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East AFRITAC opening

New center aims to strengthen East Africa's capacity to manage economic policies

Tanzanian President Benjamin William Mkapa's remarks on the inauguration of East AFRITAC could not have been clearer or more emphatic. If Africa is to define its own economic destiny, it must strengthen its ability to design and implement sound economic policies. And policy ownership and capacity building are what the new regional technical assistance center, which opened October 24 in Dar es Salaam, is all about.

East AFRITAC's member countries

The East Africa Regional Technical Assistance Center, or East AFRITAC, whose member countries are Eritrea, Ethiopia, Kenya, Rwanda, Tanzania, and Uganda, is one of the first products of Africa's request for help in strengthening institutions and in designing and implementing better policies, notably within the context of its New Partnership for Africa's Development. The AFRITAC concept—the development of regional centers for capacity-building technical assistance—is the central component of the response by the IMF and its donor partners, which, as of today, are China, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Norway, Russia, Sweden, the United Kingdom, and the African Development Bank. Two AFRITACs are planned for the near term. East AFRITAC is the first to open; another center, serving francophone west African countries, is expected to open in early *(Please turn to the following page)*

IMF, trade unions continue frank dialogue

On October 21–23, about 90 trade union representatives from 40 industrial, developing, and transition countries met with IMF and World Bank management and staff for a wide-ranging discussion of economic and labor-related issues. The meeting, continuing the exchange of views between the Bretton Woods institutions and the global labor movement that began a decade ago, renews a commitment to maintain a frank, open, and constructive dialogue.

Michael Sommer (right), President of Deutscher Gewerkschaftsbund, joins IMF Managing Director Horst Köhler for a meeting at the Managing Director's office.

The third day of the meetings took place in the IMF and was chaired by Willy Kiekens, an IMF Executive Director whose constituency includes several Eastern and Western European countries as well as Turkey, Belarus, and Kazakhstan. In an earlier meeting between the IMF Executive Board and labor unions, Kiekens paid tribute to this 10-year dialogue. It was begun, he explained, by former IMF Managing Director Michel Camdessus. In that first meeting, Camdessus promised that the IMF would pay more attention to poverty reduction, income distribution, and social safety nets. *(Please turn to page 359)*

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AFRITAC stresses country involvement

Tanzanian President William Mkapa (right, with Eduardo Aninat): East AFRITAC reflects "unprecedented mutual respect" between the IMF and African countries.

(Continued from front page)
2003. If an independent study, to be conducted in 18 months, deems the two centers effective, additional ones will be established.

The AFRITAC initiative builds on efforts already under way in Africa, notably the Partnership for Capacity Building in Africa and its implementing agency, the African Capacity-Building Foundation, the latter of which the IMF joined earlier this year. The attention to capacity building is also linked to IMF and World Bank efforts, in cooperation with donor partners, to build country ownership of poverty reduction efforts, particularly in the context of the participatory policy design process associated with poverty reduction strategy papers, or PRSPs.

There are those in the world, Mkapa noted, who still think that poor countries seeking aid from the IMF and the World Bank, to paraphrase Alfred Lord Tennyson's poem "Charge of the Light Brigade," have "no right to ask, no right to reply, no right to reason; only to do and die in the valley of economic bondage and assured death of sovereignty." Nothing could be further from the truth, he said. East AFRITAC reflects "unprecedented mutual respect" between the IMF and African countries, and its members intend to use East AFRITAC's assistance "to self-develop, to plan strategically, to ask the right questions, to reply intelligently to questions about the decisions we make, to reason deeply and logically, and certainly not to do and die at the behest of anyone outside our countries!"

Institutions matter

As both IMF Deputy Managing Director Eduardo Aninat and Abdoulaye Bio-Tchané, Director of the IMF's African Department, underscored in their remarks at the inauguration, strong domestic institutions play a vital role in development. If anything, the importance of domestic institutions has grown as economies have become more market driven. Aninat noted that "strong domestic human and institutional capacity is both a precondition for economic development and an 'insurance policy' in cases of external shocks."

These institutions also have a strong human component. In the past, Neway Gebre-ab, Chief Economic Advisor to the Prime Minister of Ethiopia, explained, many of the trained and most talented staff left public service, discouraged by past political

East AFRITAC operations

The AFRITAC initiative, which will ultimately establish several regional technical assistance centers, is part of an ambitious IMF-sponsored capacity-building effort in Africa. East AFRITAC is the first of these centers to begin operations.

The AFRITAC concept builds on experience in the Caribbean (CARTAC) and the South Pacific (PFTAC). These centers have found that a regional approach to identifying and meeting technical assistance needs ensures a greater opportunity for, and a stronger voice from, country officials in setting priorities. And that, in turn, enhances both country ownership and commitment and encourages an efficient use of scarce resources. Placing technical assistance resources directly in the region has the added advantage of increasing staff familiarity with the needs of the area and allowing for a more flexible and rapid response to capacity-building requirements.

East AFRITAC will be staffed by five resident experts and a center coordinator, John Crotty. Their work will be supplemented by short-term specialists. Tanzania generously provides office space and logistical support for the center, with a major part of the financing (more than 60 percent) underwritten by bilateral and multilateral donors, and the remainder furnished by the IMF.

Even before the center opened, much work was done by a small IMF team headed by Piroska Nagy of the African Department and Claire Liuksila of the Office of Technical Assistance Management. After start-up meetings in Addis Ababa in late May, the AFRITAC beneficiary countries prepared their capacity-building needs assessments and discussed them with IMF experts, the African Development Bank, the World Bank, and donor representatives in June.

A steering committee made up of senior officials from the participating countries and from agencies and donors supporting the center held its first plenary session on October 23 under the leadership of Daudi Ballali, Governor of the Bank of Tanzania. Among other matters, it discussed the center's work plan and the framework for monitoring and evaluating the center's work.

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regimes or by poor appreciation for their skills. Liberalization has made the loss of these skills obvious and the need for capacity building great.

Not just "technical" or "assistance"

The world and its institutions are changing and so, too, is technical assistance, Mkapa said. In remarks to an East AFRITAC workshop on capacity building, Director of the IMF's Fiscal Affairs Department Teresa Ter-Minassian emphasized how crucial it was to understand that technical assistance can no longer be thought of as simply "technical" or "assistance" to passive recipients. Countries themselves must make key strategic choices, she said, and it is they who will bear responsibility for the results of these policies. Gone, too, is a technical assistance driven by short-term expediency—one that largely amounted to gap-filling and fire fighting.

Given the fast-paced nature of the global economy, it is also essential, Mkapa noted, to stress flexibility and a willingness to experiment. If Africa is to adapt to a relentlessly changing world, he said, it cannot be bound by old ways. Citing Keynes's dictum that "the difficulty lies not so much in developing new ideas as in escaping from old ones," Mkapa looked to increased capacity to help East Africa's countries shape new policy ideas and leave behind "a world that remains only in our imagination."

