IMF SURVEY

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International Monetary Fund
VOLUME 31
NUMBER 23
December 16, 2002

IMF's Köhler optimistic about working with new Brazilian government

IMF Managing Director Horst Köhler traveled to Latin America on December 6–12 to offer the IMF's support to the region, where several large countries are working hard to stabilize their economies, following Argentina's difficulties. "At the end of the trip," Köhler said, "I remain convinced that lessons from successes in the region can help point the way forward for other countries currently experiencing difficulties." Köhler's three-nation tour, which he undertook at the invitation of the presidents of Brazil, Colombia, and Chile, was his second visit to Latin America since he took over the reins at the IMF in May 2000.

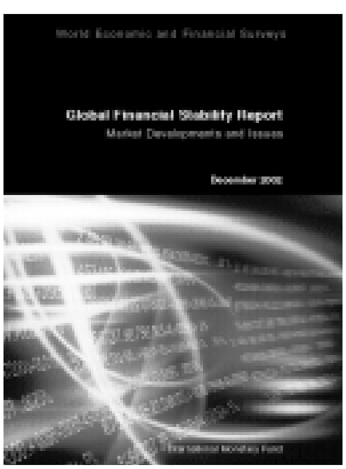
Brazil's President-elect Luiz Inácio Lula da Silva (right) held a "get acquainted" meeting with the IMF's Horst Köhler in Brasilia.

Köhler's first stop was Brasilia, where he met with outgoing President Fernando Enrique Cardoso, President-elect Luiz Inácio Lula da Silva, outgoing Finance Minister Pedro Malan, and Antonio Palocci, who will succeed (Please turn to the following page)

Global Financial Stability Report

Markets remain resilient, but recent losses and heightened risk aversion pose significant dangers

Global financial markets continue to demonstrate resilience, but the third quarter saw rising investor risk aversion—much of it attributable to a natural reaction to past excesses and current uncertainties.



The new issue of the IMF's Global Financial Stability Report *underscores the need to pursue measures to restore investor confidence.*

Concerns about the strength and durability of the global economic recovery, uncertain prospects for corporate profitability, and unsettled geopolitical conditions dampened investor sentiment in the third quarter of 2002, according to the IMF's recently released *Global Financial Stability Report*. Together, these factors heightened investor risk aversion and contributed to tiering by credit quality and to continued difficult financing conditions for higher-risk corporate and sovereign borrowers.

Despite this unusually high volatility, global financial markets remain resilient. The key now will be, the report indicates, to avoid an excessive swing away from risk taking.

In major financial centers . . .

The global financial system, the new report notes, has experienced economic recessions and growth slowdowns in various countries, the bursting of the technology-media-telecom (Please turn to page 387)

In this issue

The next issue of the *IMF Survey* will appear on January 20, 2003.

Köhler praises Chile's policies

(Continued from front page) Malan when the new government takes office on January 1. "My trust in Brazil and President-elect Lula da Silva is strengthened after the meeting," Köhler told a news conference. "This impression is based on his increasing emphasis on social equity, ethics, honesty, respect for contracts and contract rights, and respect for institutions," he added.

Köhler (left) lauded Chile's "strong and credible" macroeconomic policy framework. With him are the head of Chile's Central Bank, Carlos Massad (right), and Guillermo Le Fort (center), IMF Executive Director for Chile.

The IMF approved a record $30.4 billion loan for Brazil in September to support the country's economic and financial program through December 2003. The next $3 billion installment is expected to be disbursed after a review by the IMF Executive Board, tentatively scheduled for December 19. IMF External Relations Director Thomas Dawson said in a press conference that Köhler's visit to Brazil was not a negotiating visit, but a chance for Köhler to get acquainted with President-elect Lula da Silva and "offer him the support of the IMF and the international community as he works to formulate a program for the new government going forward into 2003 and beyond."

Köhler praised the outgoing government of President Cardoso for strengthening and democratizing Brazilian institutions, saying it provided a firm base on which Lula da Silva can build once he takes office. "We stand ready to work with the new administration to think and work out what can be done to support social objectives in a framework of macroeconomic realities," Köhler said. "What is important is that Brazil is achieving what it has promised within the program with the IMF," Köhler added in an interview with the Brazilian daily *O Globo*.

In Colombia . . .

Köhler's second stop was Colombia, where he met with President Alvaro Uribe in Bogotá. "In the short period of time that the government has been in office, it is impressive that it has already taken prompt actions to address a weakening fiscal position and develop a comprehensive strategy for stability and growth," Köhler said in a statement following the meeting.

The government has requested a new loan to succeed the present loan, which expires on December 19, 2002. Speaking at a press conference following the same meeting, Köhler said that the IMF and Colombia are expected to sign a two-year $2 billion loan agreement in January. He was confident that a series of reform bills, which include plans to significantly change pension, tax, and labor laws, will be approved soon.

And in Chile . . .

Köhler praised the Chilean authorities' for the country's "strong and credible" macroeconomic policy framework, which is based on a floating exchange rate, inflation targeting, and clear rules on fiscal policy. "This framework has been supported by low public debt, a strong belief in free trade, and the virtual absence of dollarization," Köhler said in Santiago after meetings with Chilean President Ricardo Lagos, Finance Minister and former IMF official Nicolás Eyzaguirre, and central bank officials. "Thus, Chile—like Mexico—has been able to better protect itself from adverse external shocks and maintain positive growth even during periods when international capital markets have been unsettled," he added.

While Köhler was in Chile, the United States and Chile signed a wide-ranging free trade agreement after two years of intense negotiations. The sticking point was the U.S. Treasury's insistence that Chile drop all controls on foreign capital entering or leaving the country, which Chile uses to protect itself from rapid movements in capital. Under a compromise, the United States will allow Chile to use such controls for as long as one year without imposing sanctions provided they don't "seriously impede" capital outflows.

The trade agreement with Chile, which must be approved by Chilean lawmakers and the U.S. Senate, will eliminate tariffs on more than 85 percent of all goods shipped between the two countries. Köhler, quoted in wire service reports, noted that "It's more than just the prospect for higher or sustained trade increases. That this agreement came together now is also a good signal for further confidence building into Chile's policy approach." ■

The announcement of the Managing Director's trip to Latin America (News Brief No. 02/118), and Köhler's remarks in Colombia (News Brief No. 02/121) and Chile (News Brief No. 02/122) are available on the IMF's website (www.imf.org).

Excessive risk aversion poses its own dangers

(Continued from front page, bottom) bubble, uncertainty created by corporate accounting irregularities, and significant financial losses in key sectors of the global economic and financial system. A considerable retrenchment of risk taking has accompanied these developments, amid heightened risk perceptions or risk aversion and the unwinding of bubble-period excesses. Sharp declines in equity prices (see chart, this page)—including financial-institution stocks, widening credit spreads, and record defaults—have created losses for retail and institutional investors and financial institutions. In response, major financial institutions have adjusted their business strategies, and, going forward, this may influence credit conditions and capital flows.

