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IMF Institute seminar

Mishkin weighs merits of monetary options in developed and emerging market countries

In an October 6 seminar at the IMF Institute, Fredric S. Mishkin of Columbia University examined what has worked—and not worked—in monetary policy regimes. He relied heavily on a case study approach, he explained, because in determining the effectiveness of monetary policy design, the "devil is in the details." He explored the relative strengths and drawbacks of regimes built around exchange rate, monetary, and inflation targets, and questioned the longer-term suitability of the "just do it" approach in the United States.

Fredric Mishkin

In particular, Mishkin assessed the different benefits of "nominal anchors" available to emerging market countries. Full public awareness of the nominal anchor, which is the goal of monetary policy, brings transparency and accountability to the policymaking process, he said. And this, in turn, can constrain discretionary monetary policies that produce "time-inconsistency" problems—short-term decisions that lead to less desirable long-run outcomes.

Two themes in Mishkin's presentation highlighted the importance of country-specific circumstances that lie outside the traditional purview of monetary policy. First, political economy considerations are increasingly crucial elements in the design of successful monetary policy. Institutions need to achieve a high degree of transparency and accountability, but this will mean attuning the design of these institutions to the history and dynamics of the domestic political setting. Second, effectively communicating monetary policy strategy to the public is another key prerequisite for success. This, too, will (Please turn to the following page)

Group of 20

Financial leaders pledge to cooperate in meeting policy challenges of twenty-first century

The Group of 20 finance ministers and central bank governors met in Montreal on October 24–25 to discuss the state of the world economy, associated policy challenges, and ways to address potential weaknesses in the international financial system. IMF Managing Director Horst Köhler participated in the meeting. In a statement released on October 25, ministers and governors welcomed "the continuing strengthening of global economic growth," but said they remained "mindful of the importance of sound national and economic and financial policies in building an international financial system that is less prone to crisis."

While reaffirming their belief in economic integration and the powerful benefits of globalization, including "an unparalleled opportunity to achieve sustained and broad-based improvements in living standards," the financial leaders (Continued on page 357)

Picture not available

Paul Martin (center), Canadian Finance Minister and chair of the Group of 20 meeting in Montreal, is flanked by (from left): Hans Eichel, Germany's Minister of Finance; Xiang Huaicheng, China's Minister of Finance; Peter Costello, Australia's Treasurer; and Pedro Sampaio Malan, Brazil's Minister of State for the Economy.

Mishkin discusses merits of monetary options

(Continued from front page) require tailoring the means of communication to individual country circumstances and needs.

Exchange rate targeting

Exchange rate targeting entails "importing" the monetary policy of a large, stable trading partner. Typically, the exchange rate is pegged at a given rate of exchange to that of the partner and adjusted over time to account for inflation differentials. Exchange rate targeting anchors the public's inflation expectations to that of a low-inflation country, and the automaticity of the policy mitigates the time-inconsistency problem by removing discretion. Moreover, the targeted exchange rate is transparent and understood by the public. During the early and mid-1990s, many European countries used exchange rate targeting to successfully reduce inflation.

A loss of monetary policy independence is the main disadvantage of exchange rate targeting.

A loss of monetary policy independence is the main disadvantage of exchange rate targeting. In 1990, for example, an increase in German interest rates—aimed at stemming postunification inflationary pressures—was shifted to fellow members of the European Exchange Rate Mechanism such as France and the United Kingdom, even though inflation in these two countries was low and stable at the time. For emerging market countries, the loss of independence can be less costly—even advantageous—since they would often be better off with somebody else's monetary policy if their own domestic political setting were less supportive of price stability.

The costs of financial crises driven by exchange rate devaluations, however, are a serious downside of exchange rate targeting for emerging market countries. A fixed exchange rate can increase vulnerability to a crisis by encouraging capital inflows to take advantage of a "one-way" bet against the currency—a bet that pays off when the crisis hits, as it did in the United Kingdom in 1992 and in east Asia in 1997. These capital inflows can lead to a high level of foreign corporate debt and, after a fixed exchange rate is abandoned, to much larger debt-servicing costs for domestic corporations. The resulting corporate distress can exacerbate the contractionary effect of the crisis, sending the economy into a recessionary spiral.

Mishkin also raised a more subtle disadvantage of exchange rate targeting for emerging market countries. In industrial countries, deep and liquid bond markets provide quick signals to policymakers—U.S. President Bill Clinton early in his tenure is said to have complained that 29 bond traders had more influence over monetary policy than he did. In emerging market countries, however, bond markets are shallow, and a flexible exchange rate can serve to signal concern with government policies and provide market discipline. A fixed exchange rate removes this disciplinary function.

Currency crises can be avoided through the use of a "hard peg," which serves as a more rigid exchange rate anchor. Under a currency board arrangement, for example, the central bank commits to exchanging a unit of domestic currency for a larger, more stable currency, as Argentina has done with the U.S. dollar. "Dollarization" is the wholesale adoption of the dollar by another country as its domestic currency, as Ecuador recently did. Neither arrangement is a panacea: currency boards are still subject to speculative attacks, as evidenced by domestic interest rate spreads, and output volatility can be high. A successful peg requires an independent central bank, a sound financial system, and a strong fiscal position. The bottom line, Mishkin observed, is that hard pegs may be the only feasible strategy in a setting of relatively weak political and financial institutions.

Monetary targeting

Monetary targeting is the use of a specific monetary goal as the nominal anchor. By announcing the target ahead of time, a central bank can easily hold itself accountable for policy. Money is understandable to the public and provides an immediate signal. In addition, the money target can be tailored to counter domestic shocks.

Instability in the relationship between money and inflation and output is the main disadvantage of a money target, Mishkin pointed out, as exemplified by the comment of former Governor John Crowe of Canada: "We didn't abandon the monetary aggregates, they abandoned us!" In addition, monetary aggregates can be difficult for the central bank to control with the policy instruments at hand. For these reasons, according to Mishkin, strict monetary targeting has not been seriously pursued.

In fact, Germany's and Switzerland's success with monetary targeting reflected a flexible and pragmatic approach to monetary policy. In practice, it was, Mishkin suggested, perhaps closer to inflation targeting than monetary targeting. Indeed, Germany missed more than half of its target ranges but was able to use money targets to communicate strategy and shift the attention of the public to long-run policy issues. On the grounds that monetary policy should not be either

"too rich or too thin," however, he argued that German policy was overly conservative—more concerned with overshooting than undershooting targets.

Inflation targeting

Inflation targeting is gaining popularity, even among emerging countries, as exchange rates become harder to defend and money more difficult to target, Mishkin said. The two key elements of inflation targeting are public announcement of a medium-term inflation target and enhanced transparency to provide maximum accountability for policy actions. Also important are an institutional commitment to the target and a policy strategy that utilizes all available information.

