

## IMF Conference

### Debate on Equity Invites Diverse Perspectives, Generates Pragmatic Prescriptions

Revisiting a topic that drew chiefly on academic discussion in 1995, the IMF's Fiscal Affairs Department on June 8–9 hosted a conference on "Economic Policy and Equity." Organized by Vito Tanzi, Director of the Fiscal Affairs Department, the sessions spotlighted the practi-

conference into several concrete steps, notably greater attention to the design of effective social safety nets and the elimination of unproductive spending, an increased emphasis on "second generation" reforms, improved data collection on social expenditures, and the monitoring of social output indicators. The conference offered the IMF a rare opportunity to step back from its day-to-day work and listen to ideas about what more the IMF could do and what values it should bring to its daily business, Fischer said, and the IMF looked forward to drawing further practical implications for its operations from the discussions.

#### Measuring Inequality

Equity, cautioned Amartya Sen of Trinity College, Cambridge, and Harvard University is a multidimensional concept encompassing equality of opportunity and access as well as the distribution of consumption and wealth. The key to addressing inequality is thus not simply redistribution but empowerment. Improvements in health, education, nutrition, and land ownership can enable individuals to participate more fully, and more productively, in the economy. Given the multidimensional nature of equity and the great variety of cultural and political factors, he warned against reliance on a single aggregate index or policy prescription. The IMF may not be central to the quest for equality of opportunity, he added, but it is vital that the IMF develop a broader understanding of it.

Commenting on Sen's paper, Nicolas Barr of the London School of

(Please turn to the following page)



IDB Executive Vice President Nancy Birdsall (left) with IMF First Deputy Managing Director Stanley Fischer at the conference.

tioners' perspective and reflected an increasing concern within the IMF on how its policies could be better designed and implemented to promote and sustain equitable growth. With the participation of policymakers, clergy, and labor leaders as well as academics, the wide-ranging discussions underscored the importance of, and the synergy between, sound policies and good governance. The panels also highlighted the increasingly critical role that popular support plays in the successful implementation of major reforms.

In welcoming remarks, IMF First Deputy Managing Director Stanley Fischer noted that the conference represented another step in the organization's efforts to better understand equity and to integrate equity considerations into its operational work. The IMF has tried, he said, to translate the lessons from the 1995



Amartya Sen

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(continued from front page) Economics said that any equity checklist should also include security. The dramatic decline in life expectancy in some transition economies attested to the real, and very high, cost of unemployment and dislocation. Monsignor Diarmuid Martin of the Vatican argued that the only sustainable growth is equitable growth. He also suggested that the best interests of the market were served by empowering the poor. Alicia Munnell of Boston College reminded participants that wide income disparities are more readily tolerated if wealth is perceived as the product of talent and effort and if opportunity affords economic mobility.



Diarmuid Martin

### Equity in a Globalized Economy

Who gains and who loses was, and will remain, a central question of economic policymaking, maintained Anthony Atkinson of Nuffield College, Oxford.

Looking specifically at the Group of Seven industrial countries, Atkinson found considerable national diversity, which he attributed to differences in government policy and social institutions. He called attention to the impact of social norms, arguing that the interaction of social norms and demand shifts appears to have led to increased wage dispersion in the Group of Seven countries.

Atkinson also challenged the common perception that governments are powerless in the face of globalization and questioned evidence linking greater social protection and greater labor market inflexibility to lower growth. Social security, he said, may actually facilitate economic restructuring and encourage people to take risks, retrain, and change jobs.



Anthony Atkinson

Irma Adelman of the University of California at Berkeley noted that the changes in the Gini coefficient (a standard measure of income inequality) were “shockingly large”—too large to be laid solely at the door of globalization. But globalization may, she believed, be stripping doctors of the weapons needed to battle a new disease. Nancy Birdsall of the Inter-American Development Bank remarked that the Atkinson paper left her “more worried than ever” about income inequality in Latin America. In the long term, she said, market reforms will enhance income equity; in the short term, however, they will enhance returns to those who already have assets.

Picking up the theme of equity in a global economy, Lawrence Summers, Deputy Secretary of the U.S.

Treasury Department, stressed that while the global economy offered enormous potential, people must believe this extraordinary transformation “works for them.” For the developing countries, this will mean addressing fears that market-led development breeds inequality. In the advanced economies, it will mean confronting concerns that the unskilled will be impoverished. In both instances, education has a vital role to play. As never before, Summers argued, government holds society’s fate in its hands.

### Equity Issues in Policymaking

After a lot of pain and social struggle, Chile has recorded 15 years of growth—averaging 8 percent for the past decade, according to Eduardo Aninat Ureta, the country’s Minister of Finance. Poverty has been greatly reduced, but the degree of income inequality has not fallen. How, he asked, should Chile proceed?

Sound macroeconomic policy—particularly good overall fiscal management—can bolster the purchasing power and job stability of lower-income groups and translate into higher fiscal savings, thus freeing resources for social spending. But more resources do not necessarily mean greater effectiveness. Based on Chile’s experience, Aninat offered pragmatic advice to policymakers seeking to foster social reforms, suggesting that they develop public concern over priority issues, build political consensus, help politically weak potential beneficiaries organize, ensure the consistency of more gradually implemented reforms, improve the measurement of results, and strengthen and build institutions.

In addition to exchange rates and interest rates, said Grzegorz Kolodko, former Deputy Prime Minister and Finance Minister of Poland and now with the Warsaw School of Economics, there are electorates. Extraordinary economic contraction and rising inequality—in sharply varying degrees—have characterized the transition process in virtually all the countries of central and eastern Europe. Systemic shock has played an important role, he argued, but so too have policy errors. Kolodko counseled policymakers to tolerate higher inequality in the short term to boost national savings and thus contribute to higher long-term growth. There is no substitute for growth, he said, though safety nets help in the short term. He also argued strongly that pensions should be indexed to prices rather than wages at the onset of transition.

In a lively panel discussion, Mikhail Dmitriev, First Deputy Minister of Russia’s Ministry of Labor and Social



Grzegorz Kolodko

Development, observed that welfare spending is often not means tested and is, in effect, wasted. Santiago Levy, Mexico's Undersecretary of Expenditures, stressed the importance of a proper regulatory environment and argued that "second generation reforms" should perhaps have been first-generation goals. Maria Ramos, Director-General of South Africa's Department of Finance, stressed that while there is no substitute for macrostability, developing countries must also get their



*Maria Ramos*

priorities right, ask appropriate questions about quality and efficiency with regard to social spending, and stress transparency and accountability.

### Policy Responses

Anibal Cavaco Silva, former Prime Minister of Portugal and currently with Nova University of Lisbon and the Portuguese Catholic University, observed that politicians—and the elec-

torate—place a high priority on improving equity. In practice, however, equity concerns are downplayed because politicians generally believe redistributive programs curtail growth, and equity gains are slow to materialize. Cavaco Silva sought to identify a politically realistic equity policy agenda for the European Union. It is extremely difficult, he argued, to seek equity improvements through the traditional means of tax transfers. The most promising programs, he believed, encouraged individuals to increase their "employability." At the same time, according to Cavaco Silva, steps will need to be taken to reform social security and to target welfare programs and public assistance programs to the truly vulnerable.

Governments, argued Alberto Alesina of Harvard University, have an unfortunate tendency to be either too big or too small. Organization for Economic Cooperation and Development (OECD) countries have seen the size of their governments nearly double since 1960—largely the result of a spectacular increase in transfers (and a corresponding increase in tax burdens) that has tended to dampen growth and increase unemployment in some of them. In developing countries, extensive black economies and pervasive tax evasion have limited government revenues and thus thwarted government efforts to fund needed investments and provide services essential for development.

What is the IMF's role in all this? It has always provided economic and fiscal advice, noted Alesina, but it traditionally exhibited more interest in the size of the budget deficit than in the composition of government expenditures. Recent evidence, however, increasingly suggests that the composition of government expendi-

ture matters. In the OECD countries, spending cuts have provided the basis for the longest lasting fiscal adjustments. To reduce poverty, improve income equality, and increase growth in advanced economies, pension reform and unemployment benefits will have to be tackled.

