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NEWS: De Rato applauds growth in China and India

During a recent visit to Asia, IMF Managing Director Rodrigo de Rato encouraged China and India to safeguard their economies against potential external shocks and strengthen their standing in the global market place. China, he said, is in a position to take advantage of its current strong economy and move gradually toward flexible exchange rates; India's increasingly vibrant economy stands to gain momentum if it can reduce large deficits and open up to more trade and investment.

Liu Jin/AFP/Getty Images

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RESEARCH: Pros and cons of microfinance

For the poor living in developing countries, there is often little recourse if credit is needed. Typically, it's the local moneylender or nothing. Microfinance institutions have been trying to fill the void and provide the seeds for grassroot economic activity. But are these small-scale institutions (offering typically high-cost loans) working? And should they be aiming to integrate with the formal financial sector? A new IMF review of microfinance looks at the issues and the challenges ahead.

Beawiharta/Reuters

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BOOK NOTES: The Fed after Volcker-Greenspan

Alan Greenspan's term on the U.S. Federal Reserve Board is set to expire in January 2006 and is already fueling speculation as to whether a new chair could possibly fill the big boots of Greenspan and his predecessor, Paul Volcker. Three new books examine the Fed's record and recent leadership, suggesting that personal qualities have done much to burnish the Fed's reputation, but key institutional changes may have a greater say in its future.

Henrik Gschwindt De Gyor/IMF

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COUNTRY FOCUS: United Kingdom and Canada

Since 1995, the United Kingdom and Canada have seen steady and relatively strong growth. Although their economies differ in many ways, the instruments used to achieve success have common features: solid institutional and policy frameworks, a strong commitment to fiscal rules, and assiduous implementation of structural reforms. The outlook for both economies remains promising, though they also face uncertainties and risks.

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What's on

March

21–22 International Atomic Energy Agency International Conference on Nuclear Power for the 21st Century, Paris, France

24 IMF Book Forum, "Should Europe Embrace 'Cowboy Capitalism' or Go Its Own Way?" with Olaf Gersemann, Martin Neil Baily, and Jacob Kirkegaard, Washington, D.C.

24–25 IMF seminar for legislators, Phnom Penh, Cambodia

April

5 IMF's *Global Financial Stability Report* (April 2005) released

6 IMF Managing Director Rodrigo de Rato to speak at Georgetown University, Washington, D.C.

7 IMF's Spring 2005 *World Economic Outlook* (analytical chapters) released

8 IMF Book Forum, Thomas Friedman, *The World Is Flat: A Brief History of the 21st Century*, Washington, D.C.

10–12 Inter-American Development Bank Annual Meeting, Okinawa, Japan

13 IMF's Spring 2005 *World Economic Outlook* (Chapter 1) released

16–17 2005 Spring Meetings of the IMF and the World Bank Group, Washington, D.C.

18 ECOSOC High-Level Meeting: IMF, World Bank, WTO, and UNCTAD, UN Headquarters, New York

18–20 Asian Development Bank, International Conference on Achieving Results in the Private Sector, Manila, Philippines

19–20 IMF High-Level Seminar on "Asset Securitization and Structured Finance," Washington, D.C.

20–22 World Bank Civil Society Global Policy Forum, Washington, D.C.

20–22 WTO Public Symposium, "WTO After 10 Years: Global Problems and Multilateral Solutions," Geneva, Switzerland

May

4–6 Asian Development Bank Annual Meeting, Istanbul, Turkey

4–6 Third Ministerial Conference of the Community of Democracies, Santiago, Chile

18–19 African Development Bank Annual Meeting, Abuja, Nigeria

18–20 IMF seminar for legislators and journalists, San Jose, Costa Rica

29–30 IMF High-Level Seminar on "Macroeconomic Policy and Social Equity in Latin American Countries," Santiago, Chile

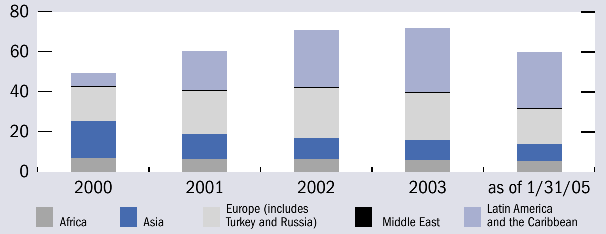
IMF Executive Board
For an up-to-date listing of IMF Executive Board meetings, see *www.imf.org.external/np/sec/bc/eng/index.asp.*

At a glance

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



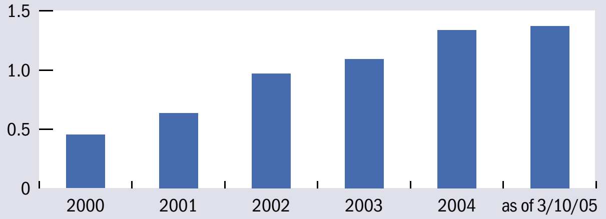
Largest outstanding loans

(billion SDRs, as of 1/31/05)

Nonconcessional		Concessional	
Brazil	16.12	Pakistan	1.04
Turkey	13.74	Zambia	.57
Argentina	8.98	Congo, Dem. Rep. of	.53
Indonesia	6.24	Ghana	.30
Uruguay	1.71	Tanzania	.27

HIPC debt relief[1]

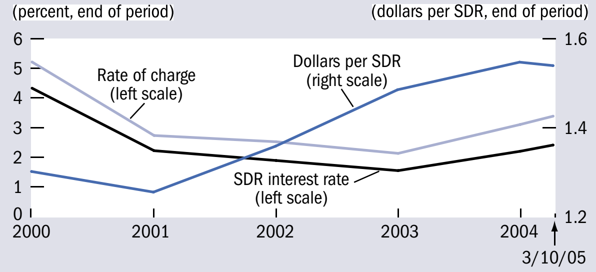
(billion SDRs, end of period)



[1]Cumulative disbursements under the Heavily Indebted Poor Countries Initiative.

Related rates

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



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

De Rato prods China, India to uphold strong growth

During a recent visit to Asia, IMF Managing Director Rodrigo de Rato encouraged China and India to bolster their already successful growth performance by taking steps that would help their economies guard against potential external shocks and cope with growing global competition.

Sebastian D'Souza/AFP/Getty Images

De Rato spoke on India prospering in a globalized economy at the Reserve Bank of India in Mumbai. With him on the dais is the Reserve Bank's Governor Y. B. Reddy.

China

In Shanghai on March 14–16, where he attended a meeting of the IMF's Capital Markets Consultative Group and met with Chinese officials, de Rato said China should seize this moment of economic strength and gradually move toward more exchange rate flexibility. After a meeting with Zhou Xiaochuan, the Governor of the People's Bank of China, de Rato told a news conference that such a move would be in the interests of the Chinese people and to the advantage of the Chinese economy. He said that this shift in policy would better protect China against external shocks and make it easier to conduct an autonomous monetary policy, but added that it was up to the authorities to choose the timing.

At the close of China's National People's Congress the previous day, Chinese Premier Wen Jiabao reiterated China's commitment to move to a market-based, managed floating exchange rate, but did not provide a timetable. De Rato also welcomed the authorities' commitment to policies aimed at restraining the overheating of the economy.

India

On the second leg of his trip, de Rato visited Mumbai and New Delhi on March 17–19 and praised India's vibrant economy, saying that the change in India is palpable: business leaders and citizens are brimming with confidence, and investors are taking note. But more needs to be done, he said, if the country is to progress at an even more dramatic rate.

