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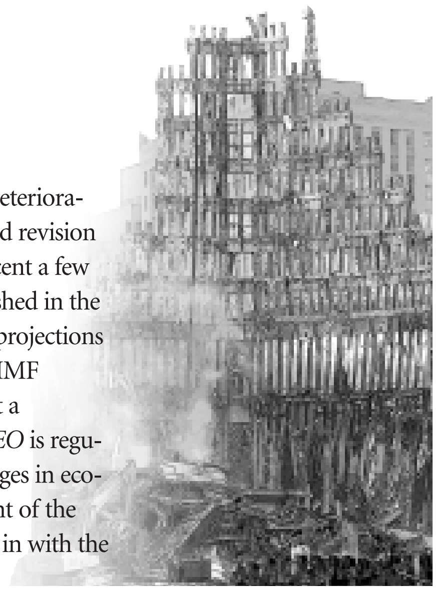
In this issue

WEO press conference

The global economy after September 11

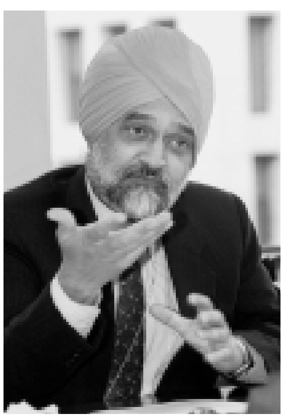


The events of September 11 and their aftermath have resulted in a sharp deterioration in confidence across the globe, which has contributed to a downward revision in the IMF's projection for world growth in 2002 to 2.4 percent from 3.5 percent a few months ago. The previous forecast, prepared before September 11, was published in the October 2001 *World Economic Outlook* (*WEO*) (see table, page 2). The latest projections were prepared for an interim update of the October report. Kenneth Rogoff, IMF Economic Counsellor and Director of the Research Department, explained at a December 18 press conference that the IMF prepares interim reports (the *WEO* is regularly published twice a year) when there have been rapid and significant changes in economic conditions. The latest interim *WEO* provides a "preliminary assessment of the events of September 11, their effects on the global economy, and how they fit in with the broader economic slowdown," Rogoff said. *(Please turn to the following page)*

Interview with Ahluwalia

Independent evaluations should put IMF on a faster learning track

In July 2001, Montek Singh Ahluwalia became Director of the IMF's new Independent Evaluation Office (IEO), which was created to conduct independent studies of issues relevant to the IMF. It operates independently of IMF management and at arm's length from the IMF's Executive Board. Ahluwalia brings to the job a wealth of public sector experience, having served in the Indian government since 1979, including as Finance Secretary in the Ministry of Finance, 1993–98, and as Member, Planning Commission, 1998–2002. He was at the World Bank from 1968 to 1979.



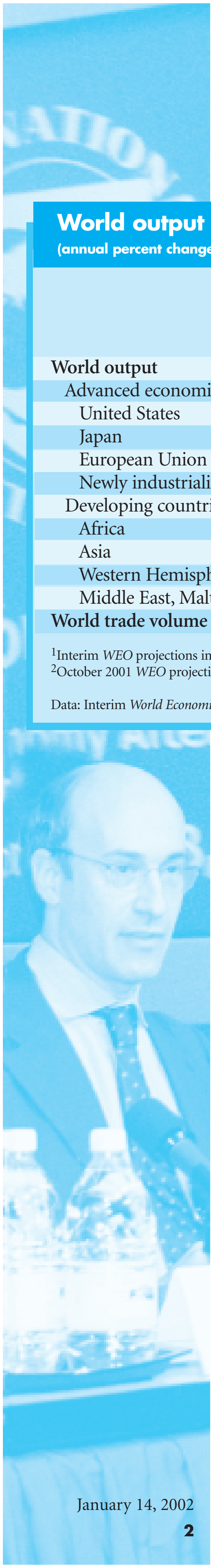
Montek Singh Ahluwalia

IMF Survey: What is the purpose of the IEO? Will its evaluations be a faultfinding exercise?

Ahluwalia: The principal purpose of the IEO is to undertake independent evaluations of the IMF's various activities, with a view to strengthening the learning process. The focus of our evaluations will not be faultfinding in the narrow sense of trying to identify which decisions were wrong and who was responsible. However, a critical review of past activity, whether it be surveillance or program financing, may throw up actions, judgments, and decisions that in retrospect may have been better done differently. We will certainly want to explore these issues to learn from past experience. We can hope to improve future performance only if we are willing to accept that we could have done better in the past.

IMF Survey: Will you be trying to establish best practices?

Ahluwalia: We may not always be able to translate our conclusions into a precise prescription of best practice. Sometimes the learning process might simply lead to the conclusion that one has to be very careful about a particular issue, and especially avoid some pitfalls, without necessarily prescribing what should be done in particular situations since so much depends upon the specific conditions prevailing. But each evaluation project will seek to identify specific *(Please turn to page 3)*



Growth in both the advanced and the developing countries is projected to slow down sharply in 2002—projections have been revised downward by 1.3 and 0.9 percentage points, respectively, since the October 2001 *WEO*. However, just looking at year-on-year growth numbers in this way might be misleading.

Does that mean that the current slowdown is not serious? No, Rogoff said, and he added that some major countries are in recession or close to it, including the United States, Japan, and Germany. However, growth in some other large countries, such as China, India, and Russia, has remained quite robust.

World output falls sharply after September 11
(annual percent change)

	December projections[1] 2001	Difference from pre–September 11 projections[2] 2001	December projections[1] 2002	Difference from pre–September 11 projections[2] 2002
World output	**2.4**	**–0.2**	**2.4**	**–1.1**
Advanced economies	1.1	–0.2	0.8	–1.3
United States	1.0	–0.3	0.7	–1.5
Japan	–0.4	0.1	–1.0	–1.3
European Union	1.7	–0.1	1.3	–0.9
Newly industrialized Asian economies	0.4	–0.6	2.0	–2.2
Developing countries	4.0	–0.4	4.4	–0.9
Africa	3.5	–0.3	3.5	–0.9
Asia	5.6	–0.2	5.6	–0.5
Western Hemisphere	1.0	–0.7	1.7	–1.9
Middle East, Malta, and Turkey	1.8	–0.5	3.9	–0.9
World trade volume (goods and services)	**1.0**	**–1.8**	**2.2**	**–3.1**

[1]Interim *WEO* projections include data compiled on the basis of information available through early December 2001.
[2]October 2001 *WEO* projections include data compiled on the basis of information available through end-August 2001.

Data: Interim *World Economic Outlook*, December 2001

In periods where there are rapid changes in growth, Rogoff said that it may be better to compare output in one quarter to output in the same quarter of the previous year. For example, the 2002 year-on-year growth projection for the United States is 0.7 percent, which masks the expected recovery in the second half of 2002. More meaningful, he said, is growth from the last quarter of 2001 to the last quarter of 2002, which is projected at 2.6 percent.

Current versus previous slowdowns

It is interesting to compare the current slowdown with previous ones of recent decades, Rogoff said. Global growth in 2001 and 2002 in the current slowdown—estimated at 2.4 percent in both cases—is higher than in the 1975, 1982, and 1991 slowdowns. It is also interesting, he observed, to look at global population growth during these slowdowns to see what was happening with per capita global GDP. In 1982, global output growth was 1.1 percent and population growth was 1.7 percent, so per capita global GDP was negative in 1982. This is also true for 1975 and 1991. However, in the current slowdown, with population growth estimated to be 1.3 percent in 2001, per capita global GDP growth is positive. Thus, compared to earlier slowdowns, particularly if one looks at per capita global GDP, the current slowdown is milder.

