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Interview with David Burton

Asia's economic outlook bright, with China leading the way

Burton: "China will need to strike the right balance between preventing overheating and avoiding an unduly sharp cutback in investment."

David Burton, a U.K. national who has worked at the IMF since 1981, took over as Director of the Asia and Pacific Department in late 2002. Laura Wallace spoke with him about the dramatic changes that are now shaping the region, including the increasing economic prominence of China, deepening regional integration, a bigger emphasis on transparency, and the recent massive buildup of foreign exchange reserves.

IMF SURVEY: What is the IMF's assessment of the outlook for Asia in the near term and the longer term? What are the risks to this outlook?

BURTON: With the global economic expansion strengthening and deepening, the near-term prospects for Asia look good. For emerging Asia—which includes all of Asia except Japan—we expect growth this year to be over 7 percent, broadly the same as last year. This rate incorporates a modest slowdown in growth in China, to perhaps about 8½ percent, as investment, which is overheated in some sectors, is cut back. For most other countries, we see significant pickups in growth on the back of strong export performance.

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Globalizing IT services, investing in human capital should generate high-skill U.S. jobs

In the 1990s, widespread investment in information technology (IT) boosted U.S. labor productivity growth and contributed to the country's economic dynamism. At a March 11 discussion, "White-Collar Outsourcing," hosted by the Institute for International Economics (IIE), Catherine Mann (Senior Fellow, IIE) argued that an even wider diffusion of IT throughout the U.S. economy, coupled with an upgrade of domestic IT skills, will spur a second wave of productivity growth. This, she said, can be achieved through a combination of the globalization of software and IT services, which will make the overall IT package affordable for more businesses, and domestic adjustment policies aimed at helping U.S. workers climb up the IT skills ladder, "as rungs on the bottom are moved elsewhere or eliminated entirely."

The most important driver of IT price declines is technological change. But in the 1990s, globalized production and international trade also helped lower prices 10–30 percent more than they would otherwise have been. The lower prices, Mann said, were key to broad-based investment in IT capital throughout the U.S. economy, which was responsible for more than half of the acceleration in labor productivity and added at least $230 billion to GDP over 1995–2002.

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The 1990s saw demand for high-skilled IT workers, such as computer software engineers, rise in the United States.

Japan still needs to battle deflation

(Continued from front page) Moreover, the balance of short-term risk is probably on the upside, with the global economy gathering steam and the information technology sector, in particular, doing well. A downside risk is avian flu, but that seems to be receding.

Looking further ahead, there are reasons to be optimistic, though significant risks are present. Our baseline scenario for 2005 shows growth slowing only slightly, as some economies revert to growth rates that are more likely to be sustainable. However, the risks are familiar—including the need for an orderly adjustment of global current account imbalances and for managing the transition to higher interest rates globally and probably higher spreads on emerging market debt. In addition, China will need to strike the right balance between preventing overheating and avoiding an unduly sharp cutback in investment, particularly as a sharper slowdown than we have in our baseline scenario would have ripple effects around the region. More generally, for growth to remain strong in Asia, the region needs to continue with its agenda of domestic reforms. This means completing corporate and financial sector restructuring and, in some countries, further reducing high debt burdens.

China's imports from the rest of the region have been growing rapidly, helping to spur recoveries in several countries, including Japan and Korea.
—David Burton

IMF Survey: Quite a few Asian countries—Indonesia, the Philippines, India, Korea, and Taiwan Province of China—have elections this year. Are there concerns over their political resolve to carry out reforms?

Burton: There is always a risk that preelection spending will put a dent in the budget—this is especially a concern in countries where the budget deficit is already big—and that politically difficult reforms will be postponed. We hope that once these elections are over and the political picture is clarified, there will be a new resolve to carry forward with needed reforms.

IMF Survey: How much progress has Japan made in restructuring its financial and corporate sectors? And is its period of stagnation finally over?

