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Chabrier interview

Security issues critical as Afghanistan moves to rebuild its economy

Following a series of international donor meetings aimed at helping Afghanistan stabilize and rebuild its economy, the IMF sent a mission to Kabul for four days in late January. The team was led by Paul Chabrier, Director of the IMF's Middle Eastern Department. He speaks here about the country's immediate needs and the IMF's role.



Two children sell bread near the ruins of a former shopping boulevard in eastern Kabul.

foreign troops ensuring security, but there are difficulties in the provinces. Unless the security climate improves, it will be very difficult to move into reconstruction and for the government to perform its traditional functions.

Second, help is needed to improve the work and efficiency of key institutions, such as the major

ministries and the central bank.

Third, the proliferation of currencies must stop. At present, there are three Afghan currencies—the official one issued by the central bank in Kabul, one issued by the Northern Alliance, *(Please turn to the following page)*

IMF SURVEY: What do you see as the immediate priorities to get the economy functioning again?

CHABRIER: There are four main priorities. First, the security situation has to improve dramatically. The present government is in full control of Kabul, with

Taking stock of poverty reduction efforts

What better way to hone the effectiveness of a new approach to policymaking for poverty reduction than to take stock of experience with it and feed the lessons back into its design and implementation? The International Conference on Poverty Reduction Strategies during January 14–17 in Washington, D.C., sought to do just that, gathering 200 representatives

from 60 countries to share their firsthand knowledge of poverty reduction strategy papers (PRSPs). Joining them were their development partners: representatives from international organizations, bilateral aid

agencies, and civil society organizations from developed and developing countries. It is clear that the PRSP approach is still evolving, and that everyone involved is learning by doing. That is why, said IMF Managing Director Horst Köhler, “it is critical that we take this opportunity, two years into the process, to ask how it can be improved in light of the early experience.”

Consensus and debate

Ideas and proposals were the purpose and the product of the conference. Reflecting the extensive consultation that had already taken place, including four regional conferences (see *IMF Survey*, January 28), the international conference refined and reinforced the main messages that had been emerging from participating groups. Chief among these messages was a strong endorsement of the PRSP approach, which all agreed had made important progress in a relatively short time. The PRSP gave a central focus to *(Please turn to page 35)*



Margaret Kakande

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Chabrier reflects on Afghanistan mission

(Continued from front page) and one by a warlord. Plus, there are indications that more are being issued. Unless the issuance of new Afghan banknotes not backed by the central bank is stopped, it could lead to massive inflation and destabilize the economy. Already, it has caused a progressive weakening of the official currency in the foreign exchange market following a rapid appreciation from October to December.

Fourth, Afghanistan must move quickly to establish a budget for the next fiscal year. It doesn't need to be elaborate, but it has to be a budget where recurrent expenditures can be appropriately assessed. The bulk of expenditures will consist of the salaries of the civil service and the army, which haven't been paid in five months. There has been an attempt to partially pay some public servants in Kabul, but payments outside Kabul have been prevented, in part, by difficulties in transporting the cash and assessing the number of public servants. A budget for 2002/03 (which starts on March 21) is required to establish the needs for external assistance and elicit the disbursement of that assistance.

IMF SURVEY: Is there a dollar figure on Afghanistan's needs for rebuilding?

CHABRIER: The World Bank and other development institutions estimate the reconstruction needs at about \$15 billion over 10 years, but it's extremely difficult to pinpoint the correct figure. The real issue is, rebuild to what level? To a modest level of functioning? The need for the next 12–18 months is put at \$1.7 billion—a sum that was pledged in Tokyo in late January. What we need to do now is ascertain the form and timing of such assistance, including some of the conditions under which it can be disbursed.

IMF SURVEY: How long will it take to see the economy functioning reasonably well?

CHABRIER: Afghanistan being basically an agricultural economy, I would say two or three years, with the proviso that security is reestablished over the whole of the territory and the basic infrastructure for agriculture is reconstructed. If security is not established, it raises doubts about the government's ability to run the country. Communication links also need to be established with the provinces; otherwise everyone begins operating independently. And, finally, the reconstruction assistance will have to flow soon.

IMF SURVEY: How about fiscal revenues?

CHABRIER: There is a very modest revenue base that consists of a few fees and some tariffs on imports. It would cover at best 10 percent of recurrent spending in the coming years. Thus, the bulk of financing of the recurrent deficit would have to be through foreign assistance. We also assume that the investment budget will be fully foreign financed.

IMF SURVEY: Was a lot of money cleared out of the central bank as reported?

CHABRIER: Yes. Before Kabul fell to the Northern Alliance, someone went to the vaults of the central bank and stole \$6 million in U.S. dollar bills and about \$1 million worth of Pakistan rupees. We saw the safe that had been cut open. It was in a room with a number of safes, some of which held relics from the royal family. But the thieves knew exactly which safe to open. So they had some inside information.

IMF SURVEY: Any chance of recovering the money?

CHABRIER: No, I don't think so. Nobody knows exactly who stole it. But the thieves have probably disappeared into the countryside.

IMF SURVEY: What is the IMF's advice on exchange rate policies?

CHABRIER: The central bank governor is absolutely convinced that the best system for Afghanistan is a free float, the system of the past 50 years. The currency should be fully flexible, and the central bank shouldn't intervene in the market. The problem is that three currencies are circulating and more are being printed. The authorities are very clear that a new, single Afghan currency will have to be established at some point in the future, replacing the current Afghanis. But what should be done between now and then? The IMF staff has made some proposals, which are being examined by a committee composed of the finance minister, the central bank governor, another minister, and a special UN representative.

It isn't easy, however, to devise a new currency; this will take some time. A key issue is what picture will go on the currency notes. This is especially controversial because, unlike in Kosovo and East Timor—territories that wanted to become independent and thus had no particular attachment to a currency—the Afghans want to reestablish a unified nation. Should the currency picture a human face, which was unacceptable under the Taliban, or a monument? If the latter, which monument would satisfy the various ethnic groups?



Chabrier: "If security is not established, it raises doubts about the government's ability to run the country."



IMF SURVEY: How will the IMF be helping?

CHABRIER: The task of rehabilitation and reconstruction covers many areas, but the IMF has to limit itself to its areas of expertise. I see us helping in three main areas. First, there is an urgent need to boost the administrative capacity of the existing institutions. The administrations exist but the personnel are not there. In the banking area, for example, we have to help the central bank rebuild its capacity to be a central bank and, in particular, to supervise commercial banks. Second, on the budgetary front, it's a question of not only helping to design the budget for the next fiscal year, beginning March 21, but also helping to ensure that the budget is properly monitored and that budget proposals are realistically linked to external assistance. Third, there is an urgent need to rebuild the statistical base. No statistics have been collected since 1996. There isn't even a central bank balance sheet. How long will it take to rebuild this base? It will probably take a year, and we will have to take shortcuts. There would be historical value in extending the statistics back to 1996, but this might take too long. The alternative would be to just start with the present and go forward.

IMF SURVEY: Do you have counterparts to work with?

CHABRIER: I think at the top level, the people at the central bank and ministries are impressive. Below them, it's more difficult to find the right type of team. You have some individuals who are pretty good, but they are all overworked. If you are knowledgeable, everybody wants to see you. This is an area where a lot of technical assistance will be needed. The IMF will have to post some experts there for a while to help the Afghans run things and establish procedures.

IMF SURVEY: Can the IMF look to any other countries as comparisons for postconflict rebuilding?

