IMF SURVEY

International Monetary Fund
VOLUME 27
NUMBER 20

November 2, 1998

Brazil and IMF Hold Preliminary Discussions to Prepare Ground for Multiyear Fiscal Program

Following discussions held during the IMF-World Bank Annual Meetings, a Brazilian delegation arrived in Washington, D.C. on Saturday, October 17, to discuss Brazil's fiscal situation, based on current policy assumptions, with IMF staff and management. A news brief, issued on October 20, described this meeting. The text follows.

The discussions were aimed at preparing the ground for prompt support by the international community, including the IMF, for the multiyear fiscal program soon to be announced by the Brazilian authorities, which will include new policy initiatives. Representatives from the World Bank and the Inter-American Development Bank also attended these meetings.

IMF Managing Director Michel Camdessus (left) confers with Brazil's Finance Minister Pedro Sampaio Malan during the Annual Meetings.

Discussions were held on the medium-term path for the primary surpluses of the public sector, within a range of 2.5–3 percent of GDP as agreed between the Brazilian authorities and IMF management during the Annual Meetings.

IMF management agreed with the position of the Brazilian delegation that, within a framework of structural reforms, a three-year fiscal program generating primary surpluses of 2.6 percent of GDP in 1999, 2.8 percent in 2000, and 3.0 percent in 2001 would fulfill the government target of stabilizing the ratio of net consolidated public sector debt to GDP by the year 2000.

Discussions are continuing with the objective of reaching early agreement on the detailed program mentioned in the Joint Statement of Understanding issued on October 8, 1998 (see *IMF Survey*, October 19, page 305). ■

Contents

337 Brazil-IMF Discussions
337 Forum on Capital Account Liberalization
340 Selected IMF Rates
341 Governors' Annual Meetings Addresses
344 Per Jacobsson Lecture
346 Group of 24 Communiqué
348 From the Executive Board
348 Board Resolution Honors Kafka
350 Recent IMF Publications
351 Camdessus on Poverty and Social Justice

Economic Forum Debates Capital Mobility Issues, Addresses IMF Role in Orderly Liberalization

In the year since the Interim Committee called upon member countries to broaden the IMF's mandate to include capital account transactions, a full-fledged emerging market crisis has reignited the debate over the appropriateness of capital liberalization for emerging markets, the usefulness of controls, and the role of the IMF in promoting capital account liberalization.

An IMF Economic Forum, meeting on October 2 on the eve of the fall Interim Committee session, examined these and related issues, taking as its focal point a recently released IMF Occasional Paper, *Capital Account Liberalization: Theoretical and Practical Aspects*.

The authors of the report—Barry Eichengreen, Professor of Economics and History at the University of California, Berkeley; and Michael Mussa, Economic Counsellor and Director of the IMF's Research Department—joined Jagdish Bhagwati, Professor of Economics at Columbia University; Richard Cooper, Professor of International Economics at Harvard; and Ricardo Hausmann, Chief Economist at the Inter-American Development Bank, for a wide-ranging discussion. The panel, moderated by IMF Executive Director Onno de Beaufort Wijnholds, agreed that capital account liberalization was a difficult process and that neither fully unfettered liberalization nor a reimposition of controls (Continued on the following page)

Irreversible changes have made highly mobile capital a fact of life.

Capital Account Liberalization Is a Likely Step For Most, If Not All, Countries

(Continued from front page) once a country had liberalized was appropriate. Many of the participants saw capital account liberalization as the likely outcome for most, if not all, countries, but views diverged on how that process should proceed and what formal role the IMF should play in encouraging liberalization.

Inevitable Capital Mobility

Powerful and irreversible changes in information and communication technology have made highly mobile capital a fact of life, but inevitable capital mobility is no argument for unregulated flows, Eichengreen argued. Clearly, as domestic experience has shown, banks and other financial intermediaries are fragile. Because their assets are relatively illiquid, but their liabilities demandable, banks are susceptible to self-fulfilling crises of depositor confidence. And because these institutions are linked, distress can spread, potentially endangering the entire system.

Eichengreen: Inevitable capital mobility is no argument for unregulated flows.

Years ago, recognition of these fragilities prompted national governments to impose prudential regulations and to be strictest where risk was highest. These same considerations even more strongly justify prudential regulation of international financial transactions, Eichengreen said. In international financial markets, information problems are more pervasive; liquidity is even more difficult to raise in emergencies; and the scope for contagion is greater.

Eichengreen did not advocate a prohibition on, or a rigid regulation of, international financial transactions, but he did favor regulation that took into account the potential for systemic risk. He suggested requiring banks to purchase cover in currency forward or future markets for their open foreign positions (to better align the private and social costs of offshore funding) and to close open positions by matching the currency composition of assets and liabilities when borrowing in foreign currency. Of course, he cautioned, these measures only shifted the risk to bank customers.

Echoing one of U.S. Federal Reserve Board Chairman Alan Greenspan's recommendations, Eichengreen also suggested that capital requirements should be keyed to the source of bank funding and should be higher for banks that borrow abroad. If emerging market bank capital is rarely written down ex post because of political pressures, he said, additional reserves put up ex ante with the central bank might be in order. On the lending side, banks in industrial countries could be required to attach higher-risk weights to short-term claims in emerging markets, with these additional costs passed on to the borrowing banks. If raising the cost of bank borrowing abroad simply encouraged nonbanks to onlend, there would be an argument, he said, "for using taxes for non-remunerated deposit requirements on all capital inflows, not just on capital inflows into the banking system."

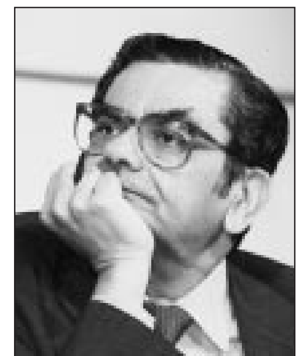
Where would all of this leave the IMF? Eichengreen saw "no contradiction between the use of taxes and tax-like instruments to manage international capital flows and capital account convertibility and the maintenance of capital account convertibility as a desirable goal." Current account convertibility is an IMF goal, he said, but the organization's Articles of Agreement do not forbid the use of import tariffs and taxes on the underlying transactions to better align private and social costs.

Giving the IMF jurisdiction over the capital account would enable it to provide guidance on the optimal speed and sequencing of capital account liberalizations and lend legitimacy to the use of tax and tax-like instruments to limit the level and shape the term structure of foreign debt, Eichengreen said. To reassure skeptics, however, who fear the IMF might be rigid or hasty in exercising these new responsibilities, the IMF should articulate its strategy for capital account liberalization, further explain its approach to sequencing, and continue to clarify its policy toward members' use of tax and tax-like instruments on short-term capital inflows. It should also, he stressed, make it clear that members would retain the right, under Article VI, to apply capital controls under exceptional circumstances.

Trade and Capital Mobility

Though often intertwined in the increasingly heated political discourse over globalization, free trade and free capital mobility are not necessarily analogous, Jagdish Bhagwati observed. "Trade in goods and services is a different animal," he said. Trade is not subject to herd behavior, panics, crashes, destabilizing speculation, and self-justifying outflows of capital currency speculation.

The United States, the Group of Seven industrial countries, and the IMF were "a bit too optimistic and therefore imprudent," Bhagwati believed, in spreading the gospel of capital account convertibility to emerging markets. Too little attention was paid to how difficult capital mobility is to handle, and, in the ethos that evolved around the wonders of cap-



Jagdish Bhagwati: Trade is a different animal from capital mobility.

ital account convertibility, prudential concerns tended to be downplayed. Finance ministers, he reported, feared they would be perceived as being "against reforms" if they did not enthusiastically jump on the capital account bandwagon. But it is apparent now, he said, that short-run exposure without prudential controls played a key role in triggering the crisis in Asia.

But what now? Bhagwati offered separate prescriptions for countries that had, and those that had not, taken the plunge into capital account convertibility. Countries that had not yet liberalized their capital account should adopt a "wait and see" strategy; he advised international organizations to simply let these countries "be where they are." But for those already committed to capital account convertibility, there were real dangers, he emphasized, in appearing to backtrack. "It's a little like trying to leave the Mafia," he joked. The odds of doing it successfully are very slim. "It's just crazy," Bhagwati argued, to try to leave the game when lots of capital has been lost. It simply reinforces the loss of confidence.

A Subversive Thought on Exchange Rates

"You will detect in my comments," Richard Cooper forewarned his audience, "a tremendous ambivalence." He favored capital mobility, he admitted, because first and foremost he preferred living in a country that allowed him the freedom to invest wherever he chose. But there were theoretical and practical reasons, too, for advocating capital account liberalization—improved resource allocation and the likelihood that capital controls would be unenforceable over the long term and would invite corruption.