Speaking at the Reserve Bank of India, de Rato observed that India is competing and winning in the global marketplace—not only in the information technology sector but also in steel production and the pharmaceutical and biotechnology sectors. He compared India's current economic boom to the early stages of the "takeoff" previously experienced by other Asian economies. Indeed, he said, if India can boost annual growth from 6 to 8 percent annually, it can double average incomes in 11 rather than 16 years, dramatically raising living standards.

If this is to be India's century, de Rato observed, a dynamic private sector will be essential, as will the country's ability to thrive amid global competition. He urged the government to put its fiscal house in order and open up its economy to more trade and investment. India's exports still account for less than 1 percent of total world exports, and average trade tariffs remain high—at about 22 percent—though plans are afoot to bring these down to ASEAN levels—around 8 percent—by 2009. The new budget makes a good start, but de Rato counseled that quicker cuts in tariffs, combined with lower nontariff barriers and an improved business climate, would allow Indian business to achieve economies of scale and fully participate in international production chains.

Some domestic sectors also need restructuring to attract investors. The country's huge and talented pool of entrepreneurs can play a vital role, too, de Rato said, but creativity, risk taking, and enterprise must be rewarded. The continued success of India's large textile and clothing sector, for example, will be dependent on lower trade barriers, liberalized labor laws, and reduced business regulation. These key changes, he said, would give India the flexibility it needs to adapt and flourish. ■

Romanian president visits IMF

Michael Spilotro/IMF

Romania's President Traian Basescu addresses the press after his visit on March 9 with IMF Managing Director Rodrigo de Rato. Their discussion focused on recent economic developments in the country and the status of Romania's Stand-By Arrangement with the IMF. De Rato assured him of the IMF's continued support for the country's efforts to stabilize the economy, sustain high growth, and accede to the European Union.

In the news

Moldova's economic recovery troubled by conflict, stalled reforms

Favorable external factors and increased consumer spending, propelled by large workers' remittances, helped strengthen the Republic of Moldova's economic recovery in 2003–04. Nevertheless, according to the IMF's annual economic assessment, Moldova is lagging considerably behind its neighbors, partly as a result of the Transnistria conflict. Moreover, productive capacity has weakened with the steady exodus of working-age Moldovans following the 1998 regional economic crisis.

The IMF Executive Board expressed concern about the recovery's fragile basis and underscored the importance of resolving the Transnistria conflict. It stressed the need to create an environment supportive of private sector development and foreign investment that will help promote lasting growth, create jobs, and reduce poverty.

Rapid money and credit growth have rekindled inflation expectations, although inflation moderated somewhat in late 2004. Following a general government surplus in 2003, fiscal policy came under pressure in 2004, while fueled by the remittances, monetary policy was expansionary. The Board recommended tighter fiscal and monetary policy to control inflation and make room for current external debt service. It welcomed the recent external debt restructuring agreements, which together with the leu's appreciation, resulted in a marked decline in the external debt-to-GDP ratio. Moldova has also resumed interest payments to its Paris Club creditors.

Moldova	2002	2003	2004 Estimates	2005 Projections
		(percent change)		
Real GDP	7.8	6.3	7.0	5.0
Consumer prices (end period)	4.4	15.7	11.0	9.5
		(percent of GDP)		
Current account balance	–4.4	–6.8	–6.7	–6.3
Total external debt	101.2	89.5	63.3	58.4

Data: IMF staff report, January 2005.

In view of stalled structural reforms and a business climate that has not improved significantly, the Board urged the authorities to take decisive steps to reduce government intervention in the economy, revamp the privatization process, phase out excessive regulation, and improve public sector service. Some progress has been registered in fiscal reforms and in revising the legal framework affecting investment, microfinance, auditing, accounting, and leasing. ■

Libya's oil-driven economy needs to reform and diversify

Libya's economy, which remains largely state controlled and heavily dependent on the oil sector, grew solidly in 2003–04, reflecting favorable developments in world oil markets, the IMF said in its annual economic review. The fiscal and external current account balances registered large surpluses, and international reserves rose sharply. Since the lifting of international sanctions, the pace of reforms, aimed at boosting private sector activity, has picked up somewhat. However, reforms continue to be implemented in an ad hoc and nontransparent manner.

The IMF Executive Board welcomed the authorities' increased reform efforts but noted that much needs to be done to transform the country into a market economy. Libya's large surpluses provide a good opportunity to speed up economic reforms, and the early creation of an interministerial economic team should help plan, coordinate, and sequence reforms.

Libya	2000	2001	2002	2003	2004 Preliminary
			(percent change)		
Real GDP	1.1	4.5	3.3	9.1	4.4
			(percent of GDP)		
Overall fiscal balance	14.4	–1.2	10.2	10.6	18.8
Nonhydrocarbon fiscal balance	–17.0	–30.4	–30.0	–36.3	–33.6
External current account balance	22.5	12.3	0.6	15.4	25.6

Data: IMF staff report, January 2005.

In the short run, policies should focus on developing market-based monetary instruments, restructuring the banking system, liberalizing prices, strengthening budgetary management and procedures, and reforming the subsidy system. The Board encouraged the authorities to reassess their one-sector-at-a-time approach to reform and to seek greater economic diversification.

A prudent medium-term fiscal framework would help reduce the large nonoil deficit by strengthening the nonoil tax base, including reducing tax exemptions and streamlining spending. The authorities should also move toward greater budget transparency and consolidate in the budget all extrabudgetary operations. New banking legislation has been passed that grants the central bank greater independence.

Given Libya's severe human resource constraints and weak institutions, the Board supported the authorities' request for technical assistance in support of economic and financial reforms, taking into consideration the country's absorptive capacity. ■

Italy enjoys cyclical recovery, but faces fiscal challenge

Italy's economy is experiencing a modest cyclical recovery, backed by a rebound in investment and exports, the IMF said in its annual economic assessment. However, there are downside risks stemming from higher oil prices and the euro's appreciation. In addition, the fiscal situation remains weak, and fiscal pressures will likely rise in coming years due to population aging. While labor participation rates have increased, productivity has been stagnant. The IMF's Executive Board said Italy needs to boost its growth potential by securing durable fiscal consolidation and pressing ahead with further structural reforms to enhance competition and strengthen the business environment.

Italy has managed to keep its fiscal deficit below the Stability and Growth Pact's ceiling of 3 percent of GDP in recent years, but this has partly been due to one-off measures. The authorities agreed that in coming years there was a need to reduce the deficit, eliminate one-off measures, and ease the tax burden. The Board urged the adoption of structural measures to ensure that this year's deficit target is met and regretted that the 2005 tax cut had not been tied to additional structural expenditure cuts or delayed. Regarding the large public debt burden, the Board favored achieving a small structural fiscal surplus before the end of the decade and underscored the need to clarify further the sources of the large gap between fiscal deficits and public sector borrowing requirements.

Italy	2001	2002	2003	2004 Estimates	2005 Projections
			(percent change)		
GDP growth	1.8	0.4	0.3	1.5	1.7
			(percent)		
Unemployment rate	9.5	9.0	8.7	8.3	8.0
			(percent of GDP)		
General government					
Overall balance	–2.6	–2.3	–2.4	–2.9	–3.1
Gross debt	110.6	108.6	106.2	105.8	104.4

Data: IMF staff report, January 2005.

