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*Germany's economic and financial "checkup"*

## Prospects are bright for Europe's largest economy if reforms are carried out

Germany's economy, once the growth engine of Europe, has underperformed for some time. But a new reform package known as Agenda 2010 has raised hopes that far-reaching changes in Germany's generous welfare system and financial sector will reinvigorate it. Camilla Andersen spoke to Ajai Chopra, mission chief for the recently completed Article IV consultation, and Tomás Baliño, who led a team conducting an in-depth assessment of Germany's financial sector under the joint IMF–World Bank Financial Sector Assessment Program (FSAP), about the need for change.

**IMF SURVEY:** The German economy has been stagnating for the past three years, and its fiscal deficit exceeds the limit set under the Stability and Growth Pact. What's to blame?

**CHOPRA:** Germany's economy has been underperforming for about a decade. Its problems are *(Please turn to the following page)*



Germany's well-educated workforce is one of the most productive in the world. Here, an employee of Bayer AG manufactures drugs for the U.S. market.

## Bio-Tchané insists Africa's future hinges largely on its own actions



Bio-Tchané: "Perhaps one of the biggest changes—and among the most appreciated—is that we have been insisting on a real discussion of policy options with the authorities, making sure that there isn't only one option on the table."

At the African Union summit in Maputo, Mozambique, in July and the IMF–World Bank Annual Meetings in Dubai in late September, African leaders underscored their commitment to sound policies and good governance but expressed strong frustration

with donor countries' slowness in keeping up their end of the bargain. Abdoulaye Bio-Tchané, who has headed the IMF's African Department for the past two years after serving as Benin's Minister of Finance and Economy, talks with Laura Wallace about what he sees as the biggest stumbling blocks to ensuring a better future for the African continent.

**IMF SURVEY:** What do you see as the top challenges facing sub-Saharan Africa today?

**BIO-TCHANÉ:** The main challenge is how to achieve sustained economic growth and poverty reduction. I believe that now, more than ever, there is a strong consensus among African leaders on what needs to be done. First, there is no longer any significant debate about the importance of sound macroeconomic policies. Second, most governments accept the need to reduce economic distortions that impede efficiency and often represent a drain on scarce government resources and that, by the way, *(Please turn to page 332)*

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## Reforms tackle Germany's labor market rigidities

(Continued from front page) rooted in structural rigidities, especially inflexible labor markets and liberal benefits for the jobless. The generous welfare system, which was extended to the new länder (states) in eastern Germany following reunification, resulted in high taxes and social security contributions. Reunification also created other imbalances, such as an enormous building boom in the new länder, the adjustment to which is still in train. Taken together, these problems have discouraged investment and the hiring of labor, keeping growth down and unemployment high. More recently, the long-standing structural rigidities have interacted with cyclical weakness in the global economy to magnify Germany's problems.

Germany's fiscal deficit appears set again to exceed in 2004 the limit of 3 percent of GDP set by the Stability and Growth Pact, in part because planned tax cuts are being advanced. Despite this, we think that the budget for 2004 is shaping up to be a reasonable compromise between competing fiscal demands—the need to achieve lasting fiscal consolidation, on the one hand, and the need to ensure there is no excessive withdrawal of fiscal stimulus, on the other. Given the nature of Germany's problems, we are putting a significant premium on long-term reforms that will deliver economic growth and fiscal savings rather than focusing excessively on short-term policies.

**IMF SURVEY:** What about the euro? Has it been a factor?

**CHOPRA:** The introduction of Economic and Monetary Union [EMU] in the 1990s had different effects on different countries. For Germany, which already had fairly low interest rates, there was less of an immediate benefit from convergence than in other countries. A number of countries also went through a lot of fiscal and structural adjustment as they were entering EMU. Spain and the Netherlands are good examples. By contrast, adjustment in Germany to strengthen competitiveness has been more drawn out as structural rigidities remained unaddressed.

Taking a more current view, interest rates, especially in real terms, are relatively high for Germany, as cyclical conditions there are more depressed than they are elsewhere in the euro area. But then monetary policy has to be set for the euro area as a whole, not just for Germany. I wouldn't want to exaggerate the importance of this particular issue, as Germany is challenged not so much by macroeconomic problems caused by monetary or fiscal policy as by

microeconomic problems caused by supply-side rigidities.

You also need to look at the exchange rate. Germany is an exporting nation, so it obviously benefited when the euro was weak. The strengthening of the euro does put a drag on the economy, but this was inevitable because it represents a return to a closer-to-equilibrium value for the euro. In the short run, the biggest risk to a recovery is a further appreciation of the euro. But right now the level of the euro is pretty much what we had assumed in our forecast. **BALIÑO:** Another consequence of the introduction of the euro is a greater integration of financial markets. This means, for example, that banks and issuers of bonds in Germany have lost a comparative advantage. When Germany still had the deutsche mark, deposits and bonds were denominated in a national currency that was considered stable and strong. Now, anybody in the euro area can do the same thing. Also, Germans can now take their savings to, say, a French bank and still have it denominated in their currency. They also benefit from the unified EU [European Union] minimum protection of savings up to €20,000.

**IMF SURVEY:** The IMF has for many years pointed to labor market rigidity as one of the factors holding Germany back. Does Agenda 2010 go far enough in tackling these problems?

**CHOPRA:** The government's strategy on labor market reform is impressive. Some people have described it as perhaps the most radical change in Germany's labor market institutions and the welfare system in the past 50 years. In the labor market, people have been entitled to lengthy unemployment benefits and so have had little incentive to look for a job. One of the major reforms proposed in Agenda 2010 is to limit the duration of benefits to 12 months for all unemployed, except for those aged 55 years or more, who will qualify for 18 months of benefits. This is a well-targeted reform that should have a considerable impact on incentives to seek work.

Germany also provides unemployment assistance, which is related to past wages, after unemployment benefits have expired. A second major reform is to merge unemployment assistance with social assistance. Social assistance is less generous, but it provides subsistence support. The number of workers and firms covered under collective wage bargaining systems is also decreasing—another positive development. All this should encourage job growth.

Can reforms be taken further? Yes. The duration of unemployment benefits could be reduced to

Banks in Germany are much less profitable than banks elsewhere in Europe.

—Tomás Baliño

12 months for all. Also, with the merging of unemployment assistance and social assistance, it will be important to cut support to people who turn down acceptable work and to target the program to the truly needy. There is also more work that can be done on job protection laws, because dismissals are very complicated. The threshold for being covered by job protection laws could also be raised. Right now, firms with just five employees are covered by these laws. But the start to labor market reform has indeed been impressive.

**IMF SURVEY:** Although the financial sector in Germany had its worst year ever in 2001–02, it is still well capitalized. What are the challenges facing Germany's banks?

**BALIÑO:** A key challenge is to adapt to the changes that have already occurred, such as reunification and the introduction of the euro. Other challenges include solving some long-standing structural problems, such as the low profitability of the system: banks in Germany are much less profitable than banks elsewhere in Europe.

**IMF SURVEY:** Why is that?

**BALIÑO:** One reason is that a large part of the financial system in Germany is not motivated by profit. Its public banks and cooperative sector have been good in terms of providing inexpensive and convenient financial services, although some people argue that these services aren't very sophisticated. The larger commercial banks have had to compete with the public and cooperative parts of the system, and this has contributed to lower profitability. The public banks have also enjoyed other privileges, such as state guarantees. Following an agreement with the European Commission, these will be phased out starting in 2005, and that is going to be an important challenge to the system.

