

IMF SURVEY

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International
Monetary Fund
VOLUME 29
NUMBER 13

July 3, 2000

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To promote sustainable growth

Industrial, developing countries must act rapidly to reduce world poverty significantly by 2015

World poverty can be significantly decreased by 2015 if developing and industrial countries implement their commitments to attack its root causes, according to a report released on June 26. The report, entitled *A Better World for All*, was prepared jointly by the United Nations (UN), the World Bank, the IMF, and the Organization for Economic Cooperation and Development (OECD).

The report was released in Geneva by UN Secretary-General Kofi Annan on the opening day of the UN special session on social development, where finding strategies to fight poverty was set as a priority. The same day, the report was also presented at the OECD 2000 forum in Paris by Sally Shelton-Colby,

OECD Deputy Secretary-General, and Louise Frechette, UN Deputy Secretary-General.

Following are edited excerpts of the joint press release issued by the four organizations on June 26 (the full text is available as IMF Press Release No. 00/37 and may be found on the IMF's website, www.imf.org).

The report urges developing and industrial countries to work to foster sustainable growth that favors the poor and provide more resources for health, education, gender equality, and environmentally sustainable development worldwide.

The report marks the first time these four international organizations have jointly assessed progress toward poverty-reduction (Please turn to the following page)

Interview

Developing countries face range of challenges in devising effective tax strategy

Vito Tanzi, Director of the IMF's Fiscal Affairs Department, and Howell Zee, Chief of the Department's Tax Coordination Division, met with the IMF Survey to talk about their Working Paper, *Tax Policy for Emerging Markets: Developing Countries*.

IMF SURVEY: What are the special characteristics and needs of developing countries that set them apart from other countries in terms of tax policy?

TANZI: The most basic characteristic is the level of taxation, which in industrial countries is twice that in developing countries. Thus, the governments of industrial countries can do many things that the governments of developing countries cannot do. When developing countries attempt to do the same things, they get into trouble because they don't have the resources. A second characteristic is the structure of taxation. In industrial countries, a large proportion of taxes comes from

income taxes, especially on individuals. In developing countries, the share of personal income taxes is very small. A third characteristic is the quality of the tax administration, which is much better in industrial countries where the actual, or (Continued on page 217)



Howell Zee (left) and Vito Tanzi.

(Continued from front page)

goals and outlined a common vision for the way forward.

The report focuses on seven interrelated development goals set during world conferences in the 1990s.

These goals, if achieved in the next 15 years, will improve the lives of millions of people.

The seven goals are halving the proportion of people living on less than \$1 a day; enrolling all children in primary school; empowering women by eliminating gender disparities in education; reducing infant and child mortality rates; reducing maternal mortality ratios; promoting access to reproductive health services; and promoting environmentally sustainable development.

Not only is progress important on each goal individually, the report says, but all goals must be met collectively to truly combat the many causes of poverty. Success on one or two will not produce a sufficient impact.

“During the 1990s, world conferences set major goals for economic and social development,” Secretary-General Annan said. “All countries, developed and developing alike, signed on to this agenda, often at the highest political level. Since then, people have been asking whether the world has made good on these commitments. What has worked? What did not, and why? And what can we do better?”

“This report provides some answers,” the UN Secretary-General added. “It is the product of unprecedented collaboration among four major multilateral organizations. And it responds to a specific request from the Group of Eight countries that such a report be prepared—to help monitor progress in the reduction of poverty worldwide—and to guide them in their partnership with developing countries. The result is a common understanding—a score card and policy road map with which to measure progress in banishing extreme poverty from our world and in achieving the targets set by the world conferences of the past decade.”

Findings

Analysis in the report shows some startling points:

- As growth increased in the mid-1990s, the proportion of people living on less than \$1 a day fell rapidly in Asia, but little or not at all in Africa. Income inequality remains a barrier to progress in Latin America.

- More than 100 million children will not be in school in 2015, if current trends prevail.

- The gender gap in primary and secondary enrollment is narrowing, but not fast enough to reach the goal of eliminating gender disparities in schools by 2005.

- For every country that has decreased mortality rates for infants and children under the age of 5 fast enough to reach the goals, 10 have lagged behind and 1 has moved backward, often because of HIV/AIDS.

- Skilled care during pregnancy and delivery can do much to avoid many of the half million maternal deaths each year.

- During the 1990s, the use of contraception increased in all regions, but Africa lagged behind.

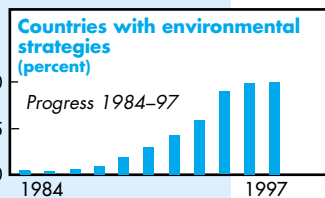
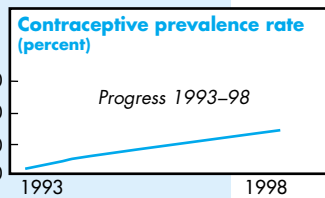
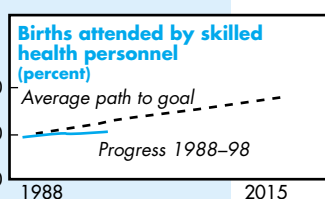
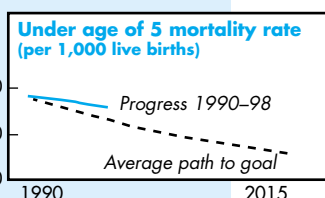
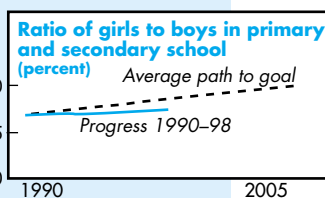
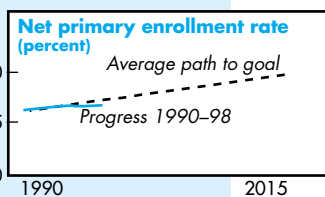
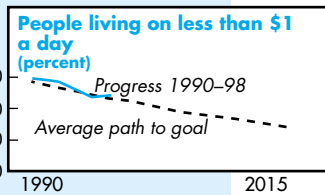
- By 1997, fewer than half the countries in the world had strategies for environmental sustainability.

The major obstacles to success, according to the report, are inadequate policies; human rights abuses; conflicts; natural disasters; HIV/AIDS; inequities in income, education, and access to health care; and unequal opportunities between men and women. The report also notes that developing countries' efforts to improve conditions for their citizens are seriously hampered by a lack of access to global markets, the debt burden, a decline in development assistance, and inconsistencies in donor policies.

Solutions

There is no single solution to achieving the goals. The report finds that greater commitment from both developing and developed countries, as well as stronger voices and more choices for the poor, can make a difference. Economic growth is part of the solution, but not a guarantee in itself. Also important is more investment in basic social services, which can produce greater payoffs in terms of development, as well as ensure that the benefits of economic progress reach the poorest people. Openness to trade, technology, and knowledge, and the capacity to use it, can also stimulate progress for the poorest.

