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The next issue of the *IMF Survey* will be published on October 8.

Aftermath of terrorist attacks

World Bank and IMF will not hold Annual Meetings as scheduled

Following devastating terrorist attacks on the World Trade Center in New York City and the Pentagon outside Washington, IMF Managing Director Horst Köhler and World Bank President James Wolfenshon announced in a joint statement that the World Bank Group and the IMF would not hold their Annual Meetings scheduled for September 29–30. The decision was taken, according to the joint statment, "out of deepest respect and sympathy for the families of all those touched by the horrific events of last Tuesday, and in order to dedicate law enforcement personnel fully to the extraordinary and immediate priorities at hand" (IMF News Brief No. 01/89, September 17).

On September 11, both the Pentagon outside Washington (above) and the World Trade Center in New York (left) were hit by terrorist attacks.

In an earlier statement issued on September 12, Köhler said: "I have assured the membership that the IMF is closely monitroing the situation, and stands ready to assist its member countries as appropriate. Our present assessment is that, despite the scale of the human tragedy, these terrible events would have only a limited impact on the international monetary and financial system." (IMF News Brief, No. 01/88, September 12).

Statements in Europe

In Rome, the Italian Treasury, the current president of the Group of Seven, issued a statement on September 12 on behalf of the Group's finance ministers and central bank governors emphasizing their commitment "to ensuring that this tragedy will not be compounded by disruption to the global economy."

The ministers of economies and finance of the European Union, the European Central Bank, and the central bank governors of the European Union and European Commission, issued a joint statement in Brussels on September 12, pledging to take "all necessary measures…to ensure the proper functioning of markets and the stability of the financial system."

Swap agreement

In a further move to stabilize the system, on September 13, the U.S. Federal Reserve Board announced that it and the European Central Bank (ECB) had agreed on a swap agreement "in order to facilitate the functioning of financial markets and provide liquidity in dollars." Under the agreement, the ECB would be eligible to draw up to $50 billion, receiving dollar deposits at the Federal Reserve Bank of New York. In exchange, the New York Federal Reserve Bank would receive euro deposits of an equivalent amount at the ECB.

The statement said that the ECB would make these dollar deposits available to national central banks of the Eurosystem, which will use them to help meet dollar liquidity needs of European banks, whose U.S. operations had been affected by the disturbances in the United States. The swap line will expire in 30 days. ■

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Interview with Masood Ahmed

Reviews of PRSP process and PRGF are designed to draw upon wide range of country, other perspectives

At the beginning of August, the IMF and the World Bank launched a review of the poverty reduction strategy paper (PRSP) process to find ways to strengthen the two year-old initiative aimed at improving the poverty focus of public policy in, and development assistance to, poor countries. The IMF launched a concurrent review of the Poverty Reduction and Growth Facility (PRGF), its concessional lending window for poor countries. Masood Ahmed, Deputy Director of the IMF's Policy Development and Review Department and Co-Chair of the Joint World Bank–IMF Implementation Committee for poverty reduction strategies and debt relief, talks to Wayne Camard about the reviews.

Ahmed: "Two years of initial experience provides us with enough of a basis to take stock."

CAMARD: You've just launched a review of the PRSP process and the PRGF. What are you hoping to accomplish?

AHMED: It's now been almost two years since the PRSP process was launched and the PRGF was set up as a successor to the Enhanced Structural Adjustment Facility [ESAF]. In both cases, the intention was to embark on approaches that would be new for the IMF as well as new in the way policies were formulated in countries and supported by donors. Two years of initial experience provide us with enough of a basis to take stock—to see how these approaches have been working in the field and how they need to be improved. On that basis, we aim to propose to our Executive Board (and to the Board of the World Bank, because the PRSP is a joint initiative) modifications that would address any concerns that have emerged in the first two years.

CAMARD: What is new about the approaches you've taken?

AHMED: In the case of the PRSP, the big change, of course, is that it puts a much stronger emphasis on organizing country development strategies around the goal of poverty reduction, and it does so in a way that brings a broad range of participants—representatives of civil society, representatives of poor groups, and the private sector—into the formulation of national development strategies. So, it's a broad participatory process. The strategies themselves are much more focused on the objectives of poverty reduction, are much more targeted on outcomes

IMF invites comments on conditionality

The IMF has released a series of papers on the streamlining and focusing of the conditions attached to its financing, known as conditionality, and is inviting public comment on these (IMF News Brief No. 01/86, September 4).

The papers, which were discussed by the Executive Board on July 25, review the initial experience with streamlining structural conditionality; examine proposals for strengthening IMF–World Bank collaboration on country programs and conditionality; and summarize the comments received through external consultations, both electronically and in seminars held this summer in Berlin, Tokyo, and London (see *IMF Survey*, July 2, page 218; July 30, page 249; and August 13, page 261). All the papers, as well as a related Press Information Notice (PIN No. 01/92, September 4), have been posted on the IMF's website (www.imf.org).

The aim of the review is to ensure that conditionality is designed and applied in a way that reinforces national ownership and the sustained implementation of country economic reforms. To this end, the review emphasizes the need to focus on those policies that are critical to achieving the macroeconomic objectives of IMF-supported programs and to establish a clearer division of labor with other institutions, especially the World Bank.

The review of initial experience with streamlining structural conditionality shows that there has been a greater concentration of conditions in the areas of the IMF's core responsibility and expertise in more recent programs. In the six months after September 2000, there was some reduction in the number of conditions in programs supported by the IMF's Poverty Reduction and Growth Facility (PRGF), the review finds, but it notes that the number of Stand-By Arrangements approved during the period was too small to draw any meaningful trends.

The paper on IMF–World Bank collaboration reviews the developments that have led to an increased need for collaboration both in the design of country programs and in the establishment and monitoring of conditions. The key message is that enhanced collaboration on conditionality will strengthen program design, but only if there is enhanced staff cooperation throughout the country program cycle.

Persons interested in commenting on the conditionality papers should send their comments to the IMF by mail or fax (202-623-4233), or by e-mail to conditionality@imf.org. Comments received by October 15 will be conveyed to the IMF Executive Board as background information for a Board discussion in November and will be taken into account in further work by the staff. Comments will also be made public on the IMF website.

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rather than on inputs, and provide a common framework within which all donors, including the IMF, can interact. Many developing countries and many development agencies had begun to work on and integrate these elements into their programs before the PRSP was launched. What the PRSP process does is bring together the best in development learning and try to use it as a common framework for the work we do in poor countries.

CAMARD: How is this new concept of partnership informing the way you're doing the review of the PRSP?

AHMED: The PRSP review is going to affect the way countries develop their national strategies and the way in which both donors and agencies like the IMF and the World Bank support these efforts. Many development agencies and independent civil society organizations have already been looking at the experience of the PRSPs. To get the best out of this review, we want to bring together all that has been learned from these different perspectives.

CAMARD: How do you plan to do that?

AHMED: The PRSP review will draw upon contributions from five sources. First, it will look at the PRSP reviews that have been done by bilateral agencies like the U.K. Department for International Development, the Swedish International Development Agency, and the Special Partnership for Africa, and by independent agencies—civil society organizations, academics, and the like.

Second, the review will draw upon a series of regional events that bring together countries that have embarked on the PRSP process. The core of the PRSP process—the most important actors in the process—has to be the countries where PRSPs are now being developed. Some three dozen countries are well advanced in preparing their national poverty reduction strategies. The experience of these country authorities has to be key in informing the PRSP review and in identifying ways the process can be improved. To make sure that we capture those experiences, we are bringing together, in a series of regional events, representatives from these national authorities to get their input.

Third, we have launched a call for inputs through our website from anybody who has been involved in the PRSP process in one way or another in any country. We've already begun to receive contributions that will help inform the process.

Fourth, in January 2002, we're planning an international conference here in Washington. This will bring together the people who have contributed to the PRSP review. Participants will include representatives of the countries where PRSPs are being done, as well as people who have reviewed the PRSP process across countries.

