IMF SURVEY

International Monetary Fund
VOLUME 31
NUMBER 13
July 8, 2002

www.imf.org/imfsurvey

In this issue

209 Group of Eight summit
209 Open letter to Joseph Stiglitz
213 Aninat on peace in Colombia
213 Köhler on Argentine progress
214 Substantial increase in Uruguay loan
215 Deaton on poverty counting woes
218 Budget cuts in poor countries
220 Köhler at ECOSOC
220 Turkey drawing cleared
222 Are African exporters more productive?
and...
217 Selected IMF rates
219 Recent publications
221 New on the web

Group of Eight summit

Leaders agree on action plan for Africa, more grant aid for poor countries

Leaders of the Group of Eight countries gathered in Kananaskis, Canada, June 26–27, for a summit that focused on terrorism, the global economy, and building a new partnership for Africa's development. It was their first meeting since the terrorist attacks of September 11. It was announced that Russia, which since 1997 has participated in summit meetings with the Group of Seven immediately following the annual G-7 summits, and which this year participated more fully as a member of the summit group, will in 2006 assume the presidency of the G-8 and host the summit. The June 2003 summit will be held in France.

Nigerian President Olusegun Obasanjo addresses a press conference at the G-8 summit. Left to right: Russian President Vladimir Putin, Canadian Prime Minister Jean Chrétien, U.S. President George W. Bush, German Chancellor Gerhard Schroeder, Algerian President Abdelaziz Bouteflika, Italian Prime Minister Silvio Berlusconi, and Senegalese President Abdoulaye Wade.

The G-7 leaders announced that they had agreed to add up to \$1 billion to debt relief for poor countries to ensure full financing of the Heavily Indebted Poor Countries (HIPC) Initiative. This action reflected renewed concern that a variety of factors—including lower commodity prices—might prevent the debt initiative from delivering (Please turn to page 212)

Rogoff's discontent with Stiglitz

An open letter
from Kenneth Rogoff, IMF Economic Counsellor and Director of Research Department
to Joseph Stiglitz, author of *Globalization and Its Discontents*

At the outset, I would like to stress that it has been a pleasure working closely with my World Bank colleagues—particularly my counterpart, Chief Economist Nick Stern—during my first year at the IMF. We regularly cross 19th Street to exchange ideas on research, policy, and life. The relations between our two institutions are excellent—this is not at issue. Of course, to that effect, I think it is also important, before I begin, for me to quash rumors about the demolition of the former PEPCO building that stood right next to the IMF until a few days ago. No, it's absolutely not true that this was caused by a loose cannon planted within the World Bank.

July 2

Dear Joe:

Like you, I came to my position in Washington from the cloisters of a tenured position at a top-ranking American university. Like you, I came because I care. Unlike you, I am humbled by the World Bank and IMF staff I meet each day. I meet people who are deeply committed to bringing growth to the developing world and to alleviating poverty. I meet superb professionals who regularly work 80-hour weeks, who endure long separations from their families. IMF staff have been shot at in Bosnia, (Please turn to following page)

It was not just that IMF policy might be regarded by softheaded liberals as inhumane. Even if one cared little for those who faced starvation, or the children whose growth had been stunted by malnutrition, it was simply bad economics.

–Joseph Stiglitz
Globalization and Its Discontents
p 119

Rogoff challenges Stiglitz

(Continued from front page) slaved for weeks without heat in the brutal Tajikistan winter, and contracted deadly tropical diseases in Africa. These people are bright, energetic, and imaginative. Their dedication humbles me, but in your speeches, in your book [see, for example, the quote cited on this page], you feel free to carelessly slander them.

Joe, you may not remember this, but in the late 1980s, I once enjoyed the privilege of being in the office next to yours for a semester. We young economists all looked up to you in awe. One of my favorite stories from that era is a lunch with you and our former colleague, Carl Shapiro, at which the two of you started discussing whether Paul Volcker merited your vote for a tenured appointment at Princeton. At one point, you turned to me and said, “Ken, you used to work for Volcker at the Fed. Tell me, is he really smart?” I responded something to the effect of “Well, he *was* arguably the greatest Federal Reserve Chairman of the twentieth century,” to which you replied, “But is he smart like *us*?” I wasn’t sure how to take it, since you were looking across at Carl, not me, when you said it.

My reason for telling this story is twofold. First, perhaps the IMF staff whom you once blanket-labeled as “third rate”—and I guess you meant to include World Bank staff in this judgment also—will feel better if they know they are in the same company as the great Paul Volcker. Second, it is emblematic of the supreme self-confidence you brought with you to Washington, where you were confronted with policy problems just a little bit more difficult than anything in our mathematical models. This confidence brims over in your new 282 page book. Indeed, I failed to detect a single instance where you, Joe Stiglitz, admit to having been even slightly wrong about a major real-world problem. When the U.S. economy booms in the 1990s, you take some credit. But when anything goes wrong, it is because lesser mortals like Federal Reserve Chairman [Alan] Greenspan or then U.S. Treasury Secretary [Robert] Rubin did not listen to your advice.

Let me make three substantive points. First, there are many ideas and lessons in your book with which we at the IMF would generally agree, though most of it is old hat. For example, we completely agree that there is a need for a dramatic change in how we handle situations where countries go bankrupt. IMF First Deputy Managing Director Anne Krueger—whom you paint as a villainess for her 1980s efforts to promote trade liberalization in World Bank policy—has forcefully advocated a far-reaching IMF proposal. At our Davos [World Economic Forum] panel in February, you sharply criticized the whole idea. Here, however, you now want to take credit as having been the one to strongly advance it first. Your book is long on innuendo and short on footnotes. Can you document this particular claim?

Second, you put forth a blueprint for how you believe the IMF can radically improve its advice on macroeconomic policy. Your ideas are at best highly controversial, at worst, snake oil. This leads to my third and most important point. In your role as chief economist at the World Bank, you decided to become what you see as a heroic whistle-blower, speaking out against macroeconomic policies adopted during the 1990s Asian crisis that you believed to be misguided. You were 100 percent sure of yourself, 100 percent sure that your policies were absolutely the right ones. In the middle of a global wave of speculative attacks—that you yourself labeled a crisis of confidence—you fueled the panic by undermining confidence in the very institutions you were working for. Did it ever occur to you for a moment that your actions might have hurt the poor and indigent people in Asia you care about so deeply? Do you ever lose a night’s sleep thinking that, just maybe, Alan Greenspan, Larry Summers, Bob Rubin, and Stan Fischer had it right and that your impulsive actions might have deepened the downturn or delayed—even for a day—the recovery we now see in Asia?

Let’s look at Stiglitzian prescriptions for helping a distressed emerging market debtor, the ideas you put forth as superior to existing practice. Governments typically come to the IMF for financial assistance when they are having trouble finding buyers for their debt and when the value of their money is falling. The Stiglitzian prescription is to raise the profile of fiscal deficits—that is, to issue *more* debt and to print *more* money. You seem to believe that if a distressed government issues more currency, its citizens will suddenly think it more valuable. You seem to believe that when investors are no longer willing to hold a government’s debt, all that needs to be done is to increase the supply and it will sell like hot cakes. We at the IMF—no, make that we on the Planet Earth—have considerable experience suggesting otherwise. We earthlings have found that when a country in fiscal distress tries to escape by printing more money, inflation rises, often uncontrollably. Uncontrolled inflation strangles growth, hurting the entire populace but especially the indigent. The laws of economics may be different in your part of the gamma quadrant, but around here we find that when an almost bankrupt government fails to credibly constrain the time profile of its fiscal deficits, things generally get worse instead of better.

Joe, throughout your book, you condemn the IMF because everywhere it seems to be, countries are in trouble. Isn’t this a little like observing that where there are epidemics, one tends to find more doctors?

