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Contents

IMF Adopts Guidelines Regarding Governance Issues

[Cam]dessus: "Good governance" is important for countries at [all st]ages of development.

On August 4, the IMF announced that its Executive Board had adopted guidelines covering the role of the IMF in issues of governance. The IMF has long provided advice and technical assistance that has helped foster good governance, including by promoting public sector transparency and accountability. Traditionally, the IMF's main focus has been to encourage countries to correct macroeconomic imbalances, reduce inflation, and undertake key trade, exchange, and other market reforms needed to improve efficiency and support sustained economic growth. As IMF Managing Director Michel Camdessus noted in remarks last month to the Economic Club of New York, "this is still our first order of business in all our member countries. But, increasingly, we find that a much broader range of institutional reforms is needed if countries are to establish and maintain private sector confidence, and thereby lay the basis for sustained growth"; and "every country that hopes to maintain market confidence must come to terms with the issues associated with good governance."

Reflecting the increased significance the membership of the IMF places on this matter, the declaration "Partnership for Sustainable Growth" that was adopted by the IMF's Interim Committee at its September 1996 meeting in Washington identified "promoting good governance in all its aspects, including ensuring the rule of law, improving the efficiency and accountability of the public sector, *(Please turn to the following page)*

IMF Completes Internal Review of ESAF

The following article—which is based on News Brief No. 97/14, dated July 28—reviews the highlights of a recently concluded internal IMF staff study of the IMF's concessional financing facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF). The full study will be published in the near future.

The IMF's ESAF and its precursor, the Structural Adjustment Facility (SAF), have been supporting adjustment and reform programs in many of the IMF's low-income developing countries for more than ten years. In March 1993, on the basis of a review prepared by the staff, the Executive Board discussed the experience of 19 countries through mid-1992 and concluded that the experience under SAF/ESAF-supported programs had been generally favorable. The current study, completed in June of this year, reviews the experience of 36 countries that had availed themselves of SAF and ESAF financing in support of 68 multiyear reform programs approved prior to December 31, 1994.

This internal review will be complemented by an external evaluation of the ESAF now under way and scheduled to be completed later this year. The external evaluators will use a case-study approach to examine in detail developments in countries' external positions, social policies and the composition of government spending, and the determinants and influence of differing degrees of national ownership *(Continued on page 248)*

and tackling corruption" as an essential element of a framework within which economies can prosper. The IMF's Executive Board has since met a number of times to develop guidance for the IMF regarding governance issues.

The Guidance Note below reflects the strong consensus among Executive Directors on the importance of good governance for economic efficiency and growth. The IMF's role in these issues has been evolving pragmatically as more is learned about the contribution that greater attention to governance issues can make to macroeconomic stability and sustainable growth. In discussing the governance guidelines, Executive Directors were strongly supportive of the role the IMF has been playing in this area in recent years. At the same time, they emphasized that the IMF's involvement in governance should be limited to its economic aspects.

IMF staff involvement is more likely to be successful when it strengthens national efforts to improve governance.

Following is the full text of the governance Guidance Note:

Introduction

1. Reflecting the increased significance that member countries attach to the promotion of good governance, on January 15, 1997, the Executive Board held a preliminary discussion on the role of the IMF in governance issues, followed by a discussion on May 14, 1997, on guidance to the staff. The discussions revealed a strong consensus among Executive Directors on the importance of good governance for economic efficiency and growth. It was observed that the IMF's role in these issues had been evolving pragmatically as more was learned about the contribution that greater attention to governance issues could make to macroeconomic stability and sustainable growth in member countries. Directors were strongly supportive of the role the IMF has been playing in this area in recent years through its policy advice and technical assistance.

2. The IMF contributes to promoting good governance in member countries through different channels. First, in its policy advice, the IMF has assisted its member countries in creating systems that limit the scope for ad hoc decision making, for rent seeking, and for undesirable preferential treatment of individuals or organizations. To this end, the IMF has encouraged, among other things, liberalization of the exchange, trade, and price systems, and the elimination of direct credit allocation. Second, IMF technical assistance has helped member countries in enhancing their capacity to design and implement economic policies, in building effective policymaking institutions, and in improving public sector accountability. Third, the IMF has promoted transparency in financial transactions in the government budget, central bank, and the public sector more generally, and has provided assistance to improve accounting, auditing, and statistical systems. In all these ways, the IMF has helped countries to improve governance, to limit the opportunity for corruption, and to increase the likelihood of exposing instances of poor governance. In addition, the IMF has addressed specific issues of poor governance, including corruption, when they have been judged to have a significant macroeconomic impact.

3. Building on the IMF's past experience in dealing with governance issues and taking into account the two Executive Board discussions, the following guidelines seek to provide greater attention to IMF involvement in governance issues, in particular through:

- a more comprehensive treatment in the context of both Article IV consultations and IMF-supported programs of those governance issues that are within the IMF's mandate and expertise;
- a more proactive approach in advocating policies and the development of institutions and administrative systems that aim to eliminate the opportunity for rent seeking, corruption, and fraudulent activity;
- an evenhanded treatment of governance issues in all member countries; and
- enhanced collaboration with other multilateral institutions, in particular the World Bank, to make better use of complementary areas of expertise.

Guidance for IMF Involvement

Responsibility for Good Governance

4. The responsibility for governance issues lies first and foremost with the national authorities. The staff should, wherever possible, build on the national authorities' own willingness and commitment to address governance issues, recognizing that staff involvement is more likely to be successful when it strengthens the hands of those in the government seeking to improve governance. However, there may be instances in which the authorities are not actively addressing governance issues of relevance to the IMF. In such circumstances, the staff should raise specific concerns in this regard with the authorities and point

Correction

The map of China that appeared in the July 21 issue of the *IMF Survey* (page 219) inadvertently omitted Taiwan Province of China.

out the economic consequences of not addressing these issues.

Aspects of Governance of Relevance to the IMF

5. Many governance issues are integral to the IMF's normal activities. The IMF is primarily concerned with macroeconomic stability, external viability, and orderly economic growth in member countries. Therefore, the IMF's involvement in governance should be limited to economic aspects of governance. The contribution that the IMF can make to good governance (including the avoidance of corrupt practices) through its policy advice and, where relevant, technical assistance arises principally in two spheres:

• *improving the management of public resources* through reforms covering public sector institutions (for example, the treasury, central bank, public enterprises, civil service, and the official statistics function), including administrative procedures (for example, expenditure control, budget management, and revenue collection); and

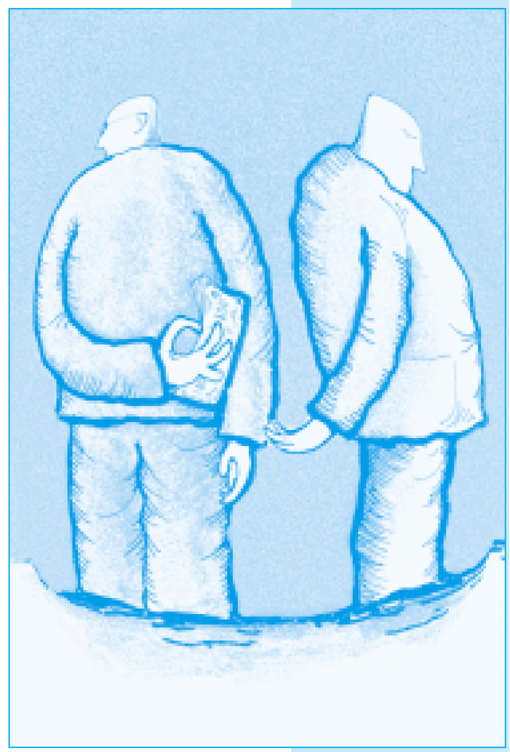
• *supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to efficient private sector activities (for example, price systems, exchange and trade regimes, and banking systems and their related regulations).*

6. Within these areas of concentration, the IMF should focus its policy advice and technical assistance on areas of the IMF's traditional purview and expertise. Thus, the IMF should be concerned with issues such as institutional reforms of the treasury, budget preparation and approval procedures, tax administration, accounting and audit mechanisms, central bank operations, and the official statistics function. Similarly, reforms of market mechanisms would focus primarily on the exchange, trade, and price systems, and aspects of the financial system. In the regulatory and legal areas, IMF advice would focus on taxation, banking sector laws and regulations, and the establishment of free and fair market entry (for example, tax codes and commercial and central bank laws). In other areas, however, where the IMF does not have a comparative advantage (for example, public enterprise reform, civil service reform, property rights, contract enforcement, and procurement practices), the IMF would continue to rely on the expertise of other institutions, especially the World Bank. But, consistent with past practice, policies and reforms in these areas could, as appropriate, be part of the IMF staff's policy discussions and conditionality for the IMF's financial support where those measures were necessary for the achievement of program objectives.

7. Although it is difficult to separate economic aspects of governance from political aspects, confining the IMF's involvement in governance issues to the areas outlined above should help establish the boundaries of this involvement. In addition, general principles that are more broadly applicable to the IMF's activities should also guide the IMF's involvement in governance issues. Specifically, the IMF's judgments should not be influenced by the nature of a political regime of a country, nor should it interfere in domestic or foreign politics of any member. The IMF should not act on behalf of a member country in influencing another country's political orientation or behavior. Nevertheless, the IMF needs to take a view on whether the member is able to formulate and implement appropriate policies. This is especially clear in the case of countries implementing economic programs supported by the IMF from the guidelines on conditionality that call on IMF management to judge that "*the program is consistent with the IMF's provisions and policies and that it will be carried out*." As such, it is legitimate for management to seek information about the political situation in member countries as an essential element in judging the prospects for policy implementation.

Criteria for IMF Involvement

8. The IMF's mandate and resources do not allow the institution to adopt the role of an investigative agency or guardian of financial integrity in member countries, and there is no intention to move in this direction. The staff should, however, address governance issues, including instances of corruption, on the basis of economic considerations within its mandate.



9. In considering whether IMF involvement in a governance issue is appropriate, the staff should be guided by an assessment of whether poor governance would have significant current or potential impact on macroeconomic performance in the short and medium term and on the ability of the government to credibly pursue policies aimed at external viability and sustainable growth. The staff could draw upon comparisons with broadly agreed best international practices of economic management to assess the need for reforms.

10. As regards possible individual instances of corruption, IMF staff should continue raising these with the authorities in cases where there is a reason to believe they could have significant macroeconomic implications, even if these effects are not precisely

measurable. Such implications could arise either because the amounts involved are potentially large, or because the corruption may be symptomatic of a wider governance problem that would require changes in the policy or regulatory framework to correct. Instances could include, for example, the diversion of public funds through misappropriation, tax (including customs) fraud with the connivance of public officials, the misuse of official foreign exchange reserves, or abuse of powers by bank supervisors that could entail substantial future costs for the budget and public financial institutions. Corrupt practices could also occur in other government activities, including the regulation of private sector activities that do not have a direct impact on the budget or public finances, such as ad hoc decisions made in relation to the regulation of foreign direct investment. Such practices would be counter to the IMF's general policy advice aimed at providing a level playing field to foster private sector activity.

The IMF's involvement in governance should be limited to economic aspects.