In developing countries, increased revenue and reform and redirection of existing spending programs hold the key. Developing countries will need to shift to a tax-paying formal economy with relatively small, but efficient, social safety nets. All of this, said Alesina, will require reduced corruption and greater bureaucratic efficiency. In this regard, he applauded the IMF and the World Bank's new emphasis on governance.

Discussant Guillermo Perry, Chief Economist for Latin America and the Caribbean at the World Bank, confirmed that tax evasion remains a critical issue for Latin America, noting that more could also be done to reduce taxes on labor and improve access to land. Siow Yue Chia of the Institute of Southeast Asian Studies cited Singapore's tremendous social mobility and culture of self-reliance, but noted that continuing globalization will place added emphasis on human resource development and governance issues.

Ravi Kanbur of Cornell University observed that as underlying income inequity decreased in OECD countries during 1950–80, redistributive efforts increased. The same inverse relationship held in the 1980s and 1990s, although in this period redistributive efforts declined as underlying income inequality grew. As the impact of globalization on industrial country workers widens, Kanbur theorized that some redistributive measures would need to be taken. Mjongonkulu Ndungane, the Archbishop of Cape Town, emphasized the international dimension of inequality and the high price Africa is paying to repay its international debt. Citing World Bank figures, he noted that in 1996, "Africa transferred \$14.5 billion of its precious financial resources to OECD countries. This equals the amount spent in Africa on education and is twice the amount spent on health." Debt cancellation could, he stressed, give Africa a fresh start and allow the continent to channel its considerable resources to the urgent task of development.



*Alberto Alesina*



*Mjongonkulu Ndungane*

In a blunt discussion of Latin America's continuing struggles with income inequity, Enrique Iglesias, President of the Inter-American Development Bank, noted that IDB research has pinpointed several major problems in education, notably poor secondary education participation rates and a high percentage of drop-outs, particularly among the poor, in primary schools.



*Vito Tanzi (left) and IMF Deputy Managing Director Alassane Ouattara at the conference roundtable.*

He also cited sharply higher wage disparities between skilled and unskilled workers than exist elsewhere. Growth will be essential for Latin America, but "there is no quality of economic growth," he said, "if we cannot do something quickly in terms of reducing poverty and increasing the standard of our income distribution."

### Lessons for Countries and the IMF

In a concluding roundtable, Alassane Ouattara, Deputy Managing Director of the IMF, asked Jean-Claude Milleron and Karin Lissakers of the IMF Executive Board, David Smith of the AFL-CIO, Vito Tanzi, and Alberto Alesina to give particular attention to what the IMF could do to promote income equity in view of its macroeconomic mandate. Alesina reiterated that getting the size of government "just right" was a crucial task. Milleron highlighted the key role of sound macroeconomic policies and noted that geographical mobility will increasingly shape fiscal debates. Policymaking is becoming more and more political in the best sense of the word, he said, and the IMF should be increasingly concerned about political accountability.



*David Smith*

Smith urged that meetings between the IMF and labor and religious leaders should become commonplace. It is not possible to sustain wrenching changes, he said, without broad support. He also underscored the importance of popular and democratic institutions. The IMF and other international financial institutions

must insist that political and human rights be protected. If we want equity, he concluded, "we must insist on rules that promote it just as vigorously as we insist on rules that protect property."

Tanzi amplified Atkinson's point that social norms interact with supply and demand to provide a range of incomes or wages. He also reviewed the breadth of observations on what constitutes effective government, noting that the size of government and expenditures is often not directly correlated to effectiveness. In her remarks, Lissakers focused on the IMF's efforts, most notably in the Asian crisis, to move beyond numbers and look at issues of institutional structures and governmental organization. The benefits of macroeconomic adjustment can be fleeting if not underpinned by sound institutions and public management. There is a realization, she said, that good governance and good economic performance go hand in hand. Debt relief is required to get some countries on a sustainable growth path, but again, the relief can be wasted if it is not associated with economic reforms. She noted that the prospect of debt relief is a very powerful incentive for governments to stay the course in implementing essential economic reforms. She also acknowledged that the IMF had not done enough systemic thinking on workers' rights and working conditions, but she credited the organization's catalytic role in Korea (and less visibly in Thailand and Indonesia) in encouraging a voice for labor in the formulation and implementation of policy.

In closing remarks, Tanzi commended participants for a rich and practically oriented discussion of key issues. Among the conclusions he drew were:

- Solid, sustainable macroeconomic policy is a necessary condition for promoting equity.
- Greater equity can promote growth.
- Education and improved human capital development have a key role in furthering greater income equity. (But it is the quality, not the quantity, of the investment that matters.)
- Equity policies should be focused chiefly on increasing the prospects of the least fortunate.
- Greater government efficiency and improvements in the quality of public services are crucial to improving equity and building wider ownership of and support for reforms.
- Over the long term, one of the best ways to help the poor is to improve their opportunity to succeed. This entails providing access to nutrition, basic health care, and good education as well as access to credit, a fair legal system, public services, and employment.
- Over the short term, social safety nets and well-targeted transfer programs, as well as restructured expenditures, can soften hardship. But these arrangements should be short term, and governments should be alert to the dangers of creating disincentives and unnecessary bureaucracies, as well as the opportunities for corruption.



In calling to a close what he termed “an extremely successful conference,” Stanley Fischer said he was especially struck by the conference’s multidimensional view of equity issues, which extended well beyond income distribution to equality of opportunity and access and to concerns over distortions in consumption, wealth, and especially human capital. He was also struck with the theme of empowerment. It was, he said, an issue the IMF has been struggling with in a number of its recent programs, most notably in Indonesia before the change of government.



Karin Lissakers

It is clear, he added, that empowerment is more than access—it is involvement in the decision-making process and the opportunity for people to influence the course of their lives.

IMF really has no choice, Fischer believed, but to be involved in these issues. More troubling for him was

how much the IMF can do and when it should do it. Should the IMF lend to a corrupt government? Where does national sovereignty end and the interests of the IMF and its membership begin? The only thing clear was that there were no easy answers. Often, said Fischer, arguments about national sovereignty are simply arguments of people protecting their own interests rather than advancing the interests of their people. But the IMF should always feel uncomfortable when it is called upon to make those judgments and decide what is better for others. The IMF may feel it can do some good by lending under less than ideal circumstances while pushing quietly on the issues. “The choices are very hard in these cases,” Fischer concluded. ■

Sheila Meehan  
Senior Editor, *IMF Survey*

For additional information about the conference, including the full text of Stanley Fischer’s opening remarks and an issues paper prepared by the Expenditure Policy Division of the IMF’s Fiscal Affairs Department, please check the IMF’s web site at <http://www.imf.org/external/np/fad/equity/index.htm>. A volume covering the conference proceedings, including the papers presented, is being prepared.

### *Third Review of Thai Economic Program*

## IMF Executive Board Releases Further Funds to Support Thailand’s Economic Program

On June 10, IMF Managing Director Michel Camdessus announced that the IMF Executive Board had completed the 1998 Article IV consultation with Thailand and the third review under Thailand’s stand-by credit with the IMF. In completing the review, a further tranche of about \$133 million was released under the credit, bringing total disbursements so far to about \$2.8 billion.

“There was recognition,” Camdessus said, “of the considerable achievements made so far under the economic program, which has helped to rebuild the confidence of financial markets in Thailand’s economy. Despite difficult regional conditions, the balance of payments outlook has improved markedly, international reserves have been substantially replenished, and the exchange rate has strengthened significantly since the start of the year.