You cloak yourself in the mantle of John Maynard Keynes, saying that the aim of your policies is to maintain full employment. We at the IMF care a lot about employment. But if a government has come to us, it is often precisely because it is in an unsustainable position, and we have to look not just at the next two weeks, but at the next two years and beyond. We certainly believe in the lessons of Keynes, but in a modern, nuanced way. For example, the post-1975 macroeconomics literature—which you say we are tone-deaf to—emphasizes the importance of budget constraints across time. It does no good to pile on IMF debt as a very short-run fix if it makes the not-so-distant future drastically worse. By the way, in blatant contradiction to your assertion, IMF programs frequently allow for deficits; indeed, they did so in the Asia crisis. If its initial battlefield medicine was wrong, the IMF reacted, learning from its mistakes, quickly reversing course.

No, instead of Keynes, I would cloak your theories in the mantle of Arthur Laffer and other extreme expositors of 1980s Reagan-style supply-side economics. Laffer believed that if the government would only cut tax rates, people would work harder and total government revenues would rise. The Stiglitz-Laffer theory of crisis management holds that countries need not worry about expanding deficits, as in so doing, they will increase their debt-service capacity more than proportionately. George Bush, Sr., once labeled these ideas "voodoo economics." He was right. I will concede, Joe, that real-world policy economics is complicated and, just maybe, further research will prove you have a point. But what really puzzles me is how you could be *so* sure that you are 100 percent right, so sure that you were willing to "blow the whistle" in the middle of the crisis, sniping at the paramedics as they tended the wounded. Joe, the academic papers now coming out in top journals are increasingly supporting the interest rate defense policies of former First Deputy Managing Director Stan Fischer and the IMF that you, from your position at the World Bank, ignominiously sabotaged. Do you ever think that, just maybe, Joe Stiglitz might have screwed up? That, just maybe, you were part of the problem and not part of the solution?

You say that the IMF is tone-deaf and never listens to its critics. I know that is not true, because in my academic years, I was one of dozens of critics that the IMF bent over backward to listen to. For example, during the 1980s, I was writing then-heretical papers on the moral hazard problem in IMF–World Bank lending, an issue that was echoed a decade later in the Meltzer report. Did the IMF shut out my views as potentially subversive to its interests? No, the IMF insisted on publishing my work in its flagship research publication, *Staff Papers*. Later, in the 1990s, Stan Fischer twice invited me to discuss my views on fixed exchange rates and open capital markets (I warned of severe risks). In the end, Stan and I didn't agree on everything, but I will say that having entered his office 99 percent sure that I was right, I left somewhat humbled by the complexities of price stabilization in high-inflation countries. If only you had crossed over 19th Street from the Bank to the IMF a little more often, Joe, maybe things would have turned out differently.

I don't have time here to do justice to some of your other offbeat policy prescriptions, but let me say this about the transition countries. You accuse the IMF of having "lost Russia." Your analysis of the transition in Russia reads like a paper in which a theorist abstracts from all the major problems and focuses only on the couple he can handle. You neglect entirely the fact that when the IMF entered Russia, the country was not only in the middle of an economic crisis, it was in the middle of a social and political crisis as well.

Throughout your book, you betray an unrelenting belief in the pervasiveness of market failures and a staunch conviction that governments can and will make things better. You call us "market fundamentalists." We do not believe that markets are always perfect, as you accuse. But we do believe there are many instances of government failure as well and that, on the whole, government failure is a far bigger problem than market failure in the developing world. Both World Bank President Jim Wolfensohn and IMF Managing Director Horst Köhler have frequently pointed to the fundamental importance of governance and institutions in development. Again, your alternative medicines, involving ever more government intervention, are highly dubious in many real-world settings.

I haven't had time, Joe, to check all the facts in your book, but I do have some doubts. On page 112, you have Larry Summers (then Deputy U.S. Treasury Secretary) giving a "verbal" tongue-lashing to former World Bank Vice President Jean-Michel Severino. But, Joe, these two have never met. How many conversations do you report that never happened? You give an example where an IMF staff report was issued prior to the country visit. Joe, this isn't done; I'd like to see your documentation. On page 208, you slander former IMF number two, Stan Fischer, implying that Citibank may have dangled a job offer in front of him in return for his cooperation in debt renegotiations. Joe, Stan Fischer is well known to be a person of unimpeachable integrity. Of all the false inferences and innuendos in this book, this is the most outrageous. I'd suggest you should pull this book off the shelves until this slander is corrected.

Joe, as an academic, you are a towering genius. Like your fellow Nobel Prize winner, John Nash, you have a "beautiful mind." As a policymaker, however, you were just a bit less impressive.

Other than that, I thought it was a pretty good book.

Sincerely yours,

Ken

You put forth a blueprint for how you believe the IMF can radically improve its advice on macroeconomic policy. Your ideas are at best highly controversial, at worst, snake oil.
—Kenneth Rogoff

G-8 sees global outlook improving

(Continued from front page) the debt reduction it has promised (see box below).

The G-8 leaders committed themselves to providing more aid to Africa in exchange for the pledge by African countries to produce clean government and strong economic policies—as spelled out in the New Partnership for Africa's Development (NEPAD). The leaders signed an agreement with the four African leaders who had led the creation of NEPAD—Abdelaziz Bouteflika of Algeria, Olusegun Obasanjo of Nigeria, Abdoulaye Wade of Senegal, and Thabo Mbeki of South Africa—all of whom attended, along with UN Secretary-General Kofi Annan. The African leaders have formally committed themselves to promoting peace, security, and good governance and to hold each other accountable for their individual and collective efforts to achieve NEPAD's economic, political, and social objectives. Major objectives of the G-8's Africa Action Plan are the following:

- directing half or more of new development assistance commitments to African nations that govern justly, invest in their own people, and promote economic freedom (an estimated $6 billion of the $12 billion a year in new resources for developing countries pledged at the UN Conference on Financing for Development in March 2002 in Monterrey, Mexico);
- combating diseases such as malaria, tuberculosis, and HIV/AIDS, as well as providing sufficient resources to get rid of polio in Africa by 2005;
- significantly increasing support for basic education; and
- improving global market access for African exports by 2005.

On the global economy, the leaders expressed confidence in the prospects for global growth and stressed the importance of strong political leadership in G-8 countries for the success of economic reforms. On terrorism, they committed themselves to "sustained and comprehensive actions to deny support of sanctuary to terrorists, to bring terrorists to justice, and to reduce the threat of terrorist attacks"—including raising up to $20 billion over the next 10 years to prevent the spread of weapons and materials of mass destruction. ■

At the G-8 summit in Kananaskis, Canada (from left) Italian Prime Minister Silvio Berlusconi, German Chancellor Gerhard Schroeder, U.S. President George W. Bush, French President Jacques Chirac, Canadian Prime Minister Jean Chrétien, Russian President Vladimir Putin, U.K. Prime Minister Tony Blair, and Japanese Prime Minister Junichiro Koizumi were joined by Spanish Prime Minister José Maria Aznar and European Commission President Romano Pradi.

Filling debt relief shortfall

In a statement on the enhanced HIPC Initiative, the Group of Seven leaders said that 26 countries are currently benefiting from debt relief under the initiative—by $40 billion in net present value terms, which is almost two-thirds of their total debt—and that as many as 37 countries are expected to benefit eventually under the initiative. "While this is very encouraging," they said, "there are factors that may prevent the Heavily Indebted Poor Countries (HIPC) Initiative from delivering the debt reduction it has promised:

- not all creditors have agreed to reduce their HIPC debts;
- the expected financing needs of the initiative have not been fully met;
- as a result of weaker growth and export commodity prices, a number of countries could be at risk of not having sustainable debt loads at the completion point."