11. Instances of corruption that do not meet the threshold of having significant macroeconomic implications are best addressed through the IMF's efforts to promote transparency and remove unnecessary regulations and opportunities for rent seeking consistent with the broad principles that apply to other issues of economic governance. Staff recommendations could include improvements in government management processes and systems that would have the beneficial side effect of preventing a recurrence of corrupt practices or advice to the authorities to seek the assistance of competent institutions for advice in these areas.

Modalities of IMF Involvement in Governance Issues

12. Governance issues are relevant to all member countries, although the problems differ depending on economic systems, institutions, and the economic situation. The mode of IMF involvement will have implications for the manner in which governance concerns are addressed by staff in different member countries. Nonetheless, whatever the mode of involvement, the IMF's main contribution to improving governance in all countries—both countries receiving financial support from the IMF and other countries—will continue to be through support for policy reforms that remove opportunities for rent-seeking activities and through sustained efforts to help strengthen institutions and the administration capacity in member countries.

Article IV Consultation Discussions

13. In Article IV consultation discussions, the staff should be alert to the potential benefits of reforms that can contribute to the promotion of good governance (for example, reduced scope for generalized rent seeking, enhanced transparency in decision-making and budgetary processes, reductions in tax exemptions and subsidies, improved accounting and control systems, improvements in statistical dissemination practices, improvements in the composition of public expenditure, and accelerated civil service reform). The potential risk that poor governance could adversely affect private market confidence and, in turn, reduce private capital inflows and investment, even in countries enjoying relatively strong growth and private capital inflows, should also be brought to the attention of the authorities. IMF policy advice should also make use of the broad experience of countries with different economic systems and institutional practices and be based on the broadly agreed best international practices of economic management and on the principles of transparency, simplicity, accountability, and fairness. In the case of international transactions that involve corruption, the staff should pay equal attention to both sides of corrupt transactions and recommend that such practices be stopped if they have the potential to significantly distort economic outcomes (for example, the tax deductibility of bribes in member countries or certain operations of official agencies). Where poor governance with a significant economic impact is evident and brought to the staff's attention in its surveillance activities, the staff should discuss the issue with the authorities.

Use of IMF Resources

14. While the policy advice indicated above in relation to Article IV consultations is also relevant in the case of IMF-supported programs, the need to safeguard the IMF's resources must also be taken into account.

15. The use of conditionality related to governance issues emanates from the IMF's concern with macro-

IMF Publications on Governance-Related Issues

Working Papers

94/86: *On Corruption and Capital Accumulation,* Carlos M. Asilis and V. Hugo Juan-Ramon

94/99: *Corruption, Governmental Activities, and Markets,* Vito Tanzi

96/98: *The Effects of Corruption on Growth, Investment, and Government Expenditure,* Paolo Mauro

97/11: *Toward a Market Economy: Structures of Governance,* Pierre Dhonte and Ishan Kapur

97/73: *Corruption and the Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?,* Caroline Van Rijckeghem and Beatrice Weder

Economic Issues

No. 6: *Why Worry About Corruption?,* Paolo Mauro

For information on ordering publications, please see Recent IMF Publications, page 251.

economic policy design and implementation as the main means to safeguard the use of IMF resources. Thus, conditionality, in the form of prior actions, performance criteria, benchmarks, and conditions for completion of a review, should be attached to policy measures, including those relating to economic aspects of governance that are required to meet the objectives of the program. This would include policy measures that may have important implications for improving governance but are covered by the IMF's conditionality primarily because of their direct macroeconomic impact (for example, the elimination of tax exemptions or recovery of nonperforming loans). While the IMF staff should rely on other institutions' expertise in areas of their purview (for example, public enterprise reform by the World Bank), it could nevertheless recommend conditionality in these areas if it considers that measures are critical to the successful implementation of the program.

16. Weak governance should be addressed early in the reform effort. Financial assistance from the IMF in the context of completion of a review under a program or approval of a new IMF arrangement could be suspended or delayed on account of poor governance, if there is reason to believe it could have significant macroeconomic implications that threaten the successful implementation of the program, or if it puts in doubt the purpose of the use of IMF resources. Corrective measures that at least begin to address the governance issue should be prior actions for resumption of IMF support, and, if necessary, certain key measures could be structural benchmarks or performance criteria. Examples of such measures include recuperation of forgone revenue and changes in tax or customs administration. The staff would need to exercise judgment in assessing whether the actions adopted by the authorities were adequate to address the governance concerns; as in the case of other policies in which the track record is weak and the commitment of the authorities is in doubt, it may be appropriate in some circumstances to call for a period of monitoring prior to a resumption of financial support. The authorities' policy response could also entail changes in management in public institutions and, as appropriate, the removal of individuals from involvement in particular operations where corruption had occurred, and efforts to recover government funds that have been misappropriated. The staff must, of course, be mindful of the need to avoid action prejudicial to any related domestic legal processes in a particular case.

Technical Assistance

17. The IMF's technical assistance programs should continue to contribute to improving economic aspects of governance. This would apply to areas of IMF expertise, including budget management and control, tax and customs administration, central bank laws and organization, foreign exchange laws and regulations, and macroeconomic statistical systems and dissemination practices. In these areas, technical assistance missions should bring to the attention of the authorities areas in which procedures and practices fall short of best international practices.

Identification of Governance Problems

18. In the context of Article IV consultations, program negotiations, and technical assistance missions, the staff should be alert to aspects of poor governance that would influence the implementation and effectiveness of economic policies and private sector activities. For example, this could be related to a weak and poorly remunerated civil service, which could be addressed through civil service reforms encompassing a restructuring or selective increase in pay scales or the process and transparency of the privatization process. The staff should also pay attention to inconsistencies or improbabilities in the various data and accounts in member countries. For instance, tax collection might fall short of the expected potential yields as a result of weak administration of tax laws, procedural complexities, or the widespread abuse of exemptions. The staff should bring data inconsistencies that are not judged to be the result of problems in statistical collection and compilation to the attention of the authorities. The staff should also advise that greater transparency in macroeconomic policy implementation could help build private sector confidence in government policies; for example, the consolidation of all extrabudgetary accounts within the budget, the early publication of the budget, and early reporting on the outcome at the end of the fiscal year.

19. It is recognized that there are clear practical limitations to the ability of the staff to identify deficiencies in governance. The availability, quality, and reliability of information are likely to be important factors affecting IMF involvement in corruption cases. The staff should continue to rely on information provided by the authorities. If inconsistencies in public accounts and reports suggest that a problem exists, the staff should, in the first instance, raise the issue with the authorities. In its endeavor to seek information, the staff may need to be prepared to face some tension in the working relationship with country authorities in specific cases potentially involving corrupt practices. The staff may also point out that, in an atmosphere of widespread rumors of corrupt practices, and where the rumors have some genuine credence, an independent audit may be desirable to address such concerns. If the staff considers that further information is required to resolve an issue that has a significant macroeconomic impact, it may be appropriate to make use of information from third parties, including other international organizations and donors. In view of the confidential nature of the information obtained by the staff from member countries, staff inquiries will need to be han-

dled with due discretion and regard for the sensitive nature of the issue.

Coordination with Bilateral Donors and Other Multilateral Institutions

20. The IMF should collaborate with other multilateral institutions and donors in addressing economic governance issues. Recognizing that the interests of these bodies are more diverse than the IMF's—ranging from political aspects of governance to specific project-related issues—the IMF staff should exercise independent judgment in formulating policy advice. In addition, the staff should focus its analysis and technical assistance only on those issues that are within its expertise. However, as noted in paragraph 6, conditionality may apply to measures to address governance concerns in areas outside the IMF staff's expertise. IMF staff should also keep abreast of changes in the policies of partner organizations and specific efforts in member countries on governance issues. This should include the activities of partner organizations, particularly the World Bank, in addressing governance issues in areas that are outside the IMF staff's competence but nonetheless important for the achievement of the economic policies advocated by the IMF (for example, the reliable enforcement of contracts).

The IMF's main contribution will continue to be support for sound policy reforms.

21. Given the commonality of interest with other multilateral institutions, the IMF should seek to strengthen its collaboration on issues of governance with them and, in particular, with the World Bank. This should include, especially when requested by the authorities concerned, coordination of action to improve governance.

Better Governance Is a Key Element of "Second Generation" Reforms

"Many countries have reduced the negative aspects of state intervention in their economies, but they have yet to develop their public institutions into a positive force for growth and development. That process begins by increasing the transparency of government operations, so as to limit opportunities for corruption and enhance public accountability. At the same time, countries must rededicate the state to fulfilling the tasks that are so essential to the confidence of private savers and investors and the smooth functioning of their economies such as providing reliable public services; establishing a simple and transparent regulatory framework that is enforced fairly; guaranteeing the professionalism and independence of the judicial system; and enforcing property rights."

IMF Managing Director Michel Camdessus, from an address to the United Nations Economic and Social Council, July 2

22. As regards bilateral donors, it is useful to distinguish two different cases in which donor responses to economic and noneconomic governance issues affect the IMF's relations with its members, although in practice there is seldom a clear separation between such economic and noneconomic aspects:

- In cases where bilateral donors or creditors withhold or interrupt external support because of concern over political and/or economic aspects of governance, the IMF should have an independent view on the economic implications. The IMF staff should examine whether these issues have a direct and significant impact on macroeconomic developments in the short or medium term. If this is the case, the staff should seek to assist the member country concerned through policy advice and technical assistance in areas of its expertise and coordinate as appropriate with donors, with a view to helping to address the governance issues before recommending provision of IMF financial support. If this is not the case, but donors continue to withhold support, the staff should seek to assist the authorities in reformulating a program with greater internal adjustment to compensate for reduced external financing, paying due regard to the medium-term sustainability in the absence of a resumption of external assistance. If this is not feasible because of a lack of financing assurances—that is, adequate external financing for the reformulated program is not in place—as a last resort, the staff should recommend that the IMF withhold its own financial support but continue to provide technical assistance support.
- In cases where governance issues significantly affect short- or medium-term economic developments but donors and creditors continue their financial assistance to the country concerned and do not assist the government in improving governance, the IMF staff nevertheless has an independent responsibility for raising the governance issue with the authorities and for reporting to the Executive Board on this issue. There may be occasions when the IMF staff may raise its concerns with donors and creditors, including at consultative group meetings and in roundtables. But these instances would need to be addressed with care, with the guidance of the Board and due regard to the confidential nature of such information. There are clear limitations to what the IMF's contribution to improvements in governance in member countries can achieve without the active support from the rest of the international community.

Reporting to the Executive Board

23. The Executive Board will be kept informed about developments in significant cases involving governance issues and will have the opportunity to comment on the operation of these guidelines as country cases are brought forward. In addition, there will be a periodic review by the Executive Board of the IMF's experience with governance issues. ■

New Regional Office to Strengthen IMF's Dialogue with Asia and the Pacific

On September 1, the IMF will begin operations at its Regional Office for Asia and the Pacific in Tokyo. The IMF Survey *spoke with Kunio Saito, Director of the Office and former head of the IMF's Southeast Asia and Pacific Department, about the opportunities the regional office presents for strengthening ties between the IMF and the Asian and Pacific region.*

IMF SURVEY: *What is the regional purview of the IMF's new office?*

SAITO: Narrowly defined, it is the area covered by the IMF's Asia and Pacific Department—that is, all of what has traditionally been labeled East, Southeast, and South Asia, and the Pacific, including Australia and New Zealand and the Pacific islands. Depending on the issue, our office may go a bit beyond that.