Curiously, Cooper admitted, it was the allocative efficiency argument that he found least persuasive. The theoretical literature suggested that while trade restrictions persist, free capital movements are likely to worsen the allocation of resources. And an enormous amount of capital seems to move to evade taxes rather than to seek more productive returns. Also troubling, he said, was the herd behavior of financial investors. However rational that behavior might be, it was also myopic and did not necessarily optimize the use of real capital.

Still, in weighing the pros and cons, he came down on the side of liberalization. His subversive thought—which he stressed had not yet crystallized into a conviction—was that high capital mobility may be incompatible with floating as well as with fixed or pegged exchange rates, notably for countries with poorly developed capital markets. In turbulent periods, it is very difficult to build strong expectations around where the exchange rate of a country without a highly developed capital market will settle, and it is very easy for one big player to move these exchange rates a lot.

The risk for all open economies—but especially for small and medium-sized ones—is that essentially arbitrary movements emanating from the financial market can be highly disruptive and lead to a misallocation of resources. If this subversive thought should become a conviction, he said, it would leave him with unhappy choices—namely, the preference for a common currency or its functional equivalent, capital controls designed to inhibit large, short-term surges.

Cooper: The decision to move to free capital mobility should be left to national governments.

What he was not ambivalent about, he noted in conclusion, was the role of the IMF in capital account convertibility. He saw no compelling reason why the international community should pressure countries to move to free capital mobility. While most countries would likely end up there, he strongly favored leaving this decision solely to national governments.

Not Whether, But Which Controls

The mantra of IMF conditionality before 1991, Ricardo Hausmann observed, was to get rid of public banks, interest rate controls, and targeted credit. Since then, however, the IMF has underscored the importance of prudential regulation and supervision. A lot of what the IMF has learned has found its way into this Occasional Paper, he said.

Complimenting Barry Eichengreen on a good theoretical case for regulation, Hausmann focused on aspects of emerging markets that needed particular attention. He contrasted the capital market environments of industrial counties and emerging markets by drawing an analogy between the port of Rotterdam, whose deep natural harbor is always full of ships, and the coast of Brittany, whose bays are crowded with small fishing boats at high tide but become an expanse of sand at low tide. Some days, Hausmann remarked, the markets love us; other days, there is no market out there at all. These sharp shifts force emerging markets to behave a bit like skin divers, he said. When they have an opportunity to breathe, they must breathe a lot and hold it.

Ricardo Hausmann: In emerging markets, liquidity requirements should also be imposed on foreign borrowing.

In view of the very liquid financial markets that characterize emerging markets, Hausmann recommended imposing liquidity requirements not only on domestic deposits but also on foreign borrowing. These liquidity requirements are equivalent to a tax or a withholding requirement on foreign transactions. It is, he noted, a capital control with convertibility—an appropriate regulation for emerging markets playing the skin diver game. He also suggested complementing this requirement with access to additional liquidity if needed.

Hausmann also listed several areas that warranted more attention—for industrial countries, the regulatory discontinuity between investment and noninvest-

ment grade markets; and, with regard to sequencing, the importance of internationalizing the domestic banking sector before liberalization proceeds (to diversify risk, provide access to secondary lines of liquidity, and indirectly generate competition between domestic and foreign regulators).

As to whether the IMF should seek further powers to develop conditionality on capital account convertibility, Hausmann argued the IMF was most effective when it tried to convince, and it did not need to change its charter to make its case.

Addressing the Risks of Capital Mobility

Michael Mussa likened capital account liberalization to fire. It could be tremendously beneficial or highly dangerous, depending on how it is used. The key question is how to maximize the benefits of capital account liberalization while minimizing its risks. Mussa expressed some sympathy for Richard Cooper's suggestion that countries should determine how rapidly and under what circumstances they pursue capital account convertibility. The current crisis, however, also vividly demonstrated that national choices have global implications, and there is "an international interest in having capital account liberalization pursued in a manner that does not generate unduly large risk," he said.

Mussa: The international community must take some responsibility.

A critically important step, Mussa continued, is determining the main areas of risk and devising ways to deal with them. Experience has indicated that foreign direct investment and portfolio equity flows, though volatile, typically do not become the stimulus for acute systemic crises. Sovereign, banking system, and broader financial system debt can, however, carry systemic risk. If a sovereign defaults, for example, "the credit rating for the entire country is written down to junk," Mussa said. Sovereign defaults, such as Russia's, can be avoided through careful attention to the term structure and currency composition of that debt.

A threat to a country's banking system—particularly from external debt denominated in foreign currency—represents a risk that no national government can ignore, Mussa said. The government thus has a strong prudential interest in regulating the banking system to avoid undue risk and in taking appropriate steps to resist massive unwarranted depreciation of the currency. Laxity in monitoring, or even policies that encourage, large-scale, short-term borrowing was at the root of the crises in Thailand and Korea. It is in the interests of these countries, as well as of the world community, he said, to ensure that countervailing policies offset incentives for large-scale, short-term borrowing. Debt flows beyond the banking system raise the question of whether broader types of taxes or other instruments are needed to discourage excessive short-term borrowing. Mussa counseled keeping an open mind on this issue.

He also noted that fixed exchange rates require adequate policies to make them viable—namely, large reserves, flexibility to raise interest rates in the event of pressure, and limited exposure to debt denominated in foreign currency (heavy exposure to debt denominated in foreign currency can make a subsequent change in the exchange rate "catastrophic"). It is primarily the responsibility of the national government, Mussa said, to support its exchange rate with adequate policies, but it is also incumbent upon the international community to remind countries of the dangers they may expose themselves, and others, to as they inevitably adopt more liberal capital account policies.

Mussa concluded by calling attention to the extreme shift in the volume of capital flows that has occurred over the past year. World capital markets pushed a flood of capital into emerging markets—reaching an annual rate of almost $400 billion in gross flows in mid-1997. By the middle of August 1998, these gross flows were zero. An effective mechanism is needed, he argued, to slow that inward movement of capital and deal with market panics in the opposite direction. "No country," Mussa said, "no matter how soundly managed its economic policies, no matter how solid its banking system, can maintain an open attitude toward international capital flows in the face of that type of system disturbance." The international community must take some responsibility—it cannot, he emphasized, insist that all of the responsibility for dealing with this rests with the emerging market countries themselves. ■

Sheila Meehan, *IMF Survey*

The full text of the Economic Forum is available on the IMF's website (www.imf.org). Copies of IMF Occasional Paper No. 172, *Capital Account Liberalization: Theoretical and Practical Aspects,* by a staff team led by Barry Eichengreen and Michael Mussa, are available for $18.00 (academic rate: $15.00) from IMF Publication Services (see page 350 for ordering information).

Selected IMF Rates

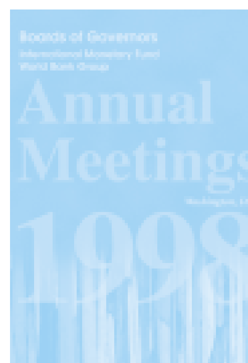
Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
October 19	3.44	3.44	3.68
October 26	3.60	3.60	3.85

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

Data: IMF Treasurer's Department

Crisis Prevention, Stronger IMF, and Multilateral Cooperation Are Focus of Discussions

IMF SURVEY



The impact of the global economic crisis and the most effective way in which the IMF, the World Bank, and other international institutions should respond to it were the primary focus of the governors who spoke during the plenary sessions of the Annual Meetings, which were held in Washington on October 6–8.

All the speakers—drawn from the central bank governors and finance ministers who represented the IMF's 182 member countries—expressed their deep concern at the effect of the crisis on industrial and developing countries alike. They examined ways to strengthen financial systems and surveillance by the IMF and to promote the orderly liberalization of capital markets. Governors drew attention to the extent to which the IMF's unprecedented support for many of the countries affected by the crisis had drained its financial resources and called for the quick approval of the quota increase, the acceptance of the New Arrangements to Borrow (NAB), and the special allocation of SDRs. Many speakers also emphasized the importance of the Enhanced Structural Adjustment Facility (ESAF) and the Heavily Indebted Poor Countries (HIPC) Initiative and called for an increase in collaboration between the IMF and the World Bank. Many also pointed to the importance of involving the private sector to a greater extent in forestalling and resolving financial crises.