The leaders called on the IMF and the World Bank to promote the participation of all creditors. This would be done by including "more detailed information on the respective countries' success in obtaining comparable treatment" and posting information on creditor participation on their websites. The G-7 leaders committed themselves to work with other donor countries and international financial institutions to ensure that the HIPC Initiative has sufficient resources. And they asked the IMF and the World Bank to ensure that the review of debt sustainability being prepared for the Annual Meetings of the institutions in the fall include an assessment of the methodology used for calculating the need for, and amount of, additional assistance. The G-7 leaders also agreed "on the need for bilateral donors to consider financing HIPCs and HIPC 'graduates' primarily through grants for a sustained period, and to refrain from supporting unproductive expenditures."

Earlier, the G-7 finance ministers, meeting in Halifax, Canada, on June 14–15, had worked out a compromise on aid for the poorest countries aimed at boosting the amount of grants versus traditional low-cost loans. They agreed that 18–21 percent of aid should be provided in the form of grants.

Peace in Colombia possible with help from the international community

Speaking on June 20 at a conference on Colombia sponsored by the Woodrow Wilson International Center for Scholars, the International Crisis Group, and the U.S. Institute of Peace, IMF Deputy Managing Director Eduardo Aninat said that, despite the recent escalation of violence, the basis for peace in the country exists. Following are edited excerpts from his address. The full text is available on the IMF's website (www.imf.org). An IMF team will visit Colombia in the second week of July to conduct its annual review of the economy. The team plans to meet with the current government as well as with the incoming government to discuss Colombia's economic outlook.

Colombia is one of the oldest and most enduring democracies in South America, but also the stage for the region's longest internal armed confrontation. Until the mid-1990s, the conflict appeared to have a relatively moderate impact on Colombia's economy, but starting in the second half of the decade, both the scale and the intensity of violence have increased at the same time as economic performance has deteriorated. President-elect Álvaro Uribe Vélez has expressed his intent to address steadfastly this issue, and I certainly wish him all possible success in this endeavor.

Promoting growth and employment

I am fully aware that policy adjustment in Colombia's current adverse circumstances is a very difficult task. In particular, it may entail delicate negotiations with interest groups that, in the past, have successfully blocked or delayed reforms. However, it is hoped that the incoming administration, benefiting from large popular support, will be in a position to proceed forcefully in several important areas:

• In the fiscal area, it is essential to put the public finances on a sustainable path so as to maintain investor confidence and financial stability. This result will, in turn, hinge on the implementation of extensive structural fiscal reforms.

• In the external area, the key objective must be the preservation of competitiveness.

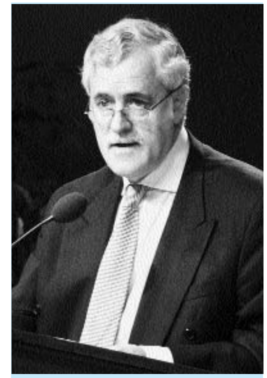
Achieving fiscal sustainability. Much has been done to reduce the fiscal deficit over the past few years, but much remains to be done to achieve medium-term fiscal sustainability. Certain structural deficiencies, including the growing deficit of the public pension system, pervasive revenue-earmarking arrangements, and extensive tax exemptions, threaten to weaken the fiscal position over the coming years. Advancing resolutely with these reforms will be crucial to consolidate macroeconomic stability and strengthen confidence.

A comprehensive pension reform is essential for the longer-term viability of the public finances. Without this reform, the deficit of the public pension system will continue to fuel an undesirable expansion of the public debt. The present outgoing government has initiated the reform process, and it will be important for the new government to carry on with it more forcefully and complete it.

The adoption of a fiscal responsibility and transparency law would increase accountability and help limit the scope for the corruption and administrative inefficiencies that still characterize many Latin American tax systems, including Colombia's.

The reduction of revenue-earmarking arrangements—which account for about 46 percent of tax revenue—would increase the flexibility of fiscal policy and the scope for sound fiscal management.

Preserving external competitiveness. The peso has appreciated by an important percentage in recent



Aninat: "It is essential to put the public finances on a sustainable path so as to maintain investor confidence and financial stability."

Köhler welcomes progress in talks with Argentina

After discussions in Washington on June 27–28 between the IMF and an Argentine delegation led by Minister of Economy Roberto Lavagna, IMF Managing Director Horst Köhler made the following statement:

"IMF management and staff and the visiting Argentine officials have held productive meetings. Two legal issues—reform of the Insolvency Law and repeal of the Economic Subversion Law—have been satisfactorily resolved, and Minister Lavagna has assured us that substantial further progress may be expected next week on the outstanding issues concerning the central government's fiscal agreements with the provinces. Consequently, Argentina and the IMF are entering an active negotiating relationship, focusing on four areas:

• finalizing the fiscal framework;

• addressing the critical problems with the banking sector;

• developing an effective monetary anchor for the authorities' economic program, ... giving consideration to identifying a group of experienced policymakers that might assist Argentina and the IMF in the design of a monetary framework; and

• reinforcing central bank independence.

We will pursue discussions actively in all these areas, including through staff missions to Argentina to accelerate momentum toward an IMF-supported program."

The full text of News Brief 02/56 on Argentina is available on the IMF's website (www.imf.org).

The international community should mobilize knowledge, financing, and international best practices to make international assistance in postconflict situations effective.
—Eduardo Aninat

months, and this could threaten the vigorous growth of Colombia's nontraditional exports. These exports have already been key to diversifying Colombia's export base and to fostering the growth of productive, income-generating employment opportunities. Different factors have contributed to the peso appreciation, including some over which the authorities have little control, like the sharp depreciation of the Venezuelan bolivar. Pressing ahead with the fiscal adjustment would also help sustain the improvement in competitiveness.

In the trade policy area, I am very encouraged by the steps being taken in the U.S. Congress with regard to the Andean Trade Preference Act, since they have the clear potential to broaden considerably the range of Colombian exports that will be granted duty-free access to the United States.

Consolidating peace

While Colombia has managed to grow in the midst of internal conflict in the past, the late 1990s saw a slowdown in growth and a deterioration of social conditions as the conflict intensified. It is difficult to estimate what have been the economic costs of violence in Colombia, but they have clearly been substantial. For example, it has been estimated that the conflict took 1½–2 percent off Colombia's annual growth rate before its intensification in the late 1990s.

An end to this conflict will clearly produce a significant "peace dividend," as it will free up substantial public and private resources that are now allocated to the armed conflict, to security, and to the fallout from the conflict. But these benefits will mostly be felt over a number of years.

Over the near term, however, peace will likely entail sizable financial costs. These costs are mainly associated with the reconstruction of physical and institutional infrastructure damaged by the conflict. In addition, large groups of people whose main skills and experience are now related to violence will have to be reintegrated into peaceful productive activities.

The fiscal costs of peace will likely outrun available fiscal resources, at least in the initial transition years. There will thus be an important policy tension between maintaining the fiscal sustainability that is essential for growth and funding social and economic policies essential to consolidate peace.

Several potential options can be combined to meet this challenge:

- It should be possible to finance a number of initial measures with the proceeds from privatization projects that had been put on hold because of the conflict.
- The initiatives in support of peace will make it all the more urgent to enhance tax collection, control nonessential public expenditure, and give priority to investments that generate synergies with pro-peace programs.
- The international community should mobilize knowledge, financing, and international best practices to make international assistance in postconflict situations effective. Colombia, in turn, should redouble its efforts to secure multilateral and bilateral support to help finance the peace process and do so by designing and proposing sound programs.

It is my sincere hope that the new administration will be able to find ways to mobilize the multiple talents and goodwill of the Colombian people and put the country back on a path of peaceful social progress. ■

IMF approves significant increase in lending to Uruguay

The IMF on June 25 approved $1.5 billion (SDR 1.16 billion) in additional lending to Uruguay to help it deal with the crisis affecting the region. The new loan is in addition to a 24-month Stand-By credit approved on March 25, 2002, increasing Uruguay's total loan to about $2.28 billion (SDR 1.75 billion). Under the package, Uruguay may draw up to $508 million (SDR 386.1 million) immediately, with a further $650 million (SDR 496 million) available under the augmented Stand-By credit during the remainder of 2002, subject to further review by the IMF Executive Board.