“Even so, the performance of the real economy is proving weaker than anticipated, and this necessitates a rebalancing of macroeconomic policy. The fiscal deficit for 1997/98 will be widened from 2 to 3 percent of GDP to allow for the effect of the recession on tax revenues and help strengthen the social safety net; monetary policy will continue to center around the goal of broad stability of the effective exchange rate; and the process of restructuring the financial sector will be intensified. The

authorities are encouraged to complement these critical measures with forceful implementation of supportive structural reforms. These include amendments to the bankruptcy law and to foreclosure procedures, improvements in conditions for foreign direct investment, and the removal of barriers to corporate restructuring. These structural measures will facilitate the necessary economic restructuring, secure efficiency gains, and help revive longer-term capital flows to Thailand.

“The authorities are to be commended on the substantial progress they have made in structural reform and economic stabilization, but considerable risks still lie ahead, as shown by the recent turbulence in financial markets. The complex task of financial and corporate restructuring has yet to be completed, and regional economic prospects remain difficult. Based on the achievements to date, the Executive Board expressed confidence in the Thai authorities’ resolve and ability to meet these difficult challenges,” Camdessus said. ■

**Photo Credits:** Denio Zara, Padraic Hughes, and Pedro Marquez for the IMF, pages 189–93 and 199; Kyrgyz Press Service, page 197.

## Africa Is a “Continent on the Move,” Says IMF Managing Director

*The following are edited excerpts of an address by IMF Managing Director Michel Camdessus at the Summit of Heads of State and Government of the Organization of African Unity in Ouagadougou, Burkina Faso, on June 9.*

Despite all the tragedies besetting it, Africa is moving forward. Economic growth has resumed in most of the continent, and your countries are reaping the fruits of implementing sound economic policies.

With many of you, we have already started thinking about a new generation of reforms that will enable you to accelerate progress and growth and more quickly win the war against poverty. But now the strength and magnitude of the Asian crisis seem to have called everything into question. The IMF is working to contain this fire and put it out, and to help the countries concerned to emerge stronger from the ordeal.

### Africa's Recent Progress

After some two decades of lost opportunities, Africa's economic performance has improved and the outlook has brightened. Real GDP for the region as a whole is growing at an annual rate of 4–5 percent, and per capita incomes are on the rise. African countries—especially those pursuing programs supported by the IMF, the World Bank, and the African Development Bank—are increasingly partaking in the economic recovery. Inflation has also come down sharply—with the average rate falling from a peak of close to 36 percent in 1994 to about 10 percent in 1997. Fiscal deficits have been cut by half in the past five years and external current account deficits, after widening slightly in the mid-1990s, were down to 2.5 percent of GDP in 1997.

These improvements do not warrant euphoria, but they should encourage us to look to the future with optimism. We can be confident, because they are attributable not to luck but to better economic and financial policies in Africa—that is, to your own rigorous efforts and the many initiatives to promote good governance, develop human resources, ensure respect for human rights, and democratize political regimes.

Yet despite this progress on so many fronts, Africa's growth performance still lags behind that of many developing countries. Thus, it is essential to build on these gains and to make endemic poverty retreat. How can we do this in such an unpredictable international context? It is here that we must interpret correctly the messages coming to us from Asia. We should read them not as a sign to reject globalization, but rather to reject the mistakes that were made.

Globalization offers access to a larger volume of financial savings, a wider range of goods and services at lower costs, new export markets, and new technologies. Such opportunities can lead the way to higher productivity, faster growth and development, higher living standards, and lower poverty. And with market integration proceeding rapidly, Africa must open up and compete if it is to take advantage of the benefits of this process. But globalization also poses two important risks: first, for countries that are slow to integrate into the world marketplace, the risk of marginalization; and second, when investors—domestic or foreign—abruptly lose confidence, the risk of capital flows drying up or reversing, thereby precipitating a crisis.

So what exactly happened in Asia? Certainly, the miracle years underscore that high savings, investing in human and physical capital, and liberalizing the economy pay off in terms of growth. But a more recent lesson is that pursuing these policies alone is not enough. Good economic governance must be maintained at all times. The soundness of the banking system in particular is something that must be monitored all the time. Finally, great care must be taken to ensure that the government conducts its affairs in an irreproachable and transparent manner—and that all forms of corruption, favoritism, nepotism, and, if I may use the expression, “cronyism” are shunned.

But let us not blame the Asian countries. These blemishes exist everywhere, and these countries' problems would not have reached such proportions if the financial institutions of certain industrial countries had not been irresponsible as well. But the lesson remains: It is now clear that all reform programs should promote transparency and accountability in government and corporate affairs, stronger banking systems, a more level playing field for the private sector, prudent and properly sequenced liberalization of capital flows, and the elimination of unproductive government spending.

It is in this new world environment that Africa must now frame its economic policies and accelerate its growth. But it cannot do it alone. And it is against this backdrop that Africa, the industrial countries, and the multilateral institutions must join forces in a world partnership that, so far, is taking shape all too slowly. So what should our agenda be?

### An Agenda for Africa

You need to prepare your own strategy that would enable Africa to maximize the benefits of globalization while avoiding its perils.



- *Consolidating macroeconomic stability.* Africa must now redouble efforts to reduce inflation to sustained low rates and ensure the viability of the external position. At the same time, fiscal efforts should focus increasingly on the quality and composition of public expenditures.

- *Ensuring economic security*—removing the sense of uncertainty that too often still plagues investor decision-making.

- *Strengthening the financial sector* to better mobilize savings and deepen financial intermediation.

- *Speeding up trade liberalization* to boost the efficiency and competitiveness of domestic producers.

- *Fostering efficient forms of regional economic cooperation and integration.*

- *Ushering in an era of good governance.* National authorities should spare no efforts to tackle corruption and inefficiency and to enhance the accountability of all public administrators.

- *Continuing the broad, frontal attack on structural problems.* Strengthen everything that encourages private investment and the entrepreneurial spirit at all levels.

These are seven priorities for Africa's development—all of which you have been talking about for some time, and some of which are in place in some of your countries. But if the world and your countries could see you adopt all seven of them together, then this image of a lagging Africa, an Africa that is ambivalent about development, an Africa that is, in the words President Compaoré, a "champion of the negative indicators"—this image will at last be replaced by the one you want to create: an Africa that is actively catching up, open, enterprising, at peace, and sure of its destiny.

### An Agenda for the Industrial Countries

How about the more advanced economies? What can they do to help Africa?

- The largest industrial countries have a particular responsibility to promote world economic growth and stability through the excellence of their own economic policies and by cooperating to minimize potential sources of instability in the global economy.

- Industrial countries should do more to open their markets to products in which African countries have, or are likely to develop, a comparative advantage.

- Donor countries must strengthen their bilateral assistance to countries that have demonstrated a commitment to reform.

- Industrial—and developing countries—need to strengthen efforts aimed at combating corruption.

- Industrial and other economically more advanced countries must ensure that the multilateral institutions have the necessary resources to promote and support adjustment efforts and, in general, fulfill their increasingly complex tasks.

### An Agenda for the IMF

The IMF is taking steps to put the Enhanced Structural Adjustment Facility (ESAF)—its concessional loan facility—on a permanent footing so that we can continue to support reform efforts over the long term. This involves securing the necessary resources to ensure that the ESAF, which was begun as a temporary facility some ten years ago, will be self-sustaining by 2005, and thus remain available in perpetuity.

To help the ESAF to serve you better, we have asked a group of experts headed by Kwesi Botchwey, the former Finance Minister of Ghana, to assist us in identifying reforms that would ensure that each new program can trigger more rapid and socially oriented growth that no longer stops at today's ceiling of 5–6 percent, which is far from negligible, but that can reach and surpass the 7 percent level.

The IMF and the World Bank have been moving swiftly to implement the debt initiative for the heavily indebted poor countries (HIPC). Africa must seize this opportunity to expeditiously reach a sustainable external debt position.

But debt is only one of the impediments to sustainable development. The countries that wish to solve this problem in the absence of an appropriate policy framework cannot hope to achieve much. That is precisely why we have stressed all along that debt relief under the HIPC Initiative be linked to programs that can act as a catalyst for high-quality growth and help position countries to tap international capital markets in due course.