CHABRIER: Because I was associated with the task, the closest case that comes to mind is Bangladesh, when it became an independent nation in 1972. In both countries, reconstruction did not have to start from scratch. In Afghanistan, there still is a government and an administrative structure, even if it's very weak. Another parallel is that Bangladesh also had a lot of external assistance, but it needed to be organized. A lot of assistance has been pledged for Afghanistan, but we will need to identify the type and timing of it. This must be done very quickly for budgetary and efficiency reasons. Salaries must be paid, and this can't be done through project loans.

IMF SURVEY: You were last in Kabul 10 years ago. What is your impression this time?

CHABRIER: It's an impression of great sadness. I knew a lot of people in the central bank and the finance ministry 10 years ago, but I couldn't find them, which means that they have died or disappeared. Also, 40–50 percent of the city has been destroyed. In the center, the destruction hasn't been as great, although there was some bombing. But when you go outside the center, you find total devastation, which has been going on since 1993. The other feeling is that the team that accompanied me to Kabul this time had an impressive will to help despite the difficult accommodation conditions. This attitude was matched by the authorities' desire to put things straight. That is the best memory I keep from this recent mission. ■

No statistics have been collected in Afghanistan since 1996. There isn't even a central bank balance sheet.

—Paul Chabrier

PRSP approach is strongly endorsed

(Continued from front page) poverty reduction, strengthened participation in policymaking, and provided a single strategy around which development partners could orient their activities.

But those attending were not shy about highlighting areas where improvements were needed. The PRSP had inevitably given rise to tremendous expectations and, in some areas, had clearly not met these. Patience, participants counseled. Recognize capacity constraints and acknowledge that countries start from very different points; set realistic growth targets; manage expectations; and realize that changing the way development partners interact will take time. "Behavioral change comes slowly," observed Jim Wolfensohn, President of the World Bank, "but when it comes, it really comes."

To move from papers to programs to poverty reduction is really the fundamental challenge, said John Page, Director, Poverty Reduction Group, World Bank. No one needs another document on a shelf, IMF First Deputy Managing Director Anne Krueger stressed—there needs to be real impact on what governments and their development partners do. And none of this, Köhler noted, will happen in a vacuum. Successful poverty reduction requires expanded market access for developing country products, reduced agricultural subsidies in developed countries, and adequate foreign assistance.

Frank and lively discussions crystallized around several key aspects of the PRSP, notably its call for broad participation and country ownership, comprehensive policy actions rooted in an analysis of coun-



Kemal Dervis



Rob Mills

try needs, and supportive actions, such as better alignment of donor assistance with the PRSP goals and effective monitoring that allows everyone to gauge progress.

Owning reform

One of the defining innovations of the PRSP approach is wide participation in the development of strategies. Why involve more people? Because greater participation brings with it greater accountability and transparency, as well as substantial and broad-based country ownership. Stanley Fischer, then Special Advisor to the Managing Director of the IMF, indicated that if the PRSP dialogue is honest, “there should be less disappointment within countries if policies reached through a process of dialogue fail, and much more willingness to rethink issues, to try and find better ways.”

Participants agreed that the PRSP approach has spurred participation and deepened understanding of the dimensions of poverty and the priorities of the poor. “We’ve gained a new culture of dialogue between government and civil society,” said Mehman Abasov, PRSP Coordinator of Azerbaijan’s Ministry of Economic Development. But in addition to information sharing, the participatory process, he believed, should also “build trust and create incentives for governments to listen and respond to civil society.”

Broad-based participation is even more essential in crisis situations, according to Kemal Dervis, Turkey’s Minister of State for Economic Affairs. Participation and transparency are critical for getting people to understand the difficult trade-offs involved, he said. “The social strain is much larger if there is no attempt to bring all stakeholders into the debate.” But in some cases, Rob Mills of Eurodad indicated, “participation serves only to rubber-stamp policies.” He called for independent assessments of the participation process accompanying the PRSP.

Some civil society organizations expressed frustration that the broader debates on structural reforms and macroeconomic policies are off the table. But Warren Nyamugasira, national coordinator of the Uganda National Nongovernmental Organization Forum, suggested it was partly because civil society has limited capacity to participate meaningfully in these policy debates, particularly the technically demanding ones. These constraints will become even more pressing, he suggested, as civil society becomes engaged in implementation, monitoring, and evaluation. He and other representatives of civil society groups called on donors to

help strengthen government and civil society capacity in this key area.

Other civil society representatives, for example, Sanjaasurengiin Oyun, a member of Mongolia’s Parliament, underscored the unique role parliamentarians play in representing the poor as constituents. She called for parliaments to be involved earlier in the PRSP process.

Content matters

But it’s not only about process, Eduardo Aninat, IMF Deputy Managing Director, emphasized. A more inclusive process must lead to better policies. It was clear that more work needed to be done on the design of pro-poor growth policies. Dominique Njinkeu, African Economic Research Consortium, Kenya, argued that most PRSPs “have little to no economic analysis focusing on the interdependence of the macroeconomic framework and specific pro-poor policies.”

Participants also identified specific ways to improve the content and quality of PRSPs.

Define better priorities. Margaret Kakande, from Uganda’s Ministry of Finance, emphasized the need to identify and specify priorities—in terms of both policy measures and the allocation of public expenditures—and to link these to the budget. And these choices must be underpinned by a poverty and social impact analysis so that the implications for the poor can be determined and compensatory measures designed. This analysis, according to Kakande, is critical in identifying trade-offs and sequencing reforms.

Develop more realistic growth projections. Many country representatives noted the tension between aspirational, politically driven policy documents and realistic performance-based strategies. The danger of the former, according to Efrain Corea, Office of the President, Honduras, is unrealistic growth targets that bear no relation to country circumstances and constraints. All agreed that the sources of and constraints to growth need more analysis.

Factor in economic shocks. Many country representatives were concerned, particularly in light of the current global economic slowdown, with the ability of poor countries to respond to external shocks without jeopardizing their poverty reduction strategies. International financial institutions should work with them, they said, to ensure that shocks are factored into PRSPs and that suitable instruments are available to respond to shocks.

Enhance capacity building. Country representatives prodded development partners to help them build up their capacity to evaluate costs and assess intersectoral trade-offs between policies. In particular,



Warren Nyamugasira



Sanjaasurengiin Oyun

they cited the value of learning activities and technical assistance and called for greater “South-South” learning.

Provide more attention to issues that cut across sectors. Gender analysis, HIV/AIDs, the environment, conflict prevention, and good governance in PRSPs are examples of issues that could benefit from a more integrated approach.

Discuss policy options. There was a strong sentiment, particularly among donors and civil society, about the need to present more policy options and consider alternative policy scenarios. They called for, among other things, improved understanding of the ingredients in successful development efforts and suggested expanded reliance on academics and think tanks.

Follow through

The PRSP’s broad scope is aimed at encouraging countries to develop, and own, strong poverty reduction efforts. But these efforts can be aided or complicated by development partners. And effective monitoring can help all parties in the poverty reduction process identify problems, emulate successes, and sustain support for the long struggle that poverty reduction entails.

How can the PRSP strengthen the partnerships between countries and donors and be used as an instrument for aid coordination? Donors clearly recognized why it was important to align the content of their assistance with the PRSPs, work within priority PRSP areas, and harmonize practices and procedures. The weak prioritization evident in many PRSPs is, in part, the product of multiple demands being generated by donors through the participatory process, admitted Peter Hansen from the Danish Ministry of Foreign Affairs. “We donors also need to exercise self-discipline in not pursuing our own individual agendas and priorities. It must clearly be the country itself that identifies the priorities.”