The region's capacity-building effort will not start from scratch. East Africa has a long history of technical cooperation with the IMF and other institutions. Workshop participants paid tribute to East AFRITAC's member countries, which have already made substantial efforts to strengthen their institutions, often in difficult circumstances. Some countries have been to the brink of chaos and collapse, but they have striven to reestablish stability, rebuild or even, in some cases, create institutions, change policies, and set their economies on a path of sustainable growth.

Economic focus

The region's commitment to ownership and institution building will give East AFRITAC a running start in terms of defining needs and setting an ambitious agenda for itself. The center's work program is meant to reflect the IMF's traditional areas of expertise: macroeconomic policy, tax and revenue administration, public expenditure management, monetary policy, exchange rate regimes, financial sector sustainability, and statistics. And there is wide consensus, as the workshop indicated, on what the center's priorities should be. These include the following:

Central banks. Macroeconomic management is impossible without a sound and respected institution to maintain price and financial stability. It will be vital to develop more effective monetary instruments, interbank money and foreign exchange markets, and treasury bill markets, and to strengthen banking system regulation and supervision to help national authorities better manage risks.

Fiscal policy. For countries seeking to reduce poverty, spur growth, and integrate their economies into the global economy, there is major work to be done in the fiscal arena. The center will give priority to improving the capacity of governments to raise revenue and use public resources more efficiently. Its assistance is expected to help countries strengthen budget management, which is a key step if countries are to direct more resources to poverty reduction within a sustainable macroeconomic framework; ensure accountable public expenditure management; and improve revenue administration, where expanding the tax net to a private sector long characterized by informal activity will be a major challenge.

Neway Gebre-Ab (left, with Alemseged Assefa Vice-Governor, National Bank of Ethiopia): In the past, many of the trained and most talented staff left public service.

Decentralization. It is critical for poverty reduction that lower levels of government develop the capacity to use public resources effectively—whether for education, health, or other social services. The center will assist both central governments and local governments in this process.

Statistics. Timely and accurate economic, financial, and sociodemographic statistics are essential if countries are to formulate effective policies, monitor their implementation, and assess their impact. All of East AFRITAC's members either are participating in the General Data Dissemination System or have expressed a strong interest in doing so. Tanzania's and Uganda's efforts to strengthen their statistical systems are expected to provide a good framework for the center's work in other countries. The statistical work is expected to emphasize the integrity, transparency, and legal basis of statistical processes and institutions as well as the quality of the data they produce.

Teresa Ter-Minassian (left, with Piroska Nagy): It is crucial to understand that technical assistance can no longer be thought of as simply "technical" or "assistance" to passive recipients.

Economic development requires skilled public officials as well as appropriate policies. In recent years, the IMF Institute and the Joint Africa Institute, which is supported by the IMF, the World Bank, and the African

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The AFRITACS represent a new partnership between providers and recipients of technical assistance.
—Sergeant and Manno

Development Bank, have stepped up and diversified their efforts to train African officials. The Africa Capacity-Building Foundation, in partnership with the IMF, will develop training programs responsive to the particular needs of each of East AFRITAC's member countries, including the postconflict countries. The first emphasis will be on a strong program to "train the trainers."

Making East AFRITAC work

What is needed to ensure the center's success? Aninat cited six key ingredients: country ownership, mutual accountability, well-defined and time-bound capacity-building targets, effective donor coordination, an overarching reform process, and an external environment that rewards reform. Mkapa, too, pointed to the value of carefully formulated and time-bound programs, effective coordination of ongoing efforts, mutual accountability of stakeholders, and meaningful benchmarks against which to assess the effectiveness of the center's assistance.

Certainly, Aninat reiterated, the IMF views country ownership as essential. "We have listened to, and worked very closely with, country officials in mapping out the work priorities of the center." There is also hope, as Rwanda's Minister of Finance and Economic Planning Donald Kaberuka noted, that the center's regional approach will encourage active peer review and allow member countries to learn from each other.

There was complete agreement on how important the governance structure of the center would be—in particular, the role of the steering committee. East AFRITAC's steering committee, which includes representatives from all member countries as well as from donor partners and the IMF, will provide guidance on the center's priorities. All agreed that emphasis should be placed on clear goals and timetables to ensure accountability and on a well-designed monitoring and feedback process.

The context in which AFRITAC operates also matters a great deal, Aninat said. With pressing needs and scarce resources, donors must coordinate their work. He also indicated that capacity building can be sustained only in the context of a comprehensive reform effort, most notably in countries' civil services. Retaining trained civil servants is a precondition, he said, "to achieving the ultimate objective of establishing durable institutions and strong capacity."

Speaking as a former finance minister, Aninat also offered some practical political advice. Capacity building is not a friction-free process: government officials will have to contend with vested interests. Reformers can win this battle, he said, but having the right external incentives in place can prove a potent ally. The prospect of European Union accession, which helped fuel Eastern Europe's transformation, may have been a unique circumstance, but Aninat suggested that the international community could do more to develop appropriate incentives for Africa. It could begin, he said, by removing current disincentives—namely, the industrial country subsidies that constrained the growth potential of many African economies.

Fruitful partnership

As Caroline Sergeant of the U.K. Department for International Development, and Francesca Manno, Advisor to the IMF Executive Director for Italy, observed, the AFRITACs represent a new partnership between providers and recipients of technical assistance. Constructive consultation and dialogue can help both to sharpen the design of that assistance and to deepen its impact. A successful East AFRITAC, Mkapa said, will make itself superfluous. It will be "a bridge to help us cross the divide from low to high capacity, nationally and regionally." ■

Available on the web (www.imf.org)

News Briefs

02/110: IMF Completes Third Review of Pakistan's PRGF-Supported Program, Approves $114 Million Disbursement, November 1

02/111: Statement by Horst Köhler, IMF Managing Director, on the Work Program of the Executive Board, November 7

Public Information Notices

02/122: IMF Executive Board Discusses the Monetary and Exchange Rate Policies of the Euro Area and the Trade Policies of the European Union, October 29

02/123: IMF Concludes 2002 Article IV Consultation with Burundi, October 30

02/124: IMF Concludes 2002 Article IV Consultation with Germany, October 31

02/125: IMF Concludes 2002 Article IV Consultation with Suriname, November 1

02/126: IMF Concludes 2002 Article IV Consultation with Botswana, November 1

02/127: IMF Concludes 2002 Article IV Consultation with Oman, November 6

02/128: IMF Concludes 2002 Article IV Consultation with Pakistan, November 6

Speeches

Farewell Speech to the Executive Board, Alexandre Barro Chambrier, IMF Executive Director, October 30

Transcripts

Conference Call on the Euro Area, by Michael Deppler, Director, IMF European I Department, October 29

Press Briefing by Thomas C. Dawson, Director, IMF External Relations Department, November 7

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Caribbean center chalks up impressive start

The Caribbean Regional Technical Assistance Centre (CARTAC), located in Barbados, is celebrating its first anniversary, and its ambitious work program suggests it got off to a flying start.