Over the years, the IMF has provided assistance to countries that have experienced political turmoil, civil unrest, or international armed conflict—and since 1995, we have had a special policy to provide emergency post-conflict assistance.

The IMF stands ready to continue to provide—and intensify—our training and technical assistance for capacity building and institutional reform in Africa.

Finally, we are particularly mindful of Africa's situation as we consider how best to help shape a new financial architecture so that the global economy will be less prone to financial crises. To this end, we will be pursuing approaches that include improving the availability and transparency of information and developing and disseminating new standards and best practices.

This is an ambitious agenda for all of us, but I am confident that as broader-based progress gathers momentum, the image of the new, emerging Africa will soon take hold. And we, at the IMF, will do our part to help make that a reality. ■

**Africa must redouble efforts to reduce inflation and ensure a viable external position.**

The full text of the Managing Director's address is available on the IMF's web site at <http://www.imf.org/external/np/speeches>.

## Kyrgyz Republic Hosts Conference on Challenges Facing Economies in Transition

The Kyrgyz Republic and the IMF co-sponsored an international conference in Bishkek on May 27 and 28 to mark the fifth anniversary of the establishment of the Kyrgyz som as an independent national currency. The main themes of the conference—stabilization, growth, and governance—were discussed in a series of sessions featuring speakers, discussants, and questions from an audience of over 200 senior international and Kyrgyz officials, diplomats, professors, business executives, and bankers. Askar Akaev, President of the Kyrgyz Republic, and IMF Managing Director Michel Camdessus spoke at the opening ceremonies.

The introduction of the som had been the country's first step toward an independent economic policy, Akaev said. He thanked the IMF for its support and counsel during the most difficult years of the development of the economy and the state. He cited the considerable progress the Kyrgyz Republic has made in stabilizing its economy, restoring growth, and restructuring on market principles. But he also cautioned against complacency, observing that it was too early to speak about the sustainability of high economic growth.

Akaev reaffirmed the Kyrgyz Republic's commitment to a second stage of reform in order to achieve higher growth, lower inflation, and higher living standards. The second stage, he said, will focus on institutional and legal reforms and on making the private sector the locomotive of sustainable economic growth.

In his address, Camdessus observed that the Kyrgyz Republic, under the leadership of President Akaev, had been at the forefront of reform within the countries of the former Soviet Union and should be a "source of inspiration" for countries in similar situations. After several years of an extremely difficult transition, the Kyrgyz Republic was starting to experience the benefits of its orientation toward a market economy: output has grown at about 7 percent for two years in a row; and inflation has been brought down from the destructive hyperinflationary level of 1,259 percent in 1992 to near single digits.

Camdessus noted that the Kyrgyz Republic's new program with the IMF aims to consolidate these gains and to make sure that the poor in particular benefit from economic expansion.

The critical issues facing Central Asia need to be put into the broader perspective of globalization, especially given the recent experience in East Asia, Camdessus said. Asia had been the "showcase of the benefits of globalization"—nearly one-half of the record \$235 billion in private capital flows to developing and transition economies in 1996 went to Asia. Although some of those funds had not been invested wisely, globalization

allowed many countries in Asia to accelerate investment and growth, create more jobs, reduce poverty, and attain other important human development goals.

Globalization entails risks, however, Camdessus observed. Although Korea, Indonesia, and Thailand had achieved macroeconomic stability, implemented outward-looking economic policies, and placed a high priority on human development, their domestic institutions were not strong enough, and their domestic policies not flexible enough, to meet the increasing demands of economic success.

To avoid pitfalls and make the most of the opportunities that globalization has to offer, Camdessus advised countries to pursue a number of key initiatives, including:

- *Let market forces set prices and allocate resources* so that the economy can operate efficiently.
- *Achieve and maintain price stability.* There is considerable scope for strengthening fiscal management in most transition economies by, for example, improving tax systems and tax administration, establishing effective treasury systems, prioritizing public expenditure, and putting pension systems on a sustainable footing.
- *Manage external debt wisely.* Excessive external borrowing—or borrowing on inappropriate terms—can compromise a country's financial stability and economic growth for years to come.
- *Build sound domestic financial systems,* by establishing strong market incentives for prudent bank management and a framework of domestic regulation and supervision consistent with international standards.
- *Adopt an institutional framework* that will give domestic and foreign entrepreneurs the confidence to invest.

Camdessus concluded by expressing concern about the relationships that existed among enterprises, banks, and government in some East Asian countries under the system of "crony capitalism" and the similar tendencies observable in a number of transition economies. He warned that, as happened in East Asia, when the structure of ownership is not transparent, regulation is inadequate and unevenly applied, too many ad hoc decisions are taken, and market forces are prevented from playing their normal disciplining role, serious imbalances and deadly inefficiencies can build up. Once exposed, these problems can provoke an abrupt market correction.

### Macroeconomic Stabilization

The Kyrgyz Republic has scored a considerable success in reducing inflation. All speakers commended the



National Bank of the Kyrgyz Republic, under the leadership of Governor Marat Sultanov, for its steadfast opposition to inflationary credit creation and for establishing modern central banking practices, liberalizing current account transactions, and allowing market forces to determine the exchange rate of the som.

### Sustainable Growth

Professor Paul Wachtel of New York University warned that large current account deficits financed largely through borrowing from abroad posed a clear if not immediate danger to sustainable growth in many transition economies. Although the Kyrgyz Republic has borrowed mainly on concessional terms and debt has not yet reached unmanageable levels, Wachtel and John Odling-Smee, Director of the IMF's European II Department, advised all Central Asian states to act promptly on reforms to raise domestic savings and attract more foreign direct investment.

Limiting fiscal deficits would help increase the low rate of domestic saving in Central Asian economies, according to Michael Kaser of the Universities of Birmingham and Oxford and Peter Keller of the IMF's European II Department, and more efficient revenue collection is urgently needed in nearly all transition economies. Marek Dawbrowski of the Warsaw-based Center for Social and Economic Research called for better ways to manage the high cost of pensions and provision of social services.

Increasing the efficiency and, thereby, the affordability of social services is imperative in order to achieve both social and fiscal policy goals. Branko Milanovic of the World Bank, UNDP Resident Representative Anna-Kristina Stjanerklint, and Thomas Crouch of the Asian Development Bank discussed the origins and prevalence of poverty and income inequality in the Kyrgyz Republic and other transition economies. The collapse of the old system of social support had most severely affected the elderly, women, and children in the Kyrgyz Republic, Crouch said, especially those living in isolated rural areas and company towns. "A whole generation is at risk," he warned.

Increased efficiency in the enterprise sector must also be a priority for public policy, according to Lajos Bokros of the World Bank and former Minister of Finance of Hungary. He recommended enforcing real budget constraints on enterprises, increasing bankruptcies, and giving due attention to the limitations of non-bank financial intermediation. Boris Fedorov, a former Russian Finance Minister, recommended reform of the banking system through, among other measures, easing restrictions on foreign investment in banks.

Foreign direct investment is an important source of sustainable financing for the current account deficit. Urkaly Isayev, Director of the Foreign Investment Agency of the Kyrgyz Republic, described strategies for attracting more such investment. However, as Michael Rathnam, Resident

Representative of the World Bank Group, noted, foreign business executives in the Kyrgyz Republic had reported cost factors and impediments to foreign direct investment, and there was a need to address these concerns.

### Governance

The Kyrgyz Republic received higher marks than its neighbors during a wide-ranging discussion on governance issues. George Abed of the IMF Fiscal Affairs Department cited empirical evidence indicating that cor-



*Camdessus: "The Kyrgyz Republic's new program with the IMF aims to consolidate gains made so far and to make sure that the poor benefit from economic expansion."*

ruption lowers growth, distorts government spending, and aggravates income inequality. He eschewed quick fixes to curb corruption. The ultimate solution, Abed and Thanos Catsamkas, IMF mission chief for the Kyrgyz Republic, said, lies in structural reforms that create a healthy balance between the state and the market, and good governance in both. Transition economies more advanced in structural reform were already having greater success in limiting the adverse effects of corruption, achieving better economic performance, and attracting private capital flows on better terms. Omar Sultanov, Head of the President's Administration of the Kyrgyz Republic, emphasized building a civil society, establishing the rule of law and an independent judiciary, developing reliable accounting systems, and ensuring the independence of finance and budget functions. ■

Robert Russell  
IMF External Relations Department

All conference papers are available on the IMF's web site at <http://www.imf.org/external/np/eu2/kyrgyz/index.htm>.

