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In this issue

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Press briefing

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International standards and codes

Widespread participation, cooperation are key in developing, implementing standards

The adoption of internationally recognized standards and codes of good practice can help to improve economic policymaking and strengthen the international financial system. The international community has called on the IMF and other forums and standard-setting agencies to develop standards and codes covering a number of economic and financial areas. As part of an ongoing outreach process, the IMF and the World Bank jointly sponsored a conference on international standards and codes in Washington, DC, during March 7–8. Participants in the conference included senior officials from selected industrial countries and from emerging market, transition, and other developing countries; IMF Executive Directors; and representatives from international agencies, standard-setting bodies, and the private sector.

From left, Guillermo Ortiz, Andrew Crockett, Jack Boorman, and Stanley Fischer.

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(Continued from front page) Streamlining Conditionality was also issued to staff in September 2000.

The four papers posted on the web take stock of how conditionality in IMF-supported programs has evolved over the past decade and what lessons we can now draw in making the IMF more effective. The first paper is a brief overview; the second looks at the policy issues in more detail; the third examines structural conditionality; and the fourth looks at trade policy. These papers provided the basis for the Board's discussion.

Background

Conditionality has been associated with IMF financing since the 1950s. It is the link between IMF financing and policy implementation by countries that make use of IMF financing. But over the past two decades—particularly over the past decade—there has been quite an expansion in the scope of IMF conditionality, particularly in structural areas, such as tax administration, government expenditure control, the financial sector, and trade liberalization. This expansion was driven in large part by the IMF's increasing emphasis on growth and its greater involvement with low-income and transition countries, which faced major structural impediments to long-term sustainable growth.

Deputy Director Masood Ahmed (center), with Tim Lane (left), Chief of the Policy Review Division, and Kathleen White, Senior Press Officer, at the March 21 briefing.

Board discussion

The IMF's Executive Directors recognized there were valid reasons for this expansion but also discussed the problems and concerns that arose from it, including expanding into areas beyond core IMF concerns; sometimes spreading ourselves too thin in the coverage of our programs; trying to support more changes than countries have the capacity to carry out; and overly intrusive conditionality that might undermine countries' sense of ownership of these programs.

For these reasons, Directors agreed the IMF now needs to move toward a more streamlined and focused approach to the application of conditionality in future IMF programs. The aim of this streamlining is not to weaken implementation of IMF programs but to ensure countries have the maximum possible scope to make their own policy choices while also ensuring IMF financing is provided only if policies essential to the objectives of the program continue to be implemented. It's about a sharpening of priorities, not a weakening of program implementation.

The IMF's Executive Directors endorsed three elements in this streamlining. First, there is a need to focus on the policies that would be covered by formal conditionality. Historically, we have tried to ensure that conditionality applied to policies relevant to the objectives of the program, but the test of relevance has been applied with considerable latitude.

The Interim Guidance Note now in effect raises the threshold of importance. Measures critical to program objectives would continue to have conditionality associated with them, but there would be a much more parsimonious approach to conditionality applied to other policy measures that may be relevant and useful, but not critical, to program objectives. Obviously there's a subjective element in trying to figure out where "critical" stops and "important" or "relevant" starts. But the presumption in program monitoring would shift from comprehensiveness to selectivity.

The Executive Board agreed there is going to be quite a bit of learning-by-doing to get the balance exactly right in drawing the line between critical and relevant. In this and in upcoming programs, there will be a specific focus on trying to clarify why certain conditions are included and others are not. This will be a real-time assessment of whether we've got the balance right over the next few months.

Second, we are going to streamline our conditionality in issues outside of our core areas by relying more on other institutions. We want to rely much more systematically on the World Bank to support governments in implementing structural and social reforms in areas like public enterprise restructuring, privatization, labor market reforms, and sector reforms in energy and agriculture. These areas have traditionally made up a significant part of structural conditionality in IMF programs, particularly those with a longer focus, such as those in transition countries and in countries supported by the Poverty Reduction and Growth Facility (PRGF).

In September, the Managing Director of the IMF and the President of the World Bank issued a joint statement on enhanced cooperation and better partnership between the IMF and the Bank. If you follow our work in low-income countries—in the context of the poverty reduction strategy papers, the PRGF, and the Bank's operations—you know these are now much more closely aligned. We are also exploring ways to develop a better division of program content and conditionality in the structural area between the Bank and the IMF.

Third, we would like to reduce the number of formal conditions associated with the steps leading up to a structural reform rather than to the end point of the reform itself. In Mauritania, for example, there were 19 specific structural benchmarks or prior actions associated with the introduction of the value-added tax. In the future, we see some scope for reducing the degree of monitoring associated with steps leading to the implementation of a particularly important measure, such as a value-added tax. Obviously, countries often see a great deal of value in having these steps laid out in detail, but we believe, and the Board feels, that this can be done better in the context of technical support or technical assistance, rather than explicitly linking them to IMF financing.

In addition, the Board endorsed efforts to clarify the boundaries of IMF conditionality more precisely. For example, Letters of Intent, which governments frequently use to lay out their overall policy program, are often broader in scope than IMF conditionality.

Obviously, governments sometimes find it useful to lay out a comprehensive vision of their agenda, partly to signal their overall program credibility to markets. But where the scope of the Letters of Intent is broader than the coverage of the IMF program, we propose setting out very explicitly within the Letter of Intent what the focus of the IMF's program and reviews will be, so there is more clarity about the boundaries between IMF conditionality and the rest of the authorities' program. Similarly, it is useful to clarify the role of structural benchmarks and prior actions. It's not always clear to people how they are related to the continuation of IMF financing.

What's ahead

Going forward, we will continue to apply this more streamlined approach to upcoming programs, and the Board will review these programs in real time to give us guidance on the extent to which we've got the balance right, in terms of the threshold for criticality.

In parallel, we will lay out our analysis and approach on our website to elicit more public discussion and feedback on these papers and issues. This is a topic on which there is a great deal of interest among academics and civil society organizations. It's very important for us to have the benefit of their work and their reactions. We are also planning a major seminar on this topic in Washington in May. This will bring together people from different perspectives. We will also obviously have an opportunity to get guidance from the International Monetary and Financial Committee in the meetings at the end of April. We will convey all of this guidance and feedback to our Executive Directors as part of their next discussion in June. And, of course, they will have the benefit of their own review of ongoing programs.

After that June review and over the summer, we will be doing additional work on a number of issues set out in the Public Information Notice. The eventual goal is to review and revise the IMF's formal guidelines on conditionality to align them more with today's realities and give due emphasis to the need for streamlining and country ownership. We hope this work will be brought back to the Board in the second half of this year.

QUESTION: Could you give us examples of a critical benchmark?

AHMED: In Mali, the cotton sector accounts for about one-third of employment and one-half of exports. Recently, an implicit tax on farmers that accounts for about 4 percent of GDP has resulted in a one-third cutback in cotton production. This issue is critical, because we can't work out a meaningful growth and macroeconomic viability scenario without dealing with it.