Burton: Japan has made significant progress. If you look at the corporate sector, profitability has increased, particularly in the bigger, more export-oriented firms. On the banking side, too, the big city banks have made quite a lot of progress in dealing with their nonperforming loan problem. Progress is a bit less marked in the regional banks. As for the recovery, it's been driven not just by rising exports—hence, by the global recovery—but also by a pickup in private investment, reflecting progress in restructuring. There is more to do, and it's certainly too early to say that deflation is beaten. For the longer term, a big challenge will be reducing the high debt level and narrowing the large fiscal deficit.

IMF Survey: The ASEAN+3 economies—the 10 members of the Association of South East Asian Nations plus China, Japan, and Korea—are strengthening regional financial cooperation and trade integration. What is the IMF's view on the macroeconomic impact?

Burton: These initiatives could potentially strengthen growth and financial stability in the region, and we have supported them. Their macroeconomic impact has so far, however, been relatively modest. The various bond market initiatives could deepen financial markets, diversify sources of finance away from bank financing, and reduce dependence on foreign-currency-denominated borrowing—something that has been a big concern in the region ever since the Asian financial crisis. The Chiang Mai Initiative—a system of bilateral swap arrangements—hasn't needed to be activated, but if it ever were, the loans involved would be pretty large. As for trade, the worry is that there is a proliferation of bilateral and regional initiatives that could lead to very complex tariff systems. Asia needs to maintain an outward-looking focus and not see these initiatives as substitutes for broader integration into the global economy.

IMF Survey: Do you feel that fears about the China threat have abated, at least in Asia, and that many Asian nations now regard the country as a major trading and business opportunity? Is the phenomenal growth in intraregional trade, particularly into and out of China, accelerating the pace of regional economic integration?

Burton: I do think fears have abated. When I visited the region about 18 months ago, there was a lot of concern about competition from China. But these days, China is seen as much, if not more, of an opportunity than as a threat. The reason for this change is pretty clear: growth and a sharp rise in imports by China from the rest of Asia—close to 45 percent last year. This trade has helped many economies in the region recover. In fact, we even hear a slightly different concern—that is, hints of overdependence on China.

IMF Survey: Some say that East Asia, led by China, is becoming a second engine of global growth after the United States. Is China's growth sustainable, and how important is the future performance of the Chinese economy for others?

Burton: East Asia, and particularly China, certainly is becoming an engine of global growth. In 2002, for example, East Asia accounted for about 44 percent of global growth in terms of purchasing power parity weights. It also absorbed almost one-fourth of the rest of the world's exports. China, of course, accounted to a large extent for these impressive statistics. Also, China's imports from the rest of the region have been growing rapidly, helping to spur recoveries in several countries, including Japan and Korea.

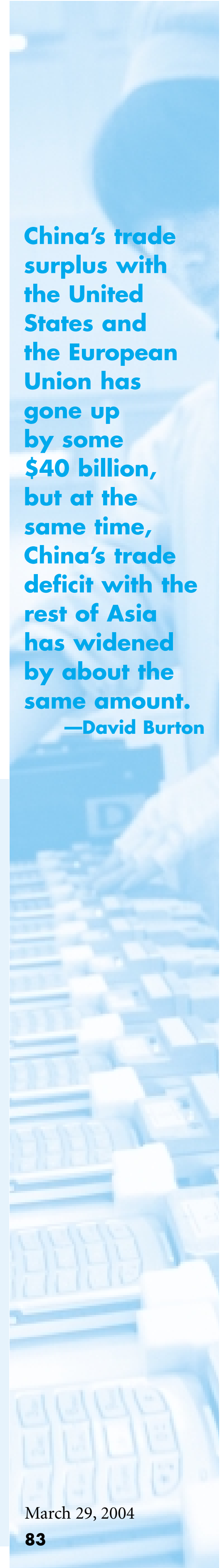
Can China keep going at its recent pace? As I said earlier, growth may slow a little bit in the near term, but in the medium term, prospects are pretty good that China can keep growing quite rapidly—although not necessarily at 8–9 percent—if it tackles needed reforms. The priorities for reform are well known and include strengthening the banking system, where much remains to be done, and tackling the still large problems of the state-owned enterprise sector.

