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Rich countries urged to lead by example on trade access



A woman collects cocoa pods at a farm in Côte d'Ivoire—the world's biggest cocoa producer.

*I*mproving market access for developing countries is one of the most important steps that rich countries can take in fighting global poverty, according to the chief economists of the World Bank and the IMF. Both institutions highlighted the issue during their recent Annual Meetings. Market access was the theme of a joint report and press conference, and a seminar.

Agricultural subsidies in rich countries amount to almost \$1 billion a day, roughly six times the level of aid to developing countries. "It's hypocrisy to encourage poor countries to open up their markets while imposing protectionist measures that cater to powerful special interests in the rich countries," Nicholas Stern, chief economist of the World Bank, told reporters at a September 27 press conference to publicize the release of a joint report, *Market Access for Developing Country Exports—Selected Issues*. "Rich countries," he said, "should lead by example."

Kenneth Rogoff, Economic Counsellor and Director of the IMF's Research Department, was equally critical. "The sheer magnitude of the support given to farmers in rich countries (Please turn to the following page)

IMF Economic Forum

Can stronger institutions and better training speed Africa's development?

*I*n keeping with its increased emphasis on national "ownership" of reforms, the IMF has focused, in several recent initiatives, on helping countries build their capacity to formulate and implement economic policy. While most agree that this is desirable, how to do it is being hotly debated. A September 12 IMF Economic Forum, "Capacity Building: Lessons for Africa?" moderated by IMF African Department Director Abdoulaye Bio-Tchané, addressed the issue and discussed how Africa could benefit.

In opening remarks, Claire Liuksila, Director of the IMF's Office of Technical Assistance Management, noted that capacity building can mean different things to different people. Some favor building strong institutions; others emphasize training; still others give priority to participatory processes. But

most agree, she said, that capacity building is a "holistic, dynamic, participatory process that emphasizes ownership and accountability for all involved—governments, civil society, bilateral aid agencies, and international institutions." (Please turn to page 323)



From left, John Audley, Oleh Havrylyshyn, Piroska Nagy, and Abdoulaye Bio-Tchané debate capacity building.

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Rich countries urged to cut trade barriers

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is stunning—over 30 percent of farmers' income," he said.

Stern tried to put the findings of the joint report in perspective with an illustration. "The average

European cow receives around \$2.50 a day in subsidy. The average Japanese cow receives around \$7.00 a day in subsidy. In sub-Saharan Africa, 75 percent of the people live on less than \$2.00 a day. By anybody's standards, these subsidies are huge," he stated.

Estimates varied on how much developing countries would benefit from a lowering of industrial country tariffs. "The bottom line is that if we got rid of all of the trade barriers, you'd be seeing

gains in the world economy about 10 years from now—it would take time to do—of the order of \$500 billion. That compares, of course, with aid at \$50 billion. At least half [of the \$500 billion] would go to developing countries. So we're talking about really big numbers compared with aid," Stern said.

Best way forward

Rogoff argued that the best way to remove agricultural support was multilaterally. "Multilateral liberalization will secure the greatest benefits to all and help to neutralize the influence of special interests," he said. Industrial countries were best placed to take the lead in promoting such liberalization, given their wealth and the relatively small size of their agricultural sectors in terms of overall GDP.

Support for reducing trade barriers also came from the IMF's 24-member International Monetary and Financial Committee (IMFC), which said that substantial trade liberalization in the Doha Round of

multilateral trade negotiations was vital for global growth. "Urgent progress is essential in enlarging market access for developing countries and phasing out trade-distorting subsidies in developed countries. Developing countries should also further liberalize their trade regimes to maximize growth and development opportunities," the IMFC said in its September 28 communiqué.

IMF Executive Directors, who considered the joint IMF–World Bank report at a session on September 18, agreed that the levels of protection in Organization for Economic Cooperation and Development (OECD) countries came at considerable cost both to them and to developing countries. A summary of their discussion noted that the estimated global welfare gains from the elimination of tariff and quota restrictions on merchandise trade—in both industrial and developing countries—range from \$250 billion to \$680 billion annually, with the gains to developing countries far outweighing annual aid budgets.

Doubts about approach

The multilateral trade negotiations launched at the World Trade Organization (WTO) in late 2001 were termed the Doha Development Agenda to signify the importance of the role that developing countries and development objectives would play in the multilateral trading system. Despite this change in terminology, there remains considerable disagreement about how developing countries can use trade to promote their development and how industrial countries might help them take advantage of the opportunities created by the global trading system.

To discuss these issues, the IMF and the World Bank sponsored a seminar during the September Annual Meetings. Panelists included Arvind Panagariya, Professor of Economics and Co-Director of the Center for International Economics, University of Maryland; Uri Dadush, Director of Trade Department, World Bank; Kevin Watkins, Head of Research, Oxfam International; Chris Padilla, recently appointed Assistant U.S. Trade Representative for Intergovernmental Affairs and Public Liaison; and Emmanuel Tumusiime-Mutebile, Governor, Bank of Uganda.

Panagariya, a former chief economist of the Asian Development Bank, cautioned that a reduction in trade barriers to goods from developing countries—particularly tariffs on textiles and clothing, footwear, and agricultural products—will not be possible outside the Doha Round. "It's not going to happen unless developing countries actually aggressively pursue this as a part of reciprocal bargaining," he said.

Billions of dollar were spent on agricultural support in 2001

Country	PSE ¹ (millions of U.S. dollars)	Percentage PSE ²
Australia	827	4
Canada	3,928	17
Czech Republic	585	17
European Union	93,083	35
Hungary	580	12
Iceland	108	59
Japan	47,242	59
Korea	16,838	64
Mexico	6,537	19
New Zealand	52	1
Norway	2,173	67
Poland	1,447	10
Slovak Republic	151	11
Switzerland	4,214	69
Turkey	3,978	15
United States	49,001	21
OECD	230,744	31

¹Producer support estimate (PSE) is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to support agricultural producers.

²The percentage PSE is the ratio of the PSE to the value of total gross farm receipts.

Data: IMF and World Bank, *Market Access for Developing Country Exports—Selected Issues*

Dadush said that two main objectives for the World Bank were to promote change in the world trading system to make it more supportive of development, especially of the poorest countries, and of the poverty reduction in the developing world; and to promote integration through trade. While the world's trading system is far more liberal than it was 40 years ago, it still discriminates against the poor, partly because they work in sectors such as agriculture that are most affected by rich-country tariffs.

Dadush urged all of the OECD countries to implement the "Everything But Arms" Initiative of the European Union (EU). The initiative is designed to assist the 48 poorest countries in the world and commits the EU to eliminating quotas and duties on most products except arms. But Watkins, arguing that the current trade system was built on hypocrisy, was skeptical about the EU initiative, noting that it had already been watered down for some agricultural products like sugar. "So 'everything but arms' becomes 'everything but farms,' and on we go."

Sending signals

If OECD countries are serious about Doha being a development round, Watkins argued, they could do several things to signal their good intentions. He recommended that they

- agree to a binding schedule for phasing out agricultural export dumping;
- fully implement market-opening arrangements for garments and textiles and start extending duty-free and quota-free access to low-income countries;
- enact a public health provision in the intellectual property segment of the WTO agreement and ensure that it is not used to push up pharmaceutical prices; and
- put the liberalization of financial services and

investment on the back burner, leaving it toward the end of negotiations.

