97/72: *External Borrowing by the Baltics, Russia, and Other Countries of the Former Soviet Union: Developments and Policy Issues*, Ishan Kapur and Emmanuel van der Mensbrugghe

97/73: *Corruption and the Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?*, Caroline Van Rijckeghem and Beatrice Weder

97/74: *How Long Is the Long Run? A Dynamic Analysis of the Spanish Business Cycle*, Humberto Lopez and others

97/75: *Exchange Rate-Based Stabilization in Western Europe: Greece, Ireland, Italy, and Portugal*, Enrica Detragiache and Alfonso J. Hamann

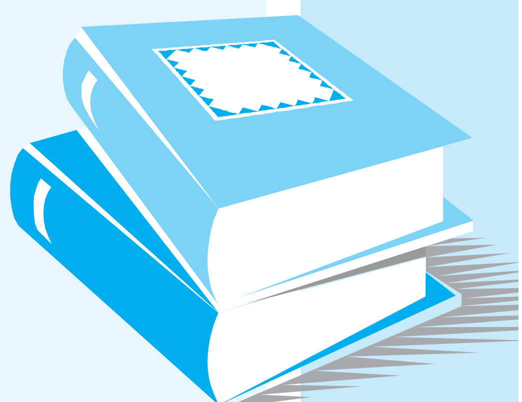
Papers on Policy Analysis and Assessment ($7.00)

97/4: *Exchange Rate Policy and Monetary Strategy Options in the Philippines: The Search for Stability and Sustainability*, Aerdt C.F.J. Houben

97/5: *Fiscal Accounting of Bank Restructuring*, James A. Daniel and others

97/6: *Monetary Frameworks: Is There a Preferred Option for the European Central Bank?*, Ramana Ramaswamy

97/7: *Dedicated Road Funds: A Preliminary View on a World Bank Initiative*, Barry H. Potter



IMF Staff Country Reports ($15.00)

97/43: Italy

NEW Press Information Notices (free)

No. 4: Nepal

No. 5: Austria

No. 6: St Kitts and Nevis

No. 7: Dominica

No. 8: Kingdom of the Netherlands

Other Publications

Staff Papers, March 1997 (annual subscription: $50.00; academic rate: $25.00; individual copies, $16.00)

Macroeconomic Accounting and Analysis in Transition Economies, Abdessatar Ouanes and Subhash Thakur ($19.00)

Summary Proceedings of the Fifty-First Annual Meeting of the Board of Governors, October 1996 (free)

Publications are available from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org.

For information on the IMF on the Internet—including the full text of the English edition of the *IMF Survey*, the *IMF Survey*'s annual *Supplement on the IMF*, an updated *IMF Publications Catalog*, full texts of IMF Working Papers and Papers on Policy Analysis and Assessment published in 1997, and daily SDR exchange rates of 45 currencies—please visit the IMF's web site (http://www.imf.org).

Structural Reforms

A comprehensive program of reform is being carried out to improve revenue performance, simplify and rationalize the tax system, increase the efficiency of public administration, develop financial markets and strengthen bank supervision, encourage sustainable agricultural development, and remove obstacles to private sector development.

Addressing Social Needs

The 1997/98 program targets an increase in social sector spending in order to reduce poverty and to improve the human capital base. There is also an emphasis on smallholder agricultural development to raise rural income levels.

Mozambique joined the IMF on September 24, 1984; its quota is SDR 84.0 million (about $117 million); and its outstanding use of IMF credit currently totals SDR 133 million (about $185 million).

Press Release No. 97/28, June 24

Armenia: ESAF

The IMF approved the second annual loan under the enhanced structural adjustment facility (ESAF), in an amount equivalent to SDR 33.8 million (about $47 million), to support Armenia's economic program in 1997. The loan is available in two equal semiannual installments, the first of which can be drawn on June 30, 1997.