IMF Survey: China's trade surplus with the United States and the European Union has continued to increase. Is China playing fair with respect to international trade?

Burton: You have to look at what's happening to China's trade in totality, not just to its bilateral trade with particular countries or regions. Over the past two or three years, China's trade surplus with the United States and the European Union has gone up by some $40 billion, but at the same time, China's trade deficit with the rest of Asia has widened by about the same amount. China's overall trade surplus has changed little in recent years. What is behind these developments? There's an ongoing restructuring of the production process in the region, with China becoming a manufacturing hub for exports to the rest of the world, while it imports parts from other Asian countries.

IMF Survey: The massive accumulation of foreign exchange reserves by key Asian countries has been one of the most striking global financial developments of recent years. Its aim has been to prevent or slow currency appreciation, even in some cases against the depreciating dollar. Particularly given the low returns—negative in real terms—on these reserves, has it really been in these countries' interests to lend to major industrial countries in this way? The IMF has been calling for greater exchange rate flexibility. Shouldn't it be pressing, in the context of its surveillance role, for more progress in this direction?

Burton: After the Asian crisis, a lot of countries in the region needed to rebuild their reserves to reduce their vulnerabilities to future crises [see box below].



China's trade surplus with the United States and the European Union has gone up by some $40 billion, but at the same time, China's trade deficit with the rest of Asia has widened by about the same amount.
—David Burton

IMF urges China to pursue greater exchange rate flexibility

Following are excerpts of David Burton's address at the 2004 Credit Suisse–First Boston Asian Investment Conference in Hong Kong SAR on March 23.

"There is a view that the inflexibility of exchange rates in the region—especially in China—reflects a deliberate development strategy centered on export-led growth and an undervalued exchange rate. Some observers have also argued that the accumulation in reserves may be sustainable for some time, especially as the large supply of low-wage labor in China will keep inflationary pressures in check. It is certainly true that reluctance to see exchange rates strengthen against the dollar stems in part from concerns about the implications for growth and job creation. At the same time, it should be remembered that China stuck to its peg to the dollar throughout the Asia crisis while other countries in the region were depreciating sharply. Also, China maintained subsequently the present peg as the dollar strengthened through 2001. So China's exchange rate policy, in my view, at least partly represents a desire for stability and continuity. That said, I do not buy the argument that China's reserve accumulation can be sustained indefinitely without inflationary consequences. Even though the pool of low-wage labor is large, pressure will be put on the prices of other scarce factors, including land and skilled labor. And we can already see signs that inflation in China is picking up. In the end, real exchange rates will adjust one way or another.

Concerns have been raised by some observers that it would be premature for China to move toward exchange rate flexibility before resolving the weaknesses in its financial system. But this argument presupposes that greater flexibility would be accompanied by capital account liberalization that could trigger outflows from banks. In fact, there is no reason why limited exchange rate flexibility should pose significant risks for the financial system if capital controls stay in place. And experience in many other countries, with India a relevant recent example, shows clearly that managed exchange rate flexibility can be successfully introduced before capital account liberalization has gone very far.