Are the forecasts accurate?

With regard to the forecasts, "this is a period of greater than usual uncertainty," Rogoff said. Generally, the spread of opinion of forecasters narrows as one gets closer to the projected year because more information becomes available. In recent months, however, taking the United States as an example, uncertainty about the forecasts (measured in terms of the variation across different private sector forecasts) rose rapidly as a result of the terrorist attacks. Indeed, Rogoff commented that the spread was so large that one could not meaningfully speak of a consensus forecast. In December 2001, however, the spread remained surprisingly large compared to other Decembers.

Although there are large downside risks to the 2002 projections, Rogoff indicated that there is still a possibility that the recovery could come more rapidly than expected. There is, he said, substantial policy stimulus in the pipeline, particularly from interest rates; the war on terrorism in Afghanistan could end sooner than expected; and there is the possibility of downside risks to oil prices. Still, Rogoff noted, the outcome for 2002 could be worse. The interim *WEO* presents an alternative scenario that combines some factors related to business and consumer confidence and global risk aversion that could get worse. "There are also many other potential sources of weakness in the world economy," Rogoff said. This is a period of significant uncertainty. ■

The text of the *World Economic Outlook*, as well as a transcript of Rogoff's December 18 press briefing, is available on the IMF's website (www.imf.org). Printed copies are available from IMF Publication Services at $42.00 each (academic rate: $35.00). See page 9 for ordering information.

Photo credits: Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF, pages 1–4, 7, 10, 12, and 14–16; Savita Kirloskar for Reuters, page 4; World Bank Institute, page 6; Ian Barret for Reuters, page 8; Thierry Roge for Reuters, page 16.

Strengthening the IMF's learning process

(Continued from front page) recommendations to foster opportunities for learning and improvement.

IMF Survey: Before you joined the IMF, what were your thoughts on our need for an independent evaluation function?

Ahluwalia: Given the focus on transparency in the new international financial architecture and also the fact that there are independent evaluation offices in every other international financial institution, I felt it was only logical to have one at the IMF. That said, I must also point out that the IMF's activity is quite different from that of multilateral development banks, so exact parallels are not possible. If you compare development ministries with central banks, you will find that in most countries development ministries almost everywhere routinely evaluate the effectiveness of their development projects and programs, but central banks typically don't have such evaluations.

IMF Survey: What do you think will be the hardest part of evaluating policy advice and decisions to support policy programs? If a program fails, can you really unravel the links?

Ahluwalia: The hardest part of any evaluation is how to quantify the counterfactual. Any retrospective evaluation involves asking whether one could have achieved better results if one had done it some other way, and it is obviously very difficult to be sure of what would have been the outcome of an alternative strategy. There are similar problems with what you call unraveling the links when a program fails. It is easy enough to define failure because the objectives of programs are usually well quantified. It is not so easy to know why it failed. Did it fail because the program was not implemented—that is, there was a policy failure—or because external factors behaved differently from what was projected? If the latter, was the original projection itself reasonable or overoptimistic? If there was a failure of policy implementation, is this because the original policy targets were unreasonable, which can be viewed as faulty design? These are difficult questions to address, but we hope to do it in a credible manner. I am also concerned that there will be a tendency for people to expect us to address every issue relevant for country performance. However, our mandate is not to assess country performance but to evaluate the IMF's activity.

IMF Survey: How will your evaluations differ from the internal reviews already taking place in the IMF?

Ahluwalia: They will differ in two ways. First, no matter how good an internal evaluation is, outsiders invariably view it as colored by the fact that it is internal. For this reason, an evaluation by an independent office will carry more credibility. Second, unlike internal evaluations, our evaluations envisage considerable interaction with outsiders. For each evaluation, we will publish an issues paper on our website and invite comments before defining the terms of reference. Once we have decided on the terms of reference, we will invite substantive contributions from interested parties wishing to respond on points included in our terms of reference. This type of interaction is not typical of internal evaluations. But unlike purely external observers, we will have the advantage of full access to internal IMF documents and discussions with IMF staff, management, and Executive Directors.

IMF Survey: Will the IEO enhance the IMF's credibility? Might there be a trade-off between the IEO's credibility and the IMF's credibility?

Ahluwalia: We can enhance the IMF's credibility only if we first establish our own credibility as an independent evaluation office contributing usefully to the learning process. If we achieve this objective, it will enhance the impression of the IMF as a learning institution that does not shy away from self-criticism.

IMF Survey: Should we expect the nature of the criticisms we receive to change? Are expectations, especially of the nongovernmental organizations (NGOs), being unduly raised?

Ahluwalia: NGOs have been strongly in favor of creating an independent evaluation office and have welcomed its establishment. That is surely a first step in recognizing that the IMF is moving toward greater transparency. For the rest, it will depend upon the quality of our output and also on the process we follow. NGOs have been particularly keen on processes that make evaluations open to input from interested parties, and we have tried to devise such processes for our work. Expectations are high, and I hope that will spur us to live up to those expectations.

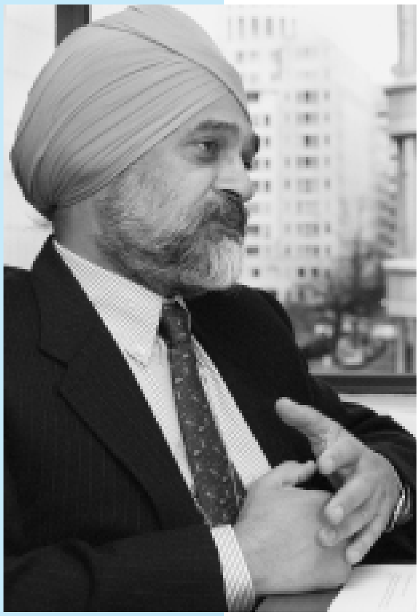
IMF Survey: For the coming year, you have chosen to review fiscal adjustment in IMF-supported programs; capital account crises in Indonesia, Korea, and Brazil; and repeat use of IMF resources. Why these three to start with?

Ahluwalia: We started by identifying about 40 topics that are consistent with our mandate and then narrowed the list down to around 15, from which we will choose around 10 to 11 to study over the next three years. The 3 we have chosen for our initial studies meet

The hardest part of any evaluation is how to quantify the counterfactual.
—Montek Ahluwalia

the criteria of addressing issues that are highly controversial and are of interest to a very large proportion of the membership. The capital account crisis cases stand out for study because they represent a new phenomenon that the IMF has had to deal with since the Mexican crisis.

As for fiscal adjustment in IMF programs, there is a widespread concern among academics and many observers in developing countries that IMF programs tend to be overly contractionary, with adverse effects on output and employment. There is also concern that the full implications of the fiscal stance, including especially its possible adverse effects on poverty, are not fully factored in. The evaluation seeks to examine the validity of these criticisms.



Ahluwalia: "Conditionality derived from a program that is fully owned is not being imposed from outside."

The study on repeat use of IMF resources addresses the problem posed by countries making frequent use of IMF resources, which goes against the expectations that IMF financing is meant to deal with short-term problems and should be temporary.

IMF Survey: Are there any particular issues that top your list for the next few years?