The region offers an exceptionally interesting and diversified mix of countries. Our regional office covers some of the most populous economies—China and India—and the second largest economy in the world in terms of GNP—Japan. It also encompasses transition economies, such as Mongolia, Vietnam, and Laos. It covers some of the highest per capita income countries, like Japan and Singapore, but also includes some of the lowest, such as Bangladesh. We also have quite a few small island economies in the Pacific.

It's a region that presents many challenges. The important thing to remember is that the regional office has been created to facilitate the IMF's work with its member countries in Asia and the Pacific. The regional office will work closely with headquarters and the IMF's area and functional departments that work with these countries.

IMF SURVEY: *Why is the IMF opening a regional office in Asia at this point?*

SAITO: The answer lies in the significant, and growing, importance of the Asian and Pacific economies in the world economy. The IMF must be there as an active and constructive participant in the economic and social developments in the region. Over the past year, the IMF's management made two decisions with regard to Asia and the Pacific. It merged two separate area departments in the IMF into one Asia and Pacific Department and created a regional office to enhance the IMF's presence in the region.

IMF SURVEY: *One of your office's responsibilities will be to strengthen contacts with other Asian and Pacific regional organizations. Which ones will you be working with and what will this entail?*

SAITO: One of the regional office's chief responsibilities will be to facilitate the IMF's dialogue with policymakers in the region through regional policy forums. The principal ones are APEC [Asian-Pacific Economic Cooperation], ASEAN [Association of South East Asian Nations], and the South Pacific Forum, but regional policy forums seem to be mushrooming. A newly formed "G-6" group had its first meeting earlier this year. There are also central bankers meetings, such as SEACEN [South-East Asian Central Banks], which basically focuses on training, and EMEAP [Executive Meeting of East Asia and Pacific Central Banks], which, among other things, is attempting to coordinate central bank operations and policies in the region. We are hoping to promote the IMF's interaction with all of these policy forums.

The IMF must be an active and constructive partner in the region.

Beyond these forums, there are several important regional organizations, such as the Asian Development Bank in Manila and ESCAP [the UN Economic and Social Commission for Asia and the Pacific] in Bangkok. Here again, the regional office will be seeking to strengthen the IMF's relations with these organizations and facilitate, for example, missions and research with them.

Saito: The IMF's new office for Asia and the Pacific will convey the organization's views, more widely and regularly, in the region's policy forums.

IMF SURVEY: *How does the IMF's regional office hope to facilitate policy coordination?*

SAITO: The presence of a regional office affords us greater opportunity for presenting the IMF's views and permits greater involvement in regional policy coordination efforts. The Managing Director, the Deputy Managing Directors, or senior staff may address the various regional policy forums. Members of the regional office, together with senior staff of the departments concerned at headquarters, will attend meetings at the deputies or working group level and will interact regularly with these groups and contribute background papers. The overriding objective is to convey, more widely and regularly, the IMF's views and to underscore the importance of sound macroeconomic policies.

The IMF always faces challenges in getting its message out. Over the past few years, we have been making greater efforts to disseminate information to the general public, as well as to policymakers. The regional office will help strengthen these efforts in the Asia and Pacific region.

Technical assistance is a key means by which the IMF also disseminates information and experience. The regional office will work with the IMF departments that provide technical assistance and hopes to help them raise additional finance for technical assistance projects. At the moment, the IMF has more requests for technical assistance than it has resources to meet them, so expanding the resources available for technical assistance is especially important.

IMF SURVEY: *Trade patterns in Asia seem to be evolving rapidly, with a growing segment of intra-Asia trade. To what extent are regional trading arrangements promoting greater intraregional trade?*

SAITO: What is happening is a very dynamic process of industrial relocation in the region, facilitated by direct foreign investment. A first wave of investment helped propel the newly emerging economies, such as Korea, Taiwan Province of China, and Singapore. A second wave has created the emerging market economies of ASEAN. Typically, foreign direct investment enters and industries mushroom. This is followed, in turn, by a surge in exports. This dynamic process has been taking place for the past 10–20 years, driven by the changing cost structure—wages rising in one part of the region encouraging a shift of industries to another part of the region.

Regional arrangements are needed to deal with problems, and the IMF should be involved.

Clearly, investment in these countries does not take place unless investors feel they can operate in them freely, sell to the domestic market, and export. Government efforts have been important, and the regional understandings have played a role. But the increase in intra-Asian regional trade has basically taken place through the markets. The dynamics of investment have been crucial, and industrial relocation has been key.

IMF SURVEY: *The IMF is beginning to emphasize regional, as well as country, surveillance. Is the IMF taking an increasingly regional perspective in Asia and will the regional office be involved in this?*

SAITO: Surveillance has always been an important issue for the IMF. The IMF has been working to strengthen it in recent years, and this has involved greater contacts with national authorities at the management, senior staff, and technical levels of the IMF. Also, we have been trying to reach a wider segment of society, partly to help build a domestic consensus for needed reforms. We have strengthened our external relations efforts for this purpose.

We have succeeded to some extent, but challenges remain. Part of our effort to strengthen surveillance in the Asia and Pacific region will be increased participation in regional policy forums, as the region is trying to improve its policy coordination through these forums. We want to be a part of this effort, but the process has just begun. Over the past few years, the Managing Director has attended some of the ministerial meetings and senior staff have attended some deputies meetings.

IMF SURVEY: *The currency turmoil in Southeast Asia underscores the risk of contagion effects and the interdependence of economies in this global era. What are the implications for regional surveillance?*

SAITO: Two things are clear. One, it is important that policymakers in the region get together regularly, compare notes, and perhaps exercise some peer pressure in order to avoid possible problems. And, two, once something unfortunate happens, it is important to have some regional arrangements—either permanent or ad hoc—to deal with the problems. The IMF should be involved in such arrangements, in both strengthening policy coordination and in developing means to deal with problems. The region has only just begun to develop mechanisms for greater policy coordination and cooperation.

IMF SURVEY: *How would you evaluate the strengths and weaknesses of Asia's financial markets?*

SAITO: The region's financial markets are evolving. Some, such as Singapore, are a bit ahead; others, such as Bombay, are somewhat behind. The differences are in the depth, size, and sophistication of these markets. But on the whole, the Asian financial markets are moving in one direction: bigger and more sophisticated.

IMF SURVEY: *The IMF in recent years has underscored the importance of strong banking systems and sound financial systems. To what extent will the IMF's regional office have a role in promoting these objectives in Asia and the Pacific? Will the IMF use the regional office to expand its contacts with the region's financial markets?*

SAITO: The regional office will supplement the staff visits that occur in conjunction with annual Article IV consultations and IMF studies of global capital markets. By being in the region, we hope to maintain more continuous contact with market participants and market supervisors and report on developments to headquarters. One of my colleagues in the regional office will visit major financial markets almost every month. Not only does the IMF need to know more about the markets, the markets need to know more about the IMF and its research and advice. In this regard, we will help disseminate more widely the IMF's publications, including its new Press Information Notices. We will also be organizing small seminars and inviting speakers from headquarters to discuss the IMF's work and research.

IMF SURVEY: *What is the IMF's message to Asia?*

SAITO: The key message is that countries must maintain appropriate policies to sustain quality growth. The region has been growing rapidly, but there is further to go in terms of raising people's living standards and improving quality of life. When the IMF advises countries on the policies needed to sustain growth, we necessarily stress avoiding balance of payments problems and maintaining low inflation. Many of the countries in Asia and the Pacific have been doing this, but as the recent currency crises make clear, countries can get into problems. It is also important to combine rapid growth with improvements in social and environmental indicators, and for that countries need to keep up with what IMF Managing Director Michel Camdessus calls the "second generation" of reforms, which emphasize these policy aspects.

I would also add that we have to let every part of the Asia and Pacific region know that the IMF is here—not only in the context of annual Article IV consultations but also, now, on a continuing basis. We have staff permanently in the region and we want to create an atmosphere in which the IMF is an important partner in efforts to achieve this shared goal of sustained growth. ■

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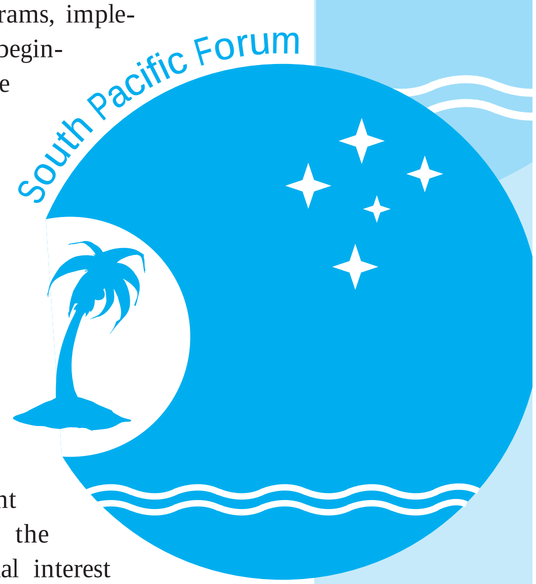
Reforms Are Key to South Pacific Response To Globalization

The following article is drawn from a presentation by Thomas Rumbaugh of the IMF's Asia and Pacific Department to the South Pacific Forum Economic Ministers Meeting in Cairns, Australia, on July 10–11. The South Pacific Forum, established in 1971, includes Australia, Cook Islands, Fiji, Kiribati, the Marshall Islands, Micronesia, New Zealand, Nauru, Niue, Palau, Papua New Guinea, the Solomon Islands, Tonga, Tuvalu, Vanuatu, and Western Samoa.

The current global environment, which features widespread growth and continuing liberalization of trade and investment regimes, offers opportunities for economies well positioned to take advantage of them. Australia and New Zealand's comprehensive financial and structural reforms have helped improve the efficiency of these economies and have helped sustain growth prospects. Among the island economies of the South Pacific, however, the pursuit of reforms has been more mixed. While several countries have designed wide-ranging reform programs, implementation is only in the beginning stages and much more remains to be done.



Australia is now enjoying its sixth consecutive year of growth. The pace of growth moderated in 1996, as private consumption growth weakened. In the 12 months to March 1997, growth stood at 2½ percent. Further declines in underlying inflation—to 2 percent in 1996—have allowed the authorities to lower official interest rates and lay the foundation for continued economic growth through 1997. In New Zealand, economic growth slowed to 2½ percent in 1996, the lowest in four years, and inflation remained low (2 percent). With indications that accelerated economic activity may be further delayed, inflation should decline further and provide scope for an easier monetary stance. In line with a planned reduction in the overall fiscal surplus, growth is expected to pick up in 1998. Both countries have achieved, and are maintaining, greater transparency in budget operations and broad structural reforms. A principle priority for both countries is to ensure that their medium-term fiscal strategies are fully implemented.

The experience of the Pacific island economies—notably IMF member countries Fiji, Kiribati, the Marshall Islands, Micronesia, Papua New Guinea, the Solomon Islands, Tonga, Vanuatu, and Western Samoa—has generally been characterized by low growth and stagnant per capita incomes. Many of these island economies have experienced financial crises in their banking systems or major public enterprises. Still others are facing the prospect of sharply reduced external assistance in the future. As a group, these economies in the past have channeled large volumes of external aid into largely inefficient public sectors that have contributed little to developing sustainable domestic economies.