CARTAC—like East AFRITAC—is one of a new breed of regional technical assistance centers established by the IMF in cooperation with other bilateral and multilateral agencies. Moving the source of technical assistance and training closer to the recipient countries and territories is intended to improve efficiency, responsiveness, and relevance. The centers are also able to support greater international and regional technical cooperation on economic and financial management issues and help coordinate technical assistance.

CARTAC was created to enhance the Caribbean's institutional and human resource capacities in macroeconomic—including fiscal and monetary—management (see box). It helps members strengthen economic and financial governance; provides hands-on technical advice and training; offers courses, seminars, and workshops; and arranges professional attachments. It also works closely with other regional bodies, such as CARICOM, the Caribbean Development Bank, the Caribbean Organization of Tax Administrators, and the Organization of Eastern Caribbean States; with international organizations, such as the United Nations Development Program, the World Bank, and the Inter-American Development Bank (IDB); and with bilateral development agencies.

In its first year of operations, CARTAC undertook 47 technical assistance missions to 14 countries; supported 8 technical conferences, involving over 300 participants; conducted 16 training courses or workshops for almost 600 trainees; provided 24 regional and 10 international specialized consultancies; and arranged 5 professional attachments.

Among CARTAC's principal activities have been the following:

An integrated regulatory framework for the Eastern Caribbean financial sector. Even before September 11, 2001, Eastern Caribbean countries were being called on to monitor and regulate their on- and offshore financial sectors more effectively. CARTAC, working closely with the Eastern Caribbean Central Bank (ECCB), has developed a strategy to strengthen the supervision and regulation of banks and nonbank financial institutions. A key element of this is a move toward a common supervisory and regulatory framework and the establishment of a single regulatory and supervisory unit in each country. CARTAC is helping countries review and redraft legislation, advising on an appropriate institutional framework, and providing training in inspection and supervisory techniques and practices.

At an April meeting in St. Lucia to discuss strengthening financial sector supervision are (left to right) Desirée Cherebin, CARTAC bank supervision advisor; Errol Allen, Deputy Governor, East Caribbean Central Bank (ECCB); and Mignon Wade, head, bank supervision, ECCB.

Strengthening Guyana's financial sector. In conjunction with the IDB, CARTAC is working with Guyana to improve supervision and regulation of its financial sector. Major elements of this project are the reorganization and skills upgrading of the banking supervision department of the Bank of Guyana.

Fiscal reform in the Eastern Caribbean. Since early 2002, CARTAC has been working with the ECCB and its member states to improve public expenditure management. Weaknesses in budgetary processes and fiscal management have contributed to poor fiscal

How does CARTAC work?

CARTAC's steering committee, which has eight members from the region and four from supporting multilateral and bilateral agencies, meets every six months to set priorities, review activities, and approve work plans.

The IMF is the executing agency for CARTAC but not, by any means, its major shareholder. CARTAC is funded in part by participating countries and territories—Anguilla, Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, British Virgin Islands, Cayman Islands, the Turks and Caicos Islands, and the Dominican Republic. The Canadian International Development Agency provides the bulk of the funding, with additional resources supplied by the Caribbean Development Bank, the Inter-American Development Bank, the IMF, the United Nations Development Program, the World Bank, Ireland, the United Kingdom, and the United States. The European Union expects to start contributing in late 2002 or early 2003.

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performance in a number of ECCB member countries. If the currency union is to deliver its expected benefits, its members need to agree on, develop, and implement fiscal rules, procedures, and convergence criteria and address institutional deficiencies in public expenditure management systems. CARTAC is providing ongoing assistance to guide and monitor implementation of the public expenditure management reform programs identified at the symposium sponsored by CARTAC and ECCB in June 2002.

Stabilization and adjustment programs in the Eastern Caribbean. In parallel with the public expenditure management reforms, CARTAC helped fund a financial programming training course for the ECCB and its members in April 2002. Country teams are now working with CARTAC experts using financial programming techniques to design, implement, and monitor "homegrown" stabilization and adjustment programs.

Trinidad and Tobago's public financial management reform. Trinidad and Tobago has sought CARTAC's assistance in designing a comprehensive reform program to modernize its public expenditure management systems. A CARTAC-supported national conference on public expenditure management held in July culminated in a consensus on the program's objectives and main elements. The authorities have asked for CARTAC's continued assistance in designing the strategic plan and advising on how to manage its implementation.

Tax reform. CARTAC has helped organize, and participated in, two IMF technical assistance missions to help Guyana and The Bahamas draw up plans for comprehensive reforms of their tax systems and administrations. Once policy decisions are made, CARTAC is expected to assist with implementation.

CARTAC also supports the work of the Eastern Caribbean Tax Commission and, in cooperation with the IMF's Fiscal Affairs Department, is advising on the preparation of a road map for tax reform in each ECCB member country within an agreed subregional framework.

Tax administration. CARTAC is helping Barbados improve certain elements of its tax administration, which will serve as both a model and a training resource for other tax administrations in the region.

Expanding statistical capacity. CARTAC and the ECCB have jointly visited each ECCB member country to help develop action plans to improve basic statistical operations. CARTAC is providing hands-on assistance to these and other countries to implement statistical improvements, as well as helping to organize a Caribbean-wide national accounts training course in cooperation with CARICOM. It is also developing a computer-based program, in cooperation with Statistics Sweden, to improve the compilation of national accounts in all Eastern Caribbean countries. The new program will be introduced over the next 18 months.

Over the first year, CARTAC has been active in The Bahamas, Belize, Suriname, and the Turks and Caicos Islands. In this period, the scope of CARTAC's work has expanded well beyond initial expectations. As Marion Williams, Governor of the Central Bank of Barbados and chair of CARTAC's steering committee, notes, it is the center's clients who ultimately judge the quality of CARTAC's work. Early feedback suggests they have been more than satisfied, and she is confident that the results of a midterm review of CARTAC's operations in the first half of 2003 will be positive and look beyond CARTAC's current three-year time horizon. ■

Nigel Bradshaw
IMF Program Coordinator, CARTAC

World Bank launches website for country analytic information

On October 31, the World Bank launched a website making it possible for multilateral and bilateral agencies to share information on country analytic work. Through the Country Analytic Work partnership website (www.countryanalyticwork.net), donor agencies will share analysis, good practices, and advice to strengthen policy dialogue; develop and implement country strategies; and carry out sound lending operations. The website will help donor institutions and their clients use development resources more efficiently, avoid duplication, and build capacity. It will also provide information on development challenges in particular countries and regions.

The website will collect and provide information on country analytic work in a number of areas:

- Lists of recently completed, ongoing, and planned projects.
- Information on programming, implementation, and quality assurance procedures.
- Names and e-mail addresses of contact points and staff in charge of sector-specific work.
- Joint and agency-specific toolkits for products.
- Examples of best practices and newly released country analytic work.
- Disclosure policies and appropriate contacts to access confidential documents.

