IMF Survey

INTERNATIONAL MONETARY FUND

MARCH 13, 2006 VOL. 35, NO. 5

www.imf.org/imfsurvey

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IMF joins effort to bolster pandemic preparations

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The IMF, like other international organizations, is stepping up efforts to help its member countries strengthen contingency planning in the event of an avian flu pandemic. Given near daily updates on the spread of the H5N1 virus among migratory birds and poultry, international organizations, led by the World Bank, are urging business continuity planners to adapt to the possible new threat. The Fund, for its part, is focusing on what countries can do to make their economic and financial systems more resilient.

MIKE CLARKE/AFP/Getty Images

Asia: gathering momentum, but not immune to risks

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The news from Asia continues to be upbeat. Growth in the region is expected to stay robust, inflation generally remains subdued, and intraregional trade is picking up. But higher oil prices are posing challenges for monetary policy. And electronics exports—a mainstay of the Indonesian, Malaysian, Philippine, and Thai economies—are also facing sharply increased competition and may not be keeping pace with rapid technological innovations.


Jay Directo/AFP PHOTO

Contemplating morality and economics

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In *The Moral Consequences of Economic Growth,* Benjamin Friedman argues that economic growth can have positive moral consequences. As he explained at a recent IMF book forum, when median incomes rise and the majority in a society experiences improved living standards, a sense of progress is created. That sense of progress, in turn, produces greater opportunity, tolerance of diversity, social mobility, fairness, and democracy. The reverse, he warns, has consequences, too.


Henrik Gschwindt de Gyor/IMF Photo

Practitioners' checklist for "scaled up" aid

page 80

For low-income developing countries—mostly in Africa—the expected increase in aid over the next 10 years will present many challenges, including how to use the funds effectively. A new IMF handbook is aimed at helping beneficiaries and donors assess the macroeconomic implications of increased aid and respond to the associated policy challenges.


Brent Stirton/Getty Images

What's on

March

14 IMF Managing Director Rodrigo de Rato to attend Central African Economic and Monetary Community (CEMAC) Summit, Bata, Equatorial Guinea

16–17 Roundtable on Multilateral Debt Relief Initiative and the IMF's Engagement in Low-Income Countries, Lusaka, Zambia

April

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

4–6 Seventh 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

24 United Nations Economic and Social Council High-Level Meeting with the IMF, World Bank, World Trade Organization, and United Nations Conference on Trade and Development, New York, 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

22–23 Organization for Economic Cooperation and Development Forum 2006, "Balancing Globalization," Paris, France

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

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

June

15–16 World Economic Forum on East Asia, "Creating a New Agenda for Asian Integration," Tokyo, Japan

19–23 World Urban Forum III, Vancouver, Canada

July

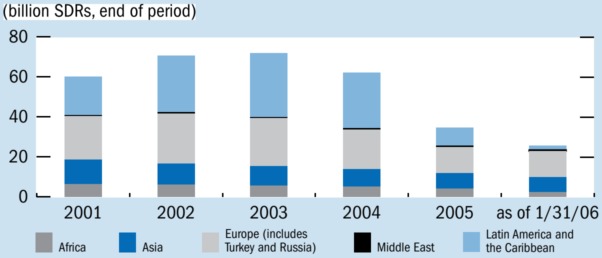
15–17 Group of Eight Summit, St. Petersburg, Russia

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*.

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



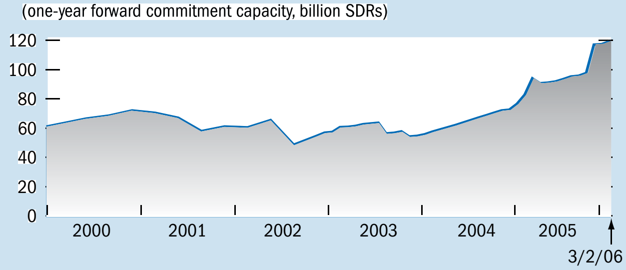
Largest outstanding loans

(billion SDRs, as of 1/31/06)

Nonconcessional		Concessional	
Turkey	10.14	Pakistan	0.99
Indonesia	5.46	Congo, Dem. Rep. of	0.55
Uruguay	1.61	Bangladesh	0.22
Ukraine	0.82	Cameroon	0.19
Serbia and Montenegro	0.60	Yemen, Republic of	0.18

IMF available resources

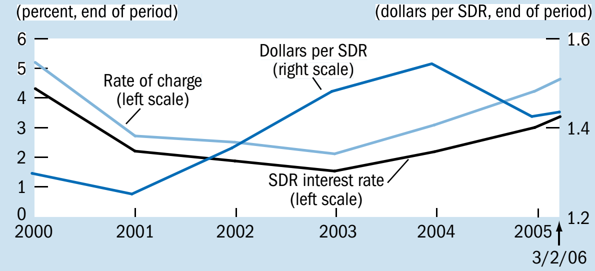
(one-year forward commitment capacity, billion SDRs)



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: 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.

IMF to help members strengthen pandemic contingency plans

With large uncertainties surrounding a possible avian flu pandemic, the IMF is complementing the efforts of other international organizations—including the World Bank, the World Health Organization, the Food and Agriculture Organization, and the World Organization for Animal Health—to help member countries strengthen national contingency plans. For its part, over the near term, the IMF will focus on helping countries manage operational risks in their financial systems if a pandemic erupts.

Sukree Sukplang/REUTERS

Livestock officials in Ayutthaya, Thailand.

In recent years, business continuity plans have become a critical component of operational risk management in the financial sector. Countries have enhanced these plans to make the critical infrastructure in their financial systems more resilient in the event of terrorism and natural disasters. Similar efforts will now be needed to help countries prepare for a pandemic.

To this end, the Fund has gathered common elements from advanced pandemic-response plans. This information is now available on the IMF's website (*www.imf.org*). In addition, the Fund is organizing regional seminars to bring together the business continuity managers of central banks to share knowledge and experience. Pandemic preparation in members' financial sectors and the appropriate economic policy response will also be discussed in the course of normal IMF consultations with country authorities.

Mounting concern

Over the past year, the world community has grown increasingly concerned about the possibility of a pandemic and the implications for human health and the global economic and financial system. Health experts are particularly concerned about the H5N1 virus strain, which has spread quickly in bird populations. In its current form, human infections are rare, but if the virus mutates to allow for efficient human-to-human transmission, a pandemic could occur. Depending on its severity, such a pandemic could threaten millions of lives globally (see *www.who.int* for detailed information).

A pandemic could have serious economic and financial effects as well. Its impact will depend on, among many factors, the number of people affected, the severity of the illness, and the duration as well as on the behavior and preparedness of firms, households, and governments, and the capacity and preparedness of health care systems.

Possible substantial impact

A severe pandemic—for example, similar to the 1918 Spanish flu—could cause a sharp but temporary decline in global economic activity. Economic disruptions in supply could come directly from high absenteeism, because people may be asked, or choose, to stay at home. Moreover, domestic demand could contract sharply—with consumer spending falling, investment being put on hold, possible trade and transportation restrictions affecting exports, reduced tourism, and lower global demand. Low-income countries are likely to be particularly severely affected because their fiscal and health care systems will make it difficult for them to purchase and distribute drugs and vaccines, treat victims, and provide for health security.