On the other hand, the IMF has for years viewed the government resources used to subsidize sugar refining in Mozambique as a distortion. These resources could be better deployed for inoculation or primary health care aimed at the poor. But the scope of this distortion is not so large that if you don't deal with it, you cannot realize a macroeconomically viable medium-term scenario. We will continue to highlight its costs, but we do not see that as justification for making it a formal condition of IMF financing because it's not critical to the program's objectives.

QUESTION: The conditionality papers suggest that the IMF believes it was almost forced into broadening its conditionality by the lack of conditionality attached to World Bank programs. Is the Bank improving its conditionality or is there at least a clearer understanding so that the IMF doesn't have to do the work of two institutions in this regard?

AHMED: The object is not simply to transfer a certain block of conditionality from the IMF to the Bank. The basic question is whether a particular policy measure is critical to the program, and that's part of a broader focus on ownership.

Work is now under way with the World Bank to develop a more coordinated approach. Particularly in low-income countries, that work is quite advanced. The Bank recently established a poverty reduction support credit that is intended to complement the IMF's PRGF in low-income countries. This will allow the Bank to systematically cover structural and social issues outside of the IMF's core areas.

In middle-income countries, that work is proceeding, but in a less structured way, as there is no similar framework. However, the Bank has recently presented several proposals to its Board on its role in middle-income countries. These proposals would provide for enhanced collaboration with the IMF.

QUESTION: Will this affect the volume of lending?

AHMED: I don't see any direct link between this work and the volume of IMF support. The goal is not to make access to IMF resources easier or more difficult; it is to focus the conditionality on measures critical to the program's objectives and therefore improve ownership and implementation of programs.

QUESTION: Was the expansion of conditionality in the 1990s a mistake? And is there now a risk that growth will be affected?

AHMED: As the papers set out, the reasons for getting involved in structural conditionality were primarily linked to the importance of structural reforms for growth. While structural conditions remain important for growth, they don't all have to be covered in the context of IMF-supported programs.

Second, and equally crucial, because measures are important for growth and the government intends to undertake them, it doesn't necessarily follow that applying formal conditionality to each and every one of these measures is the most effective way of supporting governments in this endeavor. Indeed, it is likely that excessively detailed or intrusive conditionality may actually hinder implementation. We are trying to get the balance right on how conditionality should be related to structural programs. That's precisely the focus of our case-by-case work over the next few months and what the Board will be looking for in its real-time assessments.

Question: The papers seem to bring out the fact that conditionality is only as effective as the political will of the government implementing it.

Ahmed: There is a lot of evidence that conditionality is less important for outcomes than the ownership and commitment of governments. One direction that takes us to is to be more selective in ensuring a minimum degree of government ownership as part of the basis for going forward with financing. It's never easy, however, to establish the extent and depth of ownership. Ownership by government is not one-dimensional. How broadly a program needs to be owned and is owned will vary by country and type of program. But the basic premise that ownership is essential for successful implementation, particularly of the kinds of structural and institutional changes that are the basis for long-term growth, is one that underlines a lot of the analysis in these papers. ■

Comments invited

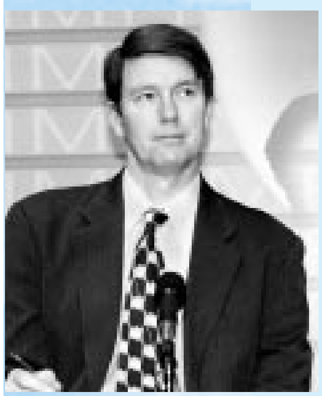
The IMF is seeking the public's views on its efforts to streamline and focus IMF conditionality. Please e-mail comments to conditionality@imf.org or mail written comments to Tim Lane, Chief, Policy Review Division, Policy Development and Review Department, IMF, Washington, DC 20431, USA.

All comments received by May 18 will be conveyed to the IMF's Executive Board as background information for its discussion in June. The public's comments will also be taken into account in further work by IMF staff.

The background papers and summary of the March 7 Executive Board discussion are available on the IMF's website. For anyone unable to access the Internet, copies of the papers are available from the Public Affairs Division, External Relations Department, IMF, Washington, DC 20431, USA.

Current review takes a new look at conditionality issues

The IMF periodically reviews the conditions it applies to the use of its resources, known as "conditionality." A 1994 study examined Stand-By and Extended Arrangements; a report in 1997 looked at programs supported by the Enhanced Structural Adjustment Facility (ESAF)—now replaced by the Poverty Reduction and Growth Facility (PRGF). Tim Lane, Chief of the Policy Review Division of the IMF's Policy Development and Review Department, describes how the current review differs from previous ones.



Lane: "The world has changed, and our conditionality has changed with it."

In the past, conditionality reviews were comprehensive, looking at experience under the entire set of programs since the previous review. They focused mainly on the design of the programs and the macroeconomic outcomes. Preliminary discussions with IMF Executive Directors in June 2000, however, indicated an interest in examining in greater detail how the IMF's financing is linked to policies. This brings us to issues such as whether a large number of conditions interferes with countries' own decision-making processes, as well as issues such as the scope of measures covered by conditionality, the detail with which we monitor countries' policy actions, the frequency of program reviews, and the role of prior actions.

This focus for the review received added impetus with the arrival of the Managing Director, who indicated early on that he viewed streamlining and focusing the IMF's conditionality as a priority. During the summer, the Managing Director held a retreat with the Executive Board, where he discussed this approach and received a broad endorsement for streamlining. An interdepartmental working group then drafted an interim guidance note, which the Managing Director issued in September. He also outlined this approach in his Annual Meetings speech and received a broad endorsement of it from the International Monetary and Financial Committee.

The four papers we prepared provided both an analytical and a factual basis for an Executive Board discussion of the modalities of IMF conditionality. The review combined Stand-By, Extended Fund Facility, and ESAF/PRGF Arrangements and looked at programs over the past decade. In contrast to previous reviews, our approach was in some ways narrower in focus, but longer in time frame and broader in country coverage. Also, to address how we should streamline, we had to reconsider what purpose conditionality is intended to serve and then ask ourselves what parts of conditionality are truly essential and what parts could be scaled back to allow more room for countries to make their own decisions.

All of the material just published on our website, as well as the upcoming seminar and public comment, and future staff work and Board discussions are aimed toward a revision of the formal guidelines on conditionality. The world has changed, and our conditionality has changed with it. The intent is to align these guidelines with current realities while retaining the injunction that conditionality should cover only what is needed to ensure performance consistent with achieving program objectives.

Development and implementation of standards

(Continued from front page) 11 areas where standards are important for the institutional underpinning of macroeconomic and financial stability, and hence useful for the operational work of the two institutions. However, there are concerns that these and other internationally determined standards are being developed only from an industrial country perspective and that standard-setting bodies and international financial institutions have pursued a "one size fits all" approach. Addressing these concerns in his keynote address to the conference, Jin Liqun, Vice Minister of Finance of China, said: "Developing countries are given to understand that they can preempt a financial crisis and achieve economic stability, provided they follow rigorously the international standards and codes. But there are two questions to answer: first, are the standards and codes suitable to the developing countries at their stage of development; and second, do they have a minimum institutional capacity to apply these standards and codes at the same level as developed countries?"

