IMF Survey Interview

Africa Seeing Rewards of Better Policies

In recent months, prices of oil, nickel, tin, corn, and wheat have hit record highs, building on dramatic increases since their lows of 2000. What does this mean for sub-Saharan Africa, a highly diverse region of net commodity importers and exporters?

Abdoulaye Bio-Tchané, who recently stepped down as Director of the IMF's African Department, tells the *IMF Survey* that, so far, unlike in past commodity booms, Africa is coping well.

But Bio-Tchané, who will shortly take over as president of the West African Development Bank, warns that Africa needs to move swiftly to sustain and broaden growth—given that few African countries look likely to meet the UN Millennium Development Goals (MDGs) on poverty and human development.

IMF photo

Abdoulaye Bio-Tchané: "I have seen, over and over again, that good economic policies make a real difference in how a country fares."

IMF Survey: How is Africa as a whole faring with the boom in oil, metals, and food prices now affecting the global economy?

Bio-Tchané: In contrast to earlier commodity booms, this time around Africa has been coping remarkably well. Resource-rich countries have been using their windfall profits to scale up outlays on infrastructure and social services, and they've also been saving a lot more than in previous episodes, reducing the risk of a boom-bust cycle.

Net commodity importers have held up quite well so far. But with the recent further increases in fuel prices and the unexpected surge in food prices, they're now facing a double blow, which could lead to higher inflation and slower growth. And, given the dire social situation in some countries, the high prices are being felt more severely than in other regions.

For African policymakers, the immediate challenge will be to find an appropriate mix of financing and adjustment. The IMF can help by being sufficiently flexible and imaginative to help them address not only an economic but also a social situation. In the years ahead, stabilization and economic reform offer the best means of adjusting to the boom.

IMF Survey: What can governments do about the impact of food price hikes?

Bio-Tchané: In the short run, they could alter tax policies or introduce targeted subsidies. For instance, in some countries, import duties on products like rice and milk are running at 40 percent, so the tax could be lowered to 30 percent or even 20 percent. In fact, a couple of countries have done just that—and the IMF has temporarily accepted the reduction. Similarly, some countries might want to subsidize transportation in urban areas, and, here again, the IMF could be supportive.

IMF Survey: Some countries have even banned exports of certain products to ensure sufficient domestic supplies. Should the IMF be supportive of that, too?

Bio-Tchané: Those kinds of measures should really be exceptional because supply, even in the short run, can be increased dramatically. Banning exports might sound like a good solution because it will allow the population to access needed commodities, such as corn. But in the short run, farmers are hurt. If prices are attractive, farmers will produce more. And there are many global initiatives now under way to help Africa increase agricultural production so that it can feed itself.

IMF Survey: What do you see as the top challenge currently facing sub-Saharan Africa?

Bio-Tchané: This is an exciting time in Africa's economic history, with sub-Saharan Africa as a whole experiencing its best growth in 30 years. Most countries have made significant progress, based on the supportive global environment of recent years, strong domestic investment, and productivity gains that have been supported by sound economic policies in most countries. All across the region, countries are using increased resources from commodity exports, debt relief, and private inflows to scale up expenditures in pursuit of the MDGs.

That said, few countries in Africa are likely to meet the MDGs, and I think this is the main challenge that Africa is facing.

IMF Survey: What types of policies will Africa need to pursue?

Bio-Tchané: It will need to take steps to sustain and broaden growth, building on a virtuous circle of reform, stabilization, and growth. The importance of developing a more dynamic private sector cannot be stressed enough. Other priorities include investing in physical and human capital (in health and education), deepening financial sectors, liberalizing business regulations, reducing trade barriers, and furthering regional integration. Also, better governance and public financial management will help to make the most out of the continent's limited resources, unlock aid, and attract foreign direct investment.

IMF Survey: What are some of the most promising changes now under way on the continent?
Bio-Tchané: One would be that the number of conflicts has declined dramatically over the past 10 years. To me, that suggests that something has improved substantially in national and international processes. From an IMF perspective, I find it extremely encouraging that more and more countries are implementing sound economic policies and that they're being rewarded with improved economic performance, thus reinforcing their commitment. These efforts need to be sustained over the long run.

