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Press Briefing
A PREVIEW OF THE WORLD BANK/IMF and
WORLD TRADE ORGANIZATION MEETINGS

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P R O C E E D I N G S

MS. GRAHAM: Hello. Welcome to Brookings and to our preview of the Bank/Fund meetings and of the WTO round. I'm Carol Graham. I direct our Governance Studies Program, and I'm also a development economist and I spend most of my time working on issues related to developing country poverty.

We have a knock-out panel today. We're going to cover a range of topics which include foreign aid and the Millennium Challenge Account, delivering social services to the poor, international economic governance issues, including restructuring sovereign debt in Argentina and Iraq, among others. And also, hopefully, we'll touch on some of the topics that are going to come up at the WTO in Cancun.

So we have a lot to cover. We have five great panelists. Lael Brainard is going to lead off with an overview of the issues that are going to come up at both the Bank/Fund meetings and at the WTO. Then Michael Kremer, who we share with Harvard, is going to talk about delivering social services to the poor. This is the relevant--not only is it a relevant topic, but it's the topic of this year's World Bank's World Development Report. So it's going to be very much on the agenda at the Bank/Fund meetings.

Then Ralph Bryant, who's a senior fellow in our Economic Studies Program, is going to talk about international financial architecture issues, followed by a slightly different take on these issues by Andrew Powell, who's on my right, who is a visiting fellow here in our Governance Studies Program, just arrived from Argentina. And finally, Lex Rieffel, who's a guest scholar with us at Brookings, is going to talk about some sovereign debt restructuring issues.

We're going to try and keep everybody's remarks to five to seven minutes so that we've got time for questions and discussion with you. And also, if we don't cover issues that you're interested in, there's a good chance that somebody on the panel can answer them even if we didn't raise them in the initial remarks. So we hope that you will jump in at the end and broaden the discussion.

Before starting, I did want to make a plug for three new books that we've just published that are directly relevant to today's discussion. The first of these is a book by Ralph Bryant called "Turbulent Waters: Cross-Border Finance and International Governance." The second is a book by Lex Rieffel called "Sovereign Debt Restructuring: The Case for Ad Hoc Machinery." And then there is a book by Lael Brainard, myself, and other co-authors entitled, "The Other War: Global Poverty and the Millennium Challenge Account." All these books are on display outside the room. And they've told me that the bookstore is open till 5:45, so you can run out and get your books, and that there's even a discount today for people that attend the meeting. So how's that for a bargain?

There are also a bunch of our papers, policy briefs, other publications out that are available for you to take on the table outside the room.

Without further ado, I'll get started and turn it over to Lael Brainard, who's a senior fellow here in economic studies and foreign policy studies.

MS. BRAINARD: Thank you, Carol.

The next few weeks have two of the most important sort of pow-wows of international economic ministers that we see all year. There are a lot of very weighty topics on the table for discussion, although I don't actually expect a lot of very concrete outcomes to come out of either meeting. Let me just give you a little sense of where the U.S. is likely to be on several of the kind of high-profile issues, and just touch on them briefly and we can come back to them, if you're interested, later in the questions.

First, the WTO ministerial in Cancun. Depending on how you look at it, this meeting is either absolutely critical or not at all important. Pascal Lamy, the trade minister for the European Union, and Bob Zoelleck have been trying to play down expectations for that meeting, in part because it's going to be very hard to get concrete results. We're right now at the mid-point of what has been termed the Development Round, which was launched in Doha in November 2001 with a firm promise that this time global trade talks would be much more in the interests of poor countries, and with a second promise that it would wrap up quickly in 2005.

We're now at the mid-point, and in fact very little concrete progress has been made. There was a recent important agreement on this vexing issue about how to square the interests of pharmaceutical companies and intellectual property in the north and access to life-saving medicines in the south, which was concluded going into these meetings, but there has been only missed deadlines and no progress on the sort of centerpiece issue of agriculture. Why does that matter? It is probably the most critical issue facing trade ministers with regard to the distribution of benefits from the global trading system, developing countries and developed countries.

The big items on the table are the subsidies that are paid by rich countries to their farmers, something on the order of $300 to $350 billion a year, more than the combined incomes of all of sub-Saharan Africa, and with, you know, staggering factoids out there, like each cow in the EU receives more in government subsidies per day than half the world's population lives on.

But this is a very tough set of issues. Both Lamy and Zoelleck want to see progress on this set of issues. Certainly, the U.S. has major commercial interests, I mean, opening agricultural markets around the world, but these are very delicate political issues. The EU and the U.S. worked out a framework which has kind of qualitatively where they want to head, without numbers. Brazil and India have formed a coalition of 20 countries that have pushed back very hard, saying we want to see more on subsidies, more reductions on subsidies and less market access in the developing countries.

Meanwhile, for the U.S., it goes into these meetings with its hands very much tied as President Bush is heading into a political season, with several of the big farm states very much important in the political equation, and similarly, the manufacturing sector.

Just a word on the Bank/Fund meetings. My colleagues are going to go into some of the issues on the table for discussion in greater depth, but let me just touch on some of the big-ticket items.

First, there's going to be lots of discussion around whether we turned the corner on the global recession, with, I think, cautious optimism all the way around, with the recovery fragile but gathering strength. Once again, though, I think the U.S. economy is going to be the primary engine of growth, accounting for about half of global demand growth since the recovery began in 2001. On the international side, concerns about the international sustainability of that, with our current account approaching 5 percent of GDP with the dollar again strengthening, and with our deficit numbers sort of growing as far as the eye can see. Real concern about what's the soft-landing scenario for the U.S. current account. And of course, on the domestic side, the big question is whether strengthening on the financial side is going to leave workers behind.

The second issue, I think, of course, which we've heard a lot about coming out of the APEC finance meetings and will continue to be important going into this set of meetings, is the flip side of that, the $360 billion worth of foreign exchange reserves being accumulated by China, the question of whether China should be pegging its currency, whether Japan should be manipulating its currency, and that issue being also a big political football on the U.S. side, with--you know, unclear that the U.S. approach is actually going to yield any results.