Padilla took a somewhat different tack, noting that, while developing countries paid 41 percent of the world's tariff bill on all merchandise, most of these tariffs went to other developing countries. "In other words," he said, "south-south payments are by far the highest percentage of developing country tariff bills." While the Doha Round must address developed country trade barriers, "it cannot ignore the extremely large percentage of south-south trade and the extraordinarily high tariffs imposed by developing countries against each other," he added.

Tumusiime-Mutebile disagreed with Watkins' advice that financial liberalization be postponed. "It is wrongheaded to argue that, because financial liberalization has caused some problems in east Asia, therefore financial liberalization is wrong. No. The cure is that there should be proper, effective, and firm-handed regulation. There should be regulation that will stop a crisis from taking place; regulation that will deal with a crisis promptly if it does take place, and regulation that will stop contagion. But by all means, liberalize," he added.

Whatever happens, most agreed that liberalization will be a long, drawn-out process. This may be no bad thing. "While associated with continuing large income losses for the world economy as a whole," the joint report concluded, "the gradual pace of any likely path of agricultural liberalization should help ease adjustment." ■

Market Access for Developing Country Exports—Selected Issues, prepared by the staffs of the IMF and the World Bank, is available on the IMF website at www.imf.org/external/np/pdr/ma/2002/eng/092602.htm.

IMF has made capacity building a priority

(Continued from front page)

The IMF has made technical assistance for capacity building a priority, and its regional centers—PFTAC (Pacific Financial Technical Assistance Center) and CARTAC (Caribbean Regional Technical Assistance Center)—embody this new focus, Liuksila said. The recently established CARTAC, she said, is an example of successful capacity building. Recipient countries generate their own work programs; CARTAC is backed by a strong political commitment to change; all the center's stakeholders—including several regional institutions—have strong ownership; and CARTAC tailors technical assistance to fit, and build on, countries' existing capacity.

The IMF contributes to capacity building both indirectly and directly, Saleh M. Nsouli, Deputy Director of the IMF Institute, said. One indirect means of capacity building that's often overlooked, he observed, is that resulting from the interaction between IMF staff and country authorities on missions. The discussions and analyses undertaken during both the IMF's annual consultations with member countries and the negotiations and follow-up in the context of IMF-supported programs constitute an important, if indirect, form of capacity building. Direct capacity building is provided by the IMF's four technical assistance departments—Fiscal Affairs, Legal,

So "everything but arms" becomes "everything but farms," and on we go.
—Kevin Watkins

Why has [Africa] not achieved more? Persistent political instability is one reason and a lack of clear incentives—in contrast to many transition countries, which had the carrot of accession to the European Union dangling before them—is another.

—Piroska Nagy

Monetary and Exchange Affairs, and Statistics—as well as by the IMF Institute, which provides formal economic training both in Washington and abroad.

The IMF Institute has paid particular attention to Africa, Nsouli added. In addition to the training of government officials at the IMF Institute, it recently established, with the World Bank and the African Development Bank, the Joint Africa Institute in Abidjan, which trained about 500 government officials in 2001. It has also initiated a number of high-level seminars on Africa and set up regional workshops, often in collaboration with local training centers. In 2000, the Institute set up a distance learning program, he said, which greatly extended its training outreach on the continent. Surveys of African authorities show that the continent is already beginning to reap the benefits of these training initiatives and will certainly continue to do so, Nsouli concluded.

Lessons from transition countries

Oleh Havrylyshyn, Deputy Director of the IMF's European II Department, focused on the lessons that can be gleaned from the IMF's experience in the former Soviet Union countries. While these countries had their own unique problems, their experiences illustrate a number of points about capacity building in general. First, he noted, a very high volume of technical assistance flooded into these countries over a short time. Because these countries already had large government bureaucracies and highly educated workforces, they were expected to absorb the technical assistance quickly. But with scant experience in market-oriented institutions, absorption was not always smooth. In some cases, countries felt little ownership of these institutions and resisted them. Another result of the large volume of technical assistance over a short time was "donor fatigue." After the initial euphoria, donors gradually became less interested.

A second major lesson had to do with prioritizing the work. Should technical assistance providers have concentrated on establishing macroeconomic institutions first, or given greater priority to establishing regulatory institutions to guard against corruption? While some critics reproached the IMF for not putting in place rule-of-law institutions before turning to macroeconomic ones, Havrylyshyn suggested that the two can evolve concurrently and, in fact, work in synergy with each other. Setting up both types of institutions in the former Soviet Union countries was important, he said, and the order was less important than accomplishing the more fundamental task of putting in place both types of institutions. Given the mandate of the IMF, it naturally focused on the macroeconomic ones.

Case for coordination, accountability

John Audley, a Senior Associate at the Carnegie Endowment, called into question the international financial institutions' hegemony in economic capacity building. Is their approach flexible enough? One measure of the success of capacity-building strategies, he noted, is how well recipient countries attract foreign investment. As an alternative to the international financial institutions' strong influence on technical assistance, he proposed opening the field to other providers. Audley also suggested that, as long as the IMF is deeply involved in designing, overseeing, and financing technical assistance programs, the organization may have difficulty convincing its critics that countries have true ownership of their policies.

Audley stressed the need for coordination among the many technical assistance providers with competing agendas. He lauded the international financial institutions for coordinating with other providers such as the United Nations Development Program, the United Nations Environment Program, and the United Nations Conference on Trade and Development, but encouraged a broader outreach to other organizations with diverse specializations.

Piroska M. Nagy, an Advisor to the Director of the IMF's African Department, examined Africa's progress in capacity building. Why has it not achieved more? Persistent political instability is one reason and a lack of clear incentives—in contrast to many transition countries, which had the carrot of accession to the European Union dangling before them—is another. The lack of strong recipient ownership and accountability of both recipients and providers has played a role, as has inadequate donor coordination. Finally, the distance of many technical assistance providers from the African recipients and the resulting time lag in providing the assistance has also contributed to the continent's mediocre results. Nagy added, however, that the IMF's soon-to-be-established African Regional Technical Assistance Centers (AFRITACs) in Dar-es-Salaam, Tanzania, and in west Africa are a step in the right direction.

The radical solution of withdrawing all Western assistance from Africa to allow local expertise to flourish has been proposed, Nagy noted, but she did not advocate that route. Instead, she argued, greater accountability on the part of both providers and recipients would improve the current system, and peer review should be used to achieve this goal. The poverty reduction strategy paper process could provide the necessary framework for both strengthened accountability and better coordination. ■

Financial globalization poses new challenges for central banks

*I*ncreasing global financial market integration is presenting new challenges for central banks as they seek to attain low inflation and financial stability. In September, the IMF's Monetary and Exchange Affairs Department and IMF Institute hosted a conference on "Challenges to Central Banking from Globalized Financial Systems." Central bank governors and senior officials from more than 45 countries examined which nominal anchor is appropriate for countries susceptible to shifts in capital flows and what can be done to prevent crises or deal decisively with those that do occur. They discussed, in particular, the difficult decisions central bankers face when the twin objectives of monetary and financial stability come into conflict.