Policy Responses to Crisis

Many speakers supported the position taken by Wolfgang Ruttenstorfer, Secretary of State at the Austrian Finance Ministry and Chairman of the Meetings, who, speaking for member countries from the European Union, said that they fully backed the IMF-supported economic and structural reform programs undertaken by the countries affected by the crisis. "Continued persistent implementation of these programs should restore confidence and lead to a resumption of capital inflows." He called on Japan to take the necessary structural reform measures and for Russia to take the necessary steps to restore credibility both inside and outside the country.

Many governors stressed the need for a cooperative response. Jean-Jacques Viseur, Minister of Finance of Belgium, observed: "We have been struck by the breadth, the contagion, and the effects of the current crisis. A concerted and cooperative strategy is therefore urgently needed." He said there were sound reasons for seeking basic improvements in the functioning of the international monetary and financial system.

Responding to points made by other speakers, Kiichi Miyazawa, Minister of Finance of Japan, indicated that the Japanese government was "fully aware that it is imperative to put its economy on the path of recovery and steady growth. Our government will continue to make appropriate policy responses, including the implementation of a range of new measures put forth by the new administration." He called for the IMF to take steps to improve the effectiveness of its programs. Recognizing the enormous capital needs of the Asian countries, Miyazawa said that Japan would provide assistance to help these countries raise funds in international financial and capital markets.

The perspective of a leading developing country was provided by Yashwant Sinha, Minister of Finance of India. He warned that "after five days of intense discussion and debate, we are still at a loss as to why contagion has continued to spread." He asked whether the "apparent ineffectiveness" in coping with the crisis "could be due to the limitations of the Bretton Woods institutions in handling crises spawned by massive reversals of private capital flows in a highly integrated global capital market." He called on the international community to "think creatively to ensure early and preemptive responses to emerging crises."

Menem: All countries should defend the principles of globalization.

President Carlos Menem of Argentina stressed the need for all countries to defend the principles of globalization. He said the time had come to adopt a more universal approach. The next step, he said, "is global integration with a view to sustainable development for all—in other words, development that benefits countries and their peoples." To achieve this goal, he continued, "we must wipe out the last vestiges of protectionism and production subsidies still lingering in the developed economies." It is also vital "to pursue transparency and ensure continuity in the economic reform process," he said. The IMF and the Bank must "be provided with full financial support and be equipped with the resources they need to carry out their tasks successfully, drawing upon the lessons learned in the past."

Bait Elmal: The IMF must monitor economic developments throughout the world.

Strengthening Financial Systems

The governors also devoted considerable attention to the capital account, with most agreeing that the growing volume of international capital flows opens up new opportunities while also imposing new administrative

and institutional challenges on many countries. James Ah Koy, Minister for Finance of Fiji, acknowledged the benefits to member countries of long-term capital flows, but cautioned that "volatile short-term speculative flows...will continue to present a challenge to emerging markets." While most governors favored capital account liberalization, they stressed that sound financial infrastructures must precede liberalization. A number of governors, including those for Ethiopia, India, and Pakistan, mentioned the need for capital account liberalization to take into account each country's individual circumstances, including the depth and breadth of its markets and institutions. Sufian Ahmed, Ethiopia's Minister of Finance, said this would ensure that "weaknesses in specific areas of an economy are not exacerbated when capital controls are removed." A few governors warned that premature liberalization could hurt economic security and social stability in their countries. Cyprus's Minister of Finance Christodoulos Christodoulou, for example, noted that the unfavorable experiences of a number of countries had made the Cypriot authorities cautious in freeing up their markets to harmonize their policies with those of the European Union countries.

Mustapa: The downside risks of liberalization have been downplayed.

A number of governors, presenting an opposing view, expressed skepticism about the benefits of liberalization. Mustapa Mohamed, Minister of Finance of Malaysia, noted that "the belief that globalization and liberalization of markets and the unfettered workings of the market, especially the financial market, can only bring benefits is flawed." In the haste to liberalize, he said, "the downside risks have been downplayed."

Several governors expressed concern about the possible reimposition of capital controls in some countries. Matti Vanhala, Governor of the Bank of Finland, speaking on behalf of the IMF's Nordic and Baltic governors, considered the imposition of currency controls a risky strategy that was generally not effective even in the short term and certainly not in the long term. The Minister for Finance of Bangladesh, Shah A.M.S. Kibria, urged the IMF and the World Bank "to take adequate measures to stem the tide of growing skepticism and any likelihood of reversal toward more insular policies."

Kibria: The IMF and the Bank must stem the tide of skepticism about globalization.

IMF Surveillance

Governors were unanimous in welcoming the IMF's initiatives to strengthen surveillance, improve transparency, and develop international standards in the areas of monetary and fiscal policy, which were seen as crucial for strengthening national financial systems. India's finance minister stressed that the search for international codes of conduct "should eschew one-size-fits-all norms, which do not allow for differences among countries." Mohamed A. Bait Elmal, Secretary of Finance of Libya, attributed the financial crises affecting certain countries to insufficient surveillance by the financial institutions and their inability to foresee these crises. "It is incumbent upon the IMF to monitor economic developments throughout the world and to intervene at the appropriate time to prevent the occurrence of similar crises," he said.

In addition, governors generally agreed that improved transparency should apply not only to public authorities and international institutions but also to private sector institutions, including hedge funds, pension funds, and insurance companies. The result would be a better information base for economic decision making. Transparency and accountability, said Fiji's governor, can help market participants make sound economic judgments rather than psychological decisions."

Role of Private Sector

With one voice, the governors stressed the important role of the private sector in collaborating in preventing and resolving financial crises, both through informal coordination with international institutions and through a financial contribution. Hans Tietmeyer, President of the Deutsche Bundesbank, said it was regrettable that some responses to the crises in recent years and months may have contributed to the "distortion of the incentive structures for financial market players and lulled investors into a false sense of security. Excessively large financial assistance by the IMF can undermine the proper working of the markets," he said, leading to moral hazard—a problem that must be taken seriously. Therefore, Governor Tietmeyer said, "the private sector must be integrated better and earlier into crisis management and bear full responsibility for its actions." Jacob Frenkel, Governor of the Bank of Israel, observed that, in a risky world, agents in the market are operating according to incentives. Thus, "if the government provides the message, implicit or explicit, that it stands ready to bail out, then...the private sector will tend to assume risk to a degree that is excessive from the society's perspective." Gerrit Zalm, Minister of Finance of the Netherlands, also stressed the moral hazard risk and the importance of involving private investors in rescue operations at an early stage. He noted that, "in a global economy with huge and ever-increasing private capital flows, public money simply cannot provide full rescue whenever private creditors panic en masse." Such large-scale responses to crisis, he said, raise unwarranted expectations.

A number of governors called for the creation of a mechanism to reschedule private sector external debt in an orderly manner in intractable cases that cannot be solved by market forces. Gordon Brown, Chancellor of the Exchequer of the United Kingdom, suggested a

mechanism whereby, in the event of a crisis, the IMF would sanction a temporary debt standstill for countries that have adopted good policies to enable them to reach agreements with creditors on debt rescheduling.

IMF Liquidity and Quotas

Governors were unanimous in calling for swift ratification of the proposed IMF quota increase, adherence to the NAB, and approval of an SDR allocation. Among those who expressed concern that IMF resources had fallen to a "critically low level" was Mikhail Mikhailovich Zadornov, Minister of Finance of the Russian Federation, who warned that "We face an immediate challenge to ensure that the role and status of the international financial institutions are fully supported by the financial sources at their disposal." Edgardo B. Espiritu, Secretary of the Department of Finance of the Philippines, expressed concern at what seemed to be "lingering hesitation on the part of the IMF's biggest member countries to give it their full support by way of enhancing the IMF's capital base."

Governor Tietmeyer of Germany, noting that Germany had already consented to the quota increase, said "the IMF's key role in overcoming the crises should encourage all members to fulfill their obligations speedily." Poland has also already consented to a quota increase, and Leszek Balcerowicz, Deputy Prime Minister and Minister of Finance, said the decision could be seen as "proof that my country is prepared to fully discharge its obligations...and that we share the assessment that an early replenishment of the IMF's financial resources has become a matter of operational necessity."

Concern that, even with a quota increase and an allocation of SDRs, the IMF's resources might not be adequate for the needs of the global economy was expressed by Hossein Namazi, Minister of Economic Affairs and Finance of the Islamic Republic of Iran. "The large shareholders should explore all possible ways and means of strengthening the financial resource bases of [the IMF and the Bank] to allow them to carry out their mandates," he said.

