

\$1.5 billion

IMF approves drawing under Stand-By Arrangement for Turkey, commends ambitious economic program

The IMF Executive Board announced on August 3 that it had completed the ninth review of Turkey's economic program supported by the three-year Stand-By Arrangement. The Board's decision will enable Turkey to draw SDR 1.2 billion (about \$1.5 billion) immediately from the IMF. The text of News Brief No. 01/73, as well as a statement issued on July 28 by IMF First Deputy Managing Director Stanley Fischer (see page 262) is available on the IMF's website (www.imf.org).

The Stand-by Arrangement for Turkey was approved in December 1999 for SDR 2.9 billion (about \$4 billion). In December 2000, SDR 5.8 billion (about \$7 billion) in additional financial resources was made available under the Supplemental Reserve Facility. On May 15, 2001, the IMF approved the increase of the Stand-By credit by SDR 6.4 billion (about \$8 billion),

bringing the total available resources from the IMF to SDR 15 billion (about \$19 billion; see Press Release No. 01/23). So far, Turkey has drawn a total of SDR 8.1 billion (about \$10 billion) from the IMF.

Commenting on the Board's discussion, Acting Chairman Stanley Fischer said: "Executive Directors commended the Turkish authorities on the strong implementation of their ambitious economic reform program. Major progress has already been achieved in restructuring the banking sector, improving budget transparency, and preparing the privatization of state-owned enterprises. Together with a strong macroeconomic framework, these measures are creating the basis for a lasting reduction in inflation and a dynamic economy generating sustainable growth."

(Please turn to the following page)

Seminar on conditionality

Speakers argue that ownership, not the number of conditions, is key to success of an IMF program

As part of its conditionality review, the IMF has organized a series of discussions on its proposals, holding seminars in Berlin in June (see *IMF Survey*, July 2, page 218) and in Tokyo in July (see *IMF Survey*, July 30, page 249). A third forum—cosponsored by the Commonwealth Secretariat, the World Bank, and the IMF and held in London on July 23–24—covered issues related to conditionality and ownership particularly relevant to low-income countries. The seminar was co-chaired by Winston Cox, Commonwealth Deputy Secretary-General; Masood Ahmed, Deputy Director of the IMF's Policy Development and Review Department; and Joanne Salop, Vice-President for the World Bank's Operations Policy and Country Services. It brought together representatives of borrowing and creditor countries, international organizations, non-governmental organizations (NGOs), and a number of other individuals with relevant expertise and experience.



Participants at the seminar on IMF conditionality in London.

Proposals for increasing ownership

Participants welcomed the review and the participatory process involved. They agreed that changes were clearly needed and that streamlining was a first, positive step. Some speakers argued that the proliferation of conditions, rather than solving any problems, had in many cases made it more difficult for countries to implement programs. Gus O'Donnell, a former U.K. Executive Director of the IMF and the

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IMF approves \$1.5 billion for Turkey

(Continued from front page) “There are encouraging signs that the economic downturn is bottoming out and that the targeted lowering of inflation is materializing, which could permit declines in interest rates. Directors noted the importance of declining interest rates for supporting the economic recovery and helping ensure that the treasury’s rollover requirements in the months ahead are met. The government’s recent efforts to demonstrate full and united support for the program, and greater consistency in its communications, are welcome steps toward restoring confidence. The IMF looks forward to further efforts in the months ahead to communicate more effectively to investors and other observers the program’s basic strategy—namely, to achieve government debt sustainability through major budget adjustment, strong supply-oriented policies, and exceptionally large financial support from the IMF and other lenders.

“Ensuring public debt sustainability makes the preservation of a significant primary budget surplus indispensable. The authorities’ determination to persevere with fiscal adjustment, notwithstanding the larger-than-expected economic downturn, is therefore

welcome. The measures to enhance the demand for government paper introduced on July 26 should help secure the government funding needed in the period immediately ahead and are a useful complement to the more fundamental economic reforms implemented under the program.

“The authorities have decided to adopt inflation targeting in the fourth quarter, which will strengthen and lend much-needed clarity to the monetary framework. In addition, the preannouncement of foreign exchange auctions should help ease market uncertainty.

“The authorities have also made considerable progress in their ambitious structural reform agenda, especially in restructuring the banking system. Although recognizing the risks that remain, Directors noted the many achievements of the reform program, as well as the authorities’ increased commitment to program policies. Directors encouraged the authorities to build on this commitment through strict implementation of the program and, by completing the review, offered their strong support to the pursuit of this ambitious goal,” Fischer said. ■

Fischer discusses goals of Turkish program, outlines challenges

Following a meeting with the Turkish authorities in Istanbul on July 28, Stanley Fischer issued a statement announcing the successful completion of negotiations for the review and commenting on the Turkish program and the country’s prospects. Slightly edited excerpts follow. The full text is available on the IMF’s website (www.imf.org) as News Brief No. 01/66.

Economic program

The goals of Turkey’s economic program are to bring about sustainable economic growth and increased living standards for the Turkish people. To achieve these goals, the program seeks a lasting reduction in inflation; to ensure the sustainability of the government’s fiscal position; and to undertake an ambitious set of structural reforms. More generally, the program seeks to modernize the economy, reduce political influence over it, and prepare it to meet the challenges for entry into Europe. Attainment of these goals is critical to the future of Turkey.

Turkey has already made impressive progress in implementing this very ambitious program: it has undertaken important banking sector and other structural reforms, continued strong fiscal adjustment

despite difficult economic circumstances, carried out an extensive legislative agenda, and undertaken a successful voluntary domestic debt swap.

All of Turkey shares the credit for what has been achieved—the government for implementing the program, parliament for completing an exceptionally heavy legislative agenda in its spring session, and especially the Turkish people for supporting the economic program despite the currently difficult economic situation.

These achievements explain why the international community—in large measure through the IMF and the World Bank—has provided an extraordinary amount of financial support to Turkey over the past year and a half.

My visit to Turkey this week has given me fresh assurance that this level of international support will continue to be justified. I say this for two reasons—the strong political support this program enjoys and the strength of the program itself.

I was privileged to meet yesterday in Ankara with Prime Minister [Bulent] Ecevit and Deputy Prime Ministers [Devlet] Bahçeli and [Mesut] Yilmaz. What struck me in talking separately to these political leaders was their unanimous support for Turkey’s economic program. Their views were aptly summarized by one of the leaders, when he told me that the pro-



IMF First Deputy Managing Director Stanley Fischer at a press conference in Istanbul on July 28.

gram would be necessary even if the IMF were not there to support it. Although a great deal has been said by critics about a lack of political cohesion in Turkey, the fact is that the Turkish government and parliament have essentially delivered on their commitments under the program—and they have not been given sufficient credit for this.

Having mentioned the strength of the program, let me say a few words about what has been achieved during this—the ninth—review.

We have agreed on some adjustments in the overall macroeconomic targets to take account of economic developments so far this year.

- Real GNP is now projected to fall by 5½ percent this year, although we believe growth will resume before the end of the year and we continue to expect 5 percent growth next year.

- Higher-than-expected inflation so far this year means that the full-year increase in the price level will be on the order of 58 percent. However, the authorities continue to aim to have the monthly rate down to 2 percent by the end of the year, and the recent decline in inflation is encouraging.

(Both these changes—the lower growth rate and the higher inflation rate—essentially reflect what has already happened, and we are not adjusting either the growth assumption or the inflation targets for the remainder of the year.)

- The external current account is expected to show a surplus of some \$5 billion this year, helped by strong exports, which are themselves influenced by the depreciation of the lira, and the decline in domestic demand.

