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In this issue

Interview with Masood Ahmed

IMF ponders ways to optimize support for poor countries

In preparation for the 2003 IMF–World Bank spring meetings, the IMF Executive Board will review progress on the IMF's efforts and plans to help poor countries further. The IMF Survey *talked to Masood Ahmed, Deputy Director of the IMF's Policy Development and Review Department, about this effort.*

Women in Côte d'Ivoire harvest sweet potato leaves for export. Low-income countries must strengthen their export performance to achieve sustainable development.

IMF SURVEY: Before we take stock of progress under the IMF's initiatives to assist low-income countries, can you tell me what lies ahead?

AHMED: Apart from improving what we are currently doing, we are exploring ways in which our mode of engagement can best reflect low-income countries' diverse needs, including postconflict reconstruction, achieving and sustaining macroeconomic stability, and attaining robust yet sustainable growth, while concurrently helping them build technical capacity.

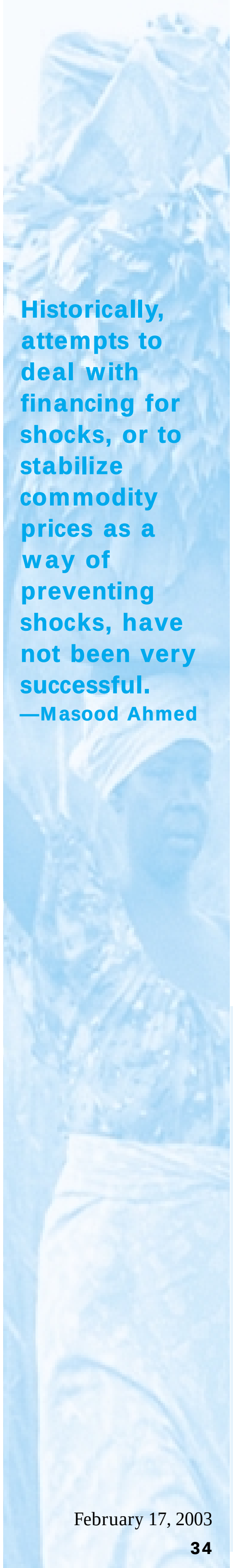
After an initial Executive Board discussion scheduled for late spring, we are planning to get the views of low-income countries and other stakeholders about the options for structuring our future support to these countries, in line with the IMF's mandate and comparative advantage. The approach that combines the Poverty Reduction Strategy Paper (PRSP) and the Poverty Reduction and Growth Facility (PRGF) is going to be the main mode of involvement, *(Please turn to the following page)*

IMF consults widely as it refines proposed sovereign debt plan

The IMF's proposal for a Sovereign Debt Restructuring Mechanism (SDRM) to improve the way countries' unsustainable debt is restructured continues to generate heated debate as time draws near for its consideration at the spring meetings of the IMF's International Monetary and Financial Committee. In an effort to further spell out the proposal, the IMF hosted a conference on January 22 to exchange views with the private sector, emerging markets, nongovernmental organizations, legal experts, and academics. Participants generally agreed that something needed to be done about unsustainable sovereign debt and they welcomed the IMF's consultative approach, but they differed sharply on solutions. What follows is coverage of that conference, along with excerpts from a speech by Jack Boorman, Special Advisor to the IMF's Managing Director, and coverage of an IMF training seminar on the SDRM held on January 6 by Peter Kenen of Princeton University.

In opening the conference, IMF Managing Director Horst Köhler noted that private capital flows stood to play a vital role in promoting economic growth and development. But with the rapid and increasing integration of capital markets, he said, the sheer scale and volatility of *(Please turn to page 37)*

Masood Ahmed on low-income countries



Historically, attempts to deal with financing for shocks, or to stabilize commodity prices as a way of preventing shocks, have not been very successful.
—Masood Ahmed

(Continued from front page, top) but we will consider ways of adapting it to address countries' specific needs. In some postconflict countries, for example, we have learned that the move from emergency post-conflict assistance to a PRGF-supported program may have come too quickly because these countries had not built up adequate institutional capacity to deal with the range of measures covered by a PRGF arrangement. We might need to consider extending our postconflict support to give these countries more time before they move to a PRGF-supported program.

A special focus of this work will be to examine whether the IMF can better assist these countries to offset the economic impact of exogenous shocks. Many low-income countries depend heavily on primary commodity exports, which makes them quite prone to external shocks, and many suffer from natural disasters. Is there merit in the IMF's targeting a greater share of its financial support to help these countries offset the impact of these types of shocks? This is a difficult question because, historically, attempts to deal with financing for shocks, or to stabilize commodity prices as a way of preventing shocks, have not been very successful. We will review this experience and recommend how we take this issue forward.

IMF Survey: How can the IMF help low-income countries better integrate with the global economy?
Ahmed: Low-income countries must strengthen their export performance to truly achieve sustainable development. Diversification of the export base may also help reduce vulnerabilities to all-too-common swings in commodity prices. In the PRGF programs, therefore, a clear objective is to support countries' own attempts to improve their outward orientation, including through greater emphasis on trade issues in PRSPs. But, sometimes, what the country can do is not enough, and the international community must also do its part. Consequently, the IMF has been active in supporting the current efforts at multilateral trade liberalization being conducted under the auspices of the World Trade Organization. In our regular policy discussions with industrial country and other developing country members, we also stress the need to reduce tariffs, quantitative restrictions, and subsidies that may be hindering poorer countries' export prospects.

How the IMF assists poor countries

Despite years of structural adjustment and international support, many low-income countries, particularly in Africa, are still struggling to achieve sustainable economic growth. As these countries' needs have evolved, so too have the ways in which the IMF supports them. In the late 1980s, the IMF began providing concessional financial assistance through the Enhanced Structural Adjustment Facility (ESAF) to support structural adjustment programs.

In 1999, the IMF converted the ESAF into the Poverty Reduction and Growth Facility (PRGF), which reinforced the focus in these countries on growth and poverty reduction. To ensure country ownership, PRGF programs are set in the context of national Poverty Reduction Strategy Papers (PRSPs). The IMF also provides debt relief to heavily indebted poor countries (HIPCs) and offers them technical assistance and capacity building.

