INTERNATIONAL MONETARY FUND

# IMF Survey

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## IMF–World Bank meetings to assess policy agenda

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The world's top financial and development officials will be gathering in Washington, D.C., on April 22–23 for meetings of the IMF's International Monetary and Financial Committee (IMFC) and the World Bank–IMF Development Committee. High on the agenda of the IMFC will be the outlook for the world economy and the IMF's strategic review. The Development Committee's agenda will include the latest *Global Monitoring Report*.

Michael Spilotro/IMF

## IMF overhaul plan set for launch

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The IMF is set to begin implementing its new Medium-Term Strategy designed to recalibrate its work. "We are now moving from analysis to implementation," says IMF Managing Director Rodrigo de Rato, who hopes to get endorsement of the plan from the IMFC at its April 22 meeting. The *IMF Survey* looks at the thinking behind the plan and suggestions from some critics of the Fund.

Eugene Salazar/IMF

## Global financial system could face cyclical challenges

page 106

The global financial system has been consistently resilient in the past two years, thanks in part to strong emerging market performance and to advanced credit derivative and structured credit markets. But the tide may be turning, according to the IMF's new *Global Financial Stability Report*. Cyclical challenges are on the horizon that could affect both markets and institutions, and, although complex financial instruments have created a more sophisticated global financial system, this "brave new world" of international capital markets poses new risks, the report says.

## Can globalization keep a lid on inflation?

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Sharp rises in commodity prices, strong growth, and accommodative monetary policies normally spell higher inflation. But that hasn't been true lately, and some contend that intensified global competition and the resulting lower prices for non-oil imports should take the credit. The IMF's new *World Economic Outlook* cautions that this may have been the case in recent years, but policymakers looking to keep a lid on future inflation will need to look elsewhere for help.

Richard B. Levine

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# What's on

## April

**19** IMF's April 2006 *World Economic Outlook* (Chapter I) released

**19–20** IMF–U.K. Department for International Development, Workshop on Macroeconomic Challenges of Scaling-Up Aid Flows, Washington, D.C., United States

**20** IMF Managing Director Rodrigo de Rato to speak at the Institute for International Economics, Washington, D.C., United States

**22–23** IMF–World Bank spring meetings, Washington, D.C., United States

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

## May

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

**17–18** African Development Bank Group Annual Meetings, Ouagadougou, Burkina Faso

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

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

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

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

**29–30** World Bank, Annual Bank Conference on Development Economics, Tokyo, Japan

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

## June

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

**19–23** World Urban Forum III, Vancouver, Canada

## July

**15–17** Group of Eight summit, St. Petersburg, Russia

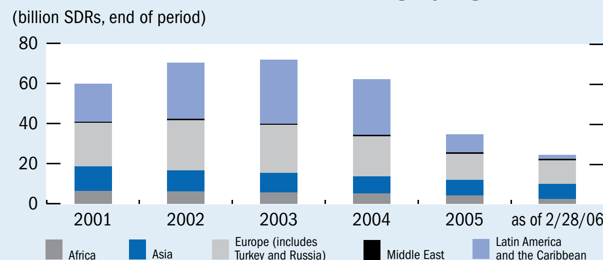
## September

**19–20** IMF–World Bank Annual Meetings, SIngapore

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

# IMF financial data

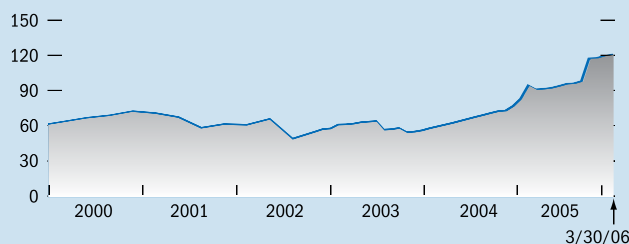
**Total IMF credit and loans outstanding, by region**
(billion SDRs, end of period)



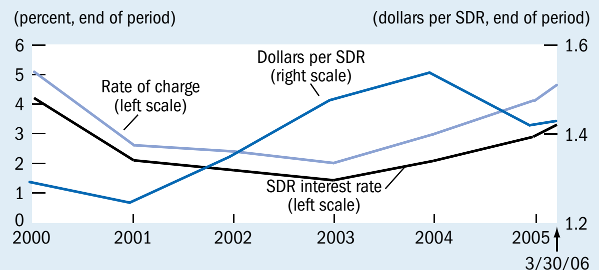

**Largest outstanding loans**
(billion SDRs, as of 2/28/06)

| Nonconcessional | | Concessional | |
|---|---|---|---|
| Turkey | 9.11 | Pakistan | 0.99 |
| Indonesia | 5.35 | Congo, Dem. Rep. of | 0.55 |
| Uruguay | 1.61 | Bangladesh | 0.28 |
| Ukraine | 0.82 | Cameroon | 0.19 |
| Serbia and Montenegro | 0.66 | Yemen, Republic of | 0.18 |

**Available IMF resources**
(one-year forward-commitment capacity, billion SDRs)




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




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

# Global economy and IMF reform to top Spring Meetings agenda

The world economic outlook and the IMF's strategic direction are expected to take center stage when the world's finance ministers and central bank governors meet in Washington, D.C., on April 22 for the Spring Meeting of the IMF's International Monetary and Financial Committee (IMFC). Also likely to be discussed are the status of the Multilateral Debt Relief Initiative and debt sustainability in low-income countries.

After months of intensive internal debate and wide-ranging external commentary, the IMF's strategic review, initiated by Managing Director Rodrigo de Rato, will move into the implementation stage with de Rato's presentation of a report to the IMFC, the Fund's policy steering committee. Also expected to be taken up is a paper outlining the IMF's policy agenda over the near term and the state of the world economy, which will be discussed against the backdrop of the analysis and projections contained in the April 2006 *World Economic Outlook (WEO)*.

The joint World Bank–IMF Development Committee will meet on April 23. It is expected to address a range of issues, among them the *Global Monitoring Report, 2006: Strengthening Mutual Accountability—Aid, Trade, and Governance,* and the role that clean energy can play in development.

Prior to the Spring Meetings, several events will serve as curtain raisers for the issues to be debated by the world's finance and development officials. In an April 20 address at the Institute for International Economics, de Rato will outline his vision for IMF reform. On April 19, IMF Economic Counselor Raghuram Rajan will brief the press on the new *WEO*'s economic projections. In addition, the Group of 24 developing countries will meet on the morning of April 21 and later that day brief the press on its proceedings. On April 25, African finance ministers will hold a press briefing on regional developments. For more information on the Spring Meetings, please consult the IMF's website *(www.imf.org)*. ■

## IMF and World Bank to accelerate, deepen review of collaboration

The IMF and the World Bank announced that they are accelerating and deepening a scheduled review of Fund-Bank collaboration. In a joint statement on March 29, IMF Managing Director Rodrigo de Rato and World Bank President Paul Wolfowitz announced the creation of the six-member External Review Committee, which will be assisted by a joint task force made up of senior staff from both institutions.

The External Review Committee will comprise Michael Callaghan, Executive Director, Australian Treasury's Revenue Group, and a former IMF Executive Director; Caio Koch-Weser, Vice Chair, Deutsche Bank, and former German Finance Secretary and World Bank Managing Director; Pedro Malan, Chair, Unibanco and former Brazilian Minister of Finance; William McDonough, Vice Chair of Merrill Lynch and former President of the U.S. Federal Reserve Bank of New York; Sri Mulyani Indrawati, Indonesia's Minister of Finance and a former IMF Executive Director; and Ngozi Okonjo-Iweala, Nigerian Minister of Finance and a former Vice President and corporate secretary of the World Bank Group. Mark Allen, Director, IMF Policy Development and Review Department, and Danny Leipziger, Vice President, World Bank Poverty Reduction and Economic Management Network, will serve as advisors and facilitate the commitee's communication with the staffs of the two institutions.