Finally, our own staff and the staff of the World Bank who have been working on PRSP issues have a contribution to make that will also help shape the outcome of the PRSP review. The end-product of these five sources will be a paper to our respective boards at the Bank and the IMF, setting out staff and management assessments of how the PRSP process has evolved, what areas of concern have emerged in the first two years, what the strengths are that we should build on, and how we should address the concerns through changes in design or implementation.

Ahmed: "The PRSP review is going to affect the way countries develop their national strategies and the way in which both donors and agencies like the IMF and the World Bank support these efforts."

CAMARD: What concerns have you heard so far? What inputs have been received?

AHMED: The concerns so far fall into three different categories. First, there are country-specific concerns. These relate to the way in which the PRSP process is being set up and implemented in individual countries. There are questions about whether the participatory process has been sufficiently broad based or whether the PRSP process has been too rushed to allow for an examination of fundamental issues of poverty reduction. These are teething problems that, in the early phase, are perfectly understandable and that I hope we can learn from.

Second, there are concerns about whether this approach will really lead to the donor community doing business in different ways. A number of civil society organizations have been skeptical about whether, as a result of the national poverty reduction strategies, the IMF, the World Bank, and the bilateral agencies would be prepared to modify the policies they have been willing to support so far. Questions

Members' use of IMF credit
(million SDRs)

	During August 2001	January–August 2001	January–August 2000
General Resources Account	1,201.46	11,880.57	2,469.95
Stand-By	1,201.46	11,769.45	1,808.63
SRF	578.40	5,164.08	0.00
EFF	0.00	111.12	661.32
CFF	0.00	0.00	0.00
PRGF	37.26	448.28	275.04
Total	1,238.72	12,328.85	2,744.99

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CFF = Compensatory Financing Facility
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

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We have seen quite good progress in focusing and streamlining conditionality.
—Masood Ahmed

about how much leeway there is in the way in which these agencies actually work have figured in a number of the contributions that we've gotten.

Third, the PRSP countries themselves have been quite vocal about the expectations for the process. Are we hoping for too much too quickly? Many countries have pointed to serious issues of institutional capacity, technical expertise, and data availability. Many of the problems that poor countries face have been intractable for many years, and launching a broad-based participatory process for developing a national strategy and distilling that into a set of goals with measurable, monitorable indicators of progress is a challenging task for any country. We shall have to see whether we are being realistic in setting the bar for what could be a gradual process of strengthening national capacities and formulating poverty strategies.

This concern is compounded by the feeling that a number of special interest groups have begun to see the PRSP process as a way of furthering their specific agendas. While each of those issues is indeed important—whether it's a question of trade or infrastructure or conflict or gender issues—a number of countries are beginning to worry that the range of issues that the PRSP is supposed to cover may become all-encompassing. There is concern that the expectation of what constitutes a satisfactory national poverty reduction strategy may outstrip the ability of countries to deliver.

CAMARD: One concern you mentioned is whether the behavior of the international lending agencies has changed very much, and that speaks very much to the planned review of the PRGF. Can you talk specifically about what will be done in the review of the PRGF that is separate from the PRSP?

AHMED: The PRGF review will be conducted in parallel with the PRSP review but is separate because it is about how the IMF does business. About a year ago, we set out seven key features that we believed would distinguish PRGF programs from the ESAF programs that were their predecessors. These features—which included a greater emphasis on fiscal flexibility, more focused conditionality, much greater emphasis on public expenditure management, and much more systematic use of ex ante poverty and social impact analysis—are all laid out in a note posted on the IMF website just before the Annual Meetings last year. A year and a half into this is a good time to look at the range of PRGF programs and see whether the new ones are systematically incorporating these features. The PRGF review will also be an opportunity to ask whether these features need to be reviewed and modified.

In addition, the PRGF review will ask the people who have been looking at PRGF programs from outside the IMF whether their experience on the ground reflects this new approach.

CAMARD: What are your preliminary impressions of the PRGF?

AHMED: In preparation for the review, we have already started to look at recent PRGF programs. In many of them, you can see the new features beginning to come through in the design. But it's also fair to say that the pace at which these features are being incorporated in programs varies across programs and across the different features. For example, we have seen quite good progress in focusing and streamlining conditionality.

A lot of impetus for this comes from the Managing Director, who has spurred efforts to focus and streamline conditionality in IMF-supported programs. If you look at PRGF programs now, you'll find that the number of structural conditions in these programs has been reduced by about one-third from earlier programs. And the conditions are much more focused on

FINANCE & DEVELOPMENT
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The September issue of *Finance & Development* features several articles about social sector reform. Among the articles in this issue are

Social Sector Reform in Transition Countries
Christian Keller and Peter S. Heller

The Truth About Pension Reform
Nicholas Barr

Debt Relief and Public Health Spending in Heavily Indebted Poor Countries
Sanjeev Gupta, Benedict Clements, Maria Teresa Guin-Siu, and Luc Leruth

Targeting Rich Country Protectionism: Jubilee 2010 et al
Jagdish Bhagwati

Trade, Growth, and Poverty
David Dollar and Aart Kraay

Intergovernmental Fiscal Relations in Russia
Nadezhda Bikalova

Was Suez in 1956 the First Financial Crisis of the Twenty-First Century?
James M. Boughton

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the core areas of IMF expertise and responsibility.

We have made less systematic progress in another area: the ex ante impact analysis on poverty and the social impact analysis of key measures supported by programs. Recently in The Gambia, Guinea, Senegal, and Vietnam, mission chiefs clearly laid out what the social and poverty impacts of the main reforms supported by the PRGF were going to be. The IMF's Board appreciated and acknowledged this in their review of those country cases. But it's still not being done as systematically as I hope will be the case in the future.

CAMARD: Are you confident that you will be able to take the lessons that have been learned in the various countries and, by looking at them in the review, get other countries to learn from the process and to adopt improvements that might be called for?

AHMED: That is certainly very much the intention of the exercise. And that is why the regional events, for example, have been organized so that countries can share their experiences and learn from the way the process has evolved in other countries. That's much more powerful than having that learning intermediated through a third party. The international conference in early 2002 will also bring countries together to share experiences.

It's worth emphasizing that the central actor in the PRSP process is the country. And making the PRSP process work is a country responsibility. Our role is to help facilitate the sharing of information. We must ensure that our own procedures, our own policies, and the way in which we work with countries facilitate the PRSP process and its evolution in the country. ■

Recent publications

World Economic and Financial Surveys

International Capital Markets, August 2001, by a staff team led by Donald J. Mathieson and Garry J. Schinasi ($42.00; academic price: $35.00)

Working Papers ($10.00)

01/92: *Bond Restructuring and Moral Hazard: Are Collective Action Clauses Costly?* Torbjorn I. Becker, Anthony J. Richards, and Yungyong Thaicharoen

01/94: *The Gender Gap in Education in Eritrea in 1991-98: A Missed Opportunity?* Zuzana Brixiova, Ales Bulir, and Joshua Comenetz

01/96: *Districting and Government Overspending*, Reza Baqir

01/97: *Can Inheritances Alleviate the Fiscal Burden of an Aging Population?* Erik Lueth

01/98: *"Big Bang" Versus Gradualism in Economic Reforms: An Intertemporal Analysis with an Application to China*, Andrew Feltenstein and Saleh M. Nsouli

01/99: *Philippines: Preparations for Inflation Targeting*, Piyabha Kongsamut

01/100: *The Two Monetary Approaches to the Balance of Payments: Keynesian and Johnsonian*, Jacques J. Polak

01/101: *The IMF and the Ruble Area, 1991–93*, John Odling-Smee and Gonzalo C. Pastor

01/102: *Monetary Policy Under EMU: Differences in the Transition Mechanism?* Benedict J. Clements, Zenon G. Kontolemis, and Joaquim V. Levy

01/103: *Financial Repression and Exchange Rate Management in Developing Countries: Theory and Empirical Evidence for India*, Kenneth Kletzer and Renu Kohli

01/104: *Reserve Pooling in the Eastern Caribbean Currency Union and the CFA Franc Zone: A Comparative Analysis*, Oral Williams, Tracy Polius, and Selvon Hazel