IMF Survey: The lack of progress under the Heavily Indebted Poor Countries (HIPC) Initiative is somewhat worrying. Only six HIPCs have gone through the process. What can be done to accelerate the pace at which countries qualify and receive debt relief?
Ahmed: First, it is worth noting that, in addition to the 6 countries that have completed the HIPC process, 20 are receiving immediate relief on debt-servicing obligations because they have passed the "decision point," the initial milestone for entering the process. As to the reasons for the slower-than-anticipated progress toward completion points, in about half the countries, delays have arisen because developing a participatory and comprehensive PRSP has taken more time than originally anticipated. Other countries have gone off track with their PRGF-supported macroeconomic programs, and, in some cases, as in Madagascar, governments have halted implementation of macroeconomic policies and structural reforms for an extended time because of political problems.

Getting to the HIPC completion point is important for many countries because it marks the moment when the country's stock of debt is irrevocably reduced. Nevertheless, it is important not to rush to this point but to proceed on the basis of a strong PRSP and program implementation that, together, provide an effective basis for long-term debt sustainability and for the effective use of additional resources freed up by debt relief.

IMF Survey: Last year's review of HIPC countries showed that in about 15 out of 25 countries, indicators of indebtedness at the completion point were likely to be worse than had been projected at the decision point. What is behind this disappointing outcome?

AHMED: In two-thirds of these cases, the cause was a lower-than-expected level of exports, driven mainly by a larger decline in commodity prices than expected. Some of the problems, however, stemmed from higher levels of borrowing than initially anticipated. Overall, our current estimate is that in about 8 to 10 countries, the debt-to-export indicators at the completion point will be above the enhanced HIPC Initiative threshold of 150 percent. This is why the initiative includes an option for topping-up assistance, which has been exercised in Burkina Faso.

A more fundamental issue we are looking at now is how best to approach debt sustainability and borrowing strategies for poor countries exiting from assistance under the HIPC Initiative and for those countries that are not HIPC-eligible but are poor and vulnerable to shocks. Some might argue that these countries really should not carry any debt at all—that they should focus on obtaining grant aid. Others would say that if these countries were to restrict themselves to the limited amount of grant financing available, they would fall further behind in meeting poverty reduction goals. They would argue that a certain amount of concessional financing is fine as long as the ratios of indebtedness remain reasonable. If we agree with this approach, what are the reasonable ratios of indebtedness and at what threshold do they give rise to concern for long-term debt sustainability? Operationally, what are the consequences for the way in which we reflect these concerns in the design of IMF-supported programs in terms of borrowing limits? After an informal seminar with the Board, we plan to address these issues over the summer with the help of academics and multi- and bilateral agencies.

IMF SURVEY: What have been countries' experiences thus far in developing and implementing poverty reduction strategies?

AHMED: Over the past three years, the PRSP approach has become broadly established as the framework for low-income countries to formulate their own development strategies and for donors to align their assistance in support of these strategies. Almost 50 countries have completed a PRSP or an Interim PRSP. Based on the review of the PRSP approach a year ago, undertaken jointly with the World Bank, we have seen that these national processes have already resulted in more focus on social and poverty issues, deepened the dialogue between the government and civil society, and produced a tangible orientation of budgets toward poverty reduction. However, many of the early PRSPs have been uneven in their focus on the obstacles to growth and in analyzing trade-offs and priorities.

The PRSP also provides the framework for the IMF's support to countries through the PRGF. Programs under the PRGF are designed to support growth and reduce poverty more directly than under the ESAF and, ultimately, to help countries work their way toward reaching the Millennium Development Goals.

IMF SURVEY: How are staff responding to the request by the Development Committee to set up a framework for monitoring the policies needed to achieve the Millennium Development Goals?

AHMED: We are working with the World Bank in trying to lay out an approach that identifies the indicators that will enable us to track and measure policies and actions of the developing countries, which must ultimately take responsibility for achieving the Millennium Development Goals, and the action industrial countries can take to support the process, such as widening market access, reducing agricultural subsidies, and improving trade relations. The indicators could be used to produce a periodic status report for the Development Committee, which serves as a locus of accountability. The approach must add value and be part of a wider effort involving the UN and other agencies. It must also be linked to the PRSP process at the country level.

Ahmed: "National processes have already resulted in more focus on social and poverty issues, deepened the dialogue between the government and civil society, and produced a tangible orientation of budgets toward poverty reduction."

IMF SURVEY: The PRGF review, completed a year ago, identified a number of areas for action. How far has this been reflected in the design and implementation of new PRGF programs?

AHMED: It found that good progress was being made in aligning PRGF-supported programs with the PRSP and with a stronger focus on growth. But it also identified areas where additional efforts were needed and on which IMF staff have been focusing. This entails, first, examining how we can ensure that macroeconomic projections and policies are ambitious yet realistic. In the past, some of the projections underpinning PRGF programs turned out to be more favorable than the ensuing reality. We must assess whether our programs are sufficiently robust to external shocks, to which many low-income countries are susceptible, and to delays in the delivery of aid, which is a large part of these countries' financing.

Second, how can we reconcile the relatively high level of spending needed to underpin a medium-term poverty-reduction strategy with the reality of limited resources? We are trying to resolve these issues by working with countries to produce alternative macroeconomic frameworks. A first framework, with cautious assumptions—including of forthcoming financing—would be prepared to underpin the budget. The second framework would be based on what is needed to achieve the country's longer-term poverty-reduction goals and objectives. It would serve to both define the needs and uses of additional financing and clarify the policies and institutions that need to be strengthened if this financing is to be used effectively. The key point of the frameworks is to help countries find ways to manage their finances prudently even as they try to mobilize additional resources and undertake policy changes that would lead to more ambitious progress toward their development goals.

Ahmed: "To really reap the benefits of the PRSP umbrella approach, tangible changes are needed over the next 12–15 months in the way in which donors work with each other and with national governments."

IMF Survey: Some critics say that PRGF programs are inflexible in accommodating higher spending on poverty reducing programs, even when the spending is financed by aid. What are the facts?

Ahmed: The issue is how to accommodate large aid flows and still maintain macroeconomic stability. I want to be clear that our working assumption is that grant financing for poverty-reduction expenditures should be additional to, and should not displace, other types of financing. But we also recognize that increases in aid flows, particularly when they are large and rapid, can raise concerns about whether a country can effectively accommodate the additional resources and associated higher spending levels. Some countries—Uganda is a good example—are concerned about the effect on their real exchange rate of higher spending levels associated with these large inflows. In other countries, debt sustainability concerns may limit the amount of new borrowing that is feasible, even if that borrowing is on concessional terms. In these cases, we will have to help countries weigh the risks associated with large aid and high spending against the long-term benefits of the spending. But, for most low-income countries, we believe that larger aid and spending can be accommodated without undue adverse macroeconomic effects.

IMF Survey: The PRSP review found that the added burden on low-income countries of producing these national strategies was not being offset by any streamlining of other donor procedures. Has there been any progress in this area?

