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Interview with former IMF Director

Geithner says IMF needs better tools to help emerging markets prevent and limit crises

On November 17, Timothy Geithner took over as head of the Federal Reserve Bank of New York after serving for two years as Director of the IMF's Policy Development and Review Department. Before that, he worked from 1988 to 2001 in the U.S. Treasury, including as Under Secretary for International Affairs. He spoke with Laura Wallace about the IMF's strengths and weaknesses, and lessons on managing and resolving crises.

IMF SURVEY: What should be the main policy issues on the IMF's agenda?

GEITHNER: One of the most important things for the IMF to explore is how to improve the quality of its surveillance of emerging market economies and the value of the insurance against contingencies that IMF lending facilities offer them. Surveillance—as it's now



Geithner: "Surveillance—as it's now designed—isn't a very valuable tool for emerging market policymakers who want to have an external anchor, or some form of external reinforcement, for their policy programs."

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India: are the skeptics right?



School children use computers at an information technology exhibition in Bangalore, India's Silicon Valley.

While public opinion in India continues to move toward the view that liberalization of the economy has been good and more of it is needed, some scholars have turned skeptical. Economists Bradford DeLong and Dani Rodrik, for example, argue that reforms cannot be credited with India's

higher growth rates in recent years because the shift in the growth rate preceded the reforms of the 1990s. In a related but slightly different vein, Joseph Stiglitz has contended that India is one of the two most impressive economies today (the other being China) and that India also, like China, has bought the least into the globalization story that the IMF and others are selling. Who's right? Arvind Panagariya, Resident Scholar in the Trade Unit of the IMF's Research Department and Professor of Economics, University of Maryland, argues that the skeptics have it all wrong.

Take a closer look at the evolution of growth and reforms in India, and three facts stand out that contrast sharply with the DeLong-Rodrik position. First, growth during the 1980s took place in the context of significant reforms. While the reforms were ad hoc and implemented quietly ("reforms by stealth" is the term often used to describe them), (Please turn to page 349)

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(Continued from front page) external reinforcement, for their policy programs. In part, this is because there isn't a mechanism for assessing individual country economies on an appropriately frequent basis. Article IV consultations, the central instrument of country surveillance, occur only every 12–18 months and, in some cases, less frequently. At the same time, the IMF's financial assistance is available only when a country has demonstrated a current, measurable need; it is typically constrained in amount and disbursed in modest increments. This isn't very well suited to the needs of a relatively open emerging market economy for insurance against crises.

What's the answer? I think the IMF needs to better think through the nexus between surveillance and its financing facilities so that it can offer emerging markets more nimble and powerful crisis prevention and management tools. Emerging market countries need access to some form of contingent insurance that can be mobilized quickly and on a sufficiently large scale, with appropriate safeguards to ensure repayment to the IMF. Maybe we need some form of enhanced surveillance, combined with a redesigned insurance mechanism that could combine the best features of precautionary arrangements, in which countries declare their intention to draw on agreed IMF financial support only if a need arises, and the Contingent Credit Lines (CCL)—a facility that was set up in 1999 to provide countries that have track records of good policies with assurance that IMF financing would be arranged if needed. [Editor's note: The CCL was introduced to provide countries with a line of defense against financial contagion, but it was never used and on November 26, the IMF's Executive Board agreed to let the CCL expire as of November 30.]

IMF SURVEY: What exactly do you mean by external anchor?

GEITHNER: The classic problem of economic policy in any country is how to reconcile the economically desirable with the politically feasible. One way the IMF can help is by giving policymakers reinforcement against both the pressures they face domestically to change course and the potential external challenges. I'm not talking about the IMF parachuting in to impose its particular model or idea or blueprint, but IMF support for its members' own programs.

IMF SURVEY: If you look at the IMF as a whole, what do you feel are its greatest strengths and weaknesses?

GEITHNER: Its greatest strengths are the talent and experience of its staff, the discipline that governs the

organization, and its capacity to act very quickly—with a lot of force, innovation, creativity, and pragmatism—to help countries solve problems. Its greatest challenge is to find a way to improve the quality of decision making within the IMF, within the Executive Board, and among its shareholders—particularly during financial crises when it has to move very quickly, the problems are especially complex, and the political constraints on its members are acute. At those moments, the IMF has to be able to harness the best experience to make difficult, hard-headed judgments as wisely and as quickly as possible.

IMF SURVEY: Any suggestions on how to do this?

GEITHNER: The IMF needs to put more resources into the area between day-to-day operational work and longer-term academic research. Somewhere in between, there should be room for us to spend more time distilling common lessons and developing dos and don'ts for policymakers. We should be constantly asking: what is the most creative, most innovative new-frontier solution to a particular problem? We need to do more to foster and reward this type of work.

IMF SURVEY: How else could the IMF improve its effectiveness?

GEITHNER: We should try to be as nimble and agile as we can in adapting to new challenges and to work as hard as we can to integrate the best outside expertise available. We also need to resist the tendency to adopt initiatives that entail a lot of bureaucracy, especially reporting requirements that place a big burden on member countries and the staff. Over time, we should review existing requirements and prune them down to the essential ones and, going forward, try to pursue these initiatives with as light and pragmatic a touch as possible.

IMF SURVEY: As soon as you joined the IMF, you became very involved with the Latin American crisis. What lessons on crisis management will you take with you to your new job?

GEITHNER: Most of the lessons in this area are now conventional wisdom, which I think is one of the accomplishments of the IMF over the past several years. The basic truth is that policymakers in emerging market countries, the financial markets, and the IMF were slow to recognize the scale of the debt buildup and the balance sheet problems in these countries and the associated risks. We'll be dealing with this legacy for some time to come. Despite the substantial improvements in fundamentals across

There are still a large number of countries worldwide with very large public sector debt burdens and debt structures that are highly vulnerable to crisis.

—Timothy Geithner

emerging markets over the past five years, there are still a large number of countries worldwide with very large public sector debt burdens and debt structures that are highly vulnerable to crisis. How to manage this risk will be the dominant challenge facing the IMF and its members in the years ahead. The old rule—and I don't know whose it was—holds that you have to treat every positive shock as temporary and every negative shock as permanent and generally calibrate policies to build in much stronger cushions against adversity.

IMF SURVEY: Any lessons on the crisis resolution side?

GEITHNER: The hardest thing for the IMF to do is make better judgments about the nature of the problem that a country in crisis faces—in particular, about whether it can better be solved with policy reform and temporary financial support or with a restructuring of the balance sheet of the sovereign nation—and to do this in the fog of uncertainty. Given the aversion of many of the IMF's major creditors to large-scale finance and given the natural desire to avoid the trauma that can come with restructuring, the IMF faces a real risk that it will be forced into the middle ground of taking a more cautious, gradualist approach. Ultimately, that would leave the IMF worse off because if it's unable to provide large-scale liquidity when it is needed or support a country undergoing restructuring, then it's going to be much less able to help countries in crisis. It's vital that the IMF and its shareholders resist the temptation to take the comfort of the middle.

IMF SURVEY: When you joined the IMF, there was a lot of interest in new crisis resolution mechanisms. Collective action clauses are now part of emerging market issuances. But the proposed sovereign debt restructuring mechanism ran into major opposition. Wearing both your IMF and central banker hats, what do you feel is the answer?