Development of standards

The process of developing standards, Andrew Crockett, General Manager of the Bank for International Settlements (BIS) and Chair of the Financial Stability Forum, noted, has given rise to several questions about the most efficient and practical way countries at all levels of development could participate in that process and have an impact on the development of standards.

Cyrus Rustomjee, IMF Executive Director for 21 African countries, favored a broad approach to developing standards. A sense of ownership, he said, is more likely when the process of drawing up the standards is part of the individual country experience. So far, he said, the cooperative process among countries, the IMF, the BIS, and the standard-setting bodies has been successful and useful, but more could be done to bring countries on board in the early stages of the process. Low-income countries have often been left out of the process, owing to a lack of resources and limited access to information.

Although some differentiation in standards had proved useful for low-income countries, Rustomjee said, a system of two standards for one world posed difficulties because investors and markets might discriminate against some countries that adhered to a lower-quality standard.

Speaking as a representative from a transition economy, Dimitar Radev, Deputy Finance Minister of Bulgaria, said that wide international acceptance of standards was extremely important. He thought the best way to address the issue of developing standards was to form constituency groups within the IMF and the World Bank, thus combining professional expertise and political representation.

Transparency and publicity at the local level were of paramount importance, Radev said, to facilitate awareness and acceptance of standards and to promote a sense of ownership and understanding that implementation of standards was being directed by national interests and was not imposed from outside.

Alastair Clark, Executive Director of the Bank of England, said the model many developed countries had followed entailed early compliance with core standards and gradual expansion outward to other standards in line with the growing sophistication of the financial system; developing countries, he said, might find this "nesting" approach useful.

Countries need to be careful, however, cautioned Haruhiko Kuroda, Vice Minister of Finance for International Affairs for Japan, about distinguishing between the immediate need for basic core international standards and the need for countries to set their own agendas and priorities for reaching those standards. Silvina Vatnick of the Argentine Ministry of Economy agreed, noting that some standards are general enough to allow for variation at the country level, while others, such as standards on data dissemination, are necessarily more specific, making them more difficult to comply with.

Andrew Procter of the International Organization of Securities Commissions suggested that standards and principles should be viewed as "aspirations" or diagnostic tools rather than inflexible requirements. He, as well as other representatives from the standard-setting bodies and international agencies—including Gregor Heinrich of the Committee on Payment and Settlement Systems, Yoshihiro Kawai of the International Association of Insurance Supervisors, and William Witherell of the Organization for Economic Cooperation and Development—stressed that the public consultative process was extremely important.

Assessment of standards

Both the IMF and the World Bank have been actively involved in assessing the extent of members' observance of standards. These assessments, which provide information to markets about the condition of a country's economic infrastructure, according to Jack Boorman, Director of the IMF's Policy Development and Review Department, should meet the needs of all the actors in the economic arena: countries, markets, and individuals. Developing countries and emerging markets, Boorman said, have expressed concerns about the process of assessing individual country compliance with international standards and publishing the results. In particular, assessments may not take into sufficient account individual situations and capacity for compliance and, hence, leave a country that is not in full compliance at a disadvantage.

Jin Liqun

Andrew Crockett

Cyrus Rustomjee

Dimitar Radev

Amar Bhattacharya

Oldrich Dedek

Guillermo Ortiz

Haruhiko Kuroda

The IMF has been attempting to meet this challenge, Boorman said: first, through the Reports on the Observance of Standards and Codes (ROSCs) (see box, below), which serve as a useful input into the IMF's technical assistance and annual consultations with member countries, as well as helping national authorities develop their own reform plans and assess compliance with standards and codes; and second, by engaging the private sector in discussions and consultations, and through outreach with bank officials and rating agencies worldwide. Private investors, Boorman said, are turning increasingly to ROSCs as inputs in their risk assessments and investment decisions. For its part, the IMF has tried to make the ROSCs balanced to meet the needs of both countries and markets. Boorman stressed that a ROSC is not a "snapshot rating," or a checklist; it is, rather, a "dynamic picture," a progress report indicating areas where technical assistance could be useful and the direction in which countries are, or should be, moving.

The World Bank's experience with assessments in the financial sector has yielded several lessons, according to Amar Bhattacharya of the World Bank. These include the importance of and benefits from a broad-based partnership—not just between countries and the Bretton Woods institutions, but also with the standard-setting bodies. Another lesson is that standards need to be pragmatically applied according to individual circumstances.

Providing perspective from a transition economy, Oldrich Dedek, Vice Governor of the Czech National Bank, said that many elements of standards and codes are not politically neutral. Domestic assessors are often at odds with groups who see standards as conflicting with their own aims. Therefore, an internationally respected authority may be able to push through necessary changes that domestic supervisory authorities cannot. Dedek did not support exemptions for transition economies. If transition economies want to become part of advanced international markets or communities (like the European Union), they should not expect to be granted concessions, he said.

Reports on the Observance of Standards and Codes

The IMF and the World Bank have been assessing the implementation of standards as part of technical assistance and Article IV consultations. The assessment of standards has been systematized in the form of Reports on the Observance of Standards and Codes (ROSCs). Each ROSC module provides a description of country practice in an area that is then benchmarked against the relevant standard. ROSCs allow for consideration of the different stages of economic development, range of administrative capacities, and different cultural, institutional, and legal traditions across countries.

The IMF and the Bank currently focus on standards in 11 areas: data dissemination, fiscal practices, monetary and financial policy transparency, banking supervision, insurance supervision, securities market regulation, payments systems, corporate governance, accounting, auditing, and insolvency regimes and creditor rights.

For more information on ROSCs, see the IMF's website at www.imf.org/external/np/rosc/2000/stand.htm#I.

Guillermo Ortiz, Governor of the Bank of Mexico, noted that his country's experience with unanticipated financial crises in the 1980s and the 1990s had highlighted the importance of transparency and the widespread dissemination of information. Standards, he said, serve a useful and specific purpose: the more transparent the information, the better the assessment.

George Vojta, President of the Financial Services Forum, said the private sector was the vital link that had to be forged to make standard assessment and implementation successful. But if the private sector is to be plugged in, Vojta said, the information flow has to be relatively comprehensive, current, and available in a user-friendly form so that it can be easily incorporated into risk analyses.

On the issue of self-assessment versus external assessment, Haruhiko Kuroda said that coordinated self-assessment exercises provided countries with an idea of progress and offered direction for further work. However, to gain credibility with the markets, self-assessment needs to be complemented by external assessment. Gregor Heinrich added that standards need to be clearly understood and implemented in a clear and consistent way across countries, and the expertise of assessors needs to be brought up to a consistently high standard.