Ahmed: It is fair to say that, in many countries, the PRSP process has added a layer to donor coordination but without replacing any existing donor requirements. For example, donors providing budget support send out independent missions to assess a country's progress over the past year and establish benchmarks for the next year, broadly covering the same policy areas. Dealing with each separate donor review is highly inefficient and consumes a great deal of the recipient country officials' time, taking away from their focus on implementing the program. Participants at the last meeting of the Special Partnership for Africa (SPA), held a few weeks ago in Addis Ababa, highlighted this concern. To really reap the benefits of the PRSP umbrella approach, tangible changes are needed over the next 12–15 months in the way in which donors work with each other and with national governments. The IMF has been working with the World Bank and the European Union to look at how the various procedures for budget support can be coordinated, streamlined, and simplified. We see progress in this area as a top priority for the coming year.

IMF Survey: There is no stated limit to the number of PRGF arrangements a country can enter into, and some critics have argued that the prolonged use of IMF resources represents a departure from the IMF's traditional mandate of providing short-term balance of payments support. How do concerns about a lack of an "exit strategy" enter into considerations of future IMF involvement in low-income countries?

Ahmed: Prolonged use of IMF assistance in low-income countries is quite different from that in the rest of the membership because the design of the PRGF envisages an engagement to address deep-seated structural problems that can be solved only over the longer term. For these countries, it is more relevant to assess the depth of what they have accomplished under IMF-supported programs. At the same time, there are legitimate concerns that long-term engagement by international agencies, not just the IMF, can lead to aid dependency or disincentives for countries to take responsibility for their own programs. For these reasons, we must think proactively and strategically about the nature of engagement over the longer term to ensure that the incentive structure does not encourage countries to move indefinitely from program to program. ■

Views of SDRM differ

(Continued from front page, bottom) these flows posed risks to sovereign debtors and creditors alike. Underscoring that the rising number of creditors had led to collective action problems—making debt restructuring, when needed, an arduous task—he argued the case for official sector involvement. The SDRM, he observed, is an important step to address this problem (see box below).

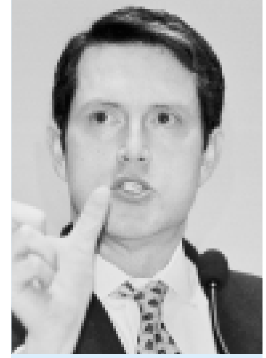
The problem

Most speakers agreed with Köhler that the sheer diversity of creditors and debt instruments had made the process of negotiation between the sovereign and its creditors more complex, leading to delays in restructuring. Randal Quarles, Assistant Secretary of the U.S. Treasury for International Affairs, harking back to the early twentieth century when U.S. railroads were being restructured, drew an analogy between the past and the current situations. Like creditors then, who perceived the problem and drove the debt restructuring process in a way that was acceptable to the majority, today's creditors—large buyers of emerging market debt—are more aware of the problems with restructuring such debt. This, in Quarles's view, makes a solution closer.

Anne Krueger, IMF First Deputy Managing Director, observed that, in the rare circumstances in which prevention had failed and countries' debt burdens had become unsustainable, time was a friend to neither debtors nor creditors, as delays created uncertainty and massive dislocation in the economy, as well as a loss of value to everyone involved. Underscoring the failure of collective action among creditors—as a group, they may be best served by agreeing to restructuring, although individual creditors may have an incentive to refuse to cooperate and instead adopt a wait-and-see approach or pursue aggressive litigation—she noted that the challenge was to establish a system that would facilitate a transparent, orderly, and expeditious restructuring of debt.

Speakers differed on the extent of the collective action problem and the design of the solution. Glenn Hubbard, Chairman of the U.S. President's Council of Economic Advisers, argued that consideration should be given first to voluntary mechanisms, such as modifying debt contracts to include collective action clauses, sharing clauses, and collective representation provisions, and to establishing a voluntary dispute resolution forum for creditors and debtors to negotiate debt restructuring. If these voluntary approaches proved to be inadequate, he said, then the case for statutory change would be even stronger.

Mark Siegel, Managing Director of the investment counsel firm David Babson & Company, Inc., observed that creditors viewed the issue of holdout creditors as a minor problem. Observing that there was further room for cooperation between sovereign debtors and their creditors to reach orderly and expeditious restructuring agreements, he noted that investors did not like contracts to be superseded and were quite skeptical of the SDRM. He also expressed concern that a country's decision to default was often motivated by political economy considerations. If default were seen as less painful, countries could be tempted to default. Echoing similar views, Agustin Carstens, the Mexican Deputy Minister of Finance and Public Credit, agreed that there was a need for better procedures to restructure sovereign debt. But he called for less intrusive mechanisms to deal with the problem, such as standards and codes for sovereign debt restructuring.



Randal Quarles

Mark Siegel

Agustin Carstens

Key features of the SDRM

The SDRM would provide a legal framework for collective creditor negotiations. Five main features underpin the SDRM:

- Agreement by a supermajority of creditors to a debt restructuring agreement that would be binding on all creditors covered by the SDRM; minority creditors would be prevented from blocking such agreements.
- Mechanisms to prevent disruptive legal action by creditors while negotiations are under way.
- Assurances to creditors that debtors will negotiate in good faith and pursue policies that help protect their claims and limit the dislocation in the economy.
- Some form of creditor-driven protection from restructuring of new private financing that is provided to facilitate the debtor's ongoing economic activity.
- A dispute resolution forum to oversee the process—verify claims, ensure the integrity of the voting process, adjudicate possible disputes, and certify the debt restructuring agreement.

In contrast to collective action clauses, the SDRM would allow for restructuring of the existing stock of debt while also allowing for "aggregation" across instruments. In addition, a statutory framework through an amendment of the IMF's Articles of Agreement would apply to all IMF member countries at the same time and would thereby eliminate the "first mover" problem associated with the inclusion of collective action clauses in debt contracts.

Thomas Palley

Anne Pettifor

Kenneth Rogoff, IMF Economic Counsellor and Research Department Director, said that painful debt crises stemmed from the tension between weak property rights and uncertain debt recovery processes in emerging market countries—which limited their access to capital markets—and the short-term horizon of governments that resulted in their taking excessive risks in the form of short-term and foreign currency–denominated debt. The problem, Rogoff argued, was that while high default costs on risky debt might act as a substitute for effective property rights, it was a poor substitute. He noted that international bankruptcy procedures, including the SDRM, focused on mitigating the costs of debt crises for both debtors and creditors by reducing collective action problems.

