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NEWS: Iraq must prioritize spending

The IMF's Executive Board commended Iraq's authorities for "having established and maintained a degree of macroeconomic stability under extremely difficult circumstances" but noted that much remains to be done. In its first report on Iraq's economy in 25 years, the staff highlighted several costly subsidies, notably for gasoline, and urged prioritizing spending in favor of reconstruction. Important steps also include establishing an effective payment system and developing a functioning banking system.

Joe Raedle/Getty Images

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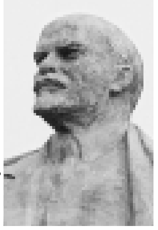
REGIONAL FOCUS: In the shadow of the Soviet empire

Central and Eastern Europe and the countries of the former Soviet Union suffered varying degrees of output loss in the early years of transition. What accounts for the sharp differences among these countries? A new IMF Working Paper argues that differences in output declines may be explained largely by variability in the extent to which markets and memories of market institutions had been eradicated under central planning, and by differences in the prevalence of armed conflicts during the transition period.



Zarembo Igor/ITAR-TASS

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COUNTRY FOCUS: Indonesia seeks sustained momentum

In recent years, Indonesia's output has returned to pre–Asian Crisis levels, and the country has seen solid growth, rising investment, strong stock market performance, and declining public debt. But risks remain—notably rising oil prices are putting mounting pressure on the country's budget and balance of payments. Critical to maintaining the economy's growth momentum will be measures to improve its investment climate, including reforms to enhance transparency and accountability in public institutions.

Supri/Reuters

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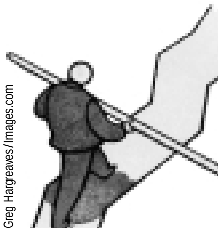
RESEARCH: Trade-offs in IMF governance

For the IMF, maintaining legitimacy among its diverse 184 member countries is key. But as Carlo Cottarelli points out in a new study, there is often a conflict between legitimacy and efficiency. While efficiency calls for selectivity—offering analysis and advice only in areas where countries truly need it—legitimacy calls for uniformity of treatment. In recent years, countries have increasingly resisted "special treatment." But can uniformity of treatment continue, with the IMF facing tighter budget constraints?



Greg Hargreaves/Images.com

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What's on

SEPTEMBER

1–2 APEC Small and Medium Enterprise Ministerial, Daegu, Republic of Korea

3 IMF–Singaporean government high-level seminar on regional financial integration, Singapore

6–7 IMF high-level seminar, "Financial Stability—Central Banking and Supervisory Challenges," Washington, D.C.

7 IMF Managing Director Rodrigo de Rato to visit Seoul, Republic of Korea

8 IMF Economic Forum, "IMF Conditionality: Good, Bad, or Ugly?" Washington, D.C.

8–9 APEC Finance Ministers Meeting, Jeju, Republic of Korea

14–16 High-level plenary meeting, UN General Assembly, to review progress on UN Millennium Declaration commitments, New York

19–23 IMF seminar for parliamentarians from Bosnia and Herzegovina, Croatia, Macedonia, and Serbia and Montenegro, Joint Vienna Institute, Austria

22–23 Global Forum on Tax Treaties and Transfer Pricing, OECD Center for Tax Policy and Administration, Paris, France

24–25 IMF and World Bank Annual Meetings, Washington, D.C.

26–30 International Atomic Energy Agency General Conference, Vienna, Austria

27–30 Meeting of the International Task Force on the Harmonization of Public Sector Accounting, IMF, Washington, D.C.

OCTOBER

15–16 Meeting of Group of Twenty Finance Ministers and Central Bank Governors, Beijing, China

19 IMF Book Forum, Pietra Rivoli, *Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade*, Washington, D.C.

NOVEMBER

3–4 IMF Jacques Polak Sixth Annual Research Conference, Washington, D.C.

4–5 Fourth Summit of the Americas, Mar del Plata, Argentina

16–18 World Summit on the Information Society, Tunis, Tunisia

27–29 World Economic Forum, India Economic Summit, New Delhi, India

DECEMBER

13–18 The Sixth WTO Ministerial Conference, Hong Kong SAR

IMF Executive Board

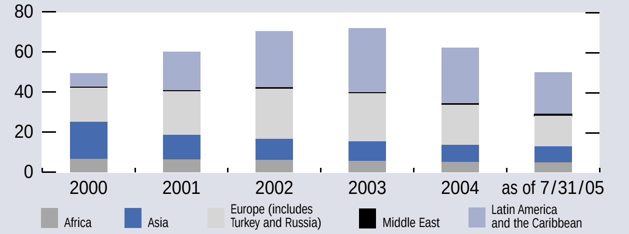
For an up-to-date listing of IMF Executive Board meetings, see *www.imf.org.external/np/sec/bc/eng/index.asp*.

At a glance

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



Major currencies, rates per SDR

	August 24, 2005	Year ago
Euro	1.199	1.205
Japanese yen	161.890	160.822
U.K. pound	0.816	0.810
U.S. dollar	1.464	1.463

IMF available resources

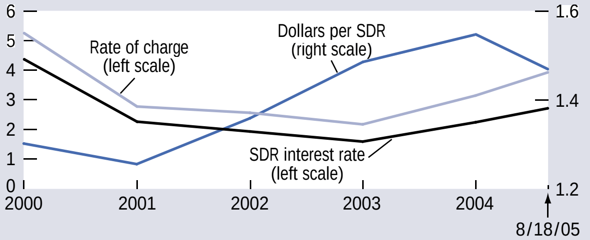
(one-year forward commitment capacity, billion SDRs)

Related rates

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

(percent, end of period)

(dollars per SDR, end of period)



Note on IMF Special Drawing Rights

Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

IMF concludes first Iraq review in 25 years

In its first review of the Iraqi economy in a quarter century, the IMF Executive Board commended the authorities for "having established and maintained a degree of macroeconomic stability under extremely difficult circumstances, and for having initiated structural reforms," but noted that the economy remains fragile, and much work remains to be done.

Since mid-2003, the IMF has supplied Iraq with technical assistance and policy advice on macroeconomic reforms, and in September 2004 it approved about $430 million in emergency postconflict assistance to help the country stabilize its macroeconomy and undertake a number of major structural reforms.

A recent IMF staff analysis found that Iraq's economy had rebounded by 50 percent in 2004 (mostly reflecting a recovery in oil production), but growth is slowing down in 2005, with no significant increase in oil production expected. Inflation, which spiked in the latter half of 2004, has been low thus far in 2005. International reserves, which rose strongly last year, have been fairly steady in 2005. Iraq's exchange rate peg to the dollar has to date been kept relatively stable, but the authorities need to stand ready to adjust monetary policy to maintain the monetary framework that the peg provides.

Iraq	2004 EPCA[1]	2004 Est.	2005 EPCA[1]	2005 Rev. Proj.	2006 Proj.
			(percent change)		
Real GDP	51.7	46.5	16.7	3.7	16.8
CPI	7.0	32.0	15.0	20.0	12.0
			(percent of GDP)		
Expenditure	133.5	121.3	125.4	115.4	92.3
Overall fiscal balance (including grants)	–42.9	–40.8	–27.7	–27.7	–4.3
			(million US dollars)		
International reserves	5,691	7,902	8,289	9,602	10,995

[1]Emergency Post-Conflict Assistance program projections.
Data: Iraqi authorities and IMF staff estimates.

