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IMF strikes deal with Argentina

IMF Managing Director Horst Köhler has recommended for Executive Board approval a transitional program for Argentina. The IMF said that while providing no net new financing, the arrangement would provide financial support and an extension of payment expectations to the IMF through August 2003. The Executive Board is expected to review the transitional program in the coming days.

The policy commitments developed by the government under the new agreement with the IMF could, if implemented consistently, nurture the macroeconomic stability seen during the second half of 2002 and build a bridge to a comprehensive program to be negotiated with a successor government after the April elections. The new agreement with the IMF would also unlock funding from multilateral development banks for social programs, which are key to protect the vulnerable groups from the adverse effects of the crisis.

In a statement released after the completion of the IMF's annual assessment of Argentina's economy, the IMF said on January 8 that the country should focus on achieving a clear political consensus in favor of reforms, with a view to building a sound fiscal framework, restoring confidence in the banking sector, increasing trade openness, rebuilding legal certainty, *(Please turn to the following page)*

Annual AEA meeting

Economists probe past, current crises for insights

In early January, thousands of economists traditionally descend on a U.S. city for the annual American Economic Association (AEA) conference. This year, the venue was Washington, D.C., which no doubt prompted the unusually large number of policy-oriented panels on top of the customary wide array of research-oriented panels. Maureen Burke, Asimina Caminis, Jeremy Clift, Elisa Diehl, Sheila Meehan, and Patricia Reynolds highlight several sessions on financial crises and on the outlook for the U.S. economy. Coverage of additional panels will appear in the IMF Survey's *next issue.*

What has Argentina taught us? Why has Argentina been so hard hit? Was this crisis avoidable? Could the international community have done anything different? And how important is an IMF program to Argentina's recovery? The depth and length of the crisis—and the need to look to the future—provided the impetus for Guillermo Calvo (Inter-American Development Bank), Michael Dooley (Deutschebank), Kristin Forbes (previously with the U.S. Treasury and now at the Massachusetts Institute of Technology), Nouriel Roubini (IMF and New York University), and Randall Kroszner (U.S. Council of Economic Advisers) to examine what went wrong and what it would take to sustain a recovery.

Guillermo Calvo

Calvo, Roubini, and Dooley essentially agreed that the severity of Argentina's crisis was due to a combination of fiscal woes, a weak banking system, and political problems. Calvo emphasized that the drying up of financial flows to emerging markets that resulted from *(Please turn to page 4)*

Argentina secures breathing space

(Continued from front page) and restructuring debt with private external creditors.

Elsewhere in the region, the IMF on January 15 approved a two-year, $2.1 billion Stand-By Arrangement for Colombia in support of its economic program through 2004. The approval makes $264 million available immediately. The authorities have indicated that they intend to treat the arrangement as precautionary. In announcing the loan, Köhler praised Colombia's "strong reform program." He noted that "the Executive Board commends the government for its rapid and determined action to address the fiscal pressures, which emerged in 2002, and develop a comprehensive strategy for stability, growth, and improved social equity."

As for Ecuador, an IMF mission is currently in Quito to hold discussions with the new economic team on a possible Stand-By Arrangement, as well as to complete a long delayed overall assessment of the state of Ecuador's economy. President Lucio Gutierrez took office on January 15, and his government is proposing a comprehensive economic program to deal with Ecuador's immediate fiscal pressures and to restart structural reforms aimed at sustaining growth in the dollarized economy.

In a statement following the IMF's annual assessment of Peru's policies, the IMF said on December 23 that it was pleased with the country's overall policy framework, which aims at maintaining macroeconomic stability and reinforcing an already solid financial system. Looking forward, the IMF noted that it was important that the authorities garner the necessary political consensus to carry out their policy agenda. Peru has a $340 million loan program with the IMF, which was approved in February 2002. The first review of the program, which was completed at the same time as the annual assessment, provides Peru with $154 million in fresh funds. The country has not made any drawings under the loan so far.

The IMF completed on December 19 the first review of Brazil's performance under the $30.7 billion loan approved last September. Completion of the review provides Brazil with $3.1 billion in additional funds, in addition to the $3.1 billion provided when the program was approved in September. The remaining amount—about $24 billion—will become available in 2003. In a statement released shortly after the conclusion of the review, Köhler said that Brazil's performance under the program had so far been "exemplary," and he called on the new administration to continue working to restore confidence in its economy. On January 1, Luiz Inácio Lula da Silva became Brazil's new president. ■

For further information on these developments, please see the following items on Colombia (Press Release No. 03/04), Argentina (Press Release No. 03/01), Brazil (News Brief No. 02/128), and Peru (News Brief No. 02/126 and Public Information Notice No. 02/139). All are available on the IMF's website (www.imf.org).

IMF Board debates SDRM design

On December 19 and 20, the IMF's Executive Board—chaired by First Deputy Managing Director Anne Krueger—continued discussions of the possible features of a new sovereign debt restructuring mechanism (SDRM). The discussion was a step toward fulfilling the International Monetary and Financial Committee's request for a concrete SDRM proposal that could be considered at its next meeting in April. The Board's debate revolved around a staff paper that reflected extensive staff contacts with private market participants, debt restructuring practitioners and other workout specialists, academics, and members of the official community.

In her summary of the Board's discussions, Krueger noted that "most Directors reaffirmed their belief that a carefully designed debt restructuring mechanism can make an important contribution to improving the comprehensive framework for crisis resolution and the international financial architecture more generally. The objective of the SDRM is to provide a framework that strengthens incentives for a sovereign and its creditors to reach a rapid and collaborative agreement on a restructuring of unsustainable debt in a manner that preserves the economic value of assets and facilitates a return to medium-term viability, and thereby reduces the cost of the restructuring process.

"To achieve this objective, the SDRM must not only address collective action problems among

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creditors, but also catalyze an early and effective dialogue and exchange of information between the debtor and its creditors. By creating greater predictability in the restructuring process, the SDRM should also be expected to improve the functioning of international capital markets—an objective that should remain a primary concern going forward."

While Executive Directors found much common ground for moving the discussion forward, a wealth of views were expressed on many aspects of a possible SDRM. For some important features of the mechanism, Directors insisted that all options under consideration remain on the table at this stage. Although a brief summary cannot do justice to the breadth of the debate, issues generating the most discussion included the following:

• ***Scope of claims to be covered.*** Directors generally agreed that, in cases where a sovereign's debt burden was unsustainable, a broad range of claims might need to be restructured—both to help ensure a return to debt sustainability and to achieve sufficient intercreditor equity to garner broad support for the restructuring. At the same time, Directors observed that the debtor could decide to exclude certain types of claims from a restructuring, in particular to limit the extent of economic and financial dislocation.

Most Directors therefore thought that the mechanism should identify the range of claims that could potentially be restructured under the provisions of the SDRM while leaving it to the debtor—in negotiations with its creditors—to determine which of these eligible claims would need to be restructured in a particular case. Much of the discussion then focused on which types of claims should be excluded from the SDRM and how to define more precisely those claims that should be included.