The report, which will serve as a joint UN, World Bank, IMF, and OECD contribution to the Group of Eight meeting in Okinawa on July 22, is intended to stimulate support for greater action by government representatives from some 190 states attending the UN General Assembly special session on social development, as well as raise awareness among the general public. ■



Data: UN-World Bank-IMF-OECD,
A Better World for All

International community collaborates on design of policies to promote poverty reduction

Following are edited excerpts of remarks by IMF Deputy Managing Director Eduardo Aninat at the Development Policy Forum meeting in Berlin on June 15. The full text is available on the IMF's website (www.imf.org).

The international community last year adopted a new approach to poverty reduction. The key innovation is deriving programs from comprehensive strategies for poverty reduction drawn up by individual governments, with the involvement of a broad range of key stakeholders, including civil society and the donor community. The strategy for each country, which is to be laid out in its so-called poverty reduction strategy paper (PRSP), will provide a focused policy agenda and promote government accountability by fostering a national dialogue on economic and social policies.

This is a collaborative effort of the international community, with each partner playing a vital role. The World Bank, along with the regional development banks and UN agencies, takes the lead on discussions with authorities on the design of policies aimed at poverty reduction—including social safety nets to protect the poor and vulnerable. The IMF will do its part by supporting economic policies that provide a conducive environment for sustainable growth.

So what is new? Let me answer from the IMF's perspective, focusing on five key elements.

First, *we have changed the objectives of the IMF's concessional lending facility to explicitly include poverty reduction.* For that reason, we reshaped the facility, previously known as the Enhanced Structural Adjustment Facility, into the Poverty Reduction and Growth Facility [PRGF]. What this means in practice is that we will help countries ensure that economic policies are pro-poor. Under the PRGF, countries will devise medium-term budgetary frameworks that contain explicit and specific poverty-reducing policies. The IMF will rely on the World Bank and other multilateral regional development banks for an assessment of the priorities included in these budgets and their costing. We will then help to ensure that these outlays are consistent with the available financing and with macroeconomic stability and faster, sustainable growth. If available financing is insufficient to meet priority spending needs in countries where additional resources could be used effectively, we will actively support countries in seeking additional resources from the donor community.

Second, *there will be a much wider participatory process in the design and monitoring of poverty reduction strategies.* This should bring benefits such as broad-based agreement within the country on priority goals, public services that reflect the needs of the poor, and better government accountability. For some countries, like Bolivia, Tanzania, and Uganda, the new programs offer an opportunity to take these processes even further.

Third, *the content of country programs should change in a number of ways.*

- There should be better availability of key information, both qualitative and quantitative, in the design phase as countries are encouraged to improve their statistical base, with technical assistance from donors, if possible. In recent years, almost 60 percent of the PRSP program countries have already completed poverty assessments; but major data gaps still exist for the rest.

- There should be more systematic analysis of the social and distributional impact of macroeconomic and structural policies before these policies are put in place—here we count on the World Bank for guidance. This will help ensure the effective implementation of social safety nets.

- There will be a shift to more pro-poor spending and service delivery in public expenditure programs. This should translate into higher outlays on primary education and health or in the productive sectors and rural infrastructure. Of course, how well the funds are spent matters as much as their size. Indeed, as we have seen in Chile, well-targeted outlays can significantly improve income distribution.

- There will be greater variation across countries in the pace and sequencing of reforms. But here, a word of caution: donors—and the international financial institutions—have a responsibility to be explicit about the sorts of reforms they will continue to favor. They must also give countries greater discretion to experiment and, even, to fail: more room for ownership!

- There will be greater attention paid to monitorable results. This will require the selection and tracking of key outcome indicators and, thus, the institutional capacity to do so. The benefit should be more ex post evaluation of reforms, with the results thus fed into new policymaking.

- There will be greater emphasis on transparency, accountability, and good governance.



Fourth, *the relationship between countries and external partners will change in a number of ways*. This includes fully respecting country ownership by basing our programs on country strategies and showing more flexibility in balancing program quality and country ownership. Conditionality associated with donor support must therefore evolve—it should be in support of objectives that emerge from the government's program; it should emphasize the results rather than the intermediate process; and it should be selective and focused on the key issues and constraints for poverty reduction. Let me say that I am comfortable with the notion of country ownership of national strategies coexisting with conditions set by development partners for their support of a country's strategy. We should also see better donor collaboration, with all donors basing their operations on the PRSPs.

Finally, there is bound to be a change in the research agenda. We need to fill some important gaps in our knowledge—such as generating more evidence on the links between policy actions in different sectors and their antipoverty effect and the impact of economy-wide policies on individual sectors and families. The latter research is important for developing better assessments of the effects on the relative distribution of incomes. Again, in this area, we will rely on the World Bank.

Why should we expect better results?

Why should we expect better results this time around? There are several reasons, all of which stem from the holistic nature of the strategy.

One reason for optimism is that the PRSPs will be specifically designed to ensure that macroeconomic policies are consistent with social goals. Country programs will continue to place a high value on sound, stable macroeconomic policies—low inflation, realistic and stable exchange rates, and reasonable fiscal burdens—which are critical for higher saving and investment and higher growth.

Another reason is that we have stronger evidence not only that growth is critical for poverty reduction but also that a focus on growth alone is not enough. Where poverty is endemic, it persists because the poor do not have adequate access to the benefits of growth, lacking access to basic social services, essential infrastructure, and income and employment opportunities. Poor governance also diminishes the potential impact of growth on poverty. Economic opportunities for the poor will expand only where there are improvements in

empowerment and security of the poor, and the enhanced approach puts the emphasis on government actions to enable the poor to benefit from this growth more fully.

We should also see big gains from the stress on explicit and monitorable shifts toward pro-poor, pro-growth policies in public expenditures. This should include explicit emphasis on greater accountability of public resource use, reliance on outcome indicators as an additional way of tracking efficiency of spending, and greater involvement of the poor in the design stage.

Another reason for higher expectations is the likelihood that structural reforms will actually be implemented, thanks to greater efforts to explain and build consensus, improve their sequencing, and build up institutional capacity. These reforms are vital for increasing the efficiency of the economy and attracting private investment.

Another reason for optimism is that the PRSPs, if well designed and properly implemented, should give donors better assurances that the funds will be well used. We expect that this will help to reverse the downward trend in official development assistance—for let there be no mistake, the poorest countries will continue to depend on official donor financing for some time to come. That source of financing should continue to be kept active. Moreover, the PRSPs, by providing a consistent framework for donor intervention, will help to reduce duplication of efforts and hopefully encourage donors to provide financing for the overall strategy—in turn, helping countries to plan ahead better.

Finally, we should take heart from the fact that the stronger focus on poverty includes a stronger debt-relief initiative for the heavily indebted poor countries (HIPC).

Challenges ahead

How do we help countries avoid macroeconomic problems, given the risks of large shocks? How do we weigh the trade-offs of speed versus ownership? How can we ensure donor financing is additional? Should donors finance PRSPs as a whole rather than favorite projects? How can we improve the patchy record of implementation?