South Pacific Economies: Selected Indicators, 1992–96

	Real GDP Growth	Consumer Prices	Budgetary Balance	Current Account[1]
	(annual average percent change)		(percent of GDP)	
Australia[2]	3.8	2.7	–3.2	–4.0
Fiji	2.7	3.2	–3.0	–7.2
Kiribati[3]	1.3	3.7	21.6	–26.1
Marshall Islands	2.4	6.7	–14.6	–56.4
Micronesia	1.6	4.6	–2.5	–52.5
New Zealand	3.2	2.0	0.8	–2.4
Papua New Guinea	6.6	8.2	–2.8	4.6
Solomon Islands	6.0	10.9	–5.7	–17.2
Tonga	1.9	3.5	–0.3	–14.9
Vanuatu	2.5	2.6	–2.3	–23.2
Western Samoa	2.4	7.4	–11.8	–22.0

[1]Excluding official transfers.
[2]Commonwealth underlying balance.
[3]Includes accrued income on external reserves held at the Revenue Equalization Resource Fund.
Data: National authorities and IMF staff estimates

Key Policy Issues

Development of the Pacific island economies has been constrained by large and inefficient public sectors, inadequate financial systems with limited competition, market rigidities arising from impediments to efficient land use and price controls, small domestic markets, and susceptibility to external shocks. Traditionally, sluggish growth and low levels of domestic saving and investment have not posed urgent concerns. Governments largely pursued conservative macroeconomic policies and external assistance was plentiful, which helped to preserve a stable financial environment.

A more vibrant role for the private sector is essential for the Pacific island economies.

In recent years, however, aid flows have dwindled and external shocks (for example, in Tonga and Western Samoa), financial crises (in Fiji and Western Samoa), and political uncertainty (in Fiji, Papua New Guinea, and Vanuatu) have damaged economic performance and called into question the sustainability of current policies. Maintaining macroeconomic stability is vital, but a more vibrant role for the private sector has clearly become essential. Achieving this will require major reforms to shrink the public sector and make it more effective, to develop the financial sector, and to liberalize trade and investment regimes.

Public Sector Reform. The public sector dominates Pacific island economies, with central government revenue and expenditure typically accounting for more than 60 percent of GDP and public sector enterprises are heavily involved in key sectors of the economy. Moreover, poor performance of public enterprises has also severely strained national budgets. For most of the island economies, fiscal adjustment and consolidation will need to be the cornerstone of reform efforts. Adjustment will necessarily entail reduced expenditures, particularly for public sector employment and wages (the ratio of civil servants to the population is, in many instances, nearly double that for the Asian region). At the same time, the high tax burden—especially with respect to high import tariffs—will need to be lowered through reductions in tax and tariff rates and a movement away from the distortionary effects of ad hoc fiscal incentives. Complementary reforms will also be needed to improve the administration of customs duties and income and value-added taxes. A tight fiscal policy is also needed to restrain aggregate demand pressures and promote continued exchange rate stability while freeing increased credit for the private sector. Channeling increased savings to private sector investment will enable these economies to better realize the benefits of globalization.

While moving to a smaller public sector, it will also be necessary to improve budgetary management. The implementation of performance budgeting can encourage more efficient government operations, but it will also be crucial for these governments to devolve human resource management and accounting transactions to line agencies, enhance accountability and upgrade economic policy advice, and improve the monitoring and regulation of the remaining public enterprises.

At present, many of the public enterprise reforms and privatization efforts that have been initiated have fallen short of their goals. Few public enterprises are financially viable, and their debt obligations continue to absorb large portions of public resources. Expenditure savings from public enterprise reform need to be redirected to greater investment in human resource development. Public sector reforms, including privatization, would also benefit from greater transparency and improved dissemination of information on public policies to the private sector.

Financial Sector Reform. The slow progress in deepening the financial sectors in the Pacific islands reflects the large subsistence sectors in most of these economies. Large interest rate spreads between deposit and lending rates also impede financial intermediation and spring from the less competitive environments that characterize these economies.

As a result, monetary policy remains a significantly circumscribed tool, and the financial sector tends to be distinguished by excess liquidity, which necessitates reliance on either direct controls or monetary instruments expressly designed to absorb excess liquidity. In many cases, the need to accumulate and maintain ample foreign reserves to cushion against external shocks also adds to domestic liquidity.

Since the late 1980s, several countries have made greater use of indirect monetary policy instruments. Open market-type operations have been introduced to a limited extent in Fiji, the Solomon Islands, Tonga, and Western Samoa. For most countries, however, the appropriate range of policy instruments has yet to be developed.

Experience elsewhere indicates that an institutional structure that supports market-based decision making is required for financial markets to develop and make their maximum contribution to growth. A well-functioning system of indirect monetary controls is, thus, a key ingredient in improving the central bank's control of money and credit, depoliticizing policymaking, and increasing financial intermediation, investment, and real growth. To enhance the use of indirect monetary policy instruments, these countries need to create supportive macroeconomic and structural preconditions, with better supervision of the financial system by monetary authorities.

The management of the public sector also plays an important direct and indirect role in the development of the financial sector. Government allocation of credit to its priorities and through public financial institutions means that a sizable segment of financial activity is not subject to market discipline. Bank financing of government operations also necessitates tighter monetary policies and higher interest rates to maintain economic stability, thus hindering loan growth and often stunting the overall development of the financial sector.

Trade Liberalization and Structural Reforms. Although global and regional trade liberalization expands trade opportunities, it also erodes the benefits of preferential trade arrangements. For the South Pacific island economies, the prospect of increasing trade competition heightens the urgency of improving competitiveness and increasing economic diversification. Two types of policy actions are important in this regard:

• External liberalization measures need to be implemented to meet commitments required under the World Trade Organization (for WTO members) or other regional initiatives. While most Pacific island economies are under little external pressure to liberalize, there are compelling economic reasons to do so. High import tariffs raise the cost of doing business, discourage exports, and encourage inefficiency. Experience suggests that the more open the economy, the greater the benefits of globalization.

• The ability to attract foreign investment will be critical to developing more vibrant private sectors. Creating a more investor-friendly environment requires a range of reforms. These include tax reforms, increased flexibility in land use, more transparent government policies, reduced administrative barriers to private investment, enforceable property rights and contracts, sound judicial systems, improved economic infrastructure, more flexible pricing, and more exposure of domestic suppliers to international competition.

As the Pacific island economies confront the challenges of globalization and, in some cases, the prospect of reduced external assistance, reform assumes a new urgency. Significantly more progress will be needed in implementing and deepening structural reforms if these economies are to reap the benefits of projected expansions in global output, trade, and investment. ■

The more open the economy, the greater the benefits of globalization.

Pacific Financial Technical Assistance Center

The Pacific Financial Technical Assistance Center, in Suva, Fiji, was created in 1993, with funding from the IMF and the United Nations Development Program (UNDP) and contributions from the Asian Development Bank (AsDB). The center was set up to provide technical assistance and develop institutional capacity in the region. It helps participating countries —including all of the South Pacific Forum's island countries—meet internationally accepted standards of government budgeting, accounting, and expenditure control; improve tax administration, banking regulation, and supervision; and maintain internationally accepted balance of payments and national accounts statistics.

The program has expanded its operations in recent years with increased funding from the IMF, the UNDP, the AsDB, and the Australian and New Zealand governments, as well as a contribution from the South Pacific Forum.

Georgia Sustains Bold Measures to Reform Social Support Mechanisms

In response to a request by the Georgian authorities for technical assistance on the design of social support mechanisms, an IMF staff team mission visited Tbilisi in late June. The IMF team, headed by Sheetal K. Chand, included Marinus Verhoeven and Meike Gretemann, all of the Fiscal Affairs Department. The following is based on an account of the mission's findings.

During the past two years, Georgia has made major strides in stabilization and structural reform after a period of acute economic crisis. Between 1991–94, the Georgian economy suffered from the disintegration of trade and financial relations in the countries of the former Soviet Union, civil war, and adverse policy choices. Real GDP declined by an estimated 60–65 percent between 1992 and 1994, and the economy experienced hyperinflation. Following the implementation of tight financial policies and the liberalization of prices, trade, and the exchange system, growth resumed in 1995. It accelerated in 1996 and is expected to reach 10 percent in 1997, against a background of a stable exchange rate and declining inflation. At the same time, structural reform has continued to advance, laying the groundwork for increased private sector activity and sustained growth over the medium term.

The economic collapse eroded Georgia's ability to sustain traditionally high social outlays. The authorities took bold steps to overhaul the country's social protection system by virtually dismantling the former full array of benefits that promoted distributive, safety net, and social insurance goals, replacing it with a pure safety net. Reforms of the social safety net and health and education sectors aim at improving services and benefits, while increasing the sustainability of the social protection mechanisms by targeting assistance to vulnerable groups. Eventually, the authorities plan to introduce social insurance schemes to supplement the safety net.

Elements of the Social Safety Net

The Georgian government channels social safety net benefits through a Social Security Fund, an Employment Fund, and a Health Fund. The Social Security Fund, established in 1991, provides old-age, invalid, and survivors' pensions on a pay-as-you-go basis. It collects its own revenues from payroll taxes that, in 1997, consist of 27 percent paid by enterprises and a mandatory contribution from workers of 1 percent of their wages. Also established in 1991, the Employment Fund, like the Social Security Fund, functions on a pay-as-you-go basis. Its revenues are derived from a 1 percent payroll tax on nonbudgetary institutions. The Employment Fund provides an unemployment benefit for those who have been out of work for a period between three and eight months.

In 1995, the government initiated radical reforms of the health sector, aimed at privatizing most health care facilities, including some hospitals, by mid-1998. Sweeping changes in government funding of health care included establishment of the Health Fund in August 1995. This fund is designed to act as a financial intermediary for the reimbursement of both private and public health care providers, but it is limited to a basic package of preventive and curative health care services. Like the Social Security Fund and Employment Fund, the Health Fund is funded by a payroll tax on enterprises (3 percent) and a mandatory contribution from workers of 1 percent of their wages. The government also provides a budgetary transfer to the Health Fund to ensure that the most vulnerable population groups who are not contributing also benefit from its provision of basic health care.

Benefits Are Targeted but Remain Low

The safety net program currently costs the equivalent of 3 percent of GDP or about one-third of the budget. To better concentrate its limited resources on the needy, the government targets benefits. For example, in 1995, nonworking pensioners became ineligible for pensions, and in February 1996, the retirement age rose from 55 to 60 years for women and from 60 to 65 years for men. Initially, this measure paradoxically increased the number of registered pensioners (1.1 million, or 43 percent of the estimated employed population) by 50,000, as previously unregistered elderly took advantage of the grandfathering provisions to register before their eligibility expired. However, in the long run, the increase in the retirement age is expected to reduce the number of pensioners by about 40 percent. In early 1997, targeted allowances to four categories of poor families—pensioners living alone; pensioners with children under 18 years; unemployed persons with children under 18 years; and single mothers not supported by alimony—replaced a universal system of child allowances. As a result, the number of beneficiaries under these programs declined to about 120,000 in 1997 from about 350,000 in 1996.

At the same time that the targeting of the social safety net has improved, social benefits have increased, generally in line with government wages. Including a 15 percent increase in benefits on January 1, 1997, benefits have increased on average by more than 200 percent, or about 100 percent in real terms, over the past two years (see chart). Still, benefit levels remain low. The standard monthly rate of lari 9.8 ($7.70) is only one-tenth the official minimum subsistence level. According to that standard, all the employees of the public sector, for whom the monthly average wage is only lari 35, are destitute (the official national poverty ratio is 65 percent).