01/105: *A Statistical Analysis of Banking Performance in the Caribbean Currency Union in the 1990s*, V.H. Juan-Ramon, Ruby E. Randall, and Oral Williams

01/106: *The Impact of Public Education Expenditure on Human Capital, Growth, and Poverty in Tanzania and Zambia: A General Equilibrium Approach*, Hong-Sang Jung and Erik Thorbecke

01/107: *Long-Term Capital Movements*, Philip Lane and Gian M. Milesi-Ferretti

01/108: *Transitional Growth with Increasing Inequality and Financial Deepening*, Kenichi Ueda

01/110: *Injury Investigations in Anti-Dumping and the Super-Additivity Effect: A Theoretical Explanation*, Poonam Gupta and Arvind Panagariya

01/112: *Economic Growth and Poverty Reduction in Sub-Saharan Africa*, Gary G. Moser

IMF Staff Country Reports ($15.00)

01/152: Belize: 2001 Article IV Consultation

01/153: The Bahamas: Statistical Appendix

01/154: The Bahamas: 2001 Article IV Consultation

01/155: Thailand: Statistical Appendix

01/156: Japan: Report on the Observance of Standards and Codes

01/157: Canada: Selected Issues

Other publications

Promoting Growth in Sub-Saharan Africa: Learning What Works, Economic Issues No. 23, Anupam Basu, Evangelos Calamitsis, and Dhaneshwar Ghura (free)

Annual Report on Exchange Arrangements and Exchange Restrictions, 2001 ($95.00)

Macroeconomic Policy and Poverty Reduction, Brian W. Ames, Ward Brown, Shanta Devarajan, and Alejandro Izquierdo (free)

IMF Research Bulletin, September 2001

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Interview with David Dollar

Globalizing countries provide evidence of faster growth, rising incomes for poor

With colleague Aart Kraay (who is on leave teaching at the Massachusetts Institute of Technology), David Dollar has written several papers on globalization and poverty reduction. Prakash Loungani speaks with Dollar, a researcher in the World Bank's Development Research Group, about their findings. The two papers cited are available on the World Bank's website at www.worldbank.org/research/growth.

Loungani: "The rich are getting richer, and the poor are getting poorer." True?

Dollar: Not true. You hear statements like that from some in the antiglobalization movement, but their rhetoric is at odds with the evidence. Since 1980, world inequality has stopped increasing and may have started to fall. More important, the number of extreme poor (those living on less than $1 a day) has dropped by about 200 million; most of this has been due to faster growth in China and India. But even if you take those cases away, there are other low-income countries that have done well, such as Bangladesh, Uganda, and Vietnam. The trend between 1820 and 1980 was for the number of poor in the world to increase. Starting around 1980, that trend reversed

Dollar: "Let's get away from the notion that there is any systematic tendency for growth or globalization to hurt the poor. Without growth in low-income countries, there's no chance of further reductions in poverty."

Loungani: If the evidence is so clear, why is there so much confusion about the facts on inequality?

Dollar: Sometimes people are talking about inequality within countries, which in some instances has gone up. The United States is one prominent example; many of the activists live there and are aware of that example. Among the developing countries, China has seen an increase in inequality between its rural areas and the rising urban centers. But it is not true in general that inequality is rising within countries—there are just as many counter examples.

Loungani: Let's take another slogan: "A rising tide sinks the poor." Many activists claim the benefits of growth go disproportionately to the rich.

Dollar: The title of my paper last year with Aart Kraay was *Growth Is Good for the Poor*. With data from 137 countries, we looked at what growth does to the share of income going to the poorest 20 percent of the population. There is simply no evidence that growth leaves these people behind: their income generally goes up in step with the average growth in the economy. You may say, "that's not good enough; I want growth to be pro-poor, I want it to help the poor more than the rich." So do I. But let's get away from the notion that there is any systematic tendency for growth or globalization to hurt the poor. Without growth in low-income countries, there's no chance of further reductions in poverty.

Loungani: You have a new paper with Kraay on globalization and growth. I'm going to guess the title is "Globalization Is Good for Growth."

Dollar: Actually, it's *Trade, Growth, and Poverty*. It compares the experiences of a group of globalizing countries with those of other developing countries. The globalizers, such as China, India, Mexico, and Brazil, have seen a big increase in the ratio of trade to GDP over the past two decades—that is, they became more integrated into the world economy by importing and exporting more. While the globalizers doubled their trade to GDP ratio in the past 20 years, the rest of the developing world actually trades less of its income today than two decades ago.

The globalizers have seen their incomes rise 5 percent a year over the last decade, compared with 2 percent a year for the rich countries and 1 percent a year for the nonglobalizers among the developing countries. So, yes, globalization seems to be good for growth, as you put it. And globalization is not increasing the gap between the globalizers and the rich countries; that gap is shrinking. What's happening is that there is a growing divergence within the developing countries because some are embracing globalization and others are not.

Loungani: How do we know that it's openness to trade that's leading to the higher growth?

Dollar: You're right. It's not just openness to trade that has led to faster growth in the globalizing countries. Countries are carrying out other domestic reforms, and these are important too. Aart and I find that trade helps

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growth even after we control for the effect of these other factors. I should add that our econometric techniques also control for the possibility that higher growth leads to more trade, rather than vice versa. But if the thrust of your question is that it's difficult to make up one's mind about these things based solely on regression analysis, I would agree. I put a lot of weight on case studies to complement the statistical analysis.

LOUNGANI: Which example comes to mind?

DOLLAR: Though China and India are the most visible successes, let me pick Vietnam. I worked on Vietnam for six years as a country economist (before moving to the World Bank's Research Department); whenever I go back, I want to see whether reforms are making a difference. Vietnam has been doing a lot of reform—much of it outside the trade area—so, not every improvement can be traced back to integration. But you see concrete examples of how trade has helped. Take some of the poorest—the small-scale rice farmers. With access to world markets, they now get a higher price for their rice and pay less for their main input, fertilizer.

Or look at the footwear industry. The wages of many people working in footwear have gone up from $9 a month to $50 a month over the past decade. Some might still view that as a tragic case of low wages and exploitation, but Vietnamese footwear workers are likely to see a fivefold increase in wages and a big increase in the number of jobs as a good thing.

There has been a broad-based improvement in fortunes. We can be sure about this in Vietnam, because the government did a survey of 5,000 households at the start of the reform process in 1992–93 and went back and visited the same households six years later. And this was a representative survey—that is, the results can be taken to apply to the Vietnamese population as a whole. We found that the level of absolute poverty had been cut by one-third in just six years. Even among the poorest 5 percent of households, virtually all were better off in 1998 than at the start of the reforms.

LOUNGANI: Are there examples of failure?

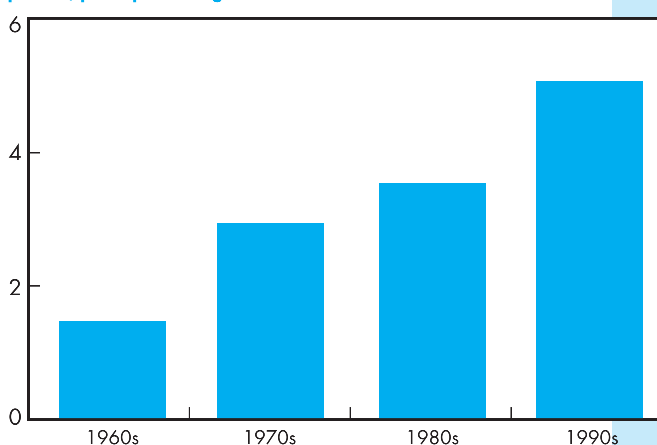
DOLLAR: You do have examples of countries that have lowered tariff rates without much good happening subsequently; but in those cases the lowered tariffs have not translated into increases in the amount of trade. Kenya is one example. It lowered tariffs, but because of corruption, poor customs administration, and inefficient ports, it hasn't seen an increase in trade in relation to GDP. And to turn your question around: no country has improved its performance in the post-World War II period by turning isolationist.