GEITHNER: What's happened on the collective action clauses front is very encouraging, but it's going to be a long time before it can really make much of a difference. Trying to figure out a way to facilitate restructuring when there's a very diffuse creditor base will continue to be a major challenge. It's healthy for everyone to step back now for a while from the broader debate about alternative legal regimes and try to gain more experience dealing with the different types of problems that countries in crisis face. Out of that, consensus for reform may emerge. The hardest problem isn't navigating the shores of the legal complexities but figuring out sensible economic and

financial strategies for countries that need to restructure. What can be done to help countries through that process of unwinding large balance sheet problems with the least amount of trauma for the country, its people, and the financial system?

IMF SURVEY: You've watched the IMF now from inside and outside. How did the impressions you gathered at the U.S. Treasury square with the reality of what you experienced here?

GEITHNER: It's very difficult for anybody on the outside to fully appreciate how difficult the IMF's job is, and that was certainly the case for me. I'm very impressed by how tough it is for the IMF to operate effectively given that its members ultimately determine what they're prepared to do and given the difficulty of getting consensus internally and in the Executive Board.

IMF SURVEY: There's a lot of skepticism about whether the IMF holds much sway over the thinking of major industrial countries like the United States.

GEITHNER: The IMF can have a lot of influence in helping to focus attention on the major policy challenges facing these countries, even when they're politically inconvenient and not on policymakers' immediate horizons. The influence may be less than with other countries, but, as everywhere, the IMF can have an effect where it brings value added. The IMF should make sure it has world-class people looking at these problems and that they operate at the frontier of what these policymakers are facing—and the IMF certainly has the intellectual and analytical talent, plus the experience, to do this.

IMF SURVEY: Do you feel that the developing countries have a sufficient voice in the IMF? Realistically,

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
November 17	1.58	1.58	2.09
November 24	1.58	1.58	2.09

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

General information on IMF finances, including rates, may be accessed at www.imf.org/external/fin.htm.

Data: IMF Finance Department

Trying to figure out a way to facilitate restructuring when there's a very diffuse creditor base will continue to be a major challenge.

—Timothy Geithner



is the IMF's governance structure likely to change?

GEITHNER: There's broad recognition that the IMF's governance structure has to evolve. But the reality is that this evolution probably won't take place without the flexibility that comes with a quota increase and that it won't fundamentally change the relative roles of the institution's creditors and its potential borrowers. Consensus is going to take some time.

IMF SURVEY: How comfortable are you with the IMF's current role in low-income countries?

GEITHNER: The right focus for the IMF going forward should be less about the broad framework for cooperation among donors—which has been laid out in Monterrey, the PRSP [poverty reduction strategy papers] framework, and the Heavily Indebted Poor Countries Initiative—and more about the substance of its policy advice. How do we help countries whose immediate challenges aren't classic stabilization ones but rather putting in place the conditions for higher growth rates? This means figuring out how to reinforce the efforts of other institutions like the World Bank to help countries improve their microfundamentals. Without faster growth rates, nothing is going to be possible in these countries.

IMF SURVEY: Your department was traditionally responsible for evaluating the IMF's performance on policy advice and program design. What do you think of the Independent Evaluation Office's [IEO] initial reports? How has the IMF's Executive Board handled them? Is the whole process working?

GEITHNER: The IEO is doing an absolutely terrific job. Its reports have been thoughtful, credible, and first

rate. It's also doing a pretty good job of trying to match its criticisms with constructive recommendations. The follow-up process is working reasonably well although the degree of consensus in the Board has varied a fair amount across the recommendations. The IEO's biggest challenge is figuring out how to provide value added in coming up with practical, concrete, creative suggestions. It's very hard for the institution to be responsive if the diagnosis and recommendation are simply that we need to be wiser, better, more effective, and more persuasive at what we do.

IMF SURVEY: The IMF still takes a lot of heat from antiglobalizers and other critics. Are we just misunderstood?

GEITHNER: The IMF operates in a complex environment. It faces—just like finance ministries and central banks everywhere—a lot of debate on, and opposition to, the hard judgments that countries have to make when resources are limited. We get caught up in that world. We get caught up in the broader anxiety about whether the system is fair to the poorest and smallest countries. And we get caught up in broader concerns about the benefits and challenges of economic integration. The best thing we can do is to make sure we're as proactive as possible in explaining the rationale behind the policies we support and the basis for our concern about a particular course of action. We can be confident that supporting packages of policies and institutional reforms that form successful integration strategies offers the best prospects for improving people's lives in developing countries. But we know that building political support for these policies is difficult. ■

IMF Managing Director appoints two new heads of department

Managing Director Horst Köhler has appointed Mark Allen to the position of Director of the IMF's Policy Development and Review Department and Leslie Lipschitz to the position of Director of the IMF Institute (the IMF's training institute). Allen and Lipschitz are both currently Deputy Directors in the Policy Development and Review Department.

Köhler said that Allen's experience and intellectual independence make him eminently qualified to help the IMF both build upon its existing policy framework and



Mark Allen



Leslie Lipschitz

adapt its policy agenda to an ever-changing global environment. Allen will replace Timothy Geithner (see interview, page 345), who has taken the position of President of the Federal Reserve Bank of New York.

In announcing Lipschitz's appointment, Köhler referred to him as an experienced communicator who will be able to interact effectively both within the organization and with member countries, thereby taking the work of the IMF Institute forward. Lipschitz will be replacing Mohsin Khan, who was earlier appointed Director of the IMF's Middle East and Central Asia Department.

1980s reforms paved way for more solid growth

(Continued from front page) they made inroads into virtually all areas of industry and laid the basis for the more extensive July 1991 reforms. Second, growth in the 1980s was fragile and varied significantly depending on the subperiod chosen. This growth was also unsustainable, as it was partially driven by external and internal borrowing. Finally, the more systematic and systemic reforms of the 1990s produced decidedly more stable and sustainable growth from 1992 on.

And, in contrast to the Stiglitz view, India's reforms have been very much in line with the policies that mainstream economists and the IMF have traditionally advocated. True, the pace of India's reforms has been slower than what even many pro-reform economists who favor gradualism over shock therapy advocate, but this is to be attributed not so much to conscious choice as to the intricate demands of the country's democratic political process. In one area—capital account convertibility—India has deliberately chosen to go slowly, but this delay is hardly inconsistent with its embrace of pro-market and proglob-alization policies in other areas. Indeed, many proglob-alization and pro-reform economists, including the author of this piece, have explicitly advocated such a delay.

Fragile growth in the 1980s

For the three decades from 1951 to 1981, India's average annual growth rate was a steady, unremarkable 3.6 percent that was often termed the "Hindu rate of growth" (see table, page 350). India hit the 5 percent mark for the first time during the 1980s and continued to grow at this rate into the 1990s. What happened in those two decades?