Ahluwalia: The short list of 12 from which the choice will be made is on the web at www.imf.org/ieo. We will make a firm choice in September or October 2002. I am keeping an open mind at this stage. A lot could happen between now and then that might alter our perception of priorities, and, in any case, we have invited comments on what our priorities should be and hope to get feedback before we decide.

IMF Survey: What is the reaction so far of IMF staff as you wander the hallways? Do they see you as a welcome independent voice or a threat?

Ahluwalia: Most staff members recognize that the IMF can be strengthened by an efficient and credible IEO, especially one that is open to external concerns about the functioning of the IMF and addresses these concerns in a responsible manner. They may wish to see our product before judging whether we are doing our job well, but that is only fair.

IMF Survey: There is an increasing emphasis in the IMF on country ownership of economic policies. What do you understand the term "ownership" to mean? Is there an inherent contradiction between ownership and stipulating conditions that countries must meet to receive a loan?

Ahluwalia: Ownership simply means that governments should undertake adjustment programs that they are fully convinced are appropriate for their circumstances and that they are willing to own publicly. Ideally, they should evolve their own program. If they need assistance, they should accept it from whatever source they like, but they should end up with a program they support and are confident they can implement.

Ownership is not inconsistent with conditionality, since the IMF must also satisfy itself whether, in its view, the program achieves the objectives for which the IMF is there to assist countries. Ownership thus becomes a necessary but not a sufficient condition. Where the program meets the IMF's requirements, conditionality is only an agreed benchmark of performance. Conditionality derived from a program that is fully owned is not being imposed from outside. It is as much an assurance being offered by the country as something imposed by the IMF, and in this sense there is no contradiction.

IMF Survey: You are regarded as one of the key people in the 1990s who helped shepherd India through a period of major economic reforms. Which ones are you the most proud of?

Ahluwalia: India's reforms were conceived as multidimensional, and progress has been made at different rates on all fronts. The areas where I can say the most has been done are the elimination of domestic licensing restrictions on private investment and the gradual, but nevertheless extensive, trade liberalization. There is still some way to go in reducing average tariff rates, but the direction has been clearly set. These changes have had a profound impact on the economy. There are a number of other important areas where a start has been made, but progress is gradual.

An important aspect of India's reforms is that they have been fully owned. There have been three changes in government since the reforms were introduced, and although there is always an element of controversy about reforms—perhaps an inevitable outcome in a democratic environment—successive governments have basically held the same line and moved forward.

IMF Survey: How did you handle the political economy of reform? Any insights for weighing the merits of IMF-supported programs?

Ahluwalia: India is a highly pluralist, participative, and, you might also say, noisy democracy. Two factors stand out. One is that the reforms have been implemented in an environment of intense debate, which has often seemed to outsiders to be dysfunctional, leading only to delay. However, it has had the benefit that the reforms have proved more enduring in the end. The second is that reforms were phased in gradually. It took 10 years to do what could have been done in 5, but there were no sudden shocks disruptive to one or another group of people.

IMF Survey: India is often cited as a country that largely escaped the instability of the 1990s by being relatively closed to foreign capital. Is it a model for others to follow, and does it carry lessons for the capital account cases you will be reviewing?

Ahluwalia: India's policy toward foreign capital in the 1990s differentiated between different types of flows. There was a considerable liberalization of the regime for foreign direct investment. There was also a liberalization of portfolio flows beginning in 1993.

However, debt flows have not been liberalized, and short-term debt in particular is tightly controlled for all Indian residents, including banks. Unlike many other emerging market countries, India also restricts capital outflows, although this has been liberalized recently to allow Indian firms to invest abroad.

One could say that this cautious approach insulated India from the destabilizing influence of highly volatile private flows. In countries where the capital account was liberalized prematurely, without adequate preparation and strengthening of the financial system to build in an appropriate reflection of risk, there have been huge inflows of capital, especially short-term borrowing, that made the countries extremely vulnerable to a sudden change in investor sentiment. India has avoided this danger.

However, it is recognized that as India globalizes—as its firms set up subsidiaries abroad and do business abroad—it will need access to capital on terms similar to those of other countries. If the capital account is opened up, the compulsion to improve the financial system and to improve other macroprudential indicators will become very strong; otherwise, the risk of crisis will increase.

IMF Survey: Can India's experience with fighting poverty shed some light on what other countries should do? Is it just a matter of faster growth and more liberalization?

Ahluwalia: There have been very significant gains in this area, with poverty falling from about 45 percent of the population in 1980 to around 27 percent in 2000. This decline is less than we had targeted—we had hoped to reduce poverty to about 18 percent by 2000—but it is a significant reduction.

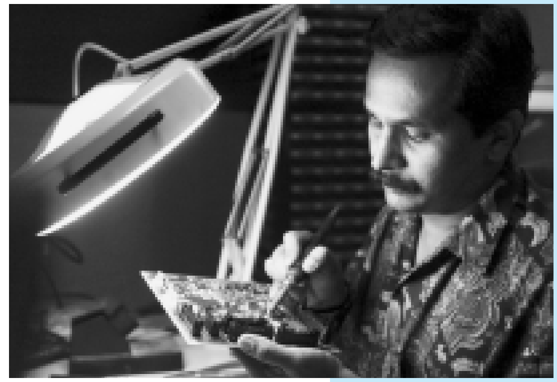
India's experience clearly shows that it is much easier to reduce poverty in an environment of substantial growth in per capita income. There was hardly any trend reduction in poverty before 1980, when growth rates were low, and a steady decline thereafter, when growth improved.

In an economy where markets are functioning, where the poorer sections are not delinked from the global process through some fundamental barriers, especially a lack of education, one can be fairly sure that the benefits of rapid growth will flow downward much faster than skeptics think. It is also clear that it is very unlikely that poverty will be reduced where growth is not taking place.

Pro-growth policies are, therefore, good for poverty alleviation, although they are not the full story. The state needs to play a big role in this process by providing education, health, and basic social infrastructure and also creating market links between rural and urban areas.

Of course, growth will not flow everywhere on its own; there will be segments of the population that will not be reached even in an environment of rapid and broad-based growth. These segments must be reached through targeted programs. However, the ability of the state to carry out targeted programs efficiently should not be exaggerated. Experience shows there are large leakages from these programs. There is need for more thought and effort on how to design programs to minimize such leakages. ■

A semiconductor chip designer in Bangalore, India—a city that has become Asia's Silicon Valley.



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Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
December 10	2.22	2.22	2.61
December 17	2.25	2.25	2.65
December 24	2.24	2.24	2.63
December 31	2.23	2.23	2.62
January 7	2.22	2.22	2.61

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

Lively regional forums set the stage for major poverty reduction conference

As the international conference on poverty reduction strategies gets under way in Washington on January 14–17, it draws heavily on a series of regional forums that were held in Africa, Asia, Latin America, and Eastern Europe in recent months. The aim of the conference is to enable participants from all interested countries and institutions to exchange views on the achievements and problems with the IMF's and World Bank's new approach to fighting poverty.

A participant in the Dakar, Senegal, forum exchanges views on the PRSP process.

The PRSP process is succeeding in making poverty reduction the central focus of policy development and in increasing a sense of country ownership.

About two years ago, the two institutions revamped their efforts to help low-income countries as part of a renewed effort on many fronts—including reducing the burden of external debt, urging rich countries to lower the barriers to poor countries' exports, and calling for increased donor aid and technical assistance. One of the chief products of this has been a refocusing of lending decisions around national poverty reduction strategy papers (PRSPs), which more than 40 countries are now developing and implementing.