What debts should be covered?

IMF staff argued that the scope of debt brought under the SDRM would, in general, be broad enough to ensure sustainability and intercreditor equity, but that some carve-outs would be required to avoid undermining domestic insolvency procedures and protect secured financing. Calling for broader coverage of debt, Patrick Bolton, Professor at Princeton University, noted that the limited coverage of debt under the SDRM, coupled with the difficulty of getting priority financing to facilitate ongoing economic activity, could tempt sovereign debtors to exclude certain debt from restructuring so as to secure access to new financing.

Thomas Palley, Director of the Open Society Institute, and Anne Pettifor of Jubilee Research observed that, in the interest of ensuring economic viability of the sovereign following debt restructuring as well as fairness in the treatment of all creditors, the coverage of debt under the SDRM should be widened to include the claims of official creditors (Paris Club) and international financial institutions. While Pettifor welcomed the IMF proposal for sovereign debt restructuring, she noted that it would not return poor, indebted nations to economic viability.

Jack Boorman noted that the issue was not about whether the claims of the Paris Club or those of

Sovereign debt: New rules, new game?

Speaking at the Annual Midwinter Strategic Conference of the Banker's Association for Finance and Trade, held in Washington on January 28–29, Jack Boorman acknowledged bankers' deep interest in the debate that was under way but noted, also, that he was well aware "... that not all of you and your colleagues in the private capital markets are yet fully convinced of the wisdom of the IMF's proposals on this subject!" Following are edited excerpts from his speech.

The SDRM is both a crisis resolution and a crisis mitigation device that could help limit sovereign debt crises if triggered early enough to prevent the severe economic dislocation that often occurs when countries resist dealing with their debt problem. All too often, countries continue to reach for less and less credible—and ultimately self-defeating—policies in the hope of finding redemption from their debt problem. Besides limiting the policy options available when the problem is finally confronted, this puts the official community, and the IMF in particular, in a difficult position in deciding whether to support those often futile policy efforts. Argentina is a dramatic case in point.

The SDRM proposal is an evolutionary phenomenon. We have listened carefully to all who have reacted to the original proposal. In particular, we have tried to address a number of the concerns raised by private market participants, academics, nongovernmental organizations, and practitioners in bankruptcy proceedings. Under the proposal now on the table, there are no new legal powers for the IMF. The IMF's role would be its traditional one of signaling its willingness to support and provide financial assistance for the government's adjustment program.

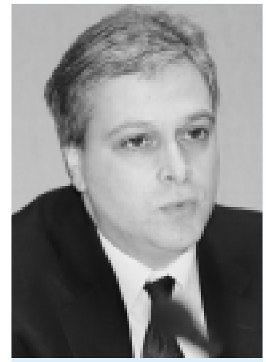
Numerous specific issues are raised by this proposal (see the box on the SDRM's five major features, page 37), and nothing as yet is cast in stone, although significant progress is being made. For example, it is now generally agreed that it may be appropriate to define classes of creditors for voting purposes under the SDRM rather than to try to aggregate votes across all claims. At the same time, it is agreed that the number of such creditor classes should be kept small; that they should not be prespecified but dealt with case by case; and that approval by each class should be required to complete the restructuring. This last point will require striking a delicate balance to ensure that the classification process itself does not create holdout problems.

Agreement seems to be emerging that sovereign debts governed by domestic law and subject to the jurisdiction of domestic courts could be excluded from the SDRM. There is also some support for excluding official bilateral claims from the SDRM and dealing with them in the Paris Club format, which may require certain changes in the policies and practices of the Paris Club. The issue here is whether domestic debt or bilateral official claims are dealt with specifically under the SDRM or, instead, under procedures specific to, and possibly more effective in, dealing with those claims. The latter seems to be more widely accepted but requires further discussion. In both cases, however, any domestic creditors should be restructured, but whether restructuring should be handled specifically under the SDRM, or in parallel (see excerpts from Boorman's speech, pages 38–39, below). Stephane Pallez, Vice-Chairperson of the Paris Club, noted that the Club was focusing on how its existing practices could be modified in light of the SDRM, regardless of whether official creditors were actually included in the SDRM.

Will creditor rights be protected?

Donald Bernstein, a workout specialist at Davis, Polk and Wardwell, generally supported the proposed SDRM. But he drew attention to specific features of the proposal—in particular, the process of notifying creditors, registering their claims, and verifying their eligibility for purposes of voting—and noted that creditors might have reason to believe that the playing field was being tilted in favor of the debtors. This is because creditors with legitimate claims could fail to register in time, while creditors connected to (or influenced by) the debtor might end up voting. This problem, Bernstein argued, is further influenced by the voting rule that would be used—75 percent of registered claims—to reach a restructuring agreement and by the role the Sovereign Debt Dispute Resolution Forum (SDDRF) would play in judging the veracity of claims.

Andrew Yianni, a workout specialist at Clifford Chance, noted that creditors perceived the SDRM as a move by the international community to bail in the private sector and called for further outreach. Observing that restructuring deals had been done with and without litigation, he suggested that creditors also viewed the SDRM as undermining their rights, including through an "aggregated" vote.



Andrew Yianni

Matthew Fisher and Sean Hagan, from the IMF's Policy Development and Review and Legal Departments, respectively, emphasized that the SDRM would not increase the leverage of sovereigns over their creditors. Drawing upon the analogy with corporate bankruptcy procedures, they noted that the SDRM did not provide for either an automatic stay on creditor litigation or an automatic cessation of payments by the

action to restructure these kinds of debt would have to be in the context of close collaboration and coordination with the creditors restructuring under the SDRM. There is also broad agreement that the debt of the IMF itself and some other international financial institutions, as preferred creditors, would not be subject to restructuring.

The Sovereign Debt Dispute Resolution Forum (SDDRF) is one of the most novel elements of this proposal. Specific modalities, including procedures for selecting members to serve on the forum, are proposed in the latest staff paper—which is posted on the IMF's website—and are under active debate. There are contentious issues here—especially about the means by which to assure its independence, including from the IMF, and about the appropriate degree of activism for the forum. If it were to become more active, its role would approach that of a bankruptcy court, which is not the intention.