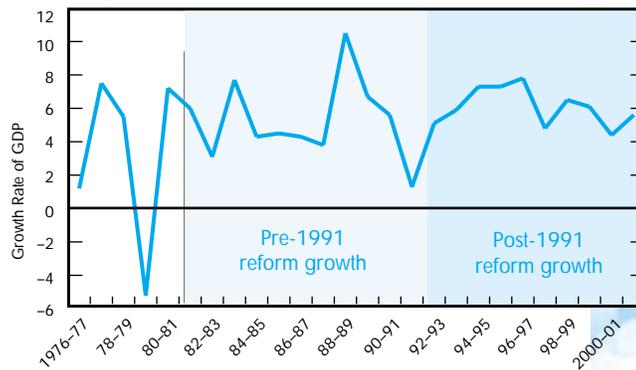
If you compare the two, the first thing that is clear is that the 1980s growth rate is far more variable within the period. For instance, the average growth rate for 1978/79–1987/88 was an unimpressive 4.1 percent. Anyone looking back at this performance would conclude that the economy was still on the Hindu growth path. Even the average growth rate during 1981/82–1987/88 was 4.8 percent—below the rate achieved under India's Fifth Five-Year Plan (1974–79). Only when the period 1988–91 is included—with its ultra-high growth rate of 7.6 percent—does the average growth rate for the decade jump to 5.6 percent. Without these three years, there would be no debate on the 1980s versus the 1990s growth rate.

Growth during the 1990s was clearly more robust and far less volatile. Major reforms were put in place after India experienced an economic crisis in June 1991. The annual growth rate quickly picked up and reached 5.1 percent in 1992–93 and never fell below

4.3 percent subsequently. And, whereas the growth spurt of the 1980s culminated in a crisis, growth in the 1990s was sustained, with no hint of crisis con-

Fragile growth in 1980s gives way to robust growth in 1990s

Financial year (April 1–March 31)



Data: Government of India, Ministry of Finance, *Economic Survey* (various issues).

cerns in the minds of India watchers. Indeed, the tale of India's pre- and post-1991 experiences is best told by its annual growth rates (see chart above).

Reforms in the 1980s

Still, what is one to make of India's fragile yet significantly higher growth during 1977–91, especially 1988–91? Two broad factors—pro-market reforms and fiscal expansion—seem to hold the answer. Some would also want to credit good luck in the form of the discovery of oil and generally good monsoons, but these would not have come to much without the other two factors.

By the mid-1970s, India's trade regime had become so repressive that imports (other than oil and cereals) had fallen from the already low level of 7 percent of GDP in 1957–58 to 3 percent in 1975–76. More than 800 of the most labor-intensive products were exclusively reserved for production by small-scale units. The remaining products were either subject to industrial licensing or produced solely by public sector units. Though government regulation of industry began to be relaxed in the early 1970s and trade restrictions started to ease in the late 1970s, the pace of reform picked up significantly only in 1985. Here, reforms on six fronts stand out:

- **A reintroduction, in 1976, of a list of items that could be imported without licenses.** Initially, the list contained 79 items, but this grew, by April 1990, to 1,339 items (more than 20 percent of total imported items). In 1987–88, 30 percent of all imports entered without licenses and, typically, with reduced tariffs.

- **Decline in the monopoly rights of the government for the import of certain items.** Between 1980/81 and 1986/87, the share of government-monopolized imports in total imports declined from 67 percent to 27 percent. Over the same period, monopolized rights for imports other than petroleum,

oil, and lubricants declined from 44 percent to 11 percent, significantly expanding the room for imports of machinery and raw materials by entrepreneurs.

- **Introduction or expansion of several export incentives, especially after 1985.** Exporters were given replenishment licenses, which could be freely traded on the market. This directly helped relax the constraints on some imports, notably inputs for goods sold in the domestic market. In addition, between 1985 and 1990, profits on

exports were exempt from taxation; the interest rate on export credit was reduced to 9 percent from 12 percent; and duty-free imports of capital goods were allowed in selected “thrust” export industries.

- **Beginning in 1985, a substantial relaxation of industrial controls.** By 1990, 31 industries were completely delicensed (27 remained under licensing); the asset ceiling of firms designated as small-scale industries was raised substantially; broad banding, which allowed firms to switch production between similar product lines, such as trucks and cars, was introduced in 1986 in 28 industry groups and expanded subsequently; also in 1986, firms that had reached 80 percent capacity utilization in any of the five years preceding 1985 were assured authorization to expand capacity to up to 133 percent of the maximum capacity utilization reached in those years; price and distribution controls on cement and aluminum were entirely abolished; and the asset limit on firms subject to the purview of the Monopolies and Restrictive Trade Practices Act was raised fivefold. This allowed firms under the asset limit to take advantage of the new liberalized measures. For firms still covered by the law, clearances were waived for 27 industries altogether, and several constraints were relaxed in other industries.

- **Major reform of the tax system.** Multipoint excise duties were converted into a modified value-added tax, which enabled manufacturers to deduct excise paid on domestically produced inputs and to deduct

countervailing duties paid on imported inputs from their excise obligations on output. By 1990, the modified value-added tax covered all subsectors of manufacturing except petroleum products, textiles, and tobacco. This change significantly reduced the taxation of inputs and the associated distortions. In parallel, the authorities introduced a more smoothly graduated schedule of excise tax concessions for small-scale industries, which reduced incentives for them to stay small.

- **And, perhaps most important, India’s adoption of a realistic exchange rate.** The real exchange rate appreciated marginally during 1979–81, stayed more or less unchanged until 1984–85, and then depreciated steadily thereafter. Between 1985/86 and 1989/90, the effective exchange rate depreciated by a hefty 45 percent in nominal terms, and 30 percent in real terms.

These reforms had discernible effects on all areas of the Indian economy. Imports expanded and, with them, the share of imported capital in total investment. The incremental capital-output ratio declined from 6 to 4.5. Industrial growth accelerated from 4.5 percent in 1985/86 to a peak of 10.5 percent in 1989/90. In their 2002 study, researchers Satish Chand and Kunal Sen of the Australian National University found that India had experienced a significant jump in productivity growth in all industrial sectors, and that this had been directly linked to liberalization.

Unsustainable borrowing and spending

But the steps that India took to liberalize its industrial and trade sectors tell only a part of the 1980s story. The country’s rapid growth before 1991 was also being fueled by borrowing abroad and rising government expenditures at home. During 1985–90, gross domestic saving and investment were, on average, 20.4 percent and 22.7 percent of GDP, respectively. With direct foreign investment negligible and annual foreign aid unchanged at approximately \$400 million through much of the 1980s, foreign borrowing largely made up the difference between saving and investment.

While foreign borrowing helped boost investment and imports, it also led to a rapid accumulation of foreign debt, which rose from \$20.6 billion in 1980/81 to \$64.4 billion in 1989/90. The accumulation was especially rapid during the second half of the 1980s, with long-term borrowing rising from the annual average of \$1.9 billion between 1980/81 and 1984–85 to \$3.5 billion between 1985/86 and 1989/2000. The ratio of external debt to GDP rose from 17.7 percent in 1984/85 to 24.5 percent in 1989/90. Over the same

India journeys from “Hindu rate of growth” toward a miracle

Period	GDP	Per capita GDP
1951–61	3.9	2.0
1961–71	3.8	1.5
1971–81	3.2	0.9
1981–91	5.6	3.5
1991–01	5.7	3.7
<i>Memo</i>		
1951–74	3.6	1.5
1977–91	5.1	2.9
1992–02	6.1	4.1

Data: Government of India, Ministry of Finance, *Economic Survey* (various issues).

period, the debt-service payments as a proportion of exports rose from 18 percent to 27 percent.