Despite these varied and significant adjustments, however, financial stability has been maintained, in part because financial institutions have been able to repackage and distribute financial risks more broadly. The global financial system remains resilient, the report says, but its robustness in the face of shocks and its ability to cope with further losses have probably declined to some extent.

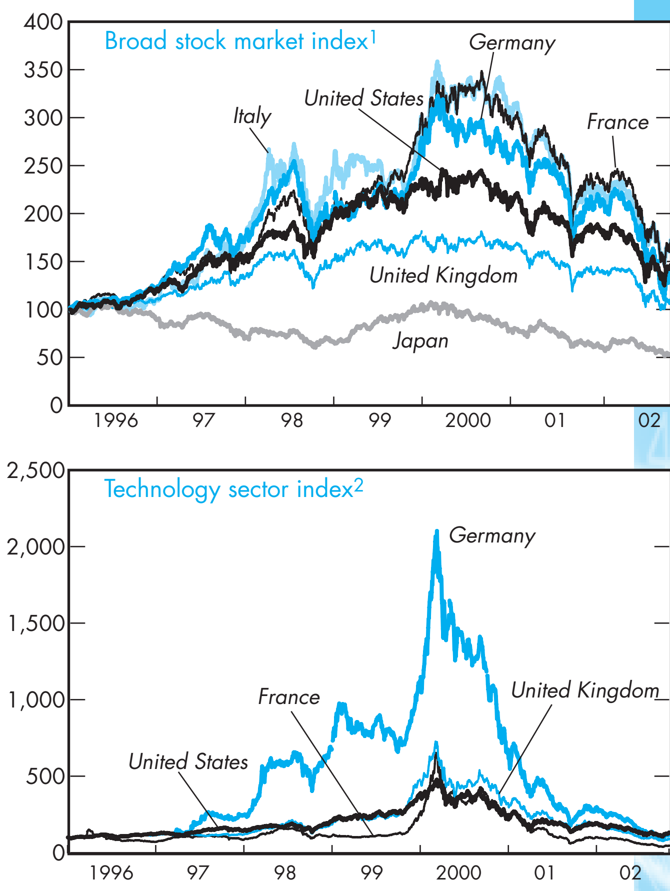
What lies ahead? The report sees the principal sources of risk for global financial stability as likely to be associated with an excessive retrenchment of risk taking in financial markets. In its analysis of what could trigger an overly large retrenchment, the report identifies potential risks in each of the major financial centers—notably, the household sector in the United States, the financial sector in Europe, and weaknesses in both corporate and financial sectors in Japan. More specifically, it notes that

- because the U.S. household sector owns (directly or indirectly) the lion's share of U.S. corporate and financial sector risks, it remains critically important to the global financial system's capacity to assume and intermediate risks. A substantial rebalancing of household portfolios—for example, a further sizable sell-off in equities—would have wide-ranging effects.
- in Europe, where financial institutions retain a significant share of corporate sector exposures, a worsening economic and financial environment has aggravated long-standing structural weaknesses in some European financial systems. Such weaknesses may affect financial institutions' willingness and ability to continue to take and manage risk, particularly exposures to high-risk mature and emerging-market borrowers.
- and, finally, the Japanese financial system continues to struggle with long-standing structural problems relating to the nexus between the corporate and financial sectors.

To address these concerns, the *Global Financial Stability Report* highlights policy actions that, taken together, should mitigate risks to financial stability, bolster investor confidence, and strengthen the markets' self-correcting mechanisms. It encourages policymakers in the advanced economies to ensure that their macroeconomic policies remain responsive to any signs that recovery may be faltering. In Japan, strong implementation of financial and corporate sector reforms remains critical to restoring investor confidence.

U.S. and European stock indexes fell to their lowest level since 1997

(January 1, 1996 = 100)



Data: *IMF, Global Financial Stability Report, December 2002*

[1]For United States, Standard & Poor's 500; for United Kingdom, FTSE 350; for Germany, Dax 100; for France, SBF 250; for Italy, MIB 30; and for Japan, Topix.

[2]For United States, Nasdaq Composite; for United Kingdom FTSE techMARK 100; for Germany, Nemax All-Share; and for France, Nouveau Marché. Data for Nemax All-Share and Nouveau Marché start in March 1997 and March 1996, respectively. Therefore these indices are rebased to the level of the Nasdaq on these dates.

In several countries where there are ongoing initiatives, further work will be needed to improve transparency and to address those shortcomings that have been identified in corporate governance, accounting, auditing, and investment banking practices. The report also recommends that supervisors of nonbank financial

The emerging bond market was not spared the aversion to risk that characterized global financial markets.
—*Global Financial Stability Report*

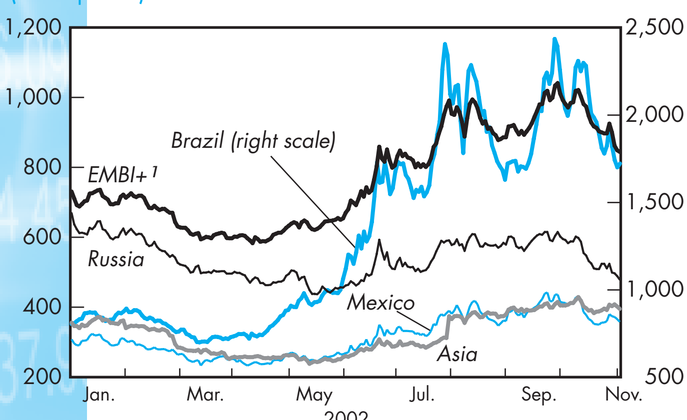
institutions, particularly insurance companies—and, in a number of cases, pension funds—be vigilant for signs of significant capital erosion stemming from falling asset prices. Finally, the report cautions that credit risk transfer instruments—which financial institutions have increasingly relied upon to manage their risks—warrant enhanced disclosure and regulatory scrutiny.

In emerging markets . . .

The anxiousness and uncertainty evident in major financial centers have reverberations in the emerging markets as well. The external financing environment for emerging markets—characterized by unusually high financial market volatility, asset price weakness, increased risk aversion, and tiering by credit quality—remains a difficult one. Like mature markets, emerging markets have experienced a sharp tiering by credit quality, and countries with large borrowing requirements are the focal point of investor concern (see chart below). There have been, however, only limited signs of broad-based contagion, reflecting continued investor discrimination. And, while volatility has increased, it has remained well below that of previous crisis periods.

Spreads on emerging market bonds widened substantially

(basis points)



[1]Emerging market bond index.
Data: *IMF, Global Financial Stability Report, December 2002*

In short, the external financing environment for emerging markets was difficult:

• Wide corporate bond spreads in the mature markets have made it hard for emerging markets to attract investors.

• Continued mature equity market weakness and volatility have proved detrimental to emerging market financing, including foreign direct investment.

• Bank lending to emerging markets has been inhibited by financial losses from lending in mature markets. In particular, continued concerns arising from the experience of foreign banks in Argentina have led banks to reassess the risks of operating in emerging markets more generally.

• Heightened risk aversion, a reduction in the number of emerging market bond dealers, and dealers' reluctance to accommodate sellers by taking securities on their balance sheets have reduced liquidity and trading volume in the secondary market for emerging market bonds.