What sets the PRSP apart from previous poverty reduction strategies is not so much its goal as its means. The PRSP process emphasizes poor country involvement in identifying root causes of poverty and in "owning" its proposed reforms. The debate and consultation that lead up to a formal PRSP tap a broad cross-section of society, striving especially to incorporate the views of the poor. To increase efficiency, the PRSP also seeks to improve coordination among the country's development partners (including bilateral donors and multilateral development banks) and focuses the international community's analytical, advisory, and financial resources on achieving concrete results.

It was the very novelty of this approach that prompted the IMF and World Bank Executive Boards to call for an early evaluation of country experience with it. What worked well needed to be shared; what didn't work needed to be fixed. This evaluation, under way since July 2001, began with internal reviews but then moved on to extensive external consultations. IMF and Bank staff have consulted with representative poor countries implementing PRSPs, bilateral donors and multilateral development banks and institutions assisting the poorest countries, and representatives of civil society organizations, both North and South, involved in country development work. These consultations have included written evaluations from the country perspective and regional forums.

Although the January conference will be the high point of the external evaluation, it is not the final step. Bank and IMF staff will marry the results of their internal analyses with the external evaluations and produce a paper for their respective Executive Boards summarizing the variety of views put forward and suggesting changes. The Boards are expected to consider the paper early in March 2002, in time to take the findings to the UN Financing for Development Conference in Mexico, March 18–22, and then present the results to the meetings of the IMFC and Development Committee in April.

Regional forums

To lay the groundwork for the January conference, the IMF and the World Bank organized forums in Senegal in September; Hungary in November; and Bolivia and Vietnam in December. The Senegal forum drew the largest number of participants—267 representatives from 32 PRSP or pre-PRSP African countries. But each of the forums had a similar composition of participants, with government officials providing more than half, and the remainder including parliamentarians, civil society, and the private sector. International organizations, such as the United Nations Development Program, the World Bank, and the IMF; regional institutions; and bilateral aid agencies also attended.

Openness and frankness characterized the discussions. Although the Bank and the IMF were the titular organizers, country representatives took the lead, exchanging accounts of their experiences—both good and bad—with their PRSPs. With some countries, such as Uzbekistan, East Timor, and Guatemala, just starting to develop their strategies and others, among them Bolivia, Uganda, and Tanzania, having several years of experience, there was much opportunity for country-to-country learning. Bank and IMF staff mostly listened—leading many country representatives to comment wryly that they had never seen the staff so quiet.

Often, it seemed more questions were asked than answered, but the forums were meant to put issues on the table and seek input. Were the voices of the poor truly being heard? Who really speaks for the poor? What are the biggest obstacles to poverty alleviation? What tools do we need to diagnose and track poverty? Will countries alter their budgeting process and tracking of government spending to ensure that PRSP priorities are acted upon? Is the PRSP a one-off exercise with no follow-through? Are the policies included in the PRSPs the right ones? Are the economic growth targets too ambitious or not ambitious enough? How should a country set priorities? Should donor support take the form of direct budget support rather than aid channeled through donor-funded and -controlled projects? How could donors be assured that aid released to country budgets went to PRSP budgets?

Despite the seeming cacophony of ideas, several points of consensus emerged:

- The PRSP process is succeeding in making poverty reduction the central focus of policy development and in increasing a sense of country ownership.
- The PRSP process is also broadening participation in the preparation of poverty reduction strategies, sharpening the diagnosis of the nature and causes of poverty, and underscoring the difficult policy choices countries face.
- PRSPs have political dimensions and must be rooted in political realities. Their preparation should not undermine existing political structures.
- Economic growth is necessary for poverty reduction, and sustainable growth requires macroeconomic stability. But targeted programs and policies must also ensure that poor households benefit from economic growth.
- The donor community has strongly embraced the principles of the PRSP approach and is increasingly linking its financial assistance strategies to it.

International poverty conference

These thoughts now feed into the international poverty conference in Washington, which will be attended by more than 300 participants representing PRSP countries, civil society organizations, the donor community, and multilateral organizations. The regional forums highlighted areas of consensus and concern across countries, facilitating the design of the conference agenda. The topics of discussion mirror the agenda for the regional forums: the preparation, content, and use of PRSPs.

How PRSPs are prepared. PRSPs, which governments prepare and monitor through a participatory process, involve a great number and wide range of people and have established a presumption of openness and transparency in the formulation of anti-poverty policy. Early experience with the process suggests that civil society's efforts have affected the content of PRSPs, particularly on issues of social exclusion and bad governance and on specific policy issues—for example, the elimination of school fees in Tanzania. Despite these achievements, the PRSP process has room to improve its inclusiveness and its organization and to develop a stronger and more effective role for civil society. The conference will examine options for doing so.

A second area of concern is how to achieve a more appropriate balance between the speed and the quality of the first full PRSPs. It was clear, from the onset, that PRSPs would take time to develop, but the preparation period has proved longer than expected. This poses a particular problem for the heavily indebted poor countries (HIPCs) that are benefiting from debt relief and require one year's implementation of a full PRSP for debt relief to become irrevocable. Some in the regional forums felt that this requirement pushed countries to rush their PRSP process. The conference will consider ways to improve the current framework to ensure an effective link between debt relief and poverty reduction.

Another issue is posed by the unique problems that conflict-affected countries confront. These countries often lack the capacity to organize an effective participatory process and face highly specialized and urgent needs, such as resettlement, demining, and demobilizing and reintegrating former combatants. The conference will discuss how the PRSP approach could be adapted to make the process more useful for conflict-affected countries.

What PRSPs contain. Each PRSP is expected to contain diagnostics on the causes of and trends in poverty, quantitative targets for poverty reduction, and short-term indicators for monitoring progress toward those targets. Most countries have made good progress in putting together this information. The process of gathering the data has improved communication and the sharing of information within the government, and generated a stronger sense of national responsibility for data collection and analysis. Important gaps in poverty data have also been identified and, with donor assistance, are beginning to be addressed. Nonetheless, the compilation and analysis of data remain a tall order for PRSP countries with generally limited capacities. The conference will discuss specific measures to improve data and diagnostics, and strengthen monitoring and evaluation capacity.

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PRSPs are expected to identify a set of priority public actions for poverty reduction over a three-year horizon within the context of a stable macroeconomic framework and a sound public expenditure program. The first set of PRSPs demonstrated an impressive ability to consolidate policy actions in

many different areas in a single document. These actions were not always clearly linked, however, to a comprehensive diagnosis of poverty or to an analysis of the impact of these policies on poverty.

Countries have found it difficult to set priorities in the face of uncertainties about their overall growth strategy, the cost of various actions, and the effective budget constraint under which they would operate. Some countries pointed to unrealistically high growth rates in the macroeconomic program—something they attributed either to weakness in the analysis of likely sources of growth or to changes in world economic conditions. Other countries found it hard to treat governance concerns consistently. The conference will seek ways to improve the clarity and coherence of public actions and prioritization in the PRSPs.

Participants in the regional forums endorsed the idea that the PRSP could serve as a unique reference document from which donors could design their own lending programs.