These are just a few of the many questions that policymakers and donors must grapple with. For they must also contend with a host of other factors—ranging from armed conflict and environmental degradation to the devastating impact of AIDS. The challenge is almost overwhelming, but perhaps we can at least take one simple but decisive step that will truly make a difference—simulating a lightning rod to help protect the poorest and most vulnerable from major adverse external shocks. ■



Macprudential indicators can play crucial role in measuring health of financial systems

Following the severe financial crises that characterized the 1990s, identifying and assessing financial sector vulnerabilities has become a key priority of the international community. The costly disruptions in global markets underscored the need to establish a set of monitorable variables that could be used to evaluate strengths and weaknesses in financial institutions and alert authorities to impending problems. These variables—indicators of financial system health and stability—are known collectively as macroprudential indicators. They are the subject of a new IMF Occasional Paper, *Macprudential Indicators of Financial System Soundness*, by a staff team led by Owen Evans, Alfredo M. Leone, Mahinder Gill, and Paul Hilbers of the Monetary and Exchange Affairs Department and the Statistics Department.

Work on the paper was initially undertaken in preparation for an IMF consultative meeting on macroprudential indicators in September 1999. At that meeting, experts from central banks, supervisory agencies, international financial institutions, academia, and the private sector exchanged information and compared experiences on the use of macroprudential indicators. Work in this area, including the results of the meeting, was discussed by the IMF Executive Board in January 2000.

Financial Sector Assessment Program

As part of the IMF's broader surveillance work, the institution has been charged with evaluating the soundness and vulnerability of financial systems within the framework of its Article IV consultations with individual member countries. In this context, the IMF and the World Bank launched a joint program in May 1999 called the Financial Sector Assessment Program, which was designed to identify financial system strengths and weaknesses and help countries develop appropriate policy responses. The IMF uses the program to derive Financial Sector Stability Assessments that focus on the aspects of the financial system that are significant for macroeconomic performance and policies. The program seeks to identify vulnerabilities early on and develop prompt responses, thus averting costly crises. These reports are presented to the IMF's Executive Board for discussion within the context of Article IV surveillance. At the World Bank, the program becomes the basis for formulating development strategies for the financial sector.

Identification and development of a core set of indicators for evaluating financial system soundness will go a long way toward supporting the institutions in their work. International institutions, of course, are not the only agents interested in using macroprudential

indicators. Countries themselves want to improve their monitoring abilities, and the private sector is interested in internationally comparable sets of data so that evaluations can be made easily across countries. Macroprudential indicators would capture key financial information that is potentially very valuable for the markets in evaluating both national and global financial system stability.

How is soundness measured?

Macroprudential indicators that are currently being used comprise two sets of measures: one at the level of aggregated financial sectors and another at the macroeconomic level. The authors provide a breakdown of the two sets of indicators with explanations of specific variables in the following categories.

Indicators used at the micro level, taken together, are called aggregated microprudential indicators. These indicators have been developed on the basis of the CAMELS framework—an acronym representing six separate groupings for analyzing individual financial institutions. The groupings are measures of capital adequacy, asset quality, management soundness, earnings and profitability, liquidity, and sensitivity to market risk. Although not part of the CAMELS framework, a seventh group included at the aggregated micro level is market-based indicators, which provide information on such measures as the price of financial instruments and the creditworthiness ratings of institutions and corporations.

Tracking developments at the macroeconomic level is also crucial. Macroeconomic indicators assess developments that can affect the health of the financial system, measuring levels of economic growth, balance of payments, inflation, interest and exchange rates, lending and asset price booms, and potential contagion effects. The paper notes that recent empirical analysis has shown that banking crises have often been predated by particular macroeconomic developments; clearly, financial systems and institutions are affected by changes in overall economic activity.

Financial crises often occur when both aggregated microprudential indicators and macroeconomic indicators identify vulnerabilities and weaknesses in financial institutions as well as shocks to the economy. The authors point out that although macroprudential indicators are critically important quantitative measures, they make up only one part of a balanced evaluation of financial system soundness. Qualitative information also needs to be included, such as institutional circumstances, supervisory and regulatory frameworks, accounting standards, disclosure requirements, and the legal infrastructure.



What is known

The paper reviews the current knowledge about macroprudential indicators and issues related to their analysis, identification, and measurement—thus providing a reference source for national authorities and for other public and private sector users of such indicators. After examining macroprudential indicators that have been identified through IMF surveillance work, the paper reviews work done at other selected international and multilateral institutions and considers statistical issues in compiling the data and possibilities for their future dissemination. To date, research has not yet produced a consensus on a core set of indicators. The authors, however, include a comprehensive literature review of theoretical and empirical work that would support selection of a core set of macroprudential indicators.

The experiences of national central banks and supervisory agencies in several countries are recounted for a comparison of the different approaches and indicators used. Much of the existing work has been done relatively recently and for the most part, but not exclusively, in industrial countries. Knowledge of macroprudential indicators is still limited, and national authorities and policymakers need to understand the importance and usefulness of these indicators more thoroughly. Work is under way in a number of countries to develop macroprudential data collection and analysis frameworks. Besides data collection and analysis concerns, authorities will also need to work on measurement issues.

The paper examines key issues affecting statistical accuracy, usefulness, and international comparability of macroprudential indicators. Reliable statistics in assessments of the financial sector are of utmost importance; clear warnings of emerging problems cannot be obtained without timely and accurate statistics. The paper notes that if macroprudential indi-

cators were comparable across countries, their usefulness would be greatly increased. Comparability would be fostered by countries' adherence to internationally agreed prudential, accounting, and statistical standards that provide clear rules for both compiling and interpreting such measures. Standardizing these indicators would facilitate monitoring the financial systems at the national and global levels and further strengthen the international financial architecture.

Development and dissemination

Significant work lies ahead in identifying a core set of macroprudential indicators for financial system surveillance and in resolving statistical measurement issues.

The paper concludes by raising the question of whether and how to disseminate the high-quality data—after various technical problems have been resolved—to the public in timely and informative ways. As part of the effort to better understand national practices and the needs of users, the IMF has sent a survey to its member countries on the use, compilation, and dissemination of macroprudential indicators. The Occasional Paper was sent along with the survey to provide respondents with background information. Respondents, in turn, will provide the IMF with information that improves the quality and development of macroprudential indicators and enhances the ability to measure the health of financial systems at the national, regional, and global levels. ■

Helen Chin
IMF External Relations Department

Copies of IMF Occasional Paper 192, *Macroprudential Indicators of Financial System Soundness*, by a staff team led by Owen Evans, Alfredo M. Leone, Mahinder Gill, and Paul Hilbers, are available for \$18.00 each (academic rate: \$15.00) from IMF Publication Services. See page 223 for ordering information.