A pandemic could also threaten countries' financial systems. Some temporary increase in risk aversion could occur, sparking a surge in demand for liquidity, declines in asset prices, and widening credit spreads. Net capital flows to emerging markets could also decline significantly but temporarily as local residents seek safe havens for their assets and foreign investors postpone transactions. In addition, market operations could become more disorderly if the trading infrastructure were to break down. If absentee rates are high and contingency planning is insufficient, countries could see major operational disruptions in the critical functions and services of their financial systems, with potential spillovers into other jurisdictions. To varying degrees, countries could address temporary balance of payments pressures by drawing on their reserves.

Once a pandemic runs its course, experience has shown that economic activity recovers fairly quickly. The pace of the recovery would depend on the return of business and consumer confidence, the speed with which international trade resumes, and the recovery of asset values.

The potential for serious, temporary breakdowns and disruptions, however, underscores the importance of careful and wide-ranging contingency planning. The IMF is committed to raising awareness of the economic and financial risks, and to helping its member countries plan and prepare for managing operational risks if a pandemic does occur. ■

Jeanne Gobat
IMF Working Group on Avian Flu

New Europe: What do labor and capital flows hold for its future?

The recent enlargement of the European Union (EU) ushered in not only its largest-ever group of new members but also countries with relatively low per capita incomes. Raising incomes in the new members has therefore taken on new importance within the overall goal of European integration. Indeed, the union of the capital-poor, generally low-employment new members and the higher-employment, capital-rich old members has set in motion forces driving labor migration from east to west and capital flows from west to east. To better understand these trends and the policies that will influence how they play out, the Joint Vienna Institute, the IMF Institute, the IMF's European Department, and the National Bank of Poland gathered academics and policymakers for a conference at the National Bank on January 30–31.

Concerns about potentially large labor and capital flows following EU enlargement have put pressure on policymakers to slow the process. Many old members, concerned about the displacement of domestic workers and downward pressure on wages, have restricted migration from new members. Ireland, Sweden, and the United Kingdom are the exceptions. At the same time, capital has moved to the new members through increased offshoring and other foreign direct investment.

What implications do these developments have for EU policymakers? The conference participants explored the potential size and determinants of labor and capital flows, the composition and likely effect of flows on domestic economies and the basis for concerns about them, and policy measures that could best enhance the benefits and mitigate the costs of these flows.

National Bank of Poland

At the Warsaw seminar, right to left: Dalia Grybauskaitė (European Commission), Dalia Marin (University of Munich), Karl Pichelmann (European Commission), and Michael Devereux (University of Warwick).

How large is migration likely to be?

Historical episodes of regional migration and the experience to date in the EU suggest that removing all restrictions on migration within the enlarged EU would probably elicit relatively small labor movements—especially in contrast to those flows originating outside the EU. Tito Boeri (Bocconi University) pointed out that labor flows since enlargement have been much smaller than had been projected. Flows to the United Kingdom and Ireland have been larger than to other destinations—perhaps because these countries have fewer restrictions, better labor market conditions, or more flexible institutions that have allowed labor inflows to be used better. Flows to other old members have been small. Boeri estimates that after full adjustment about 3 percent of the population of new members (or less than 1 percent of the population of old members) is likely to work at any one time in the old members. Robert Holzmann (World Bank) noted that, although such migration would have favorable economic effects on old members, it would do little to address their impending demographic problems in Europe.

Drawing on research done on migration into the United States, George Borjas (Harvard University) argued that migration would affect wages in old Europe. In the United States, immigration does not necessarily affect wages at the regional level but may have a significant impact at the national level, especially in the age and experience categories that correspond most closely to migrant inflows.

Surveys of public opinion in Europe, however, suggest that concerns about lower wages are not the dominant reason for opposition to immigration in the old members. Christian Dustmann (University College, London) found that the chief basis for popular antagonism to labor inflows was a perception that migrants would overwhelm domestic welfare systems. Transitional arrangements that limited access to these systems instead of limiting migration therefore made sense.

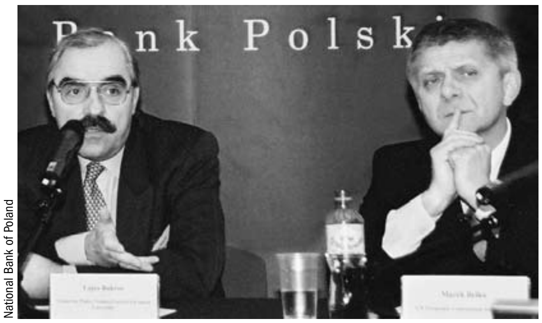
Capital may substitute for labor

Tim Hatton (University of Essex and Australian National University), considering the North Atlantic migration of the late 1800s and early 1900s, found that for some home countries (for example, Germany, Ireland, Italy, and the United Kingdom) labor and capital moved in the same direction; in others (Sweden and Finland), they moved in opposite directions.

Nevertheless, policy simulations suggested that capital flows to new members could greatly alleviate the need for migration. Antonio Spilimbergo (IMF), presenting the conclusions of Poonam Gupta and Ashoka Mody (both IMF), described evidence that the lower-productivity, more labor-intensive new members would continue to attract foreign capital. This investment, through production linkages elsewhere in the country, would generate trade. The resulting demand for labor in the new members and the increasing per capita incomes could reduce the incentives for migration.

Capital flows likely to dominate

Converging institutions and substantial differences in capital and labor ratios were bound to attract huge capital inflows to new members, and restrictions on migration would accentuate this response. Substantial flows had already taken place. Philip Lane (Trinity College, Dublin) and Gian Maria Milesi-Ferretti (IMF) noted that some Central European countries had accumulated exceptionally large net external liabilities, especially equity-type flows related to foreign direct investment.



National Bank of Poland

Lajos Bokros (left, Central European University) and Marek Belka (UN Economic Commission for Europe) at the concluding panel discussion.

Luís Campos e Cunha (New University of Lisbon)—noting that in Europe, where countries have large differences in factor endowments, Mundell's classic equivalence between trade and factor flows does not hold—paved the way for a discussion of the roles of trade and investment flows. Elhanan Helpman (Harvard University) argued persuasively that, given the huge amount of global trade, wage relativities were being established in global markets. Any attempts to protect high reservation wages or reduce wage dispersion would lead to outsourcing and offshoring—whether to new members or to countries outside the EU.

Evidence from German and Austrian firms indicates that they have improved competitiveness (particularly in the face of skill shortages) by using labor inputs from new members. In this emerging "war for talent," Dalia Marin (University of Munich), Claudia Buch (University of Tübingen), and Michael Landesmann (Vienna Institute for International Economic Studies) showed that firms in the capital-rich old members are employing migrants domestically, but, to an even greater extent, they are outsourcing and offshoring intermediate inputs. These changes have been hugely beneficial: rather than precipitating job losses, they have helped firms stay afloat in extremely competitive global markets.

How should policymakers respond?

The forces at play in European integration are a localized version of the broader forces of globalization, Eric Berloff (European Bank for Reconstruction and Development) and André Sapir (Université Libre de Bruxelles) emphasized. Marek Belka (UN Economic Commission for Europe) saw enlargement as a kind of vaccine against the perils of globalization, though he also viewed it, as he did broader globalization, as a force to be welcomed rather than resisted.

The evidence presented at the conference points to the value of policies that support competitiveness in labor and product markets. The more interplay between labor and product markets across the enlarged EU, the better positioned European firms will be to compete in global markets. Michael Devereux (Warwick University) argued that tax policies could influence the amount and location of investment. But there was little enthusiasm for strict tax harmonization and some support for tax competition, which might hasten income-equalizing capital flows.