And then the final issue is the U.S. foreign aid budget and the most recent request to Congress for Iraq, $87 billion. And with previous monies already expended, that takes us to something like $166 billion coming out U.S. taxpayers' pockets. That is putting, along with the tax cuts, a real squeeze on other areas, and so will the U.S. come to these meetings able to fulfill some of its promises on foreign aid, on HIV/AIDS, et cetera. Certainly on the Millennium Challenge Account, that looks very unlikely. Congress has cut back those requests substantially. And so what looked like a very strong hand a year ago is now, I think, increasingly going to be coming into question on the part of other countries who are looking to those resources to help them underwrite their development plans.

MS. GRAHAM: Michael?

MR. KREMER: Great, thanks.

The next World Development Report that's issued by the World Bank is going to be on the topic of making services work for poor people. And it's dealing with issues of education, health, to some extent water, electricity, sanitation. So I wanted to give you a bit of a preview of some of the issues that are going to be coming up there. I think the report comes out on the 22nd, I believe, September 22nd.

So I should give some disclosure. I've done some work on the World Development Report myself, so I'm somewhat of an interested party.

There are a lot of things in the World Development Report, but let me just touch on some of the key things that I take away from it.

The first on is there's just lots of problems in social service provision in developing countries. This is something that people, lots of us who care about problems of health and education in developing countries sometimes don't emphasize. And I think the World Bank is in some ways to be commended for highlighting that this is not an easy thing to deliver these services.

Let me just give a few examples. One issue is the budgets are often misallocated. So if you look in higher-income countries, developed countries, the expenditure on tertiary education, it costs about twice as much per student as primary education does. If you look at very poor countries, they may spend 30 times as much for a tertiary student as primary student. These are countries where, you know, that allocation of resources in developing countries is very much helping the richer people who are going to be going on to university, relative to the people who are going to primary school. And obviously there are a lot of people who are just not in--there are maybe 100 million children who should be in primary school who are just not there. I think that, actually, I should check that number. I'm not-- But there are many children who are not in primary school who should be there.

Another issue is that service quality is quite low. So one of the elements of the World Development Report that I was involved in was a project that just was visiting schools, primary schools, visiting primary health centers, and just checking are the teachers there, are the health workers there; who's supposed to be there, who's actually there. And some of the absence rates that we found were quite depressing.

So in India, for example, which has a substantial proportion of the world's children who are not in school who should be in school, 23 percent of the time--23 percent of the teachers who were supposed to be in school weren't in school. Now, some of the reasons for absence might be legitimate. They may have been doing other government duties--they had been assigned to do some work running an election, or they might have been sick, or they might have been off at a training session. But still, 23 percent of the time the teacher wasn't in the school. And the situation in health facilities was in fact much worse--43 percent of the health workers weren't there on the day of a random visit.

Indonesia, the numbers were 18 percent in schools, 42 percent in health facilities. Uganda, 26 percent of the teachers weren't there, 35 percent of the health workers weren't there.

So there's big problems this points to, big incentive problems. I think they're somewhat different in the health sector and the education sector. In the health sector, part of the issue is the doctor may not be there; they may be running their private practice on the side, treating patients privately and charging money for that. Of course, the fact that they're running a private business might give them incentives not to do such a great job in a public business. For teachers, they may just not be working at all.

So that's one element of low quality. Another element of low quality is just, for example, medicine. A study of medication in India found that more than 50 percent of all drugs prescribed were unnecessary or contraindicated.

So I think the World Bank in drawing attention to problems in social service delivery, and that being one particularly dramatic example, is doing something that's quite bold, because you might think an organization involved in foreign assistance might be reluctant to bring up some of those points.

But they also mention what they see as part of the way forward. And what they see as part of the way forward is to think very hard about issues of incentives, issues of accountability, of community participation, say is it possible to improve some of these problems through those methods. And they go through quite a variety of different approaches--everything ranging from creating incentives for teachers and health workers to trying to decentralize control over schools, over health centers to local areas or to individual local communities rather than having a centralized ministry of education or ministry of health control; trying to allow more choice for consumers; trying to inform the population at the local level so they can demand their rights. If they know--if there's information on how schools are doing and what absence rates are, how much money is supposed to be getting to schools, then if those things aren't in place, then maybe people can complain.

They give a lot of examples of programs that have succeeded. There are also examples where they say, look, here are some places that don't seem to have a lot of information or don't have a lot of democratic accountability that are--some of them are doing reasonably well on education and health.

I think one of the other things that I like about the World Development Report is that a theme running through it is that we really don't know what the ways to improve social service delivery are, and we need to learn more about what works. So they have what they call a spotlight section. I don't know how many of you have seen previous World Development Reports, but they often have these boxes and they have a whole section, a whole spotlight section on the experience of [inaudible], which is program [inaudible] Mexico, put in place, which was designed to work in poor communities to help get kids in school and to get kids basic medical care. And what the program did was provide cash grants to families, but they had to send their kids to school and they had to get basic medical care.

The Mexican government couldn't introduce this program everywhere all at once. They had to phase it in. And what they did was they randomly allocated the order of phase-in across different communities. And that created a natural--something very similar to a medical trial. There was a treatment group that had been treated already, and a comparison group, where the program hadn't yet been phased in. So now it's been phased into all the poor communities where [inaudible].

What they found was that allowed them to very rigorously evaluate it. What they found was that this really did work. There was an increase, almost 15 percent increase in enrollment among girls who'd completed grade 6 and stayed on in school.

And partly because of the clear results, there's a real--in Mexico there's a tradition of every time a new president comes in, they get rid of the old social programs, create new ones that they can claim credit for and line up with their political party. That didn't happen in this case. The program was renamed so it would be re-branded, in a way. But the program was preserved and, in fact, expanded. And similar programs have been taken up in other areas of Latin America.

So I think this message is saying, look, we don't know everything, we don't know exactly what all the answers are. What we need to do is to try things, very rigorously evaluate them, and then use that to move forward, I think, is a useful way.