Challenges

Turkey has a viable economic strategy, but its success depends on restoring confidence and reducing interest rates. And these in turn call for perseverance in policy implementation, with full and united political support. The program is designed, through its major budget adjustment and exceptionally large financial support from the IMF and other lenders, to ensure that the government debt situation remains manageable. We discussed with the treasury yesterday the outlook on its debt rollovers, and it is clear that the measures announced earlier this week by the government will significantly reduce the required rollovers and help ensure a sustainable debt situation. In addition, the treasury plans to continue adapting its financing instruments to market conditions.

Further, there are definite signs of success in reducing inflation. If, as many expect, inflation in July is low, then interest rates could begin to come down—as would be appropriate given the central bank's inflation targeting approach. Already the central bank is operating on an informal inflation targeting basis in making its interest rate decisions, and it plans to move

Accelerated disbursement for Argentina

In a news brief dated August 3, IMF Managing Director Horst Köhler announced that IMF management intends to recommend to the Executive Board an accelerated disbursement to Argentina under its Stand-By Arrangement as soon as the current review of the program is complete.

Announcing management's intention, Köhler said: "An IMF mission currently in Buenos Aires expects to conclude negotiations with the Argentine authorities on this review shortly. Upon conclusion of these talks, management intends to recommend to the Executive Board a disbursement, accelerated into August, of approximately \$1.2 billion to Argentina. This would bring Argentina's total borrowings so far under the Stand-By Arrangement to approximately \$7.3 billion, out of a total of approximately \$13.4 billion, or close to 500 percent of quota, available under the program.

"Argentina has demonstrated a strong commitment to the convertibility regime and to decisive implementation of the package of measures designed to achieve a zero fiscal deficit that will help greatly to stabilize the macroeconomic situation and strengthen confidence. In view of these resolute efforts, the IMF stands ready to support Argentina," Köhler said.

The text of News Brief No. 01/71 is available on the IMF's website (www.imf.org).

IMF management to recommend \$15 billion Stand-By for Brazil

In a news brief dated August 3, IMF Managing Director Horst Köhler announced that IMF management intends to recommend to the Executive Board the approval of a new Stand-By Arrangement for Brazil for the period through December 2002. Management will recommend that approximately \$15 billion, or 400 percent of quota, be made available to Brazil under this new arrangement. Of this total, about \$12.5 billion would be provided under the Supplemental Reserve Facility. The authorities have indicated that they intend to treat the arrangement as precautionary.

The Executive Board is expected to consider Brazil's request for this support in September 2001, and the first tranche [drawing] of about \$4.6 billion would be available upon approval of the new program by the Board.

The Brazilian authorities will announce in Brasilia next week the policy measures associated with the new program.

Announcing management's decision, Köhler said: "The Brazilian authorities are strengthening fiscal and monetary policies and implementing their structural reform agenda in the face of a difficult external environment. In light of Brazil's strong track record, and the strengthened measures it plans to implement under the program, I am prepared to recommend this new program to the IMF's Executive Board."

The text of News Brief 01/72 is available on the IMF's website (www.imf.org).

as rapidly as possible to put in place the institutional arrangements that would enable it to undertake a formal inflation targeting approach.

A flexible exchange rate is also essential in the current conditions of the economy. Fortunately or unfortunately, there is no feasible alternative to the current float of the lira—and this is well understood and accepted by the authorities. Turkey is still in a period of transition following the abandonment of the peg in February, and uncertainties about the operation of the market are naturally larger than they will be when the market settles down and develops its own hedging and other instruments that allow economic agents to deal with inevitable exchange rate fluctuations. In these circumstances, intervention can be used, sparingly, from time to time, to deal with major market instabilities, but not to target a particular rate. The adoption of formal direct inflation targeting, which will give monetary policy a well-defined nominal anchor, should also help promote financial market and exchange rate stability.

I would like to make one more point about exchange rate management. There may be some confusion about the difference between the regular foreign exchange auctions and smoothing interventions by the central bank. Under its economic program, the Turkish treasury is in effect borrowing foreign exchange from the central bank to finance part of the budget. For the treasury to obtain the Turkish lira that it needs, this foreign exchange needs to be sold in the market. It is these sales that are being conducted by regular preannounced auctions. In addition, but separately, the central bank may from time to time inter-

vene in the foreign exchange market to stabilize major fluctuations. But the auctions are in effect part of the treasury's financing program and are not intended as foreign exchange market interventions.

The period ahead is to be devoted largely to the implementation of measures already agreed and for which legislation has either already been passed or is in the pipeline. Looking forward, a number of further steps are planned that will help buttress the success of the program. The new banking supervision agency has emerged as a driving force behind the long-awaited restructuring of Turkey's banking system and will continue its efforts. In regard to other structural reforms, the authorities' attention will now turn to the implementation of reforms, following the major legislative progress since the adoption of the new program. It will be especially important to achieve tangible progress toward privatizing large state enterprises, including Türk Telekom, and to define concrete actions to further improve the business climate and enhance transparency in public sector resource management. On the macroeconomic side, the government's budget policy will remain geared toward achieving debt sustainability, and monetary policy will move as rapidly as possible toward inflation targeting.

Finally, Turkey's economic strategy needs to be communicated more effectively to investors and other observers. Continued efforts to improve the social dialogue and protect the most vulnerable segments of society will also help bolster support for the program. In all these areas, my discussions with the political leadership in Ankara yesterday and with private sector representatives in Istanbul today have been very encouraging. ■

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IMF conditionality review stresses ownership

(Continued from front page) World Bank and now at the U.K. Treasury, said that a long list of conditions also made it impossible to measure the success of a program at the time of its reviews.

Success does not depend on the number of conditions, several speakers noted, but on country ownership, meaning a willingness by countries—civil society as well as governments—to accept responsibility for their policy programs. Indeed, much of the discussion was devoted to this idea. To achieve ownership, country authorities need to have substantial input into the conditions attached to the program. Streamlining and focusing the conditions will not improve ownership if there is a widespread feeling in a country that reforms are externally dictated, argued Tony Killick, a consultant for the U.K. Department for International Development. Wesley Hughes, of the Planning Institute of Jamaica, said that it was only when his country took full responsibility for its own program, designed by the authorities, that people “bought into it, and if they believe in it, they will follow the program.”

Participants offered three concrete proposals for improving national ownership. First, the World Bank and the IMF should be more transparent and accountable in the way they design and implement conditionality. Notably, the institutions should consult thoroughly and systematically with country authorities, and preferably with other stakeholders, to determine the country’s preferences and priorities before attempting to specify conditions. If, as a result of the review, the IMF would simply pass structural conditionality to the Bank, the net effect would not be clear to countries, Killick noted.

Second, the institutions should always ensure that country authorities have a range of options from which to choose.

Both of these proposals were reflected in the poverty reduction strategy paper (PRSP) process, which participants warmly welcomed, but it was argued that they could be implemented more widely. Letters of intent, like PRSPs, should be drafted by the countries rather than by IMF staff. Makhtar Sop Diop, former Minister of Finance of Senegal, argued that letters of intent should be written by the country, even if the wording does not reflect the language usually used by the IMF’s Executive Board. Unfortunately, one speaker observed, the insistence that country papers be called PRSPs, rather than a name that better suits the country’s own needs, is a subtle indicator of the tendency of the IMF and the Bank to retain control of the process.