Other questions

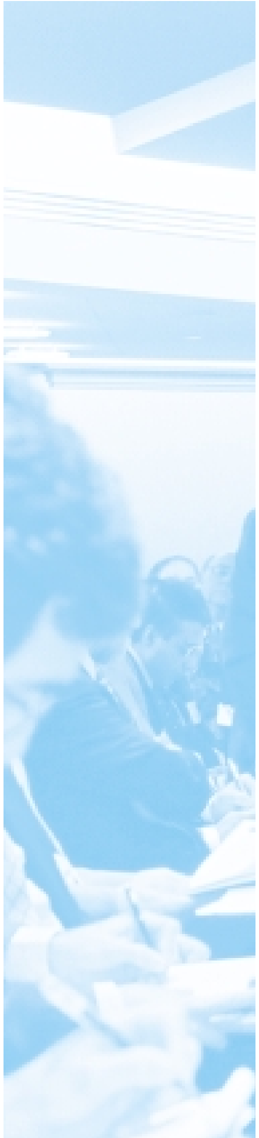
What has been the reaction of member governments? This is changing terrain, not least as the proposal itself undergoes modification in light of the reactions received. Elaboration of the proposal is supported by all IMF members. In fact, the International Monetary and Financial Committee has asked that staff, management, and the Executive Board continue to work on two tracks, pursuing proposals for both the SDRM and collective action clauses.

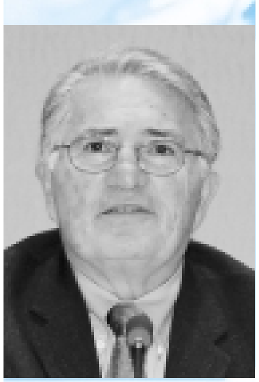
But what is the strength of that support? Most of the membership is supportive of the general outlines of the proposal, with some differences of view on a number of the specific elements. The major skepticism registered is from the United States and some of the emerging market countries. And this is critical! An amendment to the IMF's Articles of Agreement would require approval by three-fifths of the members holding 85 percent of the voting power; thus, these constituencies in the membership would have to support it. But, as I said, the situation is fluid, and I would not close off any possibilities at this point.

Jack Boorman

Let me conclude by suggesting that the various proposals that have been made need to be subjected to a number of tests. The impact of the proposed system on the efficiency of markets and, therefore, on access to and spreads on international credit is critical. So, too, are questions about the capacity of any proposed system to produce reasonably orderly restructurings within a time frame that limits the dislocation and loss of value associated with these events. Everyone gains from that preservation of value, and here, I believe, the SDRM has the edge. It holds better promise for creating the confidence needed for all parties to be willing to reach for its activation when a country's debt situation has become unsustainable and, through timely policy adjustment and debt relief, for restoring growth and sustainability with less disruption than seen in recent cases.

The full text of the speech is available on the IMF's website (www.imf.org).





Burton Lifland

sovereign debtor and that all key decisions under the mechanism were to be made by the creditors voting as a group. Furthermore, they said, the SDRM would ideally be activated prior to default as a way to make an agreement already reached between a sovereign and a supermajority of creditors binding on all creditors, including possible holdouts.

Mark Allen, Deputy Director in the IMF's Policy Development and Review Department, noted that although the SDRM would be established by amending the IMF's Articles of Agreement, the organization would play only an indirect role in the SDRM, through its lending, Article IV consultation discussions, and power to approve exchange restrictions. He underscored that the IMF's policy on lending into arrears would be predicated on debtors' making good-faith efforts toward normalizing relations with their creditors, and this, he noted, should be reassuring to the creditors.

Is a "stay" on creditor litigation needed?

While noting that some members of the official community were in favor of having an automatic stay on creditor litigation, IMF staff argued that the risks of pre-agreement litigation by creditors appeared to be low—especially since the SDRM would cover judgment claims resulting from litigation—and that the use of a stay was not proportionate to the risks. Moreover, staff noted that a general cessation of payments was critical for ensuring intercreditor equity during the period of a stay, and, given that the SDRM does not envisage a general cessation of payments by the sovereign, an automatic stay would not be appropriate. They described other aspects of the SDRM that would discourage disruptive litigation, including the "hotchpot" rule, designed to neutralize any benefits received by a litigating creditor following activation of the SDRM. While downplaying the role of creditor litigation in impeding a market-driven process of debt restructuring, Yianni noted that the hotchpot rule, which allows for existing rights to be reversed in certain circumstances, would be viewed by private creditors as less intrusive but still an interference.

Lee Buchheit, a workout specialist at Cleary, Gottlieb, Steen, and Hamilton, observed that creditors had resorted to legal action only in extreme cases, but it would be a fallacy to argue that they did not care about losing their litigation rights. It would be imprudent to extrapolate from the historical forbearance of creditors, he said, arguing that changes in capital markets had raised the specter of early litigation by creditors. However, he added, in the context of the SDRM—which holds the prospect of a supermajority of creditors reaching an agreement that would bind in a dissenting minority—an automatic stay would not be required because creditors would view litigation as being both risky and expensive. Moreover, he noted, an automatic stay would need to be accompanied by a cessation of payments, and the question would arise as to how that cessation would be enforced.

Who will oversee the process?

Once the SDRM is invoked by a sovereign debtor, three key issues to ensuring the integrity of the process—the verification of claims, dispute resolution, and sanctions to stem possible abuse—as well as certification of the restructuring agreement would be handled by the SDDRF contemplated under the SDRM. François Gianviti, General Counsel of the IMF, noted that the SDDRF would be a diverse and independent body consisting of individuals whose selection would be devoid of political considerations and whose operations would be independent from those of the IMF's governing bodies, including the Executive Board and the Board of Governors. Participants argued that the SDDRF, as currently proposed, would be independent and would be perceived as independent.

Some participants maintained that the powers of the SDDRF would not be limited to administrative functions or dispute resolution but were in fact substantive—for example, decisions concerning creditor classification, formation of creditors' committees, and disenfranchisement of creditors. Participants noted that a number of prickly issues would arise concerning the validity of claims, relating in particular to the identity of the claimant and his or her relationship to the sovereign debtor. Burton Lifland, Chief Judge, U.S. Bankruptcy Court, New York, observed that the real question was whether the low-profile SDDRF tribunal contemplated under the SDRM could effectively oversee sovereign debt restructuring. He underscored that sanctions were the most essential tool that the SDDRF would need, for example, to ensure the transparency of the process, force the sovereign to yield to the needs of the tribunal, and abort the process where there was a lack of cooperation among the concerned parties. Some participants also suggested protections would need to be provided against SDDRF decisions that were influenced by fraud, corruption, manifest abuse of discretion, or an overreach of jurisdiction. Jernej Sekolec, Secretary, UN Commission on International Trade Law (UNCITRAL), highlighted the possible role UNCITRAL could play in the context of ensuring the integrity and independence of the SDDRF. ■

Krishna Srinivasan
IMF, International Capital Markets Department

IMF training seminar on SDRM

Kenen sees problems with both contractual and statutory approaches

Peter Kenen presented the SDRM in a more positive light than he had on previous occasions, saying he now favored the statutory approach over the contractual approach (see box on features of the SDRM, page 37).