The unprecedented integration of domestic and international financial markets in recent years has shifted the policy landscape for central banks. In opening remarks, Eduardo Aninat, Deputy Managing Director of the IMF, emphasized that globalization of financial markets is a double-edged sword. It affords opportunities for greater economic growth and prosperity but also carries the danger of greater financial vulnerability. Member countries and the IMF are keenly aware of those dangers, observed Stefan Ingves, Director of the Monetary and Exchange Affairs Department, and Mohsin Khan, Director of the IMF Institute, and financial vulnerability is now a major focus of the IMF's work.

Fix or float?

Choosing the right exchange rate regime is an issue that has faced many central banks. But there are particular complications, observed Richard Webb, Governor of Peru's Central Reserve Bank, when a country has a partially dollarized economy. The limited use of U.S. dollars for transactions and wages (currency substitution or real dollarization) coupled with the vulnerability of Peru's open economy to external shocks suggest a floating exchange rate is appropriate. But with a large share of private sector liabilities denominated in U.S. dollars (financial dollarization), any large depreciation could translate into financial instability, which implies an exchange rate fixed to the dollar might be best. In Peru's case, monetary policy options are further constrained by a lack of financial instruments denominated in domestic currency.

What to do? Webb noted that Peru has been able to maintain a floating exchange rate and an explicit inflation targeting framework because its low degree of real dollarization—and thus low "pass-through" from exchange rate movements to domestic prices—allows an independent monetary policy. Alain Ize, Advisor in the Monetary and

Exchange Affairs Department, remarked that dollarization can lead to a vicious circle from currency instability to financial instability to excessive foreign exchange intervention that can lead to more dollarization. Dollarization can thus be "cured," he said, through a gradual commitment to the domestic currency in the form of an inflation target and better prudential regulation.

When monetary unions are the answer

The challenges posed by globalized financial markets may enhance the advantages of monetary unions, but this option comes with its own set of practical difficulties, according to Gert-Jan Hogeweg, Director General of Economics of the European Central Bank. Drawing from Europe's experience, he laid out a list of actions essential for a successful monetary union:

- Create, as a precondition, single markets for goods, capital, money, and labor among participating countries.
- Establish infrastructure through financial market integration, harmonization of legal systems, and area-wide payment and settlement systems.
- Pursue economic convergence. The European Monetary Union's convergence criteria served as a transparent basis for judging which countries could join. Structural reforms in goods and labor markets are also needed for economic growth.
- Develop an independent central bank, an unambiguous mandate for price stability, and a framework for sound management of public finances.
- Unify the currency (requiring a far-reaching and long-lasting process of institutional and political reshaping, made possible by a sustained political consensus).

Inflation targeting "lite"

There are special challenges, too, for countries that want to use an inflation target to define monetary policy but that cannot fully commit to a full-fledged inflation targeting regime. Mark Stone, Senior Economist in the IMF's Monetary and Exchange Affairs Department, termed the approach that countries may adopt in these circumstances inflation targeting "lite." Countries that go this route, he said, do so because a fixed exchange rate would leave them vulnerable to speculative attack; a monetary target is impractical given instability in money demand; and full-fledged inflation targeting is not feasible because they lack a sufficiently strong fiscal position and a fully developed financial sector.

Countries that opt for inflation targeting "lite" generally aim to bring inflation down to single digits and maintain financial stability, using a relatively interven-



Richard Webb



Gert-Jan Hogeweg



Mark Stone



Hugo Frey Jensen

tionist exchange rate policy. Their central banks may want to announce a long-term commitment, he said, to either a hard exchange rate peg or a full-fledged inflation target to bring forward the benefits of a single-anchor monetary regime. In his comments, Jerzy Pruski, Member of the National Bank of Poland's Monetary Policy Council, described inflation targeting "lite" as a means of buying time to undertake the structural reforms needed for a single nominal anchor.

Balancing financial and monetary stability

For a small open economy such as Denmark's, the central bank's role in managing both international debt and reserves provides an important element of financial stability, according to Hugo Frey Jensen, Assistant Director and Head of the Capital Markets Department of Denmark's central bank. This dual responsibility for international debt and reserves, he said, is an efficient way to use scarce resources and develop a broad knowledge of financial markets in a single institution. Jensen also suggested that a clear and transparent framework for debt and reserve management offers the best way to handle the various trade-offs between monetary policy and debt management and to minimize long-term government borrowing costs.

But should financial stability be an explicit central bank objective on a par with other, particularly monetary and inflation objectives? Roger W. Ferguson, Jr., Vice Chair, Board of Governors, U.S. Federal Reserve System, noted that the U.S. central bank views its financial stability objectives primarily through the lens of its macroeconomic goals—price stability and sustainable long-run growth. Today, he said, it is more important than ever for central banks and other financial authorities to share information, coordinate crisis prevention measures, and cooperate in crisis management actions.

In Ferguson's view, some of the more urgent central bank issues are whether a central bank should take preemptive actions to head off potential financial instability (even when such actions may not be fully justified by the outlook for inflation and output); how much weight to give to financial stability versus other objectives, and whether a high degree of activism could lead to higher variability of economic variables. André Icard, Deputy General Manager of the Bank for International Settlements, came down on the side of greater central bank activism in financial stability concerns, although he stressed the potential difficulties arising from the shorter time horizon for monetary objectives than for financial objectives, as well as the risk of moral hazard.

Role of financial soundness indicators

As V. Sundararajan, Deputy Director, and R. Sean Craig, Senior Economist, of the Monetary and Exchange

Affairs Department, noted in their presentations, financial soundness indicators can provide early warning signals for the three dimensions of financial stability: robust financial infrastructure, effective supervision, and adequate macroprudential surveillance.

The indicators' effectiveness can be strengthened, they said, by exploiting the interdependence among them and by using them in combination with other surveillance tools, such as stress testing of bank balance sheets, and assessments in relation to core principles and codes and standards. Extending the coverage of the indicators to nonbank financial institutions and the nonfinancial corporate sector could further improve their effectiveness. The indicators can also help focus assessments on the risks to financial stability originating in the prudential and infrastructure dimensions.

In the eye of the storm

In a concluding session, Mario Blejer, former governor of Argentina's central bank, provided a lively, firsthand account of what transpires on the frontlines of a financial crisis. Blejer analyzed the roots of the crisis, attributing the collapse of Argentina's peso to inconsistencies between the currency board and the country's fiscal stance. He noted that the subsequent banking crisis was largely caused by sovereign risk and the government's decision to impose below-market-price securities on the banking sector.

In November 2001, Blejer continued, Argentina imposed partial withdrawal restrictions (the *corralito*), abandoned the currency board, devalued the currency, and "pesoified" bank assets and liabilities at different rates. Pesoification meant the central bank could provide the liquidity needed to finance the bank run, but it had no money market or debt instruments with which to sterilize open market operations. And getting liquidity right was fraught with dangers. Too much liquidity risked hyperdepreciation and hyperinflation; too little liquidity risked a total collapse of the banking sector.

In this situation, Argentina's central bank opted for an intermediate approach—providing liquidity to banks under attack while using new instruments to sterilize and stressing the difference between the central bank and the rest of the public sector. The country actively developed the market for short-term central bank instruments, initially with 7-day maturities, and then 14- and 28-day maturities, in pesos and dollars. Interest rates reached 140 percent before declining. Meanwhile, the central bank kept up payments on its own foreign obligations and intervened in the foreign exchange market to slow the pace of depreciation and avoid chaotic conditions.

