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IMF takes another step to increase its openness

The IMF announced October 10 that its Executive Board had agreed on measures to enhance further the transparency of the institution, in particular by promoting the publication of more country documents. The agreement will be implemented following the Board's adoption, in the coming weeks, of specific amendments to its previous decision on transparency.

Over the past decade, the IMF has dramatically increased the number of documents it publishes. But progress in the publication of country documents—which, in each case, requires the agreement of the country concerned—has been uneven, with some regions lagging behind others. This prompted the Board, concluding its recent discussions of IMF transparency, to encourage more countries to agree to publication of their documents by adopting a policy of presumption that all country staff reports should be published. Presumed publication means that countries are expected—and strongly encouraged—to publish reports prepared by IMF staff on their economies. However, the country's consent is still required for the document to be published. This policy of presumption already applies to policy (as opposed to country) documents, which address issues relevant to the global economy or international financial system. As always, the Executive Board juggled the benefits of more transparency with the need to preserve candor in IMF reports and confidentiality in communications with member countries.

The most important changes in the IMF's transparency policy are the following:

First, the IMF will move from just "voluntary" to "voluntary but presumed" publication for all Article IV staff reports, Article IV Public Information Notices (PINs) and related Article IV papers (Selected Issues papers, Statistical Annexes, and Appendices prepared as background *(Please turn to the following page)*

Per Jacobsson Lecture

Arab countries need to set clear priorities to create momentum for reforms

On September 29 at the IMF–World Bank Annual Meetings in Dubai, Abdlatif Y. Al-Hamad, Director General and Chair of the Board of Directors of the Arab Fund for Economic and Social Development and former Kuwaiti Finance Minister, delivered the 2003 Per Jacobsson Lecture, "The Arab World: Performance and Prospects." His remarks are summarized below; the full text is available at www.perjacobsson.org.

The Arab region—extending from Dubai on the Arabian Gulf to Nouakchott in Mauritania on the Atlantic—is extremely large and diverse, geographically, resource-wise, and in terms of development, Al-Hamad said. The region, with a total population of 295 million, is the poorest in the world in water and agricultural resources but one of the richest in hydrocarbon reserves. Average annual per capita GDP is $2,445, placing the region in the group of middle-income countries.

Al-Hamad: The Arab world is being shaken to its very foundations by the rise of poverty and unemployment.

From 1960 to 1985, the development performance of the Arab region surpassed all regions except Asia in income growth and outperformed them all in income distribution, owing largely to the windfall earnings from oil, whose benefits *(Please turn to page 299)*

Publication of documents will be presumed

(Continued from front page) material for Article IV consultations). These changes will take effect on July 1, 2004.

Second, the IMF will move from just "voluntary" to "voluntary but presumed" publication for Use of Fund Resources (UFR) and Post Program Monitoring (PPM) staff reports. These changes will become effective as soon as the Executive Board approves the amendments to its previous decision. Documents that spell out country policy intentions (such as Letters of Intent and Memorandums of Economic and Financial Policies) and often accompany UFR staff reports are already subject to a policy of "voluntary but presumed"publication.

Third, special procedures were agreed upon for countries that have policy programs supported by IMF loans involving exceptional access to IMF resources (that is, loans above the normal limits for IMF programs—recent cases include Argentina, Brazil, and Turkey). In these cases, the Managing Director will generally not recommend Board approval of a program or completion of a review unless the authorities consent to publication of the staff report. These rules were agreed upon against the background of a significant decline from already low publication rates for UFR reports involving exceptionally high access. In the Board discussions, it was emphasized that transparency is critical in these cases, because they typically involve capital account crises where public understanding of and market support for the program strategy are particularly important. The new policy will not apply to programs that are now in place, but it will apply to all new programs involving exceptional access approved after July 1, 2004, and to existing arrangements that, because of increases in loan size after July 2004, result in exceptional access.

Directors agreed that publication would be expected to occur within 30 calendar days of the relevant Board meeting for documents that fall into the category of presumed publication. They also emphasized that the explicit consent of a country is still required before publication. Without this consent, a document will not be published.

The Executive Board also considered the IMF's deletions policy for country documents. Some Directors had proposed expanding the policy on allowable deletions, which currently covers only information that is deemed "highly market sensitive," to include "highly politically sensitive" material. However, the majority of the Board did not support such a move, so the existing deletions policy will remain in place. It covers exchange and interest rate matters and highly market sensitive material in vulnerability assessments and the banking and fiscal areas. Concerns were also raised in the Board discussion that pressure to delete significant sections in documents might intensify with increased transparency. To address these concerns, it was agreed that IMF management might recommend that the Board withhold publication of a document if deletions were deemed to undermine the IMF's overall assessment and, hence, its credibility.

Directors furthermore agreed to apply the broad principles for deletions and corrections for country documents to policy papers. In practice, this means that the positions adopted by IMF staff in policy papers will not be revised before publication, even when they differ from those expressed by the Executive Board. When there is a risk of confusion, the published version of the document will clearly identify those staff positions that have not been endorsed by the Board.

The Board also agreed to make the Board agenda public. Detailed arrangements for implementing all these changes will be worked out in the coming weeks as amendments to the Board's transparency decision are prepared.

The next review of the IMF's transparency policy is scheduled for June 2005. ■

This policy of presumption already applies to policy documents, which address issues relevant to the global economy or international financial system.

Geithner to head New York Federal Reserve Bank

On October 15, the Federal Reserve Bank of New York announced the appointment of Timothy Geithner as its President and Chief Executive Officer. Geithner, who has headed the IMF's Policy Development and Review Department (PDR) since December 2001, is expected to take up his new duties in mid-November.

IMF Managing Director Horst Köhler congratulated Geithner on his selection to one of the most prestigious posts in the U.S. Federal Reserve System. Köhler said he looked forward to working with Geithner in his new capacity, adding "Tim's work at the IMF, combined with his policymaking experience [at the U.S. Treasury] before he came to the IMF, prepares him well to take on this challenging task."

Köhler also paid tribute to Geithner. "In a very short time after joining the IMF," he said, "Tim Geithner was able to lead PDR with great effectiveness. I have relied on Tim for his counsel, which has been thoughtful, solid, and balanced even in the most challenging of times. I and the IMF will miss him, but I also know that the IMF is being honored by the selection of one of its senior staff to head this important institution."

The full text of IMF Press Release No. 03/170 is available on the IMF's website (www.imf.org).

Timothy Geithner

Some problems stem from region's oil revenues

(Continued from front page) spilled over to the entire Arab region.

But the momentum was not maintained. Over the past 15 years, investment and productivity rates declined, economic growth barely kept pace with the increasing population, and per capita growth rates dropped to less than 1 percent a year. What caused the serious reversal in the performance of the Arab region, and what dynamic forces could produce change and improve its overall performance? Al-Hamad stressed that setting clear priorities was key to jump-starting the reform process.

Performance and challenges

According to Al-Hamad, the economic ailments of some countries were caused by flawed leadership and inept policies, made possible by the huge oil revenues that accrued directly to the state. But for most countries in the region, he said, a common mix of factors caused the dramatic downturn in their economies.

Sharp decline in oil revenues. The average nominal price of crude oil decreased from $27 a barrel in 1985 to $12 by 1998, causing a dramatic decline in incomes, investment, and job creation in the Arab region. This slump was the main cause of the decline of economic growth during 1986–2002. However, the performance of some non–oil-exporting countries, such as Egypt, Syria, and Tunisia, compared with that of other developing countries, was more encouraging over the period. Their economies today are more diversified than those of the main oil-exporting countries in the region.

Collapse of the centrally planned economic systems. Because of the absence of a clear vision and in view of the pressures created by a growing population with rising social demands, Al-Hamad argued that many of these countries failed to adopt appropriate policies for growth and institutional reform. Their strategies continued to rely on physical capital accumulation while neglecting the need for human and institutional development.

Inappropriate macroeconomic policies. Inflexible and overvalued exchange rates, high interest rates, and reliance on indirect taxes led to serious distortions. Overvalued exchange rates discouraged production of both exports and import substitutes. The related policy of high real interest rates discouraged investment and promoted accumulation in short-term bank deposits and other nonproductive assets.