The high degrees of transparency and communication that are part and parcel of inflation targeting are an important advantage, according to Mishkin. In addition, inflation targeting allows the central bank to focus on domestic considerations and tends to frame policy debates on long-run inflation, thus reducing political pressures to inflate in the short run. Sweden's and Canada's adoption of inflation targeting, for example, shifted public discussions from whether interest rates should be adjusted today to promote growth to how policy should be designed to reduce inflation over the long haul.

Assessments of inflation targeting often overstate the disadvantages, Mishkin suggested. He pointed out that the price stability achieved under inflation targeting has boosted long-run economic growth, not constrained it, as some have argued. Further, inflation targeting has not amplified output volatility, because in practice the policy has been flexible. Mishkin argued that inflation targeting effectively focuses policy on long-term inflation objectives while retaining the scope needed to offset short-run shocks. He described this best-of-both-worlds regime as "constrained discretion" and concluded that it largely ameliorated the time-inconsistency problem.

Mishkin cautioned, however, that inflation targeting does have shortcomings, especially for emerging market countries. The long lags between policy actions and their impact on inflation can weaken policy accountability. While inflation targeting can highlight the risks posed by fiscal profligacy, it does not guarantee a better fiscal performance. Moreover, the emerging market countries that are employing inflation targeting often have volatile exchange rates and weak banking systems that can threaten the inflation objective.

So far, developed countries' experiences with inflation targeting have been quite positive. Output has not been dampened, Mishkin explained, because inflation targets have generally not been set too low. Gradual disinflation and flexible policies, including the accommodation of supply shocks, have forestalled output volatility. For example, before adopting inflation targeting in the early 1990s, Australia traditionally responded to an exchange rate depreciation by tightening monetary policy. When the Asian crisis hit in 1997, however, Australia eased monetary policy, thereby helping maintain growth despite the regional recession. Finally, inflation targeting has improved transparency and communication. The independence granted to the Bank of England in 1997, for example, greatly improved its accountability. But Mishkin hastened to add that inflation targeting is not a magic bullet for countries that start out with relatively high rates of inflation: the growth costs of disinflation do not seem to be reduced under inflation targeting.

Inflation targeting is gaining popularity among emerging market countries. Mishkin noted that Chile successfully used inflation targeting to disinflate during the 1990s, although he suggested the policy could be more transparent and less focused on exchange rate developments. Brazil adopted inflation targeting remarkably quickly during 1999, but Mishkin indicated that fiscal policy and central bank independence need to be shored up to ensure the new regime's success. Mexico and Peru are moving toward full-fledged inflation targeting. The experience of emerging market countries, Mishkin underscored, indicates that sound banking systems and fiscal discipline are crucial to successful inflation targeting.

The "just do it" approach

The last anchor Mishkin covered was what he described as the "just do it" approach of the United States. U.S. policy, he said, uses an implicit, not explicit, nominal anchor in the form of an overriding concern by the U.S. Federal Reserve under Alan Greenspan, supported by the President and the Treasury, to control inflation in the long run. Signs of future inflation are met with periodic "preemptive strikes" by monetary policy.

This approach has produced an excellent macroeconomic performance, with low and stable rates of inflation, but Mishkin maintained that U.S. monetary policy should be fixed even though "it ain't broke." He observed that in contrast to other countries, U.S. monetary policy is not transparent, the public is more exposed to inflation scares, and public discussion focuses on short-term rather than long-term issues. The success of the "just do it" approach hinged, he argued, on the high quality of policymakers at the Fed and the Treasury—something that cannot be guaranteed to last. The time is right, Mishkin suggested, for the United States to lock into today's low inflation rate by taking irreversible steps toward a formal inflation targeting regime. ■

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Training seminars

China and IMF work together to strengthen statistics in economic analysis and policy

As part of the technical cooperation program between the IMF and China, the IMF's Statistics Department, together with the People's Bank of China and the Ministry of Finance of China, held two training seminars simultaneously in China and in Washington, D.C., during the last two weeks of August. The seminars were funded jointly by the Chinese authorities and Japan's administered account, under which Japan contributes to the IMF's technical assistance activities.

Carol Carson (center) Director of the IMF Statistics Department; and Wang Xiaoyi (right), DIrector of the Statistics Department, People's Bank of China, at the statistics seminar in Chongqing, China.

Macroeconomic statistics for users

The seminar on macroeconomic statistics for users, which was held in Chongqing, China, on August 29–31, was the first training activity in statistics under the auspices of the recently established Joint China-IMF Training Program. The seminar, first proposed by a multisector statistics mission that visited Beijing in 1998, was aimed at Chinese agencies involved in producing and using macroeconomic statistics. The objective was to introduce high-level officials to the uses of macroeconomic statistics in economic analysis and policy formulation by highlighting the role of sound statistical frameworks and the statistical linkages among the various economic sectors. Thirty officials representing 11 Chinese government agencies involved in data compilation and policy issues attended the seminar, which received strong support from the Chinese authorities. The seminar also received wide media coverage—on the front page of China *Financial News*, on China Xinhua News Agency's Chongqing website, and on prime-time local TV—all emphasizing the importance of producing macroeconomic statistics in accordance with international standards and the crucial role of these statistics in policy decision and formulation.

The three-day seminar opened with a lecture by Carol Carson, Director of the IMF's Statistics Department, on data quality and Chinese statistics. This set the stage for subsequent lectures and discussions on national accounts, including measures of GDP and prices, balance of payments, government finance, monetary statistics, the linkages among the four macroeconomic accounts, and the uses of these statistics for policy analysis and formulation. Many participants noted that the seminar had increased their familiarity with and appreciation of macroeconomic statistics and underlined the importance of compliance with internationally recognized standards and methodologies. They suggested that another seminar of this kind be organized for senior policymakers, whose participation and support would play a key role in further developing China's statistical systems. In his closing remarks, Wang Xiaoyi, Director of the People's Bank of China's Statistics Department, stressed the importance of sound methodology in the compilation of macroeconomics statistics and expressed the hope that China would satisfy the prerequisites for the country's participation in the IMF's General Data Dissemination System in the near future.

Social security system in China

The two-week seminar on government finance statistics and social security was held in Washington and attended by a group of 33 Ministry of Finance officials from Beijing and 24 regions. The purpose of the seminar was to discuss statistical reporting on the operation of the Chinese social security system using the IMF's government finance statistics (GFS) methodology, which is the internationally accepted standard for fiscal reporting.

Lectures by staff of the Government Finance Division covered the reporting methodology of the current and the revised *Government Finance Statistics Manuals*. Staff from the U.S. Social Security Administration, the Canadian Human Resources Development Department, and Statistics Canada illustrated the operation of the U.S. and Canadian social security systems. Participants were also provided with an outline of the analytical and policy implications of social insurance program design.