But he cautioned the IMF against trying to oversell its proposal. In the January 6 seminar, Kenen discussed his views of what he called "the unfinished architecture exercise." Since the IMFC gave its go-ahead for a two-track approach at the 2002 spring meetings, he said, the IMF has overreacted somewhat in pressing the SDRM, exacerbating hostility in the private sector.

Kenen said that even though the terms of the debate had not changed much, each new proposal to reform the international financial system was always influenced by the most recent crisis. This is true of the proposal for the SDRM, he said, which "would have been wholly irrelevant to several recent crises, as they did not involve sovereign debt."

Despite his reservations about the SDRM, Kenen recognized that a statutory approach to crisis resolution had its advantages. With an SDRM in place, countries would be less likely to agree to short-term deals that would simply postpone resolution and make debt servicing even more costly. He dismissed the view that an SDRM would lead countries to default more readily, because a sovereign default would be extremely costly in both social and economic terms—not least because default is often followed by a banking crisis and a generalized loss of confidence. However, he noted, neither the contractual nor the statutory approach is likely to bear fruit within the next few years.

The main practical problem with the contractual approach, Kenen said, is that it would not have a significant impact until all debt issued under current rules had been rolled over—and all of the new bonds contained collective action clauses. Moreover, the introduction of such clauses on a broad scale faces considerable political obstacles. For example, he said, emerging market countries are resisting including such clauses in their bond issues for fear that investors might interpret that as a signal that restructuring is more likely, in which case they might demand a higher risk premium.

The statutory approach also faces broad opposition, Kenen said. The private sector, concerned that debtors would use the SDRM too frequently, argues that an international bankruptcy process would translate into reduced capital flows to emerging markets and rising borrowing costs. In the United States, which is key to securing approval for an SDRM, he noted, lawmakers would undoubtedly face great pressure from the private sector to withhold agreement on any potential abrogation of creditors' rights.

In the question and answer session, Kenen was asked what the IMF should do in the absence of tangible progress with both approaches. That is, is there an alternative to large-scale official financing? When countries are clearly unable to service their debts, Kenen said, the IMF should simply say no to exceptionally large loans. Moreover, he added, the IMF has to improve its ability to make such judgments. Kenen thought large-scale financing might still be the right thing to do for countries facing a crisis of confidence. Even a new debt-workout mechanism, he said, would probably not completely remove the need for exceptionally large loans.

Another participant asked whether there really was a need to change the rules for sovereign debt restructuring. After all, Russia, Pakistan, and Ecuador had recently restructured claims relatively smoothly with little, if any, litigation. Too much emphasis might have been placed on the Elliott Associates case against Peru, in which a so-called vulture fund successfully sued the government for full repayment of its claims following that country's Brady bond restructuring in the 1980s. Kenen said it would be important to see what happens with Argentina. Litigation, he noted, is likely once a new government is elected; bondholders are waiting for the political situation to stabilize before pressing their claims. Kenen concluded that living with the current crisis resolution regime was not intolerable.

Camilla Andersen
IMF, External Relations Department

Kenen: "With an SDRM in place, countries would be less likely to agree to short-term deals that would simply postpone resolution and make debt servicing even more costly."

Photo credits: Issouf Sanogo for AFP, pages 33 and 34; Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 35–41, 45, and 48; Gabriel Bouys for AFP, pages 42–43; Goh Chai Hin for AFP, page 47.

IMF Working Paper

Politics and budgets

Industrial countries have made very different fiscal policy choices over the past 30 years, which have been manifested in differences in their budget balances, size of government (ratio of total expenditure to GDP), and composition of revenue and expenditure. In a recent IMF Working Paper, Politics, Government Size, and Fiscal Adjustment in Industrial Countries, *Anthony Annett explores whether political and institutional factors can shed light on these differences.*

Politics matters in determining governments' expenditures and revenues. Above, workers demonstrate against the closing of a factory.

Large budget deficits in certain industrial countries in the 1970s and 1980s motivated a number of researchers to examine differences in the size and persistence of the deficits across countries and at different times. Their studies have largely established that political factors can explain differences in the size of countries' government and deficit (or debt).

These countries subsequently took steps to improve their fiscal positions. During a first era of reform in the mid-1980s, they relied on revenue increases to reduce their deficits, whereas in a second round—the late 1990s—they focused more on reducing expenditure, mainly by cutting government wages and transfers, the main cause of the earlier increase in government size. The countries' most recent reform efforts have led to some convergence of their fiscal deficits, but the size and composition of government are still very different.

What theory predicts

Different theories of political behavior offer different predictions of the role political factors play in fiscal outcomes. Much of the research focuses on distributional conflict—that is, conflicts between different social groups.

Theoretical literature. Many theories of distributional conflict in fiscal policy, Annett says, rely on some variant of the "common pool" model, in which society is divided into competing groups, none of which has an incentive to constrain its spending demands. Conflicts between groups, according to the model, can lead to large government, a buildup of debt, and delays in adopting needed reforms.

Other theories identify the underlying incentives generated by countries' different electoral systems—typically majoritarianism (rule by simple numerical majority in an organized group) and proportionality (when the number of parliamentary seats is based on vote share)—as a key source of fiscal variation. This approach focuses on the composition of government spending. One implication of the electoral system model is that spending on transfers is higher in proportional systems, while spending on public goods is higher in majoritarian systems.

Empirical evidence. Much research has analyzed the relationship between (1) political variables and the budget deficit, (2) budgetary centralization and fiscal outturns, and (3) electoral rules and the size and composition of government spending. Annett reports some of the studies' salient findings. First, a lack of fiscal discipline, as manifested in high deficits and debt, is typically associated with proportional electoral systems. Second, fragmentation—that is, the number of parties in government—is important for explaining government debt. Unlike single-party governments, coalition governments tend to loosen fiscal policy in good times. Third, the research shows that countries with stronger institutions have more favorable fiscal outcomes.

As for the significance of electoral rules, the research shows that government is smaller (especially revenues), and spending on social security and welfare is lower under majoritarian systems. In contrast, proportional systems have been found to be associated with higher spending on transfers.

