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Interview with Lorenzo Perez, head of Iraq mission team

IMF may lend to Iraq by second half of 2004

The reconstruction of Iraq typically conjures up images of bridges, roads, and power plants, but revitalizing the country's economic and financial infrastructure is just as important. After decades of neglect and internal conflict as well as three wars, the Iraqi authorities are faced with the momentous task of gathering reliable macroeconomic data, rebuilding a statistical database, and formulating a macroeconomic framework that can stabilize the economy and lay the groundwork for economic recovery. Since the end of hostilities in March 2003, the IMF has been assisting Iraq with all of these tasks (see box, page 18). Camilla Andersen of the *IMF Survey* spoke with Lorenzo Perez, the head of the Iraq mission team, about recent developments.

Construction workers in Baghdad. Iraq is counting on the international community to provide funds to repair its blighted infrastructure.

IMF Survey: The IMF's Managing Director, Horst Köhler, indicated at a donors' conference in Madrid in October that the IMF could provide loans ranging from $2.5 billion to $4.25 billion to Iraq over a three-year period. What is the likely *(Please turn to the following page)*

IMF approves first review of loan to Argentina

The IMF Executive Board on January 28 completed the first review of Argentina's performance under a three-year $13.3 billion loan in support of the authorities' economic program, paving the way for Argentina to draw an additional $358 million. IMF Managing Director Horst Köhler stated that Argentina's ongoing economic recovery has been strong, with growth of real GDP expected to be at least 7½ percent in 2003. Inflation has remained low, and the unemployment and the poverty situation have gradually improved. This performance reflects disciplined fiscal and monetary policies, and the strengthening of consumer confidence, as well as favorable external conditions and continued official international support, said Köhler.

Extending federal and provincial fiscal performance and building fiscal sustainability—the authorities' key objectives under the program—have been evolving more strongly than programmed, noted Köhler, and in the near term, a key task is to develop further the reforms of the tax structure and of intergovernmental financial relations outlined under the program.

The financial performance of banks has also improved in recent months. To sustain this performance, the authorities' program encompasses steps to strengthen bank capital, ensure tight prudential supervision, reduce impediments to financial intermediation, and diagnostic reviews of the two largest public banks. *(Please turn to page 21)*

Iraq needs debt relief to grow again

(Continued from front page) timetable for IMF lending, and what form could it take?

Perez: Since Iraq is a country emerging from conflict, the IMF will probably start out by providing financial assistance under its Emergency Postconflict Assistance policy. This usually involves a first drawing of about 25 percent of a country's quota for a period of one year, to be followed by another possible disbursement of 25 percent of quota. In Iraq's case, disbursements under this policy could total $850 million. Postconflict assistance could then be used as a launching pad for a regular IMF program, such as a Stand-By Arrangement. It is difficult to be precise about timing, but there could be a first postconflict disbursement in the second half of 2004, to be followed by a regular loan in 2005.

IMF Survey: Iraq's external debt has been estimated at some $120 billion, one of the largest in the world. What is the current state of play in the restructuring of this debt, and what is the role of the IMF?

Perez: The members of the Paris Club announced earlier this year that they do not expect their debt to be serviced until the end of 2004. That was a first step. The IMF, for its part, is carrying out a debt sustainability analysis. As part of this process, it has contacted some 50 countries that are not members of the Paris Club, requesting information about any outstanding debt and arrears owed to them by Iraq. Information generated in this way shows that debt to non-Paris Club creditors probably stands at $60–65 billion, compared with about $42 billion owed to Paris Club creditors. There is also about $15 billion that is owed to commercial creditors. IMF staff has no way of verifying this information, but the non–Paris Club information collected by IMF staff will help Iraq begin reconciling its debt with its creditors in the near future. Former U.S. Secretary of State and Secretary of the Treasury James Baker has been visiting Iraq's major creditors to discuss debt forgiveness. Once these meetings have been completed, negotiations will be turned over to the Paris Club. The IMF's debt sustainability analysis will be provided to the Paris Club in April.

IMF Survey: Do you foresee any obstacles to the debt restructuring?

Perez: The international community is predisposed to help Iraq. People realize that although Iraq has very large oil resources, its capacity to produce oil just isn't sufficient to pay for both reconstruction and debt servicing. If Iraq is to grow again and reintegrate itself with the international community, there is a need for debt relief. I think negotiations with Paris Club and non–Paris Club creditors will be moving along fairly well and in parallel.

IMF Survey: The bombing of the United Nations headquarters in Baghdad in August killed 23 people and wounded many more, including you and five other IMF staff. Since then, the IMF has had no physical presence in Iraq. How do you and your colleagues carry out your work in those circumstances?

IMF involvement in Iraq

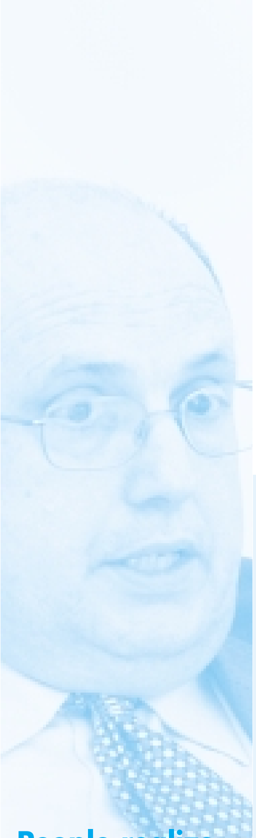
• ***Economic policy advice***. Through its policy dialogue with the Coalition Provisional Authority, IMF staff is helping create a stable macroeconomic framework to underpin economic revival. Its macroeconomic assessment for 2003–04 was published on October 21 and is available on the IMF's website.

• ***Technical assistance***. The IMF is providing technical expertise to help rebuild Iraq's economic and financial infrastructure. For instance, it is helping the finance ministry set up a modern, unified budget and tax system; assisting the central bank in designing and conducting monetary policy and ensuring the proper functioning of the banking system; and advising the statistical office on how to rebuild Iraq's statistical database. The IMF is also helping coordinate technical assistance from other agencies and countries.

• ***Debt sustainability analysis***. It is common practice for the Paris Club of creditors to ask the IMF to prepare a debt sustainability analysis before it undertakes a debt restructuring.

• ***Member of the International Advisory and Monitoring Board (IAMB)***. The IAMB oversees the work of the auditors of the Development Fund for Iraq (see box, page 19).

• ***Possible financial assistance.*** The IMF will be able to provide financial assistance to Iraq once there is an internationally recognized government in place. Before lending can take place, however, the new government would have to clear Iraq's arrears to the IMF.