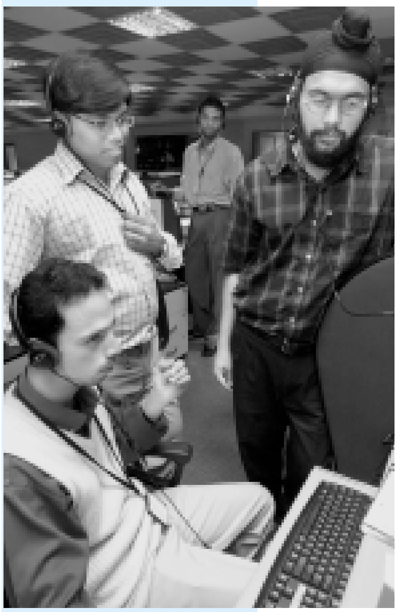
What is the best way for China to proceed? Unfortunately, there is no ideal first move toward flexibility. Options include widening the band against the dollar or pegging the renminbi to a basket of currencies, or some combination of the two. A step-adjustment could also be made as part of an initial move. Any approach, however, could involve costs. In particular, inflows could be exacerbated in the short term if the move was seen as a prelude to further appreciation. This risk could be ameliorated by some very cautious further loosening of controls on capital outflows. There are, though, no easy or risk-free solutions to this complex issue, and it is for the Chinese authorities to decide how best to move toward their stated medium-run goal of exchange rate flexibility."

The full text of David Burton's speech is available on the IMF's website *(www.imf.org)*.

You can argue that, by now, reserve positions are really quite comfortable—if not more than comfortable—in many countries, and there isn't a need to build up reserves any further. Certainly, it is costly to hold reserves because the inflows have to be sterilized, and that, in turn, can make monetary control difficult, something we've seen in China and some other countries. That is why, for some time, the IMF has been strongly encouraging greater exchange rate flexibility in a number of these countries . This can also make a contribution to the orderly resolution of the global imbalances in current account positions.

IMF Survey: Is India the new China?

Burton: India is definitely emerging as a force in its own right in the global economy. It has been growing rapidly in recent years, and growth has really picked up of late—to about 8 percent. That partly reflects recovery from drought, but there's more going on than that. Industry has been doing well, reflecting progress with corporate restructuring. Also, exports to China, especially of steel, have been doing well. Of course, everyone knows the story of the incredible growth in the information technology sector. But India isn't as open as China, which probably holds it back and keeps it from having as big an impact on the global economy.



India has benefited from incredible growth in its IT sector. Above, employees monitor an incoming call at a 24-hour call center in Bangalore, India.

IMF Survey: Is opening up further a key priority for India?

Burton: Yes, India has got to keep going with reforms if it wants to keep growing. Trade liberalization is certainly one area where it really needs to focus, because its trade restrictiveness is much higher than in other countries in emerging Asia. Reforms in the agricultural sector will also be important for raising productivity and incomes of the large rural population. And India has to deal with its very large public debt and high fiscal deficit—something the IMF has been harping on for a while. There are some signs that the deficit is beginning to come down, but it will take a big effort to put things on a sustainable path.

IMF Survey: You've spent a lot of your time in the IMF working on Asia. What changes have been the most significant? How have these changes affected countries' relationships with the IMF?

Burton: There have been several important changes: the new emphasis on regional integration and cooperation, the very large role of China, and the greater emphasis on the need for transparency and best practices in areas such as the financial sector, corporate governance, and statistics—prompting us to provide increased amounts of technical assistance in some of these areas. The nature of the IMF's relationship with the region has also changed. After the Asian crisis, we had big financial support packages with a number of countries. Now that period is over. Korea and Thailand have fully paid back their loans, and Indonesia has reached the point where it doesn't need an IMF program any more. So our relationship with these countries is a normal one of surveillance and providing technical assistance. This is a healthy evolution.

IMF Survey: The IMF is supporting programs in a number of smaller Asian nations with its concessional lending facility, the Poverty Reduction and Growth Facility. How would you assess Asia's record in recent years in poverty reduction? How does it compare with Latin America and Africa?

Burton: Asia has done quite well in recent years, certainly relative to other regions. This is particularly true in the fastest growing economies, like Vietnam, which have focused on rural sector reform. In fact, one lesson we've learned is that growth needs to be broad-based to make a real dent in poverty. Cambodia has been growing quite fast over the past few years, but the growth has been concentrated particularly in the textile sector and not so much in the rural areas, so we don't see the poverty indicators improving very much. Other countries, like Mongolia and Nepal, need to grow much more quickly. Overall, Asia is probably better placed than other regions to reach some, if not all, of the Millennium Development Goals by 2015. But the poorer countries in Asia are going to need a lot of help in this effort. ■

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
March 15	1.61	1.61	2.13
March 22	1.60	1.60	2.11

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?2004).*

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

Data: IMF Finance Department

Tax credit may entice firms to step up IT training

(Continued from front page) Without a globalization of IT hardware production, GDP growth in the United States might have been 0.2 percentage point less a year in the second half of the 1990s, she added.