To date, there is information from eight of the participating agencies, including the IMF, on the website.

For more information, see the full text of World Bank News Release No. 2003/129/S at www.worldbank.org.

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Labor and IMF exchange views on reforms

(Continued from front page) Camdessus also linked democracy to truly representative trade unions; each has an important role to play in ensuring accountable and responsive governments. Kiekens noted that, in his own service on the Executive Board, he had witnessed several instances where trade union officials were the first to alert the IMF to serious governance problems and to ask for help in fighting corruption.

Over the past 10 years, Kiekens said, the IMF has become dramatically more open. It now actively seeks out the views of civil society, including trade unions. He highlighted the benefits that have been drawn from poverty reduction strategy papers. Three years of experience with this broadly inclusive and participatory process, he said, have produced a real breakthrough in IMF and World Bank relations and in the relations between these institutions and trade unions and nongovernmental organizations.

In the October 23 meeting, IMF Managing Director Horst Köhler and staff from the IMF's Policy Development and Review (PDR) Department, including its director, Timothy Geithner, met with the labor leaders to exchange views on the state of the global economy and on progress with IMF reforms, including efforts to strengthen crisis prevention and resolution. The labor leaders welcomed Köhler's vision of the IMF as an institution open to learning from its dialogue with civil society and committed to reforms. Like Köhler, they looked forward to a further strengthening of this dialogue at both the country and the global level. Labor leaders offered some support for the IMF's proposed sovereign debt restructuring mechanism (SDRM), although they preferred a more powerful version that would more closely resemble a domestic insolvency regime with an independent arbitration panel named by debtor countries and creditors.

On proposals to allow countries to question the legality of debts incurred by corrupt governments and on the use of sanctions to force the return of capital, Geithner and the trade unionists found their views further apart. Geithner cautioned that provisions allowing countries to disavow the debt of previous regimes might chill lenders' enthusiasm, and he suggested that the best recipe for recapturing financial flows was creating the right economic environment.

Mark Allen, Deputy Director of PDR, reviewed the IMF's efforts to improve its oversight (surveillance) of countries' economic policies and of financial sector soundness and to promote greater transparency and adoption of international standards. More work is needed, he said, including with regard to corporate governance in major industrial countries.

In view of the continued potential for instability, labor leaders favor greater regulation of the international financial system, including through capital controls and a currency transactions tax (Tobin tax) to reduce speculative currency flows and raise resources for poverty reduction efforts. Allen said that the IMF tends to view the Tobin tax as peripheral to the real problem—the excessive international borrowing that can occur with open capital markets. The question, he indicated, is whether more effective restraints can be placed on the amount of international borrowing that countries permit their banks, corporate sectors, and governments to undertake.

Ronald Janssen (left), Expert, Belgium's Confédération des syndicats chrétiens; Willy Thys (center), Secretary General, World Confederation of Labor; and Bogdan Hossu (right), President of Romania's CNS Cartel Alfa.

Also of concern to the trade unions is the degree of local labor union participation in the poverty reduction strategy paper process and the quality and frequency of contacts between trade unions and the leaders of IMF country missions. In addition, they expressed support for the creation of a global economic and social council at the United Nations to oversee the interaction of the various international agencies.

While not discounting the usefulness of appropriate global structures, Reinhard Munzberg, the head of the IMF's United Nations office, said that, at present, the emphasis is on ensuring that existing institutions focus on their own areas of expertise and coordinate progress toward meeting the UN's Millennium Development Goals. ■

Rodolfo Daer (left), General Secretary of Confederación General del Trabajo de la República Argentina, with Betty Cortéz Benitez of Peru's Confederación Unitaria de Trabajadores.

Photo credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 353, 359–61, and 366–68; Piroska Nagy for the IMF, pages 354–55; Nigel Bradshaw for the IMF, page 357.

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Per Jacobsson lecture

U.S. investment spending collapse: what caused it? what have we learned?

On September 29, on the fringes of the Annual Meetings of the Governors of the IMF and the World Bank in Washington, E. Gerald Corrigan, Managing Director of Goldman, Sachs & Company, delivered the 2002 Per Jacobsson lecture, "The Boom-Bust Capital Spending Cycle in the United States: Lessons Learned." His remarks are summarized here; the full text is available at www.perjacobsson.org.

Although the extraordinary run-up and even more spectacular collapse in technology-related U.S. investment spending during the second half of the 1990s and the first two years of the new decade are still recent history, Corrigan believes we already know a fair amount about this "episode." Understanding how these factors not only influenced but dominated behavior is central to our ability to better understand what could have moderated the course of events and what can be done to help prevent or mitigate such episodes in the future.

Corrigan (left, and former IMF Managing Director Jacques de Larosière): Much of what has taken place has been forced by technology, and deregulation favors competition and the consumer.

Why did capital spending surge?

Three separate but related phenomena drove the surge in investment: a burst of new technology, notably related to the Internet and telecommunications; an erosion of business practices; and "hype" associated with the so-called new economy.

Technology. The 1990s saw three technology-related forces at work that were guaranteed to spur a dramatic surge in capital spending. Two of these were major technological platform changes—moves to a client-server platform and the Internet platform. While both of these proved to be watershed developments, their implications for capital spending were, in some respects, working at cross-purposes. The client-server platform called for greater decentralization, whereas the Internet platform pointed toward more centralization. According to Corrigan, these opposing forces caused redundancies and inefficiencies in capital spending. To further complicate matters, the industry had to contend with a third factor that had enormous implications for capital spending on technology—the approach of Y2K. The stage was set for a binge in capital spending.

As these forces fed upon themselves, it should have been more clear that capital spending was destined to overshoot. One reason, Corrigan said, was fear of being left behind. Worries about finding themselves technologically obsolete were so powerful that many companies felt compelled to push ahead with spending programs, even when there may have been doubts about their timing, if not their merits.

Erosion of business practices. Driven in no small way by technology itself, the day-to-day operations of virtually all businesses had become substantially more complex, especially in financial terms. In ways that were not fully understood, these added elements of financial complexity contributed to a breeding ground for excesses and abuses that would become more evident when, as was inevitable, the bloom came off the rose.

These financial complexities, Corrigan argued, placed enormous pressures on an already complex rules-based accounting system in the United States that was ill equipped to cope with the pace of change. Similarly, sensitivity to conflicts of interest also began to erode—a problem that, regrettably, took on particularly distasteful dimensions in the financial sector. Finally, complexity also strained some of the pillars of corporate governance, such as the ability of boards of directors to grasp highly technical—as opposed to managerial—issues. However, Corrigan insisted, even absent the extremes of Enron, WorldCom, Tyco, and others, there was a compelling case for serious reform in a number of areas of business practice.