## Study Recommends Securitization as a Means of Clearing Stock of Government Arrears

**G**overnments emerging from a period of economic upheaval—such as the hyperinflation of the late 1980s in Argentina or the collapse of the centralized economies of the Baltics, Russia, and other former Soviet Union countries—have often faced difficulties in making payments on a timely basis and have had to deal with the buildup of expenditure arrears. By running arrears, governments essentially borrow from domestic agents without their consent. Pensioners, wage earners, and others are then left with implicit claims on the government, for which they have no title. These claims are—at best—honored on an unspecified date for an uncertain value. Also, creditors cannot trade or enforce untitled government claims—a limitation that can seriously hamper their financial management capacity.

In Working Paper 98/70, *Government Expenditure Arrears: Securitization and Other Solutions*, Alberto Ramos of the IMF's Western Hemisphere Department presents and evaluates various options for addressing the arrears problem. He recommends that governments recognize their implicit financial liabilities, set a timetable for their clearance, and issue market-negotiable titles—that is, securitize their arrears. He also documents several recent country experiences with securitization operations and provides a model to support the claim that securitization can improve a country's welfare. Ramos spoke with the *IMF Survey* about his study.

**IMF SURVEY:** *What options are available to a government in addressing a buildup in its arrears?*

**RAMOS:** One option would be for the government to be passive—to do nothing in terms of the fiscal consolidation necessary to contain the arrears buildup. The stock of arrears is, however, bound to increase even further if the government does not address the fiscal imbalance at the

flow level—where current revenues fall short of current expenditure commitments. This unsustainable alternative is not viable. Presumably, the government would instead try to solve, or at least contain, the fiscal flow imbalance and strive to find the most efficient or least distortionary way to reduce the historic stock of arrears.

Once the government stabilizes the arrears problem at the flow level, it could simply elect to repudiate the stock of arrears by announcing that it will not honor its liabilities. Such an approach would be tantamount to enacting an individual-specific lump-sum tax, payable

by those from whom the government initially borrowed. This is obviously a political economy decision on which this paper is silent, but which, from a normative point of view, should be discouraged.

Old arrears can be settled in kind or offset against tax arrears to the budget. In Moldova, for example, the authorities undertook an in-kind operation to liquidate debts to pensioners. In 1997, all pensioners received a “talon,” specifying the cumulative amount of debt owed to them at the end of 1996 and enabling them to buy goods from government shops and to pay for services and taxes. One problem with this scheme, however, was that pensioners' choices were limited to expensive and potentially unwanted goods.

In countries where goods suppliers—for example—have substantial tax arrears to the budget, the government could embark on a netting operation to offset both tax and expenditure arrears. In many cases, however, government claimants do not have any tax arrears to be offset. Furthermore, avoiding payment in specie—by utilizing commodities, or bundling the problems of tax and expenditure arrears—is only a second-best solution when compared to the more direct and transparent ways of dealing with the stock of arrears.

The first-best solution is, obviously, to pay old arrears as soon as possible. But political and economic constraints might prevent the government from borrowing the required funds from the domestic markets (by securing central bank credit or issuing treasury bills) or from international capital markets. In this case, the government could opt to publicly announce a timetable for future clearance. In fact, phasing in the liability payment might be more viable than clearing arrears all at once, particularly if the stock of arrears is so large that market conditions are not ripe for the placement of sizable amounts of new debt, or if doing so would imperil other government objectives.

Beyond announcing an arrears repayment schedule, the government could securitize the current stock of arrears. This would require the government to recognize its implicit financial liabilities, set a timetable for their clearance, and issue to its claimants market-negotiable titles with a set maturity. A secondary market is likely to emerge as title holders begin to trade their securities, promoting an equitable, transparent, and efficient intertemporal allocation of resources.

**IMF SURVEY:** *What are the relative merits of the different options?*

**RAMOS:** Remaining passive, repudiating old arrears, and—to a lesser extent—making in-kind payments can damage a government's credibility. Preannouncement

**Phasing in a liability payment might be more viable than clearing arrears all at once.**

of payment is a step in the right direction but is not binding, since there is no immediate punishment for deviations from, or delays in, the announced payments schedule. Securitization increases public and market pressure on governments to honor their debts. Because it ties a government's hands and raises the stakes and the cost of default, securitization makes fiscal consolidation not an option, but a must, thus enhancing credibility. Governments will be able to reduce uncertainty, buy credibility, and bolster public trust simply by adhering to a publicly known, preset timetable for arrears clearance. Also, by readily and transparently assuming its obligations, the government imposes pressure on itself and signals strong commitment to tackle its budgetary problems and revamp public finances. Securitization is not a scheme to exonerate the government or legitimize continued overspending.

Barring repudiation, all of these alternatives are neutral in terms of the impact on budget deficits—when measured on a commitment basis—since current and future obligations are not altered by the method of payment. Securitization also has no impact on the deficit on a commitment basis, nor on government net worth, since it is merely a swap of implicit for explicit debt.

**IMF SURVEY:** *Could you elaborate on the claim that securitization operations can improve a country's welfare?*

**RAMOS:** Immediate payment will naturally benefit society's most vulnerable individuals, who in some cases belong to older age groups that discount the future very heavily. These individuals have the most to gain from a securitization operation, since unlike other government debt instruments, these securities can be specifically designed to protect the poor and the less financially sophisticated segments of society.

Thus, securitization fosters accountability and protects vulnerable groups from government discretion. Explicit recognition and titling of outstanding claims can also produce substantial efficiency gains. This is true, for example, in the context of the trade-off between present and future consumption: agents for whom liquidity has a high marginal value will be able to get cash immediately by selling their claims in the secondary market. In practice, this would be equivalent to paying first those individuals who need and value money the most: the poor.

**IMF SURVEY:** *What should governments take into account in designing a workable securitization operation?*

**RAMOS:** Securities have several properties—such as a face value, an interest rate, option clauses, and a maturity date—that can be combined in different ways. A security may, for instance, command a market interest rate, a fixed real rate, or it may even pay no interest at all. It can have a short-term or a longer-term maturity. As such, securitization operations offer quite a bit of

flexibility. Ultimately, the optimal design hinges on political economy and public policy decisions, such as the degree of protection to award specific classes of claimants and the allocation of costs among different societal classes.

Since a securitization operation would involve many small, unsophisticated, and geographically dispersed agents—as opposed to big institutional investors—securities should be issued in small denominations. To help minimize the administrative costs of implementation, the government could utilize a branch network of the postal service or a local savings bank to open accounts with accounting (not actual) balances, rather than issue paper bonds. The balances in these accounts would carry an interest rate and would only become available to claimants at a specified future date. Nevertheless, the account balance could be immediately pledged as collateral and could potentially be transferable, or tradable, between accounts. This cost-minimizing approach has the added benefit of contributing to the deepening of financial intermediation.

**IMF SURVEY:** *What are some of the key lessons that have been learned from countries' experiences with securitization?*

**RAMOS:** My study covers the experiences of Argentina, Cameroon, Moldova, Russia, and Venezuela. A common denominator of their experiences is that securitization is the alternative of choice for clearing arrears when governments face constraints on domestic or foreign borrowing and when clearing their old debts arrears is seen as a one-off operation. Governments also choose securitization as a means for clearing arrears when they want to default on “less-deserving” parts of the implicit debt—for example, debt owed to a goods supplier that has overcharged the government—but cannot do so for political or legal restrictions or when, for equity reasons, a differentiated treatment of claimants is called for. Furthermore, securitizing can provide governments with temporary relief from debt-service obligations, which would probably not be available by floating market debt instruments. ■



**Ramos:** *Securitization increases public and market pressure on governments to honor their debts.*

Copies of Working Paper 98/70, *Government Expenditure Arrears: Securitization and Other Solutions*, by Alberto Ramos, are available for \$7.00 each from IMF Publication Services. See page 202 for ordering information.