In particular, Directors supported the exclusion of claims that were already governed by domestic law and subject to the exclusive jurisdiction of domestic courts. However, they stressed that the mechanism's transparency requirements would need to help ensure that the restructuring of these claims would be adequately coordinated with the restructuring of claims under the SDRM.

Directors did not reach a definitive view on how to treat the claims of official bilateral creditors. While many thought that such debts had been efficiently restructured in the past (as needed) through the Paris Club, a number of other Directors thought that including official bilateral creditors under the SDRM would be important for achieving greater inter-creditor equity.

• ***Activation.*** Most Directors thought that the debtor should be allowed to activate the mechanism unilaterally, without third-party confirmation that the activation was justified. They noted that several proposed features of the mechanism would discourage abuse of the SDRM. Furthermore, the IMF would be able to influence a member's decision to activate the mechanism through its policy dialogue and the exercise of its financial powers.

• ***Consequences of activation.*** A central issue is whether the mechanism should provide a stay on creditor enforcement. Many Directors favored keeping open the option of an automatic stay on litigation that would remain in place for a brief period until creditors were sufficiently organized to vote on an extension.

However, many other Directors noted that an automatic stay would constitute a significant, and possibly unnecessary, erosion of contractual rights. They viewed the use of a more limited approach—which lawyers refer to as the hotchpot provision—possibly supplemented by injunctive relief as a workable alternative that would discourage litigation without imposing a limitation on enforcement rights. Some Directors urged that this rule be supplemented by a feature that would enable the Sovereign Debt Dispute Resolution Forum, upon the request of the debtor and the approval of a qualified majority of creditors, to issue a stay under specific circumstances.

Directors encouraged management and the staff to continue work on the design features of the SDRM. The conference on the SDRM—hosted by the IMF on January 22—will be an important opportunity to make further progress in clarifying outstanding issues and in building consensus on the mechanism's design. ■

The full text of the Public Information Notice on the Board discussion and the staff paper are available on the IMF's website (www.imf.org).

Members' use of IMF credit
(million SDRs)

	During December 2002	January–December 2002	January–December 2001
General Resources Account	**2,569.35**	**25,236.95**	**23,761.62**
Stand-By	2,294.11	23,948.13	23,019.62
SRF	1,141.06	9,044.73	13,240.71
EFF	275.24	1,261.85	742.00
CFF	0.00	0.00	0.00
EMER	0.00	26.98	0.00
PRGF	**120.98**	**1,344.49**	**872.64**
Total	**2,690.33**	**26,581.44**	**24,634.26**

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CFF = Compensatory Financing Facility
EMER = Emergency assistance programs for countries following conflicts and natural disasters
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

Nouriel Roubini

Michael Dooley

Kristin Forbes

Randall Kroszner

Panelists discuss Argentina, sovereign debt crises

(Continued from front page) East Asia's crisis of 1997–98 caused a sharp depreciation of the equilibrium real exchange rate. The warranted depreciation was larger in relatively closed economies like Argentina that are less able to respond by increasing their exports. Argentina was also more vulnerable because of the level of its debt denominated in U.S. dollars.

In Roubini's view, the severity of Argentina's fiscal problems distinguished it from other emerging markets. The country was basically insolvent, and this, together with currency, banking, and corporate crises, capital controls, a bank run, a freeze on deposits, and a default on domestic and external debt, made Argentina more vulnerable to financial turmoil and political strife.

Dooley blamed the severity of Argentina's crisis on the government's unwillingness to take any corrective steps. Its choices were to default or devalue, and it did neither, he said, until it was too late. Instead, it raided the banks, introduced capital controls, and redistributed wealth arbitrarily, which led to a complete breakdown of financial intermediation and uncertainty about how the problems would be resolved. Dooley's prognosis was that recovery in Argentina would be delayed as much as 10 years because of the difficulty of restructuring private sector debt. "Until all losses are allocated," he said, "there will be no economic recovery."

Was the crisis avoidable? Could the international community have done something else? As Forbes noted, none of the panelists suggested that a large bailout could have prevented the crisis. Roubini agreed in part with Dooley that a government could not be forced to default, but he argued that if official financing had been cut off in November or December 2000, even as late as the summer of 2001, Argentina, lacking another source of finance, would have experienced a rollover crisis. It would then have been forced to default and accept the consequences.

By mid- or late 2001, Roubini said, Argentina had reached the point of no return. It was too late for fiscal adjustment, and dollarization, which had been suggested, was a bad idea. Early on, he maintained, if Argentina had resolved its own problems through the private sector, debt restructuring would have been more orderly. But the country did not go that route, and, as a result, the debt restructuring occurred much later and was far more disorderly.

But, Forbes and Kroszner noted, Argentina's situation has begun to stabilize and a recovery—albeit slow—is under way. According to Forbes, output growth in 2003 should be positive; the peso has more or less stabilized following a 70 percent depreciation last year; unemployment has declined by 4 percent since May 2002; bank deposits have stabilized and are starting to increase; and although inflation is high, there is no hyperinflation. Still, Kroszner pointed out, growth needs to be reignited. For that to happen, there must be political stability and less uncertainty about future economic policies.

Forbes and Kroszner agreed that if Argentina wanted a vigorous recovery, IMF support for the economic program would be important. It would improve the chances of a stable environment and signal to foreign direct investors that recovery was starting. In Forbes's view, if the IMF made more money available to Argentina than the country needed to repay debt, the government would have the incentive to undertake difficult reforms. But Roubini had reservations about Argentina's receiving net new financing. He noted that the IMF already had a large exposure to the country, the current Argentine administration had no credibility for reform, and the huge current account turnaround, of 10 percent of GDP, suggested that Argentina needed money only to roll over its current debt.

How should sovereign debt crises be addressed? Given gaps in the current international financial architecture, sovereign states with unsustainable debt burdens often delay restructuring efforts, with painful results for debtor and creditors alike. IMF First Deputy Managing Director Anne Krueger, whose proposal in November 2001 for a "statutory" solution reenergized the debate on this issue, outlined the current state of play with regard to the sovereign debt restructuring mechanism (SDRM) proposal (see also page 2). She highlighted, in particular, work that was proceeding on a framework that would strengthen the incentives for both parties to reach a rapid and collaborative restructuring of unsustainable debts.

Randall Kroszner then reviewed U.S. administration proposals for a "contractual" approach that could expand the use of collective action and other clauses in individual bond issues and encourage the formation of voluntary dispute resolution forums.

How should the respective merits of these proposals be evaluated? Barry Eichengreen (University of California, Berkeley) acknowledged that the statutory approach would be more comprehensive because it could restructure multiple debt issues simultaneously. In practice, however, its relative usefulness would hinge, in part, on whether restructurings involving many debt issues were significantly more costly than

those involving fewer issues. His empirical evidence (undertaken jointly with the IMF's Ashoka Mody) suggested that investors did indeed perceive this to be the case. In particular, countries with the lowest credit rating (those most likely to restructure) faced higher risk premiums on new debt issues if many issues were already outstanding.

