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IMF Managing Director visits Brazil

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Stephen Jaffe/IMF

To recognize the early repayment of Brazil's outstanding debt to the IMF, President Luíz Inácio Lula da Silva invited IMF Managing Director Rodrigo de Rato to a ceremony in Brasilia on January 10. Effective economic policies and a favorable global environment have helped to strengthen Brazil's finances over the past three years, making the repayment possible. Brazil and the IMF pledged to remain partners in a continuing economic policy dialogue.

Reflections on the IMF's transparency revolution

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Michael Spilotro/Agency

Criticism of the IMF has been a constant through much of its history, but even harsh critics admit the organization is much more open now. Tom Dawson has guided the Fund through much of this transparency revolution. In an exit interview, he reflects on why the IMF remains relevant, what must be done to ensure that emerging market countries have a greater say in the Fund, and why formulating wise policy advice isn't enough—it must be communicated well, too.

Challenges in the Eastern Caribbean

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Index Stock Imagery

Buffeted by hurricanes, the loss of traditional markets, volatile tourism receipts, and rising debt, the Eastern Caribbean has had to cope with enormous challenges in recent years. Looking ahead, it will need to bolster macroeconomic and financial stability, create more dynamic private sectors, and deepen regional integration. The IMF, as Deputy Managing Director Agustín Carstens stressed during a recent visit, is working closely with the region and providing technical and financial assistance.

Trade, aid, and the pursuit of growth

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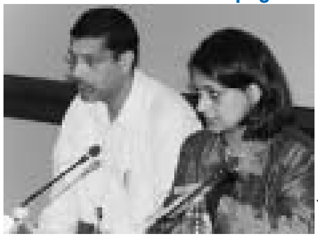

Henrik Gschwindt De Gyor/IMF

Why do some countries grow and others not? Integration with the global economy is often touted as a ticket to greater prosperity, but the track record has been uneven. While increased trade and aid should help countries, a recent IMF conference suggested that other steps, including developing sound macroeconomic policies and avoiding overly regulated labor and product markets, may provide the missing links between trade, aid, and growth.

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JANUARY

24–29 Polycentric World Social Forum 2006, Caracas, Venezuela

25–29 World Economic Forum Annual Meeting, "Mastering Our Future," Davos, Switzerland

FEBRUARY

7–9 United Nations Environment Program, Global Ministerial Environment Forum, Dubai, United Arab Emirates

8 IMF Book Forum, *Moral Consequences of Economic Growth*, Benjamin Friedman, Washington, D.C., United States

10–11 Group of Eight Finance Ministers' Meeting, Moscow, Russia

16–18 Global Conference on Social Responsibility, Vilamoura, Portugal

28–March 1 Joint IMF–Africa Institute high-level seminar, "Realizing the Potential for Profitable Investment in Africa," Tunis, Tunisia

APRIL

3–5 Inter-American Development Bank Annual Meeting, Belo Horizonte, Brazil

4–6 7th International Scientific Conference, "Modernization of Economy and the State," State University–Higher School of Economics, with World Bank and IMF participation, Moscow, Russia

5–6 World Economic Forum on Latin America, São Paulo, Brazil

22–23 IMF–World Bank Spring Meetings, Washington, D.C., United States

MAY

3–6 Asian Development Bank Annual Meeting, Hyderabad, India

20–22 World Economic Forum on the Middle East, "Embracing the Future: Unleashing the Potential of the Middle East," Sharm El-Sheikh, Egypt

21–22 European Bank for Reconstruction and Development Annual Meeting and Business Forum, London, United Kingdom

22–27 World Health Assembly, World Health Organization, Geneva, Switzerland

31–June 2 World Economic Forum on Africa 2006, "Going for Growth," Cape Town, South Africa

JUNE

19–23 World Urban Forum III, Vancouver, Canada

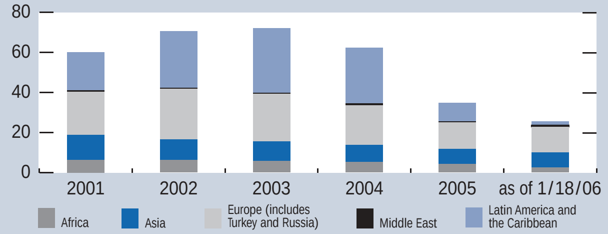
IMF Executive Board
For an up-to-date listing of IMF Executive Board meetings, see *www.imf.org.external/np/sec/bc/eng/index.asp*.

At a glance

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



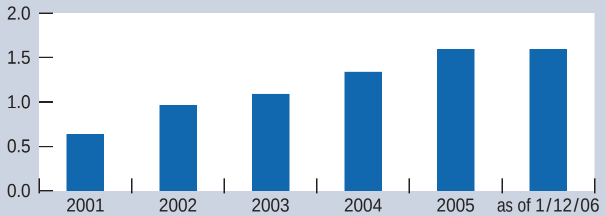
Major currencies, rates per SDR

(end of period)

	January 2006	Year ago
Euro	1.194	1.165
Japanese yen	167.465	156.069
U.K. pound	0.820	0.813
U.S. dollar	1.448	1.522

HIPC debt relief[1]

(billion SDRs, end of period)

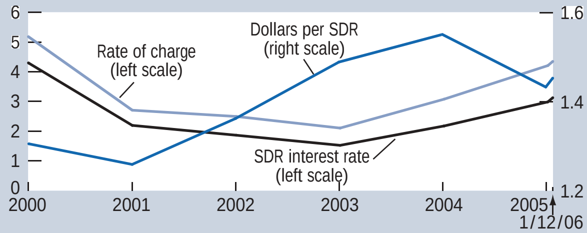


[1]Cumulative disbursements under the Heavily Indebted Poor Countries Initiative.

Related rates

SDR interest rate, rate of charge on IMF nonconcessional loans outstanding, and dollars per SDR

(percent, end of period) (dollars per SDR, end of period)



Note on IMF Special Drawing Rights

Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

Brazil resurgent

IMF Managing Director Rodrigo de Rato traveled to Brazil at the invitation of President Luíz Inácio Lula da Silva on January 10–11 to mark the nation's December 2005 repayment of its outstanding obligations (about $15.6 billion) to the Fund. The early repayment—two years ahead of schedule—was made possible by a major improvement in the country's external position, marked by a doubling of exports since 2002, renewed confidence in the economy, and rising capital inflows, which have restored foreign reserves to more comfortable levels.

Meeting in Brasilia with President Lula, Finance Minister Antonio Palocci, Central Bank President Henrique Meirelles, and other senior officials, de Rato praised the economic progress that the country has made since his last visit to the country in September 2004. The government's firm adherence to prudent macroeconomic policies, he said, has laid the basis for a sustained recovery in growth and employment, a steady reduction in inflation, and good progress in reducing poverty and inequality. Brazil has also taken full advantage of a generally favorable world economic environment to expand trade, boost international reserves, and lower its external debt, thus consolidating market confidence in the economy.

President Lula said that the central message of his meeting with de Rato was that "thanks to consistent economic policy, thanks to the committed effort of the government and society as a whole, Brazil is able to say to itself and to the world that it can now walk on its own, that it is doing what needs to be done to keep moving forward without the emergency assistance it has needed from the Fund in the past." In a similar vein, de Rato noted that Brazil "has finally put a long period of macroeconomic instability behind it. As a result, there should be no more 'lost decades,' no more debt crises or record emergency financial packages."