The Board commended Italy's passage of a pension reform and supported plans to step up privatization efforts. Product and labor market flexibility needs to be improved, however, as deep-seated rigidities are stifling competition and impeding innovation, investment, and efficiency. The Board welcomed positive trends in Italy's financial sector and noted the importance of strengthening securities market regulation and corporate governance standards. ■

Slovak economy makes strides in growth, reforms, income convergence

The Slovak Republic's economy has recorded strong productivity growth in recent years as well as declining fiscal and external deficits, the IMF said in its annual economic assessment. Key structural reforms in the areas of taxation, welfare, pensions, health care, and the labor market have increased the economy's flexibility. Large foreign direct investments and an improved business climate have expanded production capacity and boosted investor confidence. The IMF's Executive Board commended the authorities but noted that challenges remained in further reducing the fiscal deficit and inflation, curbing unemployment, and achieving convergence with western European income levels.

Inflation, though falling, is well above the euro-area average, and strong growth poses upside risks to the central bank's inflation target. In 2004, the central bank substantially cut interest rates in response to weak demand and intervened extensively in the foreign exchange market to absorb exchange rate appreciation pressures. The Board advocated a more flexible approach to the exchange rate and welcomed the central bank's adoption of a monetary policy framework that will give disinflation priority.

Slovak Republic	2001	2002	2003	2004 Estimates	2005 Projections
		(percent change)			
Real GDP	3.8	4.6	4.5	5.5	4.9
Consumer prices (annual avg.)	7.3	3.3	8.5	7.5	3.7
		(percent)			
Unemployment rate	19.3	18.6	17.5	18.1	17.1
		(percent of GDP)			
General government balance	–6.0	–5.7	–3.4	–3.3	–3.8

Data: IMF staff report, January 2005; and Slovak Statistical Office.

Data released after the IMF report showed that in 2004, the fiscal deficit narrowed slightly in relation to GDP, reflecting lower spending on wages, benefits, and interest. In an environment where substantial capital inflows could continue, the Board encouraged the authorities to further tighten fiscal policy to help reduce appreciation pressures and support monetary policy in lowering inflation. It also advised strengthening the medium-term budgetary framework to help ensure meeting the Maastricht criteria in a sustainable way. The Board noted that the authorities' timetable for adopting the euro in 2009 will require continued structural reform and highlighted the importance of improving education, public infrastructure, and the housing market for low- and middle-income households. ■

For more information, refer to Public Information Notices No. 05/17 (Italy), No. 05/23 (Moldova), No. 05/24 (Slovak Republic), and No. 05/28 (Libyan Arab Jamahiriya) on the IMF's website (*www.imf.org*).

Proposal for a new IMF country insurance facility

Voicing what has become a widespread concern among emerging market economies, Henrique de Campos Meirelles, Governor of Brazil's central bank, recently said that his country "would like to see a facility that prevents crises, particularly when they are caused by changes in market sentiment that have nothing to do with emerging markets in general." With available "insurance" options against runs being limited and costly, is there anything that the international community can do? One possible alternative, a new IMF Working Paper argues, is to create a facility that could extend automatic credit to eligible countries at a predetermined interest rate.

Many recent emerging market financial crises followed a similar script: a sudden increase in the perceived debt rollover risk led to an escalation of interest rates that made otherwise sustainable levels of debt unsustainable. As a result, emerging market economies have started to feel that globalization, for all its potential benefits, opens the door to self-fulfilling runs. In the absence of better insurance alternatives, most such economies have been favoring self-insurance via the accumulation of reserves, either in the central bank or in the banking sector through the imposition of liquid asset requirements. In many cases, however, the cost of holding reserves—that is, the country's borrowing costs in excess of the returns offered by high-grade liquid assets—can be substantial.

Current IMF facilities are more suited to fundamental solvency crises than to nonfundamental self-fulfilling runs.

Unsuccessful options

Other options have been explored. Two countries—Argentina and Mexico—have experimented with private insurance in the form of a contingent credit line with a consortium of financial institutions, but with disappointing results. There is little scope to diversify highly correlated emerging market risk, which limits the coverage and increases the cost. And, unlike standard insurers, insuring banks can hedge their exposure by selling the country's assets, thereby fueling the run.

Another alternative is to insure with the IMF. The problem is that current IMF facilities are more suited to fundamental solvency crises than to nonfundamental self-fulfilling runs. These facilities emphasize corrective actions, and their disbursements are backloaded and conditional, and usually follow arduous negotiations. This combination explains why governments in emerging market economies prefer to pay lofty rates in private markets before turning to the Fund. In any case, the amount and timing of IMF assistance are, a priori, highly unpredictable, and unpredictable assistance is not what is needed to prevent a run.

Yet another option is to have international financial institutions offer a streamlined lending facility in the event of an "exceptionally large" capital account reversal. This idea is not new. It dates back to 1972, was debated by the IMF's Executive Board in late 1994 right before the Mexican crisis, and it regained momentum after the Asian crises.

Against this background, in 1999, the IMF launched its Contingent Credit Lines (CCL) to help countries with sound fundamentals cope with liquidity crises by qualifying them for IMF financial assistance before the need arose. Eligibility for such assistance, however, remained subject to IMF approval upon the country's request, and governments may have been disheartened by the possibility that markets might interpret a mere request for prequalification as a signal that something was amiss. For this and possibly other reasons, the facility went unused and was phased out in 2004.

Automaticity is key

Since then, there have been extensive discussions about the role of the IMF as international lender of last resort, the advantages of ex ante conditionality, and the lackluster performance of the CCL.

The alternative proposed here—a new country insurance facility (CIF) through which the IMF could address the shortcomings of previous approaches and handle short-lived self-fulfilling liquidity crises—is a natural offspring of that debate. A CIF would entail the creation of a liquidity window, through which eligible countries would have automatic access to a line of credit at a predetermined interest rate to cover short-term financing needs. By offering instant liquidity, the facility would place a ceiling on rollover costs—thus avoiding debt crises triggered by unsustainable refinancing rates, much in the same way as central banks operate in their role of lenders of last resort.

Why would this scheme succeed where the CCL failed? The key is automaticity. It is essential for preempting liquidity runs, and it would distinguish the CIF from other IMF facilities, including the late CCL, which required a prequalification process.

A blueprint for country insurance

The appeal and feasibility of the proposed CIF hinge on the balance between two basic principles: predictability and sustainability. The first requires that at each point in time there is certainty regarding a country's eligibility—that is, no "constructive ambiguity" should be allowed. The second requires that, at the prefixed interest rate and without the need of unrealistic improvements in the fiscal stance, eligible countries should be able to repay their obligations. Maastricht-type criteria on debt-to-GDP ratios and the fiscal deficit are natural candidates for eligibility criteria. In addition, to the extent that foreign currency debt exposes a country to swings in the real exchange rate, foreign-currency-denominated debt could carry greater weight in any debt-to-GDP eligibility threshold.

Following lender-of-last-resort practices, the CIF could charge a penalty rate relative to precrisis levels. Thus, the interest rate of the facility could be set at a premium over the risk-free rate corresponding to the currency and duration of the credit line (as is customary when computing charges in multilateral nonconcessional loans). The spread should be set low enough so as not to compromise the country's repayment capacity and high enough to prevent abuse of the facility and to maximize the country's efforts to regain access to private markets. Something in the range of 300–400 basis points appears to be reasonable.