The official poverty standard is misleading, however. It reflects the relatively high norms for prereform subsistence consumption and does not take account of the substitutions in the basket following the major price adjustments since 1992, especially the elimination of food subsidies. The mission staff estimated an alternative basket with the same calorie content that would cost about lari 35 a month—or nearly $1.00 a day. In addition, preliminary tabulations of a recently concluded household survey indicate that cash incomes constitute only a small proportion of total household incomes, particularly in the lower deciles. It is therefore misleading to base poverty assessments solely on cash incomes, which are generally very low. When allowance is made for in-kind income, the distributions of expenditures and incomes become much flatter, especially for the first eight deciles.

While the data do not facilitate a precise estimate of the poverty ratio, IMF staff estimates show that about 25–30 percent of the population (as against the official ratio of 65 percent) fall below the poverty line. This category comprises pensioners, single mothers, large families, and displaced persons (refugees). The considerable reliance—indicated by the data—on subsistence production and other informal activities confirms the stresses the population has experienced since transformation to a market-based system. Many have managed to maintain consumption standards at about subsistence levels with support from relatives and by depleting their assets—remedies that provide only short-run relief. This situation is unsustainable, calling for improvements in the size and coverage of the benefits.

Possible Directions for Reform

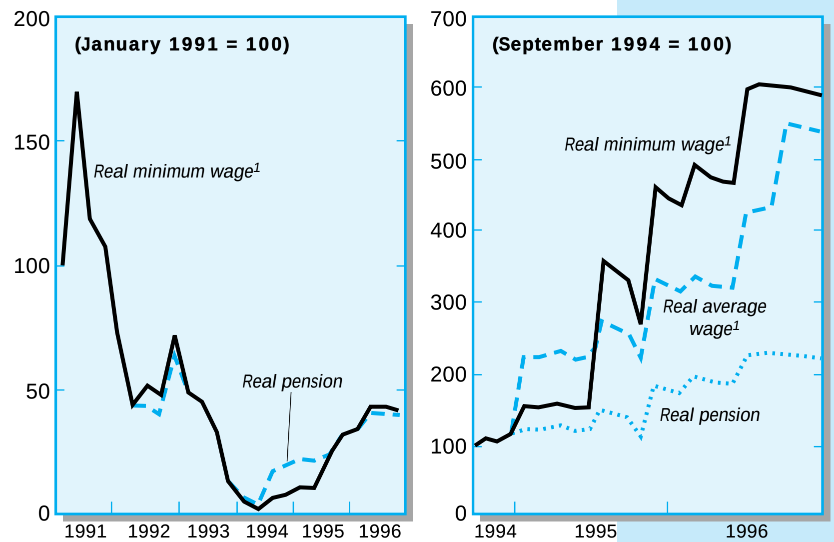
IMF staff recommended further modifications to the safety net to target additional vulnerable groups—for example, large families and single mothers. Without sufficient data, however, means testing cannot be applied, and the current practice of categorical targeting should be continued. To offset the higher costs of extending and streamlining the safety net, the IMF team proposed a number of savings. These include:

- tightening eligibility criteria;
- using presumptive income tests to weed out persons from the highest income deciles;
- introducing more self-targeting so as to make it less worthwhile for the highest income earners to avail themselves of benefits; and
- improving benefit administration systems, revenue collection, and payment delivery mechanisms.

The authorities expressed concern about the potential claims of the large numbers of unemployed that could result from rigorous enforcement of bankruptcy laws. The IMF mission suggested that such claims might be treated as candidates for severance pay rather than for unemployment insurance. Many of the prospective registered unemployed have in fact been experiencing extended periods of unemployment, because the enterprises to which they belong have not been in operation. Separating out the safety net aspects would facilitate development of a proper unemployment insurance scheme. In addition, existing unemployment benefits, insofar as they function as a safety net, are better subsumed under the current family allowances, which provide benefits to unemployed families.

The authorities would like to place the current pension system on a sound financial footing, while providing adequate support to the elderly. One proposal under consideration involves shifting the pension system to a defined-contributions scheme that would be based on individual contributions. This scheme would, however, imply a substantial loss of payroll tax collections, initially placing an insupportable burden on the budget to finance the continued retention of present safety net provisions. The IMF mission concluded that some other options may need to be considered. But for now, emphasis should continue to be placed on sustaining an adequate safety net for the elderly, without compromising the budget. ■

Georgia: Real Wages and Pension



[1]Wages in budgetary organizations.

Data: Georgian authorities and IMF staff estimates

New Book Examines Legal Issues Affecting Central Banks in a Changing World

The world banking industry is faced with a number of challenges in a rapidly expanding international financial environment. These concern derivatives, securitization, bank supervision, securities transfers, payment systems, the role of deposit insurance, and capital standards for market risk. These are among the subjects examined in Volume 4 of *Current Legal Issues Affecting Central Banks*, edited by Robert C. Effros of the IMF's Legal Department.

Legal Features of the IMF

Two aspects of the IMF—its provision of financial assistance to its members and the determination of state succession in the IMF—distinguish it from other international organizations, according to François P. Gianviti, General Counsel of the IMF:

Robert C. Effros

• *Provision of financing*. The IMF's assistance is intended to help member countries correct their balance of payments problems while avoiding recourse to exchange restrictions. Its financial assistance to members is subject to various legal rules, depending on the account from which the resources are derived.

• *State succession in the IMF*. In a review of cases involving changes in the legal status of members, Gianviti discusses the dissolution of Yugoslavia, which gave the IMF the opportunity to clarify its position on several issues of principle. For example, the IMF determines, for its own purposes, whether a member has ceased to exist and, therefore, has ceased to be a member of the IMF. If a finding of dissolution is made, the IMF identifies the successor states.

Bank Supervision

Sound bank supervision and regulation, together with appropriate early intervention, can prevent banking crises, but opinion is divided about where the supervisory authority may be most efficiently lodged. In most countries, the central bank is responsible for supervising commercial banks, but in some countries, a superintendent of banks or similar authority exercises this function. In the opinion of Ian H. Giddy of the New York University Stern School of Business, an independent agency is in the best interests of bank efficiency and depositor safety, because it "leaves the central bank free to concentrate on its proper function, monetary policy." Larry Promisel of the Board of Governors of the U.S. Federal Reserve System argues, however, that central banks need the broad knowledge of financial markets that comes from bank supervision to handle crises of systemic proportions. Other contributors offer perspectives based on the systems in France, Germany, and Sweden—all countries where authorities other than the central bank have been established to supervise banks.

Based on an analysis of the failure of the Bank of Credit and Commercial International (BCCI), Thomas C. Baxter, Jr., and Jet Joseph de Saram of the Federal Reserve Bank of New York draw conclusions for the supervision of multinational banks. They emphasize the importance of consolidated supervision by a home country supervisor and the need for international cooperation. In the BCCI case, the authors observe, each regulatory authority looked to the other as having primary responsibility for the multinational bank. Each expected the other to take the first step. As a result, no one did. The BCCI case showed that national boundaries are losing significance in bank supervision.

Role of Deposit Insurance

In considering the role of deposit insurance in the competition between depository institutions and nondepository financial service firms, James R. Barth of Auburn University and R. Dan Brumbaugh, Jr., of Brumbaugh Economics observe that any regulatory reform proposal should protect the payments and credit mechanisms from disruption, while at the same time promoting competition. One approach is to protect depositories from competition by granting them monopoly-like powers and imposing regulatory restrictions on nondepository financial service firms. Another would rely on mechanisms to correct promptly or close troubled depositories, but would neither grant such depositories monopoly-like powers nor eliminate regulatory limitations that would allow them to compete fully with other financial service firms. Those two approaches presuppose a deposit insurance system. Under a third approach, each depository would create a narrow bank whose assets would be short-term treasury securities and whose liabilities would be transaction accounts. Other regulatory constraints on depositories (except those that apply to other financial service firms) would be eliminated so that the depositories would compete fully with other financial service firms.

International Foreign Exchange Master Agreement (IFEMA)

Until the 1980s, according to John P. Emert of Citibank, N.A., participants in the foreign exchange market traded without standard documentation; and individual agreements for one net payment were necessary when two parties entered into more than one transaction. To simplify the process of netting multiple transactions and to define the rights of parties in cases of default, market participants developed standard documentation—such as the IFEMA— known as master agreements. These agreements can cover a number of individual transactions.

Financial Derivatives

Derivatives are financial instruments whose value is derived by reference to a rate, index, or underlying assets. According to Daniel P. Cunningham of Cravath, Swaine & Moore, roughly half of all derivatives transactions involve nonstandardized financial instruments that do not trade through an exchange or clearinghouse—the "over the counter"(OTC) market; the other half take place on the futures exchanges. In the OTC market, parties are subject to credit risk—if a party to an OTC derivatives transaction falls into insolvency, the other party can lose the economic value of the transaction. If a money center bank were depending on a counterparty that fell into insolvency, a "domino effect" could result, with one default triggering a cascade of defaults. Netting, says Cunningham, is one way to reduce credit risk, and a single master agreement that covers transactions between two parties creates greater legal certainty that credit risk will be decreased through netting. As with the foreign exchange market, OTC market participants have developed a master agreement applicable to swaps and other derivatives instruments—the International Swap Dealers Association (ISDA) Master Agreement.

Netting and Payment Systems

Netting—an agreed offsetting of positions or obligations by trading partners in a system—is by no means a new concept, according to Mario Giovanoli of the Bank for International Settlements. The modern tradition of clearing checks, for example, began over 200 years ago when the clerks of the main London city banks decided to meet daily in the back room of a coffeehouse to clear the checks drawn on their respective banks. Today, a hypothetical payment from a debtor to a creditor may proceed from the debtor's bank to an intermediary bank and through either the central bank or an independent payment system and then on toward the creditor's bank. Giovanoli examines two types of payment systems: gross settlement systems in which individual payments are processed separately and as soon as possible; and net settlement systems in which the payment process involves two phases—netting and settlement. In the netting phase, payment orders are transmitted to the netting agent, who calculates the positions of the participants at an agreed cut-off time. In the settlement phase, participants with net debit positions must effect settlements in favor of participants with net credit positions.

Settlement risk in respect of large-value payments, according to H. Rodgin Cohen of Sullivan & Cromwell, is the "principal systemic risk that preoccupies central bankers today." Settlement risk can be reduced by requiring all large-value payments to be made on a real-time gross settlement basis. Settlement risk can also be minimized through legally binding netting.

Other topics featured in volume 4 of *Current Legal Issues Affecting Central Banks* are the implications for central banks of two recent international agreements: the General Agreement on Trade in Services (GATS) and the North America Free Trade Agreement (NAFTA); regional developments affecting central banks—such as economic and monetary union in Europe; and banking law developments in Canada, China, the former Soviet Union, the United Kingdom, and the United States.