The review committee is expected to solicit a broad and representative sample of views on the nature and practice of Fund-Bank collaboration. It will explore whether the existing arrangements provide a sufficiently clear foundation for collaboration, whether established areas of responsibility are consistent with institutional mandates, whether the present "lead agency concept" works well, and whether the institutions can be held sufficiently accountable under this approach while still coordinating their efforts.

The review committee is expected to recommend specific improvements in Fund-Bank collaboration on country work, including on policy advice, lending operations, and technical assistance. It will also explore how collaboration can be tailored to suit members' differing circumstances. In addition, the committee will look into the improvements that can be made on thematic work, including on financial sector issues (Financial Sector Assessment Programs), trade policy, standards and codes, debt sustainability analysis in low-income countries, the Poverty Reduction Strategy Paper process, growth prospects, donor coordination, and implementation of the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative. A final report will be presented to the managements of the IMF and the World Bank before the end of 2006.

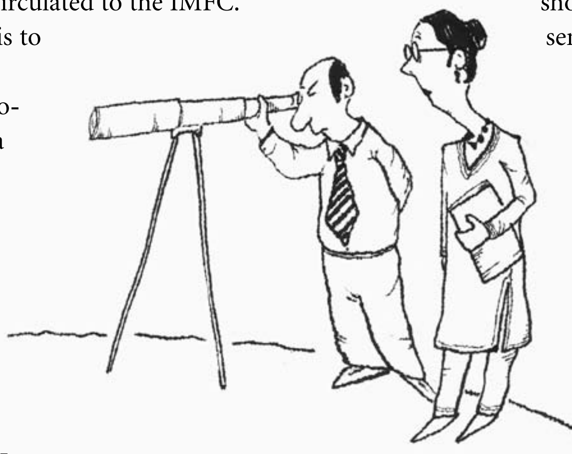
For more information, see the IMF's website (*www.imf.org*).

Reform at the IMF

# IMF revamp plan set for launch after Spring Meetings

In a proposed phased overhaul, the IMF is set to launch in the coming weeks its Medium-Term Strategy, designed to recalibrate the work of the Fund for a new era of globalization. After months of internal deliberation that took into account the views of officials of member countries as well as others outside the institution, a report from the Managing Director on implementing the Fund's Medium-Term Strategy was discussed by the IMF's Executive Board on April 3. It is now on the agenda of the International Monetary and Financial Committee (IMFC) at the IMF–World Bank Spring Meetings in Washington, D.C. The IMF is expected to publish the Managing Director's report on its website just ahead of the April 22–23 meetings, after it is circulated to the IMFC.

"We are now moving from analysis to implementation," says Managing Director Rodrigo de Rato, who is proposing an evolutionary rather than a revolutionary approach, while some external voices have called for more radical changes.



### Better-focused IMF surveillance

Rodrigo de Rato, who took over as the ninth Managing Director of the IMF in June 2004, initiated the review partly to encourage a process of deliberation about the Fund coinciding with the 60th anniversary of its founding. In his report to the IMFC in September last year, he outlined the main areas that he saw as needing to be considered in the Medium-Term Strategy. "My motivation was simple," declared de Rato in a speech to the Aspen Institute in Rome in February. "The world is changing and the IMF needs to change with it. Twenty-first-century globalization, with massive movements of capital and abrupt shifts in comparative advantage, is presenting all countries and the global community with new challenges. The Fund must help our members meet these challenges, and it will need to adapt to do so."

In recent months, the Managing Director has fleshed out the strategy in several speeches—occasions that he has also used to elicit views from outside the Fund on issues relating to the review. His report, putting forward proposals for implementation of the strategy, will be considered by the IMFC on April 22. The IMFC, chaired by U.K. Chancellor of the Exchequer Gordon Brown, is the IMF's main advisory committee of its Governors and considers key policy issues.

The strategic review has focused on how the IMF, founded in 1944, can best serve its member countries, as well as the global economy and financial system, in the evolving world of the early 21st century. Working groups of senior staff examined possible reforms in seven areas:

- how to enhance the effectiveness of the IMF's economic surveillance at the global, regional, and country levels;
- how to adapt the IMF's role in emerging market economies;
- how to better define the IMF's work in low-income countries;
- how the IMF's governance structure should be adjusted to ensure fair representation for all countries;
- how to bolster the IMF's technical assistance and training and its help for countries to meet standards and codes;
- how to streamline the IMF's internal work processes; and
- how to formulate a medium-term budget strategy for the IMF.

In his report, the Managing Director will put forward proposals that are based partly on the recommendations of these groups.

### Evolving Fund

The strategic review, coinciding with a relatively benign phase of the global economy in which several borrowing countries have repaid loans early to the IMF, has prompted a number of suggestions about how the institution should reform. In contrast to earlier bouts of criticism from nongovernmental organizations, the recent batch of suggestions has come mostly from prominent government officials and well-known economists (see box, page 102). While some have warned that the Fund risks drifting into obscurity, most have underscored that, as Edwin Truman, formerly of the U.S. Federal Reserve Board and U.S. Treasury and now of the Institute for International Economics put it, the world needs the IMF, as the principal multilateral institution responsible for international economic and financial stability, to be strong and effective.

In a series of speeches, de Rato has outlined his thinking on four main themes—IMF surveillance; the IMF's role in emerging market economies; the IMF's role in low-income countries; and the representation of member countries at the Fund. In the following pages, the *IMF Survey* looks at these issues in turn. ■

# Globalization prompts overhaul at IMF

A major driving force behind the IMF's strategic review is the increasing international integration of the world economy, involving a larger-scale global transfer of goods, services, technology jobs, and finance. This has allowed world savings to be allocated to more productive and diversified investments internationally, but it has also created new risks, especially for emerging markets and advanced economies, by giving rise to increased capital flows and allowing the buildup of large-scale payments imbalances. Increased financial integration has enabled the United States, in particular in recent years, to finance much larger current account deficits than were seen in the past.

There is a broad consensus among policymakers around the world on the measures required to reduce global imbalances. Most policymakers agree that what is needed is fiscal adjustment and measures to stimulate private saving in the United States, exchange rate appreciation and measures to stimulate domestic demand in emerging Asia, and structural reforms to stimulate demand and improve productivity in the nontradables sector in Europe and Japan. One question raised in the course of the strategic review, partly in the context of the global imbalances, is how the IMF's surveillance can be made more effective.

Eugene Salazar/IMF

**"Good [global] economic performance rests on a shaky foundation, because of large and continuing global imbalances."**

**—Rodrigo de Rato**

### Global surpluses matter too

Lawrence Summers, a former U.S. Treasury Secretary, said in a speech at the Reserve Bank of India in Mumbai in March that the IMF now needed to pay as much attention to countries that had surpluses as to those with deficits. "The IMF has always had as its raison d'être addressing imbalances, but its surveillance and, indeed, its lending have always been focused on those who are borrowing excessively."