Banks have also suffered a lot from the poor performance of the stock market over the past few years. What used to be a source of income became less so. Many of these banks will now have to find a niche they can exploit in terms of generating revenue. They have been doing quite a lot of cost cutting, but now they need to act on the other side of the equation.

**IMF SURVEY:** It would seem that the particular structure of the financial sector in Germany, with many small banks and little emphasis on profits, has served the average consumer well for many years. Why should the German public support reform?

**BALIÑO:** The system has served Germany well in terms of ensuring stability. But it seems unlikely that

the system can be sustained in the long run without transformation. Banks will have to adjust. For instance, if the public banks need to increase their capital, their owners—the municipalities and the *länder*—aren't in a strong enough financial position to provide more capital. The cooperative banks have served their members well, but this form of capital isn't very resilient during periods of stress because of the way in which voting power is structured. No matter how many shares you have, you still have one vote. Thus, cooperative banks may have to explore other ways to attract private capital.

There will be changes, and some are already well under way. There isn't much of a choice except, perhaps, whether the consolidation is going to take place only within, or also across, the three pillars of the system—private, cooperative, and public banks.

**IMF SURVEY:** The weakened financial status of many insurance companies has made the industry vulnerable to a sudden surge in claims. German reinsurance companies, holding 25 percent of the world market, are particularly vulnerable. What can be done?

**BALIÑO:** The problems of the life insurance companies are to a large extent caused by too much competition, which has led companies to pay rates of return that aren't sustainable, particularly now that returns on their assets have come down. There are also other rigidities. Life insurance companies are contractually required to transfer a large part of their profits back to policy holders instead of reinvesting. And there is a rate of return that has become a floor for the system; once reached, the companies start to outbid one another in terms of paying high yields to the customers. This means that many are actually operating at a loss. These problems will need to be addressed, lest the companies lose capital strength.

Another concern we raise in the Financial System Stability Assessment (FSSA) report concerns the reinsurance sector, which has been somewhat overlooked in terms of regulation and supervision. While this problem isn't peculiar to Germany, it still needs to be dealt with. The companies remain quite strong, and quick calculations suggest that the system could handle an event three times that of Hurricane Andrew, which was a big claim on their resources, together with claims already in the pipeline, such as the asbestos cases. But because there has been such an unprecedented accumulation of events over the past couple of years, the system is now weaker than before. The report argues that the authorities should strengthen supervision of the sector—something they are now doing even ahead of the passage of EU legislation to that effect.



The government's strategy on labor market reform is impressive. Some people have described it as perhaps the most radical change in Germany's labor market institutions and the welfare system in the past 50 years.

—Ajai Chopra

**IMF SURVEY:** Germans are savers, not investors. Recent negative trends in stock prices—with the DAX losing 60 percent from its peak in 2000 and the Neuer Markt for high-tech stocks closing down—may have further discouraged investors. Do you see a way to boost participation in Germany's stock market?

**BALIÑO:** We aren't too worried about lack of participation. Nothing much has changed over the past few years. Equity holders are still in the market. But perhaps what is needed over the longer term is a move away from bank financing to a larger role for the equity market. This can be encouraged by strengthening governance and disclosure rules so that investors have an easier time understanding risk. Part of the explanation for the large role of bank financing is that borrowing has been too cheap because of too much competition. Once spreads go up a bit, maybe some of these borrowers will decide to issue equity rather than take on debt.

**IMF SURVEY:** What are the prospects for Germany recapturing its former role as Europe's economic powerhouse?

**CHOPRA:** Much will depend on its success in implementing reforms. While there are political hurdles to overcome, the government appears determined to move forward. If it succeeds in addressing structural rigidities, particularly in the labor market, and other long-term problems related, for instance, to the aging of society, prospects are bright—especially if reforms are taken even further in the coming years. Also, the elements of the policy package work together and can create significant synergies. Labor market, health care, and pension reform should make it easier to achieve fiscal consolidation, which in turn will help reduce tax rates. If all these reforms are implemented, the potential synergies are such that the outlook is quite promising. ■

## Africa's battle with corruption

*(Continued from front page)* usually end up not benefiting the poor. Third, governance issues are now much more firmly ingrained in government agendas. This doesn't reflect the imposition by outsiders of "neoliberal models," but rather the clear recognition that social stability, transparency, and accountability are essential for a healthy democratic environment and economic progress. Of course, it is a challenge to put this into practice, but most African leaders now believe that there isn't any alternative. Fourth, there is recognition that where a country is embroiled in civil conflict, no meaningful progress on the economic front is possible. The efforts of the African Union and other regional organizations and initiatives, such as the New Economic Partnership for Africa's Development [NEPAD], should be encouraged. Finally, and this is critical, all the valiant efforts in the above areas will be greatly hampered unless there is major support from the development partners on both the aid and trade liberalization fronts.

**IMF SURVEY:** Is there a need for better dialogue between African leaders and the IMF?

**BIO-TCHANÉ:** The policy dialogue between African leaders and the IMF has become increasingly productive in developing a deeper and shared assessment of the main challenges facing Africa. Perhaps one of the biggest changes—and among the most appreciated—is that we have been insisting on a real discussion of policy options with the authorities, making sure that there isn't only one option on the table. That's really what ownership is all about. Another change is that

we've been actively seeking ideas from African leaders on how we can better align the IMF's concessional lending facility [the Poverty Reduction and Growth Facility] with countries' homegrown poverty strategies—as spelled out in their poverty reduction strategy papers [PRSPs]. We also need to better gauge their economic and political environments. Finally, the IMF is in the midst of reappraising how it should best engage with low-income countries. This is another opportunity for us to deepen our dialogue with African authorities.

**IMF SURVEY:** How about tackling corruption? Any progress? And how is the IMF involved?

**BIO-TCHANÉ:** In recent years, many countries have adopted measures to improve transparency, efficiency, and accountability in budgetary management and in the judiciary. These efforts have gained momentum as an increasing number of countries have drafted PRSPs and benefited from debt relief under the Heavily Indebted Poor Countries [HIPC] Initiative. The importance of better governance is also highlighted in NEPAD and in the African Union Convention on Preventing and Combating Corruption. But while countries are making progress in adopting the needed rules and institutions, major challenges still remain in enforcing the rules and allowing the institutions to operate. In most programs now, there are measures that cover governance issues, particularly on public expenditure management. In our discussions on Senegal's program, we are exploring how the public expenditure management system could be over-

For Africa, the top priority is getting industrial countries to open up their markets and remove agricultural subsidies.

—Abdoulaye Bio-Tchané

seen by the judiciary and then reported back to the parliament—which would be a first in Senegal. In Kenya, the new government, which took power in January, has agreed to take good governance steps that had been under discussion for several years. Another example is the work we are undertaking on oil revenue management issues with the African leaders of the Gulf of Guinea.

**IMF SURVEY:** Are you worried about the IMF, the World Bank, the African Development Bank, and other international institutions giving African leaders differing economic policy advice?

**BIO-TCHANÉ:** To my mind, this problem is a little bit exaggerated. There can be differences of emphasis and nuance among the international institutions, arising in part from their different mandates, funding sources, range of technical expertise, and so on. But we should first agree on a sharing of responsibilities, including the distribution of roles in the development agenda. Indeed, within each organization and between organizations, quite often a range of views is expressed, sometimes in a fairly spirited fashion—and this is healthy. But one needs to avoid sowing confusion among, and providing misleading signals to, our members.