Lack of urgency in implementing badly needed reforms. With an overall decline of their economies in the second half of the 1980s, Arab countries faced a number of hard choices, Al-Hamad said. Some agreed to follow the prescriptions, originally designed for Latin America (the so-called Washington Consensus), albeit reluctantly. Others, especially oil-rich countries, did not feel any urgency to restructure their economies, and their growth rates now lag behind those in Asia and Latin America and even some Arab countries.

Protectionist policies. The reluctance of a number of Arab countries to change their trade policies away from excessive protection and in favor of export-orientation hampered their growth. But the small group of countries (including Jordan, Morocco, and Tunisia) that followed the outward-orientation route made important strides.

Political and social instability, poor-quality services, and weak governance, according to Al-Hamad, contributed to the Arab countries' failure to attract significant amounts of foreign investment. The United Nations Conference on Trade and Development's *World Investment Report 2002* points out that the share of foreign investment flowing to these countries is negligible: its total in 22 countries does not even match that of Singapore. Foreign direct investment brings not only capital but, more important, technology, management skills, and access to international markets. It is critical for effective participation in the international production networks, which the countries of the region badly need.

High population growth rates. At an average rate of 2.5 percent a year, population growth is hindering progress in most Arab countries. The demographic challenge is not only about numbers; even more critical is the lack of required skills. The failure to reform the educational systems and adjust to the needs of the marketplace is a real obstacle to modernization. Growth is hampered, and unemployment and poverty are rising, including in the oil-rich countries of Kuwait and Saudi Arabia.

Water shortages represent a challenge for all Arab countries. The sources of all the rivers flowing through Arab lands are controlled by other nations, Al-Hamad said, and violent conflicts over water must be avoided. All countries should do their utmost to arbitrate disputes and ensure that water resources are shared fairly. More important, he added, all countries must follow policies for better water management.

Some bright spots

Some Arab countries have succeeded in correcting distortions that have plagued the region's economy. Productivity has increased, efficiency has been

No country can be integrated into the world economy if it lacks the rule of law, an independent judiciary system, and transparent accounting and reporting.

—Abdlatif Al-Hamad

enhanced, growth has accelerated, and foreign trade performance has improved, particularly in Egypt, Jordan, Morocco, and Tunisia. However, sustainable progress has not been achieved in most other countries.

There are a number of bright spots in social areas as well, Al-Hamad noted. Women's rights have improved in most Arab countries, and the level of school admission has grown by more than 150 percent—a rate not matched by any other region in the world. The expansion of education to include both genders and all segments of society has strengthened the desire for societal change in all Arab countries.

Reforms and priorities

How should we view the future of the Arab region? Unfortunately, Al-Hamad pointed out, its prospects seem gloomy in the short run. The dependence on oil is not likely to change soon; financial difficulties will probably endure; public investments will continue to decline; and the private sector will remain inefficient, overprotected, and too weak to provide a credible alternative.

But a number of the prerequisites for long-term growth are in place. These are in education, infrastructure, and social development. While the pace of recovery will not be the same in all countries of the region, the crucial factor is the quality and sustainability of the reform process in a difficult global environment. It is therefore imperative, Al-Hamad argued, to determine the right priorities and create the momentum for reforms. In his view, the most critical of these are in four areas:

Good governance. A key to economic development is economic and legal institutions. Improving governance is of great urgency in the Arab world. No country can be integrated into the world economy if it lacks the rule of law, an independent judiciary system, and transparent accounting and reporting.

Poor governance, Al-Hamad said, is generally considered the greatest obstacle to improving efficiency, competitiveness, and growth. Arab businesses should evolve and adopt new management styles compatible with global business practices. And government involvement in the economy should be restricted to three major roles: ensuring the supply of high-quality public services, maintaining a national legal framework that enforces laws and contracts fairly and efficiently, and managing the macroeconomy to preserve economic stability and social harmony. But bureaucracies in many Arab countries are resisting such a conversion of roles.

Freedom and democracy are lacking in the Arab world, hindering sustainable development. Genuine political participation is weak, with many restrictions on liberties, and accountability is generally lacking. No progress can be achieved, Al-Hamad observed, if citizens are unable to think freely and act independently.

Reform of financial systems. An efficient financial system, Al-Hamad noted, is an essential component of more competitive markets. Development of strict standards and best practices for Arab banking is crucial if these countries are to succeed in mobilizing savings and liquidity in financial markets. A well-regulated securities market providing sound information and protection to all investors must be developed. All these steps hinge on serious and fair privatization policies. These are only the minimum prerequisites for the creation of a viable financial system.

Education and appropriate technologies. The Arab region needs to improve the quality and quantity of education. The current workforce has four years of schooling, on average, which is not conducive to productivity. Development strategies must take into account that competitiveness is no longer based on cheap labor and abundant natural resources but on knowledge, innovation, and productivity.

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—Abdlatif Al-Hamad

What does the future hold?

The Arab region's ability to achieve sustained growth over the long run appears to be impeded by the fear that reforms might spark social and political upheaval and destroy the power base of vested interests, Al-Hamad said. The Arab world is being shaken to its very foundations by the rise of poverty and unemployment, a condition that could drive people to despair and nurture extremism and violence.

However, Al-Hamad was convinced that the Arabs were capable of rising to these challenges. They have always been open to the world—from Babylonia to Egypt, from Carthage to Andalusia, from Damascus to Baghdad—and have always been among the leaders of civilizations. They were the first to farm, build cities, and adopt each of the three monotheist religions of the world. Such a heritage should never be forgotten or squandered, but now Arab countries urgently need to implement reforms and rejuvenate institutions, not only in the economic sphere but throughout the social system. ■

Photo credits: Denio Zara, Padraic Hughes, and Michael Spilotro for the IMF, pages 297–301, 303–305, and 310–312; Andy Mueller for Reuters, page 309; Sweta Chaman Saxena, page 312.

Gender equality can foster growth and help reduce poverty

At the meeting of High-Level Women in International Finance, Economics, and Development (also see box, page 302) held in Dubai, United Arab Emirates, on September 20, Peter Heller (Deputy Director in the IMF's Fiscal Affairs Department) discussed how the IMF can help promote the Millennium Development Goals (MDGs) that address gender equality. His speech is summarized below.

One does not normally see a connection between the IMF's work and the pursuit of gender issues, Heller said. But a focus by the IMF on such issues in its work with countries on poverty reduction strategy papers (PRSPs) and programs under the Poverty Reduction and Growth Facility (PRGF) would promote the MDGs and also the IMF's objectives for poverty reduction. Three of the eight MDGs are gender related—equality in primary and secondary education, full enrollment of girls in primary education, and improvements in maternal health.

But even a focus on the MDGs that are not gender specific would require that policies be tailored to disproportionately benefit girls and women because, at present, they suffer disproportionately from poverty and unhealthful environmental conditions, as well as the direct and indirect effects of the HIV/AIDS epidemic. In several countries, girls have lower life expectancy and are more poorly nourished than their male counterparts.

Equally important, achieving these gender-related MDGs may have independent instrumental effects in fostering economic growth. Raising the level of women's education and improving their health and income status may lead to lower fertility rates and higher labor productivity. Achieving universal secondary education is particularly critical. While a primary education may have positive benefits for the next generation, only a secondary education seems to benefit women. World Bank estimates suggest that an increase of 1 percentage point in the share of women with a secondary education is associated with an increase in per capita income of 0.3 percentage point.

Should the IMF influence countries' decisions about the policy goals, such as gender equality, that guide their poverty reduction strategies? Heller argued that a key advantage of focusing on the MDGs is that they have been endorsed by virtually all countries in the context of the Monterrey Consensus. It is thus legitimate for the IMF and the World Bank to advocate the MDGs as the basis for countries' PRSPs and for the MDGs to shape a country's policies in the context of a PRGF-supported program.