People realize that although Iraq has very large oil resources, its capacity to produce oil just isn't sufficient to pay for both reconstruction and debt servicing.
Lorenzo Perez

Photo credits: Denio Zara, Michael Spilotro, and Eugene Salazar for the IMF, pages 18, 20, 22–24, 26, and 27; Karim Sahib for AFP, pages 17 and 19; and DC Photography Studio, pages 30–32. **Illustration:** Massoud Etemadi for the IMF, pages 28 and 29.

Perez: Not being able to visit Baghdad is a drawback. But the real problem is that there are so few data available on Iraq's economic situation. The Iraqis are starting to produce basic economic statistics, but the capability of the national statistical office and the central bank was severely disrupted because of the damage caused by the war and the looting that ensued.

Until we can return safely to Baghdad, we have designed a strategy to meet outside Iraq. We have had, so far, two meetings in Amman, Jordan, with Iraqi officials. Technical assistance is also being provided from outside Baghdad, mostly from Amman. This isn't ideal, but much of our work can be done outside Iraq as long as we have access to the relevant information and as long as Iraqi officials are willing to meet with us. We hope that as the security situation improves, it will be possible to travel to Iraq again.

IMF Survey: Could you give us some idea of the division of labor among institutions such as the World Bank, the United Nations, and the IMF?

Perez: The World Bank and the UN carried out a needs assessment prior to the donors' conference in Madrid. They analyzed 10–12 key sectors, including health, education, and infrastructure, and came up with estimates for Iraq's global reconstruction needs. The IMF contributed by carrying out a macroeconomic assessment. As a result of this work, two trust funds were created to channel economic assistance provided by donor countries. The trust funds are managed separately by the World Bank and the UN. The idea was to give a choice to donor countries. Those countries wishing to emphasize community development and education, for example, would channel their funds through the World Bank, whereas countries wishing to emphasize health projects would choose the UN.

IMF Survey: The IMF is a member of the International Advisory and Monitoring Board (IAMB) (see box this page). Is it normal to establish such a board, or was there a need for extra checks and balances in the case of Iraq, to remove any doubt about the use of Iraq's oil resources?

Perez: The IAMB oversees the work of the auditors of the Development Fund for Iraq, which replaced the UN's Oil-for-Food Program (see box, this page). The decision to establish the IAMB was part of the UN resolution that created the Development Fund for Iraq. It was seen as an additional means of ensuring that oil export revenues would be used exclusively for the benefit of the people of Iraq. The IAMB, for example, makes suggestions about the terms of reference for hiring auditors and the type of information that should be provided to them. The IMF has been involved from the start in setting up the Board and agreeing on its terms of reference. The Board has already met twice.

IMF Survey: What are Iraq's economic prospects for 2004?

Perez: Economic prospects depend crucially on the recovery of oil output. Current estimates see oil production rising over 10 years from about 2½ million barrels a day to twice that amount. Efforts are also being made to encourage investments and, in particular, revive the financial sector, crucial for the recovery of the non-oil economy.

The budget for 2004 is well financed because of unspent funds from the Oil-for-Food Program and significant grants from the United States and other countries. In the future, increasing oil production will be key to maintaining a sustainable fiscal position. But Iraq cannot rely simply on oil revenues; it must also create an efficient tax administration and maintain a prudent level of government expenditures while making the necessary investments in infrastructure. This is what makes our work partic-

The role of the International Advisory and Monitoring Board (IAMB)

After the end of hostilities in Iraq, the UN Security Council decided to lift sanctions imposed on the country following the first Gulf War and to terminate the Oil-for-Food Program, which had been in place since 1995. On May 22, 2003 it passed Resolution 1483, setting up the Development Fund for Iraq. The fund, which is held by the central bank of Iraq and managed by the Coalition Provisional Authority, administers all proceeds from export sales of petroleum, petroleum products, and natural gas.

To ensure transparency, the UN Security Council also decided that all export sales of petroleum, petroleum products, and natural gas from Iraq would "be audited by independent public accountants reporting to the International Advisory and Monitoring Board."

The members of the IAMB are representatives of the Arab Fund for Social and Economic Development, the IMF, the UN, and the World Bank. The Board last met on December 22 and announced it would soon establish a website to disseminate documentation and information related to its operations.

More information is available at *www.un.org* and *www.imf.org*.

The IMF agrees that a flexible exchange rate is the most appropriate policy for Iraq right now because it allows the exchange rate to help absorb economic shocks, such as changes in oil prices.

—Lorenzo Perez

ularly important and interesting: trying to come up with proposals that could result in a sustainable fiscal and external position over the medium and long term.

IMF Survey: What advice is the IMF giving to Iraq in terms of exchange rate policy?

Perez: "Economic prospects depend crucially on the recovery of oil output."

Perez: There has been a lot of discussion about what type of exchange rate regime Iraq should adopt. The central bank is pursuing a flexible exchange rate policy and carries out daily foreign exchange auctions for market participants—mostly commercial banks representing themselves and their customers. The IMF agrees that a flexible exchange rate is the most appropriate policy for Iraq right now because it allows the exchange rate to help absorb economic shocks, such as changes in oil prices.

The currency was subject to volatility right before the currency exchange—it depreciated to about 2,000 dinars per U.S. dollar in early October. However, it has appreciated since it became evident that the currency exchange was going to be successful. Replacing the currency was very important. The old currency has been replaced by new bank notes that have more security features to thwart counterfeiting and more denominations to facilitate transactions.

IMF Survey: Are there any precedents, such as the IMF's involvement in Afghanistan, that you can look to when shaping your policy advice?

Perez: Iraq's economy can be characterized as a mix between the centrally planned economies of the former Soviet Union and countries emerging from conflict. The IMF has a lot of experience working with both types of countries. IMF staff was very involved in helping former centrally planned economies make the transition to market economies, and we have gathered experience from countries that have recently emerged from conflict such as Bosnia, East Timor, and Afghanistan. The IMF's Iraq team is seeking to learn from all those cases.

IMF Survey: Despite the security situation, do you see reason to be optimistic about the outlook for Iraq?

Perez: Iraq has suffered a lot; it was for decades subject to a very damaging dictatorship and to international sanctions. The people of Iraq want to be free, run their own affairs, and get on with their lives. It is a rich country not only in terms of natural resources but also in terms of culture and human capital. Those factors give me reason to be optimistic. But it is going to take some time—years rather than months. What we are witnessing is the birth of a new nation. ■

Iraq's external debt

The Paris Club is an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor nations. Paris Club creditors agree to reschedule debts due to them. Rescheduling is a means of providing a country with debt relief through a postponement and, in the case of concessional rescheduling, a reduction in debt-service obligations. There are 19 permanent members of the Paris Club: Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Other official creditors can also participate in rescheduling sessions, subject to the agreement of permanent members and of the debtor country.