Others, however, observed that donor practice rarely matched donor rhetoric. Donors often fail to understand that this process is about “ceding power,” Warren Nyamugasira noted. Some country representatives suggested that the solution lies in countries’ taking the lead in donor coordination and called on donors to defer to government leadership. Deputy Director of the IMF’s Policy Development and Review Department Masood Ahmed, giving voice to the con-

sensus of the conference, noted that the success of the PRSP approach depended upon more rapid donor progress in reducing the cost of doing business in recipient countries, increasing predictability of aid disbursements, and improving capacity.

But even with greater coordination, how can a country and its development partners be certain that their efforts are making a difference? Mark Malloch Brown, Administrator of UNDP, called for “proper monitoring and buy-in to the concept of the Millennium Development Goals.” Köhler also emphasized this point, citing the need for a “concrete, constructive, and transparent system” for monitoring progress and coordinating activities toward the achievement of these goals—not just in the PRSP process but also in the actions of wealthy nations, donors, and international institutions.

What’s ahead

The conference’s ideas and proposals will now serve as a key input into the papers that World Bank and IMF staff are preparing on the PRSP experience. These papers will identify emerging good practices and outline staff recommendations for IMF and World Bank Executive Board discussions of these reviews in March 2002. The summary paper will also be an important contribution to the upcoming UN Conference on Financing for Development in Monterrey, Mexico. ■

Gita Bhatt
IMF Policy Development and Review Department

Aligning PRSPs and the PRGF

In parallel with the joint IMF–World Bank PRSP review, the IMF has launched a review of its concessional financing facility. Its Poverty Reduction and Growth Facility (PRGF) is intended to stem from and be consistent with the PRSP that borrowing countries prepare.

Has the PRGF done what it is supposed to do? Participants in the poverty reduction conference applauded efforts to streamline structural conditionality, increase budget allocations for pro-poor spending, and provide more flexible fiscal frameworks. But many civil society participants wanted more evidence that PRGF-supported programs were, in fact, drawn from and consistent with PRSP priorities. They suggested that the openness and transparency of PRGF-supported programs could be bolstered through discussions of alternative policy scenarios, greater analysis of poverty and social impacts, and greater elaboration in IMF staff reports of the policy dialogue and policy choices considered in program design.



Efrain Corea



Dominique Njinkeu



Peter Hansen

Photo credits: Saeed Khan for AFP, pages 33–34; Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF.

Interview with Robert Flood

IMF Staff Papers has a new look

In January 1999, Robert Flood of the IMF's Research Department became the Editor of IMF Staff Papers. Flood is a well-known researcher and former

academic, and has extensive experience in editing journals, having coedited both the *Journal of International Economics* and the *American Economic Review*. The Editorial Committee of Staff Papers has made a number of changes over the past few years to improve the quality of the journal. Flood met recently with the IMF Survey to discuss these changes.

IMF SURVEY: When you took over in 1999, the IMF decided that economists did not need to offer their Working Papers to Staff Papers before offering them to outside journals. Was that your decision, and has it hurt the journal?

FLOOD: That was a condition that I imposed for my taking over *Staff Papers*, and here's the reason. It doesn't encourage research to force all IMF staff to submit their work to *Staff Papers*. That's crazy. There used to be a policy that all Working Papers had to be submitted to *Staff Papers*. If researchers wanted to publish their work elsewhere, they would not bring their papers out as Working Papers but would just send them to outside journals. As a result, no one at the IMF knew about those papers. Instead of having good work circulate in the IMF, that policy kept us from

finding out about good research being done here. It was a really counterproductive policy.

IMF SURVEY: At the same time, you introduced the use of expert referees. How has this affected the quality and credibility of the journal?

FLOOD: Over time, I am certain that the use of outside referees will improve the quality of the journal. Before I came on board, there was no outside peer review in *Staff Papers*. Staff would submit their papers, and the Editorial Committee would have somebody read them carefully and write up a short report. Now, the comments that our authors receive are excellent, much better than from any other journal I've been involved with. Perhaps that has to do with the fact that we pay our experts quite well—the referees' median turnaround time is about 30 days. That's fantastic by economic journal standards.

IMF SURVEY: Exactly what role does the IMF see for *Staff Papers*?

FLOOD: *Staff Papers* is seen as a vehicle for staff to publish their research, like a perk for staff. To the extent that it ends up being a good academic journal, that's a bonus. There are plenty of other outlets for staff who want to publish their work outside the IMF, but outsiders can't publish in *Staff Papers* unless we let them.

IMF SURVEY: Have any seminal studies been published in *Staff Papers*?



Flood: "Over time, I am certain that the use of outside referees will improve the quality of the journal."

IMF Staff Papers: a look inside

IMF Staff Papers—the IMF's research journal—contains theoretical and empirical papers produced by IMF staff and invited guests. Since its creation in 1950, the journal has published over 1,000 papers. Papers are selected on the basis of their interest to academics and policymakers in the member countries of the IMF and cover a wide range of topics.

The three most recent issues are Volume 48, Numbers 1, 2, and 3. Volume 48, Number 1, includes articles on, for example, threshold effects in the relationship between inflation and growth, as well as the monetary transmission mechanism in Japan; Volume 48, Number 2, contains papers dealing with product variety and growth, and forest management, among others; and Volume 48, Number 3, includes papers on the 1956 Suez crisis and on

the global current account discrepancy. A special issue of *Staff Papers*, containing a collection of some of the papers presented at the First Annual IMF Research Conference, held in Washington, D.C., on November 9 and 10, 2000, was published in December 2001.

The topics covered included monetary and exchange rate policy in crisis situations, private sector involvement in crisis resolution, exchange rate regimes and currency unions, and effects of adjustment programs.

The annual subscription rate is \$56 for three regular issues a year, plus one special issue. There is a lower rate for full-time professors and students of universities and colleges. Requests for subscriptions and orders should be sent to IMF Publication Services (see page 45 for details).



FLOOD: *IMF Staff Papers* has published a variety of economics classics—papers that make most graduate reading lists—spanning the intellectual space from the effects of devaluation (Alexander) to the early papers developing the Mundell-Fleming model (Mundell and Fleming). Widely cited work that may someday graduate to “classic” status involves analysis of flexible exchange rates, growth, monetary rules, and the balance of payments. A bunch of wonderful new papers explore and explain “crisis economics” from the 1980s debt crisis to the more recent balance of payments and banking crises.

IMF SURVEY: What topics are you looking at? Will research become more policy oriented?

FLOOD: It just depends on what the staff wants to do. I don't orient the journal in any particular direction. IMF staff has a comparative advantage in putting their research-related work into a context that can't be duplicated elsewhere. They can go to a third world country, for example, and talk to the finance minister. They can actually conduct transactions in the local markets. When they come back, they can describe what they did and then do an empirical or theoretical study. That's really what I try to do with *Staff Papers*.

IMF SURVEY: In 2001, *Staff Papers* published a collection of papers from the 2000 Annual IMF Research Conference. Are there any plans for other special issues?

FLOOD: We have a special issue on transition economies coming out in the first half of 2002. Apart from that, we are not planning any other special issues besides the research conference, which will be

a special issue every year. What we are doing is setting aside sections of the journal for special issues. In a forthcoming *Staff Papers*, for example, there will be a three-paper section—two invited papers and one inside paper—on predicting economic variables.

IMF SURVEY: There have been a number of changes in the look of the journal in recent years. Has the content changed too?