IMF role in realizing the MDGs

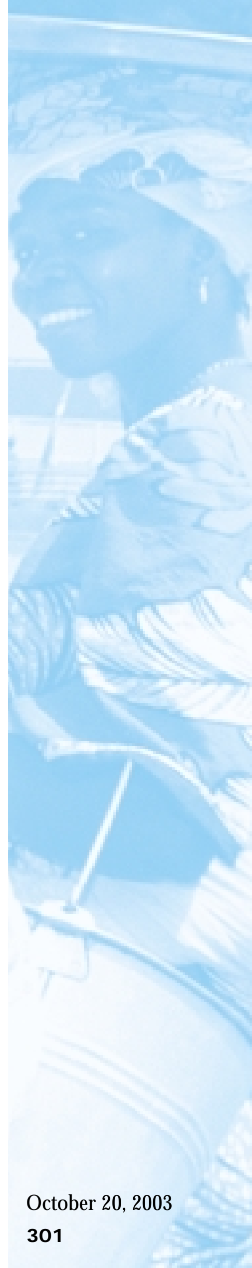
According to Heller, much of what the IMF does already supports achievement of the MDGs. IMF-supported programs in countries experiencing balance of payments crises are vital in restoring sustainable growth, which, in turn, is a precondition for poverty reduction. IMF surveillance facilitates global economic growth, which is necessary to support growth in the poorest countries. Also, in the surveillance context, he said, the IMF seeks to prevent financial crises, whose effects normally fall disproportionately on the poor, with long-lasting effects on human capital formation. This preventive role may be the most important one for women, who are often most susceptible to the adverse effects of a financial crisis.

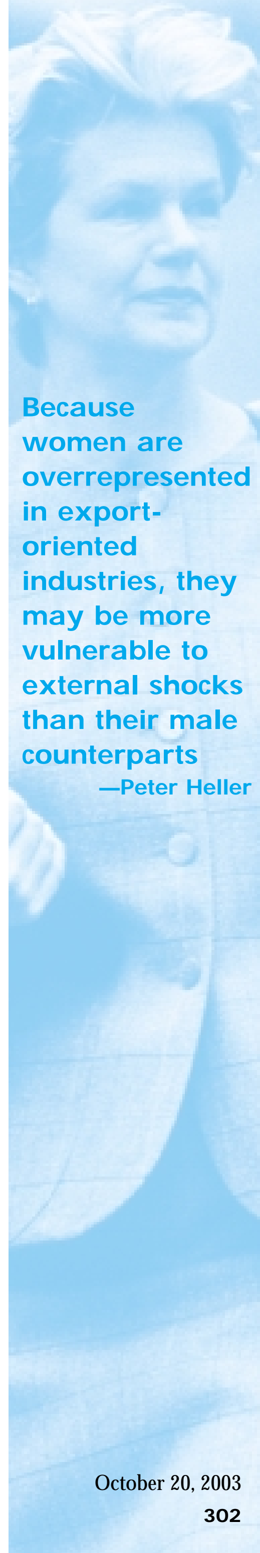
The IMF, in collaboration with the World Bank, provides technical assistance on budget systems to ensure that increased social spending reaches the intended recipients. The IMF also has been involved in efforts to promote debt relief for poor countries and to channel the resulting budgetary savings to poverty-reducing programs. Finally, Heller said, in its research efforts, the IMF analyzes such issues as the macroeconomic impact of HIV/AIDS and the design of social safety nets.

But, Heller argued, the IMF could do more to further the achievement of the MDGs. First, it could more forcefully emphasize the importance of countries' including policies that favor women and girls in their PRSPs. Second, a gender focus could be valuable in shaping the IMF's views on macroeconomic policy, although he acknowledged that IMF economists needed to strengthen their understanding of these issues. He cited a number of facts that should motivate IMF economists' work in this sphere:

• The poorer the country, the more official GDP figures underestimate women's contribution to countries' economic performance, given their greater relative importance in both the informal sector and in nonmarket activities; a failure to model the nonmarket sector of the economy can result in distortions in both analysis and operational policy conclusions. Maternal health and nutrition also bear on the health of children and thus on the quality of the capital endowed to the next generation. Women's time allocation to market activities may be affected by government policy decisions that influence the costs associ-

Heller: Raising the level of women's education and improving their health and income status may lead to lower fertility rates and higher labor productivity.





Because women are overrepresented in export-oriented industries, they may be more vulnerable to external shocks than their male counterparts
—Peter Heller

ated with necessary nonmarket activities (for example, investment in infrastructure on water or roads).

• Economic assessments of the impact of price or interest rate liberalization on production may benefit from taking gender considerations into account. Women often have little decision-making power within the family, little control over the use of household income, and little access or ownership rights to assets. This may affect the extent to which they respond, in their production and investment decisions, to improved market incentives.

• Assessments of the impact of economic shocks may also be biased to the extent that gender factors are not taken into account. Women may be excessively exposed to the effects of commodity price shocks or negative trends in the terms of trade in primary commodities. Because women are overrepresented in export-oriented industries, they may be more vulnerable to external shocks than their male counterparts. Women represent 80 percent of the two million workers employed in export processing zones in some 50 countries.

• The Asian financial crisis illustrated women's greater vulnerability to crises. They are more likely to be laid off or displaced by temporary workers or male workers. They may be forced into the informal sector at lower rates of pay. Girls may be forced to drop out of school to share the responsibilities of income generation and nonmarket activities. Women's nonmarket activities may become more burdensome, as more time is required to find low-cost foods, fuel, and water and to prepare meals. Women also often act as the de facto safety net in societies where formal social safety nets are not in place or are poorly developed.

• The adverse effects of a crisis may also be exacerbated if governments, seeking to strengthen their fiscal position, cut back on social services—in education and health—from which women would normally disproportionately benefit. Higher charges may be imposed for tuition and health services, forcing more young girls to drop out of school and reducing their access to services. The disproportionately adverse effects on girls and women may have longer-term consequences than might be immediately apparent.

• Trade liberalization may affect men and women in different ways—there is evidence in developing countries that greater trade openness is associated with a larger number of women in paying jobs.

• Gender inequality plays an important role in the spread of HIV/AIDS, which has had significant macroeconomic implications in affected countries.

Would a gender perspective influence the IMF's choice of macroeconomic policies? Modeling of the nonmarket economy might result in a different policy set or at least an awareness of the need for supplementary measures to offset particularly adverse effects on productivity or output. A gender focus would influence the choice of the expenditure or revenue instruments used to consolidate the fiscal position. Policy choices on social safety nets would also be influenced.

The third way the IMF can promote the MDGs, Heller argued, is by exploring the role of a gender-focused perspective on government budgets. This "would allow for greater analysis of the incidence of government expenditures and revenues by gender and help governments decide where policies need to be adjusted and resources reallocated to promote gender equality." It would also provide a way to hold

Network of women ministers to be created

On September 20, attendees at the meeting of High-Level Women in International Finance, Economics, and Development voted to create a formal worldwide network of women ministers of finance and economic development, related ministerial portfolios, and other women leaders in the field. "As the only organization of its kind, the network will enable all women ministers of these portfolios to meet, build alliances, and work together to promote agreed-upon directions and policies," said the Right Honorable Kim Campbell, former Prime Minister of Canada and Chair of the Council of Women World Leaders, who directed discussions on the network's creation. IMF Managing Director Horst Köhler opened the meeting, expressing support for its objectives, especially as they lead to a more balanced order by strengthening the leadership and inclusion of women.

The network will be cochaired by the Honorable Susan Whelan, Minister of International Cooperation of Canada, and the Honorable Luisa Diogo, Minister of Planning and Finance of Mozambique. According to Whelan, the network will be a vehicle for its members "to go beyond talking to action."

The mission of the Council of Women World Leaders, founded in 1996, is to promote good governance and enhance the experience of democracy globally by increasing the number, effectiveness, and visibility of women who lead at the highest levels in their countries. As such, the Council of Women Leaders is uniquely positioned to direct the formation of the network of finance ministers. In June 2002, the Council launched the International Assembly of Women Ministers, whose 500 members are all sitting ministers. This Assembly will direct the network and its activities and provide a forum for women at the ministerial level, from a wide range of portfolios to discuss their challenges and priorities.

governments accountable for their commitments to gender equality.