Wei Benhua, IMF Executive Director for China, addressed participants on IMF operations, emphasizing the importance the IMF places on transparency and the availability of timely and reliable statistical information that accords with international standards.

The leader of the Chinese delegation, Dai Bohua, Deputy Director General of the Policy and Program Department, Ministry of Finance, evaluated the Chinese social security system in terms of GFS defini-

tions. In its current form, the Chinese "unified basic system" of social insurance, comprising the "social pooling" and "individual accounts" components, meets the criteria for classification as a GFS social security system, he noted.

The Chinese system includes a number of schemes, administered by different ministries, providing pension, health, unemployment, housing, and family support social insurance that are imposed and controlled by the government. They provide social benefits to large sections of the community and generally involve compulsory contributions. Participants noted that the current system in China was undergoing continuous review and that over the next few years the authorities would continue to explore options to shore up its financial viability. The Chinese authorities are expected to begin reporting social security data for publication in next year's *Government Finance Statistics Yearbook.* ■

IMF Statistics Department

Group of 20 members issue pledge to cooperate

(Continued from front page) agreed that globalization, like any economic transformation, "can also give rise to economic difficulties and social dislocations." The ministers and governors therefore agreed "that putting in place the right frameworks and policies for promoting a globalization process that works well for all of its participants will be the key challenge for the international community in the twenty-first century."

Meeting the challenge

Pledging to work together to promote policies to meet this challenge, the finance ministers and governors of the Group of 20 specifically agreed to

- commit themselves to further improve the effectiveness of international institutions, which are fundamental to a strong and stable global financial system;
- implement the emerging international consensus on policies to reduce countries' vulnerability to financial crisis, including through appropriate exchange rate arrangements, prudent liability management, private sector involvement in crisis prevention and resolution, and the adoption of codes and standards in key areas;
- improve integration into the globalized financial world;
- create more favorable conditions for the integration of heavily indebted poor countries (HIPC) into the global economy by urging both bilateral and multilateral creditors to participate fully in the enhanced HIPC Initiative;
- strengthen efforts to combat financial abuse, including money laundering, tax evasion, and corruption, given its potential to undermine the credibility and integrity of the international financial system;
- contribute to international efforts to increase the provision of other global public goods to address serious issues, such as infectious disease, agricultural research, and the environment, which cut across national borders and require concerted global cooperation;
- support continued efforts by the World Trade Organization to build a consensus toward further multilateral trade liberalization and a strengthening of trade rules that would bring broad-based benefits to the global economy by reflecting the needs and interests of both developed and developing countries;
- promote the design and effective implementation of social safety nets that protect the most vulnerable groups of society in the process of liberalization; and
- ensure that efforts in the areas identified above, and in other areas, take account of a diversity of perspectives.

Financial crises

In an annex to the statement, the Group of 20 finance ministers and governors welcomed the movement by many countries toward exchange rate arrangements that are "more supportive of financial stability." The IMF, the statement said, "plays a key role in advising and supporting countries in this area" and should "reinforce its assessment of the compatibility of members' exchange rate regimes with their macroeconomic and financial policies." The IMF should also "encourage countries to adapt their policies by giving them advice and support, when appropriate, to help avoid unsustainable positions." ■

The full text of the statement, as well as related material on the Group of 20, is available on the Group of 20's website (www.g20.org/indexe.html).

Group of 20

The Group of 20 was created in September 1999 to provide an international forum for industrial countries and emerging market economies to discuss and review policy issues, with a view to promoting international financial stability.

Member countries of the Group of 20 include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union. The IMF Managing Director and the President of the World Bank, as well as the chairs of the International Monetary and Financial Committee and the Development Committee of the IMF and the World Bank, participate fully in the discussions.

Paul Martin, Finance Minister of Canada, chaired the meeting in Montreal.

Economic and social implications

Faced with large human losses, Swaziland focuses on controlling HIV/AIDS epidemic

When an IMF mission visited Swaziland for the annual Article IV consultation in April 2000, it discussed with the authorities the economic and social implications of the HIV/AIDS epidemic that the country is experiencing. This article highlights some of the issues that emerged during the visit, such as the scale of the demographic impact, the impact on the public and private sectors, and government strategies to combat the epidemic.

Picture not available

King Mswati III of Swaziland (right) learns about AIDS medications from A. Cornelius Baker (left), Executive Director of the Whitman-Walker Clinic in Washington, D.C., and Peter Metaxotos (center), the clinic's Director of Pharmacy.

Demographic impact

Swaziland, along with Botswana, South Africa, and Zimbabwe, is one of the countries most seriously affected by HIV/AIDS (see table, page 359). The Joint United Nations Program on HIV/AIDS (UNAIDS) estimates that, by the end of 1999, about 130,000 Swazis (out of a total population of less than a million) were infected with HIV, which represents an HIV prevalence rate of 25 percent in the working-age population (ages 15–49). HIV prevalence rates among young adults (ages 15–30) are reported to be even higher than the aggregate prevalence rate of 25 percent reported by UNAIDS. Thus, the share of this generation that will become victims to AIDS will exceed the aggregate prevalence rate.

About 7,100 Swazis died of AIDS in 1999. Because of the disease's long incubation period, this number is expected to rise over the next few years and to remain at high levels, even if the number of new infections can be reduced. For the period 2004–07, the Swazi government projects that about 60 percent of all deaths will be AIDS-related. According to the U.S. Bureau of the Census, by 1998, life expectancy at birth in Swaziland had fallen to 39 years; it would be 58 years if the country were not experiencing an AIDS epidemic. To date, 12,000 Swazis have been orphaned because of AIDS, and the government projects that the total number of underage AIDS orphans will rise to 120,000 (about 10 percent of the population) by 2010.

Rising demand for health services

There is no comprehensive study of the impact of HIV/AIDS on the health sector in Swaziland. However, the IMF staff estimates, on the basis of studies of other countries in the region, that the demand for health services created by HIV/AIDS amounted to about 1 percent of GDP in 1999 and may rise to about 1.5 percent of GDP in the near term, as more Swazis fall ill. This compares with a total health budget of 2.2 percent of GDP during 1994–98. The health sector, however, appears to be unable to cope with this rapidly increasing demand for services and has had to scale back services to the less serious cases and the terminally ill. Thus, actual health expenditure on HIV/AIDS is likely to be lower than estimates of the AIDS-related demand for health services.

In 1998, 80 percent of hospital inpatients were HIV positive, and rising mortality rates in the region suggest that the overall quality of health services is declining. At the same time, health service employees themselves are becoming infected with HIV/AIDS, and it will be difficult to train enough doctors and nurses to replace them.