**IMF SURVEY:** A major stumbling block to faster growth and poverty reduction seems to be getting the Doha trade round back on track. What do industrial countries and developing countries need to do? How can the IMF help?

**BIO-TCHANÉ:** Obviously, the breakdown in Cancún was a grave disappointment. But as IMF Managing Director Horst Köhler put it, we should consider Cancún a wake-up call and look forward, not backward. Compromises will have to be made by both industrial and developing countries. Indeed, progress was being made on agriculture before the talks broke down, and look how much was achieved in terms of generic drugs! For Africa, the top priority is getting industrial countries to open up their markets and remove agricultural subsidies. The IMF will continue to support countries adopting trade reforms aimed at faster growth and poverty reduction, particularly when these reforms lead to temporary balance of payments shortfalls.

**IMF SURVEY:** In Dubai, African governors raised serious questions about the effectiveness and credibility of the HIPC Initiative. Are these justified?

**BIO-TCHANÉ:** So far, 27 of the 38 potentially eligible HIPCs—23 of which are in Africa—have reached their decision points, the most recent one being the

Democratic Republic of the Congo in July 2003. In net present value terms, these countries account for around 85 percent of the total expected relief. And 8 of the 27 (7 in Africa) have reached the completion point, when the remainder of the debt relief is pledged. Debt-service ratios have been substantially reduced for most HIPCs, and savings from lower debt-service payments have contributed to a substantial increase in poverty-reducing spending. In 2002, such expenditures were almost four times as great as debt-service payments. That said, the African governors complained that, during the past 12 months, only two countries reached their completion points. It is true that African countries' progress in this respect has been slower than expected, but the IMF and the World Bank are moving as fast as they can. Most of the 11 countries (9 in Africa) that may require HIPC Initiative relief but have not yet reached the decision point have been involved in conflicts or had arrears to settle. The bottom line is that I don't have doubts about the effectiveness and credibility of the HIPC Initiative.

**IMF SURVEY:** How about countries that have reached their completion points but are running into trouble again because of outside shocks, such as commodity price drops?

**BIO-TCHANÉ:** For those countries that reach their completion points but still face unsustainable levels of debt on account of exogenous factors, the international community has the option of considering additional debt relief (or "topping up") on an exceptional basis beyond that committed at the decision point. Burkina Faso is one country that has been able to benefit from such topping up. For those countries that have graduated from the HIPC Initiative—that is, they have reached their completion point and received irrevocable debt relief—there is no guarantee that debt sustainability will be maintained. That is why the IMF and the World Bank have recently stepped up efforts to find a solution to this problem. The ongoing review of instruments in low-income countries [due December 2003] should also shed light on ways in which the IMF can assist its members to deal with the effects of a shock.

**IMF SURVEY:** When it comes to reaching the UN Millennium Development Goals, what do you say to those who worry that the IMF is part of the problem because it insists on countries' carefully watching outlays to avoid running up unsustainable debts?

**BIO-TCHANÉ:** The IMF is part of the solution, not part of the problem. Every analysis that has been carried out has concluded that macroeconomic stability is

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essential for achieving high, sustainable growth and reducing poverty. If the macroeconomic situation isn't stable and inflation is high, the poor are the first to suffer. Moreover, countries that scale up expenditures on the basis of unsustainable borrowing will eventually be forced to implement cutbacks to avoid an economic crisis. This reality is recognized by most Africans today. Don't forget that, even if the external financing is available, countries will need sound economic policies to generate additional domestic resources for growth. At the same time, however, the IMF has been calling for more aid in the form of grants to meet the sizable social needs of poor countries. Whenever necessary, we've sought to ensure that budget allocations were provided and that there was enough financing to meet food shortages and combat HIV/AIDS.

**IMF SURVEY:** What is the IMF doing to facilitate the efforts of countries that need to spend more to combat the HIV/AIDS epidemic?

**BIO-TCHANÉ:** The IMF supports all efforts to combat the HIV/AIDS epidemic, including through increased spending; in a number of cases already, fiscal deficits have been relaxed to make room for this. In fact, in no case has the IMF *not* accommodated the need for such spending. Virtually all HIPC agreements include a trigger that calls for higher spending on HIV/AIDS. Moreover, in many countries, the IMF's country teams explicitly incorporate the impact of HIV/AIDS in their macroeconomic assessment and policy advice. While the World Bank, UN agencies, or other development partners typically take the lead in this area, the IMF cooperates closely with them. Our mandate is to focus on the macroeconomic impact of HIV/AIDS, including on labor productivity and economic growth, government revenues, health and other social outlays, and pension systems.

**IMF SURVEY:** How important is it to promote financial sector development for growth?

**BIO-TCHANÉ:** Obviously, you can't expect growth if a majority of the population lacks access to financial services. Since the mid-1980s, there has been a growing recognition that sound financial markets are essential for growth, and that is why we've recently stepped up efforts to support certain areas of financial market development that are essential for tackling poverty. These include bringing job-creating growth to rural areas, promoting the development of small and medium-sized companies, and facilitating access to local sources of long-term credit. With financial sectors dominated by commercial banks, countries need to focus on developing nonbank financial insti-

tutions, particularly institutional investors such as private pension funds and insurance companies. It is also clear that other reforms are necessary, including enforcing property rights and reforming the judiciary.

**IMF SURVEY:** What should oil-producing sub-Saharan African countries do to better manage their resources?

**BIO-TCHANÉ:** This is a critical issue, and it's becoming even more so given the recent major oil discoveries in several countries in the Gulf of Guinea. There is no doubt that the record to date for African oil-producing countries is very disappointing overall. Put simply, oil revenues haven't translated into a commensurate improvement in living standards for most of the population. The IMF has increasingly engaged in an active dialogue with the countries concerned, which included holding a special joint seminar with the World Bank last April in Cameroon.

The messages are clear. First, governments must be transparent about oil revenues received. Second, they must be fully accountable as to how oil revenues are used—that means an end to off-budget expenditures and the holding of oil receipts in special offshore accounts that are outside regular budgetary channels. Finally, they need to establish clear rules as to what portion of current oil revenues are spent (preferably, for developmental needs) versus put aside for unforeseen developments and the eventual depletion of oil resources. Without such arrangements, there is a high risk—and there are some clear cases of this happening—that the oil windfall will have had very little to show for it, which would be a major tragedy.

**IMF SURVEY:** Now that the Chad-Cameroon oil pipeline is in operation, to what extent is the IMF going to be involved in monitoring the oil revenue management plan?

**BIO-TCHANÉ:** The IMF and the World Bank have worked very hard with the authorities to put in place the sort of framework to which I just referred, in anticipation of the coming onstream of oil revenues, which has recently begun. A great deal of progress has been made. All that remains is to put a few finishing touches to some of the precise institutional mechanisms required, which is expected to be done very soon. We all very much hope that successful implementation of this approach by Chad will serve as an excellent example for other countries. ■

**Photo credits:** Bayer AG, page 329; Denio Zara, Eugenio Salazar, and Michael Spilotro for the IMF, pages 329–40; Picture Communication, pages 343–44.

