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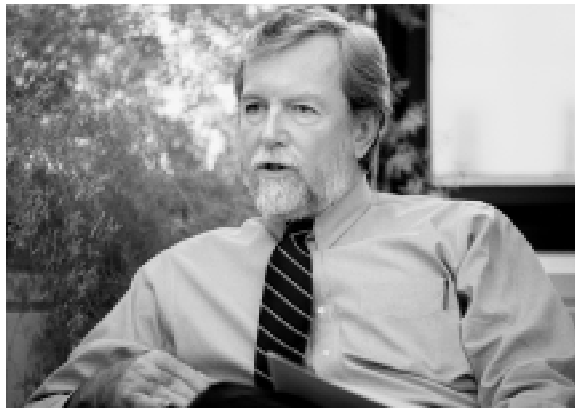
Interview with Jack Boorman

Debt relief is designed to help poorest countries implement poverty reduction strategies

Jack Boorman has been Director of the IMF's Policy Development and Review (PDR) Department since August 1990. PDR plays a central role in the design, implementation, and evaluation of IMF policies relating to surveillance and the use of IMF financing, including concessional financing for low-income countries. Boorman met recently with the IMF Survey *to discuss the important progress being made in the area of debt relief for heavily indebted developing countries.*



Boorman: "This is a big change in the way these institutions have operated."

IMF SURVEY: The Annual Meetings in Prague set a goal of bringing 20 countries to their decision points under the enhanced Heavily Indebted Poor Countries [HIPC] Initiative by the end of this year when they will begin to receive relief on their debt payments. How close are we to meeting that objective?

BOORMAN: By early December, the Executive Boards of the IMF and the World Bank had taken the necessary decisions to make assistance available to 13 eligible countries. Even now, most of them are receiving interim assistance. *(Please turn to the following page)*

Köhler to ask IMF Executive Board to approve $10 billion in support for Turkey

IMF Managing Director Horst Köhler on December 6 welcomed the additional measures announced by Turkish Prime Minister Bulent Ecevit to address Turkey's current economic and financial problems. Stressing that the program deserves strong international support, he said he would ask the IMF Executive Board to approve a package of loans amounting to more than $10 billion, comprising about $7.5 billion under the IMF Supplemental Reserve Facility (SRF) and some $2.9 billion still available to Turkey under its current Stand-By Arrangement.

In a statement, Köhler said: "I welcome today's announcement by Prime Minister Ecevit. The comprehensive set of additional measures demonstrates resolve and leadership in overcoming Turkey's current economic and financial problems. The strengthened program builds on the achievements made so far in disinflation and fiscal consolidation and moves forward decisively the country's structural reform and privatization agenda.

"I particularly welcome the government's firm commitment to implement a bold set of measures to strengthen the soundness of the banking sector, aimed at tackling the root causes of the current problems. I welcome the firm action already taken in this respect, including the decision to protect depositors and other creditors in Turkish banks. The comprehensive package of strengthened policies should provide the basis for restoring confidence and sustaining growth in the Turkish economy" (IMF News Brief, No. 00/113).

IMF European I Department Director Michael Deppler explained that at the Board meeting scheduled for December 21, the Managing Director would propose an immediate drawing of $2.25 billion under the SRF and $550 million under the Stand-By Arrangement. Additional amounts would be made available throughout 2001: $1.1 billion on January 20; $1.1 billion on February 20; and then $750 million each on March 15, June 15, August 15, and November 15.

The SRF, established in December 1997, is designed to help members experiencing exceptional balance of payments problems resulting from a sudden and disruptive loss of market confidence. Access is not subject to the usual limits, and countries drawing under the facility are expected to repay within one to one-and-a-half years from the date of each purchase, although the Board may agree to extend this period by up to one year. Turkey's current Stand-By Arrangement with the IMF was approved in December 1999 in an amount totaling $4 billion.

In this issue

The next issue of the *IMF Survey* will be published on January 8, 2001.

Boorman discusses progress in debt relief strategy

Jack Boorman, a U.S. national, holds a Ph.D. in economics from the University of Southern California (USC). He taught economics at USC and the University of Maryland and served with the U.S. Federal Deposit Insurance Corporation before joining the IMF staff in 1975. He served as a division chief in the European and Asian Departments of the IMF and as Assistant Director of the European Department before becoming Deputy Director of the then Exchange and Trade Relations Department (now Policy Development and Review Department) in 1987. He also served, from 1976–78, as the IMF's Resident Representative in Indonesia.

(Continued from front page) We have been working actively on 11 other countries over the last several months, and I am confident that we will reach the decision points for at least 6 and, more likely, 8 or 9 of them, so that we will be able to meet or be very close to the target of 20 countries by the end of December.

In every case, difficult questions have had to be answered, particularly with our focus on reaching this objective by the end of the year. The deadline has helped to coalesce support and has focused everyone's attention on making sure that everything is running as smoothly and as rapidly as possible. At the same time, we feel, as do our shareholders, that the elements of the program have to be right and designed in a way to ensure that the objectives of poverty reduction in these countries can be met and that the debt relief provided is used to further those objectives.

IMF Survey: Once the goal of assisting 20 countries has been met, what will it mean in terms of actual debt relief for the poorest countries?

Boorman: The countries that we will bring to the decision point by the end of the year will receive varying degrees of debt relief. The initiative is tailored to the specific circumstances of each of the countries and is intended to put them in a situation where their debt service and debt profile will be sustainable from now on. That requires different degrees of relief for each country. When you take account of the assistance being provided through the Paris Club and bilateral, multilateral, and regional agencies, the debt of these countries will be reduced by about two-thirds on average. And, contrary to the statements of some critics, all of these countries will see a significant immediate reduction in their debt-service payments. In one country, Zambia, the reduction is not as large as in other cases, but here the IMF is providing its relief on exceptional terms.

Boorman: "The deadline has helped to coalesce support and has focused everyone's attention on making sure that everything is running as smoothly and as rapidly as possible."

IMF Survey: Is this relief significant in terms of the overall outstanding debt of the poorest countries?

Boorman: It is indeed significant, in terms of its size and in that it is being provided by the multilateral institutions. This is a big change in the way these institutions have operated and a significant move in the direction of trying to deal with what has become an unsustainable situation in these countries. But, most important, its significance will be measured by the extent to which the relief that has been committed to these countries is used in a way that actually reduces poverty.

IMF Survey: As you note, a central component of the enhanced HIPC Initiative is the stronger and more explicit link between debt relief and poverty reduction. What's the significance of this and how is it working?

Boorman: Probably most important are the steps that the World Bank and the IMF have taken to change their operations for assisting the HIPC countries. Foremost is the development of the poverty reduction strategy initiatives for these countries and other low-income countries. These strategies have a number of important dimensions. First is to make sure that the IMF and the World Bank are doing everything they can as effectively as possible to help countries develop their poverty reduction strategies and to ensure that the programs they support in these countries work toward that goal. A second important objective is to ensure that the countries themselves develop their programs through a participatory process within the government and with civil society and parliaments and that we can endorse their objectives. We have learned that it doesn't work very well if we try to establish policies in Washington and then take those policies to the countries and ask them to implement them. This concept of "ownership" of a program goes very deep and entails a desire to see that there is support throughout the government, in the political arena, and among the civil community for the measures being taken.

Each country has different social, cultural, and political traditions that can affect its situation, and we—and they—are wrestling with what a consultative process means in these different contexts. We can't go in and dictate a process to a country. It has to be consistent with a country's traditions, which is not an easy task. We realize the difficulty of coming to a full-blown poverty reduction strategy, but we didn't want this to get in the way of the early delivery of assistance. To square that circle, we developed an interim poverty reduction strategy paper [PRSP], which is basically the first step a country needs to take in developing a full-blown poverty reduction strategy. Most of the countries that we have brought to the decision point so far have been through this interim PRSP.

IMF Survey: How would you answer the critics who argue that the HIPC Initiative is overly complex and too slow in delivering results?