This difficult external environment, coupled with concerns about policy continuity in Brazil and other key emerging markets, has led to a continuation of sharply reduced flows and external financing to emerging markets, particularly for noninvestment-grade issuers. The cumulative gross issuance of bonds, loans, and equities by emerging markets in the first nine months of 2002 lagged issuance levels of previous years by a wide margin and was highly concentrated in investment-grade credits. Although in the primary markets unsecured access was effectively closed to noninvestment-grade issuers, broad-based contagion was limited, and investment-grade issuers and Asian and Eastern European issuers benefited from relatively open access.

Performance and yield spread developments in the secondary market for emerging market bonds continued to reflect investor discrimination across regions and the credit spectrum. Emerging market borrowers with low borrowing requirements, stable debt structures, strong fiscal positions, and good prospects for policy continuity were able to maintain primary market access and experienced positive returns in the secondary markets. Nevertheless, the emerging bond market was not spared the aversion to risk that characterized global financial markets in the third quarter, when there was a general tendency for spreads to widen.

Emerging market economies, the report suggests, can take a number of policy measures to enhance financial stability. The continued ability of some emerging markets to tap international capital markets, notwithstanding the difficult external financing environment, illustrates how vital it is for countries to remain strongly committed to implementing policies that maintain macroeconomic and financial stability and strengthen institutional frameworks.

According to the report, effective policies should include the implementation of sound debt management strategies that, market conditions permitting, avoid debt structures that amplify external shocks. Deepening local financial markets to facilitate the issuance of longer-term instruments denominated in local currency would help buffer global capital markets from turbulence. And, more generally, a firm commitment to the preservation of property rights, the rule of law, transparency, and stability in the legal and regulatory frameworks are key to fostering greater investor confidence and building a more stable investor base.

Successive issues of the *Global Financial Stability Report* have underscored the importance of developing local financial markets as a means of fostering financial stability. While previous reports highlighted the role of local equity and bond markets, the current issue considers emerging derivative markets. Derivatives can contribute to a more efficient allocation of risks in financial markets but can also be used to avoid prudential safeguards and to take on excessive leverage.

To maximize the benefits that can be gained from derivatives, the report recommends developing local derivative markets within the context of a broad and well-sequenced strategy for developing local securities markets. Such a strategy should emphasize the creation of the necessary underlying legal, regulatory, accounting, and market infrastructures. To this end, transparency and adequate financial supervision are critical for ensuring that derivatives play a positive role in helping market participants price and manage risks and for preventing the buildup of financial system fragilities. ■

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Copies of *Global Financial Stability Report: Market Developments and Issues, December 2002,* are available for $42.00 (academic price, $35.00) from IMF Publication Services. See page 396 for ordering details. The full text of the report is also available on the IMF's website (www.imf.org).

IMF devises new measure of lending capacity

To give the public a clearer understanding of the amount of its regular financial resources that is available for new lending, the IMF on December 16 announced a new method of measuring its liquidity. The new yardstick—known as the one-year forward commitment capacity or FCC—indicates the amount of the organization's quota-based and nonconcessional resources on hand for member country needs. As of December 13, the IMF's one-year FCC amounted to SDR 48.951 billion (about $65.668 billion).

How is this liquidity figure arrived at? The FCC reflects the IMF's stock of usable resources minus undrawn balances from current lending arrangements, plus projected repayments by IMF borrowers (the repayments that the IMF refers to as "repurchases") over the coming 12 months. A prudential balance—intended to safeguard the liquidity of creditors' claims and to take account of any potential erosion of the IMF's resource base—is also deducted to arrive at the final FCC amount.

The prudential balance represents an indicative level of uncommitted usable resources that the IMF would normally not use to make financial commitments. This balance reflects the judgment of the IMF's Executive Board, and it is calculated as 20 percent of the quotas of member countries whose currencies are currently used for lending purposes and any amounts activated under borrowing arrangements. The prudential balance is not a rigid minimum; the IMF's uncommitted resources could, on a strictly temporary basis, fall below this level.

The FCC takes fully into account current IMF lending commitments, including those under precautionary arrangements and any commitments made under Contingent Credit Lines. In assessing IMF liquidity on the basis of the FCC, actual available resources may be larger than the FCC indicates, to the extent that commitments are not fully disbursed.

The FCC will be posted on the IMF's website weekly (Week-at-a-Glance) and monthly (Financial Resources and Liquidity). The Executive Board has decided that the FCC will replace the traditional liquidity ratio, but the IMF will continue to publish the traditional liquidity ratio for the time being.

For the full text of the IMF's press release, including explanatory notes, see the IMF's website (www.imf.org). ■

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Members' use of IMF credit
(million SDRs)

	During November 2002	January–November 2002	January–November 2001
General Resources Account	0.00	22,667.60	21,358.70
Stand-By	0.00	21,654.01	20,616.70
SRF	0.00	7,903.67	12,662.31
EFF	0.00	986.61	742.00
CFF	0.00	0.00	0.00
EMER	0.00	26.98	0.00
PRGF	111.72	1,223.52	696.53
Total	111.72	23,891.12	22,055.23

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CFF = Compensatory Financing Facility
EMER = Emergency assistance programs for countries that have emerged from conflicts and natural disasters
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals shown owing to rounding.
Data: IMF Treasurer's Department

Countries are willing to listen to the IMF, but they would like to have a dialogue in which there are some genuine options to choose from.
—James Boughton

Interview with James Boughton

New conditionality guidelines put country officials back in the driver's seat

James Boughton, former IMF Historian and now Assistant Director in the IMF's Policy Development and Review Department, was a key player in the two-year review of IMF conditionality—that is, the commitments on economic and financial policies that countries must fulfill when they borrow from the IMF. The process culminated in the adoption in September 2002 of new guidelines to replace those in place since 1979. Boughton speaks to the IMF Survey *about the review process and what's new about these guidelines.*

IMF SURVEY: Why did the IMF adopt new guidelines?

BOUGHTON: The review of conditionality was prompted by trips that IMF Managing Director Horst Köhler made to Africa and Latin America shortly after he took office in the spring of 2000. What struck him in a number of borrowing countries he visited was that very few country officials objected to the idea of IMF conditionality. What officials did tend to object to was the growing intrusiveness of conditionality. The IMF sometimes seemed to be telling them how to run their economies. Out of that initial impression came the idea that the IMF should find ways to make its work less intrusive and more of a cooperative venture with member countries.

To do this, the IMF embarked on a review of almost all aspects of conditionality—how the IMF interacted with countries, how it designed and selected conditions on structural policies, and how it presented those conditions. The IMF held a number of consultations with outside groups, such as nongovernmental organizations, officials from both borrowing and creditor countries, and academics. It also held seminars in various parts of the world and put notices on its website asking people to comment on what it was doing. We were trying to take a fresh look at the way the IMF was doing business and be completely open and transparent about it.

IMF SURVEY: What, specifically, is new about these guidelines?