## In search of better outcomes for low-income countries

Since the establishment of the Poverty Reduction and Growth Facility (PRGF)—the IMF’s concessional loan facility—in September 1999, the organization has made a concerted effort to strengthen analytical work on macroeconomic issues affecting low-income countries. One product of this drive was an October 23–24, 2003, workshop hosted by the Macroeconomic Studies Division of the IMF’s Research Department. The forum pointed to a number of ways that the IMF could make its macroeconomic policy recommendations more effective and improve the success rate of achieving program targets. These include improving data, gaining greater insight into the role of institutions, rethinking IMF program design, and reassessing how aid is disbursed.

Agustín Carstens, IMF Deputy Managing Director, opened the workshop, insisting that a better understanding of institutions in developing countries is crucial for the IMF’s work. While IMF documents provide a good sense of the macroeconomic state of a country, he said, they usually offer little insight into the institutional underpinnings of macroeconomic policy. It is also critical to improve national accounts data because poor data undermine effective policymaking. In a similar vein, Carstens also emphasized the positive role diversification can play in insulating economies from large shocks that can worsen poverty.

### Consistency of IMF programs

Can ways of improving IMF program design be found by exploring how macroeconomic outcomes are related to program targets? The IMF’s Reza Baqir, Rodney Ramcharan, and Ratna Sahay focused on how outcomes fared relative to the targets set under a program. Using data on program targets and actual outcomes for a broad range of macroeconomic variables covering 29 countries for around 12 years, they asked whether there are trade-offs between program objectives and whether intermediate targets help achieve overall objectives.

The authors did not find strong evidence of trade-offs between objectives, but, focusing on program targets for economic growth, inflation, and the current account balance, they found that all targets are met only 8 percent of the time. Second, while growth objectives are more likely to be achieved if the fiscal targets are met, there appears to be a conflict between meeting the net foreign assets and growth objectives.

Why are IMF program objectives not met more frequently? Ramcharan explained that a change in policy can change expectations and thereby affect the behavior of economic agents, who, in turn, affect the growth rate. Mohsin Khan, Director of the IMF Institute and Associate Director of the IMF’s Middle East and Central Asia Department, suggested that part of the answer may lie in a tendency to set overly optimistic program targets.



IMF Economic Counsellor and Director of Research Raghuram G. Rajan, left, speaks with Reza Baqir.

### Political foundations of “resource curse”

It is well known that natural resource endowments can have a negative effect on growth and may indeed become more of a curse than a blessing. Some resource-rich countries—such as Botswana, Chile, Malaysia, and, to some extent, Oman and Thailand—have largely avoided this curse, but others have not fared nearly as well.

Why do resource windfalls lead to worse economic performance? They seem to generate dysfunctional state behavior, such as overspending and implementation of counterproductive public policies, said Thierry Verdier (Delta-Ecole Normale Supérieure), presenting a joint paper with James Robinson (UC Berkeley) and Ragnar Torvik (Norwegian University of Science and Technology). Furthermore, resource booms may create underdevelopment, not so much because of any inefficiency in resource extraction but because they provide politicians with greater scope to influence the outcome of elections and the allocation of resources. The overall effect on economic outcomes depends on the strength of domestic institutions: countries with good institutions tend to benefit from resource booms because the institutions mitigate the perverse political incentives that booms create. Countries with bad institutions, in contrast, tend to suffer the resource curse.

### Sovereign borrowing and market access

At what stage of development can low-income countries expect to tap international capital markets? What differentiates countries that can borrow regularly from those that can do so only occasionally or never? And, to what extent do government policies matter? Gaston



Verdier: Countries with bad institutions suffer the resource curse.

Gelos (IMF), presenting the results of a study coauthored by Ratna Sahay and Guido Sandleris (Columbia University), noted that out of a sample of 143 developing countries, 51 never accessed international credit markets over the past two decades; 78 had access to the markets for fewer than 14 of the 18 years under study; and only 12 countries had consistent access (14 or more years out of 18).

What accounts for these differences?

Smaller economies, as measured by GDP, have a more difficult time tapping the markets than larger economies, suggesting that fixed borrowing costs may be an important deterrent. Not surprisingly, political stability and institutional investor ratings matter: higher political risk and lower ratings translate into less access. Vulnerability, as measured by the share of agriculture in GDP, also tends to be associated with market access. And the existence of an IMF-supported PRGF program is negatively associated with market access, which is not surprising because these programs impose strict limits on borrowing from private markets, as well as because low-income countries tend to have low debt-servicing capacity. Finally, the authors found that defaults do not appear to affect market access and that the period between default and resumption of market access was considerably shorter in the 1990s than the average of four years in the 1980s.

### New data, new doubts

An extraordinarily influential paper produced by Craig Burnside and David Dollar (World Bank) in 2000 found that “aid has a positive impact on growth in developing countries with good fiscal, monetary, and trade policies but has little effect in the presence of poor policies.” At the workshop, William Easterly (New York University (NYU)) presented the results of a study he coauthored with Ross Levine (University of Minnesota) and David Roodman (NYU) that questions the thesis that aid promotes growth even in countries with sound policies. Participants found this a very disturbing message, not only because a number of decisions (such as the establishment of the U.S. Millennium Challenge Account) had been influenced by the Burnside and Dollar paper but also because the study suggested that aid is ineffective, irrespective of policies.

Why might aid not work so well, even with good policies? Part of the answer, Easterly suggested, may be that aid agencies are fundamentally unaccountable. Because of the lack of a feedback mechanism between aid recipients and donors, aid agencies have little incentive to learn, unlike firms in the private market that must pass a market test to survive or governments that face the voter test.

Participants suggested that an analysis that distinguishes between different types of aid—such as budget support and direct project aid—may produce different results. Furthermore, if measured by a different yardstick, such as its ability to raise the consumption levels of the poor, aid may prove to be effective.

### Growth–equality trade-off?

Humberto Lopez (World Bank) entered the poverty debate by assessing the effect that pro-growth policies have on inequality. Improving education and infrastructure and lowering inflation lead to increased growth and reduced income inequality, he said. While financial development, increasing trade openness, and decreases in the size of government also lead to faster growth, they are associated with higher inequality. Is their overall impact pro-poor? Lopez argued that, while these policies are likely to be pro-poor in the long run, they are likely to lead to higher poverty in the short run. These findings, he noted, call for the adoption of a pro-poor policy package at the center of any poverty reduction strategy, as well as measures that diminish potential short-run increases in poverty.

### When is debt sustainable?

When do developing countries fall into debt distress—that is, find themselves in arrears, resorting to Paris Club debt relief, or pursuing nonconcessional IMF support? Art Kraay and Vikram Nehru of the World Bank took a closer look at what triggers unsustainable debt. They found that the risk of debt distress depends on a small set of factors: initial debt burdens, the quality of policies and institutions, and shocks. While at some level these results are not too surprising, Kraay noted, they do have profound implications for how resource transfers to low-income countries could be financed. The probability of debt distress is already high in many low-income countries and is likely to increase sharply, even if the large-scale development finance required to meet the UN Millennium Development Goals is provided in the form of highly concessional lending.

### Debt relief: Who benefits?

What should donors do when poverty reduction is the objective and funds are used instead to fund military



William Easterly (left) speaks to Mohsin Khan.



Humberto Lopez assesses the growth–equality trade-off.

procurement, public sector payrolls, urban services, or lower taxes for affluent households? Once the recipient government is in possession of the funds, it has an incentive to meet the needs of its constituency, and those with a voice are often those with means. Aid funds are therefore not only fungible but hostage to the domestic political status quo.