As the volume of India's debt grew, the quality of debt deteriorated rapidly between 1984/85 and 1989/90. The share of private borrowers in total long-term debt increased to 41 percent from 28 percent; the share of nonconcessional debt rose to 54 percent from 42 percent; and the average maturity of debt declined to 20 years from 27 years. Indeed, while external debt was helping the economy grow, it was also steadily moving it toward a crash.

Similar developments were occurring on the internal front. Defense spending, interest payments, subsidies, and higher wages stoked public sector spending. During the first half of the 1980s, current expenditures of the combined central and state governments averaged 18.6 percent of GDP. By the second half of the decade, however, these expenditures averaged 23 percent of GDP, with the bulk of the expansion coming from defense, interest payments, and subsidies, whose average rose to 11.2 percent of GDP from 7.9 percent.

Like external borrowing, high current expenditures, which manifested themselves in extremely large fiscal deficits, proved unsustainable. Combined fiscal deficits of the central and state governments, which averaged 8 percent of GDP in the first half of the 1980s, rose to 10.1 percent of GDP in the second half. Large deficits led to a substantial buildup of public debt, with interest payments accounting for a large proportion of government revenues. They also inevitably fed into external current account deficits, which rose steadily to reach 3.5 percent of GDP and 43.8 percent of

exports in 1990–91. The eventual outcome of these developments was the June 1991 crisis.

A bright future

What key lessons can be gleaned from this experience? It is that the fragile but higher growth in the 1980s provided firsthand evidence to policymakers that gradual liberalization could deliver faster growth without causing disruptions. It was a lesson that emboldened reformers to move forward with the major steps taken in the July 1991 budget. And it was these more sweeping measures that translated into the more robust and sustainable growth that India has enjoyed since 1992.

Is there still much to do? Of course, but there has been a discernible shift in attitude and confidence. Despite well-known vulnerabilities resulting from large fiscal deficits and the slow pace of banking reforms, few pundits are predicting an external crisis today. India's ratio of external debt to GDP has been declining, and its foreign exchange reserves, at approximately \$90 billion, exceed currency in circulation.

The truth is that despite numerous hiccups, India's reforms have continued and are likely to continue further. This, together with the likely continuing expansion of the country's dynamic information technology sector, augurs well for India's long-term growth prospects. ■

The longer paper on which this story was based—"India in the 1980s and 1990s: A Triumph of Reforms"—was presented at the IMF–National Council on Applied Economic Research Conference "A Tale of Two Giants: India's and China's Experience with Reform and Growth" on November 15–16 in New Delhi. A report on the conference will appear in the next issue of the *IMF Survey*.

Fragile but higher growth in the 1980s provided firsthand evidence to policymakers that gradual liberalization could deliver faster growth without causing disruptions.

—Arvind Panagariya

IMF and World Bank issue trade appeal to world leaders

As promised at the World Bank–IMF Annual Meetings in Dubai in September, IMF Managing Director Horst Köhler and World Bank President James Wolfensohn sent a letter last week to heads of government urging them to relaunch trade negotiations aimed at completing the latest round of multilateral trade talks.

In the 2001 declaration that launched the trade talks—known as the "Doha Development Agenda"—members of the World Trade Organization (WTO) pledged to "ensure that developing countries, and especially the least developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development." But talks broke down at the latest ministerial meeting in Cancún, Mexico, in September 2003.

In the letter, Köhler and Wolfensohn said that "expanding trade by collectively reducing barriers is the single most

powerful tool that countries, working together, can deploy to reduce poverty and raise living standards." They also said that trade barriers generally work against the poorest countries because they tend to be the highest in agriculture and labor-intensive manufactures.

Köhler and Wolfensohn called on world leaders not to allow the impasse at Cancún to dash the hopes vested in the Doha Agenda. Trade liberalization is not a "concession," they said, but "a step toward helping to promote opportunity and productivity that benefits the society that takes it."

Köhler and Wolfensohn added that their organizations stand ready to help member countries adjust to the effects of trade liberalization. The IMF is preparing an initiative to support countries that experience temporary balance of payments shortfalls as a result of multilateral trade liberalization. The World Bank will support programs to improve trade logistics and competitiveness.

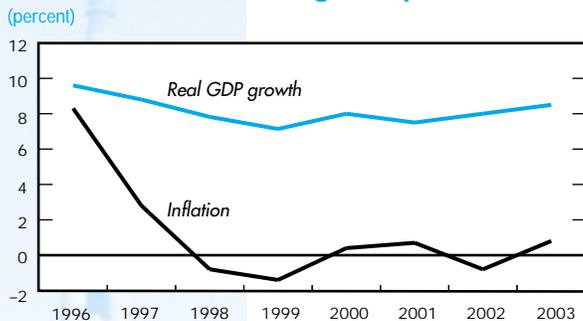
The full text of the letter is available at www.imf.org/external/np/sec/pr/2003/pr03197.htm.

China's dynamic economy needs structural reforms to sustain its rapid growth

China's economic progress to date has been remarkable. After an impressive performance over two decades in which it sustained high output growth and became one of the world's largest exporters and importers, China needs to intensify its efforts to tackle the major structural challenges that must be addressed if it is to complete its transition to

a market economy and maintain its rapid economic growth. Tarhan Feyzioglu and Tao Wang of the IMF's Asia and Pacific Department examine China's achievements over the recent past and delineate the types of reforms that will be needed in the years ahead.

Growth remains strong and prices stable

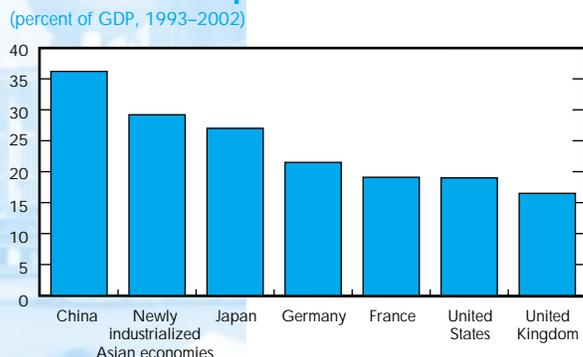


Data: IMF estimates

China's output growth has been impressive. Over the past decade, GDP has grown at an average annual rate of 8–9 percent, and growth for this year will again likely exceed 8 percent despite the recent SARS shock (see top chart).

China has more than doubled its real income in the past decade and now ranks as the world's sixth largest economy, behind only the United States, Japan, Germany, the United Kingdom, and

China leads the pack in investment



Data: IMF, *World Economic Outlook*

France. If the comparison is made on the basis of the IMF's purchasing-power-parity-based (rather than market) exchange rates, China ranks even higher—second only to the United States.

For the past decade, investment levels have been very high, averaging close to 37 percent of GDP, with the ratio set to exceed 42 percent this year. Put in a global perspective, China's investment rate is twice that of the United States or the euro area and higher even than the average of the newly industrialized Asian economies (see bottom chart). In absolute

terms, China has the world's third highest level of investment, after the United States and Japan. Its investment is supported by very large domestic saving. In fact, China has one of the highest saving rates in the world, estimated at 43 percent of GDP in 2002.