BOUGHTON: They specify that ownership is a critical component of a reform program. Countries are responsible for implementing their own policies. The IMF's job is to advise its member countries and to judge what policy changes are needed. If the IMF has serious doubts about a country's commitment to implementing essential reforms, then that's a reason for it to step back and say it's not ready to approve financing for the program. The IMF had not previously been concerned enough about ownership, although it always recognized it as an important issue. It's something that we will be paying a lot of attention to in the coming years.

Another idea that is not completely new but has new emphasis in the guidelines is what we call "parsimony," or streamlined conditionality. The old guidelines tried to limit the range of policies that the IMF looked at. But, over time, the IMF started getting involved in more aspects of policymaking in countries.

We are now trying to define more precisely which policies are "fair game" for conditionality and which ones are not. If there's a debate about whether a structural reform should or should not be a condition for an IMF loan, the burden of proof is now on the person who is making the case that it *should* be in—that it is essential to making the program work. Before, the burden of proof may have been on the person trying to take the condition out.

If the IMF wants to include a condition in an area where it lacks expertise, the new guidelines specify that it has to consult the World Bank, which will have primary responsibility for determining what the right condition is, how it should be monitored, and the appropriate time frame. The IMF has established a new, closer relationship with the World Bank to make conditionality work better.

The IMF is also specifying more clearly what the different types of conditions are. The most common type is a "performance" criterion—a measurable, quantitative target that the country must meet to qualify for financial assistance. For example, a performance criterion might say that a country's monetary growth will be no higher than a certain percentage over a period of time.

There are other kinds of conditions, too: indicative targets, such as a ceiling on the inflation rate, to monitor whether the program is working properly; and structural benchmarks, which indicate the steps a country is taking to implement structural reforms, such as privatizing an industry to make it more efficient. Failure to achieve these other types of conditions would signal problems but would not necessarily interrupt IMF financing.

The IMF has also clarified which parts of a country's reform program are, strictly speaking, subject to IMF conditionality and which are not. In other words, when a country applies for help from the IMF, it might describe wide-ranging reforms it is undertaking to use the resources provided to it. But some of these measures are not necessarily conditions. The IMF is going to make an effort under these new guidelines to distinguish what is and what is not conditionality.

IMF SURVEY: The review was notable for the time and effort expended on consultations. How do the new guidelines reflect what the IMF heard during the process?

BOUGHTON: Through the review, we were able to gain a much better understanding of the importance of ownership. Country officials are quite willing to work with the IMF to design the best possible reform program, but they don't want to be told unilaterally what the best reform program is. We learned that ownership is a flexible concept. Countries are willing to listen to the IMF, but they would like to have a dialogue in which there are some genuine options to choose from. The guidelines introduced the idea of ownership in a way that was much more conducive to dialogue and more adaptive than it might have been had we not consulted so extensively.

We also learned that flexible timing is very important to a lot of countries. The IMF frequently lends to low-income countries with limited administrative capacity to implement a large number of reforms all at once. Expecting countries to do so, especially within a short time, is asking a lot of them. Even if a reform such as strengthening tax administration is important, it might not have to be completed by a specified date. When the main purpose of the reform is to create more efficient conditions in the economy, then it does not necessarily have to be achieved by, say, next February. So, the IMF is trying to be more flexible. That message became very clear through these external consultations.

IMF SURVEY: Conditionality has a long history. From the beginning, there was a sense that the IMF would have to review it periodically and adapt it as necessary. What has all of this taught us about the need for conditionality and how to "get it right"?

BOUGHTON: Conditionality is something that will always have to be adapted to circumstances. In the early days of the IMF, in the 1950s, conditionality was limited to a small number of policies because the IMF was concerned only with trying to smooth countries' international flows of payments.

Over the past quarter century, the IMF has been called upon to provide more than just short-term help. And that has meant getting involved with a much wider range of policies than before through more extensive conditionality. It has also meant that the IMF has had to be more disciplined to keep from being too intrusive, which was never an issue when the IMF concerned itself only with short-term problems. So a process of adaptation has come about in response to changing circumstances.

I'm sure that, as we apply the new guidelines, we will find new problems with them either because they are not clear enough or because the IMF will be drawn into new issues that we have not thought of yet. The IMF is committed to conducting a full, thorough review of the implementation of conditionality every two years.

Boughton: "Getting the new guidelines on paper was a big job, but it's a much bigger job to actually get the benefits off the ground."

In those reviews, the IMF will address many hard questions. Has practice been consistent with the new guidelines? Is the IMF succeeding in promoting ownership? Has it succeeded in cutting the number of conditions it is requiring countries to implement? Are the remaining conditions properly focused on achieving program goals?

From the answers to these questions, the IMF will judge whether the guidelines need to be adapted or strengthened. I'd like to believe that the guidelines are now perfect and that we'll never have to change them again. But history suggests that they will require further adaptation over time.

IMF SURVEY: Now that we've adapted conditionality, what difference will it make for our members and for the IMF? What do you expect the impact to be?

BOUGHTON: The impact depends on the IMF's ability to change the way it interacts with member countries. If the IMF can put country officials back in the driver's seat, then I would expect two real benefits. First, IMF-supported programs would be more successful. Second, and even more important, we should see better policymaking in many countries, not just because conditionality is better but because countries are taking more responsibility for policymaking.

When the IMF tells countries what they have to do to receive financial support, countries tend to shift that responsibility to the international community. That responsibility should be with the countries themselves. But this will take time because we are trying to change the culture within the IMF and the culture of policymaking in developing countries, and because the demands of having to solve financial crises quickly will, in many cases, have to take precedence over those longer-run goals.

Getting the new guidelines on paper was a big job, but it's a much bigger job to actually get the benefits off the ground. The IMF is going to make a major effort to see that that happens. ■

Turkey negotiations back on track

IMF talks with Turkey on the release of a $1.6 billion loan—part of a $16 billion loan pact aimed at cutting chronic high inflation—resumed on December 9 with the arrival of a mission that is expected to stay in Turkey for about two weeks. This follows preliminary discussions in October.

As Turkey positions itself for accession to the European Union, it has been trying to recover from its deepest economic slump since 1945, which was sparked by a February 2001 financial crisis. The fourth review of Turkey's program supported by the IMF is expected to be completed after a follow-up visit in January, when the full 2003 budget will be discussed and a new letter of intent—which lays out specific measures the Turkish government intends to take to meet its economic goals—will be finalized.

In early December, the newly elected Prime Minister of Turkey, Abdullah Gül, and several government ministers held initial discussions with senior IMF officials. The IMF announced on December 3 that Turkey had made "major strides" this year in laying the groundwork for economic growth and financial stability. Economic growth and progress in disinflation have exceeded expectations, and these achievements, combined with the recent resolution of political uncertainty in the country and prudent signals by the winning party, have bolstered financial markets' confidence in the country's prospects. Turkey now has "a golden opportunity," the IMF indicated, "to make a final break with its high-inflation and low-growth past."

Turkey now has "a golden opportunity," the IMF indicated, "to make a final break with its high-inflation and low-growth past."