Third, the institutions should devote more resources to capacity building in developing countries. Former Central Bank of Kenya Governor Micah Cheserem observed that education is expensive, but ignorance is far more expensive, and many low-

income countries need to devote more resources to developing human capital if they are to be able to design their own programs effectively. Cheserem argued that technical assistance is inadequate for this purpose, and several speakers urged the institutions to devote more resources to capacity building.

IMF conditionality

Communication is also important, Cheserem added. The IMF should do a better job of explaining what it does in program countries and should invest more money in increasing its presence on the ground. This comment was echoed by Gray Mgonja, Deputy Permanent Secretary of Tanzania, who spoke about the need to involve “domestic stakeholders.”

During the seminar, it was also suggested that the IMF would do a better job of defining conditionality if it differentiated more clearly and systematically among the programs it supported. David Vines of Oxford University suggested a three-category definition: (1) programs aimed at short-term balance of payments support (requiring primarily macro conditionality), (2) programs designed to resolve financial crises (also requiring financial sector and other quick-acting structural reforms), and (3) programs designed to support longer-term development strategies (possibly requiring a more extensive but also more gradual approach to structural reform).

Participants suggested that each category had different implications for conditionality and ownership. Through such differentiation, they noted, the need for structural conditionality could be better defined and countries could have more control over their longer-term policy decisions in noncrisis situations. It was thought that even the coordination and division of labor between the World Bank and the IMF would benefit from the distinction.

Roles of IMF and World Bank

Regarding the relationship between the IMF and the World Bank, many participants thought that collaboration should be made more systematic, and one even suggested that the two institutions should be merged. During the discussions, a strong message also emerged about collaboration among donor countries. Mgonja said that the capacity of the borrowing countries was often overstretched by their having to negotiate with the IMF, the World Bank, a regional development bank, the European Union, and other creditors and



Don McKinnon, Commonwealth Secretary-General (center) welcomes participants. Co-Chairs Winston Cox (left) and Joanne Salop (right) look on.

donors. It would really help borrowing countries if the donor community had a coordinated strategy for conditionality, he said.

The IMF also needs to take into account the political constraints countries face at different stages of their pro-



Winston Cox (left), Joanne Salop (center), and Masood Ahmed (right) at the seminar.

grams. Indrajit Coomarasawamy, Acting Director of the Economic Affairs Division of the Commonwealth Secretariat, said that programs should factor in electoral cycles, and many speakers agreed that sustained commitment to reform is very unlikely in a weak political environment: paying more attention to budget and election cycles would improve ownership

and strengthen implementation. This requires that the IMF know the countries better; the institution came in for some criticism for limiting staff in the field to one resident representative and for not sending staff missions outside capital cities, which hinders acquiring sufficient knowledge of the countries it works with. Hussain argued that, in the IMF, those with the most knowledge of local conditions (resident representatives and area department staff) had the least power in the programs' decision-making process.

Over the one and a half days of discussions, there was general agreement on the need to streamline and focus conditionality, but participants argued that more than this needs to be done. Reducing the number of conditions would not be enough: it is also important to reduce

the amount of detail in conditionality. As Masood Ahmed of the IMF's Policy Development and Review Department noted, what is important is to distinguish clearly between measures that are critical for the success of a program and measures that are useful for the country but not critical for the program's success. Participants agreed, adding that the IMF needs to avoid trying to micromanage the economies of borrowing countries.

Several speakers called on the IMF to return to its core activities. They said that there was too much overlap in coverage of structural issues by the World Bank and the IMF, resulting partly from a gradual expansion of the IMF's mandate into growth and poverty reduction issues. One participant asserted that the "G" in PRGF (Poverty Reduction and Growth Facility) is not in the IMF's mandate, while another hoped that the only conditionality in poverty reduction programs would be that laid out in the countries' PRSPs. In the view of many speakers, the Bank is much better equipped to deal with poverty and structural issues, and the burden of proof for inclusion of structural conditions in IMF-supported programs lies with the IMF. However, many admitted that, even in low-income countries, market perception is important and that conditionality increases credibility in the reforms implemented by a country's authorities. In that view, the IMF should not back away from its insistence on such structural reforms as improving governance and strengthening financial systems. ■

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Available on the web (www.imf.org)

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- 01/76: IMF Publishes Quarterly Emerging Market Financing Report, August 8

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"The Economic Transition in Armenia," given by John Odling-Smee, Director, IMF European II Department, at the American University of Armenia, Yerevan, July 31

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IMF Financial Activities, August 3

Emerging Market Financing: Quarterly Report, IMF Research Department, August 9

*Date posted

Interview with Sala-i-Martin

Openness, market-friendly institutions, and flexibility are important ingredients for growth

During July 23–27, the IMF Institute offered a course on economic growth as part of its in-house training program. Xavier Sala-i-Martin, Professor of Economics at Columbia University, came to the IMF for the seventh time to discuss growth from a theoretical and empirical perspective. As on previous occasions, there was a large demand for this very popular course. Sala-i-Martin spoke with the Alicia Jiménez of the IMF Institute about the main factors that need to be present in order to stimulate growth.

JIMÉNEZ: If one had to choose the three most important determinants of growth, what would they be?

SALA-I-MARTIN: First, factor accumulation—physical and human capital—education, and so on. Second, various institutions that are friendly to markets. Third, openness not only to trade, but also to capital, to technology, to ideas, to foreign direct investment, and to information.

JIMÉNEZ: From a historical perspective, does the empirical evidence show that those three factors were present in most countries that have experienced sustainable growth?

SALA-I-MARTIN: My previous statement comes from empirical observation. But growth experiences are diverse; no single recipe works for every country. Some countries have done well. Other countries in the same circumstances have not done well. But by and large, the three characteristics that I have mentioned—and there are actually more—seem to be present when a country's growth effort is successful, and to not be present when it fails.

JIMÉNEZ: What does the empirical evidence say about the links between health, education, and investment in human capital and growth?

SALA-I-MARTIN: The links between health and growth are pretty clear. Good health is good for growth. Countries with a high life expectancy tend to do a lot better with growth. It's clear that at some level education matters, but the link is not as clear as one would like. In fact, a puzzling finding in the literature is that a lot of education measures—college enrollment, for example—do not seem to correlate well with growth. One possibility is that, in many countries, a college education may not really benefit or enhance human capital. You might go to college and learn a lot of the theoretical things that are not useful for production. My favorite explanation is that what you need to learn is not things, but how to *learn* things. In a world in

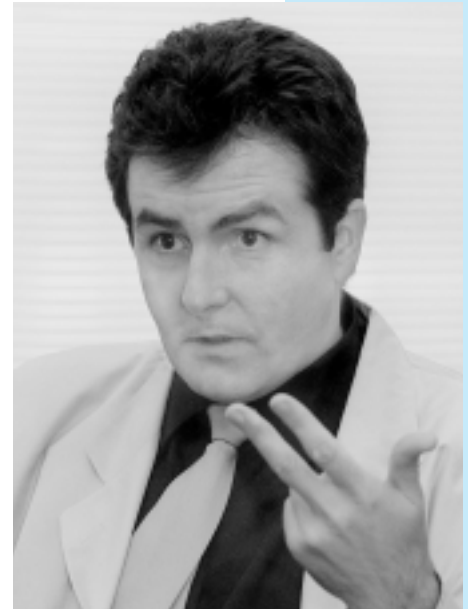
which technologies change very rapidly, the labor force needs to be educated flexibly. You learn how to produce watches today, but in the next year or two, you're going to be producing CDs; and in another five years, you'll be producing something else. So, if you are trained to produce watches, and the economy produces watches, you are fine. But the minute the economy goes on to produce CDs, then you have an inflexible labor force that has not learned to learn, and this can put the brakes on growth. And this is not measured by years of education.