Countries should be careful about initiating self-assessment without signaling their intention of moving on to an external assessment, Martin Parkinson of the Australian Treasury cautioned. One way to convince markets of their commitment to eventual full compliance was for countries doing a self-assessment to precommit to a ROSC. This would send a message to the markets that more information will be forthcoming, he said.

Assessment should not be viewed as a one-off exercise or an end in itself, Michel Cardona of the Banque de France observed. It is an ongoing process and needs updating and follow-up. There is a limited pool of experts to do assessments, provide technical assistance, and build capacity, he observed, so an important issue was how to prioritize and use resources most efficiently.

Implementation of standards

Implementation is "where the rubber meets the road," Gary Perlin of the World Bank noted, adding that it was important to recognize the connection between quasi-universal standards and realities. The implementation of standards needs to be carefully planned and prioritized in the context of individual country circumstances and is, in many cases, a complex resource-intensive process that requires technical capacity and country ownership.

Axel Nawrath, Chairman of the Financial Stability Forum's Working Group on Incentives to Foster Implementation of Standards, noted market participants have shown a growing interest in international standards, which should encourage countries to work toward implementation. However, questions remain about transparency, quality control, and sources of information.

Arminio Fraga, Governor of the Central Bank of Brazil, said that benchmarks for best practices would be useful. Although limited resources argued for a gradual implementation of standards, this approach had given rise to some anxiety among emerging markets about being left behind. Another concern was that every country would be required to adhere to a single-best standard, in which case, all countries could be found lacking. Because degree of compliance is a qualitative judgment, countries should not be assigned an absolute grade or a simple "pass/fail."

Implementation is the most critical aspect of standard-setting, according to Y.V. Reddy, Deputy Governor of the Bank of India. India supports observance of standards, but the authorities have expressed concerns about the efforts of the international financial institutions to spearhead implementation. Pace and sequencing should be at the country's discretion. Like Fraga, he favored a voluntary, gradual approach and agreed that countries should not be held to a single performing or nonperforming standard.

The Pakistani experience, according to Shaukat Aziz, Minister of Finance and Economic Affairs, has yielded several lessons. Standard-setting should be self-driven and homegrown, and goals should be "ambitious, but realistic." All stakeholders need to be mobilized in the effort, so public participation and popular support are key. The process needs to be gradual because the introduction of standards and codes calls for a change in culture. Also, the implementation of standards requires an infrastructure and an institutional framework, and much more needs to be done in the area of capacity building.

Many developing countries continue to be concerned about common universal standards, according to Urbain Olanguena of Cameroon's Ministry of Economy and Finance. For these countries, especially low-income countries, a key question is how standards can be differentiated to take into account the level of development.

The purpose of a common standard, Jack Boorman observed, is to reassure markets that countries in full compliance are good risks and to ensure that everyone has access to the same information. Do we want individual standards for each country based on its specific circumstances? Or should countries accept the universal standards and set a timetable for working toward them? Boorman noted that there are doubts that a mix of different national standards would work in an international financial market.

Conclusions

Reflecting on the day's discussions, Andrew Crockett noted that consensus appeared to be reached on several issues. The standard-setting process is not entirely satisfactory, and emerging markets need to be more involved. It was generally recognized that a single set of standards—or aspirations—is preferable, because markets are unified and because countries need a benchmark of best practices. Problems arise with implementation, however; the large gap between where many countries are and where they are expected to go has impeded acceptance. Although an early approach to standard-setting was to establish best practices and then punish those countries that failed to meet the standard, it is no longer the case that shortfalls are considered cause for discipline or punitive action. Therefore, although setting high-quality standards is generally acknowledged to be a good thing, more work needs to be done on finding the best way to get there.

In his concluding remarks, IMF First Deputy Managing Director Stanley Fischer noted that, a few years ago, standards and codes were viewed as another way of "making life difficult," but they are now recognized as a means of improving a country's economic situation as well as helping to contain global turbulence and crisis. For emerging markets and developing countries, however, the process of developing, assessing, and implementing common standards raises questions about institutional capacity and level of development compared with the developed countries. But, as Jin Liqun had noted in his keynote speech, pragmatism should be encouraged in implementing standards and codes. Standards should be regarded as benchmarks, Fischer said, en route to enhanced macroeconomic stability, but countries—like students at different points in a degree program—should not be expected to have perfect grades until they graduate. The task of standard-setting bodies and the international financial institutions is not to hand out demerits but to encourage countries to stay the course, he concluded. ■

Additional information on standards and codes is available on the IMF's website: see *Progress Report: Developing International Standards*, by the IMF Policy Development and Review Department, at www.imf.org/external/np/rosc/progrev.pdf. Also see PIN 01/17: *Assessing the Implementation of Standards—An IMF Review of Experience and Next Steps* at www.imf.org/external/np/sec/pn/2001/pn0117.htm.

Axel Nawrath

Arminio Fraga

Y.V. Reddy

Shaukat Aziz

IMF Statistics Department

Regional seminars support launch of Coordinated Portfolio Investment Survey

In January and February, the IMF's Statistics Department organized five regional seminars for country authorities in support of the 2001 Coordinated Portfolio Investment Survey (CPIS). The survey is the second undertaken by the IMF to improve the measurement of portfolio flows across national borders and to deepen understanding of how international financial markets operate. The seminars were designed to explain the purpose and methodology of the survey and allow officials who took part in the first survey, held in 1997, to share their experiences and insights with first-time participants.

Over 70 jurisdictions participated in the seminars (see box, page 109). The Belgian National Bank hosted two seminars covering the European countries, the United States, Canada, the Middle East, and Africa. The Central Bank of Costa Rica hosted a seminar for Latin American countries; the Cayman Islands Monetary Authority hosted a seminar for small economies with international financial centers; and the Australian Bureau of Statistics hosted a seminar for the Asian-Pacific region. The Japanese government funded all of these seminars through a special account established with the IMF.

Participants at the seminar hosted by the Cayman Islands Monetary Authority.

Background

During the past two decades, the volume of international financial flows through capital markets has grown sharply. Reduced regulation, technological changes, innovation, and economic globalization have all contributed to this trend. But statistics have not kept pace with these developments, generally resulting in incomplete coverage, in particular, of portfolio investment activity. Portfolio investment includes tradable securities in equity (shares, stock, participation) and debt (bonds, notes, money market instruments). It does not include the typically less volatile direct investment, which features a more lasting interest between the two parties, or foreign reserves, which are controlled by the monetary authorities.

In response to concerns about asymmetries in global balance of payments statistics in the late 1980s, an international working party, headed by Baron Jean Godeaux, former Governor of the National Bank of Belgium, recommended undertaking a coordinated survey of cross-border security positions. In the mid-1990s, at the request of the IMF Committee on Balance of Payments Statistics, then IMF Managing Director Michel Camdessus invited major investing countries to participate in the first such survey, organized under the auspices of the IMF, to improve coverage worldwide and spread best practices in compiling data on cross-border portfolio investments.