ESAF and HIPC Initiative

Governor Sufian of Ethiopia, who spoke on behalf of the African countries, emphasized the urgent need to secure financing for the Interim ESAF and the HIPC Initiative. "For a large number of African countries, there is an urgency for significant debt relief," he said. He called on the international community to move rapidly to qualify additional countries for relief under the HIPC Initiative, pointing out that "the timing of debt relief can be the critical difference as to whether a country can sustain economic reform while taking steps to address in a meaningful way the all-important question of widespread poverty." At the same time, he said, greater consideration should be given to human development indicators and the fiscal burden of debt.

The responsibility of the industrial countries to support developing countries steadfastly was brought out by Jean-Claude Trichet, Governor of the Bank of France, who called for financing of ESAF. "Steadfastness in the continued implementation of the debt initiative for the HIPCs is also crucial," he said. Speaking on behalf of the Caribbean Community countries, Owen S. Arthur, Prime Minister and Minister of Finance of Barbados, welcomed the fact that Guyana would soon be a beneficiary of the HIPC Initiative. He added: "We have no doubt that the overloading of this necessary initiative with excessive and unattainable conditionalities is a serious drawback that has slowed and will continue to slow implementation, and this needs to be addressed."

Announcing a contribution of $7 billion to ESAF, Charlie McCreevy, Minister for Finance of Ireland, said he was encouraged by the positive response to the external evaluation of ESAF. "We must ensure that the lessons of the external review increasingly influence the planning, design, and implementation of ESAF programs," he observed.

Balcerowicz: An early replenishment of IMF resources is an operational necessity.

IMF-World Bank Collaboration

Many speakers stressed the importance of close collaboration between the two Bretton Woods institutions. Governor Zadornov of the Russian Federation said that the two institutions had demonstrated the advantages of close coordination in such areas as the HIPC Initiative. He noted that while there were at times "frictions and even serious disagreements," the present division of labor seems fully justified. Similarly, Governor Tietmeyer of Germany said that the activities of the IMF and the Bank complement each other, and this cooperation "is particularly important when responding to crisis situations in order to avoid conflicting signals."

James Peterson, Secretary of State for International Financial Institutions at the Department of Finance of Canada, identified four areas for more effective collaboration: strengthened cooperation at all levels; properly coordinated policy advice to members; a clearer delineation of the roles and responsibilities of the two institutions; and priority given to collaboration on financial sector reform. Calling for a "revamping of the two institutions," Ram Sharan Mahat, Minister of Finance of Nepal, said they should be given "new vigor and strength to deal with changed circumstances."

Arthur: Overloading HIPC with excessive conditionalities has slowed implementation.

Interim Committee

The IMF's "political legitimacy" needed to be strengthened, according to Governor Trichet of the Bank of France. "The Governors must play a more active and consistent role in a body that represents the diversity of countries involved in international trade," he said. "This is why France supports the principle of changing the Interim Committee into a Council, as the IMF's Articles of Agreement in fact provide."

The principle of strengthening the Interim Committee was endorsed by Governor Viseur of Belgium, who noted that the former Chairman of the Committee, Philippe Maystadt, had recommended the formation of working parties to contribute to its deliberations. Viseur said that he also favored the proposal to transform the Interim Committee into a Council, which would "enhance the legitimacy of the IMF's decisions and, therefore, the effectiveness of its actions" and also strengthen its surveillance role. ■

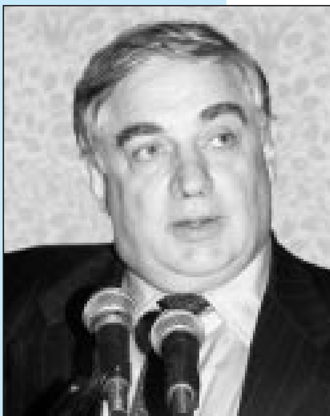
Elisa Diehl, *IMF Survey*

Per Jacobsson Lecture

Managing the International Economy in An Age of Globalization

In this year's Per Jacobsson Lecture, Peter D. Sutherland, Chairman of Goldman Sachs International and of the Overseas Development Council, discussed the challenges globalization poses for managing the international economy and suggested ways of meeting these challenges. His remarks are summarized below. The full text of his lecture is available on the IMF's website (www.imf.org).

Financial volatility may be the most pressing challenge that globalization poses for the international economy, Sutherland said, but others will remain long after the current crisis subsides. The qualitatively new world economy that has emerged under globalization is characterized by an extraordinary volume and pace of international capital flows and a structure in which the production and marketing of goods and services are integrated across national borders. The birth of dozens of new nations and the emergence of nonstate actors have also altered the world's political structure. "Efforts to address international problems must now involve a much larger number of countries than in the past," he emphasized.



Peter Sutherland: Overall, the economic impact of globalization has been positive.

Overall, Sutherland said, the economic impact of globalization has been positive, yielding gains in productivity and efficiency that are driving growth and creating jobs in industrial countries, opening the door to export-led industrialization in middle-income and developing countries, and lifting living standards in low-income countries. Although international investors have abandoned them temporarily, emerging market countries recognize that their long-term recovery requires a successful return to the global capital market.

Challenges of Globalization

Emerging market economies must minimize their vulnerability to external shocks and shifts in investor sentiment, which is exacerbated by large capital inflows. In Asia, Sutherland noted, such flows "fueled the boom on the way in and intensified its downturn on the way out." The values of local currencies plummeted, forcing borrowers to repay in local currency equivalents a multiple of what they had borrowed in dollars. Also, these struggles threaten the economic prospects of other countries, both richer and poorer, through contagion. As interdependence increases, the risks of contagion could grow, and, Sutherland noted, the international community lacks an effective "quarantine strategy" to contain these risks.

The extent to which participation in the global financial system—which is a consequence of globalization—can weaken national policy autonomy, along with the social and economic costs of the crisis, has undermined the confidence of the emerging market economies in both globalization and Western-style free-market capitalism, Sutherland said. He cautioned that a sustained and widespread rejection of these principles would be the most damaging legacy of this crisis.

Many *low-income countries* risk being bypassed entirely by globalization because they lack the human capital, institutions, physical infrastructure, and policies necessary to seize the opportunities it presents. Data from the United Nations Development Program suggest that a significant portion of the world's population has already been marginalized. Poverty, Sutherland stressed, remains the world's most urgent moral challenge.

In the *industrial countries*, globalization has benefited workers overall but has hurt some lower-skilled workers. Through trade, investment, and outsourcing, globalization makes it easier for firms to substitute lower-skilled labor from one country with that from another. Workers thus bear a higher share of the costs of these developments, through reduced bargaining power, job security, wages, and benefits. By weakening the tax base, Sutherland said, "globalization simultaneously increases the demand for social insurance...while decreasing the capacity to provide it."

Governments' political authority no longer corresponds to the geography of markets and production net-

works in which firms and workers operate. At all levels of development, governments are discovering that this growing divide between the national political and economic spheres hampers their ability to carry out policy. Sutherland highlighted some of the most difficult challenges. First, the globalization of production is making it harder for governments to pursue national trade, industrial, and competition policies. Second, the growth of intrafirm transactions is complicating taxation and economic policy. Third, governments are having difficulty managing electronic transactions because, increasingly, global markets are related only tenuously to geographical territory. Fourth, it is harder for governments to achieve social welfare goals, because capital mobility undermines the effectiveness of labor legislation and standards.

Globalization is exposing weaknesses in the current system of global leadership and imposing new pressures on key international institutions, which are being asked to take on missions for which they lack the mandate, the expertise, or the resources. Their failure to meet expectations is due in part to the absence of international political leadership, which, in turn, partly explains the lackluster way in which the world has responded to the current crisis.

New Directions

From his survey of challenges, Sutherland concluded that nations acting alone can no longer hold up their end of the social compact necessary to sustain an open world economy. A new division of labor is required, as are new forms of interaction among private actors, national governments, and the international system. International institutions must play a larger role in managing competition and promoting cooperation by tackling issues that were formerly considered to be exclusively national concerns. They must also help governments better manage the insecurity and volatility associated with globalization. He urged the IMF and the World Bank—which have distinct missions and expertise—to clarify their division of labor and to work more closely together, jointly developing emergency loan packages and conditions. National governments, for their part, must give these institutions the authority to address new global challenges. Most important, emerging market and low-income countries must participate in international decision making.