JIMÉNEZ: Can we say that all growth is the same, or are there high-quality growth paths?

SALA-I-MARTIN: There are different kinds of growth, some good, some bad. I think the best growth is the one that is sustainable in that it can keep going for a long time. For example, certain kinds of growth that are driven by heavy demand factors tend to die if there is too much of an increase in aggregate demand without a corresponding increase in aggregate supply. Then you end up with high inflation. So this kind of growth is not sustainable. Sustainable growth drives supply and demand simultaneously.

JIMÉNEZ: In many countries, in particular in Latin America, a question people ask is: Now that we have attained higher macroeconomic stability and fiscal conditions have improved, what is the next step? How do we get rid of slow growth, poverty, and unemployment?

SALA-I-MARTIN: Well-functioning macroeconomics is important, but it's not the only thing. You need well-functioning microeconomics too. And that means well-functioning labor markets that are flexible, not only from a legal point of view, but more in terms of the flexibility of the mind. You should not go into the job market at age 16, get a job in a bank and think that you are going to retire from the bank. In a changing and technology-driven world, you have to be ready to move not only across regions and maybe countries, but also across sectors. People are not born bankers or



Sala-i-Martin: "In a world in which technologies change very rapidly, the labor force needs to be educated flexibly."

“We should be very pleased about the present, because now, instead of talking about countries, we talk about people.”

—Sala-i-Martin

producers of radios; they are born people, and they should be ready to work in many different places throughout their lives.

Another component you need is well-functioning institutions. The main failure in many countries does not come from macroeconomic policy or from markets not working well, but from the lack of institutions that are important for growth—for example, property rights. If, in a certain country, there’s a strong probability that somebody is going to steal an investment or there’s going to be a war, or there’s a lot of crime and an ineffective police force, nobody is going to invest in this country even if it has implemented good policies.

Finally, you need to be connected to the world. Closed economies don’t work well. I’m not talking just about trade; an open economy means free movement of goods, capital, ideas or technologies, information, and people.

Having said this, I would say that the optimal institutions and policies are different for different countries. If you try to implement Norwegian institutions in Zimbabwe, or east Asian institutions in Lesotho, you’re going to fail. Each country—or maybe each region—has its optimal way of working.

JIMÉNEZ: So, if a region or a country is trying to find its optimal path for growth, how would the process work—through consultation among people, from the bottom up?

SALA-I-MARTIN: Exactly. That is better than having intelligent people in Washington listen to the experts, because the experts tend to look at what has succeeded. Look at Singapore, Hong Kong SAR, or Taiwan Province of China; they have grown a lot, they are big success stories. So let’s introduce these same things in Zambia. Well, that’s not going to work because Zambia’s people, history, institutions, weather, and geography are different. Zambia is not going to be able to do exactly what Singapore did. People around the region in Singapore can copy each other because they are similar culturally, historically, geographically. If you look at development worldwide, the success stories and the disaster stories tend to come in regions. I think this means that you should learn from your neighbors, not from people who are far away. I am not saying that the people inside the continent or the region know exactly what they should be doing. But at least, we should be listening to them. Those of us from the rich countries don’t know these things. We can offer advice and our expertise, but the main policies have to come from them.

JIMÉNEZ: On the relationship between the political system and growth: Many people say that for sustainable long-term growth, the best political system is a democratic one. What is your view?

SALA-I-MARTIN: I would first question the premise that democracy is a prerequisite for growth, because some of the biggest success stories have not been in countries that are very democratic. I think that, to succeed, you need to involve the very poor people in the economy. One way to make sure that people are not left behind is to institute a good democratic system that makes people feel that they belong in the process. But a lot of dictators are able to do that, too. For example, at least until 1997, Indonesia during the Suharto years did quite well, and the poor did especially well; the cronies did very well, too, of course, much better than everybody else. But the government eradicated poverty in numbers that we had not seen before. The same is happening in China. Millions of people are leaving poverty. Neither country has a democratic system. The key is not to leave the masses behind; then you can succeed.

JIMÉNEZ: What can the IMF do to help in this process of growth? Aside from promoting macroeconomic stability, what role do we have in growth and poverty reduction?

SALA-I-MARTIN: These are two different questions. Does the IMF have a role in poverty reduction? And should the IMF do it? I am not sure the answer is yes. For a number of reasons, everybody should do their job and only their job. If you try to do somebody else’s job, you don’t do as well. The IMF’s main goal is not to eradicate poverty or to educate little girls in poor countries. There are other institutions that should be dealing with these issues. Since the IMF is not the expert on these issues, when it fails, say, in trying to eradicate poverty, then everybody says the IMF is useless. But it’s not useless; it’s simply not the IMF’s job. The IMF may be doing a perfect job with the work it should be doing, but if it fails at something it shouldn’t be doing anyway, then the reputation of the whole institution suffers. That’s one part of the answer.

But suppose we say the IMF should be attempting to promote growth. As I’ve already said, there is no single recipe for growth. And even if there were, it would be impossibly complicated. So it would be foolish for a single institution to try to promote growth everywhere in the world. How would you do it? Conditionality? We’ll give you money if you do these 75 things. But we don’t know whether these 75 things are good for every country. So you’re going to make mistakes. If you try to introduce European institutions in Latin America, it’s going to be a disaster. So I think the IMF can help the process by doing what it should be doing: promoting macroeconomic stability. I know it’s only one of the four legs involved in the growth process. Other people should be responsible for the other three legs.

JIMÉNEZ: The IMF and the World Bank have been looking at poverty and growth. In your view, should it be up to each country or region to decide what is the optimum way to grow and then call in the IMF for help?

SALA-I-MARTIN: The IMF should help but should listen more. Maybe the way to do it is to set up objectives common to both of you and that they like, rather than the means to achieve objectives. Suppose you try to quit smoking. It's obvious to everybody who has tried to quit smoking that unless you want to you're not going to. Suppose somebody says, unless you quit smoking, I'm not going to give you any food. You're going to pretend you've quit, and then you're going to run to the bathroom for a smoke every time you can. Many times when the IMF tries to impose too many conditions—even if they are good for the country or the country agrees that this is exactly what it should be doing—countries say the IMF or the World Bank told us to do it, so now we don't want to. The idea must be theirs. They say, how do we start growing? They think they've come up with answers, so you tell them, "Here is the money to do what you want but within certain rules; we'll help you do what you think is right." I think this would be more successful than reading off 75 points from a recipe. And the people in the country have to be committed, because all of these things—all of these 75 points—will mean big sacrifices and lots of problems implementing these policies. Unless you are really committed, you are not going to make it, because the first time it hurts, you're going to stop.

JIMÉNEZ: What are poverty traps and why do countries fall into them?

SALA-I-MARTIN: Some countries appear to be stuck at a certain level of income and poverty and are unable to get out. In that sense, it's a trap. But I am not sure that people fall into traps. Remember, before 1750 and the industrial revolution, all the countries in the world were poor. Effectively, everybody was in the trap and slowly countries began leaving it—first England, then the United States and Europe, and then Japan and east Asia, and, most recently, India and China.

I think we should be optimistic about moving out of the poverty trap for two reasons. First, we've seen a lot of countries leaving and almost none going back. You read of many success stories; people call them miracles. But I don't agree because the word "miracle" implies that we don't know what happened. We can analyze developments in China and the east Asian economies, for example, and it is very clear what has happened.