Fourth, he said, the IMF and the World Bank should collaborate to ensure that social safety nets are appropriately directed toward girls and women during economic crises and reform programs. Adolescent girls, in particular, are extremely vulnerable (to AIDS, sexual assault, and pregnancy) and yet receive few services. In some instances, safety nets designed for women seem to be efficient. The increased emphasis on Poverty and Social Impact Analyses (PSIAs) also offers the prospect of a more acute diagnosis of the gender impact of alternative macroeconomic policy instruments.

But the IMF has limitations

Even as Heller explained that the IMF could do more to promote the gender-related MDGS, he noted that its mandate and core areas of expertise in the macroeconomic sphere leave little scope for detailed microeconomic and sectoral policy analyses. Thus, it is in partnership with country authorities and other development partners that the IMF can make the most progress in pursuing the gender-related MDGs. ■

The speech was written by Peter Heller and Erik Lueth, (Economist in the IMF's Fiscal Affairs Department). The full text of the speech is available on the IMF website (at www.imf.org).

There is evidence in developing countries that greater trade openness is associated with a larger number of women in paying jobs.
—Peter Heller

Recent publications

IMF Working Papers ($15.00)

03/167: "Diamond Smuggling and Taxation in Sub-Saharan Africa," Nienke Oomes and Matthias Vocke
03/168: "Economic Resilience with an Exchange Rate Peg: The Barbados Experience, 1985–2000," DeLisle Worrell, Harold Codrington, Roland Craigwell, and Kevin Greenidge
03/169: "From Program to Performance Budgeting: The Challenge for Emerging Economies," Jack Diamond
03/170: "Estimating Indexes of Coincident and Leading Indicators: An Application to Jordan," Joannes F. Mongardini and Tahsin Saadi-Sedik
03/171: "Measuring Contagion with a Bayesian Time-Varying Coefficient Model," Matteo Ciccarelli and Alessandro Rebucci
03/172: "The Persistence of Corruption and Regulatory Compliance Failures: Theory and Evidence," Richard Damania, Per G. Fredriksson, and Muthukumara Mani
03/173: "Reforming Tax Systems: Experience of the Baltics, Russia, and Other Countries of the Former Soviet Union," Vahram Stepanyan
03/174: "Reconciling Stability and Growth: Smart Pacts and Structural Reforms," Roel Beetsma and Xavier Debrun
03/175: "Debt Relief, Additionality, and Aid Allocation in Low-Income Countries," Robert K. Powell
03/176: "Foreign Aid and Revenue Response: Does the Composition of Aid Matter?" Sanjeev Gupta, Benedict J. Clements, Alexander Pivovarsky, and Erwin R. Tiongson
03/177: "Why Do Emerging Economies Borrow in Foreign Currency?" Olivier D. Jeanne
03/178: "Potential Output and Total Factor Productivity Growth in Post-Apartheid South Africa," Vivek B. Arora and Ashok J. Bhundia
03/179: "Nominal Anchors in the CIS," Peter M. Keller and Thomas J. Richardson
03/180: "Capital Account Liberalization and Corporate Taxes," Ben Lockwood, Michael Devereux, and Michela Redoano

IMF Country Reports ($15.00)
(Country name represents an Article IV consultation)

03/271: Iceland: Financial System Stability Assessment Update, including Report on the Observance of Standards and Codes
03/272: Ethiopia: Fourth Review and Third Annual Program Under the Three-Year Arrangement Under the PRGF and Requests for Extension of Arrangement and for Additional Interim Assistance Under the Enhanced HIPC Initiative
03/273: Sudan: Final Review Under the 2002 Staff-Monitored Program and the 2003 Program
03/274: Liberia
03/275: Liberia: Selected Issues and Statistical Appendix
03/276: Malta
03/277: Mongolia: Poverty Reduction Strategy Paper
03/278: Argentina: Third Review Under the Stand-By Arrangement and Request for Waiver of Non-observance and Applicability of Performance Criteria
03/279: Islamic Republic of Iran
03/280: Islamic Republic of Iran: Statistical Appendix
03/281: Japan
03/282: Japan: Selected Issues
03/283: Nepal
03/284: Nepal: Statistical Appendix
03/285: Dominican Republic: Statistical Appendix

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Annual Meetings seminars

Road to regional and global prosperity

The program of seminars—open to nonofficial visitors as well as officials of governments and international organizations—held September 20–22 in Dubai covered a range of issues of concern to the international community. Among the topics were the implications of the collapsed trade talks in Cancún, foreign direct investment in emerging markets, prospects for achieving the Millennium Development Goals, the role of the IMF in low-income countries (see box, page 305), and the role of official communication in the success of economic and financial policies (see box, page 306). (For seminars that focused on the Middle East, see IMF Survey, *October 6, pages 284–86, and boxes below and on page 307.)*

Developing countries could gain up to $350 billion in additional income from trade by 2015 if the Doha Round succeeded.
—Nicholas Stern

The failure to reach agreement at Cancún on the next steps in the Doha Round of World Trade Organization (WTO) trade negotiations was widely deplored at the Annual Meetings. Many officials and other participants warned that delays in liberalizing trade rules and reducing trade-distorting subsidies and other practices harmed everyone, developing countries most of all. World Bank Chief Economist Nicholas Stern quoted Bank estimates that developing countries could gain up to $350 billion in additional income from trade by 2015 if the Doha Round succeeded.

Stern and fellow panelists Eduardo Perez Motta (Mexico's Ambassador to the WTO), Francisco Thompson-Flôres (WTO's Deputy Director General), and Rashid S. Kaukab (Coordinator of the South Center's Work Program on Trade and Development) agreed that the negotiations had been complicated by the broadening of the agenda and the wide differences of view remaining on the eve of the talks. But Thompson-Flôres emphasized that substantial progress had been made in negotiations on agricultural, nonagricultural, and development-related trade issues. According to the panel, the talks broke down primarily because of disagreements about whether and how to include the so-called Singapore issues (investment, competition, trade facilitation, and government procurement policies affecting trade). However, Kaukab noted that the negotiation process itself had also

United Arab Emirates—a regional role model

The seminar "Economic Policy, Investment Opportunities, and Regulations in the United Arab Emirates" (U.A.E.) spotlighted the economy of the country that hosted the Annual Meetings.

The U.A.E. economy has performed robustly in recent years, according to Mohammed Khalfan Bin Khirbash, U.A.E. Minister of State for Finance and Industry. Over the past decade, GDP has increased 5.8 percent a year, on average, while inflation has been kept low. Even more impressive, and in line with the policy of diversifying the U.A.E.'s economic base, non-oil GDP—mainly manufacturing, finance, and tourism—has grown at an average annual rate of 8 percent for the past 10 years and now accounts for two-thirds of total GDP. The soundness of the U.A.E. financial sector, Khirbash noted, has recently been confirmed by official and private international agencies.

Drawing attention to the country's political stability and security, he observed that many different nationalities live in harmony within its borders. Khirbash added that the U.A.E. is committed to accountability and inclusiveness—hallmarks of good governance—and has recently adopted performance-based budgeting. It has also introduced an electronic project providing real-time access to government information. In short, the U.A.E. is now clearly recognized as "a safe place to invest" and is well on its way toward "becoming a global business center and a regional role model."

In an overview of bank regulation and supervision, U.A.E. Central Bank Governor Sultan Bin Nasser Al Suwaidi explained that the central bank has supervisory and regulatory authority over all types of financial institutions. He reviewed capital ratios, disclosure requirements, and examination procedures set by the central bank and noted that a Financial Sector Assessment Program report by the IMF and the World Bank last year had commended the country for its strong banking supervision and sound regulatory framework. He added that the U.A.E. was taking strong measures to prevent money laundering and the financing of terrorism and was the first country in the region to regulate informal money transfer systems (hawala).