Let me mention another example, also from Latin America. There was a school voucher program. There wasn't enough money to give vouchers to all the applicants. Again, this is in poor neighborhoods, primarily in Bogotá, but other Colombian cities as well. And again, the evaluation looked quite positive. There was a lottery to decide who'd get the vouchers. The children who won the lottery should be comparable in all ways to the ones who didn't. It was a computerized assignment of who won. They completed more schooling, they were less likely to repeat grades, they scored higher on standardized tests. And if you work out the cost effectiveness of this program, it looks extremely cost effective. So I think that's another example of you can get more information on what works and what doesn't.

So I think those are some of the key messages, first that there's lots of problems in social service provision both in terms of the budget allocation, but also in terms of the incentives for providers. And then second, here are some ways that we might be able to improve this by thinking about incentives, by decentralizing, giving community control.

I think the messages are quite valuable. If I had to add a couple of things to it, I would say that, you know, I don't think when you look at this report you should come away with only the negatives. There's been tremendous improvement both in education and health. There's a lot of terrible, as I've pointed out. But you started from a very low base. In 1960, 32 percent of adults in low-income countries were literate. It's now 70 percent. So that's--you know, there's a long way to go, but there's been tremendous improvement. In 1960, the average adult had 1.6 years of schooling in low-income countries; they now have 5.2 years of schooling.

If you look at health, you know, even very poor countries now have life expectancies that if you compare them to the--especially the U.S. having a comparable stage of development, are just way ahead. You know, a dramatic example is Vietnam. Vietnam now is substantially poorer than the U.S. was in 1900. In 1900, the U.S. had a life expectancy of 47 years. Vietnam today has a life expectancy of 69 years. And I think one of the--you know, Africa, if you looked at the period '72 through '92, per capita GDP fell by 13 percent during that period, but life expectancy actually increased 10 percent. That's been turned around by AIDS, but the--if you look at the progress that's been achieved from a very long--taking somewhat of a historical perspective, it's not quite as depressing a picture.

And there are some concrete steps that we can take to improve things. In particular, there's--you know, if you come back to this issue that there are lots of problems in social service delivery and say, you know, what's the implication for foreign assistance, for what the World Bank should do, I think there tends to be a little bit of a false debate. Some people say, well, we need more money--the Jeff Sachs of the world--and other people say, well, you know, money's not going to do any good because the systems are so messed up.

I think they're both true. The systems are messed up, and more money is needed. You know, the ideal situation, and this is something that the report points out, is to have some sort of a compact, where the money is provided but the money is only provided to those governments that are willing to take steps to reform their systems.

The other thing that I think is worth pointing out is when budgets are misallocated--so, for example, all the money goes to teacher salaries or doctor salaries and no money is available for drugs or no money is available for textbooks--well, that means there are some ways you can spend the money that are going to be not useful at all, if you're just putting more money into doctor salaries or teacher salaries and they're not even showing up. But it also means that other areas have been starved for budgets, and you can have very high payoffs in particular areas.

So let me just conclude with one final example, again an issue that I've worked on. You hear a lot about AIDS, malaria. These are obviously terrible problems. Let me take sort of a less sexy health problem, which is worms. One out of every four people in the world has intestinal worms. These are actually a big problem in the U.S. South. The Rockefeller Foundation did a lot of work to help get rid of them at the beginning of the 20th century.

These worms can be very easily treated. There's medicine that costs pennies a dose. There's no real side effects, it's cheap, it's very effective. You need to take it every six months. You can do this--remember I stressed all the problems in delivery of health services. Kids are the worst affected. So you can deliver this through schools. All the kids are there. Ninety percent of kids on some areas have these worms. You don't need to diagnose them ahead of time; you can just administer this medicine. It costs less than a dollar per child.

So we did a study in Kenya, in a randomized evaluation, and found that school absences, which had been running about 30 percent, fell by a quarter after this program was introduced. So, you know, that's--and it's just extraordinarily cost effective.

So I think there's lots of examples, and the World Development Report highlights some of them, where there really are opportunities to make very effective use of resources. And that's the one thing that I think maybe could have been brought out more strongly in the World Development Report.

MS. GRAHAM: Thanks, Michael. Indeed, a lot of the demonstration effects of some of these programs could be brought out more and have impact well beyond the countries where the programs were tried. And we all look forward to the report.

Let's turn to Ralph Bryant.

MR. BRYANT: Carol called attention to my new book, *Turbulent Waters: Cross-Border Finance and International Governance*. Let me just say a few sentences about that before going on.

The main theme of that book is the need for a pragmatic incremental approach to improving international cooperation about economic and financial issues. Unfortunately, most commentary that you read or see about the global economy espouses one or the other of two polar (and often ideologically expressed) positions. There's the untrammeled markets view, which sees government failures as pervasive at both the national level and the nascent international level. Efforts to promote governmental action are seen as more likely to be “the problem” than “a solution.” And this view trusts, or let's say hopes, that markets in individual nations themselves will cope resiliently with any difficulties that materialize.

The opposite extreme is the sweeping institutionalist reform view. And this sees market failures as everywhere pervasive, internationally as well as domestically, and it wants either to rebuild the separation fences at national borders or else to delegate greatly increased authority to international institutions.

Neither of these polar views is based on compelling analysis. And furthermore, neither is very politically realistic. What's needed is a pragmatic middle-of-the-road approach. What I try to do in the book, among other things, is to articulate that middle-of-the-road vision and spell out what in practice it would mean for the strengthening of international cooperation and the evaluation of international institutions.

Now, in the area of economics and finance, which is the subject of the IMF/World Bank meetings in Dubai, there are really four areas in which basic reforms ought to be undertaken. The first is collective surveillance of national policies. The second is development of international standards and codes to condition individual countries' behavior. The third area, one which Lex is going to talk about, is the improved cooperative management of financial crises. And then a fourth would be achieving a better balanced allocation of country's rights and responsibilities in international institutions, including the allocation of basic voting rights.