If you apply this principle generally, you will reach the conclusion that in 300 years, everybody is going to

be rich, out of the trap. Every 40 years, we have 15 countries leaving and 1 coming back. Maybe we don't want to wait 300 years, but at the end of the day, that's what's going to happen.

We should be very pleased about the present, because now, instead of talking about countries, we talk about people.

In the last 20 years, we have seen that inequality in the world is falling rapidly.

This isn't immediately apparent if you look at variations among countries. People say: Oh, the poor are becoming poorer and the

rich are becoming richer. But this leaves out something very important that is happening in the middle of the distribution: The two largest countries in the world—China and India, one-third of the world's population—are growing tremendously and eradicating poverty at rates not seen in previous history. So if you think of population rather than countries, then inequality is falling.



JIMÉNEZ: Do you think that promoting growth and preserving the environment are incompatible? Can one grow and at the same time protect the environment for the benefit of future generations?

SALA-I-MARTIN: I don't think they are incompatible. As we get richer, we are more concerned about the environment. Poor people don't worry about whales; they have other worries that are much more important. In this sense, growing might be a solution. Once everybody is rich, everybody's going to be worried about the environment. There's going to be a moment when we can say, okay, we can reserve 5 percent of GDP to protect the environment. But you have to be rich before you can save.

Second, I think growth is going to help the environment because the solution will be technological. We burn carbon dioxide, which is presumably causing this global warming, because we don't have anything better to burn. If we had a way to transmit the sun's energy for free and use it to move our cars and our industry without emissions of carbon dioxide, we would use it. Eventually, we will develop the technology, but we need to be sufficiently rich to devote enough resources to research and development. New technologies are not going to come from poor countries. So stopping growth will not help solve the problem and, in fact, could make it worse. ■

Effects of current turmoil in emerging markets may be less widespread than in previous crises

A salient feature of emerging markets has been their susceptibility to sharp spikes in volatility and “contagion” across countries as well as markets during periods of crisis. By the broadest measure, contagion would imply a co-movement in asset prices in excess of what may be explained by macroeconomic fundamentals. Recent credit concerns relating to Argentina and Turkey and the associated rise in

discrimination. In the present situation, common external factors and lack of investor discrimination are the more likely key factors explaining spikes in observed correlations.

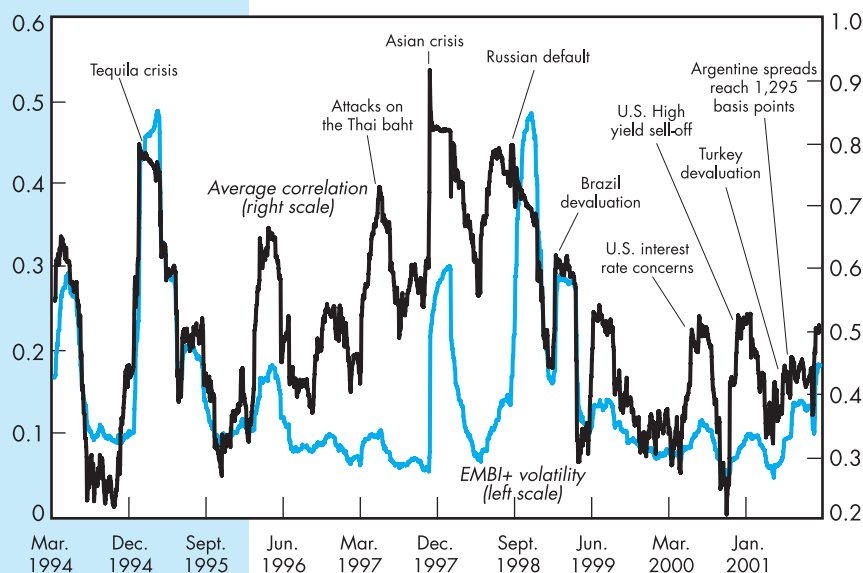
Emerging debt markets

It is evident that there were large spikes in the average cross-correlation associated with the major emerging market crises: the Tequila crisis in early 1995; the attacks on the Thai baht in early May 1997; the October 1997 Asian crisis; and the Russian default in August 1998 (see chart, page 270). The Turkish devaluation in February 2001 led to a modest rise in the average cross-correlation to 0.43. During the April Argentina sell-off, which saw sovereign spreads reach nearly 1,300 basis points, the average correlation was 0.45. Similarly, the most recent sell-off in Argentina during July, which saw sovereign spreads peak at over 1,600 basis points, resulted in an increase in average correlations, but to a relatively modest 0.47. In all three of the recent episodes of heightened credit concerns, therefore, the average cross-correlation across the emerging debt markets has been much lower than in past crisis episodes. The volatility of the benchmark EMBI+ [J.P. Morgan’s emerging market bond index plus], which has also spiked at times of crisis, has also remained remarkably subdued, not approaching anywhere near the levels seen during the Tequila, Russian, or Brazilian crises.

In terms of broad-based contagion and volatility, from a historical perspective, the most recent period of turbulence has still been one of relative stability in emerging debt markets. Several factors have played a role:

- There has not been a credit event or a “full-blown” crisis in a major emerging market.
- The heightened credit concerns have come at a time of much lower exuberance in global markets in general, and emerging markets in particular.
- The poor external environment, namely, the global slowdown, has long been anticipated, drawing capital up the credit spectrum and away from higher risk asset classes, including emerging markets.

Average cross-correlation and volatility of emerging debt markets



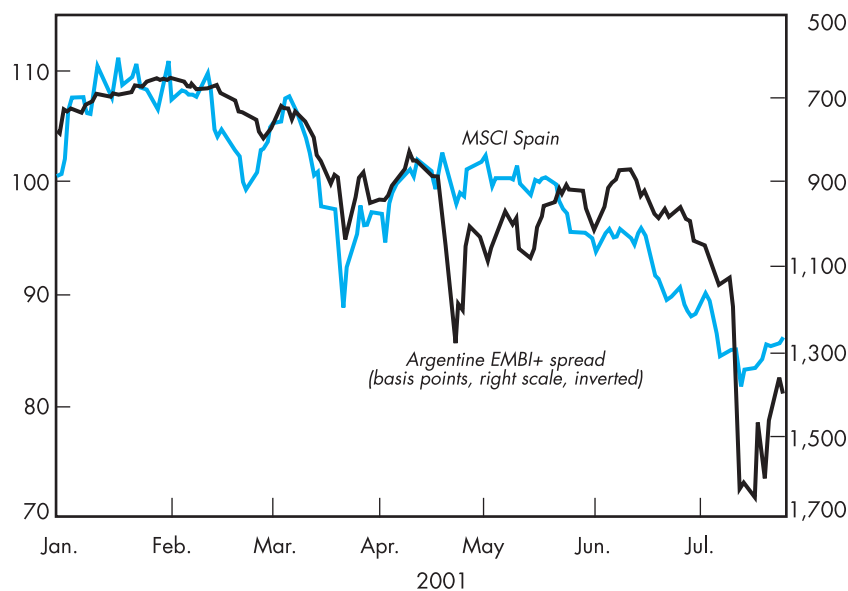
Note: EMBI+ = J.P. Morgan's emerging market bond index plus.

Data: IMF, *Emerging Market Financing*, 2001

market volatility have prompted comparisons of the extent of contagion compared with previous crisis episodes. While there clearly were specific instances of spillover of market volatility arising from particular country credit concerns to other countries, an assessment of how widespread it was needs a more precise measure. One such measure of contagion—the average cross-country correlation of returns—provides an indication of the extent of co-movement of individual country returns and indicates periods of broad-based selling or buying of emerging markets.