The idea behind the CIF is to stop and reverse short-lived liquidity runs—and, ideally, to have the facility's mere existence help prevent them altogether. For this reason, CIF loans should be short term. However, whereas longer maturities may induce undue reliance on the CIF, too short a maturity may leave open the possibility of a new run once the loan comes due. Striking the right balance would inevitably involve some arbitrariness. One possibility would be to set the duration at six months with the option to renew, at a higher rate, for another six. In this way, the CIF would represent a shorter-term alternative to the IMF's Supplemental Reserve Facility.

Naturally, no set of eligibility criteria is fail-safe. Liquidity crises may not be undone during the life of the loan and may even evolve into a solvency crisis. If so, CIF assistance would need to be phased into an IMF-supported policy program. For this reason, the size of the CIF loan should not exceed the amount of resources commonly available under an IMF-led rescue package. However, the often-made argument that small IMF-supported programs are ultimately counterproductive applies even more starkly to the CIF. A visibly inadequate amount of funds would simply fuel the run. To effectively insure a country against liquidity runs—and, ideally, to preempt liquidity runs altogether—the facility should cover most of the country's short-term financing requirements. Thus, any limit on the size of the facility automatically imposes a subceiling on the short-term debt-to-GDP ratio (the stock of debt coming to maturity over the life of a CIF loan), so that the "insurance coverage" is close to 100 percent.

The appeal and feasibility of the proposed country insurance facility hinge on the balance between two basic principles: predictability and sustainability.

Insurance as a reward for good policies

In the past, critics have charged that excessive largesse in the rescue packages of international financial institutions has undermined market discipline and diminished the authorities' incentives to pursue sound policies. As a result, the debate on how to reform the international financial architecture has centered on how to limit financial assistance rather than on how to make it more accessible. However, the untested presumption that financial assistance reduces the incentive to put in place sustainable policies is not necessarily true, particularly when crises are triggered by factors beyond policymakers' control.

On the contrary, if countries are provided with some degree of insurance against liquidity runs, long-run efforts would ultimately be rewarded, inducing the right incentives. This argument applies fully to the CIF outlined here. Furthermore, the incentives embedded in the eligibility conditions should make countries more willing to embrace sustainable policies to gain access to the facility. In this way, through the "carrot" of insurance, the CIF would replace the standard ex post conditionality with voluntary ex ante conditionality.

Ultimately, a well-designed CIF that prevents liquidity runs should be used very infrequently, if ever. Its impact should be visible, however, in an increasing number of eligible countries and in lower and less volatile emerging market risk premiums. This is indeed the metric by which the success of a CIF should be measured. ■

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This article is based on IMF Working Paper No. 05/23, *A (New) Country Insurance Facility*. Copies are available for $15.00 each from IMF Publication Services. See page 80 for ordering information.

What does the future hold for microfinance?

An estimated 400–500 million people worldwide do not have access to financial services other than informal moneylenders. This lack of access constrains private sector development and economic growth, and has distributional consequences, since the poor and those living in rural areas are disproportionately affected. Microfinance has been touted as a promising means to reach the financially underserved. Is it? A recent IMF study examined the pros and the cons.

The concept of microfinance is now several decades old. Its institutions provide small credits and other financial services to low-income households and very small informal businesses. With constant innovation to meet the specific needs of the people they serve, microfinance institutions offer a menu of options. Through group lending, for example, they are able to provide credit, with minimal reliance on collateral, to group members who take turns borrowing and are jointly responsible for loan repayment.

Many microfinance institutions are owned and operated by nongovernmental organizations that receive grants, and sometimes loans, from multilateral development agencies, private charities, governments, and similar institutions. In parts of the world, they follow the model of financial cooperatives, funding their lending from members' deposits and capital contributions. While some have grown into formal, self-sustaining financial institutions, most remain informal and dependent upon donor funds.

But after years of experience with microfinance, surprisingly little is known about it. There are no comprehensive and authoritative data, for example, on the size of the industry or the populations served. Stylized facts, however, can be drawn from studies at the country and regional levels. These suggest that while the industry comprises a very large number of institutions—in the tens of thousands by some estimates—the number of people served and the amounts of money involved are small. The studies also indicate that most microfinance activity is concentrated in a handful of countries and that only a few large institutions carry out a significant portion of the transactions.

The pros and the cons

Proponents advance many arguments in favor of microfinance. Although these loans carry a higher risk and therefore have a higher cost than traditional loans, industry supporters and practitioners see benefits for poor families. There are numerous success stories to support their claims, and beyond the anecdotal evidence, there are public policy arguments in favor of microfinance. Economists have long recognized the existence of informational failures in financial markets that could prevent the realization of otherwise efficient transactions. Besides, access to financial services may help improve the living conditions of the poor and empower them, ameliorating the "aid-dependence syndrome" associated with other redistributive mechanisms.

But others point to counterarguments and note a number of caveats and risks. To them, it is not entirely clear whether microfinance techniques are effective in circumventing imperfections in financial markets or whether microfinance institutions have an intrinsic advantage over traditional financial institutions. If they have an intrinsic advantage, it should perhaps materialize in better access to private funding, possibly various forms of cooperation and vertical integration within the financial industry. But to date, most external funding for the microfinance industry continues to come from donor sources, with very limited integration with traditional private financial institutions.

The excessive reliance of the microfinance industry on donor funding prompts a second concern. Such subsidization comes at the risk of relaxing budgetary discipline in the microfinance industry and creating unfair competition with traditional financial institutions, preventing them from expanding their outreach. Should microfinance institutions aim to be profitable and financially self-sufficient, perhaps after an initial phase of subsidization to help cover start-up costs? Proponents of commercialization consider profitability as proof that microfinance is fulfilling its goals and see self-sufficiency as essential if the industry is to grow in the future.

They also voice concern that, as nonprofit organizations, microfinance institutions may lack the appropriate ownership structure, staff, operational systems, and incentives to improve operating efficiency. On the other hand, those who see microfinance chiefly as a poverty alleviation tool stress the importance of keeping the costs of financial services as low as possible while reaching the most destitute. In their view, the merits of subsidization should be decided on the basis of a cost-benefit analysis with other anti-poverty programs.

A related open question is whether microfinance institutions are a cost-effective tool for redistributing scarce resources. How do they compare with the alternatives? While these institutions are presumed to have some advantages over more traditional redistributive mechanisms (notably through

Beawiharta/Reuters

Grassroots microsavings and loan cooperatives, like this one in Jakarta, Indonesia, provide the poor and those living in rural areas with access to financial services.

empowerment of the poor and recycling of funds through loan repayments), there is, in reality, too little data to compare their relative costs and benefits. Since providing financial services to the very poor is costly relative to the volume of resources channeled, it risks dissipating a disproportionate part of the resources in administrative and operational expenses. Besides, the increasing popularity of microfinance among donors, combined with the lack of hard evidence on its cost-effectiveness, also risks diverting scarce resources from other basic redistributive mechanisms, such as health care and education.

Challenges ahead

If it is to realize its potential, the microfinance industry will need to tackle a number of important challenges that lie ahead. One of the most important of these is achieving financial sustainability and integrating the microfinance industry into the formal financial sector. Studies indicate that only 1 percent of existing microfinance institutions worldwide are financially stable. Despite apparently high loan recovery rates, the small scale of microfinance operations, combined with the costs of reaching out to clients, pushes up operating costs and absorbs most of the interest margins. The few financially self-sustainable microfinance institutions tend to be larger, spreading fixed costs and achieving greater efficiency. But those striving to become commercially viable do not tend to target the very poor.

A related challenge entails the interaction of microfinance and traditional financial institutions. While there are success stories of microfinance institutions growing into formal financial institutions, as well as banks entering the microfinance niche and business relationships developing between banks and microfinance institutions, no clear trends have yet emerged.