Following are excerpts of recent IMF press releases. Full texts are available on the IMF's web site (<http://www.imf.org>) under "news" or on request from the IMF's Public Affairs Division (fax: (202) 623-6278).

## Djibouti: Extension and Augmentation of Stand-By Arrangement

The IMF approved a request by the government of Djibouti to extend the current stand-by credit through end-March 1999, and to augment the amount available under it by SDR 1.7 million (about \$2.2 million) in support of Djibouti's economic adjustment and reform program. The IMF's Executive Board took the decision in conjunction with the completion of the second review under the stand-by credit that was approved on April 15, 1996 (see Press Release No. 96/16, *IMF Survey*, May 6, 1996) and augmented on May 21, 1997 (see Press Release No. 97/25, *IMF Survey*, June 25, 1997) to

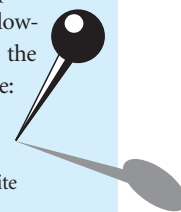
## Press Information Notices

Press Information Notices (PINs) are IMF Executive Board assessments of members' economic prospects and policies issued—with the consent of the member—following Article IV consultations, with background on the members' economies. Recently issued PINs include:

Uganda, No. 37, June 4

Burkina Faso, No. 38, June 12

Full texts of PINs are available on the IMF's web site (<http://www.imf.org/pins>).



SDR 6.6 million (about \$8.8 million). The current augmentation brings the total amount of the stand-by credit to SDR 8.25 million (about \$11.0 million).

Djibouti joined the IMF on December 29, 1978. Its quota is SDR 11.5 million (about \$15.4 million). Its outstanding financial obligations to the IMF currently total the equivalent of SDR 3.98 million (about \$5.3 million).

Press Release No. 98/21, June 1

## Djibouti: Selected Economic Indicators

	1994	1995	1996	1997 <sup>1</sup>	1998 <sup>2</sup>	1999 <sup>3</sup>
	(percent change)					
Real GDP	-2.9	-4.0	-5.1	0.5	0.4	-2.0
Consumer prices (average)	6.5	4.9	4.2	2.6	2.0	2.0
	(percent of GDP)					
External current account balance (excluding foreign grants)	-13.2	-5.9	-5.9	-6.4	-8.4	-10.5
Overall budget balance (excluding grants)	-13.4	-10.1	-5.8	-8.1	-4.5	-3.7
	(months of imports)					
Gross official reserves	3.7	3.5	3.8	3.4	3.1	3.1

<sup>1</sup>Preliminary estimates.

<sup>2</sup>Program.

<sup>3</sup>Projections.

Data: Djibouti authorities and IMF staff estimates

## Romania: Article VIII

The Minister of Finance and the Governor of the National Bank of Romania have notified the IMF that Romania has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement, with effect from March 25, 1998. IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval. A total of 144 countries have now assumed Article VIII status.

Romania joined the IMF on December 15, 1972. Its quota is SDR 754.1 million (about \$1.0 billion).

Press Release No. 98/22, June 9

## Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
June 8	4.31	4.31	4.61
June 15	4.33	4.33	4.63

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (the U.S. dollar, weighted 39 percent; deutsche mark, 21 percent; Japanese yen, 18 percent; French franc, 11 percent; and U.K. pound, 11 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 107 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF web site (<http://www.imf.org/external/np/tre/sdr.thm>).

Data: IMF Treasurer's Department

## Members' Use of IMF Credit (million SDRs)

	May 1998	Jan.–May 1998	Jan.–May 1997
General Resources Account	1,877.60	6,073.92	1,876.47
Stand-By Arrangements	1,793.12	5,036.89	373.51
Of which: Supplemental Reserve Facility	935.00	3,935.00	0.00
EFF Arrangements	84.48	1,037.03	1,395.36
CCFF	0.00	0.00	107.60
SAF and ESAF Arrangements	20.78	421.71	223.43
<b>Total</b>	<b>1,898.38</b>	<b>6,495.63</b>	<b>2,099.90</b>

Note: EFF = Extended Fund Facility  
CCFF = Compensatory and Contingency Financing Facility  
SAF = Structural Adjustment Facility  
ESAF = Enhanced Structural Adjustment Facility  
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department



## Stand-By, EFF, and ESAF Arrangements as of May 31

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
			(million SDRs)	
<b>Stand-By Arrangements</b>			<b>28,323.23</b>	<b>12,368.26</b>
Bosnia and Herzegovina	May 29, 1998	May 28, 1999	60.60	60.60
Bulgaria	April 11, 1997	June 10, 1998	371.90	0.00
Cape Verde	February 20, 1998	April 19, 1999	2.10	2.10
Djibouti	April 15, 1996	June 30, 1998	6.60	2.63
Egypt	October 11, 1996	September 30, 1998	271.40	271.40
Estonia	December 17, 1997	March 16, 1999	16.10	16.10
Indonesia	November 5, 1997	November 4, 2000	7,338.24	4,402.94
Korea <sup>1</sup>	December 4, 1997	December 3, 2000	15,500.00	3,365.00
Latvia	October 10, 1997	April 9, 1999	33.00	33.00
Philippines	April 1, 1998	March 31, 2000	1,020.79	1,020.79
Thailand	August 20, 1997	June 19, 2000	2,900.00	900.00
Ukraine	August 25, 1997	August 24, 1998	398.92	217.59
Uruguay	June 20, 1997	March 19, 1999	125.00	125.00
<b>EFF Arrangements</b>			<b>12,335.70</b>	<b>6,743.00</b>
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	December 19, 1999	58.50	26.33
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Gabon	November 8, 1995	November 7, 1998	110.30	49.63
Jordan	February 9, 1996	February 8, 1999	238.04	47.35
Kazakhstan	July 17, 1996	July 16, 1999	309.40	309.40
Moldova	May 20, 1996	May 19, 1999	135.00	97.50
Pakistan	October 20, 1997	October 19, 2000	454.92	398.06
Panama	December 10, 1997	December 9, 2000	120.00	110.00
Peru	July 1, 1996	March 31, 1999	300.20	139.70
Russian Federation	March 26, 1996	March 25, 1999	6,901.00	3,064.74
Yemen	October 29, 1997	October 28, 2000	105.90	96.90
<b>ESAF Arrangements</b>			<b>4,343.68</b>	<b>2,174.00</b>
Albania	May 13, 1998	May 12, 2001	35.30	29.42
Armenia	February 14, 1996	February 13, 1999	101.25	33.75
Azerbaijan	December 20, 1996	December 19, 1999	93.60	38.02
Benin	August 28, 1996	August 27, 1999	27.18	18.12
Bolivia	December 19, 1994	September 9, 1998	100.96	0.00
Burkina Faso	June 14, 1996	June 13, 1999	39.78	13.26
Cameroon	August 20, 1997	August 19, 2000	162.12	108.08
Chad	September 1, 1995	August 31, 1998	49.56	8.26
Congo, Republic of	June 28, 1996	June 27, 1999	69.48	55.58
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	202.47
Ethiopia	October 11, 1996	October 10, 1999	88.47	73.73
Georgia	February 28, 1996	February 27, 1999	166.50	55.50
Ghana	June 30, 1995	June 29, 1999	164.40	68.50
Guinea	January 13, 1997	January 12, 2000	70.80	35.40
Guinea-Bissau	January 18, 1995	July 24, 1998	10.50	0.00
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Kenya	April 26, 1996	April 25, 1999	149.55	124.63
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	36.37
Madagascar	November 27, 1996	November 26, 1999	81.36	54.24
Malawi	October 18, 1995	October 17, 1998	45.81	15.27
Mali	April 10, 1996	April 9, 1999	62.01	20.67
Mauritania	January 25, 1995	July 13, 1998	42.75	0.00
Mongolia	July 30, 1997	July 29, 2000	33.39	27.83
Mozambique	June 21, 1996	June 20, 1999	75.60	25.20
Nicaragua	March 18, 1998	March 17, 2001	100.91	84.09
Niger	June 12, 1996	June 11, 1999	57.96	19.32
Pakistan	October 20, 1997	October 19, 2000	682.38	454.92
Senegal	April 20, 1998	April 19, 2001	107.01	89.18
Tanzania	November 8, 1996	November 7, 1999	161.59	74.47
Togo	September 16, 1994	June 29, 1998	65.16	10.86
Uganda	November 10, 1997	November 9, 2000	100.43	60.26
Yemen	October 29, 1997	October 28, 2000	264.75	220.75
Zambia	December 6, 1995	December 5, 1998	701.68	40.00
<b>Total</b>			<b>43,554.75</b>	<b>19,335.14</b>

### Stand-By Arrangements

give members the right to draw up to a specified amount of IMF financing during a prescribed period.