Offsetting political inefficiencies

To curb the expenditure and deficit pressures created by the various political inefficiencies, industrial countries have, more recently, implemented institutional reforms, such as adopting fiscal rules or binding fiscal targets, improving fiscal transparency, and implementing budgetary reform. Examples are the Maastricht Treaty and the Stability and Growth Pact in the euro area and the commitment of some countries (Australia, Canada, New Zealand, Switzerland, and the United States) to balanced budgets. Still other countries have imposed expenditure rules and changed budget institutions to emphasize fiscal transparency.

Politics matters

Most of the existing research, Annett says, was motivated by the high deficits in the 1970s and 1980s and does not consider the periods of adjustment. Moreover, it focuses on the overall budget balance, largely ignoring the effects of political factors on the size and composition of government spending or taxation. To fill this gap in the literature, Annett addresses the effects of political variables—type of electoral system, fragmentation of policymaking, and degree of political instability—on fiscal outturns, as well as the relationship between these same political variables and the size and quality of fiscal adjustment undertaken by 19 industrial countries from the early 1980s through the late 1990s.

In his study, Annett regresses the fiscal variables—expenditure and revenue, as well as their major components—on a number of control variables combined with the political variables. His compositional results offer new evidence and make a significant contribution to the existing literature (see the working paper for details about methodology and an explanation of the results.)

Annett shows, ultimately, that politics matters in determining the size and composition of expenditure and revenue, as well as the overall budget balance. Certain political factors, such as an electoral system that emphasizes proportionality or a fragmented parliament or government, lead simultaneously to higher transfers, bigger government, and a revenue system that emphasizes labor taxes over consumption taxes.

The review of industrial countries' fiscal adjustment efforts, Annett says, clearly demonstrates that these countries did, indeed, make an effort to reverse the politically induced pattern of high expenditure, high revenue, or deficits over the past two decades, but only when conditions were favorable or when initial debt was high enough to be problematic. Then, he notes, these countries were more likely to curb the growth of transfers and switch from labor taxes to consumption taxes. Annett concludes that this does not bode well for the quality of adjustment in low-growth periods. But the newly instituted fiscal policy frameworks may prevent the emergence of politically motivated fiscal policy in the future. ■

Copies of IMF Working Paper 02/162, *Politics, Government Size, and Fiscal Adjustment in Industrial Countries,* by Anthony Annett, are available for $15.00 each from IMF Publication Services. See page 44 for ordering information. The full text is also available on the IMF's website (www.imf.org).

Available on the web (www.imf.org)

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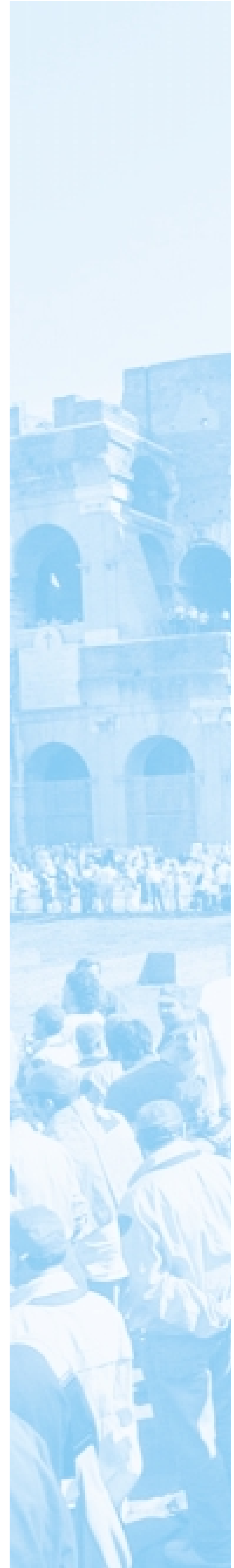

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Interview with Wanda Tseng

China's future reform agenda must address social concerns

China's economic reforms over the past two decades have brought tremendous economic transformation, rapid growth, and closer integration with the global economy. Real income per capita has increased fivefold, raising millions of Chinese out of poverty. Despite these achievements, difficult reforms—involving the state-owned enterprises and the financial sector—must still be completed, while social pressures from rising unemployment and income inequalities need to be addressed. China's recent accession to the World Trade Organization (WTO) will not only bring further economic transformation but could also prove to be a watershed for the reform process. Wanda Tseng, Deputy Director of the IMF's Asia and Pacific Department, talks with Gail Berre of the External Relations Department about China's reforms, its successes, and future challenges.

IMF Survey: Are structural reforms likely to continue and even accelerate under China's new leadership?

TSENG: There's no doubt about it. One important sign of this is the political recognition of the contribution of the nonstate sector to China's economic development. China's constitution was amended in 1999 to give private enterprises rights and legal protection on a par with the state sector. This past November, the Sixteenth Party Congress formally acknowledged the private sector as a source of growth, modernization, and employment. Now, with China's accession to the WTO, policymakers recognize that critical structural reforms must be implemented to sustain economic growth and improve living standards. So the reform process will continue because the Chinese have seen the benefits of reforms.

IMF Survey: What are some of the areas in which critical reforms are needed?

TSENG: One is the state-owned enterprise sector. In the past several years, over 2,300 smaller, nonviable companies were liquidated; more than 21 million redundant workers were laid off; many medium-size and large state enterprises were incorporated and their ownership diversified through shareholding; housing reforms were implemented; and the social safety net was overhauled to remove the social burdens of the state enterprises. But despite all the reforms, the performance of these enterprises remains weak. They still do not face hard budget constraints; there is no well-established mechanism to force nonviable companies into bankruptcy; and the state, being the majority shareholder, continues to have a big say in the running of these enterprises, which creates problems of corporate governance. So deeper reforms of the state enterprises are needed.

Tseng: "The two most pressing social concerns are rising unemployment and the growing income disparities between the urban and rural areas and between the coastal cities and the inland provinces."

Another key area is the banking sector, which has received top policy priority in recent years. Several important reforms have already been carried out. The central bank was reorganized along regional lines; asset management companies were established; state banks were recapitalized; supervision and the regulatory system were upgraded; and, in particular, a new loan classification system was implemented and provisioning standards in line with international best practices were put in place. But a lot more remains to be done. The state banks have to be allowed to operate on a commercial basis and must not be pressured to channel loans to support policy objectives. The banks themselves have to deepen operational restructuring, such as improving their risk analysis and management, strengthening their management system and internal controls, and upgrading their auditing and accounting methods. They need to continue improving operational efficiency by consolidating branches, downsizing, and developing a wider range of financial products.

IMF Survey: What are the main social challenges facing the Chinese government as the "iron rice bowl" system is phased out? How will social services be provided if the state-owned enterprises are no longer responsible for doing so?