Boorman: The world itself is complex. We could have decided simply to provide relief to the HIPC countries through immediate cash assistance, debt write-offs, or other devices. There was and is virtually no support for that approach, because the community that is contributing to this effort—the multilateral institutions, bilateral donors, and others—wants this relief to be used for the benefit of the populations of these countries through effective programs of poverty reduction. This is an area that these institutions and the countries have been working on for years. What is needed are effective programs that can be supported by the resources made available through debt relief, together with getting the needed political support for structural and developmental programs within the countries and putting in place the monitoring devices, budgetary processes, and all the other measures that are necessary to make sure the relief is really used for the intended purposes. This process can be jeopardized in many of these countries if there are program design problems, if their budgets are not executed properly, or if there is corruption. The world is sometimes a messy place. Some of the complexity, some of the time that it takes to implement this initiative, reflects the fact that we and the countries concerned are trying to get it right.

IMF Survey: As you mentioned earlier, the IMF and the World Bank cooperate closely in the HIPC Initiative and the PRSP process. How successful has that cooperation been in practice? Is it possible to avoid duplication?

Boorman: Cooperation between the two institutions in the context of the HIPC Initiative has been almost a model of the way we can work together. We have been together on this initiative from day one and we have taken it through various stages. The original initiative had features that some people thought were contributing to slower delivery of assistance than was thought necessary; also, questions were raised about the amount of relief being given. We worked together to support the discussions that began following the initiative of Jubilee 2000 and other organizations to try to press the international community to provide deeper and faster relief. However, we had to deal with the reality of finding the money to produce that result. The political pressure engendered by the lobbying efforts of these organizations and others was helpful in capitalizing additional support and securing more resources from the multilateral institutions and bilateral lenders to enable us to make the initiative more generous than it was initially.

There's another important dimension to this issue. Over the years, there have been questions about whether the operations of the IMF and the World Bank in these countries are well tailored to each other and complement each other, in terms of the substance and timing of the programs. Legitimate concerns have been raised about whether the two institutions are working together as effectively as possible. These are precisely the discussions that led to the concept of the poverty reduction strategy paper, which gives the country itself more leadership in developing its program and ensures that the IMF and the Bank will work together with the same objectives and in support of the same programs that have been developed by the country's authorities. In the IMF, we modified what had been the Enhanced Structural Adjustment Facility [ESAF] and converted it into the Poverty Reduction and Growth Facility [PRGF] to tailor our own operations better to the PRSP. The Bank has created the Poverty Reduction Support Credit [PRSC], which will allow all their operations to coalesce within a single framework that would be parallel to the PRGF. And we have set up a joint implementation committee, which meets regularly to track progress and resolve any emerging problems of collaboration.

IMF Survey: The Managing Director said in his Annual Meetings address (*IMF Survey,* October 9, page 303) that a real breakthrough in poverty reduction would be possible only if private savings and investment take root in the poorest countries. What progress has been made in these areas?

Boorman: Over the last 5–10 years, there has been a much broader acceptance of the model of an open market capitalist economy. We all know the experiments that African countries, in particular, went through with various forms of socialist economic regimes and the damage that some of these experiments did to the continent. Acceptance of the paradigm of open market economies holds the promise for many of these countries to do far better in terms of growth and poverty reduction. In a market economy, you must have good regulation, good supervision, strong financial institutions, commercial codes that protect property rights, and a judicial system that provides surety to investors, their property, and their contracts. These are key to stimulating domestic savings, on the one hand, and stimulating an inflow of

Selected IMF rates

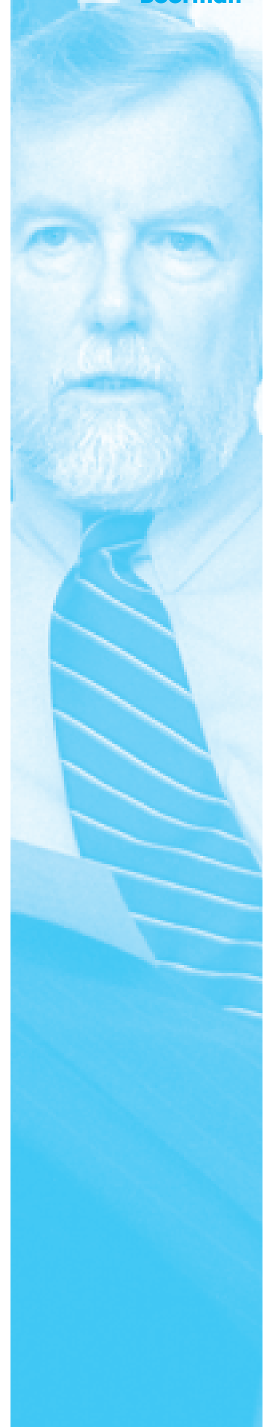
Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
November 20	4.84	4.84	5.61
November 27	4.85	4.85	5.62
December 4	4.78	4.78	5.54

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?2000).

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

Data: IMF Treasurer's Department

What is needed are effective programs that can be supported by the resources made available through debt relief.
—Boorman



resources from outside the country, on the other. Most important is to make sure that such resources are used effectively and produce growth in these countries.

However, countries' needs go well beyond simply using their own savings efficiently and attracting foreign direct investment to questions about the access these countries have to international markets for their goods. We know that there are still impediments, whether they stem from the common agricultural policy in Europe or from the health and safety regulations that are imposed in most industrial countries. It is not a matter of dismantling the regulations but, rather of assisting the developing countries to jump over the hurdles created by some of these regulations.

The estimates of the benefits to the poor countries from opening the markets of the industrial countries more widely are dramatic. They far surpass anything that could be provided through debt relief alone. Debt relief by itself is only one element of a much broader menu of initiatives that these countries—and the international community—need to integrate themselves better with global trade markets and, as a result, to grow faster than they have in the past. In this context, it could also help enormously if the industrial countries would begin to move toward the 0.7 percent of GDP figure for overseas development assistance.

IMF Survey: How would you respond to the assertion of groups such as Jubilee 2000 that the simplest and fairest course would be that of complete debt forgiveness?

Boorman: Complete debt forgiveness is a superficially attractive option. When you see the situation of some of the poorest and most heavily indebted countries, and when you think back to their geopolitical history and the manner in which they were exploited during the cold war for the purposes of one side or another, you are obviously tempted in the direction of some form of debt forgiveness. However, much of their debt is legitimate debt, commercial debt for development projects, or the result of the provision of aid. Another large part stems from the resources that the multilateral institutions provided in support of countries' development programs. So the overall picture of the composition of debt is a mixed one.

There are other very difficult issues that would have to be addressed if one were to consider a full debt write-off. First, just writing off debt is not without cost. Someone has to pay the burden of that write-off. The international community has gone far in effectively mobilizing resources. Going further would be very difficult. One of my fears is that, if we did try to go further at this stage, we would end up simply diverting resources from the already low level of overseas development assistance flows, and there would be no net gain to the indebted country.

Another important aspect that can't be ignored is that, if you decide to write off fully the debt of the poorer countries, where do you draw the line? Some countries would inevitably fall just on one side or the other of the line. There certainly is an issue of equity and fairness about drawing that line and whether or not it is effective. It would not be effective if it harmed those countries that have been the most responsible in their recent policies.

My final thought goes back to where we began, with the objective of bringing 20 of the HIPC countries to the decision point by the end of this year. This number does not exhaust the list of countries that will require assistance to have a sustainable debt situation and to devote their resources to poverty reduction. Let us not forget that, while the immediate objective is important, it is only the first step. In doing our best with the HIPC Initiative, we should not lose sight of the other countries that need assistance.

Even for those countries that will have been brought to the decision point by the end of December, this is only the beginning in implementing poverty reduction strategies and bringing debt relief to these countries. As I have repeatedly emphasized, debt relief needs to be used properly to produce the results that the countries and those providing the resources want. There is a long road ahead in terms of sticking to the policies that are identified in the poverty reduction strategy and in implementing policies that hold the promise of producing the desired results. This will be no easy task. An important part of this equation still needs to be filled in by the countries themselves. ■

Ter-Minassian to head Fiscal Affairs Department

In a press release dated December 4, IMF Managing Director Horst Köhler announced his intention to appoint Teresa Ter-Minassian as Director of the Fiscal Affairs Department, effective January 2, 2001. She will succeed Vito Tanzi, who is retiring from the IMF.

Ter-Minassian, an Italian national, is currently Deputy Director of the IMF's Western Hemisphere Department, where she has headed recent program negotiations with Brazil and Argentina, among other assignments. She is a graduate of the University of Rome and holds an M.S. degree in economics from Harvard University.