Mohamed Ali Alabbar, Dubai's Director General for Economic Development, surprised the large seminar audience by announcing that a business can now be started in just three hours in any of Dubai's four free zones, where regulations and licensing paperwork have been cut to a bare minimum, 100 percent foreign ownership is permitted, and income and capital may be repatriated freely. As a result, foreign investment in Dubai has grown rapidly in information technology, telecommunications, media, finance, and transport.

In the ensuing discussion, Khirbash was asked what the U.A.E. had hoped to achieve by hosting the IMF–World Bank Annual Meetings. He replied that it wanted to send a positive message to the world about international cooperation, especially following the collapse of trade talks in Cancún.

become a sticking point for many developing countries.

Will governments be able to muster the political will to put the negotiations back on track? This question, according to the panelists, will be on everyone's mind. Motta urged four steps for the near term: avoid finger pointing about Cancún, call on the major players to demonstrate leadership and political commitment on the main issues, avoid trade actions that could increase tensions, and discuss the decision-making process.

Hope for the MDGs?

Developing countries were the focus of the seminar "Getting Serious About Meeting the Millennium Development Goals." The panelists were Luísa Dias Diogo (Minister of Planning and Finance, Mozambique), Ahmed Mohammed Sofan (Deputy Prime Minster and Minister of Planning and International Cooperation, Republic of Yemen), Kubat Abduldaevich Kanimetov (Head, Economic Policy Unit, Kyrgyz Republic), and Evelyn Hefkens (United

Low-income countries need more grant aid in short term

What is the role of the IMF in low-income member countries? A September 20 seminar moderated by Timothy Geithner, Director of the IMF's Policy Development and Review Department, presented the views of Mark Plant, Advisor in the Policy Development and Review Department; M. Saifur Rahman, Minister for Finance and Planning, Bangladesh; and Ulan Sarbanov, Chair of the National Bank of the Kyrgyz Republic.

Low-income countries must adopt policies conducive to growth and poverty reduction to improve their prospects of realizing the Millennium Development Goals (MDGs). But they will also need to receive much more help from their development partners—both technical assistance and aid, with a larger proportion of grants. How can the IMF help most effectively, given that it is not primarily a development institution and has neither the capacity nor the mandate to contribute to the long-term flows of resources needed to meet the MDGs? Plant argued that the IMF could help countries establish macroeconomic stability as the foundation for sustained growth and deal with shocks.

In this context, he said, a number of questions must be addressed. How can IMF-supported programs promote sustained, faster growth and poverty reduction? In what areas does the IMF need to coordinate more closely with other development partners? How can the IMF support private sector development? Are the IMF's facilities adequate to provide financial support and advice to low-income members? And, finally, what role should the IMF play in cushioning the impact of shocks on low-income countries?

Plant also highlighted several principles that would help guide the debate. Clearly, he said, the IMF will remain engaged with low-income countries over the long term by embracing the poverty reduction strategy paper (PRSP) process as the framework for helping countries achieve the MDGs. Although more aid is desirable, countries need to rely on private sources of financing in the long term. The IMF must also work with industrial countries to ensure that their policies––especially in trade and agriculture––will improve low-income countries' growth prospects. It will focus on its core areas of competence––macroeconomic and financial policies––and provide policy advice through surveillance, financial assistance through programs supported by the Poverty Reduction and Growth Facility (PRGF), and technical assistance.

The discussants welcomed the IMF's attention to the issues. Rahman argued that getting effective advice from the Bretton Woods institutions would require greater coordination between the World Bank and the IMF. Too often, he said, countries are left to sort out contradictory prescriptions; instead, the two institutions should ensure that their advice and programs fit together. Rahman also argued that the IMF's increased emphasis on country ownership of policies should be matched by greater flexibility on its part, particularly in the timing of implementing policies, given that so many policy changes are highly political and thus need time to take effect. Countries should also be engaged much earlier in formulating policies. Rahman stressed, too, that private flows would come only after developing countries acquired the right enabling environment.

Sarbanov argued that the IMF also needed to pay attention to issues outside its core areas. For example, if a country has a large public sector, the IMF must look not only at tax policy but also at the energy sector or the financial sector if that is where, in fact, macroeconomic problems are rooted.

In the subsequent discussion, one participant argued that it would be better to concentrate on income distribution rather than growth. Others called for closer links between PRGF-supported programs and PRSPs to ensure that the conditions of the former did not hinder achieving the goals of the latter. It was also argued that there should be closer links between the PRGF calendar and the policy cycle of a country's authorities. It is not possible to consult everyone, Rahman noted; governments are elected to represent citizens. Participants also questioned a number of aspects of IMF-supported policies, referring particularly to privatization, whose benefits, they argued, were not proved, and to what was described as a mechanistic approach to the formulation of stabilization programs. Other participants sought ways of getting IMF policy advice into low-income countries, including postconflict situations, without necessarily being tied to financial assistance.

The staff paper "The Role of the International Monetary Fund in Low-Income Member Countries," has been posted on the IMF's website, and public reaction is being invited. Please see www.imf.org/external/np/pdr/sustain/2003/072103.htm

Although more aid is desirable, countries need to rely on private sources of financing in the long term.
—Mark Plant

Nations Secretary General's Executive Coordinator for the MDG campaign).

Moderator Mamphela Ramphele (Managing Director, The World Bank Group) opened by recalling the strong commitments the international community had made in the Monterrey Consensus, the Doha Ministerial Declaration, the World Summit on Sustainable Development, and, more recently, the U.K. initiative to provide additional financing to help meet the MDGs. But she noted that all parties needed to work harder to ensure that these commitments were fully realized.

Information and communication policy are critical for the development of efficient markets and crisis prevention.
—Agustín Carstens

Communicating policy is as important as making it

The role of public communication in the success of economic and financial policies, including reforms, was the subject of a seminar moderated by Kemal Dervis (Deputy for the Republican People's Party, Turkish National Parliament). The panelists were Fawzi Al-Sultan (Secretary General, Higher Committee for Economic Development and Reform, Kuwait), Salam Fayyad (Minister of Finance, Palestinian Authority, West Bank and Gaza), Agustín Carstens (IMF Deputy Managing Director), and Gus O'Donnell (Permanent Secretary to the Treasury, United Kingdom).

Despite the speakers' diverse backgrounds and experiences, all agreed that communication was crucial to the success of economic policies. Dervis recalled advice he had received during the 2001 Turkish crisis from Central Bank Governor Guillermo Ortiz of Mexico to spend "as much time on communicating policy as on making it." O'Donnell said communication was the most seriously undervalued element of effective policymaking, while Carstens viewed information and communication policy as critical for the development of efficient markets and crisis prevention. Al-Sultan and Fayyad said that they relied on public communication to help them respond to, and build up, coalitions and constituencies in support of reform in Kuwait and the West Bank and Gaza, respectively.

Outlining the strategy and instruments used in the ongoing public awareness campaign in Kuwait, Al-Sultan stressed the importance of systematic research and opinion surveys and of benchmarks to measure progress and trends. Communication, he said, is a two-way street, and he cautioned against a prescriptive approach to communication if the goal was to create partnerships and broad ownership of reform. Success stories, however, should be shared and disseminated to bolster reform constituencies within the country.

Fayyad emphasized the interaction between the context and the content of policy communication. In his experience, for example, there was already a strong public awareness of a problem and of the need for reform. What was needed, he said, was a clear announcement of policy intentions that would allow performance to be measured against a well-understood reform strategy. In addition, restoration of confidence in the Palestinian context required not only transparency but also "optimal exposure." In the past, Palestinian officials used to speak about all issues all the time, reducing rather than increasing confidence. His experience has confirmed that measured and well-timed exposure that focuses on delivery is more effective in reestablishing credibility.

Carstens focused on the importance of communication and information policies for the development, efficiency, and stability of financial markets. He recalled Mexico's experience before and after the 1995 crisis and the shift in official culture from withholding information to providing markets with all the information they needed. As a result, spreads declined dramatically. The earlier attitude reflected a more general view shared by many in industrial countries. In 1983, for example, the central bank governors of Mexico, Belgium, and the United States jointly advised the Chinese monetary authorities to withhold information on foreign exchange reserves, in keeping with practice at that time. Dervis noted that, 15 or 20 years ago, the IMF itself had a secretive attitude. The change and openness that have taken place have been good for the IMF and its member countries. Carstens stressed how important it was that different officials and government agencies communicate consistent messages to markets.