The annual meetings in Dubai are probably going to touch in passing on all four of these reform areas. And in fact, in the background and out of the news headlines, some modest progress is actually occurring on the details in some of these areas. The development of codes and standards for financial regulations is an example of an unglamorous subject where actually quite significant steps have been taken and further ones are being taken.

But I'm sure that Lael is right, that the headlines about the meetings are not going to pay attention to these more basic reform issues. What the headlines will be about is whether the United States is able to persuade European economies to become more engaged, on mutually acceptable terms, in management of the recovery of the Iraq economy and political system; should China change the exchange rate regime for the Yuan; what did or did not happen at the WTO meetings in Cancun; and so on.

On the principle that issues of ultimately great significance should get some attention now even if they don't capture current headlines, I'm going to use the last of my few minutes to talk about one of these reform areas, the importance of collective surveillance of national governments' policies.

I'm convinced that, over the medium and longer runs, a gradual strengthening of supranational collective surveillance of macroeconomic policies, exchange rates, and traffic regulations for cross-border financial transactions is the single most promising way for national governments and the world as a whole to foster prosperity management, by which I mean both preventing crises and encouraging a healthy evolution of the world economy in non-crisis periods.

The rationale for this international cooperation in promoting collective surveillance is straightforward and analytically sound. Decentralized national decisions fail to take into account cross-border spillovers from policy actions, and thus can produce outcomes that are inferior to more efficient outcomes obtainable through informed collective action. Think about global booms or busts that stem in part from each nation not taking adequately into account the effects of their policies on other nations. That's an example of an inferior outcome that could be mitigated with improved intergovernmental cooperation. Because increased economic integration across national borders is generating a growing variety and intensity of collective action problems that do spill across borders, the rationale for a systemic perspective and intergovernmental cooperation in dealing with it, for promoting collective surveillance, is getting stronger all the time.

It's not true, of course, that efforts at intergovernmental cooperation are invariably successful. But nonetheless, if intelligently pursued and not overly ambitious, cooperation among national governments can be plausibly expected to advance the common interests of nations' citizens.

You sometimes hear the superficial criticism that collective surveillance of national policies implies surrendering national sovereignty and making national governments subordinate to the will of some international authority. But that perspective is at least misleading, if not actually silly. International institutions like the IMF are the creatures of national governments. They're not authorities with strong independent powers. Moreover, countries choose to act cooperatively through international institutions not because they agree to bend to the will of some independent authority above them, but rather because their mutual interests justify such cooperation.

No government likes to see its policies criticized. It would prefer to have international surveillance put pressure on *other* countries to improve their policies while its own policies are immune from international pressure. But that attitude, if widely held, would undermine the basic rationale for the intergovernmental cooperation and collective surveillance.

It's the old sad story over and over again: we want to judge other people by their actions and ourselves by our motives. So superstition is some *other* person's religion, and protectionism is some *other* country's trade policy. And stubborn, short-sighted resistance to constructive surveillance is some *other* nation's policy stance, whereas foot-dragging by our own nation is warranted because of the severely binding domestic political constraints that we face.

I want to conclude by taking the unfortunately pertinent example of the budgetary policies currently being pursued by the U.S. government. The IMF next week is going to be releasing its updated analysis of the *World Economic Outlook*. This document, together with the *Report on Global Financial Stability*, is one of the main mechanisms that the IMF uses in its modest attempts to conduct collective surveillance.

The IMF's *Outlook* ought to, and it probably will, contain some remarks that are critical of the U.S. budgetary policies. The big tax cuts of recent years and the large increases in defense spending associated with the Afghan and Iraq interventions are causing, as everyone knows, a ballooning of the U.S. budget deficit. In the medium run, as almost all economists know and accept, the aging of the baby-boom generation is going to put still greater pressure on our Social Security system and government-financed health care expenditures, and hence on the budget deficit. And the United States has a very large deficit in the current account of its balance of payments, which over time is likely to require a sizable depreciation of the dollar relative to where it is now.

At the present time, the administration and the Congress have essentially no forward-looking plans or policies to deal with this set of looming problems. Fiscal policies in the

United States are irresponsible. They are termites in the basement. And they are serious longer-run threats to our economy and to the rest of the global economy.

The IMF, speaking on behalf of the interests of the rest of the world, really ought to be pointing a critical finger at the United States and urging that we design and adopt some kind of responsible policies for the medium-run consolidation of the federal budget.

I'm guessing that the criticism that will be in the IMF's *Outlook* is going to be muted and fairly cautiously stated--too cautiously stated, I'm guessing. But it's certainly in the interest of the United States that objective international observers voice this kind of criticism.

And it would be surely quite wrong-headed if the administration decided to complain that international institutions were criticizing its economic policies. It's in the genuine interests of the United States that this happen.

The government of the largest, most powerful nation in the world -- more than any other nation -- ought to eschew a self-serving national attitude and instead espouse a more self-reflective and enlightened perspective. It is the United States and other powerful nations that have the greatest stake in the healthy, prosperous evolution of the world economy and financial system.

If the most powerful conceive their interests narrowly, and if they manifest indifference to the interests of the less powerful, they will not induce the cooperation needed to create a stable, hospitable world..

Thus for encouraging the international collective surveillance of economic policies, no less than for U.S. intervention in Iraq, we need to remember that self-restraint in choosing unilateral actions is not a weakness. It is, rather, the wise use of great power.

MS. GRAHAM: Thank you, Ralph, for rather sobering concluding remarks.

Andrew, let's turn to an optimistic topic like Argentina and the IMF.

MR. POWELL: Okay, thanks, Carol. Well, you've planned this very well. I think my comments complement Ralph's extremely well. We're going sort of into a slightly more specific set of topics, then I guess we'll probably get a bit more general again afterwards. My comments are more specifically about the role of the IMF, and I'll say something about Argentina.

Carol, I think, invited me here today because I've written a couple of papers precisely on the role of the IMF, which complements to some extent Ralph's view of the world. I guess there are two broad views of the IMF. One, one might think of as the moral hazard view, which was written in--the Meltzer Report, probably, is the most famous reference for that, where the IMF may have a negative effect in that if countries know that they have an IMF agreement then they may live a little more dangerously and investors may be happy lending a bit too much to those countries, et cetera. And if a country gets into bad times, then the problem is really the problem of the country and its private creditors, and those two parties need to get together to renegotiate.