After four years as an economist in the Research Department of the Bank of Italy, Ter-Minassian joined the IMF in 1971 as an economist in the Fiscal Affairs Department. She held several senior positions in the former European Department before becoming Deputy Director of the Fiscal Affairs Department in 1988 and Deputy Director of the Western Hemisphere Department in 1997.

The full text of Press Release No. 00/65 is available on the IMF's website (www.imf.org).

Teresa Ter-Minassian

IMFSURVEY

Fischer outlines role for IMF's improved Contingent Credit Lines Facility

Following are edited excerpts of an address prepared for presentation by IMF First Deputy Managing Director Stanley Fischer at the Seventy-Fifth Anniversary Conference of the Banco de México in Mexico City, November 14–15. The full text is available on the IMF's website (www.imf.org).

Today I want to talk about a new element in the international financial system, the IMF's Contingent Credit Lines (CCL) Facility. This, I believe, is a potentially extremely significant innovation that will deploy the IMF's financial resources more effectively to help prevent financial crises, rather than to help pick up the pieces after the damage has been done. The basic idea is straightforward: the IMF offers a precautionary line of credit to countries that have demonstrably sound policies but that nonetheless believe they may be vulnerable to contagion from crises elsewhere.

Volatility and contagion

The expansion of private international capital flows from $40 billion in 1990 to $290 billion in 1997 (after which they declined to $170 billion in 1999) has been one of the most spectacular manifestations of globalization in recent years. These flows have brought economic benefits to borrowers and lenders alike, but—as we have seen too often over the last six years—there is an important downside. Countries have been exposed to periodic crises of confidence when inflows of capital were suddenly reversed.

As international capital flows have increased relative to the size of national economies, so has the potential disruption threatened by their reversal. The need to maintain investor and creditor confidence generally serves as a useful discipline. It magnifies the rewards for good policies and the penalties for bad ones. But the capital account crises of recent years drive home the possibility that volatility and contagion can on occasion become excessive.

As a crisis spreads initially, most of those involved—particularly the affected countries—tend to blame excess volatility and contagion; in other words, they claim that they were innocent bystanders. This is in part a natural human reaction, in part a rational response to events. Eventually, the policymakers in the affected countries get down to solving their problems, and there is less talk about contagion and more talk about the weaknesses in the economy.

Still, which is it—contagion or weaknesses in the affected economy? The answer is both. Establishing the presence of excess volatility and contagion in the system is complicated by the fact that a crisis of confidence can push a country from a good to a bad equilibrium: to put it simply, when a country's institutions and policies are subjected to massive pressure from a reversal of capital inflows, they may crack, thereby appearing to justify the reversal of flows that caused the crisis. Similarly, contagion does not spread randomly; rather, it hits weaker economies more quickly and more forcefully than stronger ones.

Focusing on prevention

One response has been to bolster IMF surveillance of national policies and international markets. We are concentrating more on potential weaknesses that might leave a country vulnerable to a crisis: poor macroeconomic policies; the exchange rate regime; unsound debt management; and weak financial sectors, to name but a few. Countries are also publishing more and better information about their own policies and economic developments. And a large and growing majority are choosing to publish the advice they get from the IMF. This makes it easier for investors and creditors to make better informed portfolio decisions; no less important, by making it necessary for policymakers to explain to the public what they are doing and why, transparency contributes to better policies.

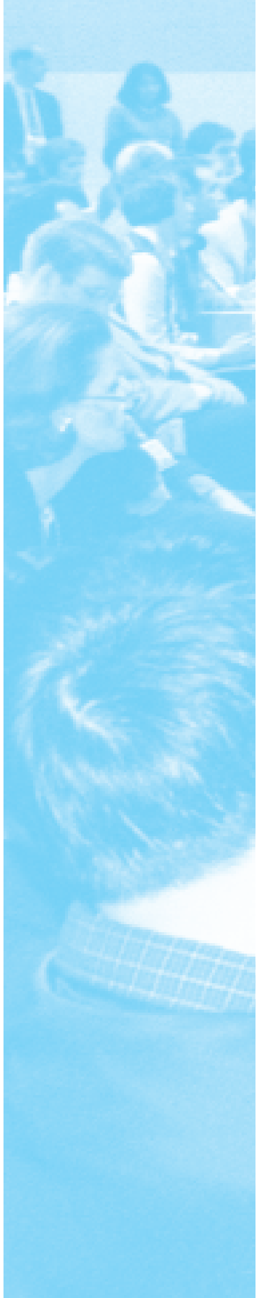
The CCL is complementary to these efforts, providing an additional financial incentive to adopt good policies. In effect, the CCL allows countries that have met certain preconditions to augment—at low cost—the foreign exchange reserves they can draw on in a crisis. The knowledge that these resources are available may in itself serve to deter speculative attacks. In addition, by offering qualifying countries a public seal of approval for their policies, the CCL also makes it less likely that investors and creditors will succumb to herd behavior by pulling out their money when a crisis strikes elsewhere.

Principles underlying the CCL

Traditionally, the IMF has offered financial support to countries already in trouble, typically when they are facing short-term balance of payments problems on the current account. When capital flows were restricted, the adjustment that a country needed to make to deal with a crisis was set by the scale of the

Photo Credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 385–88, 391–92, 394–95, and 399; and Federal Reserve Bank of Philadelphia, page 400.

Extending credit lines to countries *before* problems break out means that the IMF's lending capacity can be used to serve the cause of crisis prevention as well as crisis resolution.
—Fischer



external imbalance, rarely more than 5 percent of GDP. This was reflected in the rules determining how much a country can borrow from the IMF under a conventional Stand-By Arrangement—normally up to 100 percent of its quota, its contribution to the IMF's capital base, in any one year, with a cumulative maximum of 300 percent of quota.

Capital account crises present more of a challenge. When a country confronts a crisis of confidence over its ability to repay its foreign creditors, the scale of its financing problem is set not by the current account deficit, but by potential capital flows, related to the size of its external debt and sometimes also to the scale of the internal debt. Of course, the official sector cannot and should not meet this entire financing need. But the official sector does play an important role in helping countries avoid the full burden of adjustment that would otherwise be needed. It can achieve this not only by providing money itself, but also—through its catalytic role—by restoring confidence among private creditors and lenders.

Like the Supplemental Reserve Facility (SRF), which the IMF established in 1997, the CCL is aimed at capital account rather than current account crises. As with the SRF, there is a recognition that relatively large sums of money may be needed, so there is no formal access limit. Given the threat that contagion could strike several countries at once, the IMF Executive Board agreed that the IMF's overall liquidity position would be taken into account in deciding the scale of access in any particular case.

With both normal Stand-By Arrangements and the SRF, the IMF is picking up the pieces after an accident has happened. The CCL marks a clear departure from this model. Extending credit lines to countries *before* problems break out means that the IMF's lending capacity can be used to serve the cause of crisis prevention as well as crisis resolution.

There is obviously a risk of moral hazard here. Countries have an incentive—in theory, at least—to run weaker policies if they have an extra financial cushion in place. Perhaps more important, investors have an incentive to lend to countries with weaker policies if they believe that the presence of an IMF credit line increases the chances that they will be repaid if things go wrong. To counter this problem, the CCL is aimed explicitly at members with first-class policies that face a potential loss of access to international capital markets because of contagion, rather than domestic policy weaknesses. The four eligibility criteria have been designed accordingly:

- First, at the time the credit line is extended, the recipient country must not be expected to need to borrow from the IMF. This implies that over the medium term, the country should be expected to be able to finance its balance of payments comfortably, based on a realistic assessment of its access to private capital and a sustainable projected path for external debt.
- Second, the IMF Executive Board must have made a positive assessment of both the country's economic prospects and its progress toward meeting international policy standards.
- Third, the country must both enjoy constructive relations with its private creditors and be taking appropriate measures to limit its external vulnerability.
- Fourth, the country must outline to the Board the policies that it intends to pursue during the one-year period covered by the CCL.

One criticism of the CCL is that it would be very difficult to withdraw a country's access to its credit line if the quality of its policies slipped after the CCL was in place. The assumption is that the IMF Board would be reluctant publicly to withdraw its stamp of approval, for fear of triggering a crisis that would then be expensive to resolve. Equally, countries might be concerned to enter a CCL for fear their access might later be withdrawn. However, this problem should not be exaggerated: it is unlikely that the markets would not have noticed the policy slippages that would cause withdrawal from the CCL; and we should also recall that there are many occasions on which negotiations on the renewal of an existing IMF program have been suspended and the market reaction has been relatively subdued.