Important reforms pending. Reconstruction and efforts to strengthen Iraqi institutions and capacity have proceeded more slowly than expected. For this reason, staff underscored that Iraq can ill afford its present, very expensive system of subsidies—one of the most egregious being the heavily subsidized price of gasoline. This subsidy encourages smuggling and corruption, and deprives the country of resources that could be more effectively channeled into rebuilding the education and health care systems, and helping meet security needs. The bottom line on the fiscal front, the report said, is that the government of Iraq should prioritize expenditures in favor of the reconstruction effort.

High among Iraq's other reform priorities are establishing an effective payment system, developing a functioning banking system, formulating strategies to restructure state-owned enterprises, and reforming the social safety nets. ■

Latvia must contain demand pressures to remain competitive

During much of the past decade, Latvia's economic growth outstripped that of other new European Union (EU) members while inflation remained subdued. Sound macroeconomic policies and far-reaching structural reforms, capped by Latvia's accession to the EU in 2004 and entry into the Exchange Rate Mechanism 2 (ERM2) at end-April 2005, supported this performance. Nonetheless, per capita GDP remains the lowest in the EU, inflation and current account deficits are on the rise, and gross external debt is expanding sharply, the IMF said in its annual economic review. The IMF's Executive Board commended the economy's strong performance but cautioned that timely action to reduce inflation is crucial for euro adoption—planned for the beginning of 2008—and preserving external competitiveness. Given concerns about overheating, it recommended a broadly neutral fiscal stance for 2005. Fiscal consolidation over the medium term would also be desirable to slow the buildup in external debt and to help prefinance the cost of ongoing pension reform.

Latvia	2001	2002	2003	2004	Proj. 2005
			(percent change)		
Real GDP	8.0	6.4	7.5	8.5	7.8
CPI (end of period)	3.2	1.4	3.6	7.2	6.2
			(percent of GDP)		
Total government debt[1]	13.8	13.3	13.4	13.2	13.5
Domestic credit (non-government)	50.4	36.5	37.3	40.0	37.5
Current account balance	–8.9	–6.5	–8.6	–12.3	–10.5

[1]Excludes government-guaranteed debt.
Data: Latvian authorities; and IMF staff estimates and projections.

With rapid credit growth adding to demand pressures, the Board commended the Bank of Latvia's decision to raise interest rates and tighten reserve requirements over the past year. However, with ERM2 limiting the scope for an independent monetary policy, the Board called for other measures to slow credit growth, notably closing capital gains tax loopholes that could be fueling the mortgage boom. To safeguard financial soundness, it urged continued close oversight of banks' credit standards and currency exposures. Recent antimoney laundering amendments were welcomed, as was the authorities' request for an Anti-Money Laundering and Combating the Financing of Terrorism Report on the Observance of Standards and Codes.

The Board said the recent acceleration of wages was a risk to future competitiveness and growth, and called for policies to contain wage and price inflation while preserving labor market flexibility. To help sustain vigorous growth, the Board called for narrowing the tax wedge on low-wage earners, making the education system more responsive to employers' skill needs, while ensuring the efficient allocation of EU funds. ■

Sri Lanka sees solid economic growth, but inflation looms

Sri Lanka's economy has largely sustained its growth momentum since early 2004, although accommodative monetary and fiscal policies have added to inflationary pressures, the IMF said in its annual economic review. The IMF Executive Board commended the government for its prompt and effective relief work to cope with the loss of life, suffering, and destruction caused by the December 2004 tsunami. Going forward, a key challenge will be to manage the reconstruction activity in an efficient and transparent manner while maintaining economic stability.

Growth in 2004 was led by domestic demand, especially strong private investment, which contributed to a rapid increase in imports. Exports of goods and services also expanded, aided by textiles and tourism arrivals, but rising oil prices and a drought were a drag on growth. Nevertheless, the near-term outlook remains positive, with reconstruction activity and a strong agricultural sector expected to offset the tsunami's adverse impact on fisheries and tourism.

Noting that the recent large fiscal deficits and the high level of public debt constitute a potential source of macroeconomic instability, the Board called for stronger efforts at fiscal consolidation. It encouraged the authorities to improve debt management, curtail central bank financing of the budget, initiate a comprehensive tax reform, and shift expenditure to priority infrastructure and poverty-related projects.

In spite of the central bank's recent actions to tighten monetary policy and increase transparency, inflation has remained high, and monetary and credit aggregates continue to grow rapidly. The Board recommended additional monetary tightening at an appropriate pace to signal the central bank's determination to curb inflation. Although progress has been made on some structural reforms, problems remain, especially for some key public enterprises. ■

Sri Lanka	2001	2002	2003	Est. 2004	Proj. 2005
			(percent change)		
Real GDP	–1.5	4.0	6.0	5.4	5.3
Average CPI	12.1	10.2	2.6	7.9	14.0
			(percent of GDP)		
Overall fiscal deficit	–10.8	–8.9	–8.3	–8.2	–8.2
External current account balance	–1.1	–1.4	–0.4	–3.2	–5.6

Data: Sri Lankan authorities and IMF staff estimates.

Angola's economy strengthens after years of conflict

Since the end of violent conflict in April 2002, about 4 million displaced Angolans have returned to their communities, supported by a government-led initiative to provide emergency food aid and humanitarian assistance. Much remains to be done, however, to tackle widespread poverty, improve social and health conditions, and restore and update the physical infrastructure. In addition, the civil conflict has left the country with a sizable debt, a swollen public sector payroll, and largely unaccountable state institutions that dominate critical areas of the economy.

Recent economic developments have been favorable, mainly reflecting rising oil production, which accounts for half of GDP, and high oil prices. GDP grew by 11 percent in 2004. Outside the extractive sector, the economy grew by about 9 percent. Inflation and the fiscal deficit declined substantially in 2004 and the external current account moved into a significant surplus.

Angola	2001	2002	2003	Est. 2004	Proj. 2005
			(percent change)[1]		
Real GDP	3.1	14.4	3.4	11.2	13.8
Oil sector output	–1.0	20.6	–2.1	13.9	17.6
CPI (end-of-period)	116.0	106.0	77.0	31.0	15.0
Overall government balance[2]	–3.6	–9.4	–7.1	–4.0	3.7
Public external debt service-to-exports[3]	141.1	40.0	39.0	23.4	18.5

[1]Unless otherwise indicated.
[2]On a commitment basis, excluding grants; in percent of GDP.
[3]Ratio in percent of exports net of oil-related expenses.
Data: Angolan authorities and IMF staff estimates.

Owing to continued public sector borrowing, however, the country's external debt was still equivalent to around half of GDP at end-2004.

Discussing the staff's annual economic review in March, the IMF Executive Board commended the authorities for their successful postwar humanitarian and resettlement program; their decisive break from large fiscal deficits, money creation, and high inflation; and their initial steps to improve transparency. Looking ahead, it agreed that Angola can raise average income levels if it carefully husbands the wealth from its abundant oil and other resources, including by adopting a formalized medium-term fiscal framework, improving spending control, and forcefully strengthening governance.

On the fiscal front, the Board supported increasing public spending on infrastructure and social services, with some Directors recommending a reallocation of spending from the large government administrative and military payrolls. The Board welcomed the authorities' intention to eliminate fuel subsidies but stressed the importance of accompanying these measures with steps to protect low-income households. It also emphasized the need for structural reform measures to improve competition and develop the non-oil private sector, including streamlining bureaucracy and enhancing contract enforcement mechanisms. Finally, to help support poverty reduction efforts, it called for a clearly articulated and effective poverty reduction strategy. ■

United Arab Emirates benefits from economic reform, prudent policies

An outward-oriented development strategy, good macroeconomic management, and a business-friendly environment have all contributed to high growth in the United Arab Emirates (U.A.E.) in recent years. Last year, the economy grew at an impressive 7.8 percent, driven largely by robust export growth in both the oil and nonoil sectors, which benefited from a real depreciation of the U.A.E. currency and strong demand in export markets, the IMF said in its annual economic review. High oil export revenues reflected sharply higher oil prices, as well as increased export volumes.