Estimates of Iraq's debt (excluding war reparations) are around $120 billion, of which Paris Club creditors account for $42 billion. A substantial part of the remaining debt is owed to countries that are not members of the Paris Club. Former U.S. Secretary of State and Secretary of the Treasury James Baker has been asked by the U.S. President to help forge an international consensus in favor of restructuring Iraq's debt. As part of his mission, he has visited China, France, Germany, Italy, Japan, Kuwait, Qatar, the Russian Federation, Saudi Arabia, and the United Arab Emirates.

There are also claims for war reparations for the Iraq–Kuwait war. These claims are adjudicated and awarded by the UN Compensation Commission. Claims that have been awarded but await payment amounted to about $29 billion in December 2003, and there remains about $96 billion of claims that still need to be processed and awarded. Based on earlier awards, it is likely that a significant part of these claims will not be awarded.

Restructuring Argentina's debt is critical

(Continued from front page) Köhler cautioned, however, that restructuring Argentina's sovereign defaulted debt remains the most critical task for the coming period. He said that the authorities' intention is to launch a debt exchange offer that aims at attracting broad creditor support and, toward this end, they are expected to deepen their dialogue with private creditors in order to reach a collaborative, comprehensive, and sustainable sovereign debt restructuring.

The much improved economic outlook gives Argentina an important opportunity to put in place policies that will strengthen domestic and international confidence, thereby sustaining growth and allowing the authorities' employment and poverty reduction goals to be achieved. The key commitments under the program include steps to restore fiscal sustainability, strengthen the banking system further, address the issues confronting the utilities, and build a business environment that encourages investment. It is hoped that the authorities will use the completion of the first review as an opportunity to move forcefully forward in these areas, as well as in deepening their relations with private creditors, ahead of the second program review.

The IMF, concluded Köhler, continues to stand ready to help Argentina achieve these goals, adding that the success of the program will depend on good understanding and cooperation between Argentina, the IMF, and Argentina's creditors in a spirit of mutual trust and improved communications.

Argentina's next review under the current loan is scheduled for mid-March 2004. ■

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
January 19	1.57	1.57	2.07
January 26	1.57	1.57	2.07

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website *(www.imf.org/cgi-shl/bur.pl?2004).*

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

Data: IMF Finance Department

Available on the web (www.imf.org)

Speeches

"Building Shared Prosperity in the Americas," Horst Köhler, IMF Managing Director, Special Summit of the Americas, Monterrey, January 12

"The Rewards of Virtue," Anne O. Krueger, IMF First Deputy Managing Director, National Institute of Public Finance and Policy–IMF Conference on Fiscal Policy in India, New Delhi, January 16

"An Intolerable Surge? International Capital Flows and the Indian Policy Response," Anne O. Krueger, IMF First Deputy Managing Director, National Institute for Bank Management, Pune, India, January 21

Press Releases

04/5: IMF Completes Fourth Review of the Kyrgyz Republic's Three-Year PRGF Arrangement and Approves Request for Waiver of Performance Criterion, January 14

04/6: IMF Completes Second Review of the Republic of Tajikistan's Three-Year PRGF Arrangement and Approves Request for Waiver of Performance Criterion, January 16

04/7: IMF Mission Completes First Stage of Discussions for the Seventh Review under Turkey's Stand-By Arrangement, January 21

04/8: IMF Completes Fifth Review Under Lesotho's PRGF Arrangement and Approves $5.2 Million Disbursement, January 21

04/9: IMF Welcomes Recent Monetary Policy Action in the Dominican Republic, January 21

04/10: IMF Completes Fourth Review of Nicaragua's PRGF-Supported Program, Completes Financing Assurances Review, and Grants Waivers, January 23

04/11: IMF and World Bank Support $4.5 Billion in Debt-Service Relief for Nicaragua, January 23

04/12: IMF Deputy Managing Director Carstens Issues Statement on the Dominican Republic, January 23

04/13: IMF Approves a Three-Year $104 Million Arrangement Under the PRGF for Burundi, January 23

04/14: IMF Completes Third Review Under PRGF with Albania, Approves $5.9 Million Disbursement, and Grants Waiver, January 23

04/15: IMF Managing Director Köhler Congratulates Polish Prime Minister Miller, January 26

04/16: IMF Completes First Review of Argentina's Stand-By and Grants Waivers, January 28

Public Information Notice

04/2: IMF Concludes 2003 Article IV Consultation with Brunei Darussalam, January 26

Transcript

Press Briefing by Thomas C. Dawson, Director, IMF External Relations Department, January 15

The large developing countries should stop asking for special and differential treatment and become more forthcoming in liberalizing their trade barriers.
Shang-Jin Wei

IMF Working Paper

On the contrary: WTO makes a difference

The World Trade Organization (WTO) and its predecessor, the General Agreement on Tariffs and Trade (GATT), were set up to promote world trade. Supporters say it is self-evident that global trade has been boosted by the removal of trade restrictions, but in a rare analysis of this question, Andrew Rose (Professor at the Haas School of Business of the University of California) called into question the effectiveness and, hence, usefulness of the WTO (see *IMF Survey*, August 18, 2003). In a new IMF Working Paper, Arvind Subramanian (Advisor, African Department) and Shang-Jin Wei (Head of the Trade Unit, Research Department) attempt to reconcile the inconsistency between the apparent benefits of the WTO and Rose's conclusion. And, in another Working Paper, Aaditya Mattoo (Lead Economist, Development Economics and Research Group, World Bank) and Subramanian propose a new architecture for the WTO that would foster development. They spoke with Christine Ebrahim-zadeh of the *IMF Survey*.

IMF Survey: Rose found no evidence that the WTO has increased world trade. Shang-Jin, Arvind, did you launch your own study to respond to his findings?

Wei: Andy Rose asks an important—and, in retrospect, an obvious—question. His conclusion, that the WTO has not increased trade, provokes a number of troubling questions: Why care about the WTO at all? Why care about the liberalization of agricultural markets? Why proceed with the Doha Round? Our intuition was that his conclusion could not be right—at least not as a blanket statement about all countries and all kinds of trade.

IMF Survey: How does your approach differ from Rose's?

Subramanian: Our approach differs in three ways. First, we define trade and other important variables, such as membership in the WTO and in the Generalized System of Preferences (GSP) arrangements, in a more intuitive way. Second, our methodological approach is, we believe, more rigorous and consistent with the way recent papers suggest it should be done.

But perhaps most important, we do not just aggregate all trade but break it down into different categories: developed versus developing countries; developing countries that became members of the WTO after it was created versus pre-WTO (GATT) members; and trade in protected sectors, such as textiles and clothing and agriculture, versus trade in unprotected sectors. The reason for distinguishing between these various categories is that liberalization under the WTO has not been uniform. For example, industrial countries negotiated down their tariff barriers whereas developing countries availed themselves of "special and differential treatment" that allowed them the freedom not to liberalize. Similarly, while industrial countries reduced their barriers very substantially during the postwar period, they exempted their clothing and agricultural sectors.