With a solid parliamentary majority, the new government is now well placed to build on recent developments and take decisive measures to establish lasting macroeconomic stability and growth that will benefit all Turkish citizens. The IMF said it had been "impressed by the government's ambition and determination to pursue policies aimed at restoring high growth through debt reduction and structural reform."

The IMF's press statement noted, in particular, the government's intention to achieve a sustained reduction in Turkey's high debt burden, which the IMF saw as the key to lowering interest rates and increasing growth over the medium term. The IMF looks forward to discussing with the new Turkish government how it can achieve these goals while keeping sight of its priorities for spending, including in the social areas, and revenue policies.

The IMF also welcomed the government's support for independent agencies, notably its central bank, which will play a key role in bringing down Turkey's still-high inflation rate, and its banking supervision agency. In addition, the IMF lent its support to the government's intention to speed up privatization, encourage foreign direct investment, and fight corruption. ■

Globalization offers great potential, but Africa has achieved mixed results

Africa has not benefited as much as it should have from greater economic openness and sound macroeconomic management, Governor Charles Konan Banny of the Dakar-based Central Bank of West African States told IMF Executive Directors at a November 14 seminar at IMF headquarters.

"From the African standpoint, globalization—although perceived as unavoidable and irreversible—is frequently treated as an economic and financial phenomenon whose benefits and risks are unevenly distributed between rich and poor countries," Banny said.

African countries recognize that opening up to the outside world is the basis for growth, prosperity, and development. A number of them have committed themselves to pursuing sound macroeconomic policies and liberalization since the early 1980s, but results to date have been mixed, at best.

Several domestic and international factors explain this state of affairs, Banny suggested. In Africa, he pointed to the impact of armed conflicts, political and social instability, neglect of human development, and an uncertain business environment that saps private investment. Elsewhere, protectionism in industrial countries, worsening terms of trade, and declining levels of official development assistance have also been important constraints to growth.

According to Banny, overcoming these challenges will depend on Africa's own efforts and the support of the international community. Political leadership is required to implement a new generation of policies that can bring about prosperity, reduce poverty, and raise standards of living to acceptable levels. A longer-term perspective that goes beyond simply achieving short-term financial equilibrium is also needed. Trade liberalization in industrial countries, stronger governance and respect for the rule of law, greater capacity-building efforts, and additional debt relief and development assistance to finance investments in education, health, and infrastructure will all help Africa achieve its development goals.

In concluding, Banny stressed the need for new instruments in the international financial institutions to support integration projects and programs that could modernize economic structures and accelerate regional growth.

ILO–Carnegie–Brookings conference

Developing countries need social safety nets to temper side effects of globalization

Social protection can help cushion workers in developing countries from the unwelcome side effects of globalization. But speakers at a panel in a December 2–3 Washington conference, sponsored by the International Labor Organization (ILO), the Carnegie Endowment for International Peace, and the Brookings Institution, found that real protection may be hard to achieve. Among panels on globalization, poverty, inequality, employment, and labor standards, social protection proved to be a hot topic.

Speakers at the conference's concluding panel agreed that the biggest challenge was how to establish social safety nets that would not break the budget. In a globalized economy, all countries need social safety nets—either formal or informal—to help those adversely affected by change, but, as IMF Economic Counsellor and Director of Research Kenneth Rogoff noted, it was important to strike a balance between insurance and efficiency.

"Throughout modern history, there has been a tension between the need for a dynamic economy that embraces change and the need to provide social safety nets and social insurance that don't lose the benefits of a dynamic economy," he said.

"Globalization and change are good for some and bad for others. Technological change and global growth are good overall—there will be more people who win than lose. Over time, maybe whole generations will win," Rogoff noted. "How do you deal with the fact that changes cause some people to lose, while at the same time retaining the benefits of a dynamic economy?"

While social safety nets could sap the energy of an economy by slowing change, Rogoff argued that this was not always the case. Indeed, the lack of a good public social safety net in Japan appeared to be blocking change because politicians were worried about the rise in unemployment that would result. Social insurance could help populations embrace trade openness and technological change.

Crisis of confidence

But providing insurance coverage is not easy, particularly for developing countries. Dalmer Hoskins, Secretary General of the International Social Security Association (ISSA), which works closely with the ILO, said that social security systems in many countries faced a growing crisis of confidence. Schemes in some countries were losing ground because of declining membership; in others, corruption meant that members would not receive the full payouts to which they were entitled.

"This creates a tremendous challenge for the ILO and the ISSA," Hoskins told the concluding session of the conference. "It means that the models we relied on in the past have to be retooled and rethought. We have to assume that our existing models are not going to protect a large number of people in the rural and informal sectors."

The ISSA, with a membership of over 400 institutions in 145 countries, serves as an international clearinghouse for information on social security policy and helps member organizations improve administrative and policymaking capacities.

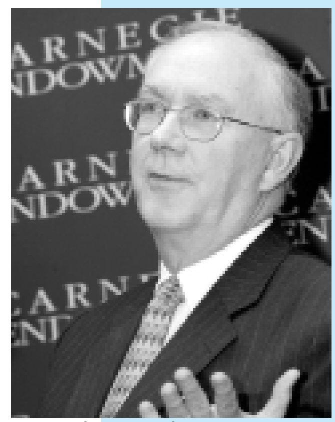
Carol Graham, Vice President and Director of the Governance Studies Program at the Brookings Institution, said it was important to ensure that the middle class was protected, and not just the poor. "A satisfied middle class is important for markets and democracy. In my view, this suggests that we need to start thinking about a social contract in these societies that really includes the middle class and that no longer focuses only on the poor through ad hoc policies, such as social funds and other kinds of safety net policies."

New models for protection

Graham, whose research focuses on Latin America, added that effective social safety nets did not have to mean the classic model of "universal expenditures with high levels of taxation." Many new models were evolving based on private contributions and nongovernmental organizations. "Nonstate actors can be very effective in providing social services," she said.

Hoskins agreed but said fitting together the different systems of social protection was going to be messy. Countries could end up with combinations of social insurance, social assistance, and some noncontributory social benefits like those Brazil and South Africa were experimenting with. "Of course, a major part of it is going to be private sector–managed insurance for health or for pen-

Kenneth Rogoff



Dalmer Hoskins

Carol Graham

sions, and some of it is going to be the old ideas of the mutual benefit societies, cooperatives, and other grassroots-based organizations," he said.

Fitting these pieces together will also be a challenge, Hoskins added. While the ILO and the ISSA have not yet developed a comprehensive approach, a key role for international organizations in this area in coming years will be to provide benchmarks for the different schemes, so that countries can compare how they are doing. ■

A transcript of the conference "Making Globalization Work: Expanding the Benefits of Globalization to Working Families and the Poor" is available on the website of the Carnegie Endowment for International Peace (http://www.ceip.org/files/events/events.asp?EventID=540).

Privatized pensions and payout options

Is there an annuity in your future?

Annuities are a venerable financial instrument, but they have not been a particularly popular one. That sentiment seems about to change. As more countries privatize all or parts of their public pension systems, the demand for annuities will rapidly rise. That increase, in turn, will spur lively debates on a host of issues, including whether purchases of annuities should be mandatory and how their providers should be regulated.