In conjunction with its high output growth and investment, China has assumed a greater role in world trade. While the dollar value of world exports grew at an average rate of 6 percent over the past decade, China's annual export growth averaged 17 percent (see top table, page 353), and in the first nine months of 2003, it reached a whopping 32 percent. At the same time, China gained greater share in foreign markets. Its exports now account for 11 percent of U.S. imports, 19 percent of Japan's, and 7 percent of the European Union's. Its exports are also becoming more diversified. While labor-intensive light manufacturing goods still account for a large share of total exports, the shares of electronics (for example, office machines and telecommunications and sound equipment), furniture, travel goods, and industrial supplies have been increasing rapidly (see also *Finance & Development*, December 2003).

Imports, too, have been growing rapidly. Annual import growth averaged 16 percent over the past decade, and surged to 41 percent in the first nine months of 2003. Increasing demand for imported materials for China's exports is only part of the story. Domestic demand has increased markedly, and accession to the World Trade Organization (WTO) in 2001 and the associated further opening of domestic markets have also contributed to rising imports. The sustained growth of Chinese imports has also had knock-on effects: helping to fuel the strong export performance in the Asian region and contributing to the recent strength in world prices for several commodities.

While China's annual trade surplus has remained moderate at around \$30–40 billion in the past several years, with strong export growth to the industrial countries and import growth from Asian economies, bilateral trade patterns have shifted considerably: surpluses with the United States (and, to a lesser extent, with the European Union) have grown large, so have trade deficits with Japan, Korea, Taiwan Province of China, and Southeast Asian economies (see middle table, page 353). During this period, China's external current account surplus has fluctuated around 2 percent of GDP.

Despite buoyant economic activity, the price level in China has remained relatively stable over the past

six years, with low inflation offset by two episodes of moderate deflation. Supply-side factors—including tariff cuts related to the country's entry into the WTO, and increases in production capacity and productivity gains from strong investment growth—appear to have been the principal moderating factors. These factors, indeed, led to deflation in late 2001, but inflation has reemerged in 2003 and reached 1 percent (on a 12-month basis) in September as food prices rose moderately, partly owing to adverse weather conditions. Excluding food, average prices were stable in the first nine months of 2003.

China's per capita GDP (in current prices) almost tripled over the past decade, climbing from about \$340 in 1990 to close to \$1,000 in 2002 (see bottom table). The country's rapid economic growth, which now spans two decades, has succeeded in lifting an estimated 200–400 million people out of poverty, accounting for much of the reduction in poverty that the world has achieved during this period.

Reform agenda

But what's next for China as it moves to complete the transformation to a market economy? A number of areas—notably the banking system, the enterprise sector, the social safety net, the labor market, and income inequalities—still pose major challenges and all of the needed reforms will entail significant fiscal costs. Moreover, all these policy challenges and the associated reforms are interlinked. For example, banking sector reform will depend on the reform of the state-owned enterprises. State-owned enterprise reform, in turn, will require improvements in the social safety net, reforms in the pension system, and the transfer of social responsibilities (for example, health care and education) now borne by enterprises to the government.

Banking sector reforms. China has one of the world's largest banking systems in the world, with total assets (as of September 2003) equivalent to 228 percent of GDP and total domestic credit equivalent to 166 percent of GDP. Virtually all of China's banks are owned by state or local governments. The challenge now will be to address a large number of nonperforming loans and make the system commercially sound.

Currently, according to official data, China's four largest banks have nonperforming loans amounting to 22 percent of their combined loan portfolios, or 19 percent of GDP. An additional 1.4 trillion yuan (\$168 billion; 13 percent of GDP) in bad loans was earlier transferred to asset management companies, but a large percentage of these loans still needs to be resolved. A recent spike in credit growth (24 percent in the first nine months of 2003 over the same period

last year) has heightened concerns about the creation of new nonperforming loans.

The broader task of strengthening China's banks has also taken on new urgency, as the country is committed, under its WTO accession agreement, to providing a level playing field for foreign and local banks by end-2006. In early 2003, the authorities established the China Banking Regulatory Commission and took steps, including issuing new regulations and guidelines, to further bolster banking supervision and regulation. Still, headway needs to be made in reducing the large stock of nonperforming loans and limiting the flow of new ones. Banks' risk management, internal controls, and governance structure require fundamental improvement, and the ability to price risk will need to be enhanced; in this regard, liberalizing interest rates would help. In addition, bank restructuring will have to diversify the ownership of state-owned commercial banks and reduce state involvement in banks' management and business operations.

State-owned enterprise reform. If China is to stem the flow of new nonperforming loans and maintain high productivity growth, continued reforms of the state-owned enterprises is essential. The authorities have been introducing a shareholding system in state-owned enterprises with the aim of improving corporate governance and management independence. They have also taken steps to reduce redundancy and close loss-making enterprises. The state-owned sector, which has laid off more than 27 million workers since 1998 (about one-third of its work force),

Fast-growing imports and exports

	1993	2002	Average annual growth
	(billion U.S. dollars)		(percent)
China's exports	76	326	17
China's imports	86	281	16

World exports	3,721	6,400	6
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Data: Chinese authorities and IMF staff consultations

Shifting bilateral trade balances

(billion U.S. dollars)

	1997	2002
United States	16	43
EU	5	10
Japan	3	-5
Taiwan POC	-13	-31
Korea	-6	-13
Hong Kong	37	48
ASEAN	0	-8
Total	40	30

Data: Chinese authorities and IMF staff consultations

GDP per capita is surging

(U.S. dollars at current price)

	1990	2002
United States	23,209	36,209
Japan	24,718	31,300
China	339	986

Data: Chinese authorities and IMF staff consultations

Photo credits: Denio Zara, Eugene Salazar, Michael Spilotro for the IMF, pages 345–48 and 356; Jagdeesh N. V. for Reuters, pages 345, 349, 351; Sunil Malhotra for Reuters, page 350; Claro Cortes IV for Reuters, pages 352–53; Li Huan for Reuters, page 354; and BOU Saroeun, pages 359–60.

now accounts for only about one-third of total urban employment, compared with more than one-half in 1997.

Rural-urban income divide

(current price, in U.S. dollars)

	1990	2002
Income per capita		
Urban	316	930
Rural	144	299
Rural income as a percent of urban	45	32

Data: Chinese authorities and IMF staff consultations

But the state-owned sector remains in urgent need of further reform. Excess labor continues to depress productivity, corporate governance is still weak, and most enterprises continue to operate without hard budget constraints and with a heavy social burden, including the provision of many social services for their employees. In recognition of the need for further reforms, the government in

March established the State Asset Supervision and Administration Commission to monitor operations and carry out key reforms. The authorities also plan to close around 2,500 large and medium-sized state-owned enterprises over the next four to five years.

Labor markets. The much-needed enterprise sector reforms are likely to add to already strong pressures in the labor market, where each year more than 9 million people are added to the labor force. As of September 30, registered urban unemployment stood at 8 million—roughly 4.2 percent of the urban labor force. But this figure understates true unemployment, since it does not include unemployed rural migrant workers or

the laid-off workers who retain ties with their enterprises. In addition, surplus labor in the agriculture sector is currently estimated at 150 million.