Stephen Jaffe/IMF

IMF Managing Director Rodrigo de Rato (left) meets with Brazilian President Luíz Inácio Lula da Silva.


Stephen Jaffe/IMF

Brazil's Finance Minister Antonio Palocci (left) greets IMF Managing Director Rodrigo de Rato.

That said, Brazil still faces many challenges in fully realizing its potential for sustained growth, better living standards, and greater resilience to shocks. "We must always remember, said President Lula, "that moments such as this do not mean that we have time to pause or rest. Although we have made great strides in Brazil over the past three years, we are perfectly aware that much remains to be done." Topping the list are maintaining sound policies and accelerating structural reforms—including, as President Lula noted, "the promotion of infrastructure, the creation of a more business-friendly environment, and simplification of the tax structure." De Rato stressed that "no effort should be spared in ensuring that the government's social programs, which have been instrumental in reducing poverty in Brazil, continue to assist the least advantaged in benefiting from macroeconomic stability and growth."

At the conclusion of his visit, de Rato said that "although Brazil is no longer a borrower from the IMF, the Fund will continue to play an important role as advisor and exchange views with Brazil on global economic issues where Brazil plays an important role. We in the Fund look forward to continuing to support the Brazilian government's commitment to economic progress and its reform efforts in whatever way we can." President Lula said that the visit was proof that relations between Brazil and the IMF "will not end with the settlement of our debt. Quite the contrary: both the level and the quality of our relationship are changing." ■

Earthquake should not have a major impact on Pakistan's economic prospects

Despite the tragic loss of life and large-scale destruction, the earthquake that hit northern Pakistan on October 8 is not expected to dampen the country's economic prospects, the IMF said in its annual economic review. Macroeconomic performance over the past few years has been favorable notwithstanding some inflationary and external pressures. Economic growth, driven by manufacturing and agriculture, is estimated to have reached 8.4 percent in 2004/05 (July–June). The international community has pledged $6 billion for earthquake relief and reconstruction; the World Bank and the Asian Development Bank have assessed these costs at over $5 billion.

Pakistan broadly met its 2004/05 fiscal targets. The central bank tightened monetary policy, because 12-month inflation had accelerated to 11 percent in April 2005, and inflation eased to below 8 percent in November. Exports performed well in 2004/05, but imports grew even faster because of rising oil prices and strong demand. And despite high workers' remittances, the current account moved into deficit. Progress was made on structural reform, particularly privatization, as highlighted by the sale of a power utility and the pending sale of 26 percent of a large telecommunications company.

The IMF Executive Board commended Pakistan for its impressive macroeconomic results, particularly the acceleration of economic growth. Still, reducing poverty and achieving the Millennium Development Goals remain a challenge. Directors emphasized the importance of continued structural reforms, particularly the need for a business climate conducive to investment. In light of the earthquake, a widening in the budget deficit in 2005/06 is anticipated, but Directors do not expect Pakistan's projected debt reduction to be altered significantly. They reiterated that a marked improvement in revenue performance was necessary to allow much-needed further increases in social and development spending. They commended the State Bank of Pakistan for raising interest rates sharply in the first half of 2005 and urged similar action should inflationary pressures persist. ■

Pakistan	2003/04	2004/05	Proj. 2005/06	Proj.[1] 2006/07
		(percent change)		
Real GDP growth	6.4	8.4	6.3	6.5
Consumer price index (period average)	4.6	9.3	8.7	7.3
Budget balance (including grants)	–1.8	–3.0	–3.7	–3.3
Total government debt	67.9	61.1	54.9	49.8
		(percent of GDP)		
Current account balance, including official transfers	2.0	–1.3	–3.4	–3.2

[1]Based on policy intentions and staff's real GDP projections.

Data: Pakistani authorities and IMF staff estimates and projections.

Structural reforms, fiscal discipline can help unleash Ukraine's economic potential

After four years of impressive gains, largely attributable to favorable external conditions and prudent macroeconomic policies, Ukraine's economic performance weakened significantly in 2005, the IMF said in its annual economic review. As a result of political and policy uncertainties that have hurt business confidence and investment, along with slow progress on structural reforms and less favorable external conditions, growth fell from a peak of about 12 percent in 2004 to a cumulative growth rate of 2.2 percent from January through November 2005, inflation accelerated, and the current account surplus fell by half.

The IMF Executive Board welcomed the authorities' expressed commitment to fiscal discipline; steps toward greater exchange rate flexibility; further progress in market-strengthening structural reforms, including some reduction in corruption; and efforts to resolve lingering uncertainty over property rights. Steadfast implementation of the authorities' sweeping vision of structural reforms, along with a reduction in inflation, is needed to unleash the economy's untapped potential. A gradual shift to increased exchange rate flexibility and inflation targeting, said the Board, would help the central bank achieve low and stable inflation.

The Board urged the authorities to continue to resist pressures to raise spending, particularly on social transfers and subsidies, in the run-up to the 2006 parliamentary elections. Recommending that the general government deficit not exceed 2¼ percent of GDP in 2006, the Board called on the authorities to allocate the windfall from the Kryvorizhstal steel company privatization primarily to debt redemptions so as not to add to domestic liquidity, and to resist pressures to reopen tax loopholes that were closed in 2005.

Over the medium term, a key priority will be the establishment of a viable public pension fund. To this end, the Board encouraged the authorities to improve the targeting of the minimum pension subsidy, raise effective retirement ages, and prune privileged pension regimes. To address continuing fragilities in the financial sector, it encouraged the authorities to further strengthen the supervisory framework. And, to shore up the banking system, the Board suggested a switch in supervision methods from a highly procedural approach to a more risk-based framework. ■

Ukraine	2002	2003	2004	Proj. 2005	Proj.[1] 2006
			(percent change)		
Real GDP	5.2	9.6	12.1	4.0	5.5
Consumer price index (average)	0.8	5.2	9.0	13.7	12.9
Terms of trade	1.6	8.6	16.4	–1.4	–5.5
			(percent of GDP)		
General government balance[2]	0.5	–0.9	–4.4	–2.9	–3.2
Current account balance	7.5	5.8	10.5	4.8	1.0

[1]Based on policy intentions and staff's real GDP projections.

[2]Excludes $98 million of noncash property income paid annually by Russia.

Data: Ukrainian authorities and IMF staff estimates and projections.

CEMAC oil boom presents opportunities to deepen reforms and regional integration

Real GDP growth in the Central African Monetary and Economic Union (CEMAC)—Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, and Gabon—reached 8.3 percent in 2004, the highest rate in 10 years, according to the IMF's annual economic review. Real oil sector GDP grew by more than 21 percent, driving the region's growth.

Growth developments in the non-oil sector were less encouraging, with regionwide non-oil GDP growth slowing from 3.6 percent in 2003 to 3.2 percent in 2004, the lowest level in five years. This performance resulted from a drought and a locust-related decline in non-oil output in Chad, and roughly constant or only slowly improving non-oil growth in the remaining oil-exporting CEMAC member countries.

Broad money growth in the region was moderate, and inflation declined to 1.7 percent—lower than in the euro area. The favorable inflation performance—in spite of the overall high growth and significant reserve inflows—was helped by good harvests in almost all countries, as well as by the appreciating nominal exchange rate vis-à-vis the U.S. dollar. Yet inflation performance differed significantly across the region. In Chad and the Central African Republic, both countries with stagnant or declining domestic demand, the price level dropped. In Equatorial Guinea, inflation reached 8 percent, reflecting mainly supply bottlenecks in the country's fast-growing economy.