Another critical question was the potential for vulnerabilities in the new members as they attracted capital inflows. Several participants downplayed the potential volatility of capital inflows, noting that they were driven predominantly by long-term investment decisions. Leslie Lipschitz (IMF), however, argued that substantial capital inflows intrinsically entailed vulnerabilities. Lajos Bokros (Central European University, Budapest) agreed, noting that the legacy of consumer goods shortages during central planning and rapid increases in permanent incomes were likely to make the new members low savers and dependent on foreign savings for some time.

For new member countries with fixed exchange rates, strong capital inflows would mean substantial increases in liquidity, bank credit, external liabilities, foreign exchange exposure, and current account deficits—alongside rapid growth. For the countries with flexible exchange rates, inflows could strengthen currencies, dampen competitiveness, and reduce profitability, investment, and growth. Good policies could lessen but not eliminate these capital flow–related problems. Susan Schadler (IMF) stressed that new members will need to pursue policies that allow them to adopt the euro, which offers substantially improved trade linkages between new and old members and eliminates currency-related vulnerabilities. ■

Clinton Shields
IMF Joint Vienna Institute

Asia: a bright outlook, with some clouds on the horizon

Asia is a vital and vibrant part of the world economy. In terms of purchasing power parity, it includes three (China, Japan, and India) of the world's four largest economies, accounting for one-fourth of global output. And its importance is increasing, because Asia also boasts two of the world's fastest-growing countries: China, which has averaged 10 percent annual growth in the past decade, and India, where annual growth has been running above 7 percent since 2003. This article examines the region's economic outlook for 2006 and the policy challenges ahead. Specifically, it weighs the implications of growing competition in electronics.

This year is expected to be another good one for Asia, with growth remaining robust and inflation generally subdued, though the outlook is clouded by risks and policy challenges. Projected growth for the region in 2006 is expected to be revised upward when the Fund's *World Economic Outlook* is released in mid-April. This bright outlook derives in large part from the momentum that Asia has gathered in recent quarters, notably from the entrenchment of Japan's recovery and a stronger and lengthier upswing in the global electronics export cycle than had been expected.

Prospects for growth have improved in nearly all parts of the region. Better growth is expected in the industrial countries, mainly because Japan's recovery (led by buoyant domestic demand) is proving to be unexpectedly vigorous. In fact, Japan's growth in the fourth quarter of 2005—at 5½ percent (seasonally adjusted annual rate)—was the strongest since 1991. Meanwhile, emerging Asia should continue to grow rapidly, led as before by China and India.

The external environment also appears set to remain strong. The U.S. economy may be slowing somewhat, but this slowdown should be offset by more rapid growth elsewhere, notably in Europe. Meanwhile, global capital expenditure is accelerating, boding well for the electronics sector, which accounts for about one-third of the region's exports. Shifts within the electronics sector, however, could have implications for growth within the region (see box, page 71).

Emerging Asia's exports will also be affected by several major developments within Asia. Regional trade, spurred by a resurgence in the rapid growth of China's imports, is picking up. At the same time, regional currencies have appreciated in real terms against the yen, by some 20 percent over the course of 2005. The impact of this appreciation may be muted, however. Few Asian countries other than Korea compete directly with Japan, and any effect on export prices may be offset by reduced costs, especially for imports of Japanese capital equipment.

Emerging Asia refers to China, India, the newly industrialized economies (Hong Kong SAR, Korea, Singapore, and Taiwan Province of China), and the ASEAN-4 (Indonesia, Malaysia, the Philippines, and Thailand). *Industrial Asia* refers to Japan, Australia, and New Zealand.

Test for monetary policy

Despite this generally bright outlook, the region faces a number of policy challenges. In particular, the doubling of world oil prices since December 2003 has posed a dilemma for some countries whose domestic fuel prices have long been controlled. Recently, each of the ASEAN-4 countries raised domestic oil prices—most sharply in Indonesia, where gasoline prices increased by nearly 90 percent on October 1. Oil prices were also significantly increased in Malaysia and fully liberalized in Thailand (they have long been free in the Philippines).

These bold price adjustments, however, now complicate monetary policy. For some time, the authorities in many Asian countries have maintained interest rates at historically low levels to spur generally weak domestic demand. This stance—made possible by low inflation—is now facing mounting pressure. Although inflation in Asia as a whole is expected to remain subdued, reduced oil subsidies in the ASEAN-4 countries have propelled average headline inflation to 10 percent and underlying inflation to nearly 6 percent. Central banks in these countries have responded aggressively, raising policy rates by 170 basis points between May 2004 and January 2006.

These actions are already paying significant dividends. For example, in Indonesia, the reduction in oil subsidies, coupled with an aggressive rise in interest rates, has led to a sharp improvement in investor confidence, with the exchange rate appreciating by 10 percent against the U.S. dollar since September 2005 and the stock market rising by 18 percent. Similarly, in the Philippines, monetary tightening—together with strenuous revenue efforts, including an extension and rate increase in the value-added tax—has caused spreads on the country's U.S. dollar bonds to fall below 300 basis points for the first time in years.

As this monetary tightening takes hold, however, Asian countries will face the renewed challenge of reviving weak domestic demand—an important source of the region's $350 billion current account surplus. This surplus has been stable in dollar terms in recent years and is expected to remain so in 2006 but with significant changes in composition. In most of the region, surpluses have been shrinking as oil import bills

ASEAN-4's electronics exports face growing competition

Electronics exports are a mainstay of ASEAN-4 economies. In the recent upturn of the electronics cycle, however, exports from some of these countries have lagged behind the regional export recovery. In 2005, this was especially evident in Indonesia (where electronics exports contracted toward the end of the year) and the Philippines (where they remained flat). Has the electronics sector in both countries become less competitive? The situation is of particular concern in the Philippines, where electronics account for over two-thirds of total exports.

These developments, by themselves, are not conclusive evidence of an emerging problem. Electronics exports from the Philippines, and to a lesser extent from Indonesia, have not always been closely linked with the global electronics cycle. Indeed, there are early signs that the Philippines' electronics exports may finally be accelerating.

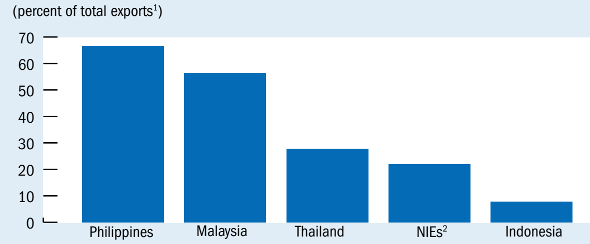
Other indicators, however, suggest that regional and technological factors are, indeed, posing a challenge for the ASEAN-4. At the regional level, the emergence of China as a location for electronics manufacturing has diverted investment in new capacity from Southeast Asia. Investment in new fabrication plants in China shot up to $16 billion over the period 2001–04, whereas investment in Southeast Asia fell to just $5 billion, with an even sharper decline in Taiwan Province of China.

This regional factor is compounded by the rapid pace of technological innovation. For example, the ASEAN-4 electronics sector tends to be heavily geared toward the production of hard drives, which, over the medium term, may be increasingly replaced with flash memory. Indeed, Apple Computer recently decided to replace hard drives in the latest generation of iPods with flash memory, a shift that will benefit primarily Japan, Korea, Taiwan Province of China, and the United States. As the capacity of flash memory evolves further, hard drives may become increasingly relegated to more mature products (such as servers), in which market growth will be slower.