A number of factors hinder the proper functioning of China's labor market, notably a household registration system that controls population movement, especially between rural and urban areas; the absence of a countrywide social safety net, which discourages workers in the

state enterprise sector from switching jobs; and the absence of portable social benefits between cities and between the state and other sectors.

Expanded social services. To alleviate some of the pressures created by downsizing in the enterprise sector, the Chinese government has strengthened the social safety net for laid-off workers, improved training and education, and created various incentives for their reemployment. If it is to address some of the broader issues of enterprise restructuring and the creation of a more efficient and less segmented labor market, however, China will need to expand the coverage of its social safety net.

Pensions, once provided by state-owned enterprises, will now need to cover those working in the private sector and be made portable. Basic social services, such as health care and education, will need to be made accessible to all urban residents and expanded to cover more rural residents. Greater access to social services, in fact, will be a key to reducing income disparities between urban and rural residents and between coastal and inland regions.

Growing income disparities. China's rapid growth has been accompanied by widening income disparities between rural residents (who account for two-thirds of the population) and urban residents, and across regions. At present, average rural income is only 32 percent of urban income—down sharply from the average 45 percent of urban income in 1990 (see top table). Coastal regions, which have benefited from better infrastructure and human capital, preferential policies, and access to external markets, have also developed more rapidly than their inland counterparts (see bottom table). Average annual GDP per capita in Shanghai, for example, was about \$4,000 in 2002, while it was less than \$600 in the western region.

The Chinese authorities have realized that developing the rural sector and the inland regions is crucial in addressing labor market pressures and ensuring the sustainability of overall economic growth. They have abolished administrative restrictions on work in urban areas by rural migrants, are gradually reforming the household registration system, boosting investment in infrastructure and education in poorer areas, and working to reduce the tax burden on farmers.

Fiscal and exchange rate implications

Of course, all of these reforms have significant fiscal implications. At present, China has relatively low government debt (equivalent to 26 percent of GDP at end-2002) and a modest budget deficit (around 3 percent of GDP this year), but nonperforming loans and unfunded pension obligations represent large contingent liabilities for the public sector.

Moreover, China is likely to incur substantially higher demands for public spending in the coming years. Its current spending on education and other social programs falls short of internationally comparable levels (assessed by the Organization for Economic Cooperation and Development in 2002) and expenditures are likely to rise over the next decade for health care (especially as the population ages) and environmental protection.

Structural reforms in the banking and enterprise sectors, as well as the pension system, could reduce government's liabilities in these areas, and the government could meet some quasifiscal liabilities by selling

Regional disparities are widening

(annual per capita GDP, current price in U.S. dollars)

	1990	2002
Coastal region	481	1,857
Shanghai	1,184	4,020
Western region	240	596
Guizhou	167	373

Data: Chinese authorities and IMF staff consultations

a part of its substantial assets. Even with these measures, however, growing expenditure pressures will likely require additional measures on both the revenue and the expenditure side. To address these concerns, the authorities are continuing to strengthen tax revenue and efficiency and are taking steps to improve expenditure management.

For basic social services such as education and health care to be effectively delivered, especially in poor areas, center-local fiscal relations will need to be reformed. Toward this goal, the authorities changed the sharing formula for income taxes in 2002. This has brought additional resources to the center, which in turn has been used to finance increased transfers to western provinces.

In tackling its major structural reforms, China would benefit from greater flexibility in its exchange rate, which is currently tightly linked to the U.S. dollar. More flexibility would also allow more room to pursue an independent monetary policy and will help cushion China's economy against adverse shocks. In concluding this year's annual (Article IV) consultation with the People's Republic of China in October (see Public

Information Notice No. 03/136), IMF Executive Directors noted that greater exchange rate flexibility could be phased in without causing major disruptions to China's economy. Also, the Directors observed that the functioning of the country's foreign exchange market could be substantially improved by eliminating trading restrictions and surrender requirements, widening the base of participants, and developing instruments for foreign exchange risk management.

In recognition of the challenges that lie ahead, the Third Plenum of the Sixteenth Congress of the Chinese Communist Party issued a communiqué in October outlining the structural reform agenda, consistent with the issues discussed above. The Chinese authorities are now in the process of specifying the measures to be put in place to implement their ambitious reform agenda. ■

The full text of Public Information Notice No. 03/136 on the conclusion of the IMF's annual (Article IV) consultation with the People's Republic of China is available on the IMF's website (www.imf.org).

Greater exchange rate flexibility could be phased in without causing major disruptions to China's economy.

Available on the web (www.imf.org)

Press Releases

- 03/187: IMF Managing Director Horst Köhler's Statement at the Conclusion of a Visit to the Republic of Armenia, November 10
- 03/188: The Republic of Uzbekistan Accepts Article VIII Obligations, November 11
- 03/189: IMF Deputy Managing Director Shigemitsu Sugisaki's Statement at the Conclusion of a Visit to Uzbekistan, November 12
- 03/190: IMF Managing Director Horst Köhler's Statement at the Conclusion of a Visit to the Republic of Tajikistan, November 12
- 03/191: IMF Completes Second Review and Grants Waivers Under Stand-By Arrangement with the Republic of Croatia, November 12
- 03/192: IMF Managing Director Horst Köhler's Statement at the Conclusion of a Visit to Russia, November 14
- 03/193: IMF Managing Director Horst Köhler's Statement at the Conclusion of a Visit to the Republic of Kazakhstan, November 14
- 03/194: IMF Approves in Principle Three-Year \$72 Million PRGF Arrangement for Nepal, November 14
- 03/195: Zambia—Joint Statement by the IMF Mission and the Government of Zambia, November 17

Public Information Notices

- 03/133: IMF Concludes 2003 Article IV Consultation with Georgia, November 7

- 03/134: IMF Concludes 2003 Article IV Consultation with Italy, November 13
- 03/135: IMF Concludes 2003 Article IV Consultation with Suriname, November 19
- 03/136: IMF Concludes 2003 Article IV Consultation with the People's Republic of China, November 18

Speeches

- "Moving on from Cancún: Agricultural Trade and the Poor," Anne Krueger, IMF First Deputy Managing Director, Agricultural Trade Policy Workshop, Washington D.C., November 3
- "Financing Water and Sanitation Services: Options and Constraints," Anne Krueger, IMF First Deputy Managing Director, Inter-American Development Bank Conference, November 10
- Opening Remarks, 2nd Ministerial Conference on Central Asia Regional Economic Cooperation, IMF Deputy Managing Director Shigemitsu Sugisaki, Tashkent, Uzbekistan, November 12
- "Opportunities and Challenges for Central Asia," IMF Managing Director Horst Köhler, Conference for the Tenth Anniversary of the Introduction of the Tenge, Almaty, Kazakhstan, November 14

Transcripts

- "Capital Flow Cycles: Old and New Challenges," IMF Economic Forum, November 7
- Conference Call on Italy with Carlo Cottarelli and Thomas Krueger, IMF European Department, November 13

IMF and World Bank seek common ground with World Council of Churches



Aruna Gnanadason, Coordinator of the Women's Program, Justice, Peace, and Creation Unit, WCC.



Katherine Marshall, Director, Development Dialogue on Values and Ethics, World Bank.