He said that the IMF must also strengthen its role in exchange rate surveillance. "It has always struck me as ironic that the IMF, which is charged with maintaining the global financial system, and therefore should be particularly focused on policy choices that affect multiple countries, is prepared to address domestic monetary and fiscal policy choices, which, while they may have international ramifications, are primarily of domestic concern, but is so reticent about addressing exchange rate issues, which by their very nature are multilateral."

U.S. critics have pointed to what they see as undervalued exchange rates in certain Asian countries that have enabled them to boost exports and build up large foreign exchange surpluses. Mervyn King, Governor of the Bank of England, argued in a speech in India in February that IMF surveillance needed to focus more on balance sheets and be more independent and that greater independence for IMF management and staff would be served by making the Fund's Executive Board a part-time, nonresident body that would hold management accountable.

David Dodge, Governor of the Bank of Canada, has said that the IMF needs to be more of an "umpire for the world economic order, unafraid to call out countries that aren't playing by the rules." At a speech in New York in March, Dodge proposed retooling the IMF to make it the global institution responsible for coordinating market-friendly reforms around the world and for issuing warnings when countries fail to heed danger signs in their own economies.

IMF Chief Economist Raghuram Rajan, meanwhile, has warned that reform at the Fund must be coupled with a recommitment by member countries to the idea of multilateralism. De Rato agrees that the IMF must enhance its focus on exchange rates and argues that the focus of surveillance must be sharpened, especially for the larger, systemically important economies, "to make it more useful and also more challenging to governments." In a speech at the Harvard Business School on April 4, he argued that the IMF needed better mechanisms for consultations with more than one member government at a time. "Global imbalances are the problem not just of one country but of many," de Rato declared, having noted that "good [global] economic performance rests on a shaky foundation, because of large and continuing global imbalances." He said the Fund could adopt a new multilateral consultation procedure for groups of countries, such as the European Union, the Gulf Cooperation Council, and the ASEAN+3—the Association of Southeast Asian Nations (ASEAN) together with China, Japan, and Korea. ■

The articles about reform at the IMF were prepared by Jeremy Clift, Elisa Diehl, and Ina Kota, with the assistance of Kelley McCollum. Illustrations by Massoud Etemadi.

# Success changes concerns of emerging markets

Most analysts see the IMF's role in emerging market countries as being at a crossroads. In the mid- to late 1990s, when some of these countries experienced sudden reversals of capital inflows, they turned to the IMF for assistance. Mexico, for example, received a financial package in 1995 amounting to $17.49 billion and succeeded in getting its economy back on track. A handful of Asian countries subsequently succumbed to financial crisis in 1997–98, resolving their difficulties with IMF financial support.

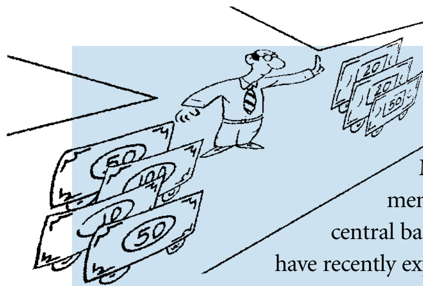
Today, most emerging market countries are less vulnerable to financial crises. Many have improved fiscal management, lowered inflation, run external current account surpluses, and acquired larger foreign exchange reserves, and their local capital markets have become more developed. These developments have owed much to policy improvements, although the benign global economic and financial environment has also played an important part.

Many countries also allow more flexibility in their exchange rate policy, which can help them absorb shocks. Associated with external current account surpluses, large amounts of capital have been flowing from the world's most successful emerging markets to industrial countries with deficits, mainly the United States. In addition to building reserves to insure themselves against future financial disturbances, emerging market economies in Asia have developed regional risk-pooling mechanisms, such as the Chiang Mai Initiative.

### A new role for the IMF?

In this environment, what should the IMF's relationship with emerging market countries be? Is there a role for Fund financing in these countries? De Rato tackled these questions in an address at the Bank of Mexico on March 23, pointing out that current global financial conditions were unlikely to remain so favorable indefinitely, which means that developments in domestic and international financial markets could still give emerging market countries unpleasant surprises. "This underlines the need for a change in the Fund's culture to put financial and capital market issues at the heart of its work," he said.

The Fund has steadily strengthened its financial sector work over the years. In 1999, the Fund and the World Bank established the joint Financial Sector Assessment Program to strengthen their monitoring of countries' financial systems. To date, about half of IMF members have completed or are close to completing such an assessment. Moreover, de Rato



## A clutch of reform proposals

Many officials of the IMF's member country governments and central banks, as well as outside experts, have recently expressed their own ideas about how the IMF should be reformed. Last September, U.S. Treasury Undersecretary ***Timothy Adams*** said that, to remain relevant, the IMF needed to refocus its work on the core mission envisaged by its founders, which he identified as international financial stability and balance of payments adjustment. He faulted the IMF's annual country consultations for only briefly referring to countries' exchange rate policies and their consistency with domestic policies and the international system. "There is almost never," Adams said, "discussion of whether an alternative regime could be more appropriate or how to transition to it. The perception that the IMF is asleep at the wheel on its most fundamental responsibility—exchange rate surveillance—is very unhealthy for the institution and the international monetary system."

***Mervyn King*** warned in a speech in February that the Fund would "slip into obscurity" without radical reform. He argued that the Fund should provide rigorous and independent analysis of countries' balance sheets and highlight where risks to the international financial system lay. A key aspect of its work, he continued, should be to examine countries' exchange rates and the links between their balance sheets. He also proposed granting the IMF's Managing Director and senior staff more power to criticize individual countries' economic policies, with a nonresident board that would act in a supervisory capacity. "The Board should step back from much of this expensive micromanagement, for example by ceasing its involvement in the day-to-day reviews of Article IV reports and concentrating instead on holding management accountable for the delivery of its mandate."

In September 2005, ***Michel Camdessus***, IMF Managing Director from 1987 to 2000, also called for the IMF to strengthen surveillance and proposed that the preliminary conclusions of staff missions, particularly for the major countries, be submitted to a broader public debate with countries before the Executive Board reviews them. He argued that the institution should pay more attention to structural rigidities, demographic developments, and large accumulations of international reserves, and said the Fund should propose a "bold initiative" to address global imbalances.

Emerging market countries, whose stock markets have strengthened considerably since the crisis of the late 1990s, have become much less vulnerable to financial turmoil.

indicated that the Fund would take additional steps this year. First, two IMF departments are being merged to establish "a single center of excellence for all aspects of financial, capital market, and monetary policy work in the Fund." Second, the Fund has established a task force to formulate an analytical framework that will make financial sector issues a central part of country surveillance, so that analyses of financial sector and balance sheet vulnerabilities will be fully integrated into staff country reports. The analyses will highlight the implications of these vulnerabilities for macroeconomic policy, capital controls and flows, and the scope for domestic and external spillovers.

For the Fund to remain relevant to all its member countries, de Rato said, it must be responsive to their needs and concerns. And the emerging market countries have indicated that the Fund's existing instruments do not meet their needs, especially for predictable and flexible financial assistance. Rodrigo de Rato thus suggested that the Fund could develop a new arrangement that would offer high-access contingent financing—financing when needed, with conditionality focused on the requirements of macroeconomic stability—to members with strong macroeconomic policies, sustainable debt, and transparent reporting that could still succumb to balance sheet weaknesses and vulnerabilities. Not all of the details have been worked out, and de Rato asked in his Mexico speech for guidance on, among other points, how conditionality should be designed and how to ensure that the target countries will find the facility useful enough to participate in it.