The first CPIS covered asset holdings of equities and long-term debt securities. The internationally coordinated approach meant that consistent guidelines for the measurement of securities were employed across countries, making the data comparable. Also, the information on asset holdings by country of debtor provided counterpart countries with information on their liability positions in securities vis-à-vis individual creditor countries. Because the data were disseminated, market analysts and researchers also benefited from this coordinated effort.

Twenty-nine countries, constituting most of the major investing countries, participated in the first survey. (Copies of *Results of the 1997 Coordinated Portfolio Investment Survey* and *Analysis of 1997 Coordinated Portfolio Investment Survey and Plans for the 2001 Survey* are available from IMF Publication Services; see page 115 for ordering details.)

2001 CPIS

Since the first survey, users of statistics have continued to emphasize the importance of good data on securities. A lack of good information impedes the ability of policymakers and market analysts to understand fully the impact of external flows and positions on the domestic economy. Recent financial crises in Latin America, Asia, and Russia highlighted the need for improved monitoring of financial flows and stock positions. On the recommendation of a task force representing a range of countries and chaired by Gunnar Blomberg of the Riksbank, Sweden, the IMF Committee on Balance of Payments Statistics decided to conduct a second survey—this one to collect data as at December 31, 2001. As it did with the first survey, the task force has assumed a central role in planning the new survey.

The 29 countries that participated in the first CPIS, which covered data as at December 31, 1997, have all indicated their intention to participate in the second CPIS. In addition, more than 40 other jurisdictions have expressed their intention to take part in the 2001 survey, making it one of the most far-reaching efforts aimed at enhancing the coverage and quality of economic statistics.

The broader participation in the 2001 survey helps fill some gaps in industrial country coverage and adds a wide range of emerging markets. A notable feature of this study is the inclusion of many small economies with international financial centers; these jurisdictions have significant holdings of portfolio investments. Bermuda is the only such country to have participated in the first survey (see *IMF Survey*, February 7, 2000, page 41).

Participants in the 2001 CPIS are required to provide data on cross-border holdings of debt (both long term and short term) and equity securities, by the residence of the issuer. Participants are also encouraged to provide data on country of holding of liabilities and disaggregations by sector and currency. The IMF is coordinating and supporting this effort by providing training, documentation, technical advice, and publication of international results. The draft *Coordinated Portfolio Investment Survey: Survey Guide* is available on the IMF's website (www.imf.org).

Participants at the seminar hosted by the Central Bank of Costa Rica.

The CPIS is intended to complement the work of the Bank for International Settlements on statistics on the cross-border positions of banks. Between the CPIS and the BIS, there will be full coverage of banking and securities markets in participating countries based on common principles. ■

Robert Dippelsman
IMF Balance of Payments and External Debt Division I

Participation in 2001 CPIS seminars

First Seminar, January 9–11, 2001
Host: Belgian National Bank, Brussels
Chair: Guido Melis, Belgian National Bank
Austria, Belgium, Cameroon, Canada, Denmark, Finland, Germany, Iceland, Ireland, Mauritius, Netherlands, Nigeria, Norway, South Africa, Sweden, Uganda, United Kingdom, United States, Zimbabwe

Second Seminar, January 15–17, 2001
Host: Belgian National Bank, Brussels
Chair: Guido Melis, Belgian National Bank
Bahrain, Bulgaria, Cyprus, Egypt, Estonia, France, Greece, Hungary, Italy, Lebanon, Malta, Poland, Portugal, Romania, Russia, Slovak Republic, Spain, Switzerland, Turkey, Ukraine, United Arab Emirates

Third Seminar, January 31–February 2, 2001
Host: Central Bank of Costa Rica, San Jose
Chair: Eduardo Rodriguez, Bank of Spain
Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama, Uruguay, Venezuela

Fourth Seminar, February 7–9, 2001
Host: Cayman Islands Monetary Authority, Grand Cayman
Chair: Simon Quin, IMF Statistics Department
Aruba, The Bahamas, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Netherlands Antilles, Vanuatu

Fifth Seminar, February 14–16, 2001
Host: Australian Bureau of Statistics
Chair: Ivan King, Australian Bureau of Statistics
Speaker: William Griever, U.S. Federal Reserve Board
Australia; Bangladesh; People's Republic of China: Mainland, Hong Kong SAR, and Macao SAR; Indonesia; Israel; Japan; Korea; Malaysia; New Zealand; Pakistan; Philippines; Singapore; Thailand

Interview with Garry Schinasi

IMF staff study examines financial implications of shrinking supply of U.S. treasury securities

Recent improvements in fiscal positions in some advanced countries have sharply curtailed their issuance of government securities. In some countries, this improvement could continue well into the next decade, creating the possibility that government securities could disappear in these countries. The possibility that this might occur in the United States has attracted the most attention. A recent study prepared by Garry J. Schinasi, Chief of the Research Department's Capital Markets and Financial Studies Division, and colleagues. Charles F. Kramer and R. Todd Smith, looks at the financial implications of the shrinking supply of U.S. treasury securities. Below, Schinasi discusses some of the main issues covered in the study.

IMF SURVEY: What concerns or developments motivated the preparation of this report?

SCHINASI: The motivation for the study is multidimensional. First, U.S. treasury securities have played an important role in private finance—both domestic and international. The U.S. treasury market has long been considered one of the deepest and most liquid financial markets in the world. But the supply of these treasury securities is shrinking, so one has to think about the implications of this decline for the depth and liquidity of these important markets.

Schinasi: "In recent financial history, the treasury market has been the main safe-haven to which investors flee during major market adjustments."

Another motivation is that government securities markets in less-developed markets—in particular in emerging market countries—can often play a very important role in providing price benchmarks; in effect, they provide the only possibility to have a risk-free rate set by the government. They help the private sector to sort through pricing issues and to hedge and shed risk during periods of turbulence. So a better understanding of these roles played by government securities in highly developed markets would be useful.

A third related motivation is to determine to what extent U.S. private securities markets, which in some segments are also very deep and very liquid (but less so than U.S. treasury securities markets), can provide private substitutes for U.S. treasury securities.

***IMF SURVEY*: Why does the IMF have a stake in the shrinking supply of U.S. treasury securities?**

SCHINASI: The dollar is an important international reserve currency. Some would say that the dollar *is* the international reserve currency. Nobel Laureate Robert Mundell wrote very recently that the world has been on a "U.S. treasury standard" since the demise of the gold standard. These observations suggest that international financial markets could possibly be affected in some way by the disappearance of the supply of U.S. treasuries, or by the decline in its supply below some threshold. The IMF clearly has an interest in international financial stability. This is why the IMF Executive Board asked us to look into this issue. So an important question is, if the supply of U.S. treasury securities were to shrink to zero, would this affect the role of the dollar in international finance?