LOUNGANI: But the message that integration with the global economy is good for growth and the poor doesn't seem to be getting through to many.

DOLLAR: If you've been working on the nonglobalizing developing countries for 10–15 years, and nothing seems to change, you can end up with a very different and somewhat pessimistic view of the world. A lot of people look at conditions in these countries and say, "Globalization has not benefited these countries." But I would say: "That's because they haven't really integrated with the global economy!"

Growth has accelerated for post-1980 globalizers

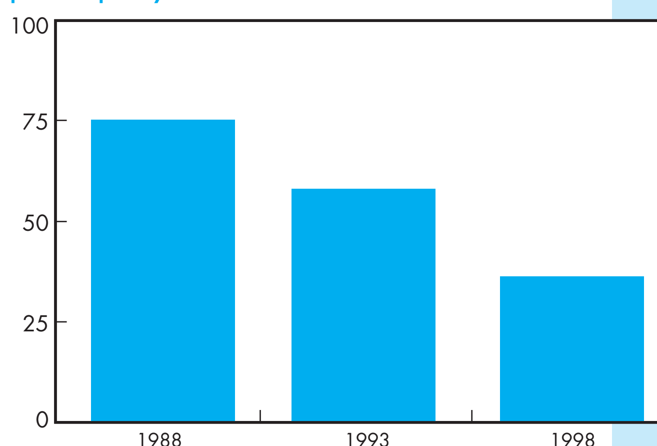
percent, per capita GDP growth



Data: David Dollar and Aart Kraay, 2001, *Trade, Gowth and Poverty*

Poverty drops as Vietnam's economy opens

percent in poverty



Data: World Bank,1999, Vietnam: *Attacking Poverty*

And even in the case of the globalizing countries, it is important to recognize that within these countries there are winners and losers from globalization. A lot of people just take for granted that the losers are mainly the poor, but our research indicates that's not correct. In many developing countries, the opposition to globalization comes from workers in the formal sector, who often do stand to lose. These workers are not the poor in developing countries, but still it is important to complement trade liberalization with good social protection policies so

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that more people are winners. Another group that can sometimes get hurt by globalization is the domestic capitalists in protected industries.

Dollar: "No country has improved its performance in the post-World War II period by turning isolationist."

LOUNGANI: What policy agenda emerges from your research?

DOLLAR: The obvious conclusion is that it is extremely difficult for a developing country to reduce poverty if it shuts itself out of the global economy; globalization, for all its risks and challenges, has been a force for poverty reduction. So it is desirable to lower trade barriers—both the barriers that the rich nations maintain against the poorer ones and the barriers that the developing countries maintain against one another. It may surprise some people to know that 70 percent of the tariff burden that developing countries face comes from tariffs imposed by other developing countries. Developing countries could gain a lot by integrating with each other. But as trade barriers are lowered, it is critical to have a social safety net in place to help those who might lose out in the short run.

LOUNGANI: Any other policy recommendations?

DOLLAR: The other recommendations come from our larger research program on globalization. For example, we are helping countries collect data from private firms more systematically so that they can evaluate and improve the investment climate. In India, we worked with the Confederation of Indian Industries to survey 1,200 firms in ten states. What's interesting there is that you can see large differences in the investment climate across states in terms of the reliability of power, the quality of their transport infrastructure and government regulation, and the degree of corruption. The states with relatively good investment climates—Karnataka is an example—attract more investment, have higher growth rates, and achieve greater poverty reduction than states with relatively poor investment climates, such as Uttar Pradesh. This work highlights the importance of complementing open trade policies with good institutions and policies at the local level.

We also make policy recommendations concerning migration. Right now, migration is the missing flow in globalization. Many people live in difficult locations. Migration—including south-north migration—can help reduce absolute poverty. Migration from poor to rich nations tends to raise the wages of the migrant. It also benefits those staying behind, either by taking some of the pressure off the labor market or through the money the migrants send home. Did you know that each year Indian workers abroad send back six times the amount India receives in foreign aid?

The main barrier to increased migration is political opposition in the rich countries. But the aging of the labor force in many rich nations may make them more receptive to young foreign workers. I'm not talking about the open borders of 100 years ago, but more liberal immigration policies in OECD [Organization for Economic Cooperation and Development] countries could be "win-win" for both poor countries and rich ones.

LOUNGANI: What role can the World Bank and the IMF play in pushing forward this agenda for greater integration?

DOLLAR: Increasingly, the Bank and the IMF are dealing with democratic regimes in the developing countries, and it is they who should be pushing this agenda if they agree with its elements. And many of them do. Successive Indian governments have chosen to integrate, and not because of lectures from the Bank and the IMF, but because they have concluded that, on net, integration is better for the country. President Vicente Fox of Mexico was just here in Washington preaching the virtues of globalization, provided that developing countries "do their homework," as he put it. We shouldn't shy away from spelling out the benefits and costs of alternate policy actions as we see them. But we should not have an exaggerated sense of our importance in pushing this or that agenda. It is up to developing countries to decide to what extent they want to integrate with the global economy. ■

For further reading, please see the September issue of *Finance & Development*, which features an article by David Dollar and Aart Kraay, "Trade, Growth, and Poverty."

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
September 3	3.34	3.34	3.93
September 10	3.30	3.30	3.88

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?2001).

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

Data: IMF Treasurer's Department

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IMFSURVEY

Fischer reviews changes, "unchanged virtues," and challenges during his years at the IMF

On August 30, Stanley Fischer addressed the IMF Executive Board in his final meeting as First Deputy Managing Director of the IMF. This farewell session was preceded by a farewell dinner for Fischer and his wife, Rhoda, on August 29, hosted by IMF Managing Director Horst Köhler and his wife, Eva, and attended by Fischer's long-term colleagues and friends, from both inside and outside the IMF. The text of Fischer's farewell to the Executive Board, excerpts of which follow, is available on the IMF's website (www.imf.org). (The text of Fischer's farewell dinner speech is also available on the IMF's website.) Fischer covered three topics each under three separate headings: changes, "unchanged virtues," and challenges.

Stanley Fischer (center), flanked by incoming IMF First Deputy Managing Director Anne Krueger (left) and IMF Managing Director Horst Köhler (right), during Fischer's farewell to the Executive Board.

Changes

Throughout its history, the IMF has been quick to adapt to changes in the economic and financial environment in which it operates. Our critics call this "mission creep"; we should recognize it as flexibility, for we cannot hope to achieve the enduring objectives laid down by our founders in the Articles of Agreement—promoting good economic performance, helping our members in times of difficulty, and providing a forum for international cooperation—if we fail to move with the times.

• *Transparency*. Looking back, I regard the transparency revolution as one of the two most important changes of the last seven years. This is not simply a bureaucratic change; it is a culture change. It has some costs—but it is overwhelmingly a positive development.

• *Work with poorest member countries.* Before I even knew I was coming to the IMF, I wrote an article about the IMF (and the [World] Bank) at fifty. In it, I criticized the IMF's rhetoric about poverty and came close to suggesting that the IMF should be getting out of the poverty business. But putting the debate in terms of whether we should be involved in the poverty business is a mistake. The issue is not whether the IMF should take an interest in poverty, but whether it should continue working, and working better, with its poorest member countries. The answer to that is yes: as a universal institution, we have to stay involved with all our members.

• *Transition economies.* Relative to the speed of convergence that was expected in the early 1990s, the outcome in the transition economies is not as good as hoped for, but there are major achievements, including in the leading East European economies and the Baltic countries. Russia is now firmly on a pro-market path, pursuing the policies that the IMF and many others have long recommended. Our role was important, especially in standing for the policies we always stand for, and in institution-building. We can regard what has been achieved with some satisfaction.

Unchanged virtues

• *The IMF's goals.* The policies we promote are essentially what is known as the "Washington consensus," something to which I subscribe. But like the word "globalization," the term Washington consensus has become a slogan, a litmus test, rather than an object of serious study. It is not worth arguing very much about those two words, but it is worth arguing for the policies that we promote—sound money, prudent fiscal policy, strong financial sectors, and open markets.