Teacher shortage

The HIV/AIDS epidemic affects both the demand for education and the supply of teachers. In spite of the epidemic, however, the Ministry of Education estimates that the number of pupils in primary and secondary schools will rise from 308,000 in 1998 to 353,000 in 2010, while the pupil-teacher ratio has risen to 40 in 2000 from 34 in 1997. In order to return to and maintain a ratio of 34 pupils for each teacher, the number of teachers will have to increase by 4,130 (to 12,450) by 2010. At the same time, 5,650 more teachers will be needed to replace those who succumb to AIDS.

The total cost of training additional teachers to replace the AIDS victims will amount to $17 million, or $1.5 million a year. Additionally, the Ministry estimates the costs of sick leave and death benefits, including pensions for surviving dependents, at an average total of $7.1 million a year until 2010. Thus, HIV/AIDS is associated with an additional annual cost of $8.6 million in the education sector, which is equiv-

alent to 12.7 percent of the recurrent education budget for the 1999 academic year, or 0.7 percent of GDP in 1999. This cost does not include additional funds that will be needed to maintain access to education for the rising number of orphans.

Decline in quality of public services

In general, as mortality rates among public sector employees rise, the quality of public services is likely to deteriorate. If the HIV prevalence rates in the public service are similar to those in the population as a whole, it means that about 1 in 60 government employees died of AIDS in 1999. As the epidemic evolves, this rate could increase to 1 in 40 or worse. This trend is causing disruptions of services, losses of experience and skills, and considerable outlays for sick leave, death benefits, and training of new employees. Taking into account the increased demand for government services, especially in the health sector, and the costs associated with the increasing mortality rates of government employees, fiscal costs of 2–3 percent of GDP (up to 10 percent of total government expenditure) related to HIV/AIDS seem plausible.

Impact on the private sector

The HIV/AIDS epidemic is lowering the supply of labor, raising production costs, and reducing productivity. Some companies in the formal sector would be able to replace employees who have died of AIDS by recruiting workers from the informal sector. However, it would be impossible to replace the most highly educated, and a shortage of well-qualified employees is consequently developing.

To maintain a constant supply of highly skilled labor, training and higher-education facilities will have to expand significantly, at a time when the number of available teachers is declining as a result of AIDS.

Various Swazi employers have indicated that the HIV/AIDS epidemic has affected their employees at all skill levels. Studies from other southern African countries suggest that the illness and death of an employee could represent total costs of 50–100 percent of the employee's annual salary, depending, for example, on the extent of a company's medical and death benefits.

Companies are taking steps to reduce the costs related to HIV/AIDS, such as screening, preventive measures, and reductions in benefits. For example, companies may become less willing to invest in training or hiring young workers, who are more likely than older workers to contract HIV. Preventive measures include sponsoring education campaigns and distributing condoms to employees.

At the household level, HIV/AIDS is leading to an increase in poverty, because families are frequently unable to compensate for the loss of a principal income earner. Moreover, the scale of the epidemic puts a severe strain on traditional social safety nets; for example, orphans may be left with no close relatives to care for them.

Changes in economic growth and income

Available studies on the impact of the HIV/AIDS epidemic on economic activity agree that rates of GDP growth will decline considerably. For southern Africa, these studies suggest that the rate of GDP growth will fall by 1–2 percent, which compares with a rate of growth of about 3 percent achieved in the region in the late 1990s. The evidence on the impact on GDP per capita is less clear. While reduced saving rates and a drop in productivity have a negative impact on per capita GDP, a decline in the rate of population growth tends to increase per capita income. For Swaziland, the IMF staff estimates that, by 2010, the rate of GDP growth will be about 2 percent lower and the level of GDP per capita 4–5 percent lower than they would be if Swaziland were not experiencing an AIDS epidemic. However, the level of GDP per capita may not be an appropriate indicator of the welfare effects of HIV/AIDS because it does not include the epidemic's many associated costs or its nonmonetary losses. A recent study by Channing Arndt and Jeffrey D. Lewis, for example, estimates that, in South Africa, HIV/AIDS-related private and public expenditure amounts to about 5 percent of GDP. For Swaziland, non–AIDS-related GDP per capita declines by about 10 percent.

Demographic impact of HIV/AIDS in selected southern African countries

	HIV prevalence rate, end-1999[1]	Life expectancy at birth, 1998	AIDS deaths, 1999
Botswana	35.8	40	24,000
South Africa	19.9	56	250,000
Swaziland	25.3	39	7,100
Zimbabwe	25.1	39	160,000

[1]In percent of working-age populations.
Data: UNAIDS and U.S. Census Bureau

Government response

The government was, by its own admission, initially slow to implement policy measures to reduce the rate of new HIV infections. However, a strategy for preventing the spread of HIV through improved education efforts at schools and information events at the community level has now emerged. Although effective prevention campaigns are difficult to implement because of the stigma associated with the illness, attitudes are, to some extent, changing. For example, King Mswati III of Swaziland and senior government officials have stressed the need to bring about a complete reversal in attitude and behavior, and a few high-profile public figures have made it known that they are HIV positive. ■

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Hernando De Soto

Integrating the poor into official legal system can unleash their economic potential

"The hour of capitalism's greatest triumph is its hour of crisis." This warning comes not from Jubilee 2000 or *Das Kapital*, but from Hernando De Soto in *The Mystery of Capital*. The Peruvian economist and author of the best-seller *The Other Path* repeated his warning on September 28 at an event organized by the American Enterprise Institute-Brookings Joint Center for Regulatory Studies.

De Soto suggested that capitalism is at risk because it does not fully utilize the tremendous potential of its largest constituency, the poor. The poor save and accumulate assets like everyone else. What they lack are widespread property rights that would allow them to readily convert their assets into capital. Copying the property rights and formal laws of the West, as some developing countries have done, does not provide the poor with true access to the fruits of capitalism. Why this is the case is the "mystery" De Soto solves in his new book.

De Soto: The assets of the poor cannot be readily turned into capital, widely traded, or used as collateral.

Dead capital

Why can't the poor participate in capitalism? According to De Soto, the poor hold their resources in the form of "dead capital"—that is, capital that cannot be used to its fullest. Though the poor in these countries—a majority of their populations—do save and accumulate assets, their property rights to these assets are not adequately protected, because these rights are recognized only within the limited informal ("extralegal" to use De Soto's favored term) economy within which the poor operate. The assets therefore cannot be readily turned into capital, cannot be widely traded, and cannot be used as collateral for a loan. In short, the wealth of the poor cannot easily be used to produce additional value.