Contagion can, and indeed does, occur at high frequencies—for example, daily. It is not generally possible to get high-frequency observations on macroeconomic fundamentals on similar high frequencies. High values for the average cross-correlation are consistent with a number of factors: common country fundamentals; real and financial linkages across countries; common external shocks; and lack of investor

Argentine sovereign risk versus western European equity indices



Note: MSCI = Morgan Stanley Capital International equity index.
EMBI+ = J.P. Morgan's emerging market bond index plus.

Data: IMF, *Emerging Market Financing*, 2001.

- A decline in leverage in the investor base has reduced the need for across-the-board liquidations in response to margin calls.

- Argentine concerns have been building for some time, thereby allowing remaining crossover investors to focus on the top credits, becoming largely noninvested in the riskier credits, and leading dedicated investors to take underweight positions in the countries of concern.

- Dedicated investors have, since late last year, followed a strategy of overweighting Mexico and Russia at the expense of Argentina and Brazil.

- The importance of local investors for sovereign external debt has risen over time, making it an unlikely channel for spillovers across emerging markets.

- The fundamentals of some of the key emerging market countries have improved relative to previous crises, putting them in a better position to absorb, and not exacerbate, any contagion.

The basic pattern of average cross-correlations between individual country returns in emerging debt markets is also evident in emerging equity and currency markets, where average correlations are, however, lower.

Contagion in mature markets?

Have there been spillovers or contagion to the mature markets? The significant exposures of some mature market banks and corporates to certain emerging market countries (via direct investments in emerging market companies, portfolio investments, or lending) imply that credit-related developments in those

emerging markets will affect market valuations of these entities. For example, equity prices of the Spanish banks and corporates, which have the highest overall exposure to Argentina among the industrial countries, have been sensitive to any sudden widening of Argentine sovereign spreads. Since these entities have a significant weight in the Spanish equity market, the overall Spanish stock market index exhibits fairly high sensitivity to the Argentine EMBI+ spread as well (see chart, this page). Similarly, Portuguese banks, because of their exposures to Brazil, and given the high correlation between Brazilian and Argentine spreads,

have also shown significant co-movements with developments in Argentina.

Conclusion

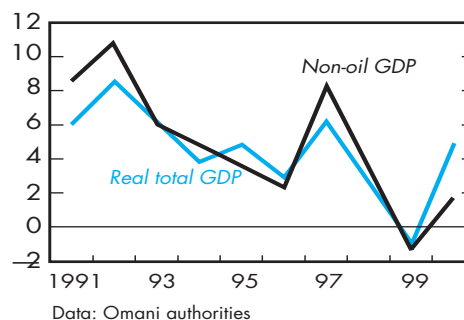
There are a number of differences between the present situation and that prevailing, for example, at the time of the Russian crisis: the current financial environment confronting emerging markets, changes in the investor base, and investor positioning. These differences both explain the limited broad-based contagion and volatility in emerging markets so far and suggest that the potential for future contagion is less than it was in the past. ■

Subir Lall

IMF International Capital Markets Department

Correction: In the article on Oman in the July 30 issue of the *IMF Survey*, Chart 2 (page 255) was mislabeled. The corrected version follows.

Chart 2. GDP growth in real terms
(percent)



Data: Omani authorities

UNDP report focuses on role of technology in advancing development and reducing poverty

The *Human Development Report 2001* was launched in Mexico on July 10. This year's report explores how new technologies can advance human development and, in effect, help make globalization work for all. Currently an urgent question in international policymaking circles, the links between technology, poverty reduction, and human development were also a prominent theme of the recent Genoa summit of the Group of Eight. Previous editions of the *Human Development Report*—the flagship publication of the United Nations Development Program (UNDP)—have scrutinized globalization, growth, poverty eradication, and human rights from the standpoint of human development.

Technology and growth

The report builds on the premises that development gains in the twentieth century were largely driven by technological breakthroughs, that technological progress accounts for much of the difference in growth rates among countries, and that it thus plays a pivotal role in sustained economic growth. But the report also reminds us that technologies taken for granted in rich countries, such as electricity, and access to basic medicines have yet to reach a third of the world's population. Meanwhile, information and communications technology (ICT) can help overcome social, economic, and geographical isolation; increase access to information and education; and enable poor people to participate in more of the decisions that affect their lives. In assessing the potential of such technology, the report notes new opportunities for poor people in terms of political empowerment (such as the global e-mail campaign that helped topple Philippine President Estrada in January); health networks (as in The Gambia and Nepal); long-distance learning (as in Turkey); and job creation (as in Costa Rica, India, and South Africa).

Potential of biotechnology

Beyond focusing on ICT, the report breaks new ground in addressing the potential of advancing development with the help of biotechnology (drugs and genetically modified crops), placing the spotlight on the trade-offs between biodiversity and food shortages. It asserts that the current debate in Europe and the United States over genetically modified crops mostly ignores the concerns and needs of the developing world. Western consumers who do not face food shortages or nutritional deficiencies are more likely to focus on food safety and the potential loss of biodiversity, while farm-

ing communities in developing countries are more likely to focus on potentially higher crop yields and greater nutritional value. For example, according to the report, recent efforts to ban the manufacture of DDT worldwide did not take into account the pesticide's benefits in preventing malaria in tropical countries. On a more positive note, the report also explains that, even in poor countries without much health infrastructure, breakthroughs in medical technologies have already raised life expectancies quickly and dramatically. For example, during the "lost decade" of the 1980s, when income growth in many developing countries was stagnant or negative, a new oral dehydration therapy and improved vaccines reduced by about three million the number of deaths from major childhood illnesses.

Uneven benefits of technology

The report refutes the argument that basic development must come before new technology. Within international development circles, some have worried that technology might draw resources from more traditional development goals. Rather, the report argues that ICT, together with biotechnology, can make major contributions to reducing world poverty. UNDP administrator Mark Malloch Brown warns: "Ignoring technological breakthroughs in medicine, agriculture, and information will mean missing opportunities to transform the lives of poor people."

Many of the most important technology opportunities have bypassed poor people to date because of a lack of market demand and inadequate public funding, the report says. Public sector funding and incentives for research and development could compensate for these market failures, but governments in both developing and

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
July 30	3.53	3.53	4.15
August 6	3.48	3.48	4.09

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/cgi-shl/bur.pl?2001).

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

Data: IMF Treasurer's Department

developed countries have so far failed to provide the necessary support. As a result, only 10 percent of global health research focuses on the illnesses that constitute 90 percent of the global disease burden. In 1998, global spending on health research was \$70 billion, but only \$300 million was dedicated to vaccines for HIV/AIDS. The diffusion of technology has also been uneven, with developed countries accounting for 80 percent of the world's Internet users. Meanwhile, the total international bandwidth for all of Africa is less than in the city of São Paulo, Brazil, and the total bandwidth for all of Latin America is roughly equal to that of Seoul, Korea. Fair use of intellectual property rights, particularly fair implementation of the World Trade Organization's agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), is central to future progress. The report argues that current commitments under TRIPS to promote technology transfer to developing countries amount to little more than paper promises while intellectual prop-

erty rights can go too far, contributing to the "silent theft of centuries of developing country knowledge and assets."