What does this imply for the usefulness of debt relief as an instrument to increase the consumption of the poor in low-income countries? To answer this question, Tito Cordella (IMF), presenting a paper coauthored with Giovanni Dell'Ariccia (IMF) and Ken Kletzer (UC Santa Cruz), argued that if the preferences of the poor and of donors are similar but differ from those of the recipient governments, and if a high debt stock prevents market access, then donors should forgive interest payments but keep the stock of debt as leverage; this will force recipient governments to redistribute these funds to the poor.

### A case for sterilizing aid inflows?

Do aid inflows, which constitute a very large share of many recipient countries' GDP, cause real exchange rate appreciations, and should the base money effect of aid inflows be sterilized to prevent this? Presenting a paper coauthored with colleagues Alessandro Prati and Ratna Sahay, Thierry Tresselt (IMF) said that large aid flows in the past had led to small real exchange rate appreciations but that these effects could become large if aid is substantial stepped up. To address this possibility, they developed a theoretical model to identify conditions under which preventing a real appreciation through sterilization improved welfare. But many participants remained skeptical that aid levels would ever rise so high and noted that evidence of real exchange rate appreciation being caused by aid inflows was weak. ■

For the full text of the papers, please check online at <http://www.imf.org/external/np/res/seminars/2003/lic/index.htm>.



Thierry Tresselt: A big increase in aid could lead to large real exchange rate appreciations.

## Available on the web ([www.imf.org](http://www.imf.org))

### Press Releases

- 03/177: IMF Executive Board Completes Sixth and Seventh Reviews of Pakistan's PRGF-Supported Program, Grants Waivers, and Approves Disbursements Amounting to \$247.54 Million, October 27
- 03/178: IMF Gives Final Approval of Malawi's PRGF Arrangement Review, October 27
- 03/179: IMF Mission Visits Bolivia, October 30
- 03/180: Rwanda Formally Begins Participation in the IMF's General Data Dissemination System, November 3
- 03/181: IMF Completes Third Review of Peru's Stand-By Arrangement, Approves \$40 Million Disbursement, November 3
- 03/182: Remarks by IMF First Deputy Managing Director Anne Krueger in Brazil, November 5 (see page 342)
- 03/183: IMF Statement on the Dominican Republic, November 6
- 03/184: IMF Executive Board Approves Amendment to General Data Dissemination System Designed to Enhance Statistical Reporting Related to the Millennium Development Goals, November 6
- 03/185: IMF Managing Director Horst Köhler to Visit Armenia, Kazakhstan, Kyrgyz Republic, Russia, and Tajikistan, November 7
- 03/186: The Republic of Armenia Subscribes to the IMF's Special Data Dissemination Standard, November 7

### Public Information Notices

- 03/128: IMF Concludes 2003 Article IV Consultation with France, October 29
- 03/129: IMF Concludes 2003 Article IV Consultation with Australia, October 29

- 03/130: IMF Concludes 2003 Article IV Consultation with Mexico, October 30
- 03/131: IMF Concludes 2003 Article IV Consultation with St. Kitts and Nevis, November 4
- 03/132: IMF Concludes 2003 Article IV Consultation with Germany, November 6 (see page 329)

### Speeches

- "Can the Tide Turn?" Raghuram G. Rajan, Economic Counselor and Director, Research Department, at Federal Reserve Bank of Dallas, October 24
- "Globalization: Challenges Arising from the Sources of Global Economic Growth," Anne Krueger, IMF First Deputy Managing Director, G-20 Ministerial Meeting, Morelia, Mexico, October 26
- "The IMF as a Partner in Implementing the Monterrey Consensus," Horst Köhler, IMF Managing Director, United Nations General Assembly, New York, October 30
- "Constant Purpose, Changing World: The IMF in the Twenty-First Century," Anne Krueger, IMF First Deputy Managing Director, University of Wisconsin, Milwaukee, October 30
- "Toward a Stronger Europe in the Global Economy," Horst Köhler, IMF Managing Director, East-West Conference, Vienna, November 3

### Transcripts

- Conference Call on Germany—with Ajai Chopra and Robert Corker, IMF European Department; and Tomás Baliño, IMF Monetary and Financial Systems Department, November 6
- Press Briefing by Thomas C. Dawson, Director, IMF External Relations Department, November 6

*IMF-BIS conference*

## More timely, reliable real estate data can play key role in financial stability



Carson: "Real estate prices can play a significant role in macro-economic policy."

Despite their importance in macroeconomic policymaking and financial stability analyses, high-quality data on real estate indicators are scarce in many countries, and internationally comparable data do not exist. As a first step toward creating reliable real estate indicators, the IMF's Statistics Department and the Bank for International Settlements (BIS) hosted a two-day conference on October 27–28 for officials and analysts from central banks, statistical institutes, international institutions, academia, and the private sector. Russell Krueger and Subramanian S. Sriram report on the proceedings of the conference—the first of its kind at the international level.



Wachter: "Banks . . . have few data on which to base careful analysis of real estate prices."

Developments in the real estate sector can have economywide repercussions, and the IMF should be concerned, Managing Director Horst Köhler said in opening the conference, because "one of the primary areas of the IMF's mission—the safeguarding of the stability of the international financial system—must necessarily deal with the relationships between real estate activity and price cycles, and the stability of banking institutions and financial systems."

The organization's own work on financial soundness indicators, he added, has pointed to the need to improve real estate statistics and gather more data on "financial sector exposures and risks related to residential and commercial real estate and construction."

Clearly, real estate prices, as prices of assets, can play a significant role in macroeconomic policy, Carol Carson (Director of the IMF's Statistics Department) observed. "They are used as information variables in making monetary policy decisions," she said, and "they also provide insights on possible balance sheet problems that the lending institutions may be facing. Hence, they provide indications of financial system stability."

With respect to the banking system, Susan Wachter (Wharton School of the University of Pennsylvania) and Bradford Case (Board of Governors of the U.S. Federal Reserve System) cautioned that "poor information and inadequate analysis of real estate risk contribute to the vulnerability of the banking system. Banks and individual managers have few data on which to base careful analysis of real estate prices." Indeed, interactions between real estate and financial

### Experts discuss way ahead on financial soundness indicators

As part of ongoing international efforts to strengthen financial system surveillance, experts from 17 member countries and 6 international and regional agencies met on October 29–30 to discuss the latest draft of the IMF's *Compilation Guide on Financial Soundness Indicators*. The meeting—the second of its kind—was intended to help finalize the draft and propose a work program to help member countries that will be compiling financial soundness indicators.



During a break, Charles Enoch (left, IMF), talks with Ruan Jianhong (People's Bank of China), Chung Chee Leong (Bank Negara Malaysia), and Xiu-zhen Zhao (IMF).

Since September 2002, when the experts first met to discuss the *Guide*, much work has been done on financial soundness indicators,

Carol S. Carson, Director of the IMF's Statistics Department, said. In March 2003, the IMF posted a first draft of the *Guide* on its website and invited public comment. The substantial comments from public and private sector agencies fed into a revised draft that the group was now considering.

The IMF also took measures to increase awareness of the *Guide* and elicit additional feedback from country officials. IMF staff has held three regional outreach seminars this year, with three additional seminars scheduled to take place in the coming months. And in June, the IMF's Executive Board broadly endorsed the *Guide's* conceptual framework, welcoming it as "a milestone in establishing a standard reference." Indeed, as Stefan Ingves and V. Sundararajan, Director and Deputy Director, respectively, of the IMF's Monetary and Financial Systems Department, noted in their opening remarks, the *Guide* represents an important tool for member countries and will help strengthen the use of financial sector indicators in the IMF–World Bank Financial Sector Assessment Program (FSAP) and in ongoing IMF surveillance of members' economic and financial policies.