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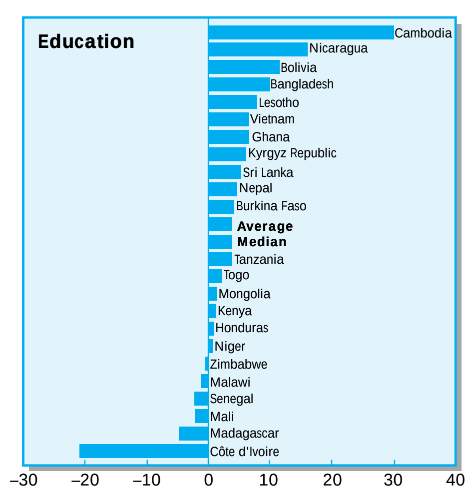
IMF Legal Department

Copies of *Current Legal Issues Affecting Central Banks*, vol. 4, edited by Robert C. Effros, are available for $65 from Publications Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org.

Correction

The chart below corrects an error in the chart appearing on page 228 of the July 21 issue of the *IMF Survey*, in the article on health and education spending in countries with reform programs supported by the IMF's Enhanced Structural Adjustment Facility (ESAF).

Real Per Capita Education Spending
In Countries with ESAF-Supported Programs[1]
(Annual average change in percent)



[1]Between the year preceding the ESAF arrangement and the latest available year.

Data: Country authorities and IMF staff estimates

Assessing the ESAF

(Continued from front page) of ESAF-supported programs. The Executive Board is expected to draw additional lessons for future ESAF-supported programs on the basis of that study.

Countries using ESAF have come a long way from the doldrums of the early 1980s.

Scope of the Review

The conclusions of the IMF staff's current review are organized around possible ways in which ESAF-supported programs may be reoriented to achieve more consistently the ESAF's two key and mutually reinforcing objectives:

- sustained higher growth, with improved living standards; and
- progress toward external viability.

The staff review considers several aspects of ESAF-supported programs: the need for further and more growth-enhancing fiscal adjustment that would also improve prospects for external viability; the case for more decisive disinflation as a spur to growth and measures to achieve it; steps to advance structural reform in two areas where performance has continued to lag—the public enterprises and banking systems; and, finally, modifications to promote more continuity in policy implementation.

The analysis steps back from program-by-program detail and looks instead at how far countries progressed between the beginning of their SAF/ESAF-supported adjustment and 1995, the most recent year for which comprehensive data were available. This approach reflects the view that adjustment and reform are continuing processes that do not begin or end with specific programs; that the full effects of policies may emerge only gradually and with an uncertain lag; and that there is now a sufficient span of experience with adjustment in the countries under review to allow a more extended perspective than was possible at the time of the last ESAF review in 1993. The current study uses a variety of before-and-after, cross-country, and control-group comparisons to examine the links between policies implemented and outcomes achieved.

The IMF staff study accepts the basic strategy for growth and adjustment underlying the ESAF, which is based on a large body of analytical and empirical literature that draws on the experience of all developing countries. The review thus focuses on assessing how well the strategy for growth and adjustment was reflected in the design and execution of programs. The study also seeks evidence on how much progress was made in strengthening economic performance in countries with ESAF-supported programs and how the basic strategy can be refined and improved.

Economic and Social Indicators in ESAF and Other Developing Countries

(Percent a year, unless indicated otherwise)

	ESAF Users		Non-ESAF Developing Countries[1]	
	1981–85	1991–95[2]	1981–85	1991–95[2]
Real per capita GDP growth	–1.1	0.0	0.3	1.0
Inflation:[3] mean	94.4	44.9	23.5	139.9
median	11.7	11.6	9.1	0.3
Gross national saving (percent of GDP)	8.0	9.9	18.6	17.4
Budget balance[4] (percent of GDP)	–9.1	–5.6	–6.8	–4.8
Export volume growth	1.7	7.9	4.4	5.7
Debt-service ratio (actual) (percent of exports of goods and nonfactor services)	27.9	25.7	18.8	15.7
External debt (face value, percent of GNP)	81.9	154.2	55.7	75.6
Gross reserves (months of imports)	2.0	3.5	4.7	5.6
Population growth	2.8	2.5	2.4	2.2
Life expectancy (years at birth)	51.5	55.0	59.7	63.6
Infant mortality (per thousand live births)	111.9	87.5	71.8	52.7
Illiteracy (percent of population age 15 +)	54.8	47.3	32.2	23.0

[1]Developing countries as defined in the IMF's *World Economic Outlook*, that is, all countries not classified as advanced economies or as countries in transition, excluding countries classified as "high income" developing countries by the World Bank and SAF/ESAF users.
[2]1991–94 for some variables.
[3]End of period when available, period; average otherwise.
[4]Overall balance, including grants as revenue.
Data: IMF, *ESAF Review Staff Studies*; *World Economic Outlook*; and *International Financial Statistics*; World Bank, *World Debt Tables* and *Social Indicators of Development*.

Achievements of ESAF Users

The accompanying table provides summary economic and social indicators for the 36 low-income developing countries that have undertaken reform and adjustment programs with the support of ESAF financing. It compares their experience in the five-year period immediately prior to the inception of the SAF in 1986 with the most recent five-year period for which comprehensive data are available. It also compares the experience of the 36 ESAF users with that of non-ESAF developing countries (other than those classified by the World Bank as "high income") during the same periods. This latter comparison is not only a useful benchmark for assessing the magnitude of the improvement in the ESAF countries. It also underscores that ESAF countries, almost by definition, started out with far worse economic indicators than other developing countries.

The internal review suggests that countries undertaking adjustment and reform programs supported by the SAF/ESAF brought their economies a long way from the doldrums of the early 1980s. By 1995, average real per capita output growth among ESAF users (excluding transition economies) caught up with that in other developing countries. The social indicators in most countries improved. Roughly three-quarters of ESAF-using countries moved closer to a viable external position. Budget deficits were trimmed and instances of very high inflation virtually eliminated. Developments during 1994–95 were even more encouraging. Although this may owe partly to the favorable global environment, the liberalization and restructuring undertaken during the past decade support the view that durable gains in economic potential were achieved in the countries reviewed.

Lessons for Future Program Design

Notwithstanding these gains, countries with ESAF-supported programs remain among the poorest in the world and must aim for *sustained and faster* economic growth than other developing countries if they are to close the enormous gap in living standards. This is not in prospect so long as these countries' investment and domestic savings rates continue to fall short of those in the rest of the developing world. Bolder strategies are needed to lift these countries onto a higher growth path. The internal review confirms that the achievement of sustained, outward-oriented growth is also critical in accelerating progress toward a viable external position. Hence, the two principal goals of the ESAF are mutually supporting and can be achieved through a common set of policies, combined with access to financing on appropriate terms and debt relief where necessary.

At the heart of a strengthened approach must be greater efforts to cut government budget deficits in the countries under review. Numerous empirical studies have concluded that public saving is the most effective policy instrument to influence national saving directly in the near term. The internal review finds that weak fiscal discipline inhibits growth through other channels too—by contributing to chronic inflation, weak external positions, and stop-go implementation of corrective policies. The supply response to stronger macroeconomic adjustment would be quicker and more pronounced if supported by structural measures to encourage private investment and entrepreneurship. Thus, the review suggests the following to strengthen ESAF-supported programs:

• stronger and reoriented fiscal adjustment based on durable budget economies, particularly from civil service reform and reduced support for public enterprises, while protecting growth-enhancing expenditures on health and education;

• more resolve in reducing inflation to single-digit levels, through use of monetary or exchange rate anchors where appropriate;

• a more concerted effort to adopt "second generation" structural reforms, especially trade liberalization, public enterprise reform, bank restructuring and strengthened property rights; and

• steps to reduce policy slippage and encourage more sustained policy implementation, including through more intensive program monitoring, greater use of contingency planning in program design, and more proactive technical assistance to build institutional capacity.

ESAF Users in Staff Study

CFA Africa	Other Africa	Asia	Western Hemisphere	Transition Economies
Benin	Burundi	Bangladesh	Bolivia	Albania
Burkina Faso	The Gambia	Nepal	Guyana	Cambodia
Côte d'Ivoire	Ghana	Pakistan	Honduras	Kyrgyz Republic
Equatorial Guinea	Guinea	Sri Lanka	Nicaragua	Lao P.D.R.
Mali	Kenya			Mongolia
Niger	Lesotho			Vietnam
Senegal	Madagascar			
Togo	Malawi			
	Mauritania			
	Mozambique			
	Sierra Leone			
	Tanzania			
	Uganda			
	Zimbabwe			

ESAF Facts

Date established: December 18, 1987.
Purpose: For low-income developing countries, to promote balance of payments viability and growth in a balanced manner, through the mobilization of domestic and external resources, improvements in resource allocation, and the removal of structural impediments.
Financing terms: Interest rate of 0.5 percent a year; repayments in ten equal semiannual installments, beginning 5½ years and ending ten years after the date of each disbursement. Amounts committed (as of June 30, 1997): SDR 7.8 billion ($10.9 billion).
Eligibility criteria: Upon establishment, low-income countries eligible for the World Bank's International Development Association (IDA) loans. Subsequent changes to the list of IDA countries affect eligibility upon a decision of the IMF Executive Board. Currently, 79 countries are eligible for ESAF loans.

Philippines: Extension and Augmentation of EFF

The IMF approved a request by the government of the Philippines to extend until December 31, 1997 the current SDR 474.5 million (about $652 million) Extended Fund Facility (EFF) credit for the Philippines, and to augment it by SDR 316.7 million (about $435 million) to support the government's 1997 economic policies. A total of SDR 508.8 million (about $699 million) is immediately available to the Philippines. The remaining SDR 246.0 million (about $338 million) will be made available following a review of performance under the program and based on end-September performance criteria. The IMF approved the current three-year EFF on June 24, 1994 in support of the Philippines' medium-term economic and financial program (see Press Release No. 94/43, *IMF Survey*, July 25, 1994). The EFF was due to expire on July 23, 1997.

In approving the request of the Philippines for an extension and augmentation of the EFF, the IMF made use, for the first time, of the accelerated procedures established under the emergency financing mechanism (EFM). The EFM was adopted in September 1995 to strengthen the IMF's ability to respond swiftly in support of a member country facing an external financial crisis and seeking assistance from the IMF in support of a strong macroeconomic adjustment program.

The performance of the Philippine economy under the EFF-supported economic program has been satisfactory. Real GDP growth accelerated to 5.7 percent in 1996, inflationary pressures were kept under control, and net international reserves increased to the equivalent of 2.8 months of imports. This performance allowed the Philippine authorities to opt, after making an initial drawing of SDR 36.5 million ($50 million), to treat the EFF approved in 1994 as precautionary and to anticipate not making any further drawings before the EFF expires in mid-1997.

While the macroeconomic program remained broadly on track in the first quarter of 1997, the authorities faced a number of important challenges in the second quarter, including increasing turbulence in the foreign exchange market, slippages in fiscal performance, and a delay in the passage of proposed tax reforms. The combination of a relatively rigid exchange rate and high domestic interest rates encouraged a large inflow of external resources into the Philippine economy, some of it in the form of unstable short-term capital. The peso came under pressure as a result of recent turbulence in regional capital markets. These pressures intensified following the float of the Thai baht on July 2, causing a significant depletion of the Philippines' international reserves.

The authorities responded decisively to pressures on the peso by floating the currency on July 11 and supporting this action by strong fiscal and monetary policies. They requested an extension and augmentation of the EFF until end-December 1997 to allow passage of tax reforms and completion of the final review of the EFF, and, importantly, to support their action to float the peso in order to discourage speculative capital flows.