• *IMF Executive Board.* The IMF derives much of its authority and legitimacy from the fact that it is a near-universal institution. With the demise of colonialism and communism, the IMF's membership has risen from 29 at the outset to 183 today. The fact that 183 countries can be effectively represented around this table is a tribute to the way this organization works. Its success is due both to weighted voting and the constituency system, which allows 24 Executive Directors to represent all 183 members; it is due, too, to the Board's preference for reaching decisions by consensus whenever possible.

• *IMF staff.* I cannot speak too highly of the virtues of the staff: their loyalty, their talent, and their capacity for hard work. Even in the most hectic days of the financial crises, they kept their cool and did a heroic job for our members. While we, the management, have the luxury of being able to fight back when we are unfairly criticized, most members of the staff cannot. And that makes it all the more important that we—the management, the Board, and your authorities—should return their loyalty and defend the staff on such occasions.

Challenges

The first challenge is to *help reduce the volatility of international capital flows.* We need to make the mar-

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kets work better. We need to do everything we can to prevent crises. We also need to do everything we can to minimize the costs of crises. That includes, in particular, the work on private sector involvement.

The second challenge is to *streamline conditionality* and combine it with *enhanced ownership* of programs. Here we have made important progress in the last year.

The third challenge is to *deal with the backlash against globalization*. We need to take this very seriously. We need to ask what policies will promote equitable growth, what problems may arise in the process, and how to deal with them. And we need to recognize that this is a debate that is taking place in the media and get on with developing simple, appealing arguments that will succeed in the court of public opinion. ■

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

Stand-By, EFF, and PRGF Arrangements as of August 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By Arrangements				
Argentina[1]	March 10, 2000	March 9, 2003	10,585.50	5,774.97
Brazil[1]	December 2, 1998	December 1, 2001	13,024.80	3,554.05
Croatia	March 19, 2001	May 18, 2002	200.00	200.00
Ecuador	April 19, 2000	December 31, 2001	226.73	75.58
Gabon	October 23, 2000	April 22, 2002	92.58	79.36
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Nigeria	August 4, 2000	October 31, 2001	788.94	788.94
Pakistan	November 29, 2000	September 30, 2001	465.00	105.00
Panama	June 30, 2000	March 29, 2002	64.00	64.00
Papua New Guinea	March 29, 2000	September 28, 2001	85.54	18.89
Peru	March 12, 2001	March 11, 2002	128.00	128.00
Serbia/Montenegro	June 11, 2001	March 31, 2002	200.00	150.00
Sri Lanka	April 20, 2001	June 19, 2002	200.00	96.65
Turkey[1]	December 22, 1999	December 21, 2002	15,038.40	5,702.36
Uruguay	May 31, 2000	March 31, 2002	150.00	150.00
Total			**41,369.01**	**17,007.32**
EFF arrangements				
Bulgaria	September 25, 1998	September 24, 2001	627.62	0.00
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
FYR Macedonia	November 29, 2000	November 28, 2003	24.12	22.97
Indonesia	February 4, 2000	December 31, 2002	3,638.00	2,786.85
Jordan	April 15, 1999	April 14, 2002	127.88	91.34
Kazakhstan	December 13, 1999	December 12, 2002	329.10	329.10
Ukraine	September 4, 1998	August 15, 2002	1,919.95	1,017.73
Yemen	October 29, 1997	October 28, 2001	72.90	26.40
Total			**8,696.57**	**6,231.39**
PRGF arrangements				
Armenia	May 23, 2001	May 22, 2004	69.00	59.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	72.40
Benin	July 17, 2000	July 16, 2003	27.00	16.16
Bolivia	September 18, 1998	June 7, 2002	100.96	37.10
Burkina Faso	September 10, 1999	September 9, 2002	39.12	16.76
Cambodia	October 22, 1999	October 21, 2002	58.50	25.07
Cameroon	December 21, 2000	December 20, 2003	111.42	79.58
Central African Rep.	July 20, 1998	January 19, 2002	49.44	24.96
Chad	January 7, 2000	January 6, 2003	42.00	20.80
Djibouti	October 18, 1999	October 17, 2002	19.08	13.63
Ethiopia	March 22, 2001	March 21, 2004	86.90	52.14
FYR Macedonia	November 29, 2000	December 17, 2003	10.34	8.61
Gambia, The	June 29, 1998	December 31, 2001	20.61	3.44
Georgia	January 12, 2001	January 11, 2004	108.00	90.00
Ghana	May 3, 1999	May 2, 2002	228.80	105.17
Guinea	May 2, 2001	May 1, 2004	64.26	51.41
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Honduras	March 26, 1999	March 25, 2002	156.75	64.60
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Lao People's Dem.Rep.	April 25, 2001	April 24, 2004	31.70	27.17
Lesotho	March 9, 2001	March 8, 2004	24.50	17.50
Madagascar	March 1, 2001	March 1, 2004	79.43	68.08
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2002	46.65	21.74
Mauritania	July 21, 1999	July 20, 2002	42.49	18.21
Moldova	December 15, 2000	December 20, 2003	110.88	92.40
Mozambique	June 28, 1999	June 27, 2002	87.20	33.60
Nicaragua	March 18, 1998	March 17, 2002	148.96	33.64
Niger	December 14, 2000	December 21, 2003	59.20	42.28
Rwanda	June 24, 1998	January 31, 2002	71.40	19.04
São Tomé & Príncipe	April 28, 2000	April 28, 2003	6.66	4.76
Senegal	April 20, 1998	April 19, 2002	107.01	28.54
Tajikistan	June 24, 1998	December 24, 2001	100.30	22.02
Tanzania	March 31, 2000	April 3, 2003	135.00	75.00
Vietnam	April 13, 2001	April 12, 2004	290.00	248.60
Yemen	October 29, 1997	October 28, 2001	264.75	94.75
Zambia	March 25, 1999	March 28, 2003	254.45	199.51
Total			**3,382.52**	**1,991.86**
Grand total			**53,448.10**	**25,230.57**

[1]Includes amounts under Supplemental Reserve Facility
EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.
Data: IMF Treasurer's Department

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IMFSURVEY

Estonia establishes itself as market economy in position for accession to European Union

In 1991, after five decades of Soviet rule, Estonia regained full independence. It was left with an inefficient planned economy and large, albeit repressed, macroeconomic imbalances. Moreover, historical trade links to Scandinavian and other countries, dating back to the Hanseatic League and surviving under Swedish and Russian rule, had been severed during the Soviet occupation. The challenges of transition to a market economy and reintegration into the world economy seemed daunting indeed.

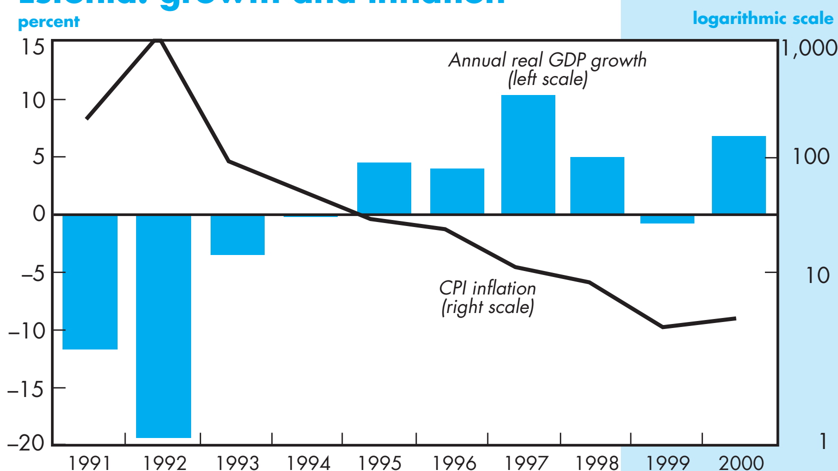
After a decade of independence, Estonia has established itself as a well-functioning market economy and a front-runner for accession to the European Union (EU). The cornerstones of its successful transition were the fast privatization of public enterprises with reliance on strategic foreign investors, a free trade regime, the early creation of a legal framework for private activity, full convertibility for current and capital account transactions, and a transparent policy framework, including the currency board arrangement. These reforms were expedited by the departure of most of the old political and economic elite and supported by a strong public determination—represented by the newly acquired democratic process—to free the economy from the legacies of Soviet planning. The successful implementation of IMF-supported programs (see below) and the prospect of EU accession also helped to provide a social and political catalyst for reform, as did financial and technical assistance from neighboring countries. Geographical advantages, such as ice-free ports and proximity to Helsinki, also played an important role. After 10 years of transition, challenges remain, but the medium-term outlook for the Estonian economy appears bright.