Available on the web (www.imf.org)

Press Releases

- 00/36: Senegal to Receive Around \$800 Million in Debt-Service Relief, June 23 (see page 220)
- 00/37: Poverty Can Be Significantly Decreased by 2015: UN-World Bank-IMF-OECD Report, June 26 (see page 209)

News Briefs

- 00/46: IMF Completes First Review of Mauritania Under PRGF-Supported Program, June 19
- 00/47: IMF Completes First Review of Senegal Under PRGF-Supported Program, June 21
- 00/48: IMF Completes Midterm Review of PRGF-Supported Program for Madagascar, June 23
- 00/49: Countries Publish More Detailed International Reserves Data on Internet, June 29 (see page 221)

Issues Briefs

- Exchange Rate Regimes in a Increasingly Integrated World Economy, June 28

Public Information Notices (PINs)

- 00/41: Kingdom of the Netherlands, June 19

- 00/42: Cameroon, June 21
- 00/43: Albania, June 23
- 00/44: F.Y.R. of Macedonia, June 23
- 00/45: Mauritania, June 27

Speeches

- Remarks by IMF Deputy Managing Director Eduardo Aninat at the Development Policy Forum, June 15 (see page 211)
- Address by IMF Deputy Managing Director Shigemitsu Sugisaki at the Oesterreichische Nationalbank Twenty-Eighth Economics Conference, June 16 (see page 215)

Letters of Intent and Memorandums of Economic and Financial Policies (date posted)

- Honduras, June 12
- Albania, June 22
- Mauritania, June 22

Concluding Remarks for Article IV Consultations

- Finland, June 12

Other

- Schedule of Public Engagements of IMF Management, June 16

Sugisaki reviews issues and reforms that have absorbed the IMF over past 15 years



On June 14, IMF Deputy Managing Director Shigemitsu Sugisaki spoke at the Oesterreichische Nationalbank Twenty-Eighth Economics Conference in Vienna, Austria, on some of the issues that have occupied the IMF during the past 15 years. Below are edited excerpts of his remarks. The full text is available on the IMF's website (www.imf.org).

Managing transition

As has been clear from the experience of the past decade, the process of transforming centrally planned socialist economies is very complex, with far-reaching changes in the political, economic, and social relations within these countries. In every case, key reform measures have included macroeconomic stabilization; price and market liberalization, including that of the exchange and trade systems; restructuring and privatization; and redefinition of the role of the state so that it provides and enforces a level playing field and corrects market imperfections.

The IMF—along with the World Bank and other national and international agencies—has been heavily involved in assisting with the transformation of centrally planned economies. All of our efforts have centered around achieving and consolidating macroeconomic stabilization and accelerating structural reform. IMF efforts, along with those of the World Bank, have in many respects broken new ground in advising on why structural reforms were essential and how they could be carried out. Our technical assistance program has played a key role in helping the

authorities adapt their monetary, exchange rate, fiscal, and statistical systems to the requirements of a market economy. The training of officials and the provision of technical assistance have also made important contributions to institution building.

The key lesson we have learned is that financial stabilization is necessary for growth, but comprehensive progress on all fronts of a broad structural reform agenda is indispensable for sustained growth. The most successful transition economies are those that have undertaken more and faster reform.

There are also areas where we have faced considerable challenges.

For example, while privatization is a key element in the reform process, both the absence of hard budget constraints and the existence of insider privatization have posed obstacles to self-induced restructuring. Similarly, poor governance—ranging from insufficient government pullback from economic intervention to inadequate law and order—has often delayed and even impeded reform by discouraging foreign investment and encouraging the flight of capital.

What is the agenda ahead? Most Central European and Baltic countries, whose reform process is very advanced, face issues similar to those of many middle-income market economies. There are, for example, the challenges of joining the European Union, a strong recovery running ahead of itself, possible reversals of capital inflows, efficient inter-mediation by the financial sector, and rationalization of expensive social programs.

For other countries in the former Soviet Union now in varied stages of recovery, the agenda ahead remains quite large. In particular, there is a need to consolidate macrostabilization, push ahead with key structural reforms, provide for an effective rule of law and fair tax and regulatory systems, strengthen the financial system so that it conforms to internationally accepted codes and standards, and improve governance. Too many resources continue to be devoted to unproductive expenditure, and corruption is at unacceptably high levels. Finally, a handful of countries in the region have scarcely begun reform; they are in danger of backsliding.

“Comprehensive progress on all fronts of a broad structural reform agenda is indispensable for sustained growth.”

– Sugisaki

Reforms in policymaking and at the IMF

The IMF is a cooperative institution of 182 members. On an ongoing basis, our membership sets priorities for the institution, and the IMF adapts its policies and operations to reflect these conclusions. The recent debate outside the IMF has been matched in intensity by the debate and actions within the IMF about reforms in economic policymaking and reforms within the IMF itself.

For the work of the IMF, surveillance—policy dialogue with the authorities of each country and the implications of these policies for the international financial system—remains at the core of IMF operations. This core activity has been transformed significantly since the Asian crisis. The focus now is on new sets of codes and standards—relating to financial sector soundness; transparency in fiscal, monetary, and financial policies; data provision; and corporate governance—to guide the conduct of economic policy in a variety of areas. This emphasis, which is supported by a significant amount of technical assistance, increases policymaking accountability and allows for better-informed lending and investment decisions. In particular, the IMF, together with the World Bank, has embarked on an ambitious Financial Sector Assessment Program to assess financial sector vulnerabilities as well as observance of financial system standards. These new directions for the IMF also pose new challenges in cooperating with other standard-setting bodies that possess substantial expertise in developing assessment methodologies, refining standards, and conducting assessments.

In recent times, there has also been much discussion about the virtues and pitfalls of pegged exchange rates. Experience shows that getting the exchange rate right is an essential element of a sound macro package. It is also clear that the macroeconomic and structural policy requirements of maintaining a pegged rate are demanding, particularly in an environment of increased capital mobility. At the same time, a number of economies with fixed exchange rate arrangements, including under currency boards, have successfully maintained exchange rate parities. All in all, experience has shown that countries that have maintained consistent monetary and exchange rate policies and have supported liberalization with financial sector reform have been better able to handle capital inflows and their subsequent reversals.

The Asian crisis also aroused a spirited debate over capital account liberalization. The IMF has emphasized an orderly and well-sequenced liberalization process, supported by an adequate institutional setup to strengthen the ability of financial intermediaries and other market participants to manage risk. Intro-

ducing or tightening capital controls is not an effective means to deal with fundamental economic imbalances. Any temporary breathing space such measures provide has to be used wisely and needs to be weighed against the long-term damage to investor confidence and the distorting effects on resource allocation.

Role of private sector

This brings me to the role of the private sector in crisis prevention and in a crisis. Private capital markets are the engines of growth around the world. Good business practices on the part of the country and the lender mean the implementation of sound policies and good risk appraisal, respectively. There is thus a need for cooperation—or constructive engagement—among borrowing countries, the private sector, and the official sector to develop broad rules that would apply in a crisis and are—and are perceived to be—fair to both creditors and countries.

Data provision

An essential element of the reform of the international financial system is the provision of comprehensive, timely, high-quality, and accurate information to the markets. The IMF releases a vast array of information to the public, such as its assessment of countries' economic policies. In addition, countries borrowing from the IMF are encouraged to release to the public their policy commitments under the program. Transparency on the part of the IMF itself can also contribute to a better understanding of policies of member countries. Here, too, important progress has been made. Regular internal and external evaluations of IMF operations are also released to the public, providing another assessment of our work.