1997 Program

The key macroeconomic objectives of the 1997 program are to achieve a real GDP growth rate of about 6 percent; bring down the inflation rate during the year to under 10 percent; and increase gross reserves to the equivalent of 2.8 months of imports. To achieve these objectives, fiscal policy will aim at reducing the overall deficit to under 7 percent of GDP from 9.3 percent in 1996. Monetary policy will be consistent with achieving the program's inflation targets.

Armenia: Selected Economic Indicators

	1995	1996	1997[1]	1998[2]	1999[2]
			(percent change)		
Real GDP	6.9	5.8	5.8	6.0	6.0
Consumer prices (end of period)	31.9	5.7	9.5	8.0	6.2
			(percent of GDP)		
Overall fiscal balance (cash basis)	–11.1	–9.3	–6.7	–5.6	–4.0
External current account balance (excluding official transfers)	–37.6	–26.6	–24.0	–23.2	–21.1
			(months of imports)		
Gross official reserves	1.6	2.2	2.8	3.1	3.1

[1]Program.
[2]Projections.

Data: Armenian authorities and IMF staff estimates and projections

Structural Reforms

In addition to the reforms under way in the banking sector and tax administration, the 1997 program follows a three-pronged approach: continued privatization to lay the basis for sustained growth; improvement of financial discipline through enterprise restructuring; and reforms in the energy, health, and education sectors.

Addressing Social Needs

The authorities will take several measures during the program period to improve the targeting of social safety net benefits to alleviate poverty and improve income distribution.

Armenia joined the IMF on May 28, 1992, and its quota is SDR 67.5 million (about $94 million). Its outstanding use of IMF financing currently totals SDR 81 million (about $113 million).

Press Release No. 97/29, June 24

Armenia: Article VIII

The government of the Republic of Armenia has notified the IMF that it has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the IMF Articles of Agreement, with effect from May 29, 1997. IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval. A total of 140 countries have now assumed Article VIII status.

Armenia joined the IMF on May 28, 1992. Its quota is SDR 67.5 million (about $94 million).

Press Release No. 97/30, June 25

IMF Welcomes Thai Exchange Rate Action

Following recent actions by the Thai authorities, IMF Acting Managing Director Stanley Fisher said on July 2:

"In response to recent developments, Thailand's exchange rate system has been changed, effective July 2, 1997, to a managed float, with the value of the baht being determined by market forces in line with economic fundamentals. To support the new exchange rate policy, the Bank of Thailand has raised the bank rate from 10.5 percent to 12.5 percent. The Thai authorities are also considering supplementary measures to alleviate potential negative effects on debt servicing and prices that may result from adjustments in the value of the baht.

"In conjunction with the recent measures in the financial sector, and the previously announced strengthening of fiscal policy, the IMF welcomes today's important steps aimed at addressing Thailand's present economic difficulties and adopting a comprehensive strategy to ensure macroeconomic adjustment and financial stability. The Thai authorities have requested technical assistance from the IMF for the effective implementation of these measures, and the IMF will be responding rapidly to these requests."

Photo Credits: Padraic Hughes for the IMF, pages 201 and 203; Ann Purcell and Carl Purcell via PNI, page 208.

Deindustrialization Is a Natural Consequence of Growth

Since the 1970s, the world's advanced economies (including the traditionally designated "industrial countries" and the newly industrialized economies, as defined in the May 1997 *World Economic Outlook*; see *IMF Survey*, May 12, page 150) have experienced a virtually continuous decline in the share of employment in manufacturing and an inexorable rise in the share of employment in the service sector. This phenomenon, referred to as "deindustrialization," has been linked in the public mind with two other economic developments: the widening disparity of earnings, mainly in the United States, and rising unemployment, mainly in Europe. But, according to a recent IMF Working Paper, *Deindustrialization: Causes and Implications*, by Robert Rowthorn and Ramana Ramaswamy, deindustrialization is not a negative phenomenon but a natural consequence of the process of economic development in an already highly developed economy. The most important factor that accounts for deindustrialization is the systematic tendency for productivity in manufacturing to grow faster than in services. Because it is an inevitable consequence of economic growth, deindustrialization will have important implications for growth and industrial relations.