### Guide revisions

In their comments on the latest draft of the *Guide*, the experts expressed appreciation for the added emphasis now given to flexibility in the implementation of financial soundness indicators. This change incorporates earlier concerns that, with differences in accounting practices and resource constraints, some countries might not be able to meet all of the called-for guidelines immediately. Nevertheless, the chair

sector activity can generate potential and actual systemic instability. Participants cited as examples the U.S. savings and loan crisis, the financial crises in Sweden and Japan in the early 1990s, and the widespread real estate market collapses and financial crises in southeast Asia in the late 1990s.

Users are “desperate” for timely and quality measures—as Keith Hall (Reserve Bank of Australia) observed—but the accurate compilation of real estate data remains a difficult task. Real estate properties are heterogeneous, transactions of individual properties are infrequent, and the detailed information needed is difficult and costly to obtain. Steps can be taken, however, to improve data and enhance comparability.

### How to compile better indicators

The conference, in fact, was designed to exchange ideas and search for consensus recommendations on such topics as what these data should look like, how they should be compiled, which international agencies should be involved in gathering comparable data, and the extent to which international standards and harmonization are called for.

**Desirable characteristics.** According to Stephan Arthur (BIS), good real estate data should have six attributes: availability, representativeness, comparability, continuity, length, and frequency. Given priorities and large gaps in data, Arthur placed less stress on timeli-

ness, but Boaz Boon (CapitaLand, Singapore) and David Fenwick (U.K. Office for National Statistics) disagreed, arguing that timeliness is also important.

**Methodology.** Developing countries that are now compiling their own real estate indices often ask which methodologies to apply and which practices are appropriate. The conference examined the pros and cons of several methodologies for constructing price and value indices for residential real estate, commercial real estate, and nonresidential properties.

There appeared to be overall support for compiling hedonic indices, which are quality-adjusted price indices, or hybrids of hedonic indices with some other methodologies. Marc Prud’Homme (Statistics Canada) said, “Hedonics is the only way to go.” But several participants voiced concerns about the cost of collecting the required data and the methodology’s complexity. Anne Laferrère (National Institute for Statistics and Economic Studies, France) disagreed on the complexity issue. France, she said, successfully compiled an aggregate real estate price index using the hedonic index method. And if cost is an issue, she and several others stressed, administrative or processing records for real estate deeds, taxes, or mortgages often provide quick, detailed, and cost-effective data for compilation purposes.

**Aggregate indicators or a family of indicators?** International organizations like the BIS and the

comment on possible modifications to the list of indicators suggested by IMF Executive Directors during their June review of the *Guide*. The experts lent their support to some of the proposed modifications in the existing list of financial soundness indicators, but there was no support for including additional indicators in the list.

With good progress made on all of the above topics, the experts agreed that, subject to some limited review of several proposed text changes, the *Guide* was ready to be finalized. The *Guide* is expected to be completed in early 2004, after which it will be provided to the IMF Executive Board for endorsement.

### What next?

Country compilation of financial sector indicators is the ultimate objective of the methodological work embodied in the *Guide*. To help countries tackle this task, the IMF intends to conduct a coordinated compilation exercise for about 60 countries, beginning in mid-2004. The experts lent their broad support to a preliminary draft of the terms of reference for this initiative. They also discussed possible ways in which the IMF could cooperate with other international and regional organizations on this effort.

To ensure that the indicators continue to reflect the evolving priorities of IMF surveillance and the capacity of countries to compile these data, the experts were invited to

Graham L. Slack  
IMF Statistics Department



Arthur: “Good real estate data should have six attributes.”



Prud’Homme: “Hedonics is the only way to go.”



Stephansen: "Harmonization of data and methodology would facilitate international comparison."

European Central Bank (ECB), government agencies in several developing and industrial countries, and private sector companies in some countries, like Absa Group in South Africa, have been compiling and/or attempting to build indices at the regional and national levels to measure developments in real estate and/or asset markets. Arthur said "aggregate asset price indices could prove a welcome addition to the set of variables considered by policymakers from the perspective of both monetary and financial stability," but the consensus was that a family of indicators was needed. These disaggregated indicators would also be useful for numerous other official and private purposes, such as tax administration, land allocation policy, bank provisioning policies, and investment decisions in the property sector.

**International standards and harmonization.**

The conference pointed to the clear need for international standards in the construction of real estate indices and in the harmonization of definitions, methodologies, and standards across countries. "Harmonization of data and methodology would facilitate international comparisons," said Kathleen Stephansen (Credit Suisse First Boston). Estrella Domingo (Philippines National Statistical Coordination Board), among several others, indicated that "the conference had increased the level of knowledge on real estate indicators," while Naseer Ahmad (State Bank of Pakistan) and others expressed the hope that a guide could be prepared on best practices.

Participants also stressed that international cooperation and joint public-private sector efforts are key to efforts to harmonize standards on data and methodology. Ivan Matalik (Czech National Bank) saw "a role for the IMF and the BIS and other international institutions such as Eurostat or the ECB" in developing these standards. Future conferences and a network or a discussion group could also help promote developments in international standards and harmonization in methodology.

**Who should collect data?** Both public and private sector organizations are involved in compiling real estate indicators, and practices differ widely between countries. Some participants, such as Wachter and Arthur, argued for putting data collection in a "public domain," while Rupert Nabarro (Investment Property Databank) countered that "it is important that the private sector operate in the area of collecting real estate prices for commercial properties." The consensus favored a role for both in compiling timely and accurate measures of real estate indicators and in developing a well-coordinated system for collecting and sharing data.



Haurin: "Better get the price index right because the effect of peaks and troughs may be explained by the data errors."

**How should countries proceed?**

For countries that would like to compile real estate price indicators, the conference provided a number of useful suggestions. Because data gathering is costly, Case, among several others, recommended exploiting existing data sources and selecting the methodology accordingly. For countries just starting this work, Donald Haurin (Ohio State University) urged them to first decide on the problem to be solved and then to formulate a clear strategy for a data collection system and the appropriate methodology. "Better get the price index right," he said, "because the effect of peaks and troughs may be explained by data errors." Thus, data collection and compilation methodology should be carefully matched to needs.

**What's next?**

Resources are constrained, Carson acknowledged, but the IMF will continue to work on real estate indicators, and, in doing so, it will continue to collaborate with other international organizations. Paul Van den Bergh (BIS) agreed, adding that "the networking established here will be useful" to support continued country efforts to compile real estate indicators. To keep up the momentum, he recommended that guidance and technical assistance be provided to emerging markets that are aiming to build real estate indicators. This conference, he reiterated, is only the first step. Pressure to resolve real estate data needs will not go away, he said, because risk managers, as key players in helping sustain financial stability, will need detailed and timely data. Van den Bergh said he looked forward to continued collaboration between the IMF and the BIS in this and in other statistical areas. ■



Van den Bergh: "The networking established here will be useful."

Final conference papers will be published in a book, expected in late 2004, designed as a resource for analysts and statistical compilers.

**Selected IMF rates**

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
November 3	1.59	1.59	2.10
November 10	1.59	1.59	2.10

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranches. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website ([www.imf.org/cgi-shl/bur.pl?2003](http://www.imf.org/cgi-shl/bur.pl?2003)).