In line with higher oil output and increasing oil prices, the region's fiscal position improved in 2004, posting an overall surplus (excluding grants) of about 3.1 percent of GDP. This positive outcome was due, in part, to windfall revenues from higher oil prices. For the region as a whole, about one-fourth of oil windfall receipts associated with the price increases accrued to the budgets of oil producers. As a result of improved non-oil revenue collection in some member countries, the regionwide non-oil overall fiscal deficit (excluding grants) also improved slightly, even though in Cameroon, the largest CEMAC economy, the non-oil fiscal balance deteriorated by 1 percent of non-oil GDP. At more than 12 percent of non-oil GDP, the non-oil deficit (non-oil revenue less expenditure) is sizable, however, underscoring the region's dependence on oil receipts for government finance.

External sector developments were also favorable in 2004. Although the CFA franc strengthened in real effective terms, the current account deficit declined in 2004 and reserves rose. Because of the regional central bank's repatriation and reserve-pooling arrangements, oil-related inflows in 2004 almost doubled its net foreign assets to more than $4 billion. With developments in the oil market dominating the region's economic prospects, growth in 2005 is forecast to remain strong, at about 5 percent, yet below the 2004 rate, which benefited from the coming onstream of oil production in Chad.

CEMAC	2001	2002	2003	2004	Prel. 2005
GDP at constant prices	6.2	4.9	4.5	8.3	5.2
Oil GDP	5.9	1.6	6.9	21.5	6.1
Non-oil GDP	6.2	6.2	3.6	3.2	4.7
Real effective exchange rate	3.7	4.3	5.9	2.4	...
Overall fiscal balance	0.4	0.6	1.3	3.1	3.5
Non-oil overall fiscal balance	–17.0	–16.0	–12.6	–12.1	–16.2
Gross official reserves	1.4	1.9	1.6	2.5	2.9

[1]Excluding grants

[2]In months of following year's imports of goods and services.

Data: IMF, World Economic Outlook database (April 2005), and staff estimates and projections.

The Executive Board welcomed the positive macroeconomic developments in 2004 but underscored that the region would need to increase non-oil growth to sustain higher overall growth rates. The region thus needs to make progress on structural reforms, diversify exports, and advance the Millennium Development Goals. The Board welcomed broad-based structural measures, such as the Economic Partnership Agreement with the European Union, which could lead to important improvements in the business environment in CEMAC member countries.

Emphasizing the importance of fiscal discipline in member countries, the Board welcomed the prudent management of increased oil revenues and noted that continued high oil prices provided scope for additional spending on infrastructure and poverty-reduction programs. That spending must, however, be consistent with members' medium-term fiscal and debt sustainability and their absorptive capacity.

The Board supported the creation of country-owned oil stabilization funds and funds for future generations under the management of the regional central bank, provided that the funds do not weaken the bank's external position and that they are managed efficiently and transparently. Any changes in the institutional arrangements for managing oil receipts, they stressed, must take into account the need to maintain adequate reserves.

Remaining obstacles to trade and financial market integration have resulted in low levels of intraregional trade and capital flows and prevented the CEMAC from reaping the full benefits of regional integration. The Board regretted, in particular, delays in the implementation of regional policies. It stressed that commitment to, and compliance with, the convergence criteria were crucial to integration and improving investor confidence in the region.

Directors encouraged the authorities to make existing regional institutions and agreements more effective before pursuing additional regional integration efforts. Premature integration with a broader group of countries could hamper the deepening of common policies in the existing area. ■

For more information, please refer to Public Information Notices Nos. 05/156 (Ukraine), 05/157 (Pakistan), and 05/151 (CEMAC) on the IMF's website (*www.imf.org*).

Public scrutiny helps reshape IMF, says departing spokesman

At the end of January, Tom Dawson steps down as Director of the IMF's External Relations Department—and IMF spokesman—a position he has held since July 1999. Previously, he spent about 25 years in the public and private sectors, including as Director of Financial Institutions at Merrill Lynch, IMF Executive Director for the United States (1989–93), and Deputy Assistant to the President at the White House (1985–87). He spoke with Laura Wallace of the IMF Survey *about the IMF's image and the challenges of communicating its work to a diverse, and sometimes highly political, audience.*

IMF SURVEY: Many Asian countries have built up massive reserves, partly, it seems, to avoid having to borrow from the IMF. In Latin America, Brazil and Argentina have been paying off IMF loans ahead of schedule, the latter declaring the end of colonization. The IMF's credit outstanding is at its lowest in 20 years, raising questions about how it will finance its operating costs. And the effectiveness of IMF surveillance continues to be frequently questioned, most recently on China. Isn't the IMF as much under siege now as it was during the Asian crisis of the late 1990s?

DAWSON: No. What Asia really wants is a greater voice and a greater stake in the IMF. And, in the case of Latin America, only a few years ago, when the IMF made several big loans to the region, the "experts" said we would never be paid back. So getting paid back can't possibly be bad news. Anyway, Brazil has a history of strong implementation of its own programs and paying back early.

Michael Spilotro/IMF

Dawson: "If we weren't relevant, people wouldn't be spending so much time arguing about us."

On lending generally, sometimes we're criticized for lending too much, but right now, we're being criticized for lending too little—or there's a concern that so little lending is somehow a threat. We're supposed to be an institution that lends when countries don't have other sources of financing. The fact that our lending is at a 20-year low, I view as good news, not bad news. Certainly there are budget implications that will need to be addressed, but this isn't a crisis. This is something that Rodrigo de Rato anticipated in his medium-term strategic review, which is now under way. There aren't very many of us old enough, other than Jacques Polak, to remember that in the 1950s, the IMF was in a similar situation—with little lending—and somehow survived.

As for surveillance, we're criticized on all sides. Many call us a tax-increasing, devaluation-preaching institution. Others criticize us at times for failing to recommend exchange rate changes they think are advisable. I take some solace in the fact that the IMF tends to be attacked from the left and the right, and it's unlikely that both are correct. I think the IMF is, as it has been for 60 years, just doing its job. In fact, the IMF remains as strong and as valid as it was in 1944, when it was established. The world is changing, and you could argue that it's changing more rapidly than ever before. But the IMF is, and will remain, one of the constants in the global equation as the leading international institution with responsibility for promoting financial and macroeconomic stability and growth.

IMF SURVEY: Is it damaging to the IMF's voice and credibility when politicians invoke its name for domestic or international purposes?

DAWSON: The IMF is used to being used in domestic and international debates. I'm certainly familiar with many cases where finance ministers have used the IMF as the excuse for taking particular measures that they knew full well were necessary to preserve their country's macroeconomic stability and a viable budget. The same holds for opposition leaders, who have attacked us but knew the measures we recommended were necessary. It's important to remember that we typically lend to countries when there are already difficulties, and our role is likely always to be somewhat controversial. But we can be controversial even when there are no immediate financial crises that imply the possibility of IMF lending. I continue to be impressed with the number of developed countries in which the IMF's Article IV consultation or its *World Economic Outlook* provide fodder for active domestic debate. Sometimes the IMF is used to advance a particular point of view, and, occasionally, the IMF's view is criticized. What all this says to me is that our critics are wrong: the IMF is still relevant. If we weren't relevant, people wouldn't be spending so much time arguing about us.