And why don't the poor try to enter the legal economy? The obstacles are daunting, according to De Soto and his research team. They have been crisscrossing the globe documenting the hurdles the poor face in finding a legal job, entering formal business, or acquiring legal housing. The examples are shocking:

- In Haiti, it takes two years to meet the bureaucratic requirements needed to obtain a five-year lease on government land.
- In Peru, the research team spent nine months of nearly full-time work to obtain all the certifications required to register a small-scale garment workshop. The cost of legal registration was over $1,200—30 times the monthly minimum wage.
- In Egypt, registering a lot on state-owned desert land involves over 75 bureaucratic procedures at some 30 public and private agencies. The process can take anywhere from 5 to 14 years.

Faced with these obstacles, the poor develop an alternate extralegal economy using informal arrangements to protect and mobilize their assets. Though such economies are often vibrant, they nevertheless do not make fullest use of the capital that the poor manage to accumulate. De Soto argued that it was a shame to waste the tremendous potential of the poor, people who have shown they have the talent and enthusiasm to eke out an existence from practically nothing.

The U.S. experience

The advanced economies went through a similar stage in their history, De Soto suggested, when the property rights of the poor were ill defined. Take the case of the United States. During its colonial period, English common law proved woefully inadequate to guide the emerging nation. In England, occupying land without having a title to it—"squatting"—was against the law. In the United States, however, squatting on available land quickly became a common practice. George Washington himself, De Soto observed, complained about the *banditti* who had taken over some of his property. The squatters began inventing their own forms of property titles. These extralegal rights were traded, just like official titles (and became the source of legal titles decades later).

Politicians struggled to keep pace with these developments, De Soto said. They tried to dislodge squatters by sending in troops. De Soto noted that in describing one such attack, an observer reported that though the troops "burnt the cabins, broke down the fences, and tore up the potato patches...three hours after the troops

were gone, these people returned again, repaired the damage, and are now settled upon the land in open defiance of the Union." When violence didn't work, piecemeal reform of the formal property system was attempted through the passage of more than 500 different laws to reform the property system. But, according to De Soto, the complicated procedures associated with these laws hampered the goal of putting property into the hands of private citizens.

Over time, sympathy for the rights of squatters increased and forced the U.S. Congress to draft legislation absorbing them into the legal system. One important legal innovation, De Soto explained, was to allow squatters to buy land they had improved before it was offered for public sale. This principle, known as "preemption," became the key to integrating extralegal property arrangements in the United States. In 1862, Congress passed the celebrated "Homestead Act," giving 160 free acres to any settler willing to live on the land for five years and develop it. According to De Soto, this "was less an act of official generosity than the recognition of a fait accompli...." But the Homestead Act had great symbolic value, because it signaled that by embracing the extralegal arrangements of the squatters, "formal law had legitimized itself, becoming the rule for most people in the United States rather than the exception." The experience of many other advanced nations is no different. For instance, De Soto noted that in Switzerland at the turn of the twentieth century, Eugen Huber integrated into one codified law the disparate conventions that protected property in different parts of the country.

Resurrecting dead capital

What are the lessons of the U.S. experience for developing countries? In many of these countries today, the official law has not been able to keep up with popular initiative, and government has lost control, according to De Soto. Thus, the primary lesson of the U.S. experience is that ignoring extralegal arrangements or trying to stamp them out—without a plan to channel these arrangements into the formal legal structure—is a strategy doomed to failure. Instead, De Soto said, the governments in these countries should uncover the existing social contracts on property established by the poor and integrate them into the official law.

This is painstaking work. De Soto and his research team spent months uncovering informal property rights in Haiti's urban areas, where some of the poorest people in the world live and where over half the population is illiterate. Contrary to the predictions of experts on Haiti, De Soto's team found that every owner of an extralegal plot of land, shack, or building had "at least one document to defend his right—even his squatting rights." In other countries as well, the research teams found informal social contracts undergirding property owned by the poor.

Once governments have uncovered information on existing social contracts, they can begin the work of organizing the contracts into temporary formal statutes, comparing informal arrangements with existing formal law, and deciding how each has to be adjusted to build a common regulatory framework for all citizens. According to De Soto, this is how Western law was built, "by gradually discarding what was not useful and enforceable and absorbing what worked." It is also the path followed by Peru between 1984 and 1994, when "formalization" of the assets of the poor became part of the country's political agenda, and legislation and regulations drafted by De Soto's organization were approved by the Peruvian Congress.

De Soto: Ignoring the extralegal arrangements of the poor or trying to stamp them out is doomed to failure.

Role of the IFIs? Iffy, at best

De Soto was dismissive of the role played by international financial institutions (IFIs) in helping the poor acquire property rights. With respect to the work of the IMF, De Soto agreed that stability in foreign exchange markets, free trade, foreign investment, and other remedies in the "Western pharmacopoeia" were beneficial in expanding the formal market sectors in developing countries. But he complained that far too much emphasis was placed on allowing legal businesses and foreign investors to prosper and not enough on making sure that the poor had the means to participate in the expanded market system. De Soto was also critical of the role of the World Bank. Though the Bank funds "titling projects" in countries such as Brazil, De Soto argued that these projects end up as "maps of the physical locations of shanty towns rather than maps of the informal property rights" of the poor. It is the latter that are needed to carry out the task of organizing the formal law around the existing social contracts of the poor.

De Soto concluded that capitalism should be more than an economic system that benefits only the elites "who live inside the bell jars" of developing countries, and globalization should be more than a process of connecting the bell jars across countries. ■

Prakash Loungani
IMF External Relations Department

Need for alternative model

Dooley urges a "fresh look" at assumptions about debt models and nature of sovereign debt

Debt models are simple, but touchy, explained Michael Dooley in an IMF Institute–sponsored seminar on September 15 on the IMF and the private sector. The former member of the IMF's Research Department and current professor of economics at the University of California at Santa Cruz urged staff to reexamine the assumptions that underline IMF debt models and take a fresh look at the nature of sovereign debt. Small changes in assumptions, he said, can make big differences in policy conclusions and prescriptions.

Dooley: His model of sovereign debt suggests that output loss is the enforcement mechanism that makes international lending possible.

According to Dooley, the IMF fashions its debt model from the world's lengthy experience with domestic banking crises. The analogy may not be completely apt, he said, challenging staff to delve more deeply into why money is lent internationally, what enforcement mechanisms make this lending possible, and why international debt contracts are so difficult to renegotiate. The answers to those questions, he said, suggest an alternative model and a different approach to private sector involvement in crisis resolution. While clearly more needs to be done to design better incentives to avoid and resolve crises, several innovative aspects of the recent debt restructurings, notably that of Ecuador's debt, left Dooley somewhat encouraged.

Understanding sovereign debt

All models of sovereign debt, Dooley explained, work backward from an assumed punishment for default. Creditors will not lend unless there are enforcement mechanisms in place to ensure repayment. Traditional debt models posit that the threat of trade sanctions or the loss of access to future credit serves such a function. But Dooley countered that neither of these outcomes has been observed in practice. His model assumed an alternative enforcement mechanism—one that is based on the observation that a sharp decline in output results when debtor countries default. These defaults occur when countries cannot renegotiate contracts quickly, and a collapse of domestic financial intermediation then ensues. This breakdown, which customarily impairs the usefulness of a country's entire capital stock, provides a powerful incentive for debtor governments to avoid default.