"Hype" over the new economy. As the second half of the 1990s unfolded, the macroeconomic and macrofinancial performance of the U.S. economy reached or exceeded benchmarks that only a few years earlier seemed unthinkable. At some point, Corrigan said, the term "new economy" became part

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of our daily vocabulary. The euphoria associated with this concept reached virtually every segment of society, public and private. Needless to say, for those who believed that the performance of the U.S. economy in the second half of the 1990s would be sustained into the new decade, the stock market was the place to be.

The perfect storm

Any one of these three forces was quite capable of producing some economic instability. But, as with the three storms tracked in the book and movie *The Perfect Storm*, when these three forces combined and interacted, the result was a chain reaction of events that had devastating consequences. And, unlike the meteorological event, the aftereffects of this perfect storm will not dissipate quickly.

The episode of the late 1990s, Corrigan noted, had all of the classic trademarks of the boom-bust cycles that have characterized recorded economic and financial history for centuries. Only history can judge how this episode—in both its diagnostics and its consequences—stacks up against others. However, one does not have to wait for history's verdict to ask whether, even now, there are lessons for the future.

Lessons for public policy

Could certain public policy initiatives have prevented or moderated the episode? Some have suggested that deregulation in a number of industries went too far. But, Corrigan warned, this suggestion badly misses the point. Much of what has taken place has been forced by technology, and deregulation, he argued, favors competition and the consumer. While there may be room for some regulatory fine-tuning, "re-regulation" would be counterproductive.

Similarly, fiscal policy is not equipped to deal with this kind of boom-bust problem except, perhaps, for some targeted changes in tax policy on which, Corrigan admitted, he had neither the experience nor the expertise to comment. Thus, countries are left with monetary policy or regulatory policy, or some combination of the two.

Monetary policy is a remarkably flexible macroeconomic stabilization tool. It is also a blunt tool, Corrigan said, that works through interest rates, exchange rates, or both. Therefore, the policy goals for most central banks are stated in broad terms and focused on price stability and/or sustainable economic growth. Not surprisingly, when asset price distortions (bubbles) occur, the question often arises as to whether central banks should target their policies at specific variables, such as stock prices. However, the overall cost of targeting such variables through the use of interest rate policy would almost certainly impose crushing costs on sectors of the economy that are not experiencing asset price inflation and have delayed and uncertain effects on the asset price inflation itself. Thus, Corrigan argued, targeting selective asset prices, or the single-minded pursuit of a policy to burst an asset price bubble at any cost, is fundamentally incompatible with sound and sensible monetary policy.

Corrigan: "There will often be a fine distinction between public disclosures that enlighten and those that may confuse."

There may, however, be circumstances in which sharp and persistent increases in asset prices justify a somewhat higher level of interest rates than if policy were focused only on the implications of these prices for the near-term outlook. Needless to say, any such tilt in interest rate policy would have to be seen as being broadly consistent with core policy objectives and not as making specific asset prices a direct goal or target of policy.

Lessons for regulatory policy

Can one or more elements of regulatory policy help prevent or limit future asset price bubbles and the excesses of behavior that inevitably accompany such events? The answer is yes, Corrigan said, especially if such regulatory initiatives are accompanied by supportive and complementary actions in the private sector.

Corporate governance. A great deal of attention has been devoted to corporate governance, with particular focus on the role of boards of directors, especially independent directors. One critical aspect of corporate governance, however, has received surprisingly little attention, Corrigan said. What should be the stature and independence of officials responsible for core control functions, including credit due diligence, risk management, and, especially, corporate control? Corporate control includes responsibility for accounting, the integrity of books and records, and, particularly in the financial institutions, price verification. Corporate executive officers and boards of directors need to ensure that the officials responsible for these functions have the independence, the stature, and, Corrigan added, the compensation to discharge their responsibilities with the highest degree of competence and integrity.

Accounting policies and practices. In the United States and around the world, current accounting

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practices are a mixed bag of procedures that have evolved over a long time. In the United States, for example, financial institutions follow a dual system, based in part on historic cost and in part on fair value accounting models. U.S. accounting principles are heavily based on rules, while U.K. and European models are primarily based on broad principles. In these circumstances, the challenges of moving to a coherent global approach that can reasonably reflect economic reality, both domestically and internationally, are truly formidable. It is in our collective best interest, Corrigan argued, to fully support the work of the International Accounting Standards Board in achieving this goal.

Public disclosure policies. Clearly, enhanced transparency is a good thing. Some aspects of enhanced transparency in the current environment are "no-brainers." As an example, the new U.S. disclosure policy that requires institutional research reports to disclose investment banking relationships of the analyst's employer is an obvious necessity. However, there are also areas in which enhanced disclosure may be aimed at inherently complex subjects. This is intended to help investors make informed judgments about the absolute and relative prospects for individual companies. Highly complex measures of market and credit risk exposures are cases in point.

According to Corrigan, however, there will often be a fine distinction between public disclosures that enlighten and those that may confuse. At a minimum, this requires that approaches to enhanced public disclosure be highly sensitive to the law of unintended consequences and rely on a blend of quantitative and qualitative disclosures that, if anything, places more stress on the qualitative than the quantitative.

U.S. economic resilience

Despite its recent excesses, Corrigan concluded, the U.S. economy has held up remarkably well in the face of considerable adversity. In fact, it has benefited from important structural improvements in recent years. Clearly, spending on the Internet and telecommunication projects got way ahead of itself, but these innovations make a real contribution to economic activity and will continue to produce long-term benefits. ■

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Transferring fiscal power

Several transition countries are currently weighing the pros and cons of devolving (transferring) revenue, spending, and borrowing powers to lower levels of government at a time when they also want to reduce their deficits. What advice does experience elsewhere offer them? A recent IMF study by Paulo Drummond (Economist in the IMF's European I Department) and Ali Mansoor (Senior Economist in the Independent Evaluation Office), Macroeconomic Management and the Devolution of Fiscal Powers, *looks at how central governments can successfully manage fiscal policy while decentralizing.*

Given the challenges associated with fiscal devolution, what prompts countries to move toward greater decentralization? The main benefits, according to the authors, are increased efficiency and a more responsive government. As long as local governments are knowledgeable and responsive to local conditions, devolving resource allocation to them should, in principle, better match public spending with the preferences of the local population. In practice, however, countries have not always found decentralization a straightforward path to realizing these benefits.

What can countries do to reap the benefits of decentralization? First, Drummond and Mansoor stress, local spending should match local resources. Local governments need to be committed to fiscal discipline. Second, successful decentralization also depends on the local availability of expertise. Third, effective decentralization requires significant local administrative capacity and locally responsive and responsible officials with substantial discretionary control to deliver services. Fourth, countries need to pay careful attention to how local institutions are set up and should include safeguards to ensure good governance.