IMF SURVEY: The issue of giving emerging markets and developing countries a greater say in the IMF—especially through adjusting quotas and votes—has been looming for years.

At this point, even the industrial countries agree on the need for change, but no one is willing to give up seats at the Executive Board. What are the risks for the IMF's credibility if this issue isn't dealt with quickly?

Dawson: The IMF's legitimacy is being questioned by many important parties. The Managing Director's strategic review recognizes this and calls for prompt work in addressing this issue. Our Annual Meetings are in Singapore this fall, and this provides both a reason and an excuse for action. I'm reasonably hopeful that enough progress will be made by then that we'll be able to see a solution ahead. It's likely to be complicated, but the imbalances in shareholdings, representation, and voice have been growing for decades.

IMF Survey: So it won't take a quota increase to get this issue resolved?

Dawson: It need not. In the long run, the quota formulas and how they've been applied over time have led to many of the imbalances. Other imbalances have come about because some countries have grown more rapidly than others. The IMF can deal with the most egregious imbalances in the short run and then work toward a quota formula that has credibility.

IMF Survey: Over the past decade, the IMF has made enormous efforts to increase transparency. Has this enhanced its effectiveness and accountability?

Dawson: The transparency revolution is probably what has changed the IMF more than anything else in the past 25 years. It's no exaggeration to say that the IMF used to publish nothing and now publishes almost everything. It's made a major change in our relationships with our members and with the public—whether nongovernmental organizations, parliaments, or other stakeholders. About the time I came to the IMF, there had been some surveys done on the IMF's image. One finding was that secrecy was associated with the IMF when one did a simple library database check. We don't see that anymore, and we don't hear the criticism that the IMF is a secretive institution.

Transparency has also contributed to accountability. I actually believe that the IMF has always been accountable, with its governance structure of Executive Directors representing all 184 member countries. It didn't used to be very easy making that case. But now with a much more open institution—and with Executive Directors themselves responding to parliaments and other stakeholders in their constituencies—the reality of the IMF as a cooperatively owned institution has become more accepted and more understood.

IMF Survey: Parliamentary outreach has really taken off under your watch. Some parliamentary groups have called for greater scrutiny of IMF-supported programs and policies. Do you see a tension between the IMF's accountability to governments and parliaments' wanting a greater say in their countries' programs with the IMF?

Eugene Salazar/IMF

Dawson (right) with IMF Managing Director Rodrigo de Rato: "The transparency revolution is probably what has changed the IMF more than anything else in the past 25 years."

Dawson: In many countries, parliaments already have a substantial say in their relationship with the IMF, particularly on country programs. Ultimately, it's a matter of the country's own governance-constitutional structure—such as parliament's role in approving budgets and loans. That said, we're quite willing to engage in a dialogue with parliaments—not to usurp the executive branch's formal and legal responsibilities but to help parliaments with their oversight. At the moment, we have more demand for parliamentary outreach than we can accommodate. And that demand is usually supported by the governments.

IMF Survey: What are the biggest communication challenges ahead for the IMF?

Dawson: There's a cultural issue in the institution that has never really been solved. Of our 2,700 staff members, 1,500 are economists. There's still too much of a tendency for the economists to talk to each other and their counterparts in governments but not to the rest of the world. If we think we have good advice to offer, we ought to pay more attention to how it's communicated. The world isn't run by economists. Before the age of transparency, when our documents were read largely by Ph.D.s, it didn't seem to matter quite as much. But now, when our advice and our work are subject to public scrutiny, we need to make sure that it's convincing and comprehensible. That remains a challenge. Part of the answer may lie in breaking down the "silo mentality" within the institution—the cultural divide between those who are economists and those who are not. That would help both internal and external communication. ■

Strong institutions can staunch capital flight

In the ongoing battle against global poverty, debt cancellation and new foreign aid are being made available to poor countries. But many poor countries, including some that stand to benefit from the IMF's recent Multilateral Debt Relief Initiative, have lost more resources through capital flight than through debt servicing. If debt relief prompts capital flight, this could jeopardize the international community's efforts to increase the amount of resources available for investment. A new IMF Working Paper, "Robbing the Riches: Capital Flight, Institutions, and Instability," explores the complex relationships between capital flight and foreign aid, and between capital flight and debt. It argues that bolstering the macroeconomic policy environment and strengthening institutions can help stop and prevent capital flight.

The causes of underdevelopment are myriad and controversial. Enduring poverty and low growth are often blamed on poor macroeconomic and structural policies. Some economists attribute low levels of development to such factors as a high incidence of disease, low agricultural productivity, and high transport costs, which may be related just as much to geography as to policies. Any of these factors can engender low saving rates and a level of capital that falls short of the threshold level required for industrialization. In this case, domestic saving would need to be supplemented by foreign aid to provide sufficient resources to spur growth and reduce poverty.

Another view, which has gained popularity in recent years, points to weak institutions as the main hindrance to long-term growth and development and a major contributor to economic volatility. Capital flight may be one of the channels through which weak institutions contribute to volatility and suppress development. Countries with a poor track record on macroeconomic fundamentals often have poor institutions—for example, a weakly constrained government executive. And capital flight may be a by-product of redistributive tools employed by a weakly constrained government executive to divert resources to favored elites—thereby "robbing the riches" of the country. A country's loss of domestic savings through capital flight reduces the resources it has available for investment. But how do unsound macroeconomic policies and weak institutions contribute to capital flight?

Massoud Etemadi/IMF

Causes of capital flight

Capital flight is associated with poor and deteriorating economic conditions. Examining the experiences of 134 developing countries between 1970 and 2001, the Working Paper found that growth had generally declined precipitously in the two years before capital flight reached its maximum level and that inflation was higher when capital was flowing out of a country than when it was flowing in. Before and during capital flight, countries' budget balances tended to deteriorate, and governments' foreign borrowing tended to surge. Moreover, before, during, and after capital flight, political, financial, and economic confidence declined dramatically, with the nadir occurring in the year of maximum capital flight. The probability of banking and currency crises also rose prior to a flight of capital.

The political environment is one variable that captures the quality of institutions. In its analysis of data across a sample of countries, the Working Paper found that a country's political environment influenced capital flight. For example, between 1992 and 2001, capital flight was, on average, greater in countries with a higher percentage of politically connected firms (those with ties to a public official). However, better bank governance and strong controls on irregular payments significantly reduced capital flight even when controlling for politically connected firms and per capita income. These cross-sectional results also corroborated the importance of institutional quality, as measured by the mortality of countries' colonial settlers. In countries where colonists faced a hostile, disease-ridden environment and a high mortality rate, they set up extractive institutions designed to loot domestic resources or exploit the native population. Such extractive institutions have tended to persist over time in the form of an unconstrained small elite that engages in a similar robbing of the riches. The study found that average capital flight was significantly higher in countries where the mortality of settlers was higher, even allowing for variations in per capita income.