There is also the matter of whether and how the microfinance industry should be regulated. So far, the industry has evolved largely outside the regulatory framework that applies to formal financial institutions. Prudential regulation of microfinance institutions would typically be predicated on whether they pose a threat to financial stability or engage in deposit intermediation. The weak approach applied to date in most countries thus seems justified, considering the small size of the industry and its infrequent reliance on deposit funding.

As microfinance institutions become larger and eventually move into traditional financial intermediation, however, regulatory and supervisory approaches would need to be considered. The optimal approach would have to weigh the specific circumstances of individual countries and avoid diverting scarce supervisory resources from more systemically important financial institutions or overburdening microfinance institutions with information and compliance requirements. In some cases, a lighter regulatory approach may be warranted, but it would have to minimize discrimination against traditional financial institutions and guard against establishing legal loopholes and opportunities for regulatory arbitrage.

Having the necessary information at hand is critical to addressing these challenges. While the information gap has been increasingly filled by independent data sets of varying quality and coverage, the task of generating more systematic information is complicated by a lack of consensus on the data needed, and the absence of clear-cut definitions of the products and services that qualify as microfinance. An ongoing World Bank initiative is seeking to assess existing data sets, determine current and anticipated data needs, and formulate the best strategy for closing these gaps. But information gathering is further complicated by the informality and dispersion of the industry, while the costs of data collection may prove excessively burdensome for microfinance institutions.

Ultimately, the path to developing a sound and sustainable microfinance industry, and deepening financial services, will provide the answers to these challenges. ■

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The full text of *Microfinance: A View from the Fund*, which provides the basis for this article, is available on the IMF's website (*www.imf.org*).

Will the Fed stay in good hands?

The successful performance of the U.S. Federal Reserve—the Fed—over the past 25 years owes much to Paul Volcker and Alan Greenspan, the two men who have headed the institution over this period. Will Greenspan's eventual successor be able to follow in their footsteps? According to three new books, the Fed's strong track record and institutional changes in recent years will do much to ensure that the Fed remains effective.

If the Federal Reserve had "retired" in 1978 at the age of 65, its career would have been considered fair-to-middling at best. The Fed is almost universally blamed for worsening, if not causing, the Great Depression of the early 1930s by applying the brakes when it should have been stepping on the accelerator. Then, just as things were finally beginning to improve, the Fed nearly brought the economy crashing down again by doubling reserve requirements in 1936–37. Much later, in the 1970s, the Fed again made a serious misstep when it failed to keep U.S. inflation in check.

That the Fed now enjoys a solid reputation despite these failures is due in large part to Volcker's conquest of inflation in the early 1980s. The personal qualities of the man who whipped inflation are the focus of *New York Times* columnist Joseph Treaster's book, *Paul Volcker: The Making of a Financial Legend*.

Whipping inflation

Treaster notes that finding the right person to tame inflation was a tough task. David Rockefeller had already turned down the job, later commenting that "I would have been responsible for implementing a set of draconian policies to wring inflation . . . . As a wealthy Republican with a well-known name, and a banker to boot, it would have been extremely difficult for me to make the case for tight monetary policy and sell it to a skeptical Congress and an angry public."

Volcker, a Democrat, was considerably less vulnerable on those counts, and his personal austerity, already well-known, made it unlikely that he could be charged with leading the good life while inflicting pain on others. Volcker, says Treaster, took delight in cheap cigars and bargain suits. On his first day as president of the Federal Reserve Bank of New York, the unusually tall Volcker found his legs would not fit under the elegant mahogany desk his predecessors had used. His solution? Have carpenters fit blocks to the base of the desk. He also had the New York Fed's official limousine replaced with a sedan.

As Chair of the Fed, Volcker continued to live "more like a graduate student than a prince of power and influence," writes Treaster. He lived in a one-bedroom apartment on F Street amid university students, watched the news on a 10-inch black-and-white television set, and lugged his dirty laundry in a suitcase to his daughter's home to run it through her washing machine.

Volcker also raised interest rates to record levels and kept them there until he had vanquished inflation. By the summer of 1982, he was able to note in a speech that "the forces are there that would push the economy toward recovery . . . . I would think that the policy objective should be to sustain that recovery." It took Alan Greenspan, then in the private sector, to translate into plain English Volcker's characterization of the Fed's decision: "They have eased," said Greenspan, who went on to replace Volcker in 1987.

You *can* stand the truth!

Alan Blinder in *The Quiet Revolution: Central Banking Goes Modern* says that having Greenspan succeed Volcker "at the helm is a bit like the New York Yankees' good fortune in being able to replace Joe DiMaggio with Mickey Mantle in centerfield. You cannot expect to do that consistently." Nevertheless, Blinder, a professor at Princeton University who served as Vice Chair of the Fed in the mid-1990s, offers three reasons why the institutional changes over which Volcker and Greenspan have presided will ensure that the Fed stays on a sound course.

The first is the revolution in how much central banks tell the public. It used to be that central bankers thought it best to keep their thinking secret and issue only guarded statements about their actions. Blinder notes that "as late as 1993—hardly the Middle Ages—the Federal Reserve did not even disclose its monetary policy decisions at the time they were made. Instead of an official announcement, markets were forced to guess what the FOMC [Federal Open Market Committee] had decided—which gave professional Fed-watchers a clear advantage over amateurs." Indeed, Blinder relates that when he became Vice Chair in June 1994, the Fed's press officer explained the rules of engagement to him, including an admonition that "we don't talk about the economy."

Only a decade later, the consensus is that it is better for central bankers to be open with the press and the public. Making the central bank more transparent improves the quality of monetary policy, says Blinder. The central bank knows that it has to provide "the legislature and the people a full and honest accounting of what it is up to and why." This forces central bankers to think harder about their actions and take better and more coherent policy actions.

Though all in favor of this trend, Blinder cautions that "transparency can and should stop short of voyeurism." He is thus against the immediate release of the verbatim transcripts of FOMC meetings, which at present are provided after five years. Immediate release will, he cautions, "limit frankness and everyday banter, prevent people from taking 'devil's advocate' positions, and otherwise stifle debate."

Who's the boss?

The second institutional change is that, despite the dominance of Volcker and Greenspan, monetary policy at the Fed and at other central banks is increasingly being made by committee. Blinder says that Greenspan leads the FOMC "with a velvet glove, not an iron fist."

There are several advantages of having monetary policy decided by committee. By reflecting the consensus view of several individuals, the committee is less likely to be volatile in its opinions or to adopt extreme positions. Also, pooling knowledge is useful when there is uncertainty about the state of the economy or the effect of monetary policy decisions on the economy.

The third change for the better is that "central banks, which used to pride themselves on lording it over the markets, have been showing them increasing deference in recent years." Blinder says this is a healthy development because "market prices succinctly summarize the collective wisdom of a vast number of people with diverse beliefs and access to different information. To believe that you can outwit the markets on a regular basis requires an extreme hubris that few, if any, modern central bankers have."