PRSP policies are to be framed by a public expenditure program, preferably cast as a three-year framework. Participants in the regional forums underscored the importance of good budgetary planning and execution to ensure that government money goes to poverty-reducing activities and to garner continued donor support. But public expenditure mechanisms in PRSP countries are often too weak to support a meaningful presentation of a medium-term framework. Also, budget allocations and execution are different, and sometimes budgetary information does not include donor-financed projects. Although the Bank, the IMF, and other donors devote considerable technical assistance to improving public expenditure management systems, the conference will be asked to consider what might be done to accelerate these efforts and ensure that the PRSPs contain adequate budgetary information on both planning and execution.

How PRSPs are used. Forum participants emphasized how critical a tool the PRSP can be in ensuring the coherence of a government's policy program across government agencies and over time. But for the PRSP to be effective in this regard, it must be integrated into a government's overall decision-making process. While this is obvious in theory, in practice countries have found it difficult. Some countries began elaborating PRSPs in parallel with other multiyear planning processes, such as budgets; often, ad hoc committees, separated from line ministry decision-making processes, prepared the PRSPs. The conference will consider what steps can be taken to better integrate PRSPs with other governmental decision-making processes.

The PRSP process, and the document itself, is intended to promote stronger partnerships between donors and countries and to improve donor coordination. Participants in the regional forums endorsed the idea that the PRSP could serve as a unique reference document from which donors could design their own lending programs. But the modalities that donors use to align their lending bear further consideration. For example, some governments expressed concern about overly demanding reporting requirements associated with lending operations in support of the PRSP, while donors indicated they were hesitant to expand program lending for PRSPs until better financial management systems were in place. Some complained that conditions attached to loans remained overly burdensome, while others argued that such conditionality was necessary to ensure proper use of donor funds. These are only a few of the issues that the conference will take up in an effort to improve country-donor and donor-donor coordination.

Finally, while regional participants rejected the view that the PRSP is a once-and-for-all exercise, there remains the question of what types of monitoring and updating will be needed to ensure that the implementation of the PRSP remains on track and that country strategies remain relevant. ■

Mark Plant
IMF Policy Development and Review Department

For more information on the conference—including the agenda and an issues papers—see the IMF's website (www.imf.org). For more info on the PRSP review, see www.worldbank.org/poverty/strategies/review/extrev.htm).

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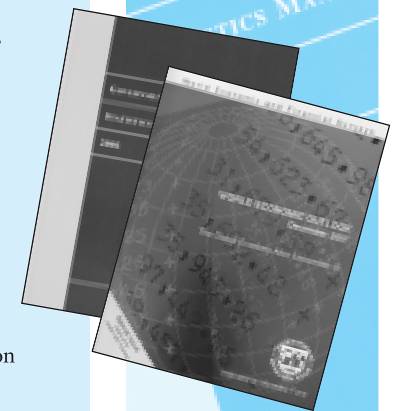

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Interview with Arora and Vamvakidis

United States increasingly serves as "engine" for world growth

In good times and in bad, the eyes of the world seem to be on the U.S. economy. Should they be? Do U.S. fortunes really shape the course of the world economy? Two IMF economists, Vivek Arora of the Western Hemisphere Department and Athanasios Vamvakidis of the European I Department, took a closer look at the United States's role as an "engine of growth." Here they discuss the findings of their recent working paper on the topic.

Arora: "Our evidence suggests that the causality runs from the United States to the rest of the world."

IMF SURVEY: We commonly refer to the U.S. economy as an "engine of growth" for the world economy. What prompted you to take a closer look at how true this is?

ARORA: When we were working on Asia during the Asian crisis, we were struck that countries that exported to the United States, like the Philippines, seemed to suffer milder downturns than countries that exported more to some other countries. We wondered whether there was something systematic to this.

And then when we started to look at this question, we found the phrase "engine of the world economy" in wide use. Policymakers used it, and so did investment banks. That made us curious. If U.S. growth changed by, say, 1 percent, what happened to the rest of the world? What's the power of this engine? We searched the empirical literature and were surprised to find little on the topic. This intuitive and widely used notion didn't seem to have a hard, quantified basis. So it seemed useful for us to try to answer the question.

IMF SURVEY: How did you go about quantifying the impact of U.S. growth on world growth and on specific countries?

VAMVAKIDIS: Our study first examined the direct impact of U.S. growth on the rest of the world through bilateral trade flows. We looked at the growth contribution of net exports during recent decades for individual industrial and developing economies. We did find the contribution to be significant and larger for some countries—notably Canada, Mexico, and several Asian countries—than for others.

For a group of nearly 40 countries, we found that net exports to the United States contributed, on average, 1/4 of 1 percentage point annually to real GDP growth during the past three decades. The direct trade impact, however, captures only part of the overall impact of U.S. growth on other countries. A more complete analysis of this requires a formal econometric estimation. So we then looked at the overall impact of U.S. growth on long-run growth in other countries by estimating a fixed-effect growth model, using cross-country panel data, to which we added the U.S. growth rate as another independent variable.

IMF SURVEY: What time period were you looking at?

VAMVAKIDIS: We examined the most recent two decades, but then to check the robustness of our results, we looked at earlier decades, starting in 1960, controlling for other important growth determinants.

IMF SURVEY: And your findings?

VAMVAKIDIS: The impact is significant—in some samples it was 1:1—that is, 1 percent faster growth in the United States leads to 1 percent faster growth in the rest of the world, keeping everything else constant. The impact is also much more significant on average for developing countries as a group, and the impact of U.S. growth on the rest of the world has increased significantly—almost doubled—during the past two decades. The past two decades, in fact, drive these results.

In addition, we found that the U.S. economy matters more than the rest of the world economy. We controlled for growth in the rest of the world to see if the impact of U.S. growth is different and matters more. Then we looked at the impact of growth in trading partners to see if the fact that the United States is the most important trading partner for most countries tends to drive these results, and it is, indeed, the main force behind our results. I should emphasize, of course, that our study looks at long-run growth—the model uses five-year averages, not short-term effects.

IMF SURVEY: Do these five-year averages allow you to look at the variable effects of upturns and downturns in the U.S. economy?

ARORA: Our five-year averages give us long-term effects; they do not allow us to isolate upturns and downturns. But the very high correlation between U.S. and world GDP growth during the past two decades takes account of both upturns and downturns. The correlation is over 80 percent between 1980 and the end of the 1990s. This is perhaps not surprising, given that the United States accounts for over one-fifth of world GDP on a purchasing power parity basis and for nearly one-third of world nominal GDP at market rates. It also accounts for over one-fifth of the expansion in world real GDP during the past two decades and nearly one-fourth of the expansion between 1992 and 2000.

IMF Survey: Did you look at the direction of causality between U.S. and world growth?

ARORA: Our evidence suggests that the causality runs from the United States to the rest of the world. Now you might argue that fast global economic growth—not U.S. growth per se—drove countries' growth. We looked at this possibility and included, separately, both U.S. growth and non-U.S. growth in our regressions. Both were significant, but U.S. growth mattered more.

VAMVAKIDIS: And taking this a step further, we found that the European Union has a smaller, but still significant, impact on world growth compared with the United States. We estimated the impact of Japan's growth on the world economy, but found that Japan does not function as an engine of world growth, though it may drive growth for certain countries.

IMF Survey: You mention that U.S. growth has had a stronger impact on developing countries than on industrial countries. Did anything in your results point to the reason?

VAMVAKIDIS: Our results suggest that the importance of the United States as a trade partner is driving these results. For many small developing economies, the United States is an important trading partner, and for these countries, exports to the United States represent a much higher share of GDP than they do for industrial countries. All of this suggests that we should see U.S. growth having a greater impact on developing countries, and we do.