In an analysis of a large panel of developing and emerging market countries using annual data for 1970–2001, the study found that both institutions and macro policies affected capital flight. Weak institutional quality, as measured by the lack of constraints on executive power, led to markedly higher capital flight even when controlling for macroeconomic policies and other economic conditions. These findings suggest that corrupt governments can use executive power to transfer resources to themselves and other elites and, thus, abroad. The results also indicate that unfavorable macroeconomic policies and conditions—low growth, large fiscal deficits, and currency crises—are important determinants of capital flight, even after controlling for institutional quality. Domestic credit growth was also significantly higher two years prior to capital flight, indicating that credit transferred to the private sector through the banking system may provide resources for flight. The macroeconomic and institutional determinants of capital flight are also robust when the data are divided by region and income group. But the Working Paper also found reason for some optimism. Countries that were able to improve both their policies and their institutions over time were able to curtail capital flight.

Countries with weak institutions have a greater propensity to accumulate debt because weak institutions spur capital flight, which, in turn, creates a financing need.

Revolving door: debt and capital flight

As many studies have found, debt also plays a role in capital flight. These studies indicate that increased foreign borrowing, particularly by the public sector, tends to coincide with outflows of capital from domestic households and firms. On the basis of a large panel of countries, the Working Paper validates this finding of a "revolving door" between debt and capital flight, which may indicate that residents fear the likelihood of a debt crisis or a potential nationalization of debt repayments or both. Controlling for a simultaneous causal relationship between capital flight and debt accumulation, the study found that, for each dollar of additional external debt, 13 cents, on average, flows out of the country. Conversely, each dollar of capital flight draws in 81 cents in new borrowing. As the maturity of debt falls, the impact of debt on capital flight becomes more pronounced. One dollar of additional short-term debt tends to generate 92 cents in capital flight, and each dollar of capital flight tends to spawn 12 cents of additional short-term borrowing.

Poor-quality institutions also factor into the equation. Countries with weak institutions have a greater propensity to accumulate debt because weak institutions spur capital flight, which, in turn, creates a financing need. That is, capital flight operates as a conduit through which poor institutional quality engenders macroeconomic instability, even as capital flight, in turn, responds to poor macroeconomic policies. As elites rob the riches and transfer resources outside the country, the country resorts to external borrowing to fill the savings gap. The ensuing buildup of debt further impairs macroeconomic stability and makes the country more vulnerable to shocks.

Institutional quality plays a role in access to finance as well. Countries with strong institutions, such as constraints on executive power, are able to tap foreign markets for borrowing even in the presence of capital flight. The ability to garner external financing may be one explanation for the observation that contemporaneous debt-fueled capital flight is more pronounced in countries with good institutions and low inequality. But a second explanation is that potential time lags occur between external borrowing, the extraction of resources by a country's elites, and the transference of those resources abroad. Indeed, after one year, debt accumulation fuels subsequent capital flight more prominently in countries with weak institutions and high income inequality.

In contrast to pure debt inflows, aid inflows and foreign direct investment (FDI) reduce capital flight. A country whose institutional quality is good is more likely to absorb aid inflows. Net FDI inflows also appear to reduce capital flight. As with aid, good institutional quality significantly helps a country absorb FDI inflows without inducing capital flight.

Policy implications

What does this study mean for policymakers in countries likely to receive debt relief and a larger volume of foreign aid? These countries can avoid raising taxes and cutting spending to finance debt repayment, and thereby reduce capital flight and the economic vulnerability associated with excessive debt. In addition, they should make it a priority to implement sound macroeconomic policies and establish an institutional environment that will allow them to allocate available resources to useful projects. ■

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Meenakshi Rishi, Seattle University
Sweta C. Saxena, University of Pittsburgh

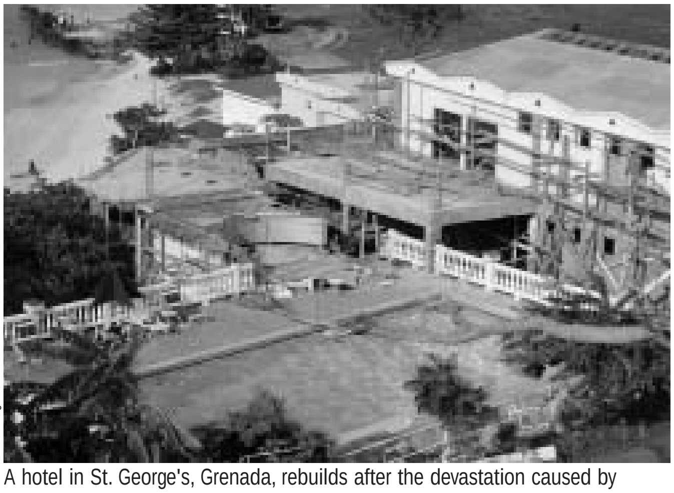
Copies of IMF Working Paper No. 05/199, *Robbing the Riches: Capital Flight, Institutions, and Instability*, by Valerie Cerra, Meenakshi Rishi, and Sweta C. Saxena, are available for $15.00 each from IMF Publication Services. Please see page 32 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

Fine-tuning the IMF's assistance to the Eastern Caribbean

Recognizing the enormous challenges facing the Eastern Caribbean, the IMF has stepped up its economic policy surveillance and technical assistance in the region. Public presentations of the findings of IMF missions in recent years have also helped spur an active public debate about how to face up to these challenges. As IMF and country officials in the region have noted in recent press briefings, the chief goals now are to ensure macroeconomic and financial stability, create more dynamic private sectors, and make greater progress toward regional integration.

In recent years, the Eastern Caribbean region has seen its medium-term growth prospects slow and public debt rise in many of its countries. In addition, the end of trade preferences has eroded the once significant role played by traditional crops, such as bananas and sugar. And tourism, now the driving force in most of the region's economies, is vulnerable to external shocks, as witnessed by the sharp downturn following the 9/11 attacks. Natural disasters are a frequent phenomenon. They can devastate economies, as was Grenada's experience with Hurricane Ivan in 2004. Declining foreign aid inflows and the recent increase in oil prices have added to the difficulty of responding to these challenges.

On recent visits to Antigua and Barbuda, Dominica, Grenada, and St. Kitts and Nevis, IMF Deputy Managing Director Agustín Carstens met with government officials, the press, and civil society representatives to discuss how countries could cope with these challenges. At the Eastern Caribbean Central Bank (ECCB), Carstens and the Director of the IMF's Western Hemisphere Department, Anoop Singh, participated in a regionwide videoconference. Singh presented the IMF's *Regional Economic Outlook for Latin America and the Caribbean.* They cautioned that, despite a recent upturn, growth in the region has been slow by international standards—lagging behind Asia as well as all developing countries as a group.


Andres Leighton/AP

A hotel in St. George's, Grenada, rebuilds after the devastation caused by Hurricane Ivan. Natural disasters are a frequent phenomenon in the region.

During the videoconference, Carstens, Singh, and Sir K. Dwight Venner, Governor of the ECCB, identified three factors that could help boost growth:

- ***Macroeconomic and financial stability.*** The region's quasi–currency board arrangement, which has helped to provide low and stable inflation, must be underpinned by fiscal prudence and sound financial sectors.
- ***More vibrant private sector–led growth.*** Governments should focus on providing the infrastructure and training needed to help create more jobs in the private sector.
- ***Regional integration.*** The area is becoming more integrated, but the pace of integration has to be increased, with decisive steps to move from intentions to implementation.

Country initiatives

In his discussions with national authorities, Carstens reiterated many of these points. In Antigua and Barbuda, he discussed the government's efforts to address the tough fiscal situation inherited after decades of profligacy. Prime Minister Baldwin Spencer and his cabinet outlined their ambitious reform program, which includes reintroducing the personal income tax, preparing for the introduction of a value-added tax this year, hiring financial advisors to normalize their relations with creditors, and passing several laws to enhance the transparency and accountability of public officers. The private sector, well aware of the difficult task facing the government, noted that a change in the mind-set of the population would also be essential. The public must recognize that the government cannot continue to be its "employer of last resort."