For most retirees, the real issue should be how much of their wealth to annuitize—not whether to annuitize.

Annuities, which provide regular payments over a set period in return for an up-front investment, date back to ancient Rome. They played a significant role in government finance in seventeenth- and eighteenth-century Europe, when life annuities helped the governments of France, Great Britain, and the Netherlands pay for their periodic wars. More recently, the variety of annuities has expanded, but the market for them has generally remained small.

In the coming years, however, annuities are likely to become a household word in a growing number of countries. Increasingly, traditional state pensions, whose amount is determined by the pensioner's salary and work history, are being replaced or supplemented by privatized defined-contribution pension plans. Participants in these plans contribute to individual accounts. When they retire, pensioners need to withdraw their accumulated contributions plus earnings, which provide them with a steady income stream. This will increase the demand for annuities and other financial instruments, depending on how withdrawals are regulated.

In Chile and other countries that have introduced privatized systems, restrictions apply to withdrawals from individual accounts. Typically, contributors elect to purchase an annuity from a life insurance company.

The demand for annuities is also likely to increase sharply in countries that have not yet opted for Chilean-style reform. In the United States, for example, a combination of changes in tax laws and the increasing reluctance of employers to assume the risk and administrative burdens of defined-benefit plans has greatly expanded the role of individual savings vehicles. As holders of these individual accounts retire, they will decide to use some of the accumulated funds to purchase annuities. Not surprisingly, annuity markets are larger and more sophisticated in countries that already have a significant individual account component in their pension systems.

Designing annuities for retirement

Why should countries be concerned about how retirees spend their accumulated savings? Traditional defined-benefit pensions—if offered by a financially stable country—possess two very valuable properties. They provide income for life (and thus ensure that retirees will not outlive their resources) and are indexed (that is, their benefit is adjusted to keep pace with the cost of living). Few private financial institutions can duplicate these features because indexed annuities require indexed bonds. At present, only a handful of countries, notably the United Kingdom, Chile, and Israel, issue such bonds.

The relatively limited private market for annuities in most countries is also thought to reflect some special features of the annuity market, particularly adverse selection. Insurance companies, which sell annuities, know that prospective annuitants are longer-lived than the population at large and price their products accordingly.

The risk of premature death may also deter prospective annuity purchasers, whose estates would suffer a large loss. But annuities can offer valuable insurance against the risk of living too long and exhausting one's savings. For most retirees, the real issue should be how much of their wealth to annuitize—not whether to annuitize. Some funds need to be set aside for large unexpected expenditures, but annuitizing too small a share of wealth is dangerous, given the difficulties many people have in controlling their expenditures and the impossibility of predicting postretirement life spans.

Mandatory annuities

Society has a stake in what individuals decide to do with the funds that accumulate in individual accounts. The standard argument for a compulsory public pension system rests on the assumption that many of us are short-sighted—left to our own devices, we do not save enough to provide for our long-term needs. Moreover, public charity creates an incentive for some not to save. Mandatory annuitization—or other restrictions on distributions from individual accounts— simply reduces the rate of dissaving.

How much of the funds in an individual account should be annuitized? For some individuals, full annuitization would be excessive. The Chilean approach offers an attractive compromise. It requires retirees to buy an annuity that equals or exceeds a stipulated income and replacement ratio (the ratio of pension to wage and salary income). They may then withdraw the amount left over.

Another approach, applicable where there has been a partial privatization of the pension system, is to require that the combination of the annuity (purchased with individual account funds) and the postreform state pension not fall short of the level of the prereform state pension. A more radical approach would require only that the combined income exceed some minimum related to the poverty line. Whatever rule is chosen, exceptions should probably be kept to a minimum to avoid administrative complexity and incentives for fraud.

The state could also require retirees to purchase indexed annuities. Indexation remains a valuable property of a pension even when inflation is low. Retirees are living longer, and even a modest annual rate of inflation can, over time, seriously erode the purchasing power of a nominal annuity. It is possible to self-insure against inflation by saving a substantial part of the nominal pension in the initial years of retirement, but, apart from the self-control this requires, self-insurance is hard when inflation is high and variable.

Mandatory annuitization also raises the question of whether there should be a guarantee on the minimum value of the annuity that the individual account will finance. What should the consequences be if individual account funds fall short of the amount needed to finance the minimum annuity? A policy of guaranteeing the sum in an individual account must avoid creating undue incentives for risky investing, especially if there are few restrictions on the allocation of funds across asset classes.

Yet another issue that arises in connection with private sector annuities is price discrimination. Women, because they live longer than men, cannot purchase the same income stream with the same initial payment. This is not an issue with state pensions, where the value of the pension depends only on age and work history. A pooling arrangement or a tax-cum-subsidy arrangement could conceivably allow the private sector to offer the same premium to both women and men.

Mandatory annuitization, in fact, offers a partial solution to the consequences of adverse selection. If the demand for annuities becomes universal, insurance companies could offer the average annuitant better terms. Group annuitization schemes could reduce premiums even more markedly. Group schemes would entail assigning individuals who reach the normal retirement age in a given year to one of a number of groups. Insurance companies could then offer these groups annuities that meet the applicable requirements.

Regulating the annuity market

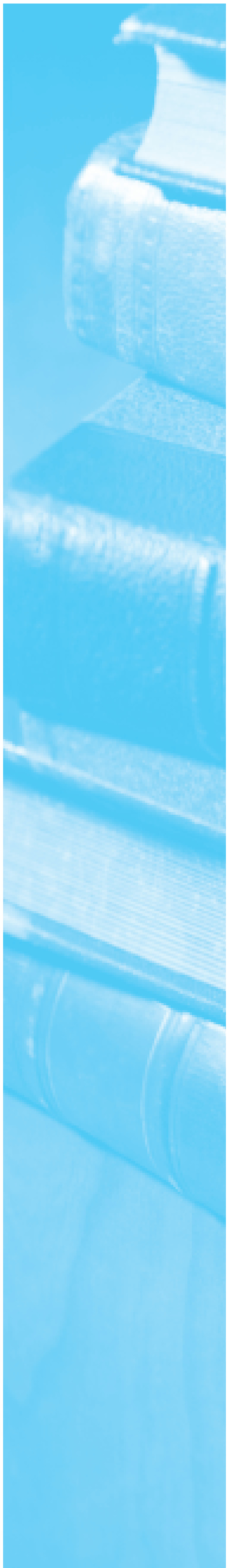
As the role of private annuities in providing retirement income increases, so does the need for sound regulation and supervision of the life insurance companies or other financial institutions that provide them. Insurance companies do go bankrupt, even in the best regulated and most stable financial markets. If retirees are required to annuitize at least a part of the funds they have accumulated, the state is likely to be under an implicit obligation to see that their annuity contracts are honored, even if there is no explicit insurance arrangement or guarantee. Unfortunately, insurance, explicit or implicit, can also entail a serious risk of moral hazard. Too generous a guarantee gives insurance companies an incentive to offer terms that they would not otherwise consider.