After underscoring the challenges facing the world, Sutherland suggested steps the international community could take: reduce the debt of those low-income countries that are committed to economic and political reform and make development assistance available to them so that they can build the capacity to expand trade and attract investment. In addition to aid and debt relief, he noted that the low-income countries need help in expanding and diversifying their trade and in attracting investment. Many low-income countries have opened their economies in recent years, and the international community should "reward these difficult reforms by expanding access to world trade markets." Sutherland welcomed the suggestion of requiring more intensive IMF monitoring of capital accounts and agreed with the need for more timely, accurate, and comprehensive data on public and private finances. In addition, he supported a proposal for increased transparency by creditors. Turning to the supervision and regulation of private finance, he underscored the need for new or strengthened standards for securities, accounting, auditing, asset valuation, corporate governance, and deposit insurance to parallel efforts to develop standards of best practices for other financial sectors, especially domestic banking.

On the question of capital controls, Sutherland commented that he could think of no circumstances under which long-term capital inflows or outflows should be controlled. However, he acknowledged that carefully structured controls might be warranted in certain circumstances in a country that needs a respite during which to reform a weak financial sector. Such controls should be temporary and simple, he stressed, and should be used to deter only short-term, overly speculative inflows at the point of entry in an economy. Also, they should be used to support and not avoid structural reform.

The second prong of Sutherland's reform agenda centered on governance. He noted that more effective governance is needed to meet the challenges of globalization and help governments improve the lives and protect the economic security of their citizens. Returning to themes he had raised earlier, he emphasized that improved governance will rest on stronger international institutions and a leadership strategy that corresponds to the scope of today's challenges. In the final analysis, he concluded, sustaining political support for an open world economy is a challenge for political leadership, especially for the leaders of the most powerful nations. They alone can supply the vision and courage necessary to move forward. ■

Fischer Briefs Asian, African Journalists Via Teleconference

On October 15, IMF First Deputy Managing Director Stanley Fischer held the IMF's first press briefing via teleconference in Washington, D.C. Speaking with journalists from Hong Kong SAR and Singapore, he reviewed developments during the IMF-World Bank Annual Meetings and discussed proposals for a new international financial architecture before responding to questions on international and regional developments.

On October 29, Fischer held a second press briefing via teleconference with journalists from Botswana, Malawi, Mozambique, South Africa, Zambia, and Zimbabwe.

The full transcripts of these press briefings are available on the IMF's website (www.imf.org).

Boards of Governors
International Monetary Fund
World Bank Group
Annual Meetings
Washington, D.C.
1998

Group of 24 Communiqué

Effective Globalization Requires Strong National, International Monetary and Financial Systems

Following is the text of the press communiqué issued after the meeting of the Ministers of the Intergovernmental Group of 24 (G-24) on International Monetary Affairs on October 3 in Washington, D.C.

World Economic Outlook

The financial crises witnessed in the Asian region and the Russian Federation have seriously damaged their development efforts. The severe consequences of these crises on the world economy have been compounded by the sharp recession in Japan. In addition to the direct contagion effects and spillovers from market to market and from country to country, a generalized loss of confidence has resulted in unsustainable pressure on the exchange rate and the capital and current accounts in many parts of the world. Contemporaneously, financial markets have exhibited volatility, which has resulted in higher interest rate spreads and the sharp slowing down of private capital flows to developing countries, leading thereby to a significant slowdown in economic activity. The substantial fall in commodity prices is adding to the difficulties faced by many countries and to deflationary pressures on the global economy. Many developing countries have suffered the loss of income, production, and export opportunities, and industrial countries have begun to feel the effects of the crises through large declines in stock markets, pressures on their financial institutions, and lower exports, with severe downside risks for consumer spending and investor confidence.

The real social and economic costs of these recent crises are already considerable. Many developing countries have taken courageous adjustment and reform measures with the assistance of the international financial institutions to face the crisis or to enhance the resilience of their economies. These adjustment efforts have also entailed important social costs. These efforts need to be supported through an early adoption of coordinated monetary and fiscal policies, as well as appropriate structural reforms, in the major industrial countries in order to revitalize the world economy.

Abdelkrim Harchaoui, Minister of Finance of Algeria and Chairman Group of 24.

Ministers call for an easing of monetary conditions in major industrial countries, which would help restore confidence in international financial markets and relieve some of the pressures of capital outflows and heavy external debt-servicing costs for emerging market and developing countries. They also urge Japan to adopt a more expansionary fiscal policy and to take effective action to address the problems in its financial sector. Ministers express concern that, without a sufficient stimulus to domestic demand, particularly in crisis-affected countries, the recent widening of trade deficits in some industrial countries could intensify protectionist pressures in these countries.

Ministers note that the imminent introduction of a new currency—the euro—presents not only new opportunities for the world economy but also challenges for macroeconomic policy formulation in an international monetary system based heretofore on national currencies. These developments require greater international cooperation and strengthened surveillance over the euro zone, in order to enhance the contribution of the euro to the stability of the international monetary system.

Resources and Debt

Ministers call for meaningful measures for debt alleviation—taking into account the needs of the poorest countries and, in special circumstances, the situation of severely distressed middle-income countries—and the acceleration of greater official development assistance in order to release resources to enhance the growth prospects particularly of crisis-stricken and heavily indebted developing countries.

Ministers reiterate their support for the Enhanced Structural Adjustment Facility (ESAF) instrument, which has made a positive contribution to the adjustment efforts of many developing countries. They note the contributions being made by developing countries toward the financing of the ESAF, despite their increasingly difficult circumstances. Ministers welcome the completion of the internal and external evaluations of the ESAF, and they urge the Bretton Woods institutions to implement the relevant recommendations resulting from these evaluations in order to improve its efficiency. In particular, they underscore the importance of strong ownership in the success of the reform process, and they call for flexibility in the negotiation phase to provide the ESAF borrowers with a greater role in the design and sequencing of their program. They also urge for more emphasis to be placed on the identification of social costs of the programs and the establishment of adequate safety nets at an early stage.

Ministers note with concern that debt workouts for heavily indebted poor countries (HIPCs) are slow and inadequate. They express particular concern over the severe impact of reduced commodity prices on many developing countries, including those potentially eligible for ESAF/IDA [International Development Association] support and the HIPC Initiative. They observe with distress that funding for the continuation of ESAF operations and for the HIPC Initiative still falls short of initially estimated requirements, even for the limited number of currently eligible countries. Of the 41 initially targeted countries, 9 countries have reached the decision point, of which only 2 countries have reached their completion points. Ministers urge the acceleration of the decision-making process under the Initiative. They also call for more flexibility to allow for the shortening of the interim period between the decision and completion points, and for the provision of sufficient assistance during the interim period. Ministers underline the need for an expansion of the bilateral contributions within the context of proportional burden sharing, so as to enable more countries to benefit from the Initiative. In light of the increasing urgency of adequate financing for these purposes, they urge consideration of further financing measures, including further contributions by the IMF from the ESAF Trust Reserve Account and the optimization of IMF reserves, including through gold sales. Ministers welcome the decision to extend the sunset clause of the HIPC Initiative to end-2000, at which time there should be another review to decide if a further extension is needed.

Ministers note with concern the deterioration in the financial position of oil- and primary-commodity-exporting countries, following the sharp decline in international demand and prices. They call on the international financial community to support the efforts of these countries in facing the financial resource constraints that have emanated from the contagion effects of the recent crises.

The IMF's response to the current problems in the global economy has put its own resources under unprecedented strain. At the same time, the likelihood of further heavy demands on IMF resources in a crisis-prone global environment is high. As such, Ministers underline the urgent need to complete the agreed IMF quota increase under the Eleventh General Review and to ratify the SDR amendment. However, given the presently tight international financial situation and the difficulty of access to international financial markets by many developing countries, even these resources will not be sufficient. Ministers therefore urge immediate steps to be taken toward a prompt and substantial general allocation of SDRs. Additionally, they express support for intensified consideration of special arrangements for crisis prevention and resolution through regional funds and other forms of bilateral or regional cooperation.

Ministers note that an expanded provision of finance for countries in crisis has put tremendous pressure on IBRD [International Bank for Reconstruction and Development] resources, affecting its capacity to continue to play a constructive role in crisis resolution and prevention and in development finance. Ministers regret the recent actions of the World Bank Board of Directors—opposed by all developing countries—on IBRD net income allocations and loan charges. These decisions include an increase in the pricing of new loans (consisting of a 25-basis-point increase in the loan spread and the addition of a 100-basis-point front-end fee), and the cut from 25 to 5 basis points in the interest waiver applicable to existing loans from fiscal year 1999. These proposals, which place too much of the burden of resolving those capacity limitations on the IBRD borrowers, are inconsistent with the principle of equitable burden sharing in the financing of Bank activities and are particularly inappropriate at a time of growing financial stress for a majority of borrowers. Raising loan charges exacerbates the weakening of the link between the provision of finance and the exercise of voting power, with adverse consequences for the institution's cooperative character in which all stakeholders should share the burden more equitably. While taking note of the considerations behind these actions—in particular, the need to maintain the Bank's high financial standing, as explained by the President of the World Bank—Ministers hope that the measures are temporary and should be reconsidered if the circumstances of the international financial markets and of the Bank change. However, Ministers urge an immediate review of all available options for strengthening the IBRD's operational and financial structure, including a general capital increase and the establishment of the Special Trust Fund supporting new financial instruments, within the framework of a broader review of the overall architecture of the international monetary and financial system.