Growth in the U.A.E. was broad-based, with most sectors of the economy growing at historically high rates, led by manufacturing, followed by services and construction. Stronger economic fundamentals have buoyed investor confidence, resulting in high levels of domestic and foreign investment in manufacturing and energy-intensive sectors. The medium-term outlook is expected to remain favorable, with the economy well positioned to consolidate recent gains from high oil prices.

The IMF Executive Board welcomed the government's continued progress in diversifying and reforming the economy, which has bolstered its ability to weather external shocks. To sustain growth, however, the Board said it is critical that the U.A.E. take additional steps to liberalize the economy and pursue further structural reforms, including lifting remaining barriers to foreign investment outside the free zones and enhancing the long-term employability of the national labor force through training and education.

United Arab Emirates	2002	2003	Prel. 2004	Proj. 2005
	(percent change)			
Real GDP	2.6	11.6	7.8	7.3
CPI	2.9	3.1	4.6	6.0
	(billion U.S. dollars)			
Exports of goods and services	52.5	67.3	82.3	103.4
Crude oil exports	16.6	22.1	29.6	41.5

Data: U.A.E. authorities and IMF staff estimates.

On fiscal and monetary matters, the Board commended the authorities' pursuit of prudent policies, but cautioned that sharply rising asset prices in real estate and stock markets and emerging inflationary pressures warrant close monitoring. While projecting an improvement in the overall fiscal balance, the Board nevertheless pointed to the need for greater fiscal coordination between the individual Emirates and the federal government. Expanding the fiscal revenue base and reducing its dependence on oil and gas revenues will also be important, the Board said.

Turning to the U.A.E. financial sector and its evolving role as a regional hub, the Board noted that the country's banking sector remains strong, bolstered by effective supervision, but it added that regulatory oversight of the capital markets and nonbanks will need to be rationalized and consolidated. ■

Slovenia's economy on track for 2007 euro entry

Slovenia's economy has performed strongly since the country's entry into the European Union and the Exchange Rate Mechanism 2 (ERM2) in 2004, the IMF said in its annual economic review. Growth has been driven by a large increase in the contribution of net foreign demand, while domestic demand growth has maintained momentum. Private consumption has strengthened, and exports have risen markedly, reflecting stronger import demand in Slovenia's main trading partners. Investment growth, however, has slowed, and total external debt has grown sharply as a result of banks' increased external financing.

With entry into ERM2, the monetary framework changed and monetary conditions became tighter. The IMF Executive Board noted that considering the degree of real convergence with other EU economies, Slovenia is well positioned to adopt the euro in early 2007. However, risks remain. While disinflation has continued, meeting the Maastricht inflation criterion and sustaining low inflation after euro adoption will be challenging. Further, the authorities will have to address the budgetary implications of an aging population.

Slovenia	2002	2003	2004	Proj. 2005	Proj. 2006
	(percent change)				
GDP	3.3	2.5	4.6	3.9	4.0
Domestic demand	2.3	4.7	4.7	3.8	3.8
Average CPI	7.5	5.6	3.6	2.6	2.5
	(percent of GDP)				
General government balance	–1.5	–1.4	–1.4	–1.3	N/A
External debt	48.9	54.1	59.4	62.1	64.8

Data: Slovenian authorities and IMF staff calculations and projections.

With the general government deficit in 2004 declining further than had been envisaged in the budget, the Board commended the authorities for their track record of prudent fiscal policy. Further fiscal consolidation would, however, be needed to create a sufficient safety margin for staying within the deficit threshold of the EU Stability and Growth Pact in case of adverse cyclical conditions. The Board called on the authorities to increase budgetary flexibility, noting the relatively large proportion of nondiscretionary spending in the overall budget.

While the authorities' sustained structural reform efforts contributed in large part to economic growth, more needs to be done to increase labor market flexibility, privatization, and competition in the electricity and gas markets and telecommunications. ■

For more information, refer to IMF Public Information Notices No. 05/117 (Iraq), No. 05/109 (Latvia), No. 05/102 (Sri Lanka), No. 05/85 (Angola), No. 05/89 (United Arab Emirates), and No. 05/97 (Slovenia) on the IMF's website (*www.imf.org*).

Research

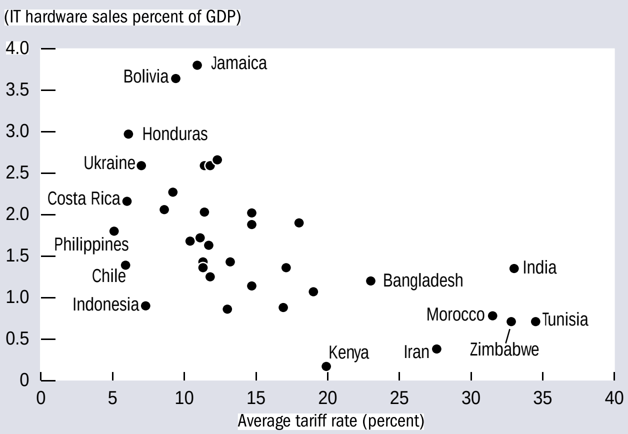
IT is transforming low-income countries, too

Advances in information and communication technologies are reshaping the global economy. While most observers have focused on the effects these technologies are having on industrial countries and a few middle-income countries, Markus Haacker, an Economist in the IMF's African Depart-ment, argues that they are playing a key role in developing and emerging market economies, too. In low-income countries, he notes, information technology (IT) hardware sales, as a percentage of GDP, are frequently higher than in the most technologically advanced nations, and a boom in cellular phone use is dramatically transforming communications.

Innovations in information and communication technology have reshaped the pattern of global trade in goods and services, and created new opportunities for economic development. They have triggered, for example, an increased fragmentation of production processes. Outsourcing of labor-intensive production processes—to an extent that would have seemed inconceivable a few decades ago—now allows low-income countries to assume a rapidly growing role in global manufacturing. Public administrations are being transformed as well, and much of the technical assistance that the IMF provides now takes the form of helping countries implement new software in numerous areas of public administration.

Higher tariffs mean lower sales

Differences in tariff rates explain cross-country differences in IT hardware sales.



Note: Data sample includes 36 countries with GDP per capita of less than $5,000.
Data: Author's calculations, based on data provided by the World Information Technology and Services Alliance.

How rapidly are technological innovations being adopted in low-income countries, and what effects are they having on these economies? Data are scarce, unfortunately, and much of the available evidence is anecdotal or builds on case studies that do not lend themselves to easy generalization. Many of the activities made possible by modern information and communication technologies, however, require the use of IT-related equipment. Thus, it is informative to look at sales of such products across countries, particularly cross-country differences in sales of IT hardware (such as computers) and examine some of the economic determinants of these differences.

While this approach works well for IT, it has limitations with regard to communication technologies. The pricing structure for access to communication technologies is more complex—for example, involving not only the purchase of equipment but also various forms of service agreements. For this reason, most observers focus on the number of land phone lines and cellular mobile phone subscriptions. Additionally, since communications services are offered by only a few providers (in the case of land lines, frequently only one), it is also useful to analyze the role that market structure plays and the effect that these new technologies have on that structure.