While the technology revolution and globalization are creating a "network age" and changing how technology is created and diffused, technology is created in response to market pressures and not to the needs of poor countries. And while national policies are indispensable (even in a network age) and all countries (even the poorest) need to implement policies that encourage innovation and the development of advanced skills, national policies will not compensate for global market failures. International initiatives and the fair use of global rules are needed to channel new technologies toward the most urgent needs of the poor. The report concludes that public policy rather than charity will determine whether new technologies become a tool for human development. ■

Axel Palmason
IMF Office, United Nations

Interview with Sakiko Fukuda-Parr

Diffusion of technology should be part of national poverty reduction strategies

Sakiko Fukuda-Parr, lead author and Director of the Human Development Report Office, spoke with Axel Palmason about the report:

PALMASON: The report focuses on how to make new technologies work for human development but not so much on how this task should be carried out. Is there a convergence with ongoing work on the internationally agreed millennium development goals, the recent debate on global public goods, and nationally owned poverty reduction strategies?

FUKUDA-PARR: Working out how to implement the ideas in the report is the next step. The recommendations of the report call for global policy initiatives for investing in poor people's technology, such as medicines for malaria and other diseases; high-performing varieties of cassava, millet, and other food crops; low-cost wireless computers; and decentralized energy sources. These are all global public goods. We consider such initiatives important for accelerating progress toward meeting the internationally agreed millennium development goals. Our analysis shows that without accelerating progress, most countries will not meet these goals. Technology accelerated progress in human survival and food security in the last century and can do so again. Adoption and diffusion of relevant technologies should be considered a part of the nationally owned poverty reduction strategies.

PALMASON: The report asserts that markets do not develop and distribute technology evenly around the

globe and that public policy, both domestic and international, must change to accommodate that failure. How might this affect existing policy priorities, particularly fiscal policy, and how can multilateral organizations help within their given mandates?

FUKUDA-PARR: The report advocates more investment in technology development, as well as adaptation and diffusion of technology for development. It provides historical evidence of investments that have had high returns and of investments in the public sector in developing countries, which are stagnating. This is a call to bilateral aid programs, multilateral organizations, foundations, philanthropists, corporations, and universities to review their expenditure priorities. Much technology development needs to occur at the global and regional levels, but there are not many dedicated sources of financing for this. We do not even know how much is being spent. Technology development can also be effective when the private sector—which has not only the finance but also the knowledge and the ownership of patents—can be brought into partnerships. A leading example is the International AIDS Vaccine Initiative.

PALMASON: In the report, you raise the issue of differential pricing for pharmaceutical and technology products; that is, developing countries should pay less for technology. What would motivate and sustain such segmented market behavior?

FUKUDA-PARR: Tiered pricing has already been more than motivated by intense public pressure on the pharmaceutical industry and by attempts to use com-



Sakiko Fukuda-Parr

“There is a broad crisis of investment in technologies for development—be they new, intermediate, or traditional...”

—Fukuda-Parr

pulsory licensing for generic drugs in developing countries. Together, these have caused the price of AIDS drugs to fall tremendously, from \$10,000 a person a year to just \$350 between December 2000 and April 2001. We believe that such policies have to go beyond the highly publicized AIDS drugs to cover all essential pharmaceutical products and beyond to other technologies. Ensuring that developing countries can legitimately put into practice TRIPS-compatible options of compulsory licensing and parallel importing will be central to this effort. These are policies that have been routinely used by Canada, Italy, Germany, the United Kingdom, the United States, and others for decades, and tremendous efforts are being made to ensure their efficacy. Sustaining such segmented markets is a challenge that needs to be addressed on all sides because fears of gray imports [goods brought into a country without payment of full duties] coming back into the home market threaten to undermine support for the current tiered pricing on offer. Product differentiation, packaging, export controls, and public education campaigns are all needed to make such pricing sustainable beyond the intense focus of public attention—though it will put additional (and needed) pressure on industrial country governments to ensure full health care coverage for the population so that there is not a consumer backlash against unaffordable prices at home in the face of discounts abroad.

PALMASON: The report also proposes that, to some extent, military expenditure in developing countries be diverted to scientific research. What would motivate such a change in policy?

FUKUDA-PARR: The report highlights military expenditure in sub-Saharan Africa primarily as a way of providing a context for the neglect of investment in research in human development. The OECD [Organization for Economic Cooperation and Development] countries likewise spent \$51 billion on defense research in 1998, against just \$300 million on AIDS vaccine research in 2000. These figures illustrate the broader point that governments in developed and developing countries need to be put under more pressure to invest in constructive, not destructive, technologies. The price of research and development (or of a \$10 billion global health fund) can seem high and unaffordable when considered in a vacuum, but these development priorities are just a fraction of funds already committed to research and development—just the wrong kind. There must be a shift from national security and defense to human security and health, environment, and agriculture.

PALMASON: The report recommends training policymakers to undertake technology policy analysis. What

branch of government should receive such training and who should provide it?

FUKUDA-PARR: Policymakers' ability to negotiate scientific and technological issues requires special attention so that developing countries can take positions that genuinely reflect their national interests.

Developing countries also need to be able to negotiate in dealing with technology acquisition and transfer arrangements. This means that policymakers in different branches of government need such training—not surprising because of the pervasive impact and influence of technology on many aspects of policymaking—from health, agriculture, and education to trade and economic growth. We believe that training such policymakers in science, technology, and human development would start to create the professional cadre needed to bring clarity to the role of science and technology in development and to promote the necessary intellectual and analytical rigor to support policy and other initiatives in this area. Currently, only a handful of universities around the world offer training in this field, and this number needs to increase significantly. National academies of science could also provide leadership by identifying training needs and encouraging universities to develop appropriate curriculums.

PALMASON: The report concludes that there is a call for a global framework for supporting research and development that addresses the common needs of poor people. Is this recommendation limited to research on ICT [information and communications technology] and biotechnology, or might it apply more generally to development issues?

FUKUDA-PARR: The call for more research and development is definitely not limited either to new technologies or to the specific areas of ICT and biotechnology. There is a broad crisis of investment in technologies for development—be they new, intermediate, or traditional—and not only for health, agriculture, and education, but also for transport, energy, and construction. The cross-sectoral decline in support for capacity building in developing countries must be reversed to enable these countries to adapt and innovate technologies to their specific needs. The long time frame of investment in research and the shorter one of project-result frameworks are part of the problem, and the report strongly calls for bilateral and multilateral organizations to rethink their stance on these kinds of investments. ■

The annual *IMF Survey Supplement* will appear at the end of August. The next regularly scheduled issue of the *IMF Survey* will be published on September 3.

Trinidad and Tobago faces the challenges of managing an energy-based economy

The Trinidad and Tobago economy is the largest among member countries of the Caribbean Community (CARICOM), with a gross domestic product in 2000 of almost \$8 billion.

Since the discovery of petroleum in the 1950s, the relative importance of agriculture has declined, while the role of the energy sector has increased markedly. This latter sector—which comprises oil, liquefied natural gas (LNG), and LNG-based industries, such as methanol and ammonia—accounted for about 40 percent of GDP at peak oil prices in 1980, but now contributes about one-fourth of total economic activity and government revenue and 80 percent of merchandise exports.

The crisis of the 1980s

The sharp fall in oil prices in the mid-1980s triggered a recession that spanned virtually a decade. Between 1982 and 1993, real GDP declined cumulatively by more than 25 percent, while the average GDP per capita fell from \$7,000 to \$3,600; international reserves plummeted from \$3 billion to US\$200 million; and the external debt rose from 13 percent of GDP to almost 50 percent, reflecting the weakening of the public finances. In addition, unemployment rose from 10 percent to a peak of near 25 percent in the late 1980s, before falling back to 19 percent in 1993; spending on poverty alleviation and social development was cut back; and emigration of skilled labor rose sharply.