IMF Survey: And what are your main conclusions?

Wei: We show that GATT and the WTO have promoted trade where they were designed to do so. For example, in 2002, industrial country imports were about 68 percent (or some $2.5 trillion) greater because of WTO membership. The WTO, on the other hand, had no discernible influence in boosting developing country imports. The good news, however, is that developing countries that joined the WTO have seen higher trade associated with membership.

IMF Survey: Does this imply that developing countries have indeed benefited from WTO membership?

Subramanian: We would stress that although the WTO did not increase developing country imports, these countries were able to export more to other WTO members, especially industrial countries. This boost in exports, which we estimate to be about one-third, was possible because industrial country partners liberalized their imports pursuant to WTO membership.

IMF Survey: Do your findings have any implications for the future of the WTO?

Wei: The most obvious implication is that the WTO still has considerable gains to offer, and this underscores why it is important to breathe life back into the Doha Round. Another implication is that the large developing countries should stop asking for special and differential treatment and become more forthcoming in liberalizing their trade barriers.

IMF Survey: Much of the discussion surrounding the Doha Round has centered on the need to integrate more fully the needs and concerns of developing countries into the trading system. Aaditya, Arvind, you take a different approach by proposing a development-friendly WTO architecture. What purpose would this serve, and what would it look like?

MATTOO: We are concerned with how the WTO—which is fundamentally about bargaining among countries for improved access to each other's markets—could foster development. Our paper addresses two issues. First, how can the scope of bargaining be expanded to facilitate mutually beneficial outcomes? We propose comprehensive coverage—that is, the WTO should cover not just liberalization of goods and services but also all factors of production, not just capital but also labor. Recent research suggests that if labor could move even temporarily across borders, that would produce bigger gains than complete trade liberalization.

Second, how can WTO rules foster liberalization while dealing with the inevitable political opposition? This task is particularly difficult because the rules will have to apply to a highly disparate membership, encompassing the United States and the European Union, on the one hand, and India and China, on the other. We believe that flexibility is a key principle. But flexibility is a two-edged sword: if there is too little, the implied rapid pace of integration may be politically unacceptable. But pushed too far, flexibility can easily degenerate into haphazardness.

We suggest a set of principles. For example, countries should not discriminate between domestic and foreign products and suppliers once the latter have entered the domestic market. Pre-entry restrictions are permitted, but there should be a presumption that they take the form of more efficient fiscal instruments like taxes rather than quotas.

IMF SURVEY: Which countries are likely to benefit from your proposed architecture?

SUBRAMANIAN: The architecture we propose would be more relevant for the larger developing countries than for very small and poor developing countries. The latter are less able to engage in the reciprocal give and take that forms the core of how the WTO operates—less able because their trading partners find their markets less attractive than those of the larger developing countries. Also, the small and poor countries tend to receive preferential access to the markets of most industrial countries and therefore have less incentive to pursue multilateral liberalization that can end up eroding their preferential access and leave them worse off as a result.

IMF SURVEY: What would it take to put such a system into effect?

MATTOO: The key to instituting a system such as we have proposed is a willingness of the industrial countries and the larger developing countries to start bargaining over the real issues. The nature of this bargain is clear: developing countries have comparative advantages in labor-intensive manufactures and services and in agriculture while industrial countries are natural exporters of capital and capital-intensive goods and services. A successful bargain requires political will on the part of industrial countries to lower barriers in labor-intensive goods and services. Developing countries, in contrast, need to be more open to inflows of capital—in the form of foreign direct investment, especially in services—and related manufacturing products.

Co-authors Arvind Subramanian (left) and Aaditya Mattoo (right). Mattoo observed that "the key to instituting a system such as we have proposed is a willingness of the industrial countries and the larger developing countries to start bargaining over the real issues."

IMF SURVEY: Is that likely to happen?

SUBRAMANIAN: That is a difficult question. The political cards are always stacked against liberalization. The costs of liberalization are concentrated among a few producers, while its benefits are diffuse, spread over many consumers. The difficulty that the United States and Europe have had in liberalizing their agricultural sectors illustrates the power of vested interests.

If labor were to move across borders, the political difficulty would be even greater, but the benefits could be huge. Take health care. It seems obvious that with the aging of their population and the explosion in their health care costs, the United States and other industrial countries have a lot to gain by finding lower cost sources of healthcare provision. According to some estimates, the costs of a heart by-pass procedure in India are about one-twentieth of those in the United States. There is a strong case for eliminating restrictions in trade in medical services through WTO negotiations. So the sheer desirability of what we are proposing will, we hope, make it more likely to happen. ■

Copies of IMF Working Paper No. 03/185, "The WTO Promotes Trade, Strongly But Unevenly," by Arvind Subramanian and Shang-Jin Wei, and IMF Working Paper 03/153, "What Would a Development-Friendly WTO Architecture Really Look Like?" by Aaditya Mattoo and Arvind Subramanian, are available for $15.00 each from IMF Publication Services. Please see page 29 for ordering details. The full texts are also available on the IMF's website (*www.imf.org*).

IDB conference

Sen calls for expanded role for ethics in development

How can the development community advance the use of ethical thinking in the cause of economic and social progress? Opening the Ethics and Development Day conference held at the Inter-American Development Bank (IDB) on January 16, Nobel Prize Laureate in Economics Amartya Sen proposed a more active, participatory role for citizens in applying ethics to further sustainable development.

Sen: "The need for broadening the instruments for sustainable development is certainly strong: participatory ethics and citizenship are clearly important in this broadening."

Commending the conference theme as "unprecedented in the history of international financial organizations," Sen's remarks also praised the Inter-American Initiative on Social Capital, Ethics, and Development for its broadening of the intellectual horizon of economists and other social scientists. Launched in 2002 under IDB President Enrique Iglesias with support from Norway's government, the initiative promotes ethical principles in Latin American development, drawing on the participation of hundreds of public and private organizations.

As Sen noted, within a short time, the Initiative has been "very successful in firmly placing ethical issues on the development agenda." Nevertheless, he stressed, it is important to continually reexamine difficult issues, take note of new results and fresh knowledge in the neighboring fields on which development ethics draw, and build on what has been established to develop further uses, applications, and extensions.

Sen more specifically explored why a fuller scrutiny of the demands of citizenship and its participatory implications may be particularly necessary now. Emphasizing that "sustaining living standards is not the same thing as sustaining people's freedom to have—or safeguard—what they value," he urged that people be seen as reasoning beings whose judgments, values, and freedoms are themselves important.

Corporate social responsibility

Commenting on the ethical responsibility of governments, civil society, and private businesses, Norway's ambassador to the United States, Knut Wollebaek, argued that the fundamental shift in power from countries' governments to corporate boardrooms is likely to grow, and this trend must be accompanied by increased corporate social responsibility. Since mobilizing businesses and governments to improve the plight of the poor is not in itself sufficient, he added, civil society must become more responsible and put ethical values at the core of our global institutions.