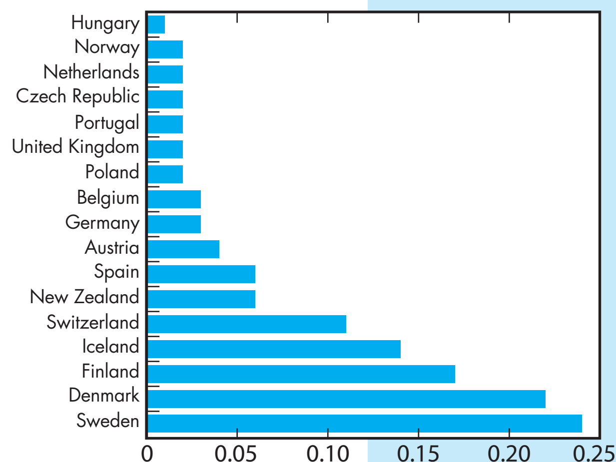
Link with deficits?

Does devolution pose undue risks to the meeting of central government fiscal targets? In other words, what is the link between reducing deficits for the government or public sector as a whole and decentralization? To investigate this link, the authors analyzed data for 174 countries, first grouped by income level and then separated into centralized and decentralized economies. For middle-income countries, the results showed that greater decentralization is associated with better governance, less variability in government balances, and greater success in reducing deficits. However, the findings showed no statistically conclusive evidence of such a link for the low- and high-income groups.

For the more advanced economies, the degree of fiscal devolution—measured by the share of tax resources handled by lower levels of government—varies greatly (see chart below). This, the authors point out, is partly due to different historical and institutional factors. Fiscal devolution is relatively weak, and central control relatively strong, in the Netherlands, Norway, Portugal, the United Kingdom, and in the Czech Republic, Hungary, and Poland. In contrast, lower levels of government are the most autonomous in Denmark, Finland, and Sweden.

Drummond and Mansoor draw two main conclusions from their sample. First, greater decentralization has not led to increased macroeconomic risks, either in the form of recurring central government deficits or in terms of being unable to reduce deficits. Second, the correlation between fiscal devolution and fiscal performance is weak.

Degree of fiscal devolution can vary greatly



Note: The numbers along the x-axis represent the coefficient of fiscal devolution. It combines the coefficient of fiscal autonomy, measured by the degree of control these governments exercise over their tax revenues, with the degree of decentralization, measured by the share of local governments in general government tax revenue. These measures are based on a recent OECD compilation of local government data that summarizes tax autonomy in 17 countries.

Data: IMF, Working Paper No. 02/76

Lessons learned

Although fiscal decentralization has occurred in different countries at different times, there is a consensus in the literature on four general prescriptions.

- Because fiscal decentralization influences a central government's ability to manage fiscal policy, it is important to discuss ways to maintain the center's ability to manage fiscal policy in tandem with the process of decentralization.
- Tax assignment between the central and lower levels of government should take into account efficient tax administration while matching revenue mobilization as closely as possible with expenditure needs.
- Fiscal consolidation and fiscal control in a highly decentralized setting can be achieved only if the allocation of resources and the revenue-raising ability of local governments are commensurate with their spending responsibilities and with sound financing mechanisms.
- Overall fiscal control can be maintained only if good governance ensures transparency in taxation

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and spending decisions, establishes reporting mechanisms that allow public scrutiny of spending, and guarantees that local governments respect the rules, including borrowing arrangements.

How can countries limit the adverse effects of decentralization? Current policies in selected advanced and transition economies provide a variety of policy options for preserving the central government's ability to manage fiscal policy.

The central government can seek agreement with, or impose budget targets on, lower levels of government.

Budget coordination mechanisms. The central government can seek agreement with, or impose budget targets on, lower levels of government. According to the authors, cooperative approaches require an understanding by the lower levels of government of the macroeconomic implications of their own policies. Some countries have relied on formal mechanisms to coordinate budget plans, such as establishing a council that oversees the financial policies of local and central governments.

Tax incentives and revenue-sharing mechanisms. To shelter local governments from cyclical effects and provide the central government with stabilization instruments, local governments should focus on taxes that are less sensitive to income fluctuations. Other considerations include transfer of tax authority in areas where economic activity being taxed is strongly linked to geographical boundaries of the region, with limited scope for movement to other jurisdictions (for example, property taxes), and distribution of tax bases across regions to avoid increased post-tax regional disparities.

Intergovernmental transfers—revenue-sharing arrangements and grants—often provide additional funding for local government spending. But countries need to be careful that such transfers do not lead to a loss of central control over fiscal policy, the authors stress. Based on the experience of the countries in this study, whenever fiscal devolution is high, intergovernmental transfers are used less to provide additional funding and more as a way to equalize income across local governments. This helps retain the center's control over fiscal policy in two ways: it avoids bilateral negotiations between the central government and the lower levels; and it avoids the moral hazard problems associated with the widespread use of grants to cover the gap between spending needs and capacity to raise revenue (by avoiding perverse incentives that can lead to budget overshooting and cost overruns through excessive spending on the expectation that the overruns would be covered by the central government). Even in countries where equity considerations across municipalities are a priority, central governments tend to aim at less than 100 percent equalization through grants to maintain incentives for local governments to strengthen their own revenue-generating capacity.

Expenditure control. In large and decentralized public sectors, there is a clear need to control local expenditures if the central government wants to preserve its ability to determine overall public spending. However, one consequence of fiscal devolution is that the central government is unable to determine the level and structure of public spending by local governments. Therefore, its ability to manage fiscal policy appropriately will rest on adequate considerations and incentives to hold down local government spending and avoid spending overruns. Some countries at a more advanced stage of decentralization have ensured that their central governments devolve revenues and increase funding to local governments in proportion to the local government's spending responsibilities.

Rules for borrowing. What kind of borrowing arrangements provide the best incentives and limit the indebtedness of local governments? Ideally, policymakers should use a combination of demand- and supply-side controls on borrowing, especially for emerging market and transition economies. On the demand side, some way of coordinating borrowing needs is required. On the supply side, financial markets could ration credit according to creditworthiness and expected returns. Using such market incentives, the authors point out, may require appropriate regulation by the monetary authorities. Actual choices made by countries at varying stages of fiscal devolution range from the center's direct control of local borrowing to rules that set limits on absolute indebtedness, the type of borrowing allowed (for example, for investment projects), or a maximum service ratio. ■

Copies of IMF Working Paper 02/76, *Macroeconomic Management and the Devolution of Fiscal Powers*, by Paulo Drummond and Ali Mansoor, are available for $10.00 each from IMF Publication Services. See page 362 for ordering information. The full text is also available on the IMF's website (www.imf.org).

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
November 4	2.10	2.10	2.69
November 11	1.98	1.98	2.53

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/cgi-shl/bur.pl?2002).