FLOOD: No, the content is basically the same. When I took over as Editor, the Editorial Committee said, “Why don't we shake up the journal?” So I went to our graphic artists and they came up with four designs. We eventually decided on the current blue design, which is going to be our look for a while.

There has been one other substantial change. *Staff Papers* used to be a quarterly journal. It now comes out in three numbered, but not dated, issues. We used to publish about 20 papers a year in four issues. Now we're doing the same number of papers in three issues, so the journal has gotten a bit thicker. Including the Annual Research Conference issue, we now publish about 30 papers a year.

IMF SURVEY: What kind of feedback do you receive from your readers?

FLOOD: Not very much. I'd like to get a lot more. When I came on board, I invited readers to send in comments, but we didn't get many. We now post every paper and the data used in the paper on the IMF's website. My understanding is that people like that and download the data on a regular basis. ■

Available on the web (www.imf.org)

Press Releases

- 02/5: IMF, World Bank Conclude Joint Poverty Reduction Strategy Conference, January 18 (see page 33)
- 02/6: IMF Approves Two-Year Stand-by Credit for Peru, February 1
- 02/7: IMF Managing Director Sees Impressive Commitment by Turkey to Economic Reforms; Executive Board Approves \$16 Billion Stand-by Credit, February 4 (see page 41)

News Briefs

- 02/5: IMF Completes Third Review of Colombia's Extended Arrangement, January 25
- 02/6: IMF, World Bank, and IDB Working Closely to Help Argentina, January 28
- 02/7: IMF Completes Fourth Review of Indonesia Program, Approves \$341 Million Disbursement and One-Year Extension of the Program, January 29
- 02/8: IMF Completes Review Under Cameroon's PRGF Arrangement and Approves \$20 Million Disbursement, January 30

Public Information Notices

- 02/4: IMF Concludes 2001 Article IV Consultation with the Republic of Lithuania, January 24

- 02/5: IMF Concludes 2001 Article IV Consultation with the Republic of Latvia, January 25

Speeches

- Breaking Out of the Third World: India's Economic Imperative—Address by Stanley Fischer, Special Advisor to the IMF Managing Director, *India Today* Conclave, New Delhi, January 22 (see page 40)
- Global Prospects after September 11 and Implications for Japan—Address by Shigemitsu Sugisaki, IMF Deputy Managing Director, Japan Society, New York, January 25
- Working for a Better Globalization—Remarks by Horst Köhler, IMF Managing Director, Conference on Humanizing the Global Economy, Washington, D.C., January 28

Transcripts

- Economic Forum—The Euro: Ready or Not, January 10
- Press Briefing (Teleconference) on Argentina by Anne O. Krueger, IMF First Deputy Managing Director, January 11
- Press Briefings by Thomas C. Dawson, Director, IMF External Relations Department, January 17 and January 31

- Concluding Statement for Article IV Consultations** Denmark, January 23

IMF Staff Papers has published a variety of economics classics—papers that make most graduate reading lists.

—Robert Flood

Fischer address

India must revitalize reform effort to boost growth, move out of third world

During the past decade, foreign direct investment in India averaged ½ of 1 percent of GDP; in China it was 5 percent of GDP.

—Stanley Fischer

On January 22, Stanley Fischer, then Special Advisor to the IMF's Managing Director, addressed a New Delhi gathering celebrating the twenty-fifth anniversary of the weekly news magazine India Today. In a session that examined what India needed to do to "break out of the third world," he stressed the need to reinvigorate the reform process. Following are edited excerpts of his address. The full text is available on the IMF's website (www.imf.org).

We should not underestimate the economic and social gains made in India since reforms began 10 years ago. Nonetheless, the economic momentum achieved through the early part of the 1990s has not been maintained, and more recently, there has been a slackening in the pace of reform. What then has to be done to accelerate growth, so as to lead India from the third world to the first? Indian policymakers know full well the important impediments to stronger growth: poor infrastructure, a high cost of capital, and persistent fiscal imbalances. All have dampened investment spending by the private sector. In addition, growth is being hampered by relatively low rates of foreign direct investment and a tendency to waste precious tax revenues on unproductive subsidies rather than worthwhile investments in, for example, primary education and health care.

All these obstacles, and more, need to be tackled. And there is no better guide to what must be done to raise India's growth to 8–9 percent a year than the excellent report in 2001 of the Prime Minister's Economic Advisory Council. This report laid out an impressive and comprehensive agenda for second-generation reforms.

I would like to focus on five key areas covered by that report—embracing globalization, structural reform in product and labor markets, education, strengthening the financial sector, and fiscal consolidation.

Embracing globalization. The Economic Advisory Council eloquently made the case for further opening the economy and undertaking the reforms necessary to benefit from doing so. It notes that globalization is unavoidable and that "there is no divine dispensation that gives India alone the power to survive and prosper as an isolationist island in a globalized world." Globalization should be embraced purposefully, cautiously, and with the appropriate safeguards, but embraced nonetheless.

Take the critical area of openness to international trade. India has made important strides in trade liberalization, but its tariffs remain very high by international standards, and the authorities frequently resort to antidumping measures. Moving quickly to further

lower trade barriers would have a significant payoff. The Advisory Council suggested moving the average industrial tariff from the current level of 34 percent to the East Asian average of 12 percent by 2005. That goal remains a sensible one.

India's cautious approach to capital account liberalization probably helped limit contagion during the Asian crisis by containing short-term debt and limiting linkages between India's financial system and the rest of the region. But there are many benefits to greater openness to capital flows, especially foreign direct investment. During the past decade, foreign direct investment in India averaged ½ of 1 percent of GDP; in China it was 5 percent of GDP. With private investment in India at around 15 percent of GDP, greater openness to foreign direct investment would permit a nearly one-third increase in private investment relative to GDP and a significant increase in growth.

Cumbersome approvals processes, questions regarding the legal system, regulatory impediments to doing business, poor infrastructure, and a perceived slowdown in the pace of economic reform have all impeded foreign direct investment. For the rest, capital account liberalization should take place gradually, but steadily, as the financial system and fiscal policy framework are strengthened.

Structural reform. India has taken important steps to deregulate telecoms, pursue privatization, and place some industrial activities outside of state control. But more needs to be done—principally in deregulating industry, reforming labor markets, reforming the agricultural sector, and improving the power sector.

Education. Despite gains, India's literacy rates are still only 68 percent for men and 45 percent for women—compared with 91 percent for men and 76 percent for women in China. Literacy, as the Economic Advisory Council observed, is "the first step toward empowerment."

Financial sector strengthening. If we have learned one lesson from the Asian crisis, it is the importance of a strong and well-regulated financial sector. India has tightened prudential norms, bolstered bank capital, strengthened its supervisory systems, and benefited from participating in a Financial Sector Stability Assessment. But important weaknesses remain and need to be addressed. The stock market scandal points to the need for further improvements in governance. Problems with the Unit Trust of India, the development finance institutions, urban cooperatives, and

weak banks all underline the importance of strengthening supervision, governance, and mechanisms for the resolution of nonperforming loans, which are high by international standards.

The government's commitment to reduce its ownership in the financial sector is welcome and should be pursued. But it is not at all clear that private investors will enter the sector, and strengthen it, so long as the government retains a controlling share in each institution, for government control over financial institutions has led almost everywhere to their progressive deterioration. This is a change that needs to be made sooner rather than later if the financial system is to do its job efficiently—particularly the job of financing investment, which is too low in India.