By mid-June 2001, Blejer noted, the trends started to reverse. Thereafter, deposit withdrawals slowed; the need for liquidity from the central bank largely



Roger W. Ferguson



Mario Blejer

declined; central bank interest rates fell to 40–50 percent; and the central bank regained about half of the initial stock of intervention.

For a central bank in crisis, Blejer said, the bottom line is to persevere to the point where “greed exceeds panic”! ■

Andrea Schaechter, Mark Stone, and Marco Arnone
IMF Monetary and Exchange Affairs Department

See also *Financial Soundness Indicators: Analytical Aspects and Country Practices*, IMF Occasional Paper No. 212. Copies are available for \$20.00 each (academic price, \$17.50) from IMF Publication Services. See page 334 for ordering details.

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Stand-By, EFF, and PRGF arrangements as of September 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
Bosnia & Herzegovina	August 2, 2002	November 1, 2003	67.60	48.00
Brazil ¹	September 6, 2002	December 31, 2003	22,821.12	20,539.01
Bulgaria	February 27, 2002	February 26, 2004	240.00	156.00
Dominica	August 28, 2002	August 27, 2003	3.28	1.23
Guatemala	April 1, 2002	March 31, 2003	84.00	84.00
Jordan	July 3, 2002	July 2, 2004	85.28	74.62
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Romania	October 31, 2001	April 29, 2003	300.00	165.33
Turkey ¹	February 4, 2002	December 31, 2004	12,821.20	2,892.00
Uruguay ¹	April 1, 2002	March 31, 2004	2,128.30	1,016.60
Total			55,862.10	32,531.80
EFF				
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Indonesia	February 4, 2000	December 31, 2003	3,638.00	1,651.48
Serbia/Montenegro	May 14, 2002	May 13, 2005	650.00	550.00
Total			6,245.00	4,158.48
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	24.00
Armenia	May 23, 2001	May 22, 2004	69.00	59.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	64.35
Benin	July 17, 2000	March 31, 2004	27.00	8.08
Burkina Faso	September 10, 1999	December 9, 2002	39.12	5.58
Cambodia	October 22, 1999	February 28, 2003	58.50	8.36
Cameroon	December 21, 2000	December 20, 2003	111.42	47.74
Cape Verde	April 10, 2002	April 9, 2005	8.64	7.41
Chad	January 7, 2000	January 6, 2003	47.60	15.80
Congo, Dem. Republic of	June 12, 2002	June 11, 2005	580.00	160.00
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Djibouti	October 18, 1999	October 17, 2002	19.08	10.00
Ethiopia	March 22, 2001	March 21, 2004	100.28	31.29
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	January 12, 2001	January 11, 2004	108.00	58.50
Ghana	May 3, 1999	November 30, 2002	228.80	52.58
Guinea	May 2, 2001	May 1, 2004	64.26	38.56
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Guyana	September 20, 2002	September 19, 2005	54.55	49.00
Honduras	March 26, 1999	December 31, 2002	156.75	48.45
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	49.96
Lao People's Dem. Rep.	April 25, 2001	April 24, 2004	31.70	18.11
Lesotho	March 9, 2001	March 8, 2004	24.50	10.50
Madagascar	March 1, 2001	February 29, 2004	79.43	56.74
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2003	51.32	12.90
Mauritania	July 21, 1999	December 20, 2002	42.49	6.07
Moldova	December 21, 2000	December 20, 2003	110.88	83.16
Mongolia	September 28, 2001	September 27, 2004	28.49	24.42
Mozambique	June 28, 1999	June 27, 2003	87.20	16.80
Niger	December 22, 2000	December 21, 2003	59.20	25.36
Pakistan	December 6, 2001	December 5, 2004	1,033.70	775.26
Rwanda	August 12, 2002	August 11, 2005	4.00	3.43
São Tomé & Príncipe	April 28, 2000	April 27, 2003	6.66	4.76
Sierra Leone	September 26, 2001	September 25, 2004	130.84	56.00
Tanzania	April 4, 2000	April 3, 2003	135.00	35.00
Uganda	September 13, 2002	September 12, 2005	13.50	12.00
Vietnam	April 13, 2001	April 12, 2004	290.00	165.80
Zambia	March 25, 1999	March 28, 2003	278.90	124.20
Total			4,824.86	2,624.81
Grand total			66,931.96	39,315.09

Members drawing on the IMF “purchase” other members’ currencies, or SDRs, with an equivalent amount of their own currency.

¹Includes 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

Experts meet to hone guide to financial soundness indicators

Crisis are often the product of unpleasant surprises. In the wake of the east Asian, Russian, and most recently Latin American crises, there is growing urgency to the search for the means to identify vulnerabilities before they erupt into disasters. In September, 32 experts from member countries and international agencies met at the IMF to discuss a preliminary draft of the IMF's *Compilation Guide on Financial Soundness Indicators*. On the table: the types of data and compilation

practices the IMF should encourage if countries are to develop stronger, more effective financial sectors.



Eduardo Aninat (left, with V. Sundararajan): Crises have spurred the search for better means to identify vulnerabilities before they erupt into disasters.

Current awareness of the need to better measure financial soundness has its roots, IMF Deputy Managing Director Eduardo Aninat observed in opening remarks, in the crises that have characterized the global economy in recent years. Financial sector problems typically loomed large in these cases—with banks weakened by insufficient capital, inappropriate lending, and inadequate efforts or ability to ensure repayments. Indeed, more than half of the IMF's member countries

experienced banking crises over the past two decades.

This costly volatility, Aninat emphasized, has underscored the importance of devising analytically sound and readily understood indicators that can give policymakers and the markets a good quantitative picture of the stability and soundness of a country's financial system. The IMF's work on the *Compilation Guide on Financial Soundness Indicators*, which has been developed by the Statistics Department in consultation with the Monetary and Exchange Affairs Department, is an important step in this direction. The objective now, Aninat told conference participants, is to encourage countries to compile and disseminate a set of generally accepted, harmonized indicators.

IMF's perspective

Financial soundness indicators are a tool—one that both the IMF and its members can put to good advantage. V. Sundararajan, Deputy Director of the IMF's Monetary and Exchange Affairs Department, outlined the contribution that these indicators can make to the organization's surveillance and research work, noting that financial soundness indicators, in combination with other surveillance tools such as stress testing, provide a quantitative basis for assessing financial sector vulnerabilities.

The IMF's current work program, Sundararajan explained, includes support for the compilation of these indicators using the *Guide* and, in some cases, technical assistance and the use of the indicators in the context of IMF surveillance through its annual

Measuring financial soundness

Financial soundness indicators offer one means to assess the current state of a country's financial institutions and the well-being of their main clients—namely, corporations and households. In combination with other tools, these indicators help identify risks to the system.

To design effective financial soundness indicators, the IMF surveyed its member countries in 2000, asking which indicators they considered useful and which, feasible to compile. Drawing on the results of this survey and on analytical work, the IMF's Executive Board in June 2001 endorsed a list of 15 core financial soundness indicators and another 26 indicators whose use was to be encouraged.

The core set of indicators seeks to assess the banks' (deposit-taking institutions') capital adequacy, asset quality, earnings and profitability, liquidity, and sensitivity to market risk. These indicators are likely to be useful in all coun-

tries, regardless of their institutional characteristics or stage of development, and are feasible to collect without excessive extra resources (although in many cases there will be technical and organizational issues to address). The core indicators should provide countries with a good basis on which to assess the soundness of their banking sector.