Experience with the CCL

In the first year of the CCL's existence, a number of countries discussed with IMF staff whether they should apply for one. But in the end, none did. Potential users pointed to several weaknesses in the original design. These were discussed in September 1999 by the Executive Board, which agreed to important changes to make the facility more attractive:

- The Board has agreed in principle to lower the surcharge over the standard loan rate. The commitment fee countries pay when securing a CCL will also be cut. This will increase the financial incentive for countries to adopt sound policies.
- Under the original rules, it was far from automatic that a country with a CCL would be able to get its hands on the money when contagion struck. In light of the strong track record required of countries that qualify, the Board has agreed to move in the direction of greater automaticity in the release of the first third or so of the resources committed under the facility.

The introduction of the CCL is potentially a highly valuable addition to the armory with which the IMF helps protect its members from the enormous economic and social costs of financial crises. I hope and believe that we will, in the coming months, see several countries enter the CCL facility—and that they and the world economy will be the better for it. ■

IMFSURVEY

Despite trend toward fewer currencies, a single world currency seems unlikely in near future

As international monetary and financial transactions become increasingly integrated, some countries have chosen to form regional currency blocs, while others have established rigid exchange rate pegs to other countries, through the adoption of a currency board, or have adopted the currency of another country as their own. This declining trend in the number of independent currencies seems to be motivated by the perceived benefits of currency integration—such as commercial efficiencies and economies of scale. But would the same perceived benefits be further maximized by a move to a single currency for the world? Or does the experience of the euro zone so far suggest that the difficulties inherent in corralling different and divergent economies into a single currency would be magnified and possibly disastrous if carried out worldwide?

These questions and related issues were the subject of a recent IMF Economic Forum—"One World, One Currency: Destination or Delusion?" moderated by Alexander Swoboda, Senior Policy Advisor in the IMF's Research Department. Participants included Robert Mundell, Professor of Economics at Columbia University and winner of the 1999 Nobel Prize for Economics; Maurice Obstfeld, Professor of Economics at the University of California, Berkeley; and Paul Masson, Senior Advisor in the IMF Research Department.

A world currency area

The concept of a single world currency, Mundell said, has few, if any, champions. It is not likely, particularly among democratic regimes, that the requisite political motivation could be found to convince countries to relinquish their national currency, which is symbolic of national sovereignty, in favor of a single currency. Although he is a longtime advocate of a world currency, Mundell said it was probably more interesting to talk about "one world, one currency area"—that is, a zone of fixed exchange rates.

Despite the current problems the euro zone is experiencing, Mundell said he was confident the union would prevail. Already, he suggested, every country that has joined the Economic and Monetary Union (EMU) has a better monetary policy than it had before it joined. Speculative capital movements have been virtually eliminated, and since EMU's implementation, there has not been a single intra-Europe financial crisis.

In Mundell's opinion, one reason that EMU has worked and will continue to work is that it has satisfied the basic requirements of an optimal currency area:

- common target or anchor for monetary policy;
- common measure for inflation;
- locked exchange rates, implying a common monetary policy; and
- means for dividing up the seigniorage (a source of revenue derived from the government's right to create money).

If the euro zone has met these requirements, Mundell asked, could they be met on a global basis? Starting with the essential requirement of a common anchor, Mundell said the approach he found most interesting was for the three big currencies—the U.S. dollar, the euro, and the yen—to form a common monetary policy that would serve as the anchor for the world price level, and then fix the exchange rates among these three areas. The euro and the yen should lock in their exchange rates with the U.S. dollar, since the United States, with a GDP of more than $10 trillion, is the largest currency area. Once a common inflation target was chosen, he said, a three-currency union (with perhaps an outside unit of account for the rest of the world to use) would make it no more difficult to manage inflation than in any single country today. To those skeptical of fixed exchange rates who claim that different rates of inflation call for fluctuations in exchange rates, Mundell would answer that the yen, dollar, and euro areas are "zones of stability" and that different rates of inflation would not be a serious issue.

The major impediment to this plan, Mundell said, would likely be the refusal of the United States to agree to fixed exchange rates. Historically, he noted, the reigning superpower has taken this position, as, for example, the United Kingdom did in the nineteenth century. The United States might be persuaded to assume leadership, however, if Japan and Europe indicated a willingness to go ahead on their own. The euro zone opens up the possibility of a reconfiguration of power, Mundell said. The United States, in an effort to maintain a balance of power, should provide the leadership needed to establish not a single currency but a world currency area.

Diversity still an option

Referring to Mundell's seminal analysis of optimal currency areas, Maurice Obstfeld noted that Mundell's theory, as well as subsequent economic analysis, actually pays scant attention to the issue of a single currency. Nevertheless, this theory is the basis for the belief that there can be efficiency gains from having larger and larger currency areas. Therefore, it is possible to draw

Robert Mundell

Maurice Obstfeld

implications from Mundell's original analysis—as well as subsequent enlargements on the theory—for the desirability of a world currency down the road.

Mundell's analysis, Obstfeld said, was based on a trade-off between the benefits of a single currency in terms of reduced transaction costs and uncertainty and the ability of regions to adjust to idiosyncratic or asymmetric shocks. According to Mundell, when two regions join in a currency union with sticky wages and prices and no labor mobility between the two areas, giving up the exchange rate does not allow for as smooth an adjustment to idiosyncratic regional shocks as might occur with exchange rate flexibility. The current situation in the euro zone provides a telling example, Obstfeld noted, where already there are signs that a single monetary policy is unable to address the problems of every constituent member. Although eligibility to participate in EMU requires that candidate countries bring inflation down to levels stipulated by the Maastricht Treaty, some regions—Ireland, for example—appear to be diverging from those levels. This suggests that, in the presence of idiosyncratic shocks, a single currency is not going to produce the same inflation rate, or the same rate of output growth and rates of employment and unemployment, in all regions. These considerations, Obstfeld said, need to be measured against the broader gains to be derived from the efficiency of using a single currency.

From left: Robert Mundell, Alexander Swoboda, Maurice Obstfeld, and Paul Masson.

Advocates of fixed exchange rates, or any regime that calls on country authorities to relinquish an independent monetary policy, point to the credibility gained from pegging to a low-inflation currency. However, Obstfeld said, the credibility issue raises a host of critical political issues. Mundell has said that economically sensible boundaries for a common currency area need not, in theory, correspond to national boundaries but, Obstfeld pointed out, political boundaries are a fact; the countries exist. Securing a broad consensus for, say, a currency board arrangement or a peg to the U.S. dollar may be possible within national borders, as in Argentina, but among the major industrial countries, Obstfeld suggested, we are unlikely to see a return to the Bretton Woods system where one superpower runs the show and everyone else lets it "call the monetary shots."

Paul Masson

The critical issue in setting up a currency union, then, is agreeing on who runs monetary policy. In Europe, this issue was solved through the establishment of the European Central Bank (ECB), Obstfeld said. But in Europe, the supranational organization has run way ahead of the political organization, as reflected in Denmark's recent referendum against joining EMU and the United Kingdom's retreat from participation.

Political constraints argue against a world currency, at least in the near term, Obstfeld said. In the meantime, he did not view floating—at least, among some of the larger economies—as a bad way to run the world economy. For the foreseeable future, he said, we can expect to see a world where smaller countries may opt to join a union through a currency board, euroization, or dollarization; where larger countries float; and where the big currency areas coexist with occasional attempts at coordination and intervention, but basically with governments acting in what they perceive as the national interest.

Fewer currencies, no single currency

The euro and the observed trend toward dollarization open up the possibility of a radical reduction in the number of currencies, Paul Masson noted. He asked, however, if this trend was likely to continue to its logical conclusion—the creation of a single world currency.

To answer this question, he said, one must first look at the role money plays in both the national and the international economy. At the national level, money has traditionally fulfilled three roles—a medium of exchange, a store of value, and a unit of account. At the international level, currency may be used for invoicing trade, denominating assets and liabilities, holding foreign exchange reserves, and providing a vehicle for foreign exchange transactions. It can also serve as a currency to which other currencies are pegged—that is, an anchor for other countries' monetary policy.