After the Executive Board discussion on Uruguay, IMF Managing Director Horst Köhler said: "The Executive Board welcomed the Uruguayan authorities' determined response to the challenges affecting the economy by strengthening the macroeconomic framework and establishing a credible strategy to restore confidence in its banking system. Implementation of this reinforced program, which the IMF strongly supports, will help Uruguay deal with the contagion effects from the Argentine crisis, place the economy and public finances on a sounder footing, and create the conditions for a resumption of sustained growth. Strengthened policies are also expected to underpin Uruguay's continued access to international capital markets in the future and to boost official financing, including from multilateral development banks."

The full text of News Brief 02/54 is available on the IMF's website (www.imf.org).

Photo credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 210–11, 215–16, and 222–24; Luke Frazza for AFP, page 209; Patrick Kovarik for AFP, page 212; Wilson Center, page 213; Arko Datta for AFP, page 217; United Nations, page 220–21.

Dialogue with Angus Deaton

When numbers don't tell the full story about poverty in India and the world

Before the world can answer questions about how poverty is reduced, it needs to know how progress can be measured. But estimates of the number of the world's poor and questions about whether it has been decreasing or increasing have given rise to one of the hottest controversies in the development community. Angus Deaton, Professor of Economics and International Affairs at Princeton University's Woodrow Wilson School, who has looked in detail at India's poverty numbers, has been at the center of this debate. He speaks here with Prakash Loungani of the IMF's External Relations Department about the dimensions of the problem and what can be done to provide more transparent and more reliable data on the world's poor.

LOUNGANI: The World Bank's estimate that 1.2 billion people live on less than $1 a day is cited everywhere. How reliable is this estimate?

DEATON: There's surely a very large margin of error in that estimate. Even small changes in the design of the survey used to measure poverty can often have dramatic impacts on the poverty estimates. For instance, you could lower the estimate of the number of poor in India by 175 million just by shortening the recall period from one month to one week.

LOUNGANI: It's a dramatic example, but you'll have to explain what a recall period is.

DEATON: To measure poverty, you have to survey people and ask them to recall their expenditures—how much they spent on food, clothing, and so forth. You have to choose whether to ask them to recall how much they spent over the past week or how much they spent over the past month. That's the recall period. Choosing a one-week recall period generally yields higher expenditures, and therefore lower rates of poverty, than choosing a one-month recall period. (The latter is measured on a weekly basis, of course, so that you're comparing like and like.)

India has long used a 30-day recall period. In recent years, the statistical authorities in India did an experiment to see what difference the recall period makes to the estimate of the number of poor. They found, as I mentioned, that shifting to a one-week recall period would essentially halve the number of poor in India. That must be the most successful poverty-reduction program in the world!

LOUNGANI: But haven't you been working to resolve such data problems and come up with a good estimate of the number of poor in India?

DEATON: Yes, I have been trying to use the parts of the survey that are consistent over time to adjust the poverty numbers and put them on a consistent track. What that has shown in the end is that there has been fairly steady poverty reduction in India. The number of people living in poverty has declined at a steady rate over the past 20–30 years; there is no evidence of a pickup in the rate of decline since the reforms of the 1990s. I end up with an estimate of a poverty rate for India of 28 percent in 2000. Scholars at the Delhi School of Economics, working independently and using methods quite different from mine, have reached similar conclusions.

Deaton: "Coming up with a more reliable estimate of India's poor goes a long way toward getting a better estimate of the world's poverty rate. But the problems we face with the poverty data in India are quite likely to be present elsewhere."

LOUNGANI: Your findings won't give much comfort to either side of the debate in India.

DEATON: I think that is broadly right. But the reformers have more to cheer about than their opponents. The findings don't give the reformers everything they would have liked—notably, a pickup in the rate of poverty reduction in the postreform era. But it certainly shows that the claims of their opponents that poverty reduction stalled as a result of the reforms or that poverty actually increased are quite incorrect.

LOUNGANI: Is the problem just with India's poverty statistics or is it broader?

DEATON: It is a broader problem, but I should remark that, even with all the problems of measurement, we do know that India accounts for about one-third of the world's poor. So coming up with a more reliable estimate of India's poor goes a long way toward getting a better estimate of the world's poverty rate. But the problems that we face with the poverty data in India are quite likely to be present elsewhere.

LOUNGANI: What are some of the problems with the poverty estimates, setting aside the issues of survey design that we've already to some extent discussed?

DEATON: Let me try to get the first problem across in a simple way. Suppose that I had tried to see if income growth in China had any impact on the poverty rate in India. Right away you'd say: "That's crazy. You need the income and poverty numbers to be from the same country." Well, in most countries the data on income and the data on poverty come from two different sources. And, exaggerating a bit now to make the point, sometimes these two sources are so far apart in the stories they tell that they may as well be from different countries.

Deaton: "The unavailability of good price indices for rural areas is in part responsible for the very conflicting views of what impact the Asian crisis had on the poor in Indonesia."

LOUNGANI: For example?

DEATON: The problem is endemic, but again the most dramatic case is India's. According to its national income accounts, India has had robust economic growth over the last decade, and this certainly accords with what most people think has happened. But, at least until the latest figures came out, the national survey statistics, which are the source of the poverty estimates, showed that average consumption has essentially been flat over the last decade.

These two stories about what's happened in India cannot both be right. How can you have strong growth in consumption in the national income accounts and no growth in average consumption in the household survey? Either consumption hasn't grown as much as the national accounts say it has or consumption has grown more—and perhaps poverty has been reduced more—than the national surveys say it has. So this, in simple terms, is the first problem—the lack of reconciliation between the household survey and the national income accounts.

LOUNGANI: The lack of price indices is also a big problem, I guess?

DEATON: Absolutely. There are two separate issues here. One is that to compare poverty rates across countries, to make the kind of $1 a day numbers that you mentioned are cited everywhere, you have to use purchasing power parity (PPP) exchange rates. Well, revisions to these exchange rates can play havoc with the poverty estimates. The World Bank itself was caught in this trap: in the 1997 *World Development Report*, before the crisis, Thailand is shown as having a poverty rate of only 1⁄10 of 1 percent of the population. This figure was attributed by then chief economist Joe Stiglitz to the Asian economic miracle. But this was less a demonstration of the miracle than of the dangers of inappropriate PPP conversion. It's a bit disconcerting when the World Bank's dream of a world free of poverty can be realized simply by misusing exchange rate data.

LOUNGANI: You said there was a second issue with respect to price indices?

DEATON: Yes, you also need good price indices to compare poverty rates within the country, particularly between urban and rural areas. Countries often have good data for urban centers but not for the countryside, which is often where most of the poor live. This can be a big problem. For instance, I think the unavailability of good price indices for rural areas is in part responsible for the very conflicting views of what impact the Asian crisis had on the poor in Indonesia.

LOUNGANI: If the poverty data are so error-ridden, why don't we rely on other socioeconomic indicators?

DEATON: That is done. Statistics on life expectancy, infant mortality, and literacy are all things that people look at to supplement the poverty numbers. Amartya Sen has been the intellectual force behind this broader look at deprivation. The United Nations Development Program has come up with a Human Development Index that aggregates all this information in a certain way. I don't think the way they aggregate it is quite right, but at least it's wrong in a very transparent fashion. But it is important to realize that income or consumption poverty is an important dimension of poverty in its own right and we should not be using other indicators as a proxy for it, any more than we should be using income poverty as a proxy for health or illiteracy. They are different things.

LOUNGANI: Should we just ignore the poverty numbers altogether?

DEATON: No, that's clearly going too far. I don't have objections to the concept of poverty. We do have a notion of poverty, like we have a notion of being cold or being hot; people can generally identify who in their community is poor. But it's one thing to have a rough notion of poverty in your community, quite another to come up with an estimate of the number of poor in the whole developing world. That, as we've discussed, requires a lot of decisions. So what I'm objecting to is the pretense that at the end of this series of decisions we can draw a very sharp cutoff, a poverty line. It encourages a rather Micawberish view of things where the result is taken to be happiness on one side of the line and misery on the other. ("Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.") We should admit that the poverty numbers have large margins of error but keep working to improve them.