Power of applied ethics

Mirta Roses, Director-General of the Pan American Health Organization, explained how introducing the ethics dimension has helped her organization set priorities to increase access to health care services. Calling for a more comprehensive view of development that includes an ethical and spiritual aspect, former president of Chile Patricio Aylwin explained that his country's policy of growth with equity was underpinned by dialogue and national consensus that helped bring about positive social policy changes in health care, worker compensation, housing, and education.

Describing applied ethics as a "very powerful tool" for change, Bernardo Kliksberg, General Coordinator of the IDB's Inter-American Initiative on Social Capital, Ethics, and Development, surveyed some recent development projects, including Brazil's Hunger Zero Project, which aims to convert hunger from a health care problem to an ethical problem.

What can ethics contribute to social and economic issues? The Reverend John McCullough, Director of the World Church Service, argued that ethics should challenge us to ask what aspects of development policies contribute to poverty's persistence. We must also ask, he said, whether a common vision unites the development community, how the community can move toward greater representation of the disenfranchised, and how transparent the community wants to be in this process. Father Gasper LoBiondo, Director of Georgetown University's Woodstock Center, explained how the Center's Global Economy and Cultures Project is compiling narratives of the lives of the poor to see how ethics is embedded in their cultures and to empower them to better control how globalization affects them.

Globalization can help

While agreeing that "something is not working right for the poor" in the globalization process, the manager of the IDB's Multilateral Investment Fund (MIF), Donald Terry, focused most of his remarks on the growing remittances sent from rich countries to poor ones—an area where globalization, by halving technology costs, has actually accelerated this "deep, ethical commitment" of family members. Picking up on Sen's point that a main aim of the conference was to discuss how to broaden instruments of sustainable development, Terry explained that the MIF is working to channel at least some of these remittances into savings accounts.

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

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	7,151.00
Bolivia	April 2, 2003	April 1, 2004	85.75	21.43
Bosnia and Herzegovina	August 2, 2002	December 31, 2003	67.60	12.00
Brazil	September 6, 2002	December 31, 2003	27,375.12	10,175.48
Bulgaria	February 27, 2002	February 26, 2004	240.00	52.00
Colombia	January 15, 2003	January 14, 2005	1,548.00	1,548.00
Croatia, Republic of	February 3, 2003	April 2, 2004	105.88	105.88
Dominica	August 28, 2002	February 27, 2004	3.28	0.31
Dominican Rep.	August 29, 2003	August 28, 2005	437.80	350.24
Ecuador	March 21, 2003	April 20, 2004	151.00	90.60
Guatemala	June 18, 2003	March 15, 2004	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
F.Y.R. Macedonia	April 30, 2003	June 15, 2004	20.00	8.00
Paraguay	December 15, 2003	March 31, 2005	50.00	50.00
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Turkey	February 4, 2002	December 31, 2004	12,821.20	1,701.00
Uruguay	April 1, 2002	March 31, 2005	2,128.30	652.40
Total			**54,439.21**	**22,331.96**
EFF				
Indonesia	February 4, 2000	December 31, 2003	3,638.00	0.00
Serbia and Montenegro	May 14, 2002	May 13, 2005	650.00	350.00
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
Total			**4,432.40**	**473.73**
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	16.00
Armenia	May 23, 2001	May 22, 2004	69.00	19.00
Azerbaijan	July 6, 2001	March 31, 2005	80.45	38.61
Bangladesh	June 20, 2003	June 20, 2006	347.00	297.50
Benin	July 17, 2000	March 31, 2004	27.00	1.35
Burkina Faso	June 11, 2003	June 10, 2006	24.08	20.64
Cameroon	December 21, 2000	December 20, 2004	111.42	31.83
Cape Verde	April 10, 2002	April 9, 2005	8.64	3.72
Chad	January 7, 2000	January 6, 2004	47.60	5.20
Cœ dIvoire	March 29, 2002	March 28, 2005	292.68	234.14
Democratic Republic of the Congo	June 12, 2002	June 11, 2005	580.00	106.63
Dominica	December 29, 2003	December 28, 2006	7.69	5.33
Ethiopia	March 22, 2001	July 31, 2004	100.28	20.86
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 9, 2003	May 8, 2006	184.50	131.80
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guyana	September 20, 2002	March 19, 2006	54.55	43.03
Kenya	November 21, 2003	November 20, 2006	175.00	150.00
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	28.68
Lao People's Democratic Republic	April 25, 2001	April 24, 2005	31.70	13.58
Lesotho	March 9, 2001	March 8, 2004	24.50	7.00
Madagascar	March 1, 2001	November 30, 2004	79.43	34.04
Malawi	December 21, 2000	December 20, 2004	45.11	32.23
Mauritania	July 18, 2003	July 17, 2006	6.44	5.52
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Nepal	November 19, 2003	November 18, 2006	49.91	42.78
Nicaragua	December 13, 2002	December 12, 2005	97.50	69.64
Niger	December 22, 2000	June 30, 2004	59.20	8.44
Pakistan	December 6, 2001	December 5, 2004	1,033.70	344.56
Rwanda	August 12, 2002	August 11, 2005	4.00	2.86
Senegal	April 28, 2003	April 27, 2006	24.27	20.80
Sierra Leone	September 26, 2001	September 25, 2004	130.84	42.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	49.00
Tanzania	August 16, 2003	August 15, 2006	19.60	16.80
Uganda	September 13, 2002	September 12, 2005	13.50	8.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Total			**4,675.96**	**2,378.65**

EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.
Data: IMF Finance Department

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IMF Working Paper

Are central banks responsible for financial market stability?

Over the past two decades, central banks have steadily become more powerful. Until the late 1980s, only the U.S. Federal Reserve, the German Bundesbank, and the Swiss National Bank were legally independent. With the surge in global inflation in the 1970s and 1980s, many central banks were given a clear mandate to tackle the problem. But low inflation does not guarantee financial stability, and now central banks face an additional challenge: preventing booms and busts in economic activity caused by large swings in asset prices. In a new Working Paper, Garry J. Schinasi, Advisor in the IMF's International Capital Markets Department, takes a closer look at the evolving role of central banks in the quest for financial stability. He spoke with Christine Ebrahim-zadeh of the *IMF Survey* about his paper, which draws on the experiences of Europe, Japan, and the United States.

Schinasi: Financial stability should be defined in terms of the system's ability to facilitate economic processes even in the presence of external shocks or internal imbalances.

IMF Survey: Why are you looking at this issue now?