IMF Survey: Turning to the IMF, how is it regarded in Africa? Are we still vulnerable to criticisms that we're holding back spending on social issues or limiting outlays because of worries of debt sustainability?
Bio-Tchané: My experience from numerous meetings with African officials and my travels through Africa—to 26 countries—is that the IMF's policy advice, financial support, and technical assistance are not only much needed but also really appreciated. During the Managing Director's recent visit to the region, African leaders asked for more, not less, Fund involvement in Africa.

That said, the IMF is also criticized, and it would be quite odd if it weren't, given the depth of its involvement in Africa. Sometimes this criticism is justified in substance, and then we have to reflect on how the IMF can improve and make changes accordingly. One such example is the more sparing use of wage bill ceilings, which can be useful tools in individual countries. Often, however, the criticism reflects misunderstandings, especially when it comes to issues such as balancing the need for higher spending on social issues with the overarching issue of preserving macroeconomic stability.

IMF Survey: What can the IMF do to remain relevant and to continue to effectively address Africa's key economic problems?
Bio-Tchané: The IMF has long helped African countries achieve and maintain macroeconomic stability, improve public financial management systems, and develop an effective financial sector that helps foster growth spearheaded by the private sector. Much has been achieved in that respect—as evidenced by strong growth and benign inflation in most countries of the region. And all these activities continue to be relevant for a large number of our African members.

But as African countries' needs change, the Fund must adapt. Going forward, we recognize that—beyond stabilization—more needs to be done for African countries to move toward middle-income status. The Fund has already made progress in reviewing the effectiveness of its policy advice and program design, and it is continuing to refine its tool kit for low-income countries. As countries make strides toward reaching the MDGs, we've tried to help ensure that they have the fiscal space needed to expand priority spending on social services, find ways to increase their capacity to absorb aid and debt relief effectively, and raise economic growth. We've also worked on finding ways to better assist postconflict and fragile countries, and we hope to bring our proposals to the IMF Executive Board soon.

At the institutional level, the IMF's emphasis is shifting from financing to policy support. Multilateral surveillance aims to better manage the risks stemming from global imbalances. For low-income countries, the IMF introduced the Policy Support Instrument, which enables us to support those countries that do not want—or need—Fund financial assistance.

IMF Survey: Should the IMF get involved in governance issues?
Bio-Tchané: The IMF has been promoting good governance for quite some time. But since its mandate in this area is limited, its involvement centers on issues that could have a significant macroeconomic impact or are critical to achieving the objectives of an IMF-supported program. In practice, this has translated into work on public resource management, financial sector soundness, and central bank safeguards. The IMF also assists resource-rich countries through a number of specialized initiatives, including the U.K. Extractive Industries Transparency Initiative.

Overall, I'm encouraged to see that African countries have made substantial progress in strengthening governance in recent years, something that is increasingly reflected in, for example, the World Bank's governance indicators. But experience in Africa and around the world suggests that real and sustainable success in this area lies in the hands of key domestic stakeholders, including parliaments and civil society organizations.

IMF Survey: At the country level, can we point to any IMF success stories in Africa in recent years?
Bio-Tchané: We've seen much improved performance in many of our members, notably the emergence of a group of "mature stabilizers," comprising countries such as Uganda, Ghana, Tanzania, and a number of others that have moved well beyond stabilization and are now trying to establish the foundations for a move to middle-income status, such as Nigeria. As an aside, the strong rise in private capital inflows to these countries provides an independent assessment of how far we have come there. Also, the IMF has helped return a number of postconflict countries to macroeconomic stability and, in some cases, move even beyond that.

IMF Survey: How has your position at the center of policymaking for so many years changed your own thinking about Africa?
Bio-Tchané: I would say, if anything, I have become more optimistic. I have seen, over and over again, that good economic policies make a real difference in how a country fares. I have seen more and more countries making real progress in that regard. And I have seen how much the IMF, in its core areas, has been able to contribute to formulating and implementing these policies. Overall, I am hopeful that we are getting close to achieving a critical mass that will finally lift the continent onto a higher trajectory of growth and development. ■

Laura Wallace
IMF External Relations Department

Study Shows Many Small States Need Smaller Governments

(continued from page 69)

countercyclical fiscal policy because small states are more prone to shocks; and second, because most small states have fixed exchange rate regimes, fiscal policy is the main tool for adjustment.