<sup>1</sup>Includes amounts under Supplemental Reserve Facility.

EFF = Extended Fund Facility

ESAF = Enhanced Structural Adjustment Facility

Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

**Books**

*Structural Change in Japan—Macroeconomic Impact and Policy Challenges* (\$26.00). Collection of staff papers on Japan presented at an IMF conference in 1997.

**Working Papers (\$7.00)**

- 98/60: *Growth, Trade, and Deindustrialization*, Robert Rowthorn and Ramana Ramaswamy. Shows that deindustrialization is explained primarily by trends internal to the advanced economies.
- 98/61: *Rethinking Public Pension Reform Initiatives*, Peter S. Heller. Argues that there are significant risks and complications associated with reliance on mandatory defined-contribution, fully funded pension schemes.
- 98/62: *Multiple Equilibrium, Variability, and the Development Process*, Luis Carranza and José E. Galdón-Sánchez. Addresses the high variability of per capita GDP displayed by middle-income countries, relative to the low variability of per capita GDP shown by both low- and high-income economies.
- 98/63: *Corruption Around the World: Causes, Consequences, Scope, and Cures*, Vito Tanzi. Discusses issues related to the causes, consequences, and scope of corruption and possible corrective actions.
- 98/64: *The Domestic and Foreign Price Gaps in the P-Star Model—Evidence from Spain*, Alicia García-Herrero and Manoj Vasant Pradhan. Uses the P-STAR model to analyze Spanish prices from 1970 to 1996 and assess the role German price movements played in Spanish inflation.
- 98/65: *Central Bank Vulnerability and the Credibility of Commitments—A Value-at-Risk Approach to Currency Crises*, Mario I. Blejer and Liliana Schumacher. Develops a methodology to assess central bank solvency and exposure to risk.
- 98/66: *The Fiscal Effects of Monetary Policy*, Momi Dahan. Develops a simple framework to examine the budgetary implications of monetary policy measures.
- 98/67: *Exchange Rates and Economic Fundamentals—A Methodological Comparison of BEERs and FEERs*, Peter B. Clark and Ronald MacDonald. Compares two approaches for examining the extent to which a country's actual real effective exchange rate is consistent with economic fundamentals.
- 98/68: *Inflation, Disinflation, and Growth*, Atish Ghosh and Steven Phillips. Addresses various methodological problems and examines the relationship between inflation, disinflation, and output growth.
- 98/69: *Deviations of Exchange Rates from Purchasing Power Parity: A Story Featuring Two Monetary Unions*, Tamim Bayoumi and Ronald MacDonald. Proposes a way of gaining a perspective on the importance of nominal shocks in generating deviations from PPP.
- 98/70: *Government Expenditure Arrears: Securitization and Other Solutions*, Alberto M. Ramos. Presents several options for addressing the arrears problem (see page 198).
- 98/71: *Current Accounts—What Is Their Relevance for Economic Policymaking?*, Malcolm Knight and Fabio Scacciavillani. Surveys the main theoretical approaches for analyzing movements in the current account of the balance of payments.

98/72: *External Debt Histories of Ten Developing Countries: Lessons from Their Experience*, Ray Brooks and others. Assesses the main factors behind the increase in the external debt burden in the past 20 years for ten low-income developing countries.

98/73: *Carbon Taxes: Their Macroeconomic Effects and Prospects for Global Adoption—A Survey of the Literature*, Javier Cuervo and Ved P. Gandhi. Shows that policymakers can minimize the effects of the carbon tax on economic growth.

98/74: *The Italian Social Protection System—The Poverty of Welfare*, Massimo V. Rostagno and Francesca Utili. Provides an empirical assessment of the effectiveness of the welfare system.

98/75: *The Macroeconomic Effects of Environmental Taxes: A Closer Look at the Feasibility of “Win-Win” Outcomes*, Jenny E. Ligthart. Reviews recent literature on the macroeconomic effects of environmental taxes.

98/76: *Does Corruption Affect Income Inequality and Poverty?* Sanjeev Gupta and others. Demonstrates that high and rising corruption increases income inequality and poverty by reducing economic growth.

98/77: *How Do the Skilled and the Unskilled Respond to Regional Shocks? The Case of Spain*, Paolo Mauro and Antonio Spilimbergo. Addresses the question of how workers of different skill levels respond to regional shocks.

**IMF Staff Country Reports (\$15.00)**

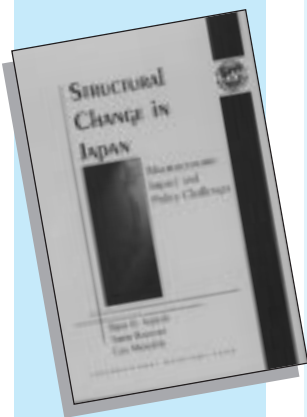
- 98/27: Islamic Republic of Iran—Recent Economic Developments
- 98/28: Israel—Background Studies, Information Notes, and Statistical Appendix
- 98/29: Lesotho—Statistical Annex
- 98/30: Vietnam—Selected Issues and Statistical Annex
- 98/31: Cape Verde—Statistical Tables
- 98/32: El Salvador—Recent Economic Developments
- 98/33: Equatorial Guinea—Statistical Appendix
- 98/34: Norway—Selected Issues
- 98/35: Sudan—Statistical Annex
- 98/36: Czech Republic—Selected Issues
- 98/37: Czech Republic—Statistical Appendix
- 98/38: Argentina—Recent Economic Developments
- 98/39: Botswana—Selected Issues and Statistical Appendix
- 98/40: Guinea-Bissau—Recent Economic Developments
- 98/41: People's Republic of China Hong Kong Special Administrative Region—Recent Economic Developments
- 98/42: Morocco—Statistical Appendix
- 98/43: Switzerland—Selected Issues and Statistical Appendix
- 98/44: The Bahamas—Statistical Appendix
- 98/45: Costa Rica—Recent Economic Developments
- 98/46: Côte d'Ivoire—Selected Issues and Statistical Appendix
- 98/47: Republic of Latvia—Selected Issues and Statistical Appendix
- 98/48: Nicaragua—Statistical Annex

**Other Publications**

*The Economy of the West Bank and Gaza Strip: Recent Experience, Prospects, and Challenges to Private Sector Development*, Steven Barnett and others (free). Reviews economic developments in the West Bank and Gaza Strip in 1997, prospects for 1998, and examines private sector development issues.

Publications are available from Publication Services, Box XS800, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

For information on the IMF on the Internet—including the full text of the English edition of the *IMF Survey*, the *IMF Survey's* annual *Supplement on the IMF, Finance & Development*, an updated *IMF Publications Catalog*, and daily SDR exchange rates of 45 currencies—please visit the IMF's web site (<http://www.imf.org>). The full texts of all Working Papers, Papers on Policy Analysis and Assessment, and Press Information Notices (PINs) are also available on the IMF's web site.