General information on IMF finances, including rates, may be accessed at [www.imf.org/external/fin.htm](http://www.imf.org/external/fin.htm).

Data: IMF Finance Department

Former Yugoslav Republic of Macedonia

## Enterprise profits hinge on private ownership and hard budget constraints

Before the iron curtain fell, most firms in Central and Eastern Europe and the Soviet Union either were owned by the state or were socially owned. Their behavior was driven by political and social considerations, such as achieving employment targets, rather than by profit-maximizing considerations. Changing the structure of incentives in which enterprises operate is a necessary condition for the successful transition to a market economy. This article, based on a Working Paper by Juan Zaldueño, Senior Economist in the IMF's Policy Development and Review Department, examines the performance of firms in the former Yugoslav Republic (FYR) of Macedonia, comparing the performance of firms created following privatization (new firms) with that of firms that predated the transition (surviving or old firms).

When FYR Macedonia achieved independence in 1991, its enterprise sector was dominated by socially owned enterprises in which employees as a group were involved in all investment and employment decisions but individually had no ownership rights. Such firms accounted for about 85 percent of employment in that sector.

The prevalence of social (as opposed to state) ownership slowed the process of privatization, and, once privatization picked up in the mid-1990s, it allowed insiders to buy firms on generous payment terms. In the end, only 20 percent of firms were sold to strategic investors. Insider privatization often led to weak corporate governance, so that firms did not operate to maximize their value and failed to mobilize the resources, know-how, and trade links needed to modernize and expand production.

Despite the weaknesses of insider privatization, aggregate profitability indicators have improved since 1997, although they continue to lag behind those in other transition economies. Zaldueño attributes this improvement to success in dealing with large loss-makers; the closure of older, inefficient firms; and the entry of new, more dynamic ones—a process that market economies rely on to weed out poor performers and foster more efficient resource allocation. The evidence suggests, he says, that this entry and exit process has taken hold in FYR Macedonia: two-thirds

### New firms are outperforming surviving firms

	1994		1997		New firms	2000	
	Surviving firms	Dying firms	Surviving firms	Dying firms		Surviving firms	New firms
Number of firms	6,710	10,200	6,710	4,080	6,961	6,710	13,725
Average employment (number)	31.0	10.6	25.5	9.6	7.1	24.4	7.8
Total employment (thousands)	208	108	171	39	50	163	108
Labor product (million 1994 denars)	0.22	0.12	0.20	0.16	0.14	0.23	0.23
Operating profits/value added	0.33	0.01	0.24	0.20	0.20	0.30	0.39
Profits/losses (net, percent of GDP)	-6.1	-5.9	-1.1	-0.8	-1.0	-0.3	0.9

Data: FYR Macedonia, Payments Bureau (ZPP) dataset; and IMF staff estimates.

of the firms that existed in 2000 started up after 1994, and about 60 percent of the firms in existence in 1994 had closed by the end of 2000.

But the performance of surviving firms remained below par (see table, this page). Their operating profits were lower than those of new firms, and labor productivity remained weak despite cuts in the workforce. This weak performance persisted despite progress in exposing firms to competition through market-based economic institutions. FYR Macedonia has low tariffs, few trade restrictions, and a market-based price system in which administered prices prevail in only a handful of sectors—features that normally compel firms to increase their efficiency.

### Essentials of restructuring

Why was the performance of surviving firms unsatisfactory? Zaldueño examines how ownership structure, hard budget constraints, and market-based economic institutions affected enterprise restructuring in a representative sample of 823 surviving manufacturing firms that operated between 1994 (the year that preceded the acceleration of privatization) and 2000 (the last year for which enterprise level data are available).

Ownership structure emerged as an important determinant of improved profitability. Surviving firms that, by 2000, were privately owned maintained stable levels of operating profits throughout the 1990s, while socially owned and state-owned firms exhibited a decline in both profits and labor productivity during the same period. Firms with mixed ownership structures—privatized firms in which the state retained residual shares or held an ownership claim until full payment of sold shares had been completed—saw improved profitability after 1997,

**Private ownership, hard budget constraints, and market-based economic institutions improve enterprise performance.**

—Juan Zaldueño

but their performance remained weak (see table, this page).

Although direct support to firms from the government budget declined during the 1990s, Zaldueño finds that budget constraints remained soft because the government tolerated arrears in wages, taxes, and social contributions. These arrears rose from 3 per-

cent of GDP in 1994 to 4 percent of GDP in 1997 before declining in the late 1990s. The evidence shows that firms' financial discipline improved when their budget constraints were hardened. FYR Macedonia has made progress on other fronts that affect bud-

get constraints. Specifically, a new bankruptcy law was enacted in 2000, and private banks play an increasingly important role in the banking sector. The changes in the legal framework, if enforced and

accompanied by improvements in bank lending practices, should compel poorly performing firms to tighten financial discipline.

**The road ahead**

Zaldueño's conclusions are consistent with the literature on transition economies: private ownership, hard budget constraints, and market-based economic institutions improve enterprise performance. These findings make it clear that FYR Macedonia has much to gain from completing the transfer to private hands of the firms that remain under social ownership. In addition, the government should avoid softening budget constraints and continue to improve the functioning of market-based institutions. In this regard, nonforbearance of arrears and improvements in bank lending practices are needed. In particular, if the large number of surviving firms still under mixed ownership are to improve their performance, the authorities must fully enforce the new bankruptcy proceedings and consider mechanisms to harden the budget constraints that these enterprises face. ■

**Of surviving firms, private firms are doing the best**

	1994	1997	2000
Total employment (thousands)			
Private	29.0	25.0	27.0
Mixed	111.0	87.0	74.0
Social or state	23.0	19.0	18.0
Labor product (million 1994 denars)			
Private	0.27	0.28	0.27
Mixed	0.20	0.16	0.19
Social or state	0.31	0.32	0.28
Operating profits/value added			
Private	0.38	0.36	0.37
Mixed	0.30	0.12	0.25
Social or state	0.49	0.48	0.33

Data: FYR Macedonia, Payments Bureau (ZPP) dataset; and IMF staff estimates

Copies of IMF Working Paper No. 03/136, "Enterprise Restructuring and Transition: Evidence from the Former Yugoslav Republic of Macedonia," by Juan Zaldueño, are available for \$15 from IMF Publication Services. The full text of the paper is also available online at [www.imf.org](http://www.imf.org).

**Brazil requests loan extension**

**O**n November 5, the IMF and Brazil provisionally agreed on a one-year extension of Brazil's current loan. The proposed \$14 billion accord, which still requires Executive Board approval, consists of \$6 billion in fresh funds as well as the \$8 billion available under the current arrangement, which would otherwise expire in December. In addition, the Brazilian authorities requested that repayments of about \$5.5 billion arising in 2005 and 2006 be delayed by one year.

IMF First Deputy Managing Director Anne Krueger told the press shortly after a meeting with Brazilian Finance Minister Antonio Palocci that the program is part of a strategy to exit from IMF support. "In my judgment, the authorities are putting together a sound program," she said. Given the strong recovery in market confidence, the government intends to treat these new funds as precautionary. "The funds will, however, be available to provide

important insurance against possible external shocks, as the government completes the process of fully restoring market confidence and consolidating the foundations for sustained, equitable growth," Krueger said.

Krueger welcomed the government's commitment to maintaining the sound policies that it had successfully implemented this year. "The government intends," she said, "to continue its program of structural reforms in areas crucial to help accelerate growth over the medium term." Key elements of the new program will enhance financial intermediation, lower bank lending spreads, and improve the business environment.