Panelists, as well as discussants Guillermo Calvo, Ann Harrison (University of California, Berkeley), and Morris Goldstein and Michael Mussa (both with the Institute for International Economics and previously the IMF), broadly agreed that the key test would be how well a proposed solution could minimize the number of financial crises and how quickly it could return crisis countries to a sustainable growth path. Most saw merit in the two-track approach: promoting the use of collective action clauses and voluntary forums while working toward agreement on an SDRM. They saw the two tracks—one that could be pursued relatively quickly and the other that would take some time—as complementary.

But several discussants also cautioned against overselling either option. Goldstein noted that neither approach addressed a critical obstacle to restructuring—the large overhang of sovereign bonds in the domestic economy. Mussa observed that, even if an SDRM had been in existence, it would have been applicable in only a small number of past crises. And very little of the enormous costs associated with financial crises has been attributable to litigation (although he conceded that the ultimate resolution of Argentina's crisis may teach us a lot about such costs). The SDRM might be useful, but Mussa cautioned against proposing it as a solution to emerging market financial crises. That, he said, was like "giving an aspirin to someone who has cancer."

Learning from history? Earlier eras of global financial integration may hold lessons for today's emerging market economies. Delving into the question of how lenders in the prewar and interwar periods assessed sovereign risk, Maurice Obstfeld (University of California, Berkeley) and Alan M. Taylor (University of California, Davis) studied the London bond market from the 1870s to the 1930s. They found that adherence to the gold standard gave sovereign borrowers credibility before World War I, shaving 40 to 60 basis points from country borrowing spreads.

In the 1920s, however, as workers and previously disenfranchised groups gained political power, and access to global markets became more democratic, markets began looking more closely at the "books." The markets no longer considered a hard peg to be a substitute for good policies, and adherence to the gold standard ceased to be a guarantee of attractive borrowing terms. Factors like public debt levels and membership in the British Empire also began to play a role in determining spreads.

Barry Eichengreen (left) with Ashoka Mody

"Plus ça change, plus c'est la même chose" was Michael Bordo's (Rutgers University) conclusion after he and Marc Flandreau (University of Paris and the Centre for Economic Policy Research) compared the financial crises of the 1990s with crises between 1880 and 1914. Little has changed over the past century except that the "core" (advanced) countries in the earlier period chose to peg their currencies to gold, whereas today, except for the euro area, they float their currencies, and paper has replaced gold and silver. Then, as now, the "peripheral" (emerging market) countries were burdened with "original sin"—that is, they could not issue long-term domestic debt or borrow abroad in their own currency. They were also hindered in their choice of exchange regime because of their lack of financial maturity, which Bordo and Flandreau defined as open and deep financial markets, stable money, and fiscal probity.

Examining the past experiences of the United States, Australia, Canada, and New Zealand, Bordo characterized the notion of original sin as an explanation for emerging market crises as "overblown." These countries had original sin in that they could not issue abroad bonds denominated in domestic currency, yet they were financially mature and fiscally sound. They were also less exposed to currency and maturity mismatches than emerging market economies today because their debt was small and mostly long term. Such mismatches are thus a recent phenomenon. What the core countries had that many peripheral countries lacked was a good track record that made their adherence to the gold peg credible, allowing them to deviate from it temporarily during a war or financial crisis and giving them the short-term flexibility they needed to implement stabilization programs. Thus, policy played a critical role then, as it does today, in preventing, or allowing a swift resolution of, a crisis.

Michael Bordo

The Corporation of Foreign Bondholders (CFB)—an association of British investors that was effective, much of the time, in coordinating orderly debt workouts during the "heyday of international bond finance" (1870–1913)—may have had an easier time than any comparable body would have today, according to Paolo Mauro (IMF) and Yishay Yafeh (Hebrew University). For one thing, in the past, individuals

Paolo Mauro

almost never sued sovereign states in the event of a default. For another, bonds were often collateralized or implicitly backed by tangible assets or tax revenues: creditors were therefore motivated to act together to seize the collateral (trading their debt, for example, for equity in such valuable entities as railroads) or even to administer and collect some of the defaulting government's tax revenues.

Individual bondholders numbered in the hundreds rather than in the tens of thousands, although mutual funds were less prominent than they are today. Moreover, the CFB had close ties with the British government, and, in a few extreme cases, it persuaded the British government to resort to diplomatic or even military intervention when other means of punishing defaulting debtors failed. For today's creditors, the appeal of defection is stronger, and the appeal of coordination weaker, than in the past. The challenges faced by a modern version of a creditor association would thus be commensurately greater today than they were for its predecessors.

Eyes on the U.S. economy

Fiscal stimulus? The panel "Fiscal Stimulus 2003" was convened hurriedly when former U.S. Treasury Secretary Paul O'Neill canceled his scheduled address. In his place, economists Alan Auerbach (University of California, Berkeley), Eric Engkin (American Enterprise Institute), Robert Hall (Stanford University), Matthew Shapiro (University of

Toward "better and fairer globalization"

Fischer: "The pro-market, pro-globalization approach is the worst economic policy, except for all the others that have been tried."

Citigroup Vice Chair and former IMF First Deputy Managing Director Stanley Fischer delivered the 2003 Richard T. Ely Lecture, "Globalization and Its Challenges," during the American Economic Association meetings. In it, he recounted the benefits of globalization—including improved growth—but also acknowledged that many of the problems critics point to are real. He highlighted a number of policies that are necessary to achieve a "better and fairer globalization." In his opening remarks, he also paid tribute to his friend and colleague Rudiger Dornbusch, who passed away in July 2002 and was to have delivered the Ely Lecture. For the full text of the lecture, see www.iie.com/fischer.

Almost everyone agrees that the world could be a better place and recognizes that much work will be required to improve it. Why, then, is so much of the globalization debate about whether the world is getting better or worse? The reason, Fischer said, is that this debate is ultimately about policies. "The implicit premise is that if the world is going to hell, then the policies of the past 50 years are likely to be wrong and if the world has been getting better, then the policies are more likely to be right." It is a separate question, he argued, whether all recent developments in global conditions can be attributed to globalization.

A set of policy recommendations for reform-minded countries that has received much attention and a large share of negative press is the so-called Washington consensus set out by economist John Williamson in 1990. Fischer regarded its 10 elements—which included fiscal discipline, tax reform, financial and trade liberalization, deregulation, and privatization—as a useful shorthand description of part of a desirable policy orientation.

What do the data show?

Globally, poverty rates have been declining, especially in Asia, Fischer noted. Developments in income distribution are more mixed, with the evidence showing that inequality has increased among the average income levels of different countries while possibly decreasing among all individuals in the world. On average, social indicators including literacy and health have improved significantly in the developing countries. It thus appears that, on average, conditions in the developing world have improved. But, Fischer emphasized, this is not the same as saying that everyone in the developing countries is doing better.

Trends in global poverty figure prominently in the globalization debate. But the facts alone do not, Fischer noted, directly address the issue of whether the trends are caused by developing countries' increasing integration with the global economy. To address this question, we must assess the impact of openness on growth.

Trade policy is a central aspect of economic policy. Many studies have shown that greater openness to trade is associated either with higher levels of income or with more rapid growth. And countries that have adopted export promotion strategies have achieved greater economic success than those that have sought to keep imports out. The evidence and the studies, he observed, should persuade many that openness to the global economy is a necessary, though not sufficient, condition for sustained growth.