The encouraged set of indicators seeks more detailed data for deposit-taking institutions and goes beyond these institutions to other key sources of vulnerability, such as nonbanks, corporations, households, and relevant markets, including securities and real estate markets. The encouraged indicators are intended to add depth to these assessments, but may be relevant at the present time for only a limited number of countries.

The majority of the indicators apply to deposit-taking institutions because of the pivotal role these institutions play in all national financial systems.

consultations with member countries and the IMF–World Bank Financial Sector Assessment Program. The work program also includes several research projects that will deepen the understanding of the relationship among these indicators and of how information on supervisory practices and financial structure, drawn from the Basel core principles and other sources, can be used to help interpret them.

Publication of the *Guide* will help move the financial soundness indicators, which were endorsed by the IMF's Executive Board in June 2001, from the theoretical to the operational. Charles Enoch, Deputy Director of the Statistics Department, explained that the intention is to provide compilers and users with guidance on the concepts, definitions, data sources, and compilation techniques for financial soundness indicators. At the same time, the *Guide* will try to minimize the demands made on country resources by using existing data sources wherever possible.

To make the *Guide* as useful and user-friendly as possible, Enoch emphasized that the IMF is consulting widely and will hold further discussions before finalizing the draft. Its methodology draws heavily on economic statistical, accounting, and supervisory standards, but many measurement issues must still be resolved, he said. There are practical matters, too, such as finding alternatives where compilation is difficult or national practices differ. He added that countries need to gain experience on how best to compile and use these indicators, and they then need to share that experience.

Expert views

Although participants' comments reflected personal expertise rather than the views of their institutions, the *tour de table* and the range of countries and agencies represented at the seminar suggested growing interest in these indicators and their effective use. A number of experts from central banks and regional organizations noted that they are putting significant resources into financial system surveillance, notably by developing procedures to monitor and analyze financial stability issues. In this context, all welcomed international guidance on compiling financial soundness indicators. Not only did this support national efforts, they said, it also facilitated the development of internationally comparable data.

There was also wide agreement, however, that the work had barely begun in many countries, and that development of these data sets could entail costs. In the short term, the experts thought it likely that compilers would need to rely on existing data sources that are based on accounting standards that vary across countries.

With this in mind, the experts expressed support for having the *Guide* rely as far as possible on existing

data sources and concepts, developing a conceptual framework and basic principles that are coherent and internally consistent, and allowing some flexibility in their application to accommodate data from different measurement systems. In particular, they stressed the importance of a flexible approach in the application of detailed definitions to accommodate existing country circumstances. Some did caution, however, that there would be a trade-off with regard to the comparability of data across countries.

Participants also noted developments in related international measurement systems, and urged that account be taken of them. The meeting was attended by representatives from the Bank for International Settlements, the International Accounting Standards Board, and the Inter-Secretariat Working Group on National Accounts—all organizations involved in developing standards to measure economic and financial activity. Indeed, Anthony Cope, Member of the International Accounting Standards Board, commented that the move by the accounting profession toward full fair-value accounting—something that he believed would allow accountants to get the numbers approximately right rather than precisely wrong—was relevant to the treatment of valuation issues in the *Guide*.

The discussions also addressed many of the key conceptual and definitional issues that would be part of calculating financial soundness indicators, such as the scope for consolidating banking activities within and across borders, methods of valuing assets and liabilities, the definition of nonperforming loans, approaches to provisioning for nonperforming loans, and measurement of banks' capital and net income. All of these issues are central to any guidance on compiling data for the monitoring of financial soundness.

What's next

The *Guide* will now be revised to take account of the experts' comments, in preparation for its presentation to the IMF's Executive Board. Over the coming months, there will be further consultations with data compilers and users from both public and private sectors, including a series of outreach seminars at the IMF's regional training centers. The IMF hopes to finalize the *Guide* during the course of 2003. ■

Armida San Jose and Robert Heath
IMF Statistics Department

For more information, see *Financial Soundness Indicators: Analytical Aspects and Country Practices*, IMF Occasional Paper No. 212. Copies are available for \$20.00 each (academic price, \$17.50) from IMF Publication Services. See page 334 for ordering details.



Enoch: The IMF is consulting widely and will hold further discussions before finalizing the draft *Guide*.



Cope: The move toward full fair-value accounting would allow accountants to get the numbers approximately right rather than precisely wrong.

With open economy and sound policies, U.A.E. has turned oil “curse” into a blessing

Next year, the United Arab Emirates (U.A.E.) will host the IMF–World Bank Annual Meetings. The country—one of the richest oil-exporting countries in the world—has managed to avoid the pitfalls that so often plague developing countries with vast natural resources. Although regional disparities remain important, the country as a whole has benefited from its hydrocarbon wealth (see box below). What explains its success?

The contribution that oil has made to U.A.E.’s GDP growth has varied significantly over the years, in part reflecting the country’s compliance with quota agreements of the Organization for Petroleum Exporting Countries. Other sectors, notably petrochemicals, aluminum, tourism, and entrepôt trade,

however, have experienced strong growth, averaging about 9 percent a year in real terms in the 1990s. In 2000, non-oil sectors accounted for about 70 percent of GDP, and non-oil exports, including re-exports, made up 43 percent of the country’s total export receipts.

The economy has developed within a highly liberal, business-friendly, and market-oriented economic policy framework. With an effective import tariff of less than 4 percent, the U.A.E. has benefited from an open trade regime as well as from a foreign exchange system free of restrictions on current and capital account transactions. An exchange rate pegged, de facto, to the U.S. dollar—the intervention currency—has served as a nominal anchor since the end of 1980, helping to keep inflation, on average,

United Arab Emirates

The United Arab Emirates (U.A.E.) is a confederation of seven emirates—Abu Dhabi, Dubai, Sharjah, Ajman, Ras al-Khaimah, Umm al-Qaiwain, and Fujairah—that hold considerable political, judicial, financial, and economic autonomy. The country accounts for close to 10 percent of the world’s crude oil reserves and about 4 percent of its natural gas reserves. GDP per capita, on a purchasing power parity basis, was estimated to be close to \$26,000 in 2001 (see chart, page 332), government debt is very small, and inflation has been low. The U.A.E. has used its hydrocarbon wealth to modernize its infrastructure, create jobs, and establish a generous welfare system. It has

also made major strides in improving social indicators, such as life expectancy and literacy, through universal and free access to education and health care.

Abu Dhabi accounts for more than half of the country’s total GDP, close to 40 percent of the population, and 90 percent of oil and natural gas resources. Dubai contributes one-fourth of the country’s total GDP and has been at the forefront of developing non-oil activities. The other emirates rely on trade and light manufacturing and on financial support from the federal government and the two largest emirates.

Each of the emirates has incorporated its comparative resource advantage into its diversification strategy. Abu Dhabi has emphasized energy-based industries, such as petrochemicals and fertilizers. In anticipation of the depletion of its crude oil reserves over the next decade, Dubai has expanded its role as a commercial, telecommunications, and financial hub and become an attractive tourist destination, leading to a booming service-based economy.

Sharjah—traditionally the center of small-scale manufacturing, including textiles—currently accounts for 45 percent of U.A.E. manufacturing. The northern emirates have focused on agriculture, quarrying, cement, and shipping services.