Dooley also observed that in developing countries, private debt is really two instruments—one in which all goes well and the debt will be repaid by the borrower and another in which things go badly and costs are socialized. International debt, in effect, is always sovereign in developing countries. And it is important to understand that debt contracts only write down what happens in good states of the world. In defaults (bad states), what is written has meaning, but not the meaning that the words seem to imply.

Because debtors want to borrow and creditors want to be repaid, both agree to contracts that are intentionally very difficult to renegotiate. Contracts are written to avoid strategic defaults—instances in which debt could be repaid but is not. The IMF and others make a big mistake, Dooley said, when they assume that contracts are designed to address a "bad luck" state in which the debtor genuinely cannot repay. "That would be nice," he noted, "but it's not the world we live in." Contracts are designed to invoke automatic punishment regardless of the reason for nonpayment. Long, hard renegotiations produce output losses—exports often boom, but the domestic financial system collapses (since other creditors are unwilling to enter a situation in which their position in the repayment queue is uncertain). Output then falls, capital flees, and the country crashes.

In bad luck circumstances, the creditors suffer as well as the debtors, but that, Dooley stressed, is what the system is designed to do. Contracts are not, and cannot be, conditional on luck. And that seemingly unfortunate circumstance is compounded by the current system in which it is neither the borrowers nor the lenders who suffer the loss of output (workers in debtor countries will bear the brunt of lost output) or finance the eventual bailout (taxpayers in debtor countries will essentially pick up the tab for this). This is a distortion of the first order, Dooley contended, but fixing it will require a clearer understanding of what is happening and why.

Finding a fix?

Something is indeed wrong, Dooley said, and, as many have suggested, the problem is one of coordination. But in his model this coordination problem is intended rather than accidental. A third party might be able to distinguish between bad luck and strategic

Photo Credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 353, 354, 360, 361, 362, 363, and 364; Shaun Best for Reuters, page 353; Shawn Thew for AFP, page 358.

defaults, but Dooley doubted that the IMF could fulfill this task. A third party can—as the IMF did in the 1980s during the debt crisis—force banks to roll over debt or provide enough assistance to maintain the status quo and prevent a loss in output. But as the 1980s suggested, waiting does not help. And the major industrial countries do not want the IMF to determine the circumstances in which private lenders should be paid. Dooley concluded that if interference with the private sector's collection processes was not credibly conditioned on the cause of default (and he believed the IMF would never have the political backing to do this), then intervention of this sort would simply reduce international lending to low levels.

According to Dooley, periods of high capital flows are synonymous with instances in which the normal constraints on lending are lifted—either through implicit guarantees (such as the ones industrial countries gave to banks because they wanted oil money recycled) or through access to official credits (such as was the case with eastern Europe and Russia after they joined the IMF). Capital inflows continue until the collateral runs out. Then there is a run on the debtor government. If the debtor government's resources are sufficient to bail out the private sector, a contract renegotiation is not necessary.

Runs should be distinguished from defaults, Dooley cautioned. Korea experienced a large run, but almost no default (because of the size of its bailout), and output loss, though sharp, was short-lived. Indonesia, by contrast, suffered a large run and a massive default because it did not have enough—still does not have enough—official resources for a bailout. Hard thought needs to be given to the relationship between what is expected and what happens, and it will be important to devise a means to forecast whether runs on reserves can lead to financial disruption. That is why, he added, "currency crises are not a big deal in industrial countries and are a big deal in developing countries."

IMF model

The IMF views international financial crises from a different perspective, however, Dooley noted. The IMF—drawing heavily on the conventional wisdom that sees an analogy between domestic bank runs and international financial crises—views liquidity runs and contagion as triggering an overreaction in asset prices and subsequent substantial losses in output. From the IMF's vantage point, then, these seemingly unanticipated—and largely unexplained—shifts in expectations are the culprit. From this, it follows that crises in confidence are inevitable and require a lender of last resort. Moral hazard results, but it is an unfortunate, though acceptable, cost of producing a necessary public good.

This perspective also argues, he said, that crises can be prevented through more effective regulation and better information and through punishment (haircuts) meted out to those at fault. What this view does not account for, Dooley insisted, is why short-term international debt exists in the first place. Ultimately, explanations of why there is international debt return to issues of enforceability and suggest why it is so hard to improve the system by punishing lenders after the fact.

Dooley noted that experience with the Brady bills underscored the fact that creditors managed to draw value from something worth essentially nothing. The conventional response to this state of affairs is to fault collective action clauses, which seem to place unreasonable bargaining power in the hands of creditors. Breaking the capacity to hold out then seems to be the best way to fix the problem. But Dooley was dubious. In his own model, this simply weakened enforcement mechanisms and ultimately reduced international credit levels.

He was more heartened by several recent restructuring agreements that seemed to reduce the incentive for holdouts by making debt not tendered more susceptible to default. In these instances, majority clauses were used to subordinate the debt of holdouts. More promising still, he said, is an element in the Ecuador restructuring agreement that reduces the contractual value of debt but makes this reduction contingent upon the absence of future defaults (in other words, the reduced debt will be added back in the event of a future default). For Ecuador, this amounted to a lot of debt reduction (40 percent) at very little cost. And better yet, it addressed the incentives question that lies at the heart of much of the debt debates, since the contingent clauses substantially increase everyone's incentives to avoid future defaults. This clever means of overcoming distortions, Dooley suggested, may offer a market-based means to distinguish between bad luck and strategic defaults. ■

Dooley: Recent innovative restructuring agreements hold promise.

Africa Forum 2000

Köhler stresses importance of "vibrant" private sector for growth in Africa

Following are edited excerpts from welcoming remarks prepared for delivery by IMF Managing Director Horst Köhler to the World Bank Group–IMF Africa Club in Washington, D.C., on October 30.

Köhler: "The private sector will only invest and develop in an environment where...perhaps above all, the government has made a clear commitment to private sector development."

On behalf of the Executive Board and the staff of the IMF, I would like to welcome you all to Washington, and thank the World Bank–IMF Africa Club for hosting the Africa Forum 2000. My presence here this morning is testimony to the great importance we attach to promoting private sector involvement and development in Africa. Indeed, it is now generally acknowledged that Africa needs the private sector to help it grow, prosper, and reduce poverty.