Since the early 1990s, a growing public debt problem in many small states has been worsened by a slowdown in growth rates, owing partly to the erosion of trade preferences and to shocks. During this period, sluggish growth and fiscal pressures have emerged in some Pacific islands, for instance, while rising debt has been especially pronounced in the Caribbean countries. Small low-income and African states also tend to have very high external debt, which curtails these economies' fiscal flexibility.

Small states are broadly defined as developing and emerging market countries that have a population of about two million or less. Using a new fiscal data set for 42 small states, the analysis showed that small states tend to have higher government expenditures, including spending on goods and services, wages and salaries, and capital investment.

Weak governance

Small states also tend to have weaker primary balances, higher public debt, and higher external debt than the large countries examined. Furthermore, the study unveiled evidence that weak governance is significantly correlated with higher total public and external debt in small states.

Why, in recent years, do many small states tend to spend more, have weaker primary balances, and have more public debt than large states? The literature shows that these fiscal challenges principally reflect the following characteristics of many small states:

- ***Remoteness and limited economies*** of scale help explain small states' higher cost structure, which raises government expenditures and can increase public debt. Remoteness tends to raise transport and input costs, and keeps the economy isolated.
- ***A lack of economic and export diversification*** stemming from fewer human and capital resources and small domestic markets can raise government expenditures because it makes small states particularly vulnerable to commodity- or weather-related shocks.
- ***Human resource constraints,*** often accentuated by a "brain drain," tend to limit capacity in both public and private sectors, which can inflate wages and government spending because skilled labor is scarcer.
- ***A high degree of openness,*** as reflected in a high ratio of external trade to GDP and in reliance on foreign capital and investment. Openness results from the fact that although small states tend to produce a narrow range of goods and services, they use a wide variety.
- ***Greater output volatility*** owing, first, to small states' greater openness, which exposes them more to changes in world market prices and world demand; second, to their lack of economic and export diversification, which leaves them more exposed to terms of trade shocks; and, third, to a propensity for natural disasters that can affect the whole country, rather than a single area.

The greater the economic volatility, the greater the volatility in government revenues and expenditures, which can affect public debt because shock-induced deficits may not be fully offset by surpluses during good times.

Fiscal consolidation in small states can reduce the vulnerability caused by their weaker fiscal positions and greater susceptibility to shocks. Low public debt and a sound fiscal position give policymakers the flexibility to respond countercyclically to shocks or downturns. Weak fiscal discipline may also exacerbate economic volatility by, for example, causing bouts of fiscal expansion and contraction.

Reverse crowding out

Fiscal discipline can help reverse the crowding out of private investment and spur private-sector-led growth in many small states. This can be important because, in small states, the public sector tends to have a larger economic role. It is important to promote private investment for economic and export diversification in small states, which in turn can help mitigate their vulnerability to shocks.

Furthermore, there is evidence that growth is higher in small states with a smaller government and a lower public debt. Since about 1993, high-growth small states on average have had lower revenues and grants, lower expenditures, stronger fiscal balances, and lower public debt than medium-growth and low-growth small states.

A study of episodes of large fiscal adjustment in small states confirms that, in most cases, growth actually rose. An episode of large fiscal adjustment occurs when the average primary balance as a percent of GDP was at least 10 percentage points of GDP greater for a three-year period than the average primary balance for the previous three-year period.

From 1990 to 2004, there were 12 such episodes, involving nine small states. In 67 percent of these episodes, economic growth increased, and the average change in growth was 1.3 percent. In fact, in only one episode was average growth negative.

The most effective way to achieve fiscal adjustment is to reduce spending. The majority of episodes of large fiscal adjustment in small states involved hefty cuts in both current and capital spending; increases in revenue tended to be less frequent and less pronounced.

The small-state fiscal data also suggest that reducing current expenditure on goods and services, transfers and subsidies, and wages is associated with higher growth. High-growth small states tended to have lower spending in these three categories and higher capital spending than medium- and low-growth small states.

The study's empirical results suggest that improving governance may also help small states reduce public and external debt and thus support fiscal adjustment. This means that many small states should strive to improve their institutional capacity to devise and implement government policies and improve the quality of public services. Measures that enhance policy credibility, such as increasing the accountability of the government to fiscal targets, should also help raise governance standards. ■

Stephanie Medina Cas and Rui Ota
IMF African Department

Europe Seen as Resilient, but Still Held Back by Structural Issues

(continued from page 69)

again. That said, I remain reasonably sanguine that Europe's economy will be more resilient than that of the United States.