The U.A.E.—together with Bahrain, Kuwait, Oman, Qatar, and Saudi Arabia—is a member of the Cooperation Council of the Arab States of the Gulf, established in the early 1980s to boost economic and financial ties in the region. In fact, a common external import tariff is scheduled to become effective early next year and a common currency, by 2010.

Dubai has expanded its role as an attractive tourist destination.



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below 3 percent a year. Having a relatively small national population, the country has maintained an open foreign labor policy to meet its labor needs. Expatriate workers, employed primarily outside the government, account for an estimated 90 percent of the labor force.

The authorities have complemented this liberal economic environment with prudent fiscal and monetary policies. Although the overall budget (federal plus emirate governments) was in deficit during much of the period between 1982 and 2000, these deficits declined, on average, from about 9 percent of GDP in the 1980s to close to 4 percent in the 1990s, before turning into a surplus in 2000–01 despite a rapid increase in spending on defense and subsidies (see chart, page 332). The country has low taxation, and the government has generally financed its deficits through changes in its foreign investments.

The currency peg together with the country's liberal capital flow regime has meant that U.A.E. interest rates have closely tracked U.S. interest rates over the years. And strong supervision and prudential regulation have helped maintain confidence in the banking system. Banks are broadly profitable and well capitalized, and the Central Bank of the U.A.E. largely complies with international standards of banking supervision, monetary policy, and payments systems. Since the end of 2000, the central bank has stepped up efforts to monitor money laundering, and a new anti-money-laundering law was passed in October 2001.

Meanwhile, despite the volatility of global crude oil prices over recent decades, the U.A.E. has consistently recorded external current account surpluses, allowing it to accumulate large official financial assets. These give the country ample latitude to respond to oil price fluctuations and remain an important donor to poor countries. Moreover, the U.A.E. has not had to resort to foreign borrowing to finance its development needs, even though investment rates have been high.

Pace of reforms picks up

With the U.A.E.'s own energy demands surging, power generation and water desalination are at the forefront of privatization efforts. Among the emirates, Abu Dhabi has taken the lead, recently opening its utility sector to local and foreign private investors through joint ventures with the government and build-operate-own projects, and several independent power projects are currently under way. Other emirates are planning build-operate-transfer projects for power and water. At the federal level, the government plans to fully privatize the electricity sector, which serves the northern emirates, over the medium term.

But public companies are run on a commercial basis, and they contribute substantially to non-oil budget revenues.

Under way at the federal level are a comprehensive reform of public expenditure management and other fiscal initiatives, including the adoption of an electronic government project. A number of important steps, including enactment of the Federal Securities Law and the creation of the Emirates Securities and Commodities Markets Authorities, have also addressed deficiencies, with formal stock exchanges (in Dubai and Abu Dhabi) opening in 2000.

Restrictions on foreign ownership of companies and properties remain in place, including a maximum 49 percent foreign ownership of companies. But these restrictions have had little practical effect because, other than Abu Dhabi, the emirates have established free zones that allow 100 percent foreign ownership of companies. These zones are particularly important in Dubai, where they have attracted a large number of foreign companies and expanded net non-oil exports, which reached \$1.4 billion in 2000. Their success reflects sound economic policies, political stability, simple and fast administrative procedures, strategic geographic location, and efficient infrastructure and communication systems, among other factors.

Challenges ahead

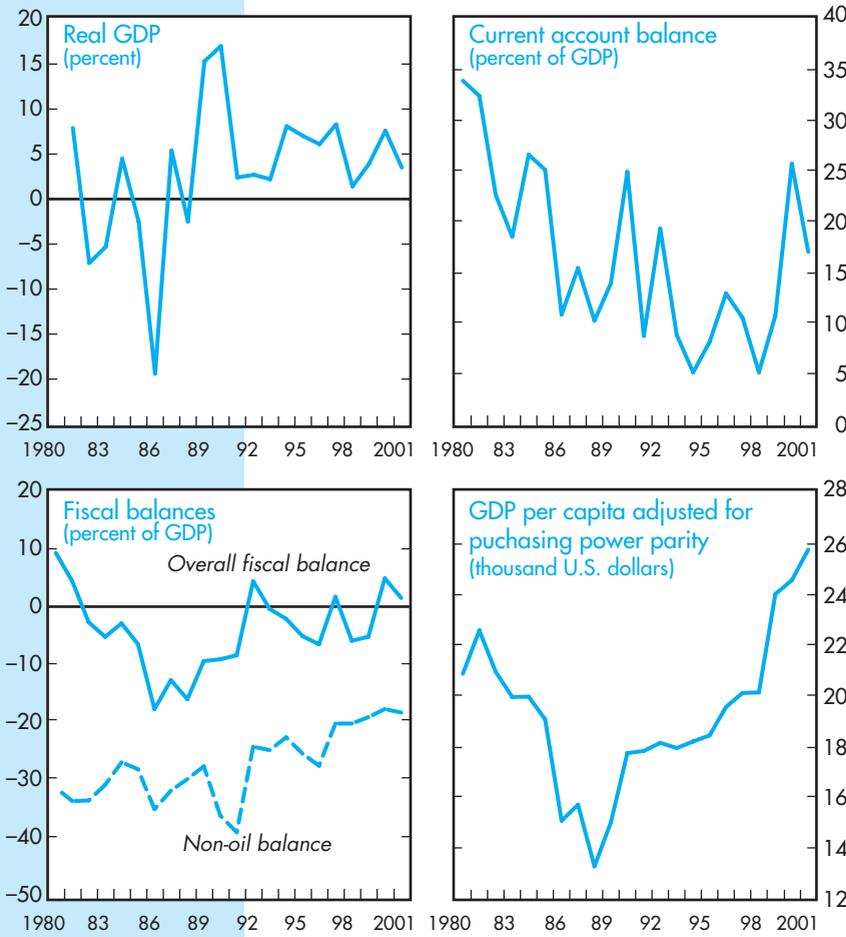
In an era of intensifying globalization, the U.A.E. cannot afford to be complacent. If it is to secure and broaden the economic and social gains it has achieved over the past decades, several further steps will be critical. These include

- sustaining a strong fiscal position. Over the longer term, this will mean diversifying the revenue base, improving the budget structure, redirecting expenditure toward education and training, and maintaining investment in physical and social infrastructure. Ultimately, the U.A.E. will need to create a modern tax system and phase out subsidies to reduce waste.
- recasting fiscal policy in a medium-term framework that is based on conservative assumptions about

U.A.E. investors attend the official opening, on March 26, 2000, of the Dubai stock exchange.



Prudent policies have served the U.A.E. well



Data: UAE authorities; and IMF staff estimates

long-run oil prices for both revenue and expenditure projections, and that ensures intergenerational economic equity.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
October 7	2.19	2.19	2.80
October 14	2.18	2.18	2.79

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).

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

Data: IMF Treasurer's Department

- addressing regional income disparities through a more balanced development strategy, adopting common policies for foreign investment and labor, and increasing coordination to avoid duplication and unfair competition among emirates.