Over time, the IMF's financial operations have been adapted to the changing economic environment. In the period ahead, we will review whether our current facilities fully meet the needs of our members. In this review, we will be guided by a number of underlying principles, including preserving the IMF's ability to provide and catalyze support for individual countries, retaining the IMF's ability to respond quickly and effectively to short-term balance of payments problems; continuing to support reforms that deal with structural problems closely related to the IMF's area of expertise; and being in a position to respond rapidly and on an appropriate scale to crises of confidence in the capital markets. Clearly, the long-run goal must be to discourage undue reliance on the use of IMF resources and encourage countries to move toward sustainable access to, and reliance upon, private capital. ■

Tax challenges facing developing countries

(Continued from front page) effective, tax system is not very different from the nominal, statutory one. The laws are broadly applied as they are intended to be applied. In developing countries, tax laws are passed, but the application is often very different.

ZEE: The differences are not independent of each other. To a large extent, the differences in the level of sophistication of tax administration in developing countries influence the way these countries raise revenue.

TANZI: Also, industrial country taxes are broadly mass taxes. In developing countries, the number of taxpayers is much smaller, because the distribution of income is much less even and the administration is not as good. So, the focus is on fewer individuals and fewer corporations.

IMF SURVEY: How critical is the level, as opposed to the composition, of taxation?

TANZI: The level is very important for determining what a government can finance. Governments have certain basic needs, such as building roads, providing schools, and hiring soldiers and police. The structure is important for determining the incidence—who pays the taxes, how fair the tax system is, and so on. But the two are, of course, related.

IMF SURVEY: What would you counsel a developing country to do if it wanted to attract different types of investment? What is the role of tax incentives in advancing economic development?

TANZI: This is a hot topic. The general view is that tax incentives are pretty useless and that the best incentives are low tax rates and a broad base. A tax system that is well designed, fairly enforced, and well administered is really the best incentive because investors want certainty; they don't want too many changes.

Yet, for a variety of reasons, governments in some countries cannot face the idea of leaving allocation to the market. They want to play an active role, and sometimes this active role is an honest role. They truly believe they can influence investment decisions in a certain way. But incentives lend themselves to corruption. They are rarely totally objective. Somebody somewhere in the government has to make the decisions. Visualize a situation where a multinational corporation wants to invest millions of dollars in a country and is negotiating with a person making \$200–\$300 a month. You can see the possibilities for corruption. Sometimes tax incentives are given to favor friends or people of your party or religion, and sometimes they are given for defensive reasons. If I am a U.S. company and I want to invest in Central

America, I can invest in any country. So I go to Costa Rica and say “Look, I want to invest this, but I'm indifferent between you and Nicaragua and Guatemala. If you give me a tax incentive, I'll come here.” There are some quite prominent economists who still argue that tax incentives are a good thing. But they often do not take fully into account all the problems that arise when you try to make these incentives operational.

ZEE: I find that no matter how many times we advise developing countries that they will run into problems if they use tax incentives, they respond that all the countries in the region have incentives, so why shouldn't they? If they abandon them, all the investments will go to their neighbors. This problem requires a multilateral approach. Advising one country to abandon tax incentives will not be persuasive. You have to take at least a regional approach. Countries in a particular region have to agree to some sort of a policy. One country will not implement a policy that other countries in the same region do not follow. Also, some incentives are much better than others, and countries should focus on those that stand a better chance of being effective.

IMF SURVEY: What are the special issues developing countries must address in expanding their tax bases?

TANZI: If you think of the income tax as being corporate and personal, the corporate income tax is about the same in industrial and developing countries, but the personal income tax has been a tremendous failure in most developing countries. Not too many developing countries collect more than 2 percent of GDP from the personal income tax, compared with 11 percent or more in industrial countries. There are several reasons for this tremendous difference. First, rich people are more powerful in developing countries than in industrial countries, and they don't pay anything. Second, there are few large establishments where you can control the income that people earn, and there is a large informal economy. The informal sector, which accounts for 50–60 percent of the workforce, is difficult to tax. Administration is not very good, so governments often end up taxing public employees and the employees of large, especially foreign, corporations. These are the ones who contribute the most, with the result that much of the revenue from the personal income tax comes from wages and salaries and not from dividends or interest or profit. The number of taxpayers is relatively small, especially those who are subject to high marginal tax rates.

IMF SURVEY: Related to this, how does a country develop a tax culture—a sense of obligation, civic duty, an understanding of why they pay taxes?



Vito Tanzi

“The personal income tax has been a tremendous failure in most developing countries.”

– Tanzi



Howell Zee

“Five to ten years down the road, these developing countries will probably face the same tax policy challenges as the industrial countries.”

– Zee

TANZI: A combination of factors would go into this. First, the government has to convince the people that government expenditure is productive and equitable, that there’s no corruption, and so forth. If people begin to feel that what they pay the government is wasted or ends up in somebody’s pocket, then the attitude toward taxes is not very good. Second, the tax system must be transparent, clear, and simple. Very often, tax systems are complex: people don’t understand them. Third, there is no culture of teaching taxpayers their obligations. Sometimes parliament passes a law, and that’s the end of it. There’s no attempt to explain the laws in simple terms. Along the same lines, services to the taxpayers are limited. In a country where the system works well, taxpayers can expect to get their questions answered quickly, get the forms they need, and make tax payments quickly and efficiently. In some developing countries, forms are often not available, questions cannot be answered, and taxpayers making payments have to stand in line for three days. This makes compliance costs extremely high. Finally, the administration must identify the taxpayers accurately and make sure they can follow simple rules. Penalties have to be reasonable, and they have to be applied. All these things help create an efficient tax system.

IMF SURVEY: How does a developing country with limited resources strengthen its tax administration?

TANZI: We do a lot of work in many countries in this area. Sometimes, it feels like we are standing beside a lake and throwing a stone in the water. That causes a lot of movement initially, but a few minutes later, everything goes back to the way it was. Our mission team goes to a country, works very hard, writes a report, and advises people. The mission leaves, and everything goes back to normal.

Tax administration requires, first, a clear strategy. You cannot identify 100 different things that need to be done and go after all of them at once. Normally, there are two or three things that need to be done first. Sometimes we recommend what we call a large taxpayer unit to identify the largest 100 or 500 taxpayers in a country and develop techniques and programs to relate to them exclusively. Once this runs smoothly, the number of taxpayers can be expanded. Tax administration is one of the essential fiscal institutions for a country. If it doesn’t work, you can pass the best laws in the world, and they will not amount to much.

The level of wages is also very important. In many countries, wages are so ridiculously low that they are an invitation to corruption. The choice of tax administrators is also important too. Those who are chosen must have a good technical preparation, but there must be some indication that they are honest.

Another issue is whether the administration organizes its procedures by tax or by function. We have

discovered that organization by function—assessment, collection, audit—is much more effective than organization by tax.