What is not widely discussed is that the private sector has needs as well. Indeed, as you well know, the private sector will only invest and develop in an environment where macroeconomic policies are sound and predictable; where labor is qualified; where the infrastructure is solid; where the regulatory framework is efficient and transparent; where good governance in corporate and public affairs exists; where there is a judicial system that is fair and accessible to all; and, perhaps above all, where the government has made a clear commitment to private sector development. The IMF is doing its part to bring these elements together through our policy advice, our technical assistance, and our financial support for reform and adjustment programs.

I want to assure you today that the IMF will stay fully engaged in Africa, and will continue to help African countries achieve faster and more sustained growth and reduce poverty. But you and I know that success will not come overnight and that, in spite of the gains achieved in growth rates and per capita incomes in the majority of African countries, many challenges remain. Africa needs higher investment and even higher growth if it

First Annual IMF Research Conference will be held in Washington

The first Annual Research Conference of the IMF will be held in Washington on November 9–10. This conference, which will take place at IMF headquarters, will bring together academic scholars from many institutions and researchers in the IMF to present and discuss papers on various topics of current interest.

As part of the program, the Mundell-Fleming Lecture (named after the economists Robert Mundell and Marcus Fleming) will be delivered by Maurice Obstfeld, professor of economics at the University of California, Berkeley. His topic will be "International Macroeconomics: Beyond the Mundell-Fleming Model." Other papers will deal with issues of monetary and exchange rate policy in international financial crises, private sector involvement in crisis resolution, exchange rate regimes and currency unions, trade, and the effect of IMF and World Bank programs on poverty. The complete conference agenda is available on the IMF website (www.imf.org).

The proceedings of the conference will be covered in a forthcoming issue of the *IMF Survey*.

Economic Forum will discuss issues of currency integration, single currency

Issues of regional currency integration and the possible emergence of a single world currency in the future are to be discussed at an IMF Economic Forum on November 8. The participants in the panel will be Robert Mundell, the Nobel laureate and professor of economics at Columbia University in New York; Maurice Obstfeld, professor of economics at the University of California, Berkeley; and Paul Masson, a Senior Advisor in the IMF Research Department. The moderator will be Alexander Swoboda, Senior Policy Advisor in the Research Department.

Among the issues to be addressed at the forum are current trends in the dollar and euro blocs, as well as the possible emergence of a yen bloc out of current proposals for Asian monetary cooperation and of a currency union among MERCOSUR members in Latin America. These developments lead inevitably to the question of whether the benefits of such economies of scale would then be maximized through the introduction of a single currency for the world.

The proceedings of the forum will be covered in a forthcoming issue of the *IMF Survey*.

wants to be able to reduce poverty and improve the living conditions of its people. Africa must also complete its integration in the globalized world economy to benefit fully from expanding trade and gain access to private foreign capital.

This is where the development of a vibrant private sector is so vital. As I have indicated to the Executive Board, to the staff, and to every African leader I have met, the development of a vibrant private sector, particularly the small and medium-sized enterprises that you represent here today, is essential to growth and poverty reduction in Africa. Let there be no mistake about your importance in this process: you are the engine of growth and prosperity; and you are the ones who will create tomorrow's jobs and tomorrow's opportunities. So it is my hope that this forum will allow you to reinforce existing relationships—and create new ones—with your foreign counterparts and among yourselves, and that together you will contribute to building a stronger Africa, active in the globalized economy.

I would like to conclude by reaffirming the IMF's endorsement and support for the World Bank–IMF Africa Club and to thank you for making this event possible. By joining their efforts to those of Africa's governments and international development partners, and to those of the private sector participants in Africa, you have made concrete the commitment we all share to overcome the many difficulties facing the continent and to help it realize its true potential. ■

Effective January 1, 2001

IMF announces new valuation for SDR, modifies composition of basket

The IMF has announced that on January 1, 2001, changes in the method of valuation of the Special Drawing Right (SDR) will come into effect (as announced in Press Release 00/55, October 12, available on the IMF's website: www.imf.org). The composition of the SDR basket has been modified to reflect the introduction of the euro. The initial weights assigned to each currency in the basket have been adjusted to take account of changes in the share of each currency in world exports of goods and services and international reserves.

On December 29, 2000, the IMF will determine a fixed amount of each currency in the SDR basket based on the initial weights and exchange rates over the preceding three months. These amounts will produce a value of the SDR in terms of the U.S. dollar on that date that is the same under the current and new valuation methods. The IMF is providing interim calculations of the currency amounts every two weeks for the remainder of this year based on exchange rates over the preceding three months to assist users of the SDR in preparing for the changeover to the new SDR valuation.

Illustrative calculation of currency amounts in new SDR basket
(October 27, 2000)

Currency	(1) Initial new weight (share)	(2) Illustrative currency amount	(3) Exchange rate[1] 10/27/00	(4) U.S. dollar equivalent
Euro	29	0.431	0.8327	0.358893
Japanese yen	15	21.0	108.5000	0.193548
Pound sterling	11	0.0969	1.4346	0.139012
U.S. dollar	45	0.585	1.0000	0.585000
SDR1 = US$				1.27645

[1]The exchange rate for the Japanese yen is expressed in terms of currency units per U.S. dollar; other rates are expressed as U.S. dollars per currency unit.

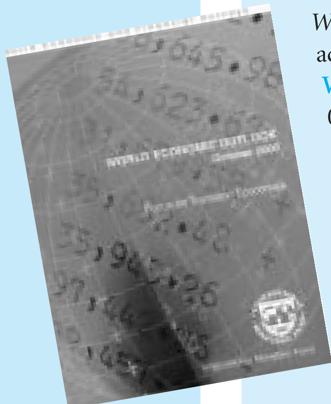
U.S. action on debt relief is welcomed, enables IMF to meet contribution to HIPC

In a news brief issued on October 25, IMF Acting Managing Director Shigemitsu Sugisaki welcomed the action by the U.S. Congress to finance debt relief for the world's poorest countries. The full text of News Brief No. 00/96 is available on the IMF's website (www.imf.org).

Sugisaki particularly welcomed the approval of legislation that will enable the IMF to meet its commitment to provide $2.2 billion toward the Heavily Indebted Poor Countries (HIPC) Initiative. "Faster and deeper debt relief is critical," Sugisaki underscored. "Today's action by the U.S. Congress will ensure that the IMF can finance its commitment to the HIPC Initiative. Without congressional approval, we would not have been able to fully utilize the resources available to us to meet our debt relief goals," Sugisaki said.

The congressional action will enable the IMF to apply to the HIPC Initiative about $800 million, which represents the balance of investment income that would be generated from the IMF's sale of 12.9 million ounces of gold. Previously, the U.S. Congress had authorized use of only a portion of the investment income.

Recent publications



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UNCTAD report

FDI is likely to exceed a trillion dollars in 2000; activity is driven by mergers and acquisitions

Foreign direct investment (FDI) by transnational corporations may surpass one trillion dollars this year, according to the *World Investment Report 2000: Cross-Border Mergers and Acquisitions and Development*, published by the United Nations Conference on Trade and Development (UNCTAD). Cross-border mergers and acquisitions are driving this record FDI activity, according to the report's tenth anniversary edition.