Such a contingent lending facility could contribute to crisis prevention. De Rato says that the Fund should be open to supporting regional and other arrangements for pooling reserves, at least by signaling sound policies. He has also indicated there might be scope for links between such arrangements and the new contingent facility he has proposed or the Fund's regular financial support. ■

***Edwin Truman*** exhorted the IMF to "develop stronger means to increase its leverage over the macroeconomic policies of systemically important countries." It must use more than sound analysis and quiet persuasion, which are essential but limited tools, he said. Truman proposed that the Fund introduce into its consultations an element of "naming and shaming" of countries that should adopt measures to improve their economic performance and contribute to global economic and financial stability.

In a workshop on the reform of the Bretton Words institutions held in Tokyo in February, ***Bandid Nijathaworn,*** Deputy Governor of the Bank of Thailand, addressed the issue of large global imbalances. With improved economic fundamentals and policies in the emerging market countries, he said, it is less likely that imbalances in these countries would lead to a crisis. Rather, "an unwinding of [global] imbalances could lead to economic slowdown and sudden changes in the financial conditions of the major economies, which . . . can create difficulties for emerging markets in terms of growth implications, abrupt reversals of capital flows, and sudden stops."

Speaking at Princeton University on March 30, ***David Dodge*** described what an "ideal IMF" would do. It should be an "independent, impartial umpire ready to call out countries that break the rules," and this function should be better supported by IMF surveillance. He argued that surveillance had to take into account the global economy's growing interdependence in order to maintain the stability of the international financial system: "The IMF should use its surveillance, not just nationally but internationally, to identify externalities and potential policy spillovers." And Dodge said that lending should *not* be the IMF's prime purpose. "In particular, long-term lending for development clearly falls outside of its mandate."

In his speech at the Reserve Bank of India in March, ***Larry Summers*** addressed the opportunity cost of what he described as the excess international reserves held by many Asian countries, which he estimated at almost $1.5 trillion. Rather than earn a zero real return, as they do currently, he said, these reserves could be invested in such a way that they could earn 6 percent, or about $100 billion, a year. He then proposed that the IMF and the World Bank create an international facility in which countries could invest their excess reserves without taking domestic political responsibility for the investment decisions and ultimate result.

# Strengthening support for the IMF's poorest members

The IMF's Medium-Term Strategy reconsiders the institution's role in its poorest member countries. Rodrigo de Rato would like to streamline the procedures that overload the Fund's work in these countries and that absorb substantial resources while yielding questionable gains.

The IMF has provided concessional financing to its poorest members since the 1970s to help them address their balance of payments difficulties. In September 1999, the IMF established the Poverty Reduction and Growth Facility (PRGF) to make the objectives of poverty reduction and growth more central to its lending operations in these countries. Also in 1999, the IMF and the World Bank initiated country-based Poverty Reduction Strategy Papers (PRSPs), which provide the operational basis for Fund and Bank concessional lending and for debt relief under the Heavily Indebted Poor Countries Initiative.

### A role gone awry?

There is virtual unanimity among the IMF's membership that the Fund plays an important role in helping low-income countries establish sound macroeconomic frameworks through its surveillance, technical assistance, and financial assistance. Nevertheless, questions have been raised about how the Fund's performance of its role could be improved. For example, Timothy Adams, noting that the IMF is not a development institution, says that its "financial involvement in low-income countries has gone terribly awry." As evidence, he cites PRGF-supported policy programs, under which many countries have not achieved the external adjustment aimed for.

Indeed, the Fund is seeking to determine how it can best contribute to the efforts of low-income countries—most of which are in sub-Saharan Africa—to boost growth and reduce poverty. In a speech in Lusaka, Zambia, on March 16, de Rato said that its role would be "to provide our best advice on macroeconomic policies that will support growth, reduce poverty, and enable governments to make the best use of aid."

To use its own limited resources wisely, de Rato said, the IMF must sharpen its focus on the policies and institutions that are critical to economic and financial stability and to growth and that fall within its core competencies in the areas of macroeconomic and financial sector policies. In the past, the IMF's advice has sometimes been spread too thin and its conditionality has been too broad.

De Rato said that the Fund should take responsibility for advice on fiscal, monetary, and exchange rate policies; trade policy; other reform measures and institutions relevant to macroeconomic and financial stability (such as financial sector soundness); debt management; and how to adapt macroeconomic policy to handle the anticipated increase in aid. IMF support would take the form of policy advice centered on PRSPs, financial assistance where needed, and capacity building. For the IMF to be able to focus effectively on these areas, de Rato said that he would like to see a more systematic division of responsibility with other international organizations and donors.

Grant Neueunburg/Reuters

A health worker vaccinates a child against measles in Mozambique, a country that has benefited from international debt relief. The IMF is encouraging countries to channel money saved on debt servicing into antipoverty programs.

To fulfill the Fund's commitment to low-income countries, de Rato says, will require additional resources to be devoted to this work. Already, the Fund has announced that a third African Regional Technical Assistance Center will be established, aimed at serving central Africa.

### Debt and aid

It is important that the countries that recently received 100 percent debt relief from the Fund as its part of the Multilateral Debt Relief Initiative not build up unsustainable new debt, especially on worse terms. The IMF, de Rato emphasized, can help them design medium-term debt strategies and can advise official creditors when debt or debt-service levels are likely to become a problem.

African countries will soon be receiving considerably more aid and must use those resources effectively. The IMF is well placed to advise them about the macroeconomic implications and how to deal with them. Among the difficulties that countries can experience with more aid are the risks of Dutch disease (adverse effects on international competitiveness through currency appreciation or higher inflation) and the increased complexity of managing monetary, fiscal, and exchange rate policies. ■

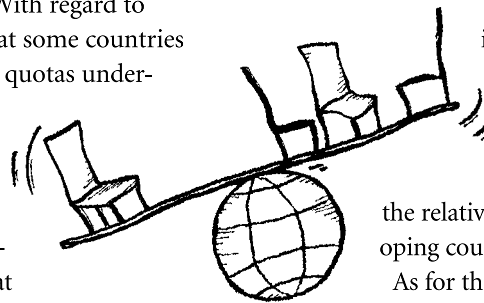
# Asia wants more say at the Fund

Recent discussions about reforming the IMF have usually included the issue of governance of the institution. This refers partly to whether member countries' representation in the IMF's decision making is fair and commensurate with their standing in the global economy—and partly to such issues as the selection of IMF management. With regard to representation, there is little disagreement that some countries are currently underrepresented because their quotas understate their economic size.

### Voice and representation

Speaking at the Bank of Mexico, Rodrigo de Rato recognized "the need for increases in voting power for some countries . . . to ensure that they have a role in the Fund's decision-making process that accords with their increased importance in the world economy." He anticipated that proposals for reforming IMF voting rights would be presented at the IMF's Annual Meeting in Singapore in September 2006.

The finance ministers of Korea and other Asian members, including Japan, China, and Thailand, have called for a fairer distribution of IMF quotas to boost the voting strength of Asian members. The current quota distribution, in the words of Japan's Finance Minister Sadakazu Tanigaki, is "another form of unsustainable global imbalance." Korea, Japan, China, and the 10 members of the ASEAN together accounted for 19 percent of world GDP in 2004 but have only a combined 13 percent voting stake in the IMF.



Timothy Adams has also backed an increase of Asian countries' quotas and their voting weight. Moreover, he has argued that the euro area could be represented by one seat on the Executive Board, thus helping increase the relative voice of emerging market and developing country members on the Board.