Loungani: That's a nice segue to my final set of questions. What institutional changes are needed to get some quality control on the poverty numbers?

Deaton: The often rather informal arrangements under which numbers are produced need to be looked at. I think the poverty numbers were first thought up for the Bank's 1990 *World Development Report*. There was a lot of heroic work by Bank economists to put these numbers together. But they weren't regarded then as frontline numbers. When folks first started doing GDP numbers, a few academics put some numbers together, and they were thought of as interesting and neat rather than solid numbers you could hang your hat on.

Now the poverty numbers have become big important numbers on which many things, including the evaluation of the Bank's own performance, hinge. At the moment, pretty much no one other than Bank economists can tell you how these numbers were put together and how they can be reproduced. So when someone comes along and accuses the Bank of biasing the numbers one way or the other, it's difficult for an outside agency or independent scholars to leap to its defense and help resolve the controversy. So we need greater transparency at the Bank on how the poverty numbers are going to be put together in the future. You could imagine setting up other institutions to do this, but greater transparency would get us going in the right direction. And helping countries resolve statistical issues is something that the Bank and the IMF should do a lot more of.

Loungani: It's difficult for the IMF to take a deep interest in poverty measurement when some still call for us to leave the "poverty business" altogether.

Deaton: I'm in favor of the IMF's staying in the poverty business, within limits. I was persuaded by [former IMF First Deputy Managing Director] Stan Fischer's remarks at the conference last year [on macroeconomic policies and poverty reduction] as to why poverty is central to the IMF's mission. He said that the IMF cannot use the "Von Braun defense"—"I just put the rockets up, and it's someone else's business where they fall"—to keep out of poverty.

I don't see how the IMF can cleanly mark out its core mission and say that poverty reduction is someone else's business. The question is, how far do you go? Certainly, you don't want to turn yourself into the Bank and hire all the specialists it has and replicate all the detailed poverty analysis it does. But showing greater awareness of poverty measurement issues is essential.

Loungani: What are some areas we could focus on?

Deaton: Several of the problem areas that we discussed are areas where IMF economists are very highly skilled. In countries where there are discrepancies between the national income accounts and the national surveys, IMF staff may have some clues about the extent to which fudges in the national income accounts are responsible. The IMF also has had a long-standing interest in accurate price indices because of the need to get accurate measures of real monetary aggregates, real exchange rates, and the like. And I believe the IMF these days actually issues guidelines on how to provide macroeconomic data and assess their quality. That should be extended to poverty data. This is not the IMF changing its line of business, but simply recognizing that to do your business well you have to be well informed about the measurement of poverty. ■

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
June 24	2.32	2.32	2.97
July 1	2.30	2.30	2.94

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

We need greater transparency at the Bank on how the poverty numbers are going to be put together in the future.

—Angus Deaton

Do budget cuts hurt low-income countries?

In low-income countries, fiscal consolidations were not harmful for either long- or short-term growth during 1990–2000.

Many studies have shown that low budget deficits are good for growth in the long run, but whether reducing deficits is good or bad for growth in the short run is still open to question. A new IMF Working Paper, Expenditure Composition, Fiscal Adjustment, and Growth in Low-Income Countries, *by Sanjeev Gupta, Benedict Clements, Emanuele Baldacci, and Carlos Mulas-Granados, looks at the impact of fiscal consolidations on both long- and short-term growth. This is an important question for the IMF, many of whose critics claim that fiscal consolidations—often an important element in the programs it supports—hinder economic growth in low-income countries.*

The traditional Keynesian view is that reducing the budget deficit can, in the short run, slow a country's growth. However, some studies, mainly covering industrial countries, have argued that, in some circumstances, fiscal adjustments or consolidations (defined as periods of deficit reduction) can be good for growth, even in the short run. This paper, in contrast, examines the impact of fiscal policy on growth in low-income countries—those eligible for support under the IMF's Poverty Reduction and Growth Facility (PRGF), which replaced its Extended Structural Adjustment Facility (ESAF)—during 1990–2000.

One important finding of earlier research on industrial countries is that the composition of fiscal adjustments plays a key role in determining whether fiscal contractions lead to higher growth. Improving fiscal positions by rationalizing the government wage bill and public transfers, rather than by increasing revenues or cutting public investment, has also been found to foster higher growth, even in the short run. The new working paper sought to assess whether the composition of fiscal adjustments also influenced how fiscal policy affected growth in low-income countries.

The authors also examine what makes fiscal adjustments sustainable; that is, what determines whether countries keep adjusting over time as opposed to abandoning their efforts? For example, are countries more likely to keep reducing their deficits if growth is high or when the fiscal adjustment strategy is based on reallocating government spending from current outlays (such as wages) to capital outlays (such as on equipment)? The answer would help explain what might cause a government's fiscal consolidation plans to be derailed.

What did the study find?

The empirical evidence suggests that, in low-income countries, fiscal consolidations were not harmful for either long- or short-term growth during 1990–2000. The study found a strong link between fiscal adjustment and per capita growth: reducing the ratio of the fiscal deficit to GDP by 1 percentage point increases per capita growth by ¼–½ of 1 percentage point, on average, in both the long and the short run.

The composition of public outlays also matters. Redirecting public expenditures toward more productive uses can accelerate growth and keep countries on track with fiscal adjustment. Cutting selected current expenditures can trigger higher growth rates than increasing revenue and cutting more productive spending. According to the working paper, protecting capital expenditures during a fiscal adjustment leads to higher growth, as does increasing the share of spending on nonwage goods and services. On average, reductions in the public sector wage bill do not harm growth.

The composition of deficit financing is also critical. Fiscal consolidations have the most positive effect on growth when they reduce a country's domestic borrowing requirements. The study finds that adjustments based on reducing domestic financing have about one and a half times the effect on growth as adjustments based on reducing both domestic and external financing.

Another question the authors looked at was whether the finding that fiscal consolidations help growth in low-income countries held for all the countries in the sample. To test for this, they split the sample into "pre-" and "post-" stabilization countries (the second group comprised those countries that maintained an average fiscal deficit, after grants, below 2.5 percent of GDP during 1990–2000). For countries in the prestabilization phase, the effects of fiscal policy are fully consistent with the view that fiscal contractions may be expansionary. However, for poststabilization countries, fiscal adjustments per se no longer have a salutary effect on real economic activity. In this context, an expansion of selected current expenditures for these countries is compatible with higher growth. The fiscal frameworks in PRGF-supported programs are consistent with these results, as poststabilization countries target relatively larger increases in public spending and in the fiscal deficit.

Regarding the factors that determine whether countries maintain or abandon their fiscal adjustment efforts, the authors found that the reallocation of spending from current to capital outlays helps prolong the fiscal adjustment period. Furthermore, countries with relatively low budget deficits at the start and a good track record of reducing the deficit are also less likely to jettison their adjustment efforts. Finally, higher tax revenues increase the probability that a consolidation effort will be maintained—a result somewhat at odds with the findings for industrial countries. Lower economic growth, in contrast, increases the chances that a country will end its fiscal adjustment.

Policy implications

The results have several policy implications for low-income countries, many of which have ongoing IMF-supported programs that aim for improvements in the composition of public spending. The empirical evidence points to a positive link between expenditure composition and growth, as fiscal adjustments that reduce unproductive expenditures and protect public investment are more sustainable and conducive to higher growth.