In some developing countries, every tax involves direct contact between taxpayers and tax administrators, and assessments are discretionary. The more opportunities there are for contact between the two, the more likely it is that they will establish a relationship, and corruption will develop. Thus, distance between taxpayers and tax administrators is very important.

ZEE: Many developing countries are using scarce administrative resources to perform tax assessments for taxpayers during the filing phase and not enough for the audit and enforcement functions in the post-filing phase. It isn’t possible for a country to have complete control over taxpayers. There are too many of them. Many countries have moved to a self-assessment system followed by a profiling according to compliance risks. In this way, an effective audit strategy can be developed.

TANZI: Without self-assessment, you cannot have mass taxation. You will be limited to relatively few individuals and enterprises. It is better to shift much of the work from the tax administration to the taxpayers.

IMF SURVEY: What do you see as the key tax priorities for developing countries in the near term?

TANZI: The first priority would be to tax personal income more effectively, because income distribution is getting worse in the majority of developing countries. A major tax in the developing world is the value-added tax, and in many countries it needs adjustment—widening the base and, in some cases, not having multiple rates. I would also emphasize pruning the tax system. Over time, most tax systems develop unproductive branches. Often, these taxes remain on the books and cause confusion. I’ve always argued that one objective of tax systems should be to reduce the number of taxes to five, six, or seven. Another goal might be to get rid of foreign trade taxes or at least reduce the reliance on them.

ZEE: Also, five to ten years down the road, these developing countries will probably face the same tax policy challenges as the industrial countries. Developing countries would be well advised to look ahead and anticipate those problems—for example, in taxing financial capital because capital can move very easily.

IMF SURVEY: Are the needs of transition countries different from those of both developing and developed countries?

TANZI: The transition countries started the transition without having either a true tax system or a true tax administration. The arrangements that existed during the centrally planned period were very different from those of a market economy. Between industrial and

developing countries, the differences are in the details and the quality of what is being done, but they are not fundamental. Between industrial countries and transition economies, there are enormous differences. The transition countries had to create a tax system and a tax administration without having the personnel, a taxpaying tradition, or accounting and legal skills. They had computer skills and could introduce computers very quickly, but they didn't know what to do with them.

They had to do all these things while maintaining a level of taxation that is very high for the level of per capita income. Generally, rich countries tax more than poor countries. Most of the transition economies are relatively poor, but they started transition with a very high tax burden—sometimes 50 percent—that really could not be maintained. Taxpayers in these economies didn't know what a tax was: they had never paid taxes. All the taxes had been transfers from state enterprises to the government.

It's also difficult to convince policymakers that they should not have tax incentives. The tremendous proliferation of tax incentives has been one of the big fights in these countries. For example, when Hungary, one of the most successful countries, went into the transition, they wanted to give preference to writers and athletes. They held the view that some people were more deserving than others, regardless of the level of income.

IMF SURVEY: What are the implications of globalization for tax policy?

TANZI: My view at the moment—which may not be totally shared by my colleagues—is that globalization will, over time, create problems in terms of tax revenues, especially for the high-tax industrial countries like Sweden, Denmark, and Canada. We know the direction of the problem, but we don't yet know the magnitude. They will have difficulty maintaining the high level of taxation for a number of reasons, which are becoming more and more important: electronic commerce, use of hedge funds, offshore centers, travelers buying goods where they are cheapest and where tax rates are lowest, and tax-haven countries that impose very low or no taxes on imports of capital so that capital is channeled through them. In developing countries, the impact of globalization is far less certain. I've worked in Latin America, and many times I've told countries to tax interest income, dividends, and so forth, and they tell me they cannot because, if they do, the money they have will move to Miami. Overall, I would guess that the impact of globalization on industrial countries, especially on the welfare states, will be larger in absolute numbers than in the others. ■

Copies of IMF Working Paper 00/35, *Tax Policy for Emerging Markets: Developing Countries*, by Vito Tanzi and Howell H. Zee, are available for \$10.00 each from IMF Publication Services. See page 223 for ordering information.

Issues Briefs offer topical analyses of economic issues for nonspecialists

The IMF inaugurated a series of Issues Briefs in April 2000 to provide succinct surveys of current economic policy issues for nonspecialist readers. The series is designed primarily to make background material available and to facilitate debate on issues of topical interest, especially subjects that are under active review in the IMF.

The IMF's emphasis on transparency in recent years has resulted in a very large volume of information now being made available to the public about IMF activities. Issues Briefs help interested readers, who may not otherwise be familiar with the IMF or its operations, to interpret this information. They are relatively concise, non-technical presentations of the many policy issues that confront the international economic and financial community.

The Issues Briefs are intended to be of interest to the general public, journalists, students—in fact, to anyone who wants to understand how the IMF is addressing current issues. All audiences, whether supportive or critical of the IMF, should find them informative and accessible.

The first six titles in the series, which are being produced in English, French, German, Russian, and Spanish, are:

- *Globalization: Threat or Opportunity?*, April 2000
- *IMF Reform: Change and Continuity*, April 2000
- *Debt Relief, Globalization, and IMF Reform: Some Questions and Answers*, April 2000
- *The IMF and Environmental Issues*, April 2000
- *Recovery from the Asian Crisis and the Role of the IMF*, June 2000
- *Exchange Rate Regimes in an Increasingly Integrated World Economy*, June 2000

It is anticipated that, by the time of the Annual Meetings in Prague in September, about one dozen Issues Briefs will be available.

Issues Briefs are available on the IMF's external website at www.imf.org/issuesbriefs, and in hard copy (free of cost) from the Public Affairs Division of the IMF External Relations Department (telephone: (202) 623-7300; fax: (202) 623-6278). Interested readers are welcome to sign up on the website for e-mail notification of future Issues Briefs. ■

Senegal to receive \$800 million in debt-service relief

Senegal has made substantial progress in implementing an economic reform program.

In a press release dated June 23, the IMF and the World Bank Group's International Development Association (IDA) announced that they had agreed to support a comprehensive debt-reduction package for Senegal under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. The full text of Press Release No. 00/36 is available on the IMF's website (www.imf.org).

Total relief from all of Senegal's creditors is worth about \$800 million. This is equivalent to about \$450 million in net present value terms, or approximately 18 percent of the total net present value of debt outstanding after the full use of traditional debt-relief mechanisms. IDA will start providing interim debt relief on July 1, 2000. The IMF will begin providing interim relief once satisfactory assurances have been obtained from Senegal's other creditors.

Senegal will reach its completion point under the initiative and receive the remainder of its debt relief from all creditors once it has fulfilled a number of steps designed to strengthen and broaden economic growth and reduce poverty. The Senegalese authorities will outline these measures in a poverty reduction strategy paper, drafted in consultation with a broad cross section of local civil society and the support of international partners. Country authorities estimate this will be completed by the end of 2001.