Schinasi: The role of central banks in ensuring financial market stability has been an important issue for some time. In the early 1980s, Paul Volcker—then Chair of the Board of Governors of the U.S. Federal Reserve System—told the U.S. Congress that the Federal Reserve System was, first, the ensurer of financial stability and, second, the manager of monetary stability. The timeliness of this issue has been confirmed by several recent events: the establishment of the European Economic and Monetary Union with centralized decision making about monetary policy and decentralized decision-making about financial system policy; the creation of an integrated financial supervisory authority in Japan; and the separation, in the United Kingdom, of banking supervision from the Bank of England.

IMF Survey: What do we mean by financial stability? Is it more than the absence of crises?

Schinasi: Financial stability should be defined in terms of the system's ability to (1) facilitate an efficient allocation of economic resources—within an economy, across economic sectors, and over time—and to price and allocate economic and financial risks; (2) facilitate the effectiveness of other economic processes, such as wealth accumulation and economic growth, which are the source of social prosperity; and (3) perform key functions by responding to external shocks or a gradual buildup of imbalances through self-corrective mechanisms.

For at least three reasons, financial stability should be seen as occurring along a continuum. Financial systems are dynamic, first of all. What might constitute stability at one point in time might be more or less stable at some other time, depending on other dynamic aspects of the economic system, such as technological, political, and social developments. Second, financial stability is consistent with various combinations of the soundness of financial institutions, the condition of the financial markets, and the effectiveness of the various components of the financial infrastructure. And, finally, financial stability depends on participants' confidence in the financial system and related infrastructure, such as the legal system.

IMF Survey: What are the implications, then, of looking at financial stability as a continuum?

Schinasi: Looking at financial stability in this way allows for the detection of potential difficulties according to their intensity, scope, and potential threat to systemic stability. One could, for example, think of problems in three categories:

- single institution or market problems not likely to have systemwide consequences for either the banking or financial system;
- problems that involve several relatively important institutions engaged in market activities with some nontrivial probability of spillovers and contagion to a subset of institutions and markets; and
- problems likely to spread to significant numbers and types of financial institutions and across usually unrelated markets for managing liquidity needs, such as forward, interbank, and even equity markets.

Each category requires different diagnostic tools and policy responses, ranging from doing nothing, intensifying supervision or surveillance of a specific institution or market, to injecting liquidity into the markets to dissipate strains, and intervening in particular institutions.

IMF Survey: Do central banks have a natural role in ensuring financial stability?

Schinasi: They have several natural roles. First, the central bank is the only provider of the legal means of payment and of immediate liquidity. Only central banks can provide fiat money—that is, legal tender that has no intrinsic value but is universally accepted as a means of payment—and the finality of payment. And, since finance is intimately related to the value and stability of fiat money, there is a direct link between monetary and financial stability.

The second natural role for the central bank is to ensure the smooth functioning of the national payment system to avoid systemic risk. Traditionally, systemic risk has been viewed as the possibility that problems at one bank would spill over to others and lead to bottlenecks in payments, which could threaten the pace of economic activity. The payment system, being the core of the economy and the financial market, has been the subject of much discussion, policy, and reform. Through the efforts of the Group of 10, there now exist real-time gross payments settlement systems that try to prevent a failure at one institution from cascading through the payment system.

The third natural role is related to a central bank's responsibility for monetary stability. The banking system is the vehicle through which monetary policy affects, in the first instance, the real economy. To the extent that the banking system is experiencing distress, it will be more difficult for the central bank to provide whatever liquidity it thinks is necessary to achieve its monetary objectives. For this reason alone, central banks have a natural interest in sound financial institutions and stable financial markets and in being in a position to influence corrective actions.

There is another explicit link between monetary stability and financial stability. When financial instability occurs, trust and confidence break down. When this happens, there is usually a rush to obtain liquidity—the most liquid asset being fiat money. This means that bank credit and the money supply begin to contract. If this process is allowed to continue, there is the potential for a sharp contraction in monetary aggregates—including bank money—that could ultimately lead to a decline in economic activity.

IMF Survey: What authority or tools does a central bank need to execute this role effectively?

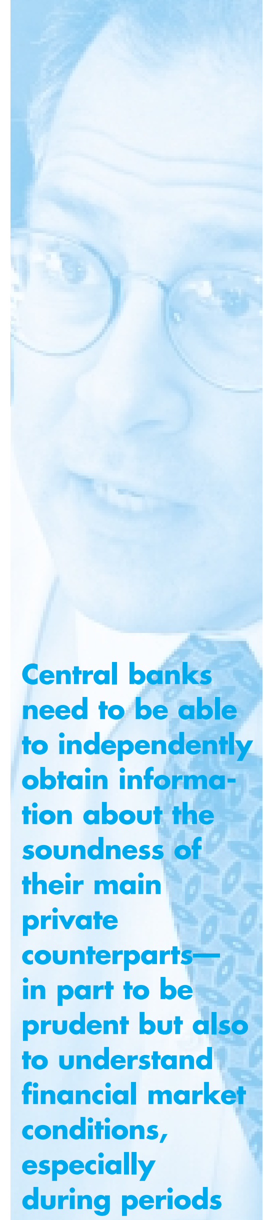
Schinasi: Most of them already have some of what they need, such as an intimate knowledge of the major institutions and oversight of the national payments system. What seems to be lacking in many cases, however, is a clear mandate for ensuring financial stability. In particular, they need to be able to independently obtain information about the soundness of their main private counterparts—the major financial institutions—in part to be prudent but also to understand financial market conditions, especially during periods of stress.

The European Central Bank (ECB) is a case in point. This newly created central bank, which is supranational, manages the one currency of 12 countries. In many ways, the German Bundesbank was the model for the ECB, both in statute and in practice. The Bundesbank, as it existed prior to the creation of the euro zone, could be characterized as a central bank based on a narrow concept of central banking. It had a single objective—the stability of the deutsche mark, which, in domestic terms, meant price stability. In practice, the Bundesbank was a de facto bank supervisor as well, even though there was a separate Federal Supervisory Office. The Bundesbank was responsible for collecting all of the information required for good banking supervision, and it provided that information to the Federal Supervisory Office, which legally was the supervisor. The Bundesbank had a very direct and central role in banking supervision.

By contrast, the ECB's mandate is to ensure price stability. It has a small role in ensuring financial stability, and this role is effectively confined to ensuring the smooth functioning of the TARGET payment system (the settlement system for the euro) and not the financial system per se. Most of the authority for banking supervision is delegated to the 12 national European central banks. The U.S. Federal Reserve, on the other hand, is a broadly conceived central bank with several mandates, including the responsibility to regulate and supervise key sectors of the financial markets, both domestic and international. The U.K. system is somewhere in between. The Bank of England plays the role of lender of last resort in ensuring financial stability, but it no longer has a mandate for banking supervision.

IMF Survey: How far have central banks actually gone in safeguarding financial stability?