Finally, the results suggest that, if expenditure reforms are to boost economic growth, they must be implemented in the proper sequence. For example, civil service reforms that attract more skilled workers to the public sector could be too costly for countries with large fiscal imbalances. For these reforms to have a positive payoff for growth, they should be implemented only after the country has achieved, and can maintain, a sound fiscal position. ■

Copies of IMF Working Paper 02/77, *Expenditure Composition, Fiscal Adjustment, and Growth in Low-Income Countries*, by Sanjeev Gupta, Benedict Clements, Emanuele Baldacci, and Carlos Mulas-Granados, are available for $10.00 each from IMF Publication Services. See below for ordering information. The full text is also available on the IMF's website (www.imf.org).

Recent publications

IMF Working Papers ($10.00)

02/97: *An Interim Assessment of Ukrainian Output Developments, 2000–01*, Julian Berengaut, Erik De Vrijer, Katrin C. Elborgh-Woytek, Diane E. Fisher, Mark W. Lewis, and Bogdan Lissovolik

02/98: *Extreme Contagion in Equity Markets*, Jorge Chan-Lau, Donald J. Mathieson, and James Y. Yao

02/99: *Calibrating Your Intuition: Capital Allocation for Market and Credit Risk*, Paul H. Kupiec

02/100: *Financial Liberalization and Real Investment: Evidence from Turkish Firms*, Cemile Sancak

02/101: *Structural Balances and All That: Which Indicators to Use in Assessing Fiscal Policy*, Nigel A. Chalk

02/102: *Establishing Initial Conditions in Support of Inflation Targeting,* Alina Carare, Andrea Schaechter, Mark R. Stone, and Mark D. Zelmer

02/103: *The Challenge of Fiscal Decentralization in Transition Countries*, Era Dabla-Norris and Paul R. Wade

02/104: *Long-Run Determinants of Exchange Rate Regimes: A Simple Sensitivity Analysis*, Grace S. Juhn and Paolo Mauro

01/105: *The Micro Basis of Budget System Reform: The Case of Transitional Economies*, Jack Diamond

IMF Staff Country Reports ($15.00)

02/115: Republic of Slovenia: Report on the Observance of Standards and Codes—Fiscal Transparency Module

02/116: Luxembourg: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes

02/117: Luxembourg: Selected Issues

02/118: Luxembourg: 2002 Article IV Consultation

02/119: Tunisia: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes

02/120: Tunisia: Selected Issues

02/121: Tunisia: Report on the Observance of Standards and Codes

02/122: Tunisia: 2002 Article IV Consultation

02/123: Kingdom of the Netherlands—Netherlands: Selected Issues

02/124: Kingdom of the Netherlands—Netherlands: 2002 Article IV Consultation

02/125: Zimbabwe: 2001 Article IV Consultation

02/126: Zimbabwe: Statistical Appendix

02/127: Republic of Poland: 2002 Article IV Consultation

02/128: Republic of Poland: Selected Issues and Statistical Appendix

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

Global Financial Stability Report

Publications are available from IMF Publication Services, Box X2002, IMF, Washington, DC 20431 U.S.A.
Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

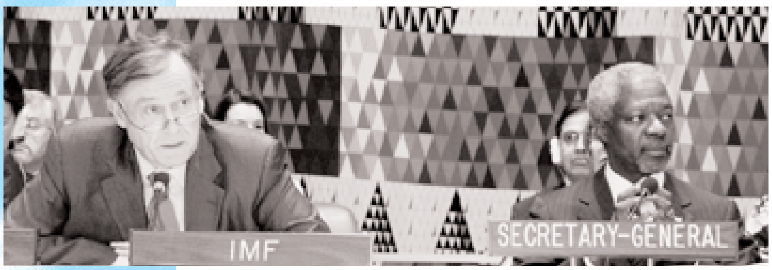
For information on the IMF on the Internet—including the full texts of the English edition of the *IMF Survey*, the *IMF Survey*'s annual *Supplement on the IMF*, *Finance & Development*, an updated *IMF Publications Catalog*, and daily SDR exchange rates of 45 currencies—please visit the IMF's website (www.imf.org). The full texts of all Working Papers and Policy Discussion Papers are also available on the IMF's website.

ECOSOC

Köhler calls on richest countries to show leadership as global economy recovers

IMF Managing Director Horst Köhler, in remarks delivered at the United Nations Economic and Social Council in New York on July 1, took stock of the global economy, lauding the resilience of the international financial system and expressing his optimism in a recovery that he saw gaining momentum in the second half of the year. But he also cautioned about risks that could imperil the strength and durability of that recovery, including questions about U.S. corporate earnings and investment, and called for transforming the goals of the Monterrey Consensus into concrete actions to confront the world's "foremost challenge"—poverty.

Below are edited excerpts of Köhler's remarks; the full text is available on the IMF's website (www.imf.org).



Köhler: "The Enron collapse and, even more, the WorldCom scandal have made it clearer than ever that there is a need to give as much attention to risks and vulnerabilities arising in the advanced countries, as we do to problems in emerging markets and developing countries."

We can all be happy that the doomsday scenarios some predicted after the terrorist attacks of September 11 did not materialize. Thanks in particular to the decisive interest rate cuts and tax reductions in the United States and the supportive policy response in Europe, a recovery of the world economy now appears to be under way. And I think it was also important for confidence that the membership of the IMF came together last November in Ottawa to define a collaborative approach to strengthen the global economy.

To be sure, there are still questions about the strength and durability of the recovery. These relate especially to corporate earnings and investment in the United States, fragilities in financial markets, and regional political tensions. But on the whole, I am confident that the world economy will gain strength in the second half of this year. What is required now is vigilance and a shift from short-term considerations to tackling decisively the underlying economic and financial imbalances in the global economy. This calls for strong leadership of the advanced industrial countries, by taking action to strengthen the prospects for sustained growth in their own economies and through leading by example in the effort to make globalization work for the benefit of all.

The Enron collapse and, even more, the WorldCom scandal have made it clearer than ever that there is a need to give as much attention to risks and vulnerabilities arising in the advanced countries, as we do to problems in emerging markets and developing countries. I therefore welcome the broad discussion and legislative activities that are under way in the United States in the aftermath of these revelations. But I also think that the international community as a whole should review issues related to accounting, disclosure, and corporate governance.

In Monterrey, I made it clear that the IMF will play an active part in the effort to achieve the Millennium Development Goals. In my talks with leaders, businesspeople, and civil society in low-income countries, I have been struck by the willingness to take responsibility for tackling the home-grown causes of poverty. It is particularly encouraging that African leaders have made good governance, sound policies, and increased trade and investment the cornerstones of the New Partnership for Africa's Development(NEPAD). Our global outreach and review has shown that the poverty reduction strategy paper (PRSP) process is broadly accepted as a practical way to put this approach into action. Most important, the PRSP process is country led and designed to take on board the views of all parts of society. PRSPs

IMF clears way for Turkish drawing

The IMF Executive Board approved on June 28 a $1.15 billion loan for Turkey under its three-year Stand-By credit (see *IMF Survey*, February 11, page 41). This is the latest part of a $16 billion package aimed at helping support the government's economic program for 2002–04 as it grapples with a banking crisis and severe recession. (For the complete text of News Brief 02/57, see the IMF's website (www.imf.org).)

On July 4, the IMF said that an IMF mission will visit Turkey for about two weeks, starting July 10, to discuss the next review under the Stand-By credit. The mission will focus on budgetary policy; monetary policy, especially policies needed to achieve the inflation target of 35 percent and prepare for a successful launch of formal inflation targeting later this year; and structural policies, notably privatization, banking reforms, and improving the business climate. The Executive Board could meet in early August to complete the review, which would release another $1.1 billion. Disbursements so far total about $11.5 billion.

recognize both social realities and the need for hard economic choices. And perhaps equally important, they provide a natural basis for coordination of activities by external donors and other development partners. I therefore trust that donors and civil society will continue to support this process and help to realize its full potential.

We have to recognize that slow progress in the reforms needed to fight poverty often reflects a lack of institutional capacity, rather than a lack of political will. As part of our support for NEPAD, we plan to establish five African Regional Technical Assistance Centers, and I already signed agreements to establish the first such centers in Tanzania and Côte d'Ivoire later this year. [World Bank President] Jim Wolfensohn and I have also been helping African countries—beginning with Ghana—to establish Investment Advisory Councils, to identify practical ways to improve the investment climate and create new economic opportunities.