Background

Senegal was first considered for debt relief under the original HIPC Initiative framework in early 1998, but it was determined at the time that other sources of debt relief (that is, a 67 percent reduction of eligible bilateral debt in the Paris Club of bilateral creditors) were sufficient for Senegal to attain a sustainable debt position as defined under the terms of the original HIPC Initiative framework. In September 1999, the international community endorsed major enhancements to the initiative designed to deliver deeper, broader, and faster relief, which lowered the qualifying threshold. (Countries are now eligible for assistance if the net present value of external debt exceeds either 150 percent of exports or 250 percent of fiscal revenue.) Under this enhanced framework, Senegal qualifies under both criteria.

The debt relief provided by IDA of \$149 million (\$116 in net present value terms) will cover 50 percent of Senegal's debt-service obligations to IDA in each of the next nine years. The debt relief committed by the IMF of \$51 million (\$42 million in net present value terms) will be delivered over a seven-year period and will cover, on average, 20 percent of debt-service obligations to the IMF.

Senegal's eligibility for debt relief under the enhanced HIPC Initiative is a recognition by the international community of the progress the country has made in implementing economic reforms and developing its poverty reduction strategy. Assistance provided under the enhanced initiative will help Senegal advance its poverty reduction programs and stimulate widely shared and sustainable economic development.

Track record

Senegal has made substantial progress in implementing an economic reform program. Supported by successive IMF Enhanced Structural Adjustment Facility arrangements and an IDA lending program, Senegal has sustained balanced growth, improved its external balance, and consolidated public finances with encouraging results. Over the past four years, average real GDP growth exceeded 5 percent, while annual inflation remained below 3 percent. There has also been a steady improvement in the government's fiscal position. Since 1995, after several years of deficit, the basic fiscal balance showed surpluses that remained above 1.5 percent of GDP between 1996 and 1999. Senegal has also made a strong structural adjustment effort in recent years, including far-reaching reforms in the external, commercial, and public sectors.

Senegal has pursued a comprehensive poverty reduction program, developed in collaboration with local civil society and support from international donors. This program, which has been integrated into an interim poverty reduction strategy, has been focusing on gathering critical poverty data necessary for improving the availability and quality of social infrastructure in poor communities, especially basic health care and primary education, and increasing the access of rural communities to basic agricultural services, such as credit, potable water, and appropriate technologies.

Steps to be taken before completion point

The full assistance from the IMF and IDA will be delivered to Senegal when it has been determined that the following conditions have been met as part of an overall satisfactory pace of progress in poverty reduction:

- Completion of a poverty reduction strategy paper through a participatory process, which needs to be broadly endorsed by the Executive Boards of the IMF and the World Bank.
- Maintenance of a stable macroeconomic environment, as evidenced by satisfactory performance under a program supported by an arrangement under the IMF's Poverty Reduction and Growth Facility, and

specific structural reform measures as part of the policy dialogue with IDA.

- Implementation of a set of other measures specifically related to poverty reduction, including improvements in the poverty database and monitoring capacity; implementation of the IDA-supported Quality Education for All program, including increased allocation of the education budget to primary education and the recruitment of teachers; and continued implementation of health sector reforms, with a focus on increasing child immunization rates,

expanding the provision of prenatal care to pregnant women, and increasing utilization of primary health care centers.

- Confirmation of the participation of other creditors in the debt-relief operation. ■

For more information on the HIPC Initiative, visit these pages on the IMF and the World Bank websites:
<http://www.imf.org/external/np/hipc/hipc.htm>
<http://www.worldbank.org/hipc/>.

Data disclosure

Countries publish more detailed international reserves data on Internet

In a news brief, the IMF announced that as of June 29, 2000, 41 of the 47 subscribers to the Special Data Dissemination Standard (SDDS) are publishing data on international reserves and foreign currency liquidity according to an internationally agreed template. The information, which is available on the websites of the countries' central banks or finance ministries, provides comprehensive and timely data on these subscribers' international reserves and related obligations. In addition, one country that does not subscribe to the SDDS also publishes data according to the template. The countries' sites are hyperlinked to the IMF's Dissemination Standards Bulletin Board (DSBB), which is accessible to the public on the IMF's external website at <http://dsbb.imf.org>.

The template on international reserves and foreign currency liquidity was developed jointly by the IMF and a working group of the Committee on the Global Financial System of the Group of Ten central banks. The template provides for improved disclosure of countries' data on international reserves and related items.

Reserves template

The template calls for data that cover both the monetary authorities and the central government. It provides for data on the authorities' liquid foreign currency resources (encompassing official reserve assets and other foreign currency assets); their short-term foreign currency obligations (including those arising from foreign currency liabilities, financial derivative positions, and other obligations and commitments); and their short-term contingent foreign currency liabilities. Detailed supplementary information appears in most subscribers' templates under the rubric of memorandum items. The subscribers disseminate their template data at least once a month, with a lag of no more than one month.

The IMF Executive Board decided in March 1999 to make this template part of the SDDS, with a transition period to run through March 31, 2000 (see Public Information Notice No. 99/25, March 26, 1999). The SDDS, established by the IMF in 1996, specifies good practices in the dissemination of economic and financial data. Countries subscribe to the SDDS on a voluntary basis.

The text of News Brief 00/49, including the list of websites of participating subscribers, is available on the IMF's website (www.imf.org).

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
June 19	4.36	4.36	5.05
June 26	4.39	4.39	5.09

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 (as of May 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (115.9 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 website (www.imf.org/external/np/tre/sdr/sdr.htm).

Data: IMF Treasurer's Department

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Financial consultant calls for better regulation, improved standards for offshore centers



Andrew Edwards

Offshore financial centers provide financial services primarily to nonresidents. Some are seen as offering low taxation, light financial regulation, and banking secrecy. In April 1999, the Financial Stability Forum (see box, page 224) asked a working group to consider the implications of offshore financial centers for global financial stability and to make recommendations for addressing any concerns. The report of the Working Group on Offshore Financial Centers was publicly released on April 5, 2000, and on May 26, the Forum released a list of offshore financial centers, in three broad groups, designed to set priorities for assessments.

Speaking at a seminar arranged by the IMF's Monetary and Exchange Affairs Department on June 19, Andrew Edwards, a consultant on financial and governance issues, discussed the Forum's initiative for offshore financial centers, the implications of the initiative for the IMF, and the best way to carry the initiative forward. Edwards, previously a senior official in the U.K. Treasury, has had firsthand experience with assessment of offshore financial centers, having been commissioned by the U.K. Home Secretary to conduct a review of the regulation of the international financial centers in the three crown dependencies—Jersey, Guernsey, and the Isle of Man. Edwards's report was published in November 1998. Although the review was met initially with resistance from the concerned centers, Edwards said the overall results were positive.

"Offshore financial centers do have the right to exist," Edwards said, and to do business like everyone else. But, he added, they do not have the right to break every rule, commit economic crime, or "rock the good ship of international stability." Our job, he said, is to make sure these centers play fair and straight. For this reason, Edwards said, he was encouraged by the Forum's willingness to "grasp the nettle" of offshore financial center regulation.