Technology and globalization, however, are blurring the distinctions between national and international uses of money and have the potential for changing these uses radically, Masson argued. Certainly, the creation of the euro has fundamentally altered the relationship between national sovereignty and national money. In addition, multinational corporations make transfers between their branches or subsidiaries that have no relation to the currencies in which the profits or revenues are earned, and often report their financial results in both local currency and a major world currency, such as the U.S. dollar. Also, currency swaps allow the transformation of capital flow denominations, while derivative instruments permit sophisticated hedging against currency risk.

Another development is that technology and financial innovations have been leading to the possibility of cashless economy. Credit cards and electronic banking have, Masson noted, economized on the use of currency and bank deposits—that is, traditional money. When we look at financial institutions, we see that required reserves on bank deposits have been reduced in many countries, and clearing balances have been reduced almost to zero, shrinking the size of high-powered money and, arguably, the effectiveness of monetary policy.

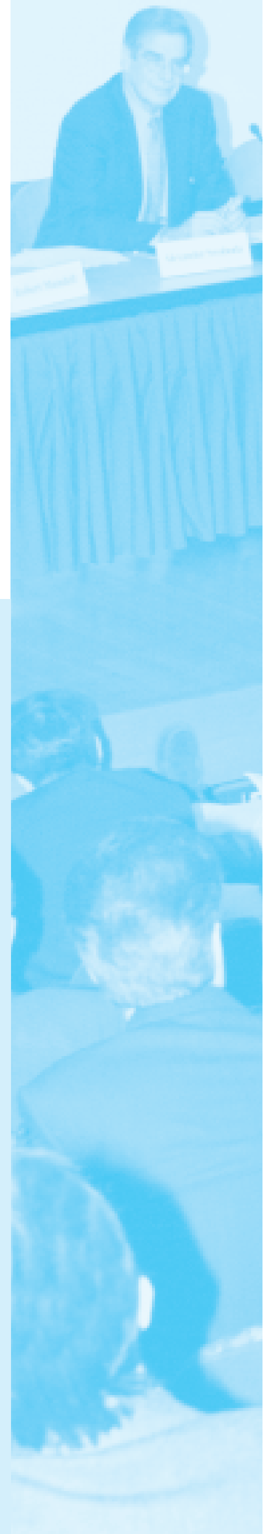
What do these trends mean for the international monetary system? On the one hand, they suggest a move toward fewer currencies. Payments may increasingly be made outside the control of governments and central banks. The notion of competing moneys may be given greater scope, allowing individuals and companies to choose between moneys. Also, because the scope for monetary independence has been reduced by increases in capital mobility, countries may be less reluctant to give up their national currency, provided the dominant world or regional currency exhibits the necessary stability in terms of purchasing power.

On the other hand, the technological advances that have allowed for the separation of the various roles of money may make the coexistence of different currencies in any given country or monetary area easier. Also, the forces of globalization are not stamping out nationalism, and a currency remains an important symbol of national or regional sovereignty, even though in practice it may not be associated with much monetary independence. Therefore, Masson said he doubted that currencies would disappear en masse or that a single world currency would emerge.

But questions remain, he said, about regional blocs and the elimination or consolidation of currencies within regional currency areas. The euro bloc will no doubt develop further, Masson suggested, mainly because of the political motivating factor—membership in the European Union. For the dollar, only the economic factor comes into play, because the United States has steadfastly refused to share monetary or other forms of sovereignty, while with a few exceptions, its own trading partners decline to abandon their own currencies. Unless the political reality changes, Masson concluded, this situation will continue.

Summing up, Masson said he envisioned a world where currency use would increasingly be dictated by private choice, not government fiat; where two major currencies—the U.S. dollar and the euro—would coexist, if uneasily; and where there would continue to be many minor currencies. But the number of currencies will matter less, because individuals will have greater options for hedging or choosing the currency in which to transact and will have less of a need to hold cash balances. ■

A transcript of this Economic Forum is available on the IMF's website (www.imf.org).



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Press Releases

00/60: Second Annual PRGF for Guyana, November 17
00/61: $590 Million Cut in Debt Service for Guyana, November 17
00/62: $14 Million in Emergency Postconflict Assistance for the Republic of Congo, November 17
00/63: $596 Million Stand-By Credit for Pakistan, November 29
00/64: $31 Million EFF and $13 Million PRGF (approved in principle) for Former Yugoslav Republic of Macedonia, November 29
00/65: Ter-Minassian to Head Fiscal Affairs Department, December 4 (see page 388)
00/66: IMF Board Names Firm to Search for Evaluation Unit Chief, December 6

News Briefs

00/102: Work Program of Executive Board, November 20 (see page 396)
00/103: IMF Considers Guinea-Bissau under HIPC, November 21
00/104: IMF Considers Niger under HIPC, November 22
00/105: IMF Considers São Tomé and Príncipe under HIPC, November 22
00/106: Köhler Welcomes El Salvador Plan, November 23
00/107: Fischer Statement on Turkey, November 26
00/108: IMF Completes Brazil Sixth Review, November 28
00/109: Köhler Welcomes Turkish Measures, November 30
00/110: IMF Endorses Tanzania's PRSP, December 1
00/111: Sugisaki Statement on Zambia, December 1
00/112: Köhler Announces Start of Talks with Turkish Authorities, December 3
00/113: Köhler Proposes $10 Billion IMF Support for Turkey (see page 385)

Public Information Notices (PINs)

00/99: Portugal (and Staff Report), November 20
00/100: Gabon, November 22
00/101: Barbados (and Staff Report), December 4
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Transcripts

Press briefings, Thomas Dawson, November 20 and December 1
One World, One Currency, November 17 (see page 391)
Köhler on Opening of IMF Center, December 1

Letters of Intent and Memorandums of Economic and Financial Policies (date posted)

Madagascar, November 20
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Greece: Conclusions of IMF Mission, November 22
Belgium: Concluding Statement, November 30

Poverty Reduction Strategy Papers (date posted)

Tanzania, December 1
Guyana, Interim Paper, December 4

Other

Kosovo: Macroeconomic Issues and Fiscal Sustainability, November 17
Schedule of Public Engagements of IMF Management, November 17
IMF Rates, November 20 and December 4
IMF Financial Activities, November 27 and December 1
Impact of Debt Reduction under the HIPC Initiative on External Debt Service and Social Expenditures, November 30
IMF Research Bulletin, December 1

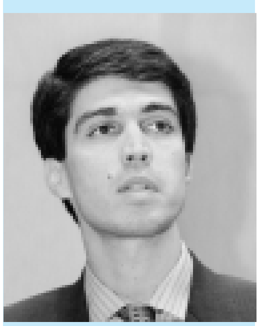
Issues in policy dialogue

Conference on fiscal decentralization addresses preconditions and country experiences

Vito Tanzi

Albert Breton

Paul Smoke



Luiz de Mello

Fiscal decentralization is assuming increasing importance in many parts of the world and in the IMF's policy dialogue with a number of member countries. At the request of members of the Executive Board, the IMF's Fiscal Affairs Department (FAD) hosted a conference on fiscal decentralization in November to discuss the requirements for effective service delivery, macroeconomic management, and good governance in an increasingly decentralized world.

Opening the conference, IMF Managing Director Horst Köhler called on participants to identify necessary preconditions for successful decentralization. He asked whether decentralization would enhance transparency and accountability at the local government level and whether it would lead to poverty reduction and better macroeconomic management. He also asked how the IMF's macroeconomic surveillance role should extend to fiscal decentralization, and about cooperation between the IMF and the World Bank and regional development banks in this area.

Vito Tanzi, retiring as Director of FAD, outlined issues to consider when countries decentralize. Dangers exist if decentralization is pursued without correct initial conditions. But acknowledging that decentralization is here to stay in many countries, Tanzi focused on the appropriate sequencing of measures to minimize the risks.

Does decentralization work?

Albert Breton (University of Toronto) made a clear case that intergovernmental competition must be the primary reason for decentralization—to check the self-interest of policymakers and promote the common good. Decentralization can fail, as can markets, and for similar reasons, involving information, coordination, and diminishing supply costs and a race to the bottom.