Strong IT hardware sales

The current consensus in the literature is that the use of IT products is relatively more important in higher-income countries and that the share of IT hardware spending in GDP (excluding some special cases, such as major producers) increases as GDP per capita rises. Data on IT hardware sales to 69 countries show that this is true for countries whose GDP per capita exceeds $5,000. But for countries with GDP per capita of less than $5,000, the rule does not hold. Some of the countries with the highest IT spending as a percentage of GDP are, in fact, lower-income countries.

At the same time, the high dispersion of spending within the lower-income group is puzzling. There is, indeed, no clear relation between IT spending and GDP per capita for this group. What accounts for such large variation among low-income countries? One potential explanation is the price of IT products. While there are no available data on the actual prices that importers pay—at least not in a consistent fashion across countries—average tariff rates do provide an approximation. The significant differences in these tariff rates, it turns out, seem to explain much of the cross-country differences in IT hardware sales (see chart, this page).

Dino Mahtani/Reuters

In Kinshasa, Democratic Republic of Congo, cell phone usage has ballooned in recent years, fueled by competition between foreign-owned service providers such as Celtel and South Africa's Vodacom.

It is also important to note that the level of IT sales to lower-income countries holds up to the level of sales to higher-income countries as a percentage of GDP despite the fact that lower-income countries have thinner markets and, with higher transaction costs, end-users are likely to pay higher prices for their IT equipment. Second, the infrastructure required to realize the full potential of IT equipment—reliable communication and uninterrupted power supply—is often not readily available in some countries with relatively low levels of GDP.

The cell phone boom

Modern technologies have also spurred a sea change in access to telecommunication in low-income countries. Perhaps the most dramatic illustration of this is the spread of cellular phone technology. In Africa, for example, the number of phone subscribers almost quadrupled—increasing by a factor of 3.7—in only five years (1998–2003), largely the result of an explosion in the number of cellular mobile subscribers. Cell phone users increased 65 percent annually (twelvefold over the five years), while the number of land lines increased by only 8 percent a year. In relative terms, the number of phone subscribers in this period rose from 2.8 per 100 inhabitant to 9.2 per 100 inhabitants, with cell phones accounting for 90 percent of the increase. Cell phones now account for 67 percent of total telephone subscribers in the region, making Africa the region with the highest share of cell phone usage in the world.

Globally and on a cross-country basis, however, the picture is more complex. Worldwide, cellular mobile phones have accounted for the bulk of the increase in phone subscribers in recent years, growing at an annual rate of 33 percent compared to 6.6 percent for land lines. It also seems clear that access to communication services is correlated with income per capita. What is less clear at first glance is the role of cellular phone technologies in low-income countries, where their share in total subscriptions varies from around zero to close to 100 percent. Why this extraordinary spread?

There are two main reasons. The first explanation is timing. Usually, the number of cellular subscribers rises very rapidly in the early years. If a country lags behind a couple of years in the introduction of such networks, the share of cell phone users in that country appears much lower than in countries that have modernized their networks earlier. For South Africa, for example, the share of cell phone subscribers increased from one-third to two-thirds in only four years.

The second explanation relates to the market structure in the communications sector. Of 21 African countries for which consistent data are available, 20 have only one national provider for land lines, and in 15 of these countries, the dominant operator is controlled and frequently wholly owned by the government. The markets for cellular phone services are very different—the average number of national providers of cellular phone services is 2.3, and of 48 national providers, 32 are controlled by multinational companies, and only 12 (including 4 monopolists) by the respective governments.

The market for cellular phone services is thus much more competitive than the market for land lines. For the group of 21 African countries, we find that a larger number of providers translates into a larger market share of cellular phone services. On average, each additional market participant is associated with an increase in the share of cellular phones in total phone subscriptions of about 6 percentage points. While the number of cell phone providers also depends on some economic variables (such as market size), this does not affect the relative demand for cell phone services, and the observed correlation thus most likely reflects the effect of increased competition.

For policymakers, there are clear implications. Access to information and communication technologies depends on the structure of the respective markets, as proxied by average tariff rates or the number of competitors. Removing restrictive trade policies or policies that limit competition in the communications sector can thus help improve access to information and communication technologies in low- and middle-income countries. ■

What does the future hold for currency blocs in Africa?

While the benefits of monetary union for Africa remain a topic for debate, many cite high transaction costs associated with changing one currency to another and the risks associated with exchange rate variability as impediments to greater intraregional trade and investment. A recent study by Etienne Yehoue (IMF Institute) looks at how currency blocs are likely to emerge in the region and whether they could lead to a single African currency. He discussed his findings with Jacqueline Irving of the IMF Survey.

IMF Survey: What has been motivating the renewed impetus to form currency unions in Africa over the past several years?
Yehoue: After Europe's launch of the euro in 1999, a new political will seems to have emerged in Africa. For instance, the former continental Organization for African Unity underwent a number of reforms culminating in the formation of a new organization, the African Union [AU], in 2001. One of the AU's goals is to promote further regional integration, including the creation of a single currency for the continent by 2021, which would follow from the creation and merger of currency unions at the subregional level.

IMF Survey: Tell us about your research aims and how you designed your study.
Yehoue: My research aims to examine whether there is any economic justification for the emergence of a single African currency. To do this, I applied a theoretical model that I developed and first applied in my earlier research on the European Economic and Monetary Union. This model has as its premise that a large-scale currency bloc is endogenously formed in a dynamic, step-by-step process of bloc expansion. The central idea is that the more a particular country trades with a bloc's existing members, the sooner the country will opt to join the bloc. Moreover, each additional member attracts other members to the currency bloc in a dynamic way.

Trade patterns are important in this evaluation because the more trade between two countries forming a monetary union, the greater the increase in the marginal benefit to be derived from the resultant lower transaction costs and reduced uncertainty from the elimination of exchange rate variability.

As a starting point, I looked at the West African Economic and Monetary Union [WAEMU], the Central African Economic and Monetary Community [CEMAC], and the rand zone in southern Africa [Common Monetary Area] during the 1960–2000 period. I also looked at some national economies as potential "anchors" in new currency unions.

IMF Survey: The introduction of the euro by a subgroup of European Union members followed quite a long history of common institutions and policies, beginning with the pooling of French and German coal and steel resources in the early 1950s and evolving to include common trade policies and other supranational efforts and initiatives. Is the AU's aim to create a single currency really comparable?
Yehoue: It will happen very slowly in Africa as well. When you look, for instance, at the degree to which economic policies converge, it is not very encouraging. Nevertheless, if there is a strong political will, it is not impossible for this to occur in the future.

Economic rationality is important for forming a currency union, but it goes beyond this. Political will was crucial, for example, in forming the European Economic and Monetary Union. Economically speaking, it was not clear that what is now the euro area was an optimum currency area. Despite that, the euro has seen the light of day and seems to be successful so far. I believe that if there is political will backing this decision, a single African currency could eventually be successfully introduced.

Based on the historical patterns of intra-African trade and co-movement of prices and output, I find little evidence to support the AU's goal for a single currency at this time, however. Rather, the trade patterns seem to suggest the emergence of three currency blocs: one in West Africa, a second around South Africa comprising the eastern and southern African states, and a third in Central Africa.

The trade patterns seem to suggest the emergence of three currency blocs: one in West Africa, a second around South Africa comprising the eastern and southern African states, and a third in Central Africa.
—Etienne Yehoue

IMF Survey: But Ghana, The Gambia, Guinea, Nigeria, and Sierra Leone—which are attempting to launch a second monetary zone in West Africa—have been unable to meet the various economic convergence criteria set down as prerequisites for the launch of a common currency. The July 2005 target date for its planned introduction was recently postponed until 2009. Do you see the emergence of these subregional blocs themselves as a very slow process?