In developed countries, FDI rose to $636 billion in 1999 (from $481 billion in 1998), while FDI to developing countries increased to $208 billion (from $179 billion in 1998), the report states. FDI is the largest source of external financing for many developing countries, which have found it to be more stable—particularly during financial crises—than portfolio investment and bank lending.

Regional picture in 1999

FDI flows to *Africa* rose to $10 billion in 1999 from $8 billion in 1998. This, the report explains, was in line with the faster growth rate generally experienced by the continent during the decade, as governments worked to create a more business-friendly environment. Investments by transnational corporations in Africa are still only 1.2 percent of global FDI flows and 5 percent of total FDI into all developing countries. About 70 percent of FDI in Africa in 1999 was concentrated in only five countries—Angola, Egypt, Morocco, Nigeria, and South Africa. The real challenge for Africa, according to the report, lies ahead: "integration into the global economy, including integration into the regional or global production networks of transnational corporations. Only then will the continent become a more prominent player in the world market and benefit more from FDI."

In the developing countries of *Asia*, investment prospects are good, given the quality of the underlying economic determinants of FDI, the region's recovery from the financial crisis, and ongoing widespread liberalization and restructuring efforts, the UNCTAD report says. Total FDI flows into developing Asia rose considerably last year to almost $106 billion (from $97 billion in 1998), contrary to an anticipated decline following the 1997–98 financial crisis. China's prospects of attracting FDI are seen as good, despite last year's decline of nearly 8 percent to $40.4 billion. This decline reflected slower growth and excess capacity in some manufacturing industries due to overinvestment in the past decade and increased competition from neighboring countries. China is expected to remain an attractive destination for FDI, particularly over the longer term, in the light of its expected accession to the World Trade Organization, the report explains. The decline in FDI to China was more than offset by the FDI boom in the Republic of Korea to $10.3 billion (almost double the $5.2 billion in 1998) and the recovery of flows into Singapore, to $7 billion from $5.5 billion in 1998, and Taiwan Province of China, to $2.9 billion from $222 million in 1998.

Cross-border mergers and acquisitions in south, east, and southeast Asia have become increasingly important, reaching a yearly average of $20 billion during 1997–99. The largest increases have occurred in the five countries most affected by the crisis, whose share of total cross-border mergers and acquisitions in developing Asia jumped to 68 percent in 1998 (from 19 percent in 1996), according to the study.

Foreign investment also increased in *central and eastern Europe* in 1999, with Poland and the Czech Republic attracting record amounts. According to the report, these two countries accounted for 55 percent of total FDI flows to the region. FDI in Poland, where foreign investors were attracted by the large domestic market, rose to a record $7.5 billion. In the Czech Republic, FDI inflows almost doubled to $5.1 billion, primarily because of a turnaround in privatization policies, following the example of countries, such as Hungary, that had successfully involved foreign firms.

The continued increase of FDI inflows to central and eastern Europe is remarkable, according to the report, despite crises—in Asia, Russia, and Kosovo—that shook confidence in emerging markets in general.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
October 23	4.80	4.80	5.56
October 30	4.83	4.83	5.60

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 (as of May 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (115.9 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/cgi-shl/sdr.pl).

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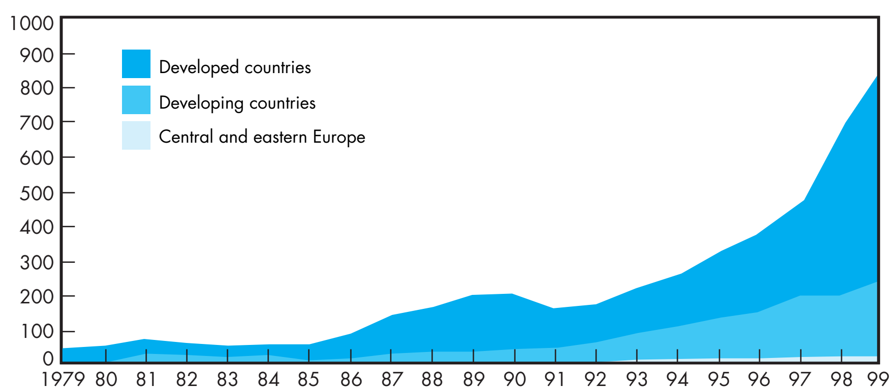
Despite the impressive $23 billion level of FDI inflows, last year, the region accounted for less than 3 percent of global FDI flows.

Latin America and the Caribbean attracted an estimated $90 billion of FDI in 1999 (from $73.8 billion in 1998), with more than 80 percent of the FDI inflows concentrated in the four largest recipients: Brazil ($31.4 billion), Argentina ($23.2 billion), Mexico ($11.2 billion), and Chile ($9.2 billion). According to the report, major privatizations and long-term growth prospects were the chief factors behind the rapid rise in FDI by transnational corporations in many Latin American countries. In some, however, perceptions of instability led to sharp declines in FDI flows: inflows to Colombia were halved, to $1.4 billion; those to Venezuela plunged to $2.6 billion from $4.4 billion; and FDI to Ecuador dropped by about 25 percent to around $600 million.

World FDI inflows, 1979–99
(billion U.S. dollars)



Data: UNCTAD, foreign direct investment/transnational corporations database

What it means

Cross-border mergers and acquisitions are having a major influence on globalization, and it is not all good, according to the UNCTAD study. The top 100 nonfinancial transnational corporations in terms of foreign assets are the principal drivers of international production. These firms control over $2 trillion worth of foreign assets and employ more than 6 million people in their foreign affiliates, and they are increasingly using mergers and acquisitions to boost their FDI.

Developed and developing countries alike are concerned about the market power of transnational corporations and the possible anticompetitive implications of mergers and acquisitions. The effects of cross-border mergers and acquisitions can be influenced by policies, and for UNCTAD, the most important concern is competition policy. "Competition policy," the report concludes, "can no longer be pursued effectively through national action alone. The very nature of cross-border mergers and acquisitions—indeed, the emergence of a global market for firms—puts the phenomenon into the international sphere." Policymakers, the report explains, need to have in place cooperation at the bilateral, regional, and multilateral levels to respond effectively to the anticompetitive practices of firms that affect their countries. ■

To order UNCTAD's *World Investment Report 2000*, please see UNCTAD's website (http://www.unctad.org/en/pub/pubframe.htm).

Available on the web (www.imf.org)

Press Releases

00/57: IMF Approves Stand-By Credit for Gabon, October 23
00/58: IMF Approves in Principle Third Annual PRGF Loan for Tajikistan, October 25

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