Trading places

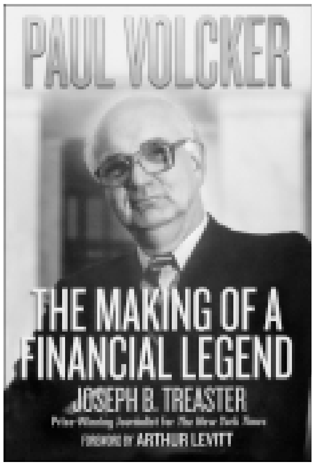
These institutional changes have occurred amid a broad movement toward granting central banks their "independence"—that is, freedom from political interference. This allows not just the chair but all the members of the monetary policy board to do their jobs based on technical assessments of the economic situation, not on the likely political fallout. It's a point that Laurence Meyer emphasizes in *A Term at the Fed: An Insider's View*. Writing about his stint on the FOMC, Meyer terms the Fed "a safe harbor, a place consciously constructed to keep us away from the political winds. So you won't see much of politics in this book."

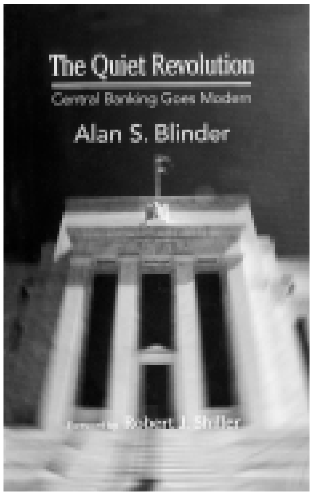
Indeed, such politics as Meyer does describe is of the "trading places" variety: members of the FOMC who might have been tagged "doves" based on their political leanings ended up urging tighter monetary policy than those who have been thought of as "hawks." With U.S. growth unusually strong in the mid-1990s, a difference of opinion emerged among the FOMC on the likely cause of this exceptional growth performance and therefore the appropriate policy response.

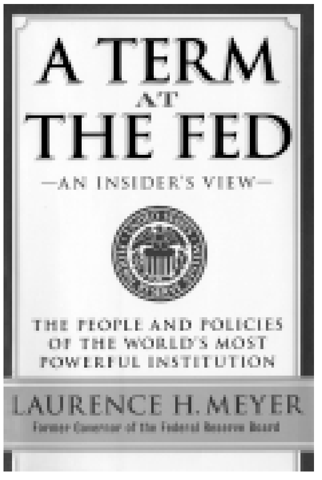
Greenspan, a Republican appointee, was of the opinion that the strong growth was due to productivity increases in the economy and was thus unlikely to trigger inflation. Democratic appointees such as Meyer pinned their faith on a traditional relationship between demand-driven growth and rising inflation, and they urged an increase in interest rates to choke off the incipient inflation. Greenspan was able to steer the FOMC toward his view, and Meyer graciously concedes that Greenspan "turned out to be right. His call on the productivity acceleration was truly a great one."

Speculating about who will succeed Alan Greenspan is a fun parlor game, but it's unlikely his successor would or could turn back the clock on such changes as bipartisanship, clear communication with the public, and the deference shown to fellow FOMC members and the markets. The reforms seem to be here to stay, and the Fed looks likely to remain a strong and effective institution. ■

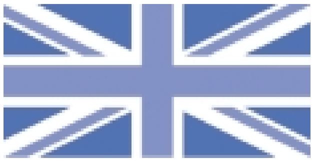
Prakash Loungani
IMF External Relations Department







Country focus



United Kingdom reaps benefits from strong reforms and sound policy frameworks

Over the past decade, U.K. economic growth has been steady and stronger than in most other major industrial countries thanks to the rigorous implementation of structural reforms, improvements in macroeconomic policies, and well-designed policy frameworks. The economy is operating at close to full capacity and is expected to continue growing at about 2½ percent a year, the IMF reported in its latest economic review.

Domestic demand remains the key driver of growth, underpinned by continued strong growth of real labor earnings and house prices, and robust corporate profitability. Unemployment has fallen to a 30-year low, nominal wage growth has been moderate, and inflation remains subdued. "The U.K. economy has benefited enormously from structural reforms during the 1980s that substantially increased flexibility, and the introduction in the late 1990s of clear and simple macroeconomic policy rules," said Susan Schadler, Deputy Director of the IMF's European Department and mission chief to the United Kingdom. "In addition, a large fiscal adjustment in the late 1990s and other favorable developments, such as improving terms of trade and rising property prices, have bolstered performance."

Uncertainties remain

The economy is well positioned to sustain growth over the medium term, but uncertainties and challenges born of the recent economic success remain. "The most immediate risks come from U.K.-specific factors—the widely perceived overvaluation of house prices, which could see an abrupt correction, and the potential for wage pressures in the context of low unemployment—as well as external influences such as a possible unwinding of global trade imbalances," Schadler said. The housing market has recently cooled, and house prices are expected to decline modestly in 2005.

United Kingdom	2001	2002	2003	2004 Projections	2005 Projections
			(percent change)		
Real GDP	2.3	1.8	2.2	3.1	2.6
Domestic demand	2.9	2.9	2.5	3.8	2.9
			(percent)		
Unemployment rate	5.1	5.2	5.0	4.8	4.6
			(percent of GDP)		
General government balance[1]	0.0	–2.2	–3.2	–2.9	–3.1
Public sector balance[1]	0.0	–2.4	–3.2	–3.0	–3.1
Public sector net debt[1]	31.0	32.3	33.7	35.4	37.1

Data: U.K. Office of National Statistics and HM Treasury; and IMF staff estimates.

[1]The fiscal year begins in April. For example, fiscal balance data for 2002 refers to FY2002/03. Debt stock data refers to the end of the fiscal year.

The U.K. fiscal position deteriorated sharply over the past five years, reflecting increased government spending to improve public services and declining revenues in the aftermath of the equity price bubble. Although the overall deficit is not unusually large compared with other major industrial countries and the debt burden is relatively low, "a persistent fiscal deficit at current levels over the next few years could undermine the credibility of the fiscal rules," Schadler said. The U.K. Treasury projects that slower spending growth and a rebound in revenues will reverse this deterioration and ensure that the fiscal rules are respected now and in the future. Tom Scholar, the U.K. Executive Director, told the Board that "the current fiscal stance remains consistent with these rules and appropriate for this point in the economic cycle."

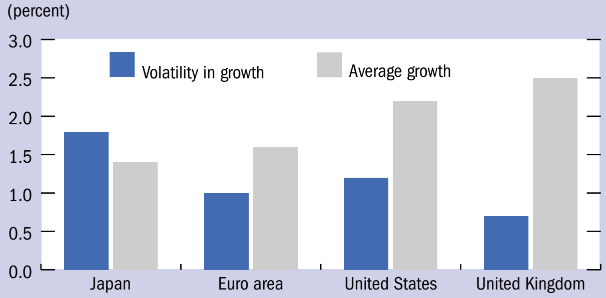
However, the question remains about how much revenues will rebound in the absence of further policy measures, and during the IMF Executive Board discussion, many Directors saw the authorities' projections as somewhat optimistic. The Board noted the authorities' commitment to take measures should they prove necessary. However, many directors recommended that a mild fiscal adjustment be started expeditiously. "Early and gradual consolidation would then start in strong economic conditions, and the adjustment would appropriately be spread over time," said James Morsink, Division Chief in the European Department. The fiscal policy framework—based on a golden rule (current balance or better over the cycle) and a debt ceiling—is one of the strongest among industrial countries. A review of the framework and consideration of ways to enhance it would be useful as the present cycle ends.

Preparing for risks

In guarding against the risks, Morsink said "monetary policy needs to be prepared to react quickly to changes in inflationary pressures, either on the downside, for example, if housing prices fell sharply, or on the upside, if labor earnings began to accelerate." The review concluded that monetary policy has been appropriate in recent years and is now well positioned to respond to shocks. The policy interest rate is in a neutral range and, given the uncertainties in the outlook, the next move in interest rates could be up or down. The Board and staff wel-

Strong and steady

During 1995–2004, U.K. economic growth per capita was higher and more stable than in most other industrial countries.