Regional challenges

Clearly, the major challenge facing the world today, Fischer said, is poverty. And the surest route out of poverty is economic growth. Growth requires good economic policies set in a policy framework that prominently includes an orientation toward integration with the global economy. A way must be found to make the global system deliver economic growth more consistently and more equitably.

Global growth is determined mainly by the performance of the industrial countries, and attitudes toward globalization in these countries are key to the future of the global economy. Governments in these countries should stand up and support the right policies; help their own people deal

Michigan), and Janet Yellen (University of California, Berkeley, and former chair of the U.S. Council of Economic Advisers, 1997–99) debated whether stimulus was warranted at this juncture and what form it should and would take.

Auerbach and Engkin argued that the recession, a historically mild one, was effectively over; Hall, Shapiro, and Yellen were not so confident. Hall and Yellen expressed concern about unemployment, and Shapiro cited intangibles—the impact of a war with Iraq and a possible asset market meltdown. For Hall, fiscal policy also lent a welcome added dimension to a U.S. economic policy framework heavily reliant on monetary policy. Yellen termed the U.S. economy "abnormally fragile." She noted that the Fed did not cause this recession (U.S. recessions typically occur after the Fed tightens monetary policy), the country had price stability, and there was no liquidity trap. But, in her view, the call on whether the U.S. economy had emerged from recession was "too close for comfort," and the Fed had few tools left in its arsenal—most of them virtually untried.

A discussion of what to do quickly turned to what *not* to do. There was universal unease with the country's fiscal position, which had deteriorated rapidly in recent years and was looking grim going into the longer term. Auerbach admitted to being "totally puzzled" by a stimulus package fashioned around a permanent cut in dividend taxation (it would, he said, "stimulate private wealth—nothing else"). He pre-

Robert Hall

with the adverse consequences of economic change; and deliver on their promises on trade, aid, and the strengthening of the international economic system.

Although most of the world's poor are moving toward sustainable growth (notable exceptions are some countries in Asia and Latin America), Fischer said that the most profound problems of poverty were increasingly concentrated in sub-Saharan Africa. It already has the world's highest poverty rate, and the number of poor has been rising rapidly. In addition, HIV/AIDS is taking a tragic toll.

National and global policy challenges

All countries have challenges to surmount if globalization is to benefit more of the world's citizens.

Implementing the right policies. The outward-oriented policies described in the 1990 Washington consensus, Fischer said, remain an important component of the right approach to economic policy, but also needed are a greater emphasis on social justice, more effective economic governance, crisis-proofing economies, and labor market reforms that allow more of the workforce to enter the formal labor market.

Delivering on trade and aid. The industrial countries need to do their part to facilitate developing countries' integration with the global economy. That means liberalizing agricultural trade and ending the massive subsidies to agriculture that impede the exports of so many developing countries. At the same time, the developing countries can achieve major gains by opening up trade to each other.

Making the international financial system less crisis prone. The shift to flexible exchange rates 30 years ago and the strengthening of macroeconomic policy frameworks have helped prevent foreign exchange crises among the industrial countries, Fischer noted. But emerging market countries are still disturbingly prone to crises. Although their shift to more flexible exchange rates will make their financial systems more stable, crises can erupt for other reasons, particularly market fears that these countries' debts are unsustainable.

Dealing with migration. Flows of labor, either temporary or permanent, are a potentially powerful force in the global economy, Fischer said. But, national economic, social, and cultural preferences are bound to take a front seat in this area. Moreover, greater clarity is needed on the economic effects of alternative policies—an area in which more public policy attention will eventually be focused.

Improving governance. Ordinary people everywhere want to improve their lives. But corrupt governments do not necessarily respond to those desires. That is why, Fischer argued, the trend to democracy is so important.

While countries are primarily responsible for their own fates, he said, outsiders—from both the public and the private sector—can influence outcomes by promoting democracy, investing in economic activity, and supporting good projects in social sectors. Through their actions, they can also help fight corruption in developing countries. With a nod to Winston Churchill's famous observation about democracy, Fischer concluded that "the pro-market, pro-globalization approach is the worst economic policy, except for all the others that have been tried."

Tribute to Rudi Dornbusch

"Collaborating with Rudi," Fischer said of his coauthor on the textbook *Macroeconomics,* "has given me as much satisfaction as anything else I have done in my professional life." In opening remarks at the Richard T. Ely Lecture, Fischer paid tribute to Dornbusch's many contributions to the theoretical and policy fields, from his influential "overshooting" paper to the equally famous 1994 Brookings Institution paper that predicted the Mexican peso crisis. Dornbusch was, Fischer said, "one of the outstanding policy economists of our time." Fischer indicated that he often called Dornbusch to discuss difficult situations at the IMF. "His advice was always thoughtful, typically nuanced, and frequently provided insights that no one else had seen—and he was willing to talk as long as it took," Fischer said. "We will miss Rudi deeply for his incisive mind, the brilliance of his insights, the exuberance of his writing, and his challenges to conventional thinking—but most of all, for his friendship and the pleasure of his company."

ferred temporary measures, notably steps to encourage business investment and extend unemployment benefits (money likely to be spent quickly).

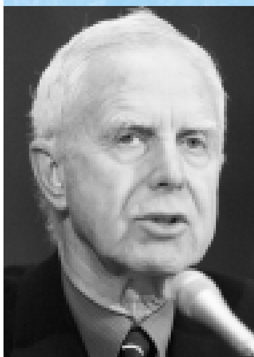
Engkin favored seizing the opportunity to enact policies that would boost long-term growth and move the country toward fundamental tax reform. Removing the tax on dividends would, he said, improve competitiveness and increase the incentives corporations have to pay dividends. He opposed raising exemptions for child care, extending unemployment benefits, or providing a temporary "holiday" on payroll (social security) tax payments. Hall, too, proclaimed the moment ripe for incremental, opportunistic tax reform. He saw the country moving rapidly toward a consumption tax and welcomed the removal of personal taxation on dividends as a step in the right direction.

Janet Yellen

It was just this type of piecemeal tax reform, however, that worried Shapiro, given looming increases in expenditures to meet pension and security concerns. Much as he did not favor accelerating scheduled 2004 tax cuts into 2003, he would do this if the scheduled 2006 tax cuts could be scrapped. He also hoped that politicians would not forget that spending was the other half of fiscal policy. He urged relief for states (many of which face severe revenue shortfalls) and a boost in federal spending on security.

In Yellen's view, stimulus should be temporary, increase demand, and provide maximum "bang for the buck" and quick results. Like Auerbach, she favored an extension of unemployment benefits to address skyrocketing long-term unemployment rates (such an extension did indeed pass shortly after the AEA conference concluded) and relief for state governments that were having to make nearly unprecedented cuts in public investment.

It was interesting, Hall observed, that the panel's discussion of short-term stimulus turned so quickly to long-term concerns. The panel expressed much less certainty that long-term issues would shape the debate that was just beginning on Capitol Hill.