As for the voice of the developing countries, Tito Mboweni, Governor of the Reserve Bank of South Africa, has called it an embarrassment. Speaking at the University of Pretoria in February, he said that the IMF and other international financial institutions should be radically reformed to give developing countries a greater voice in decision making. "If we are going to participate in these institutions, we must participate as equals."

But Lorenzo Bini Smaghi, the European Central Bank executive board member responsible for international affairs, called Europe's position in the IMF paradoxical. All non-European countries think that the European Union (EU) and the euro area are overrepresented and that their weight should be reduced, he said. But the EU and euro area countries—which hold 25–34 percent of votes—think that their influence is not comparable to that of the United States, with 17 percent of the votes.

The IIE's Edwin Truman said, "It is not sustainable that the policies of the IMF are determined principally by the votes of those countries that no longer need to borrow from the Fund when other countries, which may need to borrow from the institution, are positioned to provide financial support to its lending activities and should have more say over policies affecting those activities."

### Selection of Managing Director

Another governance issue is the selection process for the IMF's Managing Director and Deputy Managing Directors. The Managing Director has traditionally been European, and the World Bank President has traditionally been an American. Critics call for an open and competitive process in which the pool of candidates is open to all nationalities. Truman says that failure to reform this process could "undermine the legitimacy of the Bretton Woods institutions." ■

**How many seats?**

There is little disagreement that Asia is underrepresented, and some critics think that Europe is overrepresented, on the IMF's 24-member Executive Board.

| Representation by industrial and developing country groupings: | Chairs on Executive Board[1] | Voting power[2] |
|---|---|---|
| **G5** | **5** | **39.1** |
| United States | 1 | 17.1 |
| Japan | 1 | 6.1 |
| Germany | 1 | 6.0 |
| France | 1 | 5.0 |
| United Kingdom | 1 | 5.0 |
| **Other G10+Switzerland** | **6** | **24.2** |
| Europe | 5 | 20.5 |
| Western Hemisphere | 1 | 3.7 |
| **G24** | **9** | **24.6** |
| Africa | 2 | 4.4 |
| Asia | 2 | 5.7 |
| Middle East | 2 | 5.7 |
| Western Hemisphere | 3 | 8.7 |
| **Other** | **4** | **12.1** |
| China | 1 | 2.9 |
| Russia | 1 | 2.7 |
| Saudi Arabia | 1 | 3.2 |
| Other Asia | 1 | 3.3 |

Note: G5 = Group of Five leading industrial countries; G10 = Group of Ten industrial countries; and G24 = Group of 24 developing countries.
[1]Constituencies of Executive Directors may include members outside of grouping.
[2]Voting power of the chairs representing the constituencies.

# "Brave new world" of modern markets poses challenges

For the world's financial markets, 2006 is unlikely to be a stellar year like 2005, according to the IMF's *Global Financial Stability Report* (*GFSR*). The global financial system has been consistently flexible and resilient since 2004, but headwinds may be building. The report expects cyclical challenges in the coming months—especially risks stemming from higher interest rates and higher inflation, a deterioration in the credit quality of various debtors, and a sudden unwinding of global imbalances. For these reasons, the report urges governments to pursue sound macroeconomic policies, particularly prudent fiscal policy, flexible exchange rates, and active debt management programs.

Former U.S. Federal Reserve Chair Alan Greenspan recently pointed out that increasingly complex financial instruments have made the financial system "far more flexible, efficient, and, hence, resilient" than it was 25 years ago. Globalization and financial innovations have advanced, allowing credit to be channeled more efficiently, resulting in a wider dispersion of risk. Improved fundamentals in emerging market economies, particularly fiscal consolidation and rules-based fiscal and monetary policies, have increased the resilience of the global financial system to shocks. But the *GFSR* stresses that this "brave new world" of modern capital markets comes with its own risks and challenges.

### Resilient enough?

Will the global financial system be able to withstand the likely deterioration in cyclical conditions? The *GFSR* says yes, although higher interest rates and the turning of the credit cycle are expected to present particular challenges to financial markets and institutions.

***High interest rates and high inflation.*** Inflation expectations in financial markets are still well anchored, and only mild and mixed movements in short-term interest rates are expected in the year ahead. However, if inflation expectations increase significantly for a sustained period—because of further oil price hikes, for example—short- and long-term interest rates could rise. This, in turn, could lead to an economic slowdown with negative consequences for corporate earnings and credit quality, and credit spreads could widen substantially. At present, the report considers sharply higher interest rates a remote risk, but one that bears watching.

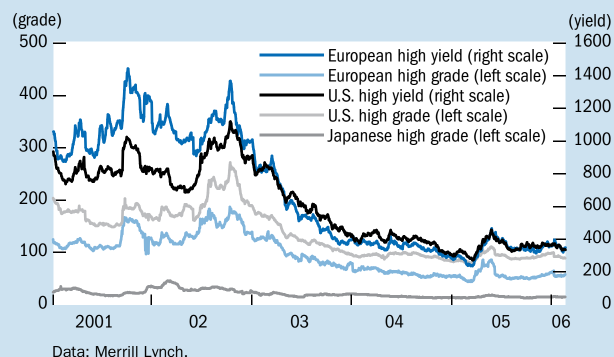
***Turning of the credit cycle.*** The credit cycle refers to fluctuations in the financial health or balance sheet quality of the corporate sector that affect firms' access to, and cost of, credit. Changes in average corporate credit quality cause credit spreads to fluctuate, which can also affect the household sector and other borrowers on capital markets. The turning of the credit cycle is not expected to pose major problems for the corporate sector as a whole, since overall balance sheets remain healthy. In advanced economies, household balance sheets have also improved since 2001, benefiting from the rise in house prices and the recovery of international equity markets.

***Deterioration in credit quality.*** Since the second quarter of 2005, corporate bond spreads have started to widen—an early sign of a turning of the credit cycle (see chart, below). Rating agency upgrades are expected to decline relative to downgrades. Default rates are expected to rise moderately, and banks have begun to tighten lending standards. While a number of corporations have begun to releverage their balance sheets, corporate sectors in many countries have strong financial positions and an improved ability to service debt. Overall, the report argues, healthy corporate sector balance sheets and still-low default rates should provide firm anchors to credit markets, enabling self-correcting forces to operate and markets to stabilize.

***Sudden unwinding of global imbalances.*** A "disorderly" unwinding of global payments imbalances could have broad and severe consequences for financial stability. Global imbalances have continued to widen. The U.S. current account deficit has risen to about 6.5 percent of GDP, while current account surpluses, particularly in Asia and the oil-exporting countries, have widened commensurately. Deep, flexible, and sophisticated U.S. financial markets offer a wide range of assets to meet different needs and enjoy high trend growth. The *GFSR* sees growth and interest rate differentials as likely to narrow, which may moderate foreign accumulation of U.S. assets, weaken the dollar, and push bond yields upward.

**Signaling a change**

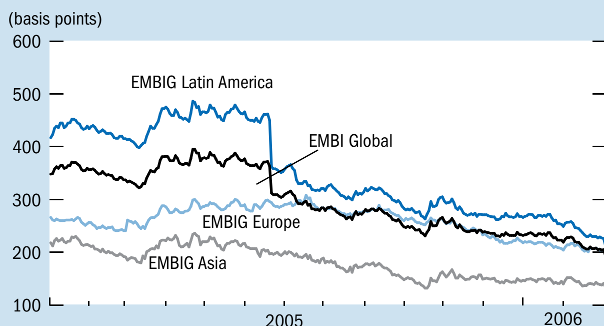
Corporate spreads have widened since mid-2005, indicating a turning of the credit cycle.