Over the medium term, each country could address these challenges by building on its competitive advantages. Thailand is an important producer of hard drives, for which demand may gradually wane. But it will benefit from the emergence of its automotive sector, which produces mainly Japanese cars for export to the rest of ASEAN. Meanwhile, Malaysia's competitive edge lies in the shorter delivery times that its infrastructure allows. This advantage may erode over time as China's infrastructure continues to improve. Indonesia benefits from low wage costs, but weak investment in the export sector since the Asian crisis may signal a longer-term structural problem. Finally, the Philippines benefits from its English-speaking labor force, but investment has been weak, and three electronics multinationals announced last year that they were moving production elsewhere in the region.

Vital role

For a number of countries in emerging Asia, electronics make up a significant part of overall exports.



[1]Average of January 2003–September 2005.
[2]Newly industrialized economies.
Data: CEIC Data Company Ltd. and IMF staff calculations.

have increased—notably in Japan and India, where domestic demand has also strengthened considerably. At the same time, China's surplus doubled, to about $160 billion (7 percent of GDP) in 2005, as exports boomed while imports stagnated for a time. This year, however, these trends should halt; in fact, China's surplus has already started to stabilize.

Faced with rising prices and generally weak domestic demand, many countries have scaled back foreign exchange intervention, allowing their currencies to appreciate to help reduce upward price pressures and boost real household incomes. During the second half of 2005, reserve accumulation outside China amounted to just $5 billion, compared with about $40 billion in the first half. And, between end-November and end-January, when there was a renewed surge in capital inflows, the region's flexible currencies (apart from those of China, Hong Kong SAR, and Malaysia) appreciated by 5 percent against the U.S. dollar. In contrast, in China, reserve growth remained approximately unchanged at about $100 billion in the second half of 2005, with a decline in capital inflows offsetting the widening of the current account surplus.

In the months to come, the region faces several risks. First, oil prices could surge again, because the margin of excess oil production capacity is low and is likely to remain so for some time. Also, with the U.S. labor market tightening, inflationary pressures in the United States could rise, leading the Federal Reserve to raise interest rates by more than expected, dampening U.S. growth and triggering a widening of emerging market spreads. In addition, there is the threat of an avian flu pandemic, which could adversely affect global growth and financial conditions. Finally, there remains a danger of a disorderly adjustment to global current account imbalances. ■

IMF Asia and Pacific Department

India's accelerated reforms can hasten economic takeoff

India's economic performance over the past several years has been truly extraordinary. The country is opening its economy and reaping the benefits of globalization. It now appears set for an extended period of rapid economic development, but such an outcome is by no means assured. Continued reforms will be essential for sustained high growth, and speeding up steps to open up the economy offers the promise of an even faster economic transformation. As India looks to a promising future, the IMF's annual consultation with the country addressed five key questions.

India's recent record is impressive: GDP growth is set to top 7½ percent for the third consecutive year in 2005/06; inflation remains under control; and large international reserves cushion a growing current account deficit (see table). But, in the near term, India will need to manage the challenges, such as inflation and rapid credit growth, that arise from rapid economic growth while continuing to pursue, and perhaps accelerate, reforms that will be necessary if the government is to achieve its ambitious goals of growth of 8–10 percent a year and dramatic progress in reducing poverty.

The authorities will also need to step up progress in bringing down the general government fiscal deficit, which, over the past few years, has declined from 10 percent to less than 8 percent of GDP. Moreover, fiscal space will be needed to accommodate increased spending on infrastructure and social services. Although the authorities have taken steps to enhance India's integration with the global economy and eliminate structural roadblocks, they will need to do much more to develop manufacturing and create jobs for the more than 100 million people set to join the labor force over the next decade.

Impressive performance

Growth has picked up and inflation remains under control, but more progress will be needed on deficits and debt.

	2002/03	2003/04	2004/05	Proj. 2005/06	Proj. 2006/07
	(year on year percent change)				
Real GDP (at factor cost)	3.8	8.5	7.5	7.8	7.2
Wholesale prices	3.6	5.4	6.5	4.5	4.8
	(percent of GDP)				
Central government deficit	6.0	5.1	4.1	4.1	3.8
General government deficit	9.7	9.0	7.4	7.5	6.8
General government debt	86.2	86.1	85.7	84.1	82.0
Current account deficit	1.3	2.3	–0.8	–3.0	–3.0
	(billion U.S. dollars, end-period)				
Gross reserves	76.1	113.0	141.5	145.9	151.6
	(year on year percent change, end-period)				
Credit to commercial sector	18.5	13.0	26.0	28.0 [1]	. . .
Stock market	–12.1	83.4	16.1	54.5 [1]	. . .

Data: Indian authorities, CEIC, and IMF staff estimates and projections.
Note: Data are for April–March fiscal years.
[1]Year-on-year percent change at end-February 2006.

What will it take?

With India possibly on the cusp of the kind of takeoff that transformed much of East and Southeast Asia, its policymakers are wrestling with five key policy questions:

How can India deal with short-term risks? While consumer price inflation has remained contained at about 4 percent a year, strong underlying pressures point to upside risks. In contrast to much of Asia, India's domestic demand is robust. Credit is expected to grow by about 30 percent in 2005/06, and the current account deficit is projected to widen from below 1 percent to 3 percent of GDP over the same period. And India still needs to pass through more of the past year's rise in global oil prices.

In this light, monetary policy has focused appropriately on keeping inflation expectations in check. Interest rate hikes by the Reserve Bank of India in October and January signaled a strong commitment to price stability, but inflation pressures will need to continue to be monitored closely. Fiscal policy can also help counter demand pressure, which underscores the importance of overperforming on this year's budget (as the government is seeking to do) and passing a prudent budget for the next fiscal year.

How can fiscal adjustment be achieved? Indian policymakers acknowledge that the fiscal deficit is too high. Past deficits have resulted in a heavy debt burden—86 percent of GDP—and current deficits, including debt service, are increasingly competing for resources with a booming private sector. At the same time, a large infrastructure gap and critical social needs require higher government spending. The 2006/07 budget, recently presented to parliament, aims to reduce the central government deficit from 4.1 to 3.8 percent of GDP, based on a modest broadening of the tax base and containment of nonpriority spending. While the proposed budget aids India's gradual progress on the fiscal front, much more remains to be done:

- *Continued tax reform is critical.* Last year, India took key steps, including introducing a value-added tax in most states. But it must go beyond the limited measures offered in this year's budget to further broaden the tax base—including trimming exemptions and moving to a national goods and services tax.

• *More can be done to make spending more efficient.* There remains scope to improve the targeting of subsidies—including for petroleum products, food, and fertilizer—for the neediest.

• *Fiscal reform in the states is crucial.* States account for about half of the general government deficit, which underscores why more progress is needed. In 2006, the center is providing additional grants and new incentives to encourage greater adjustment in state budgets. Imposing a hard budget constraint—including by moving to market-based borrowing—would also encourage needed reforms.

How can infrastructure bottlenecks be eased? The government has rightly emphasized the need to address India's huge infrastructure needs. Shortages of electricity and clean water are widespread, while inadequate roads, ports, and airports are increasingly constraining the booming economy. Given the limited ability of India's public sector to increase spending, a successful approach will require an expansion of public-private partnerships. Progress has already been achieved in some areas, notably in the development of model concession agreements for roads (which have attracted significant private participation) and the recent awarding of private contracts to modernize Delhi and Mumbai airports. Further progress will depend on advances in creating a regulatory environment across all sectors that is conducive to private participation.