- creating job opportunities for its rapidly growing indigenous population—an estimated 60 percent of Emiratis are under the age of 20. To address their needs efficiently, the authorities should rely mainly on education and training rather than on mandatory mechanisms, such as quotas. There is scope, too, to improve training and educational curriculums in collaboration with the private sector and to encourage domestic entrepreneurship. In addition, extending the availability of pensions and social benefits throughout the country would facilitate labor mobility.

- encouraging greater private sector participation by lifting the remaining impediments to foreign investment in areas outside the free zones, speeding up privatization, and contracting out government-run services.

- improving the quality of, and public access to, U.A.E. data. A major improvement in fiscal transparency would also promote the formulation of effective economic policies and offer greater assurance to private investors.

In sum, an open economic system and sound economic management have allowed the U.A.E. to escape what for some countries has been the curse of oil, but its ability to sustain strong growth and retain investor confidence will hinge on continued fiscal discipline, a strong financial sector, labor market flexibility, and full private sector participation in the development process. ■

Ugo Fasano
IMF Middle Eastern Department

Members' use of IMF credit
(million SDRs)

	During September 2002	January–September 2002	January–September 2001
General Resources Account	2,432.50	22,657.97	21,306.70
Stand-By	2,415.15	21,654.01	20,564.70
SRF	1,141.06	7,903.67	12,662.31
EFF	0.00	986.61	742.00
CFF	0.00	0.00	0.00
EMER	17.35	17.35	0.00
PRGF	60.10	1,086.40	495.12
Total	2,492.60	23,744.37	21,801.82

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CFF = Compensatory Financing Facility
EMER = Emergency assistance programs for post-conflict countries and natural disasters.
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals shown owing to rounding.
Data: IMF Treasurer's Department

Is global inequality rising?

In recent years, much debate has swirled around the relationship between growth, poverty, and income inequality. Has the pursuit of more market-oriented policies helped or hurt? Ratna Sahay of the IMF's Research Department moderated an IMF Economic Forum that made a spirited contribution to the ongoing debate.

Growth matters. For Surjit Bhalla (Oxus Research and Investments), there was no argument. The evidence was conclusive. The pro-market policies pursued in many developing countries—particularly in Asia—over the past 20 years have generated impressive growth and the most dramatic fall in poverty rates seen in history. Inequality of incomes among people, though not necessarily among countries, has declined, he said (see interview, page 335). And what that tells us, he concluded, is that country policies should be focused on generating growth.

Growth alone is not enough. But even in countries such as India that have seen huge reductions in poverty, there are states, such as Bihar, where poverty remains entrenched. This should temper any expectation, emphasized Martin Ravallion (World Bank), that growth alone can transform economies and societies.



Ratna Sahay (left) with John Cavanaugh of the Institute for Policy Studies.

What experience is telling us, he said, is that a given amount of growth can translate into different amounts of poverty reductions in different countries or regions. The Bank's focus on pro-poor growth is an attempt to understand why such differences arise and which policy choices can help squeeze the most poverty reduction out of a given amount of growth.

But what produces pro-poor growth? John Cavanaugh (Institute for Policy Studies) argued that the experience of countries under World Bank–IMF

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- 02/48: IMF Approves \$13 Million in Emergency Postconflict Assistance for Burundi, October 9

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- 02/110: IMF Executive Board Discusses Market Access for Developing Country Exports, September 27 (see page 321)
- 02/111: IMF Reviews Experience and Next Steps in the IMF's Transparency Policy, September 27
- 02/112: IMF Executive Board Discusses the Status of Implementation of the Enhanced HIPC Initiative and Update on Financing of PRGF and HIPC Operations and Subsidization of Postconflict Emergency Assistance, September 28
- 02/113: IMF Concludes 2002 Article IV Consultation with Ethiopia, October 3
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- 02/115: IMF Concludes 2002 Article IV Consultation with The Gambia, October 8
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- 02/117: IMF Reviews Progress on Strengthening IMF–World Bank Collaboration on Country Programs and Conditionality, October 9
- 02/118: IMF Concludes 2002 Article IV Consultation with the Republic of Armenia, October 9

Speeches

- “Toward a Better Globalization,” Sérgio Pereira Leite, Assistant Director, IMF Office in Europe, Seminar on Europe and Globalization, Ligue Européenne de Coopération Economique, Paris, October 7
- Opening Remarks for a Press Conference on the *World Economic Outlook*, Kenneth Rogoff, IMF Economic Counsellor and Director of Research, Tokyo, October 9

Transcripts

- Annual Meetings Closing Press Conference, IMF Managing Director Horst Köhler and World Bank President James D. Wolfensohn, September 29
- Press Briefing, Thomas C. Dawson, Director, IMF External Relations Department, October 10



Ravallion: The Bank's focus on pro-poor growth is an attempt to understand which policy choices can help squeeze the most poverty reduction out of growth.

policies belied the rhetoric of pro-poor growth and caring about the poor. What has happened to Mexico, he said, is a good example of why the left opposes the typical Bank–IMF policy prescriptions. Mexico has pursued, perhaps more than any other emerging market country in the western hemisphere, a pro-market and free trade orientation—particularly through the North American Free Trade Agreement. While these policies have brought in investment and led to growth, they have also been associated with increased poverty and greater income inequality.

And even the growth that is generated is not all to the good, Cavanaugh said, because it is often associated with an abuse of workers' rights, displacement of the poor from their homes and traditional livelihoods, and environmental degradation. Instead of

the Mexican model, he preferred the more limited and careful engagement with the global economy that countries such as China and India have pursued.

But Sahay took issue with Cavanaugh's characterization of China's and India's policies, noting that these countries, like Mexico, have moved toward more market-oriented policies and free trade. Admittedly, they have done so in a more measured way, she said, but it remains a subject of debate whether their chosen speed was the optimal one.

In concluding remarks, Sahay added that despite the panelists' sharp disagreement on many matters, there was one policy that they could all support: greater access for developing country products to industrial country markets. ■

Prakash Loungani
IMF External Relations Department

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Interview with Surjit Bhalla

Growth, poverty, inequality—getting the facts right

Poor countries have grown about twice as fast as rich countries over the past two decades, reversing the pattern of the prior two decades. As a consequence, world poverty has fallen to 13 percent—below the Millennium Development Goal of 15 percent by 2015—and global income inequality is at its lowest level in a century. These are the conclusions of *Imagine There's No Country: Poverty, Inequality, and Growth in the Era of Globalization*, a new book by Surjit Bhalla (Institute for International Economics, 2002). Bhalla is managing director of Oxus Research and Investments, a New Delhi-based firm, and a former economist with the World Bank. He talks to Prakash Loungani about why his findings differ from conventional wisdom.

LOUNGANI: Your book suggests that we should be concerned about growth, poverty, and inequality in that order. Why?