ARORA: Our paper looks at trade shares and finds that net exports to the United States account for a larger share of growth in Asia than in Europe. That's partly because the share of the United States in Asian

Japan does not function as an engine of world growth, though it may drive growth for certain countries.
—Athanasios Vamvakidis

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Press Releases

01/50: IMF's Independent Evaluation Office Announces Work Program, December 5 (see page 1)

01/51: IMF Executive Board Approves $1.3 Billion PRGF Credit to Pakistan, December 7

News Briefs

01/127: IMF Gives Final Approval of PRGF Arrangement for the Kyrgyz Republic, December 7

01/128: IMF Gives Final Approval of Fourth Review Under the PRGF Arrangement for Burkina Faso, December 10

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Public Information Notices

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01/125: IMF Reviews Strengthening Country Ownership of Fund-Supported Programs, December 14

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01/128: IMF Concludes 2001 Article IV Consultation with San Marino, December 21

02/1: IMF Concludes 2001 Article IV Consultation with Vietnam, January 4

Speeches

"The Euro—An Emblem of the Successes and Challenges of European Integration," Horst Köhler, Informal Meeting of ECOFIN Council, Laken, December 14 (see page 16)

"A New Approach to Sovereign Debt Restructuring," Anne Krueger, IMF First Deputy Managing Director, Indian Council for Research on International Economic Relations, Delhi, December 20

Transcripts

IMF Economic Forum, *Transparency at the International Monetary Fund: The Road Ahead*, December 13

Press Conference on the interim *World Economic Outlook*, December 18 (see page 1)

Press Briefing, Thomas C. Dawson, Director, IMF External Relations Department, December 20

Statement at Donors' Meeting on East Timor, Stephen Schwartz, Deputy Division Chief, IMF Asia and Pacific Department, Oslo, December 12

Letters of Intent and Memorandums of Economic and Financial Policies

Jamaica, December 20

trade is much larger than in Europe—a phenomenon that's broadly true for developing versus industrial countries, with the exception of Canada.

I would add, however, that the effect of the United States as a global trading partner extends beyond the direct effect of net exports to the United States. It could be that as a country grows in importance as a trading partner, it also becomes more important as a source of foreign direct investment flows or other capital flows.

Vamvakidis: "If in the next five years the U.S. economy grows considerably less than it did in the second half of the 1990s, this will have very significant implications for the world economy."

IMF Survey: Were you able to draw regional observations from your data?

Vamvakidis: To check the robustness of our results, we excluded some major regions from our model and found that our results remained robust, suggesting that the impact, on average, does not seem to vary significantly across regions. If you look at net exports, though, it seems that the United States matters a lot in Asia, but in terms of overall impact, there seems to be a similar effect across regions but a clearly different impact, as we said earlier, on developing and industrial countries. For almost all countries, though, the United States ranks as one of the top four trading partners.

IMF Survey: Did you ask yourself how the United States was serving as an engine of world growth?

Arora: That is a larger question than whether it is or by how much. I am sure the "how" question will require more than one paper to answer. Our study does raise the issue of transmission channels, however.

Vamvakidis: We suggest the growth effect of the United States as a major trading partner may be transmitted through trade directly, but possibly also through foreign direct investment, consumer or business confidence, financial market linkages, and other channels. We don't document each of these channels separately, but it would be interesting to do so in future research.

IMF Survey: Now that you have provided evidence that the U.S. economy serves as an engine of world growth, what are some of the questions that it may be interesting to address in future research?

Arora: The research suggests a whole set of questions, and we hope to tackle some of them. First, it would be useful to be able to analyze the impact on developing countries of specific economic changes in the United States—for instance, a boom in import demand or a surge in investment in emerging markets or a big flow of capital abroad. To do this we really need to know how U.S. growth is transmitted to developing countries. If it is transmitted through trade flows, then it would be useful to know whether it is transmitted through volumes of trade. If it is transmitted through capital flows, it would be useful to know whether this is taking place through foreign direct investment, portfolio flows, or some other effect. Those are interesting and not just academic questions. The answers will allow developing country policymakers to analyze the impact of particular economic changes in the United States, whether it is a stock market decline, a surge in consumer demand, or something else.

It would also be interesting to see how cyclical developments in the United States influence cyclical developments in other countries. This has been touched on by other researchers, but certainly bears closer attention. And it would be interesting to look at something you asked earlier—that is, does U.S. growth matter more for certain regions of the world? Is it more crucial for Latin America than for Asia, for example? Our preliminary results suggest a pretty even distribution, but this, too, could benefit from further study.

IMF Survey: A final word on the impact of the U.S. economy on the world?

Vamvakidis: The world economy benefited from the fact that during the 1990s—and more during the second half of the 1990s, actually—there was a considerable acceleration in U.S. growth. And the world economy will be hurt if the current slowdown in the United States persists. If in the next five years the U.S. economy grows considerably less than it did in the second half of the 1990s, this will have very significant

Members' use of IMF credit
(million SDRs)

	During November 2001	January–November 2001	January–November 2000
General Resources Account	52.00	21,358.70	3,088.39
Stand-By	52.00	20,616.70	2,011.68
SRF	0.00	12,662.31	0.00
EFF	0.00	742.00	1,076.72
CFF	0.00	0.00	0.00
PRGF	62.92	696.53	393.14
Total	114.92	22,055.23	3,481.53

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CFF = Compensatory Financing Facility
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

implications for the world economy. This is a main conclusion one could draw from our paper.

Arora: When we discuss forecasts with member countries, the first thing many will ask is "what is your forecast for the United States?" That, in itself, is telling. ■

Copies of IMF Working Paper No. 01/119, *The Impact of U.S. Economic Growth on the Rest of the World: How Much Does It Matter?* by Vivek Arora and Athanasios Vamvakidis, are available for $10 each from IMF Publication Services. For ordering details, see page 9.