As IDA is increasingly becoming the main source of concessional finance for several developing countries—particularly the poorest among them—Ministers call for substantial funding for IDA-12 replenishment before the end of 1998, as planned. They also strongly urge that the cost of IDA lending should not be increased.

Human capital and institutional constraints are major obstacles for implementing reforms in sub-Saharan Africa. As the African Governors' Capacity-Building Initiative is at an advanced stage, Ministers strongly urge the international community to provide the funding needed for implementing the Initiative, and they strongly support the urgent establishment of a Trust Fund for this purpose.

Architecture of the International Monetary and Financial System

While reiterating their commitment to an open global trade and payments system, Ministers note that for globalization to be effective requires the creation of strong national and international monetary and financial systems, so that all countries benefit from it. The widespread turbulence in the financial markets of emerging economies and its spreading contagion to established markets in the major financial center countries have brought into sharp focus the necessity of greatly strengthening the architecture of the international monetary and financial system and facilitating the effective allocation of adequate international liquidity.

Ministers take note of the intensified involvement of the Bretton Woods institutions in financial sector issues. They encourage them to help disseminate best practices in the financial supervision and regulatory areas and to strengthen their own capacity to promote technical assistance in these areas. Ministers emphasize that surveillance activities related to financial sector issues must be symmetric between capital-receiving and capital-source countries. In this context, they stress the importance of strengthening supervision of financial institutions in the major financial markets—including hedge funds, currency traders, and other firms undertaking large cross-border transactions.

Bimal Jalan, Governor, Reserve Bank of India (left) and Ismail H. Mohamed, Governor, Central Bank of Egypt.

While fully committed to the provision of accurate and timely information on economic developments and prospects in their countries, Ministers note that premature disclosure of certain types of information remains sensitive and might interfere with policy implementation. While supportive of progress made on transparency in the operations of the Bretton Woods institutions, Ministers nevertheless expect that further progress in transparency should take fully into account the need to protect the confidentiality and candor of the exchanges between member countries and the Bretton Woods institutions.

While recognizing the importance of a dialogue between the Bretton Woods institutions and market participants, Ministers expect the institutions to be mindful of the confidentiality of their relations with members, avoid sharing information with selectively chosen participants, and not allow themselves to be put in the position of serving as rating agencies for market institutions.

Ministers agree that, given the recent experience in the international financial markets, it would be prudent for countries to proceed cautiously with the liberalization of their capital accounts. They also reiterate that the pace of liberalization should take into account the specific circumstances of each country. Ministers note the importance of strengthening the prudential regulation and supervision of their financial systems, in particular, to ensure that they are able to intermediate short-term cross-border flows efficiently. In the case of nonfinancial entities, they underscore the need for improved trans-

parency and corporate governance. In this regard, they express a preference for market-based measures—as opposed to administrative measures—when deemed necessary to discourage short-term external borrowing. Ministers nevertheless expect that, while pursuing the liberalization of their capital accounts, members will have to keep open the possibility of applying appropriate measures to oversee the cross-border exposures of private sector entities and to curb excessive speculative activity in their foreign exchange and equity markets.

Ministers support the extension of the scope of the 1989 IMF policy of lending into arrears in circumstances where members are forced, through the declaration of debt standstills or moratoria, to interrupt the servicing of nonsovereign debt obligations in order to facilitate collaborative agreements between private debtors and their external creditors.

Ministers support the continued exploration of other proposals to support members' efforts to achieve orderly debt workouts, including amendment of the IMF's Articles of Agreement to authorize a stay on the enforcement of creditor claims during the period when the member is negotiating and implementing an IMF-supported adjustment program.

In view of the formidable economic and social difficulties facing postconflict countries, Ministers stressed the importance of implementing well-structured postconflict programs, including the establishment of a Trust Fund that, among other things, could help alleviate their debt burden.

IMF-World Bank Collaboration

Ministers express their strong support for steps to improve collaboration between the IMF and the World Bank, while avoiding cross-conditionality. The current global financial crises, as well as the increased demands on the two institutions and the constraints of their resources, have highlighted the need for improving cooperation and collaboration. These efforts should aim at clearly delineating their respective responsibilities and mandates, preventing duplication, and making better use of their resources.

Institutional Arrangements for Systemic Reform

The recent wave of crises underscores the intensity of the interaction between the economies and confirms the need to identify long-term responses to the many challenges of globalization. In particular, the need for constructive dialogue among developed and developing countries, especially with regard to the repeated appeals for reform of the international monetary and financial system, has become more urgent than ever. Accordingly, Ministers once again call for the establishment of a task force with participation from industrial countries and representatives from a wide range of developing countries to engage in an in-depth examination of issues related to the reform of the international monetary and financial system, especially those identified in the most recent G-24 ministerial communiqué [see *IMF Survey*, April 27, page 131]. The terms of reference of the task force could include the examination of ways to approach these issues more efficiently within existing bodies.

The ongoing discussions among the industrial countries and a number of emerging or transition countries with respect to the problems that have arisen, and appropriate solutions to these problems, are an important step toward a dialogue that, to be comprehensive and effective, must necessarily include more adequate representation of the developing countries. This dialogue should not be a substitute to the relevant discussion in the appropriate decision-making organs of the multilateral financial institutions. ■

IMF Executive Board Praises Kafka's Distinguished Record of Service

On October 29, the Executive Board of the IMF adopted the following resolution of appreciation on the retirement of Alexandre Kafka as Executive Director and dean of the Board:

"Whereas, on October 31, 1998, Mr. Alexandre Kafka will relinquish the post of Executive Director of the IMF, which he has held since November 1, 1966, thus completing a distinguished record of service to the IMF that began when he first joined the staff in 1949: and

Alexandre Kafka

"Whereas, Mr. Kafka has indefatigably and devotedly sought to foster the spirit of international cooperation and to work for the realization of the ideals which the IMF was established to promote; and

"Whereas, Mr. Kafka has been a mentor, colleague, source of inspiration, and friend to many generations of Executive Directors, members of management, and staff;

"Now therefore, it is resolved: that the members of the Executive Board express to their associate and dean, Mr. Kafka, their tribute to his long, committed, and effective service to the IMF and the world community; their appreciation of his dedication to the IMF and to those associated with it; and their hope that they will continue to benefit from his friendship and counsel for many years to come."

Press Release No. 98/54. October 29

From the Executive Board

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

IMF Names New Head of Monetary and Exchange Affairs Department

IMF Managing Director Michel Camdessus has appointed Stefan Ingves, a national of Sweden, as Director of the IMF's Monetary and Exchange Affairs Department for a four-year fixed-term appointment, effective January 4, 1999. Ingves, aged 45, succeeds Manuel Guitián, who is retiring from the IMF.

Stefan Ingves

Ingves is currently First Deputy Governor of the Bank of Sweden and in this capacity is a member of the Group of Ten Deputies, the Bank for International Settlements Eurocurrency Committee, the Banking Supervisory Committee of the European Central Bank, and the European Union Commission's Banking Advisory Committee. He studied at the Stockholm School of Economics, where he received his Ph.D. in economics in 1984, and at Princeton University. He previously served as Director General of the Swedish Bank Support Authority,

Undersecretary in the Swedish Ministry of Finance with responsibilities for financial markets and institutions, and President of Sweden's Options and Futures Exchange, and was a Board member of both the National Debt Office and the Stockholm Stock Exchange.

Manuel Guitián, a national of Spain, joined the IMF staff in 1970 and has served in a number of senior positions, including Deputy Director of the Exchange and Trade Relations Department (now the Policy Development and Review Department) and Deputy Director of the European Department, before his appointment as Associate Director of the Monetary and Exchange Affairs Department in 1991 and as Director in 1994.

The Monetary and Exchange Affairs Department provides advice to member countries and supports the IMF's area departments on issues related to central banking, monetary and exchange management, monetary and exchange market institutions and reforms, and financial system soundness; administers the IMF's program of technical assistance in these areas; and coordinates this assistance with collaborating central banks and other international organizations. The Department also conducts analyses of the institutional and structural aspects of monetary and exchange policies and instruments, including identification and analysis of issues in banking and financial markets that bear on macroeconomic policies. In this latter role, the Department is providing policy advice and considerable technical assistance to over 92 countries, including Indonesia, Korea, and Thailand, as they restructure their financial systems under IMF-supported economic programs.