How can a world-class financial system be created? Enhancing financial intermediation and ensuring broader access to financial services are keys to promoting growth and poverty reduction in India. The health of the banking system has improved dramatically in recent years. But bank credit to the private sector—at about 40 percent of GDP—remains relatively low despite the current rapid expansion, and large segments of the population lack access to banking services.

In this context, it will be important to address the risks that arise from rapid credit growth while the financial sector is opened to increased competition. The Reserve Bank of India has taken important steps to tighten prudential regulations—notably by raising general provisioning and tightening the supervision of lending to real estate and other potentially risky sectors. To encourage financial development, the Reserve Bank of India has also initiated reforms to increase the autonomy of public sector banks (which dominate the banking system) and gradually lift restrictions on foreign competition.

More ambitious action to attract new private and foreign participation could produce significant benefits, however. In particular, bringing forward from 2009 the target date for allowing foreign direct investment (FDI) in domestic, non-distressed banks and allowing public banks to reduce their government-owned share below the current 51 percent floor could bring technical know-how to India and increase the banking sector's efficiency and reach.

How can globalization's benefits be maximized? India's recent impressive economic performance has gone hand in hand with its gradual opening to the global economy. The country is competing successfully—most notably in information technology services and outsourcing but also increasingly in manufacturing. Despite ongoing reforms, however, India remains a relatively closed economy. To develop the manufacturing base further—a critical step in generating large numbers of less highly skilled jobs to serve as a ladder out of poverty—India needs to deepen its integration with the global economy through a number of important steps:

• *Accelerate tariff reductions.* Import tariffs have been declining for a number of years. Last year, average tariff rates fell by 5 percentage points (to an average rate of 17 percent) and further cuts are contemplated in the draft budget. An acceleration of India's planned convergence to ASEAN tariff levels—now scheduled for 2009—would enhance competitiveness.

• *Liberalize FDI.* India has made progress toward liberalizing FDI. With interest high (India is among the top two or three potential destinations in several surveys) but FDI still low, the country stands to reap sizable rewards from lifting remaining restrictions and continuing to improve its overall business climate.

• *Increase labor market flexibility.* Less restrictive labor laws can enhance prospects for employment gains. Despite rapid growth in recent years, employment has remained flat. India's labor laws are relatively rigid and complex, stalling the development of large-scale manufacturing. A number of helpful reforms are under consideration, including expanding the ability of firms to hire contract workers, streamlining labor regulations, and exempting more small firms from certain labor laws, inspections, and reporting requirements.

Over the past decade, India has become an important player in the world economy. The current environment of much-deserved optimism provides an ideal opportunity for India to move ahead with further reforms that can promote continued rapid economic development. ■

Jerald Schiff
IMF Asia and Pacific Department

Copies of *India: 2005 Article IV Consultation* (Staff Report, Staff Statement, and Public Information Notice on the Executive Board Discussion) (IMF Country Report No. 06/55) and *India: Selected Issues* (IMF Country Report No. 06/56) are available, for $15.00 each, from IMF Publication Services (see page 80 for ordering details). The full text is also available on the IMF's website (*www.imf.org*)

Italy's "growth gloom" requires domestic reforms

Italy's economic performance since 2001 has been subpar. A cyclical recovery, albeit timid, is finally under way, and growth is expected to strengthen moderately in 2006. However, absent structural reforms to create a more dynamic and liberalized economy and decisive moves to improve the public finances, medium-term growth prospects remain gloomy.

The good news for Italy is that its short-term prospects have been slowly improving. A modest cyclical recovery is under way, although its robustness is a concern. After a flat 2005, real GDP is expected to grow moderately this year, with net exports and investment benefiting from the recovery in Italy's main European Union (EU) partner countries. Inflationary pressures are expected to remain benign. But downside risks, stemming from higher energy prices and a slower-than-expected recovery in industrial production, remain.

Despite the cyclical improvements, the medium-term outlook is worrying. Potential growth is estimated at only 1¼ percent annually, reflecting productivity growth that was the lowest among all industrial countries over 1996–2004. Without reforms, potential growth is likely to weaken further, as population aging shrinks the workforce. The public debt-to-GDP ratio is the highest in the industrial world—above 100 percent of GDP in 2005—even after a decade of declines, reflecting high budget deficits and slow growth.

Anatomy of the problem

Although outside factors or a historical legacy are often blamed for Italy's slow growth, its economic problems are mainly homegrown. To be sure, the euro's appreciation and increased competition from emerging markets have contributed to weak export performance. Growth has also suffered because of the prevalence of small, often family-owned firms—which discourages innovation and risk taking—and a traditional product orientation toward relatively low-tech goods that are encountering increasing competition from emerging market producers. But history is not destiny. Indeed, firm size and specialization depend in the long run on domestic practices and policies, among other factors. The resistance of Italy's economic structure to change is a symptom of deep-seated rigidities and inefficiencies in its labor, product, and services markets.

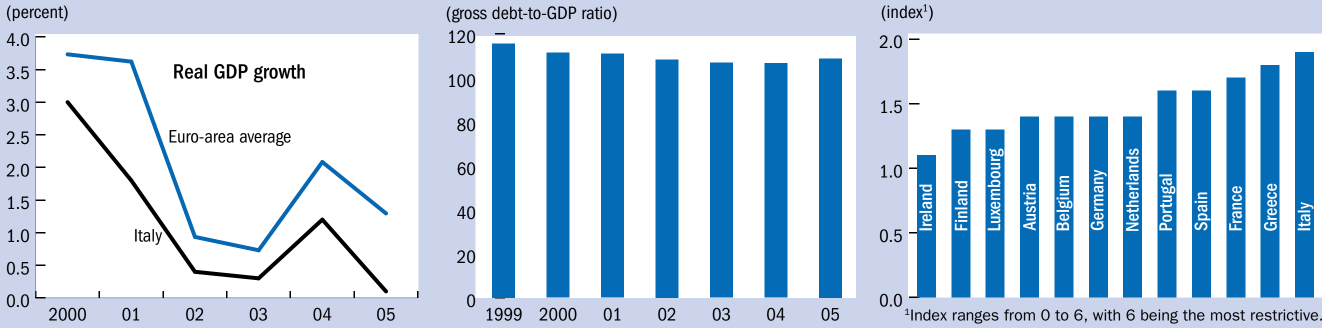
Italy's situation has been further complicated by policy failings over the past decade. It has squandered the fiscal dividend accruing from the lower interest rates associated with monetary union. In fact, it has used the euro-related decline in interest expenditure to finance higher spending elsewhere in the budget. Such policies have produced a deficit now appreciably above the 3 percent of GDP ceiling called for by the EU's Stability and Growth Pact (SGP). The large deficits have inhibited a rapid reduction in the public debt and require a fiscal policy stance that is attenuating the economic recovery. In addition, although important labor market reforms have facilitated a significant increase in employment in recent years, a failure to liberalize product and services markets with the same vigor has perpetuated the rigid productive structure.

A call for action

A successful reform program will need to pursue a two-pronged approach—fiscal adjustment and structural change—that takes advantage of complementarities between the two. Expenditure-based fiscal adjustment will be necessary because Italy's extraordinarily high public debt and siz-

How it can be done

To boost growth prospects, | Italy needs to reduce debt . . . | and ease product market regulation.



Data: Eurostat.

Data: Eurostat and IMF staff calculations.

[1]Index ranges from 0 to 6, with 6 being the most restrictive.

Data: OECD.

able fiscal deficit divert resources from more productive uses and contribute to uncertainty about future fiscal policies. Structural reforms in product, labor, and services markets will also be essential because, without them, increased competitiveness and productivity will remain beyond reach.