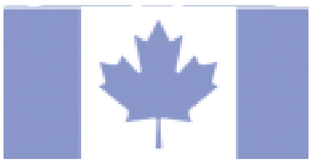
Data: IMF, *World Economic Outlook* database.

comed the increased emphasis on inflation projections based on market expectations of future interest rates and the extension of the projection horizon from two to three years.

The challenges of population aging, although less severe than in most other industrial countries, are also moving to the forefront of public debate in the United Kingdom. A recent interim report by the U.K. Pensions Commission concluded that many people are not saving enough for retirement, noting that about half of the working-age population over age 35 has inadequate savings to supplement the relatively minimal state pension. While staff and the authorities agreed on some aspects of the solution to this problem, particularly increasing the pensionable age, views differed widely on the appropriate role of the government in promoting private saving.

The Board welcomed the narrowing of the productivity gap between the United Kingdom and the average in other major industrial countries and encouraged the systematic evaluation of government initiatives to boost productivity. The authorities also intend to address structural rigidities in the housing market. Indicators of the health of the financial system remain quite favorable. ■

Copies of "United Kingdom: 2004 Article IV Consultation," IMF Country Report 05/80, and "United Kingdom Selected Issues," IMF Country Report No. 05/81, are available for $15.00 each from Publication Services (see page 80 for ordering details) or on the IMF's website (*www.imf.org*).



Canada's track record on growth and budget position tops Group of Seven

For almost a decade, Canada has recorded the fastest economic growth and strongest budget position of the Group of Seven (G-7) major industrial countries. Since 1995, Canada's real GDP growth has averaged 3½ percent a year—2½ percent on a per capita basis—narrowing the gap with the United States and remaining well above most other G-7 countries. Moreover, the country has kept its fiscal accounts in balance, which helped reduce the net debt ratio by almost 35 percentage points of GDP.

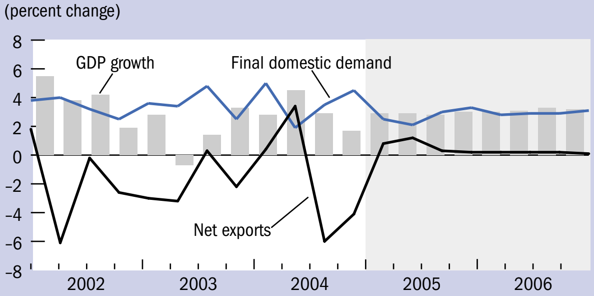
What lies behind this strong track record? The answer is twofold: a strong institutional framework, which is based on inflation targeting and a strong commitment by the federal government to maintain balanced budgets or better, and continuing structural reforms, including of the employment insurance system, tax cuts, and trade liberalization.

Looking ahead

The economic outlook remains broadly favorable, but external developments are creating significant uncertainties. A series of shocks hit the economy in 2002–03, including an almost 30 percent exchange rate appreciation vis-àvis the U.S. dollar, an outbreak of Severe Acute Respiratory Syndrome (SARS), forest fires, a large power outage, and

Strong at home, weaker abroad

Domestic demand has been the backbone of Canada's expansion, while net exports have contributed little.



Note: Shaded area indicates projections.
Data: Statistics Canada and IMF staff calculations.

a case of "mad cow" disease. Nevertheless, the economy rebounded strongly in 2004 and is expected to continue expanding in 2005, supported by a pickup in investment, rising personal incomes, and buoyant corporate profits. "Canada's strong macroeconomic framework and flexible economy have positioned the country well to respond to macroeconomic disturbances," said Tamim Bayoumi, Assistant Director and mission leader to Canada in the IMF's Western Hemisphere Department.

As an open economy whose exports are concentrated on the U.S. market and contain a high proportion of commodities, Canada remains susceptible to external shocks. Hence, the recent further appreciation of the Canadian dollar, uncertainty about the underlying strength of net exports, and commodity price volatility pose some risks.

In addition, Canada—like other industrial countries—faces a sharp increase in the share of the elderly population. But, Bayoumi said, "owing to its strong macroeconomic framework and flexible economy, Canada is already well-placed to face these challenges." Meeting these challenges would require sustained fiscal prudence, fundamental reform to control health care costs, and structural policies to maximize productivity. Bayoumi added that "additional reform efforts could be directed at reducing the relatively high tax burden, increasing labor utilization, and eliminating the remaining barriers to trade and competition."

Leading the pack

During 1995–2003, Canada recorded the fastest growth and the strongest budget position among the major industrial countries.

	Real GDP		GDP per capita	General government (percent of GDP)			
				Fiscal balance		Net debt	
	Growth	Per capita growth	2003[1]	Average	2003	Change 1995–2003	2003
Canada	3.5	2.5	31,942	0.0	1.2	–34.5	34.8
France	2.2	1.8	27,047	–3.0	–4.1	3.8	42.7
Germany	1.2	1.1	28,104	–2.5	–3.9	12.3	52.0
Italy	1.5	1.5	27,480	–3.4	–2.5	–11.6	93.6
Japan	1.2	1.0	28,278	–6.2	–8.0	54.9	79.4
United Kingdom	2.8	2.4	27,777	–1.2	–3.2	–3.8	33.5
United States	3.3	2.1	38,031	–1.3	–4.7	–12.7	46.2
Unweighted average excluding Canada	2.0	1.6	29,453	–2.9	–4.4	7.2	57.9

[1]In U.S. dollars at purchasing power parity exchange rates.
Data: IMF, *World Economic Outlook*; and OECD, *Economic Outlook*.

Room to maneuver

As the rebound in growth reduced economic slack in the third quarter of 2004, the Bank of Canada began to withdraw monetary stimulus in September and October of last year. The Bank has since left interest rates unchanged, partly due to concerns over a renewed appreciation of the Canadian dollar in recent months.

"The Bank of Canada has had considerable success in keeping inflation within its target range, which has contributed to very low inflation expectations," Bayoumi said. Considering the absence of wage pressures, the risks to the outlook, and well-anchored inflation expectations, there was still room for a cautious and pragmatic approach to withdrawing stimulus, consistent with the inflation target.

Improved economic conditions have also helped Canada make further progress in reducing its debt-to-GDP ratio. The federal budget surplus in 2003–04 was well above earlier estimates, reflecting buoyant tax revenue from the rebound in economic activity. Provincial government finances deteriorated slightly, but budgets remained close to balance, and the strength of federal finances left the general government with a significant surplus.

"The Canadian government has embarked on a comprehensive expenditure review, which is likely to generate considerable savings," Bayoumi said. "At the same time, fiscal room for maneuver is limited by recent commitments to increase federal transfers to provinces."