Press Release No. 98/50, October 19

Ethiopia: ESAF

The IMF has approved the second annual loan for Ethiopia under the Enhanced Structural Adjustment Facility (ESAF), equivalent to SDR 29.5 million (about $42 million) to support the government's economic and financial program for the fiscal year 1998–99 (July 8–July 7). The loan will be disbursed in two equal semiannual installments, the first of which is available immediately.

Medium-Term Strategy and Program for 1998–2001

The government's medium-term economic strategy is geared at securing fast, broad-based, and more equitable economic growth in the context of macroeconomic stability. The principal macroeconomic objectives for 1998–2001 are to achieve an average annual GDP growth of 7.75 percent a year, contain inflation below 4 percent, and rebuild gross foreign reserves to a more comfortable level. The external current account deficit is projected to remain at 8–8.5 percent of GDP, owing to growing imports and weak prospects for coffee export prices.

Within this medium-term strategy, Ethiopia's program for 1998–99, which will be supported by the second annual ESAF arrangement, projects a significant recovery in GDP growth—possibly in the 8–9.5 percent range—keeping inflation under 4 percent and containing the external current account deficit at about 8 percent of GDP.

Structural Reforms

The government's agenda in the structural area includes financial sector reforms, trade liberalization, strengthening the country's legal and regulatory framework, raising health and education standards, protecting the environment, and alleviating poverty through fostering rural development.

Ethiopia joined the IMF on December 27, 1945. Its quota is SDR 98.3 million (about $139 million). As of end-September 1998, Ethiopia's outstanding use of IMF resources totaled SDR 62.8 million (about $89 million).

Press Release No. 98/51, October 23

Ethiopia: Selected Economic Indicators

	1994/95	1995/96	1996/97		1997/98		1998/99	1999/2000	2000/01
			Program	Estimated	Projected	Estimated		Program	
	(annual percent change)								
GDP at constant prices (at factor cost)	6.2	10.6	6.0	5.6	2.8	0.5	8.0–9.4	6.7	7.0
Consumer prices (period average)[1]	13.4	0.9	1.2	–6.4	5.0	2.5	3.9	3.7	3.4
	(percent of GDP)								
External current account balance, excluding official transfers	–4.4	–9.9	–10.5	–7.1	–10.7	–7.6	–8.2	–8.6	–8.4
Overall fiscal balance, excluding grants (commitment basis)	–7.4	–8.7	–7.7	–5.1	–6.9	–7.3	–5.9	–6.8	–7.2
External debt (including to IMF)	80.3	71.6	73.5	64.4	74.0	157.0	144.6	144.1	142.5
Debt-service ratio[2,3]	35.1	35.2	32.6	42.4	29.2	45.0	60.0	55.0	36.5

Note: Beginning in 1997/98, all data pertain to the period July 8–July 7; prior to that, fiscal and monetary data cover the period July 8–July 7, and other data, July 1–June 30.

[1]Addis Ababa retail price index until 1996/97 and national consumer price index thereafter.

[2]Before debt relief and including ruble-denominated debt and debt service to Russia beginning in 1997/98; evaluated at US$1 = SUR 0.6, where SUR denotes the former Soviet Union ruble.

[3]On a commitment basis; expressed in percent of exports of goods and nonfactor services.

Data: Ethiopian authorities and IMF staff estimates and projections

Bangladesh: Emergency Assistance

The IMF approved a request for emergency assistance by Bangladesh equivalent to SDR 98.13 million (about $138 million) to assist in the country's economic recovery in the aftermath of devastating floods.

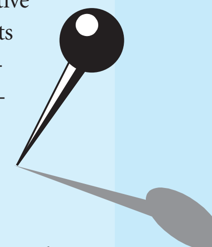
Public Information Notices

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

Ireland, No. 80, October 22

Benin, No. 81, October 23

Full texts are available on the IMF's worldwide website (http://www.imf.org/pins).



From mid-July to late September this year, Bangladesh was struck by severe floods that at its worst had inundated three-fourths of the country. The floods have inflicted human hardship on a large scale and caused widespread damage to the nation's infrastructure. The adverse impact on the 1998/99 budget is provisionally estimated at 1.6 percent of GDP, reflecting tax revenue losses and additional outlays for relief operations, and for rehabilitation. Bangladesh has taken several steps to strengthen the macroeconomic framework and the IMF stands ready to provide technical assistance in strengthening tax administration.

Bangladesh has made considerable progress over the last few years in stabilizing and liberalizing its economy. Although economic growth will slow to 3–4 percent in the current fiscal year as a result of the floods, real GDP growth was a robust 5½ percent in 1997/98, led by strong export performance and a recovery in the manufacturing sector. Looking ahead, the government has to accelerate structural reforms in three key areas—revenue, banking, and public enterprises. This will lay the foundations for sustained economic growth.

Press Release No. 98/52, October 29

Photo Credits: Denio Zara and Padraic Hughes for the IMF.

Recent IMF Publications

Working Papers ($7.00)

98/121: *Capital Structures and Portfolio Composition During Banking Crisis: Lessons from Argentina 1995*, Alberto M. Ramos. Constructs a theoretical framework rationalizing banks' adjustment dynamics following a period of financial distress.

98/122: *Tax Smoothing in a Financially Repressed Economy: Evidence from India*, Paul Cashin and others. Using data from 1951 to 1997, finds that the central government of India has tax smoothed, while the regional governments have not.

98/123: *Does the Long-Run PPP Hypothesis Hold for Africa?: Evidence from Panel Co-Integration Study*, Jun Nagayasu. Addresses whether parallel market exchange rates in Africa behave in the long run consistently with the purchasing power parity hypothesis.

98/124: *Self-Fulfilling Risk Predictions: An Application to Speculative Attacks*, Robert P. Flood and Nancy P. Marion. Shows that changing market beliefs about currency risk can generate a self-fulfilling speculative attack on a fixed exchange rate.

98/125: *Fixed Investment and Capital Flows: A Real Options Approach*, Jorge A. Chan-Lau and Peter B. Clark. Draws a link between international capital flows and the real options approach to investment by extending a model of real estate investment.

98/126: *Central Banking in Transition Economies*, Helmut Wagner. Focuses on the preconditions of disinflation and successful stability policy in transition countries.

98/127: *Financial Crisis and Credit Crunch as a Result of Inefficient Financial Intermediation—with Reference to the Asian Financial Crisis*, Jorge A. Chan-Lau and Zhaohui Chen. Develops a model of private debt financing under inefficient financial intermediation.

Papers on Policy Analysis and Assessment ($7.00)

PPAA/98/11: *Capital Account Liberalization in the Southern Mediterranean Region*, Saleh M. Nsouli and Mounir Rached. Examines to what extent countries in the region need to reinforce policies to sustain capital account convertibility.

PPAA/98/12: *Inflation, Credibility, and the Role of the International Monetary Fund*, Carlo Cottarelli and Curzio Giannini. Discusses the different options that would allow the IMF to support programs aimed at disinflation.

IMF Staff Country Reports ($15.00)

98/86: Federated States of Micronesia—Recent Economic Developments
98/87: Algeria—Selected Issues and Statistical Appendix
98/88: Benin—Selected Issues and Statistical Appendix
98/89: Central African Republic—Statistical Annex
98/90: Republic of Croatia—Selected Issues and Statistical Appendix
98/91: Eritrea—Selected Issues
98/92: Republic of Lithuania—Selected Issues and Statistical Appendix
98/93: São Tomé and Príncipe—Statistical Appendix
98/94: Seychelles—Statistical Annex
98/95: Sri Lanka—Recent Economic Developments
98/96: South Africa—Selected Issues
98/98: Cyprus—Selected Issues
98/99: Georgia—Recent Economic Developments and Selected Issues
98/100: Greece—Selected Issues
98/101: Haiti—Recent Economic Developments
98/102: Kingdom of the Netherlands—Selected Issues

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

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

Camdessus on Debt Relief and Poverty Alleviation

Plight of the Poorest and Social Justice Are Important Items on the IMF's Agenda

Following are edited excerpts of an address given by IMF Managing Director Michel Camdessus at the Conference on the Ethical Dimensions of International Debt, Seton Hall University, South Orange, New Jersey, on October 22. The full text of this speech is available on the IMF's website (www.imf.org).