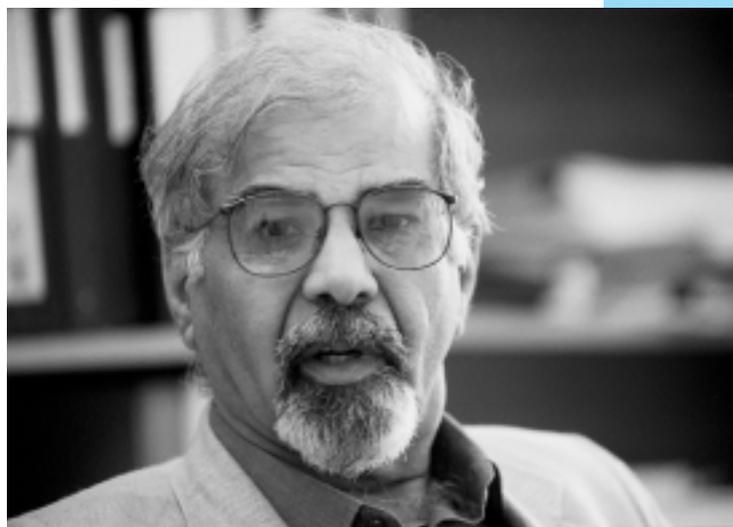
BHALLA: Without growth, we will not get anywhere with the other two. We certainly cannot reduce poverty, in an absolute sense, without growth. And you might reduce inequality without growth, but simply by cutting the pie into thinner and thinner slices. That kind of equality in misery gets tiresome, as we learned from the experience of countries like North Korea and from the failure of the Soviet Union.

LOUNGANI: But do we know how to get growth going in the developing world?

BHALLA: I think we do, but rather than get into that debate we should first pay attention to the facts and recognize that we have seen some phenomenal growth in the past few decades. Look at how Asia has been transformed. First, you had Japan's miraculous catch-up with the living standards of the West. Then came the rapid growth among the Asian tigers, then among many of the ASEAN members, then China and India, and now Vietnam and Bangladesh.

LOUNGANI: So there is hope that the Asian drama will not end in tragedy. But what about Africa?

BHALLA: Remember that in the 1960s when Gunnar Myrdal was writing *Asian Drama*, the average Asian was making half what an average African made, and the prospects for Asia were considered bleak. So bleak prospects for Africa today can be a completely misleading forecast of what can happen over the next couple of decades under the right conditions. And even in Africa, a few countries have grown despite the ravages of war and disease.



LOUNGANI: What about Latin America?

BHALLA: Those countries have clearly been on a roller coaster. Growth in the 1960s and 1970s turned out not to be sustainable, and they had their “lost decade” of the 1980s when incomes declined. Over the past decade, some of these countries have managed to climb out of that hole, but it hasn't been easy or without reversals. Still, Mexico and Chile are good examples of countries that have been subject to many a stumble and fall but that have done well in terms of average growth over the past decade. Argentina was doing well until recently, as was Brazil, until the uncertainty induced by the elections.

LOUNGANI: Some might look at your facts about growth and dismiss them as just Asia getting lucky.

BHALLA: To say that is to dismiss casually what has happened to over 3 billion people, two-thirds of the population of the developing world. A more important point is there is nothing intrinsic in the Asian experience that would lead us to believe that growth cannot be replicated elsewhere in the developing world. In fact, as I mentioned, there are examples of growth in Africa and Latin America.

LOUNGANI: Let's move on to poverty. What are the facts here?

BHALLA: They follow directly from the facts on growth. No economist worth his salt would say that growth does not reduce poverty. The question is: how much poverty reduction is achieved through growth? My estimate, using commonly accepted thresholds for who's considered poor, is that the number of poor people in the world was about 650 million in 2000.

Bhalla: “The Bank's estimate is that the number of poor is 1.2 billion—550 million more than my estimate.”



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That's still a huge number, but it represents a poverty rate of 13 percent, below the Millennium Development Goal of achieving a 15 percent rate by 2015. We're already there if only we'd wake up and assess the facts. The reduction in the poverty rate in the past 15 years has been comparable to what was achieved over the previous 50 years.

LOUNGANI: How do your estimates of the poverty rate differ from those of others?

BHALLA: The biggest gulf is with World Bank estimates. The Bank thinks the poverty rate is about twice as high as I think it is. In terms of the number of poor, the Bank's estimate is that the number of poor is 1.2 billion—550 million more than my estimate.

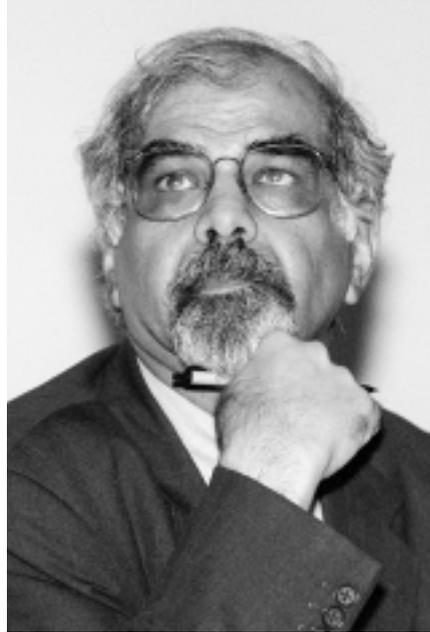
LOUNGANI: What accounts for this huge difference?

BHALLA: The first big mistake the Bank makes is to take Peter's income to measure Paul's poverty. It measures income based on the average rate of consumption (and income) growth from household survey data. But—as Angus Deaton mentioned in the interview he did with you [*IMF Survey*, July 8, pages 215–17]—these have considerably lagged behind the average rates of income growth from the national accounts data. By using what I and many others consider to be artificially low growth rates of average income, the Bank adds about 350 million to the ranks of the poor.

LOUNGANI: That still leaves 200 million.

Bhalla: That is due to what I consider an inappropriate exchange rate adjustment used for South Asia. To compare poverty rates across countries, one has to convert to a common base using purchasing power parity exchange rates. To generate the poverty estimates for South Asia, the Bank has been using special estimates of purchasing power parity exchange rates that differ from those that are in common use. When the Bank's special estimates are used, another 200 million are classified as poor.

LOUNGANI: What are the policy implications if your poverty estimate is right rather than that of the World Bank?



Bhalla: "If I'm right, growth is sufficient, period."

BHALLA: If I'm right, growth is sufficient, period. If the Bank is right, there is a big mystery about why growth has not translated into much poverty reduction. This, in turn, justifies the entire cottage industry of getting pro-poor growth, improving the quality of growth, developing a holistic approach, and so on.

LOUNGANI: That leaves the last of the trinity—inequality. Has growth been associated with a decline in inequality?

BHALLA: That's difficult to answer right off the bat because, like the gods in the Hindu trinity, inequality takes many forms. So when people make a blanket statement like "the rich are getting richer,

and the poor are getting poorer," it's clear they are being either intellectually dishonest or intellectually lazy.

LOUNGANI: Our readers are honest, smart, and not lazy. What are the different forms of inequality?

BHALLA: First, there is inequality of incomes within a country; for the United States, this is the difference between Bill Gates and the poor people in this country. Second, there is the difference among countries. This is the difference between the average person's income in, say, the United States and the average income in a poor nation. And, third, there is world inequality. This is where you "imagine there's no country" and rank everyone in the world from the richest to the poorest. Using this last definition, I estimate that inequality has declined because millions of Chinese and Indians have left their place at the very bottom of the income distribution and marched up toward the middle.

LOUNGANI: How do your estimates of world inequality differ from those of others?

BHALLA: My method gives a more accurate measure of world inequality than other estimates because it is based on using information on the percentile distribution of incomes—so that, roughly speaking, the same income is attributed to 25 million people rather than 250 million people. My estimates of world inequality were presented, as you know, in a seminar at the IMF in June 2000. Subsequent work by Columbia University's Xavier Sala-i-Martin has also found a decline in world inequality. ■