Yehoue: Yes, these West African countries will need more time to improve and converge their macroeconomic policies. Once they achieve more disciplined policies, it would become easier to merge this group with the existing eight-member WAEMU and circulate a single currency in West Africa. It is true that the correlation between the economy of Nigeria, a major oil exporter, and the other four economies is very low. Aside from Nigeria, most of the non-WAEMU West African economies could form a bigger bloc with the current WAEMU. But Nigeria is demonstrating strong political will, so it is not impossible for a larger subregional currency union to occur in West Africa in the future.

IMF Survey: Your paper emphasizes that countries that trade more are more likely to form a currency union. But intraregional trade in Africa has been relatively low, compared with, say, trade within the euro area.

Yehoue: Historically, recorded trade patterns clearly indicate no economic rationale for the emergence of a currency bloc in Africa. Trade between the Common Monetary Area and other southern African countries is quite substantial compared with trade within other subregions in Africa, but overall intra-African trade is extremely low. There is not much hope for the emergence of a currency union based solely on historical trade data. But the formation of a currency union can, ex post, have a positive effect on trade among its members. And there is also a lot of unrecorded trade within Africa that is not captured by the available data. Trade flows between Benin and Nigeria, for example, are certainly higher than the data show.


Eugene Salazar/IMF

Yehoue: "The formation of a currency union can, ex post, have a positive effect on trade among its members."

IMF Survey: An often-cited benefit of a common currency is that it could reduce the risks and transaction costs associated with a fluctuating exchange rate, which can impede intraregional trade and the ability of member countries to attract foreign direct investment [FDI]. But to truly reap these benefits of a common currency in Africa—whether within a smaller grouping of countries or a continentwide currency union—wouldn't there first have to be significant improvements to transport links and infrastructure?

Yehoue: I agree that even when a currency union has well-managed macroeconomic policies, that is not enough to increase intraregional trade and attract FDI. As an example, the West and Central African CFA franc zone countries—two currency unions operating since 1948 with stable macroeconomic policies including a track record of low inflation—have not been very successful in attracting FDI and increasing intraregional trade compared with some other currency unions elsewhere in the world. More is needed, including good infrastructure and transport links. Because poor infrastructure and inadequate transport links greatly increase the costs of trading goods and doing business in the region, they impede intra-African trade and deter investors—unless they are interested in investing in natural resources, where the returns have tended to be high. It is also important for African countries to develop their private sectors, which would increase their attractiveness to foreign direct investors.

IMF Survey: You suggest that the euro could be a good choice for anchor currency for an African currency union, should one emerge in the future. But would such a currency peg be the best choice for the region's commodity exporters, who might benefit from some flexibility in their exchange rate? Some have argued that a currency basket—including the euro and the dollar, and perhaps even the yen—might provide some insurance against large movements of the dollar against the euro.

Yehoue: A currency union does not necessarily need an anchor currency. But if the members of a future currency bloc choose to peg to an anchor, it will be important for them to consider the bloc's trade pattern with the rest of the world. Africa trades substantially more with the euro area than with the United States or Japan. It is true that once a country pegs its currency, it loses its ability to use its monetary policy to counteract real shocks, and many of these countries have been exposed to significant terms of trade shocks in the past. It would therefore be important that some mechanisms of fiscal insurance be developed at the regional level so that, for example, a country hit with an asymmetric shock can receive temporary fiscal transfers. If there is no mechanism for risk sharing between members of a currency union, the countries will have an incentive to leave the union if they suffer an asymmetric shock. ■

Copies of IMF Working Paper No. 05/45, *On the Pattern of Currency Blocs in Africa*, are available for $15.00 each from IMF Publication Services. See page 264 for ordering information. The full text of the paper is also available on the IMF's website (*www.imf.org*).

Regional focus

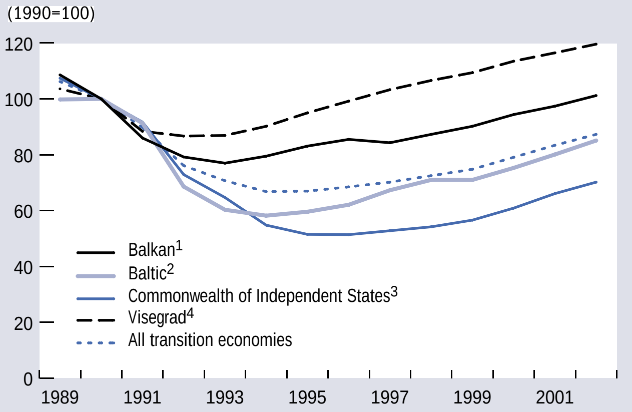
The long shadow of the Soviet empire

More than 15 years after the fall of the Berlin Wall, the transition economies of Central and Eastern Europe and the former Soviet Union continue to suffer the consequences of output losses incurred in the early years of transition. A recent IMF Working Paper analyzes the sharp differences in output decline among these transition economies, focusing on two major factors—armed conflicts and institutional quality. The differences in the extent of conflict and the quality of institutions, it argues, explain 60 percent of the differences in output decline.

During the early transition phase, output declined in all 25 economies of Central and Eastern Europe and the former Soviet Union. In the extensive literature on this subject, the suggested reasons for the decline include the sudden breakdown of the coordination mechanism of central planning, disrupted production links and energy supplies, former "phantom" output, the collapse of the payment system, and a credit crunch. There were major differences among countries, however. While the fall in output amounted to only 16 percent in the Czech Republic and Poland, it reached more than 60 percent in Georgia, Moldova, and Ukraine. With few exceptions (Moldova, Turkmenistan, and Ukraine), economies recorded their lowest real output within the first five years of the transition.

Output performance in transition economies

During the transition to a market-based system, output declines varied considerably across different country groups.



[1]Balkan: Albania, Bulgaria, Croatia, the former Yugoslav Republic of Macedonia, Romania, and Slovenia.
[2]Baltic: Estonia, Latvia, and Lithuania.
[3]Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.
[4]Visegrad: the Czech Republic, Hungary, Poland, and the Slovak Republic.
Data: IMF staff calculations.

Conflicts, poor institutions take toll

For analytical purposes, the economies of Central and Eastern Europe and the former Soviet Union can be divided into four subgroupings: the Visegrad countries—an informal grouping of the Czech Republic, Hungary, Poland, and the Slovak Republic, set up in 1991; the Balkan region; the Baltic region; and the Commonwealth of Independent States (CIS). The differences in output performance among these four groups during 1989–2002 were substantial (see chart, this page). While the growth paths following the trough were similar, the intensity of the initial fall in output varied widely—largely due to conflicts in some countries and marked variability in the quality of institutions among the transition countries.

During the first transition decade, several countries in Eastern Europe and the former Soviet Union were engaged in either cross-border wars or domestic conflicts. While in some countries, such as Armenia, Azerbaijan, Croatia, and Moldova, the conflicts lasted between two and five years, in Georgia and Tajikistan the violence continued throughout the 1990s. Beyond causing human suffering on a vast scale, these prolonged conflicts had negative effects on output in the affected economies.

The varying quality of institutions at the beginning of the transition process was also partly responsible for the differences in output performance among the transition economies. To assess institutional quality in transition economies, the study relies on the broad index of institutional development compiled in 2003 by Daniel Kaufmann of the World Bank and other researchers. The Kaufmann study combines a large number of individual perceptions to develop six basic dimensions of governance. Out of these, the indicator for corruption is the most critical one, as it affects economic performance directly.