Stand-By, EFF, and PRGF Arrangements as of November 30

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina[1]	March 10, 2000	March 9, 2003	16,936.80	7,180.49
Brazil[1]	September 14, 2001	December 13, 2002	12,144.40	8,468.82
Croatia	March 19, 2001	May 18, 2002	200.00	200.00
Ecuador	April 19, 2000	December 31, 2001	226.73	75.58
Gabon	October 23, 2000	April 22, 2002	92.58	79.36
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Panama	June 30, 2000	March 29, 2002	64.00	64.00
Peru	March 12, 2001	March 11, 2002	128.00	128.00
Romania	October 31, 2001	April 29, 2003	300.00	248.00
Serbia/Montenegro	June 11, 2001	March 31, 2002	200.00	100.00
Sri Lanka	April 20, 2001	June 19, 2002	200.00	96.65
Turkey[1]	December 22, 1999	December 21, 2002	15,038.40	5,702.36
Uruguay	May 31, 2000	March 31, 2002	150.00	150.00
Total			**45,800.43**	**22,612.78**
EFF				
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Indonesia	February 4, 2000	December 31, 2002	3,638.00	2,477.20
Jordan	April 15, 1999	April 14, 2002	127.88	60.89
Kazakhstan	December 13, 1999	December 12, 2002	329.10	329.10
Ukraine	September 4, 1998	August 15, 2002	1,919.95	726.95
Total			**7,971.93**	**5,551.14**
PRGF				
Armenia	May 23, 2001	May 22, 2004	69.00	59.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	72.40
Benin	July 17, 2000	July 16, 2003	27.00	12.12
Bolivia	September 18, 1998	June 7, 2002	100.96	37.10
Burkina Faso	September 10, 1999	September 9, 2002	39.12	16.76
Cambodia	October 22, 1999	October 21, 2002	58.50	25.07
Cameroon	December 21, 2000	December 20, 2003	111.42	79.58
Central African Rep.	July 20, 1998	January 19, 2002	49.44	24.96
Chad	January 7, 2000	January 6, 2003	42.00	18.20
Djibouti	October 18, 1999	October 17, 2002	19.08	13.63
Ethiopia	March 22, 2001	March 21, 2004	86.90	52.14
FYR Macedonia	December 18, 2000	December 17, 2003	10.34	8.61
Gambia, The	June 29, 1998	December 31, 2001	20.61	3.44
Georgia	January 12, 2001	January 11, 2004	108.00	81.00
Ghana	May 3, 1999	May 2, 2002	228.80	105.17
Guinea	May 2, 2001	May 1, 2004	64.26	51.41
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Guyana	July 15, 1998	December 31, 2001	53.76	28.88
Honduras	March 26, 1999	December 31, 2002	156.75	48.45
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Lao People's Dem. Rep.	April 25, 2001	April 24, 2004	31.70	27.17
Lesotho	March 9, 2001	March 8, 2004	24.50	17.50
Madagascar	March 1, 2001	February 29, 2004	79.43	68.08
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2003	51.32	26.40
Mauritania	July 21, 1999	July 20, 2002	42.49	18.21
Moldova	December 21, 2000	December 20, 2003	110.88	92.40
Mongolia	September 28, 2001	September 27, 2004	28.49	24.42
Mozambique	June 28, 1999	June 27, 2002	87.20	25.20
Nicaragua	March 18, 1998	March 17, 2002	148.96	33.64
Niger	December 22, 2000	December 21, 2003	59.20	42.28
Rwanda	June 24, 1998	April 30, 2002	71.40	9.52
São Tomé & Príncipe	April 28, 2000	April 27, 2003	6.66	4.76
Senegal	April 20, 1998	April 19, 2002	107.01	19.54
Sierra Leone	September 26, 2001	September 25, 2004	130.84	84.00
Tajikistan	June 24, 1998	December 24, 2001	100.30	22.02
Tanzania	April 4, 2000	April 3, 2003	135.00	55.00
Vietnam	April 13, 2001	April 12, 2004	290.00	248.60
Zambia	March 25, 1999	March 28, 2003	254.45	149.63
Total			**3,335.53**	**1,910.48**
Grand total			**57,107.89**	**30,074.40**

[1]Includes amounts under Supplemental Reserve Facility.
EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

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

Economic Forum

IMF conditionality: how much is enough?

In the 1990s, the IMF's deep involvement in crisis countries and its wide-ranging efforts to promote reform in many low-income countries raised questions about the number and the type of conditions attached to its financing. Many critics charged the IMF had overextended its "conditionality," while studies increasingly linked successful reform programs with high degrees of government and public "ownership" of these efforts.

In response to internal and external concerns, IMF Managing Director Horst Köhler has taken the lead in streamlining and refocusing conditionality. An IMF Economic Forum on December 19 explored how the IMF is progressing. Participants in the panel included James Boughton, Assistant Director in the IMF's Policy Development and Review Department; Joanne Salop, Vice President of the World Bank for Operations Policy and Country Services; and John Williamson, Senior Fellow, Institute for International Economics. It was chaired by Masood Ahmed, Deputy Director in the IMF's Policy Development and Review Department.

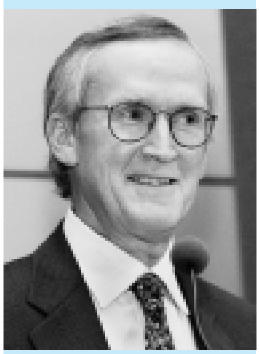
History of IMF conditionality

Boughton began by suggesting that the title of the seminar should not have been "how much is 'enough'?" because it was "impossible to come up with an exact number of how much conditionality is enough." Rather, he said, the title should have been "what is the IMF trying to achieve with conditionality?"

He then moved on to how IMF conditionality has evolved over almost half a century. It actually began in a Stand-By Arrangement for Peru in 1954. That program had one condition: that Peru promise to keep its exchange rate stable. Over the next few years, conditionality became more formalized, as the IMF developed a model linking the balance of payments to monetary, fiscal, and exchange rate policies. Instead of requiring countries to act directly on the balance of payments, that model required countries to act directly on policies that they could control, monetary and fiscal policies.

Paraguay's program in 1957 was the first to apply this model through performance criteria. But such conditionality was applied in a very haphazard way for some time. If necessary, conditions were imposed, and if not, the program was not subject to conditions. This came to a head in 1967, when the United Kingdom had a large arrangement with the IMF without any explicit performance criteria. This raised questions of uniformity of treatment and, as a result, the IMF set out guidelines governing its policy of conditionality. These guidelines established the principle that if countries borrowed large amounts relative to their quotas, they would be subject to a standard set of performance criteria.

In the 1970s, Boughton said, the IMF experimented with more extensive conditionality. An effort was made in the late 1970s to cut back, resulting in 1979 in a new set of guidelines still in effect today. However, during the 1980s and 1990s, the IMF slipped away from some of the principles for two reasons. First, by focusing on targets for aggregates like the overall fiscal deficit and credit creation, IMF conditionality left governments with a lot of scope to fix their own policies within those targets. That often led to bad outcomes. Second, as the IMF dealt more and more with countries experiencing long-lasting structural problems, it broadened conditionality into structural areas, particularly in the 1990s. One oft-quoted example is that of Indonesia in the late 1990s, with 117 structural conditions.



Boughton: "The IMF is now trying to develop new guidelines to restore some of the old principles and still meet today's problems."

The IMF is now trying to develop new guidelines to restore some of the old principles and still meet today's problems—the aim being to "streamline, focus, and foster ownership," he said. More generally, the objectives of conditionality are to

- help countries alleviate their balance of payments problems;
- make certain that countries do not take measures destructive of national or international prosperity to solve their balance of payments problems; and
- ensure that the IMF helps countries improve their sustainable growth rates.

The main aim is to have a "minimum amount of conditionality that enables countries to meet these goals," Boughton said.

How can these goals be achieved? He said that the IMF needs to be more flexible, not dictating to a country what policies are needed. The country should be allowed to present a program to the IMF. There has to be broad participation in the discussion of policies in the country. And the IMF needs to be selective, patiently waiting for the country to be ready. Already, there are promising signs. The streamlining process is under way, and collaboration with the Bank has been strengthened. The other goals, however, will require more time, he noted.

World Bank–IMF collaboration

Joanne Salop looked at the complex and changing interplay between the IMF and the World Bank over the past 55 years. Though the Bank's first loans in the late 1940s were program loans, most of its early loans—both for the reconstruction of war-torn Europe initially and subsequently to other countries for development—were for physical investments in infrastructure. During the 1970s, even as the Bank added new areas, such as education, its focus on bricks and mortar remained, providing a natural brake on the operational overlap between the two institutions.