That view of the world, then, says that the role of the IMF should be a rather limited one. Of course it should help countries, but subject with very much this moral hazard problem in mind.

The opposite school is what I refer to as the liquidity school, which basically says that sometimes there's a lot of liquidity in the world, there's a lot of capital flowing to emerging economies, which has a tendency to suddenly dry up. And Guillermo Calvo at the InterAmerican Development Bank has named this sudden stops in capital flows. And he is perhaps one proponent of this liquidity school.

My view is that both views of the world have their validity, that they're both right in some sense. And that means that the IMF is in an extremely difficult position because it's playing off these two particular problems. Now, things are not so pessimistic because, as Ralph a little bit was suggesting, perhaps countries and the IMF can kind of cooperate and reach the best of all possible worlds where the country does the right thing and the IMF also assists, and get over this particular problem.

The interesting feature of this problem as I've modeled it is that when times are bad and the IMF has an agreement with a country in place, it's at precisely that moment that the incentives for the country to try to live dangerously actually arise. So there is a sort of natural incentive when things are getting worse for countries to kind of live a little bit more dangerously.

And that, then, puts the IMF in a really very, very difficult position. And for those of you that have followed Argentina, this perhaps will be familiar. As things got worse, especially through 2001, the kind of policies that Argentina was trying to do to try to get itself out of the hole were making the IMF increasingly uncomfortable. But at the same time, the IMF knew that if it was going to withdraw, it would create this liquidity shock or sudden stop, which would provoke the crisis and the default and et cetera, which is precisely what everybody was trying to avoid.

So that's the kind of characterization of the world, and it's not a particularly optimistic one. And it really implies, I think, that the international financial architecture remains incomplete in this context. Innovations like collective action clauses in bonds do do some good, they do some small good, but they don't solve the fundamental problems. A sovereign default restructuring mechanism, the SDRM, might have a better chance at solving these problems, but the analysis that I present is essentially that an SDRM that is generous enough to do something for this underlying problem is really one that the G7 countries, at least at the moment, politically do not appear willing to stomach.

So an SDRM which is not sufficiently generous doesn't do the job, and an SDRM that is sufficiently generous, it looks at the moment, at least, the G7 countries don't have the stomach to go there. And of course there are objections also from emerging countries to the SDRM that was proposed.

So I think there is still a lot of creative thinking required in terms of the international financial architecture to understand precisely what the position of the IMF is in dealing with emerging economies that suffer the kind of problems that Argentina and others have been through.

Now, on Argentina, the news today is that there's no news, and that's not really much of a surprise. It's what happened a year ago as well. We know--the rumors are behind the background that the U.S. is very strongly pushing for an agreement. Of course, Argentina knows this, and so now there's tension between the negotiations between Argentina and the staff of the IMF and the IMF's board.

And this actually comes back to something that Ralph said about strengthening collective surveillance, which I think is a very interesting point. And I agree that it's very important. And I think the G7, basically the political masters of the IMF, will have to decide how much it needs to respect the opinions of the staff and how much it's willing to go over the opinions of the staff in terms of developing that collective surveillance going forward and the credibility of the institution as a surveillance institution going forward.

To finish my comments, I'd also like--I think perhaps in the annual meetings, I don't know if there are going to be topics that come up in the annual meetings, but there have been a set of interesting proposals of reform of the international capital markets. There's been a proposal within the IMF itself--a research paper, so it's not necessarily the view of the institution, but an interesting research paper advocating the role of GDP-indexed bonds. And there's also been a proposal using an index of emerging economies' exchange rates and issuing emerging country debt index.

These are kind of innovations to try to improve the risk-sharing qualities, if you like, of capital markets. And they go back, really, to the debate in the 1980s, which fostered the Brady Plan. The Brady Plan was extremely successful in solving one problem, which was the debt problem of the 1980s and, really, creating a new set of securities. It was less successful at creating securities that had very good risk-sharing properties. The bonds were issued in dollars, and these bonds have proven quite difficult to renegotiate. I think we'll have more comment on that coming up.

So I think that this is a debate that ought to be fostered and welcomed--what is the next class of securities that we can invent which might help share risks better in international capital markets?

I'll stop there.

MS. GRAHAM: Great, Andrew. Thank you. And indeed, it was actually more optimistic than expected.

Lex?

MR. RIEFFEL: Yeah, let me say a few words about the sovereign debt restructuring mechanism and collective action clauses and the code of good conduct, which are issues that will be discussed at the annual meeting--particularly in the context of the IMF meeting in Dubai in 10 or 12 days. And then I'll say a couple of words about Argentina and Iraq.

A year ago, there was an esoteric but heated debate underway in the international financial community about restructuring the sovereign debt of countries in default. This debate centered on debt in the form of bonds that are issued in the international capital markets, and this debate was inspired by the case of Argentina.

Anne Krueger, the First Deputy Managing Director of the IMF, stirred up debate in a major way in November 2001--this is almost two years ago--by proposing the creation of a permanent institution for restructuring sovereign debt, and this soon acquired the label of the Sovereign Debt Restructuring Mechanism, or SDRM. The SDRM proposal was greeted with enthusiasm in some quarters, but with dismay in others. The private financial community in particular saw it as a devise that would tip the balance away from private creditors in favor of debtor countries.

An alternative approach for facilitating bond restructuring actually was highlighted as far back as 1996 in a report of the Group of Ten. This involved adding collective action clauses to bond contracts that would allow the terms of bonds to be changed with the approval of a high majority, something like 85 percent, instead of the unanimous consent found in most bonds issued under New York law.

After a year of debating this SDRM proposal and an incredible volume of IMF staff papers, the debate cooled off earlier this year when John Snow replaced Paul O'Neill as secretary of the treasury in the U.S. When this happened, the U.S. position on the SDRM and collective action clauses changed from one of supporting work on both approaches, to see whether they could work in a complementary fashion, to a position of strongly favoring the introduction of collective action clauses, but opposing further work on the SDRM. And in April, Snow sort of declared in his major speech at the IMF meetings in April, it is neither necessary nor feasible to continue working on the SDRM.