The insurance business is complex and demands highly specialized actuarial and financial expertise. The regulatory bodies that oversee the insurance industry must be similarly staffed with highly qualified professionals. The heavy demands that effective regulation places on the state may, in fact, explain why some countries have opted to apply simplifying measures—such as strict rules for calculating premiums that embody conservative assumptions about mortality and restrictions on the assets that may fund annuities—to all annuity providers.

Private or public

The private sector can provide a substitute for the state pension, but it will have to surmount a number of obstacles first. For many countries that partially privatize their pension systems, the most expedient policy may, in fact, be to keep the distribution phase of the

If the demand for annuities becomes universal, insurance companies could offer the average annuitant better terms.



system public. Part, if not all, of the funds that accumulate in the individual accounts could simply be converted automatically into a traditional public pension. This would ensure that individuals beginning retirement are charged a reasonable premium—one that would be substantially less than the premiums of private insurance companies, given the low administrative costs of group provision and the absence of adverse selection—and might receive an indexed pension.

Even if the state retains its traditional role as provider of a basic pension, however, population aging and the private sector's enhanced role in annuity provision will ensure that in the years to come annuities will be a growth industry in many countries. ■

G.A. (Sandy) Mackenzie
IMF Fiscal Affairs Department

This article is drawn from IMF Working Paper 02/161, *The Role of Private Sector Annuities Markets in an Individual Accounts Reform of a Public Pension Plan*, by G. A. Mackenzie. Copies of the paper are available for $15.00 each from IMF Publication Services. See page 396 for ordering information. The full text is also available on the IMF's website (www.imf.org).

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Governance, Corruption, and Economic Performance, George Abed and Sanjeev Gupta ($37.50)

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Stand-By, EFF, and PRGF arrangements as of November 30

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina[1]	March 10, 2000	March 9, 2003	16,936.80	7,180.49
Bosnia & Herzegovina	August 2, 2002	November 1, 2003	67.60	48.00
Brazil[1]	September 6, 2002	December 31, 2003	22,821.12	20,539.01
Bulgaria	February 27, 2002	February 26, 2004	240.00	156.00
Dominica	August 28, 2002	August 27, 2003	3.28	1.23
Guatemala	April 1, 2002	March 31, 2003	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Romania	October 31, 2001	April 29, 2003	300.00	165.33
Turkey	February 4, 2002	December 31, 2004	12,821.20	2,892.00
Uruguay[1]	April 1, 2002	March 31, 2004	2,128.30	1,016.60
Total			**55,862.10**	**32,531.80**
EFF				
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Indonesia	February 4, 2000	December 31, 2003	3,638.00	1,651.48
Serbia/Montenegro	May 14, 2002	May 13, 2005	650.00	550.00
Total			**6,245.00**	**4,158.48**
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	24.00
Armenia	May 23, 2001	May 22, 2004	69.00	39.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	64.35
Benin	July 17, 2000	March 31, 2004	27.00	8.08
Burkina Faso	September 10, 1999	December 9, 2002	39.12	0.00
Cambodia	October 22, 1999	February 28, 2003	58.50	8.36
Cameroon	December 21, 2000	December 20, 2003	111.42	47.74
Cape Verde	April 10, 2002	April 9, 2005	8.64	7.41
Chad	January 7, 2000	December 6, 2003	47.60	10.40
Congo, Dem. Republic of	June 12, 2002	June 11, 2005	580.00	160.00
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Djibouti	October 18, 1999	January 17, 2003	19.08	10.00
Ethiopia	March 22, 2001	March 21, 2004	100.28	31.29
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	January 12, 2001	January 11, 2004	108.00	58.50
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	September 19, 2005	54.55	49.00
Honduras	March 26, 1999	December 31, 2002	156.75	48.45
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	49.96
Lao People's Dem. Republic	April 25, 2001	April 24, 2004	31.70	18.11
Lesotho	March 9, 2001	March 8, 2004	24.50	10.50
Madagascar	March 1, 2001	February 29, 2004	79.43	56.74
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2003	51.32	12.90
Mauritania	July 21, 1999	December 20, 2002	42.49	6.07
Moldova	December 21, 2000	December 20, 2003	110.88	83.16
Mongolia	September 28, 2001	September 27, 2004	28.49	24.42
Mozambique	June 28, 1999	June 27, 2003	87.20	16.80
Niger	December 22, 2000	December 21, 2003	59.20	25.36
Pakistan	December 6, 2001	December 5, 2004	1,033.70	689.12
Rwanda	August 12, 2002	August 11, 2005	4.00	3.43
São Tomé and Príncipe	April 28, 2000	April 27, 2003	6.66	4.76
Sierra Leone	September 26, 2001	September 25, 2004	130.84	56.00
Tanzania	April 4, 2000	June 30, 2003	135.00	15.00
Uganda	September 13, 2002	September 12, 2005	13.50	12.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Zambia	March 25, 1999	March 28, 2003	278.90	124.20
Total			**4,596.06**	**2,435.11**

[1]Includes amounts under Supplemental Reserve Facility
EFF = Extended Fund Facility
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals owing to rounding

Data: IMF Treasurer's Department

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

Interview with George Abed and Sanjeev Gupta

Reducing corruption's heavy toll

Corruption has long been deplored, but only recently have economists begun to focus on its economic impact. A new compilation of research on the subject, Governance, Corruption, and Economic Performance, *discusses the causes and consequences of corruption and possible ways to curb it. The* IMF Survey *met recently with the book's editors, George Abed, Director of the IMF's Middle Eastern Department, and Sanjeev Gupta, Assistant Director, IMF Fiscal Affairs Department, to discuss its findings.*

Abed: "Designing a good policy is not enough—one has to go deeper to see how the institutions function, by what performance standards they operate, and how much capacity countries possess to implement policies effectively."

IMF SURVEY: The IMF traditionally did not view corruption as relevant to its macroeconomic mandate, but that seems to have changed. Why?

ABED: Most economists working in the policy area now realize the importance of sound institutions for good economic performance. The recent crisis in Asia highlighted this amply and led us to take a closer look at institutions. We asked ourselves how efficient they were, what role special interests played, and whether there was rent seeking.

We discovered that we didn't know as much as we needed to. We now realize that the more we know about financial markets, banking systems, and government operations of member countries, the more effective we will be in preventing crises. All this has led to a greater focus on the importance of good governance and the adverse effects of corruption.

Gupta: "Most of the book's studies use indices that measure perceptions of corruption in countries, rather than corruption per se."

GUPTA: The thinking in the economics profession has also evolved. Much of the scholarly research until the 1980s focused on weaknesses in public institutions and incentives for seeking rents. Some even argued that corruption didn't really hurt an economy, that it "greased the wheels" of production.

Earlier textbooks on development economics did not even mention the word corruption. It is only recently that good governance is seen as critical for achieving good social and economic outcomes. The studies in our book provide evidence that corruption cuts into government revenue and leads to wasteful public spending and thus *does* affect a country's macroeconomic position.

IMF SURVEY: Your book's overview says that, during the Cold War, bilateral donors paid little heed to the strict criteria of economic performance and commitment to reform when dispensing aid. But why didn't the international financial institutions look at the economic criteria and perceive corruption as an economic problem earlier?