Forum initiative

While noting that offshore financial centers have not played a major role in creating systemic financial

problems, the Forum's report nevertheless cautions that these centers have featured in some crises, and, as national financial systems grow more interdependent, future problems in offshore financial centers could have consequences for other financial centers.

Offshore financial activities, however, need not be a disruptive element that threatens global financial stability, the report points out, provided they are well supervised and the supervisory authorities cooperate, as is the case for some offshore centers. At the same time, offshore financial centers that are unable or unwilling to adhere to internationally accepted standards for supervision, cooperation, and information sharing do create a potential systemic threat to global financial stability. Such centers, the report suggests, are weak links in an increasingly integrated international financial system.

To address the concerns posed by some offshore financial centers, the report recommended a framework to encourage these jurisdictions to adhere to relevant international standards. The framework identifies priority standards for offshore financial centers and recommends that the IMF take responsibility for developing, organizing, and carrying out a process for assessing the centers' adherence to these standards.

The Working Group on Offshore Financial Centers began by conducting a survey of banking, insurance, and securities supervisors in both onshore and offshore jurisdictions to obtain information on the quality of supervision and the degree of cooperation in jurisdictions with significant offshore financial activities. The purpose of the survey was to help set priorities for the standards assessment process recommended by the working group in its report. Based on the survey, the jurisdictions were arranged into three "merit categories" reflecting their perceived quality of supervision and degree of cooperation. The findings of this survey were released to the public—a decision that Edwards said was "constructive." There has to be some form of accreditation, he said, and the public ranking of jurisdictions is a good start.

Edwards was also encouraged by the Forum's recommendation that the IMF take the lead in carrying out the initiative. An international agency is needed to monitor and direct the accreditation process, Edwards said, to allow us to move beyond the "imposition of standards and sanctions by major countries that take the law into their own hands through special penalty taxes or scrutiny of the financial activities of private citizens." The IMF, with its expertise in the area of

IMF Board to discuss Forum proposal

The IMF Executive Board was asked by the International Monetary and Financial Committee in April to assess the relevant recommendations of the Financial Stability Forum; and the Board will shortly discuss the Forum's recommendation that the IMF take on assessments of offshore financial centers.

financial markets and its near-universal membership, is well suited to such a task, he said.

Remaining challenges

Despite these encouraging first steps taken by the Forum, Edwards voiced several concerns about the ability of the initiative to succeed. For one thing, international standards are not yet well defined, even for financial institutions and markets. For example, there is little guidance on the ability of local centers to service or regulate particular activities; the conduct of business in all sectors; reinsurance and the solvency of insurance operations; regulation of conglomerates; and division of responsibilities and relations between home and host supervisors outside the banking industry.

In addition, there are gaps in international standards, and thus no guidance for company registrations, trusts, and providers of financial, company, and trust services, which, Edwards said, made them vehicles for “appalling abuse” by trustees and those setting up trusts. International standards for dealing with conflicts of interest are lacking: Are regulators independent of the politicians? Is the judiciary indepen-

dent? Prosecution and judicial frameworks are as important as proper regulation, Edwards said, but many centers lack such frameworks. Another major lacuna in international standards is the absence of an effective mechanism to combat economic crime. The Financial Action Task Force, which was established in July 1989 to prevent banking systems and financial institutions from laundering the proceeds of criminal activities, does some work in this area, Edwards said, but it is by no means comprehensive.

A further concern is that even if an offshore financial center nominally observes all international standards, it might still be carrying out risky activities; for example, Edwards said, a center may have adequate banking supervision, but “an appalling record in company registrations, trusts, and international cooperation on economic crime, including tax evasion.”

Role of IMF

The Forum has urged the IMF to lead the effort to assess offshore financial centers’ adherence to international standards. But this task raises several questions, Edwards noted, including how the IMF will approach

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00/74: Albania: Staff Report for the 2000 Article IV Consultation (Pilot Project)

00/76: Former Yugoslav Republic of Macedonia: Staff Report for the 2000 Article IV Consultation (Pilot Project)

Other

IMF Committee on Balance of Payments: *Annual Report 1999* (free)

The prices for the following publications have been increased, effective June 21, 2000:

World Economic Outlook (from May 2000), \$42.00 (academic rate: \$35.00)

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Edwards: "Publication is the most powerful weapon of all to make bad centers good."

the task and what the assessments will cover. The Forum report suggests that the priority for assessment be placed on those offshore centers where procedures for supervision and cooperation are in place but where there is substantial room for improvement. The report also suggests a five-stage review process involving public commitment by the center to observe standards; self-assessment, assisted by an external monitor; technical assistance; external assessment; and monitoring. This process, Edwards said, is a good starting point, but the deficiencies and lacunae in international standards are a serious problem. It would be harmful, he said, to give centers a high rating if they satisfied certain standards but fell short in the important ones, such as conflict of interest, economic crime, tax competition and secrecy, and prosecution and judicial frameworks.

Edwards suggested that the best way to proceed is to associate the offshore financial centers with the review process from the beginning—for instance, by setting up a forum for periodic discussion with the centers to counter protests about imposition of standards from above or outside. The IMF is particularly suited to convene such a forum, Edwards said.

Another important component of the review process is division of labor; reviews should be treated as joint efforts with center authorities. Drawing on his experience with the Channel Islands, Edwards said it was of the utmost importance that the review process involve no surprises. It should be completely transparent, and the steps to be followed set out in the early stages of the process.

It is essential, Edwards said, that the assessment results be published: "publication is the most powerful weapon of all to make bad centers good." Friendly, private negotiations between the center authorities and the IMF will not work, Edwards cautioned; offshore financial centers have to believe that the world will

go after them if they do not improve. It is thus also essential that sanctions be imposed. These sanctions could take the form of agreement by major countries to take discriminatory action against noncompliant centers, especially in the tax field, but also in financial areas such as market access, capital requirements, and special permission. The odium for the sanctions, however, would not fall on the IMF, whose function remains to make the assessment and publish the results, Edwards said.

In addition to directing the review process, Edwards said, the IMF should encourage efforts to fill in the remaining gaps and correct the deficiencies in international standards mentioned earlier. In some of these areas, such as economic crime and tax issues, the IMF should keep in close touch with other agencies pursuing similar agendas, such as the Financial Action Task Force and the Organization for Economic Cooperation and Development.

Finally, Edwards said, in time, the review process could be generalized, extending to all financial centers and further protecting the international financial system against instability and disruption. ■

Financial Stability Forum

The Financial Stability Forum was convened in April 1999, under the chairmanship of Andrew Crockett, general manager of the Bank for International Settlements. The result of an initiative of the finance ministers and central bank governors of the Group of Seven industrial countries, the Forum's mission is to promote international financial stability through the exchange of information and through international cooperation in financial supervision and surveillance.

The Forum brings together on a regular basis national

authorities responsible for financial stability in significant international financial centers and institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The Forum seeks to coordinate the efforts of these various bodies to promote international financial stability, improve the functioning of markets, and reduce systemic risk.

The report of the Working Group on Offshore Financial Centers is available on the Forum's website: <http://www.fsforum.org/>.