Schinasi: Let me answer with three examples. The first is the collapse of the Barings Bank in the United Kingdom in 1995. In that case, the Bank of England, along with other official bodies, including the U.K. Treasury, decided that Barings was not systemically important. It was, at best, a medium-sized bank, and



Central banks need to be able to independently obtain information about the soundness of their main private counterparts—in part to be prudent but also to understand financial market conditions, especially during periods of stress.

Garry J. Schinasi

it was not central to the U.K. payment system. The Bank of England, because it still had a supervisory role at the time, apparently understood the relationship Barings had with the U.K. and other European counterparts. Over a weekend, it was able to decide that Barings could be allowed to fail. If a ready and able buyer had taken over Barings during the weekend, the Bank of England probably would have been very happy. In this case, the central bank's financial stability role was to decide how important this institution was for the U.K. and European financial systems, and it decided it was not important enough to save.

The second example is the U.S. Federal Reserve's involvement, in 1998, in coordinating a private rescue of Long-Term Capital Management (LTCM), a $4 billion hedge fund on the brink of failure. There appear to be two main reasons why the Federal Reserve coordinated the private rescue and reduced interest rates (in three separate moves totaling 75 basis points) simultaneously. One was for financial stability; certainly, although the fund was relatively small by U.S. standards, there was tremendous turbulence in the deepest and most liquid markets in the world. The other reason is that there was a real threat to future monetary stability in that if risk taking were not restored to at least a normal level, even small, thriving businesses would not have been able to receive the credit they needed to conduct their day-to-day business. This would have been a threat to monetary stability.

A third example is the Hong Kong Monetary Authority's intervention in support of the equity markets during the Asian crisis in 1997. One possible reason for the intervention was to establish financial stability in the face of attacks on currencies, sometimes

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IMF Survey: Can any further steps be taken to make central banks more effective?

Schinasi: One thing that can be done is to rationalize specific mandates for financial stability. Some countries do that more than in others. The extreme would be the ECB, where it's clear from the Maastricht Treaty that it has very limited direct oversight of financial stability except insofar as it affects the TARGET payment system. That leaves some gaps of surveillance, and perhaps even regulation and supervision, in the center of the still integrating pan-European markets and European banking systems. To give the ECB a central role in ensuring financial stability or in banking supervision would require opening up the Maastricht Treaty. So, a greater and more transparent specification of the mandates across the European System of Central Banks and a better alignment of other supervisory and regulatory bodies' mandates with financial stability would help. This requires a more clearly defined framework for thinking about financial stability issues and a better working definition of financial stability—if not along the lines I mentioned earlier, then some other mutually agreed definition. ■

Copies of IMF Working Paper No. 03/121, "Responsibility of Central Banks for Stability in Financial Markets," by Garry J. Schinasi, are available for $15.00 each from IMF Publication Services. Please see below for ordering details. The full text is also available on the IMF's website (www.imf.org).

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Singapore conference

Is Asia staging a comeback?

Amid growing optimism in the region, over 30 policymakers, researchers, market analysts, and journalists from the larger economies of the Association of South East Asian Nations (ASEAN)—Indonesia, Malaysia, the Philippines, Singapore, and Thailand—and China and Japan gathered in Singapore for an IMF-sponsored seminar—"Asia's Economic Challenges and Opportunities"—on December 11–12, 2003. The participants foresaw a dynamic future for the region provided it adopted a more entrepreneurial and innovative response to an increasingly competitive global environment.

Among the participants of the Singapore conference were (left to right) Pasuk Phongpaichit, Li Shantong, Arvind Subramanian, Xianbin Yao, and Thanong Khanthong.

From the early 1980s through the mid-1990s, the major ASEAN and newly industrialized economies of Asia made extraordinary strides in achieving rapid economic growth, attracting unprecedented amounts of global investment, achieving macroeconomic stability, and reducing poverty. This impressive performance was interrupted, however, by a crisis in 1997–98 that left the region suddenly associated not with a miracle but with structural weaknesses.

The interruption proved relatively short-lived. While a few economies remain fragile, Asia is again playing a crucial role in supporting world growth. This year, developing Asia—with a projected growth rate of 6½ percent or higher—looks to top regional growth rankings for the fourth year in a row. Its growth this time is driven by the performance of China and India. Asia now accounts for one-third of world output and one-fifth of world exports, and attracts one-third of all foreign direct investment in emerging markets.

Against this backdrop, seminar participants were upbeat and confident about the region's future but equally certain that a sharply more competitive global economy would not tolerate rigidity or complacency. In today's environment, they saw no way to return to East Asia's "old" model, which had achieved vigorous growth through resource-driven, export-led development, boosted by state-directed capitalism and top-down corporate and bureaucratic organizations. With the greater integration of China and India into the world economy, Asia's smaller emerging markets have seen their export edge diminish. More fluid capital flows have also made untenable the fixed exchange rate regimes that once helped these economies secure export markets and attract foreign direct investment. And, in some cases, nonperforming loans continue to burden financial systems. What Asia needs, participants agreed, is a new mind-set that will promote entrepreneurship and innovation in a more globalized world.

New development models

But what exactly would a development model look like that reflects this new mind-set? There was a good deal of interest in the potential benefits that Thailand's dual-track model might offer. This model relies on domestic demand as well as exports to propel growth and places a special focus on rural development. Some participants urged policymakers to take advantage of the region's growing number of affluent domestic consumers. Others cautioned that a stimulative fiscal strategy ran the risk of building up undue contingent liabilities for the government with questionable impact on poverty reduction. Indeed, there was broad agreement that whatever the composition of the new development model, more equitable income distribution would be crucial in preserving political stability and social harmony.

On the supply side, participants underscored the role that innovative business approaches could play in ensuring that the region played an active role in the technology-intensive, knowledge-based global economy. Some viewed the world as currently dominated by international companies with ties to no particular country and with the capacity to outsource most operations. In this environment, they said, a domestic company is typically part of a complex production chain.

What advice was there, then, for developing Asian economies? Several participants suggested that the focus should be on areas of strength, with these economies seeking opportunities to move up the value chain. As evidence of the benefits of such approach, one participant pointed to the more competitive, and more profitable, Information technology (IT) firms of the United States. These companies use a modular approach to focus on specific areas (notably research and development, and after-sales services) and outsource steps lower in the value chain (such as the manufacturing of parts and components). The modular approach, the participant noted, stands in notable contrast to the integrated and less profitable approach of Japanese IT companies that spread their resources to all fields. Still, not all participants were ready to advise rushing into the production of high-end products, and some suggested that there will always be a demand for "hum drum" activities, such as the production of food and other basic necessities.

Rethinking the state's role

A new mind-set model seemed likely, too, to call for a new role for government. Researchers and practitioners alike agreed that industrial policies, in which the state selects which products should be made and then promotes investment in their manufacturing capacity, are no longer relevant. Instead, they said, input-oriented policies should be key, with the state investing in, among other things, skill upgrading and technology research, development of urban infrastructure attractive to knowledge workers, and steps to foster open and competitive environments.