"As the president and his administration celebrate the first anniversary of their election, we at the IMF would like to extend our congratulations," Krueger said. The implementation of the government's agenda, she noted, has already done much to reduce Brazil's vulnerabilities. ■

Singapore seminar

## Parliamentarians debate more active role in budget oversight, poverty reduction

On October 13–14, the IMF sponsored a seminar in Singapore on growth and poverty reduction in South Asia with parliamentarians and other political and social leaders from Bangladesh, Nepal, Pakistan, and Sri Lanka—countries that have prepared or are preparing poverty reduction strategy papers. The forum drew participants from across the political spectrum in each country, focusing on the political economy of reforms and the role of legislators. Much of the debate centered on policy trade-offs, the importance of building consensus, and the larger task of broadening participation in the reform process.

The IMF has long interacted with legislators in meetings at IMF headquarters or in country capitals, but more recently, it has broadened its outreach (see box, page 344). Why the expanded effort? In part it is an aspect of the increased openness and transparency of the IMF. It also reflects the increased attention being paid by the IMF to the need for national ownership of policy programs. In low-income countries, in particular, parliamentarians, as political representatives of the people, can play a key role in formulating poverty reduction strategies, approving and monitoring national budgets, and passing legislation on economic reforms. In addition, legislators can play a pivotal role in ensuring that the voices of the people are heard in public policy debates and in helping forge consensus when there are differing views.

### Making choices, building consensus

What policy trade-offs confront decision makers in promoting pro-poor, pro-growth budgets? Poverty reduction requires not just growth but also, in the short run, targeted social spending and other policies specifically designed to reduce poverty and, for the long run, investment in education and infrastructure, and the building of supportive institutions, noted the IMF's Kanitta Meesook. Thus, difficult choices must be made to integrate poverty-reducing expenditures into the budget framework while preserving macroeconomic stability. The budget, parliamentarians underscored, is the government's most important policy-making tool, and it involves difficult policy choices. There was general agreement with Deep Kumar Upadhyay, former member of the Nepalese parliament, that parliamentarians should exercise budget oversight and hold the government accountable for its priorities.

Of course, in the short run, some economic reforms, such as restructuring or privatizing state-owned enterprises and banks, create winners and losers and thus lead to opposition. "Privatization of national icons alarms people," said Ravindra Randeniya, member of the Sri Lankan parliament. Political leaders need to take these views into account in setting public policy, participants observed, agreeing with Abdul Mannan, a member of parliament from Bangladesh, that "without a national consensus, governments will not be able to undertake these reforms."

But there were differences of view as to how a consensus could be achieved. The government should understand the effects of reforms in advance and think about how the adverse effects on some can be mitigated, including by providing social safety nets to protect the most vulnerable members of society, suggested Dilli Raj Khanal, former member of parliament, from Nepal. Others echoed the views of Hina Rabbani Khar, member of Pakistan's parliament, and Ravindra Randeniya of Sri Lanka, who said it was not a good idea to "keep people on the dole" and, moreover, that handouts take resources from other uses that could help the poor in a more sustained way.

A number of parliamentarians felt that macroeconomic reforms were not enough to reduce poverty. They argued that more attention had to be paid to microeconomic reforms, particularly in rural areas where the majority of South Asia's poor live. "We have achieved great things [under the IMF-supported program], but the IMF needs to do a better job of understanding the reality on the ground," Pakistan's Khar said. The legislators at the seminar agreed that the poverty reduction strategy paper (PRSP) was the right vehicle for linking the macroeconomic and microeconomic aspects of poverty reduction, but they urged the IMF and other development partners to focus more on ensuring that the benefits of reform did indeed accrue to the poor.

The prevalence of corruption was also a concern. "It does not matter who is in the government or who is in the opposition; the public does not trust political leaders," observed one member of Bangladesh's parliament. There was universal agreement that good governance is essential to improve the climate for investment and growth, but the real challenge, the parliamentarians said, was building a national consensus on the importance of combating corruption.



Legislators can play a pivotal role in ensuring that the voices of the people are heard in public policy debates.



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## Promoting participation

Several legislators stressed that the process of formulating poverty reduction programs needs to be broadened to include, especially, the poor. One participant observed that the voices of the people have not been heard in the reform process, their interests have not been taken into account, and they have not been properly consulted. Another wondered whether PRSPs are truly homegrown or just another Washington product. They are indeed homegrown, the IMF's Mark Plant observed, but this does not preclude the IMF and other development partners from having a role in the PRSP process. Ultimately, he said, it is up to the governments to ensure an open and inclusive process, and domestic and international partners must be willing both to contribute to the process and to listen to the input of others.

As for their own role in the economic reform process, several members of parliament observed that they have not had the input they would have liked in the budget process and in approving lending arrangements that international financial institutions have agreed with their governments. The discussion also revealed that the extent of parliamentary debate on economic reforms and on formulating and formally



Hina Rabbani Khar, member of parliament from Pakistan, addresses the Singapore gathering.

approving PRSPs varies from country to country, depending on the prevailing institutional arrangements. Nepal's Dilli Raj Khanal captured the participants' overall sentiment, noting that in their countries "most policy decisions are made outside the parliament." Norbert Mao, member of the Parliamentary Network on the World Bank and Ugandan parliamentarian, urged legislators to be proactive. They must, he said, take the initiative and make themselves relevant in the budget and PRSP discussions.

In his keynote address, IMF Deputy Managing Director Shigemitsu Sugisaki stressed

the importance of an "active and informed public dialogue on reforms" and noted that the seminar had played a useful role in deepening the dialogue between the IMF and parliamentarians. But now, he said, it is really important "that this dialogue be carried out in your home countries." ■

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The full text of IMF Deputy Managing Director Shigemitsu Sugisaki's keynote address is available on the IMF's website ([www.imf.org](http://www.imf.org)).

## IMF's outreach to legislators

The IMF's dialogue with national legislators, which has expanded in recent years, takes a number of forms:

- IMF management, Executive Directors, and staff meet with legislators on their travels to member countries and when legislators visit Washington. IMF resident representatives and visiting staff teams also meet with national legislators.



IMF Executive Director Sri Mulyani Indrawati participated in the Singapore seminar.

- At seminars in Zambia (2000), Indonesia (2000), Kenya (2002), Cameroon (2003), and Ghana (2003), IMF staff and legislators have discussed the countries' poverty reduction strategies, IMF-supported programs, and the role and activities of the IMF.

- Training has been provided at the IMF's Joint Vienna Institute for legislators from the transition economies, since 1995.
- The IMF has participated in the annual conferences, field visits, and regional East Africa chapter of the Parliamentary Network on the World Bank. At the network's annual conference this year, IMF Managing Director Horst Köhler engaged in an hour-long question-and-answer session with parliamentarians (see *IMF Survey*, March 31, 2003).
- IMF staff have attended conferences and meetings of the Inter-Parliamentary Union (IPU) when issues of interest to the IMF were being discussed. IMF staff participated in a panel on the Bretton Woods institutions at the IPU's annual meeting in October 2003.
- The IMF has collaborated with the Global Organization of Parliamentarians Against Corruption (GOPAC), including by participating in a seminar for parliamentarians with GOPAC and the African Parliamentarians Network Against Corruption in Nairobi in November 2003, on measures to combat money laundering and the financing of terrorism.