At the same time, globalization did not, on balance, undermine competitiveness as U.S. multinational firms maintained a net positive trade balance in IT hardware exports. By sourcing their components abroad, Mann said, these firms were able to build a competitive foundation for enhanced export competitiveness for IT hardware.

What about IT jobs?

The diffusion of IT investment throughout the U.S. economy is reflected in the fact that two-thirds of U.S. workers who use IT in their occupations—such as programmers, systems engineers, analysts, and database administrators—work in non-IT sectors. But has investment in IT equipment and software translated into job creation? They move in lockstep, said Mann, pointing to the rate of change in the number of jobs and investment in IT software processing equipment, both of which boomed beginning in 1991, peaked in 1997, and declined dramatically in 2001. In 2003, however, growth in IT investment picked up again, and the decline in IT job growth moderated.

Moreover, over the course of the 1990s, the demand for workers with the highest IT skills rose rapidly in conjunction with investment in IT. Mann compared IT employment numbers for 1999 with those for 2002. Over that period, she noted, about 241,000 people in the sector—data entry operators, computer operators, and computer programmers who earned between $23,000 and $64,000 a year—lost their jobs. Over the same period, however, the number of computer software engineers whose annual salary averaged nearly $75,000, grew by more than 115,000. The data do not differentiate, however, between jobs lost because they moved abroad and jobs made obsolete by new technology and possibly replaced by higher-paid positions. But this very rapid increase in the demand for more sophisticated IT skills is important for policymakers to keep in mind, Mann said.

Future sources of productivity gains

The sectors of the U.S. economy that had the greatest uptake of IT during the 1990s were wholesale trade, securities and commodities brokerages, depository institutions, and telecommunications. These sectors, which also contributed most to productivity gains, are intensive users of skilled IT workers and have managed to retain a positive financial balance in the trade accounts. In contrast, two other large sectors—health services and construction—stand out for not being IT-intensive and for having below average productivity growth. Small and medium-sized enterprises also generally invested less in productivity-enhancing IT. Mann emphasized that IT-based productivity gains could be achieved in these lagging sectors, particularly if globalization of software and services takes on the pattern of the price declines that have characterized the globalization of IT hardware production. Getting these sectors to improve their use of IT capital, she said, would enhance IT diffusion, leading to job creation and productivity gains.

A major obstacle facing the industries that did not participate in the productivity growth of the 1990s is the increasing share of software costs as part of the IT package. "What was globalized and globally sourced in the 1990s was IT hardware," Mann said, but increasingly important on that hardware platform are software and service applications. As the platform price has fallen, the proportion of services and software in overall costs has increased, and now represents at least 50 percent of the total package of software services and hardware.

The second obstacle to meeting the needs of these lagging sectors is the difficulty and cost involved in writing software applications for these industries. The big players in the software and service application industries "have gone and picked up the $1,000 bills that are on the sidewalks," explained Mann, adding "there are lots and lots of $100 bills down there, but it has not been worth their while, yet, to pick them up." One thing that will increase the attention that software firms pay to these unexploited opportunities is the capacity to outsource production of IT products that are more routine and do not involve design, marketing, integration, or analysis of customer needs. Outsourcing these jobs will reduce the price of software and service applications and will generate increased investment in IT and, along with it, Mann indicated, more jobs for IT workers.