***IMF SURVEY*: What are the key characteristics and roles of U.S. treasury securities, and how would their disappearance affect markets?**

SCHINASI: First, government securities issued by the major countries have minimal credit risk—the government can always pay them off by, for example, raising taxes. Government securities markets, when actively traded, have well-developed market infrastructures. They generally have a dense and broad yield curve, meaning there are benchmark government issues at various maturities, ranging from short term—3 months—out to 10 years and, for the United States, even extending out to 30 years. As private markets grow up around these government securities markets, they develop supporting repurchase agreement and derivatives markets for repackaging these risks. This all leads to price and allocative efficiency. Because of these characteristics, government securities have come to play important roles in private finance: they provide benchmark interest rates; they are vehicles for hedging interest rate risk; they are investments; and they are useful for position funding and liquidity management.

In addition, during periods of stresses and strains in markets, government securities tend to assume the role of a near-money or a safe haven. This safe-haven attribute relates directly to their minimal credit risk. In principle, government securities—say, of a three-month term—are pretty close to federal reserve notes, except that you have to wait three months to get delivery of the cash. Some risk is thus associated with holding the treasury securities, as opposed to money, because the value of the treasury security can fluctuate. But there is also risk associated with holding a dollar bill because of inflation.

IMF SURVEY: Concerns have been expressed about the ability of private instruments to fill the traditional roles played by U.S. treasury securities. How is the private sector responding to the shrinking supply of U.S. treasuries?

SCHINASI: We've spent a lot of time talking to market participants in both New York and London and, more recently, in a broader group of countries in Europe about how the private sector is adapting. We have spoken to commercial and investment banks, and even pension funds and insurance companies. We have also discussed the issue with key foreign central banks that have large foreign exchange reserve portfolios and hold a significant part of those reserves in U.S. treasury securities.

As far as benchmark interest rates are concerned, the private sector relied in the past on U.S. treasuries, quoting a spread on a corporate bond relative to a treasury issue. Since the treasury supply has started shrinking, the private sector has been, in fact, quoting corporate spreads off other benchmarks, including agency paper and even LIBOR [London interbank offered rate], which are interbank deposits. As hedging vehicles, treasury securities markets are still very deep and very liquid, but private participants in New York have come to rely more on swaps as hedging vehicles. And to some extent, this has affected the relationship between interest rates on treasuries and interest rates on swaps.

For investments, and in particular for investments by insurance companies and pension funds, the disappearance of long-term treasury securities poses serious challenges. These institutions have long-term liabilities, and good risk management dictates that you cover long-term liabilities with long-term assets; and the 30-year U.S. treasury is a safe long-term asset. As the supply of these U.S. treasuries has shrunk, the value of 30-year treasuries has gone up. But if they eventually disappear, the question is, how will insurance companies match their long-term liabilities? The absence of these securities could leave gaps in maturities of assets and liabilities.

IMF SURVEY: Because U.S. treasury bills comprise a large part of countries' foreign exchange reserve holdings, what would be the international impact of a continued shrinking supply of U.S. securities?

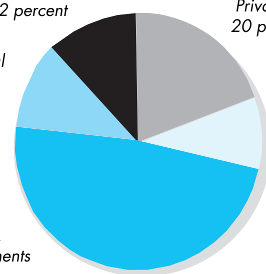
SCHINASI: This is a fascinating and complex question. It involves thinking through the role of the dollar in international finance and, in particular, in international financial stability. One has to ask the question: does the role of U.S. treasury securities in international finance originate in the role of the dollar, or does the role of the dollar originate in this deep and liquid treasury securities market?

From our discussions with financial market participants—and as the result of our own thinking—we have come to the conclusion that for a number of important reasons, it is the role of the dollar that accounts for the role that U.S. treasury securities have played historically, particularly since the 1970s when the treasury actively developed the long end of the yield curve. Our discussions with private market participants further suggest that it is really the role of the U.S. economy in the world economy—and the depth, liquidity, and stability of U.S. financial markets generally, not just the U.S. treasury market—that affords the dollar its role in international finance.

The portfolio behavior of foreign central banks that own relatively large supplies of U.S. treasury securities has obviously been affected. As the supply of U.S. treasuries shrinks while the dollar remains dominant, foreign central banks are gravitating toward close substitutes for U.S. treasuries. Our discussions with foreign exchange reserve managers suggest that they are already moving into Fannie Mae and Freddie Mac paper—that is, paper issued by the congressionally chartered corporations that buy mortgages on the secondary market and issue securities to finance this activity—and other

Ownership of U.S. treasury securities

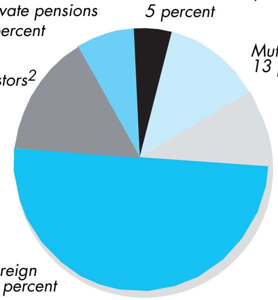
(percent of total, end-June 2000)



Data: U.S. Department of the Treasury, *Treasury Bulletin* (December 2000)

Ownership of U.S. treasury securities outside of U.S. government accounts[1]

(percent of total, end-June 2000)



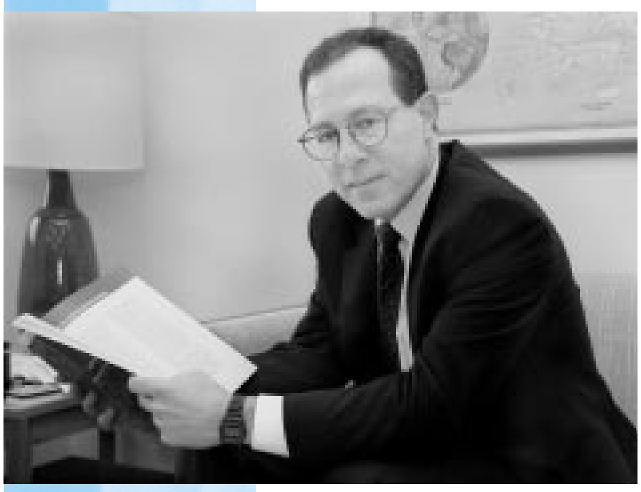
Data: U.S. Department of the Treasury, *Treasury Bulletin* (December 2000)
[1]Outside of U.S. federal, state, and local government accounts.
[2]Includes individuals, government-sponsored enterprises, brokers and dealers, bank personal trusts and estates, corporate and noncorporate businesses, and other investors.

government agency paper. They are also gradually considering private instruments—mostly bank instruments like swaps and short-term deposits.

IMF SURVEY: What are some of the major public policy questions raised by the shrinking and possible disappearance of the supply of U.S. treasury securities?

SCHINASI: The paper addresses several important issues, but the central unresolved issue for us is whether there are private substitutes for the safe-haven role of U.S. treasury securities. Let me explain this safe-haven role. During times of significant economic or financial shocks that cause investors to seek to reduce the riskiness of their portfolios, risky short-term debt is either rolled over at higher prices or not at all, and the prices of risky long-term debt and equity fall sharply. A large and liquid treasury market implies that there is a large pool of investments—treasuries—that are completely free of private credit risk. In recent financial history, the treasury market has been the main safe haven to which investors flee during major market adjustments.