Philippines: Selected Economic Indicators

	1994	1995	1996	1997[1]
	(percent change)			
Real GDP growth	4.4	4.8	5.7	6.3
Consumer prices (year average)	9.1	8.1	8.4	6.5
	(percent of GNP)			
Consolidated public sector balance	–0.6	–0.1	0.1	0.3
External current account balance	–4.5	–4.3	–4.3	–4.6
	(months of imports)			
Net international reserves	2.7	2.2	2.8	2.1

[1]Program.

Data: Philippine authorities and IMF staff estimates

The 1997 Program

The objectives of the government's economic program for 1997, which is supported by the EFF, are to achieve economic growth of 6.3 percent after 5.7 percent in 1996; to reduce the average rate of inflation to 6.5 percent from 8.4 percent in 1996; to contain the external current account deficit to about 4.6 percent of GNP after a deficit of 4.3 percent in 1996; and to hold net international reserves equivalent to 2.1 months of imports of goods and services by the end of the year.

To these ends, the new exchange rate policy will be supported by strong monetary and fiscal policies. Interest rates will be kept high for some time until the foreign exchange market stabilizes, and base money growth is to be reduced to keep annual broad money growth at 23 percent, a rate consistent with the inflation and growth targets. Fiscal policy will be tightened in the second half of 1997 to offset slippages in the first half and achieve a public sector surplus of 0.3 percent of GNP for 1997, after a surplus of 0.1 percent in 1996. The fiscal tightening will include revenue-enhancing measures as well as expenditure cuts.

Under the program, the government will seek passage of the remaining elements of the comprehensive tax reform package, a vital element of its policies to strengthen savings performance. The financial system will be further strengthened by recently adopted measures to tighten the limits on the exposure of banks to the real estate market and to discourage the growth of foreign currency liabilities through new liquidity requirements; and by removing tax disincentives to peso deposits.

The Philippines joined the IMF on December 27, 1945, and its quota is SDR 633.4 million (about $871 million). Its outstanding use of IMF financing currently totals SDR 188 million (about $258 million).

Press Release No. 97/33, July 18

Recent IMF Publications

Books

Macroeconomic Issues Facing ASEAN Countries, edited by John Hicklin and others ($26.00)

A review of the macroeconomic performance of the members of the Association of South East Asian Nations and of the policies needed for sustained growth.

Working Papers ($7.00)

97/76: *A Model of an Optimum Currency Area*, Luca A. Ricci
Investigates the circumstances under which participation in a currency area is beneficial.

97/77: *Unemployment Persistence and Capital Shortage: The Case of Trinidad and Tobago*, Benedikt Braumann
Examines the link between capital stock and the persistence of unemployment to understand unemployment in Trinidad and Tobago during the past 20 years.

97/78: *Tax Burden and Migration: A Political Economy Perspective*, Assaf Razin and Efraim Sadka
A stylized model of migration and human capital formation that suggests that low-skill migration may lead to a lower tax burden and less redistribution than no migration.

97/79: *Leading Indicators of Currency Crises*, Graciela Kaminsky and others
Examines the empirical evidence on currency crises, with a proposal for a specific early warning system.

97/80: *Inflation in Transition Economies: How Much? and Why?*, Atish R. Ghosh
An examination of the effects of inflation in transition economies suggesting that low inflation may be important for achieving remonetization and sustained output growth.

97/81: *Financial Sector Reforms in Algeria, Morocco, and Tunisia: A Preliminary Assessment*, Abdelai Jbili and others
A review and assessment of financial sector reforms in three Middle Eastern countries.

97/82: *Macroeconomic Fluctuations in Sub-Saharan Africa*, Alexander W. Hoffmaister and others
An examination of the sources of macroeconomic fluctuations in sub-Saharan Africa through a comparison of CFA franc countries with non-CFA franc countries.

97/83: *Do Central Banks Need Capital?*, Peter Stella
An analysis of "central bank capital" and the conditions under which a central bank may need to be recapitalized.

97/84: *Recovery Ratios and Survival Times for Corporate Bonds*, Ivailo Izvorski
An analysis of the determinants of the recovery ratios and survival times (time until default) for U.S. corporate bonds.

97/85: *Growth, Investment, and Saving in the Arab Economies*, Amer Bisat and others
An analysis of growth, investment, and saving during 1971–96, suggesting that sustained long-term growth requires improvements in investment and domestic saving in Arab countries.

97/86: *Borrowing Risk and the Tequila Effect*, Pierre-Richard Agénor
An analysis of the effects of the collapse of the Mexican peso in December 1994 in a model of the Tequila (or contagion) effect.

97/87: *Capital Flows and the Twin Crises: The Role of Liquidity*, Ilan Goldfajn and Rodrigo O. Valdés
Examines the interaction of liquidity creation by financial intermediaries with capital flows and exchange rate collapses.

IMF Staff Country Reports ($15.00)

97/52: Djibouti
97/53: Dominica
97/54: Gabon
97/55: Malta
97/56: Kingdom of the Netherlands: Aruba
97/57: Tunisia
97/58: Turkmenistan
97/59: Zimbabwe
97/60: Colombia
97/61: Kiribati
97/62: Nepal
97/63: Russian Federation
97/64: Suriname

Press Information Notices (free) 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.

No. 12: Finland
No. 13: Algeria
No. 14: Ireland
No. 15: Bulgaria

Publications are available from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org.

For information on the IMF on the Internet—including the English edition of the *IMF Survey*; the *IMF Survey*'s annual *Supplement on the IMF*, full texts of Press Information Notices; *IMF Publications Catalog*; full texts of IMF Working Papers and Papers on Policy Analysis and Assessment published in 1997, and daily SDR exchange rates of 45 currencies—please visit the IMF's web site (http://www.imf.org).

The IMF: A Quarter-Century of Change

This August marks the IMF Survey's *twenty-fifth anniversary. To commemorate the event, Margaret Garritsen de Vries, former Historian of the IMF, traces the main developments in the IMF's evolution in the 25 years since 1972.*

The *IMF Survey* came into being at a time of momentous change in the international monetary system. Monetary officials, under the leadership of Managing Director Pierre-Paul Schweitzer, were trying to save the ailing par value system, whose implementation had been a central reason for the IMF's creation in 1944. A special committee of experts (the Committee of Twenty) was just being established to work out a reformed system—also, presumably, to be based on "stable but adjustable par values."

The ensuing 25 years have witnessed large changes in the international monetary system, in the rest of the world economy, and in the world itself. One crisis after another burst on the world economic scene. These crises and other changes in global economic and monetary conditions have led to evolutionary change in the IMF—affecting its functions, activities, and policies—all within the context of its basic mandate, as laid out in the IMF's Articles of Agreement.

1973: A Pivotal Year

The Committee of Twenty had barely begun to meet in March 1973 when the par value system collapsed, and floating exchange rates were instituted by some large countries, including the United States. Some observers questioned whether the IMF had outlived its usefulness; even IMF officials had some doubts about the institution's future role.

H. Johannes Witteveen

More economic turmoil was on the way. By midyear, inflation in the industrial countries had surged to several times the rates prevailing in the 1950s and 1960s, signaling the onset of double-digit inflation that persisted throughout the 1970s. Then, at year's end, oil producing countries, acting in unison as the Organization of Petroleum Exporting Countries, announced a quadrupling of oil prices, triggering sudden unprecedented disequilibria in international payments. The "oil crisis" was at hand.

The IMF's reaction to the oil crisis initiated an approach that has continued ever since. H. Johannes Witteveen took over as Managing Director in September 1973. Fearing that inflation and massive oil-related payments deficits would result in large and destabilizing swings in exchange rates—and even in competitive depreciations and a return to trade and payments restrictions on a scale reminiscent of the 1930s—the IMF set up a special, temporary facility to help channel financing to member countries with oil-related deficits. Through the oil facility, the IMF began lending quickly and on a large scale. Overall lending during 1974–78 expanded substantially, averaging SDR 3.5 billion a year, compared with SDR 808 million annually in the previous five-year period.

Under Witteveen, the IMF took on added responsibilities. With the world economy in trouble—both from inflation and much slower growth rates than the average 5–6 percent a year in the 1950s and 1960s—critical analyses of economic trends and policies became more vital. The World Economic Outlook exercise was transformed into the centerpiece of the IMF's surveillance of its members' economic policies; this multilateral surveillance was especially important for the IMF's oversight of industrial country policies. The other key vehicle of IMF surveillance was its regular (usually, annual) consultations with each member country. The Second Amendment of the IMF's Articles of Agreement in 1978 gave the IMF the mandate to "exercise firm surveillance over the exchange rate policies of members," along with giving legal sanction to an almost unlimited variety of exchange rate arrangements. Two new ministerial-level committees of Governors—the Interim Committee of the IMF's Board of Governors and the joint IMF-World Bank Development Committee—were created to make high-level policy recommendations to the Executive Boards of the IMF and Bank.

IMF Innovates in Response to Debt Crisis

As it turned out, although the IMF increased the credit it extended to members, only a small proportion of the financing of oil-related payments deficits came from the IMF. By far, the bulk took the form of recycling of "petrodollars" through a large expansion of lending by private commercial banks during 1979–82. Using a steadily rising flow of deposits from oil exporting countries, commercial banks began, for the first time, to lend directly to the governments of many developing countries. As bank credit became readily available, many developing countries opted to accumulate large external debts instead of undertaking the macroeconomic and structural adjustment needed to adapt to higher oil prices.

Soon, however, the debt crisis of the 1980s would break out. Inflation in industrial countries had gotten out of hand; this was followed by another steep run-up in oil prices, which resulted in a second oil crisis. In contrast to their response to the first oil crisis, monetary authorities of industrial countries adopted tight anti-inflationary policies. These policies continued through 1981 and the first half of 1982, even as world recession persisted. They led to higher world interest rates and to large declines in exports and growth rates of many developing countries. Commercial bank lenders, reappraising the ability of developing countries to service their debts, abruptly and severely cut back their lending. Many developing countries—beginning with Mexico in August 1982 but extending to others as well—could not meet debt-service payments on schedule, which precipitated considerable anxiety among private bankers and monetary officials.

In the wake of the debt crisis, the IMF came to play a leading and highly visible role in world finance. In conjunction with monetary officials, Jacques de Larosière, who had become IMF Managing Director in 1978, developed a three-pronged debt strategy to deal with debt problems on a case-by-case basis. The IMF undertook:

- to help members design and implement growth-oriented adjustment programs that would achieve a viable balance of payments position in the medium term;
- to lend substantial amounts to members undertaking adjustment programs (the IMF disbursed SDR 36 billion during 1982–86), on the condition that bank creditors continue some of their lending; and
- to help debtor countries and commercial banks arrange an unprecedented number of debt restructurings and reschedulings.

The IMF received both praise and criticism for its innovative initiatives to manage the debt crisis. While the international financial system did not crumble as had been feared, the conditionality of adjustment programs came under attack. Critics alleged that the IMF set unreasonable targets for payments adjustment, causing unduly difficult conditions. This, in turn, imposed particular hardship on the poorest groups in debtor countries and entailed sizable net flows of funds (as repayments of earlier loans) from developing members to private bankers. The criticism diminished as the debt crisis in the major borrowing countries gradually receded toward the end of the 1980s and led to some recovery from the sharp declines in income that had occurred in some debtor countries.