World Bank and IMF staff held a two-day forum with representatives of the World Council of Churches (WCC) in Washington, D.C., in late October to discuss issues of common concern and lay the ground for a top-level meeting of the three institutions in 2004.

In January 2002, the Reverend Dr. Konrad Raiser, general secretary of the WCC, initiated a dialogue with the Bretton Woods institutions by sending a letter to IMF Managing Director Horst Köhler and World Bank President James Wolfensohn. A year later, the first meeting was held at the WCC headquarters in Geneva, Switzerland, during which further meetings were planned.

The WCC—an organization of 342 Christian churches in more than 120 countries—has been a critic of the Bretton Woods institutions. Its representatives say the IMF and the World Bank are dominated by their major shareholders, strongly influenced by the “neoliberal paradigm,” and insufficiently attentive to the economic and social consequences of their policy advice in poor countries.

The discussion during the second meeting, held October 28–29, focused on four themes:

Governance and accountability. The WCC called for a reform of voting rights within the IMF and World Bank, arguing that the United States and, to a lesser degree, Europe wield excessive power within the two organizations. Staff noted that the IMF and the World Bank are financial institutions serving a universal membership and that voting rights reflect the economic contributions of each member country

to their organizations' budgets. They also explained that voting rights are only part of the story of how the institutions' policies and actions are determined—sophisticated consensus and coalition building allow developing countries a greater say than their voting rights alone would suggest.

Role of civil society. IMF and World Bank staff noted the success of the poverty reduction strategy paper (PRSP) approach in terms of economic growth and better social services for the poor. PRSPs have also led to greater openness in the policy formulation process within countries, although more needs to be done to ensure that people affected by change are consulted in a legitimate fashion. WCC representatives suggested that the PRSP could be used as a vehicle to promote democracy in countries with IMF and World Bank programs.

Roles of the private and public sectors. The three parties agreed that social services constitute a basic human right and are therefore a responsibility of the state. But there was considerable disagreement on how those services should be provided. The IMF and the World Bank said governments often skewed spending toward the more affluent urban population. An appropriate balance between public and private sectors could serve as an incentive for better services. The WCC said that markets only supply people who have buying power and only value what has a price. Hence, the public sector must be responsible for basic social services.

Globalization. Globalization and its effects on the poor were also debated. IMF staff suggested that there is clear evidence that trade promotes economic

IMF guide to help staff interact with civil society

The meeting with the WCC is just one example of the increasing importance the IMF attaches to its relations with civil society. Yet IMF staff are sometimes hesitant about engaging in outreach. Some fear alienating the government they are working with; others feel they lack the knowledge about local civil society organizations to engage confidently in a dialogue. To assist staff in conducting outreach, the IMF published a guide in October that explains what staff can hope to gain from outreach and provides practical advice for building positive relationships.

The guide received extensive input from Professor Jan Aart Scholte, University of Warwick, who has been researching the relationship between the IMF and civil society. In an interview with the IMF's civil society newsletter

in April 2003, Scholte said that “eight years ago, the widespread view at the IMF was that engaging with civil society organizations would alienate government authorities and damage the prospects of a successful program implementation. Nowadays, the widespread view is that engaging with civil society groups is part of building the political ground for a constructive implementation of programs.”

Civil society representatives gave a qualified welcome to the guide at the World Bank–IMF Annual Meetings in Dubai in September. Alan Waites, Director of World Vision (a Christian relief and development organization), said that much more could be done, especially in terms of enhancing the IMF's capacity to undertake effective in-country outreach.

The guide is available at www.imf.org/external/np/cso/eng/2003/101003.htm. Comments are welcome.

growth, but that timing and proper sequencing of policy changes are important: Countries should take a gradual approach and introduce measures to protect those who “lose out” as the result of these changes. WCC representatives questioned the links between poverty reduction, and economic growth and trade expansion. They urged that human rights issues be given more prominence in discussions of trade mea-

sures. And a more disaggregated approach, they said, would highlight the negative effect of trade expansion on specific countries and groups of people.

The next preparatory meeting between the three organizations will likely focus on case studies, to further deepen the dialogue. The final high-level meeting of the three institutions' leaders will probably take place in the second half of 2004. ■

Stand-By, EFF, and PRGF Arrangements as of October 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
(million SDRs)				
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	7,151.00
Bolivia	April 2, 2003	April 1, 2004	85.75	21.43
Bosnia and Herzegovina	August 2, 2002	December 31, 2003	67.60	12.00
Brazil	September 6, 2002	December 31, 2003	22,821.12	5,621.48
Bulgaria	February 27, 2002	February 26, 2004	240.00	52.00
Colombia	January 15, 2003	January 14, 2005	1,548.00	1,548.00
Croatia, Rep. of	February 3, 2003	April 2, 2004	105.88	105.88
Dominica	August 28, 2002	February 27, 2004	3.28	0.62
Dominican Rep.	August 29, 2003	August 28, 2005	437.80	350.24
Ecuador	March 21, 2003	April 20, 2004	151.00	90.60
Guatemala	June 18, 2003	March 15, 2004	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
F.Y.R. Macedonia	April 30, 2003	June 15, 2004	20.00	12.00
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Turkey	February 4, 2002	December 31, 2004	12,821.20	2,041.20
Uruguay	April 1, 2002	March 31, 2005	2,128.30	652.40
Total			49,835.21	18,072.47
EFF				
Indonesia	February 4, 2000	December 31, 2003	3,638.00	344.06
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
Serbia and Montenegro	May 14, 2002	May 13, 2005	650.00	350.00
Total			4,432.40	817.79
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	16.00
Armenia	May 23, 2001	May 22, 2004	69.00	29.00
Azerbaijan	July 6, 2001	March 31, 2005	80.45	51.48
Bangladesh	June 20, 2003	June 20, 2006	347.00	297.50
Benin	July 17, 2000	March 31, 2004	27.00	1.35
Burkina Faso	June 11, 2003	June 10, 2006	24.08	20.64
Cameroon	December 21, 2000	December 20, 2003	111.42	47.74
Cape Verde	April 10, 2002	April 9, 2005	8.64	4.95
Chad	January 7, 2000	January 6, 2004	47.60	5.20
Congo, Dem. Rep. of	June 12, 2002	June 11, 2005	580.00	106.63
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Ethiopia	March 22, 2001	July 31, 2004	100.28	20.86
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	January 12, 2001	January 11, 2004	108.00	58.50
Ghana	May 9, 2003	May 8, 2006	184.50	158.15
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Guyana	September 20, 2002	March 19, 2006	54.55	43.03
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	28.68
Lao P.D.R.	April 25, 2001	April 24, 2005	31.70	13.58
Lesotho	March 9, 2001	March 8, 2004	24.50	7.00
Madagascar	March 1, 2001	November 30, 2004	79.43	34.04
Malawi	December 21, 2000	December 20, 2004	45.11	32.23
Mauritania	July 18, 2003	July 17, 2006	6.44	5.52
Moldova	December 21, 2000	December 20, 2003	110.88	83.16
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Nicaragua	December 13, 2002	December 12, 2005	97.50	69.64
Niger	December 22, 2000	December 21, 2003	59.20	13.52
Pakistan	December 6, 2001	December 5, 2004	1,033.70	516.84
Rwanda	August 12, 2002	August 11, 2005	4.00	2.86
Senegal	April 28, 2003	April 27, 2006	24.27	20.80
Sierra Leone	September 26, 2001	September 25, 2004	130.84	42.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	49.00
Tanzania	August 16, 2003	August 15, 2006	19.60	16.80
Uganda	September 13, 2002	September 12, 2005	13.50	10.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Total			4,568.44	2,518.54

Members drawing on the IMF “purchase” other members' currencies, or SDRs, with an equivalent amount of their own currency.