Ten years of transition

Following independence, Estonia's main reform goal was to curtail the role of the state while putting in place the mechanisms that would allow the country to operate as a market economy. The legal framework for private activity, including effective bankruptcy legislation, was enacted in September 1992. Privatization of small-scale enterprises, mostly shops and restaurants, had already started in March 1991 and was largely completed by the end of 1992. In June 1993, the Estonian Privatization Agency (EPA) was created to oversee the privatization of public enterprises. The EPA adopted the approach followed by the Treuhand in the former east Germany: large public enterprises, most of them in their entirety, were sold to strategic foreign investors that were willing to provide new investments and know-how to modernize the production process. This approach, together with the emigration of most of the old political and economic elite, successfully averted the governance problems and the "state capture" by vested interests that plagued privatization programs elsewhere. By the end of 1994, the agency had privatized more than 50 percent of all large public enterprises, and the share of the private sector in GDP began to exceed that of the public sector. The job of the EPA has been completed this year, with only a portion of the electricity sector left to be privatized.

The second goal of reform was to create an environment conducive to foreign trade and investment. Full convertibility for current account and most capital account transactions was established in June 1992.

Estonia: growth and inflation



Note: Official statistics probably overestimate the output decline in the earlier years (1991–93), as output at the beginning of transition was measured at inflated prices. See Anders Åslund, *The Myth of Output Collapse After Communism*, Carnegie Endowment Working Paper 18, 2001.

Data: Estonian authorities

Virtually all trade restrictions inherited from the former Soviet Union were dismantled at the same time. While a few tariffs on selected agricultural products were introduced in 2000 in preparation for EU accession, Estonia's trade regime remains one of the most liberal in the world.

An important priority of economic reform from the beginning was the achievement of macroeconomic stability. Most prices had already been liberalized by the end of 1991, but inflation became rampant throughout the ruble zone. In Estonia, inflation peaked at 80 percent a month in early 1992, while the economy was contracting sharply (according to official statistics, output declined by 19 percent in 1992, but the decline is

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probably overestimated, given the overvaluation of production during the Soviet period). Radical macroeconomic reform was needed, and public opinion was strongly behind this reform movement.

On June 20, 1992, the government created a new currency, the Estonian kroon, pegged at a fixed exchange rate of 8 krooni for 1 deutsche mark. The peg was guaranteed by a currency board arrangement, which by law required the Bank of Estonia to hold 1 deutsche mark of reserves for every 8 krooni in circulation or in bank deposits at the central bank. The currency board was a success: inflation fell from 1,069 percent in 1992 to 48 percent in 1994 and economic growth resumed (see chart, page 303). Under the currency board arrangement, the Bank of Estonia could no longer provide any domestic financing, either to the government or to commercial banks, except under exceptional circumstances. Before the currency reform, therefore, the government had to decisively cut its fiscal deficit to achieve a budget that could be appropriately financed. This established the important principle that fiscal policy needed to be subordinated to the currency board arrangement, a principle that has resulted in a very prudent fiscal policy for the past 10 years.

Estonia: selected economic indicators
(percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000
Real GDP (percentage change)	4.0	10.4	5.0	–0.7	6.9
CPI (average percentage change)	23.1	11.2	8.1	3.3	4.0
Unemployment rate (percent)	10.0	9.7	9.9	12.3	13.7
General government balance	–1.5	2.2	–0.3	–4.6	–0.3
Total public debt	8.0	7.6	6.4	7.2	6.2
Exports of goods and nonfactor services	67.1	78.4	79.7	77.2	95.4
Imports of goods and nonfactor services	78.6	90.0	90.1	82.1	100.4
Current account balance	–9.2	–12.2	–9.2	–4.7	–6.4
Gross international reserves (millions of DM)	995	1,363	1,364	1,667	1,942

Data: Estonian authorities

As a consequence, private sector activity started to thrive, particularly in small and medium-sized enterprises, driving output growth in the second half of the 1990s. The banking sector, liberalized at the end of Soviet rule, expanded rapidly in 1991–92. By the time of the currency reform, 41 banks were in operation. A period of consolidation followed, partly because of bank failures but also because of stricter licensing requirements and more stringent banking supervision, which led to a number of closures and mergers. By the end of 1997, the number of banks had fallen to 11.

The resilience of the Estonian economy was tested by the crises that erupted in Asia in 1997 and Russia in 1998. Between 1996 and 1997, Estonian banks overextended their portfolios, and exposure to external shocks was growing. When the Asian and Russian crises hit, foreign credit lines to commercial banks were suddenly withdrawn at the same time as the quality of the loan portfolio was deteriorating. These sudden shocks strained the Estonian banking system. Following the Russian crisis, economic activity also suffered because of the loss of a major export market, resulting in a brief recession in 1999. However, the problems in the banking system were resolved swiftly. In late 1998, Swedish banks bought majority stakes in the two largest Estonian banks. Smaller insolvent banks were closed or forced to merge with larger ones. One bank was taken over by the Bank of Estonia, restructured, and sold to foreign investors in 2000. Major foreign banks now control over 95 percent of all commercial banks' assets, and only six banks are currently in operation. According to a recent IMF–World Bank Financial System Stability Assessment, the health of the banking system has been restored and banking supervision has been substantially strengthened. Indeed, Estonian banks are increasingly playing an important role in neighboring countries, and nonbank financial services are expanding rapidly.

In May 1992, Estonia joined the IMF, which has been an important partner in Estonia's transition process. In September of that year, the IMF Executive Board approved a Stand-By Arrangement for $40 million in support of the reform effort; a second arrangement followed in 1993 for an additional $16 million, together with financial support to the government of $32 million under the IMF's Systemic Transformation Facility (a temporary facility established in April 1993 to provide financial assistance to transition economies. No purchases have been possible under this facility since the end of December 1995). The IMF also provided technical assistance in a number of areas, including central and commercial bank regulations, banking supervision, tax policy and administration, and statistics. Four precautionary arrangements spanned the period April 1995–August 2001. While no financial resources were disbursed during this period, IMF-supported programs provided a catalyst for social and political consensus on economic reforms. More recently, the goal of EU accession began to play a similar catalytic role.

Is the transition over?

The Estonian economy now bears little resemblance to the planned economy of a decade earlier. Between 1995 and 2000, economic growth averaged 5 percent and inflation declined to 4 percent (see table, this page). By 2000, exports of goods and nonfactor services accounted for 95 percent of output, the fiscal accounts were broadly in balance, and public debt was very small. According to the 2000 transition report of the European Bank for Reconstruction and Development, Estonia has achieved advanced economy standards in

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small-scale privatization and trade and foreign exchange systems, and is near those standards for large-scale privatization and the banking system. Estonia ranks ahead of many advanced economies in terms of competitiveness and transparency indicators, and its future prospects are very favorable. Notwithstanding the short-term risk of a sharp slowdown in the world economy, Estonia should be able to grow rapidly over the medium term, as prudent policies, low labor costs, and good EU accession prospects attract large foreign direct investment inflows. In turn, this should continue to support substantial improvements in living standards, thus narrowing the gap with EU income levels.