Credible fiscal adjustment needed

It will be necessary to undertake fiscal adjustment over an extended period. In the near term, reducing deficits below the SGP-compatible levels is essential, and strengthening spending discipline remains a key priority. The 2006 budget targets a deficit of 3.5 percent of GDP. However, sustaining the envisaged deep expenditure cuts—in the absence of measures to address structural spending determinants and given a history of leniency toward past noncompliance with spending norms—will depend on the authorities' willingness to implement strictly the budget's enhanced control and sanction mechanisms.

In the longer term, bolder steps are needed to put public finances on a sustainable footing. Despite a series of pension reforms over the past decade, substantial further deficit reduction will be required to respond to pressures arising from population aging. Analysis by IMF staff indicates that a consolidation path yielding overall fiscal balance by 2010 is needed to achieve long-run fiscal sustainability.

To be credible, adjustment should focus on expenditure containment, supported by enhanced transparency. The steady growth in primary current spending since the late 1990s—at an annual average rate of 2 percent in real terms—is at the core of Italy's current fiscal fragility. Reversing this trend will require a targeted approach to expenditure rationalization within a medium-term budget framework. Moreover, Italy's budget presentation falls well short of industrial country transparency practices, and the timeliness of some information is unsatisfactory, which complicates analysis and budget control. Last, but not least, the ongoing devolution of functions from the central government highlights the need for a properly designed system of fiscal federalism, with incentives for all levels of government to be fiscally responsible.

Boosting productivity and efficiency

Structural reforms, which should focus on boosting productivity and efficiency, are also crucial to improved medium-term prospects. To be effective, the reform will require an unequivocal commitment to steps that enhance competition, reduce price markups, and promote freedom of choice, including by dismantling systems that protect economic rents of various insider groups at the expense of the public at large. Measures are needed to eliminate protection in sectors such as retail trade and key network industries, eliminate rules that inhibit competition in professions, and enhance the powers of antitrust authorities. Many of these reforms will have low budgetary costs and can be pursued despite the tight fiscal position.

In addition, there remains scope for increasing labor market flexibility. Participation rates, especially for women and the young, are still low. The key priorities include an overhaul of Italy's social protection system; better unemployment support (properly conditional on participation in active labor programs and job search activities and accompanied by a relaxation of employment protection legislation); and greater variation of wages in line with productivity differences, which is critical to redress competitiveness losses in the short term.

Improvements to the business environment are also necessary. Cross-country data indicate that Italy still lags behind other industrial countries on many fronts, with firms forced to confront a slow legal system and heavy administrative burdens. Addressing these shortcomings will mean enhancing the delivery of public services, accelerating legal processes, streamlining bureaucratic requirements, improving the quality of public investment and infrastructure, and strengthening enforcement of the rule of law.

Finally, a competitive financial sector is also critical to support faster growth and a more vibrant economy. The recent IMF Financial Sector Assessment found Italy's financial system to be generally sound, and stress tests indicate little vulnerability to unfavorable macroeconomic shocks. However, as noted in the recent IMF staff country report, a number of structural weaknesses limit the role of the financial system in promoting growth, including high fees and commissions, undersized corporate bond and equity markets, and a predominantly relationship-based orientation that favors incumbents over new entrants. ■

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IMF upholds sanctions against Zimbabwe

In a recent review of Zimbabwe's overdue financial obligations to the IMF and the sanctions against the country, the IMF Executive Board decided not to restore Zimbabwe's voting and related rights or its eligibility to use the IMF's general resources.

Although Zimbabwe recently settled its arrears to the IMF's General Resources Account, it continues to be in arrears (totaling about $119 million) to the Poverty Reduction and Growth Facility (PRGF)-Exogenous Shocks Facility (ESF) Trust Fund. Zimbabwe is thus ineligible for a new arrangement under the PRGF.

The Executive Board noted that Zimbabwe urgently needs to implement macroeconomic stabilization and structural reforms and to try to settle its overdue financial obligations to the PRGF-ESF Trust.

The full text of Press Release No. 06/45 is available on the IMF's website (*www.imf.org*).

Morality in a material world?

Does economic growth have morally beneficial consequences? Celebrated economists and philosophers like Adam Smith and John Rawls have long recognized the connection between economics and morality. In his new book, *The Moral Consequences of Economic Growth*, Harvard University professor Benjamin Friedman argues that materialism and morality are not at odds with each other, that economic growth yields benefits far beyond the material, and that economic growth and moral growth go hand in hand, reinforcing each other. At a February 8 Book Forum sponsored by the IMF, panelists Sebastian Mallaby (*The Washington Post*), Nigel Ashford (George Mason University), Simon Johnson (MIT), and moderator the Reverend Andrew Small (U.S. Conference of Catholic Bishops) joined Friedman for a debate on economic growth, morality, and policy.

As Friedman sees it, when median incomes in a society are rising—that is, when the *majority* of the population is experiencing an improved standard of living in material terms—a sense of progress will be created that will have positive moral consequences. To Friedman, who draws on the ideas of Enlightenment thinkers like Locke and Montesquieu, those are "greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy."

Henrik Gschwindt de Gyor/IMF Photo

Friedman argues that if the majority of the population is not moving ahead, there will be negative moral consequences, even if the top 10 percent is doing well.

Friedman argues that the reverse is also true. Stagnating or declining in living standards and median incomes will tend to bring about a sense of retreat, which will have negative moral consequences, like less opportunity and less tolerance of diversity. His focus "is not aggregate GDP growth" but, rather, the type of growth where the standard of living increases for the majority of the population. A rise in overall GDP is not enough, Friedman says, because such an increase often affects only the top 10 percent of a population. What matters for a sense of progress is "what is happening to the bulk of society that falls between the 10 and 90 percent" of a population; if the majority of the population is not moving ahead, there will be negative moral consequences, even if the top 10 percent is doing well.

In defining economic growth in terms of rising median incomes, Friedman suggests that it is the majority of the population that wields influence in moral terms. When their standard of living rises, the majority of people not only see progress but are also optimistic that they can participate in that progress and enjoy the gains from economic growth. When people's standard of living declines, the result is just as powerful and can ignite distrust and insecurity in a society. Friedman said his economic model "is not about being rich and is not an argument that having a higher income level makes us happier. It's about what difference the notion of progress makes in people's lives."

A sense of progress

From Friedman's perspective, a society's sense of progress is essential. If this sense is missing or diminished, then no society, no matter how wealthy in aggregate terms, is immune to having its basic democratic values put at risk. To illustrate, Friedman traced U.S. attitudes toward immigrants from 1850 to the present, highlighting periods in which immigrants were and were not welcomed and made corresponding connections with economic growth during each period.

He noted that slow growth in the 1880s was one factor underlying the reimposition of segregation in the American South; in the 1950s and 1960s, the American civil rights movement gained momentum when the U.S. economy was experiencing unprecedented growth. Although it would be foolish, he said, to pretend that "every twist and turn" of immigration policy or step toward racial equality over the past 150 years "was narrowly anchored in the underlying economics of growth versus economic stagnation," it would be more foolish "to pretend that the underlying economics had nothing to do with it." In each instance, he said, underlying economic growth or stagnation played a significant role in shaping attitudes toward immigrants, religious prejudice, race relations, and improvements in democracy and fairness.

Growth = happiness?