Gradually, economic recovery gained momentum, thanks to the firm implementation of adjustment programs, debt renegotiations and reschedulings, and other arrangements to alleviate debt burdens. The IMF was centrally engaged along with creditors and debtor countries in these initiatives.

New debt arrangements continue to evolve. As the debt crisis eased in the middle-income countries, the focus of the debt strategy shifted to low-income developing countries. At present, the IMF and the World Bank are participating in a broad initiative involving all creditors of heavily indebted poor countries (HIPCs) to reduce their debt burdens to sustainable levels.

Jacques de Larosière

In light of the resumption in growth, and renewed creditworthiness, of many indebted developing countries, the IMF's policy advice embodied in IMF-supported adjustment programs would appear to have been vindicated. Indeed, by the early 1990s, a sea change had occurred in attitudes toward IMF conditionality. Developing countries, as well as industrial countries—in what Managing Director Michel Camdessus, appointed in 1987, has often referred to as the "silent revolution"—have come to accept the need for macroeconomic policies that avoid excessive budget deficits and credit expansion, keep inflation under control, and maintain a realistic exchange rate and for structural policies that effectively increase an economy's supply capacity.

IMF Becomes Major Player

The IMF, under the leadership of Michel Camdessus, has become even more of a key player in the global economy. By the early 1990s, the IMF's public profile had risen, partly reflecting its important role in lending. Structural adjustment programs—the package of macroeconomic and structural adjustment policies developed by member countries and supported by IMF financing—were aimed at improving the macroeconomic position of these countries and reshaping their economic structure to enhance their supply response—both by increasing the efficiency of resource use and increasing output potential. Structural measures included tax and financial reforms, privatization, and measures to enhance the flexibility of labor markets.

After the debt crisis, the IMF came to play a highly visible role in world finance.

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The IMF has attracted still more attention in the wake of the collapse of the former Soviet Union, owing to its role in supporting economic reform in Russia and other formerly centrally planned economies in the region and in Eastern Europe. IMF lending to the transition economies (as it has been for developing countries) has been much more broad-based than financial support of earlier years. The relatively straightforward objectives of the past—viable external payments positions or stable exchange rates—are overshadowed by such medium- or longer-term objectives as helping to restructure the economy in a market-oriented way, laying the basis for economic growth while trying to protect the poorest segments of the country and avoid further deterioration of the environment. The IMF's lending objectives have coincided more and more with those of the World Bank, and the two institutions have been working together more closely during the 1990s.

For the past 25 years, the IMF has adapted continuously within the context of its mandate.

Financial Crises and the IMF's Further Evolution

In the mid-1990s, the increasing global integration of capital markets required the IMF to strengthen its surveillance. The end-1994 Mexican financial crisis underscored how the heightened scale of capital flows and the increasing integration of capital markets could—with a shift in market views about the economic situation or policies in an emerging market country—quickly precipitate massive shifts of capital. The result could be a severe financial crisis, with enormous amounts of capital quickly pouring out of a country and serious spillover effects on markets in neighboring and other countries.

The crisis made it clear that a larger lending role for the IMF in emergency situations was required, but was not enough. The IMF would have to put more emphasis on preventing financial crises. It was critical to keep private investment flowing to developing countries since such investment had become a key engine of their growth. And the countries that benefited most from foreign investment were those that pursued sound policies—a condition the IMF had always attached to its lending—yielding economic stability, low inflation, reduced budget deficits, reasonable credit expansion and interest rates, and realistic exchange rates.

To help avert future financial crises, the IMF acted swiftly to strengthen its surveillance of member country policies. IMF surveillance became more candid and continuous—especially for countries more likely to be susceptible to financial crises and those with potential spillover effects. The IMF also increased its attention to capital account movements in the wake of globalization of financial markets; at present, the IMF is engaged in work on an amendment to its Articles of Agreement that would extend its jurisdiction to include capital account flows.

In an effort to enhance the quality and timeliness of data reported to it and to the markets, the IMF, in April 1996, established a Special Data Dissemination Standard (SDDS) for countries with, or seeking, access to world financial markets, and began work on a general data system for all other IMF members.

The issue of banking soundness has also become important, sparked by concerns about the fragility of banking systems in many economies—concerns brought into focus by the global integration of capital markets. The IMF is collaborating with the World Bank in an effort to to help member countries strengthen their financial sectors. It is also disseminating among its members "core principles" for effective banking supervision developed by the Basle Committee on Banking Supervision. And, most recently, the IMF has begun paying greater attention to the issue of good governance among its membership and to policies needed to sustain growth, reduce poverty, and achieve equitable distribution of income.

As this brief review of developments since 1972 demonstrates, the IMF has adapted continuously within the context of its mandate. The institution's evolution has been such that the IMF today is very different from what it was 25 years ago, and likely to be different still 25 years hence. ■

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
July 21	4.08	4.08	4.47
July 28	4.11	4.11	4.50

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 109.6 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.

Data: IMF Treasurer's Department

IMF Survey Adapts to Reflect IMF's Evolving Role and Openness

The IMF has sought increasingly to explain itself to the public through issuing a range of publications, as well as press releases, fact sheets, and speeches by its senior managers. The *IMF Survey* was created to further help in this effort. It was introduced in August 1972 at a time of momentous change in the international economy and, consequently, at the IMF (see story, page 252). The Bretton Woods system was on the verge of collapse; oil prices had quadrupled and were threatening the stability of the global economy; and high and persistent inflation was undermining growth in much of the industrial world, with damaging spillover effects on developing countries. These developments suggested the need for a periodical to explain the significance of these changes—notably, the new international monetary system post-Bretton Woods—and the IMF's adaptation to them, and to disseminate more nonconfidential information on member country economies.

The IMF's publications program emerged largely in response to a provision in the IMF's Articles of Agreement that "[The IMF] shall act as a center for the collection and exchange of information on monetary and financial problems, thus facilitating the preparation of studies designed to assist members in developing policies that further the purposes of the Fund" (Article 8, Section 5(c)). The IMF's charter requires the institution to publish only an Annual Report, an audited statement of accounts, and IMF holdings of members' gold and currencies; it is also required to report annually on exchange market restrictions maintained by members. Other publications—including the *IMF Survey*—have been introduced over time in response to requests from the Executive Board or to needs perceived by the IMF's management and staff.

Jay H. Reid, former Chief Information Officer, introduced the concept of a biweekly newsletter. Reid recalls that the publication would not have been welcome in the early days of the IMF, as "national authorities reacted to war damage, debt, and inflation with restrictions on foreign exchange and also on public information." The *IMF Survey* was designed from the outset to be the IMF's journal of record, publishing all press releases, speeches by senior management, and data on IMF financial activity and country information. In its early days, under the editorship of Charles Gardner, the *IMF Survey* described the activities of the IMF in the broader context of international economic and financial developments, to give the publication, as Gardner says, "added credibility for being more than a house organ." Thus, the *IMF Survey* initially carried a considerable amount of news of economic and financial developments outside the IMF, in addition to its survey of IMF policies and activities.

In the following decades, the IMF continued to evolve in response to changing global economic circumstances, and the *IMF Survey* documented its evolution. During the 1970s, the IMF extended the scope of its financial support for its members—paying greater attention to structural problems in their economies. Throughout most of the 1980s, the developing country debt crisis occupied much of the institution's time and energy. In the early 1990s, the IMF took on the task of helping formerly centrally planned economies restructure their economies in a market-oriented way and integrate them into the global economy. The December 1994 Mexican financial crisis underscored the need for timely and accurate data reporting by member countries. In response, the IMF strengthened its surveillance of member country policies and introduced a special data standard to guide members with, or seeking, access to capital markets in publishing better and more timely data. As the decade progressed, the themes of increased transparency and openness assumed greater importance—both in the IMF and among many of its mem-

IMF Survey and IMF Publications

The *IMF Survey* appears biweekly, in English, French, and Spanish. The annual *Supplement on the IMF*, a comprehensive reference source, is updated every year in September; the *Supplement* is also translated into Arabic, Chinese, German, and Russian. Total printed copy circulation of the *IMF Survey* is about 33,000, with readers in 194 countries. The *IMF Survey*'s reach is effectively greater, given the publication's "pass-along rate" and the appearance of the English edition on the IMF's worldwide web site (http://www.imf.org).

The *IMF Survey* constitutes just one element of the IMF's publications program. This program (which includes statistical and nonstatistical publications) has expanded substantially in recent years—to publicize staff research and shed more light on IMF policy advice to member countries. In fiscal 1998 (May 1997 to April 1998), the IMF will publish more than 70 titles, generating revenues of about $5 million.

David M. Cheney
Editor

Sara Kane • Sheila Meehan
Senior Editors

Christine Hellemaa
Assistant Editor

Sharon Metzger
Editorial Assistant

Lijun Li
Staff Assistant

Philip Torsani
Art Editor

Victor Barcelona
Graphic Artist

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ber countries. Some members took steps to disseminate more information about their economies—publishing, for example, letters of intent (statements of policy intentions by national authorities to prequalify for IMF financing) and concluding statements of IMF Article IV consultation missions. In this environment of increasing openness, the *IMF Survey* began to publish more cogent descriptions of evolving IMF policies and current and candid information about individual country policies.

Mirroring the added responsibilities taken on by the IMF, the depth and breadth of its country analyses, research, technical assistance, and financing grew in the early 1990s. In part, this owed to analytical work related to helping formerly centrally planned economies move to market-oriented systems, but it was also the result of the globalization of markets and its multiple implications for the membership and for the IMF. To obtain a clearer idea of its readers' preferences, given the rapidly evolving global environment and the IMF's continuous adaptation to it, the *IMF Survey* undertook a commercial readership poll in June 1993. The poll revealed that the *IMF Survey* was its readers' main source of information about the IMF. The publication's subscribers—primarily officials of member governments and of international financial institutions, academics, bankers, and the international media—were most interested in topical macroeconomic policy issues, analyses of country situations, and explanations of the IMF's policies and operations.

The IMF Survey *has changed its look twice since its creation.*

Responding to this feedback, as well as to the IMF's higher global profile in a world in which globalization was presenting new challenges, the *IMF Survey* shifted its focus. It has more recently put almost exclusive emphasis on explaining IMF activities and policies—increasing the candor and timeliness of country analyses and featuring current perspectives on regional and broad policy issues through interviews of key senior staff and more selective coverage of conferences. In a new departure, in March 1994, the *IMF Survey* published a special supplement explaining the significance of the 50 percent realignment of the African CFA franc, featuring interviews with the Director of the IMF's African Department and with senior officials of some CFA countries. Special supplements on major global developments will continue to be published as needed.

The greater complexity of IMF operations and the heavier volume of internally generated material—especially topical research—allows the *IMF Survey* to fill its pages with a diversity of IMF-originated research and analyses on current issues. Because of the increased channels of global economic and financial information, the publication has trimmed its coverage of developments outside the IMF accordingly; it still benefits, however, from the perspectives of outside experts on key issues through selective coverage of conferences. In addition, for greater breadth of content per issue, articles have been shortened, and new technologies have allowed the *IMF Survey* to cover late-breaking developments. English editions of the *IMF Survey* are also now available on the IMF's worldwide web site, along with press releases and other IMF publications—including the *Annual Report*, Press Information Notices, country background documents, and working papers—to extend their global reach.

David M. Cheney
Editor, *IMF Survey*