Investing in people

Mann conceded that the specter of losing white collar jobs looms large: the globalization of software and IT

Mann: "Higher-paid jobs that demand IT skills are projected to grow very quickly in the United States, especially as more sectors of the economy and more businesses use IT packages."

services means that some IT jobs will be performed abroad. The job categories that are projected to shrink, however, are at the low-wage, low-skill end of the IT job spectrum. Higher-paid jobs that demand IT skills are projected to grow very quickly in the United States, especially as more sectors of the economy and more businesses use IT packages.

For workers hurt by international competition, Mann supported extending unemployment benefits and wage insurance. More generally, she called for a strategy to ensure open markets abroad for internationally competitive services. But it will also be vital, Mann explained, to ensure that U.S. workers are prepared to fill higher-skill jobs. To be able to compete internationally and be domestically strong, "we need to invest in people," she said. To this end, Mann recommended the introduction of a tax credit for investment in human capital, based on the same rationale as that for the tax credits for research and development and capital investment. Specifically, the tax credit for investments in human capital would mitigate the incentives that firms now have for not training workers because they fear losing them to rival firms. Firms could apply for a partial investment tax credit to cover the cost of training. Asked why the firm should receive the credit as opposed to the individual, she said that the firm plays a vital role in matching workers' skills to specific jobs. And, in general, job training done through firms is significantly more successful than when done through other venues.

How likely are firms to take advantage of a tax credit for human capital? And, even if they do, how likely is it that workers truly in need of training will receive it? This selection problem applies to other tax credits, Mann said, but "if it's good for capital and good for research and development, then why not apply it—with all the well-known warts—to people?" We ought to take this opportunity now, she said, "rather than wait for years." ■

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Available on the web (www.imf.org)

Public Information Notices

04/16: IMF Executive Board Discusses Financial Risk in the Fund and the Level of Precautionary Balances, March 5
04/17: IMF Concludes 2004 Article IV Consultation with Bosnia and Herzegovina, March 5
04/18: IMF Concludes 2004 Article IV Consultation with Canada, March 10
04/19: Follow-Up on the Recommendations of the Independent Evaluation Office Report on Fiscal Adjustment in IMF-Supported Programs, March 11
04/20: IMF Concludes 2003 Article IV Consultation with Sri Lanka, March 12
04/21: IMF Executive Board Reviews Technical Assistance, March 17
04/22: IMF Discusses Liberia's Postconflict Situation and Prospects through June 2004, March 18

Transcripts

"In Defense of Globalization," IMF Economic Forum, February 18
Press Conference by Horst Köhler, IMF Managing Director, February 25
Press Briefings by Thomas C. Dawson, Director, IMF External Relations Department, February 26, March 10

Press Releases

04/45: IMF Releasing Semiannual Reports on the Incidence of Longer-Term Program Engagement, March 5
04/46: IMF Executive Board Reviews Pakistan's PRSP, March 8
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04/48: The Kyrgyz Republic Subscribes to the IMF's Special Data Dissemination Standard, March 8
04/49: IMF Executive Board Reviews Noncomplying Disbursement to The Gambia, March 8
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04/52: IMF Staff Statement on the Conclusion of the Seventh Review Discussions Under Turkey's Stand-By Arrangement, March 15
04/53: IMF Completes Fourth Review of Madagascar's PRGF-Supported Program, Approves an Augmentation of Access Under the PRGF Arrangement, and a Disbursement of $34.7 Million, March 17
04/54: IMF Issues Warning on Website's Misuse of the Fund's Name, March 19
04/55: Statement by a Group of IMF Executive Directors on the Selection Process for a New Managing Director, March 19 (see page 89)
04/56: IMF Completes First Review Under Burkina Faso's PRGF Arrangement and Approves $5.1 Million Disbursement, March 19
04/57: IMF Executive Board Completes Second Review of Argentina's Stand-By Arrangement, March 22 (see page 93)
04/58: IMF Executive Board Completes First Review of Dominica's PRGF Arrangement, March 24

PRGF=Poverty Reduction and Growth Facility
PRSP=Poverty Reduction Strategy Paper