The objective of lowering the federal debt-to-GDP ratio to 25 percent within 10 years will be an important element in preparing Canada for the long-term fiscal challenge posed by population aging. In particular, growing health-care spending will increase pressure on the country's fiscal balances. The IMF stressed that more needed to be done to ensure the sustainability and efficiency of the health-care system through measures that improve incentives for both health-care providers and health-care consumers. "Canada is one of the few countries with a fully funded public pension system," Bayoumi said. "Therefore, public policy can and should focus on reforming the universal public health system, whose costs have sharply increased in recent years." ■

Stand-By, EFF, and PRGF arrangements as of February 28

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	4,810.00
Bolivia	April 2, 2003	March 31, 2005	128.64	26.80
Brazil	September 6, 2002	March 31, 2005	27,375.12	10,175.48
Bulgaria	August 6, 2004	September 5, 2006	100.00	100.00
Colombia	January 15, 2003	April 14, 2005	1,548.00	1,548.00
Croatia	August 4, 2004	April 3, 2006	97.00	97.00
Dominican Republic	January 31, 2005	May 31, 2007	437.80	385.26
Gabon	May 28, 2004	June 30, 2005	69.44	27.78
Paraguay	December 15, 2003	September 30, 2005	50.00	50.00
Peru	June 9, 2004	August 16, 2006	287.28	287.28
Romania	July 7, 2004	July 6, 2006	250.00	250.00
Ukraine	March 29, 2004	March 28, 2005	411.60	411.60
Uruguay	April 1, 2002	March 31, 2005	1,988.50	0.00
Total			**41,724.38**	**18,169.20**
EFF				
Serbia and Montenegro	May 14, 2002	May 13, 2005	650.00	187.50
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
Total			**794.40**	**311.23**
PRGF				
Albania	June 21, 2002	November 20, 2005	28.00	8.00
Azerbaijan	July 6, 2001	July 4, 2005	67.58	12.87
Bangladesh	June 20, 2003	June 19, 2006	400.33	251.83
Burkina Faso	June 11, 2003	August 15, 2006	24.08	10.32
Burundi	January 23, 2004	January 22, 2007	69.30	35.75
Cape Verde	April 10, 2002	July 31, 2005	8.64	1.26
Chad	February 16, 2005	February 15, 2008	25.20	21.00
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Congo, Republic of	December 6, 2004	December 5, 2007	54.99	47.13
Democratic Republic of the Congo	June 12, 2002	June 11, 2005	580.00	53.23
Dominica	December 29, 2003	December 28, 2006	7.69	4.71
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	June 4, 2004	June 3, 2007	98.00	70.00
Ghana	May 9, 2003	May 8, 2006	184.50	105.45
Guyana	September 20, 2002	September 12, 2006	54.55	27.79
Honduras	February 27, 2004	February 26, 2007	71.20	50.86
Kenya	November 21, 2003	November 20, 2006	225.00	150.00
Kyrgyz Republic	December 6, 2001	March 14, 2005	73.40	9.56
Lao People's Democratic Republic	April 25, 2001	April 24, 2005	31.70	13.58
Madagascar	March 1, 2001	March 1, 2005	91.65	11.35
Mali	June 23, 2004	June 22, 2007	9.33	8.00
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Mozambique	July 6, 2004	July 5, 2007	11.36	8.12
Nepal	November 19, 2003	November 18, 2006	49.91	35.65
Nicaragua	December 13, 2002	December 12, 2005	97.50	41.78
Niger	January 31, 2005	January 30, 2008	6.58	5.64
Rwanda	August 12, 2002	August 11, 2005	4.00	1.71
Senegal	April 28, 2003	April 27, 2006	24.27	17.33
Sierra Leone	September 26, 2001	June 25, 2005	130.84	14.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	29.40
Tanzania	August 16, 2003	August 15, 2006	19.60	11.20
Uganda	September 13, 2002	September 12, 2005	13.50	6.00
Zambia	June 16, 2004	June 15, 2007	220.10	55.02
Total			**3,358.18**	**1,616.91**

EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.
Data: IMF Finance Department.

Initial assessments completed for offshore centers

Offshore financial centers, which nowadays account for a significant portion of global financial flows, typically do better than many countries in complying with international standards and codes of good practice, and in cooperating and sharing information among regulatory bodies, reflecting the on-average higher incomes of these centers. A staff report on the initial assessment phase of the IMF program noted that 41 of 44 contacted jurisdictions had been appraised, and these centers have published their reports.

The assessments, which are designed to bolster global financial stability through the early identification of gaps in supervision and regulation, evaluate compliance with international standards in banking, insurance, securities, and the policies, laws, and methods needed to prevent money laundering and the financing of terrorism. According to the IMF staff report, progress has been made in meeting priorities set out by the Fund's Executive Board—regular monitoring, improved transparency, expanded technical assistance, and greater collaboration between standard setters and onshore and offshore supervisors.

Deficiencies remain to be addressed, however, notably in the centers' efforts to combat money laundering and the financing of terrorism and in providing more effective cross-border cooperation and improving information exchange among jurisdictions and even between domestic agencies. The Financial Stability Forum, which in 2000 encouraged offshore financial centers to take steps to meet international standards and codes and asked the IMF to undertake initial assessments of these centers, welcomed the wrap-up of the first phase.

The Forum also underscored the need to ensure that offshore financial centers continue to meet evolving international standards and redress weaknesses identified by the assessments. It expressed support for the IMF's follow-up monitoring and encouraged the IMF to give priority to "weaknesses that are systemically important from an international perspective." The Forum also noted that the IMF should seek input from the various international standard-setting bodies and from national authorities in identifying specific problems and in helping the IMF prioritize and conduct future assessments. ■

41 financial centers have been appraised for their compliance with international standards

Standard(s) assessed [1, 2]	Jurisdictions[3]
BCP	Costa Rica, Cyprus, Panama
BCP, ICP	Aruba, Macao SAR
BCP, ICP, SCP	Gibraltar
BCP, ICP, SCP, FATF	Barbados, Luxembourg, Switzerland
BCP, FATF	Anguilla, Antigua and Barbuda, Cook Islands, Dominica[4], Grenada[4], Andorra, Marshall Islands, Mauritius, Montserrat, Palau, Samoa, St. Kitts and Nevis[4], St. Lucia[4], St. Vincent and the Grenadines, Seychelles
BCP, SCP, FATF	The Bahamas; Monaco (partial BCP)
BCP, ICP, FATF	Belize, British Virgin Islands, Netherlands Antilles, Turks and Caicos Islands, Vanuatu
BCP, ICP, SCP, FATF	Bermuda, Cayman Islands, Guernsey, Hong Kong SAR, Isle of Man, Jersey, Liechtenstein, Malaysia (Labuan), Malta, Singapore
Technical assistance	Nauru,[5] Niue[5]
Proposed new jurisdictions to be assessed	*Brunei, Botswana, Dubai (U.A.E.), San Marino, Uruguay*

[1]BCP = Basel Core Principles; ICP = IAIS Insurance Core Principles; SCP = IOSCO Objectives and Principles of Securities Regulation; and FATF = Financial Action Task Force Recommendations. Module 2 assessments evaluate compliance with the BCP, FATF, and, if the sectors are significant, with the ICP and SCP.
[2]In several jurisdictions, the anti-money laundering/combating financing of terrorism (FATF) standard was assessed using draft versions of the methodology available at the time of the assessment mission.
[3]Financial Sector Assessment Program (FSAP) assessments were conducted in Ireland and Lebanon as part of the FSAP pilot. The IMF did not publish reports produced in the pilot. Compliance with the BCP was assessed in Bahrain prior to the start of the program.
[4]Only supervision of the domestic banking system was assessed as part of the Eastern Caribbean Currency Union FSAP. Offshore activities were not significant enough to warrant an assessment, but the jurisdictions have been invited to participate in the information dissemination and monitoring initiative to facilitate offsite monitoring.
[5]Given the limited volume of activities, these jurisdictions are receiving technical assistance in lieu of assessment.
Data: IMF, *Offshore Financial Centers—the Assessment Program—a Progress Report.*

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