What does it mean for the IMF to serve the poor? It is valuable, in the midst of the present global turmoil to concentrate on the most persistent crisis, the continuing poverty of too large a proportion of our global community. Strategically speaking, it is important to have this twin focus—debt relief and poverty alleviation—as they can be mutually reinforcing. But let us focus on *both*, because if we exclusively stress debt relief, we might perhaps win a battle, but we would lose the war. And we are losing the war! Since we started, at the end of 1995, talking about an initiative for the heavily indebted poor countries (HIPC), official development assistance (ODA) has fallen from the already very low ratio of more than 0.3 percent of GDP to just over 0.2 percent—the lowest rate recorded in the past half century!

Strategies for Poor Countries

Because the IMF is a *monetary*—not a development—institution, how do we bring these poverty concerns to the heart of our program design? Chiefly, by progressively convincing our membership that our ultimate goal must be high-quality growth, which may be briefly defined as growth that

- can be sustained over time without causing domestic and external financial imbalance;
- is accompanied by adequate investment, particularly human investment through education and health, to take full advantage of the tremendous leverage of human capital for future growth;
- to be sustainable is based on a continuous effort for more equity, poverty alleviation, and empowerment of poor people; and
- promotes protection of the environment and respect for national cultural values.

Even if the IMF is not a "development" institution in the classic sense of that term, we are *always* motivated by the objective of establishing this high-quality growth. All our assistance—policy advice, financial support, technical assistance, and training—seeks this end.

But to design programs for the poorest countries, we must first understand the reasons for their poverty and indebtedness. Many factors have been identified, including a harsh external environment, poor macroeconomic management, poor governance in both public and private sectors, and declining ODA flows. Borrowed resources were not used productively, and income growth was retarded, and external debt rose to very high levels.

Debt relief on its own, without responses to all the other causes of poverty, will not resolve the problem in a lasting fashion. But such debt relief should not be seen as a universal panacea for the problems of the poorest countries. Each case may be seen as a quest for a well-judged blend of policy adjustment—including adequate social support mechanisms—and external financing, including the possibility, in many cases, of indispensable debt relief. We have been doing that for 11 years through our Enhanced Structural Adjustment Facility (ESAF), which has become the centerpiece of the IMF's support for the poorest countries.

But some countries face exceptional problems. Time has shown, and the international community has finally acknowledged, that countries' own efforts were just not enough, even when supported by the ESAF and existing debt-relief mechanisms and aid flows. Therefore, the HIPC Initiative was launched by the World Bank and the IMF. The Bank and the IMF are actively encouraging all potentially eligible countries to pursue their adjustment efforts so as to qualify for assistance as soon as possible.

Should there be an outright cancellation of poor countries' external debt? Though appealing, this suggestion is most unlikely to be realized. It took a tremendous effort to reach consensus on the HIPC Initiative, and many creditors have yet to make their contributions to enable the IMF to play its full part. It is not plausible that these countries will be convinced of the need for a new round of debt forgiveness. Also, ODA budgets are increasingly constrained. This has created the strong risk—already materializing—that more debt relief could lead to lower aid flows to other, equally needy countries.

Further, there is the question of moral hazard. Do debt relief and concessional aid flows encourage less than optimal policy by debtor governments or reckless behavior by investors? You are only too aware of how difficult it is to make sure that ODA and NGO [nongovernmental organization] resources reach the target groups, especially if the resources must be channeled through government budgets.

Recognizing that relief under the HIPC is conditional upon policy implementation, it is valid to ask: Is structural adjustment working in these poor countries? There is no doubt that economic reform can be painful. But the experience of the past five years, as many countries have implemented IMF-supported adjustment programs, is striking. Two decades of distressingly weak performance

IMFSURVEY

Ian S. McDonald
Editor-in-Chief
Sara Kane • Sheila Meehan
Senior Editors
Elisa Diehl
Assistant Editor
Sharon Metzger
Senior Editorial Assistant
Jessie Hamilton
Administrative Assistant
Li Lijun
Staff Assistant
Philip Torsani
Art Editor
Victor Barcelona
Graphic Artist

The *IMF Survey* (ISSN 0047-083X) is published in English, French, and Spanish by the IMF 23 times a year, plus an annual *Supplement on the IMF* and an annual index. Opinions and materials in the *IMF Survey* do not necessarily reflect official views of the IMF. Any maps used are for the convenience of readers, based on National Geographic's *Atlas of the World*, Sixth Edition; the denominations used and the boundaries shown do not imply any judgment by the IMF on the legal status of any territory or any endorsement or acceptance of such boundaries. Material from the *IMF Survey* may be reprinted, with due credit given. Address editorial correspondence to Current Publications Division, Room IS9-1300, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-8585; or e-mail any comments to imfsurvey@imf.org. The *IMF Survey* is mailed first class in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged $79.00 annually. Apply for subscriptions to Publication Services, Box XS800, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-7430. Fax: (202) 623-7201; e-mail: publications@imf.org.

have been followed in most sub-Saharan African countries by a return to positive per capita income growth. But the global financial crisis now threatens these countries with a weaker external environment. This is not a time for relaxing adjustment and reform efforts, but it certainly is a time for us to be ready to take extra steps to help these countries maintain their own efforts.

Strategies for Reaching Poor People

A first principle was clearly articulated for us by Amartya Sen on the occasion of a recent IMF conference on Economic Policy and Equity [see *IMF Survey*, June 22, page 189]. He noted that "the greatest relevance of ideas of justice lies in the identification of *patent injustice*, on which reasoned agreement is possible, rather than in the derivation of some precise formula for determining how the world should be run." With limited resources, assistance should be targeted at the most seriously disadvantaged. For the rest of the population, the goal of government policy should be to provide equitable access to opportunities for education, health care, and nutrition.

These issues also emerged clearly from the recent internal and external reviews of the ESAF and were echoed in the review of the HIPC Initiative [see *IMF Survey,* March 23, page 181; and August 5, 1997, page 233]. The dominant theme of the ESAF review was the need to protect vulnerable social groups better. Some clear messages emerged from these reviews that showed where we can reinforce our efforts:

• Strong monetary policy to fight high inflation is an integral and indispensable part of the effort on behalf of the poorest.

• Strong fiscal policy is crucial for long-term development, by increasing total national saving and making more investable resources available.

• Where public resources are constrained, it means that the *quality* of fiscal adjustment is an essential ingredient for successful programs.

• To achieve lasting benefit, programs need to consider a third dimension of policies beyond "traditional" structural adjustment—governance.

When reform measures are taken, almost inevitably some social group loses out. Where patent injustice arises, *social safety nets* are needed not as an afterthought, but from the outset. The task is made difficult by severe emergency conditions with poor data availability and administrative capacity, weak political commitment, vested interests, and limited foreign aid. We are still in a learning process, but the recent decision of the World Bank to double its contribution to emergency social loans eloquently demonstrates how seriously the issue is taken by the Bretton Woods institutions.

Many of these issues require action that lies far outside the IMF's traditional mandate. Generally, the IMF recognizes that the programs it implements have far-reaching consequences in the economies and societies of its members. We accept an obligation to ensure that the adverse consequences are minimized and that our advice is consistent with all aspects of reform programs. But we cannot do that alone. We must rely on the expertise of other agencies, such as the World Bank, regional development banks, bilateral donors, and NGOs, to ensure that the diverse elements of these programs are implemented.

Camdessus: The IMF recognizes that the programs it implements have far-reaching consequences in the economies and societies of its members.

Let us emphasize some ingredients for an improved strategy for the poorest countries:

First, they must be designed with the permanent objective of regional integration as part of the process of broader integration in the world economy.

Second, "ownership" of the programs by the authorities is vital. Programs work only where the authorities are fully committed to their objectives. When authorities are only mildly committed to social change, where do we draw the line in pushing our social or governance agenda? All of us—churches, NGOs, and ourselves—have an important role to play. There is great scope for the churches and the NGOs to engage with us in constructive dialogue to reconcile human needs and policy frameworks.

Third, you can join us in urging the donor community to fulfill—and go beyond—its pledges. We need to ensure that the ESAF and the HIPC Initiative are fully funded. The donors should be encouraged to give urgent attention to reversing the relative decline in ODA flows, and to see as sacrosanct the Development Assistance Committee target of reducing by one-half the proportion of the world's population living in extreme poverty by 2015.

As for the IMF, we recognize a need to continue to deepen our attention to social policies in partnership with the authorities and with other official agencies and the NGOs. But we are mainly economists, particularly attentive to macroeconomic realities. You have a unique wealth of grassroots experience. Please help us to perceive the message of the voiceless and continue to help us by your questioning, your friendly criticism, to stay alert to the impact of our actions.