Data: Merrill Lynch.

**Emerging markets prosper**

Emerging market bond spreads are trending to record-low levels, thanks to improved fundamentals and external financial conditions.




Data: JPMorgan Chase & Co. and Merrill Lynch.

Such cyclical challenges are expected to be easily weathered, thanks to the absence of a systemic underpricing of risks, healthy corporate balance sheets, strong banking sectors, and sophisticated credit derivative and structured credit markets. Because of the benign economic and financial environment, risk premiums have been low. There is no evidence of a systemic underpricing of risks, but as cyclical conditions become less favorable, volatility—and, ultimately, risk premiums—could increase. Banks in many countries have strong capital bases, good profitability, and improved asset quality, as evidenced by low nonperforming loan ratios. But if cyclical conditions become less favorable, banks' balance sheets will be affected. Sudden and negative developments, such as a major terrorist attack or an avian flu pandemic, could seriously disrupt global financial markets, especially the payment clearing and settlement system.

### Wider dispersion of risk

The sophistication and resilience of the global financial system is partly due to the recent explosion in credit derivative and structured credit products, which have dispersed credit risk to a broader and more diverse group of investors. This increases the shock-absorbing capacity of the system, contributing to stability. The less stringent reporting requirements among nonbank participants in these markets, however, are a source of concern. There is insufficient information, the *GFSR* argues, about who holds risk outside the banking system and in what amount. The growing complexity of these instruments holds the potential for mispricing and sudden swings in investor sentiment.

***Untested structured markets.*** Rapidly growing market liquidity and infrastructure of credit derivative markets have not yet been tested by a severe downturn. Complexity of instruments means that valuation models may be inaccurate, and the lack of information means that it is difficult to ascertain concentrations of risk. There is concern, although no supporting evidence, that these markets have simply shifted credit concentrations elsewhere in the financial system. Future credit losses are likely to be more broadly distributed, removing a general policy concern for a particular sector. Still, the report recommends that a more liquid secondary market be developed in a number of market segments to make credit derivative and structured credit markets more complete and to enhance financial stability.

***Continuing to develop and deepen capital markets.*** Supervisors and regulators are encouraged to measure, monitor, and manage risk through increased dialogue with market participants and public officials; promote an increasingly diversified investor base in structured markets; and strengthen the institutional, legal, and regulatory infrastructures to attract investors and ensure the flow of capital within and between markets. Best practices could be applied to building emerging capital markets. The report urges policymakers to support the development of such markets, including risk transfer markets.

### Emerging markets continue to thrive

Low global interest rates, better fiscal performance, higher creditworthiness, and lower spreads have enabled emerging markets to improve debt management and diversify their investor bases (see chart, this page). Macroeconomic performance, especially in Asia, has also improved significantly since the 1997–98 crisis—allowing many countries to enhance fiscal performance and build healthy balance of payments positions.

In light of these strong fundamentals, contagion from adverse shocks in individual countries is likely to be limited. Likewise, efforts by emerging market countries to manage economic performance and to structure debt should cushion them against any moderate deterioration in external financing conditions. An investor base that is growing more diverse and seeing an increasing number of strategic and long-term investors should give the emerging market asset class greater stability.

There are areas of concern, however. While major emerging sovereign debt markets are becoming less vulnerable to external risks, countries with weak fiscal positions, large debt burdens, and wide current account deficits need to be especially alert to potential pressure arising from a less favorable structural environment. To reduce future vulnerabilities, these countries need to build on their recent successes, focusing on sound macroeconomic policies, structural reforms, strong public debt management, local capital market development, and measures to broaden the investor base. ■

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*IMF External Relations Department*

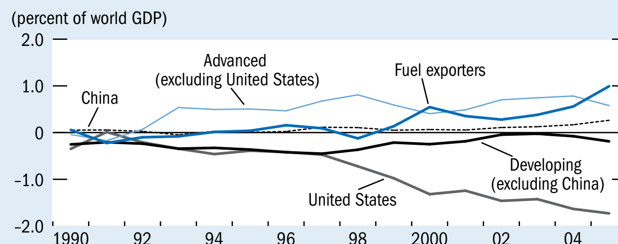
# Rising oil prices: adding fuel to global imbalances?

Global payments imbalances—the large U.S. current account deficit, which reached 6.4 percent of GDP in 2005, and the corresponding surpluses, mainly of oil-producing countries, a number of Asian economies, and some advanced economies—are at the heart of the current global economic policy debate. As recent issues of the IMF's *World Economic Outlook (WEO)* have underscored, the continuing large U.S. current account deficit increases the risks of a disorderly downward adjustment in the U.S. dollar, which would, in turn, sharply push up U.S. interest rates and possibly lead to a global slowdown and even recession.

A related issue is the possible interaction between these persistent global imbalances and increases in international oil prices. Chapter II of the April 2006 *WEO* examines the extent to which the sharp increase in international oil prices over the past few years may have exacerbated global imbalances and, looking ahead, how higher oil prices might affect the resolution of these imbalances.

**Widening external imbalances**

Rising oil prices are worsening already large global imbalances.




Data: IMF, *World Economic Outlook*, April 2006.

### Oil's effects

The *WEO* analysis argues that higher oil prices have indeed widened global external payments imbalances. In particular, higher oil prices account directly for one-half of the deterioration in the U.S. current account (a contribution equivalent to about 1 percentage point of U.S. GDP) over the past two years. Data suggest that the oil-exporting countries have so far been relatively cautious about increasing spending in line with their increased revenues. As a result, they are now running current account surpluses amounting to 15 percent of GDP or higher.

Oil is having an impact through other channels as well. There is some evidence that the recycling of petrodollars through international capital markets is helping to keep long-term interest rates low in the United States, further fueling the current account deficit through domestic demand. International capital inflows have depressed yields in the United States by perhaps ¾ of 1 percentage point. The precise effect of petrodollars on financing conditions is difficult to isolate, but there is evidence that some of these capital inflows are indeed oil-related.

### What may lie ahead

The *WEO* analysis suggests that, in the future, current accounts may adjust more slowly to the oil price shock than they have in the past. In previous oil price shocks, oil-importing countries saw higher energy prices lead to increases in inflation and interest rates, slower growth of domestic demand, and declines in exchange rates and asset prices, resulting in relatively fast current account adjustment. This time—in part because many countries have strengthened their monetary frameworks and improved central bank credibility—the impact on the real side of the world economy has been smaller. These developments, coupled with deeper financial integration and subdued spending to date in oil-exporting countries, suggest that current accounts may now adjust more slowly.

Nevertheless, the *WEO* study argues, policies can play an important role in speeding up the adjustment process and reducing the risks that the global imbalances will be resolved through a disorderly adjustment. For oil-importing countries, it will be important to allow a full pass-through of world oil prices to domestic energy prices to reduce oil consumption, accompanied by monetary policy that guards against any increase in core inflation. For producers, most of which are developing countries, it will be highly desirable—both from a domestic perspective and to help reduce global imbalances—to take measures to boost expenditures in areas where returns are high. It will also be vital to pursue structural reforms to boost domestic supply, particularly of nontradable goods. ■

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**World Economic Outlook, April 2006**

The full text of chapters II, III, and IV of the April 2006 *World Economic Outlook* is available on the IMF's website (*www.imf.org*). Published copies of the full *World Economic Outlook* will be available on April 19. Copies are $49.00 ($46.00 academic rate) each from IMF Publication Services. Please see page 112 for ordering information.