This all began to change in the 1980s, when the Bank introduced structural adjustment lending to help countries respond to the debt and oil crises. This shift in lending instruments enlarged the interaction between the Bank and the IMF, as it required the Bank to consider macroeconomic issues, the IMF's core area of work. Operationalizing the change raised many questions: How should the Bank take into account the IMF's views on macroeconomic issues? Could the Bank provide a structural adjustment loan if the IMF was not satisfied with the country's macroeconomic policies? Should the Bank prepare its own macroeconomic work or rely on the IMF's work?

During the 1990s, Salop said, it was the IMF's turn to shift, increasing its attention to the social and structural areas important to poverty reduction—the Bank's core mandate—and setting in train many of the operational questions on conditionality and related issues the IMF is now addressing. Underlying both institutions' shifts was the fact that the development paradigm they subscribed to increasingly recognized that macroeconomic issues were linked with social and structural issues, and that both mattered for development outcomes.

But, Salop noted, having a shared model of development raised other questions. Would it make sense for the international community to have a Bank that looks just like the IMF, and vice versa? Indeed, with virtually all development agencies espousing the same paradigm, should they all replicate each other's strengths, or should they be more strategically selective, complementing each other's strengths? In recent years, she said, there has been an increasing recognition in development circles that individual agencies should specialize in their core areas of dynamic comparative advantage, sharing expertise and knowledge across agencies through development partnerships.

Making this principle of comparative advantage work in the context of the Bretton Woods institutions, according to Salop, will require effective management of conditionality and implementation issues. On the former, it is clear that each institution is accountable for its own lending decisions. The Board of Directors of each institution makes its decisions based, as always, on the advice of management. But, going forward, according to the recent joint Bank-IMF work on collaboration on conditionality and country programs, the advice and recommendations of management to the Board may be explicitly informed by the views of staff from the other institution—the so-called lead agency concept.

The larger challenge to the strategic selectivity approach is implementation, given the different operational work and styles of the two institutions, especially on timing, where, Salop pointed out, effective Bank-IMF collaboration and support to client countries often hinge on appropriate phasing of the macroeconomic and structural elements of the program. Structural issues are more complex and longer term, and there have been—and will be—cases where they cannot be addressed adequately within the time frame of preparation and implementation of macroeconomic programs.

If the Bank team is to provide timely and effective inputs to IMF missions on a wide range of social and structural issues in the required depth, it needs to be prepared with the requisite underlying analytic work. The Bank's current program to rebuild its diagnostic economic and sector work will help. However, it is also essential that the Bank team get an early jump on the issues likely to be needed by the IMF team.

View from outside

John Williamson, who had worked at both the IMF and the World Bank and is now at a private think tank, sought to bring an "outside" perspective to the discussion. He proposed ways in which the IMF and the Bank could work more effectively.

There was "a lot of concern in the early 1980s that IMF conditionality had a deflationary bias and that it was thus bad for growth," Williamson noted. When governments were asked to lower public expenditure, for example, they often made cuts in areas that hurt long-term growth and equity and then blamed the IMF for forcing them to take those measures. So, he said, it was easy to understand the pressures that led to the emergence of structural conditionality. But this has created another set of problems: far too many conditions and conditions in areas that are not part of the IMF's core functions.

Different IMF lending facilities raise different issues, he pointed out. For example, facilities that deal with traditional balance of payments problems (Stand-By Arrangements and the Supplemental Reserve Facility) should not require many structural conditions. In such cases, he said, what is most relevant is the right combination of monetary and fiscal policies to correct the balance of payments problem.

In the case of the Poverty Reduction and Growth Facility (PRGF), which is designed to help low-income countries, there is a greater need for structural measures, Williamson suggested. The IMF should ensure that the macroeconomic aspect of the program sup-

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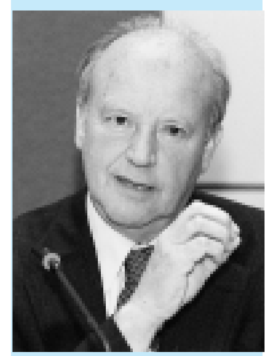

Williamson: "The PRGF would be handled by the Bank. The IMF would continue to have a role in that type of facility, but only to certify that the macroeconomic measures were appropriate."

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Masood Ahmed

ports the poverty reduction strategy. Here, however, the IMF has perpetuated an accounting problem that should be remedied. In the fiscal accounts, the IMF does not treat aid receipts as current receipts, but places them below the line, even though they do not create indebtedness. This leads to problems—particularly in aid-dependent countries—in that "the IMF appears to have an excessive zeal for fiscal contraction in circumstances where it is not appropriate," he noted.

On what areas fall in the purview of the Bank or the IMF, Williamson cited a number of areas, including governance, liberalization, privatization, social expenditures, and environment, where the Bank clearly has a comparative advantage. And how, he wondered, should the two institutions coordinate in the case of the PRGF, which deals primarily with areas that fall under the purview of the Bank?

One possibility, he said, could be for the IMF to lend based on macroeconomic conditions and for the Bank to lend based on structural conditions. Essentially, both institutions would work independently of one another. But, Williamson said, that is not a good solution. Another possibility could be for each institution to lend based on its own set of conditions but require approval by the other institution.

A third possibility, which Williamson supported, was to consolidate the lending into one organization. Specifically, the PRGF would be handled by the Bank. The IMF would continue to have a role in that type of facility, but only to certify that the macroeconomic measures were appropriate.

Was there a fourth and perhaps more radical alternative? One could argue for abandoning conditionality altogether and having both organizations indicate whether the country strategy is appropriate. This "common-pool" approach is used by donors in the poverty reduction strategy papers that countries prepare. In that exercise, he said, the donors indicate how much they are prepared to provide, and then the IMF gives guidance on whether the program is appropriate on the macroeconomic side and the Bank on the structural side. The problem with that approach is that one would still have to decide whether, for instance, IMF approval should depend only on macroeconomic issues or also on Bank approval.

Other issues to consider

The IMF's Masood Ahmed closed the discussion by raising two important issues that need to be considered in parallel with the conditionality exercise. The first issue, he said, deals with the content of policy advice in different circumstances. Economic analysis is clear about what works in some circumstances; however, it is not so clear in other situations. Second, the effective implementation of programs depends not only on the policy content and modalities of conditionality but also on how the IMF interacts with borrowing countries. ■

Köhler sees euro bolstering global financial stability

On December 14, as 12 European countries approached the final stage of the introduction of the euro, IMF Managing Director Horst Köhler spoke at an informal meeting of the Economic Affairs and Finance (ECOFIN) Council in Laken, Belgium. The full text of his speech is available on the IMF's website (www.imf.org). Here, we reprint his conclusion.

The euro project is a success. In a remarkably short time, it has created a large, stability-oriented economic and monetary space. But the record to date falls short of the results we have all hoped for. The hope has been that the euro would prove a spur to stronger growth and job creation. Given developments over the past few years, I am beginning to worry that it may be having the opposite effect: the elimination of the exchange rate constraints, and the associated discipline on policies, may have reduced rather than enhanced the drive for structural reform.

The Laken summit is the right place to bring renewed energy to economic and monetary union and to revitalize the momentum for Europe in facing two critical challenges:

- The economic challenge—to enhance growth in Europe by more ambitiously embracing structural change and realizing the full potential of the single market for income and job creation; and
- The political challenge—to clarify the future quality of European integration and stand up to a true leadership role in the world.

As European leaders rise to these challenges, I am confident the euro will prove to be a lasting success for Europe and the major contribution to the stability of the international monetary and financial system.