In his empirical analysis, Daniel Treisman (University of California at Los Angeles) did not find that competition between decentralized jurisdictions created greater efficiency in governance. Countries with more tiers of government tend to have higher perceived corruption and appear more ineffective at service provision. Joachim von Braun of the University of Bonn found that fiscal decentralization in itself is unlikely to benefit the poor without prior—and effective—political and administrative decentralization. In contrast, Tugrul Gurgur and Anwar Shah, both of the World Bank, found that decentralization supports greater accountability and reduced corruption.

In his discussion, Michael Keen (FAD) pointed out that economic outcomes matter and that corruption may not be a deciding factor against decentralization.

Africa

Paul Smoke (New York University and Massachusetts Institute of Technology) and Giorgio Brosio (University of Turin) separately reviewed diverse African experiences, identifying preconditions for successful fiscal decentralization. Viable local political mechanisms are needed to determine preferences and to hold governments accountable to their constituents. Local institutional, technical, and managerial capacity is needed to deliver services demanded by their constituents, and local authorities must have access to the financial resources, including their own tax revenues and transfers, to meet their responsibilities. These conditions are only weakly met in many African countries, which tend to have fragile democratic and administrative institutions. Decentralization processes therefore require careful sequencing and implementation.

Ismail Momoniat of the South African Finance Ministry provided a practitioner's perspective. In South Africa, the center has been able to retain macroeconomic control by setting clear expenditure responsibilities and closely monitoring budgetary processes. He strongly emphasized that budget management, including expenditure monitoring, audits, and accounting, is critical for the success of a decentralized system.

Asia

Ehtisham Ahmad and Ali Mansoor (both of FAD) argued that the current "big bang" decentralization process in Indonesia has been motivated by the political reaction to the end of decades of highly centralized rule. The local emphasis is more on control over natural resources than on effective local service delivery. The absence of effective sequencing poses risks not just to the decentralization process itself but to macroeconomic stability and interregional equity.

Decentralization in India has been a more gradual process, according to Govinda Rao (Institute for Social and Economic Change, Bangalore). The overall deficit, at around 15 percent of GDP, is considerably higher than that excluding district governments. A growing mismatch between expenditure and revenue assignments needs correction. Discussant Ke-young Chu (FAD) pointed to the importance of properly evaluating subnational finances to determine the extent of fiscal deficits and vulnerability.

Latin America

José Afonso (Brazilian National Development Bank) and Luiz de Mello (FAD) described the most recent fiscal decentralization reforms in Brazil, which concentrated on strengthening the role of third-tier governments (municipalities) in service delivery. These reforms have strengthened revenue sources at subnational levels, but the center took a stronger role in financing key social services (health and education) to achieve equity objectives. The country's fiscal responsibility act has been instrumental in restoring subnational fiscal discipline by limiting expenditures and borrowing.

Ernesto Rezk (University of Cordoba and Ministry of Finance, Argentina) reviewed the Argentine experience of decentralization with a currency board arrangement. Inappropriate borrowing by provincial governments was based on the ability of subnational administrations to use future shared revenues as collateral for bank loans. Juan-Pablo Jimenez (Ministry of Economy, Argentina) also focused on local government borrowing and the efforts of the administration to implement a subnational fiscal responsibility law and a program of fiscal adjustment and financial restructuring. The discussant, Teresa Ter-Minassian of the IMF's Western Hemisphere Department, also described some of the decentralization issues that had featured in the IMF's policy discussions with both Brazil and Argentina.

Transition economies

Jorge Martinez-Vazquez (Georgia State University), John Norregaard (FAD), and Era Dabla-Norris (IMF Institute) focused on Russia, Ukraine, and Kazakhstan; and Jean-Jacques Dethier (World Bank) described the decentralization process in Hungary and Slovakia. These countries tend to show unclear assignments of tax and expenditure responsibilities, they emphasized.

Alexei Lavrov (Russian Ministry of Finance) and John Litwack and Douglas Sutherland (both from the Organization for Economic Cooperation and Development) examined the conditions necessary to make decentralization work in Russia. This assessment had clear parallels with the Chinese case—examined by Ehtisham Ahmad, Li Keping (State Council, China), and Tom Richardson (IMF European II Department). Both papers argued for a centralization of social responsibilities, especially pensions and unemployment insurance; a redefinition of tax assignments; and a proper system of equalization transfers to permit lower administrations to effectively address truly local functions, such as education and health care.

Christine Wallich (Asian Development Bank and World Bank) saw a common trend toward some recentralization, both to ensure macroeconomic stability and to allow central governments to address equity and concerns over nation building and preservation. However, powerful rich regions and provinces could block such trends, she noted. The success of the reforms depends on three assumptions—an effective central tax administration, adequate fiscal resources to finance centralized expenditures and equalization transfer, and local hard budget constraints.

Europe

The European Union session included papers on Italy (Piero Giarda, Italian Treasury), Spain (Julio Vinuela, FAD), and Germany (Paul Bernd Spahn, University of Frankfurt). The extent of regional equalization is strongly influenced by national characteristics and history. In Germany, the constitution mandates a high degree of "horizontal" equalization through a system of transfers between states, reflecting the German espousal of uniform standards and readiness to share wealth. Spanish decentralization sought to ease the democratic transition and reduce centrifugal tendencies in some regions. This has led to an asymmetric treatment of regions. Well-off Italian regions also benefit from similar asymmetries. Pierre Salmon (University of Bourgogne) addressed the scope of decentralization in the European Union, given the addition of the supranational layer in Brussels. His paper suggested issues that might be relevant in country and regional surveillance by the IMF.

Lessons learned

In the concluding roundtable, Tanzi stated that he was not against decentralization per se, and that where countries are already decentralized it was imperative to seek ways to make it work. However, in setting out on this path, countries needed to be careful about sequencing and implementation.

Robert Ebel (World Bank) stressed that decentralization can bring substantial benefits in governance and economic management. Piero Giarda emphasized that assigning own tax revenue sources to each level of government is particularly important. Successful decentralized systems contain mechanisms for coordination and competition between governments.

Ismail Momoniat argued that a strong central government is needed to regulate and monitor intergovernmental competition and take responsibility for equalization. It should also assist in providing effective public expenditure management systems—including budgeting, classifications, accounting, and audit mechanisms. He stressed the need for technical assistance in these areas. Ehtisham Ahmad suggested that a few principles appear to be generally applicable. Successful systems need to foster transparency and accountability and should be simple and comprehensible. Wherever the political environment allows, the design and implementation of reform programs should be gradual and carefully sequenced. The sequencing should take account of administrative capability—the assignment of function should follow the existence of capacity and should precede the assignment of revenues. ■

Matt Davies
IMF Fiscal Affairs Department

John Litwack

Christine Wallich

Robert Ebel

Ehtisham Ahmad

Emerging Market Financing

Report highlights significant impact of move to "free float" adjustment in equity indices

With global markets beginning to factor in a slowing U.S. economy, higher oil prices, and a weaker euro, the performance of emerging market assets diverged sharply in the third quarter of 2000. Equity markets almost unanimously registered losses in the period, while emerging debt markets ranked as the best performing fixed-income asset class. The current issue of *Emerging Market Financing*, which is published quarterly on the IMF's website (www.imf.org) and is an integral part of the IMF's surveillance of capital market developments, analyzes the causes and consequences of this bifurcation between bond and equity markets, and examines several structural changes in emerging market financing, the outlook for emerging market financing in the near term, and potential risks (such as those posed by the convergence of yields of U.S. high-yield, or "junk," bonds and emerging market bonds).

Divergent emerging market asset trends

In the third quarter, emerging market debt, which rose 5.2 percent, outperformed all other fixed-income asset classes. Emerging market equity, which experienced a 13 percent decline, was among the worst performers. According to the report, some of this divergence can be traced to global fund managers who shifted from equity to bond markets in the face of a U.S. slowdown, with the accompanying decline in corporate earnings and lower interest rates encouraging this shift. High returns in emerging debt markets stemmed largely from positive developments in yields and capital gains on U.S. treasury securities (against which dollar-denominated emerging market bonds are priced) and from the high yields on emerging market debt. Perceived improvements in the quality of emerging market credit made a relatively modest contribution to the quarter's returns. Asian debt was also supported by the relatively modest supply of sovereign debt from the region, with Latin America accounting for the bulk of new and outstanding emerging market bonds. Conversely, Asian companies dominate emerging market equities. Given the direct sectoral links between Nasdaq and global equity markets, and the larger proportion of technology shares in Asia, the region was more affected by the U.S. tech stock correction than other regions. Higher oil prices also had a greater impact on Asian equities, given the region's higher dependence on imported oil, while large reserve accumulations in Asia protected sovereign Asian bonds.