Sebastian Mallaby noted that both Friedman and Richard Layard (London School of Economics) explore the relationship between growth and happiness. Layard's book, *The New Science of Happiness*, observes that people are not necessarily happier when they are richer, and it questions the usefulness of trying to maximize GDP growth. Whereas, to Friedman, growth brings about a more morally tolerant and open society, to Layard, "hard work, which is one of the inputs of growth, can lead to unhappiness." Mallaby explained that, according to Layard, "if I work hard, then my neighbor has to work hard, too, in order to keep up. And if he falls behind, he will feel unhappy. So my working hard has this effect of forcing everybody else to work hard, so that we are all working too hard and we are all stressed out." Friedman and Layard reach virtually opposing conclusions, Mallaby said.

Friedman focuses on the societal as opposed to the individual value of growth, leading Mallaby to ask "how social morality would be enhanced unless it worked through the mechanism of changing the individual." Mallaby insisted that society is "a collection of individuals," and would have liked Friedman to comment more on the impact of growth on individuals. He nonetheless welcomed Friedman's view that individuals indeed feel more open and are likely to be more tolerant if they are prospering "more than they were 5 years ago or 10 years ago." In Mallaby's view, growth is good for the individual because it "extends the field of human experience." Thus, although making individuals richer would not necessarily make them happier, it would provide them with "a broader range of individual experiences, which would contribute to openness and tolerance and, hence, social morality."

"There is something seriously deficient in the way we talk publicly about economic growth today."

—Benjamin Friedman

Getting the right rate of growth

Economists often talk about the "right rate of growth" as being the market-determined rate—the idea being that, left to their own devices, firms and households will make decisions about saving and investment that deliver an optimal rate of growth. Friedman disagreed, saying that the right rate of growth is different from, and in fact faster than, the market-determined rate. There is no way, he said, to account for intangible moral assets like tolerance, democracy, fairness, and opportunity in market terms to determine the right rate of growth. Thus, in his view, a market-determined rate that does not take these moral components into account will be slower than it could be. There is an opportunity, he said, for "a positive role for public policy" to stimulate a rate of growth faster than "the market, left to its own devices, would provide."

Nigel Ashford voiced strong disappointment with the "exaggerated role" that Friedman attributes to public policy in promoting growth. In recommending that government foster a rate of growth greater than the purely market-determined one, Ashford said Friedman "makes the classic error that, because markets fail, government should step in. But there is both market and government failure. One should compare real markets and real governments, and not real markets and ideal government." Ashford also took issue with Friedman's claim that "markets have negative externalities that require intervention," arguing that this "ignores both the positive unintended consequences of markets and the negative unintended consequences of governments." Indeed, he asked, how does one know what the right rate of growth is, and why should Friedman's view be accepted over that of other economists?

In keeping with the times

The panelists agreed on one point: too little attention is given to the connection between economics and morality. Simon Johnson observed that, although economists spend a lot of time worrying about economic growth, they rarely delve into its moral consequences. According to Friedman, "there is something seriously deficient in the way we talk publicly about economic growth today." His concern is that, if people evaluate economic growth and the policies that impede it in purely material terms, then two camps will form: one for growth and one against growth.

Ashford praised Friedman's book for offering a set of stimulating questions, and Mallaby lauded its "terrific blend of different disciplines." He also appreciated its timeliness and imaginative advocacy of growth. "Just because median incomes haven't gone up," Mallaby said, "we shouldn't be giving up on the whole idea of growth. We need to have growth that does affect median income."

Johnson agreed with Friedman's view that, although growth is good in the long run, it can sometimes have negative short-run effects. Growth can initially harm the environment, Johnson noted as an example, "but then, over time, as incomes accumulate and values change, people are able to worry about deforestation or air pollution, and the environment will improve."

Applying his theory to the present, Friedman expressed concern that, for the sixth year in a row, the average standard of living in the United States, as measured by real median incomes, has not grown. GDP is expanding, but the majority of the population has not enjoyed the fruits of the gains from that increased production because the "average American's living standard is not growing." To Friedman, this suggests a "daunting and sobering" trend and, possibly, a current example of a lost sense of progress. Even in advanced economies, such a loss can threaten the quality of democracy and, more fundamentally, the moral character of a society. ■

Ina Kota
IMF External Relations Department

Out of the dark

Not long ago, the general view among central bankers was that it was best to say nothing about monetary policy and to let actions speak for themselves. Now there is broad agreement that greater visibility, transparency, and communication can help shape public expectations and significantly improve the effectiveness and credibility of monetary policy. But there is a wide range of best practices, depending on monetary policy, exchange rate regimes, and other factors. A recent IMF-sponsored seminar in Mumbai, India, took a closer look at central bank communication and the challenges it faces in the Asia-Pacific region.

Participants cited many reasons for the new emphasis on communication and transparency: the need to keep markets well informed, the importance of promoting understanding of policies (and thus enhancing their credibility, sustainability, and effectiveness), the increased independence of central banks (which calls for broader accountability to bolster legitimacy), the adoption of inflation targeting in some countries, and heightened public expectations about transparency and government accountability.

Clearly, communication is essential to accountability, and effective communication is not just a matter of transparency; it also encompasses education, guidance, persuasion, and dialogue. In his keynote speech, Y.V. Reddy, Governor of the Reserve Bank of India, noted that communication policy may also try to influence policy direction, through effects on market expectations, but it must, at times, also engage in "open eyes and ears only" operations.

One size does not fit all

The choice of communication policy depends both on the country's monetary policy regime and on the authority's governance framework and decision-making process. For example, Singapore, with its pegged exchange rate regime, would naturally have a different approach to communication than countries using an inflation targeting framework. Indeed, even in countries with inflation targeting, different governance structures might permit diverse views (as the Bank of England's Monetary Policy Committee does) or emphasize consensus (as the Bangko Sentral ng Pilipinas does).

Communication must also be a two-way street, noted Deputy Governor Bandid Nijathaworn (Bank of Thailand). A central bank must listen to, and consult with, its target audiences to gauge the usefulness and effectiveness of its communications. Richard Lambert (Bank of England, Monetary Policy Committee) stressed that it was vital to communicate for a reason and to adopt a "strategic approach." Charles Enoch (IMF) echoed this point, noting that a strategy that cannot be communicated effectively cannot be implemented effectively.

Central bank communications have two main audiences: the general public and its political representatives, and financial markets and economic commentators. Many participants cautioned that central banks should let markets be markets; otherwise, it may be difficult to get a true reading of market expectations. Governor Reddy questioned whether the effectiveness of central bank communications may already have led to an underpricing of risk by the private sector, while Deputy Governor Toshiro Muto (Bank of Japan) asked if central banks' apparent success in anchoring inflation expectations had, in effect, made it more difficult for them to influence long-term interest rates—one way of looking at the conundrum of sticky and historically low bond yields.

Central banks' credibility will, in any case, continue to depend more on their actions and achievements than on their communications. Particularly in countries with histories of high inflation and exchange rate crises, said Deputy Governor Diwa Guinigundo (Bangko Sentral ng Pilipinas), what central banks do will matter much more than what they say. It will also be critical, observed Paul Barry (Reserve Bank of Australia), for central banks to know what is being said about them. Monitoring and analyzing media coverage can help central banks assess the efficacy of their communications. But, he cautioned, media criticism should not necessarily be perceived as a sign of failure in central bank communications.