EFF = Extended Fund Facility
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals owing to rounding.
Data: IMF Finance Department

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- 03/301: Uganda: PRSP Annual Progress Report
- 03/302: Mongolia: Joint Staff Assessment of the PRSP
- 03/303: Chile
- 03/304: Mongolia: First and Second Reviews Under the PRGF, and Requests for Waiver of Performance Criteria, Extension of Arrangement and Rephasing of Purchases
- 03/305: Nepal: PRSP
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- 03/315: Islamic Republic of Mauritania: Statistical Appendix
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Second East Asia and Pacific Regional Conference

Phnom Penh gathering spotlights poverty reduction experiences

More than 150 government officials, civil society representatives, parliamentarians, and academics gathered in Phnom Penh October 16–18 to share their experiences on poverty reduction strategies. The Second East Asia and Pacific Regional Conference—sponsored by the Asian Development Bank, the IMF, the United Nations Development Program, and the World Bank—focused on developments in Cambodia, Indonesia, the Lao People’s Democratic Republic (P.D.R.), Mongolia, Timor-Leste, and Vietnam. It also offered practical advice on broadening participation, decentralization, “localizing” efforts to reach the Millennium Development Goals (MDGs), and addressing gender issues.

Four years into the process of crafting poverty reduction strategy papers (PRSPs), several of the low-income countries in East Asia and the Pacific are ready to move from design to implementation. And the poor want to see real results in terms of pro-poor growth.

One topic that drew considerable attention at the conference was the need to strengthen links between national policymaking and poverty reduction strategies, and between the poverty reduction strategies and the MDGs. Participants also saw rural development as a key part of a pro-poor growth strategy, since about three-quarters of East Asia’s poor still live in rural areas. In particular, several speakers urged that specific steps be taken to raise the productivity of small farmers and the nonfarm sector, and to improve the delivery of services to the poor. All of this would be essential, they said, if the poor are, in fact, going to benefit from growth.

There was broad agreement, too, that trade opportunities should play a critical role in efforts to boost growth and reduce poverty. For their part, country teams acknowledged the need to improve local transport and expand the types of goods produced for foreign markets beyond traditional exports such as garments. But the teams also issued strong calls for industrial countries to further open their markets to the exports of poor countries.

Broadening participation

One of the distinguishing and widely supported characteristics of the PRSP process is its emphasis

on greater inclusiveness in the development process. The conference raised some concerns about the quality of that participation. Some expressed a fear that participation had become “ritualistic” and cited the need to “narrow the gulf between the state and the people.” Russell Peterson of the Cambodia NGO Forum called for greater efforts to ensure that domestic civil society groups, ethnic associations, and trade unions are adequately represented. As it is now, he said, many of the non-governmental organizations (NGOs) in Cambodia are international.

A practical measure that could enhance local participation, one delegate said, would be to hold more discussions on PRSPs in the local language. Too often, these discussions are in English, even where this is not a widely used language. A number of participants also made the case for expanding the role of legislators, arguing that the poor need an effective voice in the poverty reduction process, and that legislators, as representatives of the people, need to be more broadly and deeply involved.

But cautionary notes were sounded, too. Broader participation requires greater coordination, and that can be demanding. Khempheng Pholsena observed that in his country, Lao P.D.R., “achieving coherence and strengthening coordination among all development partners . . . required an outstanding effort of consultation and participation.”

Decentralizing

Are national and subnational planning processes and the policy priorities generated by them integrated and balanced? Can local planning be better aligned with national planning? Chea Vannath, of Cambodia’s Center for Social Development, pointed out that while decentralization is frequently held up as a means to reduce corruption at the central level, it often succeeds in relocating corruption



Country delegation and development partners at the opening session of the Second East Asia and Pacific Regional Conference.



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rather than reducing it. Others agreed, noting that too often local elites are not committed to pro-poor policies.

Speaking of Indonesia's experience, Bambang Bintoro was more optimistic about decentralization, but still cautious. He observed that Indonesia's "big bang" approach to decentralization has led to "a new intergovernmental fiscal framework . . . a new accountability system at the local level, and it has promoted a vibrant civil society at the local level that can critically monitor local politics. The result is that Indonesia is moving from being a very centralized system to a very decentralized one."

But as he and others noted, decentralization poses several challenges for governments and should be approached with care. There are often, for example, a lack of clarity in the division of power and responsibilities between the central, provincial, and local governments; inadequate human and institutional capacity; and difficulties in raising revenues and strengthening accountability at the local level. These are areas where financial support and technical assistance from development partners can help, noted Singkham Khongsavanh of the Lao P.D.R.

Localizing the MDGs

What is the relationship between poverty reduction strategies and the MDGs? Many saw the MDGs and the PRSPs as reinforcing each other, with the PRSP providing the framework to achieve the MDGs. More generally, country representatives saw the MDGs as providing useful benchmarks for poverty reduction and as a means of mobilizing political commitment.

East Asia is at the forefront in meeting a number of the MDGs. Two of the goals, halving between 1990 and 2015 the number of people living in extreme poverty and hunger and achieving universal primary education by 2015, appear well within reach. But other goals, notably improving maternal health and ensuring environmental sustainability, present greater challenges.

Delegations from Cambodia and Vietnam described how their countries were "localizing the MDGs"—tailoring them to meet their own particular



Phnom Penh conference weighs strategies for East Asia and Pacific to reach poverty goals.

circumstances. Nguyen Van Phuc of Vietnam indicated that his country has opted to create different time frames for different goals. It has made substantial progress, for example, in boosting incomes, but in other areas where more progress is needed, it has added new goals for itself, such as governance measurements.

Country delegations also grappled with whether their poverty reduction targets should be set ambitiously to meet the MDGs or calibrated more realistically to match available financing and the prospects for policy reform.

The consensus seemed to be that a fine balance would need to be struck between ambition and realism to keep people motivated.

Integrating the gender perspective

Delegates also took up how gender issues, including those embodied in the MDGs, are being addressed in poverty reduction strategies and reflected in budget frameworks. While substantial progress has been made on gender issues in recent years, many challenges remain, notably with regard to the role of women in decision making, promoting greater equity in property ownership, and making macroeconomic policies and national budgets more gender sensitive.

What's ahead

Two years earlier, when the country teams met at the First East Asia and Pacific Regional Conference in Hanoi, many countries were just embarking on their poverty reduction strategies. As the Phnom Penh conference drew to a close, participants pointed to progress that had been made and indicated they would be returning home with fresh ideas and renewed momentum.

The Phnom Penh conference, which is the most recent in a worldwide series of regional PRSP outreach conferences, will be followed by a Balkan conference, scheduled to be held in spring 2004.

For more information about the conference, please check the IMF's website at www.imf.org/external/np/prsp/2003/eng/101603.htm. ■