IMF Survey: How real is the risk of a financial crisis in Europe's emerging markets?

Deppler: In my view, Europe's emerging countries are also resilient. But some of them are susceptible to financial shocks, which could make the situation dramatically worse. While financial markets clearly are backing away from assets they view as too uncertain, there is still an appetite for relatively high-yielding assets for which risks are perceived as less influenced by the crisis in advanced country financial markets. Therefore, lending to emerging Europe remains reasonably buoyant and growth is being sustained, at least for now.

In sum, we do not know yet how big the shock is going to be in emerging Europe. But these countries will not be able to avoid the more general slowdown, and a number of them need to work harder at ensuring the continued confidence of investors.

IMF Survey: As Director of the European Department, you have led missions to the euro area for a number of years. Do you think Europe has finally overcome the ills that has prevented its economy from realizing its full potential?

Deppler: I wish I could say yes, but I have to say no. Europe has made major strides forward over the years, and its prospects are the better for it. But it still has structural problems it really needs to address. During the 1970s and 1980s, these problems were essentially ignored. But since then, reforms have been implemented—to my mind, with considerable success. If you look at employment, clearly we are in a different frame of reference than we were 10 to 15 years ago. And if you think in terms of Europe's standing in the world economy, the continent has also come a very long way—the 27-member European Union is, at current exchange rates, the world's largest economy. European goods are renowned for their quality and design, and Europe's institutions are admired for what they have been able to achieve—not least, a single European currency.

That being said, Europeans still have a lot of problems to deal with, and some are quite tough. These problems can often be traced back to privileges that have been bestowed upon various social groups—privileges that have now become deeply embedded in society, dragging down economic performance and productivity.

IMF photo

Michael Deppler: "I remain reasonably sanguine that Europe's economy will be more resilient than that of the United States."

European performance relative to that of the United States has flagged, most noticeably in terms of lagging productivity in the service sector. However, while it is clear that sectors sheltered from competition are doing poorly, it is less clear how Europe's politicians can put together the majorities needed to reform them. The people who profit from the lack of competition are obviously not keen to see these protectionist measures dismantled. Collectively, however, these privileges add up to a huge burden on overall performance.

IMF Survey: Does Europe's positive experience with integration hold lessons for the rest of the world?

Deppler: It is hard to imagine what Europe would look like today if it were not for integration. It has been a source of tremendous growth and opportunity, essentially because it brings competition to markets that would otherwise remain protected. Although there are some downsides, such as the agricultural policy, being a member of the European Union amounts to reform by stealth. That is why, of course, there has been a certain backlash against integration in some countries. But I firmly believe that Europe stands tall. The continent's experience—including with the euro and the single market—has excited a lot of interest around the world.

IMF Survey: You are about to leave the IMF after 37 years. As you look back at your career, what stands out as the most important events, for the Fund and for you personally?

Deppler: It has been a very exciting 37 years. I received my letter of acceptance to the Fund on April 15, 1971—the day Nixon announced the break with gold. All my colleagues in university were saying: "Why are you going to the Fund? The Fund no longer has a job." And yet, looking back, I have been involved in many exciting things over the years.

First there was the creation of the IMF's *World Economic Outlook*—a secret activity back in the early 1970s. Then came the oil facility, the debt problems in the 1980s, the transition economies in the 1990s, and our programs with Poland and Bulgaria, and later Turkey. So it has been a career full of continuing interest.

The lessons to take from these varied experiences are pretty basic, but they have been important to me—as well as to the institution—over the years. The first lesson that has struck me repeatedly is how critical politics is to economics.

I was on the 1976 Stand-By mission to the United Kingdom when confidence in sterling reached a low ebb and the country came to the Fund for support [the United Kingdom was the last industrial country to borrow money from the IMF]. As far as I could tell, this crisis reflected mainly a lack of political resolve. They could have taken a few measures, told us to go home, and done fine.

Twenty years later, I was leading the missions to the United Kingdom when Gordon Brown became Chancellor of the Exchequer. He came into office with an ambitious reform program, including a commitment to achieve the very tough expenditure targets of the previous government, which had lost all credibility. He promptly set out to do just that, gained massive credibility, and succeeded in crowding in even larger volumes of private spending, which helped spur the sustained growth that has followed.