Explaining Deindustrialization

For the industrial countries, the process of economic growth has led, first, to an increase in the share of industrial employment in the early industrializing phase of economic development and then to deindustrialization and transition to a service economy in the later stages. Since the beginning of the late 1970s, manufacturing employment as a share of civilian employment has declined continuously in most advanced economies (see chart, page 216). For the industrial countries, this share fell to about 18 percent in 1994 from about 28 percent in 1970. The other side of this development has been the fairly uniform and virtually continuous increase in the share of employment in services since 1960. Yet, as the IMF study shows, the shift in employment from manufacturing to services since the early 1970s has not been associated with any significant shift in the pattern of expenditures between these two sectors. How, then, to account for the shift?

A comparison between secular shifts in employment in the industrialization stage of development (that is, from the latter decades of the nineteenth century up to the early 1960s) and in the period since the early 1970s shows that differences in productivity are the prime movers behind the shifts. In the pre-1960s industrialization stage, the share of employment in manufacturing rose steadily, largely representing the movement of employment from agriculture to industry. This reflected not only the shift in the pattern of demand from agricultural to manufactured products and services that typically comes with economic growth, but also the rapid growth of labor productivity in agriculture owing to a wide range of innovations. Similarly, the secular shift in employment from manufacturing to services since the early 1970s mainly reflects the impact of differential productivity growth between manufacturing and services.

> ***Deindustrialization is not necessarily a symptom of the failure of the manufacturing sector.***

For the industrial countries, the average annual growth rates of output were roughly similar in services and manufacturing between 1960 and 1994, but labor productivity in manufacturing consistently outpaced that of services. According to the IMF study, if there is no long-term tendency for the real output of services to grow faster than that of manufactured goods, but productivity in manufacturing increases consistently faster than in services, then the pattern of employment will shift away from manufacturing and into services. The service sector will then have to absorb an ever-greater proportion of total employment just to keep its output rising in line with that of manufacturing.

Relative productivity effects, the IMF study finds, account for more than 60 percent of deindustrialization in the industrial countries between 1970 and 1994. Contrary to popular perceptions, North-South trade (that is, trade between the industrial and the developing world) has probably had only a small impact on the process of deindustrialization.

Deindustrialization is not necessarily a symptom of the failure of a country's manufacturing sector or of the economy as a whole. On the contrary, according to the IMF study, it is simply the natural outcome of the process of successful economic development and is, in general, associated with rising living standards. Admittedly, deindustrialization can, at times, be associated with difficulties in the manufacturing sector or the economy as a whole. For example, although economic dynamism explains a large part of the decline in the share of manufacturing employment in both the United States and Europe between 1970 and 1994, deindustrialization has also been associated with some negative features—stagnant earnings and widening income disparities in the United States, and high unemployment in Europe. Had these countries grown faster than they did during 1970–94, however,

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deindustrialization would still have occurred but with more favorable effects on living standards and employment.