Today, 26 countries are receiving debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative, with a total value of over $40 billion, and we are working hard to help other eligible countries qualify for HIPC assistance. The resulting reduction in debt-service payments is already permitting recipient countries to raise poverty related expenditure, on average, from about 6 percent to 9 percent of GDP. The bulk of this spending will go to much needed health care (particularly HIV-AIDS treatment and prevention), education, and basic infrastructure such as rural roads. We will continue to take advantage of the possibility of topping up HIPC relief in cases—like Burkina Faso—where exogenous factors have caused fundamental changes in a country's underlying economic circumstances.

While it is crucial not to neglect any element of comprehensive support for poverty reduction, trade is clearly the best form of help for self-help—not only because it paves the way for greater self-sufficiency but also because it is a win-win proposition for developed and developing countries alike. Real progress in cutting agricultural subsidies in advanced economies and reducing tariffs for processed goods should be a benchmark for a successful conclusion of the Doha Round. But I would also stress that the evident case for market opening in the industrial countries would become even more credible if developing nations demonstrate their ambition to reduce the barriers to trade among themselves, which are often even higher than those with industrial countries. ■

Available on the web (www.imf.org)

News Briefs

02/48: IMF Completes Fourth Review Under Mozambique's PRGF Arrangement and Approves $11 Million Disbursement, June 17

02/49: IMF Management Recommends Augmentation of Uruguay Stand-By, June 18

02/50: IMF Completes Third Review of Stand-By Arrangement with Brazil, June 18

02/51: IMF Completes Sixth Review of Indonesia Program, Approves $358 Million Disbursement, June 21

02/52: IMF Gives Final Approval of PRGF Arrangement for Albania, June 21

02/53: IMF Completes Second Review of Vietnam's PRGF Program and Approves in Principle $53 Million Disbursement, June 21

02/54: IMF Increases Stand-By Credit to Uruguay by $1.5 Billion, June 25 (see page 214)

02/55: IMF Completes Second Review of Lithuania Under Stand-By Arrangement, June 27

02/56: IMF's Köhler Welcomes Progress in Talks with Argentina, June 28 (see page 213)

02/57: IMF Approves $1.15 Billion Tranche to Turkey Under Stand-By Credit, June 28 (see page 220)

Press Releases

02/29: IMF Approves in Principle Three-Year, $36 Million PRGF Loan to Albania, June 19

02/30: IMF and World Bank Support $1.1 Billion in Debt-Service Relief for Mauritania: West African Country Reaches Completion Point Under Enhanced HIPC Initiative, June 20

Public Information Notices

02/61: IMF Concludes 2002 Article IV Consultation with Luxembourg, June 17

02/62: IMF Concludes 2002 Article IV Consultation with Tunisia, June 19

02/63: IMF Concludes 2002 Article IV Consultation with the Kingdom of the Netherlands, June 19

Speeches

"The Economic Foundations of Peace in Colombia," Eduardo Aninat, IMF Deputy Managing Director, Conference on Peace and Security in Colombia, Washington, D.C., June 20 (see page 213)

"The Role of the IMF in Safeguarding the Stability of the International Financial System," IMF Managing Director Horst Köhler, 150th Anniversary Celebrations of Giesecke & Devrient, June 25

"The Role of the IMF in the Global Economy," IMF Managing Director Horst Köhler, UN ECOSOC, New York, July 1 (see page 220)

Transcripts

Press Briefing, Thomas C. Dawson, Director, IMF External Relations Department, June 19 and July 2

An Open Letter to Joseph Stiglitz from Kenneth Rogoff, Economic Counsellor and Director of IMF Research Department

Interview with Taye Mengistae and Catherine Pattillo

Why are African manufacturing exporters more productive than nonexporters?

Many firm-level studies in developed and developing countries alike have found that exporters, in general, are more productive than nonexporters. But, until recently, the literature in this area had little to report on how productivity varies among different types of manufacturing exporters in Africa. Taye Mengistae, a Research Economist at the World Bank, and Catherine Pattillo, a Senior Economist in the IMF's Research Department, met with the IMF Survey *to discuss their Working Paper,* Export Orientation and Productivity in Sub-Saharan Africa, *which looks at this issue.*

IMF SURVEY: What prompted this study?

PATTILLO: A policy debate spurred our interest and prompted us to undertake this research. There are two commonly held views. One view holds that promoting greater export orientation of the manufacturing sector in Africa will increase productivity. Another says that policy intervention is necessary to raise the productivity of African manufacturing—by lowering the transaction costs associated with foreign trade and providing technical assistance—to eliminate any kind of productivity gap between exporters and potential exporters that may be preventing the latter group from competing. There has not been much research to try to answer some basic questions: are exporters in Africa more productive than nonexporters, and, if so, what does it mean? Does it mean that there are productivity gains from the exporting itself? Or does it mean that there is a competitiveness gap that policy needs to address to make firms more productive?

Mengistae: "A higher productivity premium would suggest that the economy tolerates less efficient nonexporters."

MENGISTAE: The issue is related to the traditional policy question of whether an export-oriented strategy is better than a more inward-looking one. This was also one of the themes of a symposium held in 1999 on the development outlook for sub-Saharan Africa over the coming decades. There is a degree of consensus that Africa needs to boost nontraditional exports, of which manufacturing exports are an important category. Whenever there is a call for export growth, the question of "why?" arises. And, as Catherine said, there are two possible answers. One, of course, is that export growth would generate the foreign exchange that firms need to finance the import of better equipment and better intermediate inputs. A second, more recent answer is that the very act of participation in export markets could be a medium for transferring better technology from trading partners.

IMF SURVEY: How did you choose the data—samples of manufacturing firms in Ethiopia, Ghana, and Kenya?

PATTILLO: Panel data on African manufacturing firms are difficult to obtain. National industrial statistics in many countries either are not available or are inadequate. But, luckily, there is a set of data generated by the World Bank's Regional Program on Enterprise Development in collaboration with some universities inside and outside Africa. This data set is available for some nine countries. And the Ethiopian data are from a survey that was similar in design and sampling methodology to that used to generate the World Bank data, so that the corresponding panel data are comparable. For most of the countries, the survey data are on some 220–230 firms in the manufacturing sector in the mid-1990s—the exact years vary from country to country. The panel data are fairly representative of the manufacturing sectors in these countries in that they provide for different size categories of firms and have been generated from surveys carried out in a number of different cities. The manufacturing subsector coverage is similar across the different surveys.

We chose samples of manufacturing firms in Ethiopia, Ghana, and Kenya because they represent the spectrum of the relative importance of the export sector in the manufacturing sectors across Africa. At one extreme, Kenya—where 25 percent of the firms export—has one of the more export-oriented manufacturing sectors in Africa. In Ethiopia, at the other extreme, only 3 percent of the firms export; so it is representative of a manufacturing sector where most of the firms are much more involved in import substituting. Ghana is somewhere in the middle.

IMF SURVEY: How did productivity vary among exporters and nonexporters in these three countries?

PATTILLO: We found that exporters are more productive than nonexporters—there is a productivity premium for exporters. And we found that the average productivity premium for exporters in the three countries is about 16 percent. That figure conceals quite a bit of cross-country variation: it ranges from a productivity premium of 11 percent in Ghana—a country in the middle of the range—and a much larger premium in Kenya, at about 28 percent. This productivity premium comes from estimating a production function while controlling for lots of other channels for international diffusion of technology that have been found to be important and that are correlated with exporting status. So we control for factors such as the import intensity of inputs, the extent of foreign direct investment,the extent of foreign involvement, technical assistance, or foreign licensing agreements.