Participants were also mindful of shorter product life cycles, especially for electronics and IT products. For less advanced economies to move up the value chain, governments will need to be instrumental in designing incentive systems that ensure fewer barriers to firm entry and exit and greater labor mobility. More specifically, participants cited the importance of developing venture capital markets to help ease entry, putting in place workable bankruptcy laws to facilitate exit, and creating portable pension and benefits systems for employees. It will also be imperative, they added, to establish strong institutions capable of protecting property rights, upholding the rule of law, combating corruption, and promoting social stability. These effective institutions would have dual value—not only boosting economic growth and competitiveness but also helping address growing demands for political accountability.

Discussing alternative models for sustaining growth in Asia are (left to right) Nibhat Bhukhanasut, Jim Walker, Risaburo Nezu, and Shahid Yusuf.

New model for reform management?

Will a confident Asia, charging forward under a new development model, mean that its postcrisis agenda—notably financial and corporate system reforms—is no longer considered a challenge? Andrew Sheng (Chair of the Hong Kong Securities and Futures Commission) raised the issue in keynote remarks entitled "Managing the Financial Reform Process: Toward a Balanced Economy."

Asian economies have gone through long and painful adjustment processes, with seemingly piecemeal and transitory payoffs. There is a fear now that "reform fatigue" may be setting in. Are countries in a position to call off corporate and financial sector reforms? Seminar participants answered with a resounding "no," indicating that the reform agenda remains on the table and that each economy needs to plow ahead.

But the participants also acknowledged that these reforms involve changing long-entrenched behavior of stakeholders who often have conflicting goals.

Program and participants

Session one: Asia's economic challenges

Manu Bhaskaran, Centennial Group Holdings, Singapore
Bernardo Villegas, University of Asia and the Pacific, the Philippines
Chia Siow Yue, Singapore Institute of International Affairs, Singapore
Mari Pangestu, Center of Strategic and International Studies, Indonesia
Xianbin Yao, Asian Development Bank, the Philippines

Lunch keynote speech

Andrew Sheng, Chair, Securities and Futures Commission, Hong Kong SAR

Session two: Asian economic integration

Pasuk Phongpaichit, Chulalongkorn University, Thailand
Arvind Subramanian, IMF Research Department
Gordon de Brouwer, Australia National University, Australia
J. Soedradjad Djiwandono, Institute of Defense and Strategic Studies, Singapore; Former Governor, Central Bank of Indonesia
Li Shantong, Development Research Center of the State Council, China

Dinner keynote speech

Haruhiko Kuroda, Special Advisor to the Cabinet, and Graduate School of Economics, Hitotsubashi University, Japan

Session three: Sustaining economic growth

Hiroyuki Hino, IMF Regional Office for Asia and the Pacific
Nibhat Bhukhanasut, Offices of the Prime Minister, Minister of Finance, and Minister of Energy, Thailand
Jim Walker, CLSA Asia-Pacific Markets, Hong Kong SAR
Risaburo Nezu, Fujitsu Research Institute, Japan
Shahid Yusuf, World Bank

Session four: Panel discussion

Alan Wheatley, Reuters Singapore
Ammar Siamwala, Thailand Development Research Institute
Tan Sri Noordin Sopiee, Institute of Strategic and International Studies, Malaysia
Haruhiko Kuroda

Other participants

Denis Hew, ISEAS, Singapore
Thanong Khanthong, *The Nation*, Thailand
Vincent Lingga, *The Jakarta Post*, Indonesia

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Clearly, the process is complex and may even take another generation to complete. Several participants underscored the importance of sequencing and managing strategic steps, suggesting that governments pursue a few priorities at a time and ensure that regulatory agencies perform in a coordinated way.

Here, too, the global environment is dictating change, requiring public sectors to become more flexible, and to be able to collect and utilize feedback from all affected parties. Policymakers and regulators across disciplines—economists, lawyers, accountants, political and social scientists, environmentalists—can no longer perform in isolation if behavioral changes are to be brought about effectively. One participant made the case for adapting hierarchical bureaucratic structures to matrix management. This, it was argued, would force technocrats to seek out and incorporate information and requirements from each other rather than focusing solely on their own functional areas. Although there was no agreement on a single best approach, there was support for holding public servants accountable for the success of the overall reform process.

Increasing economic integration

One of the seminar's hottest topics and liveliest debates centered on whether there is a need for greater regional coordination of exchange rate management and whether, given China's entry into the World Trade Organization, the current levels of the renminbi and other Asian currencies are appropriate. Haruhiko Kuroda (Special Advisor to the Prime Minister of Japan) led that debate with a keynote address "Toward a Stable Currency Regime in East Asia." As one might expect, there was no consensus among participants on the question.

There was, however, broad agreement on several other aspects of Asia's growing economic interdependence and integration. Participants saw China and India, along with the United States, as the engines for Asia's strong growth in the period ahead and Japan's role subsiding. Conscious that Chinese imports from the major ASEAN countries have grown by an average of 14 percent a year over the past decade, participants focused more on the opportunity that further regional integration could bring—expansion of intraregional demand and productivity gains—and less on the competitive challenge posed by either of the two neighboring giants.

While nationalism may have played a part, most participants saw the recent rise of Asian regionalism as a natural response to the setback in the Doha Round and to rising regional integration elsewhere. Participants noted the important contributions that regional policy dialogue had made in terms of economic cooperation (such as the Asian Free Trade Area), institutional reforms (Asian bond market), and support for financial stability (implicit avoidance of competitive devaluation). Asian integration should be viewed, participants insisted, as a constructive step toward global integration and not as a reflection of protectionism. All the same, several cautioned that regional and bilateral arrangements could lead to inconsistencies with the global agenda, especially if motivated primarily by narrow political or security concerns.

In a concluding panel, (from left) Haruhiko Kuroda, Tan Sri Noordin Sopiee, and Ammar Siamwala discuss what Asia needs to do to meet its challenges and what the role of the IMF could be.

The IMF's contribution?

As Asia strives to overcome what one participant termed its "midlife growth crisis," there is scope, a number of participants said, for the IMF to play a greater role in advising member countries. The IMF could draw on its international experience—lessons from advanced economies, Latin America, and Asia's own reform experiences—to demonstrate "how to reform" as well as "what to reform." It could reinforce the importance of communicating clearly, openly, and often about reform goals and the steps needed to get there. Participants expressed interest in learning more from the experience of the euro area in sequencing the different aspects of regional integration—from trade, investment, and monetary union—before full integration can be achieved. Finally, one participant counseled the IMF not to shy away from providing road maps for reforms and policy advice that may run counter to the thinking of countries' own policymakers. ■

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