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

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Stand-By, EFF, and PRGF arrangements as of October 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina[1]	March 10, 2000	March 9, 2003	16,936.80	7,180.49
Bosnia & Herzegovina	August 2, 2002	November 1, 2003	67.60	48.00
Brazil[1]	September 6, 2002	December 31, 2003	22,821.12	20,539.01
Bulgaria	February 27, 2002	February 26, 2004	240.00	156.00
Dominica	August 28, 2002	August 27, 2003	3.28	1.23
Guatemala	April 1, 2002	March 31, 2003	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Romania	October 31, 2001	April 29, 2003	300.00	165.33
Turkey[1]	February 4, 2002	December 31, 2004	12,821.20	2,892.00
Uruguay[1]	April 1, 2002	March 31, 2004	2,128.30	1,016.60
Total			**55,862.10**	**32,531.80**
EFF				
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Indonesia	February 4, 2000	December 31, 2003	3,638.00	1,651.48
Serbia/Montenegro	May 14, 2002	May 13, 2005	650.00	550.00
Total			**6,245.00**	**4,158.48**
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	24.00
Armenia	May 23, 2001	May 22, 2004	69.00	39.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	64.35
Benin	July 17, 2000	March 31, 2004	27.00	8.08
Burkina Faso	September 10, 1999	December 9, 2002	39.12	5.58
Cambodia	October 22, 1999	February 28, 2003	58.50	8.36
Cameroon	December 21, 2000	December 20, 2003	111.42	47.74
Cape Verde	April 10, 2002	April 9, 2005	8.64	7.41
Chad	January 7, 2000	December 6, 2003	47.60	10.40
Congo, Dem. Rep. of	June 12, 2002	June 11, 2005	580.00	160.00
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Djibouti	October 18, 1999	January 17, 2003	19.08	10.00
Ethiopia	March 22, 2001	March 21, 2004	100.28	31.29
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	January 12, 2001	January 11, 2004	108.00	58.50
Ghana	May 3, 1999	November 30, 2002	228.80	52.58
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Guyana	September 20, 2002	September 19, 2005	54.55	49.00
Honduras	March 26, 1999	December 31, 2002	156.75	48.45
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	49.96
Lao People's Dem. Rep.	April 25, 2001	April 24, 2004	31.70	18.11
Lesotho	March 9, 2001	March 8, 2004	24.50	10.50
Madagascar	March 1, 2001	February 29, 2004	79.43	56.74
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2003	51.32	12.90
Mauritania	July 21, 1999	December 20, 2002	42.49	6.07
Moldova	December 21, 2000	December 20, 2003	110.88	83.16
Mongolia	September 28, 2001	September 27, 2004	28.49	24.42
Mozambique	June 28, 1999	June 27, 2003	87.20	16.80
Niger	December 22, 2000	December 21, 2003	59.20	25.36
Pakistan	December 6, 2001	December 5, 2004	1,033.70	775.26
Rwanda	August 12, 2002	August 11, 2005	4.00	3.43
São Tomé & Príncipe	April 28, 2000	April 27, 2003	6.66	4.76
Sierra Leone	September 26, 2001	September 25, 2004	130.84	56.00
Tanzania	April 4, 2000	April 3, 2003	135.00	35.00
Uganda	September 13, 2002	September 12, 2005	13.50	12.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Zambia	March 25, 1999	March 28, 2003	278.90	124.20
Total			**4,824.86**	**2,599.41**
Grand total			**66,931.96**	**39,289.69**

[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

Extended Fund Facility arrangements are designed to address payments imbalances that stem from structural problems.

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Borensztein: "This idea would help change the structure of a country's debt in a way that would reduce the probability of crisis."

Interview with Eduardo Borensztein and Paolo Mauro

Reviving the case for GDP-indexed bonds

Two IMF economists have proposed that countries issue bonds that have a varying interest rate linked to the growth rate of the economy. The idea is to reduce the risk of default during economic downturns and to make fiscal policies less procyclical. The IMF Survey *interviewed Eduardo Borensztein, head of the Strategic Issues Division of the IMF's Research Department, and his deputy, Paolo Mauro, about the idea.*

IMF SURVEY: Why are you raising this issue now?
BORENSZTEIN: Considerable effort has been put into strengthening the international financial architecture at various levels. One of the most notable parts of this has been the initiative to address how to handle defaults by sovereign countries. At the same time, work is under way throughout the IMF to determine how to anticipate and prevent crises better, on the one hand, and to take measures to resolve them, on the other. Part of crisis prevention has to do with the policies adopted by countries, but another important aspect might have to do with the way international financial markets work. So this idea would help change the structure of a country's debt in a way that would reduce the probability of crisis. These bonds would give countries a structure to their payment obligations that would make default less likely.

IMF SURVEY: How do they do that?
BORENSZTEIN: The payments on the bonds would not be a fixed amount but would depend on how the country's economy is doing. Our basic model would be one in which the coupon payment of the bond is a fixed rate plus something that depends on the growth rate of the economy. When the country is doing well, it will pay a higher coupon rate; when the country is not doing so well, it will pay a lower coupon rate. This would make it much easier for the country to keep its fiscal accounts in order and make external debt payments. The country would be less likely to default and creditors would recognize that.

IMF SURVEY: In terms of the overall architecture, how important is this?
MAURO: At present, people are very interested in preventing crises—more like wearing seat belts rather than just fixing the damage after the accident happens. This instrument won't be foolproof, but it will make it a little bit easier for a country to avoid getting into a debt crisis. Ultimately, pursuing the right policies is what keeps you out of trouble.

IMF SURVEY: It sounds good in theory, but isn't it the reverse of normal practice? Don't bond market investors expect a higher return when things are getting worse?
BORENSZTEIN: When things are getting worse, investors see the probability of default rising, so they demand a higher premium. Now, in this case, even though things are getting worse, the risk of default would be at least reduced by the easier debt payments. The main objective of designing this kind of instrument is precisely to reduce the probability of default. In addition, fiscal policy would have to adjust less in bad economic times.

IMF SURVEY: So, an investor is trading something for a bit more certainty. But, for this to work, wouldn't the GDP-indexed bonds have to be widely used?
BORENSZTEIN: There are two kinds of issue. One is how the market price of this bond, if it existed, would relate to those of other bonds if the market were well developed, liquid, and so forth. In our view, the premium attached to these bonds wouldn't be large because investors can diversify. They can spread GDP risk across countries.

The other issue is that there is no such market now. If you try to start a new financial market, maybe there won't be sufficient liquidity and maybe the instrument will be seen as a little bit exotic. In these instances, the borrower will be paying a premium for investors to hold a bond that they cannot easily sell or that they cannot, perhaps, easily understand.

It would take time and, maybe, official intervention to start markets of this kind, but in the end they are not that complicated. We have floating rate bonds. Every country has bonds that are indexed, say, to LIBOR [London interbank offered rate]. In this case, instead of LIBOR, you would have the growth rate of GDP. People know about GDP and track it very closely if they are investing in a country. Assuming there are no problems with the GDP data, it's a matter of seeing how to start such a market on a sufficiently large scale for it to make a difference for the country.