Fiscal reform. At nearly 10 percent of GDP, India's general government deficit is among the highest in the world. As a result, general government debt has risen to almost 65 percent of GDP, and all the consolidation since the 1991 crisis has been erased. A deficit this large cannot be sustained. Unless convincing steps are taken to reduce the deficit in an orderly fashion, it will likely decline in a disorderly way, with serious consequences for growth. The deficit is already crowding out private investment and imposing a heavy interest burden on the budget, using resources that could otherwise be directed to development needs.

Draft legislation to eliminate the revenue deficit is welcome as far as it goes. But lasting fiscal stability will require harder budget constraints at the state government level, tax reform, reductions in subsidies, and more rapid progress with privatization. Further, the so-called golden rule of a budget balanced on current expenditures has no particular analytic backing, and it would be more useful to focus on the overall deficit.

Effort on all these fronts will no doubt take years to implement fully, but international experience sug-

gests that there will be large payoffs in terms of macroeconomic performance and the economy's capacity to cope with shocks. The sooner action is taken—and sustained—the better. The plans for very gradual improvement in the 1990s failed; a more determined rate of reduction would make more economic and political economy sense.

I have seen what happens to too many countries in the phase in which India is now—with the government borrowing heavily but with few visible adverse macroeconomic consequences—to take any comfort from the present fiscal situation. And, in any case, there are adverse consequences even now, for too large a share of private saving is being used to finance the government rather than finance investment and contribute to growth.

These measures constitute a formidable reform agenda, but they can and must be taken if India is to fulfill its economic potential, increase growth to 8–9 percent, and, over time, move out of the third world. India is also in a position—as the world's largest democracy and home to one billion people—to inspire many other countries to undertake needed reforms.

The challenge is a mighty one, but it is time for India to meet it. Over a decade ago, I was asked how the needed reforms could be implemented. Indian policymakers need to answer that question in detail, but I would repeat what I said then, "Just do it." ■

At nearly 10 percent of GDP, India's general government deficit is among the highest in the world.

—Stanley Fischer

IMF Executive Board approves new "record" loan for Turkey

On February 4, the IMF Executive Board approved a new three-year, \$16 billion loan to help support the Turkish government's economic program for 2002–04. This new loan package is the largest one the IMF has extended to date.

The Board's decision will enable Turkey to draw \$9 billion from the IMF immediately. The new loan with Turkey replaces the previous stand-by credit, which was approved in December 1999 and amounted to a total of \$19 billion. Total disbursements to Turkey under the previous loan package came to \$15 billion. The remaining undisbursed \$4 billion was folded into the new arrangement and is included in the total amount.

After the Executive Board discussion on Turkey, IMF Managing Director Horst Köhler said: "Today's decision is a recognition by the international community of Turkey's success in developing and implementing a bold and comprehensive economic reform program. Progress is impressive, and the authorities are committed to doing what is necessary for the country's economic and financial recovery through continued steadfast policy implementation. The IMF continues to support Turkey in its truly "owned" program."

For further details, please see the full text of IMF Press Release 02/7, February 4, which is available on the IMF's website (www.imf.org).

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
January 28	2.25	2.25	2.65
February 4	2.27	2.27	2.67

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

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

Data: IMF Treasurer's Department

Cato Institute event

Are we there yet? Åslund assesses progress of transition economies after a decade

Anders Åslund has been a cheerleader for transition economies, particularly Russia, for the past decade. In a presentation at the Cato Institute on January 17, based on his new book *Building*

Capitalism: The Transformation of the Former Soviet Bloc, Åslund outlined some reasons to be optimistic about the future of many of these economies. Stanley Fischer, then Special Advisor to the IMF's Managing Director, served as discussant.

The race to transform centrally planned economies into market economies

has led, 10 years later, to one group of countries approaching the finish line, a second positioned about half-way down the track, and a third group barely off the starting blocks. According to Åslund, radical reformers in Central Europe and the Baltics have already built democratic and dynamic market economies and are knocking on the doors of the European Union. Among the gradual reformers—Bulgaria, Romania, Russia, and most former Soviet Republics—there has been uneven progress toward democracy and a market economy. Although these remain “rent-seeking economies,” their prospects may have improved in recent years. The nonreformers—notably Belarus, Turkmenistan, and Uzbekistan—have maintained firm dictatorships with state-controlled economies. The novel part of Åslund's presentation dealt with his views on why the prospects for the gradual reformers may be rosier than generally believed.

Supply-siders relocate to Russia?

Economic growth over the past few years in many of the gradual reformers has come as a surprise to most economists. High oil prices, and a temporary boost to exports from the depreciation of the ruble following the 1998 crisis, are typically credited for the good economic performance of countries such as Russia in recent years. But another reason, Åslund suggested, may be that the gradual reformers have been moving from a system of “high taxes paid by a few to low taxes paid by many.”

During much of the transition process, Åslund said, high taxes—and the opportunities they offer for

extortion—have suppressed honest entrepreneurs, while dishonest businessmen have benefited from large subsidies. This tended to depress growth, particularly in countries like Russia and Ukraine. But now, he observed, the tide has turned. The current fashion in the region is drastic tax reduction, along the lines of the supply-side revolution unleashed by Ronald Reagan in the United States in the 1980s.

The trendsetter in this regard was Estonia, which implemented a 26 percent flat rate of personal income tax in 1994. Latvia and Croatia also moved to a flat-tax system; then in April 2001, Russian President Vladimir Putin unveiled a 13 percent flat tax. Through much of the region, Åslund said, there has been a sharp reduction in the number of taxes; personal income taxes are now subject to flat rates of 10–20 percent; corporate-profit and payroll taxes have been lowered; and taxes for individual entrepreneurs are low and levied on a lump-sum basis. With lower tax rates, Åslund noted, tax revenues have actually risen and taxes are less likely to serve as a means of extortion.

Privatization better than its reputation?

Åslund also challenged conventional wisdom about the benefits to the gradualist reformers from privatization. It is a “pipe dream,” he argued, to think that privatization should occur only after sound (non-corrupt) institutions are in place. If that became a precondition, privatization would never take place; the real choice, he said, is “dirty privatization or none.” Åslund noted that mass privatization of the kind carried out by Russia had acquired a bad name because of the corruption associated with some of the deals and because it did not appear to have changed the incentives for managers and workers.

But the benefits of privatization do kick in after the share of the private sector in the economy reaches a threshold level of, say, 60 percent of GDP, according to Åslund. Before that point, with most of the public sector still up for grabs, people focus on rent seeking and deal making. But once the bulk of the economy is privatized, the incentives turn toward improving the quality of enterprises through a clearer definition of property rights, better corporate governance, and greater transparency in operations. Fischer agreed—to a point. Privatization, he said, had indeed conferred benefits in terms of increased economic growth, but some schemes—



Åslund: Gradual reformers have been moving from a system of “high taxes paid by a few to low taxes paid by many.”



for example, the loans-for-shares scheme in Russia in 1995—had gone well beyond the pale in terms of corruption.

So why is capital still fleeing?

If the prospects of these gradual reformers are on the mend, why does capital continue to flee? In Russia, for instance, capital flight is generally estimated at about \$20 billion a year. In sharp contrast, private capital returned quickly to the radical reformers once the direction of reforms was clearly established. In the Central European economies, net outflows of \$15 per capita reversed to net inflows of \$75 per capita a few years after the start of reforms. Likewise, in the Baltics, net outflows of \$30 per capita turned into net inflows of \$70 per capita once the reforms took hold.