Arthur Levitt

Lessons from Enron. Following a string of corporate scandals in the United States, policymakers, regulators, and economists are examining how to improve corporate governance and revive confidence in the equities markets. At a luncheon speech organized jointly by the AEA and the American Finance Association, Arthur Levitt, chair of the U.S. Securities and Exchange Commission during 1993–2001, called the scandals a collective failure of all the gatekeepers—the accountants, the lawyers, the boards of directors, the standard setters, the rating agencies, and the regulators. "The whole system was asleep at the switch," he said.

Levitt, now a senior advisor to the Carlyle Group, a private global investment firm, said that it was up to boards of directors to rein in excesses in executive compensation. "There is little doubt that some executives have been paid more than they would if it weren't for boards of directors stacked with their cronies; if it weren't for quirks in our tax laws that favor certain types of stock options over other types of pay; and if it weren't for the fact that options don't have to be expensed," he argued. "In the 1990s, top executives extracted $3.3 billion from companies that they led into bankruptcy. That's unconscionable. We need standards of corporate governance that ensure that executive compensation does more than just line the pockets of executives."

A key change would be to require the expensing of stock options, meaning that companies would account for the cost of options in their balance sheets. At present, such options are listed in a footnote of the corporate accounts. "Options have a real value to the executive receiving them and a real cost to the shareholders who grant them," Levitt said. "Like any other form of compensation, they should be expensed. Investors deserve, and the integrity of our markets demands, an accurate and full picture of a company's financial outlook, and expensing stock options will help us paint that picture." He added that "new rules regarding auditor independence and expensing of stock options will go a long way to improve the workings of our markets."

In a separate session, Kevin Murphy (University of Southern California) also highlighted the expensing of options as a key element in reform. Options now account for 51 percent of the pay of senior executives, he said, and part of the problem is that managers and boards of directors do not understand the true cost of stock options. "They think they are free," he said. Wayne Guay (University of Pennsylvania) indicated that it was clear that options should be treated like business expenses; otherwise, the balance sheet presented a distorted picture. But one consequence of expensing the options, Murphy said, would be the granting of fewer options.

The bottom line, Levitt explained, was that it was important to retain investor confidence in the markets. "Just as quickly as we have brought millions of new investors into our markets, we may have lost that confidence in those markets." He urged companies to appoint independent directors willing to ask awkward questions. "All the regulations in the world can't replace a board willing to ask tough questions," he said.

Social security reform on the back burner? Unlike fiscal stimulus and corporate governance, reform of the U.S. social security system is not prominent in U.S. newspaper headlines. But, with a huge group of postwar "baby boomers" nearing retirement and

financial storm clouds on the horizon, the issue is not going away.

In a forum on public policy, John Campbell (Harvard University) addressed the risk aspects of social security reform, noting that a major problem is that people often compare the historical average of returns available in the U.S. stock market with the implied returns of the current social security system. This comparison, of course, ignores some serious issues: past performance does not guarantee future results, stock returns are risky, and returns on the current system are low because most contributions are devoted to paying the benefits of current retirees, and these benefits represent a huge unfunded liability.

The existing pay-as-you-go (PAYG) system of social security reduces the national saving rate, making a funded component necessary. The current challenge, Campbell said, is to address how the government should use its taxation authority to operate the system's PAYG component, how big the federally funded component should be, and how the funds should be invested.

He described two different reform proposals, both of which have advantages and disadvantages. One is based on individual retirement accounts (favored by Republicans) and the other (favored by Democrats) consists of a centralized system with an independent board to oversee the investment of the social security trust fund. He suggested that a compromise system could be devised that addressed the disadvantages of each. One important consideration, Campbell concluded, is ensuring that investment risk is shared by future generations and current savers.

Peter Diamond (Massachusetts Institute of Technology) took up three different issues relating to social security reform: the indexing of benefits and taxes for life expectancy, the use of earmarked funds, and the idea of dedicating the estate tax to social security. Indexing, Diamond noted, is already done for wages and prices and could work well for life expectancy if handled through a rule, making it automatic and thus politically less contentious.

The United States, he explained, finances its social security system through an "earmarked" payroll tax. Earmarking—dedicating revenue to a particular expenditure—has limited pressure for higher benefits and permitted increases in the tax because the revenues are for an extremely popular purpose. Thus, earmarking has played an important role in the political process and has made the public think about the tax much more sensibly. (In general, the public favors expenditures and opposes taxes, which does not add up.) In Diamond's opinion, the estate tax with a large exemption is an excellent tax. It is currently under siege, but linking it to social security, he said, may offer a good way to defend it.

Diamond concluded with a broader warning about the upcoming debate over social security reform. Beware politicians who promise to fix social security without cutting benefits or raising taxes. It can't be done, he said. ■

Peter Diamond

Margaret de Vries receives Carolyn Shaw Bell award

On January 3, retired IMF economist and historian Margaret Garritsen de Vries received the 2002 Carolyn Shaw Bell award from the American Economic Association's Committee on the Status of Women in the Economics Profession (CSWEP). The award honors an individual who has advanced the status of women in economics through example, achievement, or mentoring.

As a child in Detroit, Michigan, during the Great Depression, de Vries personally witnessed the devastating effects of unemployment, which sparked her interest in economics. The first member of her family to finish high school, de Vries won a full scholarship to the University of Michigan, where she obtained a B.A. with honors in economics and was elected to Phi Beta Kappa. In 1946, she received a Ph.D. in economics from the Massachusetts Institute of Technology, shortly after Nobel prize winner Paul A. Samuelson founded the economics department there.

Joining the IMF in July 1946, de Vries was one of the institution's first staff members. Her female colleagues were few in number, and her early mentors, notably Edward Bernstein and Irving Friedman, were men. She represented the IMF on negotiating missions to such countries as Burma (now Myanmar), Costa Rica, India, Israel, Mexico, Nicaragua, the Philippines, Thailand, Turkey, and Yugoslavia and helped develop and implement IMF policy on multiple exchange rates. De Vries rose to the rank of Division Chief—the first woman to do so—in 1957.

In 1952, she married her colleague Barend A. de Vries, an eminent economist who later worked at the World Bank. After a brief hiatus from the IMF when her children were young, de Vries returned as the institution's first full-time historian and served in this capacity until her retirement in 1987.

In presenting the award, Barbara Fraumeni of CSWEP paid tribute to de Vries's distinguished career at the IMF and made special note of her pioneering role and lifelong commitment to mentoring women.

Honoree Margaret Garritsen de Vries had a long, distinguished career at the IMF.

Bretton Woods Committee

Why is Latin America still prone to crises?

With a number of Latin American countries experiencing financial difficulties, and others in outright economic and political crisis, the Bretton Woods Committee hosted a symposium on December 12 to examine turmoil in the region. The policymakers, business leaders, and representatives from the international financial institutions who met at the Inter-American Development Bank exchanged ideas on how economic growth could be restored, democracy preserved, and crises reduced in number and severity.

Enrique Iglesias, President, Inter-American Development Bank, set the stage for the conference with a review of the economic, social, and political turmoil in Latin America over the past year and the less-often-highlighted bright spots in the region. Many countries had been experiencing weak growth or recession, rising unemployment, increasing poverty, a collapse in capital inflows, and high interest rates and levels of debt—which left little room to pursue countercyclical policies. Nonetheless, others—including Chile, Mexico, and Peru—had been recording moderate growth and were relatively untouched by the problems in the region. Foreign direct investment had also held up relatively well despite financial strains in the region.