Absence of market mechanisms

Soviet policies were directly at odds with the development of the basic features of market economies, such as markets for capital, credit, foreign exchange, energy, housing, and labor. The lack of market institutions was exacerbated by limited private sector activity, and underdeveloped tax, commercial banking, and legal systems. The communist legacy had a direct, linear effect on post-Soviet output decline. The more pervasive these Soviet legacies—that is, the greater the intensity of the communist rule that preceded the transition—the more difficult the subsequent institutional development and the deeper the output contraction. In trying to estimate the size of these effects, researchers face the problem of endogeneity, namely, if institutions affect output, output would also affect the development of institutions. The authors use the statistical technique of instrumental variables to address this problem.

In addition, the duration of the Soviet system had an indirect, nonlinear effect (see diagram below). Most CIS countries became Soviet republics either shortly after the Russian revolution or in the early 1920s. Soviet rule, in the economic sense, began with the launching of the first Five-Year Plan in 1928 and lasted until 1991. By contrast, Moldova and the Baltic countries came under Soviet rule somewhat later, in 1940. The Visegrad and Balkan countries endured central planning under Soviet influence for an even shorter time—from 1947, when Communist regimes were firmly established in most of them, until 1989, when the Berlin Wall fell. In countries that had endured Soviet rule for more than two generations, the memory of market institutions died out when the last generation with a memory of market institutions died out. These "generational effects" were much more pronounced in the CIS countries than in the other three country groups because of the longer duration of Soviet rule.

Without discounting the importance of country-specific factors, 60 percent of the differences in output decline among the four groups of countries examined can be explained by differences in the prevalence of conflicts and the intensity of the Soviet legacy. In the matrix (above), the differences underlying this classification explain the very different outcomes.

A matter of degree

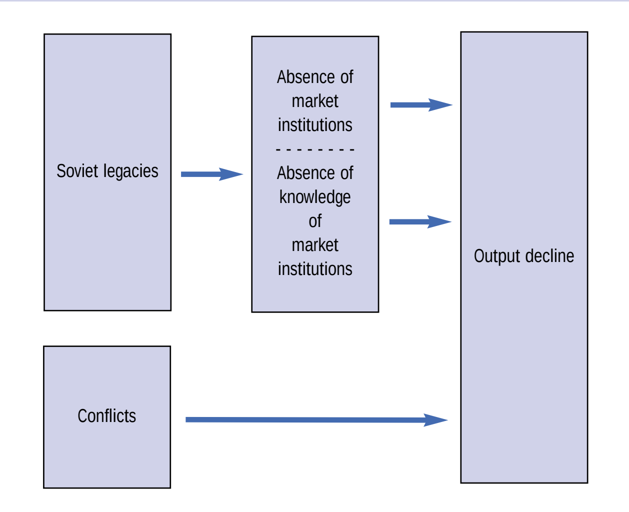
Varying intensities of legacies and conflicts explain differences among country groups.

Soviet Legacies / Conflicts	Relatively limited	Relatively extensive
Low	Visegrad	Baltic
High	Balkan	Commonwealth of Independent States

Data: IMF Working Paper No. 05/68.

In the absence of markets

Post-Soviet output declined as markets and the memory of market institutions had disappeared and conflicts prevailed.



Data: IMF Working Paper No. 05/68.

Anarchy and dictatorship

The results can also be interpreted in the framework developed by Simeon Djankov and others in the 2003 study *The New Comparative Economics*. This framework assumes that all societies face the two opposing dangers of disorder/anarchy and dictatorship. On the one hand, disorder leads to the risk of private expropriation; on the other hand, dictatorship entails the risk of expropriation by the state or its agents. Institutions provide a means to control these two risks. In the transition economies, the dissolution of the command-based economic system reduced the risks of adverse state actions. However, it initially resulted in a high degree of economic disorganization, some of which continued even when markets began to work, thus heightening the risks of adverse private actions. The framework suggests that compared with the CIS econo-mies, the Visegrad countries, as well as the Balkan and Baltic countries, incurred lower costs of both government and market failures. ■

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This article is based on IMF Working Paper No. 05/68, *Who Is Still Haunted by the Specter of Communism? Explaining Relative Output Contractions Under Transition.* Copies are available for $15.00 each from IMF Publication Services. Please see page 264 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

Indonesia looks to keep pace with dynamic Asia

Indonesia has come a long way since the 1997–98 financial crisis. While its recovery lagged that of its Asian neighbors, per capita income recovered to its precrisis level last year, and the economy is growing at a 5½–6 percent pace this year. Macroeconomic stability has been broadly maintained and, encouragingly, investment is showing signs of rebounding after several years of sluggish growth. While important challenges remain, hopes are running high that the country's new government will continue to steer the economy successfully toward high and sustained growth, which will help reduce unemployment and poverty.

With around 220 million inhabitants, Indonesia is Southeast Asia's most populous country and has the region's highest GDP ($260 billion in 2004). With real GDP growth averaging 6 percent a year from 1970–96, the country had earned a place among the "Asian tigers," but underlying this was a web of well-connected industrial groups financed in large part by directed lending from state-owned banks, and a corporate sector that had borrowed heavily in largely unhedged foreign currency.

When the crisis engulfed much of Asia, Indonesia was the worst affected among the crisis-stricken economies. Real GDP contracted by 13 percent in 1998, and by July 1998 the rupiah had depreciated by 80 percent from the previous year and inflation had accelerated to 70 percent a year. There were large-scale defaults by corporate borrowers, and a general loss of confidence in the banking system resulted in bank runs.

In late 1997, Indonesia turned to the international community for help in bolstering its reserves and restoring investor confidence. Initial IMF support came in the form of a Stand-By Arrangement in November 1997, with two successive Extended Arrangements supporting deep-seated structural reforms. Progress was uneven, however, with slippages in economic reforms and a prolonged political crisis that culminated in the impeachment of President Wahid in July 2001.

Indonesia	2001	2002	2003	2004	Proj. 2005
			(percent change)		
Real GDP	3.8	4.4	4.9	5.1	6.0
Domestic demand	5.0	2.4	2.4	10.3	8.0
Gross fixed investment	6.5	4.7	1.0	15.7	14.5
			(percent of GDP)		
Central government balance[1]	–3.2	–1.5	–1.9	–1.4	–1.0
Central government debt	76.4	68.0	59.3	54.0	49.4
Total external debt	81.0	65.7	56.8	53.2	48.0

1The figure for 2005 includes discretionary measures of 0.5 percent of GDP.
Data: Indonesian authorities and IMF staff estimates.

In July 2001, Megawati Sukarnoputri (then vice-president) was appointed president, and her new economic team pledged to intensify economic reforms. Indeed, the new government provided renewed momentum, and important advances were made in establishing macroeconomic stability and implementing structural reforms, including substantial fiscal consolidation and recapitalization and restructuring of the banking sector. In December 2003, Indonesia graduated successfully from IMF financial support. Since then, the IMF has been engaged in "post-program monitoring"—designed to foster a close policy dialogue—and has continued to provide extensive technical assistance and training.

Continued improvement

Although growth has been slower than in neighboring countries, Indonesia's growth momentum has continued unabated since 2001. In 2004, real GDP grew by 5.1 percent—the highest since the crisis—and investment made a major comeback, increasing by some 15 percent. Inflation remained stable at about 6½ percent, the stock market gained almost 50 percent, and public debt, which peaked at 98 percent of GDP in 2000 as a result of the bailout of the banking system, declined to just over 50 percent (see table).