If Russia is at a similar point of takeoff, why does capital flight persist? Åslund attributed continued capital flight to the absence of a strong banking system. “The Russian citizens’ bank is located outside Russia,” he said. Income was being generated in Russia as its prospects improved, but Russians were unwilling to trust their savings to domestic banks. Even the Bank of New York scandal, according to Åslund, was actually a case of “sensible Russians transferring their money holdings abroad.”

No U-turns on road to capitalism?

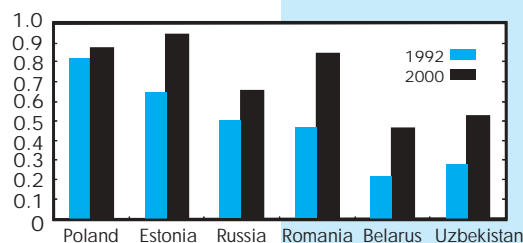
A decade after the fall of the Soviet Union, Åslund had no fears the gradual reformers would turn back to communism. Westerners, he said, are more worried about transition economies returning to central planning than are the people in these countries. Fischer agreed with this assessment, noting that an early study by Yale economist Robert Shiller showed that people in New York and Moscow had quite simi-

lar attitudes toward market economies. (Fischer alluded to the widely used quip that the similarity in attitudes may have arisen from the fact that many New Yorkers are socialists!)

Åslund and Fischer were also in accord that having a clear external goal helps focus the minds of reformers and the populace. For the radical reformers, the promise of accession to the European Union and the desire to be thought of as part of the West helped generate support for market-oriented reforms and democracy. IMF programs had also served this purpose to some extent by giving countries clear targets and a coherent framework within which to carry out reforms. It may be that, in the post-September 11 environment, Russia has moved more clearly into the Western sphere. This may, Fischer said, give its reform efforts added impetus. ■

Prakash Loungani
IMF External Relations Department

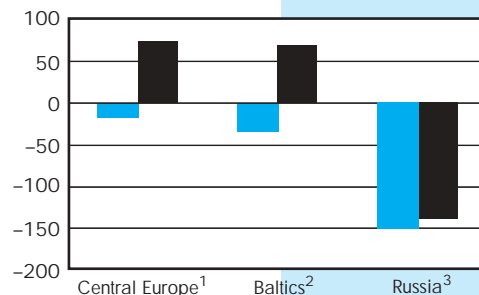
EBRD structural reform index: the pace has varied considerably



Data: European Bank for Reconstruction and Development

Capital flight reversed in Central Europe and Baltics, but continues in Russia

(dollars per capita)



¹ Left bar is for 1990-92; right is for 1993-96.
² Left bar is for 1992-94; right is for 1995-98.
³ Left bar is for 1994-98; right is for 1999-2000

Data: IMF, *International Financial Statistics*

Abdoulaye Bio Tchane to head IMF African Department

IMF Managing Director Horst Köhler announced on January 10 the appointment of Abdoulaye Bio Tchane as Director of the IMF’s African Department. Bio Tchane, a national of Benin, will succeed G.E. Gondwe, a national of Malawi, who will retire in February after heading the African Department for three years.

Bio Tchane currently holds the position of Minister of Finance and Economy in Benin. He holds master’s degrees in economics from the University of Dijon and in banking from Centre ouest-africain de formation et d’études bancaires in Dakar.



He began his career as an economist in the Central Bank of West African States (BCEAO), where he rose to become Director of the Economic and Monetary Survey Department—a post he held until being appointed Benin’s Minister of Finance in 1998. In the early 1990s, Bio Tchane spent two years in the IMF’s African Department on secondment from the BCEAO.

“I am delighted to welcome Abdoulaye Bio Tchane as head of the African Department,” Köhler stated. “His distinguished career in the BCEAO and as Benin’s Finance Minister makes him an outstanding choice to lead the IMF’s African Department and to build on the important achievements of his predecessor.”

Interview with Max Corden

How should developing countries choose an exchange rate regime?

On January 9, W. Max Corden, Professor of International Economics at the Johns Hopkins School of Advanced International Studies, presented an IMF Institute seminar on what developing countries need to consider in choosing an exchange rate regime. Here he speaks with Prakash Loungani about why floating combined with inflation targeting might be the right choice for a wide range of countries—advice that will be contained in a tantalizingly titled upcoming book, *Too Sensational*.

LOUNGANI: What have we learned from the Argentine crisis?

CORDEN: The country's history of crises is quite remarkable—the last decade was an interregnum. To be blunt, crises are difficult to avoid if people are unwilling to pay taxes for all the things they expect from the government—especially if government spending cannot be restrained during the good years.

All this sounds very harsh at the moment.

Argentina did do very well for a few years after the adoption of the currency board in 1991. But what the crisis has taught us is that tying a government's hands on monetary policy does not guarantee that it will be able to put its fiscal house in order.

LOUNGANI: After the Argentine experience, what advice can we offer developing countries on how to choose an exchange rate regime?

CORDEN: Well, we should first make a distinction between smaller and very open countries, and medium-sized or larger economies. For many of the smaller countries, joining a monetary union or dollarizing remains a sensible option. But for medium-sized economies, I've never been completely comfortable with advocating hard exchange rate pegs. Advocating hard pegs was on its way to becoming the orthodoxy, because such pegs were said to discourage inflation by providing a nominal anchor for wages and prices and to provide both discipline and credibility. It is indeed true that in Argentina the hard peg of the currency board brought down inflation drastically. But I always found the hard-peg solution a bit extreme. It's like a father teaching his son to swim by throwing him into the pool and saying, "Look, my hands are tied behind my back. I won't be able to help you if you drown, so you'd better learn to swim."

That kind of pressure may work sometimes, but if it doesn't, the effects are catastrophic. In Argentina's case, tying the government's hands through the currency board didn't help generate the pressure to reform the labor market or to produce the fiscal policies needed to avoid a debt crisis. But, again, I don't want to be unsympathetic. Their troubles were surely compounded by bad luck in the second half of the 1990s—first by the strength of the U.S. dollar, then by the depreciation of the Brazilian real.

LOUNGANI: So you advocate a floating exchange rate regime? What keeps inflation from getting out of hand under such a regime?

CORDEN: On the whole, I favor a floating exchange rate, but with some management or even with short periods of pegging. A flexible exchange rate provides a country with an additional lever to adjust to the many real shocks an economy faces almost continually. Floating, in combination with inflation targeting, seems to be working well in some countries by giving both exchange rate flexibility and low inflation. Monetary policy, as well as a flexible fiscal policy, can be used to moderate recessions.

Now, what keeps inflation from getting out of hand? I guess ultimately it is a social and political consensus in the country that inflation is bad and that there must be fiscal restraint over a cycle. The country must save during the good times so that it can go into deficit during the bad times. An inflation targeting regime is sustained by societal consensus, not just by the technical aspects that economists sometimes focus on. And I don't think inflation targeting should mean that the central bank cares only about inflation. Certainly, low inflation has to be a major medium- and long-term objective, but the authorities should also be very sensitive to real conditions—unemployment and the like. For short-term policy, I remain in favor of old-fashioned Keynesianism—some monetary expansion to reduce unemployment when necessary.

LOUNGANI: What is a good example of a country that has combined a floating exchange rate with the sort of flexible inflation targeting you recommend?

CORDEN: My own country, Australia. You know, Australia is similar in some respects to Argentina. Both are important exporters of primary products, and both have a history of powerful trade unions. But Australia moved successfully to a floating



Corden: "On the whole, I favor a floating exchange rate, but with some management or even with short periods of pegging."

exchange rate in 1983, though admittedly this was not a “pure float.” There was some intervention.