"Free float" adjustments

With \$2 trillion to \$4 trillion of equity funds benchmarked against Morgan Stanley Capital International's All Country World Index and an additional amount against the family of Emerging Markets Free Indices, changes in the composition of these indices have an enormous potential impact on flows to emerging equity markets. Morgan Stanley Capital International is considering changing the way it constructs its indices and moving to a "free float." A free float would weight constituent companies in the indices according to how easily a company's shares can trade, and it would adjust for such factors as cross-shareholdings, block holdings, government ownership, and foreign ownership restrictions.

Executive Board to focus on benefits of globalization, IMF lending facilities

On November 20, the IMF announced that the Executive Board had adopted a work program that broadly defines the Board's agenda leading up to the spring meetings of the International Monetary and Financial Committee (IMFC) on April 29, 2001. The full text of News Brief No. 00/102 is available on the IMF's website (www.imf.org).

The work program has been designed to implement the vision of the future role and activities of the IMF set out by IMF Managing Director Horst Köhler in his address to the IMF–World Bank Annual Meetings in Prague in late September 2000 (see *IMF Survey*, October 9, page 303).

Priorities

The IMFC and the Annual Meetings gave new momentum to the effort to develop answers to critical questions about globalization and the fight against poverty. The membership of the IMF wants, first and foremost, to put crisis prevention at the heart of IMF surveillance. Therefore, the IMF's surveillance has to be conducted with an increasing emphasis on identifying sources of vulnerability and on financial sector and financial market issues. At the same time, the membership wants the IMF to stay strongly engaged with its poorest member countries. Priorities in the work program for the coming months therefore include

- finding ways to help countries exploit the opportunities of the global economy while containing the risks;
- working to make a success of the Heavily Indebted Poor Countries Initiative;
- considering the best ways to streamline conditionality and improve country ownership of IMF-supported programs;
- reaching formal decisions on the review of IMF lending facilities; and

Emerging market equities typically have a lower free float than equities in mature markets, reflecting higher government stakes, more pervasive restrictions on foreign ownership, and greater cross shareholdings in conglomerates. If Morgan Stanley Capital International moves to a free float, the share of emerging markets in world indices is expected to drop significantly, with potential outflows from emerging equity markets of between $30 billion and $60 billion. Within emerging markets, Latin American and Asian equities are generally expected to gain at the expense of emerging markets in Europe.

A move to a free float, observes *Emerging Market Financing*, would avoid some types of mispricing and help reduce volatility, as more liquid stocks would merit relatively higher weights. Competition among emerging markets for investment would also encourage countries to privatize state enterprises and reduce restrictions on foreign investor participation in local stock markets.

Emerging market–high yield nexus

As yields on emerging market bonds continued to inch closer to U.S. high-yield bonds during the third quarter (see chart, this page), *Emerging Market Finance* notes that high yields available from U.S. high-yield bonds may pose a risk to emerging markets, despite improved fundamentals in emerging markets and continued deterioration in the U.S. high-yield sector. Historically, average emerging market yields have been higher than those in the high-yield sector, and past episodes of convergence have been brief and followed by a sharp and persistent widening of emerging market debt spreads. Those who invest primarily in mature market assets but occasionally "cross over" into emerging markets to enhance returns view the two as competing asset classes, contributing to this dynamic.

But as the *Emerging Market Financing* report points out, the current episode of yield convergence is different. It has occurred at a higher level of average absolute yields for both asset classes, with yields on the high-yield sector rising, unlike in the previous two notable episodes of convergence in October 1997 and December 1993. Since the current convergence has been motivated by differential movements in fundamentals rather than by a broad-based hunt for yields from the high-yield sector into emerging markets, it should not be surprising if emerging market yields fall below that of the high-yield sector. But emerging market yields are not likely to fall too far below the high-yield sector, as the two asset classes still compete for funds from a large variety of investors.

Finally, surveying the outlook for emerging market financing, the current issue of *Emerging Market Financing* is guarded. Conditions for emerging market borrowers have deteriorated in international capital markets. Overall financing flows in the fourth quarter are expected to moderate, but syndicated lending—lending in which a group of international banks jointly make a loan at floating interest rates—is expected to remain supportive in spite of choppy conditions in bond and equity markets. ■

Emerging market and high-yield bonds, July–November 2000

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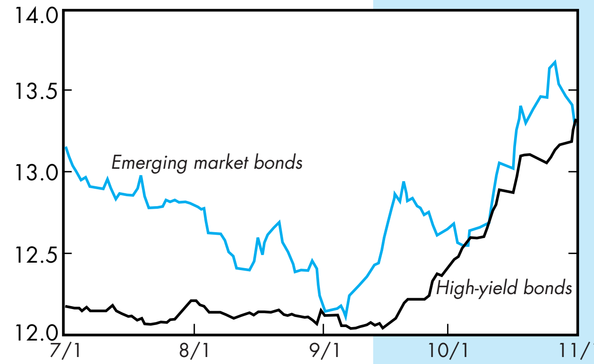

Data: IMF, *Emerging Market Financing*

Subir Lall
IMF Research Department

• considering ways that IMF technical assistance can provide stronger support for institution building and the implementation of measures to reduce the risk of financial crises.

In the coming period, the Board's activities are likely to be distributed as follows:

• Well over half of the Board's time would be spent on country operational matters.

• About one-fourth of the Board's time would be in discussion on policy items, concentrated in several areas, as set out in the semiannual work program.

• The remainder would be devoted to the World Economic Outlook exercise and other key operational matters, such as the IMF's finances and administration.

Other activities

In the coming months, the Board will review the pilot of the IMF–World Bank Financial Sector Assessment Program, discuss issues relating to the involvement of the private sector in the prevention and resolution of crises, and discuss the continuing staff work on issues such as exchange arrangements, regional integration, and regional payments arrangements.

A key step in helping the IMF to learn from experience and adapt to change was the decision to establish the independent Evaluation Office (EVO) to provide outside assessments of the IMF's work (see Press Release Nos. 00/49 and 00/53). Management will continue to work with the Board on recruitment of a Director of the EVO and other steps aimed at making the EVO operational before the 2001 spring meetings.

In proposing the work program to the Board, the Managing Director also called on Executive Directors to think about the direction for further reform of the IMF.

Communications Technologies: The Force Driving Global Interdependence?

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Monetary and trade conference

Panelists agree technology developments are driving continued global economic expansion

After much of the world was rocked in the 1990s by financial and economic crises, recovery began to take hold in late 1998 and became widespread in 1999. The outlook for the world economy in the near future is generally favorable, with the rate of expansion expected to slow slightly to a more "comfortable" pace, according to panelists at the Nineteenth Annual International Monetary and Trade Conference, sponsored by the Global Interdependence Center in Philadelphia on November 13. They noted that any discussion of the increasingly interdependent global economy must consider how communications technologies are transforming human activities and contributing to ongoing economic growth. Conference participants debated the opportunities and challenges for labor and management, the economic impact of investment in technology, the governance of electronic commerce, and visions of how technology can transform both developing and developed economies.

World economic outlook

Setting the stage for the discussion, Lawrence Klein described the current state of the world economy and the implications of communications technology for its continued expansion. Among the countries that did not succumb to crisis in the 1990s, he said, are Australia, Canada, New Zealand, the United Kingdom, and the United States, which are all performing well. The United States, in particular, he said, was able to keep crisis from engulfing the globe during the 1990s by lending stability to, and providing the engine of growth for, the whole world. What permitted the United States to grow uninterruptedly for 115 months was new technology. Even if world growth slows somewhat, Klein said, the U.S. economy can continue to expand and share the benefits of technology with the rest of the world.

Already, he said, a number of other countries are participating in the technology boom, including Finland and Sweden, which invest heavily in research and development and are well advanced in wireless technology, and Ireland, which has an abundant supply of young, well-educated workers. Countries outside of Europe traveling down the information highway include India, which has a well-educated, English-speaking workforce, and Israel, which is blessed with highly educated immigrants from the former Soviet Union. In Asia, Taiwan Province of China and Korea are leaders in technology and in the creation of hardware. China has less experience with a modern economy but is catching up quickly. According to Klein, the United States will not dominate information technology much longer.