In 2004, the country also underwent a historical political transition, holding its parliamentary elections and then choosing its first directly elected president, Susilo Bambang Yudhoyono. Despite worries, both the parliamentary and presidential elections were completed peacefully. The new government took office in October 2004, with an economic strategy focusing on maintaining macroeconomic stability and further improving the investment climate.

But amid all the positive developments, the country suffered a devastating earthquake and tsunami at the end of 2004. Despite this setback, the new government has moved ahead with the economic reforms initiated by its predecessor, aimed at placing Indonesia on a high and sustained growth path and reducing unemployment and poverty. At the same time, the government formulated a blueprint for reconstruction of the tsunami-affected regions.

Toward deeper reforms

Positive trends have broadly continued in 2005, but risks have emerged. Real GDP in the first half of the year was 5½ percent higher than in the same period of 2004. Foreign direct investment approvals, while coming off a low base, were up by 70 percent over the same period. Real GDP growth is expected to be in the 5½–6 percent range for the year as a whole, and is expected to increase to 6–7 percent a year over the medium term on the assumption that the government can implement its economic agenda as planned. Although 12-month inflation is projected to tick up to 8 percent by the end of 2005, over the medium term it is targeted to converge to trading partner countries' inflation rates.

On the fiscal policy front, the government plans to cut the deficit to around 1 percent of GDP this year to further reduce the public debt burden, while focusing on improving tax collections and enhancing the efficiency of government spending. To this end, the government increased domestic fuel prices by an average of about 30 percent in March, although international prices have continued to rise rapidly since then, eroding the expected benefits to the budget.

Indeed, the sharp increase in oil prices has not only raised the cost of fuel subsidies for the budget but has also led to a large increase in the oil import bill, with domestic supply constrained by declining production on account of weak investment in recent years and aging oil fields. The current account surplus has therefore been narrowing, putting pressure on the foreign exchange market. With the central bank seeking to limit the depreciation of the rupiah, foreign exchange reserves have declined though they remain at comfortable levels.


Supri/Reuters

Rebuilding has begun in tsunami-devastated Banda Aceh.

On the monetary side, Bank Indonesia has taken steps toward establishing a formal inflation-targeting framework. Since July, it has been using the one-month interest rate, instead of monetary targets, as its intermediate operational target. And with inflation higher and exchange rate pressures adding to price pressures, the central bank has gradually raised interest rates. To further strengthen the financial sector, Bank Indonesia is making encouraging strides to bolster risk-based supervision and to upgrade banking regulations toward international standards, and has introduced new asset classification rules. Furthermore, recent management changes at top state-owned banks aim to help improve governance. The authorities have also started scaling back the blanket guarantee on bank deposits introduced during the crisis, replacing it with a limited deposit insurance scheme. And, in June, with an eye on the future, Bank Indonesia announced new regulations to guide the strengthening and consolidation of the banking system.

Boosting investment, curbing corruption

One of the most intensive efforts that the new government has made is to deepen and accelerate steps to improve the investment climate, which is seen as key to enabling Indonesia to respond to the challenges and opportunities presented by Asia's increasing economic importance. To enhance governance, the authorities have recently set up a Corruption Eradication Commission to coordinate and oversee the work of the various government agencies charged with investigating cases of irregularities and corruption, including in state banks and local government offices.

Progress is also being made in other areas. In the energy sector, the government has published a new petroleum strategy designed to revitalize the sector and attract foreign direct investment. Following the successful Infrastructure Summit in January, the government is revising regulations in several areas to encourage private sector participation in infrastructure development. A new investment law aimed at substantially reducing the time needed to start a business is expected to be submitted to Parliament in August. Efforts are also being made to resolve investor disputes. An agreement has been reached in principle in the longstanding dispute between ExxonMobil and Pertamina with regard to the development of the large Cepu oil field.

Challenges ahead

With its vast natural resources, large labor pool, and strategic location in one of the world's most dynamic regions, Indonesia's potential is enormous. The government has made a promising start, but it will be important to maintain momentum, particularly in improving the investment climate. On the macro front, rising oil prices are posing a challenge both to the budget and to the balance of payments. Moreover, the pickup in inflation and exchange rate pressures calls for careful maneuvering of monetary policy.

On the structural front, speedy progress will be important in implementing pending reforms, notably those designed to enhance the legal and judicial systems, transparency and accountability in public institutions, and labor market flexibility. All will play crucial roles in helping Indonesia compete for sustained investor interest in a region where investors have many attractive investment destinations. ■

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Country focus

Bhutan and the pursuit of national happiness

Gross National Happiness—a concept closely identified with the tiny landlocked Himalayan Kingdom of Bhutan—may draw a chuckle, but its four pillars—sustainable and equitable socioeconomic development, environmental conservation, cultural preservation and promotion, and good governance—form a large part of what sensible nations aspire to. This philosophy of holistic development has guided Bhutan now for over three decades of general political stability. This stability—and substantial external assistance, including from its large neighbor India—has fostered measured change, economic growth, modernization, and integration into the international community even as Bhutan has sought to overcome the constraints of a difficult terrain and limited natural resources.

Over the past two decades, real GDP growth has averaged a robust 6 1/2 percent a year, and substantial progress has been made on a number of Millennium Development Goals. Growth was powered by an expansion of the hydropower sector—the backbone of the economy—including the Chukha project in the mid-1980s. And there is considerable additional potential. Indeed, GDP is projected to grow by almost 20 percent in fiscal year 2006/07 as the large 1,020-megawatt Tala hydropower project comes on stream and pushes average annual real GDP growth to 9–10 percent for the remainder of the decade.


Enric Fernandez/IMF

In coming years, Bhutan's growing number of young people will need jobs.

In addition, annual inflation has remained in the low single digits, thanks to the exchange rate peg, at par, to the Indian rupee. International reserves have remained comfortable, although the Royal Monetary Authority guards zealously its convertible currency reserves, the major source of which is external aid since the bulk of exports, including electricity, are directed to India.

Bhutan seems to have done all right, but challenges are looming, including job creation for a young, growing population; management of public debt; and poverty reduction.

Creating jobs. In the coming years, jobless growth is a real possibility. The absorption capacity of the public sector is limited relative to the large number of labor market entrants, mostly high-school leavers. These entrants are unlikely to possess the skills—in areas such as construction and management—that the market demands. Policy action is required to create an enabling environment in which the private sector produces jobs. Creating such an environment will entail streamlining the regulatory regime, liberalizing the trade and foreign direct investment regimes, implementing financial sector reforms, and investing in infrastructure to reduce nonlabor costs.

As for areas in which the private sector can expand, the options are circumscribed. Tourism holds the greatest demonstrated potential, but a rapid, unbridled expansion is unacceptable to Bhutanese society at large. Do high-end tourist resorts hold the key to generating high growth while preserving Bhutan's fragile environment and cultural heritage? Only time can tell.

Managing debt. Other things demand attention as well. Public debt—estimated at 100 percent of GDP at end-2004/05—needs to be monitored. Almost two-thirds of this is for the power sector and in Indian rupees, and should be serviceable from electricity exports to India. With limited avenues for hard currency earnings, debt service for the remainder, in convertible currencies, would require that external aid be available on a timely basis and in adequate amounts. If aid disbursements slip and expenditures are carried out as planned under the Ninth Five-Year Plan, however, there are risks that the resulting domestically financed deficits could create current account pressures and drain reserves.