In St. Kitts and Nevis, the IMF team met with Prime Minister Denzil L. Douglas, a number of senior government officials, the sugar transition team, and a representative from the financial sector. After 300 years of operation, the sugar industry, which had employed nearly 10 percent of the labor force, was shut down last year. Discussions focused on how to reduce the country's extremely high debt to a more manageable one and how to manage the transition of workers into new industries.

Index Stock Imagery

The Eastern Caribbean now relies heavily on tourism, but it has proved to be a volatile source of income.

In this context, Governor Venner relayed the dissatisfaction expressed by Caribbean governments with the insufficient support offered by donors to mitigate losses from the erosion of trade preferences. He also voiced concern that the pace of regional integration has been hampered by the perception that integration would benefit the bigger islands at the expense of the smaller ones. Some resources have to be found, Governor Venner said, to smooth the transition.

While the Fund's involvement in the region has largely taken place through surveillance of economic policies and provision of technical assistance, it has also provided some financial assistance. Dominica, for example, has been receiving assistance under the IMF's Poverty Reduction and Growth Facility. In a meeting with Carstens, members of Dominica's cabinet expressed gratitude for the Fund's help, noting that the IMF-supported program has gone well to date.

With institutional capacity a real constraint in the region's small countries, extensive technical assistance is needed to support reforms.

Many challenges remain, however, including completing the debt-restructuring process, removing structural rigidities to private sector–led growth, streamlining public sector employment, addressing the remaining threats to public finances, and reducing vulnerabilities in the economy, including those in the financial sector. The cabinet members were concerned, however, that the momentum of reforms could slow if growth did not pick up substantially and if the concerns of the poor, particularly those employed in the banana sector, were not addressed.

Grenada, too, has received financial assistance, in this case under the IMF's emergency assistance policy to help countries cope with the effects of natural disasters. Prime Minister Keith Mitchell expressed his country's appreciation for the IMF's intense involvement since Hurricane Ivan struck the island. Mitchell also cited the critical role the Fund has played in triggering donor support, ensuring that the country's debt-restructuring process was market-friendly, and providing sound macroeconomic policy advice during the reconstruction and rebuilding period. With assistance from the Fund, the authorities are now developing a comprehensive medium-term reform agenda to foster economic growth, restore fiscal balances, ease the debt burden, reduce other vulnerabilities, and alleviate poverty.

What's ahead?

How can the IMF fine-tune its support for the Eastern Caribbean region? Carstens told the IMF's Executive Board that he had taken away a number of lessons from his trip. First, because institutional capacity is a real constraint in such small countries, extensive technical assistance is needed to support reforms. It was gratifying, Carstens said, to see that all countries in the region were satisfied with the efforts of the IMF's Caribbean Regional Technical Assistance Center, based in Barbados.

Second, gaining the trust of the region's authorities has required allocating additional IMF staff resources, in terms of both the number of staff and the intensity of their involvement in carrying out analytic work and offering policy advice. Carstens saw this as an important and timely investment in these member countries. Preventing crises through enhanced surveillance, he said, is likely to save potential costs in terms of crisis management in the six highly indebted countries that share a common currency board arrangement. The authorities are engaged in the effort to improve policies—including in those countries without an arrangement—and Fund advice is helping to define the policy agenda.

Third, the IMF should continue to strengthen its public outreach to help the authorities sustain the momentum of reforms. ■

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IMF External Relations Department

For more information on the Caribbean region, including the IMF's economic outlook for the region and Agustín Carstens' concluding remarks after his visits to Antigua and Barbuda, Dominica, Grenada, and St. Kitts and Nevis; please see the IMF's website (*www.imf.org*).

Germany: Is too much regulation preventing faster growth?

The headlines on the German economy are familiar: unemployment near historically high levels, a sluggish economy, and a stubbornly large fiscal deficit. Since reunification in 1990, Germany's real GDP has grown on average by about ½ of 1 percent a year less than that of its European peers. Is excessive market regulation to blame? Two recent IMF papers find that policies to increase labor participation rates offer the greatest potential for increased labor supply and output growth, and that these positive effects are largest when deregulation includes both labor and product markets.

Germany's poor economic performance is not an isolated case in Europe. The economic vitality of much of the European Union (EU) has been on the minds of policymakers for some time. The Lisbon Agenda—a policy package aimed at making the EU more competitive—has called attention to the barriers to competitiveness posed by excessive market regulation. Until recently, the lack of comparable data made the empirical assessment of this claim difficult, but recent studies, based on new indicators, confirm the negative effect of regulations on growth.

A comparison of aggregate regulatory restrictiveness in product and services markets across countries (see chart) suggests that Germany's level of regulation is on par with the average of the EU15 (the 15 European Union countries prior to the 2004 expansion). Disaggregated data, however, show large differences for the main subcategories of regulation. In particular, administrative burdens tend to be higher in Germany for the services sector, where regulation is especially tight in the crafts and so-called liberal professions, including architecture, accountancy, engineering, pharmacy, and the law. Remnants of the guild system, with its extensive licensing and qualification requirements, limit market entry and competitiveness.

A comparative look at Germany's labor market regulation yields similar results. Overall, the level of employment protection does not stand out as relatively restrictive by EU15 standards. However, disaggregation shows that protection of regular employment (that is, full-time jobs) is higher than in the EU15 (see table). By contrast, regulation of part-time or temporary employment is more flexible than in other countries, in part because of reforms in the 1990s, and has its origins in attempts to fight unemployment by liberalizing temporary "entry" jobs.

Protecting employment

Germany's aggregate level of employment protection is not overly restrictive, but protection of regular employment is higher than the EU15 average.

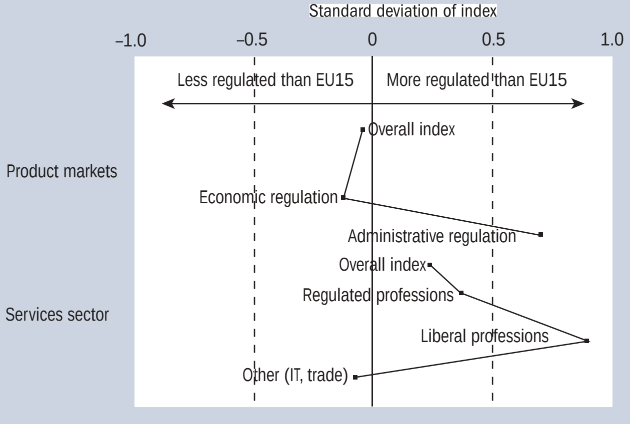
Index of employment protection

	Late 1980s		Late 1990s		2002–03	
	Germany	EU15	Germany	EU15	Germany	EU15
Comprehensive index	3.2	2.7	2.5	2.3	2.2	2.1
Temporary employment	3.8	3.0	2.3	2.2	1.8	2.0
Regular employment	2.6	2.5	2.7	2.3	2.7	2.3
Collective dismissals	...	...	3.5	3.4	3.8	3.4

Note: EU15 = The 15 European Union countries prior to the 2004 expansion.
Data: Organization of Economic Cooperation and Development, and IMF staff.