Now, should treasury securities diminish beyond a critical level—that is, beyond which U.S. treasury securities markets are deep and liquid—market participants may see them less and less as a reliable short-term safe haven. A useful mind experiment is to consider what will happen if there are no treasuries and a liquidity or credit crisis occurs. Logic dictates that market participants would rebalance their portfolio holdings toward the safest instruments. So we need to think about what those securities would be. Currently, triple A–rated instruments—bonds issued by very highly rated corporations and some financial institutions—would be favored over less highly rated paper. In fact, U.S. Federal Reserve Chairman Alan Greenspan commented during recent testimony that should treasury securities shrink beyond a critical level, or even disappear, the market will most likely create what he called "quadruple–A paper." This could be something like repackaged agency paper.



Schinasi: If the public benefits are perceived as significant, then a key policy concern is: should the supply of government securities be allowed to shrink below a critical threshold?

Another possibility is that as the supply of treasury securities shrinks, the Fed itself will have to restructure its balance sheet. So, in effect, it could be that the markets will seek to hold whatever the Fed decides to hold in its portfolio of assets to back its issuance of federal reserve notes. This could become the market's new standard. Of course, market participants may interpret the Fed's shifting into private assets as tantamount to its underwriting of some of the risks associated with the issuer. This raises two important questions. First, to what extent should a central bank systematically incur credit risk and other financial risks to achieve its monetary and financial stability objectives? Second, to what extent is it prudent for central banks to become engaged in monetary and financial stability decisions that also, by their nature, change the allocation of capital among competing sectors or firms within the economic and financial system?

It is unclear whether the safe-haven role of U.S. treasury securities has served to buffer financial asset prices and markets from significant shocks. Nevertheless, the markets may identify, and come to rely on, new safe-haven assets. How smooth this transition will be, whether market dynamics will be significantly altered, and how the nature of domestic and international systemic risks will be changed are questions that cannot yet be answered.

IMF SURVEY: Will the shrinking supply of U.S. treasury securities affect the international role of the dollar?

SCHINASI: The U.S. dollar is the main currency of denomination for international financial transactions, accounting for about 40 percent of international bonds and bank loans. The dollar's predominance in international finance reflects several facts. First, market participants consider the U.S. economic and financial system to be stable, resilient, transparent, and well managed, possessing a robust legal and operational infrastructure. Thus, the risk of an isolated, unilateral, and catastrophic collapse in the U.S. economy and financial system is viewed as remote. Also, U.S. dollar fixed-income markets are arguably the deepest and most liquid in the world. Finally, U.S. treasury securities have historically been the main intervention tool in foreign exchange markets used by central banks around the world.

As I noted earlier, central banks and private market participants have responded to the shrinking supply of treasury securities by substituting into other dollar financial instruments. In light of the historical international role of the dollar, this raises the question of whether that role will shift as other financial instruments increasingly substitute for treasuries in their traditional functions. The predominant view among market participants is that it will not. The role of U.S. trea-

Photo Credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 101–102, 104–107, 110, 112, 114, and 116; Robert Dippelsman, pages 108–109 .

suries in international finance appears in large part to be due to the role of the U.S. economy and dollar financial markets in international finance. The shrinking supply of treasury securities has already resulted in a shift in the menu of securities used to support international financial activities, rather than a marked shift in the major currencies used in international financial activities. Moreover, the shrinking supply of treasury securities has not reduced the international significance of U.S. dollar markets.

IMF Survey: What are some remaining concerns about the shrinking supply of U.S. treasury securities?

SCHINASI: Government securities may provide public benefits in national (and for U.S. treasuries, also in international) markets—by providing deep and liquid securities markets, for example—that might be difficult or impossible to replicate with private instruments. Reliable private substitutes for government securities simply do not exist in many, if not most, financial systems. The public benefits of effective, if not efficient, government securities markets for pricing, quoting, and hedging private financial risks can be significant. Moreover, in providing some of the important characteristics of base money, and in serving as a safe haven during periods of turbulence, well-developed markets for government securities in adequate supplies in a range of maturities may provide significant public benefits that would be difficult, if not impossible, to replicate.

If the public benefits are perceived as significant—both in the United States and elsewhere—then a key policy concern is: should the supply of government securities be allowed to shrink below a critical threshold beyond which they no longer reliably provide or support these valuable public benefits? The resolution of this question requires knowledge about the financial market benefits of government securities markets, whether reasonably cost-effective private substitutes are possible, as well as other costs and benefits of public debt. Ultimately, countries must decide what role government securities markets can play in providing public benefits in the form of a financial market structure that fosters efficient finance and encourages and helps manage systemic financial stability. The forthcoming 2001 *International Capital Markets* report will delve more deeply into some of these issues. ■

The Financial Implications of the Shrinking Supply of U.S. Treasury Securities, by Garry J. Schinasi, Charles F. Kramer, and R. Todd Smith, is available on the IMF's website at www.imf.org/external/pubs/ft/supply/2001/eng/.

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IMF seminar

Bhagwati counters critics of globalization, stresses its social and economic benefits

Why do many people get so agitated by globalization? Speaking at an IMF seminar held on March 2, Jagdish Bhagwati, Professor of Economics and Political Science at Columbia University and Senior Fellow in International Economics at the Council on Foreign Relations, took issue with the notion, held by many critics, that globalization may be good for economic prosperity but is definitely bad for social goals.

Bhagwati: "Somehow, the critics who argue that globalization is harmful are seen by many as having seized the moral high ground."

On one level, he said, it is tempting to dismiss some protesters as part of the "tyranny of the missing alternative"—there is simply nothing else to protest against. For such groups, the protest against the institutions and corporations of the global economy might be written off as a knee-jerk reaction against the triumphalism of capitalism. But more significantly, Bhagwati observed, the voice of civil society has begun to be heard strongly even inside some international financial institutions. The many groups with an interest in broad "social agendas" sometimes concede that globalization may be economically benign but argue that it is socially malign.

Somehow, the critics who argue that globalization is harmful are seen by many as having seized the moral high ground. For many years, Bhagwati argued, the free traders held the high ground, and the protectionists appeared to be merely defending narrow special interest groups. But now, in the eyes of many, it is the antiglobalization groups who wear the halo and who claim that free trade damages social justice, peace, and women's rights, for example. Are these groups wrong? One of their shortcomings, argued Bhagwati, is the "fallacy of aggregation." Opponents do not distinguish between the different forms of globalization—trade, short-term capital flows, foreign direct investment, migration, and technology. They visit the sins of one form of globalization on all the others.

For instance, there is much hostility toward globalization in Asia because of the 1997–98 crisis. But this was a crisis caused by problems with just one aspect of globalization—capital flows. Bhagwati asserted that capital liberalization had been pressed too hard, without adequate support mechanisms. That said, he believed it would be absurd to turn away from capital flows. The ability to borrow, Bhagwati noted, is a very productive force and just because there was a problem with short-term capital flows, there was no reason to turn away from trade.