Reducing poverty. Finally, despite robust growth, poverty remains high. In the 2004 Poverty Analysis Report—the first of its kind—the poverty headcount was 32 percent, with large rural-urban and regional differentials. Growth does not appear to have filtered down enough to raise living standards for all and may have to be supplemented by targeted programs to reduce the overall poverty rate and narrow differences across regions.

Accomplishing all this when the political landscape is undergoing historical change will demand some skill. The Kingdom of Bhutan is in the midst of considering a written constitution that delegates greater authority to elected representatives through the National Assembly. It is certainly hoped that these new arrangements will foster greater happiness for the Bhutanese people. ■

Sanjay Kalra
IMF Asia and Pacific Department

HIPC debt relief (status as of August 18, 2005)

IMF member	Decision point	Completion point	Amount committed	Amount disbursed[1]
			(million SDRs)	
Heavily Indebted Poor Countries (HIPC) Initiative				
Under original 1996 Initiative				
Bolivia	September 1997	September 1998	21.2	21.2
Burkina Faso	September 1997	July 2000	16.3	16.3
Côte d'Ivoire	March 1998	—	16.7[2]	—
Guyana	December 1997	May 1999	25.6	25.6
Mali	September 1998	September 2000	10.8	10.8
Mozambique	April 1998	June 1999	93.2	93.2
Uganda	April 1997	April 1998	51.5	51.5
Total original HIPC			**235.2**	**218.5**
Under the 1999 Enhanced HIPC Initiative				
Benin	July 2000	March 2003	18.4	20.1
Bolivia	February 2000	June 2001	41.1	44.2
Burkina Faso	July 2000	April 2002	27.7	29.7
Burundi	August 2005	Floating	19.3	0.1
Cameroon	October 2000	Floating	28.5	5.5
Chad	May 2001	Floating	14.3	8.6
Congo, Democratic Republic of the	July 2003	Floating	228.3[3]	2.3
Ethiopia	November 2001	April 2004	45.1	46.7
Gambia, The	December 2000	Floating	1.8	0.1
Ghana	February 2002	July 2004	90.1	94.3
Guinea	December 2000	Floating	24.2	5.2
Guinea-Bissau	December 2000	Floating	9.2	0.5
Guyana	November 2000	December 2003	31.1	34.0
Honduras	June 2000	April 2005	22.7	26.4
Madagascar	December 2000	October 2004	14.7	16.4
Malawi	December 2000	Floating	23.1	11.6
Mali	September 2000	March 2003	34.7	38.5
Mauritania	February 2000	June 2002	34.8	38.4
Mozambique	April 2000	September 2001	13.7	14.8
Nicaragua	December 2000	January 2004	63.5	71.2
Niger	December 2000	April 2004	31.2	34.0
Rwanda	December 2000	April 2005	33.8[4]	37.5
São Tomé and Príncipe	December 2000	Floating	—	—
Senegal	June 2000	April 2004	33.8	38.4
Sierra Leone	March 2002	Floating	98.5	66.0
Tanzania	April 2000	November 2001	89.0	96.4
Uganda	February 2000	May 2000	68.1	70.2
Zambia	December 2000	April 2005	468.8	508.3
Total Enhanced HIPC			**1,609.5**	**1,359.2**
Combined total			**1,844.8**	**1,577.7**

Definitions

Decision point: Point at which the IMF decides whether a member qualifies for assistance under the HIPC Initiative (normally at the end of the initial three-year performance period) and decides on the amount of assistance to be committed.

Completion point: Point at which the country receives the bulk of its assistance under the HIPC Initiative, without any further policy conditions. Under the Enhanced HIPC Initiative, the timing of the completion point is linked to the implementation of pre-agreed key structural reforms (that is, floating completion point).

[1]Includes interest on amounts committed under the Enhanced HIPC Initiative.

[2]Equivalent to the committed amount of $22.5 million at decision point exchange rates for March 17, 1998.

[3]Amount committed is equivalent to the remaining balance of the total IMF HIPC assistance of SDR 337.9 million, after deducting SDR 109.6 million representing the concessional element associated with the disbursement of a loan under the Poverty Reduction and Growth Facility following the Democratic Republic of the Congo's clearance of arrears to the IMF on June 12, 2002.

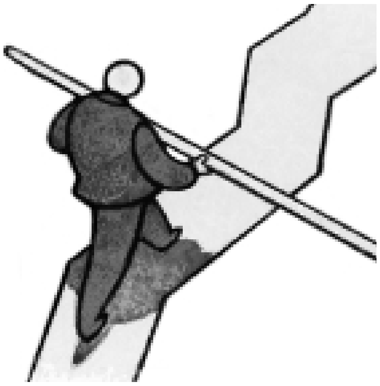
[4]Excludes commitment of additional enhanced HIPC assistance of SDR 12.98 million subject to receipt of satisfactory financing assurances from other creditors.

Data: IMF Finance Department.

Getting the balance right

For an international institution like the IMF, maintaining legitimacy as an organization that is useful to, and representative of, its global membership is key. But as Carlo Cottarelli, Deputy Director in the IMF's Policy Development and Review Department, points out, there is often a trade-off between legitimacy and efficiency. "Governance structures aimed at enhancing the institution's legitimacy may reduce its operational efficiency," he says in a new Working Paper (these papers do not necessarily represent the views of the IMF).

IMF staff and management face this trade-off every day when providing economic advice, technical assistance, and financial support to the institution's 184 member countries. According to Cottarelli, "evenhandedness in the treatment of member countries is seen as a critical requirement for the IMF as it seeks to maintain its legitimacy. And yet, economic conditions do differ across countries. Thus, it stands to reason that efficiency requires selectivity—applying certain procedures or approaches only to the countries that need them."



Greg Hargreaves/Images.com

Special treatment

Striking the right balance between efficiency and legitimacy has not always been easy. In fact, there has been a trend away from selectivity in recent years, with countries resisting "special treatment." Take the example of surveillance, the IMF's framework for providing policy analysis and advice. IMF staff currently apply broadly the same formula to all countries, covering fiscal, monetary, external, and structural policies. Attempts to focus more narrowly on issues that are particularly relevant to a given country have been resisted by countries who dislike being "singled out." Other programs, such as the standards and codes initiative and the financial sector assessment program, are also offered to all countries, as is debt sustainability analysis, introduced by the IMF following the emerging market crises of the late 1990s.

Just what the doctor prescribed

Applying the same procedures to all countries may help ensure legitimacy, but it is costly. And, like all other organizations, the IMF is subject to resource constraints. So what can be done? The trick, Cottarelli says, is to define transparent and objective criteria for selecting certain topics for certain countries. He likens his approach to going to your doctor for a general physical exam. "Only a standard battery of tests is run for everybody. More in-depth work is done only once the initial screening process shows areas of risk," he explains.

Revisiting the division of labor between the IMF and other international economic institutions, such as the Organization for Economic Cooperation and Development and the World Bank, might also be worth considering, but this is likely to be more controversial. Some observers have, for instance, proposed that the IMF reduce its engagement with advanced economies.

Will the IMF manage to find a better balance between legitimacy and efficiency? After years of expansion resulting from the growth in membership associated with the end of colonialism and the collapse of the Soviet bloc, and from a series of financial crises, the IMF is now faced with a tighter budget. This is likely to exacerbate the dilemmas facing the Fund as it seeks to redefine its mission in the 21st century. ■

Copies of IMF Working Paper No. 05/107, *Efficiency and Legitimacy: Trade-Offs in IMF Governance*, are available for $15 each from IMF Publication Services. See this page for ordering information. The full text of the paper is also available on the IMF's website (*www.imf.org*).

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