Ricardo Hausmann

Roots of financial crises

Why have the ghosts of crisis and volatility come back to haunt the region? And what policies are needed to put the region back on a more positive course? Harvard University's Ricardo Hausmann stressed that the key to understanding why Latin America is prone to repeated crises relates to sudden drops in capital inflows to the region and the inability of these and other emerging market countries to borrow internationally in their own currency—a condition he has dubbed "original sin."

Michael Mussa

With accumulated debt denominated in foreign exchange, foreign-currency-denominated liabilities far outweigh assets, so that countries' balance sheets suffer from a serious currency mismatch. Exchange rate depreciations then have seriously negative consequences. To alleviate these problems, Hausmann proposed creating a synthetic basket currency based on a set of emerging market currencies. The international financial institutions, he suggested, could issue debt in this synthetic currency and offer loans denominated in the local currencies to each of the emerging market countries in the basket. The major industrial nations could also issue debt denominated in the basket currency and then swap out of it with each country whose currency is included.

Michael Mussa, Senior Fellow at the Institute for International Economics, agreed that the inability of developing countries to issue debt in their own currency was important, but he emphasized that other factors also played crucial roles. First, many Latin American countries lacked fiscal discipline and had therefore accumulated high levels of public debt that left them vulnerable to domestic and external shocks. Second, in emerging market countries with long histories of financial problems, easing monetary and fiscal policies tends to be ineffective in alleviating financial strains. A tightening of policy is needed, but it may have a negative impact on economic activity in the short term. Third, international trade for most Latin American countries is limited (particularly relative to Asian countries), and exchange rate depreciation does little to boost the economy via a pickup in exports. Mussa stressed that strong domestic policies are a prerequisite for Latin America to be less vulnerable to crisis.

A more resilient Latin America also requires, in the view of the U.S. administration, a greater emphasis on policies that promote growth. Randal Quarles, Assistant Secretary for International Affairs at the U.S. Treasury, discussed recent U.S. initiatives to promote higher growth and foster increased economic and financial stability in emerging market countries, particularly in Latin America. He emphasized U.S. efforts to further liberalize trade and strengthen financial linkages with Latin America.

Future of democratic institutions

Dissatisfaction with the results of democracy has been on the rise in Latin America, with political turmoil erupting in a number of countries. But Mark Falcoff, a Resident Scholar at the American Enterprise Institute, remained optimistic about the future of the region's democratic institutions. He cited a rise in the number of civil society organizations—in particular, nongovernmental organizations actively promoting human rights and environmental concerns—as a promising sign and noted the growth of a vibrant free press and access to electronic media. ■

Paula De Masi
IMF Western Hemisphere Department

The full text of the remarks of the symposium speakers is available on the website of the Bretton Woods Committee (www.brettonwoods.org).

African leaders tackle NEPAD's stiff challenges

More than a year after the creation of the New Partnership for Africa's Development (NEPAD), ministers, governors, and other senior officials from some 20 African countries met in Dakar, Senegal, in mid-December to discuss the challenges confronting the initiative. Participants at the high-level seminar, hosted by the IMF Institute and the Joint Africa Institute, included donor representatives, academics, and staff of regional and international institutions.

Despite progress by an increasing number of countries, Africa's overall economic performance has continued to lag behind that of other developing country regions. Over the past two decades, as noted by Saleh Nsouli, Deputy Director, and Norbert Funke, Senior Economist, IMF Institute, the gap between sub-Saharan Africa's per capita income and that of other regions has widened; its share of world trade has declined; and its share of global foreign direct investment has fallen.

Securing a positive turnaround in Africa's socioeconomic indicators calls for the effective implementation of wide-ranging economic and financial reforms at the country and regional levels. This is the overriding goal of NEPAD, a framework for Africa's renewal, conceived and developed by African leaders and adopted in 2001 by member states of the African Union. Its specific objectives are to promote accelerated growth and sustainable development, eradicate widespread and severe poverty, and halt the marginalization of Africa in the globalization process.

Turning words into action

As President Abdoulaye Wade of Senegal stressed when he opened the seminar, the time has come to finance NEPAD and implement its objectives. Successful implementation will require that participating countries establish appropriate institutional frameworks, generate a strong consensus for reform from the wider public, and attract adequate international support, said Omar Kabbaj, President, African Development Bank. To meet NEPAD's ambitious objectives—including a targeted rate of economic growth of about 7 percent over the next decade—African countries will also need to make an unprecedented effort to consolidate macroeconomic stability and pursue broad-based structural reforms, including a strengthening of institutional capacity, Nsouli noted. Charles Konan Banny, Governor, Central Bank of West African States, also pointed out that regional institutions would have a key role to play in implementing the partnership.

Gathering for the high-level seminar in Dakar are (left to right): Abdou Aziz Sow (Minister for the NEPAD, Senegal); Saleh Nsouli (IMF Institute); Omar Kabbaj (President, African Development Bank); President Abdoulaye Wade of Senegal; Ismaila Usman and Damian Ondo Mañe (IMF Executive Directors); Koffi Yao (IMF); Abdoulaye Diop (Minister of Finance, Senegal); Seyni N'Diaye (National Director, BCEAO, Senegal); and Samba Thiam (Economic Advisor to the President of Mauritania).

Reducing poverty

At the heart of much of NEPAD's agenda is the quest to reduce poverty. This multifaceted problem has long resisted easy and quick solutions. T.N. Srinivasan, Yale University, emphasized that redistributing assets and/or income from the rich to the poor—even if beneficial in the short and long runs—can be politically difficult. It is often more feasible to identify and implement policies that have a major influence on the socioeconomic-political framework in which the poor make their own decisions. Some participants felt that existing poverty reduction strategies and national development plans already act as important vehicles for identifying these policies and for translating the NEPAD framework into an operational blueprint.

Promoting trade and capital inflows

African economies must position themselves to compete in world markets, and trade holds one of the keys. By opening up their economies more rapidly, African countries can derive increased economic benefits, said Felix Ndukwe, Chief Macroeconomist, African Development Bank. Many African countries have already made substantial progress in trade liberalization, observed Alexandre Barro Chambrier, Executive Director, International Institute for Africa; now it is time for the industrial countries to open their markets further to developing country exports. Kwasi Asamoah-Baffour, Special Advisor, Ghana, urged African countries to identify measures to increase intraregional trade, and Modise D. Modise, of Botswana's President's Office, indicated that African economic integration would require an alignment of countries' objectives and efforts with those of NEPAD's.

If Africa is to achieve the UN's Millennium Development Goals, however, it will need to fill an annual resource gap of $64 billion—equivalent to

President Abdoulaye Wade of Senegal opened the high-level seminar.

some 12 percent of Africa's GDP. Although this will require increased domestic savings, a substantial part of the needed resources will have to come from abroad. Elizabeth Asiedu, University of Kansas, pointed out that foreign direct investment can play a potentially pivotal role, but Africa must substantially improve its investment climate. Although, as Koffi Yao, IMF Resident Representative in Senegal, and Jackson Kinyanjui, Ministry of Finance, Kenya, noted, even countries with sound economic policies can be negatively affected by political or economic instability in neighboring states.