Comparing measures of restrictiveness

Large differences exist between Germany and the EU15 across main subcategories of regulation in product and services markets.



Data: Organization for Economic Cooperation and Development; Copenhagen Economics; and Institute of Advanced Studies, Vienna.

Room to catch up

Being average overall does not mean that Germany can put regulatory reform on the back burner. First, the European average tends to be high compared with competitors outside the EU15. Second, countries with the lowest restrictiveness scores show the best growth and job creation. And, third, the distribution of restrictiveness within subcategories of labor, services, and product markets can make a difference. For instance, job growth in the less-regulated temporary job market is much faster than in the full-time job market. Performance of the full-time job market, however, has a greater impact on overall labor (and fiscal) conditions.

Loosening the licensing and permit system stands out as one area of much-needed reform in the product and services markets. With a large share of economic activity conducted by small and medium-sized enterprises, barriers to entry—particularly into the services sector—can constrain economic dynamism and limit output and employment growth. In this connection, the rejection of the EU services directive—which

Germany must build on initiatives to ensure durable economic improvement

Economic activity in Germany is slowly picking up, with scope for further firming of growth in 2006, the IMF said in its annual economic review. But the recovery remains unbalanced and strong export growth has yet to feed through into higher household spending. Firms are investing cautiously, and structural labor market weakness (giving rise to slow job and wage growth) is inducing cautious consumer spending.

The IMF Executive Board commended the new German government's agenda to meet the challenges of globalization and demographic change. Directors welcomed the authorities' perseverance in introducing far-reaching and politically difficult labor market reforms in 2005 that have improved incentives to work and their plans to further reform the labor market and entitlement programs. At the same time, substantial challenges lie ahead, as trend growth is low and unemployment remains high.

To secure a durable improvement in economic performance, Directors urged the authorities to build on initiatives already announced to reduce distortions and structural rigidities and achieve fiscal sustainability over the medium term. They welcomed the priority placed on fiscal consolidation, notably policies to bring the fiscal deficit below 3 percent of GDP in 2007. Several Directors considered that more ambitious fiscal adjustment could have been contemplated for 2006, especially in the current circumstances of an improved economic outlook.

Directors also emphasized the need to raise the rate of labor utilization to mitigate the impact of a decline in the working-age population on growth and public finances. To complement ongoing reforms, which have enhanced labor supply, additional steps will be needed to promote greater wage differentiation and thus help increase labor demand. They encouraged the authorities to proceed more vigorously in deregulating product and service markets to foster job creation and reinforce labor market reforms.

Financial sector soundness continues to improve. To enhance performance further, Directors recommended amending the banking sector's legal framework to support market-based restructuring in both public and private banks. ■

For more information, please refer to Public Information Notice No. 06/04 on the IMF's website (*www.imf.org*).

was proposed to provide a legal framework for the free movement of services within the internal market—appears to be a missed opportunity to infuse much-needed competition into a sector that employs two-thirds of Germany's workers.

In the area of labor market regulation, there is scope to alleviate procedural burdens and dismissal protection. For low-skilled workers, in particular, these nonpecuniary costs of employment can have a perverse effect. Instead of protecting against unemployment, they can dampen labor demand and reduce opportunities for the unemployed to find jobs. The planned extension of the probation period to two years from six months by the new coalition government could improve this situation.

Coordinating reforms

Growing evidence points to the need to coordinate reforms across product and labor markets. Reform spillovers magnify benefits that might be too small if reforms are implemented in isolation. One example of a partial approach is Germany's recent labor market reform package, dubbed Hartz IV (named after Peter Hartz, the head of the commission on reforms set up in 2002). The reform has forced some inactive people back into the labor force, but it has not yet generated strong job increases. One reason may be the lack of coordination with complementary product and services market reforms. While the Hartz IV labor market reforms are having an effect, larger gains could probably have been achieved, in the short and medium terms, if the reforms had taken place in conjunction with a reduction in regulatory constraints.

Why would policymakers forgo broader-based reforms if they appeared to be a first-best strategy? One reason may be that the policymakers are not fully aware of the benefits of coordinated reforms. Another reason is fractured decision making or the need to appease interest groups. All of these factors can hamper reforms. While there seems to be no easy remedy for these problems, some steps that may help include increased efforts to educate the public on the benefits of more comprehensive reforms and, possibly, the delegation of reform design to a nonpartisan expert group.

Deregulating labor and product markets should be a high priority in Germany. Finding a formula that allows coordinated reforms will be important to ignite job creation and bring growth back up to rates seen in other European countries. ■

Helge Berger and Stephan Danninger
IMF European Department

Copies of IMF Working Paper No. 05/277, *Labor and Product Market Deregulation: Partial, Sequential, or Simultaneous Reform?* by Helge Berger and Stephan Danninger, and IMF Country Report No. 06/17, *Germany: Selected Issues*, are available for $15.00 each from IMF Publication Services. Please see page 32 for ordering details. The full texts are also available on the IMF's website (*www.imf.org*).

Stepped-up reforms are key to diversifying Kazakhstan's economy

With proven and probable crude oil reserves amounting to 30 billion barrels, and oil production expected to almost triple to about 3 million barrels a day by 2015, Kazakhstan is poised to become one of the world's major oil-exporting countries. The emergence of the hydrocarbon sector has also served as a major engine of growth for the country's economy, which grew by an average of 6 percent between 1996 and 2004.

A reliance on oil revenues, however, also poses challenges. Economies dominated by natural resource sectors tend to have lower long-term growth, higher income inequality, and larger volatility associated with changes in commodity prices. An antidote to these problems is greater economic diversification. Kazakhstan, which began to see non-oil output growth increase in 2000, benefited from the positive side-effects of booming oil revenues. The authorities are intensifying diversification efforts to ensure that the non-oil sector can sustain its growth, independent of volatile oil revenues. This will help the country achieve balanced economic development, create more jobs, and further reduce poverty.

Non-oil sector performance

According to national accounts data, Kazakhstan's non-oil sector has grown on average by about 9 percent a year since 1998. In 2004, the sector's share in the economy, in real terms, stood at about 95 percent of GDP. These data tend to overstate the sector's true size and growth, however, because they include services linked to the extraction of oil—such as the construction of extraction facilities and transportation of petroleum—which have grown particularly rapidly. Adjusting for these services, the share of non-oil output in the economy is significantly smaller—84 percent of GDP in 2004. Even after the adjustment, however, estimated non-oil output shows remarkable growth, averaging more than 8 percent a year since 1998.

For the Kazakh authorities, however, key questions are how the non-oil sector's growth fared relative to its potential (or trend) growth and what the future holds. Data for 1998–2004 indicate that, although non-oil output remained below its estimated trend level in 1999–2002, it has exceeded that level since then, indicating a possible emergence of capacity constraints.

An examination of the sources of growth—capital, labor, and total factor productivity—sheds some light on the sector's growth prospects. Both gains in total productivity and factor accumulation (increases in the quantity of capital or labor used in production) have contributed to non-oil output growth. If estimated total factor productivity growth and capital accumulation rates remain broadly in line with those of the recent past, non-oil sector growth could remain as high as 6–8 percent a year over the near term. But there has been a steady decline in the contribution of labor force growth to Kazakhstan's overall growth, possibly indicating that the economy is approaching full employment. If this is the case, employment growth is likely to contribute much less to future output growth. This development, along with the emerging capacity constraints, may dampen the 6–8 percent a year growth projection over the medium term.