As a result, crisis resolution--and this is the label attached to this aspect of crisis management, I mean, there's crisis prevention and crisis resolution--crisis resolution at this upcoming meeting is going to be a back-burner issue, but it has not gone away entirely. In particular, you should know that a major breakthrough on the collective-action clause front occurred in the spring, when Mexico issued bonds containing collective action clauses for the first time. Since then, quite a few emerging market countries have issued bonds with collective action clauses, and my guess is that within a year, almost all new emerging market bonds will contain collective action clauses.

Separately, in an effort to bridge the gap between supporters of the SDRM, this permanent machinery, and collective action clauses, French central bank governor Jean-Claude Trichet proposed that the G7 and the IMF, the issuing countries and the financial industry all together, collaborate in developing a code of good conduct to help ensure speedier and more orderly sovereign workouts. This is a work in progress, but it's happening pretty much off-scene. At the moment, the financial industry and the major issuers are taking the lead in drafting the code, and it remains to be seen whether agreement can be reached between these two parties, and then the extent to which the IMF and the G7 embrace a new code.

Now, does any of this matter? I don't know how many people are from the press and writing stories about this. My initial thought was, you know, is this news for your readers? I believe it is, but I have to say it's taken me 340 pages in the book I've just written to prove the point. My argument, in a nutshell, is that the number of countries likely to experience a sovereign default in a give year is pretty small--it's on the order of two or three--and that the existing ad hoc machinery--it's called the Paris Club for bilateral official debt and the London Club for commercial bank debt--this machinery can be adapted to handle bond default. This makes it unnecessary to have permanent machinery such as the SDRM, and furthermore, I would argue, permanent machinery risks becoming obsolete the day it becomes operational because of the rapidity of changes in the world of finance.

But now let's move from the abstract, the policy debate, to the more real and interesting cases of Argentina and Iraq. Most of you know, I imagine, that the government of Argentina defaulted on its debt at the beginning of 2002. At the time, Argentina, the government, had about $150 billion of debt. Fifty billion was domestic--most of which is still being serviced--and out of the $100 billion of external debt, $60 billion was in the form of bonds, all of which are in default.

This $60 billion of defaulted bonds represented the biggest sovereign bond default ever. Well, so what? Argentina--I hope Andrew Powell would agree with me--Argentina wants to have a growing and a strong economy, and that will be easier if it has access to global capital markets. This is an objective that is shared fully by the IMF, the G7, and of course the global investment community.

Capital market access cannot be restored without a debt workout. The practical problem that the world faces right now is that there's no clear model for a workout in which bonds are the main form of debt. In particular, there's no formal counterpart, like a bank steering committee, for the government to negotiate with. How this problem gets solved is likely to have important ramifications for emerging markets finance for years to come.

A first step, I think, inevitably, is for the government of Argentina to produce a credible economic reform program. Credible in two respects. One is that it reflects an exceptional effort to get its own house in order, and also credible because it does not include promises that cannot be met--or, to put it the other way around, because it includes promises that can be met with a high degree of probability. Unfortunately, more than 20 months have passed since the default, and the government still seems to be having trouble putting together a credible program.

Now, some people wonder why don't the bond holders just accept 10 cents on the dollar and let Argentina get on with its business. I mean, why all of this Sturm und Drang? Well, the short answer is that they cannot do this because of the signal this would send to debtors everywhere else in the world. Good-faith negotiation is required to retain the respect for contracts that is the bedrock of the international financial system.

Other people worry that if the government comes out with a good program, the bond holders will not be able to agree on a deal consistent with that program, leaving Argentina twisting in the wind. Well, I would argue that there really is no precedent for such a pessimistic outcome. Normally private creditors are eager to complete a workout as soon as they see a decent program and, I would suggest, usually are willing to settle for a fig leaf of a program rather than to haggle over strengthening a program.

So I suggest you should watch this case closely. It will influence how much of your pension money you want to invest in emerging market bonds or how much you want your pension managers to invest in these instruments, and that in turn will affect the flow of capital to developing countries around the globe and the pace of economic progress in these countries. And I should point out, not so much flows to governments that you should be concerned about, but flows of capital to private sector borrowers in these countries.

Finally, a couple of words about Iraq, which is in some respects a bigger challenge than Argentina and in other respects a smaller challenge. I would say it's a smaller challenge because the amounts of commercial bank and bond debt are pretty small; therefore, the systemic consequences of the Iraq workout are negligible in terms of the impact on the way capital flows into developing countries in the world.

But Iraq is a little bigger challenge in the sense that the total claims are larger. The CSIS has put these close to $400 billion. Now, half of this is Gulf War reparations; it's not, sort of, debt in the narrow sense--a claim, as distinct from a debt. Another $60 billion is signed contracts that have not yet been fulfilled by Iraq for work in their oil sector and so forth. $130 billion of this is loans owed by Iraq, mostly the government, to foreign governments and commercial banks. Of this 130 amount, the principal may be something closer to $80 billion, and the rest is interest payments.

A few policy issues have surfaced. First, should most or all of Iraq's debt be cancelled or forgiven because it was contracted for by a horrible government? My answer to the question is no, that it's important to go through the motions, again to maintain respect for contractual obligations everywhere in the world. But the outcome of debt restructuring negotiations with Iraq is not in doubt. There will be--I insist, there will be a substantial, even huge, reduction of debt agreed to because the capacity of the Iraq economy to service external will be severely limited for years to come.

The other issue that has surfaced is should the workout be negotiated in the Paris Club or some special forum? I think it's amazing how skeptical people can be about the Paris Club. I think this is mostly from ignorance, and that was actually the original reason for writing my book. I see nothing in the Iraqi case that requires that it be taken out of the Paris Club. The Paris Club is not a rigid institution, and one advantage of being ad hoc is its flexibility. But don't expect to see any perceptible movement on this issue in Dubai. Iraq is unlikely to be in a position to negotiate with the Paris Club or any other creditors until 2005, at the earliest. In the meantime, I would argue, everything you hear on this subject is posturing.