According to the United Kingdom's O'Donnell, the separation that often exists between government economists and officials in charge of communication is dangerous. He shared his experience as a government spokesperson following the return of the Labor Party in 1997 and outlined a number of ways to help restore credibility. Among these are the use of constrained discretion (for example, assigning monetary policy decisions to a technical nonpolitical body); reaching a clear understanding of the causes of a problem and communicating that to the public to increase support for the solution; and viewing presentation as an integral element of policy from the outset. O'Donnell also put forth the concept of "optimum transparency." Sometimes, he said, insufficient accountability (such as when the monetary policy authority is not elected) requires a large offsetting level of transparency; at other times, the optimal level may be lower. However, credibility is absolutely critical.

Panelists were asked about the failure to communicate the global harm caused by trade protection. O'Donnell acknowledged the lack of progress in this area and the need for better communication about the benefits of comparative advantage and of redistribution mechanisms to make everyone better off. Recalling again the Mexican experience, Carstens noted that the mentality and sentiment toward trade liberalization changed dramatically as a result of active communication of the government's economic vision to various stakeholders and interest groups. Dervis concluded by pointing to other noneconomic concerns that often complicate attitudes toward liberalization and reform. Whether well founded or not, he said, perceptions that liberalization and globalization will somehow weaken distinct cultures and lifestyles need to be factored into the articulation and communication of reform messages, particularly in the area of trade.

Discussing individual countries' prospects for achieving the MDGs and the obstacles they faced, the panelists said that development indicators at the country level were improving but that more still needed to be done. Diogo said that Mozambique had integrated the MDGs into its policy reduction strategy paper (PRSP), known as the PARPA, and established a body to monitor its effectiveness with the assistance of the United Nations Development Program. Yemen's PRSP is consistent with the objectives and policies of the MDGs, according to Sofan, and the government is continuously assessing the country's poverty situation. Some of the main challenges facing these countries include reducing vulnerabilities; enhancing national capacity for policy analysis, monitoring, and evaluation; increasing ownership of policies; and improving aid practices.

To achieve the eighth Millennium Development Goal—establishing a global partnership for development—Hefkens exhorted the international community to address the following seven challenges, which she presented under the acronym GO DUTCH: (1) **G**lobal partnership for development. (2) **O**wnership; (3) **D**ebt sustainability; (4) **U**ntied external assistance; (5) **T**ransfer of resources, including in the form of budget support; (6) **C**ontingency mechanism to address external shocks; and (7) **H**armonization of aid procedures. The MDGs are the right policy and the right priority and are achievable, she concluded. What is missing is the political will to do what is necessary.

Following the markets

Another seminar delved into issues facing emerging market economies, including their prospects for for-

Financial sector reform should be part of a broader effort to create an attractive environment for private sector investment.
—Ibrahim Dabdoub

Middle East and North Africa need to spur private sector development

Another seminar centered on the Middle East and North Africa (MENA) region discussed the role of financial sector reform in promoting private sector development and growth; it reviewed the results of a decade of financial sector reform in this region and highlighted the challenges ahead.

Shaukat Aziz (Minister of Finance and Economic Affairs, Pakistan) pointed out that the financial system is a catalyst for economic growth and highlighted the main pillars of financial sector reform: an autonomous and independent central bank with appropriate capacity; strong prudential regulation and the capacity to strictly enforce it, together with high-quality professional management of banks; market-oriented monetary management; a clear legal framework and an effective judiciary system to enforce the law; and private ownership of financial institutions and a level playing field for all, including foreign banks. Government should not be in the business of financial intermediation, he said, and privatization of public banks is an important component of financial sector reform.

Panelist Jean-Claude Bérthelemy (Professor of Economics, Université Paris I Panthéon Sorbonne) noted that after a decade of financial sector reform, a number of MENA economies still had inadequate financial services and performed poorly. Gradual financial reforms have yielded only modest results in terms of financial deepening and capital market development. These countries now need to achieve a critical mass of reforms: strengthening the protection of creditors' rights; reducing restrictions to entry of foreign banks; fostering competition; and providing adequate information on individual debtors' financial situation, including through the establishment of private credit bureaus.

Ibrahim Dabdoub (Chief Executive Officer, National Bank of Kuwait) pointed out that financial sector reforms were necessary but not sufficient to significantly spur private sector development in the region. Key impediments remain, notably the crowding out of private sector investment by the public sector, ownership of many private banks by a few individual groups, and directed credit to a few companies and industries owned by the same people. The financial system also had not channeled capital to productive investments, and macroeconomic and credit risks, coupled with limited competition, had kept the cost of credit relatively high. Financial sector reform should be part of a broader effort to create an attractive environment for private sector investment, Dabdoub said.

While agreeing with the other speakers, the moderator, Mohammad Al-Jasser (Vice Governor, Saudi Arabian Monetary Agency), stressed the need for strong bank regulation, corporate governance, and high standards of accounting and auditing. He also saw merit in a division of labor that would allow investment banks and the capital market to develop services that were not provided by commercial banks while being subject to separate supervisory authorities.

The audience raised a number of questions about the degree of regulation, the quality of bank auditing, and the independence of auditors. In response, the panelists stressed that deregulation did not mean abdication; an independent regulator could play a strong role in setting capital adequacy ratios, provisioning, and promoting high-quality management but should not be involved in controls on lending margins or allocation of credit, which should be left to banks and the markets to determine.

Aziz concluded by reiterating the importance of the pillars of reform. He also emphasized the importance of political will in carrying out effective financial sector reforms, together with efforts to inform and educate the boards of directors of financial institutions, in particular, and the public, in general.

eign direct investment (FDI). Nicholas Stern, who chaired the September 21 seminar on this topic, observed that FDI levels had been impressively stable despite some decline since the late 1990s. The growing share of investment into services in emerging markets, especially finance and telecommunications, is an important trend.

Gerd Häusler, IMF Counsellor and Director of the International Capital Markets Department, highlighted key findings from a survey of 50 major multinational companies. The best news is that companies are not withdrawing wholesale from emerging markets but are instead taking a long-term view of investment opportunities and paying more attention to risk factors. Financing of long-term investment is becoming more challenging, however, as banks' appetite for project financing has waned. Companies are giving more importance in their decision making to the domestic markets of the countries seeking inward investment, as well as to a stable macroeconomic, political, and security environment and infrastructure, including a predictable legal and regulatory environment. Geographically, Asia remains the top destination for planned investments, with slower growth of investments likely in Latin America and limited interest in Africa, apart from South Africa.

The speakers who followed Häusler reinforced the messages from the survey. Francisco Luzón, Member of the Board and General Director for Latin America for Banco Santander Central Hispano, reviewed the Santander Group's rapid expansion in Latin America in the 1990s, which he attributed largely to opportunities arising from liberalization and privatization in the region. Santander has had a good return on its investments over the past few years despite the region's problems and will consolidate its presence in Latin America.