Looking ahead

The future may hold more challenges. The advent of greater central bank independence has coincided with a period of benign economic and financial conditions in which monetary policy has not had to test potentially unpopular stringency. If and when the tide turns, respect for central bank independence may be more severely tested, particularly among politicians. Central bank communications will then, Lambert said, become even more important. And this underscores the importance of preparing the ground by communicating more effectively today. ■

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For more information, please see www.imf.org/external/np/seminars/eng/2006/central/index.htm.

HIPC debt relief (status as of March 2, 2006)

IMF member	Decision point	Completion point	Amount committed	Amount disbursed[1]
			(million SDRs)	
Heavily Indebted Poor Countries (HIPC) initiative				
Under original 1996 Initiative				
Bolivia	September 1997	September 1998	21.2	21.2
Burkina Faso	September 1997	July 2000	16.3	16.3
Côte d'Ivoire	March 1998	—	16.7[2]	—
Guyana	December 1997	May 1999	25.6	25.6
Mali	September 1998	September 2000	10.8	10.8
Mozambique	April 1998	June 1999	93.2	93.2
Uganda	April 1997	April 1998	51.5	51.5
Total original HIPC			**235.3**	**218.6**
Under the 1999 enhanced HIPC Initiative				
Benin	July 2000	March 2003	18.4	20.1
Bolivia	February 2000	June 2001	41.1	44.2
Burkina Faso	July 2000	April 2002	27.7	29.7
Burundi	August 2005	Floating	19.3	0.1
Cameroon	October 2000	Floating	28.5	11.3
Chad	May 2001	Floating	14.3	8.6
Congo, Democratic Republic of the	July 2003	Floating	228.3[3]	3.4
Ethiopia	November 2001	April 2004	45.1	46.7
Gambia, The	December 2000	Floating	1.8	0.1
Ghana	February 2002	July 2004	90.1	94.3
Guinea	December 2000	Floating	24.2	5.2
Guinea-Bissau	December 2000	Floating	9.2	0.5
Guyana	November 2000	December 2003	31.1	34.0
Honduras	June 2000	April 2005	22.7	26.4
Madagascar	December 2000	October 2004	14.7	16.4
Malawi	December 2000	Floating	23.1	11.6
Mali	September 2000	March 2003	34.7	38.5
Mauritania	February 2000	June 2002	34.8	38.4
Mozambique	April 2000	September 2001	13.7	14.8
Nicaragua	December 2000	January 2004	63.5	71.2
Niger	December 2000	April 2004	31.2	34.0
Rwanda	December 2000	April 2005	46.8	50.6
São Tomé and Príncipe	December 2000	Floating	—	—
Senegal	June 2000	April 2004	33.8	38.4
Sierra Leone	March 2002	Floating	98.5	66.0
Tanzania	April 2000	November 2001	89.0	96.4
Uganda	February 2000	May 2000	68.1	70.2
Zambia	December 2000	April 2005	468.8	508.3
Total enhanced HIPC			**1,622.5**	**1,379.1**
Combined total			**1,857.8**	**1,597.7**

Definitions

Decision point: Point at which the IMF decides whether a member qualifies for assistance under the HIPC Initiative (normally at the end of the initial three-year performance period) and decides on the amount of assistance to be committed.

Completion point: Point at which the country receives the bulk of its assistance under the HIPC Initiative, without any further policy conditions. Under the enhanced HIPC Initiative, the timing of the completion point is linked to the implementation of preagreed key structural reforms (that is, floating completion point).

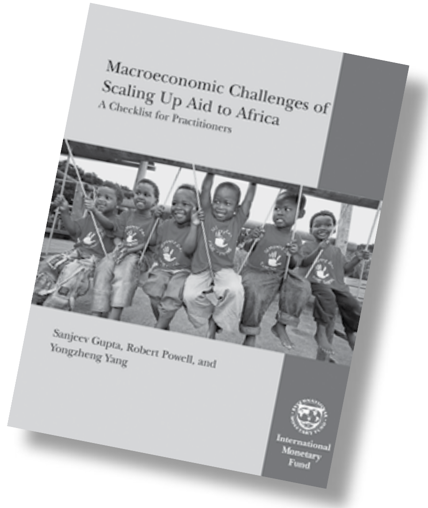
[1]Includes interest on amounts committed under the enhanced HIPC Initiative.

[2]Equivalent to the committed amount of $22.5 million at decision point exchange rates for March 17, 1998.

[3]Amount committed is equivalent to the remaining balance of the total IMF HIPC assistance of SDR 337.9 million, after deducting SDR 109.6 million representing the concessional element associated with the disbursement of a loan under the Poverty Reduction and Growth Facility following the Democratic Republic of the Congo's clearance of arrears to the IMF on June 12, 2002.

Data: IMF Finance Department.

Using increased aid effectively



Over the next decade, African countries are expected to be the largest beneficiaries of increased donor aid, which is intended to improve their prospects of achieving the Millennium Development Goals. To help these countries assess the macroeconomic implications of increased aid and respond to the associated policy challenges, the IMF has published a study by its African Department: *Macroeconomic Challenges of Scaling Up Aid to Africa: A Checklist for Practitioners.*

The handbook is directed at policymakers, practicing economists in African countries, and the staffs of international financial institutions and donor agencies who participate in preparing medium-term strategies for African countries, including in the context of poverty reduction strategy papers. It provides five main guidelines for developing "scaling up" scenarios to help countries identify important policy issues involved in using higher aid flows effectively.

- **Seek to absorb as much aid as possible**: Countries can alleviate Dutch disease—when higher domestic demand raises the price of nontradables in relation to tradables and diverts productive resources away from the exporting sectors—by ensuring a high import content in additional public spending, focusing spending on infrastructure, and liberalizing trade. It is unclear how high the risks of Dutch disease are for Africa. The evidence is mixed: in some countries aid surges have been associated with real exchange rate depreciation.
- **Boost growth in the short to medium term**: Not all aid goes to activities that will boost growth (humanitarian aid and disaster relief, for example, do not), but aid used to build infrastructure (roads, irrigation, ports, and electricity) can be expected to boost growth in the short to medium term. Governments must adopt policies that will allow them to absorb more aid effectively and remain alert to emerging supply pressures in different sectors.
- **Promote good governance and reduce corruption**: Strengthening institutions for public expenditure management and public auditing and reducing corruption are likely to increase the benefits of aid, allowing more funds to be channeled to productive uses.
- **Prepare an exit strategy**: Governments must be prepared if, or when, the scaled-up aid returns to, or even falls below, normal levels. It may be difficult to cut back expenditures financed by higher aid, thereby increasing the pressure for higher domestic financing of deficits. Scaling-up scenarios need to include a strategy that countries can follow in such a situation.
- **Regularly reassess the policy mix**: Scaling-up scenarios are not forecasts. Their precision depends on both the amount of aid and the implementation of policies that allow countries to absorb the aid without such destabilizing effects as increased inflation, a loss of competitiveness, or a rise of debt to unsustainable levels. Countries and donors should regularly reassess the scenarios to update their vision for the future.

The handbook, written by Sanjeev Gupta, Robert Powell, and Yongzheng Yang, will be distributed at the seminar "Sources of Growth," to be held in Equatorial Guinea on March 14 and at a roundtable on the Multilateral Debt Relief Initiative and the IMF's role in low-income countries in Lusaka, Zambia, on March 16–17. IMF Managing Director Rodrigo de Rato will participate in both events. ■

Copies of *Macroeconomic Challenges of Scaling Up Aid to Africa: A Checklist for Practitioners,* by Sanjeev Gupta, Robert Powell, and Yongzheng Yang, are available for $25.00 each from IMF Publication Services. Please see this page for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

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