Challenges remain, however. Accession to the North Atlantic Treaty Organization and the European Union require significant additional spending, which may produce tensions within the government's balanced budget policy. The privatization of the energy power generators should be completed this year, but the electric distribution network remains in public hands. While agriculture is now fully privatized, land restitution has proved to be a drawn-out process. More important, the transition to a market economy has left a portion of the population behind. Unemployment—mostly concentrated in the Russian minority living in the northeastern region of the country—remains stubbornly high as a result of a skills mismatch, language differences, and limited geographical mobility. On balance, transition can be considered over in Estonia insofar as the establishment of a well-functioning market economy is concerned. Legacies of the past, however, remain, especially in the labor market, where only a longer period of sustained economic growth will integrate all members of society into the newly established market economy.

Although Estonia had important historical and geographical advantages, its success can be attributed as much to the country's radical reforms and stringent fiscal policies, which were transparent and enjoyed strong public support. The privatization with reliance on strategic foreign investors brought know-how, management skills, and good corporate governance. The early elimination of current account, capital account, and trade restrictions established an environment conducive to foreign trade and investment. The currency board arrangement provided a stable policy framework. All these reforms created a transparent framework that allowed a vibrant market economy to prosper. ■

Joannes Mongardini
IMF European II Department

Available on the web (www.imf.org)

Press Releases

01/35: World Bank Group and IMF Set Meetings for September 29–30, August 14

01/36: IMF Approves $111 Million Stand-By Arrangement for Lithuania, August 30

01/37: IMF Augments Argentina Stand-By Credit to $21.57 Billion and Completes Fourth Review, September 7 (see page 308)

News Briefs

01/83: IMF Approves $39 Million Disbursement to Jordan, August 29

01/84: IMF Executive Board Adopts Resolution of Appreciation for Stanley Fischer, August 30

01/85: IMF to Coordinate New Caribbean Regional Technical Assistance Center, August 31

01/86: IMF Invites Comments on Streamlining Conditionality, September 4 (see page 300)

01/87: IMF Completes Third Review of Indonesia Program, Approves $395 Million Disbursement, September 10

Public Information Notices

01/92: IMF Concludes Discussions on Strengthening IMF–World Bank Collaboration on Country Programs and Conditionality, September 4

01/93: IMF Concludes 2001 Article IV Consultation with the Kingdom of the Netherlands—Aruba and Staff Report, September 7

Speeches

Managing Director Horst Köhler—Dinner in Honor of Stanley Fischer, August 30

Stanley Fischer—Farewell Dinner, August 30

Stanley Fischer—Farewell to the IMF Executive Board, September 7

Transcripts

Press Briefings, Thomas Dawson, External Relations Department Director, August 30 and September 7

Letters of Intent and Memorandums of Economic and Financial Policies*

Jordan, August 29

Republic of Lithuania, August 31

Côte d'Ivoire, September 5

Indonesia, September 10

IMF Factsheets

Social Impact Analysis of Economic Policies (update), August 28

IMF Surveillance (update), August 28

Gold in the IMF (update), August 29

IMF Quotas and Quota Reviews, August 29

The General Arrangements to Borrow, The New Arrangements to Borrow (update), August 29

Debt Relief for Poor Countries: What Has Been Achieved? September 4

Debt Relief Under the Heavily Indebted Poor Countries Initiative, September 4

Special Drawing Rights, September 4

Fiscal Transparency, September 5

Report on the Observance of Standards and Codes*

Cameroon—Data Module, August 24

* Date posted.

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Fundamental reform

Cambodia takes first steps toward achieving sustainable development and poverty reduction

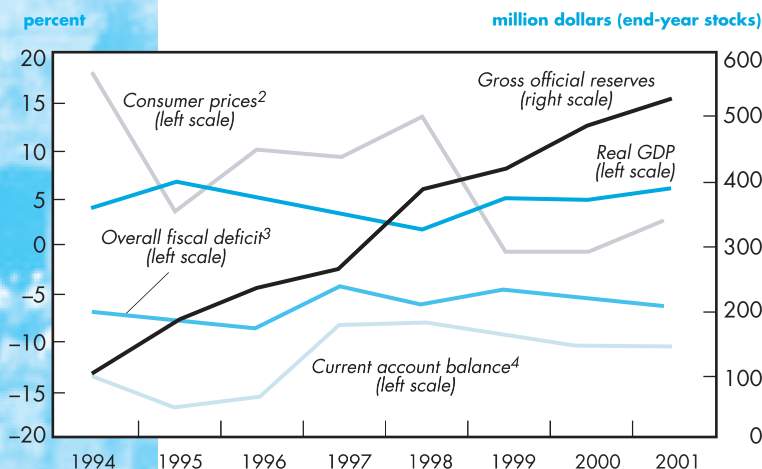
Since late 1998, when peace was secured and a coalition government formed, Cambodia has initiated fundamental reforms in many crucial areas. Significant progress has been made since the inception of the IMF-supported reform program, but Cambodia's economic position remains vulnerable. Much remains to be done to rebuild a society and an economy shattered by almost three decades of civil strife. Sustained development, and the alleviation of pervasive poverty, will hinge critically upon continued implementation of key structural reforms. Moreover, Cambodia's nascent democracy will be tested by upcoming communal and general elections slated for early 2002 and 2003, respectively.

Background

In the early 1990s, Cambodia first attempted to reconstruct its economy, supported by a United Nations–sponsored peace agreement and large inflows of international assistance. Reflecting a period of macroeconomic instability in the late 1980s and the large inflow of foreign aid, the economy became almost completely dollarized. But after an initial period of growth, ongoing civil strife and political instability interrupted reform efforts. Reconstruction efforts were not renewed until the late 1990s, when the country firmly unified under the control of one administration.

In a break from the past, the coalition government formed in 1998 committed itself to pursuing increased transparency within an open political and economic environment. These changes permitted important measures to be initiated, notably revenue-enhancing actions, improvements in forestry management, and banking reform. The IMF has supported the authorities' efforts since late 1999 under a three-year Poverty Reduction and Growth Facility (PRGF) in an amount of $81 million. Cambodia's IMF-supported reform effort chiefly aims to ensure macroeconomic stability, accelerate economic reconstruction, improve governance, and reduce poverty. These reforms are also being supported by a comprehensive Technical Cooperation Action Plan that addresses weaknesses in budgetary management, tax and customs administration, banking reform, economic statistics, and legal reform.

Cambodia: selected economic indicators



[1]Data for consumer prices and real GDP reflect annual percentage changes; those for overall fiscal deficit and current account balance refer to percent of GDP.
[2]End-period inflation.
[3]Excluding grants.
[4]Excluding official transfers.

Data: Cambodian authorities

Reforms and performance since 1999

Macroeconomic performance has strengthened since the beginning of the program. Economic growth has averaged around 5–6 percent since 1999, despite severe flooding in 2000. Buoyant garment exports, a recovery in tourism, and a continued increase in agricultural output have been the chief elements spurring economic growth. Inflation has also remained very low, reflecting fiscal and monetary restraint, improved food supply, and cheaper imports, owing to the depreciation of neighboring countries' currencies vis-à-vis the U.S. dollar.

Given an extremely low ratio of revenue to GDP and a pressing need to rebuild infrastructure and increase social outlays, Cambodia must substantially improve its revenue effort while redirecting military and security expenditures toward health, education, and rural development. The country has sharply improved its overall fiscal performance since 1999, increasing revenue by about 3 percentage points of GDP, reflecting, in part, the introduction of a value-added tax in 1999. Military expenditure has been reduced in tandem with increased social expenditure relative to GDP. The authorities have achieved fiscal restructuring while maintaining macroeconomic stability, as current budget surpluses have remained at about 1½ percent of GDP, and overall deficits, including development expenditure, have been contained at less than 6 percent of GDP (excluding grants). Cambodia has avoided domestic financing of the budget since 1999, thus providing room for an expansion in private credit.

The authorities have simultaneously pursued a prudent monetary policy aimed at low inflation and a stable exchange rate. The increase in broad money has been largely accounted for by an increase in net foreign assets, while net domestic assets of the banking system have declined, owing to the improved fiscal position.