"Free trade is great, but great is not good enough"

This brought Bhagwati to his main theses: first, the growth of trade does lead to economic prosperity, and, second, trade is the friend, not the foe, of social agendas. But he introduced two broad qualifications:

- Countries need broad institutional support—governance—to deal with the problems that arise from liberalizing; and
- Even if social agendas are ultimately advanced by rising incomes, it may still be desirable to press ahead faster. For instance, child labor is almost certain to decline as poverty is reduced, but there are also good grounds to tackle it more directly and more quickly.

Bhagwati characterized the objections of the protesters, and even some academics (Jeffrey Sachs, Dani Rodrik, Joseph Stiglitz), as being based on selected instances of market failure. But even where there is market failure, the benefits of trade expansion may well outweigh the costs. For example, when an economy opens up, unemployment may occur because real wages do not fall (wage rigidity). But the population as a whole may gain—through a rise in the terms of trade and an increase in consumption—from the creation of new export industries. The better solution, of course, would be to fix the market failure, so that the conditions for free trade are created. If there is a market failure, such as environmental damage, the solution may be to establish, say, a "polluter pays" principle.

At the end of the day, the empirical evidence is all in favor of free trade. Contrast the experience of India—25 years of inward-looking policies and modest growth—with that of east Asia with its outward-looking policies and much higher growth rates. Or consider Japan, long viewed by some as proof of the success of protectionism, now languishing after a decade of low growth.

"Trade liberalization is the friend, not the foe, of social agendas"

Bhagwati argued that the social benefits of globalization are perhaps not as evident as the economic ones. It was, he said, desirable for economists to engage protesters on the very issues that they claim are the downside of globalization. He presented four examples to illustrate his argument.

Trade and gender. Take Japan, where, in the public domain, women are treated poorly compared with their peers in other high-income countries. The 1980s and 1990s saw a boom in Japanese foreign direct investment. Although it was the men who represented Japanese corporations in markets around the world, women went as spouses. These women then saw firsthand how women are treated elsewhere, and they became instruments of change when they returned home.

While not defending "sweat shops," Bhagwati pointed out that women held most of the jobs in the export-processing zones in many developing countries and clamored for overtime to build their household savings as rapidly as possible. Imagine the alternative—probably oppression—if these women lacked such opportunities.

Trade and culture. Trade means cultural as well as economic interchange. Bhagwati dismissed complaints about the transfer of "low-culture" symbols, such as McDonald's or Taco Bell, asking whether it really mattered. More important, he suggested, was the transfer of "high culture," by which he meant values such as women's and children's rights. Surely, there is nothing to complain about, he said, if globalization spreads values that improve conditions for women and children. It is the traditional elites who are most affected by globalization, Bhagwati argued, and it is they who are most likely to react against social change.

Trade, poverty, and literacy. From the 1950s through the 1980s, India was held back by antiglobalization sentiment and had, at best, a modest record of growth and poverty reduction. It would have been astonishing, Bhagwati said, if poverty had been reduced substantially when overall growth was so slow. But has globalization helped India? The crisis of the early 1990s undoubtedly led to important reforms, in which the IMF played a role. The country's new outward orientation has led to growth and the prospect of faster social change.

For years, India lacked the resources to build enough schools, despite a reordering of expenditures. Against that background, Bhagwati said, it is difficult to imagine increased literacy or greater educational attainment. Stronger growth, he emphasized, offers the hope of higher social expenditure and the possibility of building more schools and clinics.

Trade and wages. One argument, heard particularly from trade unions in the advanced countries, is that globalization leads to lower real wages and job loss. Critics paint a picture of a flood of labor-intensive goods from low-wage developing countries destroying jobs in the industrial countries. Bhagwati challenged this argument, noting that it is often used to restrict imports from the developing countries.

In fact, Bhagwati observed, the story is rather more complex. Over the past few decades, first one group of countries then another has begun to open up and benefit from trade. As these countries grow richer, their real wages rise, and they are no longer competitive in labor-intensive production. Not only do they cease to be a threat to workers in the industrial countries, he said, but they become importers of labor-intensive goods themselves. This process was seen first in Japan in the 1970s, east Asia in the 1980s, and China in the 1990s. India may well be next if it keeps its reforms on track.

Accelerating social agendas

The gains from globalization almost always outweigh the losses, Bhagwati noted. But there are losses, and, to deal with them, countries need appropriate institu-

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tions. First, they need national institutions. Consider the example of an export-oriented shrimp-farming project in India. It generated economic growth and social progress within the region but also produced some pollution from spillovers. The answer, Bhagwati emphasized, was not to close the operation down—as some activists wanted—but to find solutions to specific problems. The appropriate economic response, in his view, is to introduce a mechanism whereby the polluter pays. But in practice, he acknowledged, institutions such as an environmental ministry and a legal and judicial structure are needed to make that mechanism work.

Bhagwati: Gains from globalization almost always outweigh losses. Where there are losses, countries need appropriate institutions to deal with them.

Second, countries need support from international institutions. Bhagwati recalled the "banana case" whose settlement had created costs of up to 10 percent of GDP in some of the Caribbean countries affected. The international community cannot simply leave such countries to fend for themselves. It must find ways of providing real support to help them through the transition. It is not inappropriate, he argued, for activists and governments in the rich countries to want to advance social goals in the poor countries. But they should choose the right instruments, and not be so quick to resort to trade sanctions.

Take child labor. With 200–300 million children affected, it is simply too large an issue to address through generalized trade sanctions. Perhaps it can be addressed in selected industries, such as rug making. But the problem needs to be tackled through targeted programs, at the ground level, adapted to the particular circumstances. This is where local nongovernmental organizations (NGOs) have a role to play.

Bhagwati accused the "quad powers" (Canada, the European Union, Japan, and the United States) of incoherence in advancing social agendas. Although they are willing to subscribe only small amounts of money to the World Trade Organization (WTO), they still pressed for a "social clause." It is impossible for the WTO, a tiny institution, to have an impact on social issues, Bhagwati said. If these countries are really interested in social goals rather than trade sanctions, they should look to the International Labor Organization, the World Health Organization, or other international agencies with a relevant mandate.

Finally, Bhagwati pointed to a factor that contributed to the failure in Seattle: a North-South divide, not just among nations, but within civil society. NGOs in the North see themselves as civil society institutions and, as the international organizations are reformed, expect their voices to be heard. But the countries—and the NGOs—of the South want to make their own case, he said. Of course, this is partly a resource issue: the northern NGOs and unions are much better placed financially than their southern counterparts.

In concluding, Bhagwati stressed that we need the NGOs in international life. Each international organization must learn to work with civil society in ways appropriate to its mandate and activities. Some agencies, like the WTO, deal with treaties and international negotiation. Others, like the IMF, also offer financial support and detailed policy advice to individual member countries. As these organizations establish their own ways of working with civil society, they can help diminish the agitation felt by so many about globalization. ■

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Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
March 19	4.10	4.10	4.75
March 26	3.91	3.91	4.53

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).

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Data: IMF Treasurer's Department