Future prospects

What can the authorities do to boost growth prospects in the non-oil sector? Although there has been considerable progress with structural reforms since the early 1990s, the pace of reform has slowed in recent years. Privatization of small and medium-sized enterprises is basically complete, prices have been liberalized, and a framework for prudential regulation and supervision of the financial sector is in place. In addition, the authorities have taken steps to bring foreign trade policy legislation and enforcement practices into compliance with the World Trade Organization (WTO). European Bank for Reconstruction and Development transition indicators, however, show little improvement since the late 1990s in competition policy (regulations designed to promote competition and restrict monopoly practices) and enterprise restructuring.

Stepped-up structural reforms—institutional development, particularly procurement systems and public investment monitoring—would enhance governance and improve the investment climate. Reforms in competition policy and enterprise restructuring should ensure better basic services and lower the cost of doing business in Kazakhstan. Finally, in the trade area, further liberalization (particularly through accession to the WTO), a reduction in tariff dispersion, and steps to facilitate regional trade would also help boost the non-oil sector's growth prospects. ■

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This article is based on IMF Country Report No. 05/240, *Republic of Kazakhstan: Selected Issues*. Copies are available for $15.00 each from IMF Publication Services. Please see page 32 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

Stand-By, EFF, and PRGF arrangements as of November 30, 2005

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	4,810.00
Bolivia	April 2, 2003	March 31, 2006	145.78	34.28
Bulgaria	August 6, 2004	September 5, 2006	100.00	100.00
Colombia	May 2, 2005	November 2, 2006	405.00	405.00
Croatia	August 4, 2004	April 3, 2006	97.00	97.00
Dominican Republic	January 31, 2005	May 31, 2007	437.80	288.94
Macedonia, FYR	August 31, 2005	August 30, 2008	51.68	41.18
Peru	June 9, 2004	August 16, 2006	287.28	287.28
Romania	July 7, 2004	July 6, 2006	250.00	250.00
Turkey	May 11, 2005	May 10, 2008	6,662.04	6,106.87
Uruguay	June 8, 2005	June 7, 2008	766.25	704.95
Total			**18,183.82**	**13,125.49**
EFF				
Serbia and Montenegro	May 14, 2002	December 31, 2005	650.00	62.50
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
Total			**794.40**	**186.23**
PRGF				
Armenia	May 25, 2005	May 24, 2008	23.00	16.44
Bangladesh	June 20, 2003	December 31, 2006	400.33	184.55
Benin	August 5, 2005	August 4, 2008	6.19	5.31
Burkina Faso	June 11, 2003	August 15, 2006	24.08	6.88
Burundi	January 23, 2004	January 22, 2007	69.30	28.60
Cameroon	October 24, 2005	October 23, 2008	18.57	15.92
Chad	February 16, 2005	February 15, 2008	25.20	21.00
Congo, Democratic Republic of the	June 12, 2002	March 31, 2006	580.00	26.53
Congo, Republic of	December 6, 2004	December 5, 2007	54.99	39.27
Dominica	December 29, 2003	December 28, 2006	7.69	2.32
Georgia	June 4, 2004	June 3, 2007	98.00	56.00
Ghana	May 9, 2003	October 31, 2006	184.50	79.10
Guyana	September 20, 2002	September 12, 2006	54.55	18.52
Honduras	February 27, 2004	February 26, 2007	71.20	40.69
Kenya	November 21, 2003	November 20, 2006	225.00	150.00
Kyrgyz Republic	March 15, 2005	March 14, 2008	8.88	6.35
Mali	June 23, 2004	June 22, 2007	9.33	6.67
Malawi	August 5, 2005	August 4, 2008	38.17	32.75
Mozambique	July 6, 2004	July 5, 2007	11.36	6.50
Nepal	November 19, 2003	November 18, 2006	49.91	35.65
Nicaragua	December 13, 2002	December 12, 2005	97.50	41.78
Niger	January 31, 2005	January 30, 2008	26.32	14.57
Rwanda	August 12, 2002	February 11, 2006	4.00	0.57
São Tomé and Príncipe	August 1, 2005	July 31, 2008	2.96	2.54
Senegal	April 28, 2003	April 27, 2006	24.27	13.86
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	February 10, 2006	65.00	9.80
Tanzania	August 16, 2003	August 15, 2006	19.60	5.60
Uganda	September 13, 2002	December 31, 2005	13.50	2.00
Zambia	June 16, 2004	June 15, 2007	220.10	44.02
Total			**2,702.49**	**1,144.40**

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

In search of the link between trade, aid, and growth

While it is now fairly well accepted that greater integration with global markets can spur more rapid economic growth and poverty reduction, nagging questions remain. Why, for example, do researchers have difficulty finding empirical evidence that increased trade integration and aid have had strong positive effects on growth in low-income countries? The underlying connections between trade, aid, and growth formed the basis for a conference on January 9 sponsored by the Trade and Investment Division of the IMF's Research Department.

In a joint paper, the IMF's Arvind Subramanian and Raghuram Rajan took up the question of why it is so difficult to find a robust positive relationship between aid and growth and how policies can increase the likelihood that countries more fully reap the benefits of aid. They found that aid inflows have systematic, adverse effects on a country's international competitiveness, as reflected in lower relative growth rates of labor-intensive and exporting industries, as well as lower growth for manufacturing as a whole. They also determined that the channel for these effects is the real exchange rate appreciations caused by aid inflows.

Henrik Gschwindt De Gyor/IMF

Caroline Freund argued that excessive regulation can divert resources from the most productive sectors.

On the trade side, the World Bank's Caroline Freund, with Bineswaree Bolaky from the University of Maryland, explored the sometimes muted effect that trade opening can have on growth. Excessive regulation, they argued, is the culprit, because it can prevent resources from being shifted to the most productive sectors of the economy. Indeed, using World Bank data on labor and business entry regulations, they found that trade does not stimulate growth in economies that are overly regulated.

Another reason researchers have had difficulty finding robust empirical evidence of the effect of trade on growth is that good indicators of trade policies and trade restrictiveness are hard to find. This, in turn, complicates the task of comparative analysis across countries and over time.

A new measure of trade restrictiveness—the Anderson-Neary Trade Restrictiveness Index—has gained a lot of attention in academic and policy circles lately and was the focus of Stephen Tokarick's (IMF) research. He suggested that the major contribution of the new index is that it is firmly based in theory and can be implemented in practice.

Just how robust is this index? According to Tokarick, the index can be sensitive to a country's underlying economic structure. For example, it is actually a virtue of using the Anderson-Neary index that two countries may have the same trade policies—as represented by tariff rates—but that the value of the trade restrictiveness index for each country may be quite different.

The IMF's Kalpana Kochhar noted that the conference sought to achieve a better understanding of the observed difficulty in deriving the full benefits of economic integration through trade as well as from aid flows. Part of the difficulty in finding uncontroverted empirical evidence about the beneficial effects of trade and aid, she said, is the fact that growth is affected by many factors in addition to trade and aid flows. Institutional capacity and quality, for example, can influence how much an economy benefits from trade. Also, structural and macroeconomic policies can be more or less supportive of efforts to open up the economy and absorb and use aid flows effectively. ■

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Copies of conference papers are available on the IMF's website at *www.imf.org/external/np/exr/seminars/ index.htm.*

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