What’s behind this success? Australia has been able to achieve political consensus on a reasonably cautious fiscal policy. A switch in political parties does not raise fears about a U-turn in economic management or about inflation. And despite Australia’s strong unions, nominal depreciations of the currency have not led to immediate demands for wage increases, which, as you know, would undo the advantages of the depreciation. This flexibility allowed Australia to weather the Asian crisis quite well.

Our neighbor, New Zealand, had a harder inflation targeting regime that locked it into a tighter monetary policy. It got into a recession during the Asian crisis. But I don’t want to suggest that the successful cases are just from my part of the world. Mexico and Brazil in recent years are also examples of this kind of approach.

LOUNGANI: Would you recommend this approach to Hong Kong?

CORDEN: No, I make an exception for Hong Kong. Despite the Argentine experience, there’s no reason for Hong Kong to be thinking right now of giving up its currency board. It has built up fiscal surpluses during the good years, for example. Its markets are flexible; wages and prices fall if needed to moderate recessions. And it has the backing of high international reserves, both its own and China’s. Still, sooner or later, China—I mean the economy of the People’s Republic—may well move to a flexible exchange rate system, and that

may force Hong Kong to reconsider its system. It would be odd for Hong Kong to stay pegged to the U.S. dollar when its major trading partner, China, no longer is.

LOUNGANI: Is all this advice to developing countries spelled out in your forthcoming book, *Too Sensational?*

CORDEN: Yes, I lay out the options, and especially the inevitable trade-offs. There are difficult trade-offs involved in choosing any exchange rate regime. But once there is a crisis, almost any path chosen is likely to be painful. I have both theory and numerous case studies. I show how the choice of exchange rate regime relates both to fiscal policy and to trade policy.

Like most economists, I now think the fixed-but-adjustable Bretton Woods-style exchange rate regime is unsuitable for countries with open capital markets. Such regimes lead to crises that are “too sensational.” By the way, do you know where the title of the book comes from? It comes from Oscar Wilde’s play, *The Importance of Being Earnest*. Oscar was referring to something that happened in the late nineteenth century to the Indian rupee. It is all explained in my book! ■



Corden: “There are difficult trade-offs involved in choosing any exchange rate regime. But once there is a crisis, almost any path chosen is likely to be painful.”

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*Poverty reduction strategy***Burkina Faso's perseverance with PRSP process bodes well for the future**

The PRSP process has opened the door to considerable analysis and debate about the country's growth prospects.

Following a decade of economic stagnation under a centrally planned system in the 1980s, Burkina Faso adopted market principles in 1991, instituting reforms that yielded higher growth and increased competitiveness. But a decade later, poverty remains widespread, and the country is burdened with massive debt. Burkina Faso is tackling these problems through its poverty reduction strategy paper (PRSP), and although the first year's results are mixed, there are many promising signs.

Burkina Faso is a poor, landlocked sub-Saharan African country with limited resources, high vulnerability to external shocks, and immense social needs. During most of the 1980s, it followed a development strategy based on central planning and pervasive controls that resulted in large macroeconomic imbalances and a stagnant economy. In 1991, the country reversed direction, adopting a series of reforms supported by the IMF and the World Bank to stabilize the economy, institute market principles, and boost growth. After moving away from central planning, Burkina Faso began to see improvements in its economy (see table, page 47). The 1994 devaluation of the CFA franc—the common currency of the West African Monetary Union—was also a boon to the region and helped Burkina Faso regain international competitiveness.

Burkina Faso's production of cottonseed (cotton represents about 60 percent of the country's total exports) more than doubled between 1995 and 2000, improving its current account. In addition, over the past five years, the country's public finances have improved as a result of reforms of the tax and customs administrations that broadened the tax base and reinforced tax collection. On January 1, 1999, the authorities widened the civil service wage scale and introduced a merit-based promotion system. At the same time, they increased the allocations for health care and education and implemented a public investment program.

Together, the devaluation and the reforms sparked growth in Burkina Faso—real GDP picked up in 1994 and has averaged 5.5 percent a year since then. Inflation also improved, registering less than 3 percent between 1997 and 2001 because of increased production of cereals and other essential foodstuffs. Clearly, however, the country faces enormous development challenges. Its continued vulnerability to external shocks was demonstrated in 2000, when GDP growth fell to 2.2 percent because of poor

weather conditions in the country and higher petroleum prices. The incidence of poverty remains high, with 45 percent of the population—a level almost unchanged since 1990—living below the poverty line. In 2000, Burkina Faso's real per capita GDP was about \$340. Despite higher production of cotton, the recent negative outlook for international cotton prices means that Burkina Faso should improve efficiency by further liberalizing its cotton industry.

On the social front, the country has taken steps to promote essential services—basic education and health care, clean drinking water, nutrition, hygiene, and sanitation—but still needs to do much more. Despite the authorities' emphasis on education, less than half of school-age children are attending school, impeding the road to universal education. In terms of health, Burkina Faso is one of the most disadvantaged countries in the world. Life expectancy is 54 years, and more than one-third of all children suffer from malnutrition. Compounding these difficulties, Burkina Faso is one of the countries in West Africa most severely affected by the HIV/AIDS epidemic, with a seroprevalence rate of 7 percent in its population of about 12 million, which is growing at 2.8 percent a year.

Preparing a PRSP

Burdened by these and other disadvantages, including debt equal to about 65 percent of GDP in 2000, Burkina Faso was declared eligible for debt relief under the IMF–World Bank Heavily Indebted Poor Countries (HIPC) Initiative. As part of the HIPC process and to address their primary challenge of improving living conditions and social indicators, the authorities prepared and implemented a PRSP in April 2000. Their first step was to establish an interministerial committee to review existing poverty reduction programs, identify data gaps, clarify macroeconomic and sectoral links to poverty trends, and discuss the process for formulating the strategy. Government representatives, civil servants, media representatives, civil society groups, and donors were all invited to contribute to discussions and decisions. The PRSP received broad political support and was approved by both chambers of the country's parliament and the economic committee of the Economic and Social Council. The IMF and the World Bank endorsed the paper in July 2000, and the country has since begun receiving interim relief of about \$25 million a year and could become eligible for more debt relief this spring.

Burkina Faso is one of the few West African countries to have conducted two major and consistent surveys—in 1994 and 1998—that can be used to analyze poverty trends over a five-year period. Based on these surveys, the government issued poverty profiles in 1996 and 2000 that have made it possible to measure poverty outcomes and clarify the nature of poverty and its determinants. The government's resulting monitoring and evaluation system is appropriate, and its medium- and long-term goals for reducing poverty are well defined. The goals are based on a range of outcome indicators for monitoring progress and ensuring that policies in the priority sectors—education, health, rural development, and water—are well designed and effectively implemented (see chart, page 48).

The PRSP process has opened the door to considerable analysis and debate about the country's growth prospects. In 1999, the government commissioned a comprehensive analysis of economic competitiveness and long-term sources of growth in Burkina Faso, which was published in 2001. The study identified four major impediments to growth: poor health and inadequate education, low labor productivity, and high unemployment; poor economic infrastructure, high input costs, and a small private sector; weak institutional capacity; and outflow of labor to neighboring countries. The authorities decided that focusing on health care and education would be the most sustainable way to increase productivity in rural areas, ensure continued economic growth, and fight poverty. They chose to address the other constraints sequentially in sectoral reform programs to be supported by the donor community. The PRSP also focuses on achieving a stable macroeconomic environment and sustainable growth policies, improving governance, and fighting corruption. It has the following goals:

Macroeconomic stability. The aim is to achieve real GDP growth averaging 7 percent a year; inflation of less than 3 percent; and a current account deficit in the balance of payments, excluding grants, of about 13 percent of GDP. These targets are expected to allow per capita income to increase by at least 3 percent a year and to lead to improved living conditions and the development of human resources. The authorities understand that achieving such goals would imply not only pushing forward with ongoing reforms but also emphasizing programs designed to enhance growth and improve competitiveness.