# Globalization may no longer contain inflationary pressures

In recent years, one pleasant surprise in the global economy has been remarkably subdued inflation despite sharp rises in commodity prices, strong growth, and monetary policies in the major currency areas that have been broadly accommodative. Some analysts theorize that intensifying global competition has kept firms from raising prices and exerted downward pressure on wages. If so, the argument goes, continued integration of lower-cost producers in emerging market and developing countries should contain inflation for the foreseeable future. Chapter III of the IMF's April 2006 *World Economic Outlook (WEO)* explores the relationship between globalization and inflation and asks whether intensifying competition can provide durable insulation from rising inflation.

### Uneven effects

The *WEO* finds that globalization has varying effects on advanced and emerging market economies.

***In industrial economies, the direct effect of import prices on inflation has generally been small*** (see chart). That said, when global spare capacity has increased—as it did following the 1997–98 Asian financial crisis and during the 2001–02 global economic slowdown—declines in import prices have had sizable effects on inflation over one- to two-year periods, shaving more than 1 percentage point off actual annual inflation in some advanced economies. With low average inflation, such effects are economically significant. This lends support to the view that inflation targets should not be set too close to zero—otherwise, shocks of this size could result in periods of deflation.

***Globalization has helped reduce the sensitivity of inflation to domestic capacity constraints in advanced economies.*** Over the past couple of decades, the prices of many items produced or consumed at home have been increasingly determined by foreign demand and supply factors. Because global economic developments have become increasingly important for domestic inflation, monetary policymakers will need to monitor these developments more closely in the years ahead.

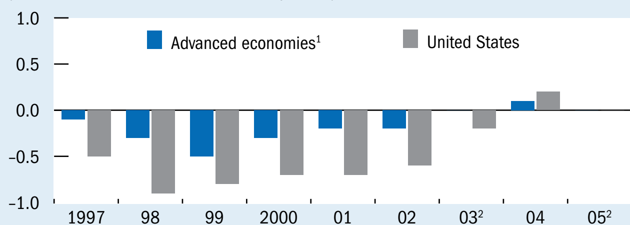
***Although the impact of globalization on overall inflation has been small, its effect on prices in certain sectors, such as textiles, has been significant.*** In these sectors, producer prices have declined relative to the overall price level. The sectors that have become more exposed to foreign competition have seen the largest relative price declines in recent years. Globalization is not the only factor driving relative price changes, however. While openness has been important, particularly in low-tech and low-skill sectors, productivity growth has also contributed significantly to relative price changes.

***Globalization has no lasting impact on inflation unless it changes the overarching objectives of monetary policy.*** Over the medium term, the prevailing nominal anchor—for example, the central bank's inflation target—will determine inflation. The impact of globalization on inflation will therefore be temporary unless central banks change their inflation target. In the industrial countries, it is unlikely that globalization-related pressures on prices will lead to a lowering of inflation targets (explicit or implicit), which are already set at low single-digit levels. In emerging market and developing countries, however, there is reason to believe that greater openness has already been an important factor behind the improved policies underlying the sustained decline in inflation in recent years, and the globalization effect may have further to go.

**Diminishing impact**

Low non-oil import prices helped to contain inflation in the late 1990s, but that effect now seems to have run its course.

(annual contributions to CPI inflation in percent)




[1]The group of advanced economies was at the historical average rate of about 1.6 percent a year.
[2]Zero where no data are indicated.
Data: Eurostat, Haver Analytics, national authorities, and IMF staff estimates.

### Risk of rising inflation

Whatever restraining influence increased global competition has had on inflation over the past decade or so, the study says that monetary authorities now need to be alert to the fact that robust global growth and lessened economic slack have diminished the degree to which declining import prices have restrained inflation. With strong global growth expected to continue, the primary risk going forward is that a further upturn in import prices could result in stronger inflationary pressures, particularly in countries that are well advanced in the economic cycle. Monetary policymakers will therefore need to remain vigilant for any signs of a pickup in inflation. Globalization can no longer be relied upon to keep a lid on inflationary pressures. ■

*Thomas Helbling, Florence Jaumotte, and Martin Sommer*
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# Awash with cash: why corporate saving has risen recently

Corporate sector behavior in the major industrial countries has undergone a sea change since the equity market bubble burst in 2000. Companies in many industrial countries have elected to use sharply higher profits, net of interest payments and taxes, to accumulate financial assets and repay debt rather than reinvest in their businesses or increase dividend payments. As a result, nonfinancial companies have, in effect, been lending resources to the household and government sectors rather than borrowing from them—a reversal of the pattern of behavior generally seen in past decades (see chart).

This corporate thriftiness is also likely to be a key factor behind the conundrum of persistently low long-term global interest rates alongside a U.S. current account deficit that has continued to balloon. In 2003–04, the Group of Seven countries' $1.3 trillion of corporate excess saving (accumulated internal funds, after taking account of investment in physical assets) was more than twice the size of the cumulative current account surpluses of emerging market and developing countries during those two years. These are the surpluses labeled a global "savings glut" by U.S. Federal Reserve Board Chair Ben Bernanke.

## The corporate puzzle

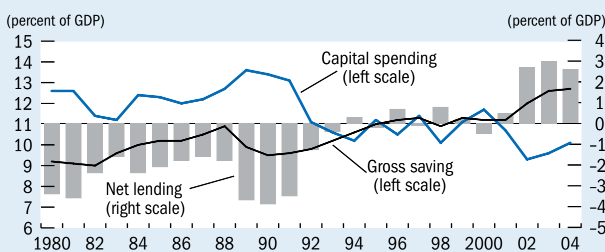
Why have corporations been saving so much? And is this a temporary or a more long-term phenomenon? Chapter IV of the April 2006 *World Economic Outlook* (*WEO*) takes up these questions. First, it examines the commonly held view that increased corporate saving has mainly been a reaction to the excess debt and physical capital that companies amassed in the 1990s. If this is so, then the recent level of saving is likely to be a passing phenomenon. Once these excesses are worked out, the corporate sector will again become a net borrower.

But has high corporate saving been primarily a reaction to past excesses? The *WEO* analysis suggests that the story is not that simple. Debt repayment accounts for only a small portion of companies' excess saving. And, even if net borrowing has declined in all of the Group of Seven countries since the late 1990s, corporate leverage ratios remain close to their late 1990s levels, with the exception of those of Canada and Japan. The *WEO* finds that other factors—some cyclical and some structural—have played key roles, although their importance has differed across countries. It emphasizes these findings:

- ***Reduced interest payments (reflecting low interest rates) and reduced corporate tax payments are the primary reasons that corporate profits have been strong.*** Abnormally high operating profits have not been the driving factor behind the rise in net corporate profits. And, in Japan and the United States, where operating profits have accelerated sharply in recent years, the increase appears roughly in line with previous cyclical episodes.
- ***Subdued capital spending at least partly reflects lower relative prices of capital goods.*** Technological change has reduced the relative prices of capital goods and lowered the nominal spending needed to achieve a given volume of capital goods.
- ***Companies have been reallocating resources from domestic capital accumulation to the purchase of assets abroad.*** Rather than invest in physical capital at home, companies have been pursuing expansion strategies that involve acquiring existing or new physical assets abroad.
- ***Companies have been choosing to hold more cash.*** Why? There appear to be a number of considerations behind the preference for larger holdings of liquid assets, including companies' perceptions that they now face a more uncertain operating environment; the increasing role of intangible assets, such as patents and goodwill (which require more internal financing); and, possibly, some uncertainties associated with how currently unfunded pension liabilities will be met.