MS. GRAHAM: Lex, thank you. We now have roughly 20 minutes for questions of any of the panelists or just more general questions, and we can field them and see who is best suited to answer them.

The lady up here-- Please speak from the microphone. And also identify yourself.

QUESTION: Elaborate a little bit about Iraq and the meeting of Dubai. You said Iraq will not be able to negotiate in 2005. Why?

MS. GRAHAM: Could you please identify yourself as well?

QUESTION: Hod Adelphia [ph] from El Ahram newspaper, Cairo, Egypt.

MR. RIEFFEL: Well, if I may make a reference to Argentina, I mean, look how much difficulty Argentina has had in putting together a program that can be the basis for negotiations with creditors.

QUESTION: [Off microphone, inaudible.]

MR. RIEFFEL: But I don't think that Iraq is going to be in a position to negotiate a restructure of its debt until it has a medium-term program which, in the world we live in, is loosely defined as a sort of three-year-- [change tape]. Until it's possible to have some sense of what the country's balance of payments is going to look like for the next three years, at a minimum, it's very hard to reach agreement with creditors, for a country to reach agreement with its creditors on how much to pay them. And I just--you know, this is not going to happen until 2005 at the earliest.

MS. BRAINARD: If I could just add to that. I think Iraq will be very much on the agenda, at least in the corridors. But it's more, at this juncture, how much the international community is going to contribute to the effort and what kind of arrangement the World Bank will have to have in order to participate in that process. The U.S. has been targeting a donor's conference, and it's going to be working extremely hard, given the large request they have before the U.S. Congress to show that they can get the rest of the international community to ante up as well.

MS. GRAHAM: The gentleman back there.

QUESTION: Thank you. This is Phillippe du Ponte [ph] from IntelliBridge Corporation. I have a question on the WTO, which is: On WTO, what kinds of concessions, if any, might we expect from the U.S. and Europe on agriculture with regard to subsidies, market access, and preferential treatment? Or is it just going to be language?

MS. BRAINARD: I think the likely outcome, the good-case scenario coming out of Cancun, is that they agree to a framework which I think to most people would seem a fairly unimpressive result. But the reality is they're not in the realm of talking numbers at this juncture. What they're trying to figure out is what boxes to put different kinds of subsidies in--are they outright violative, or are they going to be given special treatment because they're seen as environmentally friendly and not trade-distorting. Those are the kinds of issues that are being hotly debated right now.

To what extent can the Europeans agree to an explicit end date for a phase-out of export subsidies? So far, no way, no how. To what extent can the U.S. and the EU come to terms with Brazil and India wanting a very big differential between the market access opening commitment on the part of the developed countries and the developing countries? So at this juncture, what they're really trying to do is establish the terms for the negotiations. My understanding is that countries have not even begun putting offers on the table in terms of the particulars on their own subsidies and their own tariffs.

MS. GRAHAM: Michael, one more comment as well?

MR. KREMER: Yeah, I just wanted to comment on the issue of agricultural impact on the developing world. The standard line out there that a lot of both NGOs and organizations like the World Bank are pushing is that the agricultural policies of the developed world are just a disaster for the developing world. And I think there's a lot of truth to that. And agricultural subsidies in particular are a disaster for the developing world. But I think it's important to distinguish between the type of commodity. If you're talking in particular about things like cotton and things like grain, if you're talking about cotton, I think that that story's just completely right. There's really nothing on the other side. Poor West African countries that rely very heavily on cotton see the prices at rock-bottom levels because of subsidies in the U.S. and elsewhere.

It's a more complicated story if you're talking about grains, because the big exporters of grains are not developing countries. The big exporters of grains are the U.S., Australia, Canada, Argentina. These are middle-income countries. So there are at least some people in developing countries who benefit from the lower prices that these exporters--and we may be shooting ourselves in the foot; I wouldn't call it that with these subsidies to grains. But many people in developing countries are benefiting from this. Obviously, the farmers in developing countries aren't, but there are lots of people consuming these grains as well, so it's not quite as simple a picture as sometimes pictured.

MS. GRAHAM: Thanks. The gentleman right there in the middle had his hand up for awhile.

QUESTION: I'm Jim Smallhout . I'm an independent journalist here in Washington. My question is for Ralph Bryant.

Ralph, I was hoping you would elaborate a little bit more on your criticism of the budget deficits. In particular, what would the policy mix look like that you would recommend in order to restore internal balance to the economy, given that we have underutilized resources?

MR. BRYANT: It's a big subject, and politically very difficult. I'll give you a few snapshot comments, but I won't pretend that they're adequate. What should be done? I think we should rescind some of the tax cuts. And we should gear fiscal stimulus, such as it exists, to trying to expand the economy in the short run. Most of the tax measures that were passed in the last three years don't do that. I think there's some scope for changing expenditures over the medium run. But the single biggest thing is we ought to start getting serious about reforms of the Medicare system, Medicaid and Social Security. The country used to have a lot of time to implement such reforms.. By 2003 we don't have nearly as much time, but there's still an opportunity to change course over the next few years. But if we keep putting it off, it's going to be harder still. We're not that far away--five, six, seven, eight years--when the baby-boom generation is going to retire, and when the fiscal pressures will be much more serious even than they are today.

QUESTION: I'm Marie Cruz McGowan [ph] from the Environmental Protection Agency. My question refers to Argentina, but could also apply to other developing countries.

What would be the effect on the Argentinean financial recovery from the crisis that was caused from lack of consumer confidence, knowing that the consumers in Argentina and similar countries know that this crisis was caused by mismanagement of the national accounts and plain corruption?

MS. GRAHAM: Do you want to take that, Andrew.

MR. POWELL: I'm not quite sure I understood the question. The question is what is the effect on confidence because of the way the crisis was caused?

QUESTION: Effect of lack of consumer confidence in the recovery. There is no such confidence at this point.