TSENG: The two most pressing social concerns are rising unemployment and the growing income disparities between the urban and rural areas and between the coastal cities and the inland provinces. A key task would be to build a national social safety net system to cover unemployment insurance, medical insurance, and a pension system. In all three cases, these would have to be funded by a combined contribution from the budgets of the central and local governments, the enterprises, and the employees themselves. The sale of government shares in the state enterprises is another potential source of funding for the social safety net.

IMF SURVEY: What other initiatives are envisaged or are under way to address social concerns?

TSENG: To address labor market pressures, it's

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

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina	January 24, 2003	August 31, 2003	2,174.50	1,427.50
Bosnia and 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
Colombia	January 15, 2003	January 14, 2005	1,548.00	1,548.00
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			42,614.80	25,999.70
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
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 Republic	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			4,501.12	2,422.73

[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

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

important to develop workers' skills through training and to facilitate the job search process. A significant initiative announced just last month is the liberalization of the residency permit system, which will reduce barriers to the migration of surplus labor from rural areas. Job creation would have to come from the private sector. But for the private sector to expand, it needs to have access to capital, which is again linked to financial system reforms. Also, barriers to market entry have to be reduced by abolishing state monopolies in key sectors and eliminating or liberalizing licensing requirements.

As for the growing income disparities, initiatives are focused on raising rural incomes by promoting higher value-added agricultural activities, such as horticulture and aquaculture, and encouraging nonfarm businesses.

Also, the recent "tax for fees" reform is reducing the fiscal burden on farmers, who are subject to a variety of ad hoc fees. The government's "develop the west" policy provides substantial funds for infrastructure investment, technological upgrading, and training and education in the poorer provinces. But here, fiscal relations between the central and local governments need to be reformed so that the poorer provinces have resources to provide basic public services. A new sharing formula for income taxes, introduced last year, will provide additional transfers to poorer regions. But there is still a need to further examine intergovernmental spending and revenue assignments, as well as the transfer system, to address the uneven fiscal impact of structural reforms across provinces and regions.

A promoter stands by a computer as performers entertain visitors at an exhibit of Internet technology in China, where the "develop the west" policy provides funds for technological upgrading.

IMF Survey: Why do you believe China's accession to the WTO could prove to be a watershed for the reform process?

Tseng: The main reason is that WTO accession really entrenches the process; in a sense, there's no going back now. WTO accession should be seen as part of China's broader reforms and as a catalyst for accelerating or even completing China's transition to a market economy. For example, under the WTO accession agreement, barriers to entry for foreign banks will be lifted by 2005, and foreign banks will be allowed to compete with Chinese banks on an equal footing. This establishes a time frame for China to improve its financial system substantially. Once a deadline is set, it adds a sense of urgency. And the state banks themselves know that; if they don't become competitive soon, they're going to fall behind.

IMF Survey: What are some of the policy changes and reforms WTO membership will bring about in China?

Tseng: There's been a lot of interest in China's commitments under the WTO and the impact of WTO accession on China and the region. Among the key commitments is China's reduction of tariffs and nontariff barriers on both industrial and agricultural products. It has agreed to open up many sectors that were long closed to foreign direct investment, particularly in financial services, telecommunications, and the retail and wholesale sectors. China has committed itself to complying with WTO rules ranging from protection of intellectual property to equal treatment for domestic and foreign enterprises. Also, it has agreed to upgrade its legal system to comply with WTO rules.

WTO accession will involve a lot of adjustment challenges for the country. When we talk about state

Further market opening and the entry of foreign firms will certainly increase competition, and this will be a force to propel reforms and improve the efficiency of the Chinese economy.

—Wanda Tseng

Members' use of IMF credit
(million SDRs)

	January–2003	January 2002
General Resources Account	749.93	400.82
Stand-By	747.00	125.58
EFF	0.00	275.24
CFF	0.00	0.00
EMER	2.93	0.00
PRGF	0.00	5.40
Total	749.93	406.22

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

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Tseng: "WTO accession should be seen as part of China's broader reforms and as a catalyst for accelerating or even completing China's transition to a market economy."

enterprise reform, we're talking about people losing jobs as a result of this process. That will have to be addressed through the social safety net and the creation of more job opportunities. It will also affect agriculture in China, and we have to remember that a large majority of the population depends on the agriculture sector. But, looking at the positive aspects, further market opening and the entry of foreign firms will certainly increase competition, and this will be a force to propel reforms and improve the efficiency of the Chinese economy. Over time, economic growth based on increased productivity will improve living standards in China.

IMF Survey: What about the impact of China's growth on the Asian region and the world economy?

Tseng: I believe that a more open and rapidly growing China will benefit the region and the world economy. We can see this already as China's growing domestic market is attracting a lot of foreign investment and creating many business opportunities for companies in other countries. We also see this in the rise of Chinese exports and imports in world trade. For instance, China's share of world exports increased from 2.9 percent in 1995 to 5 percent in 2002. Over the same period, its share of world imports rose from 2.7 percent to 4.3 percent.

China has also emerged as an important link in the region's production chain, because more of the region's exports are being channeled through China for final processing and assembly for export to other countries. This contributes to increased efficiency worldwide because businesses can outsource production to countries where goods can be produced most efficiently, which in turn benefits both consumers and producers.

That's not to say that there are not challenges and costs for the region. In particular, other Asian countries that compete with China on labor-intensive products will be adversely affected, and they will have to restructure their economies and reposition themselves in the global economy. This inevitably entails transition costs. I think the challenges for other Asian countries are probably no less than the challenges the region faced when Japan emerged as an industrial power, or when Korea, Singapore, Hong Kong SAR, and Taiwan Province of China were emerging as industrial economies.

Recently, there have been a lot of stories about China, the 800-pound gorilla or, perhaps I should say, the 800-pound panda. One needs to keep that in perspective. It is true that China has grown very rapidly; but despite that, China's GDP is only one-fourth that of Japan and one-tenth that of the United States. China's trade is still only 5 percent of world trade. One needs to have a more balanced perspective about China's opening to the outside world—it offers opportunities and challenges. The other Asian countries will be facing these challenges, but they have faced them before and, with the right policies, have met them successfully. ■

Copies of the book *China: Competing in the Global Economy*, edited by Wanda Tseng and Markus Rodlauer, are available for $26.00 each from IMF Publication Services. See page 44 for ordering information.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
February 3	1.88	1.88	2.41
February 10	1.84	1.84	2.36

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 euro, the Japanese yen, the pound sterling, and the U.S. dollar, which 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.

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

Data: IMF Treasurer's Department