Building an institutional framework

To overcome existing obstacles to growth and sustainable development, African countries must foster an enabling environment for private initiative, including maintaining peace, security, and respect for property rights. In his paper, Soumana Sako, Executive Secretary, African Capacity Building Foundation, praised NEPAD for emphasizing the importance of good governance and a sound institutional framework for reducing poverty, enhancing growth, and attracting more foreign investment. Saade Chami, IMF, and Jean-Claude Brou, Director, Central Bank of West African States, argued that a well-functioning market economy had to be supported by various types of institutions, such as regulatory and social insurance bodies. Most important, African leaders need to ensure the rule of law, which, according to Michael Sarris, Director, World Bank Institute, requires an independent, impartial judiciary.

Partners doing their share

Africa's partners in the international community must also hold up their end of the bargain. Abdoulaye Bio-Tchané, Director of the IMF's African Department, explained that his organization helped countries formulate domestic economic policies, foster regional integration, and build capacity. The IMF is putting in place five African Regional Technical Assistance

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Centers (AFRITACs) and is continuing to enhance the training activities of the IMF Institute. Broad international support will also be needed for capacity and institution building.

Participants stressed, however, how critical it was for Africa's partners to take action to remove barriers to trade, expand and speed up debt relief, and raise official development assistance to the UN target level of 0.7 percent of GNP and reform the modalities of such assistance.

Identifying the next steps

If NEPAD is to succeed, African countries must ensure good governance, too. In this regard, the African Peer Review Mechanism, a voluntary monitoring instrument of the African Union, could serve as an important vehicle and enhance credibility. Jean-Eric Aubert, Senior Policy Advisor, World Bank Institute, emphasized that peer learning could substantially improve governance, but participants noted that it would be vital for these peer reviews to meet consistently high standards and be free of political interference. Countries must also be willing to take the corrective measures recommended by the reviews.

One of the preconditions for NEPAD's success, according to IMF Executive Directors Damian Ondo Mañe and Ismaila Usman, will be its ability to establish and maintain a sound institutional framework. Together with Seyni N'Diaye, National Director, Central Bank of West African States, they urged enhancing capacity building in NEPAD's priority sectors and saw the peer review mechanism as the first test of Africa's ability to improve its institutional framework. As Guy Darlan, Regional Coordinator,

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03/03: IMF Concludes 2002 Article IV Consultation with the Republic of Tajikistan, January 3
03/04: IMF Concludes 2002 Article IV Consultation with Tanzania, January 6
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Speeches

"Sovereign Debt Restructuring: Messy or Messier?" Anne Krueger, IMF First Deputy Managing Director, Annual Meeting of the American Economic Association, Washington, D.C., January 4
"Hopes and Fears: The Global Outlook, Asia, and the IMF," Thomas C. Dawson, Director, IMF External Relations Department, Hong Kong Foreign Correspondents Club and Singapore International Chamber of Commerce, January 8

Statements at Donor Meetings

IMF Staff Statement at Interim Donor Meeting on East Timor, December 9

Transcripts

Press Briefing, Thomas C. Dawson, Director, IMF External Relations Department, January 16

World Bank Institute, noted, the crucial question is whether the review mechanism itself will become a well-functioning and credible institution.

In the area of regional integration, Sherifa Kamal Rahmy, Central Bank of Egypt, emphasized that the highest priority should be given to improving infrastructure to catalyze further integration. Isaac Aluko-Olokun, a member of the NEPAD Steering Committee, also underscored how important it would be to better communicate NEPAD's goals and implementation plan to garner much wider and stronger support from the general public.

Now is the time, Evangelos Calamitsis, former Director of the IMF's African Department, concluded, for African countries and institutions to redouble their efforts, notably in the critically important areas of establishing an enduring foundation for peace, security, democracy, good governance, and the rule of law. ■

Norbert Funke
Senior Economist, IMF Institute

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

Stand-By, EFF, and PRGF arrangements as of December 31, 2002

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina[1]	March 10, 2000	March 9, 2003	16,936.80	7,180.49
Bosnia & Herzegovina	August 2, 2002	November 1, 2003	67.60	36.00
Brazil[1]	September 6, 2002	December 31, 2003	22,821.12	18,256.90
Bulgaria	February 27, 2002	February 26, 2004	240.00	156.00
Dominica	August 28, 2002	August 27, 2003	3.28	1.23
Guatemala	April 1, 2002	March 31, 2003	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Romania	October 31, 2001	April 29, 2003	300.00	165.33
Turkey	February 4, 2002	December 31, 2004	12,821.20	2,892.00
Uruguay[1]	April 1, 2002	March 31, 2004	2,128.30	1,016.60
Total			**55,829.10**	**30,204.69**
EFF				
Indonesia	February 4, 2000	December 31, 2003	3,638.00	1,376.24
Serbia/Montenegro	May 14, 2002	May 13, 2005	650.00	550.00
Total			**4,288.00**	**1,926.24**
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	24.00
Armenia	May 23, 2001	May 22, 2004	69.00	39.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	64.35
Benin	July 17, 2000	March 31, 2004	27.00	8.08
Cambodia	October 22, 1999	February 28, 2003	58.50	8.36
Cameroon	December 21, 2000	December 20, 2003	111.42	47.74
Cape Verde	April 10, 2002	April 9, 2005	8.64	6.18
Chad	January 7, 2000	December 6, 2003	47.60	10.40
Congo, Dem. Rep. of	June 12, 2002	June 11, 2005	580.00	160.00
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Djibouti	October 18, 1999	January 17, 2003	19.08	5.45
Ethiopia	March 22, 2001	March 21, 2004	100.28	31.29
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	January 12, 2001	January 11, 2004	108.00	58.50
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Guyana	September 20, 2002	September 19, 2005	54.55	49.00
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Kyrgyz Rep.	December 6, 2001	December 5, 2004	73.40	49.96
Lao People's Dem. Rep.	April 25, 2001	April 24, 2004	31.70	18.11
Lesotho	March 9, 2001	March 8, 2004	24.50	10.50
Madagascar	March 1, 2001	November 30, 2004	79.43	45.39
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2003	51.32	12.90
Moldova	December 21, 2000	December 20, 2003	110.88	83.16
Mongolia	September 28, 2001	September 27, 2004	28.49	24.42
Mozambique	June 28, 1999	June 27, 2003	87.20	16.80
Nicaragua	December 13, 2002	December 12, 2005	97.50	90.54
Niger	December 22, 2000	December 21, 2003	59.20	25.36
Pakistan	December 6, 2001	December 5, 2004	1,033.70	689.12
Rwanda	August 12, 2002	August 11, 2005	4.00	3.43
São Tomé and Príncipe	April 28, 2000	April 27, 2003	6.66	4.76
Sierra Leone	September 26, 2001	September 25, 2004	130.84	56.00
Tajikistan	December 11, 2002	December 10, 2005	65.00	57.00
Tanzania	April 4, 2000	June 30, 2003	135.00	15.00
Uganda	September 13, 2002	September 12, 2005	13.50	12.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Zambia	March 25, 1999	March 28, 2003	278.90	41.38
Total			**4,520.21**	**2,428.18**

[1]Includes amounts under Supplemental Reserve Facility.