MS. GRAHAM: In Argentina, or outside Argentina?

QUESTION: Well, I'm talking about the Argentinean case, but I think it's a generalized problem in the developing countries that are facing similar or worse financial crisis, debt crisis. The fact that just knowing that the IMF or the World Bank is going to provide a loan doesn't convince the citizens of those countries that they are going to have a recovery, because they know that the resources that go from the World Bank or the IMF don't go all, at least most of them, to improve the social services, but to private accounts.

MR. POWELL: Okay. Well, I think I'm going to repeat something that was said here, that the most important thing for the Argentine recovery is that Argentina puts together a sustainable plan. I mean, that's obviously much more important than, as you say, getting another loan from the IMF. So the sustainable plan coming from Argentina is the most important thing.

Now, you mentioned corruption, and of course corruption is an issue, is a very serious issue in a lot of places. We have seen countries grow even though Transparency International and others claim that they are not 100 percent clean. So corruption's certainly an important issue and should be dealt with, but I'm not sure--it's also not going to stop the recovery process if Argentina can put together a sustainable plan.

MS. GRAHAM: I would also argument that, granted that's an extreme view and there is certainly a good dose of reality in it, but I think both the international financial institutions and the efforts of NGOs like Transparency International have actually really highlighted the problem and have put a sort of peer pressure on countries to make changes. And there's some very good work by Shang-Jin Wei, who's a senior fellow here that we share with the IMF, showing that actually foreign investment flows much less to countries that are corrupt, and that's a changing trend over time. So I think the picture, at least as I see it, is not as negative as you portray it.

MR. KREMER: You know, in the current issue of should the IMF make the loan to Argentina, this obviously is not going to be primarily new money. This is Argentina has a lot of debt to the IMF, and the question is do they say, okay, we're making a new loan and you're paying it back to us, or do they simply recognize what's occurring and say that Argentina's not paying the IMF. And, you know, that has a lot of implications for how the IMF books look like, and it certainly has some implications for how investors are going to see Argentina and so on. But I don't think this is--there might be some new money, but I don't think it's a vast amount of new money that would be going in. I think that it's primarily a question of what's the accounting treatment of this. And we've seen--I guess we saw in the U.S. domestic economy what tricky accounting can do, and some question about whether we'll find out soon in the international arena.

MR. POWELL: Just a point of information, there is no new money. Not from the IMF, anyway.

MS. GRAHAM: Ma'am?

QUESTION: Thanks. My name is Elena McCollum [ph], and I'm with InterAction. We're an association of U.S.-based development NGOs. And my question is for Michael Kremer about the WDR.

This WDR went through a rather extensive consultation process--my understanding--certainly in distinction to earlier editions or perhaps the most recent WDR. And one of the--I appreciate your setting forth the ways in which this text takes on some of the real problems of social service provision through the public sector--absenteeism and the host of issues that you raised.

Throughout the consultation process there was input from many groups that the text, at least at that point, lacked a correspondingly close scrutiny of the ways in which private provision of social services is oftentimes carried out. Similar problems with corruption, perhaps, stemming from the lack of an adequate preexisting regulatory framework, lack of access on the part of poor people because of, be it lack of cross-subsidies and the way a given privatization program was carried, for example.

And so my question, essentially, is what sort of glimpses can you give us as to how the final WDR is going to be on these issues? And specifically whether it will include a substantial discussion of the way in which provision of social services is likely to be affected by the GATS, the General Agreement on Trade and Services. Because this is something that came up in a number of the consultations as well.

That's essentially what I wanted to say. I want to add just one last thing. Maybe if you could say a bit about the way in which it addresses the role of the client as citizen, as well as client, and what that can do in terms of unpacking some of the power dynamics that poor people face in accessing social services. Thanks.

MR. KREMER: Sure. First, I should make clear I was--they asked me to work on a couple of particular issues, so I did some work on those, and I was part of this huge input process and gave them some input. But I don't--you know, I don't know exactly what's going to be in the final version.

Let me take some of these issues separately. First, what's the impact of the GATS. I don't know how they're going to address that one.

On the issue of private provision, I don't think they take a strong line at all in favor of private provision. And the related issue--in fact, if anything, I would say that the main message of this is that you need to strengthen the role of citizens in providing feedback and empower them to manage schools, manage communities either through local communities or through national political processes, or providing more information to them to allow them to give feedback to the government. So I think that's a very strong message and I think that's there very strongly.

In fact, you know, I guess my own personal take on this would be that they actually are very--they really shy away from discussion of the role of private providers. You know, that's mentioned, but they're very lukewarm on school choice, for example, saying, okay, sometimes it works, sometimes it doesn't, it's not a disaster. I really think the objective here should be to try and make poor people better off, and whatever is the best way to do that is what should be pursued.

If you take some of this evidence from, for example, the voucher program in Colombia, there you really have a very clear-cut, you can really--if you're just comparing kids who go to private school and public school, there's all sorts of differences between them. But if you're comparing kids who applied for a voucher program, some won the lottery and some didn't, you track them down several years later, you know, you really saw a real difference between the ones who have the opportunity to attend private schools and the ones who don't. It's not to say that there aren't many serious issues with school choice and vouchers.

I think in the health area, the issues of private provision are a lot more difficult, and there's some discussion of that in the WDR.

MS. GRAHAM: Can I just add to what Michael said. Certainly, in my experience looking at a number of experiments with private provision and-- [inaudible] private and public provision of services is that it's usually the cases where the public sector is so bad that have the most to gain from introducing experiments. And there you also have very weak regulatory systems, so it's not a surprise that you get large differences in outcomes. But when you're starting at a very, very low base in terms of quality of services, it's probably worth some experimentation without being sort of doctrinaire about whether it's public or private. And I think the debate has probably moved forward several steps since that very doctrinaire debate about public and private services.

I think we have time for a last question and then we really should conclude, if there are any. If not, it gives you some extra time to visit the bookstore to get our great books.

I'd like to thank all the panelists and also to the audience for coming.

[End of press briefing.]