Peter Puf, Director of Economic Research for DaimlerChrysler AG, said that his firm has a 10-year horizon for investments and tends to "go where the markets are." He added that suppliers often follow DaimlerChrysler abroad, investing in the same locations. Puf encouraged countries to pay close attention to ensuring fundamental macroeconomic stability and property rights (including allowing foreigners to hold majority ownership) and to reducing uncertainty about the legal and regulatory environment. Herman Mulder, Senior Executive Vice President of ABN-AMRO Bank, said that his bank takes a holistic approach to assessing risk that helps it avoid undue concentration on single factors. He suggested that a forward-looking perspective is needed that considers forms of investment (such as licensing and joint ventures) other than FDI. ■

Available on the web (www.imf.org)

Public Information Notices

03/116: Strengthening Surveillance—Further Considerations, September 10

03/117: IMF Executive Board Reviews the Role of the IMF in Low-Income Countries over the Medium Term, September 10

03/118: IMF Executive Board Discusses Euro Area Policies, September 16

03/119: IMF Concludes 2003 Article IV Consultation with Thailand, September 17

03/120: IMF Executive Board Reviews Poverty Reduction Strategy Papers—Progress in Implementation, September 22

Press Releases

03/159: IMF Approves $12.55 Billion Three-Year Stand-By Credit for Argentina, September 20

03/160: Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, September 21

03/161: Statement by Kenneth Rogoff on the Death of Franco Modigliani, September 26

03/162: IMF Completes Second Review of Bolivia's Stand-By Arrangement, Approves $15 Million Disbursement, October 6

03/163: Vietnam Formally Begins Participation in the IMF's General Data Dissemination System, October 6

03/164: IMF Extends Stand-By Arrangement for Bosnia and Herzegovina through December 31, October 7

03/165: IMF Completes Tenth Review of Indonesia Program, Approves $493 Million Disbursement, October 8

03/166: IMF Managing Director Proposes Appointment of Japan's Takatoshi Kato as Deputy Managing Director, October 9 (see page 312)

03/167: Second Regional Conference on Poverty Reduction Strategies, October 16–18, Phnom Penh, Cambodia, October 9

03/168: Discussions for the Sixth Review of Turkey's Stand-By Arrangement to Start on September 25, October 15

03/169: Mission Discussions for the Sixth Review of Turkey's Stand-By Arrangement Concluded, October 15

03/170: IMF Managing Director Congratulates Geithner on Appointment to the Federal Reserve Bank of New York, October 15 (see page 298)

Transcripts

Closing Press Conference of the 2003 Annual Meetings of the Boards of Governors of the World Bank Group and IMF in Dubai, United Arab Emirates, September 24

Press Briefing by Thomas C. Dawson, Director, External Relations Department, October 9

Are highly leveraged firms in the euro area a cause for concern?

During the second half of the 1990s, soaring stock markets seemed to many to signal an era of unprecedented growth and profit opportunities and contributed to investment booms in many countries. Corporations in the euro area embarked on such an investment binge and relied increasingly on borrowing as their financing needs quickly outpaced the availability of internal funds and net equity issues. When stock market valuations crashed in 2001 and 2002, corporations were left with high levels of debt.

In a recent IMF Working Paper, Albert Jaeger (Deputy Division Chief, European I Department) takes a look at what this legacy of high corporate debt and leverage might mean for future investment spending. He spoke with the IMF Survey *about his study.*

IMF Survey: Why the concern about high euro-area corporate debt?

Jaeger: The recent sharp rise in the area's corporate indebtedness could have adverse effects on euro-area investment. Theory holds no clear answers on this question. One theoretical benchmark suggests that corporate leverage should not affect investment. Or, as it is sometimes put, corporate investment decisions should not depend on how the liability side of the balance sheet is sliced up into debt and equity. But other models of corporate investment behavior argue that more leveraged corporations will find it more difficult or costly to obtain financing than corporations with identical investment projects but sounder leverage positions.

The conventional wisdom about a year ago was that U.S. corporations sorely needed to clean up their balance sheets—implying cuts in capital spending, taking a hard look at whether past financial acquisitions made sense, and reducing labor and other costs. By contrast, euro-area corporations were viewed as being in relatively good shape. Operating profits in the euro area seemed to be quite high compared with levels during previous downturns, and capacity utilization rates were close to the historical average, suggesting that the area's investment overhang (an excessive buildup of capital during a boom) was limited. But corporate investment in the euro area was as anemic as in the United States, with no clear signs of picking up. This pointed to the possibility that overleveraged corporate balance sheets were the main brake on investment spending. Corporations seemed to prefer to use their cash to repay debt rather than to invest.

IMF Survey: Why was it not apparent earlier that deleveraging played a role in constraining euro-area investment?

Jaeger: Leverage is usually not considered a prime culprit in shaping business cycles—macroeconomic policies and the links between profits, investment, and credit are viewed as more important. In the euro area, pertinent data were also in short supply. The European Central Bank started publishing sectoral balance sheet data in August 2002. Once these data became available, it was quite clear that euro-area and U.S. corporations had gone through similar corporate boom-bust cycles and associated balance-sheet dislocations.

IMF Survey: What was the extent of the recent boom-bust cycle in euro-area equity valuations, and how much leverage did euro-area corporations take on?

Jaeger: At least from the point of view of postwar data, the rise and fall in equity valuations seem to have been unprecedented: in 1995, euro-area corporate equity was worth the equivalent of about 70 percent of the area's GDP; valuations mushroomed to more than 150 percent of GDP in 1999 but then fell to about 95 percent of GDP in 2002. This boom-bust cycle very closely mimicked what we saw in the United States. And while the technology sector accounted for a lot of the volatility in the area's equity valuations, the boom was by no means a mere high-tech bubble. Measures of leverage suggest that once the boom reversed, it rose sharply. For example, before the boom started, corporate debt was about 60 percent of GDP. By the end of 2001, it had risen to about 80 percent of GDP.

IMF Survey: At what point does a corporation's balance sheet become "overleveraged"? Why is this of concern?

Jaeger: Defining "overleverage" for corporations is a bit like defining "overweight" for people. There are useful rules of thumb in both cases. The corporate finance literature offers two competing paradigms of what corporations consider to be a normal leverage position; the key distinction is whether corporations look at leverage as a flow or a stock issue. The trade-off paradigm looks at leverage as a stock issue and predicts that corporations have well-defined targets for their desired debt-equity mix. In determining this mix, firms weigh the benefits and costs of debt, trading off the tax

Defining "overleverage" for corporations is a bit like defining "overweight" for people. There are useful rules of thumb in both cases.
—Albert Jaeger

and incentive benefits of debt financing against the expected cost of financial distress. If a boom-bust equity cycle dislocates their financial structure, corporations try to move the mix back to target.

By contrast, according to the pecking-order paradigm, firms generally prefer internal to external finance, while among external financing options, they prefer first to use safe debt, then risky debt, and finally, as a last resort, equity. This paradigm looks at leverage as a flow issue and predicts that corporations care mainly about the sizes of their financing flows, particularly internal versus external. The debt-equity mix in stock terms is then largely an accident of history.

Jaeger: "In the euro area's particular case, tackling structural reforms that boost medium-term growth prospects could make a significant contribution by increasing expected profit opportunities for investment."

The bottom line is that balance-sheet adjustments under the trade-off paradigm could take pretty long because the corporation would have to move back to a stock rather than a flow target.

IMF Survey: Should we be more worried about the impact of corporate indebtedness on investment?

Jaeger: There are certainly good reasons to keep an eye on corporate balance sheets. In addition to my earlier comments, two more points seem relevant. First, whether corporations view themselves as over-leveraged and, as a consequence, hold back on investment may also depend on specific experiences. For example, when corporate bond markets virtually closed down in mid-2002 following the WorldCom scandal, even some big-name corporations seemed to have come close to bankruptcy. That kind of experience could have made corporations much more cautious in judging what constituted a sound leverage position. Second, the speed of the balance-sheet adjustment process also seems to depend on the type of financial system that a corporation is facing. The euro area's financial system is largely bank-based, and relationship lending could mean that adjustment pressures are less pronounced than in systems largely based on capital market intermediation. By the same token, however, the adjustment process could also take longer under a bank-based system.

IMF Survey: What is the general prognosis for euro-area recovery?

Jaeger: The baseline of most forecasters is a gradual recovery, starting in the second half of 2003. But this assumes that corporations' balance-sheet adjustments have largely run their course. There are indeed encouraging signs that euro-area corporations have made considerable progress in strengthening internal cash flows and cutting back on external financing. Moreover, low nominal interest rates provide a helpful backdrop. Nevertheless, present baseline forecasts seem to be premised on the assumption that the pecking-order paradigm is on the mark. However, if one believes the trade-off paradigm is more relevant, one would have to assume there are downside risks to the baseline forecast. After asset price booms, downturns tend to be quite protracted, particularly in low-inflation environments. It's also a fact that forecasters don't have a great record in projecting growth in this type of macroeconomic environment.