Education. The 10-year basic education program is intended to increase the gross primary enrollment ratio from 41 percent in 2000 to 70 percent in 2010. This ambitious but realistic program supported by 19 donors will generate the same increase in the enrollment ratio that was achieved during the previous 40 years. In addition, in the context of the HIPC Initiative, the government intends to increase the share of education in the budget from 21.6 percent in 2000 to 26 percent in 2010, with 60 percent devoted to basic education.

Health. The government's strategy in the health sector has been articulated in the PRSP as follows: focusing first on health problems afflicting the poor; reducing financial barriers to poor people's access to services; and involving communities in the planning, management, and implementation of local health activities. The PRSP action plan outlines appropriate incremental

Despite some progress, Burkina Faso has much work to do

(annual percent change, unless otherwise indicated)

	1990	1995	2000	Average 1990–94	Average 1995–2000	Sub-Saharan Africa
Population (millions)	10.0	11.0	12.0	10.0	11.0	666.0
Population growth	2.9	2.4	2.8	2.5	2.6	2.9
Real GDP (million U.S. dollars)	2,765.0	3,252.0	4,160.0	3,028.0	3,729.0	395,620.0
Real GDP growth	-1.5	4.0	2.2	2.3	4.9	3.0
Real GDP per capita ¹	289.0	302.0	339.0	301.0	324.0	594.0
Fiscal deficit (percent of GDP) ²	-4.6	-1.9	-5.7	-3.9	-3.0	-2.3
Inflation ³	-0.8	7.8	-0.2	5.0	3.3	5.4
Export growth ⁴	62.2	14.4	-10.0	0.7	7.2	8.7
Population living below \$1 a day (percent)				...	45.0	45.0
Literacy rates (percent)				19.0	19.0	61.0
Gross primary enrollment (percent)				35.0	41.0	78.0
Female primary enrollment (percent)				29.0	34.0	71.0
Infant mortality (per thousand live births)				108.0	105.0	161.0
Life expectancy at birth (years)				...	54.0	47.0
Child malnutrition (percent)				30.0	33.0	...
Prevalence of HIV/AIDS (percent)				...	7.0	...

¹In U.S. dollars, at 1990 prices, using 1990 exchange rates.

²Including grants.

³Percentage change of average consumer price index.

⁴Real exports of goods and services growth.

Note: ... means data not available.

Data: IMF, African Department database, October 2001, and *World Economic Outlook*, October 2001

financing for the campaign against HIV/AIDS, including cost-effective preventive interventions and greater emphasis on treatment and counseling. Burkina Faso's new HIV/AIDS strategy is increasingly based on a multisectoral, decentralized approach, with a strengthened partnership with civil society.

Rural development. In the medium term, the rural strategy is to increase cotton production while diversifying the export base, ensuring broad access to income-generating activities, enhancing food security,



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Prakash Loungani
Contributing Editor

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and preserving the environment. For 2000–03, the action plan focuses on rural roads and research, credit, and extension services directed at small farmers and rural enterprises.

After one year, results are mixed

In September 2001, with wide participation from civil society and donors, the authorities issued the first annual PRSP progress report, which was endorsed by the IMF and the World Bank Executive Boards in late November 2001. Despite the unforeseen external constraints it faced, Burkina Faso persevered with its poverty reduction program, promoted an environment conducive to growth, and ensured the effective implementation of priority actions listed in its PRSP. The government also maintained social spending at the levels committed to in the PRSP and met most of the social targets while developing an action plan to improve the tracking and reporting of the uses of poverty-reducing expenditures. In view of the fragility of the economy, the authorities have realized that the growth target presented in the PRSP (an average of 7 percent real GDP growth for the period 2000–04) might be difficult to achieve. It was thus revised downward to 6 percent in the first progress report, although the poverty reduction objectives were preserved.

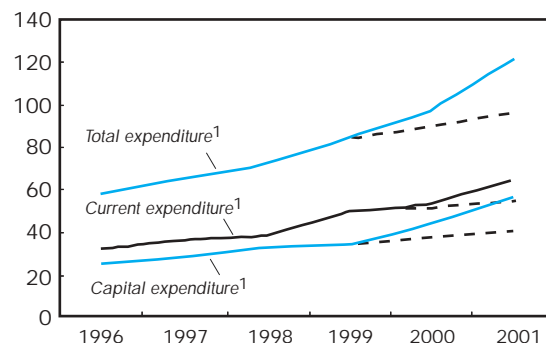
In the area of primary education, performance continues to be mixed. The authorities have realized that they must redouble their efforts to increase school attendance—of girls in particular—in the poorest provinces; improve the effectiveness and efficiency of spending, including by improving priorities for project selection and costing; and improve the quality of education and strengthen management and supervision.

Burkina Faso has fared better in its health goals, either meeting or exceeding most targets. Immunization coverage rates were raised, supplies of essential drugs were ensured, and the staffing of primary health facilities was improved. The government has taken an important step forward by eliminating fees for preventive treatment. Moreover, it has fostered greater involvement by village health committees in determining priorities, formulating strategies, and overseeing resources from cost recovery. However, use of health care services remains low, with no discernible improvement in the past year. Efforts are needed to improve the performance of primary health care facilities by reducing staff turnover. Finally, the recent establishment of the National Council on HIV/AIDS/sexually transmitted diseases in the president's office is expected to enhance the program's visibility, strengthen national leadership, and improve coordination.

In the rural sector, the government increased its efforts to provide clean drinking water and encour-

Social outlays rising with debt relief

(billion CFA francs)



Note: -- Equals expenditure level without HIPC Initiative resources.

¹ Including HIPC Initiative, 2000–2001.

Data: Burkinabé authorities, and IMF estimates.

aged people to diversify their sources of income. The lack of road infrastructure affects access to local markets and is one of the major obstacles to rural development. The government therefore focused on extending rural roads, supporting agricultural activity through a comprehensive program involving the construction of 6,000 kilometers of roads by 2004. As part of the poverty reduction strategy, an additional program supported by HIPC resources was undertaken in 2000 to build 266 kilometers of rural roads in four provinces at a total cost of CFAF 1.8 billion. With an allocation of approximately CFAF 2 billion in 2001 HIPC Initiative resources, the program was extended to nine provinces for the building of 387 kilometers of roads. The government took important steps in the fight against corruption by publishing tenders on government contracts, initiating the revision of the general regulation of procurement, and creating a high authority to lead the fight against corruption.

The government's efforts to foster ownership of and political support for the PRSP have been impressive. By disseminating the document in French and national languages, it has greatly strengthened the participatory process designed to obtain feedback for revising the strategy and fostering ownership.

All in all, Burkina Faso is an excellent example of a country that wholeheartedly adopted the PRSP process in a broad participatory way. Despite the mixed results of the PRSP's first year, the authorities have shown determination to stay on track, even in the face of difficult external factors. Their strong will to persevere and learn from the experience of their first year bodes well for their progress in coming years. ■