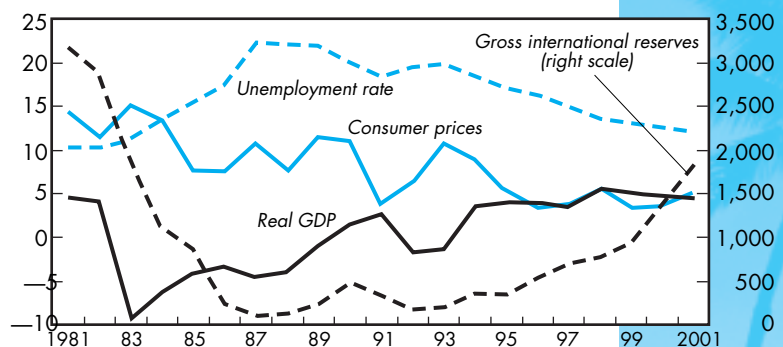
The authorities sought to tackle this crisis through a combination of financing, adjustment, and reform under programs that were supported by the IMF, the World Bank, and the Inter-American Development Bank. Adjustment measures intensified beginning in 1988 and included adjustments of public utility tariffs; cuts in public expenditure, including temporary wage cuts; and increases in interest rates. In addition, to help correct the appreciation of the currency by about two-thirds, the government implemented two devaluations in 1985 and 1988 and, in 1993, floated the exchange rate. The result was a rate of TT\$5.8 per U.S. dollar by end-1993. The pace of reform accelerated in the early 1990s, with the further liberalization of the exchange and trade systems, privatization, and tax reforms—including a simplification of the income tax and the introduction of a value-added tax (VAT).

Recovery in the mid-1990s

The adjustment measures and reforms went a long way toward stabilizing the economy and increasing efficiency. A period of sustained growth—the first in about 12 years—began in 1994, reflecting a recovery in the energy

sector following an easing of the tax regime and the regulations governing investments in that sector. Also, inflation slowed to 5 percent, the unemployment rate fell slightly, the finances of the public sector improved, and the international reserve position strengthened. The turnaround was maintained during the remainder of the decade. After some softness in the energy sector in 1994–97 related to a

Trinidad and Tobago: selected economic indicators



Note: Data for consumer prices and real GDP reflect annual percentage changes; those for unemployment refer to annual rates, in percent; while those for international reserves represent end-year stocks in millions of U.S. dollars.

Data: IMF *International financial statistics*; Central Bank of Trinidad and Tobago; and IMF staff estimates.

slowdown in crude oil production, real GDP growth picked up to 5 percent a year in 1998–2000, reflecting substantial new discoveries of natural gas. The most positive aspect of the turnaround has been the sustained growth of the non-energy sectors—by about 5 percent a year—reflecting a pickup in the demand for manufactured goods exports, and strong growth in construction, distribution, and services. By contrast, the agricultural sector experienced alternating periods of growth and decline related to weather conditions but, overall, has been weak because of the financial and other difficulties facing the state-owned agricultural company, CARONI.

The recovery was accompanied by a further decline in inflation to 3½ percent in 2000, reflecting a shift toward balanced budgets, effective liquidity management, a stable exchange rate, and low import prices. The current account of the balance of payments shifted from significant deficits in 1997–98 to small surpluses in 1999–2000 on account of increased energy exports, and international reserves reached \$1.4 billion at the end of 2000. Unemployment declined to 12.5 percent in 2000, real GDP per capita has been rising by about 4 percent a year, and Trinidad and Tobago ranks 41 out of 160



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countries in the United Nations Human Development Index. The country has benefited from an investment grade rating for its foreign debt since 1999.

Economic performance is likely to continue to be favorable in 2001, with real GDP growing by 4–5 percent, inflation falling to 2–3 percent, and international reserves reaching \$1.8 billion, or four months of imports of goods and services. An easing of liquidity conditions in the financial sector allowed a reduction in banks' reserve requirements from 21 percent to 18 percent in late May 2001, and banks' lending rates have declined by about 1–1½ percentage points during the year to date.

Prospects for growth over the medium term are good. Real GDP is projected to expand by 4½–5 percent, and, on present trends, unemployment would decline to about 10–11 percent by 2005. Construction of two additional gas-processing terminals is expected to be completed by 2003, and engineering studies have begun on another terminal that would raise the country's total LNG capacity to 14 million tons a year—converting it into one of the world's top five LNG producers. Increased LNG output would provide a further stimulus to downstream activities like petrochemicals and help generate additional demand in some other sectors, including construction and manufacturing. Prospects for the services sectors—such as telecommunications and distribution—also appear favorable, and, in recent years, the country has become one of the Caribbean region's main financial centers and an important source of capital. In agriculture, however, short-term prospects are not encouraging, as sugar-producing operations remain unprofitable and efforts to restructure CARONI and diversify its activities are still in the initial phases.

Policy framework and challenges ahead

While an important part of Trinidad and Tobago's recent performance can be attributed to favorable prices for oil and gas, a sound economic policy has also played a key role. This has included

- prudent fiscal policies;
- steps to save part of the windfall tax revenues from the energy sector in a revenue stabilization fund—about two-thirds of the windfall was set aside in fiscal year 1999/2000, and by the end of the current fiscal year, resources in the fund are expected to reach the equivalent of 2 percent of GDP;
- effective liquidity management by the central bank through open market operations;
- exchange rate stability—the exchange rate has been stable at about TT\$6.3 per U.S. dollar since 1997, without adversely affecting competitiveness; and

Trinidad and Tobago: basic indicators

Area (sq. km)	5,130
GDP at market prices (million U.S. dollars, 2000)	7,800
Population (2000)	
Total (million)	1.4
Rate of growth (percent a year)	0.6
GDP per capita (U.S. dollars)	5,800
Rate of growth of GDP per capita (average: 1997–2001)	4.1
Population characteristics	
Life expectancy at birth (years)	73
Physicians per thousand	3.2
Infant mortality (per 1,000 live births)	12
Access to electricity	92
Access to safe water	96
Primary enrollment rate	88
Human Development Index	41

Sources: World Bank; United Nations Development Program; and IMF staff estimates.

- progress in structural reforms—particularly privatization, the regulatory framework for public utilities and the financial system, and the further development of money, capital, and foreign exchange markets.

The key challenge facing Trinidad and Tobago is how to strengthen the policy framework to ensure continued growth, including in jobs, and social progress. Clearly, macroeconomic stability will be essential, and the key factor in ensuring this stability will be a sound fiscal position. The government has begun to address the weak control and accountability over procurement and spending in some public enterprises, which have led to the recent increase in transfers to these bodies and to the growth in the public debt from 54 percent of GDP in 1986 to about 60 percent in 2000. It will also be important to contain the increase in the government wage bill and improve tax yields—especially on the VAT and in the energy sector. A strengthened fiscal performance would enable the government to increase spending on health, education and skills training, public safety, and poverty reduction without increasing the debt, and also help reduce pressures on interest rates.

It would also be important to ensure that macroeconomic stability is complemented by additional reforms to create a favorable environment for business, characterized, in part, by efficient basic services and a simple, rules-based regulatory framework. In such an environment, the speeding up of the government's privatization program could be expected, over time, to help generate a wide range of opportunities for new investment and job creation. Similar opportunities are likely to result from the further expansion by Trinidad and Tobago businesses into new markets, including in CARICOM, Latin America, and the proposed Free Trade Area of the Americas (FTAA). ■

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