IMF Survey: Was it difficult to control for and isolate the effects of these other channels, given that the lines may be blurred: a company that exports may have a licensing agreement with and/or be partly or wholly owned by a foreign firm?

Mengistae: While we know that there is an exporter's productivity premium, we cannot tell conclusively whether this is because exporters engage in these sorts of things—whether the premium is due to technical assistance arrangements with foreign firms or from licensing agreements with foreign firms. We do know that exporting firms tend to have more access than nonexporting firms to these other channels for international diffusion of technology. So, yes, it is difficult to disentangle these effects.

Pattillo: We don't have lots of information on when different firms established these foreign links or began exporting. By way of example, if one could observe that a firm signed a technical assistance contract, say, 10 years ago and then began exporting only very recently, we would be able to sort out the causality. But our data are really for short panels—3 years—and the frequency of observations in some of these variables is small.

IMF Survey: In seeking explanations for productivity gains associated with exporting, you compared the productivity of different types of manufacturing exporters in these three African countries—direct and indirect exporters, exporters outside Africa, and exporters within the region. What did you find?

Pattillo: We found that direct exporters—firms in direct contact with their foreign clients—were, on average, four times more productive than indirect exporters—those that exported through domestic intermediaries rather than directly to their foreign clients. And those firms exporting to destinations outside Africa were significantly more productive than those exporting within the region. The productivity premium specifically for direct exporters outside Africa was about 35 percent on average for all three countries; for firms that are direct exporters within Africa, the average premium was 20 percent. Keep in mind, here, that the average premium for exporters as a whole across the three countries was 16 percent. Looking at indirect exporters that are exporting within Africa, the premium, at just over 5 percent, was small and statistically insignificant.

Thus, productivity is a lot higher for direct exporters than for indirect exporters. Within the group of direct exporters, productivity is higher again for those that are directly exporting outside of Africa. This also varies quite a bit across the three countries, with the highest premiums, again, for Kenya. These findings are what we consider to be the new and interesting part of our research results. We had not seen this kind of examination of subgroups of exporters in the literature on this topic. On the productivity premium issue alone, our findings were comparable to those in the literature: the size of the overall premium that we found in these three African countries was comparable to that of some other studies that have looked at export productivity premiums for firms from China or Taiwan Province of China or even for U.S. firms.

Pattillo: "Productivity is a lot higher for direct exporters than for indirect exporters."

Mengistae: There are at least two possible ways of trying to assess productivity gains from participation in export markets. One is the use of dynamic panel data techniques. Unfortunately, the panel of observations at hand can sometimes be too short for the application of the same techniques, as it was in our case. The second method is to compare the productivity premiums of exporters that are more likely to be in more direct or intimate contact with buyers that are potential sources of better techniques of production with the productivity premiums of exporters that are less likely to have such contacts. If exporting per se enhances productivity at all, then the premiums normally should be higher for the first group. The underlying idea is that technical information is more likely to flow from clients that are in direct contact with suppliers.

IMF Survey: To what extent can the higher productivity be explained by some sort of "self-selection" of more efficient producers in export markets versus "learning by exporting"—that is, lower costs or improved product quality due to a relatively inexpensive flow of technical information to exporters from their developed country clients?

Pattillo: Given the short time period of the data, it is impossible to definitively prove that learning by exporting is the explanation rather than self-selection. That is why we decided to exploit those additional data on the subgroups of exporters. So we argued that the learning-by-exporting hypothesis would predict higher productivity for direct exporters. Since this

IMF SURVEY

Laura Wallace
Editor-in-Chief
Sheila Meehan
Senior Editor
Elisa Diehl
Assistant Editor
Natalie Hairfield
Assistant Editor
Jacqueline Irving
Assistant Editor
Lijun Li
Editorial Assistant
Maureen Burke
Editorial Assistant
Philip Torsani
Art Editor
Julio R. Prego
Graphic Artist

Prakash Loungani
Contributing Editor

The *IMF Survey* (ISSN 0047-083X) is published in English, French, and Spanish by the IMF 23 times a year, plus an annual *Supplement on the IMF* and an annual index. Opinions and materials in the *IMF Survey* do not necessarily reflect official views of the IMF. Any maps used are for the convenience of readers, based on National Geographic's *Atlas of the World*, Sixth Edition; the denominations used and the boundaries shown do not imply any judgment by the IMF on the legal status of any territory or any endorsement or acceptance of such boundaries. Text from the *IMF Survey* may be reprinted, with due credit given, but photographs and illustrations cannot be reproduced in any form. Address editorial correspondence to Current Publications Division, Room IS7-1100, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-8585; or e-mail any comments to imfsurvey@imf.org. The *IMF Survey* is mailed first class in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged $79.00 annually. Apply for subscriptions to Publication Services, Box X2002, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

subgroup is in direct contact with its purchasers, there is more likely to be a flow of knowledge that would help lower costs and improve product quality. And learning-by-exporting effects are more likely to occur for exporters that are exporting outside Africa because these exporters are in contact with industrial country clients that are more likely to have a higher level of technical and managerial information to share. So it would seem that learning effects might be stronger for these two subcategories.

There are also going to be selection effects that partly explain these premiums, but it is harder to say definitively which subgroup would be likely to have stronger selection effects. Selection effects relate to such factors as the amount of the per period fixed costs and the level of productivity that is necessary to reach a certain threshold for a firm to be able to export. However, there is an additional factor in that firms that can meet competitive pressures more effectively are more likely to be able to "select" into exporting. Because it seems plausible that competitive pressures are going to be greater on international markets, one could argue that selectivity effects would be stronger for those exporters that export their products outside Africa. But comparing direct to indirect exporters, one might still expect the relative strength of selectivity effects to go either way.

In conclusion, we are arguing that if one considers the mechanisms behind selection and learning-by-exporting effects, a finding of higher productivity for those who export outside Africa and direct exporters could be interpreted as more likely reflecting learning-by-exporting effects. But because there also may be selection factors at work, the actual causes of higher productivity are not completely clear-cut.

Mengistae: For the subcategories of direct versus indirect exporters, the case for selectivity as the source of the higher premiums for direct exporters is even weaker. One can argue that those firms that export outside of Africa typically would be shipping to more distant locations—say, to Europe. Therefore, to cover greater transport costs, they would need to be more productive than those exporting just across the border. But there is no obvious reason why direct exporters would need to overcome greater natural barriers to trade than indirect exporters would.

IMF Survey: What policy conclusions can be drawn?

Pattillo: If one could definitively prove that the productivity premium is due to either learning by exporting, on the one hand, or selectivity, on the other, there would be clear-cut policy implications. And those policy prescriptions would differ depending on the finding. If one could prove that learning by exporting explained the premium, then there would be a case for export subsidies, for example. While if one could prove that selectivity is the cause, then the findings would favor the kinds of policies that would help close the productivity gap by lowering the transaction costs of trade or directly targeting policies, in general, to improve manufacturing firms' productivity. But since we aren't able to definitively prove one channel or the other, it is difficult to have really strong policy implications. One general policy implication is that the results support the case for open trade that provides nondiscrimination against exports and don't support the case for infant industry policies—those policies that protect firms in a new industry from foreign competition until they have grown strong enough to compete—or heavy export taxes.

Pattillo: "The results support the case for open trade that provides nondiscrimination against exports and don't support the case for infant industry policies . . . or heavy export taxes."

Mengistae: Even if we concluded that there would not be any significant productivity gains from exporting under any circumstances, the average productivity premium of exporters is a useful indicator of the openness of an industry or an economy to international competition. In that case, a higher productivity premium would suggest that the economy tolerates less efficient nonexporters. In general, the more open an economy, the lower would be the productivity premium of exporters that the economy could tolerate. ■

Copies of Working Paper 02/89, *Export Orientation and Productivity in Sub-Saharan Africa,* by Taye Mengistae and Catherine Pattillo, are available for $10.00 each from IMF Publications Services. See page 219 for ordering information. The full text is also available on the IMF's website, www.imf.org.