IMF SURVEY: How would indexation work in terms of the GDP data? In some countries, GDP is revised several times.
MAURO: It really depends on how the indexation clause is written. To make things simple, you look at GDP

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when the contract is signed; then, if this is a 10-year bond, what ultimately matters is the level of GDP 10 years from now. So what really determines the return and what really matters to investors should be the average growth rate of the country over the 10-year life of the bond. Revisions would be pretty small in comparison.

IMF Survey: But if a country announced its GDP growth rate and then later had to revise it after making a coupon payment, wouldn't that affect future coupon payments?

Mauro: What would really matter to investors is having some clear and previously agreed way of establishing when such revisions stop being relevant for the coupon payments. As long as there is no intentional bias in the revisions or their timing, this is not a big issue. The real issue is guaranteeing the integrity of the process and making sure that the information is out there and easily available and, especially, that nobody's trading on inside information.

Borensztein: The market's going to form an expectation and the bond price will change, as happens when a company announces sales estimates and then revises them. The key point is ensuring that the way the information is disseminated does not give rise to doubts about the integrity of the market.

IMF Survey: Why should the IMF be involved?

Mauro: First, the IMF has privileged access to the governments it talks with on a regular basis. We can sound them out on their interest in this type of bond. Second, we can talk to the investment community, float the idea, see how people react to it, and then, perhaps, stimulate a dialogue. But, more concretely, one of the main objections to this type of idea is that countries themselves come up with the GDP numbers, and there would be an incentive for them to cheat. It's difficult to guess exactly how big a problem that would be. But there is an effort to improve statistics and the transparency of a number of economic indicators. One could go further and maybe encourage countries to have more independent statistical agencies. One might even think of having some mechanism whereby someone certifies the GDP accounts.

IMF Survey: So there's no intention that the IMF should be some sort of referee?

Mauro: That's not the idea. But there is an international effort to improve statistics and their transparency, and the IMF plays a role in that. This falls in the same area.

IMF Survey: But you mention in your paper that an international institution will need to play a catalytic role to get this idea rolling.

Borensztein: Yes, but we don't know exactly what role. If you look at how new securities and new markets start, it often occurs with the help of some government intervention. One example that's often studied is the mortgage-backed securities market in the United States. It's a huge market and it's a great success. But it really developed with strong government support.

We're not sure how this new bond market would develop. One scenario is in the context of debt restructuring. Several of the restructurings in Latin America in the 1980s included bonds whose value recovery rights were linked to either GDP or export prices such that, when GDP recovered to a certain value, the return on the bond would also start to be higher. So, there's a little bit of experience, but it's not quite the same idea as we are proposing.

If this works, then a country may offer some kind of bond exchange on a relatively large scale. In those cases, the international institutions could provide advice.

IMF Survey: So, initially, you see development of this market as being linked to an initiative by a particular country?

Borensztein: That's one scenario.

Mauro: An alternative scenario is that a group of countries just decide that this is a good idea. They coordinate their efforts and float these new bonds simultaneously. They could hire a big investment bank to do this in a coordinated way. A coordinated approach is good because, from the point of view of an investor, once you have a lot of countries issuing these bonds, you don't have to worry so much about

Members' use of IMF credit
(million SDRs)

	During October 2002	January–October 2002	January–October 2001
General Resources Account	**9.63**	**22,667.60**	**21,306.70**
Stand-By	0.00	21,654.01	20,564.70
SRF	0.00	7,903.67	12,662.31
EFF	0.00	986.61	742.00
CFF	0.00	0.00	0.00
EMER	9.63	26.98	0.00
PRGF	**25.40**	**1,111.80**	**633.61**
Total	**35.03**	**23,779.40**	**21,940.31**

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

Mauro: "One of the main objections to this type of idea is that countries themselves come up with the GDP numbers, and there would be an incentive for them to cheat."

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the GDP indexation aspect. In those years when GDP does well in one country, it does badly in another country, and the two countries can offset each other. That's probably the cleaner scenario.

IMF SURVEY: What has to happen next for this idea to gain ground?

BORENSZTEIN: Quite a lot. It's an idea that has to be discussed in the context of the reform of the international financial architecture. Clearly, attention is focused on what countries, investors, and international organizations should be doing about sovereign debt and emerging market international debt in general.

Our idea fits in with this but needs work. For example, there could be other contingencies. We look at GDP because it's the broadest base indicator of how a country is doing and would work well in every country. But there could be other ways of doing it that could make investors more comfortable. In the oil-exporting countries, for example, the bonds could be indexed to oil prices. In terms of actual bond issues, there could be different scenarios. In addition to the context of debt restructuring, another scenario could be in the context of a large debt exchange at a time of favorable conditions in international capital markets.

IMF SURVEY: What is the likelihood of success?

MAURO: As with many instances of financial innovation, it's hard to predict. Why does the United Kingdom have inflation-indexed bonds and other similar countries don't? It's a bit of a random process. If there were both political will and widespread interest in these instruments, it could be done. From a legal standpoint, it's easy. It's a matter of inserting an indexation clause into an otherwise standard bond contract. But the idea has been out for several years; it hasn't happened, so obviously there are some unresolved issues.

BORENSZTEIN: Changes happen during crises, which is when people really concentrate on doing things that otherwise wouldn't happen. Clearly, the attention of all the participants is focused on these issues now. This is, I think, a good time to try to push ideas of this sort. Markets are getting more sophisticated all the time, so you see new kinds of securities out there. Implementing our proposal might be a little hard, but markets are looking for innovations. ■

For more information, see IMF Policy Discussion Paper 02/10, *Reviving the Case for GDP-indexed Bonds*, by Eduardo Borensztein and Paolo Mauro. Copies of the paper are available on the IMF's website (www.imf.org) or may be ordered, for $10.00 each, from IMF Publication Services. See page 362 for ordering details.

IMF holds outreach meeting on reserve management practices

The IMF held an outreach meeting in Washington on October 25 to discuss the draft Accompanying Document to the Guidelines for Foreign Exchange Reserve Management, which the organization developed in September 2001. The draft document, which contains 20 case studies, illustrates how countries at different stages of economic and financial development and with various institutional structures have developed their reserve management principles and practices. Sound reserve management practices are important because they can increase a country's resilience to shocks.

Banu Kesim, Central Bank of the Republic of Turkey.

The participants—24 representatives from 16 of the 20 participating countries, the Bank for International Settlements, and the World Bank—commended the IMF on the document and offered useful suggestions on details and emphasis. The case studies will provide a useful reference point for member countries seeking to strengthen their reserve management policies and practices. The document does not advocate any single approach or practice. Participants also discussed key issues of concern, such as managing information technology, developing business continuity procedures, assessing the impact of market uncertainty, and handling credit and legal risks.

Roberto De Beaufort, Bank of the Republic of Colombia.

The Accompanying Document will be revised further and submitted first to the participating countries and then to the IMF's Executive Board in the spring of 2003 for final approval. After its approval, the document will be posted on the IMF's external website.

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