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Mirroring the monetary policy stance, the riel has been relatively stable in U.S. dollar and real effective terms since late 1998; and official international reserves have increased to about three months of imports of goods and services. The external current account deficit has remained broadly stable at around 10 percent of GDP (excluding official transfers), because of the strong performance of garment exports. The authorities are liberalizing the trade regime in the context of meeting requirements for membership in the Association of South East Asian Nations and the World Trade Organization. The country's exchange system is free of restrictions on payments and transfers for current international transactions.

Cambodia has made substantial progress in implementing key structural reforms, although there have been delays in some important areas. The country's reform efforts have also focused on improving governance and combating corruption. The government established the National Audit Authority and approved the Governance Action Plan in early 2001. The authorities are disseminating the action plan among government agencies and are preparing an implementation plan and monitoring mechanisms.

Key features of the governance action plan are being assisted by the IMF-supported PRGF program, including reforms in budget management, tax and customs administration, financial sector reform, and preparation and dissemination of statistics. Initial steps to improve governance in the forestry sector have also been taken in recent years through the establishment of the Forest Crime Monitoring Unit—with the participation of an independent monitor—and the cancellation of noncomplying forestry concessions. A new forestry law, sent to parliament in mid-2001, provides the framework for sound governance, sustainable exploitation of forestry resources, and adequate revenue mobilization.

The authorities have made strides in restructuring the country's banking system since the passage of the Financial Institutions Law in mid-1999. The banking system, which provides only limited services and has not contributed to overall economic activities, is in need of deep restructuring. Since the beginning of the restructuring effort in late 1999, 29 commercial banks have been subject to a relicensing process, and 11 of these have been declared nonviable and had their licenses revoked. A restructuring process has begun for 14 potentially viable banks; the remaining banks were declared viable. In addition, the restructuring process legally separated the state-owned Foreign Trade Bank from the National Bank of Cambodia and led to the recapitalization of the former in mid-2001.

The ability to finance higher social spending as well as needed increases in civil service salaries will require the successful downsizing of the military. A successfully completed pilot military demobilization program in 2001 led the World Bank and other donors to endorse a $42 million comprehensive demobilization program in August 2001. This effort is intended to reduce Cambodia's armed forces by 20 percent during 2001–02—effectively demobilizing 30,000 soldiers. Cambodia also embarked on civil service reform, undertaking a census of civil servants in mid-1999, and subsequently created a computerized civil service payroll. With these data in hand, the authorities were able to remove irregularities from the payroll and accrue $1.2 million in annual savings. But low civil service salaries continue to severely hamper good governance and the efficient delivery of public services. A recently formulated civil service reform strategy for 2002–06 will provide higher incentives for senior managers, develop a merit-based job classification system and a new compensation system, and strengthen capacity building through enhanced human resources management.

Cambodia: key economic indicators

	1995	1996	1997	1998	1999	2000	2001 Proj.
Population (million; midyear)	10.7	11.0	11.6	12.3	12.7	13.0	13.3
GDP per capita (U.S. dollars)	289	287	266	229	237	248	259
	(percent change)						
Real GDP growth	6.7	5.5	3.7	1.8	5.0	5.0	6.0
Inflation rate (end-period CPI)	3.5	10.0	9.2	13.3	–0.5	–0.8	3.0
	(percent of GDP, unless otherwise indicated)						
Fiscal balances							
Revenue	8.5	9.0	9.6	9.0	11.7	11.8	12.2
Expenditure	16.0	17.3	13.8	14.9	16.1	17.3	18.3
Current balance	–0.8	–1.2	0.7	–0.3	1.8	1.5	1.3
Overall balance (excl. grants)	–7.5	–8.3	–4.1	–6.0	–4.4	–5.5	–5.7
External balances							
Current account balance (excl. official transfers)	–16.7	–15.5	–8.1	–8.0	–9.4	–10.4	–10.4
Gross official reserves (months of import of goods and services)	1.5	2.1	2.4	3.5	3.3	2.8	2.8

Data: Cambodian authorities; and IMF staff estimates

Challenges ahead

While initial performance under the reform effort has been good, there is little room for complacency. Significant actions will be needed in the period ahead to firmly establish a basis for sustainable growth and reduced poverty. Governance and transparency issues remain at the forefront of Cambodia's reform agenda. In this regard, strict adherence to the actions and timetable set forth in the Governance Action Plan will be crucial. Central to improving governance will be the establishment of a modern legal and judiciary system

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that can provide for a clear rule of law and modern commercial laws and regulations. In addition, effective operation of the National Audit Authority will have to be demonstrated. Fiscal transparency should benefit from the ongoing strengthening of budget management procedures under the Technical Cooperation Action Plan. The establishment of a reliable, timely, and comprehensive statistical framework is still required.

The essential macroeconomic challenge in the period ahead is to further improve budgetary performance through revenue mobilization and increased spending for the social sectors. However, options for further increasing tax revenue are constrained to a few economically challenging and politically difficult measures, given the limited direct tax potential at Cambodia's current level of development. In this context, efforts to increase tax revenue will need to focus on broadening the tax base and improving tax administration while strictly limiting exemptions. The ability to raise government salaries in the future, as the civil service reform strategy calls for, is directly tied to achieving annual targets for revenue performance and military demobilization.

Timely implementation of the bank restructuring process and payments system reform will be crucial in broadening financial intermediation. In the period ahead, the authorities will face additional challenges with bank restructuring, including smooth liquidation of nonviable banks, monitoring of bank asset quality, and modernization and privatization of the Foreign Trade Bank. With respect to external policies, Cambodia still needs to refrain from contracting nonconcessional foreign borrowing and to resolve outstanding debt reschedulings with major bilateral creditors.

Angkor Wat—a recovery in tourism has been one of the chief elements spurring Cambodia's economic growth.

Cambodia's medium-term strategy to support a rate and a pattern of economic growth consistent with drastic reductions in poverty is set forth in its interim poverty reduction strategy paper (PRSP) and the forthcoming second Socioeconomic Development Plan for 2001–05, developed in conjunction with the IMF, the World Bank, and the Asian Development Bank. A further elaboration of the strategy is expected in 2002, when Cambodia completes a full PRSP exercise. ■

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IMF augments Argentina Stand-By credit

On September 7, the IMF Executive Board approved an augmentation to SDR 16.9 billion (about $21.6 billion) of Argentina's Stand-By credit, initially approved on March 10, 2000, and augmented on January 12, 2001. The full text of Press Release 01/37, as well as 00/17 and 01/3, is available on the IMF's website (www.imf.org).

The Executive Board's decision, which was made in conjunction with the completion of the fourth review of Argentina's program supported under the original Stand-By credit, makes SDR 4.9 billion (about $6.3 billion) available immediately, of which SDR 4.0 (about $5.05 billion) is under the new augmentation. An additional drawing of SDR 976.2 million (about $1.2 billion) would be made available later in 2001 following the completion of the fifth review of the program. Further credit will be made available in 2002, according to a schedule yet to be specified (SDR 5.4 billion or about $6.9 billion), and in 2003 (SDR 764 million or about $973 million). Up to the equivalent of $3 billion of the drawings scheduled for 2002 may be brought forward to support a voluntary and market-based operation to improve Argentina's debt profile.

The authorities' revised program centers on a fiscal policy geared to the immediate elimination of the federal government deficit, in line with the requirements of the "zero deficit" law. The announced policies, if firmly implemented, are expected to result in a lasting decline in the risk premium on Argentine debt and of domestic interest rates, thus creating conditions for a modest recovery of real GDP growth in the final quarter of 2001 that would pave the way for growth of about 2.5 percent in 2002.

Commenting on the Executive Board discussion, Anne Krueger, IMF First Deputy Managing Director and acting Chair, said, "The IMF welcomes the major strengthening of the fiscal effort in the reformulated program of the Argentine authorities, which should restore macroeconomic stability and address important structural impediments to a recovery of investment and output."

Argentina joined the IMF on September 20, 1956. Its quota is SDR 2.1 billion (about $2.7 billion). Its outstanding use of IMF credit currently totals SDR 6.5 billion (about $8.3 billion).

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