Michael Mussa fleshed out the picture that Klein had sketched of the world economy and its prospects. According to the IMF, he said, we are seeing the

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00/180: *The Cost of Government and the Misuse of Public Assets*, Vito Tanzi and Tej Prakash
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strongest results in a decade, with growth registering $4\frac{1}{2}$–5 percent and expected to be reasonably well sustained in 2001. The economy is "hitting on all cylinders." Europe is picking up, Japan is doing better, and developing countries are performing well. However, he noted, there is evidence that growth is slowing. In Europe, growth bounced back after dropping off in late 1998 and 1999, but industrial production is now slowing. Consumer and business confidence are leveling off and even declining modestly. He mentioned that the uptick in inflation—to $2\frac{1}{2}$ percent—caused by the increase in oil prices is one source of concern.

In the United States, Mussa noted that the growth of employment is slowing, although there is as yet no sign that the economy is in danger of falling into a recession. Contributing to the U.S. slowdown are a weakening of consumer and business confidence and a slowing of investment spending. There is also some concern that inflation might creep upward—wages and salaries have already done so, and world oil prices have more than tripled over the past 18–20 months. Equity prices have bounced around since early in the year, Mussa noted, and, although credit markets are calmer, private credit conditions are looking "less hospitable" than earlier in the year, with credit costs increasing.

Michael Mussa

Investing in technology

Discussing the economic impact of investment in technology, Philip L. Swan reiterated that spending on information technology was still a U.S.-based phenomenon, but it was spreading. Although other countries, including Scandinavia and some other European countries, are investing more in information technology, a capital investment gap still exists between the United States and Europe. For its part, Asia must encourage such investment, promote competition, enhance security for e-commerce, and help developing countries nurture their information technology industries, Swan noted.

In the United States, information technology is linked to positive economic trends, Swan said, including improved business productivity, a higher average GDP growth rate, and steady employment growth, with declining unemployment.

On the level of the firm, returns are related to organizational architecture, Swan explained. Firms benefit from advances in technology only if they restructure to obtain them. Those firms that restructure will have higher returns if they decentralize decision making, install an incentive-based reward system, and establish an education-intensive culture. Most of the benefits come with networking. For global enterprises, this means that the workforce is decentralized; customers, suppliers, and partners are all linked; and markets compete 24 hours a day, 7 days a week. Swan also observed that the date rollover on January 1, 2000—the so-called Y2K bug, which after much hype turned out to be a nonevent—was an impetus for firms to focus on computing and on how they could use their computers to better effect.

Catherine Mann centered her discussion on the impact of technology on U.S. growth and on the sustainability of U.S. external imbalances. She concluded that a scenario that included greater investment in technology and a more liberalized global trade environment would be more stable than a scenario that did not. In Mann's high-tech scenario, the U.S. current account deficit did not appear to be an issue through 2001, while the capital account surplus could be more problematical, particularly if the growth in international wealth were to slow or if investors decided to keep most of their wealth in home assets.

Catherine Mann

Management and labor

Presenting a micro perspective—that of labor management—Ronald Naples introduced himself as a "practitioner speaking to thinkers." Going global, he said, is a natural evolution of business theory but has serious implications for people. What, he asked, does globalization as a business model mean for progress? While international, multinational, and global firms all operate around the world, only global firms operate as a single company in which integration is the core value. To accomplish the firm's goals, workers from disparate cultures must find common ground in different perceptions about risks, challenges, business practices, benefits, and compensation. Globalization, Naples concluded, is at a crossroads. Organizations must turn change into progress, and communication, through technology, allows this to occur.

Speaking from the perspective of labor in the new high-tech environment, Michael Merrill discussed what U.S. workers think about globalization. Since 1970, he said, wages have fallen, and working conditions and benefits have deteriorated. Firms are more productive than ever, thanks to new technologies, but workers who are let go when firms downsize cannot find other jobs. Merrill also noted the widening income and experience gap between the top third and bottom two-thirds of the population. Workers attribute these disparities to globalization and consider it the source of their problems.

Merrill, however, disagreed that globalization was to blame for workers' ills. In his view, workers would benefit from *more* globalization, from institutions of social solidarity that would not leave "every man for himself." He likened the present moment to the end of the nineteenth century, when people had to come to terms with changes brought about by nationalization. He said that new forms of upheaval could emerge if we did not figure out how to spread the benefits of globalization more widely. He was optimistic about the outcome, however, predicting "a positive learning curve."

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E-commerce

James Barth asked whether every country needs its own currency, stock exchange, and banking system. He noted that of the world's 200-some countries, 182 of them are IMF members, and two-thirds of these have experienced a banking crisis since 1980. The problem for most countries is that their debt is denominated in foreign currencies. When a country experiences a sudden reversal of capital flows, the results can be disastrous. Every country does not need its own currency, Barth concluded. Fixed rates encourage too much foreign currency borrowing, while floating rates diminish trade. In fact, a hot debate today is whether the world should do away with all but three currencies—the dollar, the euro, and the yen—and move toward currency boards, which facilitate trade. In Barth's view, countries would be better off either adopting a currency board or another country's currency (such as the U.S. dollar or the euro) as their own, as some have already done.

The International Monetary and Trade Conference took place on November 13 at the Federal Reserve Bank of Philadelphia.

Nor do countries necessarily need their own banking system, in Barth's view. New Zealand, which outsourced its entire banking system, is one of a handful of countries that have performed well in recent years, largely unaffected by the crises of the 1990s. This phenomenon, Barth said, can be attributed to globalization.

Lee Congdon described changes occurring within Nasdaq. Its goals, to be accomplished within the next few years, are to make trading securities digital, global, and accessible "24/7." Electronic markets are preferred, Congdon said, because they obviate the need to bring people together physically. This is one reason the overall number of stock exchanges, despite new entries, is declining.

Technology and Internet access are increasing worldwide, Congdon said. In some areas where wired access will not be available for some time, wireless technology will become the paradigm of the future. While technology and the broad access to information are driving global equities markets, he said, there are factors that could potentially inhibit them. These include differences in disclosure and transparency standards, regulations, and business laws; hours of operation; clearance, settlement, and currency; and taxation issues.

Global transformation

With activities moving from traditional markets to cyberspace, governance takes on new meaning. Stephen Kobrin observed, however, that although e-commerce is revolutionary, it is still a market. The Internet, he said, will be regulated and taxed, although it is still unclear how and by whom. Jurisdiction can also pose a challenge because, in digital commerce, there is no location for buyer or seller. How, Kobrin asked, does a regulatory authority know when a transaction occurs? As for taxation, he argued that it was not fair or equitable to exempt digital transactions because people who are not wired would be penalized.

The Internet is heavily international, and governance must also be international, Kobrin maintained, but he noted that there are problems of sovereignty. While he doubted the U.S. Congress would be willing to relinquish taxing rights to an international entity, he did believe the United States was beginning to recognize that regulation could not be left entirely to the markets. At the same time, Europe is learning that government regulation alone will not work. A hybrid scheme appears to be emerging, Kobrin said, and whatever form cybergovernance takes, it will have to be international and nonterritorial and involve governments, businesses, and civil society.

Summing up the day's sessions, Howard Perlmutter suggested "transformation" as a catchword to describe the emerging global cybercivilization. In his view, global interdependence has both a dark side and a light side, with the vast digital divide between villages and industrial urban centers embodying the dark side. He described two possible scenarios for the future. In the first, the digital divide becomes wider and the world looks as it does today, with islands of wealth dotting seas of poverty. In this scenario, Perlmutter said, the digital divide is considered unbridgeable, the poorest continue to receive aid and charity, and we hope for the best.

In the second scenario, the digital divide is being bridged. The global economy is truly interdependent, and there is a dialogue between rich and poor. The poor are connected to the cyberworld and are part of a partnership in which everyone learns from each other.

How, Perlmutter asked, can we design institutions that embody human values in this changing world? The answer is to design equipment that can allow the dialogue between rich and poor to take place. This, he concluded, should lead to a global vision to develop a strategy for global governance. ■

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