ABED: I think, for the most part, the international financial institutions did focus on the merits of each case. However, they were not exempt from the pressures of the moment during the Cold War. If you look at the history of these institutions' involvement in some of the more politically sensitive countries, the role of Cold War politics in influencing financing decisions was no doubt important.

But, more generally, economists at the time didn't understand the development process very well. We focused on models of growth and theoretical policy design, and we assumed that governments were somehow competent to implement these policies and that the necessary institutions were in place. In time, we discovered that designing a good policy is not enough—one has to go deeper to see how the institutions function, by what performance standards they operate, and how much capacity countries possess to implement policies effectively.

IMF SURVEY: How does the IMF's anticorruption work fit into the larger picture of the institution's poverty reduction strategy?

ABED: Reducing poverty is an enormously important task. It's such a large problem that it dominates almost any other that we face in developing countries. In trying to mobilize funds for these countries, we realized that it was crucial that resources be channeled in a transparent and accountable manner to reduce poverty and enhance the welfare of recipient countries.

A lot of other organizations also got involved in the development process—nongovernmental organizations, the media, and so on. They, too, insisted that we examine the channels through which resources are directed and the activities to which they are dedicated. That prompted us to look at how institutions function in poor countries, how money is allocated and spent,

Photo credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF; Mauricio Lima for AFP, page 385; and Cris Bouroncle for AFP, page 386.

and whether there are enough safeguards to ensure that these funds go to reducing poverty and are not siphoned off into other, less desirable activities.

GUPTA: The book's conclusions are useful for the IMF's work on the Heavily Indebted Poor Countries (HIPC) Initiative as well as on the Poverty Reduction and Growth Facility (PRGF). Both initiatives call for increasing public spending to reduce poverty and promote economic growth. If public resources are not properly allocated, you will not achieve the desired economic and social outcomes. Corruption lowers economic growth, worsens poverty and income distribution, and limits the access of the poor to social services.

It is important that debt relief reach its intended beneficiaries—that is, the poor—and that there be no leakages. In this regard, both the World Bank and the IMF are helping countries improve their public expenditure management systems, and this is something that is closely linked to the IMF's work on the HIPC Initiative and the PRGF.

IMF SURVEY: Have recent IMF initiatives—such as the code of good practices on fiscal transparency, the Reports on the Observance of Standards and Codes (ROSCs), and safeguards assessments—made much headway in the fight against corruption?

GUPTA: The ROSCs, which are voluntary, assess the extent to which a country's practices differ from internationally recognized good practices. Typically, these reports lead to the formulation of a reform agenda. To the extent that these countries are implementing reforms on the basis of these reports, ROSCs are helping reduce rent-seeking behavior and incentives for corruption.

ABED: The transparency initiative and the codes and standards that we are promulgating, and to which many countries have already subscribed, provide a first assessment of the soundness of government and banking sector institutions as well as a statistical base on which policy is formulated. This first diagnosis helps reveal inefficiencies and areas where mismanagement, malfeasance, and corruption could possibly be taking place. By identifying the problems, this assessment paves the way for governments to follow up and tackle these issues.

IMF SURVEY: Do you see these voluntary transparency measures eventually becoming compulsory?

ABED: For most emerging economies, it's important, almost imperative, for them to undertake those assessments because of their need to maintain access to financial markets. A fiscal transparency report or a financial sector assessment from the IMF and the World Bank could only help these countries—even if only by reducing uncertainties.

The very poor countries don't have access to international markets, but they do receive a lot of financial assistance through the HIPC Initiative, the PRGF, and other initiatives. Many donors are beginning to insist that these countries' public expenditure and financial management systems be subject to some kind of assessment. These assessments, therefore, may never

When you see a number of indices, based on the opinions of different economic agents, agreeing to rate one country as having better governance than another, it most likely is true.
—George Abed

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become compulsory, but there is definitely peer pressure on countries to undertake them, and they are becoming more commonplace.

IMF Survey: Is it possible to accurately assess the full impact of corruption on an economy?

Gupta: Most of the book's studies use indices that measure perceptions of corruption in countries, rather than corruption per se. The indices are based on polls of a particular group and what that group has faced in a given country. One index, for instance, is based on polls of foreign investors and whether they had to pay bribes at the different levels of government. A range of indices has been created over the past four or five years. We find these indices are highly correlated, and the statistical results reported in the book are broadly similar using different indices.

Abed: Perception indices have improved over the past few years; they are more broadly based—that is, more and more relevant groups are being asked questions about practices in each of the countries being surveyed. Some surveys try to measure not just corruption but also the general openness and competitiveness of a country's markets, the prevalence of the rule of law, and other important elements of good governance. Of course, there's no smoke without fire. So when you see a number of indices, based on the opinions of different economic agents, agreeing to rate one country as having better governance than another, it most likely is true.

IMF Survey: What future direction should the fight against corruption take, and do you see the IMF's contribution to this effort changing?

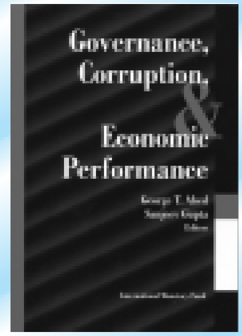
Abed: There are many ways to deal with corruption, including administrative or legal measures. That is, improvements can be made in the laws and regulations that govern markets and the operation of governments. These can ensure that playing fields are level, transactions are transparent and accountable, institutional checks and balances are in place to reduce or eliminate illicit rent seeking, and public funds are not subject to malfeasance or misdirection.

Another way is to provide a proper economic policy framework and an incentive system. This is where the IMF plays an important role. If a country has very high tariff rates—say, 300 or 500 percent—on a commodity like alcohol or perfume, you can be sure that a lot of people will try to smuggle these goods into the country by bribing officials to let them in.

The tariff and customs reforms that the IMF and the Bank undertake rationalize the tariff structure and improve the operation of customs. These, in turn, reduce the opportunity for corrupt practices and fraud. The IMF is involved in these activities through its technical assistance and policy advice.

Gupta: We also need to do further policy research—such as the work presented in our book—to stimulate debate on this important issue, both inside and outside the IMF. Unless we keep thinking about the causes, the consequences, and the remedies needed to curtail corruption, we will not be able to highlight its pernicious impact on the macroeconomy. So the IMF should persist in its current multipronged approach to fighting corruption. ■

Governance, Corruption, and Economic Performance, edited by George T. Abed and Sanjeev Gupta and featuring papers by IMF staff and others, highlights some of the latest research on corruption and reflects the growing interest in the connection between governance and economic performance.



The volume covers a range of topics, including the causes and consequences of corruption, the link between corruption and government expenditure, and how corruption affects tax revenues. The book also looks at corruption in transition countries and the IMF's role in promoting good governance.

Copies of the *Governance, Corruption, and Economic Performance* are available, for $37.50 each, from IMF Publication Services. See page 396 for ordering details.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
December 2	1.96	1.96	2.51
December 9	1.92	1.92	2.46

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?2002).

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

Data: IMF Treasurer's Department