Turkey was the same thing. The government that was in place from 1998 to 2002 wanted to do the right things, particularly once Kemal Dervis became treasury minister, but it did not have the necessary political cohesion to make its commitments credible. When the new government came in with a large majority, it committed to basically the same policies, also with financial support from the IMF. We now had a success in the making. So politics is central to economic outcomes—an obvious point, but one that economists focused on doing things right by the lights of our trade need to bear in mind.

The other big lesson I take away from my years at the Fund is the importance of institutions. I was in favor of shock therapy back in the early 1990s working on the transition economies, and I remain in favor of it. Political opportunities must be seized. But the transition experience has taught us the importance of institutions to well-functioning markets. The Fund's new emphasis on governance and capacity building stems from that lesson.

But probably the most important lesson for today is the quickening of financial markets, all the more so in the face of political and governance issues. I remember thinking, back in Poland and even Bulgaria in the 1990s, how slow the markets were to react. Nowadays, of course, markets can—and often do—react almost instantaneously. Here, also, the Fund has moved in the right direction by giving much higher priority to the financial sector and its links to the real economy.

IMF Survey: You were one of the leaders behind the Fund's first multilateral consultation, which aimed to reduce global economic imbalances. What lessons did you take away from that experience?

Deppler: The multilateral consultations were proposed by former IMF Managing Director Rodrigo de Rato. In his view, the world had become much more multipolar, and the IMF needed to have procedures in place that would enable us to engage key players on key problems, directly and at a high level. The need for such a mechanism—with the Fund acting as an independent broker—remains patently obvious, in my view. And to make progress, you need genuine, active debate, which means keeping participation limited and engaging high-level policymakers.

The first multilateral consultation did so. It was aimed at reducing global economic imbalances, and involved the United States, the euro area, China, Saudi Arabia, and Japan. My view of the outcome is very positive: it remains the touchstone of how we look at global imbalances. The context, of course, is evolving. The financial crisis has brought a new dimension, and there is a need to incorporate the lessons learned so far.

But I would say that in terms of both the concept itself and our achievements—a better understanding of what the key players thought about global economic imbalances, and how their policy intentions fit with those of other key players—the consultation was very much to the Fund's credit. I am certain it will be viewed as a significant first step toward redressing the imbalances that have made the global economy vulnerable to a slowdown. ■

Camilla Andersen
IMF External Relations Department

Regional outlook for Europe

Financial market strains, spillovers from the U.S. slowdown, and the global reassessment of risks will adversely affect Europe in 2008, the IMF's latest *Regional Economic Outlook* (REO) says. The euro's appreciation and the increase in commodity prices are adding to these troubles.

In advanced Europe, output growth is expected to slow from 2.8 percent in 2007 to 1.5 percent in 2008. In emerging Europe, growth should decelerate from 6.9 percent in 2007 to 5.5 percent (see table). Uncertainties surrounding the outlook remain unusually high, emphasizes the REO, published on April 21.

Headwinds to growth

Growth in Europe is expected to slow significantly in 2008–09, reflecting spillovers from weaker global growth, rising commodity prices, and the strains in financial markets.

(real GDP growth; annual percent change)

	2007	2008	2009
Advanced European economies[1]	2.8	1.5	1.4
Emerging European economies[1, 2]	6.9	5.5	5.2
Euro area	2.6	1.4	1.2
Advanced European economies			
France[3]	1.9	1.4	1.2
Germany[3]	2.5	1.4	1.0
Italy[3]	1.5	0.3	0.3
Spain[3]	3.8	1.8	1.7
United Kingdom[4]	3.1	1.6	1.6
Switzerland	3.1	1.3	0.9
Emerging European economies			
Czech Republic[4]	6.5	4.2	4.6
Hungary[4]	1.3	1.8	2.5
Poland[4]	6.5	4.9	4.5
Russia	8.1	6.8	6.3

Source: IMF, *World Economic Outlook*.
[1]Average weighted by purchasing power parity GDP.
[2]Montenegro is excluded from the aggregate calculations.
[3]Member of both the European Union (EU) and the euro area.
[4]Member of the EU.