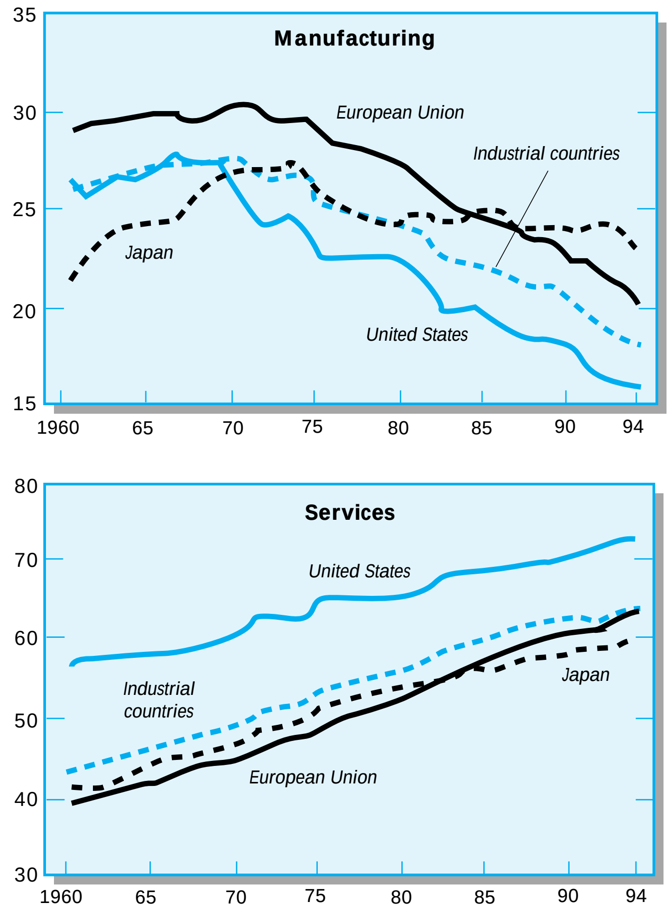
Implications of Deindustrialization

Continued deindustrialization has important implications for long-term growth prospects in the advanced economies. A starting point for analyzing growth issues, the authors note, is the observation that productivity growth is persistently faster in some activities than in others. Productivity tends to grow rapidly in manufacturing, because production in this sector can be readily standardized; consequently, the information required for production can be formalized in a set of instructions that can then be easily replicated. Some services that are impersonal, such as telecommunications, have attributes similar to manufacturing. But personal services—certain types of medical care, for example—cannot be easily standardized and are not subject to the same mass production methods used in manufacturing; productivity in these services would thus tend to grow more slowly.

Because the share of employment in manufacturing has been declining, the overall rate of growth of productivity in the economy has come to be determined more and more by productivity growth in the service sector. Contrary to popular perceptions, productivity growth in manufacturing is therefore less important than it used to be in determining the overall growth of productivity and living standards in the advanced economies. As the process of deindustrialization continues, the overall growth of productivity will increasingly depend upon productivity developments in the service sector. The evolution of productivity growth in this sector will, in turn, depend on future developments in areas such as information technology. Product innovation in manufacturing will continue to be important, however, because of the spillovers to productivity growth in services.

Employment by Sector

(Percent of total civilian employment)



Data: IMF, *Deindustrialization: Causes and Implications*, Working Paper 97/42

Deindustrialization is also likely to have important implications for industrial relations in the advanced economies. Trade unions, for example, have traditionally derived their strength from industry, where the mode of organizing production and the nature of work make it easier for unions to organize workers. In the service sector, unionization is less prevalent and more difficult to organize, because of the wide differences in the nature of work and the size of enterprises across different activities.

Countries with centralized wage bargaining arrangements are likely to face particularly serious challenges, because centralized wage bargaining has been associated with a conscious attempt to narrow wage differentials between different groups of workers. This policy had some chance for success in a period when traditional manufacturing—with roughly similar work requirements across activities—provided the major source of employment. However, as employment shifts increasingly toward the service sector—where the nature of the work, the level of skill required, and the degree of job security vary a lot between activities—a bargaining arrangement that compresses wage differentials is likely to prove problematic. It is generally difficult for a centralized union to make decisions on the appropriate wage differentials in a fast-changing environment. Centralized wage bargaining in a service economy could therefore have adverse consequences for the growth of productivity. ■

Copies of IMF Working Paper 97/42, *Deindustrialization: Causes and Implications*, by Robert Rowthorn and Ramana Ramaswamy, are available for $7.00 from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org. The full text is also available on the IMF's web site (http://www.imf.org).