IMF Survey: What are the policy implications of your findings?

Jaeger: Macroeconomic policymakers should be supportive of the adjustment process but may also have to be patient. As regards monetary policy, providing a low-interest rate environment coupled with an accommodative bent in the policy outlook is important. On the fiscal side, recourse to brute-force reflation, advocated by some, is unlikely to work and could well have the perverse effect of destroying the credibility of the euro area's existing fiscal framework. In the euro area's particular case, tackling structural reforms that boost medium-term growth prospects could make a significant contribution by increasing expected profit opportunities for investment. ■

Copies of IMF Working Paper No. 03/117, "Corporate Balance Sheet Restructuring and Investment in the Euro Area," by Albert Jaeger, are available for $15.00 each from IMF Publication Services. Please see page 303 for ordering details. The full text is also available on the IMF's website (www.imf.org).

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
October 6	1.54	1.54	2.03
October 13	1.54	1.54	2.03

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

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

Data: IMF Finance Department

Did output recover from the Asian crisis?

While the Asian financial crisis of 1997–98 generated a plethora of research analyzing its causes, less attention has been paid to its aftermath. How long did the associated recessions last, and to what extent have the levels of output been lowered in the affected countries? In a recent IMF Working Paper, Valerie Cerra (Economist, European I Department) and Sweta Chaman Saxena (Assistant Professor, University of Pittsburgh) analyze whether the recession following the Asian crisis temporarily or permanently lowered output levels. They talked with the IMF Survey *about their study.*

IMF Survey: The economies directly affected by the Asian crisis experienced varying degrees of recession. Why was it important to determine whether the output impact was temporary or permanent?

Saxena: The question of whether the losses were permanent (in the sense of entailing a lower level of output than if the crisis had not occurred) or temporary has implications for understanding the costs of crises and recessions and for designing more effective policy responses. A permanent loss of output is equivalent to a permanent, continuing loss of welfare, unless it is caused by people voluntarily taking more vacations or other highly unlikely circumstances.

Cerra: Understanding whether the losses are temporary or permanent may also shed light on the nature of shocks that generate recessions. For example, there is a long-standing academic debate over whether the business cycles of industrial countries tend to be generated by supply-side shocks, such as productivity shocks, or by demand shocks that lead to recessions through a combination of real and nominal rigidities in the factor and product markets. Permanent losses in the level of output would be more suggestive of supply shocks.

IMF Survey: What implications does the output impact of a crisis have for economic performance?

Cerra: A permanent effect on output implies a permanent decline in living standards relative to the country's precrisis trend and relative to other countries. Misunderstandings of such developments could lead one to make incorrect inferences about the effects of policy on economic growth. For example, in other work, we found that Sweden's banking crisis in the early 1990s led to a permanent loss of output and a fall in its per capita income ranking relative to other advanced countries. A prominent scholar pointed to the fall in the ranking as evidence that Sweden's welfare state had undermined growth, but a closer study relates the decline to the impact of the banking crisis. So, analysts have to be careful. A permanent decline in the level of output may lead some to conclude that lower long-run growth is the result of policies other than those that contributed to the crisis.

Cerra: "The recovery phase is predominantly characterized by a return to the normal growth rate rather than a higher-than-normal growth rate."

IMF Survey: Is it possible for output to recover to a higher level than before a crisis?

Saxena: A crisis can spur a country to implement beneficial reforms that were not politically feasible under tranquil conditions. Indeed, it is now conventional wisdom that economic crises can facilitate or cause reforms. If so, the recovery could potentially be strong enough to lift output permanently above its precrisis trend.

IMF Survey: What does your study find?

Cerra: Our study shows that all of the Asian crisis countries experienced some permanent output loss despite a rapid rebound in their growth rates. The recovery phase is predominantly characterized by a return to the normal growth rate rather than a higher-than-normal growth rate. Hence, the level of output is permanently lower than its initial trend path.

IMF Survey: Which country was worst hit? What was the extent and duration of damage to output?

Saxena: Our sample consisted of six Asian economies that experienced crises in 1997–98—namely, Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, and Singapore. (Unfortunately, because of a lack of quarterly data, we were unable to include Thailand.) Our results show that the permanent cumulative loss of output in the Asian crisis varied from as low as 1.5 percent for the Philippines to 22.3 percent for Indonesia. Our results also indicate that the expected duration of a contraction ranges from one quarter to four quarters, and expansions are expected to last considerably longer than contractions in all of the countries. The longer duration of expansions is a result similar to the findings in the U.S. business cycle literature.

IMF Survey: What do your findings imply for possible policy responses?

Saxena: The appropriate policy responses depend on the type and sources of the loss. A permanent loss is associated with a downward shift in potential output,

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so attempting to restore output by measures to stimulate demand could be inflationary. In these circumstances, the government should focus on macroeconomic or structural policies that raise productivity and potential output, and eliminate the distortions responsible for the loss.

Saxena: "A permanent loss [in output] is associated with a downward shift in potential output, so attempting to restore output by measures to stimulate demand could be inflationary."

IMF SURVEY: Is there more research to be done in this area?

CERRA: A wide range of methods have been used to examine the nature of U.S. business cycles, and more of these methods could be brought to bear in studying crisis-driven recessions and recoveries. Moreover, our understanding of these recessions and recoveries could benefit from advances in the estimation and diagnostics of nonlinear models, such as the Markov switching models used in our study.

SAXENA: It would also be interesting to look at more episodes of financial crises and examine whether the extent of output loss in the associated recession is correlated with the strength of the subsequent recovery. In addition, if there are differences in the output effects of recessions that follow financial crises relative to other types of recessions, this might give us clues as to the nature of the permanent and transitory effects. Such work could also shed light on whether there is empirical support for the view that crises lead to reform. The relationship between the frequency and the magnitude of crises and between the trend growth rate and prevalence of crises could also be explored.

CERRA: Further work is needed to flesh out the sources of any permanent loss in output. For example, there might be a persistent rise in unemployment or a decline in productivity caused by a collapse in financial intermediation that creates a wedge between savings and their efficient allocation. Research could also test whether the magnitude of output loss and the behavior of the recovery are functions of economic policy responses. ■

Copies of IMF Working Paper No. 03/48, "Did Output Recover from the Asian Crisis?" by Valerie Cerra and Sweta Chaman Saxena, are available for $15.00 each from IMF Publication Services. Please see page 303 for ordering details. The full text is also available on the IMF's website (www.imf.org).

Japan's Takatoshi Kato nominated as IMF Deputy Managing Director

On October 9, IMF Manager Director Horst Köhler nominated Takatoshi Kato, Japan's former Vice Minister of Finance for International Affairs, to the position of Deputy Managing Director, effective February 1, 2004. Kato, currently Advisor to the President of the Bank of Tokyo-Mitsubishi and a Visiting Professor at Waseda University, will succeed Shigemitsu Sugisaki, who has served as IMF Deputy Managing Director since February 1997.

Between 1995 and 1997, Kato served as Vice Minister of Finance for International Affairs. During more than 30 years of public service, he has been Japan's representative to the Asian Development Bank and has served with the Secretariat of the Organization for Economic Cooperation and Development. After leaving Japan's finance ministry, he served in advisory roles at the Asian Development Bank and the World Health Organization. Kato, who is 62, holds degrees in law from Tokyo University and public policy from Princeton University.

In proposing the appointment, Köhler said: "Takatoshi Kato is no stranger to the workings of the Fund, having spent a large part of his career in high-level positions within the Japanese government, including as the G-7 Deputy for Japan. He is an individual with strong professional competency—in economic, public policy, managerial, diplomatic, communication, and leadership skills. I expect he will provide solid and balanced leadership at the Fund.

"I and my management colleagues look forward to Mr. Kato's joining the IMF's management team. With his extensive experience in government, international organizations, and academia, he will build upon the distinguished contribution of his predecessor."

The full text of Press Release No. 03/166 is on the IMF's website (www.imf.org).