EFF = Extended Fund Facility
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

Interview with Dimitri Demekas

Rethinking what postconflict aid can accomplish

Over the past decade, countries recovering from war and civil unrest have received substantial amounts of postconflict aid designed to address their humanitarian emergencies, rebuild destroyed infrastructure, and restore public services. In a new IMF Working Paper, Dimitri Demekas (Advisor, European I Department); Jimmy McHugh (Resident Representative in Armenia); and Theodora Kosma (Athens University of Economics and Business) examine the impact of postconflict aid on an economy. Demekas talked with the IMF Survey *about the new study.*

IMF Survey: What prompted you to develop a new framework for analyzing the impact of postconflict aid?

DEMEKAS: The original idea for the study came from Jimmy McHugh, who was then our desk officer for Bosnia. At the time, I was leading missions to Kosovo, and we had just finished a major joint IMF–World Bank paper on Southeastern Europe after the Kosovo conflict. Our work on that paper, as well as on Bosnia and Kosovo, turned our attention to the amount of aid that went into these countries after the wars. Jimmy originally proposed a paper on the economic impact of an influx of refugees and of refugee-related aid flows. This aid helps host countries deal with the cost of assisting refugees and facilitates the postconflict return of refugees to their countries of origin. The idea quickly led us to the broader issue of postconflict aid. We discussed our outline with senior staff in the European I Department and, in mid-2002, wrote the paper with the indispensable input of our summer intern, Theodora.

IMF Survey: Is postconflict aid really all that different from conventional development assistance?

DEMEKAS: Three characteristics of postconflict aid distinguish it from traditional aid. The first and most noticeable is, of course, its size. Look at some of the examples we cite in the paper: Rwanda's aid reached 95 percent of GDP during the first year after the conflict; Bosnia's, 75 percent of GDP; and Kosovo's, 65 percent of GDP. These are huge amounts of money, which drop off very quickly four or five years later, typically down to a range of 10–25 percent. Traditional development aid is a trickle compared with that: on average, the amount of aid that middle- and lower-income countries receive is something like 2.5 to 3 percent of GDP. But then it lasts for 20, 30, or even 40 years in the case of Africa. We felt that these two kinds of aid were essentially different phenomena and decided to develop a new analytical approach because we suspected that the tools developed to analyze the impact of development aid were not really appropriate for postconflict aid.

Another reason the traditional aid literature does not provide appropriate tools for examining postconflict aid is that it basically models aid as a transfer of tradable goods or, in more sophisticated models, a transfer of foreign currency. But this is not the typical case in postconflict countries. In these countries, you instead see a lot of resources allocated toward rebuilding infrastructure—roads, telephone networks, water supply systems, and houses—that has been destroyed. And you also see armies of foreign consultants rebuilding institutions—a ministry of finance, a modern tax system, a central bank—that, of course, are at least as important as physical infrastructure.

In postconflict situations, there is also a very clear difference between humanitarian aid and reconstruction aid. Humanitarian aid provides a huge burst of money in the first year or two after the conflict. Then, in most cases, it tapers off very quickly, while reconstruction aid continues for several years. That is not the pattern of development aid, where the distinction between these two kinds of flows is much less sharp.

IMF Survey: How does your model help in assessing the impact of postconflict aid?

DEMEKAS: I think the main achievement of our model is that it distinguishes the impact of humanitarian aid from that of reconstruction aid. We distinguish between the two types of aid to reflect their fundamentally different objectives: reconstruction aid aims to improve productive capacity, while humanitarian aid is intended to support basic consumption. We also include reconstruction aid in the production function to account for the fact that, by rehabilitating infrastructure and public institutions, postconflict reconstruction directly boosts productivity.

IMF Survey: And what did you conclude?

DEMEKAS: Our main finding is that humanitarian aid and reconstruction aid do have different effects. Humanitarian aid has pretty much the same impact as

Demekas: "Our advice would be to give larger amounts of humanitarian aid over a shorter period of time, instead of disbursing relatively small amounts over a long period of time."

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traditional development aid: it is a transfer of income that tends to be consumed rather than saved. It gives a boost to consumption in the short term but reduces savings, capital accumulation, and, in the long run, growth.

Reconstruction aid, however, has a completely different impact. In particular, its effect on capital accumulation, which is the key to growth, is ambiguous in our model but, within reasonable constraints, we believe it can be positive. In addition, our model also provides a bit of comfort because it shows that reconstruction aid, when properly designed, does not necessarily lead to "Dutch disease."

A Kosovo family receives humanitarian aid.

IMF Survey: What is "Dutch disease," and why is it of concern?

DEMEKAS: If a country receives a transfer of tradable goods (or foreign exchange that makes it possible for the country to buy tradable goods), the relative price of nontradable goods rises. As a result, resources (capital and labor) shift toward the nontradable goods sector and the tradable sector shrinks. This phenomenon is called "Dutch disease" because Holland experienced a contraction in its tradable goods sector after the discovery of large natural gas deposits and the foreign exchange inflow associated with it.

The same thing can happen when a country receives foreign aid: aid boosts consumption but can depress the tradable goods sector and jeopardize the long-term potential of the country. Our paper shows that in postconflict economies, in particular, the design of the aid package has a crucial impact on whether or not postconflict aid will cause the tradable goods sector to shrink.

IMF Survey: How should postconflict aid be designed?

DEMEKAS: There are perfectly legitimate reasons for giving humanitarian aid. But from an economic perspective, in the long run, it is "growth-destroying" because people lose their incentive to save and invest. Our advice would be to give larger amounts of humanitarian aid over a shorter period of time, instead of disbursing relatively small amounts over a long period of time. Also, in designing reconstruction aid, which is the component typically disbursed over a longer period of time, channel it toward the tradable goods sector. Spend the money on activities or infrastructure or institutions that help that part of the economy. If you must choose, for example, between rebuilding churches and sports facilities and rebuilding roads and sewer networks, you are better off—from an economic point of view—doing the latter.

IMF Survey: What are the broader lessons you would like to see policymakers draw from your study?

DEMEKAS: In the traditional aid literature, there is little agreement on whether aid is beneficial and, if indeed it is, under which circumstances. It is remarkable how disappointing the results of almost 50 years of economic research in this area are. This has been one of the major motivations behind our effort to give a fresh look at how we model aid. Our hope is to stimulate a new trend in thinking about it. The main benefit for policymakers would be the creation of new analytical tools to help them make better choices about allocating the limited aid resources between different uses—for instance, humanitarian and reconstruction aid—and design aid packages more effectively. ■

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
January 6	1.91	1.91	2.44
January 13	1.90	1.90	2.43

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

Copies of IMF Working Paper No. 02/198, *The Economics of Postconflict Aid,* by Dimitri Demekas, James McHugh, and Theodora Kosma, are available for $15.00 each from IMF Publication Services. See page 12 for ordering information. The full text is also available on the IMF's website (www.imf.org).