## Crisis Management Is Key to Crisis Prevention

In its sixty-eighth Annual Report, the Bank for International Settlements (BIS) advises Asian developing economies to adopt IMF reforms, noting that “prompt, and above all politically committed, responses to the prescriptions of the International Monetary Fund would do more to revive growth prospects than anything else in countries where such a commitment is lacking.” The report, which covers the year ending March 31, was released on June 8 and includes an analysis of the effects of the Asian crisis on the global economy and offers measures for crisis prevention and management.

### Asia

The report calls the “suddenness with which the crisis began, the relentless progress of contagion across countries, and the magnitude of the collapse in exchange rates and asset prices” unprecedented, noting that it is not clear that the worst is over. While financial markets have stabilized somewhat, the report suggests that the full impact on domestic companies and the institutions that have lent to them as well as the social costs “remains to be seen.” On a more positive note, it concludes that the worst may be over in Asia itself, given that financial markets there have stabilized to some degree. Adopting IMF reforms in countries of the region would, the report states, “help restore confidence, allowing interest rates to decline and exchange rates to rise from excessively low levels.”

### Rest of the World

Despite the traumatic events in Asia, the BIS report indicates that economic prospects for the rest of the world still look generally positive. The Asian crisis and its impact on world prices for oil, electronic products, and other commodities will reinforce disinflationary trends around the world, and financial markets worldwide have responded “extremely favorably” to them. In the United States and the United Kingdom, strong growth of domestic demand has pushed output to, and possibly beyond, levels previously thought to be incompatible with nonaccelerating inflation.

In continental Europe, the repercussions of the crisis may be harder to identify, the report says, because a significant proportion of external European trade is with Asia and European export orders to Asia have not begun to falter. But European bank exposure to Asian banks is almost as great as that of Japanese banks, though this degree of expansion is somewhat mitigated by the overall health of the European banking sector. Despite the uncertain Asian situation, the report states

that European economic and monetary union will be introduced on schedule amid emerging signs of strengthening growth and confidence.

Japan is the one worrisome exception, according to the report. After domestic demand fell steeply following a tightening of fiscal policy in April 1997, business and consumer confidence has been eroded further by shocks, including rising unemployment and fears of prospective industrial restructuring, the Asian crisis and the resulting decline in exports to the region, and the fragile state of the Japanese financial system.

### Crisis Prevention and Management

The BIS report notes that financial and exchange rate crises have become more frequent in the 1990s and “preventative measures to date have been inadequate.” A great deal of work has been undertaken in recent years, however, with considerable progress in some areas.

To head off a crisis, the report explains, market participants and regulatory authorities need adequate access to information. One positive development has been the growing number of IMF member countries subscribing to the IMF’s Special Data Dissemination Standard. But better information, the report cautions, while necessary, is not a sufficient condition to prevent crises. “What is also needed is the vision to imagine crises and the will to act preemptively.”

Initiatives to strengthen financial systems nationally and internationally include:

- A report on financial fragility in emerging markets prepared by the representatives of emerging markets and the Group of Ten (G-10) countries, which set out a strategy for formulating sound principles and practices. It has been endorsed by over fifty countries.

- The Core Principles for Effective Banking Supervision, drawn up by the Basle Committee on Banking Supervision in conjunction with supervisors from non-G-10 countries. These were presented at the IMF/World Bank Annual Meetings in Hong Kong SAR and have received wide acceptance from the international financial community. The Basle Committee is working with these two institutions to promote their implementation.

- The Committee on Payment and Settlement Systems and the Euro-Currency Standing Committee have published studies and recommendations on topics including foreign exchange settlement risk, market liquidity in times of stress, the year 2000 problem, and settlement arrangements for securities and derivatives.

**International Bank Lending to Various Regions<sup>1</sup>**



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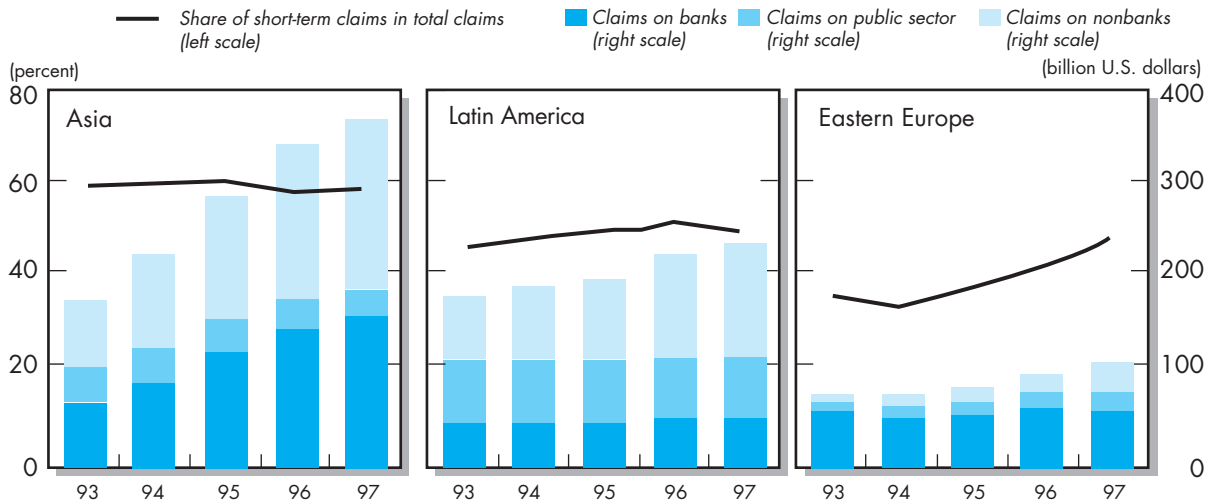
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<sup>1</sup>Amounts outstanding at end-year. For 1997, end-June data, which include major breaks in series affecting, among other things, the maturity distribution of claims.

Data: Bank for International Settlements

The IMF-led international effort to stabilize the Asian situation, the report explains, combined successively larger packages of liquidity support with traditional demand-side conditionality and financial reform, and supply-side measures to support long-term growth. According to the report, the Asian crisis was the first in the “postwar period featuring the combination of banks as the principal international creditors and private sector entities as the principal debtors.” Thus, the principles of how to manage such a crisis were not known—and, indeed, they are still under discussion. As with crisis prevention, it will take some years before all the lessons have been understood, the report notes, and probably longer before they have all been accepted and applied. The report provides some possible policy prescriptions suggested by events during the year under review.

Because of the speed with which economic circumstances can change, the report urges that economic projections and judgments be undertaken with humility. As the Asian crisis illustrated, the financial and economic world is an uncertain place where perceptions of liquidity, market and credit risk can interact to cause multiplicative effects and unpredictable outcomes. Add to that the social and political ramifications of economic developments, and the results can be even more uncertain. Success also often “contains within it the seeds of failure.” The report thus warns against overoptimism on the part of markets and policymakers.

The report does not suggest that economic growth, deregulation, and low inflation should be avoided because of the possible risks. It does, however, draw three precautionary conclusions:

- Better understanding of the dynamics of macroeconomic processes may enable policymakers and others

to head off problems before they become too disruptive.

- Market liberalization must be pursued vigorously but prudently.
- Financial systems everywhere must be strengthened to build up their resilience in the face of the larger shocks likely in freer markets.

In addition to following IMF reforms, the report recommends that emerging markets in Asia undertake an early, transparent, and politically neutral restructuring of domestic banking systems.

Although the Asian crisis is not yet over, the report says, some lessons for managing crises are already evident.

- The private sector needs to take some responsibility for continuing to provide credit to customers to which they had previously lent too freely.
- The threat of a unilateral stay on payments would help bring banks to the negotiating table sooner.
- After the Mexican crisis, the G-10 Deputies made recommendations to facilitate crisis management, but none of these recommendations has been implemented, raising the question of what could be done in this regard.

The report ends with the hope that resolving issues relevant to crisis management will encourage “policymakers not only to redouble their efforts to promote price and financial stability, but also to plan their reactions in advance should events fail to unfold as they might desire.”

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