**Why so thrifty?**

In recent years, various uncertainties seem to have spurred corporations in major industrial countries to save rather than invest.




Data: IMF, *World Economic Outlook,* April 2006.

## Don't count on it

Whatever the rationale for the excess corporate saving in recent years, the *WEO* finds little reason to expect record-high levels to be sustained for long. The turnaround may come soon, especially if the slack in advanced economies continues to narrow—thereby encouraging more investment spending—or if some factors driving recent net profits begin to wane.

The watchword for the future is caution. Policymakers will do well to avoid relying on high corporate saving to keep longer-term interest rates low. Without some increase in household and government saving in the coming years, changes in corporate behavior are likely to put upward pressure on interest rates. ■

*Roberto Cardarelli*
*IMF Research Department*

## HIPC debt relief (status as of March 30, 2006)

| IMF member | Decision point | Completion point | Amount committed | Amount disbursed[1] |
|---|---|---|---|---|
| | | | (million SDRs) | |
| **Heavily Indebted Poor Countries (HIPC) initiative** | | | | |
| **Under original 1996 Initiative** | | | | |
| Bolivia | September 1997 | September 1998 | 21.2 | 21.2 |
| Burkina Faso | September 1997 | July 2000 | 16.3 | 16.3 |
| Côte d'Ivoire | March 1998 | — | 16.7[2] | — |
| Guyana | December 1997 | May 1999 | 25.6 | 25.6 |
| Mali | September 1998 | September 2000 | 10.8 | 10.8 |
| Mozambique | April 1998 | June 1999 | 93.2 | 93.2 |
| Uganda | April 1997 | April 1998 | 51.5 | 51.5 |
| **Total original HIPC** | | | **235.3** | **218.6** |
| **Under the 1999 enhanced HIPC Initiative** | | | | |
| Benin | July 2000 | March 2003 | 18.4 | 20.1 |
| Bolivia | February 2000 | June 2001 | 41.1 | 44.2 |
| Burkina Faso | July 2000 | April 2002 | 27.7 | 29.7 |
| Burundi | August 2005 | Floating | 19.3 | 0.1 |
| Cameroon | October 2000 | Floating | 28.5 | 11.3 |
| Chad | May 2001 | Floating | 14.3 | 8.6 |
| Congo, Democratic Republic of the | July 2003 | Floating | 228.3[3] | 3.4 |
| Congo, Republic of the | March 2006 | Floating | 5.6 | — |
| Ethiopia | November 2001 | April 2004 | 45.1 | 46.7 |
| Gambia, The | December 2000 | Floating | 1.8 | 0.1 |
| Ghana | February 2002 | July 2004 | 90.1 | 94.3 |
| Guinea | December 2000 | Floating | 24.2 | 5.2 |
| Guinea-Bissau | December 2000 | Floating | 9.2 | 0.5 |
| Guyana | November 2000 | December 2003 | 31.1 | 34.0 |
| Honduras | June 2000 | April 2005 | 22.7 | 26.4 |
| Madagascar | December 2000 | October 2004 | 14.7 | 16.4 |
| Malawi | December 2000 | Floating | 23.1 | 11.6 |
| Mali | September 2000 | March 2003 | 34.7 | 38.5 |
| Mauritania | February 2000 | June 2002 | 34.8 | 38.4 |
| Mozambique | April 2000 | September 2001 | 13.7 | 14.8 |
| Nicaragua | December 2000 | January 2004 | 63.5 | 71.2 |
| Niger | December 2000 | April 2004 | 31.2 | 34.0 |
| Rwanda | December 2000 | April 2005 | 46.8 | 50.6 |
| São Tomé and Príncipe | December 2000 | Floating | —[4] | — |
| Senegal | June 2000 | April 2004 | 33.8 | 38.4 |
| Sierra Leone | March 2002 | Floating | 98.5 | 66.0 |
| Tanzania | April 2000 | November 2001 | 89.0 | 96.4 |
| Uganda | February 2000 | May 2000 | 68.1 | 70.2 |
| Zambia | December 2000 | April 2005 | 468.8 | 508.3 |
| **Total enhanced HIPC** | | | **1,628.1** | **1,379.1** |
| **Combined total** | | | **1,863.4** | **1,597.7** |

**Definitions**

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

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

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

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

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

[4]At the time of its decision point, São Tomé and Príncipe did not have any eligible debt to the IMF.

Data: IMF Finance Department.

# Is profitable investment in Africa possible?

Over the years, African policymakers have become knowledgeable about the reforms needed to promote investment, but they continue to have difficulty implementing them. A high-level seminar, organized by the IMF Institute under the auspices of the Joint Africa Institute in Tunis, Tunisia, and held on February 28–March 1, looked at how some of the main obstacles to investment—infrastructure, tax systems, access to finance, and governance—were hindering the implementation of reforms.

***Infrastructure and governance.*** Although poor governance might be one of the first obstacles to investment that comes to mind, private sector participants pointed to inadequate infrastructure, especially in the transport and energy sectors, as a major bottleneck. Indeed, when machines cannot be powered and products cannot get to market, pro-business reforms are unlikely to succeed. Without underestimating the importance of good governance, participants said there is substantial scope to promote investment and growth by further developing and improving access to infrastructure in Africa.

Ali Daibe

From left: Berlin Msiska (Zambia Revenue Authority), Victor Afonso Gonçalves Fidalgo (Cape Verde's Rotunda da Cruz do Papa), and Maggie Kigozi (Uganda Investment Authority).

It has become increasingly popular to fund infrastructure development through private financing initiatives or public-private partnerships, but such arrangements seem underused in Africa. Most participants agreed that strong leadership and political commitment, an appropriate regulatory framework, and good governance were required to make these arrangements work. There would also need to be genuine risk transfers from the public to the private sector and limited government guarantees.

***Tax systems.*** In principle, if private finance cannot be found, governments must raise additional tax revenues. Yet evidence indicates that cumbersome tax systems sometimes coupled with corrupt and coercive tax administrations are among the greatest obstacles to investment and deter entrepreneurship and the establishment of formal businesses.

Participants suggested that simplifying tax systems, reorganizing tax administrations along functional lines, and establishing responsive taxpayer services would provide opportunities to promote voluntary compliance and widen tax bases. One of the main challenges, however, will be to design tax systems that can support long-term development objectives. Current practices are almost exclusively geared to short-term revenue collection.

***Access to finance.*** If long-term growth hinges on private sector development, then access to finance for businesses in urban and rural areas is crucial. This entails further progress on microfinance, introduction of flexible financial instruments, and promotion of equity finance and venture capitalism.

Microfinance initiatives are spreading, but some uncertainty remains about their ultimate contribution to investment and economic growth. Moreover, most countries are still behind in developing small-scale and dynamic financial markets and a culture of entrepreneurship. Participants observed a mismatch between the abundance of liquidity in financial markets and the inability to channel such resources to foster productive investments and entrepreneurship in Africa.

***African potential.*** Measured by productivity levels on factory floors, many African countries have the potential to compete globally and, in fact, are succeeding in certain niches. However, the obstacles discussed at the seminar seem to be depressing investment returns and hindering more systematic progress. The participants concluded that the implementation of reforms leading to economic growth in Africa would require effective partnerships between the public and private sectors, as well as innovative approaches to overcome the infrastructure, tax, and finance obstacles. ■

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